EXTERNAL COMMERCIAL BORROWINGS BY INDIAN COMPANIES MADE EASY

Introduction

On November 30, 2015, the Reserve Bank of India (the "**RBI**") revamped the regime governing external commercial borrowings ("**ECBs**") by Indian companies and introduced a revised framework (the "**Revised Framework**"). The Revised Framework significantly relaxes the rules on permitted lenders, rupee denominated borrowings ("**RDBs**") and long term foreign currency denominated borrowings ("**LTBs**"). The Revised Framework will become effective on the date it is published under the Foreign Exchange Management Act, 1999 (which is imminent), and it shall then supersede the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000, (the "**ECB Regulations**").

This update discusses the key highlights of the Revised Framework.

Key Highlights of the Revised Framework

Under the Revised Framework, the RBI has created three categories of ECBs based on the term of the loan, the currency and the minimum average maturity period ("**Maturity Period**"). This is a complete change from the ECB Regulations, under which ECBs could be availed under the automatic route or the approval route depending on the Maturity Period, the type of lender, the type of borrower and the use of the funds.

*Medium Term Foreign Currency Denominated ECB with a Maturity Period of three (3) to five (5) years ("**Track I**")*

- Amount: Under Track I, an ECB up to US$50 million can have a Maturity Period of three (3) years, and an ECB beyond US$50 million can have a maturity period of five (5) years. Previously, an ECB up to US$20 million could have a Maturity Period of only three (3) years.

- Eligible Borrowers: The list of eligible borrowers has been narrowed down for ECBs under Track I. Eligible borrowers under Track I are companies in the manufacturing and software development sectors, shipping and airlines companies, the Small Industries Development Bank of India (SIDBI), companies or units in Special Economic Zones ("**SEZs**") and with the RBI's permission, the Export Import Bank of India (the "**EXIM Bank**").

- Recognized Lenders: International banks; multilateral, regional and government owned financial institutions; export credit agencies; suppliers of equipment; foreign equity holders (which include direct foreign equity holders with a minimum 25% direct equity holding in the borrowing entity, or indirect equity holders with a minimum indirect equity holding of 51% in the borrowing entity, or a group company having a common overseas parent); overseas branches or subsidiaries of Indian banks (subject to applicable prudential norms); international capital markets investors; overseas long term investors such as: (a) prudentially regulated financial entities; (b) pension funds; (c) insurance companies; (d) sovereign wealth funds; and (e) financial institutions located in international financial service centers in India, are recognized lenders under Track I. The Revised Framework introduces long term lenders like pension funds and insurance companies as lenders in addition to those listed under the ECB Regulations, thereby adding to the pool of recognized lenders under Track I.

- All-in-cost Ceiling: The all-in-cost ceiling (i.e., the total cost that an Indian borrower pays under an ECB to a foreign lender) for ECBs with a Maturity Period of three (3) to five (5) years is three hundred (300) basis points per annum over the six (6) month London Inter Bank Offered Rate ("**LIBOR**") or applicable benchmark for a specific currency. For ECBs with a Maturity Period of more than five (5) years, it is four hundred and fifty (450) basis points per annum over the six (6) month LIBOR or applicable benchmark for a specific currency. It has also been specified that penal interest, if any, payable on a default or breach of covenants should not be more than 2% over and above the contracted rate of interest. The all-in-cost ceiling has been reduced. Previously, it was three hundred and fifty (350) basis points over the six (6) month LIBOR for ECBs with a Maturity Period of between three (3) and five (5) years and five hundred (500) basis points over the six (6) month LIBOR for ECBs with a Maturity Period of more than five (5) years.

- Permitted end-uses of ECB proceeds: The permitted end uses under the Revised Framework remain largely the same as under the ECB Regulations. In addition to the existing permitted end uses, ECBs may be availed by shipping and airline companies for import of vessels and aircrafts, respectively, and for payment of towards capital goods already shipped/imported but not paid for. However, ECBs for import of second hand goods as prescribed and for on-lending by the EXIM Bank shall be permitted only with prior RBI approval.

Furthermore, ECBs can be availed for general corporate purposes, including working capital, if the ECB is raised from foreign equity holders (which include direct foreign equity holders with a minimum 25% direct equity holding in the borrowing entity, or indirect equity holders with a minimum indirect equity holding of 51% in the borrowing entity, or a group company having a common overseas parent), and the ECB has a Maturity Period of five (5) years. This is a significant change from the position before, where an ECB could be raised for general corporate purposes only if the Maturity Period was seven (7) years and certain other conditions were fulfilled.

However, ECBs are not permitted for working capital in the civil aviation sector, for repayment of rupee loans/fresh capital expenditure by companies with consistent foreign exchange earnings under the US$10 billion scheme, or in the low cost affordable housing segment under the Revised Framework.

Entities may raise ECBs for the above mentioned end uses under the ECB Regulations until March 31, 2016, provided the agreement in respect of the loan is signed and the loan registration number is obtained before the date the Revised Framework comes into effect.

*LTBs with an AM of ten (10) years ("**Track II**")*

- Amount and Maturity Period: Under Track II, the Maturity Period of an ECB will be ten (10) years irrespective of the amount of the ECB. Therefore, eligible borrowers (listed below) will qualify under Track II only if the ECB has a Maturity Period of ten (10) years.

- Eligible Borrowers: Eligible borrowers under Track II include eligible borrowers listed under Track I, companies in the infrastructure sector, holding companies, core investment companies, real estate infrastructure trusts ("**REITs**") and infrastructure investment trusts ("**INVITs**"). This will open the doors for REITs and INVITs to raise funds, which is much needed, given the paucity of funding in this area.

