

Outbound Investments – FEMA Regulations

Conference on FEMA 2015

Western India Regional Council

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Statutory Framework...

Outbound Investment / Direct Investment Outside India is governed and regulated entirely by the RBI

Powers delegated to the Authorized Bank- (AD)

Section 6 of FEMA - Capital Account Transactions

FEM (Transfer or Issue of any Foreign Security) Regulations, 2004 - FEMA 120 / 2004-RB dated 7 July 2004

Master Circular on Outbound Investments – Master Circular No. 11/ 2015-16 dated 1 July 2015

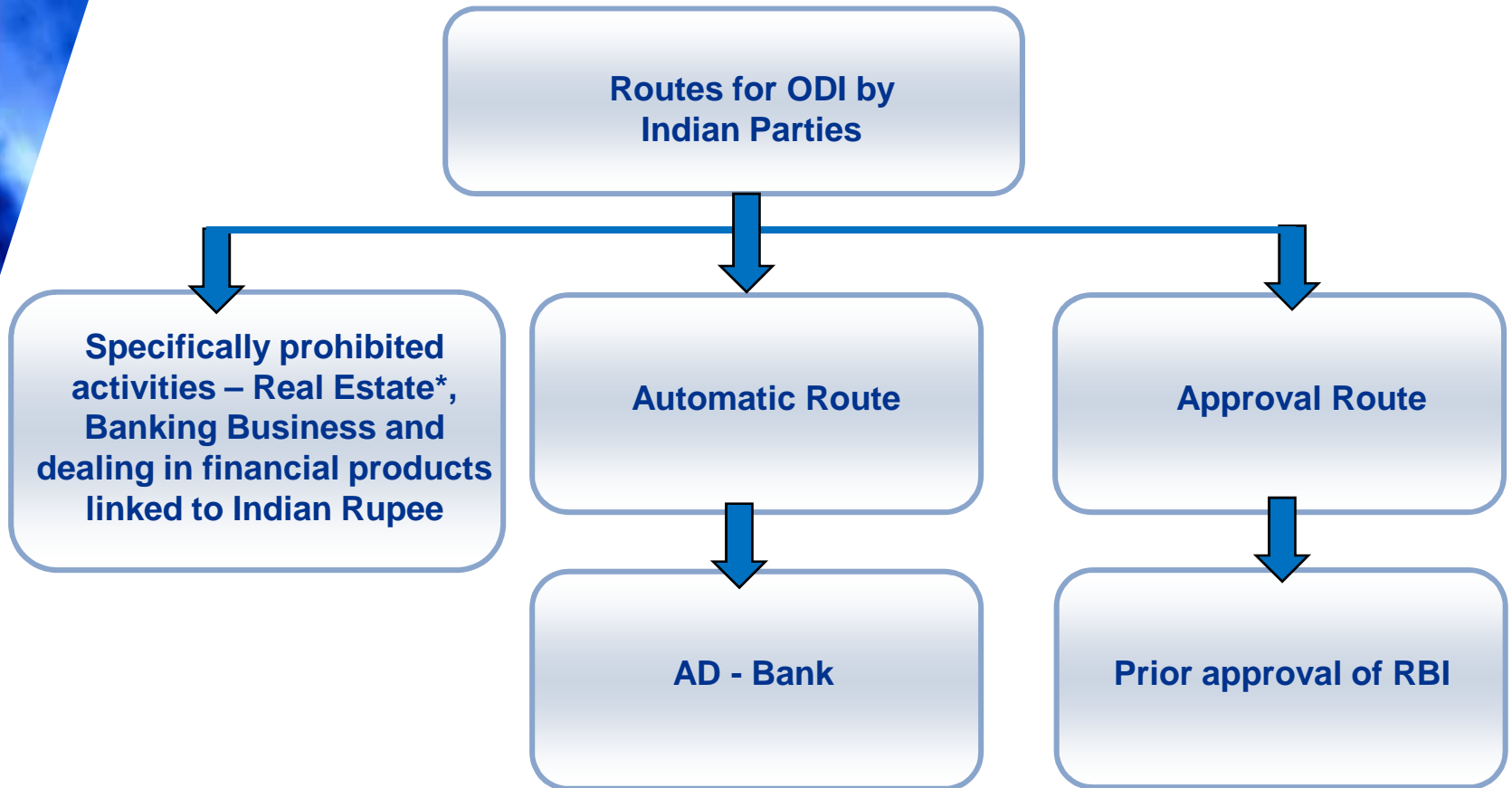
A.P. (DIR Series) Circulars issued by RBI from time to time

FAQs issued by the RBI

(Currently updated as on 4 July 2014)

Available on website www.rbi.org.in

Routes for ODI



***Real Estate Business means buying and selling of real estate or trading in Transferable Development Rights but does not include development of townships, construction of residential / commercial premises, roads or bridges.**

Important Definitions

Direct Investment outside India

- Investment either under Automatic Route or the Approval Route, by way of contribution to the capital or subscription to MOA of a foreign entity; or
- By way of acquisition either a partial stake (JV) or the entire stake (WOS) in an already existing entity overseas but does not include portfolio investment.

Indian Party

Means a company incorporated in India or a body created under an Act of Parliament or a partnership firm registered under the Indian Partnership Act, 1932 or a LLP incorporated under LLP Act, 2008 making investment in a JV or WOS abroad, and includes any other entity in India as may be notified by the RBI.

Joint Venture

Means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party makes a direct investment.

WOS

Means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country, whose entire capital is held by the Indian party.

ODI - Automatic Route

Under Automatic Route an Indian Party can make direct investment in JVs / WOSs outside India (except Pakistan*) without obtaining any prior RBI approval. The following conditions to be fulfilled:

Total Financial Commitment of the Indian Party in all its overseas JVs / WOSs – 400% Net Worth of Indian Party as per the last audited balance sheet.

Prior RBI approval required if Financial Commitment exceeds USD 1 billion in a FY.

Overseas JVs / WOSs to be engaged in a bonafide business activity except real estate and banking.

