# FEMA - EXTERNAL COMMERCIAL BORROWINGS

## Part-A (Technical aspects of ECB Master Direction)

### Difference between External Commercial Borrowing and Foreign Direct Investment

- ECB means any kind of funding other than Equity whereas, if the foreign money is used to finance the Equity Capital, it would be termed as Foreign direct investment.
- The ECB should satisfy the ECB regulations stipulated by the Government or its agencies such as RBI. The Bonds, Credit notes, Asset Backed Securities, Mortgage Backed Securities or anything of that nature are included in ECB.
- Following are not included in the ECBs:
  - Any investment made towards core capital of an organization such as equity shares, convertible preference shares or convertible debentures. All convertible into equity are covered by FDI policy.
  - Any other direct capital is not allowed in ECB.

### Objective of ECB

- Government permits the ECBs as an additional source of financing for expanding the existing capacity as well as for fresh investments
- The ECB Policy of the government seeks to emphasize the priority of investing in the infrastructure and core sectors such as power, telecom, Railways etc.

### Forms of ECB

There are totally 7 forms of ECB which are as follows:

- Buyers Credit
- Suppliers Credit
- FCCB
- Financial Lease
- Loans
- FCEB (Only through approval route)
- Securitized instruments (Floating rate notes, Fixed rate bonds, non-convertible or optionally convertible or partially convertible preference shares or debentures.

### Available routes for raising ECB

- There are 2 types of routes for raising ECB namely:
  - Automatic route
  - Approval route
- Issuance of FCEBs can be done only through approval route, (all remaining can be done through both routes)
- While the regulatory provisions are mostly similar there are some differences in the form of amount of borrowings, eligibility of borrowers, permissible end uses, etc. under 2 routes.

# Framework of Amended ECB

There are various methods through which Indian Companies may raise funds from abroad, out of which one method is by issuing ECB.

The ECB framework enables permitted resident entities to borrow from recognised non-resident entities.

The new ECB framework rationalizes the existing ECB framework by merging the existing Track I (medium term foreign currency denominated ECB) and Track II (Long term foreign currency denominated ECB) into one track as 'Foreign currency denominated ECB'.

Existing Track III (INR denominated ECB) and INR denominated Bonds (Masala Bonds) route has been merged as 'Rupee denominated ECB'.

There are 2 tracks in the ECB namely

- Foreign currency denominated ECB
- INR denominated ECB.

To improve ease of doing business in India, the RBI on 16th January 2019 notified new ECB framework.

## What are automatic and approval routes?

Approval route: Under the approval route, the prospective borrowers are required to send their requests to the Reserve Bank through their AD Banks for examination.

In a lucid way one can understand automatic and approval routes can be understood as under

Automatic route doesn't involve more authorities especially it doesn't involve RBI whereas in approval route it involves central government.

Automatic route: Foreign currency denominated ECB

## Who are eligible borrowers under ECB?

In new ECB framework, all entities eligible to receive FDI can borrow under new ECB framework irrespective of type of ECB.

**FCY denominated ECB**

All entities eligible to receive FDI can make FCY ECB.

Further, the following entities are also eligible to raise ECB.

- Port Trusts
- Units in SEZ
- SIDBI; and
- EXIM Bank of India

**INR denominated ECB**

All entities eligible to raise FCY ECB can make INR ECB.

Registered entities engaged in micro-finance activities like

- Registered Not for Profit companies
- Registered societies
- Registered trusts
- Registered cooperatives &
- Non-Government Organizations

**Author Note:** This is a key step in liberalization as previously there was a narrow list of eligible borrowers. This change is expected to open ECB avenues for a range of new borrowing entities, such as companies in a service sector

## Who are recognised lenders under ECB?

- Lenders who are resident of FATF or IOSCO compliant country.
- Like, International monetary fund or World Bank or Asian Development Bank or European Development Bank
  - Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad.
  - Foreign branches / subsidiaries of Indian banks are permitted as recognised lenders only for FCY ECB (except FCCBs and FCEBs).
- Multilateral and Regional Financial Institutions where India is a member country

## What do you mean by foreign equity holder?

Foreign equity holder means

- Direct foreign equity holder with minimum 25% direct equity holding in the borrowing entity,
- Indirect equity holder with minimum indirect equity holding of 51%, or
- Group company with common overseas parent

## What is an IOSCO compliant country?

A country whose securities market regulator is a signatory to the International Organisation of Securities Commission's (IOSCO'S) Multilateral Memorandum of Understanding or a signatory to bilateral Memorandum of Understanding with the SEBI for information sharing arrangements.

