

EXTERNAL COMMERCIAL BORROWINGS AN OVERVIEW

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ECBs provide an additional source of funds to the companies allowing them to supplement domestically available resources and take advantage of lower rates of interest prevailing in the international financial markets. ECBs have become very popular amongst the Indian companies, during the past few years due to limitations in the Indian debt market in the form of short maturity period and high rate of interest. This article gives an overview of the regulatory framework for raising funds through ECBs.

Introduction

1. The world of Indian corporate finance revolves around a three letter word - (External Corporate Borrowings) 'ECB'. ECBs are one of the modes of raising funds from abroad. ECBs refer to commercial loans, [in the form of bank loans, buyers' credit, suppliers' credit and securitized instruments (e.g., floating rate notes and fixed rate bonds)] availed from non-resident lenders with minimum average maturity of 3 years.

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domestically available resources and take advantage of lower rates of interest prevailing in the international financial markets. ECBs have become very popular amongst the Indian companies, during the past few years due to the limitations in the Indian debt market in the form of short maturity period and high rate of interest.

Advantages of ECBs

2. Hereinbelow have been listed some advantages of ECBs :

- The first and the foremost advantage is that ECBs are very economical source of raising funds, since the interest rate is far less as compared to the interest rate on the debt raised in India.
- Huge sum of money can be raised through ECBs from the international financial market, depending upon the risk perception of the foreign market, which is not possible in the domestic market.
- ECBs provide foreign currency funds to the corporate sector that are necessary for import of capital goods, etc.
- There is no need for credit rating. Moreover, ECBs carry fewer covenants as compared to the debt raised from Financial Institutions/Banks in India.

Disadvantages of ECBs

3. Hereinbelow have been listed some disadvantages of ECBs:

- Since the funds are raised through ECBs in foreign currency and the interest and redemption proceeds are also payable in the foreign currency, the issuing company has to hedge its foreign exchange exposure, which involves expenditure. In case the company opts to keep its foreign exchange exposure unhedged, it carries a huge risk due to fluctuation in foreign exchange rates. The RBI has also acknowledged this problem and has *vide* its circular dated October 22, 2008 instructed the banks to put in place a system for monitoring the unhedged foreign exchange exposure of small and medium enterprises.
- The funds raised through ECBs have to be utilised in accordance with the end uses permitted under the guidelines; as such these funds cannot be utilized for working capital or general corporate purposes.

Regulatory Framework For ECBs

4. The guidelines on ECBs were issued by the Ministry of Finance (ECB division) on June 30, 1997. Detailed guidelines were announced in July 1999. The said guidelines have been amended from time to time keeping in view the changes

in the international financial markets and the requirements of the Indian corporate sector.

ECBs are governed by section 6(3)(d) of the Foreign Exchange Management Act, 1999 read with Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000, which is also known as Notification No. FEMA 3/2000-RB dated May 3, 2000. The latest guidelines on ECBs have been consolidated by the RBI at one place in the Master Circular No. 07/2008-09 on 'External Commercial Borrowings and Trade Credits' dated July 1, 2008. The aforesaid circular has been issued with a sunset clause of one year. Therefore, it shall stand withdrawn on July 1, 2009 and will be replaced by an updated Master Circular. The guiding principles of the ECB policy are to maintain long maturity period, low all-in-costs and give impetus to the infrastructure and core sectors, which are essential for the overall accelerated growth of the economy. The ECB policy basically deals with the following aspects:—

- 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.

ECBs can be accessed under two routes *viz.*, (i) automatic route and (ii) approval route. ECBs for investment in real sector - industrial sector, especially infrastructure sector in India, are under the automatic route, *i.e.*, do not require RBI / Government approval. Borrowers may enter into loan agreement(s) in compliance of the ECB guidelines with the recognised lender(s), for raising ECBs under the automatic route. In case of doubt as regards eligibility to access automatic route, the applicants may take recourse to the approval route.