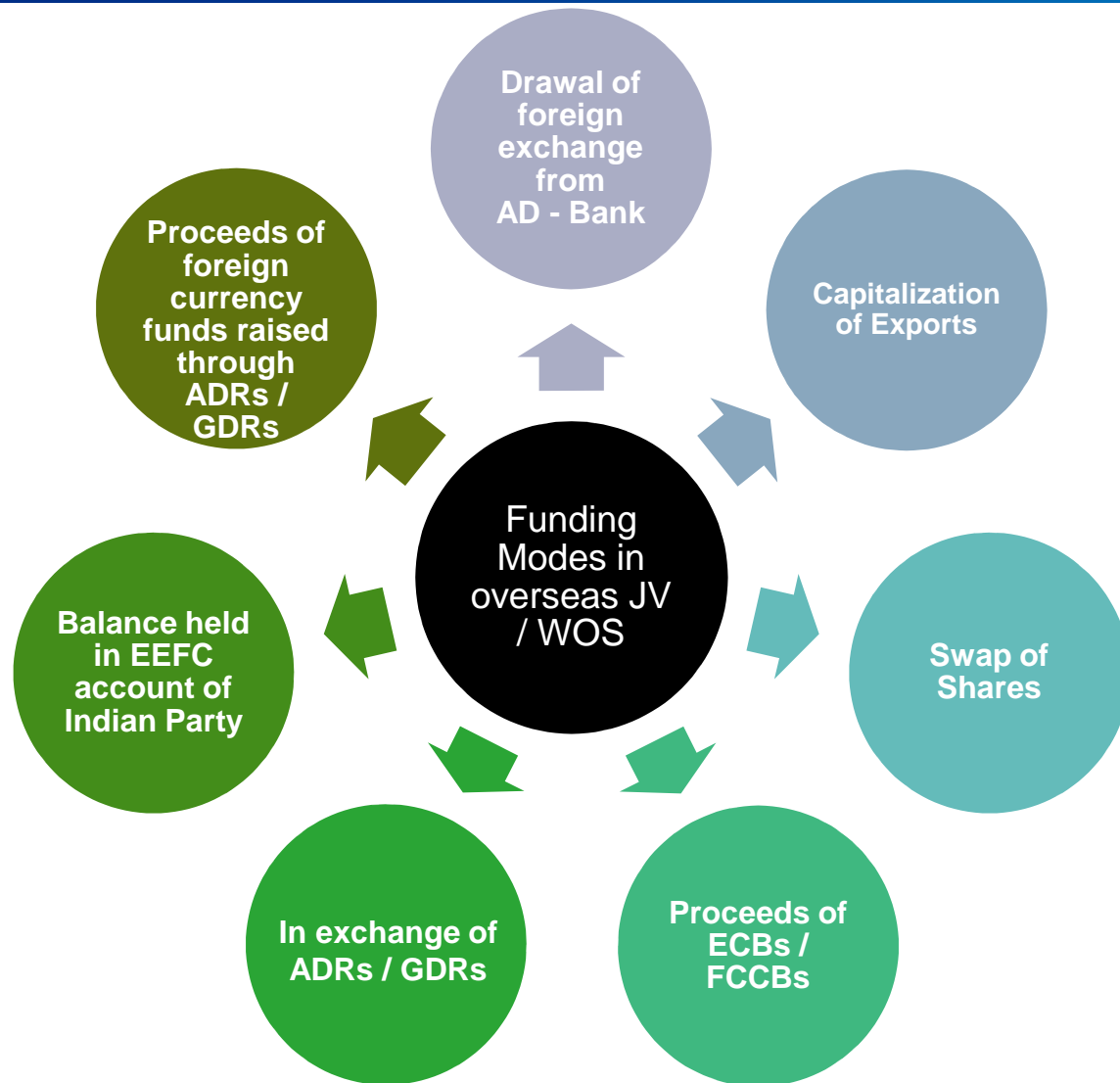
Indian party not on the RBI's Exporters' Caution list / list of defaulters / under investigation by an Authority.

Submission of Form APR (Annual Filings for ODI) in respect of all its overseas investments.

Investment in unincorporated entity engaged in oil sector.

* Investment in Pakistan by Indian Parties are permissible under approval route.

Methods of Funding



Financial Commitment - Meaning - (1/2)

Financial Commitment is the sum total of the following:

- 100% of the amount of equity shares;
- 100% of the amount of compulsorily and mandatorily convertible preference shares;
- 100% of the amount of other preference shares;
- 100% of the amount of Loan;
- 100% of the amount of guarantee (other than performance guarantee) issued by the Indian Party;
- 100% of the amount of bank guarantee issued by a resident bank on behalf of JV or WOS of the Indian party and the bank guarantee is backed by a counter guarantee/collateral by the Indian party;
- 50% of the amount of performance guarantee.

Ceiling not applicable for investments out of EEFC A/c or funds raised through ADRs / GDRs.

Maximum limit would be:

400% of net worth
(subject to prior RBI
approval for limit exceeding
USD 1 Billion per FY)

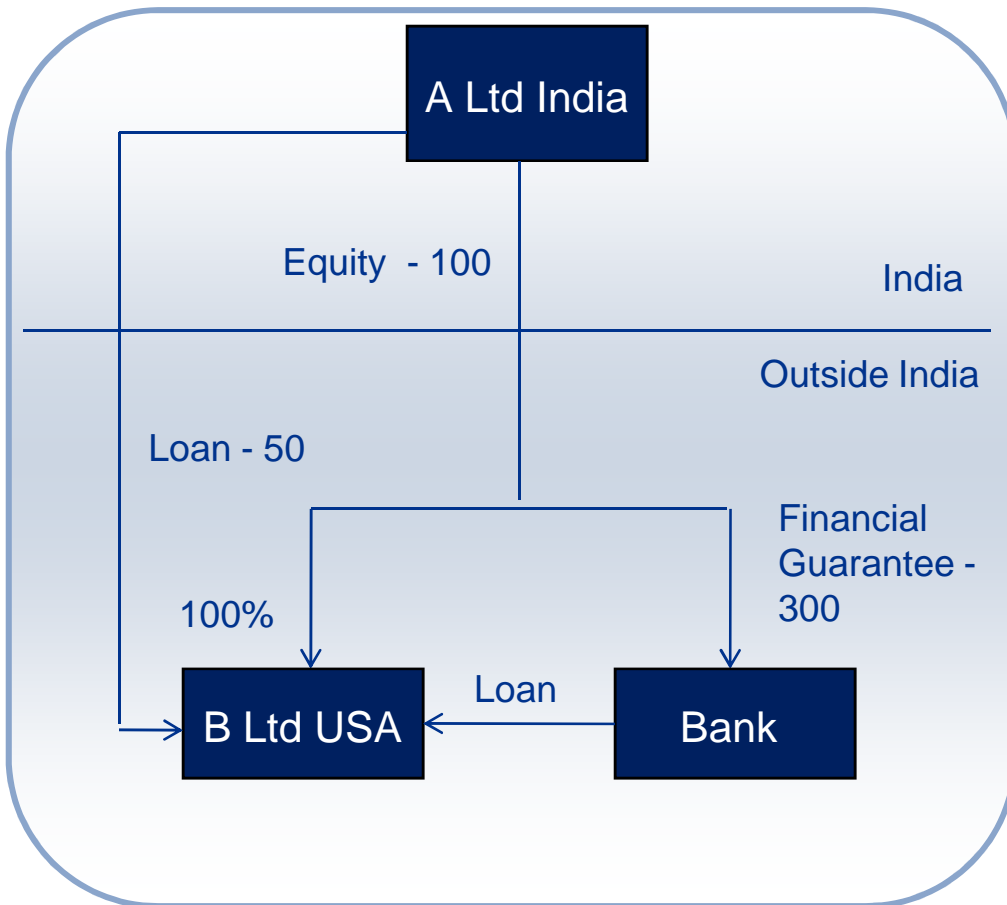


Balance in EEFC
Accounts



ADR / GDR proceeds

Financial Commitment - Calculation - (2/2)



- B Ltd., a company incorporated in USA is a wholly owned subsidiary of A Ltd., an Indian company.
- A Ltd.'s investment in B Ltd are as under:
 - Equity contribution – 100
 - Loan – 50
 - Financial Guarantee of 300 to a Bank on behalf of B Ltd
- What is the financial commitment?

Financial Commitment of A Ltd: 100 (E) + 50 (L) + 300 (FG) = 450

Loan and Guarantee - (1/4)

Loan

- Indian Entity can extend loan only to JV/WOS in which it has Equity participation.

