

External Commercial Borrowings

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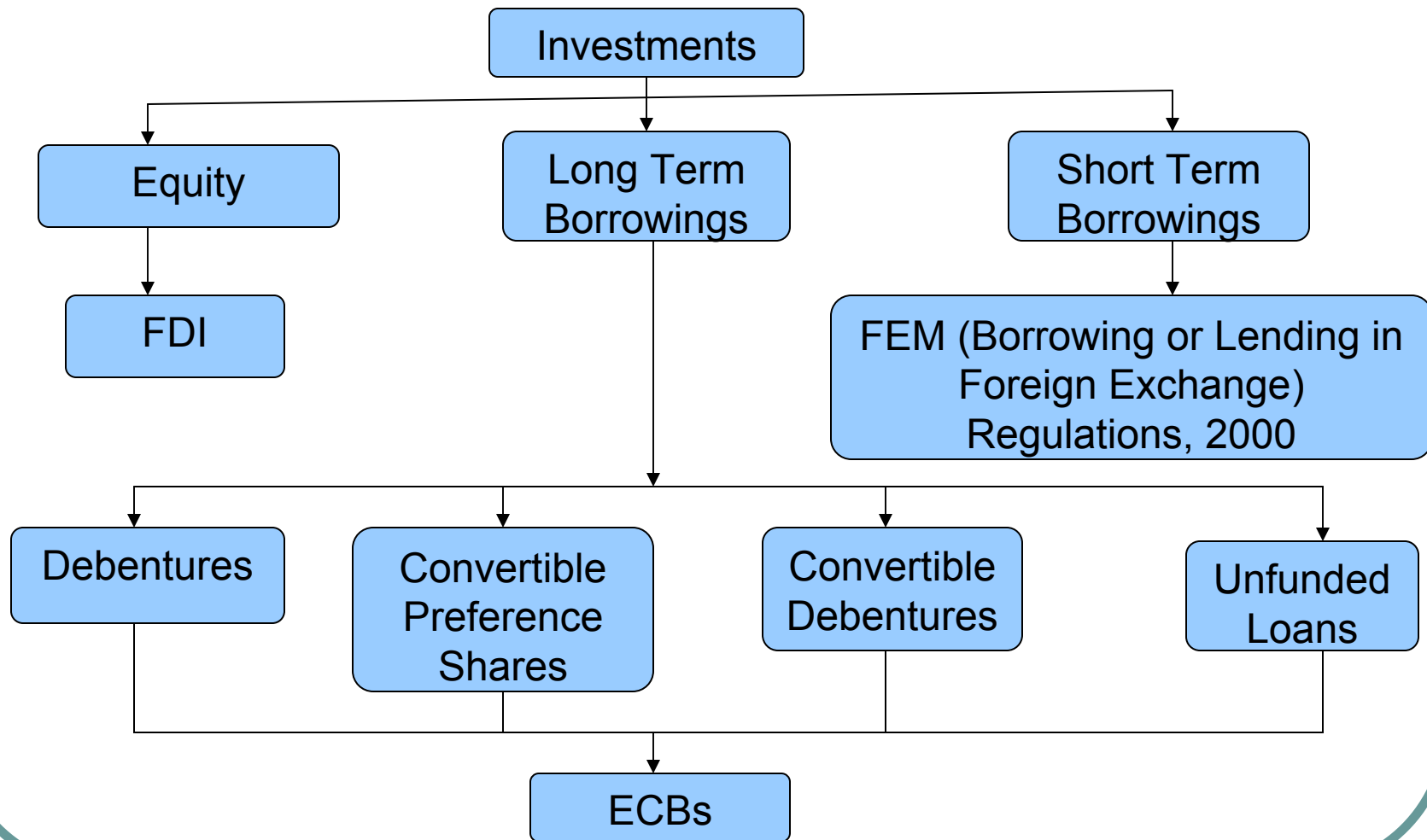
What is ECB?