5. Eligible Borrowers

(I) The following entities may borrow funds through ECBs under the **automatic route**:—

- Companies registered under the Companies Act, 1956, 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. They cannot transfer or on-lend ECB funds to their sister concerns or any other unit in the Domestic Tariff Area.

(Individuals, trusts and non-profit making organisations are not eligible to raise ECBs).

(II) The following entities may borrow funds through ECBs under the **approval route**:-

- Financial institutions dealing exclusively with infrastructure or export finance such as IDFC, IL&FS, Power Finance Corporation, Power Trading Corporation, IRCON and EXIM Bank.
- Banks and financial institutions which had participated in the textile or steel sector restructuring package, as approved by the Government, are also permitted to the extent of their investment in the package.
- ECBs with minimum average maturity of 5 years can be raised by NBFCs from multilateral financial institutions, reputed regional financial institutions, official export credit agencies and international banks to finance import of infrastructure equipment for leasing to infrastructure projects.
- Special purpose vehicles, or any other entity notified by the RBI, that has been set up to finance infrastructure companies / projects.
- Multi-State Co-operative Societies engaged in manufacturing activities.
- Non-Government Organisations (NGOs) engaged in micro finance activities having satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank, which is authorised to deal in foreign exchange, can also raise ECBs. Such NGOs would be required to furnish a certificate of due diligence on 'fit and proper' status of its Board/ Management Committee from the designated Authorised Dealer Bank. Such NGOs can raise ECBs up to USD 5 million during each financial year. The designated AD bank has to ensure that the forex exposure is hedged immediately at the time of drawdown.
- Corporates in service sector, viz., hotels, hospitals and software companies can also avail

ECBs up to USD 100 million in each financial year for import of capital goods.

6. Recognised Lenders

(I) An eligible borrower can raise ECBs under the **automatic route** through any of the following recognized lenders :-

- (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions (such as IFC, ADB, CDC, etc.), (iv) export credit agencies, (v) suppliers of equipment, (vi) foreign collaborators and (vii) foreign equity holders (other than erstwhile OCBs).
- A 'foreign equity holder' in order to be eligible as a recognised lender under the automatic route would require minimum holding of equity capital in the borrower company as detailed below:
 - (a) For ECBs up to USD 5 million - equity shareholding of 25 per cent or more.
 - (b) For ECBs of more than USD 5 million - equity shareholding of 25 per cent or more and debt-equity ratio not exceeding 4:1 (i.e., the proposed ECB should not exceed four times the foreign equity directly held by the lender). It is worth noting here that for the purpose of calculation of debt-equity ratio in this case, only the paid-up equity share capital directly held by the lender is taken into account and the reserves and surplus are excluded.

(II) Under the **approval route**, ECBs can be raised from any of the following recognized lenders:

- (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions (such as IFC, ADB, CDC, etc.), (iv) export credit agencies, (v) suppliers' of equipment, (vi) foreign collaborators and (vii) foreign equity holder (other than erstwhile OCBs).

It may be noted here that an ECB can be raised from a 'foreign equity holder' subject to the condition that such 'foreign equity holder' directly holds minimum 25 per cent of the paid-up equity capital of the borrow-

ing company. In such cases, the debt-equity ratio may exceed 4:1, if the RBI permits.

- Overseas organisations and individuals may provide ECBs to Non-Government Organisations (NGOs) engaged in micro finance activities subject to the following conditions:-
 - (i) The concerned overseas organization furnishes a certificate of due diligence from an overseas bank. The said 'due diligence' certificate confirms that the lender is maintaining an account with the bank since at least last two years; the lending entity is organised as per the local laws and holds good esteem in the business / local community and there is no pending criminal action against it.
 - (ii) Similar 'due diligence' certificate has to be furnished by an individual lender. Other documents to be submitted include audited statement of accounts, income-tax return, etc. Individual lenders from countries wherein banks are not required to adhere to Know Your Customer (KYC) guidelines are not eligible to extend ECBs.

