

# LEGAL ALERT

## ECB Revised Framework 2015 – Simplification for General Corporate Purposes

By Dipak Rao and Gunjan Gupta

### Introduction

External Commercial Borrowings, more commonly referred to as ECB, includes bank loans, buyers' credit, suppliers' credit, foreign currency convertible bonds, financial lease, foreign currency exchangeable bonds and securitized instruments which can be availed by specified Indian borrowers from recognized foreign lenders for the permitted end-uses under the regulations notified by the Reserve Bank of India ('RBI') from time to time. Any borrowing from a foreign lender, whose maturity period extends beyond three years, is eligible to qualify as an ECB. Due to the prolonged duration of such borrowings, they qualify as long term debts and thus, can be termed to be capital account transactions as defined under the Foreign Exchange Management Act, 1999.<sup>1</sup>

The recent trend of investment in Indian companies has been enthralling for startups and innovative companies. In order to promote investment into businesses, Securities Exchange Board of India ('SEBI') and the RBI have been striving to liberalize financing. While the SEBI has floated concept papers on crowdfunding and has introduced an institutional trading platform for startups and the small and medium-sized enterprises, the RBI has moved to improve the foreign investment prospects in Indian companies by issuing various circulars on this subject matter, from time to time.

ECB can be obtained either through automatic or approval route, depending on the restrictions which may be in force at the time of filing the application. For automatic route, the cases are examined by the concerned Authorised Dealer Banks ('AD Banks'), whereas under the approval route, the prospective borrowers are required to send their requests to the RBI through their concerned AD Banks.

The RBI in 2013<sup>2</sup> for the first time permitted the eligible borrowers to avail ECB from their direct foreign equity holders, for general corporate purposes, subject to certain conditions specified therein, under the approval route.

In 2014<sup>3</sup>, the RBI further permitted the eligible borrowers (viz. the companies belonging to manufacturing, infrastructure, hotels, hospitals and software sectors) to obtain ECB from direct equity holders for general corporate purposes (including working capital requirement), under the automatic route.

Recently, a revised framework ('Revised Framework') of ECB policy was floated by the RBI in November, 2015<sup>4</sup> for further simplification of the procedure for availing ECB, inter-alia, for general corporate purposes. The said Revised Framework has been enforced with effect from December 02, 2015.<sup>5</sup> This article will elaborate on

<sup>1</sup> Schedule I of Foreign Exchange Management (Permissible Capital Account Transaction) Regulations, 2000.

<sup>2</sup> Vide Circular No. 31 dated September 04, 2013

<sup>3</sup> Vide Circular No. 130 dated May 16, 2014

<sup>4</sup> Vide Circular No. 32 dated November 30, 2015

<sup>5</sup> Date of publication of the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange)

the allowed ECBs for general corporate purposes, in view of the reformative outlook of the RBI.

### **ECB – Former Regime**

Under the former regime, eligible borrowers were only permitted to avail ECB for general corporate purposes from foreign direct equity holders, under approval route/automatic route, subject to the specified conditions.

Following conditions existed under both, automatic route as well as approval route.

- a) Eligible borrowers were permitted to avail ECB from the foreign direct equity holders, up to USD 5 million or its equivalent, if the foreign direct equity holders were holding minimum 25% equity holding in the borrowing entity.
- b) Minimum average maturity period for availing ECB for general corporate purposes was 7 years. Also, no prepayment was allowed before the expiry of the said 7 years of minimum average maturity period.

The conditions which distinguished availing ECB under automatic route/approval route were as under:

- a) In case of automatic route, the eligible borrowers were permitted to avail ECB from the foreign direct equity holders beyond USD 5 million or its equivalent, if (i) the foreign direct equity holders were holding minimum 25% equity holding in the borrowing entity and (ii) ECB liability: equity ratio was not more than 4:1 i.e. ECB liability of the borrower (including all outstanding ECBs and the proposed one) towards the foreign equity

holder was not more than 4 times of the equity contributed by the foreign direct equity holder. Whereas, in case of approval route, the eligible borrowers were permitted to avail ECB from the foreign direct equity holders beyond USD 5 million or its equivalent, if (i) the foreign direct equity holders were holding minimum 25% equity holding in the borrowing entity and (ii) ECB liability: equity ratio was not more than 7:1 i.e. ECB liability of the borrower (including all outstanding ECBs and the proposed one) towards the foreign equity holder was not more than 7 times of the equity contributed by the foreign direct equity holder.

In case of automatic route, the borrower was entitled to a maximum of USD 200 million ECB in a financial year in hotels, hospitals and software sectors, and a maximum of USD 750 million in manufacturing and infrastructure sector in a financial year. Whereas, in case of approval route, the borrower was entitled ECB beyond USD 200 million in a financial year in hotels, hospitals and software sectors, and ECB beyond USD 750 million in a financial year the manufacturing and infrastructure sectors.

