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Liberalisation of the Overseas Direct Investment Regime

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Regulatory Changes

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An entirely new regulatory framework from August 22, 2022. An approach similar the one for FDI into India: the debt and non-debt split.

Non debt framework issued by the Central Government

Debt framework and ODI Directions issued by the RBI

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KEY NEW CONCEPTS: ODI REGIME

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Foreign Entity (FE)

- Subsumes the extant concepts of a JV / WOS.
- An entity formed or registered or incorporated outside India that has limited liability.
- The restriction of limited liability shall not apply to an entity with core activity in a strategic sector (energy and natural resources sectors such as oil, gas, coal, mineral ores, submarine cable system and start-ups)

Subsidiary/ Step Down Subsidiary

- Must be under the **control*** of the Foreign Entity.
- Typically, must have limited liability.

*** Control:**

Qualitative test (appoint majority directors or control over management or policy decisions, directly or indirectly) or
Quantitative test (**10%** or more of voting rights)

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Overseas Direct Investment

- acquisition/subscription of any **<u>unlisted</u>** **<u>equity</u>** of a foreign entity**;** or
- **<u>10%</u>** or more of the **<u>listed</u>** equity of a foreign entity; or
- **<u>control</u>** of a listed foreign entity.

Once an ODI, always an ODI*:* even if does not fulfil the '10%' or 'control' or listing threshold at any subsequent point in time.

Overseas Portfolio Investment

- Typically, any overseas investment in foreign securities which does not constitute ODI.

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Key changes in the new ODI regime

- Enhanced clarity with respect to various definitions
- Introduction of the concept of "strategic sector" – includes oil, gas, coal, start ups.
- Dispensing with the requirement of approval for:
  - deferred payment of consideration
  - investment/disinvestment by persons resident in India under investigation by any investigative agency/regulatory body – instead, needs to seek an **NOC** from such investigative agency/ regulatory body by making an application, which is **presumed approved** within **60 days**.
  - issuance of corporate guarantees to or on behalf of second or subsequent level SDS
  - write-off on account of disinvestment
- Introduction of "late submission fee" for reporting delays

Key requirements for making an ODI

- Foreign Entity must be engaged in a bona fide business activity.
- Financial commitment exceeding USD 1 (one) billion in an FY **shall require prior approval of the RBI** even when the total financial commitment of the Indian entity is within the eligible limit under the automatic route.
- ODI is not permitted in any Foreign Entity either engaged in:
  - any real estate activity;
  - gambling in any form; or
  - dealing with financial products linked to the Indian rupee **without specific approval of the RBI**.
- An Indian entity will require **prior approval of the Central Government** for making any financial commitment in Pakistan or in any other jurisdiction advised by the Central Government.

ODI in an FE, which is directly or indirectly engaged in financial services activity (FSA), by Indian entity engaged / not engaged in FSA in India

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Indian entity - engaged in FSA	Indian entity - not engaged in FSA
• Indian entity must have posted net profits during the preceding 3 financial years*.	• Indian entity must have posted net profits during the preceding 3 financial years*.
• Indian entity is registered with or regulated by a financial services regulator in India.	• ODI not permitted in an entity engaged in banking or insurance.
• Indian entity has obtained approval from the regulators of such FSA - both in India and the host country/ jurisdiction for engaging in such FSA.	• Indian entity not engaged in the insurance sector may make ODI in general and health insurance where such insurance business is supporting the core activity undertaken overseas by such Indian entity .

**If this criteria is not met due to the impact of Covid-19 during the period from 2020-2021 to 2021-2022, then the financial results of such period may be excluded for considering the profitability period of 3 years.*