7. Quantum of Funds and Maturity Period

Automatic route

- The maximum amount that can be raised by a corporate through ECBs under the automatic route is USD 500 million or equivalent during each financial year.
- ECBs up to USD 20 million or equivalent in a financial year should have minimum

average maturity period of three years. ECBs up to USD 20 million can have call/put options, provided the minimum average maturity period of three years is complied with before exercising the call/put option.

- ECBs above USD 20 million and up to USD 500 million or equivalent should have minimum average maturity period of five years.

Approval route

In case the requirement of funds is more than USD 500 million in a financial year or it is not possible to adhere to the minimum average maturity periods given above, the concerned company has to seek prior approval of the RBI. Corporates can avail ECBs up to an additional amount of USD 250 million with an average maturity period of more than 10 years under the approval route. This limit of USD 250 million is over and above the existing limit of USD 500 million during each financial year under the automatic route. However, prepayment and call/put options are not permitted in respect of the aforesaid additional limit up to 10 years.

All-in-Cost Ceilings

8. 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. In view of the global financial turmoil and the tight liquidity conditions, which have resulted in the widening of the credit spreads in the international financial markets, the RBI has twice relaxed the all-in-cost ceilings during the past few months, *i.e.*, on September 22, 2008 and again on October 22, 2008. The revised ceilings are as under:—

Average Maturity Period	All-in-Cost ceilings over 6 months LIBOR*		
	Ceiling as on July 1, 2008	Ceiling w.e.f. September 22, 2008	Current ceiling (w.e.f. October 22, 2008)
3 years and up to 5 years	200 bps	200 bps	300 bps
More than 5 years and up to 7 years	350 bps	350 bps	500 bps
More than 7 years	350 bps	450 bps	500 bps

* For the respective currency of borrowing or applicable benchmark.

It may be noted here that the all-in-cost ceilings are same under the automatic route and the approval route. Hence, these all-in-cost ceilings for raising ECBs have to be strictly adhered to and cannot be exceeded under any circumstance.

Permitted End Uses of ECB Proceeds

9. The funds raised through ECBs can be utilised for the following purposes under the automatic route :

- Import of capital goods by new or existing production units in the industrial sector, including Small and Medium Enterprises (SME).
- Investment in infrastructure sector, which has been defined as (i) power, (ii) telecommunication, (iii) railways, (iv) roads including bridges, (v) sea port and airport, (vi) industrial parks, (vii) urban infrastructure (water supply, sanitation, and sewage projects) and (viii) mining, exploration and refining (with effect from October 8, 2008).
- Overseas direct investment in Joint Ventures (JV)/Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/WOS abroad.
- Payments to Government by telecom companies for obtaining license/permit for 3G Spectrum (allowed with effect from October 22, 2008).

In addition to the above uses under the automatic route, the ECB proceeds can also be utilised for the following purposes with the prior approval of the 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, viz., hotels, hospitals and software companies.
- The first stage acquisition of shares of public sector undertakings in the disinvestment process by the Government and also in the mandatory second stage offer to the public.

- Refinancing of an existing ECB, provided that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained.

