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RBI REVISES ECB NORMS: A STEP IN THE RIGHT DIRECTION?

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Background

In view of the Central Government's objective of improving "ease of doing business" in India, the Reserve Bank of India (RBI) announced a new framework for external commercial borrowings (ECB) on 16 January 2019 liberalising the current ECB policy (the Revised ECB Framework).

The key highlights of the Revised ECB Framework are as follows:

Reclassification and Merging of Tracks

The bifurcation of ECBs into three distinct identified 'Tracks' under the erstwhile regulations has been largely modified by merging Track I and Track II as "FCY denominated ECB" and merging of Track III and Rupee Denominated Bonds (Masala Bonds) framework as "INR denominated ECB". The Revised ECB Framework is aimed at being "instrument-neutral" and is differentiated largely on the basis of the currency denominating such external commercial borrowing.

Eligible Borrowers List Expanded

While the erstwhile regulations categorised the eligible borrowers under different tracks and permitted certain identified entities to avail ECBs, the Revised ECB Framework simply provide that all entities eligible to receive foreign direct investment (FDI) as per the extant FDI policy are eligible to raise ECB from persons resident outside India. In addition, specific entities such as Port Trusts, Units in SEZ, SIDBI, EXIM Bank are permitted to raise foreign currency (FCY) denominated ECB as well as Indian rupee (INR) denominated ECBs. It is relevant to note that registered entities engaged in micro-finance activities (registered Not for Profit companies, registered societies/trusts/cooperatives and NGOs) are only permitted to raise ECBs under the INR denominated ECB route. It may now be possible for Indian banks to raise ECBs as eligible borrowers (as they are permitted to avail FDI). This is in line with the eligible borrower list applicable to Masala Bonds as per the erstwhile regime.

Although under the Revised ECB Framework the list of eligible borrowers have expanded, this change would also result in entities which are not permitted to avail FDI under the FDI policy (such as, those in the lottery business, gambling and betting including casinos, chit funds, Nidhi company, entities in real estate business, companies manufacturing cigars etc., activities/sectors not open to private sector investment such

as atomic energy, railway operations etc) to be restricted from availing ECBs as per the Revised ECB Framework.

Wider Pool of Recognised Lenders

In contrast to the erstwhile regulations which provided for an intricate system for recognised lenders under different tracks, the Revised ECB Framework eases the classification of 'recognized lenders' to bring it in line with the regime provided for Masala Bonds. The Revised ECB Framework states that in order to qualify as a 'recognised lender', such lender should be a resident of a Financial Action Task Force (FATF) or International Organization of Securities Commission (IOSCO) compliant country.

Further, multilateral and regional financial institutions where India is a member country will also be considered as recognised lenders. Related party lending for Masala Bonds is also now permitted under the Revised ECB Framework with the merging of Track III and the Rupee Denominated Bonds (Masala Bonds) framework. This is a major departure from the erstwhile Masala Bonds regime under which entities classified as related parties were not eligible to invest in Masala Bonds.

Additionally, under the Revised ECB Framework, individuals are also permitted as 'recognised lenders' only if they are a foreign equity holder or for subscription to bonds/debentures listed abroad. This is a shift from the erstwhile regime, which allowed individuals to lend ECBs only under Track III (INR denominated ECB) and subject to additional due diligence requirements. Therefore, individuals can now lend under FCY track or INR track provided they are either a foreign equity holder or are subscribing to bonds/debentures listed offshore. The position in relation to overseas branches/subsidiaries of Indian banks as participants as arranger/underwriters/market-makers/traders for Masala Bonds remain the same.

The changes in the 'recognised lender' regime under the Revised ECB Framework increases lending options, allowing various new lenders, including hedge funds, overseas corporate bodies, foreign portfolio investors, limited liability partnerships, etc. to lend from the offshore market to domestic entities, subject to compliance with the applicable regulatory conditions.

