

FEMA: EXTERNAL COMMERCIAL BORROWINGS (ECB)

① Introduction:

Recognised non-resident (NR) Entity $\xrightarrow{\text{commercial loans \$ or ₹}}$ Eligible resident entity

ECBs are commercial loans granted by NR to R and which must conform to parameters like:

MAMP (minimum avg maturity period)	Permitted / Prohibited End uses	Max AIC (AU in cost) etc.
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② ECB framework as per RBI FED Master Direction no. 5 / 2018-19 shall be the regulation to be complied with.

③ Parameters	Foreign Currency (FCY) denominated ECB	INR denominated ECB
A. Currency of Borrowing	Any freely convertible foreign currency	Indian Rupee (INR)
B. Forms of ECB	Loans, Bank loans, Floating / fixed rate notes / bonds / deb (≠ fully & compulsorily convertible instrument)	Loans, Bank loans, Floating / Fixed rate notes / bonds / deb / preference shares (≠ fully & comp conv. instrument)
(FYI)	Trade credits (>3 yrs) Financial lease	Trade cr (>3 yrs) Financial lease
• FCCB - convertible to issuer's shares	Foreign Currency conv. Bonds (FCCBs)	Plain Vanilla RDBs (Rupee denominated Bond)
• FCEB - exchangeable for a company's shares (≠ issuer's shares)	Foreign Currency Exchangeable Bonds (FCEBs)	issued overseas placed privately or listed on exchanges
• Vanilla = no convertible / call / put option		

	FCY	INR
C. Eligible Borrowers	<ul style="list-style-type: none"> • Entities eligible to receive FDI • Port Trusts • SEZ Units • SIDBI • EXIM Bank of India 	<ul style="list-style-type: none"> • Entities eligible to raise FCY ECB • Registered entities in MICRO-FINANCE activities like - Not for profit co., Registered trusts / societies / co-operatives, NGOs.
D. Change of currency	Change of denomination from one freely convertible foreign currency to other, or to INR is permitted	Not allowed
E. Which exchange rate is to be used for above?	<ul style="list-style-type: none"> • As on date on which agreement for such change is entered (or) • At a rate lesser than above if consented by lender 	N/A

④ HEDGING:

FCY ECB repayment is in FOREX.
INR ECB repayment is in Rupee.

NR

(For NR, forex = INR)

∴ It will hedge receipts on INR ECB settlement

R

(For R, forex = \$/£/€...)

∴ It will hedge payments to be made on FCY ECB

* Types of Hedging

Financial Hedge



Resident has to pay forex so it can use derivatives like fwd / fut / options etc. to protect itself from the appreciation of \$, etc.

Natural Hedge



When a resident's revenue itself is earned in forex (eg. Exports business)

* Rules for overseas investors (LENDER NR) to hedge their Rupee exposure:

Allowed to hedge by using permitted derivative products with Authorised Dealer (AD) Category I Banks in India

Can also access domestic markets through an Indian Bank's abroad branch /subsi or through Foreign Bank's Indian branch

* Rules for Resident Entities (Borrowers) to hedge forex exposure:

Follow hedging guidelines issued by sectoral regulators

for Infrastructure Space companies:

BOD approved risk mgmt policy must be adopted

Hedge 70% of ECB exposure if avg maturity is < 5 yrs

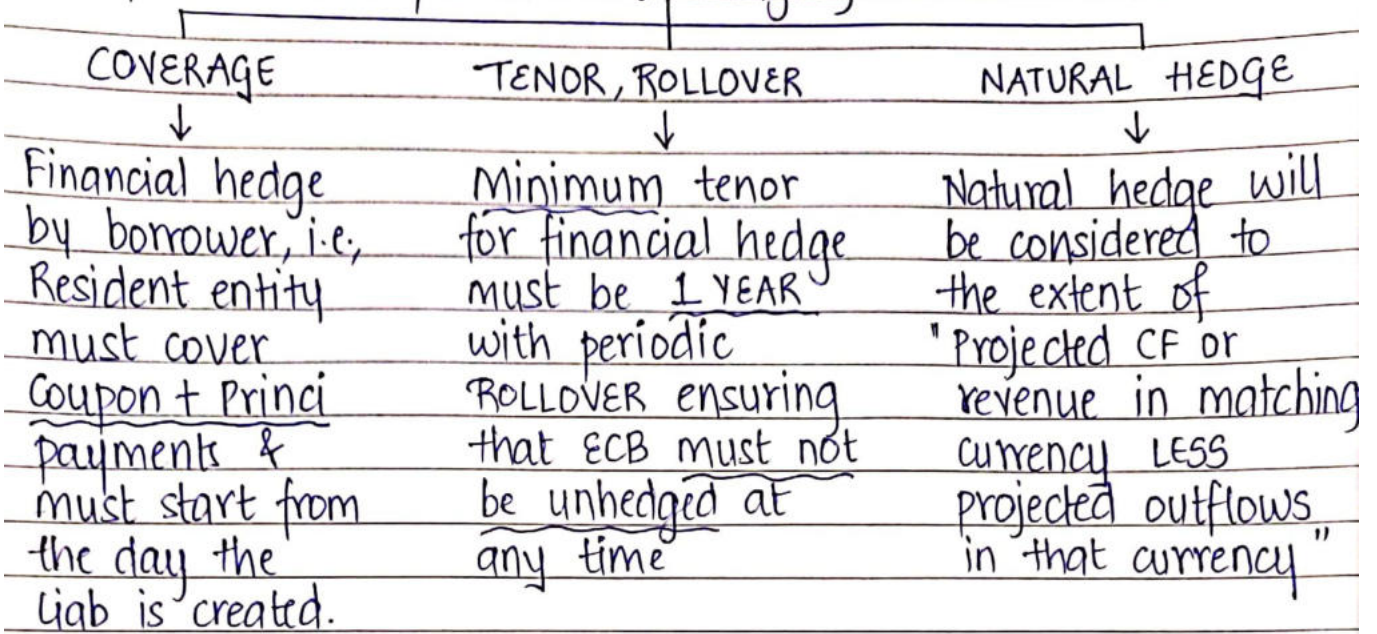
Designated AD CAT I Bank shall verify 70% requirement & report to RBI via FORM ECB-2