## What is FATF compliant Country?

A country that is a member of the Financial Action Task Force (FATF) or a member of a FATF-Style Regional Body; and should not be a country identified in the public statement of the FATF as

- A jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or
- 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

## What is FCEB and its relation with ECB?

Every thing is same as FCCB except for the case where the FCEB converts into shares of another company rather than the company issuing the bond.

## What is minimum average maturity period generally?

MAMP for ECB will be 3 years

# What is minimum average maturity period in specific cases?

| Category | MAMP |
|---|---|
| 1. ECB raised by manufacturing companies up to USD 50 million or its equivalent per financial year. | 1 year |
| 2. ECB raised from foreign equity holder for working capital purposes, general corporate purposes or for repayment of Rupee loans | 5 years |
| 3. ECB raised for<br>(a) Working capital purposes or general corporate purposes.<br>(b) On-lending by NBFCS for working capital purposes or general corporate purposes. | 10 years |
| 4. ECB raised for<br>(a) Repayment of Rupee loans availed domestically for capital expenditure<br>(b) On-lending by NBFCs for the same purpose | 7 years |
| 5. ECB raised for<br>(a) Repayment of Rupee loans availed domestically for purposes other than capital expenditure<br>(b) On-lending by NBFCs for the same purpose | 10 years |
| For the categories mentioned at (b) to (e)<br>(a) ECB cannot be raised from foreign branches / subsidiaries of Indian banks.<br>(b) The prescribed MAMP will have to be strictly complied with under all circumstances. | |

# ANALYSIS ON MAMP (a) Simplified view point

| Raised by (Borrower) | Raised from (Lender) | Raised up to/for (Time/Purpose) | MAMP |
|---|---|---|---|
| Manufacturing Companies | Eligible Lender | Up to 50 million or its equivalent per FY | 1 Year |
| Eligible borrower | Foreign equity holder | (a) General corporate purposes<br>(b) Repayment of rupee loans | 5 Years |
| Eligible borrower | Eligible Lender except foreign branches / overseas subsidiaries of Indian banks | Working capital purposes or General corporate purposes. | 10 Years |
| | | Repayment of Rupee loans availed domestically for capital expenditure. | 7 Years |
| | | Repayment of Rupee loans availed domestically for purposes other than capital expenditure. | 10 Years |
| NBFC | Eligible Lender except foreign branches / overseas subsidiaries of Indian banks | Working capital purposes or General corporate purposes. | 10 Years |
| | | Repayment of Rupee loans availed domestically for capital expenditure. | 7 Years |
| | | Repayment of Rupee loans availed domestically for purposes other than capital expenditure. | 10 Years |

# ANALYSIS ON MAMP

# (b) Illustration on MAMP

**Name of Company: KPL LTD** **Loan Amount: $ 2 million**

| Date of Drawal / repayment (MM/DD/YYYY) | Drawal | Repayment | Balance | No. of Days** balance with the borrower | Product = (Col.4 x Col. 5)/(Loan amount x 360) |
|---|---|---|---|---|---|
| 05.11.2015 | 0.75 | | 0.75 | 24 | 0.0250 |
| 06.05.2015 | 0.50 | | 1.25 | 85 | 0.1476 |
| 08.31.2015 | 0.75 | | 2.00 | 477 | 1.3250 |
| 12.27.2016 | | 0.20 | 1.80 | 180 | 0.4500 |
| 06.27.2017 | | 0.25 | 1.55 | 180 | 0.3875 |
| 12.27.2017 | | 0.25 | 1.30 | 180 | 0.3250 |
| 06.27.2018 | | 0.30 | 1.00 | 180 | 0.2500 |
| 12.27.2018 | | 0.25 | 0.75 | 180 | 0.1875 |
| 06.27.2019 | | 0.25 | 0.50 | 180 | 0.1250 |
| 12.27.2019 | | 0.25 | 0.25 | 180 | 0.0625 |
| 06.27.2020 | | 0.25 | 0.00 | | **0.00** |
| **Average maturity** | | | | | **3.2851 years** |

