Practical Strategies for Outward Investment for Indian Companies and Individuals
Rationale

- Market access
- Access raw materials
- Secure technology
- Diversification of country risk
- Acquiring overseas assets
- Expanding business
- Upgrade their competitive strength in the overseas market
Statistics

Recent data released by the Reserve Bank of India ("RBI") shows that overseas investments by Indian companies or entities was at US$ 19 billion for the first six months of 2011-12.
Legal Regulations

Reserve Bank of India has been given powers to regulate outward investments under Section 6(3)(a) and Section 47 of the Foreign Exchange Management Act, 1999 ("Act")

Governing FEMA Notification No. 120/ 2004 – RB dated 7.7.2004 – Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 ("Regulations")

Modified, clarified and amended from time to time by issue of further Notifications, Master Circulars and AP (Dir. Series) Circulars.
Important provisions of the Regulations

- As per section 2 (e) of the Regulations “Direct investment outside India” means (i) investment by way of contribution to the capital or subscription to the Memorandum of Association of a foreign entity or (ii) by way of purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange, but does not include portfolio investment.
As per section 2 (m) of the Regulations, “Joint Venture” means a foreign entity formed, registered or incorporated in accordance with the regulations of the host country in which the Indian party makes a direct investment.
Purchase or Sale of Foreign Security
General Permission

In terms of Regulation 4 of the Notification, general permission has been granted to persons residents in India for purchase / acquisition of securities in the following manner:

(i) out of the funds held in RFC account;
(ii) as bonus shares on existing holding of foreign currency shares; and
(iii) when not permanently resident in India, out of their foreign currency resources outside India.

General permission is also available to sell the shares so purchased or acquired.
Different modes of Investment

Part I - Direct Investment Outside India by Corporates/Body Corporates/Partnership

Part II – Investment abroad by Individuals

Part III – Investments in Foreign Securities other than by way of Direct Investment

Investments can be made under 2 routes
(i) Automatic Route
(ii) Approval Route
Part I

Automatic Route

In terms of Regulation no. 6 of the Regulations, an Indian party has been permitted to make investment in overseas Joint Ventures (JV) / Wholly Owned Subsidiaries (WOS), not exceeding 400 per cent of the net worth.

For the purpose of these Regulations, Indian Party shall mean

(i) a company incorporated in India
(ii) a body created under an Act of Parliament
(iii) or a partnership firm registered under the Indian Partnership Act, 1932
The ceiling of 400 per cent of net worth will not be applicable where the investment is made out of balances held in Exchange Earners’ Foreign Currency account of the Indian party or out of funds raised through ADRs/GDRs.

The above ceiling of 400 percent includes contribution to the capital of the overseas JV/WOS, loan granted to the JV/WOS and 100 percent of the guarantees (other than performance guarantees) and 50 per cent of the amount of performance guarantees.

Indian parties are prohibited from making investment in a foreign entity engaged in real estate (meaning buying and selling of real estate or trading in Transferable Development Rights (TDRs) but does not include development of townships, construction of residential/commercial premises, roads or bridges) or banking business, without the prior approval of the Reserve Bank.
Valuation of the shares of the foreign company shall be

- In case of partial / full acquisition of an existing foreign company, where the investment is more than USD 5 million, valuation of the shares of the company shall be made by a Category I Merchant Banker registered with SEBI or an Investment Banker / Merchant Banker outside India registered with the appropriate regulatory authority in the host country; and, in all other cases by a Chartered Accountant or a Certified Public Accountant.

- In cases of investment by way of swap of shares, irrespective of the amount, valuation of the shares will have to be made by a Category I Merchant Banker registered with SEBI or an Investment Banker outside India registered with the appropriate regulatory authority in the host country. Approval of the Foreign Investment Promotion Board (FIPB) will also be a prerequisite for investment by swap of shares.
The investments are subject to the following conditions:

- The direct investment is made in an overseas JV or WOS engaged in a bonafide business activity.
- The Indian Party is not on the Reserve Bank’s Exporters caution list/ list of defaulters to the banking system circulated by the Reserve Bank or under investigation by any investigation / enforcement agency or regulatory body.
- The Indian Party has submitted it’s Annual Performance Report in respect of all its overseas investments in the format given in Part III of Form ODI.
- The Indian Party routes all transactions relating to the investment in a JV/ WOS through only one branch of an authorised dealer to be designated by it.
- The Indian Party submits Part I of Form ODI, duly completed, to the designated branch of an authorised dealer.
The Indian party / entity may extend loan / guarantee only to an overseas JV/ WOS in which it has equity participation.