FYI:

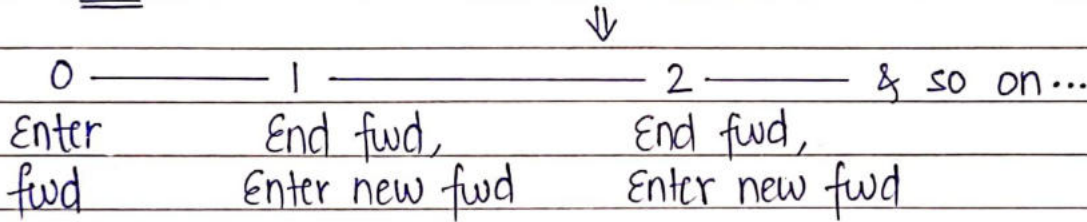
Infra space co → Any co. in infra sector (eg. L&T), NBFCs undertaking infra financing, Core investmt cos. undertaking infra financing, etc.

* Also includes Exploration, mining & refinery biz.

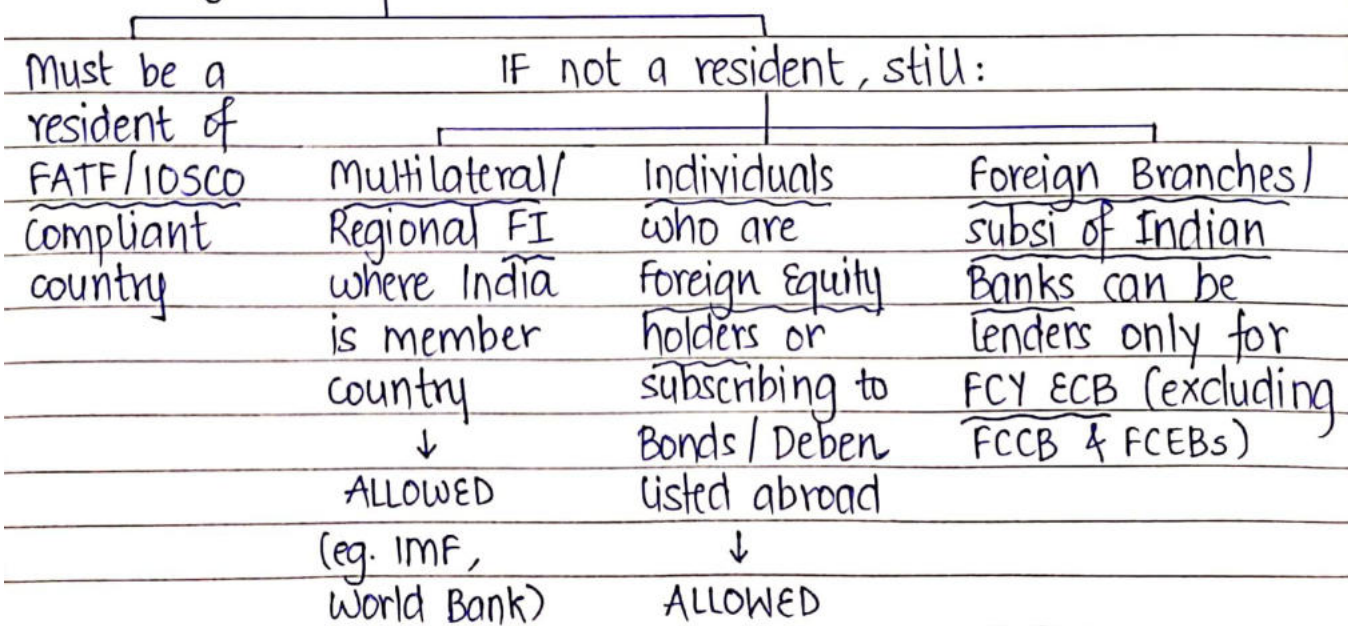
* Operational aspects w.r.t. hedging to be ensured:



FYI: Rollover means 'renewal'



⑤ Recognized lenders :



FATF → Financial Action Task Force, IOSCO → International orgⁿ of securities commissions, FI → Financial Institutions

* Foreign Equity holder means any person who is:

