



External Commercial Borrowings & Trade Credits

Annual FEMA Summit 2019

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FEMA Regulations governing ECB/TC

Foreign Exchange Management Act, 1999

Section 6 (3)(d) - Borrowing or Lending in Foreign Exchange

Power to regulate (Section 47)

Notifications

FEM (Borrowing or Lending in Foreign Exchange) Regulations, 2018 and Notified through Notification No. 3(R)/2018-RB dated December 17, 2018 vide GSR 1213(E) dated December 17, 2018

Master Direction

Master Direction on External Commercial Borrowings and Trade Credits

AP DIR Series Circulars

AP (DIR Series) Circulars issued by RBI from time to time



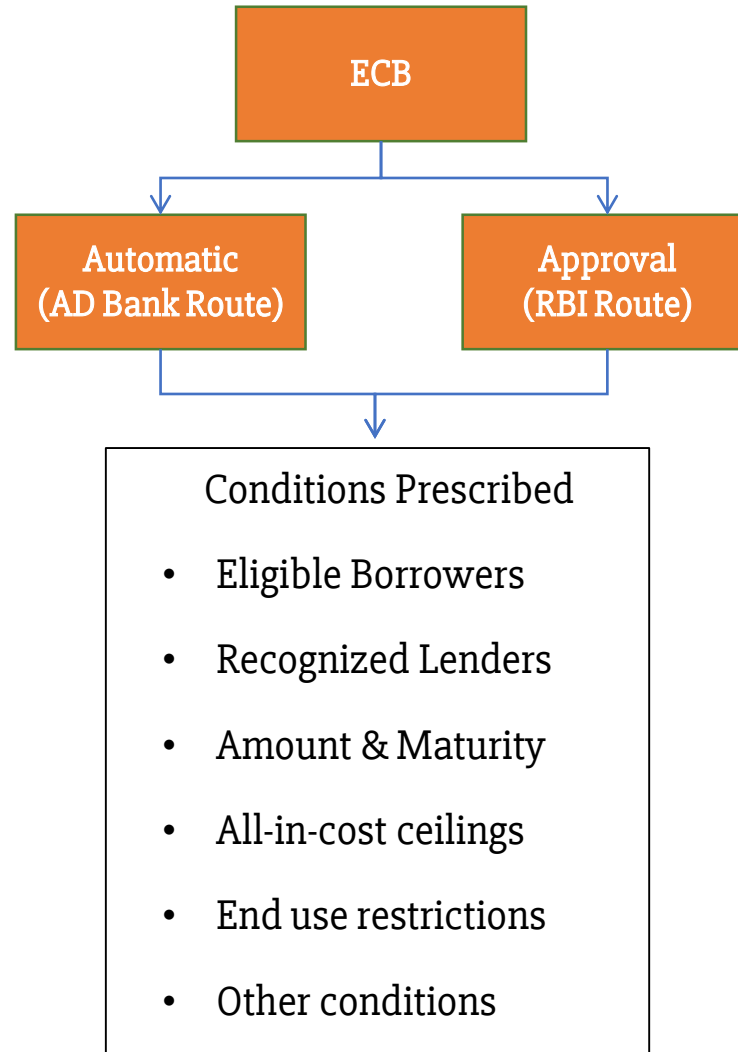
Definitions

Commercial loans raised by eligible resident entities from recognised non-resident entities conforming to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc.

ECB could be Foreign Currency denominated or Indian Rupees denominated and can be in following forms:

| ECB in Foreign Currency | ECB in Indian Rupees |
|--|--|
| Loans including bank loans; floating/ fixed rate notes/ bonds/ debentures (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; FCCBs; FCEBs and Financial Lease. | Loans including bank loans; floating/ fixed rate notes/bonds/ debentures/ preference shares (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; and Financial Lease. Also, plain vanilla Rupee denominated bonds issued overseas, which can be either placed privately or listed on exchanges as per host country regulations |

ECB – Permitted routes



Eligible Borrowers

| ECB in Foreign Currency | ECB in Indian Rupees |
|--|--|
| <ul style="list-style-type: none">▪ All entities eligible to receive FDI*. Further, the following entities are also eligible to raise ECB:<ul style="list-style-type: none">- Port Trusts;- Units in SEZ;- SIDBI; and- EXIM Bank of India | <ul style="list-style-type: none">▪ All entities eligible to raise FCY ECB; and▪ Registered entities engaged in micro-finance activities, viz., registered Not for Profit companies, registered societies/trusts/cooperatives and Non-Government Organizations. |