- Source of funds for corporates from abroad with advantage of
 - lower rates of interest prevailing in the international financial markets
 - longer maturity period
 - for financing expansion of existing capacity as well as for fresh investment
- Defined as to include commercial loans [in the form of bank loans, buyers' credit, suppliers' credit, securitised instruments (e.g. floating rate notes and fixed rate bonds, CP)] availed from non-resident lenders with **minimum average maturity of 3 years**

Source of Law

- The set of rules that governs foreign investment in form of borrowings is called ECB Regulations by MOF
- Section 6(3)(d) of the **Foreign Exchange Management Act, 1999** read with the **Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000** which is also known as Notification No. FEMA 3 / 2000-RB dated 3rd May 2000.
- Consolidated RBI **Master Circular** No. /07 /2008-09 on “External Commercial Borrowings and Trade Credits” dated 1st July 2008 having sunset clause of one year .This circular will stand withdrawn on July 1, 2009 and will be replaced by an updated Master Circular.

Basic Financing Structure



Modes of raising ECBs- contd..

- Foreign currency loan raised by residents from recognised lenders
- 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 (considered foreign direct investment) be it Bonds, Credit notes, Asset Backed Securities, Mortgage Backed Securities or anything of that nature, satisfying the norms of the ECB regulations.

Modes of raising ECBs- contd..

- Commercial Bank Loans : in the form of term loans from banks outside India
- Buyer's Credit
- Supplier's Credit
- Securitised instruments such as Floating Rate Notes (FRNs), Fixed Rate Bonds (FRBs), Syndicated Loans etc. Syndicated Loan, CP
- Credit from official export credit agencies
- Commercial borrowings from the private sector window of multilateral financial institutions such as International Finance Corporation (Washington), ADB, AFIC, CDC,
- Loan from foreign collaborator/equity holder, etc and corporate/institutions with a good credit rating from internationally recognised credit rating agency
- Lines of Credit from foreign banks and financial institutions
- Financial Leases
- Import Loans

Modes of raising ECBs

- Investment by Foreign Institutional Investors (FIIs) in dedicated debt funds
- External assistance, NRI deposits, short-term credit and Rupee debt
- Foreign Currency Convertible Bonds
- Non convertible or optionally convertible or partially convertible debentures
- Redeemable preference shares are considered as part of ECBs
 - As per Indian corporate law, all preference shares are mandatorily redeemable unless they are convertible
 - Hence, convertible preference shares will not be ECB (will be Foreign Direct Investment)
 - Non convertible, partly convertible or optionally convertible preference shares are treated as ECBs
- Bonds, Credit notes, Asset Backed Securities, Mortgage Backed securities
 - Not expressly covered but Guidelines refer to securitised notes

Exclusions from ECBs

- Investment made towards core capital of an organization viz.
 - investment in equity shares,
 - convertible preference share and
 - convertible debentures
- 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
- Equity capital
- Reinvested earnings' (retained earnings of FDI companies)
- Other direct capital (inter-corporate debt transactions between related entities)

Trade credits- contd..

- Credits extended for imports into India directly by the overseas supplier, bank and financial institution for **maturity of less than three years**
 - **Suppliers' credit** relates to credit for imports in to India extended by the *overseas supplier*
 - **Buyers' credit** refers to loans for payment of imports in to India arranged by the importer from a *bank or financial institution outside India* for maturity of less than three years.
- Buyers' credit and suppliers' credit for **three years and above** come under the category of **ECBs**
- AD banks permitted to approve trade credits up to MUSD 20 per import transaction with a maturity period up to one year (maturity period of more than one year and less than three years in case of import of capital goods)
- No rollover/ extension permitted beyond the permissible period.

Trade credits

- The current all-in-cost ceilings are as under:

Maturity period	All-in-cost ceilings over 6 months LIBOR*
Up to 1 year	75 bps
More than 1 year but less than 3 years	125 bps

* for the respective currency of credit or applicable benchmark.

- AD banks are permitted to issue Letters of Credit/guarantees/Letter of Undertaking (LoU) /Letter of Comfort (LoC) in favour of overseas supplier, bank and financial institution, up to MUSD 20 per transaction for a period up to 1 year for import of all non-capital goods and up to 3 years for import of capital goods.
- The period of such Letters of credit / guarantees / LoU / LoC has to be co-terminus with the period of credit, reckoned from the date of shipment.

FCCBs

- Policy for ECB also applicable to Foreign Currency Convertible Bonds (FCCBs) in all respects read with Notification FEMA No. 120/RB-2004 dated July 7, 2004, except in the case of housing finance companies for which criteria will be notified by RBI.

