Corpsec Hotline

March 28, 2006

RBI'S FIRST STEP TOWARDS CAPITAL ACCOUNT CONVERTIBILITY

Earlier this month, the Prime Minister of India, Mr. Manmohan Singh, asked the Finance Minister and the Reserve Bank of India ("RBI") to prepare a road map towards full capital account convertibility, by July 31, 2006. In pursuance of which the RBI has set up a committee headed by Mr. S.S. Tarapore, former deputy governor of the RBI.

The RBI, commencing its journey down the road towards full capital account convertibility has issued circular RBI/2005-06/ 338 A.P. (DIR Series) Circular No. 29, dated March 27, 2006 ("**Circular**"), with a view to granting more operational flexibility to Indian corporates by liberalizing the rules governing corporate guarantees and disinvestments as well as easing the regulatory regime for overseas investment by proprietary concerns.

The significant changes proposed under the Circular are:

Guarantees

Previously, only promoter companies are allowed to offer guarantees on behalf of their wholly-owned subsidiaries (WOS) and joint ventures (JVs) without prior approval of the RBI, i.e. under the automatic route.

Under the new regime, Indian corporates may offer any form of guarantee - corporate or personal / primary or collateral / guarantee by the promoter company / guarantee by group company, sister concern or associate company in India subject to the following requirements: (i) the financial commitment is within the overall prescribed ceiling for overseas investment, (ii) the amount of the guarantee is specified upfront, and (iii) the same is reported to RBI, in Form ODR.

Overseas Investments by Proprietorship Concerns

Prior to the Circular, only a company incorporated in India, a body created under an Act of Parliament, a partnership firm registered under Indian Partnership Act, 1932, or any other entity notified by the RBI was eligible to invest in an overseas JV/WOS.

Now, proprietary / unregistered partnership firms may set up a JV/WOS outside India with the prior approval of the RBI if they satisfy certain eligibility criteria detailed in the annexure to the Circular, which includes inter alia that (i) the partnership / proprietorship firm must be a DGFT recognised Star Export House, i.e. having exports exceeding Rs.15 crore per annum, (ii) the partnership / proprietorship firm must have a proven track record, and (iii) the amount of investment must not exceed 10% of the average of the past three years exports or 200% of the net owned funds of the Indian firm, whichever is lower.

- Kishore Joshi & Siddharth Shah
You can direct your queries or comments to the authors

Source: RBI Circular - RBI/2005-06/ 338 A.P. (DIR Series) Circular No. 29, dated March 27, 2006

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