

## Foreign Exchange Developments

May 2011

### 1. Pledge of Shares for Business Purposes

It has been decided to liberalise, rationalise and simplify the processes associated with FDI flows to India and reduce the transaction time. Accordingly, it has been decided to delegate powers to the AD Category – I banks to allow pledge of shares of an Indian company held by non-resident investor/s in accordance with the FDI policy in the following cases subject to compliance with the conditions indicated below.

- (i) Shares of an Indian company held by the non-resident investor can be pledged in favour of an Indian bank in India to secure the credit facilities being extended to the resident investee company for bonafide business purposes subject to certain conditions:
- (ii) Shares of the Indian company held by the non-resident investor can be pledged in favour of an overseas bank to secure the credit facilities being extended to the non-resident investor/non-resident promoter of the Indian company or its overseas group company, subject to certain conditions:

[A.P. (DIR Series) Circular No. 57  
dated May 2, 2011]

### 2. Opening of Escrow Accounts for FDI Transactions

It has been decided to permit AD Category – I banks to open and maintain, without prior approval of the Reserve Bank, non-interest bearing Escrow accounts in Indian Rupees in India on behalf of residents and/or non-residents, towards payment of share purchase consideration and/or provide Escrow facilities for keeping securities to facilitate FDI transactions subject to certain terms and conditions as given in Annex. It has also been decided to permit SEBI authorised Depository Participants, to open and maintain, without prior approval of the Reserve Bank, Escrow accounts for securities subject to certain terms and conditions.

In both cases, the Escrow agent shall necessarily be an AD Category- I bank or SEBI authorised Depository Participant (in case of securities' accounts). These facilities will be applicable for both issue of fresh shares to the non-residents as well as transfer of shares from/to the non-residents.

[A.P. (DIR Series) Circular No. 58  
dated May 2, 2011]

### 3. Foreign Exchange Management Act, 1999 – Import of Rough, Cut and Polished Diamonds

It has been decided that Suppliers' and Buyers' credit (trade credit) including the usance period of Letters of Credit opened for import of rough, cut and polished diamonds should not exceed 90 days from the date of shipment.

AD Category – I banks should ensure that due diligence is undertaken and Know-Your-Customer (KYC) norms and Anti-Money Laundering (AML) standards, issued by the Reserve Bank are adhered to while undertaking the import transactions. Further, any large or abnormal increase in the volume of business should be closely examined to ensure that the transactions are bonafide and are not intended for interest/currency arbitrage.

[A.P. (DIR Series) Circular No. 59  
dated May 6, 2011]

### 4. Comprehensive Guidelines on Over the Counter (OTC) Foreign Exchange Derivatives and Overseas Hedging of Commodity Price and Freight Risks

In view of the representation received from the industry associations and as 30/32 standards are yet to be notified by the Ministry of Corporate Affairs, it was decided to amend the eligibility criteria for the users of cost reduction structures.

Listed companies and their subsidiaries/joint ventures/associates having common treasury and

consolidated balance sheet or Unlisted companies with a minimum net worth of ₹ 200 crore provided:

- All such products are fair valued on each reporting date;
- The companies follow the Accounting Standards notified under section 211 of the Companies Act, 1956 and other applicable Guidance of the Institute of Chartered Accountants of India (ICAI) for such products/contracts as also the principle of prudence which requires recognition of expected losses and non-recognition of unrealized gains;
- Disclosures are made in the financial statements as prescribed in ICAI press release dated 2<sup>nd</sup> December 2005; and
- The companies have a risk management policy with a specific clause in the policy that allows using the type/s of cost reduction structures.

(Note: The above accounting treatment is a transitional arrangement till AS 30/32 or equivalent standards are notified.)"

These eligibility criteria would also be applicable to the users of OTC option strategies involving a simultaneous purchase and sale of options for overseas commodity hedging.

[A.P. (DIR Series) Circular No. 60 dated May 16, 2011]

## **5. Know Your Customer (KYC) norms/ Anti-Money Laundering (AML) standards/Combating the Financing of Terrorism (CFT)/Obligation of Authorised Persons under Prevention of Money Laundering Act, (PMLA), 2002, as amended by Prevention of Money Laundering (Amendment) Act, 2009- Money Changing Activities**

It was decided to amend the instructions contained in Paragraph 4.4 (e) (i), 4.4 (e) (ii) and 4.13 (i) of F-Part-I of the Annex to A.P. (DIR Series) Circular No.17 {A.P. (FL/RL Series) Circular No. 4} dated November 27, 2009 as follows:

