

Regulatory Hotline

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EXTERNAL COMMERCIAL BORROWINGS: REGULATORY FRAMEWORK SUBSTANTIALLY RELAXED

- Regulatory framework for ECBs substantially liberalized.
- Basket of eligible lenders expanded and end-use restrictions limited.
- Eligible borrowers substantially expanded, and includes LLPs

Funding Indian corporates through debt has been traditionally been a preferred mode of funding due to inherent advantages such as security creation, minimum guaranteed returns and tax optimization for both the lender as well as the borrower. The modes for offshore debt funding have been limited to external commercial borrowings ("ECB"), non-convertible debentures ("NCD"), compulsorily convertible debentures and certain hybrid debt instruments. Each of these options have been subjected to regulatory restrictions in terms of eligible lenders, eligible borrowers, end-use restrictions, etc. Tightening of the NCD route (see hotline here), and the introduction of Rupee-denominated bonds under the ECB route (see hotlines here and here) have seen the ECB route gain more prominence as a preferred route, despite the challenges in the route for parties.

The Reserve Bank of India ("RBI") has now revised the framework substantially relaxing the regime for ECBs. The changes have removed almost all restrictions on eligible lenders and eligible borrowers and have substantially expanded the scope of end-use restrictions.

BACKGROUND

The ECB framework has been governed by the regulations of the RBI framed under the Foreign Exchange Management Act, 1999 ("FEMA"), and the 'Master Direction – External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers' (the "ECB Master Direction"). The RBI on January 16, 2019 has by way of a circular ("Circular") revised the entire existing regulatory framework for ECBs in India.

CHANGES

- Forms of ECB

Existing regulatory framework

- Track I and Track II: Foreign currency ECB
- Track III: Rupee denominated ECB
- Rupee denominated bonds ("RDB") as a separate category

Revised framework introduced under the Circular

- Option 1: Track I and Track II ECBs clubbed as 'Foreign currency denominated ECB' ("FCY ECB")
- Option 2: Track III and Rupee denominated bonds clubbed as INR denominated ECB ("INR ECB")

Takeaway: The various forms of ECB made the regulatory framework quite complex, and the rationale for the distinction (except for the foreign currency denominated ECB and the Rupee denominated ECB) was considered redundant in recent times. The clubbing of Track I and Track II ECB as a single option, i.e. the FCY ECB and the clubbing of Track III and RDBs into a single ECB option, i.e. INR ECB is a welcome move. The RBI has gradually over the last 12 – 18 months amended the ECB Master Directions such that the regulatory differences between Track I and Track II ECBs, as well as between Track III and RDBs have been narrowing. While there were still pertinent differences between the various options (eligible lenders, eligible borrowers and end use prescriptions), such differences also offered the parties opportunities for regulatory arbitrage. The clubbing of the tracks will result in the ECB regulatory framework being simpler and less complex, and reduce regulatory arbitrage.

- Eligible borrowers

Existing regulatory framework

- Track I, Track II and Track III: Specified entities – engaged in particular activities
- RDB: Any corporate / body corporate / Real Estate Investment Trusts / Infrastructure Investment Trusts.

Revised framework introduced under the Circular

- FCY ECB: All entities eligible to receive foreign direct investment ("FDI")
- INR ECB: Same as FCY ECB, i.e. all entities eligible to receive FDI.

Takeaway: One of the most important considerations for determining if ECB was a viable option for raising offshore debt was whether the proposed borrower is eligible to raise ECB. This was often considered to be a substantial bottleneck, considering that the ECB framework also provided for end-use restrictions in terms of the funds raised through the ECB (see below).

The RBI has now done away with the specific eligibility requirements, and prescribed that any entity eligible to raise FDI shall be permitted to raise ECB. This is a positive move in considering that the list of entities eligible to raise FDI

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are sufficiently regulated in any case under the regulations applicable to FDI. The specific permission for real estate investment trusts and infrastructure investment trusts have been removed since FDI is permitted in such entities, and they would qualify for availing ECB in any case. Basis the same logic, an interesting aspect to be noted here is that FDI is also permitted in certain limited liability partnerships (“LLP”), and hence ECB may also be availed of by LLPs. It is unclear if the RBI intended to open the ECB route for LLPs as well, but if this is the case, it would provide a much needed encouragement to LLPs as well, and may result in growth in the number of LLPs used for structuring investments.