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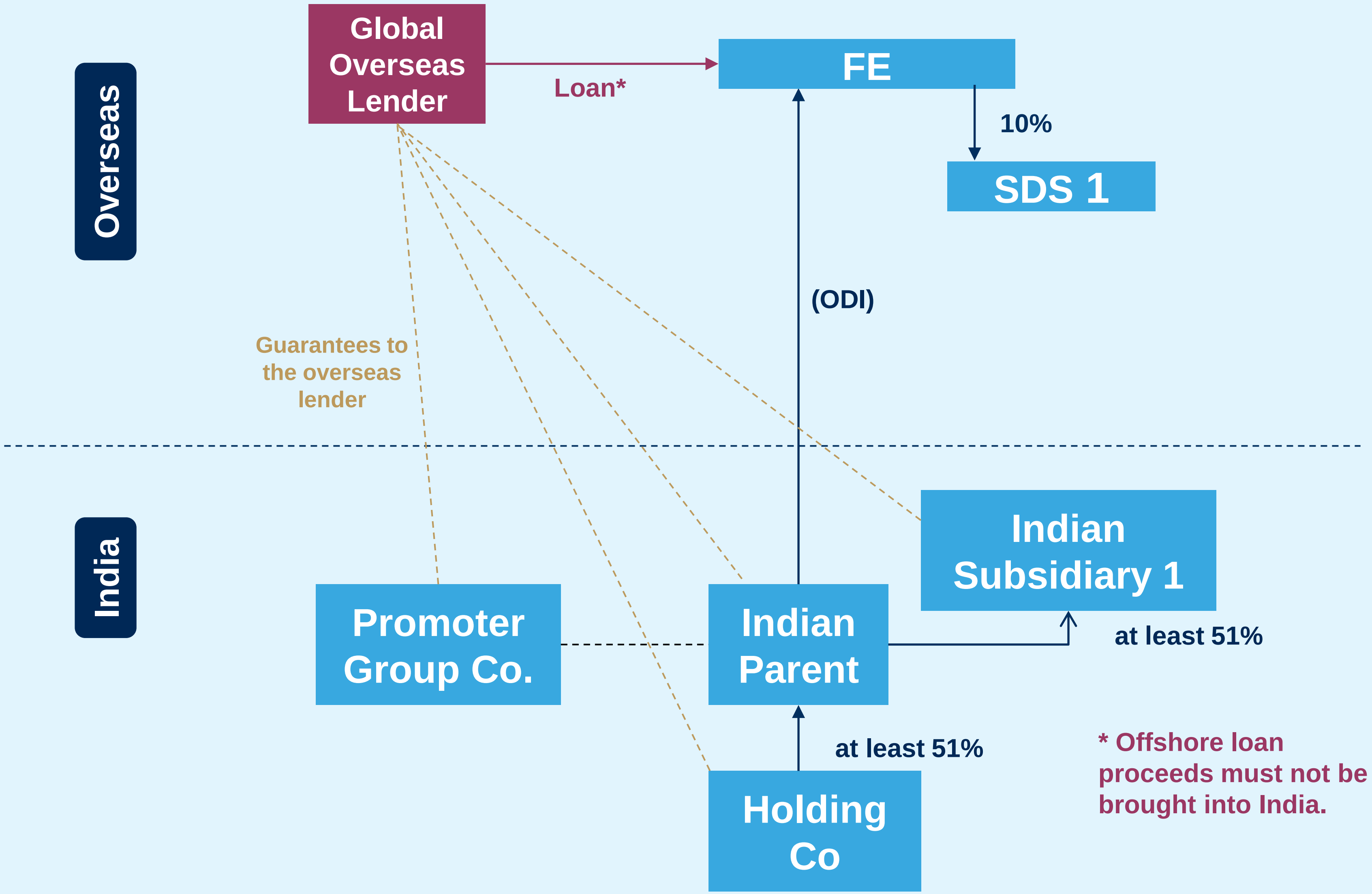
LEVERAGING BALANCE SHEET OF INDIAN COMPANIES FOR FOREIGN SUBSIDIARIES

Guarantees

Automatic permission to issue guarantees on behalf of any foreign entity or SDS, regardless of their level, provided such entity is controlled by the Indian entity, has been given to:

- the Indian entity;
- a holding company of the Indian entity (holding at least 51% stake);
- a subsidiary company of the Indian entity (holding at least 51% stake in the subsidiary; and
- a <u>'promoter group'</u> company