Holding $\geq 25\%$ Eq
directly in the
borrower entity

Holding $\geq 51\%$ Eq
indirectly in the
borrowing entity

A Group company
with common
overseas parent

* Note: Foreign branch/subsi of Indian Bank

can be lender
for FCY ECB
(\neq FCCB & FCEB)
↓
(INR ECB X)

can participate as
underwriter / market
maker / arranger etc
for RUPEE DENOMINATED
Bonds issued overseas

cannot underwrite
Rupee denominated
Bonds issued
by that Indian
Bank

⑥ MAMP \rightarrow minimum Average Maturity Period:

Normally MAMP for ECBs = 3 YEARS

IF ECB has call / put option, then it shall not be exercised before MAMP. MAMP for special cases:

CASE	MAMP
A. ECB raised by MFG co. upto \$50 million or equivalent per FY	1 year
B. ECB raised from foreign Eq Holder for repayment of ₹ loan or for \rightarrow	5 years
C. ECB raised from anyone \neq B for \rightarrow or ECB raised by NBFC for on-lending for \rightarrow	10 years
Working capital / General corporate purposes	
D. ECB raised for \rightarrow or ECB raised for onlending by NBFC for \rightarrow	7 years
Repayment of ₹ loans availed domestically for CAPEX	
E. ECB raised for \rightarrow ECB raised for onlending by NBFC for \rightarrow	10 years
Repayment of ₹ loan availed domestically for \neq CAPEX	

for case B, C, D, E → ECB cannot be raised from foreign branch / subsi of Indian Banks.

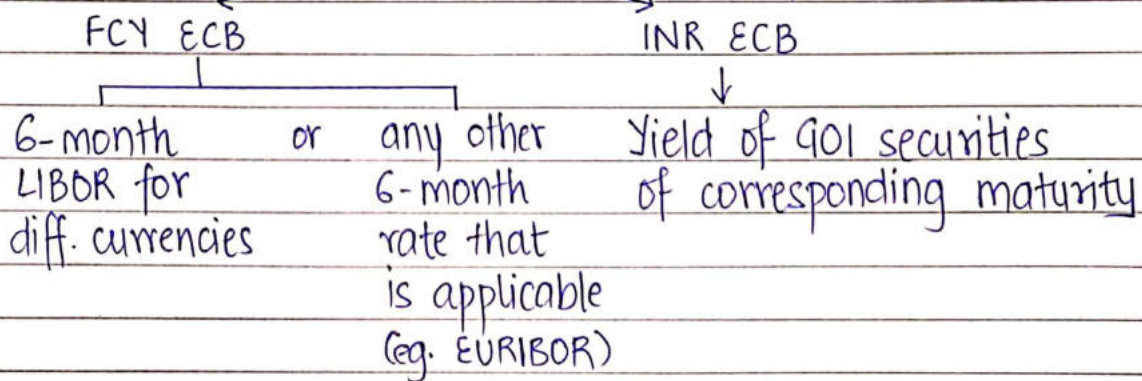
Simplified Rules for MAMP :

CASES	From foreign equity holder	From others
1. Raised by MFG CO. ≤ 50 mn \$ per FY	1y	1y
2. For Working cap	5y	10y
3. For General corporate	5y	10y
4. for ₹ loan (CAPEX)	5y	7y
5. for ₹ loan (≠CAPEX)	5y	10y
6. Other than 1 to 5 (eg. MFG > 50 mn \$)	3y	3y

FYI: Call / Put for Bonds → Call = right to redeem bonds earlier (Issuer has the right) & Put = right to sell the bond back to issuer before maturity (Investor has the right)

⑦ All-In-Cost ceiling per annum :

Ceiling p.a. = Benchmark rate + 450 Bps (4.5%)

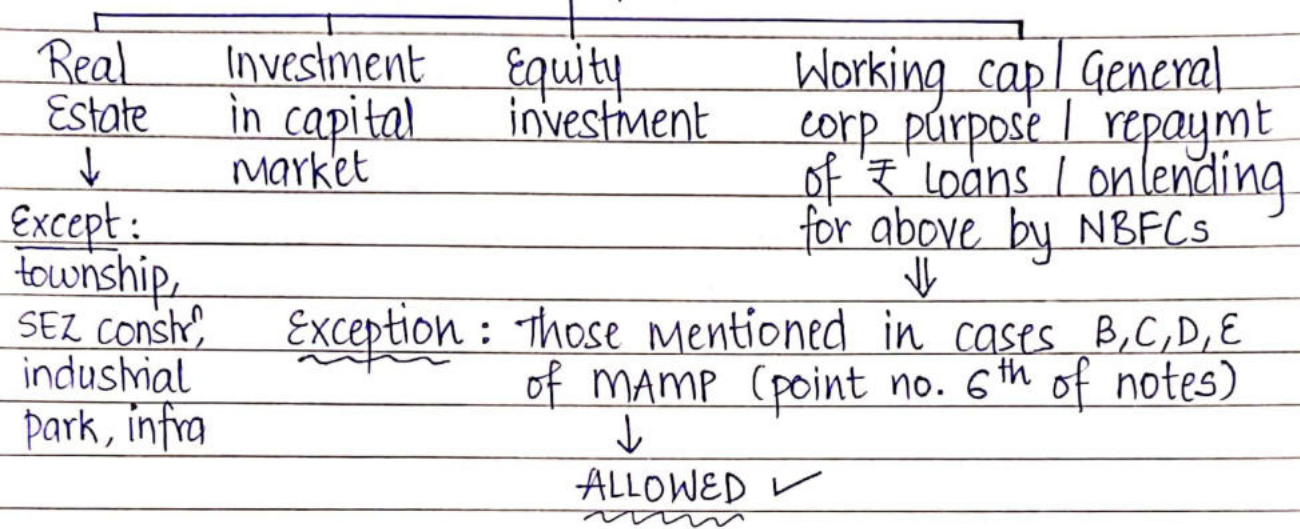


⑧ Other costs (over & above AIC ceiling) like penal interest, prepayment charge, etc. for breach of covenants (T&C) cannot exceed 2% over & above the contracted interest rate on o/s Principal.

