Corpsec Hotline

April 18, 2012

THE NORMS OF OVERSEAS INVESTMENT RELAXED AND RATIONALIZED

In a move to rationalize the norms for overseas investments by Indians, RBI has recently issued three circulars amending the Foreign Exchange Management (Transfer or Issue of any Foreign Security) (Amendment) Regulations, 2004 ("**Regulations**").

The A.P. (DIR Series) Circular No. 96 issued on March 28, 2012 deals with the overseas investment by Indian party whereas A.P. (DIR Series) Circular No. 97 issued on the same date deals with the overseas investment by resident individuals. In addition to the above two circulars, the RBI has also issued a circular no. A. P. (DIR Series) Circular No.101 on April 02, 2012 with respect to opening of foreign currency account for the purpose of making overseas investment.

Herein below, we analyze the changes made to the Regulations by the circulars (the "**Amendments**") and their implications.

OVERSEAS INVESTMENT BY INDIAN PARTY [1]

Creation of charge on immovable/movable property and other financial assets:

Currently, prior approval of the RBI is required for the creation of any charge on immovable property/pledge of shares of an Indian parent/its group companies in favor of a non-resident entity. Shares of an overseas joint venture ("**JV**")/ wholly owned subsidiaries ("**WoS**") can, however, be pledged by an Indian party without any approval of the RBI, for the fund based or non-fund based facility for its own purpose or for the benefit of JV/WoS.

With the introduction of the Amendments, an Indian party is allowed to create charge in the form of pledge/mortgage/hypothecation ("**Charge**") on the immovable property/movable property and other financial assets ("**Properties**") of the Indian Party and also its group companies for the purpose of providing financial assistance to its overseas JV/WoS. The RBI has also mentioned in the relevant circular that an Indian party willing to create Charge on its Properties or the Properties of its group companies has to seek prior approval of the RBI and also is required to furnish a no objection certificate to the RBI obtained from the Indian lender.[2]

This is in addition to the Indian party's right to create charge on the shares of JV/WoS. The RBI has also clarified in the circular that any financial assistance to an overseas JV/WoS by creating Charge on the Properties of an Indian party and its group companies should be well within the overall limit of financial commitment.[3]

Bank guarantee issued on behalf of JV/WoS

Currently, only the corporate guarantee and the performance guarantee issued by an Indian party in favor of its JV/WoS is reckoned for the purpose of the calculation of overall limit fixed for the financial commitment.

With the introduction of the Amendments, the RBI has decided to include the bank guarantee issued by a resident bank on behalf of an overseas JV/WoS of an Indian party which is backed by a counter guarantee/collateral by the Indian party in the overall limit fixed for the financial commitment of the Indian party.[4]

Issuance of personal guarantees by the direct/indirect individual promoters of the Indian party

Currently, personal guarantee of promoters of an Indian party is allowed under the general permission. With the introduction of the Amendments, the RBI has allowed indirect resident promoters of an Indian party also to give personal guarantee for the benefit of JV/WoS. This move is likely to benefit the Indian parties especially when net worth of their direct promoters is insufficient for the purpose of giving personal guarantee.

Financial commitment without equity participation to JV/WoS

Currently, it is mandatory for an Indian party to have the equity participation in its JV/WoS before extending any loan or guarantee in favor such JV/WoS. Considering the laws of certain host countries wherein it is permitted to incorporate a company without any equity participation by an Indian party, the RBI has decided to allow the Indian party to extend the loan or guarantee to its JV/WoS under the approval route without any equity participation in such JV/WoS in case of such countries.

- **Submission of Annual Performance Report**
  Currently, it is mandatory to file annual performance report in form ODI in Part III along with audited accounts of JV/WoS with the RBI through the Indian party's authorized dealer.

  It may be noted that certain countries do not mandatorily require audit of the accounts of JV/WoS. Keeping this in mind, the RBI has decided to dispense with this condition for JV/WoS set up in countries wherein audit of accounts

Research Papers

Littler International Guide (India) 2024
November 08, 2024

Unmasking Deepfakes
October 25, 2024

Are we ready for Designer Babies
October 24, 2024

Research Articles

The Bitcoin Effect
November 14, 2024

Acquirers Beware: Indian Merger Control Regime Revamped!
September 15, 2024

Navigating the Boom: Rise of M&A in Healthcare
August 23, 2024

Audio

Digital Lending - Part 1 - What's New with NBFC P2Ps
November 19, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part I
August 26, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part II
August 26, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

"Investment return is not enough" Nishith Desai with Nikunj Dalmia (ET Now) at FII8 event in Riyadh
October 31, 2024

Analysing SEBI's Consultation Paper on Simplification of registration for FPIs
September 26, 2024

is not mandatory subject to the following conditions:

- The statutory auditor of the Indian party certifies that "the unaudited annual accounts of the JV/WoS reflect true and fair picture of the affairs of the JV/WoS;
- That the un-audited annual accounts of the JV/ WoS has been adopted and ratified by the board of the Indian party.

Compulsorily Convertible Preference Shares ("CCPS")

Currently, the Regulations envisage setting up of JV/WoS by subscribing to the equity capital of the JV/WoS. Any contribution to the preference share capital (whether convertible or non-convertible) is considered as loan to them. Keeping in view the basic nature of the CCPS, the RBI has decided to treat CCPS at par with equity shares.

