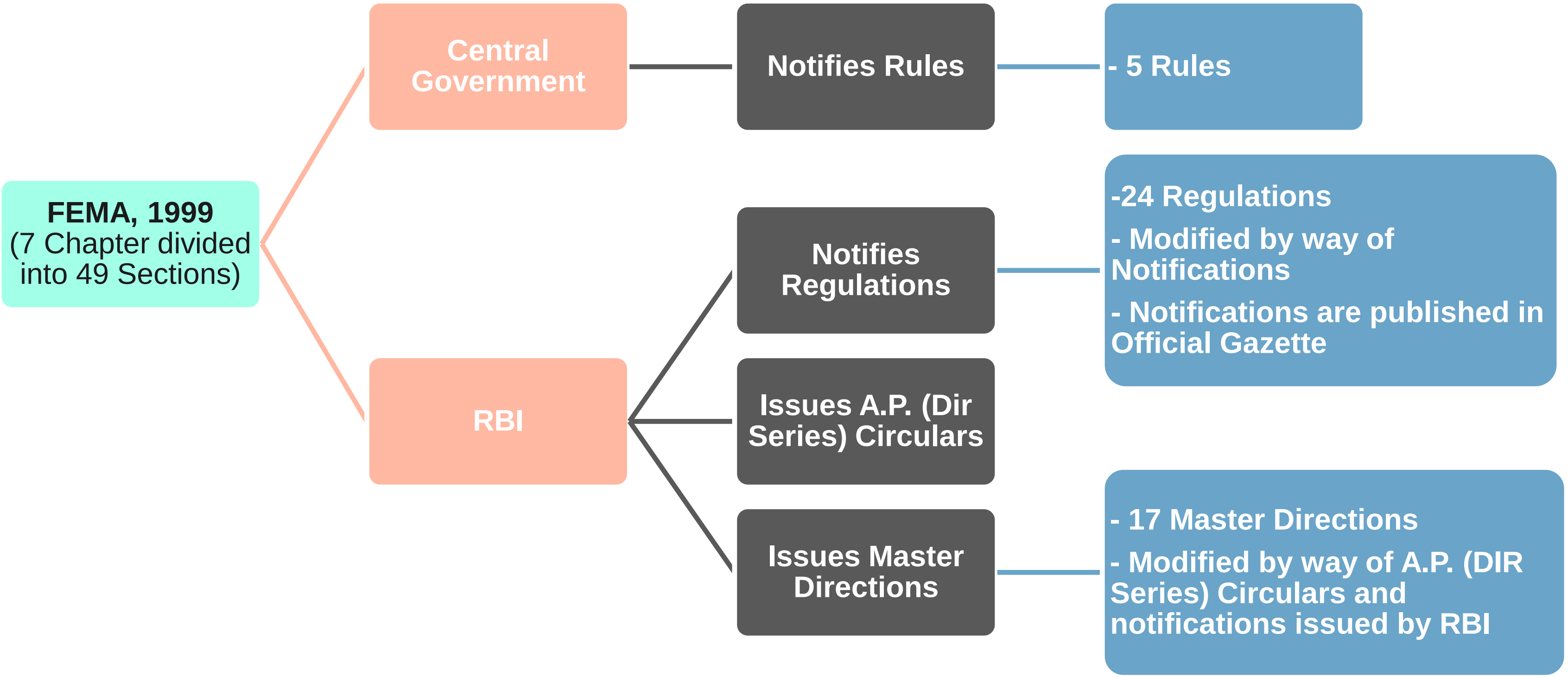
Funding Options for foreign companies in India