Example → IF 6-m LIBOR = 2.5%, then max cost:

$$= \underset{\substack{\downarrow \\ \text{LIBOR}}}{2.5} + \underset{\substack{\downarrow \\ \text{AIC}}}{4.5} + \underset{\substack{\downarrow \\ \text{other cost}}}{2} = \underline{9\%}$$

⑨ Prohibited End-Uses of funds raised via ECB:



⑩ ECB framework doesn't apply to investment in NCDs in India by registered FPIs (Foreign Portfolio Investors)

FYI: FDI = come to India & set up a biz, own assets, etc.

FPI = come to India for investing in shares, bonds, etc.

(i.e. Indirect) and not to set up biz or own assets.

⑪ ECB limits & leverage:

Automatic route



1. Raise ECB up to \$750 million or equivalent per FY
2. For FCY ECB raised from direct Foreign Eq Holder, the ratio of ECB Liab : Equity is upto 7:1 (Ratio N/A if existing o/s ECB + proposed ECB is upto \$5mn)

↳ allowed even if > 7:1

Approval route

(take RBI approval)



If case doesn't fall under automatic route (eg. > \$750 mn or > 7:1)

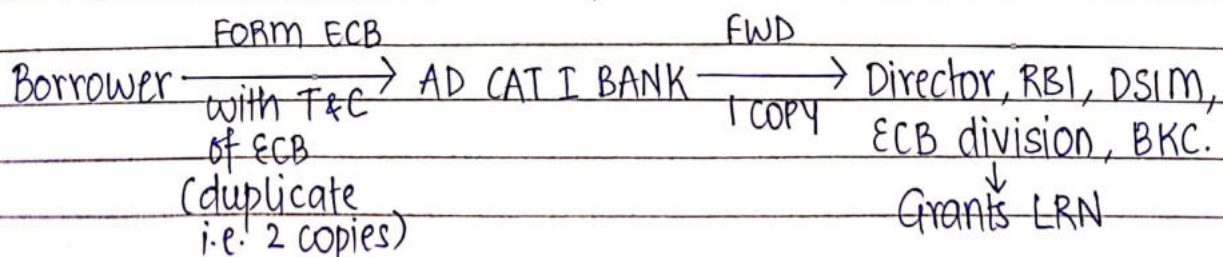
- *
$$\frac{\text{ECB Liab}}{\text{Equity}} = \frac{\text{All ols} + \text{proposed (from "that" FEH)}}{\text{PVSC} + \text{FR} + \text{Share prem in (forex) (from "that" FEH)}}$$
- * Use latest audited BLS figures
- * Only direct FEH (who holds $\geq 25\%$ directly in borrower) will be considered
- * In short \rightarrow $\frac{\text{FCY Liab (direct FEH who lends)}}{\text{FCY Eq (direct FEH who lends)}}$

(12) AUTOMATIC ROUTE	APPROVAL ROUTE
↓	↓
Approach AD Category I Bank with their proposal along with filled "FORM ECB"	Approach RBI with application under "FORM ECB" for examination through AD CATEGORY I Bank
	↓
	RBI shall consider guidelines, merits, macro eco situation; Place applic" before 'EMPOWERED COMMITTEE'; consider its recomm & take the decision.



FYI: All India FI = NABARD, EXIM, NHB, SIDBI

(14) Loan Registration Number (LRN) is needed to draw-down ECB (i.e. to receive funds)



- * DSIM → Dept of statistics & info mgmt
- * Copies of loan agreement are not reqd to be submitted

(15) Changes in T&C of ECB, including reduced repayment by mutual agreement

↓
report to DSIM via REVISED "FORM ECB" within 7 DAYS from date of change

↓
mention all changes in it

(16) Monthly reporting of actual transactions:

Month end → submit "FORM ECB 2" to AD CAT I BANK in such a manner that it reaches DSIM within 7 DAYS from month-end

FORM ECB 2 must include changes in ECB parameters also.

FORM ECB FORM ECB 2
✓ ✓

(17) Late Submission Fee (LSF) for delay in reporting drawdown of ECB before obtaining LRN or delay in filing returns via FORM ECB 2:

FORM	DELAY PERIOD	LSF
FORM ECB 2	upto 30 days from due date of submission (DOS)	₹ 5000
FORM ECB 2	upto 3 years from DOS	₹ 50000 pa
FORM ECB	upto 3 years from date of drawdown (DOD)	₹ 50000 pa
FORM ECB 2	Beyond 3 yrs from DOS	₹ 1 LAKH pa
FORM ECB	Beyond 3 yrs from DOD	₹ 1 LAKH pa

Pay fee through AD CAT I Bank by DD in favor of "Reserve Bank of India." Delay will be = contravention subject to compounding & adjudication u/ FEMA 1999.