Guarantee

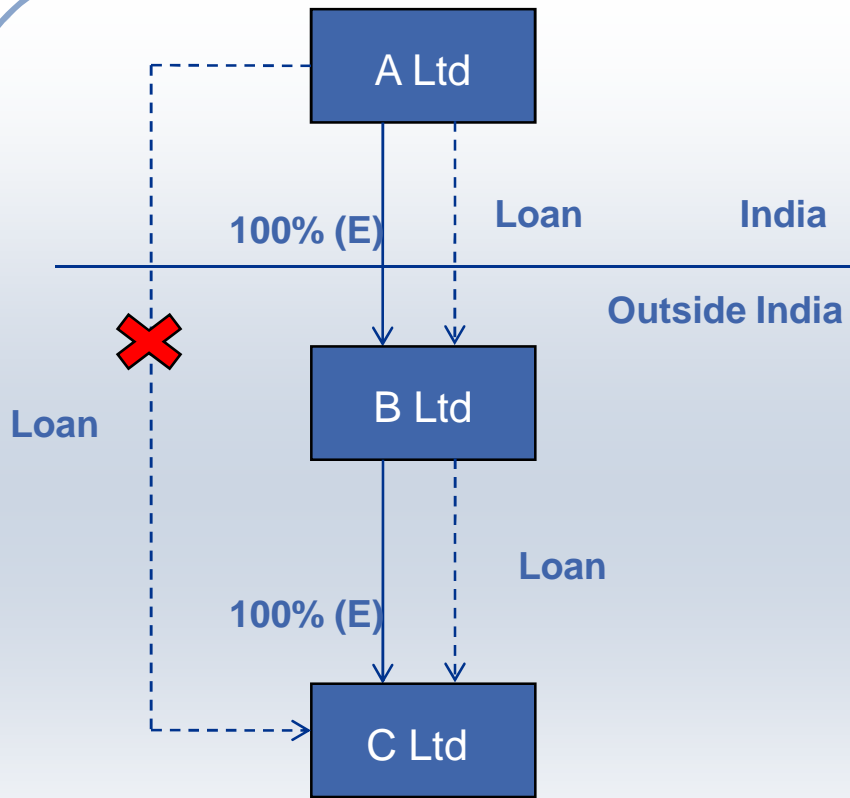
Indian Party can issue Guarantee (corporate or personal)

- To its Overseas JV / WOS under automatic route subject to certain conditions.
- To its step-down first generation operating subsidiary – JV / WOS may be SPV or Operating company under automatic route within the prevailing limit.
- To its step-down second generation or subsequent level operating subsidiaries – Under the prior RBI approval route provided the Indian Party holds directly / indirectly 51% stake in the overseas subsidiary for which such guarantee is intended to be issued.
- No Guarantee should be 'open-ended'. The amount and period of guarantee should be specified upfront.

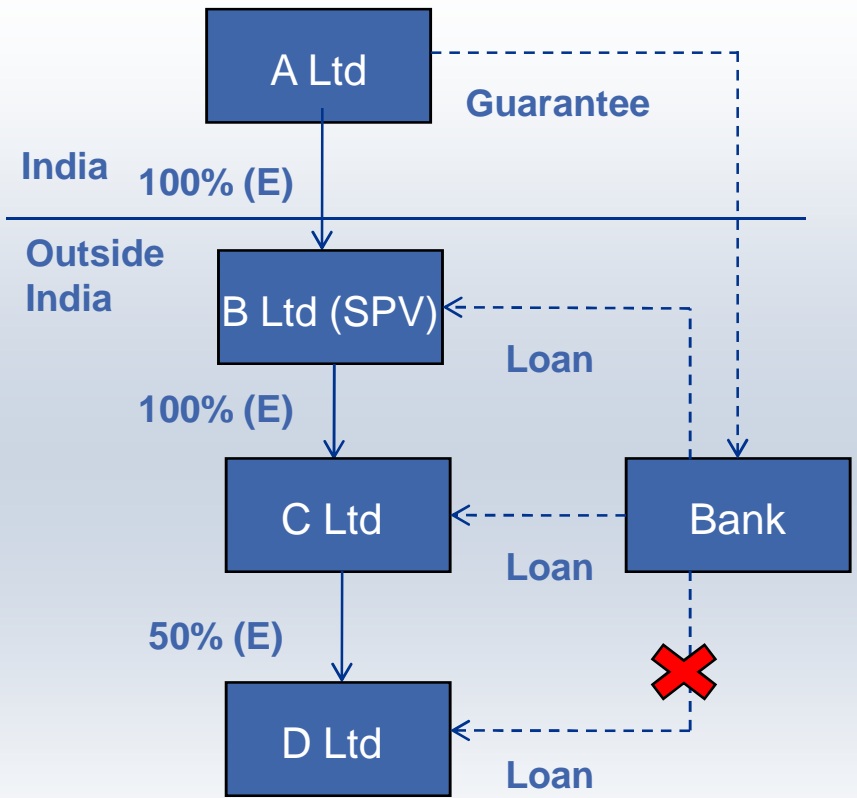


Proposal for undertaking financial commitment without equity participation may be considered by RBI under approval route.

Loan and Guarantee - (2/4)

