

# **Making of foreign investments into Debt Instruments in India**

**The Golden Sparrow is attracting Foreign Investors**

## ***Introduction***

Prior to 1991, there were days when Foreign Investment (FI) was considered necessary evil. Foreign firms were allowed to enter the Indian market only if they possessed technology unavailable in India. Almost every aspect of production and marketing was tightly controlled, and many of the foreign companies that came to India eventually abandoned their projects.

The Indian regime has seen a sea change in last few years, with more relaxations to attract resources to India. 21<sup>st</sup> Century has witnessed remarkable liberalization in the Indian laws governing foreign investment. The country has well accepted the fact that the growth and prosperity of India requires more business with foreign countries.

***The world has acknowledged the arrival of India!*** India has become the *second-most* favoured destination for foreign direct investment after China. It has now been named as the top reformer in South Asia in the Annual Doing Business Report issued by the International Finance Corporation (IFC). The principal sources of FI between 1991 and March 2007 have been Mauritius, US, UK, The Netherlands, Japan, Germany and Singapore. The principal sectors attracting FI during this period have been electrical equipment, services, telecommunications, transportation, fuels, chemicals and construction.

***It is evident; India is on the rise in terms of Foreign Investment!*** And the figures appear to be improving by the day. While Foreign Direct Investment (FDI) equity flows in India were US\$ 5.5 billion in 2005-06, it increased almost three times to US\$ 15.7 billion in 2006-07, representing a growth rate of 184 percent. With this, the cumulative FDI inflows in to the country since 1991 reached US\$ 54.6 billion. ***If waves of FDI are soaring high ECB is no less!*** The External Commercial Borrowings (ECB), both Automatic Route and Approval Route for the month of March 2007 is approx USD 4.8 billion.

## **Legal Framework in India for Foreign Investment**

In India the Legal framework for foreign investment in India is segregated primarily in two parts; one governs the investment in capital and the other borrowings. The set of rules that govern the investment in capital is commonly called Foreign Direct Investment (FDI) Regulations. Whereas the set of rules that governs foreign investment in form of borrowings is called External Commercial Borrowing (ECB) Regulations.

Let us first have a closer look to what exactly falls under which set of rules. Foreign Direct Investment as the name suggests is the investment made towards core capital of an organization viz. investment in equity shares, convertible preference share and convertible debentures. Till late there was ambiguity about the partially convertible preference shares and debentures being considered as part of Foreign Direct Investment. ***However in June 2007 the Reserve Bank of India has clarified that only instruments which are fully and mandatorily convertible into equity within a specified time would be reckoned as part of***

*equity under the FDI Policy and will be eligible to be issued to person's resident outside India under the Foreign Direct Investment Scheme.* Thus it is now crystal clear that the investment in non-convertible or partially convertible preference shares and debentures or any instrument with no definite period for conversion in equity will come under the purview of ECB Guidelines. Moreover any investment as commercial loans [in the form of bank loans, buyers' credit, suppliers' credit, securitised instruments (e.g. floating rate notes and fixed rate bonds)] availed from non-resident lenders with minimum average maturity of 3 years will also come under the purview of ECB Guidelines.

### **External Commercial Borrowings**

The ambit of ECB is wide it recognizes simple form of credit as suppliers' credit as well as sophisticated financial products as securitisation instruments. Basically ECB suggests any kind of funding other than Equity be it Bonds, Credit notes, Asset Backed Securities, Mortgage Backed Securities or anything of that nature, **satisfying the norms of the ECB regulations.**

The External Commercial Borrowing in India is on rising trend; the major reasons of such rise can be attributed to gradually shifting of the Governments policy towards liberal control for the overseas borrowings.

#### *Why ECB is attractive?*

##### **Investor**

- ECB is for specific period, which can be as short as three years
- Fixed Return, usually the rates of interest are fixed
- The interest and the borrowed amount are repatriable
- No owners risk as in case of Equity Investment

##### **Borrower**

- No dilution in ownership
- Considerably large funds can be raised as per requirements of borrower
- Usually only a fixed rate of interest is to be paid
- Easy Availability of funds because ECB is more appealing to Investors

***ECB attractive, but far from reach.*** Though ECB is attractive and Government regulations have been softened to attract more resources to India. The existing eligibility criteria's impose a strong check on the inflow and outflow of money in India through ECB. Corporates can avail ECB up to USD 500 million with minimum average maturity period of 5 years under the automatic route and ***an additional amount of USD 250*** million with average maturity of more than 10 years under the approval route during a financial year. Prepayment and call/put options, however, would not be permissible for additional ECB up to a period of 10 years.

