

Liberalization of security creation under ODI Regulations

Executive Summary

- In addition to the shares of its overseas JV/WOS, security can be created over the shares of any step down subsidiary as well under the automatic route subject to certain conditions.
- Creation of charge over domestic assets (other than shares) held by Indian parties group companies, sister concerns, associate concerns promoters and/or directors in favour of overseas lenders for facilities availed by group companies is now permitted under automatic route subject to certain conditions.
- Creation of charge over overseas assets (other than shares) held by JV/WOS/step down subsidiaries, in favour of Indian AD banks for facilities availed by JV/WOS/step down subsidiaries is now permitted under automatic route subject to certain conditions.

The Reserve Bank of India (“**RBI**”) *vide* its notification¹ dated 14 October 2014 (“**Notification**”) amended the FEMA (Transfer or Issue of any Foreign Security) Regulations, 2000 (“**ODI Regulations**”). RBI recently issued a circular² dated December 29, 2014 (“**Circular**”) to clarify the amendments which relax security creation by Indian Companies and their offshore joint ventures/wholly owned subsidiaries (“**JV/WOS**”).

Clarifications Outlined in the Circular

1. **Pledge of Shares of JV/WOS and Step Down Subsidiaries** – RBI has *vide* the Notification permitted an Indian party³ to create a pledge even on the shares of step down subsidiaries (“**SDS**”) under the automatic route in favour of domestic or overseas lenders subject to satisfaction of certain conditions. Previously, the pledge could be created only on the shares of JV/WOS. However, in case of facilities to overseas lenders, the overseas lender needs to be regulated and supervised as a bank.

The security can be used for facilities availed by the (i) Indian party; (ii) JV/ WOS/ SDS whose shares have been pledged; or (iii) any other JV/ WOS/ SDS of Indian party.

The Circular has specified certain additional conditions to be complied such as:

- a. Compliance of Regulation 6 and 7 of ODI Regulations pertaining to total financial commitment and compliances required to be done when the Indian party is engaged in financial services.
- b. Period of Charge if not specified, to be co-terminus with end use for which charge is created.
- c. Use of loan/facility: The Loan/ facility availed by JV/WOS/SDS to be utilized for its core business activities only and not for investing back in India in any manner whatsoever.

¹RBI Notification No. FEMA.322/2014-RB

²RBI/2014-15/371 A.P. (DIR Series) Circular No.54

³ Indian Party includes companies, statutory bodies, partnership firms, Limited Liability Partnerships,

- d. Certificate from statutory auditors: A certificate from Statutory auditors of the Indian Party to the effect that the Loan/ Facility availed by JV/ WOS/SDS has not been utilized for direct or indirect investments in India, to be furnished to AD bank.
 - e. Compliance with Norms and Guidelines: The said facilities extended by domestic lender will be governed by prudential norms and guidelines issued by RBI-Department of Banking Regulation.
2. **Creation of charge on domestic and foreign assets** – Previously, an Indian party required RBI approval to transfer by way of mortgage, pledge or hypothecation its property (other than shares) of the Indian party or its group companies for facilities availed by the JV/WOS.

The Notification permitted Indian party to create a charge under the Automatic route over:

- a. Assets (movable, immovable, financial or other) held by Indian party or its group companies, sister concerns, associate concerns in India or a promoter and/or director for facilities availed by JV/WOS/SDS from overseas lender (regulated and supervised as a bank); or
- b. Assets (excluding shares) held by its JV/WOS/SDS for facilities availed by Indian party or any of its JV/WOS/SDS from Authorised dealer banks in India

subject to inter alia the following conditions in addition to those mentioned in Point 1 as laid down in the Circular:

- a. No Securitization of Assets: The domestic and/or overseas assets, on which charge is being created, should not be securitized.
- b. Sale of domestic assets to residents only: Undertaking by overseas lender that on enforcement they shall transfer the domestic assets by way of sale to residents only.
- c. Prior approval of RBI: The approval of RBI is only required when in case of invocation of charge, resultant remittance exceeding the prescribed limit (400%) of the financial commitment of the Indian party at the time of creation of charge.
- d. Pledge of shares of Indian Company: Pledge of shares of Indian Company, if made, will be governed by FEMA provisions and FDI policy issued by DIPP from time to time.

ARA LAW View

The Notification and Circular provides tremendous relaxation and flexibility to Indian parties with respect to overseas direct investment.

By permitting Indian parties to create charge on their properties under automatic route, the amendments may provide entities to leverage their assets of all the group companies both within and outside India) to obtain financing for the entire group operations. Specifically, Indian parties which are asset rich in India may now be able to leverage their Indian assets for financing their overseas operations.

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