Pledge on Securities

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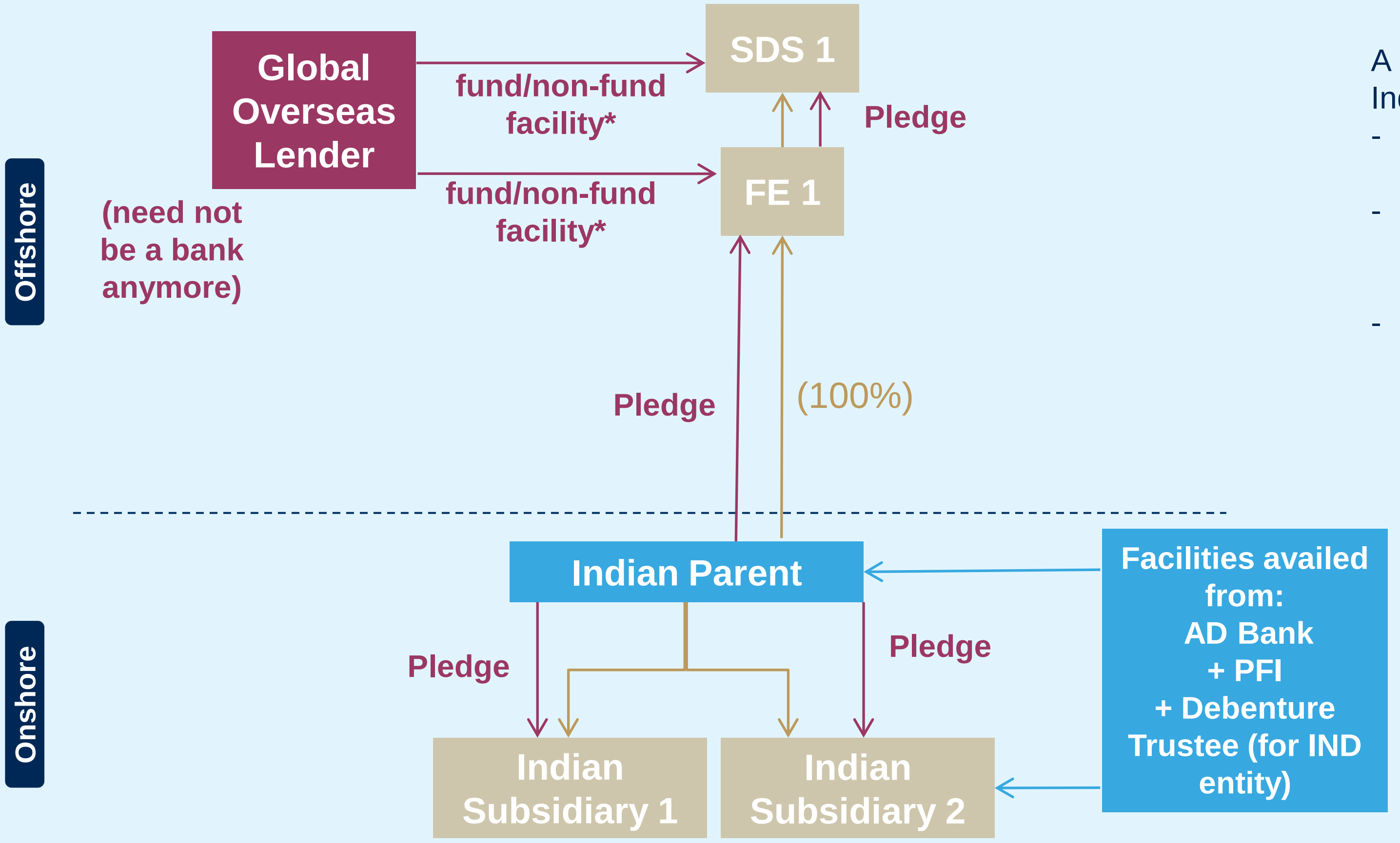
A pledge may be created by the Indian entity (Indian Parent):
- in favour of an overseas lender
- to secure fund/non-fund based facilities for any foreign entity (FE1)/ its SDS outside Indian (SDS 1)
- on the equity capital of the foreign entity (FE 1) /its SDS outside India (SDS 1).

