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Revised Framework for External Commercial Borrowings

Introduction

The Reserve Bank of India (the "**RBI**") issued a circular on 16 January 2019 (the "**2019 ECB Framework**"), effectively changing the Master Direction on External Commercial Borrowings, Trade Credits, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers dated 1 January 2016, as amended from time to time (the "**Master Direction**").[1]

The 2019 ECB Framework makes access to external commercial borrowings ("**ECBs**") easier for Indian entities and is expected to bolster the "masala bonds" market. It represents a significant rewrite of the previous regulatory framework.

The Master Direction is now being amended to reflect the changes introduced by the 2019 ECB Framework.

We discuss below certain key changes brought about as a result of the 2019 ECB Framework.

Key Features*

- **Two simplified ECB tracks – INR and freely convertible foreign currencies.**
- **RBI approval is no longer required for masala bonds.**
- **Masala bond proceeds can no longer be used towards working capital or general corporate purposes or for the repayment of rupee loans.**
- **All entities eligible to receive FDI can raise ECBs; all NBFCs can now raise foreign currency funds.**
- **Minimum maturity reduced to three years in most cases.**
- **Uniform limit to raise ECBs up to USD 750 million (or the equivalent) in each financial year.**

** Exceptions are applicable to many of these features. Please consult with legal counsel on the specifics of a particular situation.*

[1] The RBI had earlier, through a notification dated 17 December 2018, consolidated the provisions relating to borrowing and lending in foreign currency and Indian Rupees under the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018, which replaced the Foreign Exchange Management (Borrowing or Lending in Rupees) Regulations, 2000 and superseded Regulation 21 of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) (Amendment) Regulations, 2004.

Summary of Key Changes

The key changes introduced pursuant to the 2019 ECB Framework are summarised below.

Merging of Tracks and Uniform Minimum Average Maturity

- Under the Master Direction, the framework for raising ECBs comprised three tracks:
    - Track I comprised of medium-term foreign currency denominated ECBs ("**FCY Denominated ECBs**") with a minimum average maturity period (the "**MAMP**") of three to five years;
    - Track II comprised of long-term FCY Denominated ECBs with a MAMP of 10 years; and
    - Track III comprised Indian Rupee denominated ECBs ("**INR Denominated ECBs**") with a MAMP of three to five years.
- The 2019 ECB Framework has now merged:
    - Track I and Track II into a single track comprising FCY Denominated ECBs; and
    - Track III with the provisions related to Rupee denominated bonds ("**RDBs**") into a single track comprising INR Denominated ECBs.
- The MAMP across both FCY Denominated ECBs (including Foreign Currency Convertible Bonds ("**FCCBs**") and Foreign Currency Exchangeable Bonds ("**FCEBs**")) and INR Denominated ECBs is now three years.

All-in-Cost Ceiling

The all-in-cost ceiling across both FCY Denominated ECBs and INR Denominated ECBs continues to remain 450 basis points over the benchmark rate. For FCY Denominated ECBs, LIBOR or any other six-month interbank interest rate applicable to the currency of borrowing (e.g., EURIBOR) can be the benchmark rate.

Uniform Limit

All eligible borrowers can now raise ECBs in an amount up to USD 750 million (or its equivalent) in each financial year under the automatic route, replacing the sector specific limits previously set out under the Master Direction.

No Prior Approval for Masala Bonds

The requirement for obtaining prior approval of the RBI for issuing RDBs has been dispensed with. This is a significant relaxation for issuers intending to issue masala bonds.

End Use Restrictions

Under the Master Direction, proceeds from the issuance of RDBs could be used for working capital or general corporate purposes or for repayment of rupee loans. However, under the 2019 ECB Framework, proceeds from the issuance of RDBs can be used for working capital or general corporate purposes or for repayment of rupee loans only if such RDBs are held by foreign equity holders.

Expanded List of Eligible Borrowers

- The list of eligible borrowers has been expanded to include all entities eligible to receive foreign direct investment ("**FDI**"), among others.
- As a result, entities operating in sectors such as broadcasting, defence, e-commerce, insurance, pharmaceuticals and print media, which were previously not covered as 'eligible borrowers' are now eligible to raise ECBs.
- However, this would also mean that entities operating in sectors that are not permitted to receive FDI (such as real estate business, gambling business, railway operations and atomic energy) will be restricted from raising ECBs.
- Certain non-banking finance companies ("**NBFCs**") were previously not eligible to raise FCY Denominated ECBs. They can now raise both FCY Denominated ECBs and INR Denominated ECBs under the 2019 ECB Framework.
- In addition, Indian banks (which were only permitted to issue certain types of RDBs under the Master Direction) can also raise ECBs under the 2019 ECB Framework.