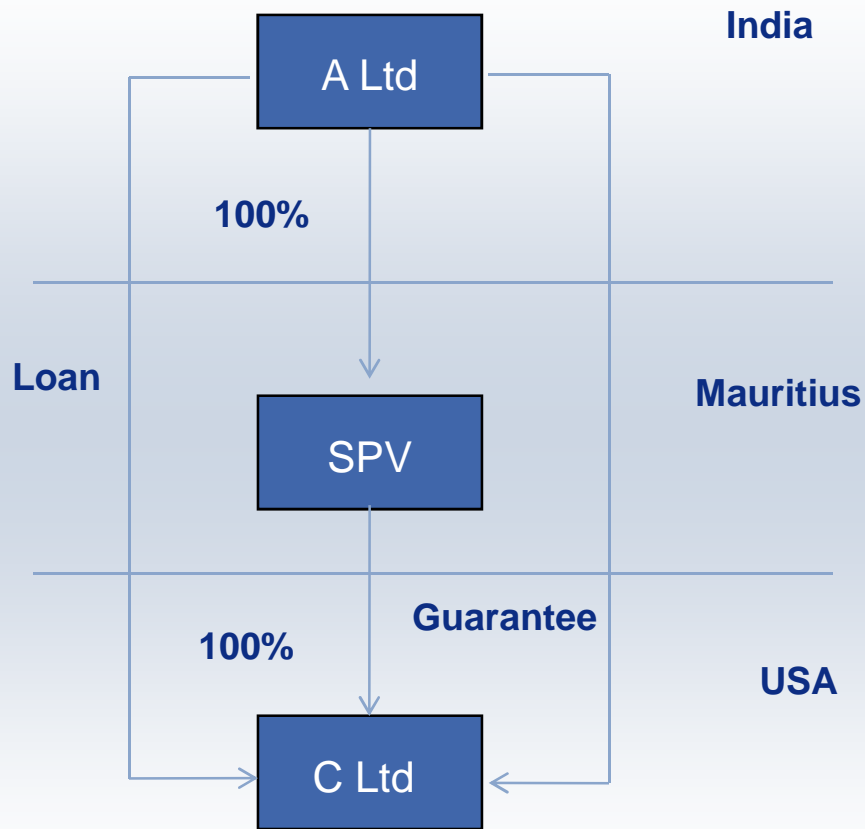


Direct Loan from A Ltd to C Ltd – Not Permissible



Shareholding of C Ltd in D Ltd 50% – Guarantee Not Permissible

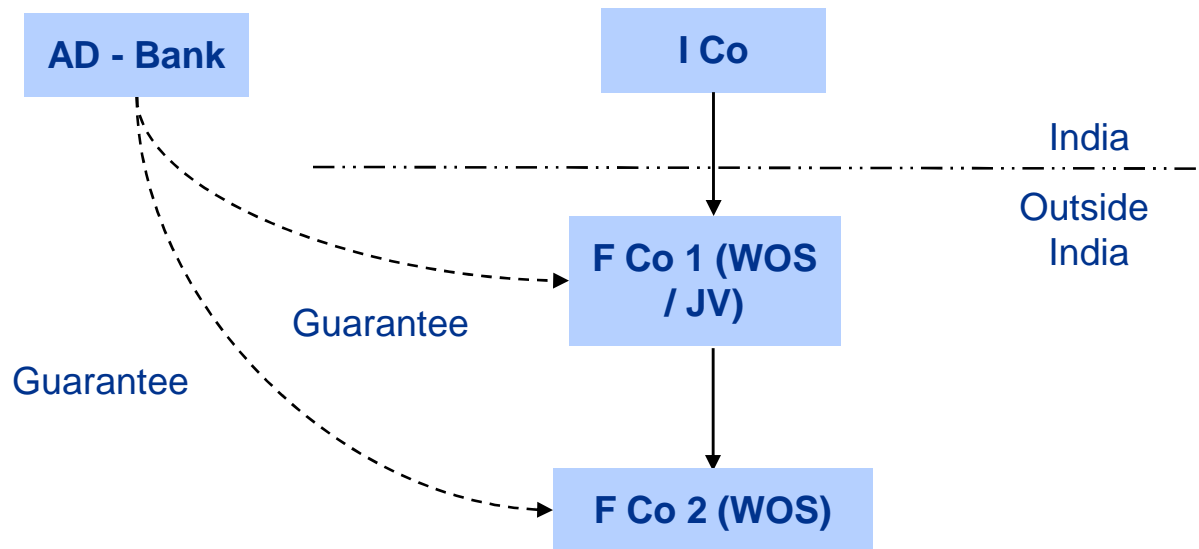
Loan and Guarantee - (3/4)



- A Ltd. proposes to set up a SPV in Mauritius through which investments would be made in USA (C Ltd.).
- Whether investment through SPV is permitted under the automatic route ?
✓
- Whether A Ltd can fund (Loan) to C Ltd directly?
X
- Whether A Ltd. can give guarantee to or on behalf of C Ltd. for its business ?
✓

Loan and Guarantee - (4/4)

Department of Banking Operations and Development's Guidelines on Exposure Norms



- As per DBOD Guidelines on Exposure Norms, banks can issue guarantees to JV / WOS abroad and step-down subsidiaries which are WOS only.
- No such WOS condition exists under FEMA where guarantee can be even for JVs.
- Summary – Banking Regulations are also relevant for any funding arrangements.

Routing of funds raised abroad in India

Routing of funds raised abroad in India - A.P. (DIR Series) Circular No. 41 dated 25 November 2014

Background:

- RBI observed that Indian companies have been accessing overseas market for debt funds through overseas holding / associate / subsidiary / group companies.
- Borrowings have been raised at rates exceeding ceiling rates under FEMA.
- Funds so raised were routed to the Indian companies.
- Under the extant ECB guidelines, there are restrictions on the cost at which Indian firms raise overseas borrowings.
- If funds are routed easily to the Indian arm, then such foreign – raised funds may be used for all kinds of purposes which may not be allowed under present regulation.

Clarification by the RBI:

- Indian companies not allowed to issue any direct / indirect guarantee or create contingent liability or offer any security in any form for such borrowings by their overseas holding / associate / subsidiary group companies – except for purposes explicitly permitted under the regulations.
- Funds raised abroad with the support of Indian companies cannot be used in India unless it conforms to the general or specific permission granted under the relevant regulations.
- Indian companies using structures which contravene the above will be liable for penal action.

Pledge and Charge

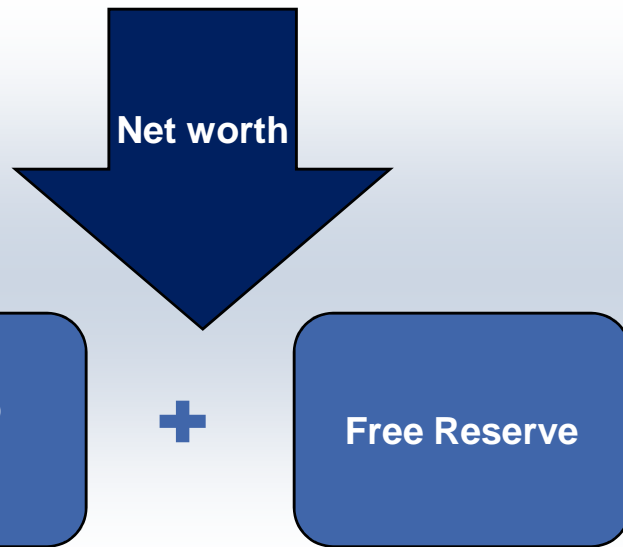
Pledge of shares of JV / WOS / SDS

- Indian Party may pledge shares of JV / WOS / SDS outside India as security in favor of AD - Bank / PFI / overseas lender to avail fund or non-fund based facility for itself or its JV / WOS / SDS whose shares have been pledged or for any other JV / WOS / SDS of the Indian Party.
- ***Subject to terms and conditions prescribed under Regulation 18 of FEMA 120 and A.P. (DIR Series) Circular No. 54 dated 29 December 2014.***

Charge on domestic and foreign assets

- Indian Party may create charge (mortgage / pledge / hypothecation or otherwise) on its assets (including assets of group companies, sister concern or associate company in India, promoter and / or director) in favor of overseas lender as security for availing fund and / or non fund based facility for its JV / WOS / SDS outside India.
- Indian party may create charge (mortgage / pledge / hypothecation or otherwise) on the assets of its overseas JV / WOS / SDS in favour of AD – Bank in India as security for availing of fund based and / or non fund based facility for itself or its JV / WOS / SDS outside India.
- ***Subject to terms and conditions prescribed under Regulation 18A of FEMA 120 and A.P. (DIR Series) Circular No. 54 dated 29 December 2014.***

Net worth - Meaning - (1/6)



Share premium

- Companies Act 1956 – Explanation to Section 2(29A) - Free reserves includes Securities premium.
- Companies Act 2013 - Section 2(43) - Free reserves does not include Securities premium which is included in Net Worth definition – Section 2(57).
- Is Share premium now part of Net Worth?

- For calculation of Net worth of the Indian party following to be considered:
 - Net worth of the Indian Investing company (say A Ltd).
 - Net worth of the Indian Holding company of A Ltd (which holds at least 51% stake of A Ltd.).
 - Net worth of the Indian Subsidiary Company of A Ltd (in which A Ltd holds at least 51%).
- Letter of disclaimer in favour of the Indian Party.
- The facility not available to partnership firms. Also partnership firm's net worth cannot be taken into account by an incorporated entity.

