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RBI Gets Stringent on Overseas Business of NBFCs:

Regulator puts restrictions on
overseas subsidiaries and JVs of NBFCs

Aditi Jhunjhunwala
aditi@vinodkothari.com
Vinod Kothari & Company

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In the recent past, NBFCs have had several pieces of bad news – here is one more. The RBI has put restrictions on overseas direct investment (ODI) in case of NBFCs. Compared to the previous regime which did not make distinction between NBFCs and non-NBFCs or non-banking non-financial companies (NBNCs), the new directions limit the scope for overseas investment to 1/4th of what it earlier was. Besides, there is no scope for automatic approval for investment by NBFCs, as NBFCs will have to obtain prior no objection certificate of the RBI for making investments overseas.

The change above has come in form of Non-Banking Financial Companies (Opening of Branch/Subsidiary/Joint Venture/Representative Office or Undertaking Investment Abroad by NBFCs) Directions, 2011(Directions) on 14 June 2011[1]. Accordingly, no NBFC (both deposit taking and non-deposit taking) shall open any branch/subsidiary/Joint Venture/Representative Office or make any investment abroad, without the prior NOC of RBI. The directions prescribe specific and general conditions for such investment.

Background

Overseas direct investment (ODI) is covered by general Master Circular on Direct Investment by Residents in Joint Venture (JV)/ Wholly Owned Subsidiary (WOS) abroad. Prior to the specific directions on NBFCs as per the Directions above, there was no separate set of guidelines applicable to NBFCs. Hence, NBFCs were covered by the Master Circular as in case of NBNCs.

The Directions are not novel but the formalization of RBI's draft Guidelines for extending NOC for opening Branch/Subsidiary/Joint Venture/Representative Office or make any investment abroad issued in 2008. The Guidelines too prescribed for General and Specific provisions. In the precedent years NOC was granted on case to case basis in line with the draft guidelines. Though, nothing new, the Directions issued now are much more detailed and comprehensive in nature. Hence, it lays clear regulatory requirements for obtaining such NOC and making investment. The Directions are also in addition to those prescribed by Foreign exchange department (FED). The FED general conditions are contained in the Master Circular.

Further, as per the Master Circular dated May 3, 2010[2] RBI had clearly communicated its intent that any NBFC desirous of making any overseas investment is to receive NOC from DNBS of RBI. The said regulations were

[1] DNBS (PD) CC. No. 222 /03.10.001/2010-11

[2] DNBS (PD).CC. No.173/03.10.01 /2009-10

formulated as it was observed by the department that few NBFCs were making overseas investment without obtaining such regulatory clearances as specified. Any investment now made without such clearance is in contravention to the provisions of FEMA 2004 and attracts penal provisions.

General Conditions

The Directions as mentioned above lay some General conditions for opening branch/subsidiary/Joint Venture/Representative Office or make any investment abroad. Some of them are:

- No investment is permitted in non-financial sectors
- No direct investment allowed in activities prohibited by FEMA or in sectoral funds
- Investment allowed only in entities having their core activities regulated by financial sector regulator in host jurisdiction or country
- Aggregate overseas investment not to exceed 100% of their NOF, i.e. Aggregate investment < 100% NOF
- Investment in single entity, including step down subsidiaries < 15% of NBFC's owned fund. The same to be by way of equity or fund based commitment
- CRAR requirement post investment
    - For deposit taking NBFC, should not be less than applicable as per Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank Directions, 2007; as amended from time to time
    - For non-deposit taking NBFCs (other than NBFC-ND-SI), investment in subsidiary abroad should not be less than 10%; as modified from time to time
    - For NBFC-ND-SI should not be less than applicable as per Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank Directions, 2007; as amended from time to time
- Level of Non-Performing Assets < 5% of net advances
- There should be profit incurred by NBFC in the last three years along with a satisfactory performance
- NBFC to also comply with regulations of FEMA 1999
- Compliance with the KYC norms

- Depending on the %age of investment in overseas entity, any SPV set up abroad or acquisition abroad to be treated as investment/subsidiary/joint venture
- Compliance of the Direction to be certified annually from the statutory auditors and to be submitted to the Regional Office of DNBS
- Quarterly return in the prescribed format is also to be submitted to the Regional Office of the DNBS and Department of Statistics and Information Management. Such return contains various disclosures in terms of CRAR, NOF, amount of remittances, cumulative investment, financial details etc.

