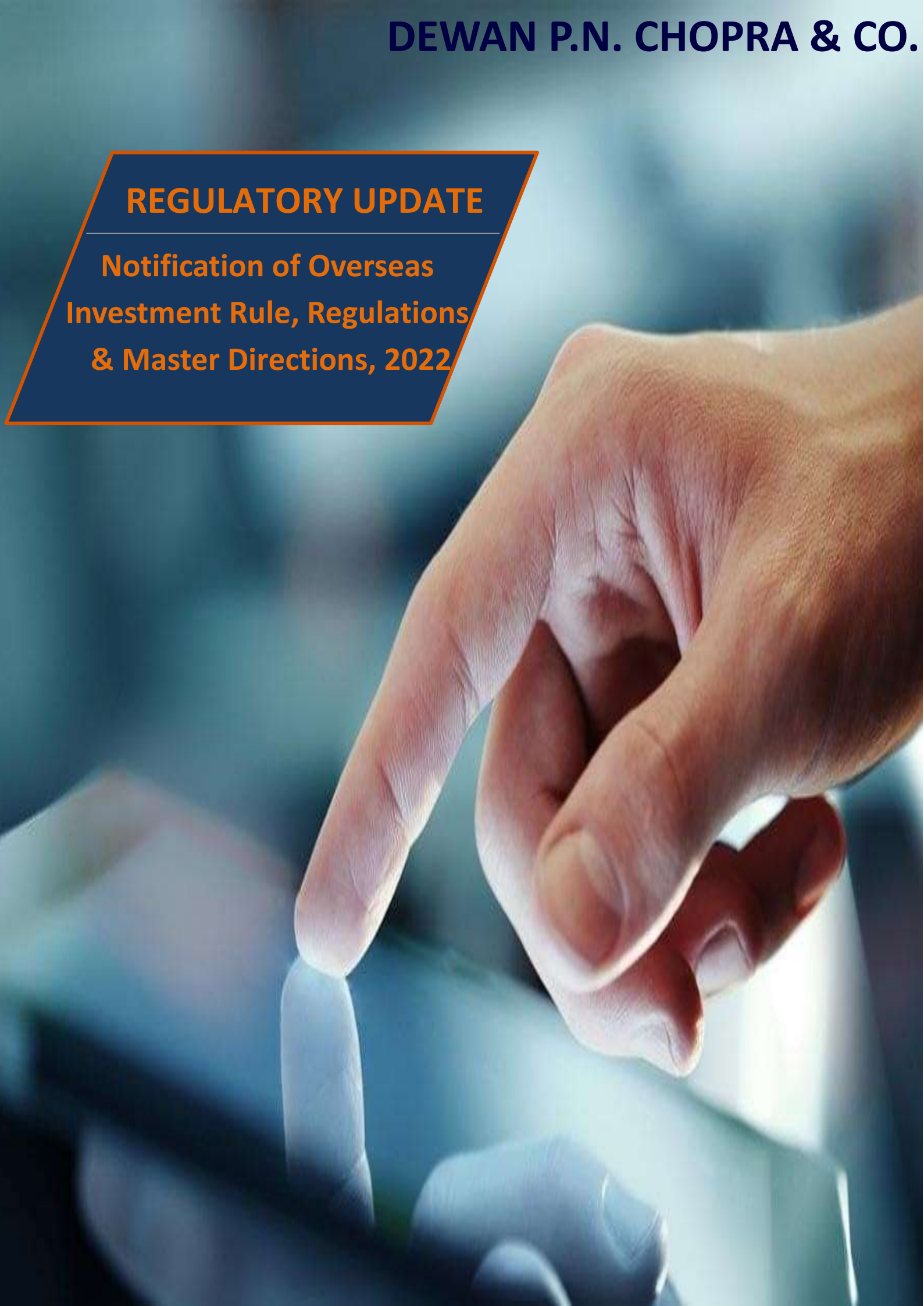


REGULATORY UPDATE

**Notification of Overseas
Investment Rule, Regulations
& Master Directions, 2022**



Notification of Overseas Investment Rules, Regulations & Master Directions, 2022

In keeping with the spirit of liberalization and to promote ease of doing business, the Central Government and Reserve Bank of India had been progressively simplifying the procedures under Foreign Exchange Management Act, 1999. Continuing with the same intent, a new regime towards Investments Outside India by Indian Entities and Resident Individuals has been enforced w.e.f. 22nd August, 2022.

