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RBI Liberalizes Portfolio Investment Norms with respect to overseas funds



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BACKGROUND

The Foreign Exchange Management (Overseas Investment) Directions, 2022 ("**Directions**"), along with Foreign Exchange Management (Overseas Investment) Rules ("**Rules**"), 2022 and the Foreign Exchange Management (Overseas Investment) Regulations, 2022 lays down the revised regulatory framework for overseas investment outside India. The revised norms had been notified on August 22, 2022.

The Reserve Bank of India has *vide* RBI/2024-25/41 A.P. (DIR 3Series) Circular No. 09, dated June 07, 2024 ("**Amendment**") carried out an amendment to the Directions.

The Rules define "Overseas Portfolio Investment" or "OPI" as 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.'

Whereas, the said Rules, define "Overseas Direct Investment" or "ODI" as 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 ten per cent. of the paid-up equity capital of a listed foreign entity.

As compared to the definition of OPI as provided under the Rules, the Directions provides a broader definition of OPI. The definition of OPI, as provided under the Directions, specifically talks about investment in units of overseas funds. The Directions state that the investment (including sponsor contribution) in units of any investment fund overseas, duly regulated by the regulator for the financial sector in the host jurisdiction, shall be considered as OPI. Accordingly, in jurisdictions other than IFSC, listed Indian companies and resident individuals may make such investment. Whereas, in IFSC an unlisted Indian entity may also make such OPI in units of an investment fund or vehicle, in terms of Schedule V of the Rules subject to limits, as applicable.

NEED FOR CLARIFICATION AND RELAXATION

With respect to the aforesaid conditions governing investment in overseas funds, there were long standing clarifications/reliefs sought by the industry players concerning two aspects i.e. firstly, investment in overseas funds, other than by way of investment in 'units' and secondly, the aspect of regulation of the overseas fund vis-à-vis investment manager.

These clarifications/reliefs were sought considering the varying nature of the laws of the jurisdictions where the funds are set up. For the perspective, some jurisdictions regulate the fund i.e., require the fund to seek the registration under the local laws. Whereas some jurisdictions require the investment manager to obtain the necessary registrations. In India itself, the SEBI registered alternative investment funds, other than those situated /set up in the GIFT City, require the fund to be registered with SEBI in terms of the SEBI (Alternative Investment Regulations), 2012. On the other hand, the alternative investment funds which are set-up in GIFT City, require the Investment Manager to seek necessary registration with the International Financial Services Centres Authority under the IFSCA (Fund Management) Regulations, 2022.

This diverse requirement with respect to the fund and investment manager requiring registration under the laws, in different jurisdictions, was creating practical difficulties and ambiguity considering the earlier language of the Directions, the extract of which is reproduced hereunder:

*..... in units of any **investment fund overseas, duly regulated by the regulator** for the financial sector in the host jurisdiction, shall be considered as OPI....."*

Considering this ambiguity, the Authorised Dealers were adopting a safe approach by approving only those transactions where investments were in the overseas fund which were regulated by the local laws and not in those overseas funds, where the local laws require the investment manager instead to obtain the necessary registrations. This led to substantial hardships in the structuring of overseas funds transactions. The case in point being the funds in the US and Singapore where the investment managers are regulated as opposed to the fund.

CHANGES AND CLARIFICATIONS

Now, Paragraph 1(ix)(e) of the Directions have been amended to cover broad scenarios, by providing a new Explanation, the revised language being as follows:

Explanation: *'investment fund overseas, duly regulated'* for the purpose of this para shall **also include funds whose activities are regulated by financial sector regulator of host country or jurisdiction through a fund manager.** "

The second aspect, where clarifications were sought was investment in 'units' of overseas funds. The extract of the existing language of the Paragraph 1(ix)(e) of the Directions reads as follows:

The investment (including sponsor contribution) in units of any investment fund overseas, duly regulated by the regulator for the financial sector in the host jurisdiction, shall be considered as OPI.

As such, industry players had concerns that not all overseas funds are structured in a form of trust. Some overseas funds may be structured as a corporate or such other form, where such funds may not issue 'units' but may issue 'shares' or such other instrument. The concern stemmed from the existing language of Paragraph 1(ix)(e) of the Directions which provided for investment only in 'units' of overseas funds. Due to the restricted language, the Authorised Dealers were finding difficulty in providing a go ahead to investments in overseas funds, other than by way of 'units'. The concern has been addressed by modification to the language, the revised one being as follows:

*The investment (including sponsor contribution) **in units or any other instrument (by whatever name called) issued by an investment fund overseas...** Whereas in IFSCs, an unlisted Indian entity also may make such OPI in **units or any other instrument (by whatever name called)**.*

Consequently, Paragraph 24(1) of the Directions have been replaced as follows:

"A person resident in India, being an Indian entity or a resident individual, may make investment (including sponsor contribution) in units **or any other instrument (by whatever name called)** issued by an investment fund or vehicle set up

in an IFSC, as OPI. Accordingly, in addition to listed Indian companies and resident individuals, unlisted Indian entities also may make such investment in IFSC. "

As such, the unlisted Indian entities are also permitted to invest in IFSC under the OPI Route which was only earlier permitted to listed Indian companies and resident individuals.

CONCLUSION

The above amendments have provided much needed clarity and relief and have the potential to propel the portfolio investment in overseas funds by Indians since the investment opportunities stand to rise due to the wide basket of funds (whether registered as a trust, corporate or otherwise) and instruments to invest (i.e. in addition to units). The existing norms created bottlenecks and structuring difficulties for the funds. However, the relaxations should be able to provide necessary room and flexibility in setting up of overseas funds, opting for the jurisdiction having favorable regulatory regime, including availability of any tax and treaty benefits. The change appears to have provided additional room to favorably structure the transactions with a view to optimize the commercial proposition to the extent possible. This change has the possibility of not only enhancing the overseas investment opportunities for Indians but also has the likelihood to invigorate and bring in more foreign investments in India, especially if one considers the structural legroom now on offer. The change also appears to be an intent to streamline the Indian locals with those of the global counterparts, preferred by the fund managers. This change should only further augment the prospects of India being becoming one of the leading investor friendly destinations globally.

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