INDUSLAW
THOUGHT LEADERSHIP ... APPLIED

INFOLEX
NEWSALERT

JANUARY 2019

THE RBI ISSUES A NEW EXTERNAL COMMERCIAL BORROWING POLICY

1. INTRODUCTION

Towards the end of last year, the Reserve Bank of India (the "**RBI**") in its Statement on Developmental and Regulatory Policies[1] proposed to consolidate regulations governing all types of borrowing and lending transactions between a person resident in India and a person resident outside India in both foreign currency and Indian Rupee ("**INR**").

Pursuant to the statement, the RBI notified the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 (the "**Regulations**") on December 17, 2018 superseding the previous regulations.

With the intent of further improving the ease of doing business in India, in line with the revised Regulations and to further rationalise the existing framework for external commercial borrowings ("**ECB**") and INR denominated bonds, the RBI issued a revised ECB policy (the "**New ECB Policy**")[2] on January 16, 2019.

The New ECB Policy has come into effect immediately.

2. KEY FEATURES

2.1 Change in Structure

The previous framework for raising loans through ECB consisted of three tracks and a regime for Rupee denominated bonds (commonly known as *masala* bonds) listed on foreign debt exchanges.

In particular, that framework essentially provided for:

(a) Medium term foreign currency denominated ECB with minimum average maturity of 3 to 5 years, except in the case of manufacturing sector companies who could raise foreign currency denominated ECBs with a minimum average maturity period of only 1 year ("**Track I**");

(b) Long term foreign currency denominated ECB with minimum average maturity of 10 years ("**Track II**");

---

[1] Available at https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=45658 dated December 5, 2018

[2] A.P. (DIR Series) Circular No. 17 available at https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11456&Mode=0

(c) INR denominated ECB with minimum average maturity of 3 to 5 years, except in the case of manufacturing sector companies who could raise INR denominated ECBs with a minimum average maturity period of only 1 year ("**Track III**"); and

(d) INR denominated bonds issued by an Indian entity in foreign markets of which the interest payments and principal reimbursements were denominated in rupees ("**Rupee Denominated Bonds**").

The New ECB Policy has collapsed the existing four-tiered structure into just two tiers, depending on the currency.

Tracks I and II have been merged into the category *Foreign Currency Denominated ECB* ("**FC ECB**").

Track III and Rupee Denominated Bonds have been merged into the category *Rupee Denominated ECB* ("**INR ECB**").

This new framework is now instrument neutral and we note that in particular, in relation to INR ECB, it includes both the *private placement* or *listing* of Rupee denominated bonds overseas.

The New ECB Policy further clarifies that it shall *not* apply to investments in non-convertible debentures in India made by registered foreign portfolio investors ("**FPIs**").

2.2 Expansion in the List of Eligible Borrowers

The previous framework provided for a specific list of *eligible borrowers* under each track.

The New ECB Policy, however, permits a *wider* set of end-users to tap overseas markets for loans.

The list has now been expanded to include all entities *eligible* to receive foreign direct investment ("**FDI**"), essentially permitting them to borrow through the ECB route.

Additionally, Port Trusts, Units in SEZs, SIDBI, EXIM Bank, registered entities engaged in micro-finance activities, (including registered not for profit companies, registered societies and trusts, cooperatives and non-government organisations) can also borrow under the New ECB Policy.

In the context of *eligible borrowers*, we would stress that the language of the New ECB Policy refers to entities *eligible* to receive FDI and therefore we query to what extent the Indian borrower *actually* has to have any FDI. On the assumption that it doesn't, the new framework is a considerable liberalisation from the previous regime.

It should also be noted that the New ECB Policy contains a specific section on ECB for *start-ups*, subject to a cap on borrowings of USD 3 million per year.

2.3 Recognised Lenders

Under the New ECB Policy, *recognised lenders* are required to be a resident of a country which is *FATF* or *IOSCO* compliant and multilateral and regional financial institutions will also be recognised, if India is a member country.

Individuals will also be recognised lenders, to the extent that they are foreign equity holders, or they subscribe for bonds or debentures *listed* abroad.

Generally, these changes increase the number of lending options available for borrowers and should further allow the entry of various new lenders.