■ **Eligible lenders**

Existing regulatory framework

- Track I, Track II and Track III: Specified entities – engaged in particular activities
- RDB: Any resident of a country (i) which is a member of the Financial Action Task Force (FATF) (or a member of a FATF style regional body); or (ii) whose securities market regulator is (a) a signatory to International Organization of Securities Commissions Multilateral Memorandum of Understanding or (b) a signatory to bilateral memorandum of understanding with SEBI for information sharing arrangements. 'Related parties' of the borrowing entity are not entitled to invest in the RDBs being issued.

Takeaway: The Circular revises the persons who are eligible to be lenders under the ECB framework. While earlier specified persons were only entitled to be eligible lender (under the 3 tracks), the RDB route was preferred since there was no specific requirement on a person to be an eligible lender. However, by now having the same eligibility for lenders under the FCY ECB and INR ECB, lenders who were not eligible under track I and track II are also now eligible. This would provide a major push for such lenders, who wanted to lend in foreign currency, but were unable to due to ineligibility as lenders. This also broadens the options available for potential lenders under the ECB framework.

Another major benefit of the changes introduced under the Circular is the removal of the restriction on related parties (defined under the applicable accounting standard) to invest in RDBs. Captive lending, i.e. lending by parent companies to its Indian subsidiaries has often been a preferred mode of investment into subsidiaries by offshore parents. However, this restriction on subscription of RDBs by related parties resulted in this option being unavailable to parent companies till now. The removal of the restriction would also provide offshore parents the option to invest through RDBs.

■ **Minimum average maturity period**

Existing regulatory framework

- Track I: Minimum average maturity period (“MAMP”) of 3 years for ECB of up to USD 50 million, and 5 years for ECB of above USD 50 million (save certain exceptions);
- Track II: MAMP of 10 years;
- Track III: MAMP of 3 years for ECB of up to USD 50 million, and 5 years for ECB of above USD 50 million (save certain exceptions);
- RDB: MAMP of 3 years for ECB of up to USD 50 million, and 5 years for ECB of above USD 50 million (save certain exceptions). Call / put options (if any) also to comply with the MAMP.

Takeaway: The Circular has removed the distinction between the MAMP applicable under the various tracks and RDB. The new ECB framework has a single MAMP applicable to both FCY ECB as well as INR ECB. This is a welcome step since the distinguishing factor between the various tracks was becoming redundant. For instance, the long MAMP under Track II was proving to be a deterrent for parties to avail ECB under Track II.

■ **End-use restrictions**

Existing regulatory framework

- Track I and Track III: The end use restrictions are (a) real estate / purchase of land; (b) investment in capital market; (c) equity investments; (d) working capital purposes or general corporate purposes; (e) repayment of Rupee loans; and (f) on-lending for the above activities;
- Track II: The end use restrictions are (a) real estate / purchase of land; (b) investment in capital market; (c) equity investments; and (d) on-lending for the above activities;
- RDB: The end use restrictions are (a) real estate / purchase of land; (b) investment in capital market; (c) equity investments; (d) activities prohibited as per FDI guidelines; and (d) on-lending for the above activities.

Revised framework introduced under the Circular

- FCY ECB and INR ECB:
- All residents of a FATF or IOSCO compliant country.
- Individuals are eligible to be lenders under the ECB framework if they are foreign equity holders (i.e. hold 26% directly or 51% indirectly in the borrower).

Revised framework introduced under the Circular

- FCY ECB and INR ECB: MAMP of 3 years (irrespective of amount). However, for ECB raised from foreign equity holders for general corporate / working capital purposes, the MAMP is 5 years.

Revised framework introduced under the Circular

- FCY ECB and INR ECB: The end use restrictions in case of both FCY ECB and INR ECD are (a) real estate activities; (b) investment in capital market; (c) equity investments; (d) repayment of Rupee loans (except if from foreign equity holder); (e) working capital purposes and general corporate purposes (except if from foreign equity holder); and (f) on-lending for the above activities.

Takeaway: While the Circular has sought to simplify and harmonize the end-use restrictions across the various tracks and RDB by prescribing a single negative / restrictive end-use prescription. However, an unwanted implication of the harmonizing the end-use restriction is that the restrictions that were not applicable to Track II and RDBs earlier (most notably being general corporate purpose and working capital purposes) are now applicable to them. This could have major implications for ECBs through RDBs, since general corporate purposes / working capital purposes was one of the pre-dominant purposes for which ECB was raised.

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CONCLUSION

The revision of the regulatory framework for ECB by the RBI is a positive step in simplifying the extant regime for ECB, and has resulted in substantial easing of the regime for debt funding by foreign corporates. The tax sops that have been introduced for ECBs, coupled with relaxation on LLPs raising ECBs, bucket of eligible lenders and the purpose for which ECBs can be raised, should encourage further ECB flows into the country.

— **Abhinav Harlalka & Karan Kalra**

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