

Revamped Overseas Investment Regime (Part II) – Overseas Debt Investments Rationalized

Key Takeaways

- Control threshold introduced for offshore debt – a shift of focus towards strategic growth
- Offshore private credit and special situation funding now permitted
- Debenture trustee's introduced to encourage offshore funding to an Indian entity
- Financial commitment limits liberalised for funding availed by an Indian entity
- Computation of networth to be on a standalone basis – clarifying the ceiling on financial commitment

Introduction

In this piece, we analyse the New OI Regime from an offshore debt investment perspective. We have separately analysed the revised framework for equity investments overseas, introduced through the Foreign Exchange Management (Overseas Investment) Rules, 2022, the Foreign Exchange Management (Overseas Investment) Regulations, 2022 and the Foreign Exchange Management (Overseas Investment) Directions, 2022 (***New OI Regime***); click *here* to view.

The New OI Regime has introduced significant changes to outbound debt investments by Indian entities. While the ambit of debt instruments has been widened, debt investments can now only be made where the Indian entity has control – unlike the erstwhile regime where debt could be infused even where the Indian entity had nominal equity holding. The ambit of debt providers has been expanded to offshore private credit players as against only banks which have a rather limited risk appetite.

Overall, these amendments are likely to give a major shot in the arm to overseas M&A activity on the back of a substantially deregulated regime for accessing onshore and offshore leverage for overseas acquisitions.

I. Offshore debt permitted only with 'control' – guardrails for a strategic growth path

Under the erstwhile regime, a loan or guarantee could be given to an offshore entity if the offshore entity was a joint venture or a wholly owned subsidiary (***JV/WOS***) of the Indian entity. The term 'joint venture' was rather exploited, as even one share in the offshore entity could technically qualify the offshore entity as a joint venture. Whilst the regime did provide for portfolio investments, since there was no definitional clarity, even nominal investments would qualify as direct investments.

The New OI Regime only allows debt investments if the foreign entity is under 'control' of the Indian entity. ***Control*** has been defined as *"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 shareholder's agreements or voting agreements that entitle them to ten per cent. or more voting rights or in any other manner in the entity."*

The subjective test of the ability to control management or policy decisions has been drawn from the definition under the Takeover Code and should be interpreted in the same light. Having said that, in the spirit of the regulations, it may be advisable to make debt investments only where the objective thresholds of 10%, or majority directors are

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met, and avoid excessive reliance on the subjective thresholds.

In a rational alignment, the 'control' criterion will not apply to listed debt investments made under the OPI route. The difference lies in the quantum of investment allowed - with an Indian entity only allowed to invest upto 50% of its net worth under the OPI route, whereas with 'control' the investment can extend up to 400% of net worth. Net worth under the erstwhile regime meant the aggregate of paid up capital and free reserves, but now also includes securities premium account, as the definition has been aligned with the Companies Act, 2013 ("**Companies Act**").

II. Revised guarantee framework

a. Under the revised framework, a guarantee can be issued to/ on behalf of the (1) foreign entity, and (2) any step-down-subsidiary ("**SDS**"). The term 'subsidiary' has been specifically defined in context of 'control' defined above, and not in context of the definition provided under the Companies Act. The master directions further clarify that guarantees can be given to second or subsequent level SDS as well without prior approval.

b. Group company aggregation for net worth. Earlier, for computing the net-worth of the Indian entity, net worth of subsidiaries/ holding companies could also be aggregated in context of determining the available financial commitment for giving guarantees. Now this will be restricted to an individual entity-level test, and an Indian entity can no longer access the unutilised net worth limits of its group companies. Separately, if there is any fund-based exposure of a group company to the Indian entity, or vice versa, this will be deducted from the group company's net worth.

c. Group companies can now back a bank guarantee. Earlier, a bank guarantee had to be backed by a counter guarantee or collateral by the Indian entity only. Now, in addition, a bank guarantee can also be backed by the Indian entity's group companies.

III. Pledge and Charge framework – key changes for offshore private credit investors

a. Moving beyond banks - introduction of offshore private credit players. The New OI Regime redefines the concept of an 'overseas lender' and extends the ambit of the term to mean any overseas lender, as against the erstwhile regime which restricted the term to mean a bank or an entity supervised and regulated as a bank. This is a significant change considering the rather limited risk appetite of banks to lend, and their requirements to lend against hard collateral, which may not always be the case with new age asset light businesses. Private credit players and special situation funds are mushrooming on their ability to deliver tailored special situation solutions with flexible products, which may also sometimes include equity kickers and other innovations. The New OI Regime allows access to such capital and

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permits creation of security interest in favour of such lenders via (i) pledge of foreign entity's or its SDS' equity capital; and (ii) a charge on assets in India. Surprisingly, a charge on offshore assets (other than pledge of foreign shares) cannot be given if the lending is from an overseas lender, but can be given if it's from an Indian lender (albeit restricted to AD banks and public financial institutions).

b. Introduction of debenture trustee – another opening for private credit players. The New OI Regime paves the way for an Indian entity to raise funding by issuing debentures and creating a charge in favour of the debenture trustee. Although this can only be done by way of: (a) pledge of the foreign entity's or its SDS' equity capital; and (b) charge on the foreign entity's assets outside India. Permission to create a charge on Indian assets in favour of the debenture trustee is conspicuous by its absence, which seems to be counter-intuitive. Having said that, creation of charge in favour of the debenture trustee for a rupee borrowing may not require express permission under the OI Regulations and should still be permissible.

c. Financial commitment computation - Earlier, the value of any facility being availed (for the Indian entity itself, or the foreign entity or its SDS) was counted towards the total financial commitment limit of the Indian entity – irrespective of whether the facility was being availed for the Indian entity itself. Under the New OI Regime, the financial commitment will be deducted depending on whom the facility is being availed for. This is probably driven basis the net outflow from the perspective of Indian exchequer.