No guarantee should be 'open ended' i.e. the amount and period of the guarantee should be specified upfront.

As in the case of corporate guarantees, all guarantees (including performance guarantees) are required to be reported to the Reserve Bank, in Form ODI-Part II.

Specific approval of the Reserve Bank will be required for creating charge on immovable property and pledge of shares of the Indian parent/ group companies in favour of a non-resident entity.

In cases where invocation of the performance guarantees breach the ceiling for the financial exposure of 400 per cent of the net worth of the Indian Party, the Indian Party shall seek the prior approval of the Reserve Bank before remitting funds from India, on account of such invocation.
Issue of Guarantee by an Indian Party to step down subsidiary of JV/ WOS

Indian Parties are permitted to issue corporate guarantees on behalf of their first level step down operating JV /WOS set up by their JV / WOS operating as a Special Purpose Vehicle (SPV) under the Automatic Route – Subject to the extent limit for ODI

Further, the issuance of corporate guarantee on behalf of second generation or subsequent level step down operating subsidiaries will be considered under the Approval Route (provided Indian Party holds 51% or more stake in the overseas subsidiary)
Investment through SPV under Automatic Route

Investments in JV/WOS abroad by Indian parties through the medium of a Special Purpose Vehicle (SPV) are also permitted under the Automatic Route, subject to the conditions—

(i) not included in the Reserve Bank's caution list.
(ii) under investigation by the Directorate of Enforcement.
(iii) included in the list of defaulters to the banking system circulated by the Reserve Bank/any other Credit Information company as approved by the Reserve Bank.
**Investment in unincorporated entities**

- Investments in unincorporated entities overseas in the oil sector (i.e. for exploration and drilling for oil and natural gas, etc.) by
  
  (i) Navaratna PSUs, ONGC Videsh Ltd. (OVL) and Oil India Ltd. (OIL) may be permitted by AD Category - I banks, without any limit,

(ii) by other Indian companies (up to 400 per cent of their net worth duly supported by certified copy of the Board resolution approving such investment).

Provided such investments are approved by the competent authority.

**Capitalization of exports and other dues.**

- Indian party is permitted to capitalise the payments due from the foreign entity towards exports, fees, royalties or any other dues from the foreign entity for supply of technical know-how, consultancy, managerial and other services within the ceilings applicable. Capitalisation of export proceeds remaining unrealised beyond the prescribed period of realization will require prior approval of the Reserve Bank.
In terms of Regulation 7 an Indian party seeking to make investment in an entity outside India, which is engaged in the financial sector, should fulfill the following additional conditions:

(i) be registered with the regulatory authority in India for conducting the financial sector activities;

(ii) has earned net profit during the preceding three financial years from the financial services activities;

(iii) has fulfilled the prudential norms relating to capital adequacy; and

(iv) has obtained approval from the regulatory authorities concerned both in India and abroad for venturing into such financial sector activity.
Additional Investments by a JV/ WOS or its step down subsidiary will also have to comply with the above conditions.

Regulated entities in the financial sector making investments in any activity overseas are required to comply with the above guidelines.

Unregulated entities in the financial services sector in India may invest in non financial sector activities subject to compliance with the provisions of Regulation 6.

A company not complying with Regulation 7 needs to seek express approval of RBI for every remittance, loan or guarantee made to WOS/JV.
Master Circular 2011 - Opening of Branch-Subsidiary-Joint Venture Representative office or Undertaking Investment Abroad by NBFCs

The July, 2011 Circular has introduced three important provisions with respect to NBFCs registered with the RBI.

(i) Investment in non-financial service sectors shall not be permitted.
(ii) Overseas investment should not involve multi layered, cross jurisdictional structures and at most only a single intermediate holding entity shall be permitted.
(iii) In case of opening of subsidiary abroad, the parent NBFC shall not be permitted to extend implicit or explicit guarantee to or on behalf of such subsidiaries; and ….
(iii) In case of subsidiary, it should not be a shell company i.e "a company that is incorporated, but has no significant assets or operations." However, companies undertaking activities such as financial consultancy and advisory services with no significant assets shall not be considered as shell companies;

(iv) The aggregate overseas investment should not exceed 100% of the NoF. The overseas investment in a single entity, including its step down subsidiaries, by way of equity or fund-based commitment shall not be more than 15% of the NBFC's owned funds.
Listed Indian companies are permitted to invest up to 50 per cent of their net worth in (i) shares and (ii) bonds / fixed income securities (rated not below investment grade) issued by listed overseas companies.