Expanded List of Recognised Lenders

Unlike the Master Direction which specified a set of recognised lenders (under each of the tracks) from whom a borrower could raise an ECB, the 2019 ECB Framework does not specify a set of recognised lenders. It instead provides that any resident of a Financial Action Task Force ("**FATF**") or International Organisation of Securities Commissions ("**IOSCO**") compliant country[2] can provide ECBs to eligible borrowers.

In addition, individuals (who were earlier permitted to only lend in INR and were subject to additional due diligence requirements) can be recognised lenders,

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[2] The 2019 ECB Framework clarifies that:

- a "**FATF compliant country**" is a country that is a member of 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 strategic Anti-Money Laundering (AML) or Combating the Financing of Terrorism (CFT) 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 FATF to address the deficiencies;
- an "**IOSCO compliant country**" is a country whose securities market regulator is a signatory to:
  - IOSCO's Multilateral Memorandum of Understanding (Appendix A Signatories); **or**
  - a bilateral memorandum of understanding with the Securities and Exchange Board of India for information sharing arrangements.

provided they are foreign equity holders or if they have subscribed to bonds or debentures listed on a foreign stock exchange.

FCCBs and FCEBs continue to be Subject to Other Regulations

FCCBs continue to be subject to the requirements of the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme 1993, as amended.

Similarly, FCEBs also continue to be subject to the requirements of the Issue of Foreign Currency Exchangeable Bonds Scheme 2008, as amended.

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The key provisions of the 2019 ECB Framework following these changes are summarised in the **Annexure** for easy reference.

Annexure
Key Provisions of the 2019 ECB Framework

Key Provisions	FCY Denominated ECB	INR Denominated ECB
Currency	Any freely convertible foreign currency.	Indian Rupees.
Minimum Average Maturity	• The MAMP across both FCY Denominated ECBs (including FCCBs and FCEBs) and INR Denominated ECBs is now three years. • The MAMP for ECBs up to USD 50 million (or the equivalent) raised by companies engaged in the manufacturing sector is one year. • If the ECB is raised from a foreign equity holder <u>and</u> used for working capital purposes, general corporate purposes or for the repayment of Rupee loans, the MAMP will be five years. • Put and call options are not exercisable prior to the completion of the applicable MAMP. ***Key Changes from the Master Direction:*** *The MAMP for Track I and Track III ECBs under the Master Direction was as follows:* • *The MAMP for borrowings of up to USD 50 million (or the equivalent) was three years and the MAMP for borrowings above USD 50 million was five years.* • *The MAMP for companies engaged in the infrastructure sector, non-banking financial companies - infrastructure finance companies and certain other companies in the manufacturing sector was three years, irrespective of the amount of borrowing.* • *The MAMP for FCCBs or FCEBs, irrespective of the amount of the borrowing, was five years.*	
All-in-cost Ceilings	• The all-in-cost ceiling across both FCY Denominated ECBs and INR Denominated ECBs continues to remain 450 basis points over the Benchmark Rate[3]. ○ The prepayment charge or penal interest, if any, for default or breach of covenants cannot be more than 2 per cent. over the contracted rate of interest on the outstanding	

[3] "**Benchmark rate**" for:

- FCY Denominated ECBs is six-month LIBOR or any other six-month interbank interest rate applicable to the currency of borrowing (e.g., EURIBOR); and
- INR Denominated ECBs is the prevailing yield of Government of India securities of corresponding maturity.

	principal amount and will not be included within the all-in-cost ceiling. • All-in-cost has been defined to include the rate of interest, other fees, expenses, charges, guarantee fees, export credit agency charges, whether paid in foreign currency or Indian Rupees but will not include commitment fees and withholding tax payable in Indian Rupees. Default interest and pre-payment charges are also excluded from the all-in-cost ceiling. • In the case of fixed rate loans, the swap cost plus spread cannot be more than the floating rate plus the applicable spread. • For FCCBs, the issue related expenses cannot exceed 4 per cent. of the issue size and in the case of a private placement, these expenses cannot exceed 2 per cent. of the issue size. • Various components of the all-in-cost have to be paid by the borrower without recourse to the drawdown of the ECB; in particular, ECB proceeds cannot be used for the payment of interest or charges. ***Key Changes from the Master Direction:*** • *Export Credit Agency charges have now been included in the definition of "all-in-cost".* • *For FCY Denominated ECBs, any other six-month interbank interest rate applicable to the currency of borrowing (e.g., EURIBOR) can be considered as the benchmark rate.* • *It has been clarified that certain components of the all-in-cost have to be paid by the borrower without recourse to the proceeds of the ECB, including payment of interest or charges.*
Eligible Borrowers	• All entities that are eligible to receive FDI are now eligible borrowers. • Additionally, port trusts, units in special economic zones, Small Industrial Development Bank of India, Export-Import Bank of India, registered entities engaged in micro-finance activities, registered not for profit companies, registered societies and non-governmental organisations can also raise ECBs under the 2019 ECB Framework. ***Key Changes from the Master Direction:*** • *Under the Master Direction, only certain entities specified by the RBI could raise ECBs. The 2019 ECB Framework has broadened the list of eligible borrowers to all entities which are eligible to receive FDI.* • *As a result of this change, entities such as certain NBFCs and those operating in sectors such as broadcasting, defence, e-*