OVERSEAS INVESTMENT BY RESIDENT INDIVIDUALS

The Amendments have brought some important changes with respect to the norms applicable to resident Individuals for the acquisition of shares of an overseas entity. The highlights of the changes are mentioned herein below:

Acquisition of qualification shares:

Currently, the Regulations permit a person resident in India to acquire foreign securities as qualification shares issued by a company incorporated outside India for holding the position of director in the Company subject to the following conditions:

1. The number of shares so acquired shall be the minimum required to be held for holding the post of director and in any case shall not exceed 1 (one) per cent of the paid-up capital of the company, and
2. The consideration for acquisition of such shares does not exceed the ceiling as stipulated by RBI from time to time.

With the introduction of the Amendments, the RBI has removed the ceiling of 1 (one) percent subject to the following conditions:

1. A resident individual can acquire foreign securities as qualification shares to the extent prescribed as per the law of the host country where the company is located in order to hold the position of the director;
2. The total remittance to be made for the purpose of acquisition of qualification shares should be well within the overall limit for the LRS at the time of acquisition.

Shares as a consideration for professional services or director's remuneration

RBI has removed the existing condition of seeking its prior permission by resident individuals to acquire shares of an overseas entity as a consideration for the professional services rendered to an overseas entity. Further, the RBI has also granted general permission to resident individuals to acquire shares of an overseas entity in lieu of director's remuneration. The RBI has also clarified in the circular that the value of shares to be acquired under both the situations as described herein above should be within the overall ceiling prescribed for resident individuals under LRS in force at the time of acquisition.

Acquisition of shares in a foreign company through ESOP scheme

Currently, a resident individual who is an employee, or, a director of an Indian office or branch of a foreign company, or of a subsidiary in India of a foreign company, or, an Indian company in which foreign equity holding, either direct or through a holding company/special purpose vehicle, is not less than 51 percent can acquire shares of the foreign company under the ESOP scheme offered globally on the uniform basis.

With the introduction of the Amendments, the RBI has removed the condition of holding of at least 51% stake in an Indian company by a foreign entity directly or indirectly for the purpose of issuing of shares to resident individuals under ESOP scheme subject to the following conditions:

1. The shares under the ESOP Scheme are offered by the issuing company globally on a uniform basis; and
2. An annual return is submitted by the Indian company to the RBI through its authorized dealer giving the details of the remittance/beneficiaries.

OPENING OF FOREIGN CURRENCY ACCOUNT

Currently, the Regulations require Indian party to seek prior permission of the RBI open, hold and maintain foreign currency account ("**FCA**") in a foreign country for the purpose of overseas direct investments in that country, in case the regulation of the host country requires that the investment in the country is to be made through a particular account to be opened with the commercial bank of the country.

In order to provide operational flexibility to the Indian party, the RBI has dispensed with the seeking of its prior permission for opening of a FCA subject to certain conditions as prescribed in in the relevant circular.

CONCLUSION

While the Amendments are indeed a welcome policy measure to rationalize overseas investments, there are a few wrinkles that may still need to be creased out. For instance, there is a debate on whether an Indian company can set up wholly owned subsidiaries beyond two step down subsidiaries since Regulation 13 can be interpreted to cover multiple layers of step down subsidiaries. While the RBI's approach on such ambiguity is unclear, we understand based on the earlier precedents that RBI has recently been liberal and has permitted to allow Indian entities from setting up multiple layers of step down wholly owned subsidiaries. Further, there may also be a need to allow setting up of JV/WoS by resident individuals under LRS.

With the total overseas investment touching as high as USD 123.3 billion[5] as on September 2011, the RBI's initiative to liberalize and rationalize the norms applicable for the overseas investment is indeed a commendable step and also a proactive effort to align the exchange control policies to suit dynamic business environment.

Scope of judicial interference and inquiry in an application for appointment of arbitrator under the (Indian) Arbitration and Conciliation Act, 1996
September 22, 2024

– Vishwanath Kolhar & Ruchir Sinha

You can direct your queries or comments to the authors

[1] As per the Regulations, Indian Party means a company incorporated in India or a body created under an Act of Parliament or a partnership firm registered under the Indian Partnership Act, 1932 making investment in a Joint Venture or Wholly Owned Subsidiary abroad , and includes any other entity in India as may be notified by the RBI:
Provided that when more than one such company, body or entity make an investment in the foreign entity, all such companies or bodies or entities shall together constitute the "Indian Party"

[2] RBI also clarified in the circular that it would introduce appropriate mechanism for capturing the financial commitment on account of creation charge on immovable property/movable property and other financial assets of the Indian Party and their group companies.

[3] Financial commitment means the amount of direct investments outside India by an Indian Party -
(a) by way of contribution to equity shares of the JV / WOS abroad
(b) as loans to its the JV / WOS abroad
(c) 100% of the amount of corporate guarantee issued on behalf of its overseas JV/WOS and
(d) 50% of the amount of performance guarantee issued on behalf of its overseas JV/WOS.

[4] The RBI has also clarified in the circular that it would introduce shortly appropriate mechanism for capturing the financial commitment on account of issuance of bank guarantee.

[5] Source: Half-yearly Report on Management of Foreign Exchange Reserves (September 2011) released by the RBI on February 28, 2012.