### **ECB – New Regime under the Revised Framework**

Revised Framework segregates ECB broadly into following three tracks<sup>6</sup>:

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(Amendment) Regulations, 2015 in the Official Gazette of Government of India – Extraordinary – Part-II, Section 3, Sub-Section (i) dated 02.12.2015- G.S.R.No.920(E).

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<sup>6</sup> Master Direction – External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers dated January 01, 2016

<b>Track I</b>	Medium term foreign currency denominated ECB with minimum average maturity period of 3/5 years
<b>Track II</b>	Long term foreign currency denominated ECB with minimum average maturity period of 10 years
<b>Track III</b>	Indian Rupee denominated ECB with minimum average maturity period of 3/5 years

The Revised Framework has bifurcated the permitted sectors of the older regime where ECB was permitted for general corporate purposes, under all 3 Tracks (for manufacturing and software development sector) and under Track II & Track III (infrastructure sector<sup>7</sup> which inter-alia includes hospitals and hotels) under the new regime. Meaning thereby, infrastructure sector<sup>8</sup> which inter-alia includes hospitals and hotels can no longer avail Medium term foreign currency denominated ECB under the new regime.

Although, the Revised Framework clearly states that Track I eligible borrowers viz. companies in manufacturing and software development sector can avail medium term foreign currency denominated ECB for general corporate purposes (including working capital) from foreign equity holders with a minimum average maturity period of 5 years, it appears that all Track II eligible borrowers (which also includes Track I eligible borrowers) can avail long term foreign currency denominated ECB for general corporate purposes (including working capital) from all the recognized lenders including foreign equity holders, with a minimum average maturity period of 10 years. It also appears that all Track III eligible borrowers (which also includes Track I and II eligible borrowers but excludes NBFCs, NBFCs-MFI, NGO, not for profit companies under the Companies Act, 1956/2013, developers of SEZs and NMIZs) can avail Indian rupee

denominated ECB for general corporate purposes (including working capital) from all the recognized lenders excluding foreign equity holders, with a minimum average maturity period of 3 years for ECB up to USD 50 million or its equivalent or 5 years for ECB beyond USD 50 million or its equivalent.

Under the Revised Framework, the definition of the 'foreign equity holder' has been simplified and includes (a) a direct foreign equity holder with a minimum direct equity shareholding of 25% in the borrower entity, (b) an indirect equity holder with a minimum indirect equity shareholding of 51% in the borrower entity or (c) a group company with a common overseas parent.

The individual limits, on the other hand, have remained the same for companies in manufacturing, infrastructure and software development sector. The following table explains the proposed model for obtaining ECBs in the permitted sectors-

<sup>7</sup> Liberalisation of definition of Infrastructure Sector under A.P. (DIR Series) Circular No. 48 dated September 18, 2013

<sup>8</sup> Ibid.

Individual limits (per financial year)	Manufacturing and Infrastructure including Hospitals and Hotels	Software Development Sector and Sector	Other Sectors
<b>Upto USD 200 Million or its equivalent</b>	Automatic Route	Automatic Route	Automatic Route
<b>Upto USD 500 Million or its equivalent</b>	Automatic Route	Approval Route	Automatic Route
<b>Upto USD 750 Million or its equivalent</b>	Automatic Route	Approval Route	Approval Route
<b>Beyond USD 750 Million or its equivalent</b>	Approval Route	Approval Route	Approval Route

Under the Revised Framework, the criteria for determining the applicable route i.e. approval route/ automatic route is still largely based on individual limits.

### Conclusion

It is pertinent to note that ECBs have developed as an instrumental mode of investment into Indian companies, which is of prime importance when the Indian Government has initiated Make in India campaign wherein the sole objective is to make FDI policy more progressive and turn India into the most coveted investment destination of the world. The RBI has envisaged applicability of the Revised Framework upon those transactions which are executed on or after December 02, 2015<sup>9</sup>. Thus, ECB can be availed under the older regime up to March 31, 2016, provided the loan agreement was executed prior to the enforcement of the Revised Framework i.e. December 02, 2015, except, (i) ECB facility for working capital by airlines companies; (ii) ECB facility for consistent

foreign exchange earners under the USD 10 billion

scheme; and (iii) ECB facility for low cost affordable housing projects (low cost affordable housing projects as defined in the extant foreign direct investment policy) where agreement can be executed and loan registration number can be obtained by March 31, 2016 irrespective of enforcement of the Revised Framework. The minimum average maturity period with respect to the ECBs for general corporate purposes has increased for Track II eligible borrowers, from 7 years to 10 years, it has comparatively reduced for Track I and III eligible borrowers. Reshuffling of automatic/approval route, widening of the list of the recognized lenders and minimization of the restricted end-uses may further solidify investments in various sectors. As various stakeholders applaud the liberalization of policies by the RBI, the impact of the Revised Framework remains to be seen.



**Dipak Rao**  
Senior Partner  
dipak@singhania.in



**Gunjan Gupta**  
Senior Associate  
gunjan@singhania.in

<sup>9</sup> Para 2.22 of the Master Direction – External Commercial Borrowings, Trade Credit , Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers dated January 01, 2016.