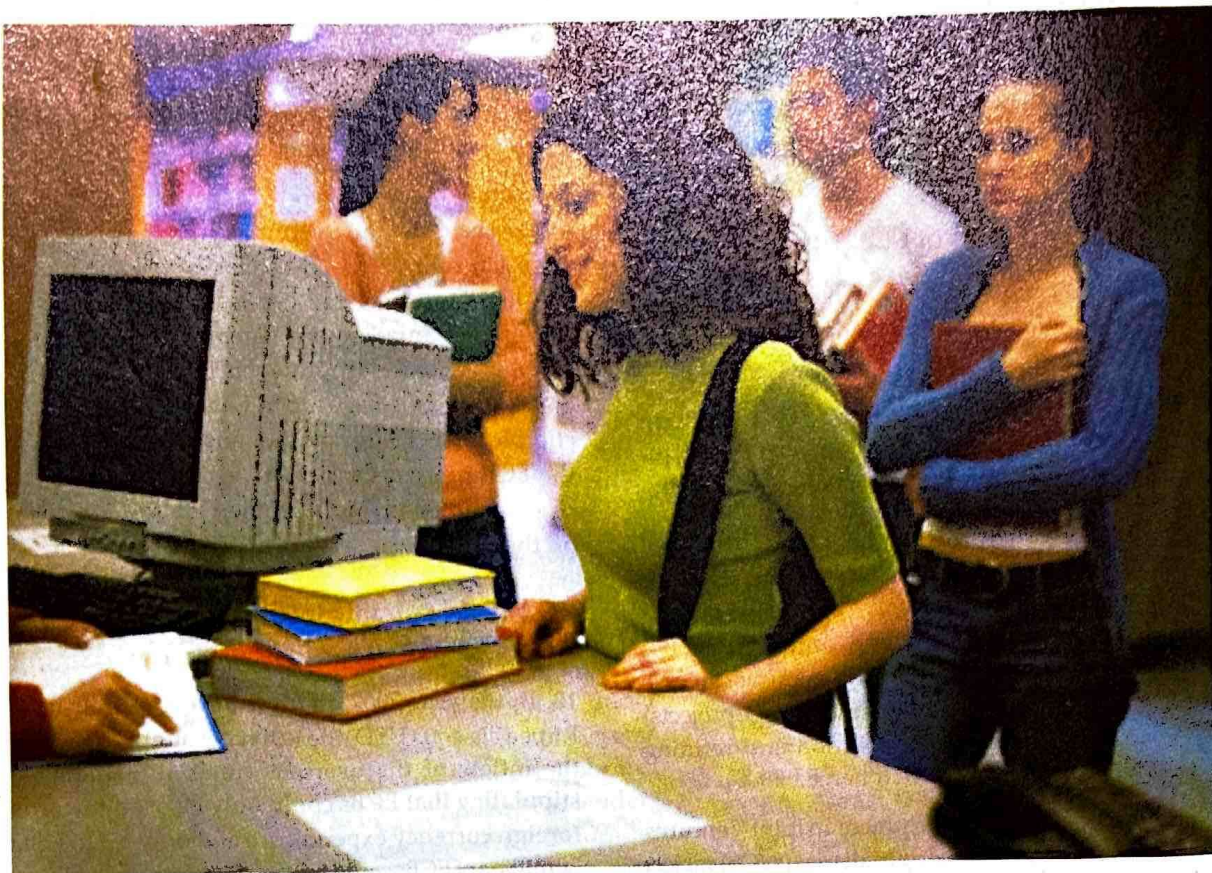
The funds raised through ECBs cannot be used, under the automatic route as well as under the approval route, for investment in real estate; on-lending; investment in capital markets; acquisition of companies or part thereof in India; working capital; general corporate purposes and for repayment of existing Rupee Loans. However, the eligible financial institutions and banks can utilise the ECB proceeds for the purpose of acquisition of companies in India, subject to the approval of the RBI.

Permissible Limit for Rupee Expenditure in India

10. In the year 2007, in view of the appreciating Rupee *vis-a-vis* USD, the RBI had sought to restrict the inflow of the overseas funds into India by stipulating that ECBs could only be used towards foreign currency expenditure and only up to USD 20 million of ECBs could be used for rupee expenditure with the prior approval of the RBI. Later on, this limit was enhanced and the corporates in the infrastructure sector were allowed to utilise ECBs up to USD 100 million and corporates in the industrial sector were allowed to utilise ECBs up to USD 50 million for Rupee expenditure in India with the prior approval of the RBI within the overall limit of USD 500 million in each financial year. The balance amount raised through ECBs has to be spent in making payments to the foreign vendors.

In view of the tight liquidity conditions and huge funding requirements of the infrastructure sector, the RBI *vide* its Circular No. RBI/2008-09/190 dated September 22, 2008 allowed the corporates in the infrastructure sector to utilise ECB proceeds up to USD 500 million per financial year for meeting rupee expenditure in India under the approval route subject to the condition that ECBs in excess of USD 100 million for Rupee expenditure shall have minimum average maturity period of 7 years. The limit of USD 50 million for corporates in the industrial sector was left untouched.