(18) Parking of ECB proceeds abroad:

ECB proceeds meant for FCY expenditure can be parked (deposited) abroad till its utilization by investing in the following LIQUID ASSETS:

Deposits, Certificate of deposits issued by Bank rated not less than "AA-" (by S&P, FITCH IBCA) or "Aa3" (by moody's)

Treasury Bills, other monetary instruments of 1 year maturity with same minimum rating

Deposits with foreign branch/ subsi of Indian banks abroad

(19) Parking of ECB proceeds domestically:

ECB proceeds meant for INR expenditure must be credited immediately to RUPEE ACCOUNTS with AD CAT-I Banks in India. Funds can be parked in TERM DEPOSITS with AD CAT I Banks for max 12 months cumulatively.

Term deposits must be un-encumbered (not be kept collateral)

(20) Standard Operating Procedure (SOP) for Untraceable Entities (UE):

• UE → A Borrower who has raised ECB will be "UE" if

Entity/directors/Promoters/Auditors are not reachable/responsive over email/letter/phone for ≥ 2 QUARTERS with ≥ 6 documented reminders/comm.

⊕

Entity not found to be operative, at regd office as per address with AD CAT I Bank, or during visit by AD Bank's officials or any of its agencies.

⊕

Entity has not submitted its statutory auditor's certificate for ≥ last 2 yrs.

• SOP must be followed by AD CAT I Bank in case of UE which has failed to submit returns under ECB framework (physically/electronically) for ≥ 8 QUARTERS.

• Actions to be taken by AD CAT I BANK

File revised form ECB, if required, and last form ECB 2 without certification from co. with 'UNTRACEABLE ENTITY' written in bold on top	ED* must be informed when any entity = UE	No fresh applic ⁿ from UE can be processed
↓ liability will be written off from India's external debt amt, but lender can still recover it ✓	No inward remittance or debt servicing will be allowed under automatic route	

* ED = Directorate of Enforcement

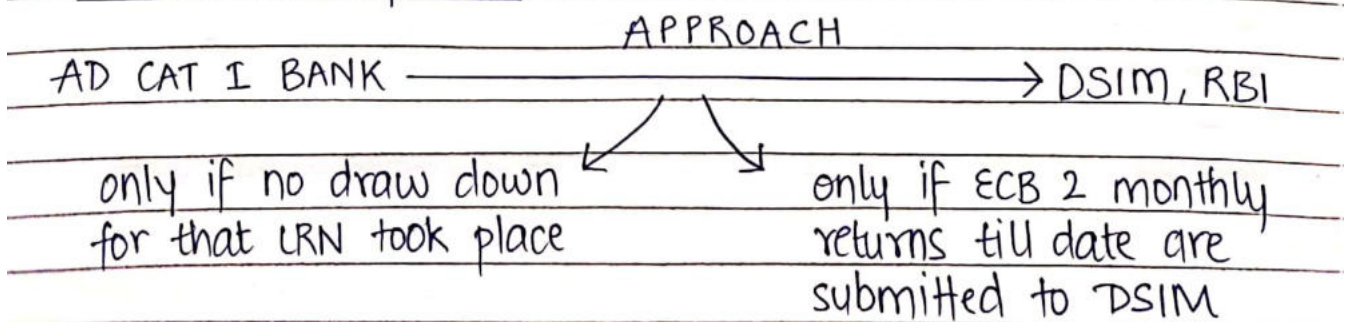
(21) Powers delegated to AD CAT-I Banks :

They can approve any requests from borrowers wrt. changes in ECB (except FCCB & FCEB)	They must ensure all changes including change of borrower/lender, transfer of ECB, etc. comply with ECB norms & are done with <u>lender's consent</u>
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(22) The following can be done under automatic route :

Change of AD CAT I BANK	Cancellation of LRN	Refinance ECBs	Convert ECB → Eq.	Security for raising ECB
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- Change of AD CAT I Bank → allowed after taking NOC from existing AD CAT I Bank
- Cancellation of LRN:



• Refinancing of existing ECB:

Borrow to repay a loan!

- Refinancing existing ECB by fresh ECB = allowed if:

Outstanding maturity of existing ECB is NOT REDUCED

AIC < AIC (fresh) (existing)

Borrower is eligible as per present framework of ECB

- Refinancing of ECB raised under old framework is also allowed if new ECB framework eligibility is met.

- Part refinancing is also allowed.

- Indian banks can participate in refinancing:

only for highly rated corporates (AAA rated)