Specific Conditions

The Directions no more permit NBFCs to open branches abroad. However, existing branches shall be permitted to continue subject to the compliance of the conditions specified in the Directions. Some of the important specific conditions are:

- In case of opening a subsidiary /joint venture abroad, the parent NBFC not permitted to extend any implicit or explicit guarantees to or on behalf of such subsidiary/joint venture
- Liability of the NBFC in the proposed overseas entity to be restricted to its either equity or fund based commitment. The same to be disclosed in the subsidiary's/joint venture's Balance Sheet
- The subsidiary/joint venture should not be shell companies. However, activities such a financial consultancy and advisory services with no significant assets are an exception
- The subsidiary/joint venture should not be used as a vehicle for raising resources for creating assets in India
- The parent NBFC to obtain periodical reports/audit reports about the business activity undertaken by the subsidiary and such reports to be made available to RBI and its inspecting officials
- NBFC shall set a representative office abroad for the purpose of liaison work, market study and research and not for any activity involving outlay of funds, provided it is subject to regulation in the host country

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The Directions are effective from the date of their issue. The Directions have been issued for the purpose of enabling the banks to regulate the credit system to the advantage of the country. The violation of these Directions shall invite penal action under provisions of RBI Act, 1934.

Investments by and in NBFCs and NBNCs

A comparative statement on investment abroad by a NBFC and a Non-NBFC, into an NBFC and NBNC, is shown by the Table below:

Investing Co → / **Investee Co ↓**	**NBFC**	**NBNC**
NBFC	Investment not to exceed 100% of NoF	Investment to be subject to the conditions in Regulation 7 in terms of registration and all other provisions as applicable to NBFCs
Investment in NBFC	Investment Prohibited	No Prohibition

A comparative statement of the restrictions and permissions in case of investment abroad as referred in the above statement is briefed in the table below:

PARTICULARS	**Investment by NBFCs**	**Investment by NON-NBFCs**
Amount of Investment allowed	Aggregate overseas investment not to exceed 100% of the NoF	• Upto 400% of the net worth. The limit includes- -Contribution to capital -Loan Granted -100% of the guarantees other than performance guarantee -50% of performance guarantee • Investment by Proprietorship/unregist

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		ered partnership exporter firm -Amt of investment not exceeding 10% of av. Export realization or 200% of its net owned fund
Extension of Guarantees	NBFCs opening subsidiary abroad cannot extend guarantees	The Indian party is allowed to extend CG also to their first level step down by their JV/WOS abroad, under Automatic Route, within the limit specified
Investment in single entity and group company	Investment in single entity including step down not to be more than 15% of NBFCs own funds	No such limit prescribed
Method of Funding	-Equity -Fund based Commitment	-Capitalization of exports -swap of shares -Proceeds of ECB/FCCBs -In exchange of ADRs/GDRs -balance held in EEFC account -proceeds of foreign currency raised through ADR/GDR -Drawal of foreign exchange from AD bank in India (Para B.3)
Mode of Investment	No such route prescribed so do the general guidelines prevail?	Under- Automatic Route Approval Route
Requirement of CRAR	For **NBFC-D-** not less than 12% (such ratio shall not be less than 15% by March 31, 2012) **For NBFC-ND-SI-** 15% (was 12% until	No such requirement except in case of investment in Financial sector, which is guided by the Prudential norms of the regulatory authority concerned.

	31.3.2010 and should have been 15% by 31.3.11) **For NBFC-ND-**(other than NBFC-ND-SI) should not be less than 10%	
Operational Limits	NBFC to maintain required level of NoF after accounting for investment-Sec 45-IA	No such requirement
	NBFCs liability in the proposed overseas entity restricted to equity or fund based commitment. Non-fund-based support, for example, guarantees and derivatives are not allowed.	Guarantees are allowed
Whether approval of the RBI required or automatic investment?	Investing company to get NoC from DNBS, RBI prior to making of investment	No such requirement except in case of investment in financial sector, where prior approval is required
Branch restrictions	NBFCs not to open a branch abroad	Making investment in foreign entity engaged in real estate or banking business subject to prior approval of RBI
Level of NPAs	Not exceeding 5% of net advances	No such requirements
Writing off capital	No such provision; however, we are of the view that the restrictions applicable to non-financial companies	Indian party setting up WOS/JV may write off the capital or other receivables subject to limit of 25% in case of listed companies under automatic route, and 25% in

	will apply here too	case of unlisted companies under approval route, subject to reporting to RBI
Disinvestment	No such mode prescribed. However, we are of the view that the procedure applicable to non-financial companies is applicable	Modes of disinvestment are transfer, write off, hedging