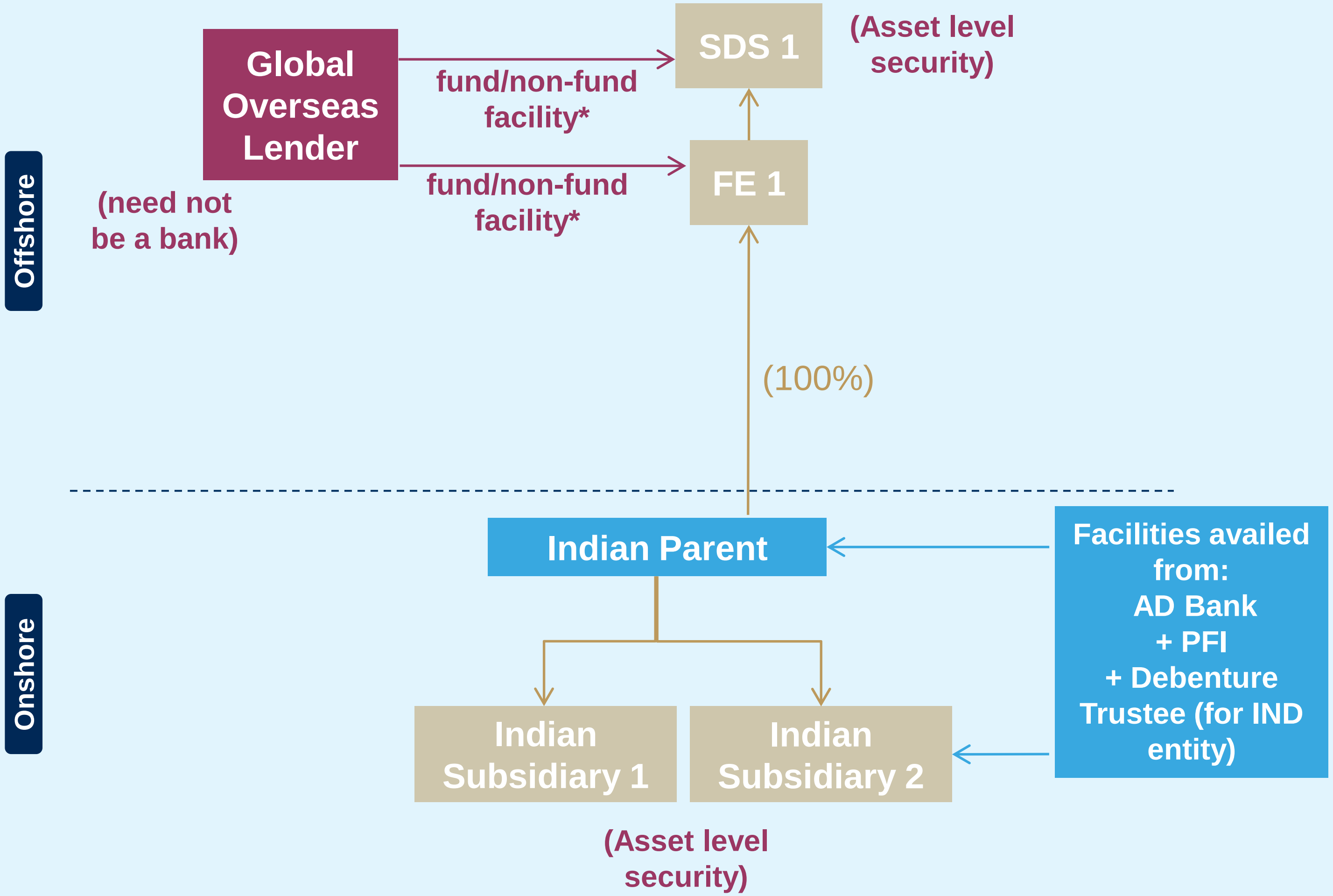


A pledge may be created by the Indian entity (Indian Parent):
- in favour of AD Bank or PFI or a debenture trustee;
- to secure fund/non-fund based facilities for the Indian entity (Indian Parent)
- on the equity capital of the foreign entity (FE 1) /its SDS outside India (SDS 1).

*** Offshore loan proceeds must not be brought into India.**

Charge on assets

A charge may be created:
- in favour of the global overseas lender
- for fund/non fund based facility for foreign entity (FE1) and its SDS outside India (SDS1)
- on the assets of the Indian entity in India (Indian Parent), including the assets of its group company or associate company, promoter or director (IS 1/ IS2)



A charge may be created:
- in favour of the AD bank or PFI or debenture trustee (only for fund based facility) in India
- for fund/non-fund based facility for Indian entity (Indian Parent)
- on the assets outside India of the foreign entity (FE1)/ its SDS outside India (SDS 1).