# ANALYSIS ON MAMP

# (c) Yet Another Illustration on MAMP

**Name of Company: KPL LTD** — **Loan Amount: $ 2 million**

| Date of drawal/ repayment (MM/DD/YYYY) | Drawal | Repayment | Balance | No. of Days** balance with the borrower | Product = (Col.4 x Col. 5)/ (Loan amount x 360) |
|---|---|---|---|---|---|
| 11.05.2015 | 0.75 | | 0.75 | 24 | 0.0250 |
| 05.06.2015 | 0.50 | | 1.25 | 85 | 0.1476 |
| 30.08.2015 | 0.50 | | 1.75 | 120 | 0.2917 |
| 31.12.2015 | 0.25 | | 2.00 | 177 | 0.4917 |
| 27.06.2016 | | 0.25 | 1.75 | 180 | 0.4375 |
| 27.12.2016 | | 0.25 | 1.50 | 180 | 0.3750 |
| 27.06.2017 | | 0.20 | 1.30 | 180 | 0.3250 |
| 27.12.2017 | | 0.20 | 1.10 | 180 | 0.2750 |
| 27.06.2018 | | 0.20 | 0.90 | 180 | 0.2250 |
| 27.12.2018 | | 0.20 | 0.70 | 180 | 0.1750 |
| 27.06.2019 | | 0.20 | 0.50 | 180 | 0.1250 |
| 27.12.2020 | | 0.25 | 0.25 | 180 | 0.0625 |
| 27.06.2021 | | 0.25 | 0.00 | | |
| **Average maturity** | | | | | **2.956 years** |

# What is the All-in-Cost of ECB?

**The All-in-Cost ceiling per annum – Benchmark rate plus 450 bps spread**

All-in-cost includes

- Interest cost
- Fees
- Expenses
- Charges
- Guarantee fees
- ECA Charges [ECA = Export Credit Agency]

**Notes:**

(1) AIC doesn’t include Commitment fees and Withholding tax payable in INR.

(2) In the case of fixed rate loans, the swap cost plus spread should not be more than the floating rate plus the applicable spread.

(3) For FCCBs, the issue related expenses should not exceed 4 per cent of the issue size and in case of private placement, these expenses should not exceed 2 per cent of the issue size, etc.

# What are the End-Use Prescriptions under ECB?

**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 in case of ECB mentioned at [b] and [c] above
- General corporate purposes, except in case of ECB mentioned at [b] and [c] above
- Repayment of Rupee loans, except in case of ECB mentioned at [d] and [e] above.
- On-lending to entities for the above activities, except in case of ECB raised by NBFCs as given at (c), [d] and [e] above

# Illustrations:

| | |
|---|---|
| Can ECB be availed of for making equity investment domestically or buying goodwill? | **No.** Equity investment either directly or indirectly (through purchase of goodwill] is not permitted. |
| Can ECB be availed of for making contribution in an LLP? | **No,** it is not permitted. |

| | |
|---|---|
| Can an eligible borrower raise fresh foreign currency ECB for repayment of existing Rupee denominated ECB? | Refinancing of Rupee denominated ECB with Foreign Currency denominated ECB is not permitted.<br>**Note**: Refinancing is the replacement of an existing debt obligation with another debt obligation under different terms. |
| Can ECB proceeds be used by eligible resident borrowers for investment in their overseas JV/WOS as per the extant overseas investment guidelines? | **Yes**. ECB proceeds can be utilized for overseas investment as permitted under the overseas investment guidelines. |
| Is on-lending treated as working capital for borrowers who are engaged in the business of on-lending?<br>**Note**: On-lending means lending the borrowed money to a 3rd party. | For the purpose of ECB, on-lending by borrowers who are engaged in the business of on-lending is not treated as working capital. Additionally, the borrowers shall need to adhere to the guidelines issued by the concerned sectoral or prudential regulator in this regard. |

# What are the limits on Borrowing?

Under the aforesaid framework, all eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year under the automatic route.

Further, in case of FCY denominated ECB raised from direct foreign equity holder, ECB liability-equity ratio for ECB raised under the automatic route cannot exceed 7:1.

**Exception**:

This ratio will not be applicable if the outstanding amount of all ECB, including the proposed one, is up to USD 5 million or its equivalent.

**Note**:

**ECB liability-Equity ratio**: For the purpose of ECB liability-equity ratio, ECB amount will include all outstanding amount of all ECB (other than INR denominated) and the proposed one while equity will include the paid-up capital and free reserves (including the share premium received in foreign currency) as per the latest audited balance sheet. Both ECB and equity amounts will be calculated with respect to the foreign equity holder. Where there is more than one foreign equity holder in the borrowing company, the portion of the share premium in foreign currency brought in by the lender(s) concerned shall only be considered for calculating the ratio. The ratio will be calculated as per latest audited balance sheet.

