

External commercial borrowing by foreign lenders in rupees

AUTHOR Dinesh Gupta, Abha Shah

PUBLISHED 15 September 2014

Borrowing of fund by Indian companies from overseas are regulated by the External Commercial Borrowing ("ECB") guidelines^[1] prescribed by Reserve Bank of India ("RBI"). Recently, RBI eased the procedures relating to ECB, in order to allow non-resident lenders to provide foreign loans to Indian borrowers in Indian currency .

What is ECB?

ECB refers to commercial loans availed by Indian borrowers from non-resident lenders. The borrowings could be in the form of bank loans, buyers' credit, suppliers' credit and shareholder's loans. The minimum average maturity of ECB must be for at least 3 years. ECBs can be taken up under the automatic route as well as the approval route. The maximum amount of ECB which can be raised by a corporate is \$750 million or its equivalent during a financial year. Corporates in the services sector such as hotels, hospitals and software sector and miscellaneous services sector are allowed to avail of ECB only up to \$200 million or its equivalent in a financial year.

ECBs can be used only for limited purposes as prescribed by RBI. ECB can be raised for: import of capital goods, investments in new projects or modernization/expansion of existing production units in industrial sector, infrastructure sector and specified service sectors, for first stage acquisition of shares in the disinvestment process, for lending to self-help groups and non-governmental organizations, for micro-credit or for micro finance activity and payment for spectrum allocation. The borrowings cannot be utilized for any other purpose including on-lending, investment in capital market, acquiring a company in India by a corporate or for real estate sector.

Who can avail of ECB?

Corporates, including those in the service sectors, Non-Banking Finance Companies ("NBFCs") infrastructure finance companies, asset finance companies, Small Industries Development Bank of India (SIDBI), trusts and non-governmental organizations engaged in micro-finance activities, units in Special Economic Zones (SEZ) are eligible to raise ECB.

Financial intermediaries, such as banks, financial institutions, housing finance companies and NBFCs, other than those specifically allowed by RBI, individuals, trusts and non-profit making organizations ((other than those specified) are not eligible to raise ECB.

Who are the recognized lenders for ECB?

Internationally recognized sources such as international banks, international capital markets, multilateral financial institutions, regional financial institutions and government owned development financial institutions, export credit agencies, suppliers of equipment, foreign collaborators and foreign equity holders are considered as recognized lenders.

Why do Indian companies prefer ECB?

Indian companies prefer ECBs over domestic borrowing as the cost of funds borrowed from external sources is comparatively lesser. The domestic rates of lending are very high in contrast with interest rates of ECBs. The international market is also a better source of funding in terms of availability of huge funds and flexibility offered for providing security.

What are the risks associated?

Since the funds are raised through ECBs in foreign currency and the interest & redemption proceeds are also payable in the foreign currency, the borrowers are exposed to risks associated with currency fluctuation. RBI had already acknowledged this problem and allowed Indian borrowers to raise funds through ECBs in Indian currency from foreign equity holders^[2].

What is the recent change brought about by RBI?

The Reserve Bank of India has relaxed the norms related to ECB by allowing recognized non-resident lenders to provide loans in Indian Rupees^[3]. There are certain conditions prescribed:

- The lender will have to enter into swap arrangements with Indian Banks^[4] to mobilize funds in Indian rupees.
- The ECB contract should comply with all other conditions applicable to the automatic and approval routes as the case may be.
- The all-in-cost^[5] of such ECBs should be commensurate with prevailing market conditions.
- The recognized non-resident lender has an option of setting up a representative office in India as per the procedure prescribed.

What is the impact of these provisions?

The new provisions have extended the facility of lending in Indian currency to foreign lenders which was earlier restricted to only foreign equity holders.

Indian lenders will now be competing with foreign lenders as the new provisions have opened the Indian market for foreign banks to provide funding to Indian companies in Indian Rupees. The option of setting up representative offices in India for the purpose of lending to Indian companies will also encourage banks that are contemplating future business prospects in India.

The foreign banks have an added advantage over Indian banks which have to comply with the requirements of Cash Reserve Ratio and Statutory Liquidity Ratio. Foreign banks, not being fettered by such requirements will be able to lend at lower rates as compared to Indian banks. This will, in turn benefit the Indian borrowers who will have to repay a relatively lesser amount of loan to the foreign lenders.

This relaxation in ECB norms would also make it easier for Indian corporates to raise funds at reduced forex risk. The new norms would insulate the borrowers from depreciation of the rupee value. However, on the flipside, they will also be thwarted from availing the benefits of rupee appreciation.

[1] *External Commercial Borrowings and Trade Credits availed of by residents are governed by section 6 (3) (d) of the Foreign Exchange Management Act, 1999 read with Notification No. FEMA 3/ 2000-RB viz. Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000, dated May 3, 2000, as amended from time to time.*

[2] *AP (DIR Series) Circular No. 27 dated September 23, 2011*

[3] *A.P. (DIR Series) Circular No.25 dated September 3, 2014*

[4] *Authorized Dealer Category-I bank in India*

[5] *All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees.*