* As per FEMA 20(R):

Regulation 2(1)(xvii) – FDI is the investment through capital instruments by a person resident outside India (a) in an unlisted Indian company; or (b) in 10 percent or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company

Regulation 2(1)(xviii) – Foreign Investment is any investment made by a person resident outside India on a repatriable basis in capital instruments of an Indian company or to the capital of an LLP

Recognised Lender

The lender should be resident of FATF or IOSCO compliant country, including on transfer of ECBs. However:

(a) Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognised lenders;

(b) Individuals as lenders can **only be permitted** if they are **foreign equity holders** or for subscription to bonds/debentures listed abroad; and

Foreign branches / subsidiaries of Indian banks are permitted as recognised lenders only for FCY ECB (except FCCBs and FCEBs).

(c) Foreign branches / subsidiaries of Indian banks, subject to applicable prudential norms, can participate as arrangers/underwriters/market-makers/traders for Rupee denominated Bonds issued overseas. However, underwriting by foreign branches/subsidiaries of Indian banks for issuances by Indian banks will not be allowed.

All in cost ceiling

All-in-Cost:

- Includes rate of interest, other fees, expenses, charges, guarantee fees, ECA charges, whether paid in foreign currency or INR **but will not** include commitment fees and withholding tax payable in INR.
- In the case of fixed rate loans, the swap cost plus spread should not be more than the floating rate plus the applicable spread. Additionally, for FCCBs the issue related expenses should not exceed 4 per cent of issue size and in case of private placement, these expenses should not exceed 2 per cent of the issue size, etc.

Benchmark rate:

- In case of FCY ECB/TC - 6-months LIBOR rate of different currencies or any other 6-month interbank interest rate applicable to the currency of borrowing.
- In case of Rupee denominated ECB/TC - prevailing yield of the Government of India securities of corresponding maturity.

Presently, Benchmark rate plus 450 bps spread

Minimum average maturity period (MAMP)

Minimum average maturity period is 3 years

Manufacturing sector companies

MAMP of 1 year for ECB up to USD 50 million or its equivalent per financial year

ECB is raised from foreign equity holder and utilized for working capital purposes or general corporate purposes or repayment of Rupee loans

MAMP will be 5 years

The call and put option, if any, **shall not** be exercisable prior to completion of minimum average maturity

Negative End use – All Tracks

The negative list, for which the ECB proceeds **cannot** be utilized, would include the following:

- Real estate activities.
- Investment in capital market.
- Equity investment.
- Working capital purposes **except** from foreign equity holder.
- General corporate purposes **except** from foreign equity holder.
- Repayment of Rupee loans except from foreign equity holder.
- On-lending to entities for the above activities.

Quantum of ECB and conditions

| | |
|---|--|
| All eligible borrowers | Can raise ECB up to USD 750 million or equivalent per financial year under automatic route |
| FCY denominated ECB raised from direct foreign equity holder | ECB liability-equity ratio for ECBs raised under the automatic route cannot exceed 7:1 This ratio will not be applicable if outstanding amount of all ECBs, including proposed one, is up to USD 5 million or equivalent |
| Additional restrictions/caps applicable to borrowing entities | Guidelines on debt equity ratio issued, if any, by the sectoral or prudential regulator concerned |

Hedging requirement

ECB in FCY

- Guidelines for hedging issued, if any, by the concerned sectoral or prudential regulator in respect of foreign currency exposure shall apply.
- **Infrastructure space companies** to have a **board approved risk management policy** and required to mandatorily hedge **70 per cent of their ECB exposure** in case average maturity of ECB is less than 5 years.
- The AD Category-I bank to verify that 70 per cent hedging requirement is complied with during the currency of ECB and report the position to RBI through Form ECB 2.
- **Principal as well as coupon** should be covered through financial hedges.
- A **minimum** tenor of **one year of financial hedge** would be required with periodic rollover duly ensuring that the exposure on account of ECB is not unhedged at any point during the currency of ECB
- Natural hedge, in lieu of financial hedge, will be considered only to the extent of offsetting projected cash flows / revenues in matching currency, net of all other projected outflows arising within the same accounting year