Net worth - Calculation - (2/6)

Net Worth - 200

ABC Ltd

50%

Net Worth - 150

A Ltd

India

100%

Outside India

B Ltd

Net Worth of A Ltd.: 150

A Ltd

Net Worth - 150

51%

XYZ Ltd

Net Worth - 50

India

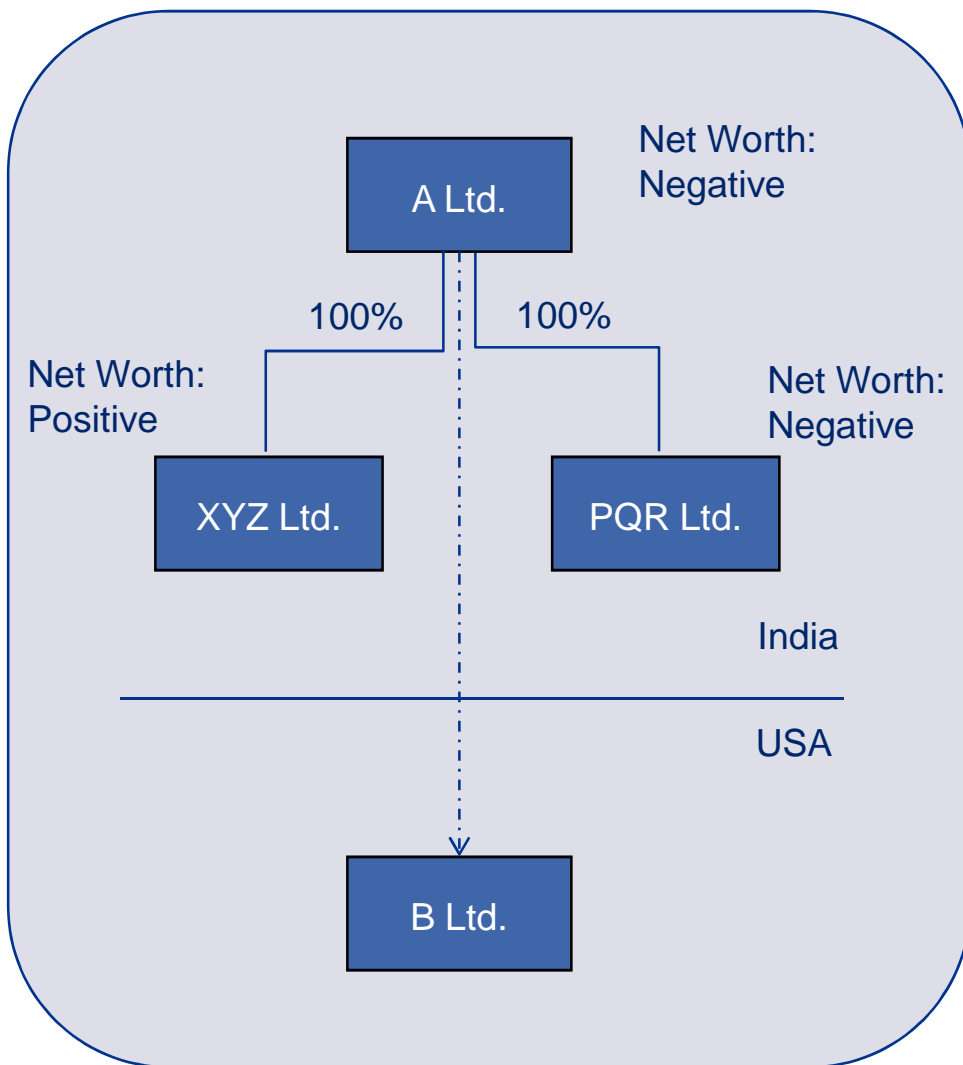
100%

Outside India

B Ltd

Net Worth of XYZ Ltd.: 150 + 50 = 200

Net worth - Calculation - (3/6)



- A Ltd. holds 100% of XYZ Ltd. & PQR Ltd.
- A Ltd. proposes to set up a wholly owned subsidiary (B Ltd.) in USA.
- As on the last date of audited balance sheet, A Ltd.'s net worth is negative, XYZ's net worth is positive & PQR's net worth is negative.

Question:

Whether A Ltd. has an option to consider only the positive net worth of XYZ Ltd. & ignore the negative net worth of PQR Ltd. for calculating its net worth for the proposed investment?

Net Worth / Financial Commitment - (4/6)

A Ltd., Indian Co.

Particulars	Option 1	Option 2
Net worth of A Ltd.	100	100
Balance in EEFC Account	100	300
Acquired B Ltd, USA at a cost of:	60	30

What is the balance limit available to Indian Co. for further overseas acquisitions?

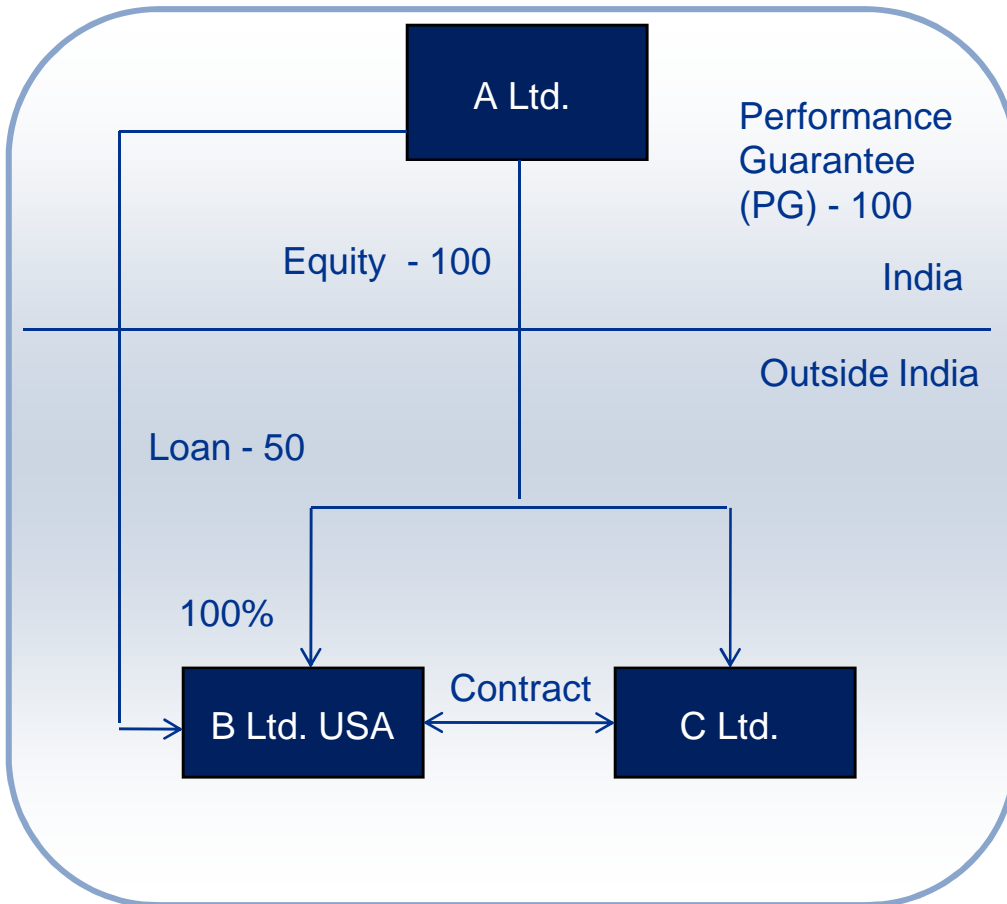
Answer:

440

670



Net Worth / Financial Commitment - (5/6)



- B Ltd., a company incorporated in USA is a wholly owned subsidiary of A Ltd. an Indian Co.
- A Ltd.'s (with net worth of 50) investment in B Ltd are as under:
 - Equity contribution – 100 ; Loan – 50
 - A Ltd. has also given PG of 100 to C Ltd. on behalf of B Ltd.
- What is the financial commitment of A Ltd.?
- If the PG is invoked by C Ltd. whether A Ltd. can remit funds from India on account of such invocation?