To illustrate,

Facility availed by	Amount counted towards financial commitment
Indian entity	No amount will be counted towards the financial commitment
Foreign entity/ SDS outside India	Value of the pledge/charge or amount of the facility, whichever is lesser

The key changes to the pledge framework are summarised in **Annexure 1.**

Conclusion

One of the biggest advantages of the New OI Regime has been the introduction of avenues for private credit players in the form of overseas lenders and through debenture trustees, to make debt investments. There are several situations where such deregulation may be helpful. First, in case of leveraged buy-outs where an offshore fund would want to extend tailored credit solutions (possibly with equity kickers) against

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cashflows of the Indian entity or a hard asset in India of the Indian entity or its group entity. Second, in situations where the Indian entity wants to borrow in INR from Indian special situation funds or other credit players against the pledge of offshore shares and assets. Such structures will now be permissible. To that extent, Indian entities looking for inorganic growth overseas may now be able to access a wider range of capital for acquisitions.

Annexure 1

	Earlier position	New Position
Security	Shares of JV/ WOS/ step down subsidiary (***SDS***)	Equity capital of foreign entity/ SDS
In favour of	Authorised dealer, or public financial institution in India, or an overseas lender (who is regulated and supervised as a bank)	Authorised dealer, or public financial institution in India, or an overseas lender, or in favour of a debenture trustee, in case a fund based facility is being availed for the Indian entity itself
Facility	Fund based or non-fund based	
Facility for	• the Indian entity itself, or • the JV/WOS/SDS whose shares are being pledged, or • any other JV/WOS/SDS of the Indian entity	• the Indian entity itself, or • foreign entity in which ODI is made, or its SDS.
Financial commitment	The value of the facility will count towards the financial commitment limit	• In case the facility is for the Indian entity – this will not count towards the financial commitment limit • In case its for the foreign entity/ SDS, the value of the charge OR the amount of the facility (whichever is lesser) shall count towards the financial commitment

**Text in red has been removed/ modified in the new framework*

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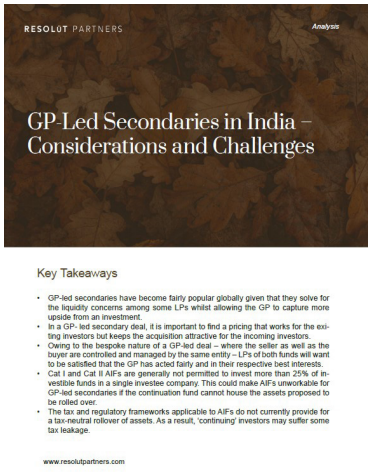
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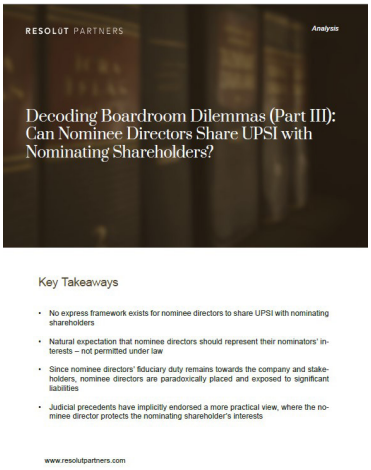
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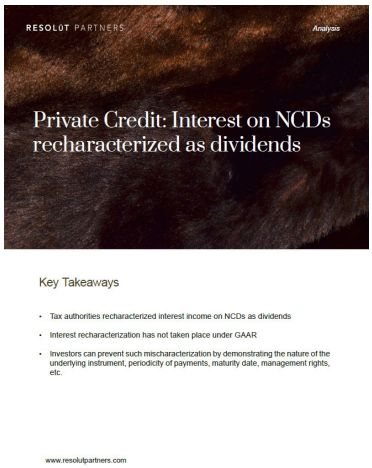


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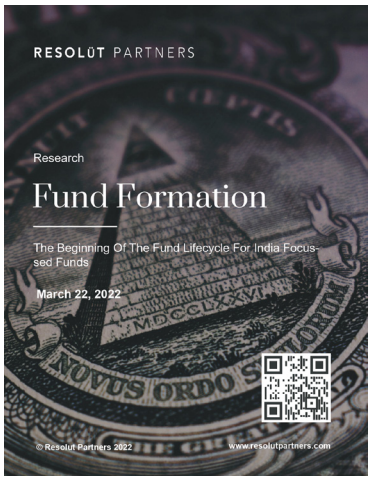
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