Convertible Preference Shares

- Preference shares only *fully and mandatorily convertible* instruments are now considered to be FDI.
- Foreign investment in preference shares of any nature other than fully and mandatorily convertible, including *non-convertible (that is, purely redeemable), optionally convertible or partially convertible* preference shares and preference shares or any instrument with *no definite period for conversion in equity* would be considered as debt and shall require confirming to ECB guidelines.
- Proceeds cannot be used for acquisition of existing shares (FEMA)
- Issue of preference shares *of any type* would continue to conform to the guidelines of RBI/SEBI and other statutory bodies and would be subject to all statutory requirements.

Convertible Debentures

- Debentures only *fully and mandatorily convertible* instruments are now considered to be FDI.
- All other debentures (including *non / optionally convertible*) treated at par with ECB – i.e. Debt.

Two Routes for ECB

- ECBs can be accessed under two routes
 - (i) Automatic Route and
 - (ii) Approval Route.

Bases of Comparison

- Eligibility criteria for accessing international financial markets.
- Total quantum limit of funds that can be raised through ECBs.
- Maturity period and the cost involved.
- End uses of the funds raised.

Eligible Borrowers

Automatic Route

- Indian Companies except financial intermediaries (such as Banks, Financial Institutions (FIs), Housing Finance companies and NBFCs).
- Units in Special Economic Zones (SEZ) are allowed to borrow funds through ECBs for their own requirements.
- *(Individuals, Trusts and Non-Profit making organisations are not eligible to raise ECBs).*

Approval Route

- Financial Institutions dealing exclusively with infrastructure or export finance
- Banks and Financial Institutions which participated in the textile or steel sector restructuring package
- ECBs with minimum average maturity of 5 years by NBFCs to finance import of infrastructure equipment for leasing to infrastructure projects.
- FCCBs by housing finance companies satisfying the prescribed criteria
- SPVs, or any other entity notified by RBI, set up to finance infrastructure companies / projects.
- Multi-State Co-operative Societies engaged in manufacturing activities.
- Corporates engaged in industrial & infrastructure sector
- NGOs engaged in micro finance activities satisfying the criteria laid down
- Corporates in service sector for import of capital goods.

Recognised Lenders

Automatic Route

- Internationally recognized sources (international banks, capital markets, multilateral financial Institutions, export credit agencies, equipment suppliers, foreign collaborators)
- foreign equity holders (other than erstwhile OCBs) if:
 - ECB up to 5 MUSD – minimum equity of 25%
 - ECB above 5 MUSD – minimum equity of 25% and debt-equity ratio not exceeding 4:1

Approval Route

- Internationally recognized sources (international banks, capital markets, multilateral financial Institutions, export credit agencies, equipment suppliers, foreign collaborators)
- foreign equity holders (other than erstwhile OCBs) if:
 - such 'foreign equity holder' directly holds minimum 25 % of the paid up equity capital of the borrowing company.
 - In such cases the debt-equity ratio may exceed 4:1, if the RBI permits.
- Overseas organisations and individuals may provide ECBs to NGOs engaged in micro finance activities subject to the conditions prescribed

Amount and Maturity

Automatic Route

ECB up to MUSD 20 or equivalent	3 years
ECB above MUSD 20 and up to MUSD 500	5 years
Max amount of ECB by eligible borrower	MUSD 500 during a FY
ECB up to MUSD 20 can have call/ put option	If the minimum maturity of 3 years is complied before exercising call/ put option

MUSD means million United States Dollars

Approval Route

- Corporates - additional amount of USD 250 million with average maturity of more than 10 years, over and above the existing limit of USD 500, during a financial year. Prepayment and call / put options not permitted in respect of the aforesaid additional limit upto 10 years.
- Corporates in infrastructure sector -ECB up to USD 100 million and corporates in industrial sector -ECB up to USD 50 million for Rupee capital expenditure for permissible end uses within the overall limit of USD 500 million per borrower, per financial year, under Automatic Route.
- NGOs engaged in micro finance activities -ECB up to USD 5 million during a financial year
- Corporates in the services sector -ECB up to USD 100 million, per borrower, per financial year, for import of capital goods.

All-In-Cost Ceilings

Automatic Route

- All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, withholding tax and fees payable in Indian Rupees.

