Intra Legem

Revamped ODI Framework - Impetus for Undertaking Foreign Transactions or Old Wine in New Bottle?

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Introduction

Foreign exchange laws in India are the most important and dynamic laws. It is important since all the inbound and outbound foreign transactions as well as the structuring and documentation of these transactions are required to be foreign exchange laws compliant. It is dynamic since there have been periodical amendments and revamping of these laws from time to time.

With the aim to address the regulatory and operating challenges, the Central Government and the Reserve Bank of India recently revamped the laws dealing with overseas direct investment in India. by introducing the Rules[1], Regulations[2], and Directions[3] ("***Revamped Regime***").

The Revamped Regime governs investment and immovable property transactions outside India and the same shall supersede the earlier regime[4] dealing with these transactions. It should however be noted that certain earlier circulars and notifications issued by the RBI, barring those listed in Directions[5],

1. Foreign Exchange Management (Overseas Investment) Rules, 2022
2 Foreign Exchange Management (Overseas Investment) Regulations, 2022
3 Foreign Exchange Management (Overseas Investment) Directions, 2022
4 Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015
5. Annex II of the Foreign Exchange Management (Overseas Investment) Directions, 2022

shall still be applicable and must be read in conjunction with the Revamped Regime. The focus shall be on the Rules and Regulations and for guidance purposes, the Directions should be referred to.

In this article, we briefly discuss some of the significant changes brought about through the Revamped Regime for overseas direct investment ("***ODI***") transactions, the impact of the changes on the existing and new foreign transactions, key challenges, areas of concern, issue of round-tripping, ramifications for non-compliance, the scope for regularization if any, and the practical issues that the company and the individuals may have under the Revamped Regime.

Revamped ODI Framework

The Revamped Regime has introduced several new definitions, and new provisions, and has also done away with the approval requirements in certain cases as provided under the Directions for (i) deferred payment of consideration, (ii) investment or disinvestment by persons resident in India under investigation by any investigative agency or regulatory body, (iii) issuance of corporate guarantee to or on behalf of the second or subsequent level step-down subsidiary, and (iv) write-off on account of disinvestment. Although the approval requirement has been removed, there are certain preconditions required to be fulfilled as provided in the Revamped Regime for such transactions.

Like, in the case where the Indian Entity acquires or subscribes equity capital[6], the payment of consideration amount can be deferred for a definite period to be agreed upon upfront between the issuer company and the subscriber or the acquirer. Notably, there is no outer time period provided within which the total or the balance consideration amount should be paid. As such it has been left to the parties to decide the outer timeframe, which will have to be determined after taking into consideration the laws of the host jurisdiction. While the parties are required to agree on such timelines upfront, there is no clarification on whether such timelines can be extended by way of an amendment. Some other conditions required to be fulfilled in relation to the deferred payment of consideration are that the foreign securities equivalent to the total consideration amount shall be required to be transferred or issued upfront and

6. Rule 2(e) of the Foreign Exchange Management (Overseas Investment) Rules, 2022

the payment of the consideration should be in compliance with the pricing guidelines.

Earlier, when the company was under investigation by any regulatory body, prior approval of the authorities was required before any investment or disinvestment. Now under the Revamped Regime in such a scenario, including where the account of the Indian Entity is NPA, any investment or disinvestment shall be subject to obtaining the NOC from the lender bank, investigative agency, and regulatory body. While there is no specific clarification, it appears that the NOC should be unconditional. Also, in the event the lender or the authority fails to provide their NOC within the stipulated time period of 60 days, then it will be considered deemed approval. This is a similar provision as provided in the LODR[7]. for obtaining NOC from the Stock Exchange; although earlier it was permitted to submit the scheme of merger and demerger if the NOC was not provided by the Stock Exchange within the then stipulated time period, now the scheme cannot be filed with the NCLT until the NOC has been granted. While the timelines are specified there is no particular application format given for obtaining the NOC under the Revamped Regime.

Further, the Revamped Regime clarifies that the NOC is required only at the time of making a financial commitment[8]. Hence, after making the financial commitment if the Indian Entity is under investigation and at the same time is required to honor any financial commitment, then there is no requirement to obtain prior NOC. By way of an example, if the Indian Entity decides to issue a guarantee for or on behalf of the Foreign Entity or its subsidiary or step down subsidiary, then the question of obtaining or not obtaining the NOC will have to be evaluated only at the time of issue of the guarantee not at the time of invocation of the guarantee, even if the Indian Entity is then under investigation or its account is NPA.

Further, the earlier blanket prohibition[9] to set up a subsidiary or step-down subsidiary by the Indian Entity has been done away with and it is now allowed

7 Regulation 37 of the Securities And Exchange Board of India (Listing Obligations and Disclosure Requirement Regulations, 2015

8 Rule 10 of the Foreign Exchange Management (Overseas Investment) Rules, 2022

9 RBI FAQ No. 64 on ODI (not available)

to have two layers of subsidiaries. However, these restrictions shall not be applicable to certain classes of companies like the banking and financial companies as mentioned in the rules[10] prescribed under the Companies Act, 2013. This is a welcome change that will help and encourage the companies to structure their genuine investment transactions and encourage more overseas investments at the same time. Also, the fulfillment of the conditions and restrictions under the Revamped Regime will hope to serve as proper checks and balances to address the issue of siphoning of funds and round-tripping.