2.4 End Use Restrictions

Under the New ECB Policy, we note that the end restrictions on the use of ECB are broadly similar to the previous framework: real estate activities; investments into the capital markets; equity investments; and on-lending remain prohibited.

We do draw your attention to the permissible use by an Indian borrower of ECB for both working capital and general corporate purposes, if it is raised from a *foreign equity holder*.

However, the ability to refinance and repay other Rupee denominated loans has been narrowed and it is now only permissible *if* the ECB is raised through an inter-company loan from a *foreign equity holder*.

We note that for the purposes of the New ECB Policy, a *foreign equity holder* is defined to mean:

(a) a direct foreign equity holder, holding at least a 25 per cent equity in the Indian borrower; or

(b) an indirect foreign equity holder, holding a minimum 51 per cent indirect equity hlding in the Indian borrower; or

(c) a group company with a common overseas parent.

2.5 Minimum Average Maturity Period

The previous framework provided for multiple minimum average weighted maturities, depending upon the amount of borrowing.

However, under the New ECB Policy, the RBI has kept the minimum average maturity period at 3 (three) years for all ECBs, *irrespective* of the amount borrowed.

Nevertheless, if a manufacturer raises overseas debt of up to USD 50 million in a financial year, the minimum average maturity period will be 1 (one) year.

Further, any ECBs raised from a *foreign equity holder* utilised for specific purposes[3] will have a minimum average weighted maturity of 5 (five) years.

2.6 Borrowing Limit

The previous framework provided for individual limits for the amount of ECB which may be raised in a financial year under the *automatic route*. ECB proposals beyond those limits came under the *approval route*.

Under the New ECB Policy, existing *sector wise* limits have now been replaced, and all *eligible borrowers* may now raise ECBs of up to USD 750 million or its equivalent in any particular financial year under the *automatic route*.

In the case of any FC ECB inter-company loan raised under the automatic route from a direct foreign equity holder, note that the ECB liability to equity ratio cannot exceed 7:1.

However, an exception has been made in the context where *existing* ECB liabilities (in aggregate with the new loan) of less than USD 5 million. Note further that any applicable *sectoral* debt to equity caps also need to be observed.

3. INDUSLAW VIEW

While the New ECB Policy is part of the on-going efforts of the Government of India to rationalise and liberalise multiple regulations framed under the Foreign Exchange Management Act, 1999, it raises some interesting consequences.

The Government appears to be opening up the debt market to attract potential foreign currency inflows by significantly expanding the list of *eligible borrowers*. While *prima facie*, this might be a positive step forward, in light of potential currency depreciation against the dollar, Indian borrowers will need to carefully consider hedging options and the cost of those hedging options to protect against future currency risk.

The additional requirement imposed on *recognised lenders* to be a resident of *FATF* or *IOSCO* compliant countries should strengthen the anti-money laundering and anti-terrorism financing frameworks, though having said that, in the case of inter-company loans, there appears to be no requirement for the *foreign equity holder* to be resident in such a compliant jurisdiction.

Notwithstanding the relaxation of the rules, and the encouraging developments generally in the insolvency resolution process, foreign lenders are likely to continue to view the difficulty in enforcing security in an event of default situation, question marks relating to mandatory prepayment events occuring during any lock-in period and the complexity of entering into water-tight intercreditor relationships with existing lenders as lingering concerns.

Critically, refinancing options for Indian corporates have essentially been narrowed. Under the previous ECB framework, companies were able to refinance rupee denominated debt with Track II or Rupee Denominated Bonds. However, under the New ECB Framework, Rupee denominated debt can now only be refinanced in the local market, or through an inter-company loan from a *foreign equity holder*.

---

[3] Please refer to point 2.1(v) of the New ECB Framework available at https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11456&Mode=0

Finally, with a view to further rationalising the regulation of debt instruments in general, we would recommend reviewing the ECB framework in the context of the regime for subscription for non-convertible debentures by FPIs. In particular, we raise the question about the intent and purpose of continuing separate tracks?

Authors: Ran Chakrabarti | Kriti Gangwar

Practice Areas: Banking & Finance | Projects & Project Finance | Government & Regulatory

Date: January 21, 2019

DISCLAIMER