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RBI CLAMP DOWN ON ROUTING DEBT FUNDS TO INDIA

Background

The Reserve bank of India (“**RBI**”) has issued a circular dated 25 November 2014 (“**Circular**”), by which it seeks to clamp down back door transactions which result in routing funds raised abroad to India.

It has come to the notice of RBI that some Indian companies are accessing overseas market for debt funds through overseas holding / associate / subsidiary / group companies. It has also been reported that such borrowings are raised at rates exceeding the ceiling under the applicable regulations framed under the Foreign Exchange Management Act, 1999 (“**FEMA**”) and that the funds so raised are routed to the Indian companies which accounts for sole/major operations of the group. Different modalities/structures are resorted to for channelling such funds for Indian operations including investment in rupee bonds floated by the Indian company.

RBI Clarifies

The RBI has clarified in the Circular as follows:

- i. Indian companies or their authorised dealer banks are not allowed to issue any direct or indirect guarantee or create any contingent liability or offer any security in any form for such borrowings by their overseas holding/ associate/ subsidiary/ group companies, except for the purposes explicitly permitted in the relevant regulations framed under FEMA
- ii. Funds raised abroad by overseas holding/ associate/ subsidiary/ group companies of Indian companies with support of the Indian companies or their authorised dealer banks as mentioned in point (i) above, cannot be used in India unless it conforms to the general or specific permission granted under the FEMA regulations;
- iii. Indian companies or their authorised dealer banks using or establishing structures which contravene the above shall render themselves liable for penal action as prescribed under FEMA.

The clarifications provided in the Circular are related to FEMA regulations on external commercial borrowings (ECB), issuance of guarantees, and overseas direct investment from India.

Implications of the Circular

The issue or creation of any guarantee, contingent liability or security by an Indian company for the borrowings of its the overseas holding/ associate/ subsidiary/ group companies of Indian companies would not be permitted except for the purposes explicitly permitted in the FEMA regulations.

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Further, such funds raised abroad will not be permitted to be used in India unless they conform to the provisions of FEMA regulations.

The RBI has cautioned that those Indian companies or their authorised dealer banks using or establishing structures which contravene the applicable FEMA provisions will render themselves liable for penal action.

ALMT Analysis

The Circular seems to be unclear on what kind of loopholes and FEMA violations the RBI is contemplating under the Circular, as any money routed to India would be routed under normal banking and regulatory channels in compliance with FEMA regulations.

Having said that, one type of transaction that the RBI may possibly be contemplating that could fall within this Circular is a case where the Indian company issues a guarantee on behalf of its overseas subsidiary/ affiliate/ group company against an overseas borrowing at low interest rates, and subsequently such overseas entity routes such borrowed money to its Indian affiliate, by way of subscription to convertible instruments at higher interest rates.

It would however, be helpful if RBI provides further clarity on the method of re-routing the funds into India that would be prohibited under the Circular. Until such time, one can take a wait and watch approach to see if any transaction comes within the ambit of this circular in order to understand the exact scope of the prohibition.

General penalties under FEMA

Penalties for contravention of *inter alia* FEMA or any regulation, direction or order issued thereunder, will, upon adjudication, render a person liable to a penalty up to thrice the sum involved in such contravention if the amount is quantifiable, or up to INR 200,000 where the amount is not quantifiable. Continuing contraventions are liable to a further penalty which may extend to INR 5,000 for every day after the first day during which the contravention continues.

Further, an adjudicating authority referred to above, adjudging any contravention may, if he thinks fit, in addition to a penalty which he may impose for such contravention, direct that any currency, security or any other money or property¹ in respect of which the contravention has taken place be confiscated to the Central Government and further direct that the foreign exchange holdings, if any, of the persons committing the contraventions or any part thereof, be brought back to India or be retained outside India in accordance with the directions made in this behalf.

It is also provided that where a person committing a contravention is a company, every person who, at the time the contravention was committed, was in charge of, and was responsible to the company for the conduct of the business of the company, as well as the company, will be deemed to be guilty of the contravention and ordinarily be liable to be proceeded against and punished accordingly².

¹ “**Property**” in respect of which contravention has taken place would include:

- (a) deposits in a bank, where the said property is converted into such deposits;
- (b) Indian currency, where the said property is converted into that currency; and
- (c) any other property which has resulted out of the conversion of that property.

² A person shall not be liable to punishment if he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent such contravention.

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Further, if a contravention has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer will also be deemed to be guilty of the contravention, and will be liable to be proceeded against and punished accordingly.

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