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ECBs & FCCBs

12.1 ECBs – Introduction

In Chapter 11 we dealt with how an Indian company can raise funds from overseas by way of ADRs/ GDRs. In this Chapter, we will look at the other two modes, namely, ECBs and FCCBs.

ECBs or External Commercial Borrowings have become increasingly popular with Indian companies in the last few years. The increased appetite for ECBs has made the RBI constantly change and modify the ECB Policy to keep it abreast with the changing times. In fact, according to RBI estimates, the ECB mark is expected to cross $ 15 billion in 2005-06. Simply put, an ECB is a loan obtained in foreign currency by an Indian entity. The lenders are foreign investors. The repayment of the loan as well as the interest thereon is to be paid in foreign currency. Thus, in an ECB, the borrower (i.e., the Indian company) would be exposed to the risk of foreign exchange fluctuation. Unlike in the case of ADRs/ GDRs, the Government is very cautious with the use of ECBs as a means of financing. One of the key concerns of the Government with freely allowing ECBs is that Indian high-cost debt would be substituted with foreign low-cost debt. This would impact the Indian banking sector. ECBs can be issued under two routes:

(a) Automatic Route of the RBI: Companies eligible to raise ECBs under this route do not need any permission.
(b) Approval Route of the RBI: Companies which are ineligible to raise ECBs under the Automatic route need the prior permission of the RBI. Even if a company has a doubt as to whether or not it is eligible under the Automatic Route, then it can adopt the Approval Route.

12.2 Guidelines for Automatic Route

The important provisions of the latest ECB policy are as follows:

(a) Eligible borrowers
   (i) Corporates registered under the Companies Act except financial intermediaries (such as banks, financial institutions (FIs), housing

finance companies and NBFCs) are eligible. These entities can raise up to US$500 million in any one financial year, either at one-shot or in tranches. An additional amount of USD 250 million can be raised with an average maturity period of more than 10 years.

(ii) Certain Non-Government Organisations (NGOs) engaged in micro finance activities are eligible to avail ECB. These entities can raise up to US$5 million in any one financial year.

(iii) Any other entity as may be specified by the RBI.

(b) Recognised Lenders

The following category of lenders are allowed in case of an ECB under the Automatic Route:

(i) Borrowers can raise ECB from internationally recognised sources such as international banks, international capital markets, multilateral financial institutions (such as IFC, ADB, CDC etc., export credit agencies, suppliers of equipment, foreign collaborators and foreign equity holders. Overseas organisations and individuals complying with following safeguards may provide ECB to NGOs engaged in micro finance activities.

(ii) Overseas organisations planning to extend ECB would have to furnish a certificate of due diligence from an overseas bank which in turn is subject to regulation of host-country regulator and adheres to Financial Action Task Force (FATF) guidelines to the designated Authorised Dealer.

(iii) An Individual Lender has to obtain a certificate of due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence/ documents such as audited statement of account, income tax return, need to be certified and forwarded by the overseas bank. Individual lenders from countries wherein banks are not required to adhere to Know Your Customer (KYC) guidelines cannot be lenders.

(iv) In case the ECB is from a "foreign equity holder" under the automatic route, then he would require minimum holding of equity required by him in the borrower's company is as under:

- If the ECB is up to USD 5 million – then a minimum equity of 25 % must be held directly by the lender,
- If the ECB is more than USD 5 million – then a minimum equity of 25% must be held directly by the lender and the debt-equity ratio of the company must not exceed 4:1(i.e., the proposed ECB should not exceed four times the direct foreign equity holding).

(c) Amount and Maturity

For ECBs up to USD 20 million or equivalent the minimum average maturity is 3 years. For ECB above USD 20 million and up to USD 500 million or equivalent the minimum average maturity is 5 years. The maximum amount of ECB which can be raised by a corporate is USD 500 million during a financial year. ECB up to USD 20 million can have a call/ put option provided the minimum average maturity of 3 years is complied before exercising call/ put option. An additional amount of USD 250 million can be raised with an average maturity period of more than 10 years.

(d) All-in-cost ceilings

The all-in-cost ceilings for ECB currently valid are as follows:

Average Maturity Period	All-in-cost Ceilings over 6 month LIBOR*
3 to 5 years	150 basis points
More than 5years	250 basis points

* LIBOR = London Inter Bank Operating Rate

(e) End-use restrictions

There are several dos and don’ts as regards the utilisation of the ECB proceeds:

ECB can be raised only for investment (such as import of capital goods, new projects, modernisation/ expansion of existing production units) in real sector - industrial sector including small and medium enterprises (SME) and infrastructure sector - in India. Infrastructure sector is defined to mean power, telecommunication, railways, road including bridges, ports, industrial parks and urban infrastructure (water supply, sanitation and sewage projects);

(i) ECB proceeds can be utilised for overseas direct investment in Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/ WOS abroad.