Hedging requirement

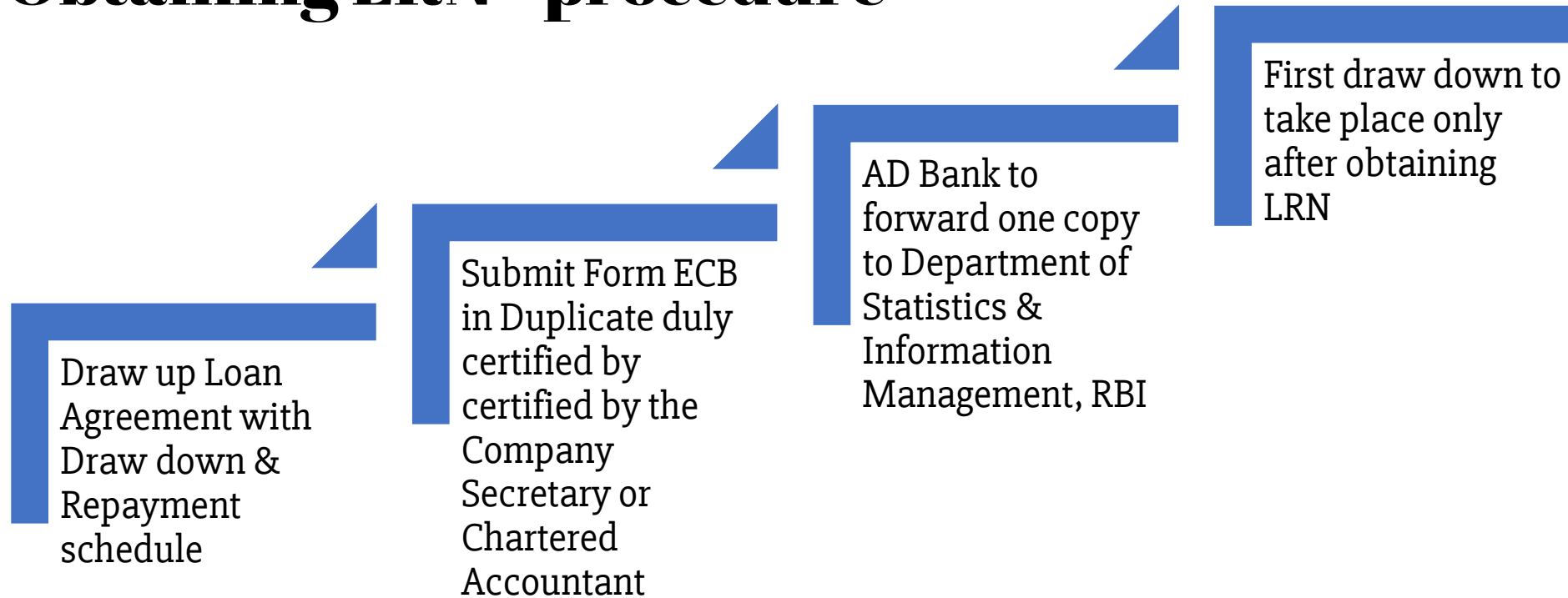
ECB in INR

- The overseas investors are eligible to hedge their exposure in Rupee through permitted derivative products with AD Category I banks in India.
- The investors can also access the domestic market through branches / subsidiaries of Indian banks abroad or branches of foreign banks with Indian presence on a back to back basis.

Parking of ECBs abroad

- ECB proceeds meant only for foreign currency expenditure can be parked abroad pending utilization. Till utilization, these funds can be invested in the following liquid assets
 - Deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/ Fitch IBCA or Aa3 by Moody's;
 - Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above and
 - Deposits with overseas branches/ subsidiaries of Indian banks.
- ECB proceeds meant for Rupee expenditure to be repatriated immediately for credit to their Rupee accounts with AD Category I banks in India.
- ECB borrowers may park ECB proceeds in term deposits (in unencumbered position) with AD Category I banks in India for a maximum period of 12 months.

Obtaining LRN - procedure



In the event of **Approval route**, prior approval from RBI in form ECB is required before the above steps

On-going compliance

- ECB-2 Return certified by the CS/CA to be submitted through AD bank on monthly basis
- ECB-2 Return to reach DSIM RBI within seven working days from the close of month to which it relates.