Financial Commitment of A Ltd: 100 (E) + 50 (L) + 50 (PG) = 200

Net Worth / Financial Commitment - LLPs - (6/6)

- **LLPs permitted to make overseas investments by A.P. (DIR Series) Circular No. 131 dt. 19.5.2014 / FEMA 299 dt. 24.3.2014**
 - LLPs as per LLP Act 2008 notified as Indian Party under clause (k) of Regulation 2 of FEMA 120
- **ODI by LLP - Select issues**
 - Net Worth
 - Whether both Current and Capital Account of Partners to be considered for calculating Net Worth?
 - How to apply concept of Free Reserves?
 - Whether benefit of Net Worth a Holding / Subsidiary company available?
 - RBI FAQ Qn. 27 – this benefit not available to partnership firm
 - Reasons for this exclusion? Whether also for LLP?
 - Indian party definition includes partnership firm / LLP

ODI in Financial Services Sector

Financial Service sector

- Not defined in Outbound Regulations.
- Guidance can be taken from Inbound Regulations and ODI form
 - E.g. Banks, NBFC, Insurance, Asset management etc.
 - Trading in Commodities Exchanges overseas and setting up JV/WOS for trading in overseas exchanges will be reckoned as Financial services activity.

Additional conditions to be satisfied for ODI in financial services sector

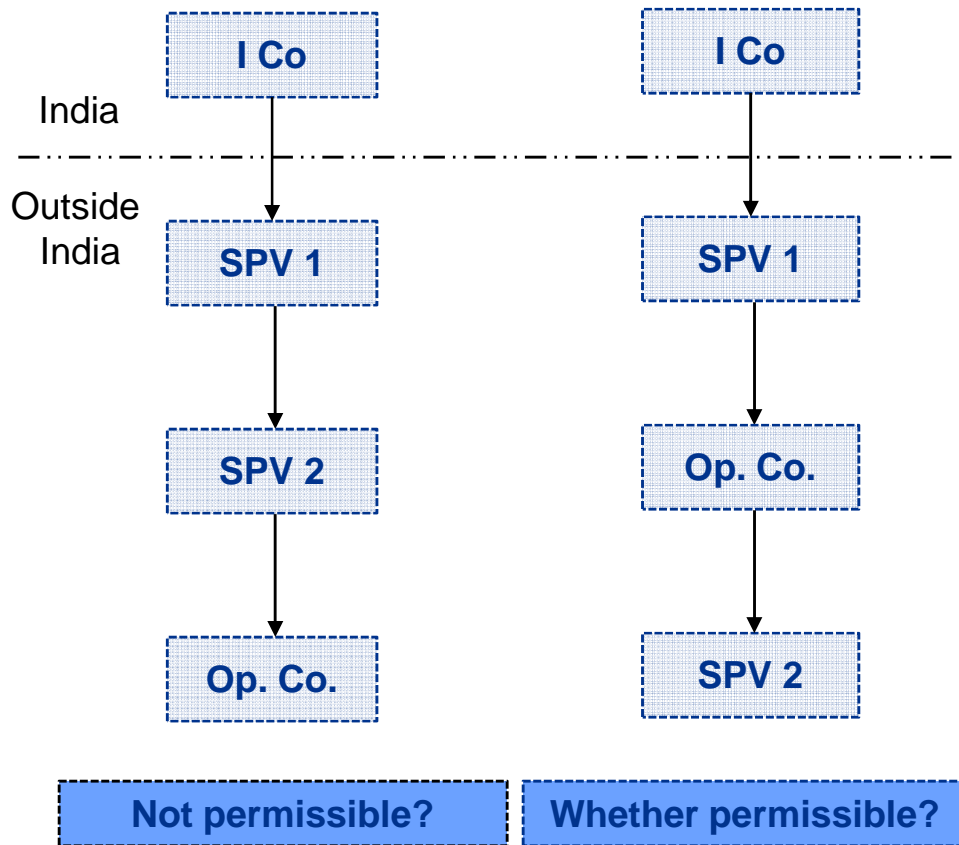
- Registration with appropriate regulatory authority in India.
- Earned net profits during the preceding 3 years from financial services activity.
- Approval from concerned regulators in India and abroad for such investment.
- Compliance with prudential norms relating to capital adequacy norms as prescribed by the concerned regulatory authority in India.

Regulated entities in financial sector making investments in any activity overseas are required to comply with additional conditions. Unregulated financial services sector Entities can invest in non-financial sectors subject to compliance with provisions of Regulation 6 of FEMA 120.

ODI - Approval Route

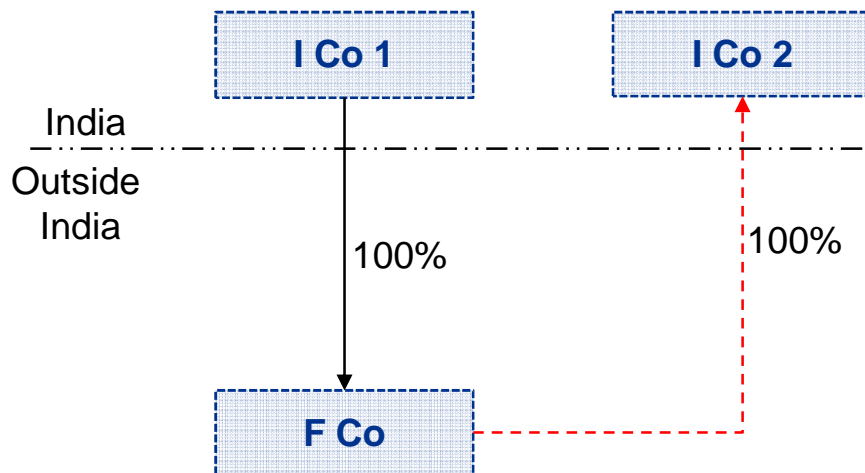
- Cases not covered under Automatic Route.
- Specific application to RBI with necessary documents in Form ODI through the AD – Bank.
- RBI would inter alia consider the following factors:
 - Prima facie viability of JV/WOS outside India;
 - Contribution to external trade and other benefits which will accrue to India through such investment;
 - Financial position and business track record of the Indian party and foreign entity;
 - Expertise and experience of the Indian party in the same or related line of activity of the JV / WOS outside India.

