

Legal Update

VINOD KOTHARI & COMPANY

RBI Liberalising ODI Norms- Relieving Investors

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Three recent circulars issued by the Reserve Bank of India (“**RBI**”), viz., Circular no.96¹, Circular no. 97² and Circular no. 101³ have liberalized and rationalized the policy for overseas direct investment (“**ODIs**”) by Resident individuals in India by altering certain provisions of the Foreign Exchange Management Act(herein after referred to as “the Act”).

Circular no. 96 is a significant step towards rationalising various regulations with regard to ODIs by Indian Party. Hitherto, the circular envisages the following:

1. Proposals from the Indian party for creation of charge in the form of pledge / mortgage / hypothecation on the immovable / movable property and other financial assets of the Indian Party and their group companies may be considered by the RBI under the **approval route** within the overall existing limit of 400% for financial commitment subject to submission of a ‘No Objection’ by the Indian Party and their Group companies from their Indian lenders.
Existing Regulations of FEMA on transfer or issue of any foreign security are stringent and do not envisage creation of charge on the immovable / movable property and other financial assets (except shares of JV / WOS) of the Indian Party because as per the Act an Indian Party may transfer, by way of pledge, shares held in a JV or WOS outside India as a security for availing of fund based or non-fund based facilities for itself or for the JV / WOS from an authorised dealer (AD) or a public financial institution in India.
2. Bank guarantee issued by a resident bank on behalf of an overseas JV / WOS of the Indian party, backed by a counter guarantee / collateral by the Indian party, **shall be reckoned** for computation of the financial commitment of the Indian Party and is required to be reported accordingly, which was not reckoned earlier. RBI shall be introducing the appropriate reporting mechanism for capturing the financial commitment on account of issuance of bank guarantee soon.
3. Issuance of personal guarantee by the promoters of the Indian Party as presently allowed under the General Permission route of RBI shall also be **extended to the indirect resident individual promoters** of the Indian

¹ <http://rbidocs.rbi.org.in/rdocs/notification/PDFs/ODIIP280312.pdf>

² <http://rbidocs.rbi.org.in/rdocs/notification/PDFs/OIRI280312.pdf>

³ <http://rbidocs.rbi.org.in/rdocs/notification/PDFs/TEODI300412.pdf>

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- Party with same conditions as in the case of personal guarantee by the direct promoters.
4. One of the major amendments brought in by this Circular is that now the proposals from the Indian Party for undertaking financial commitment even without any equity contribution in JV / WOS will be considered by the RBI under the **approval route**. AD banks shall be forwarding the proposals from their constituents after ensuring that the laws of the host country permit incorporation of a company without equity participation by the Indian party.
 5. In terms of the provisions of Regulation 15(iii) of the Foreign Exchange Management (Transfer or Issue of any Foreign Security) (Amendment) Regulations, 2004, an Indian Party needs to submit to the RBI an Annual Performance Report (APR), every year in Form ODI Part III in respect of each JV or WOS outside India, set up or acquired by the Indian party, after the finalization of the audited accounts of the JV / WOS outside India.
The Circular has **relieved the cases where the law of the host country does not mandatorily require auditing of the books of accounts of JV / WOS**, and the APR may be submitted by the Indian party based on the un-audited annual accounts of the JV / WOS provided:
 - a) The Statutory Auditors of the Indian party certifies that 'The un-audited annual accounts of the JV / WOS reflect the true and fair picture of the affairs of the JV / WOS' and
 - b) That the un-audited annual accounts of the JV / WOS has been adopted and ratified by the Board of the Indian party.
 6. The Circular notifies that the Compulsorily Convertible Preference Shares (CCPS) shall be **treated at par with equity shares for the purpose of ODIs** and any investment in CCPS shall be counted for the purpose of financial commitment of the Indian Party.
As per the existing ODI provisions contribution to the preference share capital (whether convertible or non-convertible) of the JV / WOS abroad by the Indian party is treated as loan to them. Keeping in view the nature of the Compulsorily Convertible Preference Shares (CCPS), this review has been made.

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Circular no. 97 lists the amendments pertaining to Indian residents who can hold shares in a foreign entity. The Circular lays down amendments with regard to the following:

- (i) Shares held by directors as qualification shares;
- (ii) Shares acquired under an ESOP scheme;
- (iii) Shares allotted in return of professional service rendered or in lieu of Directors remuneration.

Above mentioned amendments of the Circular in details:

1. Under existing provisions a person can hold the minimum number of shares required for being qualified as a director in a company, not exceeding 1 % of the company's total paid up capital. The RBI now decided to remove the cap of 1% as the minimum number of shares required for qualification is governed by the laws of the country in which the company is situated. Moreover, the person shall be allowed to hold the minimum number of shares required for being qualified as a director of the said company.
2. AD Category – I banks were permitted to allow remittances for purchase of shares by eligible persons under the existing provisions irrespective of the method of operationalisation of the scheme by following certain conditions. It has now been decided that resident employees or Directors may be permitted to accept shares offered under an ESOP Scheme globally, on uniform basis, in a foreign company irrespective of the percentage of the direct or indirect equity stake in the Indian company subject to these conditions:
 - a. The shares under the ESOP Scheme are offered by the issuing company globally on a uniform basis, and
 - b. An Annual Return is submitted by the Indian company to the Reserve Bank through the AD Category – I bank giving details of remittances / beneficiaries, etc.
3. As per the new guidelines in Circular no. 97, the RBI has decided to grant general permission with respect to the shares being remitted as part or full consideration for the service rendered by the person to the company, subject to the condition that the shares have been provided as director's remuneration subject to the overall ceiling limit prescribed under the liberalized remittance scheme.

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Circular no. 101 has removed the approval requirement of RBI for opening, maintaining and holding Foreign Currency Accounts (FCAs) by a person resident in India on fulfillment of certain conditions. Under the existing provisions of FEMA, an Indian party is required to obtain permission of the RBI to open, hold and maintain FCAs in a foreign country for the purpose of ODIs in that country.

The Circular provides the following conditions, fulfillment of which will not require RBI approval by the Indian party to open hold and maintain FCA abroad or the purpose of ODIs:

1. The Indian party meets the eligibility for ODIs in terms of Regulation 6 (Regulation 7, if applicable) of Notification No. FEMA 120/RB- 2004 dated July 7, 2004, as amended from time to time;
2. As per the regulations of the host country, the investments into the country are required to be routed through a designated account;
3. FCA shall be opened, held and maintained as per the regulation of the host country.
4. The remittances sent to the FCA by the Indian party should be utilized only and only for making overseas direct investment into the JV / WOS abroad.
5. Any amount received in the account by way of dividend and / or other entitlements from the subsidiary shall be repatriated to India within 30 days from the date of credit.
6. The Indian party should submit the details of debits and credits in the FCA on yearly basis to the designated AD bank with a certificate from the Statutory Auditors of the Indian party certifying that the FCA was maintained as per the host country laws and the extant FEMA regulations / provisions as applicable.
7. The FCA shall be closed immediately or within 30 days from the date of disinvestment from JV / WOS or cessation thereof.