(ii) Utilisation of ECB proceeds is permitted in the first stage and second stage acquisition of shares in the disinvestment process of PSU shares.

(iii) NGOs engaged in micro finance activities may utilise ECB proceeds for lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building.

(iv) Utilisation of ECB proceeds is not permitted for on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate.

(v) Utilisation of ECB proceeds is not permitted in real estate. Recently, the use of ECBs have been prohibited even for the development of integrated townships.

(vi) End-uses of ECB for working capital, general corporate purpose and repayment of existing Rupee loans are not permitted. This is a very crucial restriction which must be borne in mind while raising an ECB.

(f) Guarantees

Banks, financial institutions and NBFCs, cannot issue guarantee, standby letter of credit, letter of undertaking or letter of comfort relating to ECB.

(g) Security

The choice of security to be provided to the lender/ supplier is left to the borrower. However, creation of charge over immovable assets and financial securities, such as shares, in favour of overseas lender is subject to the FEMA Regulations.

(h) Parking of ECB proceeds overseas

ECB proceeds should be parked overseas until actual requirement in India. They can be invested in short-term investment routes.

(i) Prepayment

Prepayment of ECB up to USD 300 million may be allowed by Authorised Dealers without the prior approval of the RBI subject to compliance with the stipulated minimum average maturity period as applicable to the loan.

(j) Refinance of existing ECB

Refinancing of existing ECB by raising fresh ECB at lower cost is allowed provided that the outstanding maturity of the original loan is maintained.

12.3 Approval Route

The following are the important provisions for ECBs covered under the Approval Route.

(a) Eligible borrowers

(i) Financial institutions dealing exclusively with infrastructure or export finance such as IDFC, IL&FS, Power Finance Corporation, Power Trading Corporation, IRCON and EXIM Bank are considered on a case by case basis.

(ii) Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government are also permitted to the extent of their investment in the package and assessment by RBI based on prudential norms.

(iii) Cases falling outside the purview of the automatic route limits and maturity period.

(iv) ECBs with minimum average maturity of 5 years by non-banking financial companies (NBFCs) from multilateral financial institutions, reputable regional financial institutions, official export credit agencies and international banks to finance import of infrastructure equipment for leasing to infrastructure projects.

(b) Recognised Lenders

Borrowers can raise ECB from internationally recognised sources such as international banks, international capital markets, multilateral financial institutions (such as IFC, ADB, CDC etc., export credit agencies, suppliers of equipment, foreign collaborators and foreign equity holders. The requirement for an ECB from a foreign equity holder is that the minimum equity held directly by the foreign equity lender is 25% but the debt-equity ratio exceeds 4:1(i.e. the proposed ECB exceeds four times the direct foreign equity holding).

(c) All-in-cost ceilings

Same as under the Automatic Route

(d) End-use Restrictions

Same as under the Automatic Route

(e) Guarantees

Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, financial institutions and NBFCs relating to ECB is normally not permitted. However, the RBI will consider applications for providing guarantee/ standby letter of credit or letter of comfort by banks, financial institutions relating to ECB in the case of Small and Medium Enterprises on merit subject to prudential norms.

(f) Security

Same as under the Automatic Route

(g) Parking of ECB proceeds overseas

Same as under the Automatic Route

(h) Prepayment

- Prepayment of ECB up to USD 300 million may be allowed by Authorised Dealers without the prior approval of RBI subject to compliance with the stipulated minimum average maturity period as applicable to the loan.
- Pre-payment of ECB for amounts exceeding USD 200 million would be considered by the Reserve Bank under the Approval Route.

(i) Refinance of existing ECB

Refinancing of outstanding ECB by raising fresh ECB at lower cost is permitted subject to the condition that the outstanding maturity of the original loan is maintained.