&

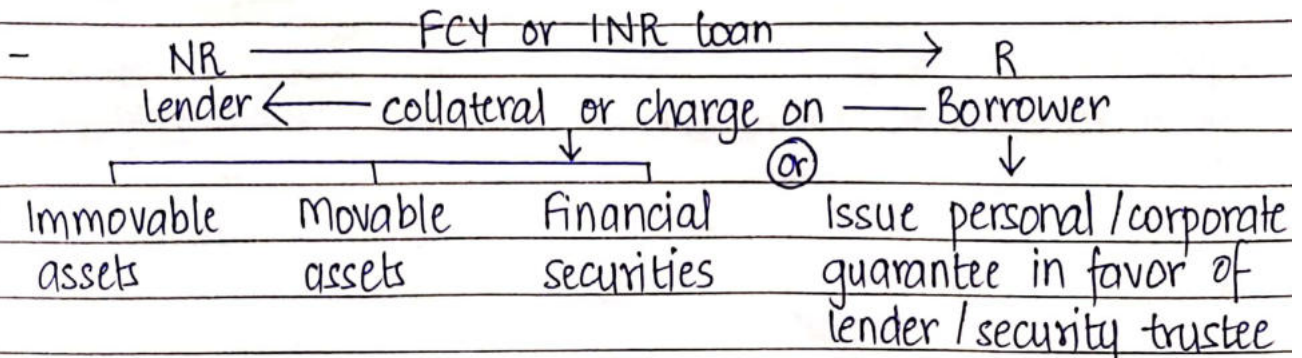
only for Maharatna / Navratna PSUs

• Conversion of ECB to equity:

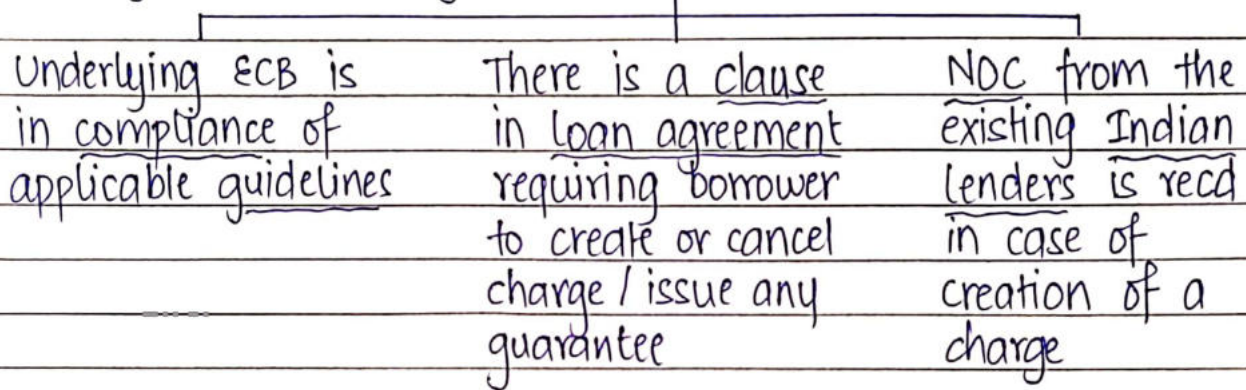
Matured but unpaid, or ECB not yet matured, can be converted to equity subject to following conditions:

Activity of Borrower company is covered by <u>automatic route</u> for FDI, or <u>Govt's approval</u> is received wherever applicable as per FDI policy	Conversion should be with <u>lenders' consent</u> without <u>any addⁿ cost</u> & without breaching FDI sectoral cap as per pricing guidelines of Govt	<u>Partial conversion:</u> File form <u>FCGPR</u> for FDI flow & <u>ECB-2</u> for ECB.
Exchange rate as on date of agreement of conversion (or) lesser rate can be applied with mutual agreement with lender.	Other lenders to the borrower must give consent, or at least be informed of it. RBI's restructuring guidelines to be followed ✓	<u>Full conversion:</u> File <u>FCGPR</u> & one <u>ECB-2</u> for the <u>last time</u> . ECB-2 must be filed with remarks "ECB partially or fully converted to Equity."

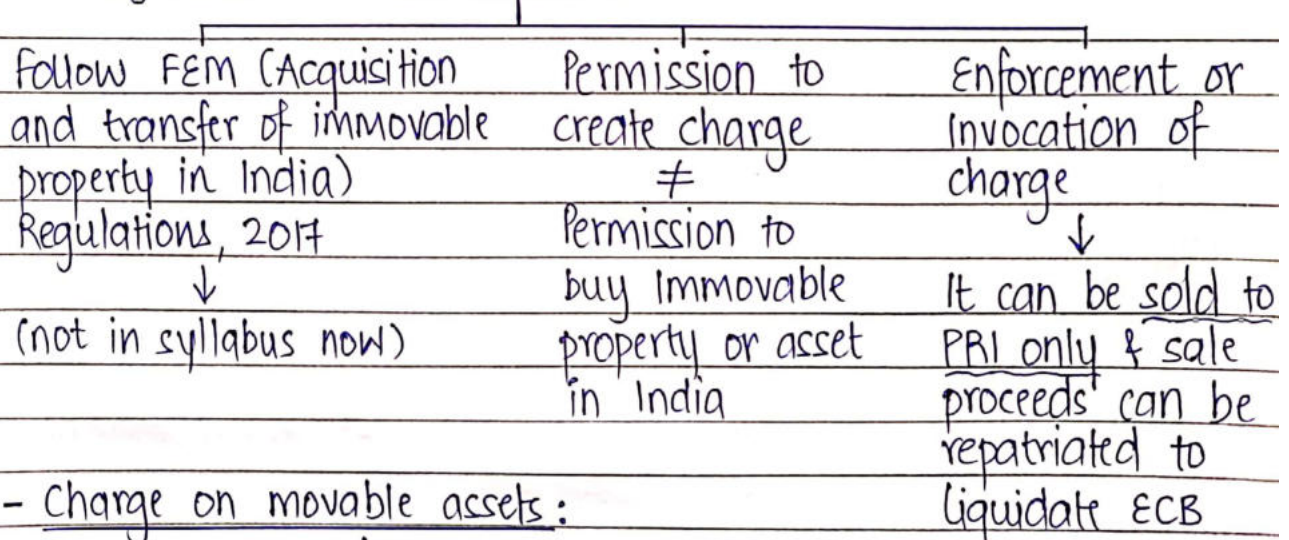
• Security for raising ECB :



- AD CAT I Banks can allow creation / cancellation of charge or issue of guarantees if:



- Charge on Immovable assets:



- Charge on movable assets:

↓

Enforcement / Invocation of charge \rightarrow lender can take over or sell etc. but claim \leq ECB amt outstanding only.

