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External Commercial Borrowing Guidelines – An Overview

EXTERNAL COMMERCIAL BORROWING GUIDELINES - AN OVERVIEW

☞ INTRODUCTION

The term External Commercial Borrowing (ECB) denotes the overseas sourcing of funds by companies in India. It provides extra financial support to the Indian companies and helps them meet their financial requirements. The Government of India has adopted a liberal approach towards ECBs. Increasingly, wholly owned subsidiaries of foreign companies in India have felt a need to adopt the facility available under the ECB route. This newsletter intends to provide an overview of the existing Indian lending and borrowing regulations[1].

The guiding principle with respect to ECB is to keep its borrowing maturities long and costs low. ECB can be availed in the form of commercial loan/ syndicated loan, line of credit, buyer's credit, financial lease, suppliers' credit, export credit, securitized instruments such as bonds, floating rate notes.

The ECB guidelines have been revised from time to time based on the current economic situation. The last revision was announced by the Government in a press release on January 19, 2004. Pursuant to this, the new changes in the ECB policy were notified by the RBI[2] on January 31, 2004.

Existing ECB Policy

Under the present policy, ECB can be availed through two routes, namely, (i) Automatic Route i.e. no prior RBI approval; and (ii) Approval Route, i.e. with prior RBI approval. The cases that do not fulfill the prescribed eligibility criteria will qualify under the approval route.

The following types of loans will qualify under the automatic route:

a) ECB up to USD 20 Million with minimum average maturity of 3 years.
b) ECB between USD 20 Million and USD 500 million with minimum average maturity of 5 years.
c) ECB up to USD 20 Million can have call/put option[3] provided the minimum average maturity of 3 years is complied before exercising call/put option.

The other features of the present ECB policy are set out herein below. The sign '*' against the titles in italics below denotes the common feature of both the automatic and approval route.

Eligible borrowers

Only the companies registered under the Companies Act, 1956 are eligible to raise ECBs under the automatic route. Borrowings by financial institutions and banks are considered on a case to case basis under the approval route.

Recognised lenders*

ECB can be raised from recognized sources such as international banks, international capital markets, multilateral financial institutions, export credit agencies, suppliers of equipment, foreign collaborators and foreign equity holders.

[1] Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2003, FEMA 3/2000 RB dated 3.5.2000.
[2] A.P. (DIR Series) Circular No. 60 of January 31, 2004.

[3] Call/put options can be exercised in respect of the Floating Rate Notes and Bonds.

Purpose*

The present guidelines also provide for keeping the funds abroad until actually required by the borrower. ECB can be used for certain specific purposes viz.

- Investment in real sector[4] and infrastructure[5] such as import of capital goods, new projects, modernization of the existing production units;
- Acquisition of shares in the disinvestment process;
- Offer to the public under the disinvestment scheme of Public Sector Units.

Prohibited use*

ECBs cannot be used for working capital, general corporate purposes, on-lending, investment in capital market by companies and real estate.

Prohibited instruments*

Guarantees, stand-by letter of credit and letter of comfort by banks are not permitted. However, corporate guarantees by directors, promoters of Indian companies and Indian joint venture partners are permitted, if asked by the lender.

Security*

The parties are free to opt for securing the loans by creating charge over the movable or immovable property/assets of the borrower. A separate prior RBI approval is required for creating charge over the shares[6] and immovable properties[7].

Prepayment*

The borrowers are permitted to prepay ECB up to USD 100 million subject to compliance of the minimum average maturity period of three years. The borrower can opt for prepayment of ECB only after the period of three years.

[4] Real sector includes industrial sector comprising of small and medium enterprises.
[5] Infrastructure sector comprises of power, telecommunications, railways, roads including bridges, ports, industrial parks and urban infrastructure.
[6] Under Regulation 3 of Notification No. FEMA 20/RB-2000, dated May 3, 2000.
[7] Under Regulation 8 of Notification No. FEMA 21/RB-2000 dated May 3, 2000

Refinancing*

There is a provision for refinancing of existing ECB. This can be availed by raising fresh loans from the same lender provided the costs are low and the outstanding maturity of the original loan is maintained.

Ceiling on costs*

RBI has imposed ceilings on costs relating to ECB such as rate of interest, other fees and expenses, pre-payment fee and fees payable in Indian rupees. The existing ceiling on such costs is as below:

Minimum average maturity period	All-in-costs ceilings over six month LIBOR
3 years and up to 5 years	200 basis points (2%)
More than 5 years	350 basis points (3.5%)

Procedure for availing ECB

The borrower has to comply with the ECB guidelines and, therefore, the procedure for availing ECB under both the automatic route and the approval route has to be followed by the borrower. If borrower contravenes the ECB guidelines, RBI may initiate a penal action[8].

The foremost requirement for availing ECB is that both the borrower and the lender should enter into a Loan Agreement (Agreement) setting out the terms and conditions. Unlike previous policy, there is no need for filing of a copy of the Agreement with the RBI. Under the Automatic Route, RBI has prescribed Form 83 (form) for reporting of the Agreement and for grant of Loan Registration Number (LRN).

Application under the Approval Route is made in Form ECB prescribed by RBI. The application is considered by the Empowered Committee which meets every fortnight to consider the matters under the approval route.

It is very critical that remittances towards ECB should only come after the grant of LRN under the Automatic Route and after the grant of approval under the Approval Route. The borrower companies must consult their bankers before receiving any

[8] Clarification issued vide A.P. (DIR Series) Circular No. 82 dated April 1, 2004.

remittances towards ECBs as both, Form 83 and Form ECB are routed through the bankers. Form 83 also requires certification by a Chartered Accountant before it is certified by the bank, which is not the case under the Approval Route.

☞ CONCLUSION

The enhanced credit limits under the automatic route with average maturity period of three and five years respectively has given flexibility to the borrowers as far as the quantum of ECB is concerned.

The present ECB guidelines also attempt to simplify the procedure. A word of caution is that before availing the ECBs, companies that qualify under the automatic route must ensure that the LRN is issued by the RBI before remittances are sent by the lenders.

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