

Newsflash

New Overseas Investment Regulations and Rules

Introduction

The Central Government recently notified the Foreign Exchange Management (Overseas Investment) Rules, 2022 (“**Rules**”). In furtherance to these Rules, the Reserve Bank of India (“**RBI**”) notified the Foreign Exchange Management (Overseas Investment) Regulations, 2022 (“**Regulations**”) and Foreign Exchange Management (Overseas Investment) Directions, 2022 (“**Directions**”), in supersession of the Foreign Exchange Management (Transfer or Issue of any Foreign Security) (Amendment) Regulations, 2004 and Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015.

Some of the key features of the Rules, Regulations and Directions governing overseas investments by Indian residents and entities (collectively referred to as “**Guidelines**”) are set out below:

1. Enhanced clarity with respect to significant definitions

➤ Overseas Direct Investments & Portfolio Investments

The Rules provide for distinction between Overseas Direct Investments (“**ODI**”) and Overseas Portfolio Investments (“**OPI**”) which are together defined as Overseas Investments (“**OI**”). In the erstwhile regime there was no distinction between direct investments and portfolio investments. ODI means (a) investment by way of acquisition of unlisted equity capital of a foreign entity, or (b) subscription as a part of the memorandum of association of a foreign entity, or (c) investment in ten per cent, or more of the paid-up equity capital of a listed foreign entity or (d) investment with control where investment is less than ten per cent of the paid-up equity capital of a listed foreign entity. OPI means investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an International Financial Services Centre (“**IFSC**”), or any derivatives, unless otherwise permitted by RBI or any commodities, including Bullion Depository Receipts.

➤ Foreign Entity

The term joint venture (“**JV**”) and wholly owned subsidiary (“**WOS**”) has been replaced by the term ‘*foreign entity*’ which means an entity formed or registered or incorporated outside India, including IFSC in India, that has limited liability. While the registration and incorporation requirements are the same as the definitions of JV and WOS, the condition of foreign entities having limited liability has been newly introduced.

➤ Control

The Rules have introduced the definition of control which means the right to appoint majority of the directors or to control management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders’ agreements or voting agreements that entitle them to ten per cent or more voting rights or in any other manner

in the entity. Although the definition of control is similar to the definition provided in the Companies Act, 2013, the Rules provide a condition that it should entitle the shareholder to ten percent or more voting rights in the entity. This is significant for ascertaining if an entity would be considered a 'subsidiary' or a 'step down subsidiary' ("SDS") of a foreign entity, since only an entity in which the foreign entity has control would be a subsidiary or SDS of the foreign entity.

➤ **Financial commitment**

The erstwhile ODI regime, defined financial commitment as the amount of direct investment by way of contribution to equity, loan and 100 per cent of the amount of guarantees and 50 per cent of the performance guarantees issued by an Indian party to or on behalf of its overseas JV or WOS. The definition of financial commitment has now been modified to mean the aggregate amount of investment made by a person resident in India by way of ODI, debt other than OPI in a foreign entity in which ODI is made and includes the non-fund based facilities extended by such person to or on behalf of such foreign entity. As per the Guidelines, an Indian entity making a financial commitment in a foreign entity by way of loans or by investing in debt instruments, is permitted to make such financial commitment only if the Indian entity is eligible to make ODI, the Indian entity has made ODI in the foreign entity and the Indian entity acquires control in such foreign entity at the time of making such financial commitment.

➤ **Strategic Sectors**

The Rules have introduced the definition of strategic sectors to include energy and natural resources sectors such as oil, gas, coal, mineral ores, submarine cable system and start-ups and any other sector or sub-sector as deemed necessary by the Central Government. The total financial commitment made by an Indian entity in all the foreign entities taken together at the time of undertaking such commitment shall not exceed 400 percent of its net worth as on the date of the last audited balance sheet, however investment in strategic sectors above this limit may be permitted on an application made to the Central Government through the RBI. In case of a foreign entity with core activity in a strategic sector the condition of limited liability (as stated above) will not apply.

2. Waiver of the requirement of approval

The Regulations have dispensed with the requirement of prior RBI approval for acquisition or transfer by way of deferred payment of consideration. The period of deferment shall be determined upfront. It has been clarified that the part of the payment (towards consideration) deferred by the person resident in India shall be treated as non-fund based financial commitment by such person.

3. Investment in Debt instruments by Indian Entity

The Rules define debt instruments as government bonds, corporate bonds, all tranches of securitisation structure which are not equity tranche, borrowings by firms through loans and depository receipts whose underlying securities are debt securities. The Regulations state that an Indian entity may lend or invest in any debt instruments issued by a foreign entity only if

such a loan is duly backed by a loan agreement and the rate of interest is charged on an arm's length basis.

4. **Requirement of no-objection certificate (“NOC”)**

The Rules provide that, every Indian resident who (a) has an account appearing as a non-performing asset, or (b) is classified as a wilful defaulter by any bank, or (c) is under investigation by a financial service regulator or investigative agencies, is required to obtain a NOC from the relevant lender or regulator or investigative agency before making any financial commitment or undertaking disinvestment. If the lender bank or regulatory body or investigative agency does not issue the certificate within sixty days of receipt of such application, it can be presumed that there is no objection to the proposed transaction.

5. **Restrictions on investment**

The Rules prohibit an Indian resident from making any investment in a foreign entity engaged in (a) real estate activity, or (b) gambling in any form, or (c) dealing in financial products linked to the Indian rupee, without specific approval of the RBI.

6. **Two-layer ODI Structures**

The Rules provide that an Indian resident shall not make financial commitment in a foreign entity that has invested or invests into India, at the time of making such financial commitment or at any time thereafter, either directly or indirectly, resulting in a structure with more than two layers of subsidiaries. There is some ambiguity as regards how the layers of subsidiaries would be counted. One interpretation is that an Indian entity would invest in country ‘A’ and such an entity has a subsidiary in country ‘B’ which in-turn has a step down subsidiary in India. The other interpretation is that investment in the overseas entity would be the first layer of investment and thereafter the step down subsidiary in India would be the second layer. These restrictions however do not apply when such investment is made in a banking company, a non-banking financial company, an insurance company and a Government company.

7. **Gifts**

A resident individual can:

- (a) acquire foreign securities by way of inheritance from a person resident in India (who is holding such securities in accordance with the Foreign Exchange Management Act, 1999 (“FEMA”)) or from a person resident outside India;
- (b) acquire foreign securities by way of gift from a person resident in India who is a relative and holding such securities in accordance with FEMA;
- (c) acquire foreign securities by way of gift from a person resident outside India in accordance with Foreign Contribution (Regulation) Act, 2010.

However, resident individuals are not permitted to transfer any overseas investment by way of gift to a person resident outside India.

8. **Reporting and Regulatory Changes**

Since the Guidelines provide for a category for OPI, a new Form OPI has also been issued

which has to be filed in case of a person resident in India (other than a resident individual) making an OPI. Further, the erstwhile Form ODI for overseas investments is now replaced with Form FC.

The Late Submission Fee (“**LSF**”) has been introduced for delays in filing forms for overseas investments. The option of LSF shall be available up to three years (a) from the due date of reporting/submission under OI Regulations, and (b) from the date of notification of OI Regulations in case of delayed reporting/submissions under the Foreign Exchange Management (Transfer Or Issue Of Any Foreign. Security) Regulations, 2004 and earlier corresponding regulations.

Conclusion

The Guidelines have introduced new concepts thereby providing much needed clarity on the existing concepts relating to overseas investments. Further, the new Guidelines have eased certain compliances and dispensed with certain conditions and the requirement of seeking approvals as discussed above.

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