Central Government and Reserve Bank of India vide powers conferred on them under Section 46 and Section 47 of the Foreign Exchange Management Act, 1999 have revamped the Overseas Investment Guidelines and prescribed the **Foreign Exchange Management (Overseas Investment) Rules, 2022** (“Rules”) and the **Foreign Exchange Management (Overseas Investment) Regulations, 2022** (“Regulations”) as enforceable w.e.f. 22nd August 2022, which would supersede the erstwhile regime under the **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**.

Apart from the foregoing Rules and Regulations, the Reserve Bank of India has issued the Master Direction in this respect vide **Foreign Exchange Management (Overseas Investment) Directions, 2022** and accordingly amended the **Master Direction - Liberalised Remittance Scheme (LRS)** and **Master Direction – Reporting under Foreign Exchange Management Act, 1999**

The key highlights in brief of the newly introduced Rules, Regulations and Master directions are as follows:

1. Introduction of certain new definitions and amendments:

- **Control** 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 10 % or more of voting rights or in any other manner in the entity;

- **Disinvestment** means partial or full extinguishment of right, title or possession of equity capital acquired under these rules;
- **Equity capital** means equity shares or perpetual capital or instruments that are irredeemable or contribution to non-debt capital of a foreign entity in the nature of fully and compulsorily convertible instruments;
- **Financial Commitment** means the aggregate amount of investment made by a person resident in India by way of Overseas Direct Investment, debt other than Overseas Portfolio Investment in a foreign entity or entities in which the Overseas Direct Investment is made and shall include the non-fund-based facilities extended by such person to or on behalf of such foreign entity or entities;
- **Foreign Entity** means an entity formed or registered or incorporated outside India, including International Financial Services Centre, that has limited liability. The restriction of limited liability shall not apply to an entity with core activity in a strategic sector;
- **Overseas Investment** or **OI** means financial commitment and Overseas Portfolio Investment by a person resident in India.
- **Overseas Direct Investment** or **ODI** means investment by way of acquisition of unlisted equity capital of a foreign entity, or subscription as a part of the memorandum of association of a foreign entity, or investment in ten per cent, or more of the paid-up equity capital of a listed foreign entity or investment with control where investment is less than 10% of the paid-up equity capital of a listed foreign entity.

Explanation - For the purposes of this clause, where an investment by a person resident in India in the equity capital of a foreign entity is classified as ODI, such investment shall continue to be treated as ODI even if the investment falls to a level below ten per cent. of the paid-up equity capital or such person loses control in the foreign entity;

- **Overseas Portfolio Investment** or **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 IFSC:

Provided that OPI by a person resident in India in the equity capital of a listed entity, even after its delisting shall continue to be treated as OPI until any further investment is made in the entity;

- **Subsidiary or Step-down subsidiary** of a foreign entity means an entity in which the foreign entity has control;

2. **Demarcating difference between Overseas Direct Investment and Overseas Portfolio Investment**

In the erstwhile regime of ODI regulations the definition of “Direct Investment outside India” excluded portfolio investments. However, no-where the term “portfolio investment” was defined.

In the new regime the terms “Overseas Direct Investment” and “Overseas Portfolio Investment” have been clearly defined along with separate limits for Indian Entities to make ODI or OPI basis their last audited net-worth.

“**Overseas Direct Investment**” or “**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;**

Under the new regime, an Indian entity is allowed to make “financial commitment” to the tune of 400% of its net-worth basis the last audited balance sheet. The term Financial Commitment by a person resident in India means the aggregate amount of investment by way of:

- a) ODI,
- b) debt other than Overseas Portfolio Investment (OPI); and
- c) non-fund-based facility or facilities extended by it to all foreign entities.

