March 30, 2018

FOREIGN EXCHANGE MANAGEMENT (CROSS BORDER MERGER) REGULATIONS, 2018

The Reserve Bank of India ("**RBI**") has notified the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 ("**Merger Regulations**") and they have come into effect from March 20, 2018. The Merger Regulations provide the framework for mergers, amalgamations and arrangements between Indian and foreign companies, covering both, inbound and outbound investments.

Background:

On April 13, 2017, the Ministry of Corporate Affairs notified Section 234 of the Companies Act, 2013 ("**CA 2013**") which provides for the cross border mergers of Indian and foreign companies. Consequently, new Rule 25A was inserted in the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 ("**Companies Rules**"). Please refer to our JSA Prism of May 25, 2017 detailing these provisions.

Key provisions of the Merger Regulations:

1. *Cross border merger:* The term '*Cross border merger*' has been defined under the Merger Regulations as any merger, amalgamation or arrangement between an Indian company and foreign company in accordance with Companies Rules notified under CA 2013. This may be in the form of an *inbound merger* or an *outbound merger*.

2. *Deemed RBI approval*: Section 234 of the CA 2013 and Rule 25A of the Companies Rules requires a prior approval from the RBI in case of cross border mergers. However, the Merger Regulations has a deeming provision that states that any cross border merger in compliance with the Merger Regulations shall be deemed to have been approved by the RBI and no separate approval will be required. Further, any cross border merger not in compliance with the Merger Regulations would require prior RBI approval.

3. *Inbound merger:* The Merger Regulations has defined an inbound merger as a merger where the resultant company[1] is an Indian company. The following conditions would need to be adhered to for an inbound merger:

   i. the issue or transfer of any security by the resultant Indian company to the foreign transferor company must be in compliance with:

      - the provisions relating to sectoral caps, pricing guidelines, entry routes, reporting requirements of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017;
      - the provisions of the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004, where the foreign transferor company is a joint venture ("**JV**") or wholly owned subsidiary ("**WOS**") of the Indian company or where the merger leads to acquisition of a step down subsidiary of the JV/WOS of the Indian company.

[1] Being the company which takes over the assets and liabilities of the companies involved in the cross border merger.

ii. any overseas guarantee or borrowing of the foreign transferor company which becomes the borrowing of the resultant Indian company, must conform, within 2 years, with the applicable Foreign Exchange Management Act, 1999 ("**FEMA**") rules and regulations such as the ECB Directions, Foreign Exchange Management (Guarantee) Regulations, 2000 etc. No remittance for repayment of such liability can be made from India within such period of 2 years.
iii. the resultant Indian company can acquire, hold and transfer assets outside India in accordance with applicable FEMA rules and regulations. However, if the resultant Indian company is not permitted under FEMA to acquire or hold any asset or security outside India, it must sell such asset or security within 2 years of date of sanction of the scheme. The sale proceeds shall be repatriated to India immediately. Any liability outside India not permitted to be held by the resultant Indian company can be extinguished using these sale proceeds.

4. *Outbound merger:* The Merger Regulations has defined an outbound merger as a merger where the resultant company is a foreign company. It may be noted that for the purpose of outbound mergers, the foreign company should be incorporated in a jurisdiction specified in Annexure B[2] to the Companies Rules. The following conditions would need to be adhered to for an outbound merger:

i. a person resident in India holding shares in the Indian transferor company can acquire or hold securities of the resultant foreign company in accordance with the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004. If such a shareholder is an Indian individual, such acquisition must be in accordance with the Liberalized Remittance Scheme.
ii. the guarantees or outstanding borrowings of the Indian transferor company which become the liabilities of the resultant foreign company shall be repaid as per the sanctioned scheme in terms of the Companies Rules. Further, the resultant foreign company shall not acquire any rupee denominated liability payable to a lender which is not in conformance with FEMA rules and regulations.
iii. the resultant foreign company can acquire, hold and transfer assets in India in accordance with applicable FEMA rules and regulations. If the resultant foreign company is not permitted under FEMA to acquire or hold any asset or security in India, it must sell such asset or security within 2 years of date of sanction of the scheme. The sale proceeds shall be repatriated outside India immediately. Any liability in India can be extinguished using these sale proceeds within a period of 2 years.

5. *Other conditions:*

i. the offices of the transferor company would be deemed to be the branch/office of the resultant company in accordance with applicable FEMA rules and regulations.
ii. the resultant company can open bank accounts in the jurisdiction of the transferor company for carrying out transactions incidental to the cross border merger for a maximum period of 2 years from the date of sanction of the scheme.

[2] Jurisdictions –
(i) whose securities market regulator is a signatory to International Organization of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with SEBI, or
(ii) whose central bank is a member of Bank for International Settlements (BIS), and
(iii) a jurisdiction, which is not identified in the public statement of Financial Action Task Force (FATF) as:
(a) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or
(b) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

6. *Valuation:* The valuation of the Indian company and foreign company must be done in accordance with Rule 25A of the Companies Rules i.e. by members of a recognised professional body and in accordance with internationally accepted principles on accounting and valuation.

Conclusion:

The Merger Regulations read together with Section 234 of the CA 2013 and the Companies Rules provide the broad framework in relation to cross border mergers, amalgamations and arrangements between Indian and foreign companies. Large multinational corporates will benefit from these regulations as they permit cross border consolidation of business without RBI approval, provided the conditions detailed above are adhered to. This will also have a positive impact on the numerous insolvency and bankruptcy proceedings in India as it will encourage foreign companies to purchase assets in India.

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