Conversion of ECB into Equity

Conditions:

- Activities to be covered under Automatic Route / FIPB approval obtained
- Sectoral Cap not breached
- Pricing guidelines followed (listed / unlisted company)

Reporting structure

Form FC-GPR for converted portion to be filed with AD

Form ECB-2 to be filed with DSIM within 7 working days from the close of the month

Powers delegated to AD Banks

AD Banks have been delegated with wide powers to approve the changes in ECB's (other than FCCB and FCEB). For instance:

- Changes/modifications in the drawdown/repayment schedule - with or without change in the average maturity period or all-in-cost;
- Changes in the currency of borrowing;
- Change of the AD bank;
- Changes in the name of the Borrower / Lender;
- Transfer of ECB;
- Cancellation of LRN;
- Change in the end-use of ECB proceeds;
- Reduction in amount of ECB;
- Change in all-in-cost of ECB
- Extension of matured but unpaid ECB

ECBs for Startups

| Criteria | Requirement |
|---------------------|--|
| Eligibility | An entity recognised as a Startup by the Central Government as on date of raising ECB. |
| Maturity | Minimum average maturity period will be 3 years. |
| Recognized Lender | Resident of a FATF compliant country. Overseas branches/subsidiaries of Indian banks and overseas wholly owned subsidiary / joint venture of an Indian company will not be considered as recognized lenders |
| Form of Borrowing | Loans or non-convertible, optionally convertible or partially convertible preference shares |
| Currency | Any freely convertible foreign currency or in INR or a combination thereof. In case of borrowing in INR, the non-resident lender, should mobilize INR through swaps/outright sale undertaken through an AD bank |
| Amount | USD 3 million or equivalent per financial year |
| All in cost ceiling | As mutually agreed between the borrower and the lender |

ECBs for Startups

| Criteria | Requirement |
|------------------------|--|
| End use | For any expenditure in connection with the business of the borrower |
| Conversion into equity | Freely permitted subject to Regulations applicable for foreign investment in Startups |
| Security | Choice of security to be provided to the lender is left to the borrowing entity |
| Guarantee | Issuance of corporate or personal guarantee is allowed. Guarantee issued by a non-resident is allowed only if such parties qualify as lender . Issue of guarantee, Standby LC, LoU, LoC by Indian Banks/Indian Financial Institutions/NBFC is not permitted |
| Hedging | The overseas lender, in case of INR denominated ECB, will be eligible to hedge its INR exposure through permitted derivative products with AD banks in India. The lender can also access the domestic market through branches/ subsidiaries of Indian banks abroad or branches of foreign bank with Indian presence on a back to back basis. |
| Conversion Rate | Conversion will be at the market rate as on the date of agreement. |
| Other Provisions | Other provisions like parking of ECB proceeds, reporting arrangements, powers delegated to AD banks, borrowing by entities under investigation, conversion of ECB into equity will be applicable as per policy. ECB liability : equity ratio will not be applicable |

Late submission fee (LSF)

New concept introduced in the ECB framework

Permits the borrower to pay a LSF and regularize:

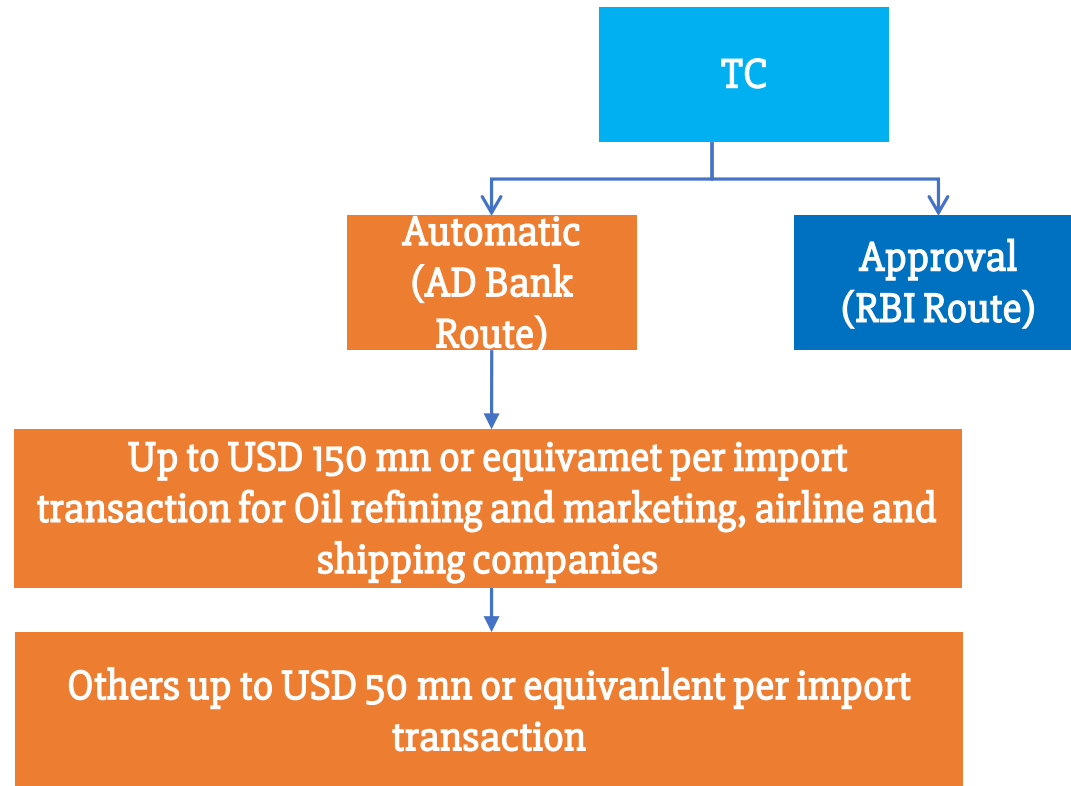
- the delay in reporting of drawdown of ECB proceeds before obtaining LRN or
- delay in submission of Form ECB 2 returns

