EXTERNAL COMMERCIAL BORROWINGS & TRADE CREDITS

FEMA guidelines provide Indian companies to access funds from abroad by following methods:-

a) External Commercial Borrowings (ECB):- It refers to commercial loans in the form of bank loans, buyers' credit, suppliers' credit, securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares) availed of from non-resident lenders with a minimum average maturity of 3 years.

b) Foreign Currency Convertible Bonds (FCCBs):- It refers to a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency.

c) Preference shares- (i.e. non-convertible, optionally convertible or partially convertible). These instruments are considered as debt and denominated in Rupees and rupee interest rate will be based on the swap equivalent of LIBOR plus spread.

d) Foreign Currency Exchangeable Bond (FCEB):- FCEB is a bond expressed in foreign currency, the principal and interest in respect of which is payable in foreign currency, issued by an Issuing Company and subscribed to by a person who is a resident outside India, in foreign currency and exchangeable into equity share of another company, to be called the Offered Company, in any manner, either wholly, or partly or on the basis of any equity related warrants attached to debt instruments. The FCEB may be denominated in any freely convertible foreign currency.

ECB can be accessed under two routes, viz.:-

A) **Automatic Route**:-

- Access of funds under Automatic Route does not require RBI/GOI approval. Corporate including hotel, hospital, software sectors (registered under the Companies Act 1956) and Infrastructure Finance Companies (IFCs) except financial intermediaries such as banks, FIs, HFCs, and NBFCs are eligible to raise ECB. Units in SEZs are allowed to raise ECB for their captive requirements. NGOs engaged in micro finance activities are eligible to avail of ECB (subject to certain conditions). **Trusts and Non-Profit making organizations are not eligible to raise ECB.**

- ECB can be raised by borrowers from internationally recognized sources such as (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions (such as IFC, ADB, CDC, etc.)/ Regional Financial Institutions and Government owned Development Financial Institutions, (iv) Export Credit Agencies, (v)

Suppliers of Equipments, (vi) Foreign Collaborators and (vii) Foreign Equity Holders (other than erstwhile Overseas Corporate Bodies).

- Overseas organizations and individuals may provide ECB to NGOs engaged in micro finance activities subject to complying with some safeguards outlined in the RBI circular.

Amount & Maturity

Category	Amount (USD) per unit/ per financial year	Average Maturity
Corporate other than those in services sector viz. hotel, hospital, and software.	750 Mn. or equivalent	*Upto USD 20 Mn. of equivalent in a financial year – 3 years (Can have put/call option) *Above USD 20 Mn. and upto 750 Mn. – 5 years
Corporate in service sector i.e. hotel, hospital, and software (Proceeds of ECBs should not be used for acquisition of Land)	Upto 200 Mn. or equivalent	--Same --
NGOs engaged in micro finance activities	10 Mn. or equivalent (Forex exposure to be fully hedged)	--Same --

All-in-cost ceilings

- 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. The payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost.

Average Maturity Period	All-in-cost ceiling over 6 months LIBOR*
Three years and up to five years	350 bps
More than 5 years	500 bps

* for the respective currency of borrowing or applicable benchmark

End use

- ECBs can be raised for investment (import of capital goods as classified by DGFT in Foreign Trade Policy (FTP)) in new projects, modernization/expansion of existing units in industrial and service sectors including infrastructure sector.

- Overseas direct investment in Joint Ventures (JV)/Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/ WOS abroad.
- First stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public under the Government's disinvestment programme of PSU shares.

- NBFCs categorized as Infrastructure Financing Companies (IFC) are permitted to avail ECBs including outstanding in existing ECBs upto 50% of their owned funds under Automatic Route for on lending to infrastructure sector and beyond 50% of owned funds under Approval Route.
- For lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building by NGOs engaged in micro finance activities, etc.

Restrictions

- Utilization for on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate, investment in real estate sector, for working capital, general corporate purpose and repayment of existing Rupee loans.

- Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, FIs and NBFCs from India relating to ECB.

- The borrower has the option to offer security against the ECB. Creation of charge over immoveable assets and financial securities, such as shares, in favour of the overseas lender is subject to FEMA regulations and ECB guidelines.

Other provisions

- Borrowers are permitted to either park the ECB proceeds abroad or to remit these funds to India. ECB proceeds parked in various liquid assets as per regulation can be invested in Treasury Bills and other monetary instruments of one year maturity and having minimum rating etc. The funds may be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

- ECB funds may also be repatriated to India for credit to the borrowers' Rupee accounts with banks (AD) in India, pending utilization for permissible end-uses.

- Upon compliance of minimum maturity period applicable to the loan, prepayment of ECB up to USD 500 Mn. can be made by AD banks without prior approval of RBI.