Mutual Funds are registered with SEBI are permitted to invest within an overall cap of USD 7 billion in ADRs/ GDRs, equities of overseas companies listed in recognized stock exchanges, money market instruments etc.

A limited number of qualified Indian Mutual Funds, are permitted to invest cumulatively up to USD 1 billion in overseas Exchange Traded Funds as may be permitted by SEBI.

Domestic Venture Capital Funds registered with SEBI may invest in equity and equity linked instruments of off-shore Venture Capital Undertakings, subject to an overall limit of USD 500 million.
Approval Route

- Prior approval of the Reserve Bank would be required in all other cases of direct investment abroad.
- For this purpose, application together with necessary documents should be submitted in Form ODI through their Authorised Dealer Category – I banks.
- RBI should take into account the prima facie viability of the JV/ WOS abroad, contribution to external trade and other benefits, financial position and business track records of the Indian party and its expertise etc.
Overseas Investments by Proprietorship Concerns, Registered Trust / Society

- Proprietorship concerns and unregistered partnership firms are allowed to set up JVs / WOS outside India with the prior approval of the Reserve Bank subject to satisfying certain eligibility criteria mentioned in the Regulations.
- Registered Trusts and Societies engaged in manufacturing / educational / hospital sector are allowed to make investment in the same sector(s) in a JV/WOS outside India, with the prior approval of the Reserve Bank, after satisfying the eligibility criteria mentioned in the Regulations.
Post investment changes / additional investment in existing JV / WOS

- A JV / WOS set up by the Indian party as per the Regulations may diversify its activities / set up step down subsidiary / alter the shareholding pattern in the overseas entity (subject to compliance with regulation 7 of the Regulations in the case of financial sector companies).
- Indian Party should report details of such decision with the RBI through AD Category 1 Bank within 30 days of the approval of those decisions by the competent authority of the JV / WOS concerned.
Restructuring of the balance sheet of the overseas entity involving write-off of capital and receivables

- To provide more operational flexibility, Indian promoters who have set up WOS abroad or have at least 51% stake in an overseas JV, may write off capital or such other receivables even while such JV/WOS continues to function as under:
  (i) Listed Indian companies are permitted to write off capital and other receivables up to 25% of the equity investment in the JV/WOS under the Automatic Route; and
  (ii) Unlisted companies are permitted to write off capital and other receivables up to 25% of the equity investment in the JV/WOS under the Approval Route.

- The write off/restructuring has to be reported to the RBI through AD-Category 1 Bank within 30 days of such write off/restructuring. Write off/restructuring shall also be subject to submission of the following:
  (i) A certified copy of the balance sheet showing the loss in the overseas WOS/JV set up by the Indian Party; and
  (ii) Projections for the next five years indicating benefit accruing to the Indian company consequent to such write off/restructuring.
An Indian Party who has made an investment abroad is under the obligation to do the following things:

(i) receive share certificate or any other document as an evidence of investment;
(ii) repatriate to India the dues receivable from foreign entity;
(iii) submit the documents / Annual Performance Report to the Reserve Bank.
Transfer by way of sale of shares of a JV / WOS

An Indian Party without prior approval of the Reserve Bank may transfer by way of sale to another Indian Party or to a person resident outside India, any share or security held by it in a JV or WOS outside India subject to the following conditions:

› the sale does not result in any write off of the investment made.
› the sale is effected through a stock exchange where the shares of the overseas JV/ WOS are listed;
› if the shares are not listed on the stock exchange and the shares are disinvested by a private arrangement, the share price is not less than the value certified by a Chartered Accountant / Certified Public Accountant as the fair value of the shares based on the latest audited financial statements of the JV / WOS;
› the Indian party does not have any outstanding dues by way of dividend, technical know-how fees, royalty, consultancy, commission or other entitlements and / or export proceeds from the JV or WOS;
› the overseas concern has been in operation for at least one full year and the Annual Performance Report together with the audited accounts for that year has been submitted to the Reserve Bank;
› the Indian party is not under investigation by CBI / DoE/ SEBI / IRDA or any other regulatory authority in India.
Indian Parties may disinvest in any of the following cases without permission of RBI:

(i) Incase the JV/ WOS is listed in an overseas stock exchange

(ii) in cases where the Indian Party is listed on a stock exchange in India and has a net worth of not less than Rs.100 crore.

(iii) if Indian Party is unlisted, and the investment in the overseas venture does not exceed USD 10 million.