SOY JOSEPH

Director, SAS Partners Corporate Advisors

Framework under FEMA



Capital Account Vs Current Account

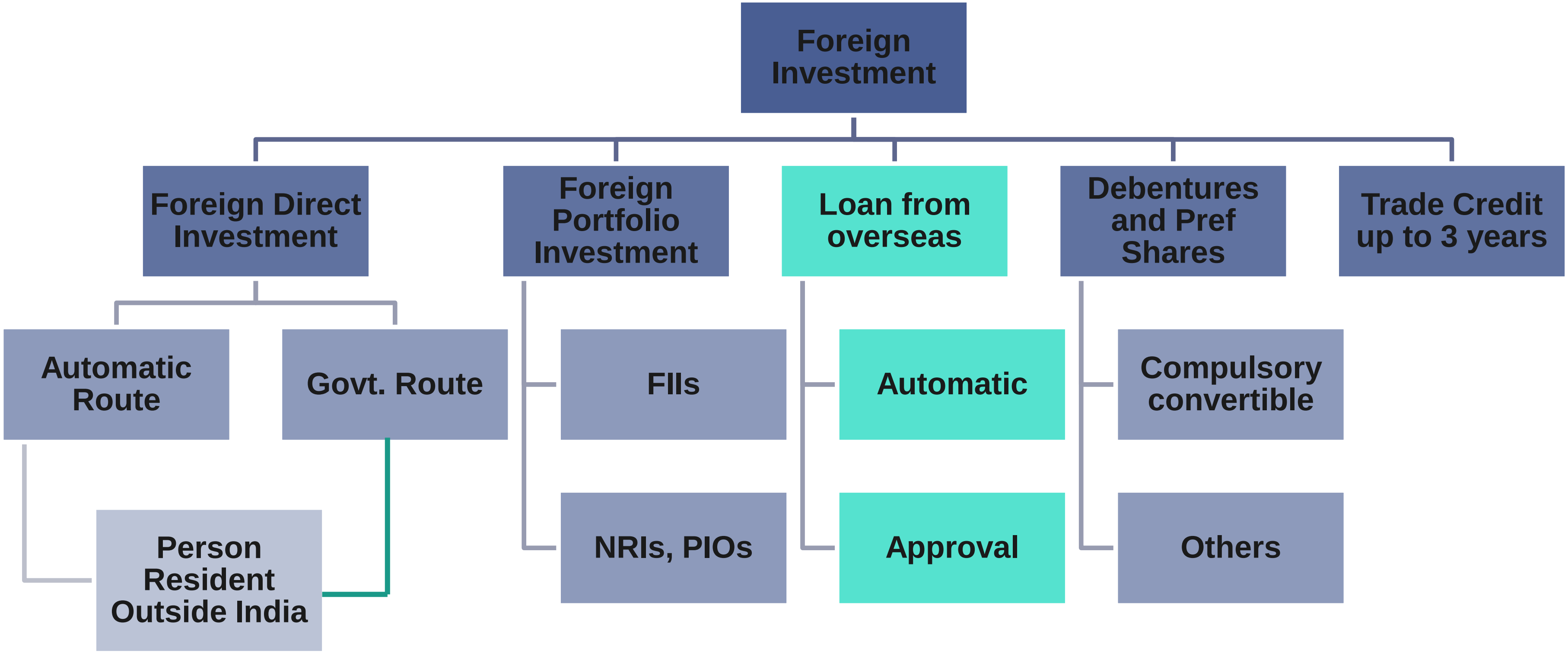
Capital Account Transaction generally prohibited unless permitted (generally or specifically)

Every transaction is either Capital or Current

Current Account Transaction generally permitted unless prohibited

Is India moving towards complete Capital Account Convertibility?