Non payment of LSF will be treated as a contravention of reporting provision and shall be subject to compounding or adjudication

| Type of return | Period of delay | Applicable LSF (INR) |
|----------------|--|----------------------|
| ECB 2 | Up to 30 days from due date of submission | 5,000 |
| ECB 2/ ECB | Up to 3 years from due date of submission/ drawdown | 50,000 per year |
| ECB 2/ ECB | Beyond 3 years from due date of submission/ drawdown | 100,000 per year |

Trade Credits (TC)

Trade Credits (TC) - credits extended by the overseas supplier, bank, financial institution and other permitted recognised lenders for imports of capital/non-capital goods permissible under the Foreign Trade Policy of the Government of India.



TC – Recognised lenders

Recognized lenders:

For suppliers' credit. Supplier of goods located outside India.

For buyers' credit. Banks, financial institutions, foreign equity holder(s) located outside India and financial institutions in IFSCs located in India.

Maturity period :

- 3 years for import of capital goods.
- 1 year for non-capital goods or the operating cycle, whichever is less.

For shipyards/ship builders, TC for import of non-capital goods can be up to 3 years

All in cost ceiling :

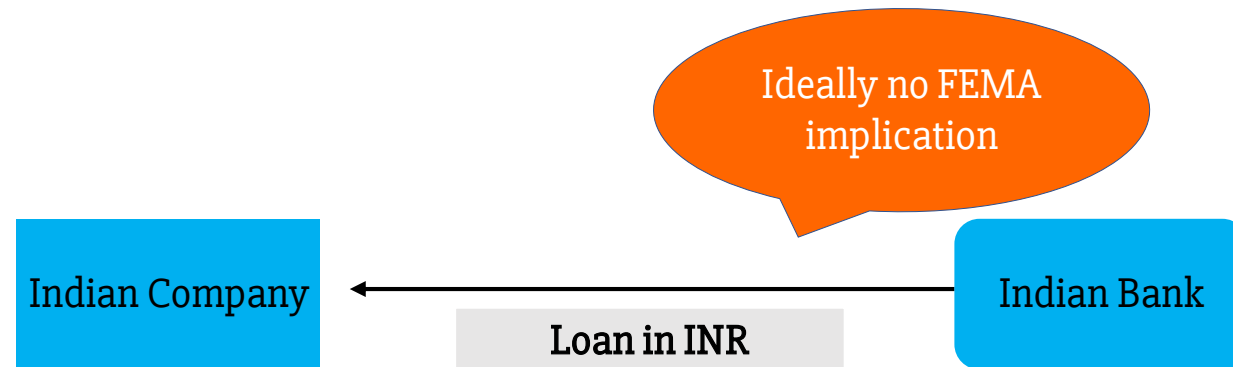
Benchmark rate plus 250 bps spread

TC – Security

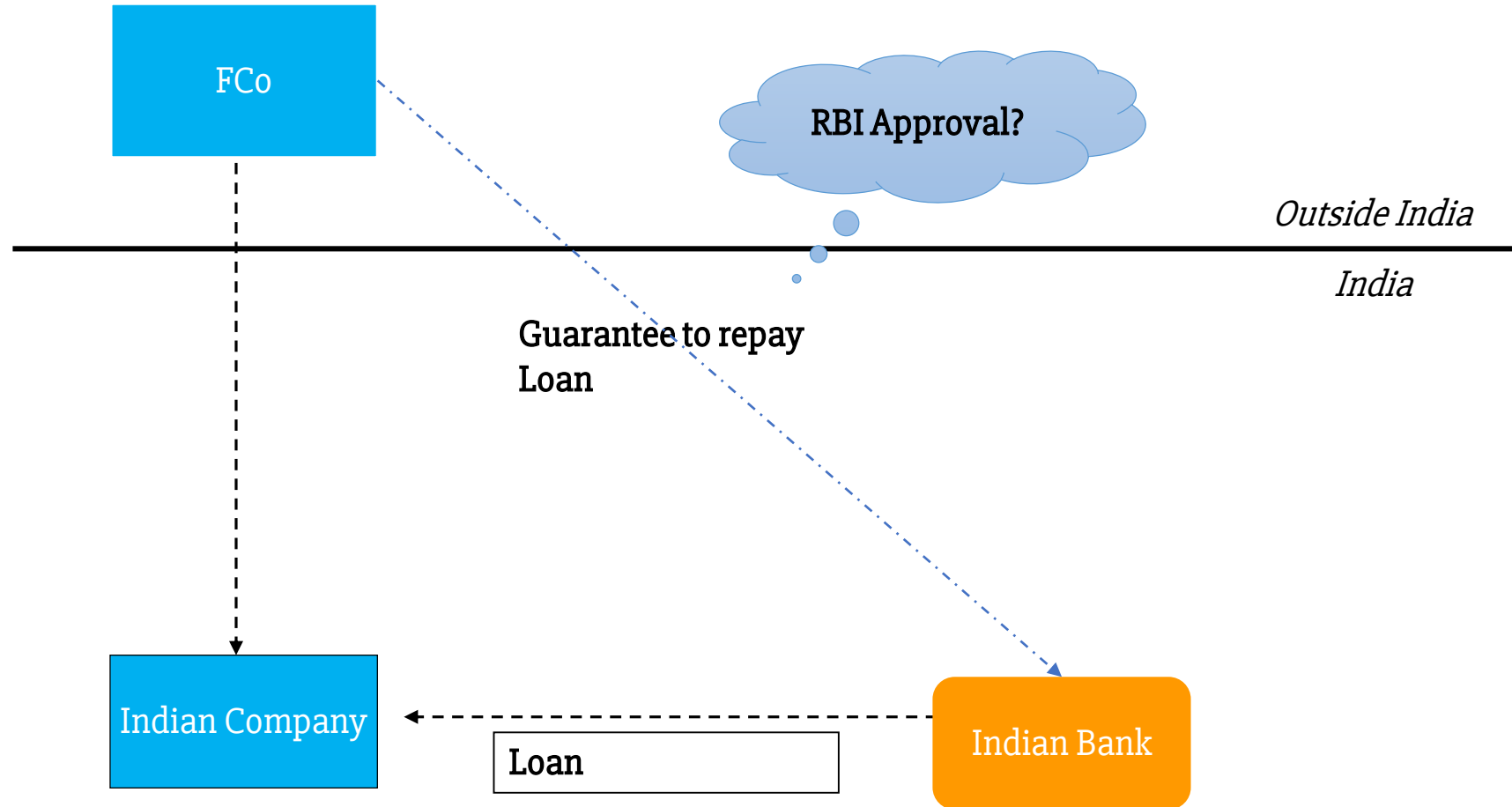
Guarantee

- AD banks and their overseas Branch/ Subsidiaries abroad are permitted to issue bank guarantee in favor of overseas lender not exceeding amount of TC.
- Importer may also offer security of movable assets (including financial assets) / immovable assets (excluding land in SEZs) / corporate or personal guarantee for raising trade credit. ADs may permit creation of charge on security offered / accept corporate or personal guarantee subject to certain conditions.