Multilayer Outbound Investments



- Overseas JV / WOS investment through SPV – No specific regulations under FEMA 120.
- RBI guidelines / circulars suggest that overseas JV / WOS permitted through a SPV.
- No specific guidelines on multi-layer investments.
- Whether overseas investment through multilayer SPVs should be permitted in genuine cases where this situation is:
 - Imposed by JV partner
 - Financing structure - overseas loans and Private Equity Funding
 - Overseas Listing Flexibility
 - Regional Benefits
- Whether Op. Co. below SPV can have one more SPV?

Round Tripping



Facts

- I Co 1 holds 100% in F Co – operating company.
- F Co proposes to acquire / invest in I Co 2.

Issues

- Whether investment by F Co in I Co 2 would be permissible / require RBI approval?
- What if F Co is proposing to invest from its own profit earned overseas?
- What if F Co is proposing to invest from its borrowings from overseas?
- Which is the specific regulation prohibiting this structure?
- Whether bonafide business activity test for overseas JV / WOS fails in such cases?

Disinvestment in JV / WOS - (1/6)

Forms of disinvestment

Sale

Gift

Buy back

Dilution

Liquidation / Merger
/ Demerger

Asset
Sale/Slump sale

Capital
reduction/repayment

Accounting
write-off

Which forms of disinvestments are governed by FEMA Regulations?

Disinvestment in JV / WOS - (2/6)

Transfer by way of sale of shares of JV / WOS outside India

Indian parties, without prior RBI approval, may transfer by way of sale to another Indian Party or to any person resident outside India, any share or securities held by it in a JV / WOS outside India.

Procedural Aspects

- Submission of necessary details to AD - Bank within 30 days of divestment closure / winding up / voluntary liquidation.
- Repatriation of sale proceeds of shares / securities within 90 days.

Transfer by way of sale of shares subject to satisfaction of additional conditions.

Disinvestment in JV / WOS - (3/6)

Additional conditions:

- The sale does not result in any write off of the investment (or financial commitment) made.
- Sale is effected through an overseas stock exchange where shares of JV/ WOS are listed.
- If shares of JV / WOS are unlisted, share price is not less than fair value as certified by Chartered Accountant or Certified Public Accountant based on last audited financial results of JV / WOS.
- The overseas concern has been in operation for atleast one full year.
- Indian Party does not have any outstanding dues from JV / WOS.
- The Indian party is not under investigation by CBI /ED /SEBI / IRDA or any other regulatory authority in India.

In all other cases specific approval of RBI needs to be obtained

Disinvestment in JV / WOS - (4/6)

Transfer by way of sale of shares of a JV / WOS involving Write Off of investment

Indian parties may disinvest, without prior RBI approval, where the amount repatriated after disinvestment is less than the original amount invested:

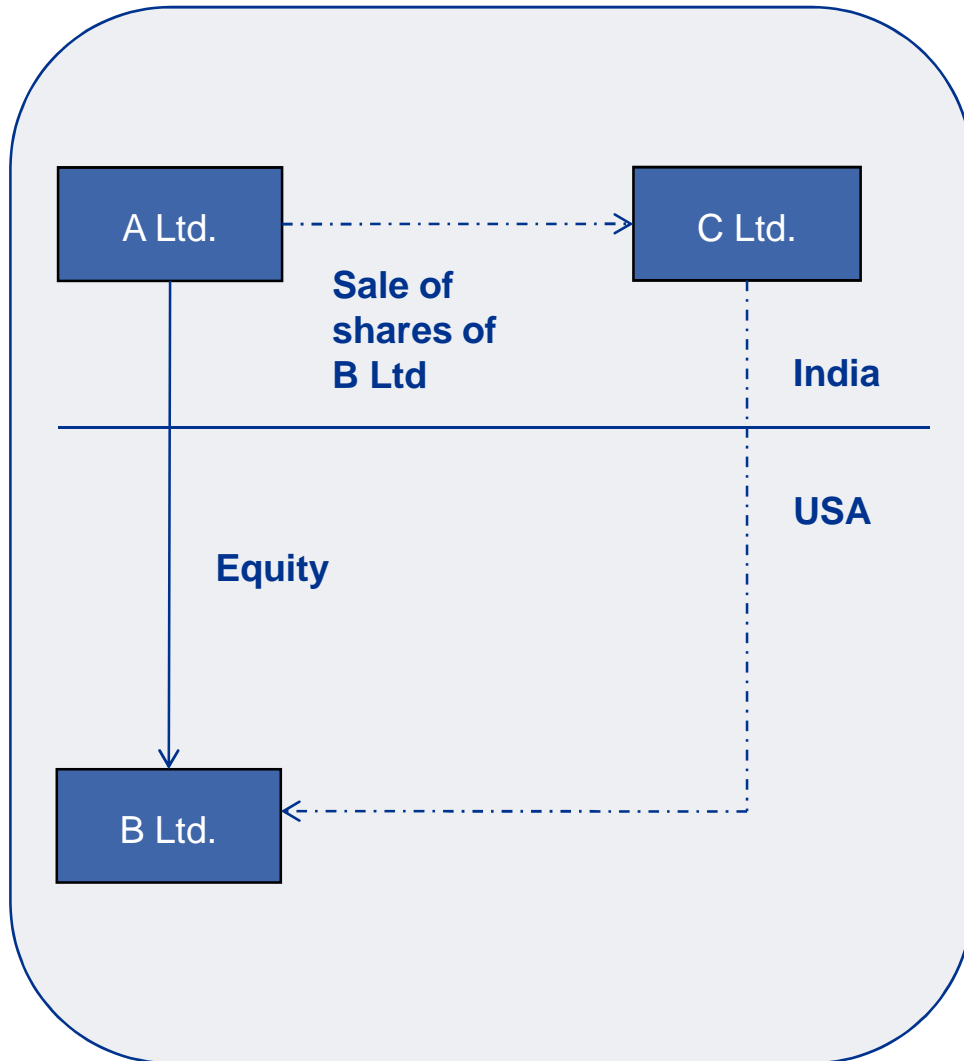
- Overseas JV / WOS is listed on a overseas stock exchange;
- Indian promoter company is listed on an Indian stock exchange and has net worth of not less than Rs 100 Crores;
- Indian promoter company is listed (with net worth of less than Rs 100 crore) but investment in overseas venture does not exceed USD 10 million;
- Indian promoter company is unlisted and the investment in overseas venture does not exceed USD 10 million.

Procedural Aspects

- Submission of necessary details to AD - Bank within 30 days of divestment closure / winding up / voluntary liquidation.
- Repatriation of sale proceeds of shares / securities within 90 days.

Additional conditions are required to be satisfied for disinvestment.