Ways of Foreign Investment

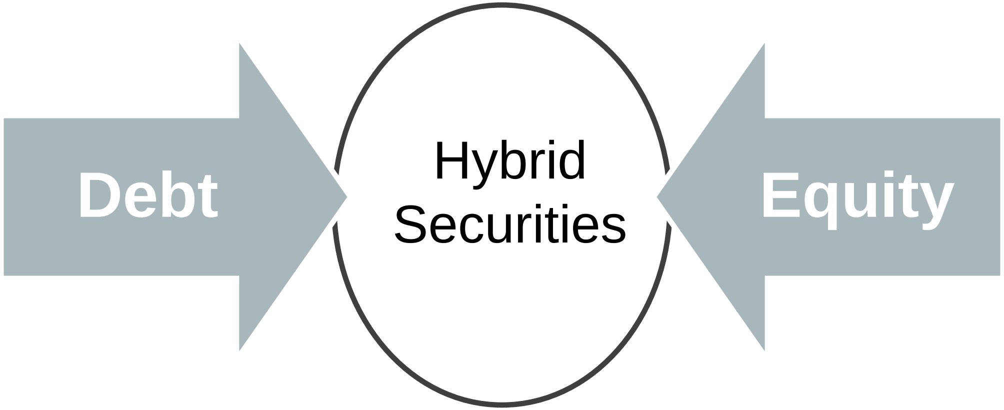


Source of Finance

Source of Finance- Based on ownership and control

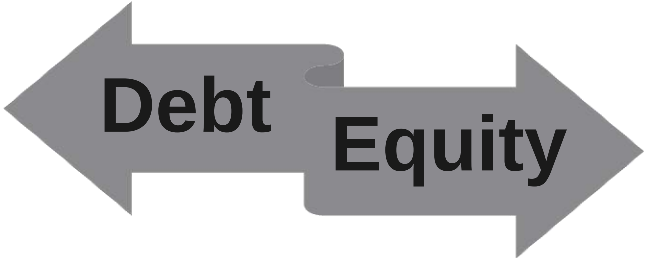
Owned
- Equity Capital
- Preference Capital
- Retained Earnings
- Convertible Debentures
- Venture Funds or Private Equity

Borrowed
- Loan from financial institutions and commercial Loan
- Non Convertible/Partly convertible Debentures



- Greater Return
- Diversify Risk
- Provide profits from both interest rates and equity share prices