An Indian entity may lend or invest in any debt instruments issued by a foreign entity or extend non-fund-based commitment to or on behalf of a foreign entity, including overseas Step Down Subsidiaries of such Indian entity, subject to the following conditions:

- a) the Indian entity is eligible to make ODI;
- b) **the Indian entity has made ODI in the foreign entity;**

- c) *the Indian entity has acquired control in the foreign entity on or before the date of making such financial commitment.*

“Overseas Portfolio Investment” or “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 IFSC.

3. Eradicating ambiguity under LRS vis-à-vis Overseas Investment (OI) Route:

Post the amendment of Master Direction - Liberalised Remittance Scheme, there is now only one route for Resident Individuals to make investment outside India in Foreign Entities i.e. in the manner prescribed under Overseas Investment Rules and Regulations.

4. Limits of Investment:

- Financial Commitment (ODI & Debt) by Indian Entities: Upto 400% of its net-worth basis the last-audited balance sheet;
- Overseas Portfolio Investment (OPI) by Indian Entities: Upto 50% of the net worth basis the last-audited balance sheet;
- ODI or OPI by Resident Individual: Shall adhere to the maximum limit prescribed under the Liberalized Remittance Scheme which is currently USD 2,50,000/- per financial year.

5. Criteria to be classified as Foreign Entity:

The Term “foreign entity” has been defined as an entity formed or registered or incorporated outside India, including International Financial Services Centre that has **limited liability**.

The relaxation of limited liability clause is provided to a foreign entity engaged in strategic sector.

6. Strategic Sectors:

The term strategic sector has been defined which include(s) energy and natural resources sectors such as oil, gas, coal, mineral ores, submarine cable system and start-ups. Under the Strategic Sector investment in foreign entities in such sectors can be made beyond the prescribed limit of 400% of net-worth post seeking approval from Central Government.

Applications for approval shall be forwarded by the AD banks from their

constituents to the Reserve Bank as per the laid down procedure for onward submission to the Central Government.

7. Overseas Investment in context of Real Estate:

The definition of “Real Estate Activities” and its exclusion is as under:

*“For the purposes of this sub-rule, the expression “real estate activity” means buying and selling of real estate or trading in Transferable Development Rights but does not include the development of townships, **construction of residential or commercial premises**, roads or bridges for selling or **leasing.**”*

8. Overseas Investment permissibility is widened in Financial Services activities:

Diverting from the erstwhile regime wherein investment in financial services sector was permitted only by Indian Companies engaged in financial services sector, the new regime places a more relaxed approach for companies not engaged in financial services and wish to undertake financial services activities overseas. The new Rules provide as under:

a. Indian Entities engaged in Financial Services Sector:

Similar to the erstwhile regime wherein any Indian Entity which is engaged in Financial Service sector shall be allowed to invest in foreign entity which is engaged in financial services sector subject to following conditions:

- (i) Indian entity possesses net profits during the preceding three financial years;
- (ii) Indian entity is registered with or regulated by a financial services regulator in India and has obtained approval as may be required from the regulators of such financial services activity, both in India and the host country or host jurisdiction.

b. Indian Entities engaged in Non-Financial Services Sector:

Any Indian entity engaged in Non-Financial service sector shall also be allowed to invest in a foreign company engaged in financial services, except banking or insurance, subject to the condition that such Indian entity has posted net profits during the preceding three financial years.

9. ODI- FDI Route Restrictions eased off upto two layers of Subsidiaries:

New regime brings out allowance on ODI-FDI structure with restrictive covenants. The financial commitment by a person resident in India 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, is permitted resulting in a structure with upto two layers of Subsidiaries.