(iv) if Indian Party is listed, with net worth of less than Rs.100 crore but investment in an overseas JV/WOS does not exceed USD 10 million.
Pledge of Shares

An Indian party may pledge the shares of JV / WOS to an AD Category – I bank or a public financial institution in India for availing of any credit facility for itself or for the JV / WOS abroad in terms of Regulation 18 of the Notification. Indian party may also transfer by way of pledge, the shares held in overseas JV/WOS, to an overseas lender, provided the lender is regulated and supervised as a bank and the total financial commitments of the Indian party remain within the limit stipulated by the Reserve Bank for overseas investments, from time to time.
Part II – Investment Abroad by Individuals

➤ Prior permission in Form ODI – to accept shares of company outside India in lieu of fees due to it for professional services (subject to conditions mentioned in the Regulations)

➤ RBI to consider:
  (i) Credentials/Net Worth/nature of profession;
  (ii) Forex earnings/ balances in EEFC/RFC accounts;
  (iii) Financial and business track record;
  (iv) Potential for forex inflow to the country.
Liberalized Remittance Scheme

Under the Liberalised Remittance Scheme, all resident individuals, including minors, are allowed to freely remit up to USD 200,000 per financial year (April – March) for any permissible current or capital account transaction or a combination of both.

Under the scheme resident individuals can acquire and hold immovable property or shares or debt instruments or any other assets outside India, without prior approval of the Reserve Bank. Individuals can also open, maintain and hold foreign currency accounts with banks outside India for carrying out transactions permitted under the Scheme.

However there are certain prohibitions such as:

(i) purchase of FCCBS.
(ii) trading in forex board.
(iii) setting up a company abroad
(iv) directly or indirectly to Bhutan, Pakistan, Nepal and Mauritius.
(v) directly or indirectly to countries identified by FATF as “non co-operative countries and territories”, from time to time.
(vi) margins or margin calls to overseas exchanges.
(vii) those individuals and entities identified as posing significant risk of committing acts of terrorism
Permission for acquisition/ purchase of foreign securities in certain cases

- General permission has been granted to a person resident in India who is an individual –
  - to acquire foreign securities as a gift from any person resident outside India;
  - to acquire shares under cashless Employees Stock Option Programme (ESOP) issued by a company outside India, provided it does not involve any remittance from India;
  - to acquire shares by way of inheritance from a person whether resident in or outside India;
to purchase equity shares offered by a foreign company under its ESOP Schemes (subject to certain conditions more particularly mentioned in the Regulations)

- Foreign companies are permitted to repurchase the shares issued to residents in India under any ESOP Scheme (subject to certain conditions more particularly mentioned in the Regulations)

- In all other cases not covered, approval of the Reserve Bank is required for acquisition of foreign security.
Pledge of a foreign security by a person resident in India

The shares acquired by persons resident in India in accordance with the provisions of the Act or Rules or Regulations made thereunder are allowed to be pledged for obtaining credit facilities in India from an AD Category – I bank / Public Financial Institution.
Part III – Investment in foreign security other than by way of Direct Investment

- A person resident in India, being an Indian Company or Body Corporate created by an act of Parliament,
  - May issue FCCBS not exceeding USD 500 million to person resident outside India (subject to Regulation)
  - May issue FCCBs beyond USD 500 million with specific approval from the RBI.
  - May issue Foreign Currency Exchangeable Bonds to a person resident outside India in accordance with the Regulations.

- The company/ body corporate issuing FCCBs shall within 30 days from the date of issue, furnish a report to the RBI giving the details and documents as under:
  - Total amounts for which FCCBs have been issued
  - Names of the investors resident outside India and no. of FCCBs issued to each of them
  - The amount repatriated to India through normal banking channels and/ or amount received by debit to NRE/ FCNR accounts in India
Consequences of Violation

Penalties
Under the Act, if any person contravenes any rule, regulations, notification, direction or order issued in exercise of the powers under this Act, he shall be liable to a penalty of upto thrice the sum involved, or upto two lakh rupees where the amount is not quantifiable, and where such contravention is continuing a further penalty which may extend to five thousand rupees per day.

Power to compound contravention.
Any contravention may be compounded on application made by the person committing such contravention, within 180 days from date of receipt of such application.

Where a contravention has been compounded under sub-section (1), no proceeding or further proceeding, as the case may be, shall be initiated or continued, as the case may be, against the person committing such contravention under that section, in respect of the contravention so compounded.
Interesting Questions

- Can individuals receive shares of a foreign company in exchange of shares held by them in Indian Companies?

- Can an Indian Party make investments in overseas L.L.P.?
THANK YOU