*** Offshore loan proceeds must not be brought into India.**

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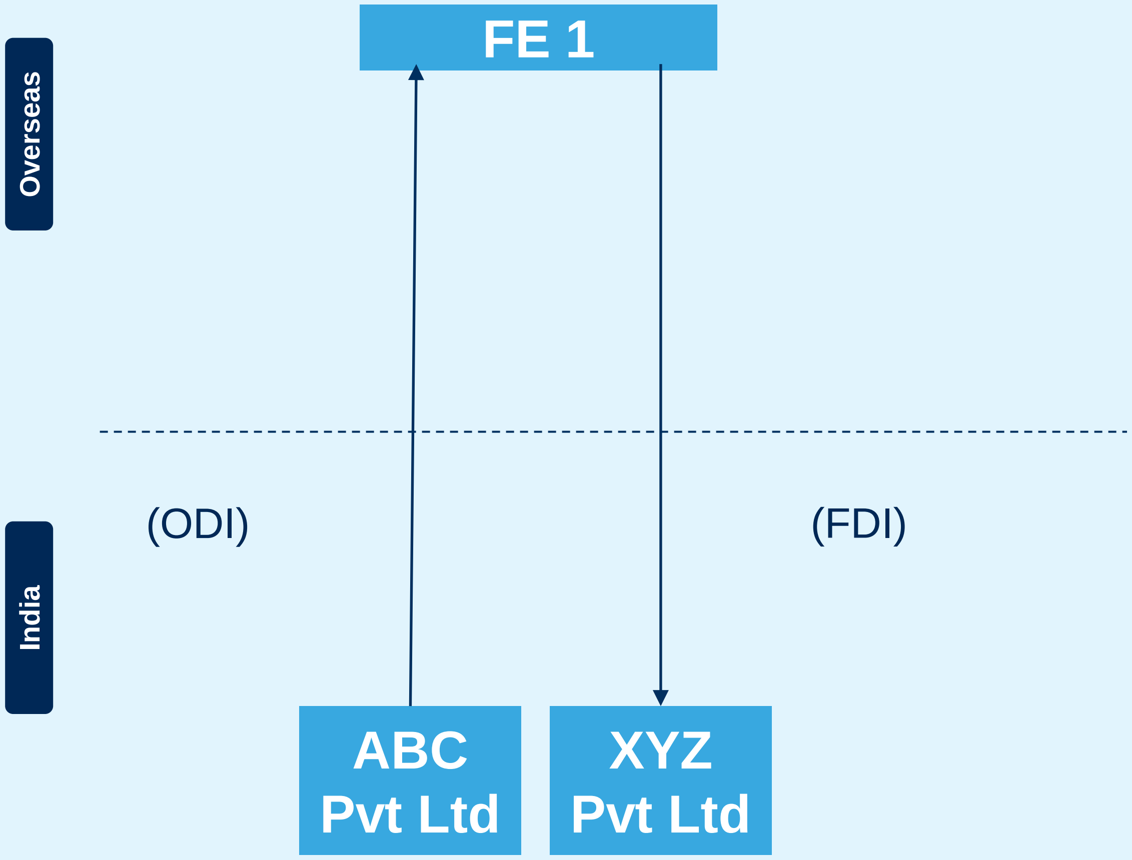
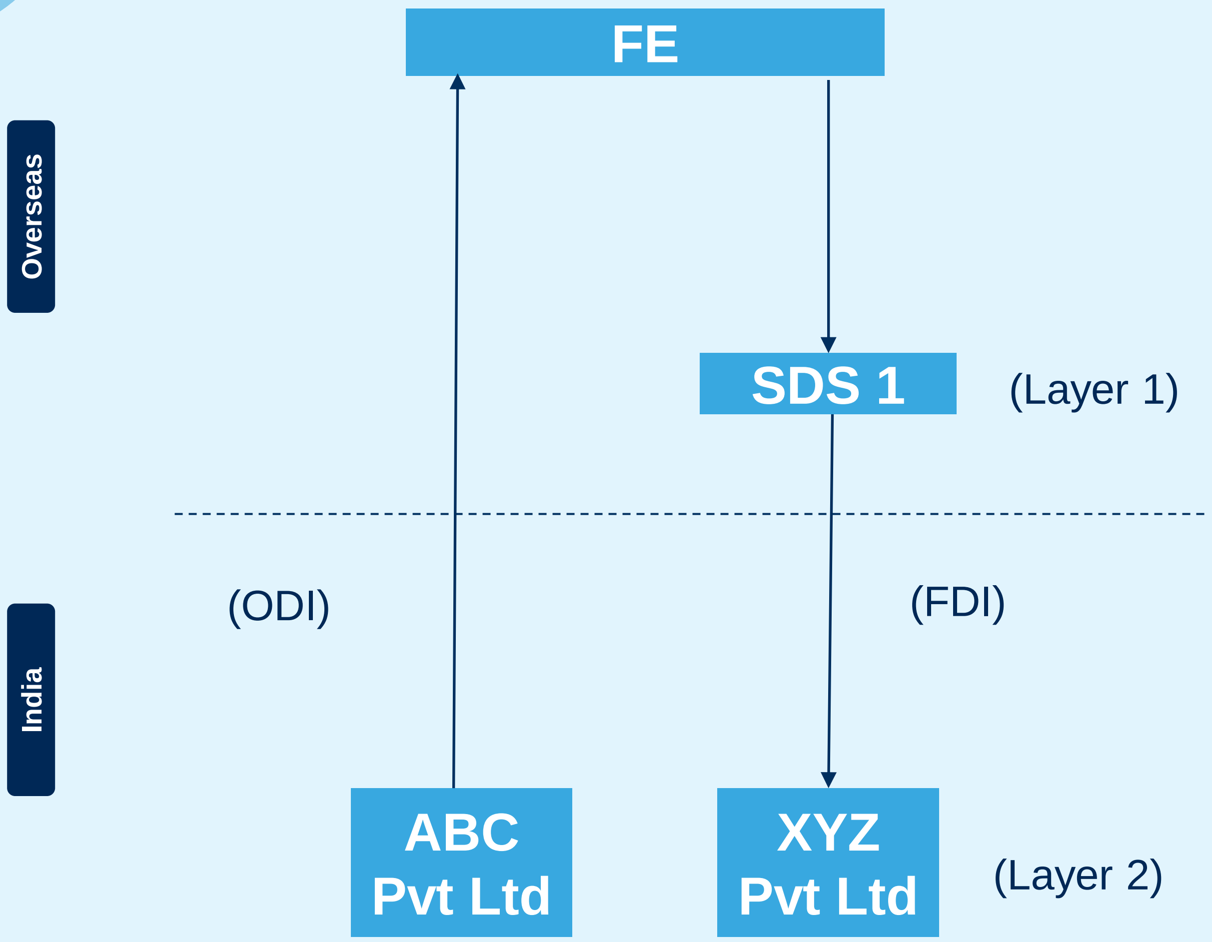
PERMISSIBLE ODI + FDI STRUCTURES