Debt vs Equity



Assured Return

Capital repatriation

Tax Benefit

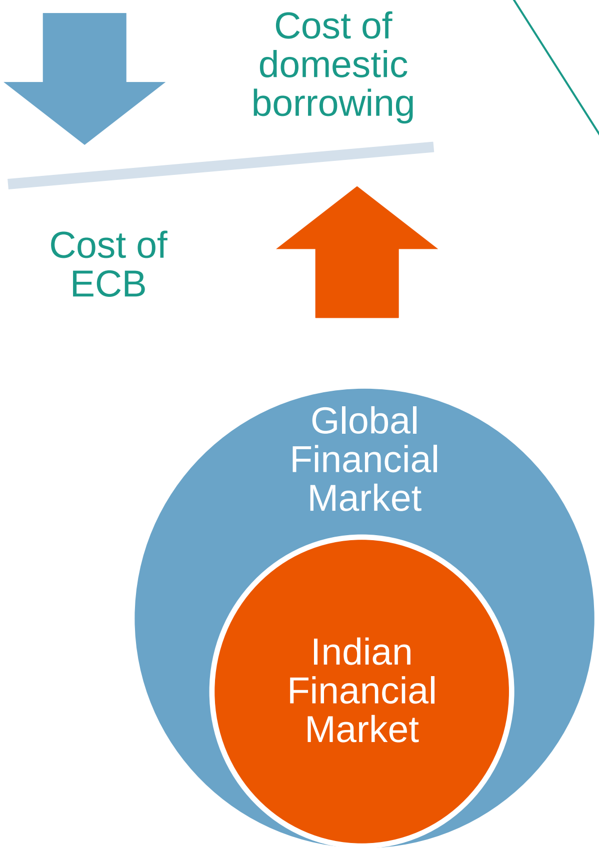
Sources of Payment

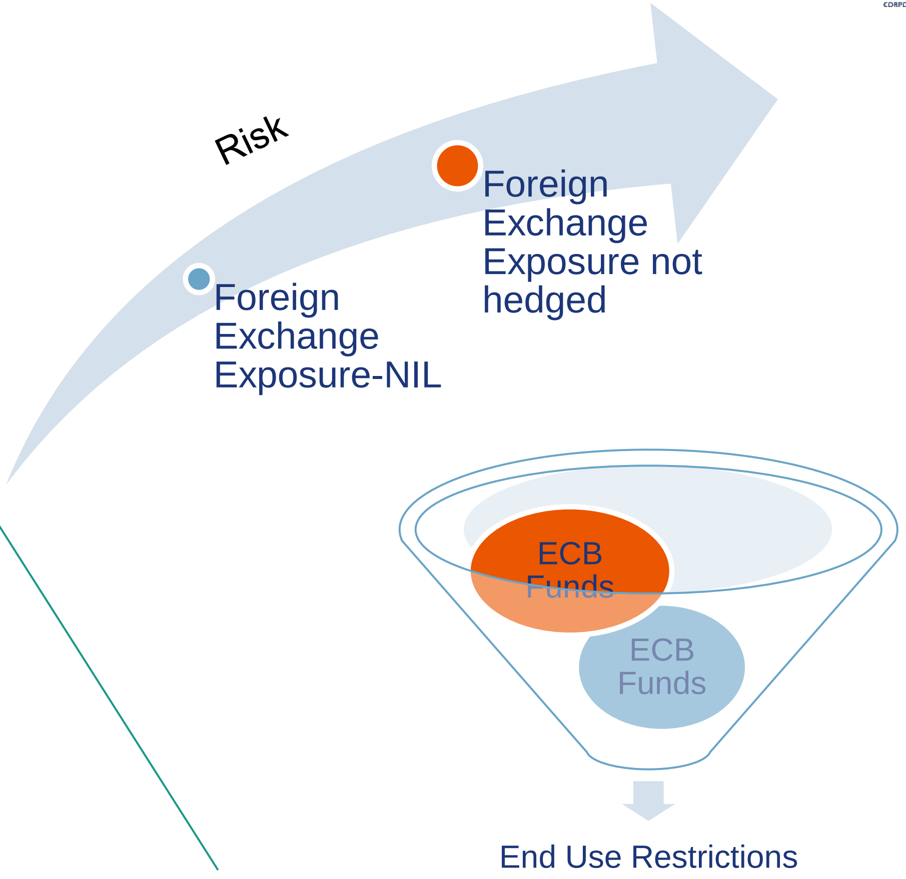
Security

Return on Investment

External Commercial Borrowing

ECB vs domestic borrowing





Forms of ECB


Loans including bank loans
Floating/ fixed rate notes/ bonds/ debentures
Trade credits beyond 3 years
FCCBs
FCEBs
Financial Lease
Rupee denominated bonds

New ECB Framework

- In December 2018, RBI issued the new Regulation on Borrowing and Lending.

Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations, 2000

Foreign Exchange Management (Borrowing and Lending in Rupees) Regulations, 2000

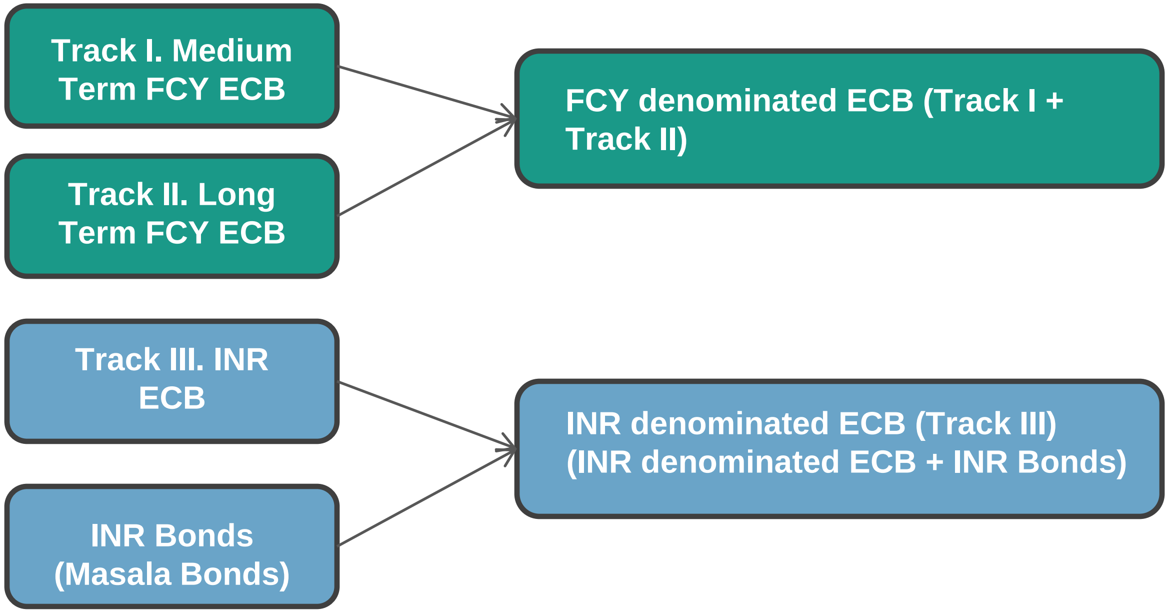
Foreign Exchange Management (Borrowing and Lending) Regulations, 2018

- In January 2019, the revised ECB framework in line with new regulation was introduced.

- In March 2019, the revised Trade Credit Policy was introduced.

Merging of categories

Erstwhile ECB Framework | Revised ECB Framework



Key Takeaways:

- Common Eligibility criteria and requirements for both FCY and INR denominated ECB, apart from the currency exchange rate, hedging requirement and forms of ECB, the other eligibility criteria and requirements.

Eligible Borrowers- who can borrow?

Erstwhile ECB Framework	Revised ECB Framework
TRACK I: Companies in manufacturing, infrastructure and software development, shipping , airlines Companies, SIDBI, EXIM Bank, Port Trusts, Units in SEZ etc.	All entities eligible to receive FDI. Further, the following entities are also eligible to raise ECB: • Port Trusts • Units in SEZ • SIDBI • EXIM Bank • Registered entities engaged in micro-finance activities • Section 8 companies •Societies / trusts/ cooperatives
TRACK II: All entities listed under Track I, Real Estate Investment Trusts (REIT) and Infrastructure Investment Trusts (INVIT) coming under the regulatory framework of the SEBI.	
TRACK III: All entities listed under Track II, NBFCs, NBFC-micro finance activities, Companies engaged in Miscellaneous services	

Key Takeaways:

➢Eligible borrowers include all entities eligible to receive FDI.

➢LLPs can now avail ECB.

➢Service sector can now avail FCY ECB.

➢NBFCs have an opportunity to receive foreign funds (FCY ECB).

➢Specific permission for REIT and INVIT have been removed.

Recognised Lenders- who can lend?

Erstwhile ECB Framework	Revised ECB Framework
TRACK I: International banks, International Capital markets, Multilateral Financial Institutions, Export Credit Agencies, Suppliers of equipment, Foreign equity holders, Overseas Long Term investors, Overseas branches / subsidiaries of Indian banks	•The lender should be resident of FAFT or IOCSO Country. •Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognized lenders. • Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad. •Foreign branches / subsidiaries of Indian banks are permitted as recognized lenders only for FCY ECB.
TRACK II: All entities listed under Track I except overseas branches / subsidiaries of Indian banks.	
TRACK III: All entities listed under Track I except overseas branches / subsidiaries of Indian banks.	

Key Takeaways:

- ➢ Major push for lenders, who wanted to lend in foreign currency.
- ➢PE and VCF can lend monies without mandatorily having equity participation.
- ➢Foreign parent companies can lend to its Indian subsidiaries through RDBs- Restriction on investment by related parties removed.
- ➢Angel investors, foreigners or PIOs investing in individual capacities in Indian ventures, holding 25% of the equity- can lend to these companies, instead of capitalizing through an additional equity.