- a) For purchase of foreign currency notes and/or Travellers' Cheques from customers for any amount equivalent to or less than ₹50,000/-, photocopies of the identification document need not be obtained. However, full details of the identification document should be maintained. If the Authorised Person has reason to believe that a customer is intentionally structuring a transaction into a series of transactions below the threshold of ₹50000/-, the A.P. should verify identity and address of the customer and also consider filing a suspicious transaction report to FIU-IND.
- b) For purchase of foreign currency notes and/or Travellers' Cheques from customers for any amount equivalent to or in excess of ₹50,000/-, the documents, as mentioned at (F-Part-II) annexed to the A.P. (DIR Series) Circular No.17 {A.P.(FL/RL Series) Circular No.4} dated November 27, 2009, should be verified and copies retained.
- c) In case of any suspicion of money laundering or terrorist financing, irrespective of the amount involved, enhanced Customer Due Diligence (CDD) should be applied. Whenever there is suspicion of money laundering or terrorist financing or when other factors give rise to a belief that the customer does not, in fact, pose a low risk, APs should carry out full scale Customer Due Diligence (CDD) before undertaking any transaction for the customer.

Authorised Persons and their Indian agents were advised to introduce a system of maintaining proper record of transactions prescribed under Rule 3, as mentioned below:

- a) all cash transactions of the value of more than Rupees Ten Lakh or its equivalent in foreign currency;
- b) all series of cash transactions integrally connected to each other which have been valued below Rupees Ten Lakh or its equivalent in foreign currency where such series of transactions have taken place within a month and the aggregate value of such transactions exceeds Rupees Ten Lakh;

- c) all transactions involving receipts by non-profit organisations of value more than Rupees ten lakh or its equivalent in foreign currency [Ref: Government of India Notification dated November 12, 2009- Rule 3, sub-rule (1) clause (BA) of PML Rules];
- d) all cash transactions where forged or counterfeit currency notes or bank notes have been used as genuine and where any forgery of a valuable security or a document has taken place facilitating the transaction; and
- e) All suspicious transactions whether or not made in cash and by way of as mentioned in the Rules.

[A.P. (DIR Series) Circular No. 61 & 62 dated May 16, 2011]

#### **6. Anti-Money Laundering (AML) standards/Combating the Financing of Terrorism (CFT) Standards - Money changing activities**

Financial Action Task Force (FATF) has issued a further Statement on February 25, 2011 on the subject to calling upon its members and other jurisdictions to apply counter-measures to protect the international financial system from the ongoing and substantial money laundering and terrorist financing (ML/FT) risks emanating from Iran and Democratic People's Republic Korea (DPRK). Authorised Persons were accordingly advised to take note of the above information contained in the Statement.

[A.P. (DIR Series) Circular No. 63 dated May 20, 2011]

#### **7. Anti-Money Laundering (AML) standards/Combating the Financing of Terrorism (CFT) Standards - Cross Border Inward Remittance under Money Transfer Service Scheme**

Financial Action Task Force (FATF) has issued a further Statement on February 25, 2011 on the subject to calling upon its members and other jurisdictions to apply counter-measures to protect the international financial system from the ongoing and substantial money laundering and terrorist financing (ML/FT) risks

emanating from Iran and Democratic People's Republic of Korea (DPRK). All Authorised Persons (Indian Agents) were accordingly advised to take note of the above information.

[A.P. (DIR Series) Circular No. 64 dated May 20, 2011]

#### **8. Anti-Money Laundering (AML) standards/Combating the Financing of Terrorism (CFT) Standards - Money changing activities**

FATF has further issued a Statement on February 25, 2011 to calling upon the jurisdictions listed in the Statement to complete the implementation of their action plan within the timeframe. The FATF, in the Statement has called upon its members to consider the information given in the statement. Authorised Persons were accordingly advised to take note of the above information.

[A.P. (DIR Series) Circular No. 65 dated May 20, 2011]

#### **9. Anti-Money Laundering (AML) standards/Combating the Financing of Terrorism (CFT) Standards - Cross Border Inward Remittance under Money Transfer Service Scheme**

Financial Action Task Force (FATF) has further issued a Statement on February 25, 2011 for calling upon the jurisdictions listed in the Statement to complete the implementation of their action plan within timeframe. The FATF, in the Statement has called upon its members to consider the information given in the Statement. Authorised Persons were accordingly advised to take note of the above information.

[A.P. (DIR Series) Circular No. 66 dated May 20, 2011]

#### **10. Forward cover for Foreign Institutional Investors – Rebooking of cancelled contracts**

Foreign Institutional Investors (FIIs) were permitted to cancel and rebook upto two percent of

the market value of the portfolio as at the beginning of the financial year. On a review, it has been decided to enhance the existing limit of two per cent as above to ten per cent with immediate effect.