Round Tripping: Two Layers



- The outright prohibition on round tripping structures has been removed.
- Structures with ODI + FDI possible without prior RBI approval.

Round Tripping: Two Layers



- Round tripping structures with more than 'two layers of subsidiaries' are not permitted.
- The level of step-down subsidiary (SDS) shall be calculated treating the FE as the parent. So, an SDS directly under the direct FE should be treated as first level SDS and the SDS under the first level SDS would be treated as second level SDS, so on and so forth.

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POSSIBLE BOND STRUCTURES

OFFSHORE + ONSHORE FINANCING

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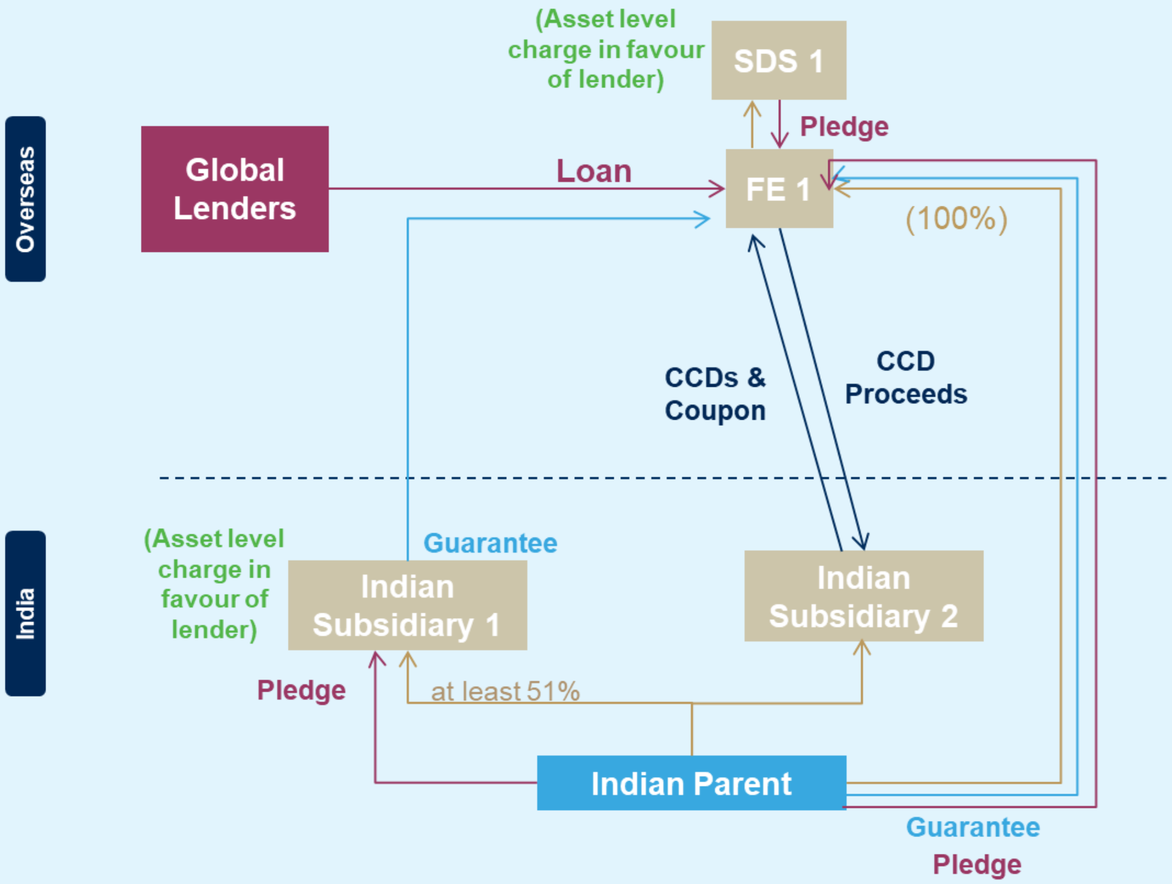

Step 1 –Borrowing Funds Offshore

- Company raises dollar funding via a loan in direct wholly owned foreign subsidiary (FE1)
- Offshore loan can be secured by Indian Parent through either:
  - **pledge** of its equity capital of FE1;
  - **charge on its assets** in India (other than FE1);
  - Parent, Indian subsidiary 1 (if Indian Parent has atleast 51% stake) can provide a **guarantee** for the offshore debt subject to the applicable regulatory thresholds; or
  - onshore assets held by Indian Subsidiary 1 and offshore assets held by step down subsidiary (SDS 1) can also be **charged** in favour of overseas lenders.

Step 2 – Bringing Proceeds Onshore

- Offshore loan proceeds are used by FE1 to subscribe for onshore Compulsory Convertible Debentures (CCD) issued by onshore Indian Subsidiary 2.
- Proceeds of the CCD can be used by Indian Subsidiary 2 for business operations and expansions, brand acquisitions, working capital, etc.
- Indian Subsidiary 2 pays interest coupons on CCDs to FE1 which are then used by FE1 to service interest on offshore borrowing.

Step 3 – Redemption of offshore borrowing

- FE1 to sell CCDs to onshore Indian Parent at fair value.
- Proceeds received from sale of CCDs can be used to repay offshore borrowing at redemption.

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ACQUISITION BY INDIVIDUAL

Overseas investment by resident individual

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- ODI by way of investment in equity capital - in an operating foreign entity not engaged in FSA and which does not have subsidiary or step down subsidiary where the resident individual has control in the foreign entity.

- Overseas portfolio Investment (OPI), including by way of reinvestment, i.e., an investment other than ODI, in foreign securities (other than unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC).

Forms of ODI or overseas portfolio investment (OPI)

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Capitalisation of any amount due from the FE the remittance of which is permitted/ does not require prior permission of the Central Government or the RBI

Swap of securities on account of a merger, demerger, amalgamation or liquidation

Inheritance*

Acquisition of equity capital through rights issue or allotment of bonus shares

Acquisition of minimum qualification shares issued for holding a management post in an FE*

Acquisition of shares or interest under ESOP or Employee Benefits Scheme*

Gift in accordance with the specified conditions

Acquisition of sweat equity shares*

*ODI may be made in an FE whether or not such foreign entity is engaged in FSA or has subsidiary or step down subsidiary where the resident individual has control.

* Except for Inheritance, acquisition of less than 10% of the equity capital, whether listed or unlisted, of FE without control will be treated as OPI.

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THANK YOU

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