Other Hotline

July 04, 2014

RBI RESTORES OVERSEAS INVESTMENT LIMIT TO 400% FOR INDIA INC.

OVERSEAS DIRECT INVESTMENTS

By issuing the A.P. (DIR Series) Circular No. 23 dated August 14, 2013 ("**Circular 23**"), the Reserve Bank of India ("**RBI**") had reduced the overseas direct investment ("**ODI**") limit for the India Inc. from 400% to 100% of the net worth of the Indian entity as per its last audited balance sheet, under the automatic route. In a positive move for the globalizing Indian corporates, the RBI has now issued an A.P. (DIR Series) Circular No. 1 dated July 3, 2014 ("**Circular 1**") whereby the said limit has been restated to 400% of the net worth as per the last audited balance sheet of the Indian entity.

Circular 1 is a welcome change for the Indian corporates that wish to get a strong foothold overseas; however, the same comes with a caveat *i.e.*, any ODI or financial commitment of more than USD 1 billion in a particular financial year will require prior approval of the RBI, even if such ODI or financial commitment is within the eligible ODI limit of 400%.

LIBERALIZED REMITTANCE SCHEME

Simultaneously with Circular 23, RBI had also issued an A.P. (DIR Series) Circular No. 24 on August 14, 2013 ("**Circular 24**") which brought down the threshold of remittance by resident individuals outside India under the liberalized remittance scheme ("**LRS**") to USD 75,000 from the erstwhile applicable limit of USD 200,000 per financial year. Keeping an eye on the stabilizing Indian rupee, RBI had issued an A.P. (DIR Series) Circular No. 138 on June 3, 2014 ("**Circular 138**") under which the said limit for overseas investments by resident individuals was raised to USD 125,000 from USD 75,000.

The detailed impact of Circular 23 and Circular 24 was analyzed by us here.

EFFECT OF THE CHANGE

Increased opportunity for India Inc. to Globalize: With increased investment limits under Circular 1, Indian corporates can better diversify their existing overseas holdings, de-risk their investment portfolios and also access new technology and innovations overseas. This will also be coupled with all the incidental benefits of globalizing domestic businesses and help the ever expanding business plans of the Indian corporates.

Option to secure finance overseas: Due to relatively lower cost of borrowing overseas, Indian corporates prefer that their overseas subsidiaries raise finance overseas for their business operations or for making specific acquisitions. Usually, the loan procured by a subsidiary overseas is secured by a guarantee provided by the Indian parent entity. Considering that the ability to provide guarantees was limited due to the changes introduced by Circular 23, raising finance overseas was impacted. However, Circular 1 has again relaxed this route of securing alternate funding overseas for Indian corporates.

CONCLUSION

Increased foreign investment due to a stable government in the Indian parliament and increase in foreign exchange reserves has improved the Indian macroeconomics in the recent past. Circular 1 is a welcome response from RBI to the stimulus provided by this improvement. These changes would significantly impact outbound investments by Indian corporates.

On the one hand, the restoration of ODI limits indicates that RBI is supporting domestic businesses to expand globally and on the other, RBI is also taking steps to ensure an increase in the foreign investments into India. RBI had attracted criticism with the reduction in ODI and LRS limits under Circular 23 and Circular 24, respectively, when it tried to arrest the downfall in the Indian rupee in 2013 by introducing these capital controls in India. However, Circular 1 and Circular 138 can be seen as the right steps to restore RBI's image as a business friendly regulator. As a next welcome change, RBI may consider restoring the remittance under LRS to its original limit of USD 200,000 per each financial year.

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