In the wake of a sharply declining rupee caused by an ever increasing current account deficit, the Reserve Bank of India (RBI) has, in order to curb outflows of foreign exchange, reduced the monetary limit applicable to 'overseas direct investments' by Indian parties under the automatic route.

Previously, the total direct investment by an Indian party in overseas joint ventures (JV) or wholly owned subsidiaries (WOS) was limited to the extent of 400% of the Indian party’s net worth. This limit has now been reduced to 100% of the Indian party’s net worth. The reduced limit is also made applicable to investments by Indian companies in overseas unincorporated entities in the oil sector. It has however been clarified that, as was previously the case, overseas investments in the oil sector by Navratna Public Sector Undertakings, ONGC Videsh Limited and Oil India Limited would not be subject to any investment limits under the automatic route. The above changes were introduced by the RBI in a circular dated 14 August, 2013 (RBI Circular).

In a separate circular on the same date the RBI also reduced the existing limit under the Liberalised Remittance Scheme (LRS) for resident individuals from USD 200,000 per financial year to USD 75,000 per financial year. It was also clarified that the LRS should no longer be used by resident individuals for acquiring immovable property outside India.

Prospective application

The RBI Circular clarifies that the revised investment limits are applicable to all fresh proposals for overseas direct investment on a prospective basis but do not apply to existing JV / WOS that were set up under the erstwhile 400% regime. From this clarification, it appears that the RBI does not expect any existing investments in JV/WOS to be unwound. However, it is equally unclear, as to how fresh direct investments (i.e. investments made after the date of the RBI Circular) in existing JV/WOS would be treated. For example, would fresh direct investments in an existing JV/WOS be reckoned under the 400% limit? Or, if the existing overseas direct investment in the JV/WOS has already exceeded 100% of the Indian party’s net worth, would the Indian party have no headroom to make further direct investments in the JV/WOS?

Direct investment or financial commitment
Interestingly, the RBI Circular uses the phrase 'Overseas Direct Investment' rather than 'Financial Commitment' while defining the reduced investment limit. The existing regulations define 'Overseas Direct Investment' to mean contribution to the capital of the JV / WOS by way of loan or equity whereas 'Financial Commitment' has been defined to include (in addition to equity and debt) guarantees issued by the Indian shareholder and bank guarantees issued by an Indian bank with recourse to the Indian shareholder. The existing regulations stipulate that the total 'financial commitment' of the Indian party should not exceed 400% of the net worth of the Indian party.

Based on a strict interpretation of the language in the RBI Circular, it seems that the revised investment limit applies to 'direct investments' in the nature of equity or loan and is not applicable to 'financial commitments' such as guarantees issued to or on behalf of the JV / WOS. This argument could be supported by the reasoning that in the normal course there would be no immediate outflow of funds on account of a guarantee commitment, and therefore such commitments do not pose an immediate concern in the context of a substantial current account deficit.

In an already bleak economic environment, the RBI's move to restrict overseas investments has received a skeptical response. The ambiguities in the RBI Circular also lend to this skepticism and it is hoped that the RBI would clarify some of these issues soon.

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