10. Restructuring of financials amounting to diminution of investment/ write-Off

Erstwhile, ODI regime allowed restructuring involving write-off with restrictive covenants. However, the new Rules, give a breather by providing that a person resident in India who has made ODI in a foreign entity may permit restructuring of the balance sheet by such foreign entity which has incurring losses for previous 2 years subject to ensuring compliance with reporting and other requirement. Further in case diminution exceeds USD 10 million or 20 % of the outstanding dues, diminution in values shall be certified by a valuer.

11. ODI by NPA Account(s)/ Willful defaulters/ under investigation by a financial service regulator shall need No Objection Certificate

No Objection certificate of lenders/ regulatory bodies/ investigative agencies shall be required by entities who are classified as NPA Account(s)/ Willful defaulters/ under investigation by a financial service regulator.

Provided where the lender bank/ regulatory bodies/ investigative agencies fail to furnish certificate within 60 days from the receipt of such application, it may be presumed there was no objection to proposed transaction.

12. Gifting of Foreign Securities to Resident Individuals:

- a) From Relatives: Without any limits from Resident Relatives;
- b) From Non-Relatives: Shall be made in accordance with and subject to the Foreign Contribution (Regulation) Act, 2010 and rules and regulations made there under.

13. Pricing Guidelines for Overseas Investment(OI):

Overseas Investment shall be made at a price arrived on an arms-length basis the valuation as per any internationally accepted pricing methodology.

14. Restrictive Activities for Overseas Direct Investment (ODI)

No ODI shall be permitted in the following activities:

- (a) real estate activity;
- (b) gambling in any form; and
- (c) dealing with financial products linked to the Indian rupee without specific approval of the Reserve Bank.

15. Eligibility of Unique Identification Number (UIN):

Now an application for Unique Identification Number or “UIN” from the Reserve Bank for the foreign entity in which the ODI is intended to be made, can be made **before sending outward remittance or at time of acquisition of equity capital in a foreign entity, whichever is earlier.** Whereas as per previous regulation, the UIN was applied **at the time of making outward remittance.**

16. No submission of APR Reports in certain cases:

No reporting of APR shall be required where—

- a) a person resident in India is holding less than 10 per cent. of the equity capital without control in the foreign entity and there is no other financial commitment other than by way of equity capital; or
- b) a foreign entity is under liquidation.

17. Late Submission Fee (LSF) in case of Delay in Reporting:

In the event a person resident in India does not make the requisite filing within the prescribed time limit may make such filing along with Late Submission Fee. No further financial commitment towards such foreign entity or transfer shall be allowed till the delay in reporting is regularized.

For further details or clarifications, please refer the link to relevant notifications and master direction as under:

- 1. The Foreign Exchange Management (Overseas Investment) Rules, 2022**
<https://rbidocs.rbi.org.in/rdocs/content/pdfs/GazetteRules23082022.pdf>
- 2. The Foreign Exchange Management (Overseas Investment) Regulations, 2022**
<https://rbidocs.rbi.org.in/rdocs/content/pdfs/GazetteRegulations230822.pdf>
- 3. Foreign Exchange Management (Overseas Investment) Directions, 2022**
<https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT110B29188F1C4624C75808B53ADE5175A88.PDF>
- 4. Master Direction – Liberalised Remittance Scheme**
<https://rbidocs.rbi.org.in/rdocs/notification/PDFs/03MD945692290C104C5595AEDAC89AE78788.PDF>
- 5. Master Direction – Reporting under Foreign Exchange Management Act, 1999**
<https://rbidocs.rbi.org.in/rdocs/content/pdfs/13MDR291215.pdf>

DISCLAIMER: -

The summary information herein is based on Notifications and Master Direction as on August 22, 2022. While the information is believed to be accurate, we make no representations or warranties, express or implied, as to the accuracy or completeness of it. Reader should conduct and rely upon their own examination and analysis and are advised to seek their own professional advice. This note is not an offer, advice or solicitation. We accept no responsibility for any errors it may contain, whether caused by negligence or otherwise or for any loss, howsoever caused or sustained, by the person who relies upon it.