In order to ease the liquidity conditions in India, the RBI has taken a number of measures like successive



reductions in cash reserve ratio, increased ability of authorised dealers to raise funds from abroad, etc. In continuation of these measures, the RBI has *vide* its Circular No. RBI/2008-09/245 dated October 22, 2008, completely lifted the restrictions placed on the utilisation of ECB funds for Rupee expenditure in India. Now all the corporates, whether engaged in the infrastructure sector or not, are allowed to utilise full amount of USD 500 million for Rupee expenditure in India, under the automatic route. Accordingly, the requirement of minimum average maturity period of 7 years for ECBs exceeding USD 100 million for Rupee capital expenditure by the borrowers in the infrastructure sector has also been dispensed with. This amendment has been made in order to enable the corporate sector to meet its fund requirements and also to control the trend of rising interest rates in India. However, in view of the global financial turmoil and the consequent liquidity crunch in the international financial markets, it is doubtful whether the Indian corporates would be able to take full advantage of this relaxation or not.

The RBI's Master circular provides that the ECB proceeds should be parked outside India in the form of specified liquid investments till the actual requirement arises in India. However, the RBI *vide* its aforesaid circular dated October 22, 2008 has relaxed this restriction also. Now the Indian companies, that are having ECB proceeds parked outside India, can remit the funds to India for credit to their Rupee accounts with AD Category I Banks, irrespective of the fact whether there is immediate requirement or not. These amendments by the RBI in the ECB guidelines are laudable, in view of the recent global financial turmoil and the liquidity problems being faced in India. This will not only help in arresting the declining trend of Indian Rupee *vis-à-vis* US dollar but also replenish the forex reserves, which have depleted from USD 300 billion as on March 31, 2008 to USD 236.90 billion as on November 21, 2008 (decline of 21.03 per cent).

Creation of Security

11. The Master circular provides that security to be provided to the overseas lender/supplier for

securing the ECBs is left to the borrower. However, 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 May 3, 2000. Accordingly, the proposals for creation of charge on immovable assets/financial securities and issue of corporate/personal guarantees under the automatic as well as the approval route were considered by the RBI on case-to-case basis.

In order to rationalize the procedure, the RBI has issued a Circular No. RBI/2008-09/92 dated July 11, 2008 allowing the Authorised Dealers (Category - I Banks) to convey 'no-objection' under FEMA for creation of charge on immovable assets/financial securities and also for issue of corporate/personal guarantee in favour of overseas lender/security trustee to secure the ECBs. Before according 'no-objection', authorised dealers have to ensure that, (i) the underlying ECB is strictly in compliance with the extant ECB guidelines, (ii) there exists a security clause in the loan agreement requiring the borrower to create charge on immovable assets/financial securities or furnish corporate/personal guarantee, (iii) the loan agreement has been executed between the lender and the borrower, (iv) the borrower has obtained Loan Registration Number from RBI and (v) Board Resolution of the company issuing corporate guarantee.

In the event of enforcement/invocation of the charge, the immovable property will have to be sold only to a person resident in India and the sale proceeds shall be repatriated to the lender. In case the shares were pledged to secure the ECBs and the pledge has been invoked due to default in payments, the transfer of shares shall be in accordance with the extant FDI policy.

Guarantee by Banks/Financial Institutions

12. Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, financial institutions and NBFCs relating to ECBs is normally not permitted. Such applications for guaranteeing ECBs raised by small and medium enterprises are considered on merit basis subject to prudential norms. However, issuance of guarantees,

etc., in respect of ECBs by textile companies for capacity expansion and modernisation are considered by the RBI under the approval route subject to prudential norms.

Pre-payment and Refinancing

13. The designated AD banks have general permission to make remittances of instalments of principal, interest and other charges in conformity with the ECB guidelines. Pre-payment of ECBs up to USD 500 million may be allowed by the AD banks without the prior approval of the RBI subject to compliance with the stipulated minimum average maturity period, whereas amounts exceeding USD 500 million can be prepaid only after obtaining approval of the RBI.