12.4 FCCBs - Meaning

FCCBs or Foreign Currency Convertible Bonds are another source of raising foreign investment. An FCCB as the name suggests is basically a Bond. However, it also carries with a feature of being converted into equity shares of the company. Thus, although it is a debt instrument it has the capability of being converted into equity shares and hence, it can be termed as a quasi-equity instrument. The popularity of FCCBs with corporate India as a means of financing can be judged from the fact that in 2005 Indian companies have raised $4.59 billion via FCCBs. As compared to this it was $2.4 billion in 2004 and only $150 million in 2003. Some of the important features of this extremely popular instrument are as under:

(a) The FCCBs are convertible into equity shares at any time before the redemption date.
(b) FCCBs are normally listed on a European stock exchange, such as Luxembourg, London, etc. However, they may also be listed on other exchanges such as Singapore, etc.
(c) FCCBs carry an interest rate or a coupon. Normally because of the conversion option, this rate is lower than a pure ECB.
(d) The price at which the conversion of the FCCB into equity shares would take place is specified. It may be a fixed price but normally it is formula based, e.g., an average of the prices for the week prior to conversion.
(e) No lock-in applies to the FCCBs.
(f) FCCBs do not carry any voting rights till such time as they are converted into equity shares.

12.5 Regulatory framework

The FEMA Guidelines provide for the issue of an FCCB. Further, the ECB Guidelines also apply to FCCBs. Hence, all the provisions mentioned for ECBs would also apply to an FCCB. The important provisions of the FEMA Guidelines as applicable to FCCBs are summarised below:

(a) No person resident in India is permitted to issue or transfer a foreign security without special or general permission of the RBI. However, an Indian Company or a Body Corporate created by an Act of Parliament is given permission to:
    i) issue FCCBs not exceeding USD 500 million to a person resident outside India in accordance with and subject to the specified conditions.
    ii) issue FCCBs beyond US $ 500 million with the specific approval of the Reserve Bank.
(b) The company/ body corporate, issuing the FCCBs shall, within 30 days from the date of issue, furnish a report to the Reserve Bank giving the specified details and documents.
(c) The FCCBs must conform to the Foreign Direct Investment Policy (including Sectoral Cap and Sectors where FDI is permissible) of the Government of

India as announced from time to time and the Reserve Bank's Regulations/directions issued from time to time.

(d) The issue of FCCBs shall be subject to a ceiling of USD 500 million in any one financial year.

(e) In case of a public issue of FCCBs, it shall be only through reputed lead managers in the international capital market. In case of a private placement, the placement shall be with banks, or with multilateral and bilateral financial institutions, or foreign collaborators, or foreign equity holder having a minimum holding of 5% of the paid up equity capital of the issuing company. Private placement with unrecognised sources is not permitted.

(f) The maturity of the FCCB must not be less than 5 years. Any call and put option, cannot be exercisable before 5 years.

(g) Issue of FCCBs with attached warrants is not permitted.

(h) The "all in cost" will be on par with those prescribed for External Commercial Borrowing (ECB) schemes, which is as under:

Average Maturity Period	All-in-cost Ceilings over 6 month LIBOR*
3 to 5 years	200 basis points
More than 5 years	350 basis points

* LIBOR = London Inter Bank Operating Rate

(i) The FCCB proceeds shall not be used for investment in Stock Market, and may be used for such purposes for which ECB proceeds are permitted to be utilized under the ECB schemes.

(j) FCCBs are allowed for corporate investments in industrial sector, especially infrastructure sector. Funds raised through the mechanism may be parked abroad unless actually required.

(k) FCCBs for meeting rupee expenditure under automatic route must be hedged unless there is a natural hedge in the form of uncovered foreign exchange receivables.

(l) Financial intermediaries (viz. a bank, DFI, or NBFC) are not allowed to raise FCCBs, except those Banks and financial intermediaries that have participated in the Textile or Steel Sector restructuring package of the Government/ RBI subject to the limit of their investment in the package.

Further, FCCBs can also be raised by housing finance companies satisfying the following minimum criteria: (i) the minimum net worth of the financial intermediary during the previous three years shall not be less than Rs. 500 crore, (ii) it must be listed either on the BSE or on NSE, (iii) the minimum size of the FCCB is US$ 100 million, (iv) the applicant should submit the purpose/ plan of utilization of funds. Recently, HDFC raised an $500 million by way of an FCCB issue.

(m) Banks, FIs, NBFCs cannot provide guarantee/letter of comfort etc. for the FCCB issue.

(n) The issue related expenses shall not exceed 4% of issue size and in case of private placement, shall not exceed 2% of the issue size.

(o) The issuing entity shall, within 30 days from the date of completion of the issue, furnish a report to the concerned Regional Office of the Reserve Bank of India through a designated branch of an Authorized Dealer giving the prescribed details and documents.