Minimum Average Maturity Period Relaxed

While the erstwhile regulations categorised ECBs under three tracks, Medium term ECB with minimum average maturity period (MAMP) of 1/3/5 years, Long term ECB with MAMP of 10 years and Indian Rupee denominated ECB with MAMP of 3/5 years, the Revised ECB Framework has set out an overall MAMP of 3 years across all tracks/forms of ECB irrespective of the amount of borrowing.

However, for oil marketing companies, the minimum maturity period is 3 years, provided that the overall borrowing does not exceed USD 10 billion or equivalent in a financial year.

Similarly, for ECBs availed from foreign equity holders which are proposed to be utilised towards working capital purposes, general corporate purposes or for repayment of rupee loans, the MAMP remains 5 years.

Uniform Application of All-in-Cost Ceilings

The Revised ECB Framework provides for a uniform all-in-cost ceiling of 450 basis points plus the benchmark rate. The prepayment charge or penal interest, if any, for default or breach of covenants needs to be restricted to 2% over and above the

contracted rate of interest on the outstanding principal amount and will be outside the all-in-cost ceiling.

Now, all-in-cost also includes Export Credit Agency (ECA) charges. For Foreign Currency Convertible Bonds (FCCBs), all issue related expenses cannot exceed 4% of the issue size and in case of private placement, such expenses cannot exceed 2% of the issue size.

End-Uses: Negative List Prescribed

The erstwhile ECB regulations provided a negative end-use list for ECBs which stated that ECB proceeds, raised under all tracks could not be utilised for investment in real estate activities, equity investments and investment in capital markets. Further, ECB proceeds raised under Track I and Track III, could not be utilised for (i) working capital; (ii) general corporate purposes; (iii) repayment of Rupee loans except when raised from a foreign equity holder provided that the MAMP of the loan is 5 years or such ECBs are availed under Track II (with a minimum average maturity of 10 years).

The Revised ECB Framework prescribes a common negative list for all forms of ECBs including Rupee denominated bonds, with a modification that ECBs for working capital/general corporate purposes and for repayment of rupee loans can only be availed from foreign equity holder.

Additionally, given that Rupee Denominated Bonds are now merged under the same track as INR denominated ECBs, the same end-use set out for all ECBs under the Revised ECB Framework would be applicable to Rupee Denominated Bonds as well. This may add certain restrictions to the erstwhile end-use regime for Masala Bonds which permitted proceeds from Masala Bonds to be utilised towards working capital purposes, general corporate purposes or for repayment of rupee loans. As per the Revised ECB Framework, even for masala bonds, for certain end-uses (such as working capital purposes, general corporate purposes/repayment of rupee loans), the investor needs to be a foreign equity holder, which seems to imply that related parties can now subscribe to Masala Bonds.

Further, the Revised ECB Framework has now explicitly defined "real estate activities" to mean and include any real estate activity involving owned or leased property for buying, selling and renting of commercial and residential properties or land and 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/development of industrial parks/integrated township/SEZ, purchase/long term leasing of industrial land as part of new project/modernisation of expansion of existing units or any activity relating to exploration, mining and refinery sectors. This adds clarity to the interpretation of the end-use restrictions under the ECB regime, as under the erstwhile regulations, 'real estate activities' were not specifically defined.

Borrowing Limits Liberalised

Under the Revised ECB Framework, all eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year which replaces the existing sector wise limits. This was the highest limit available only to entities in the infrastructure and manufacturing sectors. Now software development companies and micro-finance NBFCs can also raise ECBs upto USD 750 million.

Further, in case of FCY denominated ECB raised from a direct foreign equity holder, the ECB liability-equity ratio cannot exceed 7:1. Under the Revised ECB Framework, for the purposes of calculation of the ECB liability-equity ratio, the ECB amount will include all outstanding amounts of ECBs (other than INR ECBs) and the proposed one (for

refinancing, only outstanding ECB amount is to be calculated). The ECB amount and the equity will be calculated with respect to the foreign equity holder.