- Recognized Lenders: All eligible lenders listed under Track I (except for overseas branches and subsidiaries of Indian banks) will be able to disburse Track II ECBs.

- All-in-cost Ceiling: The maximum spread over the LIBOR can be five hundred (500) basis points per annum and the remaining conditions shall be as prescribed under Track I. Having a high all-in-cost ceiling for long term ECBs is expected to result in the availability of long term funds important for India's infrastructure requirements.

- Permitted end-uses: ECBs under Track II may be availed for all purposes except: (a) real estate activities; (b) investments in the capital markets; (c) use of the proceeds for equity investments domestically; (d) on-lending to other entities with any of the above objectives; and (e) the purchase of land. Also, holding companies can use ECB proceeds for providing loans to their infrastructure special purpose vehicles. The Revised Framework prescribes only a negative list of permitted end uses for LTBs, which will enable borrowers (especially infrastructure companies) to raise long term funds.

*RDBs with a Maturity Period of three (3) to five (5) years ("**Track III**")*

- Amount and Maturity Period: The amount of the ECB and the Maturity Period under Track III will be the same as under Track I.

- Eligible Borrowers: All eligible borrowers under Track II, non-banking financial companies ("**NBFCs**") and eligible NBFC-Micro Finance Institutions ("**MFIs**"), not for profit companies registered under the Companies Act 1956 and/or 2013, societies, trusts and cooperatives registered under central or state statutes, non-government organizations engaged in microfinance activities, companies engaged in supporting infrastructure, companies providing logistics services and miscellaneous services (including research development and training), and developers of SEZs and national manufacturing and investment zones ("**NMIZs**") will be eligible to borrow under Track III. New categories of eligible borrowers like logistics service companies have been expressly included in the Revised Framework under Track III.

- Recognized Lenders: All eligible lenders listed under Track I (except for overseas branches and subsidiaries of Indian banks) will be able to grant ECBs under Track III. Further, NBFCs-MFIs, other eligible MFIs, not for profit companies and non-governmental organizations will be able to avail ECBs from prescribed eligible overseas organizations and individuals.

- All-in-cost Ceiling: The all-in-cost ceiling will be in accordance with market conditions, and no artificial limits have been imposed.

- Permitted end-uses: ECBs may be availed for all purposes except: (a) real estate activities; (b) investments in capital markets; (c) use of the proceeds for equity investments domestically; (d) on-lending to other entities with any of the above objectives; and (e) the purchase of land. However, certain restrictions have been placed on the permitted end-use of ECBs in case of NBFCs, developers of SEZs and NMIZs, NBFC-MFIs, other eligible MFIs, non-governmental organizations, and not for profit companies registered under the Companies Act 1956 or 2013.

Some Other Highlights

- Limits: ECBs up to the limits listed below can be raised by eligible entities under the automatic route in each financial year under the three tracks.

- Up to US$750 million for companies in the infrastructure and manufacturing sectors;

- Up to US$200 million for companies in the software development sector;

- Up to US$100 million for entities engaged in microfinance activities; and

- Up to US$500 million or its equivalent for other entities.

Separate limits have been specified for issuance of RTBs overseas. The limits of borrowings set out in the ECB Regulations have been consolidated.

- The Revised Framework introduces certain additional conditions as regards the ECB currency and does not, *inter alia,* permit the change of currency from Indian Rupees to another currency.

- The conditions in relation to creating a charge on immovable or movable assets, or financial securities, and issue of corporate and personal guarantees remain to be largely the same as those prescribed under the ECB Regulations. In respect of issue of corporate and personal guarantees, the Revised Framework states that ECBs can be credit enhanced, guaranteed, or insured by an overseas entity only if they fulfill the criteria of recognized lender under the ECB Regulations.

- The Revised Framework stipulates that any entity undergoing corporate debt restructuring or being managed by a joint lender forum can raise ECBs only with the explicit permission of the appropriate committees of the joint lender forum or corporate debt restructuring.

- The Revised Framework also introduces some small changes in respect of the parking of ECB proceeds, and the powers of the authorized dealer banks ("**AD Banks**") in respect of ECBs. Under the Revised Framework, ECB proceeds meant for Rupee expenditure can be parked in term deposits with AD Banks for a maximum period of twelve (12) months as opposed to the earlier maximum period of six (6) months. Further, AD Banks will no longer be required to conduct due diligence before approving a change of the designated AD Bank, and a no objection certificate from the existing AD Bank is sufficient to effect a change. Furthermore, prepayments may be allowed by AD Banks without the approval of the RBI. Under the ECB Regulations, prepayments beyond US$500 million required the RBI's approval.

Conclusion

The Revised Framework is a simpler and more liberalized regime, which expands the list of eligible borrowers, recognized lenders, as also the parameters for availing ECBs. It is clear that the Revised Framework will ease the process of raising ECBs by infrastructure companies, REITs, INVITs and core investment companies, and the underlying objective of augmenting the flow of funds from abroad into India will be addressed to a large extent, especially in case of LTBs and RDBs. However, true liberalization will only be achieved if there is a very small negative list of eligible borrowers, and the restrictions on permitted uses are further whittled down.

Additionally, the Revised Framework does not provide clear rules, *inter alia,* in relation to borrowings in the nature of trade credits, Foreign Currency Convertible Bonds, Foreign Currency Exchangeable Bonds and take-out finance as had been elaborated in the ECB Regulations. The RBI has said that the Revised Framework will be modified after one (1) year based on the ECB activity and the macroeconomic situation prevailing then. This is good as it shows the RBI's commitment to tweak policy more frequently to ensure that the purpose of the policy is fulfilled.