Encumbered assets can be taken abroad only after getting NOC from Domestic lenders.

- Charge on financial securities:

Consider Borrower = RIL, Promoter = Mukesh Ambani

Permitted assets for pledge / charge are:

1. Shares of Borrower co. (RIL) → held by promoter (mukku)
2. Shares of domestic associate co. (Jio) } → held by RIL
of Borrower (RIL)
3. Bonds, Debentures, G-sec, Govt savings } held by borrower
certificate, UTI / MF units, security receipts, } → or promoter
loan assets, current assets, ₹ Bank Alc } (RIL / mukku)
with AD Banks / Institutions
4. ₹ Alc in form of escrow arrangement } held by borrower
or debt service reserve Alc (i.e. account } → or promoter
opened for repayment → eg. sinking fund) } (RIL / mukku)

* Invocation of pledge (i.e. lender takes over such assets),
transfer of securities must be as per FDI / FII policies
including sectoral cap & pricing rules

* follow FEM (Transfer or issue of security by PROI) Regⁿ

- Issue of Corporate / Personal guarantee:

Copy of Board resolution is
needed from corporate
guarantor, specifying name
of authorised officials:

Specific request
from personal
guarantor must
be received

Follow FEM
(guarantees)
Regⁿ, 2002

to execute guarantee
on behalf of co.

(or) to execute guarantee
in individual capacity

Imp note → ECBs can be guaranteed / insured / credit enhanced
by overseas party only if that party is eligible
to be recognized lender!

Imp note → Indian Banks, All India FI, NBFCs cant give
guarantees

→ HPCL / BPCL / IOCL

(23) ECB for Public Sector Oil Marketing Companies (OMC):

Can raise ECB for working cap purposes with MAMP = 3 yrs from recognised lenders under automatic route	Mandatory hedge = N/A Limit - \$750m p.a = N/A but overall ceiling on ECB must be <u>\$10 Bn</u>	Must have BOD approved forex MTM procedure & prudent risk mgmt policy	Other rules shall apply as usual
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(24) ECB for start-ups recognized by CG under automatic route:

MAMP	3 Years																		
Recognized lenders	<table border="0"> <tr> <td>lender is resident of FATF compliant country</td> <td>ECB</td> <td>→ startup entity</td> </tr> <tr> <td></td> <td>ALLOWED</td> <td></td> </tr> <tr> <td>lender is foreign branch/subsi of Indian banks</td> <td>ECB</td> <td>→ startup entity</td> </tr> <tr> <td></td> <td>NOT ALLOWED</td> <td></td> </tr> <tr> <td>lender is overseas entity in which any Indian entity has made ODI</td> <td>ECB</td> <td>→ startup entity</td> </tr> <tr> <td></td> <td>NOT ALLOWED</td> <td></td> </tr> </table>	lender is resident of FATF compliant country	ECB	→ startup entity		ALLOWED		lender is foreign branch/subsi of Indian banks	ECB	→ startup entity		NOT ALLOWED		lender is overseas entity in which any Indian entity has made ODI	ECB	→ startup entity		NOT ALLOWED	
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lender is overseas entity in which any Indian entity has made ODI	ECB	→ startup entity																	
	NOT ALLOWED																		
Forms of ECB	Loans, Non convertible / optionally convertible / Partially convertible preference shares only.																		
Currency	Any freely convertible FCY or INR or combo. If ECB is in INR, the lender must mobilise (send) INR through AD CAT I Bank in India through swap or sale (i.e. \$ ↔ ₹)																		
Amount	Max \$3mn or equivalent per FY in aggt																		
All in cost	As agreed bwn borrower & lender																		
End use	Only for business expenditure																		
Conversion to Equity	Freely allowed subject regulations applicable to foreign investments in startups																		