Hedging Provisions Revamped

The Revised ECB Framework reduces the mandatory hedging requirements for eligible borrowers raising FCY denominated ECB to 70% from the erstwhile requirement of 100%. The relaxed hedging norms will apply to ECBs with an average maturity of less than 5 years. This further eases the norms for overseas borrowing reducing hedging cost.

Introduction of late submission fee (LSF) for delay in reporting

The Revised ECB Framework prescribes payment of a late submission fee for the delay in reporting of drawdown of ECB proceeds before obtaining LRN or for delay in submission of Form ECB 2. This requirement obviates the need for direct compounding of such contraventions and provides additional time to the ECB borrowers for rectifying any irregularity in filing before such breach requires compounding with the RBI. Under the Revised ECB Framework, the RBI has also introduced the concept of 'untraceable entities', which are entities who are in breach of reporting requirements under the ECB regulations for 8 or more consecutive quarters. For such untraceable entities, the revised framework provides for standard operating procedures which sets out the actions that would be undertaken by the AD/RBI in respect of such entities.

Refinancing of existing ECB

Refinancing of existing ECB by raising fresh ECB is permitted provided that the outstanding maturity of the original borrowing or the weighted outstanding maturity in case of multiple borrowings is not reduced and all-in-cost of the fresh ECB is lower than the all-in-cost of the existing ECB or the weighted average cost in case of multiple borrowings.

ECB by entities under restructuring

Entities undergoing restructuring or if corporate insolvency resolution process has commenced under the provisions of the Insolvency and Bankruptcy Code, 2016, such entities will be eligible to raise ECBs only if it expressly permitted under the resolution plan.

Reporting Changes

While the reporting regime for ECBs largely remain the same, Form ECB is now required to be filed for application of the loan registration number from the RBI and for obtaining approval from RBI. In addition, monthly reporting of ECBs is still required to be done through filing of Form ECB 2 Return.

Comment

The Revised ECB Framework is aimed at boosting ease of doing business in India which would allow a wider-set of entities to borrow funds from the overseas market. Amidst the current liquidity concerns in the market, the liberalised regime is also expected to result in higher inflows widening the lender pool and making the ECB route a more favourable route for fund raising. With the merging of routes for Masala Bonds and INR denominated ECBs, additional end-use restrictions have been made applicable for Masala Bonds and this may result in the route for investment by FPIs seem to be more liberalised. However, the modifications brought about by the RBI in the revised framework are a step in the right direction as this would significantly increase activity in the foreign currency borrowing space by Indian entities.

However, while the new framework has been drafted with a view to provide a simplified and more liberalised regime for ECBs which would help in streamlining the applicable regulatory framework, further clarity is required on some aspects (as set out below), in order to properly achieve the policy objectives:

- *The Revised ECB Framework is silent on the provisions in the erstwhile ECB regulations on structured obligations and trade credits. Consequently, it is unclear whether these provisions continue to remain applicable and may require clarifications from RBI in due course;*

- *It appears that the Masala Bonds regime is to be read in conjunction with the new ECB framework (under INR denominated ECBs). This would mean that the requirement for obtaining RBI approval for all Masala Bonds are now removed and would result in a significant relaxation to the rupee denominated bonds sector.*

- *Another relaxation that seems to have been provided to the Masala Bonds route is that under the erstwhile regime, related parties were not permitted to invest in Masala Bonds. Now that this route is merged with INR ECB, it seems that foreign equity holders are recognised lenders/investors for all routes, which would also include Masala Bonds.*

- *The end-use for working capital/general corporate purposes have been restricted for Masala Bonds under the Revised ECB Framework. Under the earlier regime, proceeds out of Masala Bonds could be used for working capital and general corporate purposes and as per the revised framework, this can only be done if the investors are foreign equity holders.*

- *Given that all entities in permitted to avail FDI can now raise ECBs, this can be interpreted to mean that Indian banks can also be considered as 'eligible borrowers' for ECBs for this purpose and this could be a conscious step taken by the RBI to align the process with that of the erstwhile Masala Bonds regime which permitted Indian banks as eligible borrowers.*

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