Average Maturity Period	All-in-cost Ceilings over 6 month LIBOR* (w.e.f. 22/10-2008)
3 years and up to 5 years	300 bps
More than 5 years	500 bps

* for the respective currency of borrowing or applicable benchmark

Approval Route

- ECB beyond the permissible all-in-cost ceiling can be availed of under the Approval Route. (to be reviewed after June 30, 2009)

Permitted End Uses Of ECB Proceeds

Automatic Route

- Import of capital goods by new or existing production units in real sector- industrial sector, including SMEs.
- Investment in infrastructure sector,
- Overseas direct investment in Joint Ventures (JV) / Wholly Owned Subsidiaries (WOS)
- Payments to Government by telecom companies for obtaining license / permit for 3G Spectrum

Approval Route

- **In addition**, the ECB proceeds can also be utilised for the following purposes with the prior approval of RBI –
- Implementation of new projects and modernisation / expansion of existing production units by the companies engaged in the industrial sector including SME.
- Import of capital goods by service sector companies
- First stage acquisition of shares of PSUs in the disinvestment process by Government and also in the mandatory second stage offer to the public.
- Refinancing of an existing ECB

End uses not permitted

Automatic Route

- On-lending or investment in capital market or acquisition of companies or part thereof
- Investment in real estate;
- Working capital, general corporate purpose and repayment of Rupee loans

Approval Route

- Same
- However, the eligible Financial Institutions and Banks can utilise the ECB proceeds for acquisition of companies in India, subject to the approval of RBI.

Security

- Security to be provided to the overseas lender / supplier for securing the ECBs is left to the borrower.
- Creation of charge over the immovable assets and financial securities, such as shares, in favour of the overseas lender are subject to Regulation 8 of Notification No. FEMA 21/RB-2000 and Regulation 3 of Notification No. FEMA 20/RB-2000 both dated 3rd May 2000.

Guarantees

- Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, financial institutions and NBFCs relating to ECBs in favour of overseas lender on behalf of their constituents for their borrowings in foreign exchange is normally not permitted.
- Applications in the case of SME will be considered on merit subject to prudential norms.
- Issuance of guarantees etc., in respect of ECBs by textile companies for capacity expansion and modernisation are considered by RBI under the approval route subject to prudential norms.
- FEMA 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

Structured Obligations

- In order to enable corporates to raise resources domestically and hedge exchange rate risks, domestic rupee denominated structured obligations are permitted to be credit enhanced by international banks/international financial institutions/joint venture partners.
- Such applications will be considered under the Approval Route.

Debt Servicing, Prepayment And Refinancing of an existing ECB

- The designated AD banks have general permission to make remittances of installments of principal, interest and other charges in conformity with the ECB guidelines.
- Prepayment of ECBs up to MUS\$ 500 without approval of RBI subject to compliance with minimum average maturity period, whereas amounts exceeding USD 500 million can be prepaid only after obtaining approval of RBI.
- Existing ECB may be refinanced by raising a fresh ECB subject to the condition that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained.

Parking of ECB Proceeds

- To be parked overseas until actual requirement in India

Recent Developments - ECB

- **Minimum Average Maturity:** ECB upto USD 500 million per borrower per financial year is permitted for rupee expenditure and/ or foreign currency expenditure for permissible end-uses under the automatic route
- **Parking of ECB proceeds:** The borrowers have been provided with a flexibility to either keep their ECB proceeds offshore or keep it with the overseas branches/ subsidiaries of Indian banks abroad or to remit these funds to India to credit to their Rupee accounts with banks in India, pending utilization for permissible end-uses.
- **All-in-Cost Ceilings:** ECB beyond the permissible all-in-cost ceiling can be availed of under the Approval Route.
- **Definition of Infrastructure** expanded to include, power, telecommunication, mining exploration and refining

Recent Changes in ECB Policies as part of the 'Second Stimulus Package'

- The 'all-in-cost' ceilings on such borrowing would be removed, under the approval route of RBI;
- To facilitate access to funds for the housing sector, the 'development of integrated townships' would be permitted as an eligible end-use of the ECB, under the approval route of RBI;
- NBFCs, dealing exclusively with infrastructure financing, would be permitted to access ECB from multilateral or bilateral financial institutions, under the approval route of RBI.
- In order to give a boost to the corporate bond market, FII investment limit in rupee denominated corporate bonds in India would be increased from US \$ 6 billion to US \$ 15 billion. (To be reviewed after June 30, 2009)

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