	commerce, insurance, pharmaceuticals and print media, which were previously not covered as 'eligible borrowers' are now eligible to raise ECBs. • *However, this would also mean that entities operating in sectors that are not permitted to receive FDI (such as real estate business, gambling business, railway operations and atomic energy) will be restricted from raising ECBs.* • *Certain types of NBFCs, which were previously not eligible to raise FCY Denominated ECBs, can now raise both FCY Denominated ECBs and INR Denominated ECBs under the 2019 ECB Framework.* • *Indian banks (which were only permitted to issue certain types of RDBs under the Master Direction) can also raise ECBs under the 2019 ECB Framework.*
Recognised Lenders	• Any resident of a FATF or IOSCO compliant country can lend ECBs to eligible borrowers. • Multilateral and regional financial institutions where India is a member country are also recognised lenders. • Individuals will be recognised lenders only if they are foreign equity holders or are subscribers to bonds or debentures listed on a foreign stock exchange. • Foreign branches or subsidiaries of Indian banks are permitted as recognised lenders only for FCY Denominated ECBs. They are still not eligible to invest in FCCBs and FCEBs. • Foreign branches or subsidiaries of Indian banks, subject to applicable prudential norms, can participate as arrangers, underwriters, market-makers or traders for RDBs issued outside India. However, foreign branches or subsidiaries of Indian banks cannot underwrite issuances by Indian banks. ***Key Changes from the Master Direction:*** • *Under the Master Direction, only certain entities specified by the RBI were listed as "recognised lenders".* • *In addition, individuals (who were earlier permitted to only lend in INR and were subject to additional due diligence requirements) can be recognised lenders, provided they are foreign equity holders or if they have subscribed to bonds or debentures listed on a foreign stock exchange.*

Negative End-Uses	The list of activities for which ECB proceeds cannot be used now includes the following: • Real estate activities; • Investment in capital markets; • Equity investment; • Working capital purposes, except from foreign equity holders; • General corporate purposes, except from foreign equity holders; • Repayment of Rupee loans, except from foreign equity holders; and • On-lending to entities for the above activities. ***Key Changes from the Master Direction:*** • *Under the Master Direction, proceeds from the issuance of RDBs could be used for working capital or general corporate purposes or for repayment of rupee loans. However, under the 2019 ECB Framework, proceeds from the issuance of RDBs can be used for working capital or general corporate purposes or for repayment of rupee loans <u>only</u> if such RDBs are held by foreign equity holders.* • *The 2019 ECB Framework also provides for negative end-use restrictions on use of proceeds for "real estate activities", as opposed to the Master Direction which provided that ECBs could not be raised for "investment in real estate or purchase of land".* ○ *The 2019 ECB Framework further defines "real estate activities" as "any real estate activity involving own or leased property for buying, selling and renting of commercial and residential properties or land and also includes activities either on a fee or contract basis assigning real estate agents for intermediating in buying, selling, letting or managing real estate". However, this would not include construction or development of industrial parks, integrated townships, special economic zones, purchase or long term leasing of industrial land as part of a new project or the modernisation or expansion of existing units or any activity under the definition of 'infrastructure sector'.*
Individual limits	All eligible borrowers, irrespective of the industry sector they operate in, can now raise ECBs of up to USD 750 million (or its equivalent) in each financial year under the automatic route.

	Key Changes from the Master Direction: *The Master Direction provided various sectoral limits in respect of ECBs that could be raised by different types of eligible entities under the automatic route in each financial year.*
Hedging Provisions	Under the 2019 ECB Framework, infrastructure space companies are required to have a board approved risk management policy and are required to mandatorily hedge 70% of their ECBs where the average maturity is less than five years. Such companies were earlier required to mandatorily hedge 100% of their ECBs under the Master Direction.
ECBs for Entities subject to Restructuring	The 2019 ECB Framework also includes a provision that an entity which is subject to a restructuring scheme or a corporate insolvency resolution process can raise ECBs only if it is specifically permitted to do so under its resolution plan. This is consistent with the recent changes to the insolvency laws in India.

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