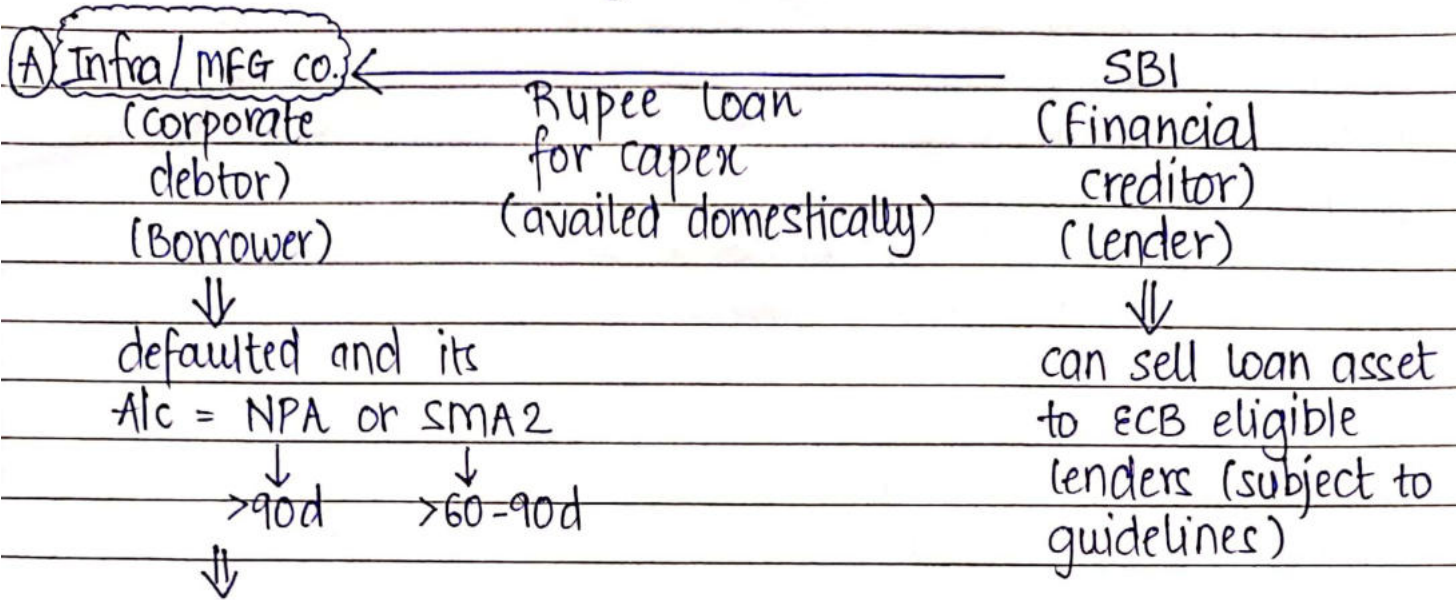
Security	Borrower entity can provide <u>any security</u> like Movable / Immovable / Intangible assets, financial securities, etc. Rules regarding FDI / FPI etc must be followed
Guarantee	Corporate / Personal guarantees = Allowed If <u>Guarantor = NR</u> , then it should be <u>eligible lender</u> under ECB for startups. Issuance of guarantee / LOC / LOU (Letter of credit, comfort or undertaking) by Indian Banks, All India FI, NBFCs ⇒ <u>NOT ALLOWED</u>
Hedging	For lender to hedge INR ECB exposure ↳ same as usual (4 ^m point of notes) For start-up (Borrower) to hedge FCY ECB ↳ <u>advised</u> to have risk mgmt policy ✓
Equity holder ratio	N/A
7:1 rule	
Start ups ≠ recognised by CG	They can accept ECB if they are eligible to receive <u>FDI</u> .
Other rules	Same as usual

(25) ECB by Entities under Investigation / Adjudication / Appeal for violation of FEMA or its regulations:

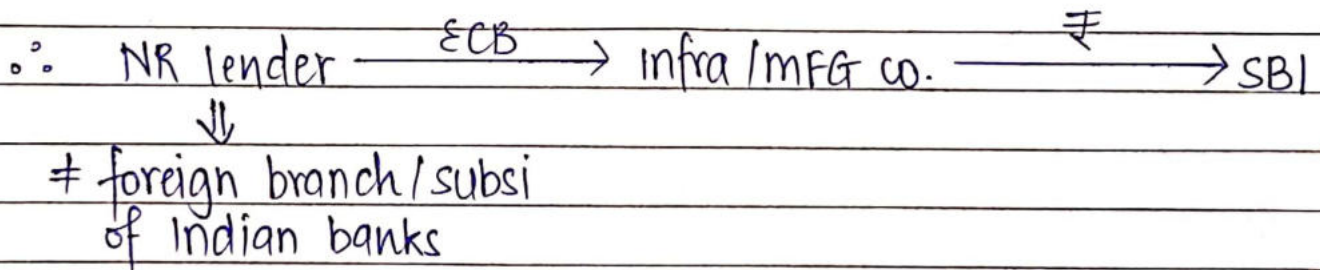
<u>CAN</u> raise ECB as per this framework by informing AD CAT I Bank or RBI about I/AIA	Allowed even if I/AIA is pending or is concluded (Ignore its outcome)	AD CAT I Bank / RBI must inform I/AIA authorities while approving ECB proposal
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(26) Dissemination of Info → for purposes of transparency, the name of borrower, amt / maturity / purpose of ECB under auto / approval route are put up on RBI website on monthly basis with a 1-month lag (delay)

(27) ECB by entities under restructuring (or)
ECB for re-financing stressed assets :



Co. can avail ECB for repayment of ₹ loan above under one-time settlement with lender (SBI).



(B) Eligible Borrower ⇒ under CIRP (corporate insolvency resolution process) of IBC 2016
 (Any company)

↓

<p>only if <u>resolution plan permits it</u> & <u>RBI approves ECB</u></p>	<p>← can raise ECB to repay ₹ loans from eligible lenders (≠ foreign branch/subsi of Indian banks)</p>
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