# Forms of ECB

Forms of ECB are different for both FCY denominated and INR denominated ECB and they are as follows:

| In case of FCY denominated ECB | In case of INR denominated ECB |
|---|---|
| Loans (Banks or otherwise) | Loans (Banks or otherwise) |
| Floating rate bonds | Floating rate bonds |
| Fixed rate bonds | Fixed rate bonds |
| Trade Credits | Preference shares |
| FCCB | Trade Credits > 3 years |
| FCEB | FCCB |
| Finance lease | FCEB |
| | Finance lease |
| | **Note:** Plain vanilla Rupee denominated bonds issued overseas. |

# Dealing with Exchange Rates

In case of FCY denominated ECB

Conversion shall be made at the exchange rate prevailing on the date of the agreement (May agree at a lower rate, if mutually consented

In case of FCY denominated ECB

The exchange rate shall be the rate prevailing on the date of settlement

# Hedging Provision

**In case of INR denominated ECB**

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.

**In case of FCY denominated ECB**

The following aspects shall be considered:

| Particulars | Details |
|---|---|
| Coverage | ▪ The ECB borrower will be required to cover the principal as well as the coupon through financial hedges.<br>▪ The financial hedge for all exposures on account of ECB should start from the time of each such exposure (i.e. the day the liability is created in the books of the borrower). |
| Tenor and roll-over | A minimum tenor of one year for the 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 the ECB. |
| Natural hedge | ▪ 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.<br>▪ For this purpose, an ECB may be considered naturally hedged if the offsetting exposure has the maturity/cash flow within the same accounting year.<br>**Note**: Any other arrangements/ structures, where revenues are indexed to foreign currency will not be considered as a natural hedge. |
| Special provisions for infrastructure space companies | ▪ Infrastructure space companies shall have a Board approved risk management policy.<br>▪ Further, such companies are required to mandatorily hedge 70 per cent of their ECB exposure in case the average maturity of the ECB is less than 5 years.<br>▪ The designated AD Category-I bank shall verify that 70 per cent hedging requirement is complied with during the currency of the ECB and report the position to RBI through Form ECB 2.<br>**Infrastructure space company means**: Companies in the infrastructure sector, Non-Banking Finance Companies undertaking infrastructure financing, Holding Companies/ Core Investment Companies undertaking infrastructure financing, Housing Finance Companies regulated by National Housing Bank and Port Trusts. |

# Change in currency of borrowing

- **In case of FCY denominated ECB**
  - Change of currency of ECB from one freely convertible foreign currency to any other freely convertible foreign currency as well as to INR is freely permitted.
- **In case of INR denominated ECB**
  - Change of currency from INR to any freely convertible foreign currency is not permitted

# Special dispensations under ECB frame work

## PART A: in case of oil marketing companies

- **Applicable to whom:** Public Sector Oil Marketing Companies
  - Indian Oil Corporation Ltd (IOCL)
  - Hindustan Petroleum Corporation Ltd (HPCL)
  - Bharat Petroleum Corporation Ltd (BPCL)
  - Numaligarh Refinery Ltd (NRL)
  - Mangalore Refinery & Petrochemicals Ltd (MRPL)
  - Bharat Oman Refineries Ltd (BORL) and
- **Purpose:** For Working capital purposes
- **MAMP:** 3 years
- **ECB from whom?:** All recognised lenders
- **Which route?:** Automatic route
- **Overall ceiling:** $ 10 billion
- **Overriding effect:** This dispensation shall apply notwithstanding the end-use restrictions, Hedging requirements and Limits and leverage

**Note:** Reliance petroleum ltd, Essar, Shell are private oil marketing companies and thus are not governed by this dispensation

## PART B: ECB for startups

- **Eligibility:** An entity recognised as a Start up by the Central Government as on date of raising ECB
- **Recognised lender:** Lender / investor shall be a resident of a FATF compliant country. However, foreign branches/subsidiaries of Indian banks and overseas entity in which Indian entity has made overseas direct investment as per the extant Overseas Direct Investment Policy will not be considered as recognised lenders under this framework
- **MAMP:** Minimum average maturity period will be 3 years