- An existing ECB may be refinanced by raising a fresh ECB subject to the fresh one raised is at a lower all-in-cost and the outstanding maturity of the original ECB is maintained.

- The designated AD bank has the general permission to make remittances of instalments of principal, interest and other charges in conformity with the ECB guidelines.

Borrowers are required to enter into an agreement with recognized lender in compliance of ECB guidelines without RBI approval and obtain a Loan Register Number (LRN) from RBI before drawing the ECB as per the procedure laid down in the policy.

B. <u>APPROVAL ROUTE</u>

Proposals falling under the category include:-

a) On lending by the EXIM Bank for specific purposes (case to case basis).
b) Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government.
c) ECB with minimum average maturity of 5 years by NBFC to finance import of infrastructure equipment for leasing to infrastructure projects.
d) Infrastructure Finance Companies (IFCs) i.e. NBFCs, categorized as IFCs, by RBI (beyond 50% of their owned funds) for on-lending to the infrastructure sector as defined under the ECB policy and subject to compliance of certain stipulations.
e) Foreign Currency Convertible Bonds (FCCBs) by Housing Finance Companies.
f) Special Purpose Vehicles (SPV) or any other entity notified by the RBI, set up to finance infrastructure companies / projects exclusively.
g) Financially solvent Multi-State Co-operative Societies engaged in manufacturing.
h) SEZ developers for providing infrastructure facilities within SEZ.
i) Eligible Corporate under automatic route other than in the services sector viz. hotels, hospitals and software sector can avail of ECB beyond USD 750 million per financial year.
j) Corporate in the service sector for availing ECB beyond USD 200 Mn. per financial year.
k) Cases falling outside the purview of the automatic route limits and maturity indicated, etc.

ECB can be availed from the recognized lenders as explained under Automatic Route.

<u>Amount and Maturity</u>

- Eligible borrowers under the automatic route other than corporate in the services sector viz. hotel, hospital and software can avail of ECB beyond USD 750 or equivalent per financial year.
- Corporate in the service sector beyond ECB 200 Mn. for permissible end-uses.

<u>All-in-cost</u>

All-in-cost ceilings are the same as that of ECBs under Automatic Route.

<u>End-use</u>

- End-use would be the same for the funds raised under Automatic Route.
- The payment by eligible borrowers in the Telecom sector, for spectrum allocation may, initially, be met out of Rupee resources by the successful bidders, to be refinanced with a

long-term ECB, under the approval route, subject to certain conditions outlined in the Circular.

Restrictions

Restrictions are the same as that of ECB under Automatic Route.

Other Provisions:-

- Indian Infrastructure companies (as defined under the extant ECB policy) are permitted to import capital goods by availing of short term credit (including buyers' / suppliers' credit) in the nature of 'bridge finance', under the approval route, subject to the conditions prescribed.

- Airline companies registered under the Companies Act, 1956 and possessing scheduled operator permit license from DGCA for passenger transportation are eligible to avail of ECB for working capital with a minimum average maturity period of three years within the overall ceiling of USD one billion for the entire civil aviation sector and the individual maximum permissible ceiling of USD 300 million. The liability should be extinguished from foreign exchange earnings of the companies only.

- Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, FIs and NBFCs from India relating to ECB in case of SME as also for facilitating capacity expansion and technological upgradation in Indian Textile industry can be considered on merit subject to prudential norms.

- The borrower has the option to offer security against the ECB. Creation of charge over immoveable assets and financial securities, such as shares, in favour of the overseas lender is subject to FEMA regulations and ECB guidelines.

- Borrowers are permitted to either park the ECB proceeds abroad for foreign currency expenditure pending utilization or to remit these funds to India for rupee expenditure pending utilization. ECB proceeds parked abroad can be utilized in various liquid assets as per regulation, and for investment in Treasury Bills and other monetary instruments of one year maturity and having minimum rating etc. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

- Upon compliance of minimum maturity period applicable to the loan, prepayment of ECB up to USD 500 Mn. can be made by AD banks without prior approval of RBI. Pre-payment of ECB for amounts exceeding USD 500 Mn. would be considered by the Reserve Bank under the Approval Route.

- 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.

- The designated AD bank has the general permission to make remittances of instalments of principal, interest and other charges in conformity with the ECB guidelines.

Foreign Currency Exchangeable Bonds

- The Issuing Company shall be part of the promoter group of the Offered Company and shall hold the equity share/s being offered at the time of issuance of FCEB. The Offered Company shall be a listed company, which is engaged in a sector eligible to receive FDI and eligible to issue or avail of FCCB or ECB.

- Entities complying with the FDI policy and adhering to the sectoral caps at the time of issue of FCEB can subscribe to FCEB. Prior approval of the Foreign Investment Promotion Board, wherever required is to be obtained.