An 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.

Applications For Approval

14. The borrowers, under the automatic route as well as the approval route, have to submit Form 83 to the Authorised Dealer, in duplicate, for allotment of Loan Registration Number (LRN). A copy of the same is to be forwarded by the designated AD to the Director, Balance of Payments Statistics Division, Department of Statistics and Information Systems (DSIM), Reserve Bank of India, Bandra-Kurla Complex, Mumbai - 400 051. The borrower can draw-down the loan only after LRN is allotted by DSIM.

For the purpose of accessing ECBs under the approval route, applicants are required to submit an application in Form ECB, through the designated Authorised Dealer Bank (AD), to the Chief General Manager-in-Charge, Foreign Exchange Department (ECB Division), Reserve Bank of India, Central Office, Mumbai - 400 001, along with the following documents (as may be relevant):—

- Copy of offer letter from the overseas lender/supplier furnishing complete terms and conditions of proposed loan/credit arrangement.
- Copy of import contract, proforma/commercial invoice/Bill of Lading.

The RBI has set up an Empowered Committee to consider proposals coming under the Approval Route.

Reporting Requirements

15. The borrowers are required to submit a monthly return in Form ECB-2, in respect of actual ECB transactions that have taken place during the previous month. In case there have not been any transactions during the previous month, a 'NIL' return has to be submitted. The aforesaid form has to be certified and forwarded by the designated AD bank so as to reach DSIM, RBI within seven working days from the close of the month.

For providing greater transparency, information with regard to the name of the borrower, amount, purpose and maturity of ECB under the automatic route as well as the approval route are put on the website of the RBI on a monthly basis with a lag of one month to which it relates.

The primary responsibility of ensuring various compliances under the ECB guidelines is on the borrower. The designated AD bank is also required to ensure that raising/utilization of ECBs is in accordance with the applicable RBI guidelines.

Conversion of ECBs Into Equity

16. Conversion of ECBs into equity shares is permitted subject to fulfilment of the following conditions :-

- The activity of the concerned company is covered under the automatic route for Foreign Direct Investment, otherwise the Government approval for foreign equity participation has been obtained.
- The foreign equity holding after conversion of ECBs into equity is within the sectoral cap, if any.
- Pricing of shares is as per SEBI/erstwhile CCI guidelines/regulations in the case of listed/unlisted companies, as the case may be.

Conversion of ECB may be reported to the RBI in the following manner: -

- (a) In case full amount of ECBs has been converted into equity shares, Form FC-GPR has to be submitted to the concerned Regional Office of RBI. In addition thereto, Form ECB-2 is also be submitted to DSIM, RBI within seven working days from the close of month. Once conversion has been reported, Form ECB-2 is not required to be filed in respect of the subsequent months.
- (b) In case of partial conversion of outstanding ECBs into equity shares, borrowers are required to report the converted portion in Form FC-GPR to the concerned Regional Office of RBI as well as in Form ECB-2 to DSIM, the RBI clearly differentiating between the converted portion and the unconverted portion. In subsequent months, the outstanding portion of ECB needs to be reported to DSIM in Form ECB-2.

Conclusion

17. The objective of ECB Regulations is to provide flexibility in borrowings to the Indian companies on the one hand and on the other hand maintain prudent limits on external borrowings. ECB is not just a three letter word but a lifeline for the Indian corporate sector. In the past few years, ECBs have proved to be very effective source of raising funds at economical cost. However, the recent global financial turmoil, liquidity crunch in the international financial markets and the depreciating Rupee have made it difficult for the corporate sector to raise funds through ECBs. This is amply clear from the fact that the funds raised through ECBs in October 2008 were USD 1.12 billion as compared to USD 2.80 billion raised in September 2008. In view of these problems, it has become necessary for the corporates to maintain a balance between the funds to be raised through ECBs and the funds from the domestic borrowings. Nevertheless, the significance of ECBs as a source of raising finance cannot be undermined.