Minimum Average Maturity Period

Erstwhile ECB framework	Revised ECB framework
Track I Up to USD 50 million / or its equivalent –3 years Beyond USD 50 million / or its equivalent –5 years NBFC IFC / NBFC-AFC, Holding Company, CIC –5 years FCCB / FCEB –5 years	• MAMP will be 3 years. • 1 year upto USD 50 million per FY for Manufacturing Sector. • 5 years if the ECB is raised for working capital, general corporate purposes or repayment of Rupee loans from Foreign Equity Holder.
Track II 10 years irrespective of the amount	
Track III Same as Track I	

Key Takeaways:

➢ Standardised for all forms of ECB- irrespective of the amount borrowed

➢ REITs and INVITs borrowing under Track II has been considerably benefitted. Long MAMP under Track II was deterrent to avail ECB, now MAMP reduced from 10 to 3 years.

➢ MAMP for RDB is also relaxed- 3years (irrespective of the amount).

End Use Restriction- ECB cannot be used for...

- Real estate activities
- Investment in capital market
- Equity investment
- Working capital purposes except from foreign equity holder
- General corporate purposes except from foreign equity holder
- Repayment of Rupee loans except from foreign equity holder
- On-lending to entities for the above activities

Key Takeaways:

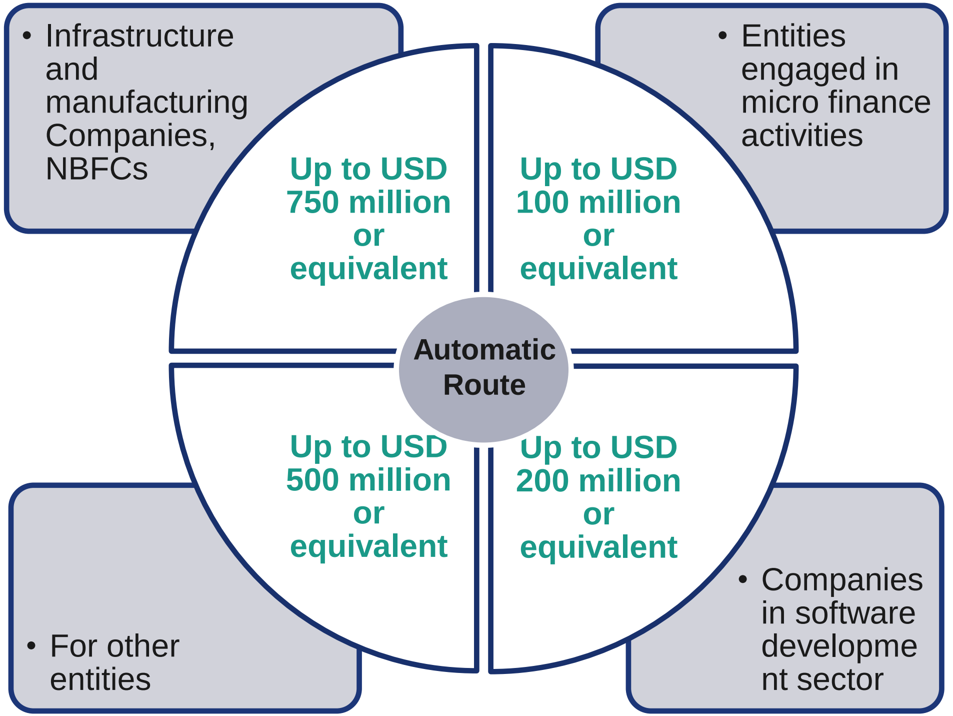
➢ Restrictions not applicable to Track II and RDB earlier are now applicable- Now REITs and INVITs cannot borrow for the working capital purpose and general corporate purpose, except from an equity holder- <u>it was one of the pre-dominant purposes for which ECB through RDB was raised.</u>

All in Cost of ECB

FCY denominated ECB	INR denominated ECB
• 450 basis points per annum over 6-month LIBOR rate of different currencies or any other 6-month interbank interest rate applicable to the currency of borrowing.	• Maximum spread will be 450 basis points per annum over the prevailing yield of the Government of India securities of corresponding maturity.