- An Indian company, which is not eligible to raise funds from the Indian securities market, including a company which has been restrained from accessing the securities market by the SEBI **are not be eligible to issue FCEB**. Entities prohibited to buy, sell or deal in securities by the SEBI **will not be eligible to subscribe to FCEB**.

End Use

- The proceeds of FCEB may be invested by the issuing company overseas by way of direct investment including in Joint Ventures or Wholly Owned Subsidiaries abroad subject to the existing guidelines on overseas investment in Joint Ventures / Wholly Owned Subsidiaries.

- The proceeds of FCEB may be invested by the issuing company in the promoter group companies which may utilize the proceeds in accordance with end-uses prescribed under the ECB policy.

- The promoter group company receiving such investments **will not be** permitted to utilize the proceeds for investments in the capital market or in real estate in India.

All-in-cost: The rate of interest payable on FCEB and the issue expenses incurred in foreign currency shall be within the all-in-cost ceiling as specified by RBI under the ECB policy.
Other provisions:

- Minimum maturity of FCEB shall be five years. The exchange option can be exercised at any time before redemption. While exercising the exchange option, the holder of the FCEB shall take delivery of the offered shares. **Cash (Net) settlement of FCEB shall not be permissible.**

- The proceeds of FCEB may be retained and/or deployed overseas by the issuing / promoter group companies in accordance with the policy for the ECB or repatriated to India for credit to the borrowers' Rupee accounts with banks in India pending utilization for permissible end-uses.

- Issuance of FCEB requires prior approval of the RBI under the Approval Route for raising ECB.

TAKE-OUT FINANCE THROUGH ECB

- Existing guidelines **do not** permit refinancing of domestic Rupee Loans with ECB with the exception of infrastructure sector for which Take-out financing through ECB is presently available to eligible corporate borrowers who availed Rupee Loans from domestic banks for development of new projects in sea port and airport, roads including bridges and power sectors. The Scheme is subject to certain conditions viz.

a) The borrower should have a tripartite agreement with domestic banks and overseas recognized lenders for either a conditional or unconditional take-out of the loan within three years of the scheduled Commercial Operation Date (COD). The scheduled date of occurrence of the take-out should be clearly mentioned in the agreement.
b) The loan should have a minimum average maturity period of seven years.
c) The domestic bank financing the infrastructure project should comply with the extant prudential norms relating to take-out financing.
d) The fee payable, if any, to the overseas lender until the take-out shall not exceed 100 bps per annum.
e) On take-out, the residual loan agreed to be taken- out by the overseas lender would be considered as ECB and the loan should be designated in a convertible foreign currency and all extant norms relating to ECB should be complied with.
f) Domestic banks / Financial Institutions will not be permitted to guarantee the take-out finance, etc.

Compliance with ECB Guidelines

The primary responsibility rests with the borrower as regards and ECB raised/utilized and they are in conformity with the ECB guidelines/RBI regulations/directions. Any contravention of these would attract penal action under FEMA.

TRADE CREDITS FOR IMPORTS INTO INDIA

- Trade Credits' (TC) such as suppliers' credit or buyers' credit refer to credits extended for imports directly by the overseas supplier, bank and financial institution for maturity of less than three years.
- Suppliers' credit refers to credit extended by the overseas supplier for imports into India whereas the buyers' credit refers to loans for payment of imports into India arranged by the importer from a bank or financial institution outside India for maturity of **less than 3 years**.

- Suppliers' credit and buyers' credit for 3 years and above come under the category of ECB and governed by ECB guidelines.

Amount/Maturity/All-in-cost/Guarantee

- Banks (AD) are permitted to approve trade credits for imports into India upto USD 20 Mn. per import permissible under FTP with maturity period up to one year. For capital goods, the trade credits can be permitted upto USD 20 Mn. with maturity period of more than one year and less than 3 years (from the date of shipment).

- No roll-over/extension will be permitted beyond the permissible period and banks are not authorized to approve trade credit exceeding USD 20 Mn. per import transaction.

- All-in-cost ceilings over 6 months' LIBOR for maturity period upto one year and more than one year but less than three years would be **350 bps for the respective currency** of credit or applicable bench mark.

- **Banks are permitted** to issue LC/Letter of Undertaking (LOU)/Letter of Comfort (LOC)/ in favour the overseas supplier, bank and financial institution upto USD 20 Mn. per import of goods other than capital goods and for capital goods upto 3 years subject to prudential norms.

- Banks are required to report the details of approvals, drawal, utilization, repayment, etc. of trade credits granted by branches in a consolidated statement and issuance of LC/LOU/LOC/guarantee by the branches in a consolidated statement on monthly and at quarterly intervals respectively to RBI.

(Source: RBI M. Circular)

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