Disinvestment in JV / WOS -(5/6)



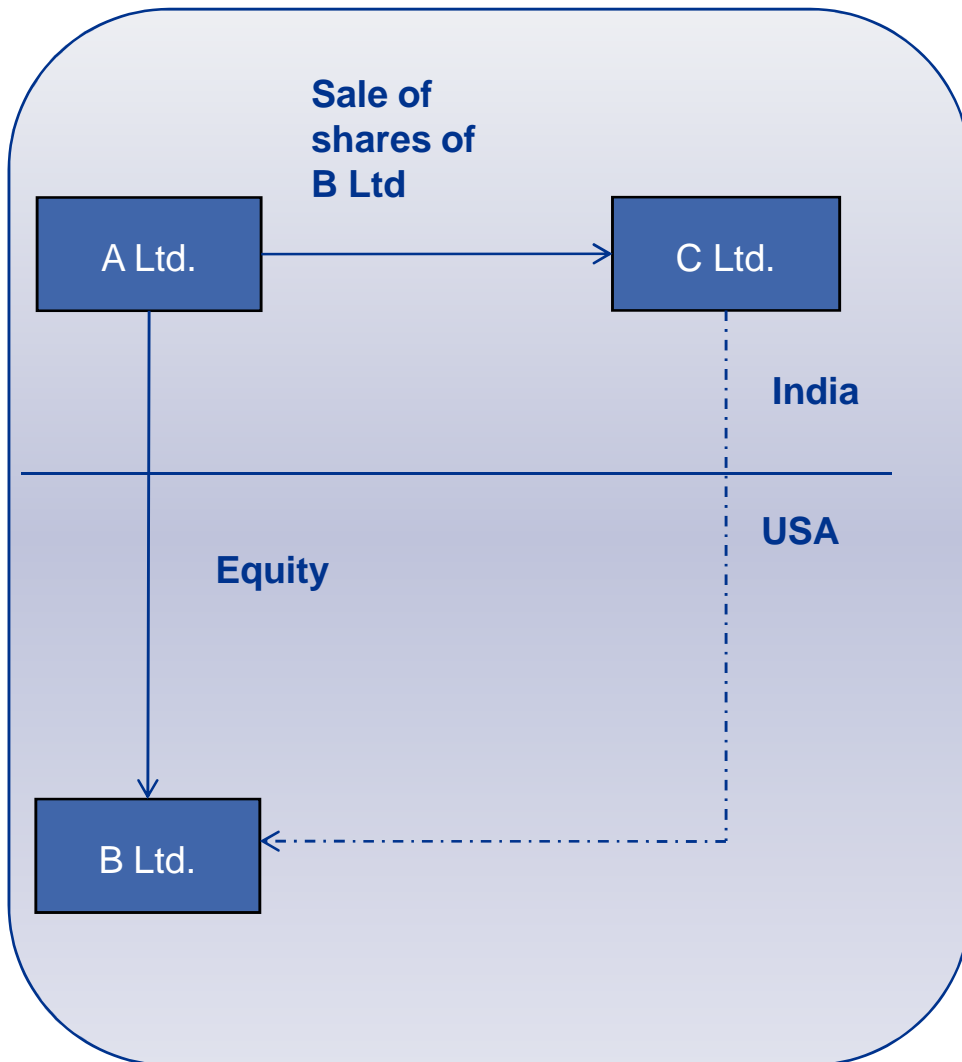
- A Ltd., an Indian unlisted company has subscribed to equity capital of B Ltd, a company incorporated in USA. in January 2015. The investment value is less than USD 10 million.
- B Ltd. has commenced its operations in February 2015.
- A Ltd. proposes to sell shares of B Ltd. to its group company C Ltd. in April 2015.

Question:

- Whether A Ltd. can sell the shares without B Ltd. prior approval of the RBI ?

X

Disinvestment in JV / WOS - (6/6)




- A Ltd., an Indian unlisted company has invested USD 15 million in B Ltd, USA.
- A Ltd proposes to divest its holding in B Ltd. (after some write off) to C Ltd, an Indian company.

Question:

- Whether A Ltd. can sell the shares without approval of the RBI?

X

Restructuring of Balance Sheet of the overseas entity

- 
- Indian parties which have overseas WOS or have at least 51% stake in overseas JV, may write off capital (equity / preference shares) or other receivables such as loans, royalty, technical know-how fees and management fees in respect of such JV / WOS, even while such JV / WOS continue to function as under:
 - Listed Indian Companies - upto 25% of the equity investment in JV / WOS under the Automatic Route; and
 - Unlisted Indian Companies - upto 25% of the equity investment in JV / WOS under the Approval Route.
 - The write-off/restructuring have to be reported to the Reserve Bank through the AD – Bank within 30 days of write-off/restructuring.

Form ODI

All transactions relating to investment in JV / WOS to be routed through one branch of AD - Bank

Form ODI is divided into following :

Part I - includes the following:

- Section A - Details of Indian Party
- Section B - Details of Investment in New Project
- Section C - Details of Investment in Existing Project
- Section D - Funding for JV / WOS
- Section E - Declaration by Indian Party
- Section F - Certificate by the Statutory Auditors of the Indian Party

Part II - Reporting of Remittances

Part III – Annual Performance Report

Part IV - Report on Closure / Disinvestment / Voluntary Liquidation / Winding up of JV / WOS

Obligation of Indian Party

- Receive share certificates or any other document as an evidence of investments within 6 months, or such further date as the RBI may permit.
- Repatriate to India all dues receivable from the foreign entity, like dividend, royalty, technical fees, etc within 60 days of its falling due.
- Submit the APR every year by 30 June as long as the JV / WOS is in existence.
- Where law of host country does not require auditing of books of accounts of JV / WOS, the APR can be submitted based on un-audited annual accounts provided:
 - Statutory Auditors of Indian Party certify that the un-audited annual accounts of the JV / WOS reflect true and fair picture.
 - The un-audited annual accounts of the JV / WOS has been adopted and ratified by the Board of the Indian Party.

Overseas Direct Investments by Residents Individuals

14 Aug 2013 onwards

LRS limit
reduced to USD
75,000 p.a.

3 June 2014 onwards

LRS limit
enhanced to USD
125,000 p.a.

26 May 2015 onwards

LRS limit
enhanced to USD
250,000 p.a.

- **Two Routes for Outbound Investments by Resident Individuals - LRS and ODI**
- **ODI Route introduced by FEMA 263 dt. 5.8.2013 vide Circular No. 24 dt. 14.8.2013**
 - Investment in overseas JV / WOS only by way of equity / compulsorily convertible preference shares
 - JV / WOS to be engaged in bonafide business activities except real estate / banking / financial services
 - ODI in “non-co-operative countries and territories” as per FATF not permitted
 - Resident individual not to be on RBI caution / defaulters list
 - Limit of investment in JV / WOS as per LRS limit (currently USD 250,000 per annum)
 - Investment made from EEFC / RFC account also included in prescribed LRS limit
 - JV / WOS to be operating entity only - No step down subsidiary to be acquired or set up by JV / WOS
 - Valuation /Reporting and Post investment obligations same as applicable to ODI by Indian Companies
 - Write off not permitted in cases of disinvestments

Glossary

Acronym	Explanation
AD - Bank	Authorized Dealer Bank – Category - 1
ADR	American Depository Receipt
APR	Annual Performance Report
ECB	External Commercial Borrowing
EEFC	Exchange Earner's Foreign Currency
FCCB	Foreign Currency Convertible Bond
FEMA	Foreign Exchange Management Act, 1999
FEMA120	Foreign Exchange Management (Transfer or Issue of any foreign security) Regulations, 2004 – Notification No. 120 / 2004 – RB
FY	Financial Year
GDR	Global Depository Receipt
JV	Joint Venture
LLP Act, 2008	Limited Liability Partnership Act, 2008
LRS	Liberalized Remittance Scheme
MOA	Memorandum of Association
NBFC	Non Banking Financial Company.
ODI	Overseas Direct Investment
PFI	Public Financial Institution
RBI	Reserve Bank of India
RI	Resident Individual
SDS	Step Down Subsidiary
SPV	Special Purpose Vehicle
WOS	Wholly Owned Subsidiary

Thank You