Individual Limits for borrowing

Erstwhile ECB framework	Revised ECB framework



➢All eligible borrowers can raise ECB upto USD 750 million or equivalent per financial year.

➢ For startups, the RBI continues with its conservative approach by providing a limit of ECB for only USD 3 million or its equivalent per financial year.

ECB Liability- Equity Ratio

Erstwhile ECB framework	Revised ECB framework

ECB from direct equity holder

+

Total of all ECBs raised is more than USD 5 million or equivalent

→

ECB liability of the borrower (including all outstanding ECBs and the proposed one) towards the foreign equity holder should not be more than 7 times of the equity contributed by the latter.

➢The 7:1 ratio is applicable for FCY ECB only.

➢Ratio will not be applicable if outstanding amount of all ECBs, <u>including proposed one</u>, is up to USD 5 million or equivalent.

Reporting Compliances & Penalty provision

- Any draw-down in respect of an ECB should happen only after obtaining the LRN from the Reserve Bank.

- To obtain the LRN, borrowers are required to submit duly certified **Form ECB** with AD Bank.

- **Changes in ECB parameters** in consonance with the ECB norms, including reduced repayment by mutual agreement between the lender and borrower, should be reported within 7 days from the changes effected.

- **Monthly Reporting of actual transactions** The borrowers are required to report actual ECB transactions through **Form ECB 2 Return** through the AD Category I bank on monthly basis within seven working days from the close of month.

- **Late Submission Fee (LSF) for delay in reporting**

Trade Credit

Trade Credit

- **Importers** can raise TC upto USD 50 million equivalent per import transaction. The period of trade credit for import of non-capital goods is max. 1 year and for that of capital goods is max. 3 years.

- SEZ units can avail TC for imports from outside India, within SEZ and purchase from different SEZ.

- TC can be availed from suppliers, banks, financial institutions and foreign equity holder as well.

- All-in-cost ceiling per annum – 250 basis points

Other important areas

- **Hedging Provision**- Companies are required to mandatorily hedge 70 per cent of their ECB exposure in case average maturity of ECB is less than 5 years- earlier 100 per cent hedging was mandatory at all times.

- **Security for raising ECB**- AD Banks can allow creation of charge on immovable assets, movable assets, financial securities and issue of corporate and/ or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised / raised by the borrower.

- **Parking of ECB proceeds**- ECB proceeds are permitted to be parked abroad as well as domestically depending on its foreign currency expenditure/ rupee expenditure.

- **Hybrid Instruments**- Optionally convertible debentures, presently covered under ECB, would be governed by specific hybrid instruments' Regulations when notified by the Government of India.

- **Refinancing of existing ECB**- Existing ECB can be refinanced by raising fresh ECB- provided the outstanding maturity of original ECB is not reduced and all-in-cost of fresh ECB is lower than all-in-cost of existing ECB.

Other important areas (contd.)

➢ **<u>ECB for Startups</u>**- Entities recognised as Startup by the Government can raise ECB of USD 3 million or equivalent per financial year either in INR or any convertible foreign currency or a combination of both, with MAMP of 3 years. The end use should be for business purpose only.

➢ **<u>ECB facility for Resolution Applicants under CIRP*</u>-** ECB can be raised from the recognised lenders, except the branches/ overseas subsidiaries of Indian banks, for repayment of Rupee term loans of the target company under the approval route.

*Vide A.P. (DIR Series) Circular No. 18 dated February 07, 2019.

SAS
PARTNERS
CORPORATE ADVISORS

www.saspartners.com