Some of the criteria are laid down below:

<b>Automatic Route</b>	<b>Approval Route</b>
<b>Eligible Borrower:</b>	<b>Eligible Borrower:</b>

<p>(a) Corporates except financial intermediaries. Individuals, Trusts and Non-Profit making Organisations are not eligible to raise ECB.</p> <p>(b) Non-Government Organisations (NGOs) engaged in micro finance activities are eligible to avail ECB subject to certain conditions.</p> <p>(c) Units in Special Economic Zones (SEZ) are allowed to raise ECB for their own requirement.</p>	<p>a) Financial institutions dealing exclusively with infrastructure or export finance</p> <p>b) Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government</p> <p>c) ECB with minimum average maturity of 5 years by Non-Banking Financial Companies (NBFCs) from multilateral financial institutions, reputable regional financial institutions, official export credit agencies and international banks to finance import of infrastructure equipment for leasing to infrastructure projects.</p> <p>d) Foreign Currency Convertible Bonds (FCCB) by housing finance companies satisfying the minimum criteria.</p> <p>e) Special Purpose Vehicles, or any other entity notified by the Reserve Bank, set up to finance infrastructure companies / projects exclusively, will be treated as Financial Institutions and ECB by such entities will be considered under the Approval Route.</p> <p>f) Multi-State Co-operative Societies engaged in manufacturing activity satisfying the some conditions</p>
<p><b>Eligible Lenders:</b></p> <p>(a) Borrowers can raise ECB from internationally recognised sources such as (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions, (iv) export credit agencies, (v) suppliers of equipment, (vi) foreign collaborators and (vii) foreign equity holders (other than erstwhile OCBs) subject to certain conditions.</p> <p>(b) Overseas organisations and individuals complying with certain safeguards may provide ECB to Non-Government Organisations (NGOs) engaged in micro finance activities.</p>	<p><b>Eligible Lenders:</b></p> <p>(a) Borrowers can raise ECB from internationally recognised sources such as (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions, (iv) export credit agencies, (v) suppliers' of equipment, (vi) foreign collaborators and (vii) foreign equity holders (other than erstwhile OCBs) subject to some restrictions.</p>
<p><b>Procedure:</b></p> <p>Borrowers may enter into loan agreement complying with ECB guidelines with</p>	<p><b>Procedure:</b></p> <p>Applicants are required to submit an application in form ECB through designated</p>

<p>recognised lender for raising ECB under Automatic Route without prior approval of RBI. The borrower must obtain a Loan Registration Number (LRN) from the Reserve Bank of India before drawing down the ECB. For allotment of loan registration number, borrowers are required to submit Form 83, in duplicate, certified by the Company Secretary (CS) or Chartered Accountant (CA) to the designated AD bank. One copy is to be forwarded by the designated AD bank to the Director, Balance of Payments Statistics Division, Department of Statistical Analysis and Computer Services (DESACS), Reserve Bank of India, Bandra-Kurla Complex, Mumbai – 400 051</p>	<p>AD bank to the Chief General Manager, Foreign Exchange Department, Reserve Bank of India, Central Office, External Commercial Borrowings Division, Mumbai – 400 001 along with necessary documents.</p>
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**Amount and Maturity:**

- Corporates can raise maximum ECB of USD 500 million under the automatic route and additional ECB of USD 250 million under approval route during a financial year.
- ECB upto USD 20 million with a minimum average maturity of three years
- ECB above USD 20 million and upto USD 500 million with a minimum average maturity of 5 years
- NGOs engaged in micro finance activities can raise ECB up to USD 5 million during a financial year.
- ECB upto USD 20 million can have call/put option provided the minimum average maturity of 3 years is complied with before exercising call/put option.

There has been some *end use restrictions* put on ECB such as utilisation of ECB proceeds is not permitted for on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate. Further ECB proceeds is not permitted to be used for investment in real estate, working capital, general corporate purpose and repayment of existing Rupee loans.

**All-in-cost ceilings<sup>1</sup>**

In the Month of May 2007 the Reserve Bank made revision in All in cost ceilings in contour with the current macroeconomic situation.

Average Maturity Period	All-in-cost Ceilings over 6 month LIBOR*
Three years and up to five years	150 basis points
More than five years	250 basis points

<sup>1</sup> All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees. Moreover, the payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost.

In spite of all restrictions and eligibility criteria the trend shows that investment through ECB will rise in near future. The lucrative investment in ECB in India is soon expected to capture international market.

### **Guarantees**

Foreign Exchange Management Act allows guarantees in very limited circumstances to person/corporate resident outside India. A person resident in India may give guarantee in following circumstances:

- an exporting company may give a guarantee for performance of a project outside India subject to the regulations
- a company in India promoting or setting up outside India, a joint venture company or a wholly-owned subsidiary, may give a guarantee to or on behalf of the latter in connection with its business

Be it FDI or ECB the fact is India has opened gates to wealth, prosperity and success. India is one of the most sought countries in terms of international investments. Business has grown multifold with the increasing foreign participation in Indian business. Today India is on that footing that we can proudly say that we do not discuss the future of India but ***India is the future.***

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