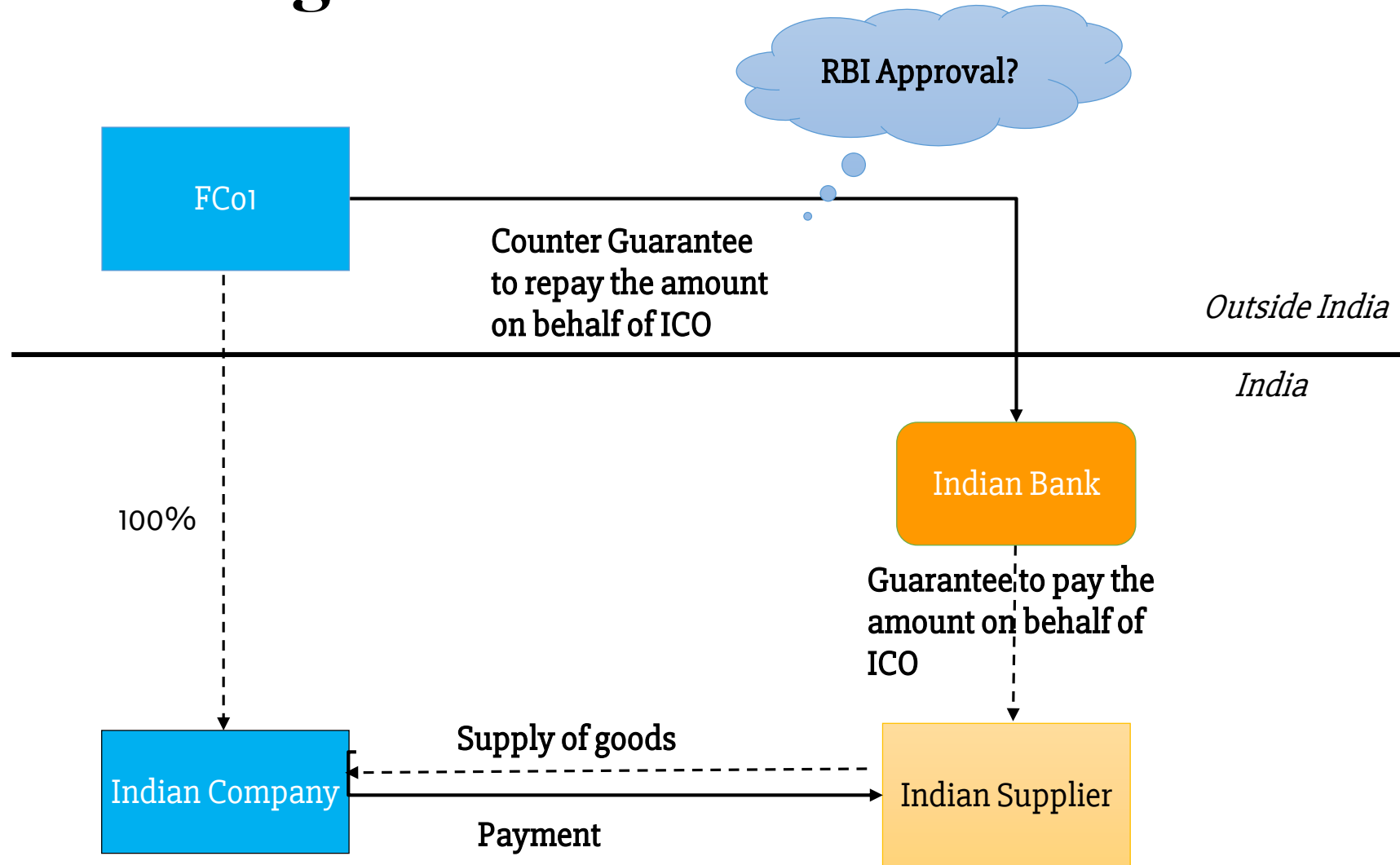
Structured obligations



Structured obligations



Structured obligations



Issues

1. Can LLPs avail ECB under the new framework
2. Is there a concept of deemed ECB
3. LRN not allotted even after 2 months – Can you drawdown the first tranche
4. In case of ECB from a direct shareholder can the percentage holding in the borrower fall below 25% after contracting the ECB?
5. Does the ECB liability- equity ratio of 7:1 apply in case of an Indirect equity holding under automatic route
6. Can refinancing/ partial refinancing be undertaken under auto route even for ECBs raised under approval route, subject to compliance with guidelines?
7. Is refinancing of ECBs raised from foreign equity holders and utilised for working capital/ general corporate purpose/ repayment of Rupee loans permitted?
8. Is LSF applicable to old ECB 2 returns also?
9. Can the interest accrued on ECB be converted into Equity under the extant norms?

Thank
you

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