[A.P. (DIR Series) Circular No. 67  
dated May 20, 2011]

### 11. Hedging IPO flows by Foreign Institutional Investors (FIIs) Under the ASBA Mechanism

It has been decided that for Initial Public Offers(IPO) related transient capital flows under the Application Supported by Blocked Amount(ASBA) mechanism, foreign currency-rupee swaps may be permitted to the FIIs subject to the following terms and conditions:

- i. FIIs can undertake foreign currency- rupee swaps only for hedging the flows relating to the IPO under the ASBA mechanism.
- ii. The amount of the swap should not exceed the amount proposed to be invested in the IPO.
- iii. The tenor of the swap should not exceed 30 days.
- iv. The contracts, once cancelled, cannot be rebooked. Rollovers under this scheme will also not be permitted.

[A.P. (DIR Series) Circular No. 68  
dated May 20, 2011]

### 12. Overseas Direct Investment – Liberalisation/Rationalisation

With a view to providing more operational flexibility to Indian corporates having investments abroad, it has been decided to further liberalise/rationalise the following regulations relating to overseas direct investment:

#### i) Performance Guarantees Issued by the Indian Party

It has been decided that only 50 per cent of the amount of the performance guarantees may be reckoned for the purpose of computing financial commitment to its JV/WOS overseas, within the 400

per cent of the net worth of the Indian Party as on the date of the last audited balance sheet. Further, the time specified for the completion of the contract may be considered as the validity period of the related performance guarantee. In cases where invocation of the performance guarantees breach the ceiling for the financial exposure of 400 per cent of the net worth of the Indian Party, the Indian Party shall seek the prior approval of the Reserve Bank before remitting funds from India, on account of such invocation.

#### ii) Restructuring of the Balance Sheet of the Overseas entity Involving Write-off of Capital and Receivables

To provide more operational flexibility to the Indian corporates, it has been decided that Indian promoters who have set up WOS abroad or have at least 51 per cent stake in an overseas JV, may write off capital (equity/preference shares) or other receivables, such as, loans, royalty, technical knowhow fees and management fees in respect of the JV/WOS, even while such JV/WOS continue to function as under:

- (i) Listed Indian companies are permitted to write off capital and other receivables up to 25 per cent of the equity investment in the JV/WOS under the Automatic Route; and
- (ii) Unlisted companies are permitted to write off capital and other receivables up to 25 per cent of the equity investment in the JV/WOS under the Approval Route.

The above write –off/restructuring may be allowed by designated SD Category – I bank under Automatic Route subject to submission of certain specified documents within 30 days.

- (a) Currently, in terms of Regulation 16 of the Notification No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time to time, all disinvestments involving 'write off', *i.e.*, where the amount repatriated on disinvestment is less than the amount of original investment, need prior approval of the Reserve Bank. In terms of A.P. (DIR Series) Circular No. 29 dated March 27,

2006 it was decided to allow the undernoted categories of disinvestment under the Automatic Route without prior approval of the Reserve Bank, subject to the following conditions:

- i) In cases where the JV/WOS is listed in the overseas stock exchange;
- ii) In cases where the Indian promoter company is listed on a stock exchange in India and has a net worth of not less than ₹100 crore; and
- iii) Where the Indian promoter company is an unlisted company and the investment in the overseas venture does not exceed US\$ 10 million.

In partial modification of the above, it has now been decided to include listed Indian promoter companies with net worth of less than ₹100 crore and investment in an overseas JV/WOS not exceeding US\$ 10 million, for disinvestment under the Automatic Route with the requirement that the Indian Party shall report the disinvestment through its designated AD Category I bank within 30 days from the date of disinvestment.

- (b) It is also clarified that disinvestment cases falling under the Automatic Route would also include cases where the amount repatriated after disinvestment is less than the original amount invested, provided the corporate falls under the above mentioned categories.

#### iv) Issue of Guarantee by an Indian Party to Step Down Subsidiary of JV/WOS Under General Permission

- (a) Currently Indian Parties are permitted to issue corporate guarantees on behalf of their first level step down operating JV/WOS set up by their JV/WOS operating as a Special Purpose Vehicle (SPV) under the Automatic Route, subject to the condition that the financial commitment of the Indian Party is within the extant limit for overseas direct investment. As a measure of further liberalisation, it has been decided that irrespective of whether the direct subsidiary is an operating company or a SPV, the Indian promoter entity may extend corporate guarantee on behalf of the first generation step down operating company under the Automatic Route, within the prevailing limit for overseas direct investment.
- (b) Further, it has also been decided that issue of corporate guarantee on behalf of second generation or subsequent level step down operating subsidiaries will be considered under the Approval Route, provided the Indian Party directly or indirectly holds 51 per cent or more stake in the overseas subsidiary for which such guarantee is intended to be issued.

[A.P. (DIR Series) Circular No. 69  
dated May 27, 2011]