In relation to the implementation of various regulatory provisions under the Revamped Regime, the Authorised Dealer has been provided significant responsibility to scrutinize the ODI transaction before the same is permitted. This includes ensuring the bonafide of transactions, compliance with the provisions of the Foreign Exchange Management Act and Anti-Money laws, and reporting any doubtful or suspicious transactions to the Directorate of Enforcement. In order to satisfy the bonafide of the transactions, the AD has been advised to have a suitable internal policy in place. Any non-compliance will attract penal provisions for the AD. Besides recommending that the AD can take a suitable declaration from the Indian Entity, neither the RBI nor the Central Government has issued any directions in relation to the nature of documents and information that the AD should ask from the Indian Entity to satisfy itself and has left it to the AD to decide the same. Again, the format for such a declaration is not provided. Considering that there are no preset parameters for evaluating overseas transactions, each AD will have its own compliance requirements, which may possibly delay the implementation of investment decisions, since even no timelines are provided for clearing these transactions by the AD.

Another significant provision is the concept of Control, the newly inserted term. This term is central to evaluating various provisions of the ODI investments including establishing the eligibility criteria for any financial commitment (in the form of fund-based and non-fund-based commitments) and identifying the subsidiary or step-down subsidiary. This definition is similar to the one provided under the Companies Act and the Securities Exchange Board of India (Substantial Acquisition and Takeovers) Regulations, 2011 which focuses on the

10 Rule 2 of the Companies (Restriction on Number of Layers) Rules, 2017

right to control the management, the policy decisions, and the board constitution with the additional provision that a shareholding of 10% or more in the Foreign Entity will also be the determining factor for establishing control. As per the Directions simply holding 10% shareholding will pass the test of control and the Indian Entity shall then be bound by the provisions applicable to the ODI transaction.

Further, the Revamped Regime clarifies that if at the time of making the financial commitment control is established and subsequently the Indian Entity loses control, it will not alter the status of the ODI already done by the Indian Entity.

There has been a much-required change brought about through the Revamped Regime by allowing regularization of the non-fulfillment of reporting requirements for the ODI transactions through introducing the provisions of late submission fee ("***LSF***"). The provisions of LSF which are applicable for FDI and ECB transactions have also been extended for ODI transactions[11]. The outer timeline provided for LSF is 3 years from the reporting date. While it is again a welcome change, since the lengthy and time-consuming compounding proceedings will not be required to be initiated for regularizing the non-compliance of the reporting requirement, however, if not done within the time period it will attract penal provisions. Also, more clarification will be required on the operational guidelines for initiating and completing the LSF formalities together with the nature of documentation and filings to be done for the same.

Final Thoughts

The Revamped Regime is clearer, simplified, and liberal which will reduce compliance burden and compliance cost for the companies.

However, certain ambiguous provisions will need the attention of the Central Government and the Reserve Bank of India. As in the case, whether once the ODI will always be the ODI (as discussed above in relation to the concept of control) since there can be possible misuse of the Revamped Regime where the

11 RBI Circular dated September 30, 2022, A.P. (DIR Series) Circular No.16

Indian Entity will be permitted to do all such transactions which are otherwise permissible only to Indian Entity having control in Foreign Entity. In such cases, the Indian Entity will also then be required to adhere to all the compliance requirements, even when there is no actual control over the Foreign Entity. Ideally, some time period should have been provided to retain the actual control after losing it.

Some clarification should also be provided in relation to the option of compounding proceedings after the period of 3 years has lapsed when the Indian Entity has not regularized the non-compliance through the LSF option since the Revamped Regime provides that penal provisions will get attracted if non-compliance is not regularized within the stipulated time period. This would mean that in addition to compounding penalties the Indian Entity will also attract penal provisions before the non-compliance is regularized.

Also, it will be useful if definite timelines are provided for clearing the transactions by the AD, just like the way timelines of 60 days have been provided for giving the NOC. The authorities should also consider providing the formats for documents and undertakings to be submitted at different stages of an investment cycle to speed up the process and avoid back-and-forth clarifications.

Lastly, it should be noted that the company that has done ODI transaction under the old regime are required to comply with certain provisions under the Revamped Regime. Hence, it will be important for the Indian Entity to evaluate the provisions and put their house in order and take cognizance of the new provisions while finalizing the documents to avoid breaching the laws and any consequential actions against them. Any non-compliance could possibly trigger penal penalties and restrict the Indian Entity to make future investments or transfer existing shares, which may further lead to non-compliance under the definitive agreements.

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