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Amendments to ECB and FDI policy

-Abhijit Nagee
abhijit@vinodkothari.com
Vinod Kothari Consultants Pvt. Ltd.

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NOTE

The Reserve Bank of India ("**RBI**") have been taking active steps to encourage greater foreign lending to the infrastructure sector and to allow Indian corporates borrow internationally on more favourable commercial terms than the significantly more expensive domestic debt. The RBI has also been concerned about the fact that most Indian banks have been nearing the limits which have been set on the amount that can be advanced to certain sectors and certain borrower groups. One of the steps which have been taken by the RBI is several amendments to the external commercial borrowing ("**ECB**") regulations to give greater flexibility to Indian companies in the infrastructure sector to avail ECBs. Some of the steps taken by the RBI in this regard have been vide the following RBI circulars:

1. RBI Circular No. 11 dated September 7, 2011 to simplify the procedure in relation to approval of ECB.

2. RBI Circular No. 25 dated September 23, 2011 relaxing the ECB norms for the infrastructure sector.

3. RBI Circular No. 26 dated September 23, 2011 permitting bridge financing in the infrastructure sector.

4. RBI Circular No. 27 dated September 26, 2011 permitting bridge financing in the infrastructure sector.

5. RBI Circular No. 28 dated September 26, 2011 further clarification with regard to debt-equity ratio of infrastructure ratio of infrastructure companies.

6. RBI Circular No. 30 dated September 27, 2011 permitting Indian Infrastructure companies to avail ECBs in RMB under the approval route.

The table below summarizes the changes brought forth by the above-stated circulars.

Particulars	Old Regulation	New Regulation	RBI Circular details
ECB – Simplification of Procedure	Any request for change of the lender for an existing ECB is required to be referred by the Authorised Dealer Bank to the Reserve Bank for necessary approval.	❖ Power to approve the request from the ECB borrowers with respect to change in the recognized lender has been delegated to the designated AD Category-I banks when the original lender and the new lender belong to any of the following categories: ▪ an international bank or a	**Circular No. 11**[1]**,** dated September 7, 2011.

[1] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/APD11ES0911.pdf

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		multilateral financial institution (such as IFC, ADB, CDC, etc.); or ▪ a regional financial institution; or ▪ a Government owned development financial institution or an export credit agency; or ▪ supplier of equipment. ❖ The delegation of the aforesaid power to the Authorised Dealer is subject to the following conditions:- ▪ the new lender is a recognized lender as per the extant ECB norms; ▪ there is no change in the other terms and conditions of the ECB; and ▪ the ECB is in compliance with the extant guidelines. ❖ Any such change to be reported to Department of Statistics and Information Management, RBI in Form 83. ❖ No change is made in other aspects of the ECB policy including: ▪ changes in the recognized lender in case of foreign equity holder and foreign collaborator; ▪ USD 500 million limit per company per financial year under the automatic route; ▪ eligible borrower, end-use, all-in-cost ceiling, average maturity period, prepayment;	

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		▪ refinancing of existing ECB and reporting arrangements.	
ECB for the Infrastructure Sector – Liberalisation	Repayment of existing Rupee loans not a permissible end-use for ECB.	❖ Indian companies involved in the infrastructure sector have been allowed to utilise 25% of the fresh ECB raised by the corporate towards refinancing of the Rupee loan(s) availed by them from the domestic banking system, ***under the approval route***. ❖ The above, however, is subject to the following conditions with respect to utilization of the fresh ECB proposed to be raised:- ▪ at least 75% – for capital expenditure towards a new infrastructure project(s); ▪ Remaining 25% – for repayment of the Rupee loan availed of for 'capital expenditure' of earlier completed infrastructure project(s); and ▪ the refinance shall be utilized only for the Rupee loans which are outstanding in the books of the financing bank concerned. ❖ Banks in India not permitted to provide any form of guarantees.	**Circular No. 25**[2]**,** dated September 23, 2011.
ECB – Bridge Finance for Infrastructure Sector	No provision permitting bridge financing in the infrastructure.	❖ Indian companies involved in infrastructure sector, are permitted to import capital goods by availing short term credit (including buyers'/ suppliers' credit) in the nature of 'bridge finance', ***under the approval***	**Circular No. 26**[3]**,** dated September 23, 2011.

[2] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/APD2230911FC.pdf
[3] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/APD26092011.pdf

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		route. ❖ The above permission is subject to the following conditions:- ▪ the bridge finance shall be replaced with a long term ECB; ▪ the long term ECB shall comply with all the extant ECB norms; and ▪ prior approval shall be sought from the RBI for replacing the bridge finance with a long term ECB. ❖ Banks in India not permitted to provide any form of guarantees.	
ECB – Rationalisation and Liberalisation	Credit enhancement is permitted to be provided by multilateral / regional financial institutions and Government owned development financial institutions for domestic debt raised through issue of capital market instruments, such as, debentures and bonds, by Indian companies engaged exclusively in the development of infrastructure and by the Infrastructure Finance Companies (IFCs), which have been classified as such by the RBI under the approval route.	❖ Direct and indirect foreign equity holders are permitted to provide credit enhancement to Indian companies engaged exclusively in the development of infrastructure under ***automatic route***. ❖ Direct foreign equity holders need to hold atleast 25% of the paid-up capital of the borrower and indirect foreign equity holders are required to hold at least 51% of the paid-up capital of the borrower to provide credit enhancement to Indian companies engaged exclusively in the development of infrastructure.	**Circular No. 27[4],** dated September 26, 2011.
ECB Policy – Structured Obligations for infrastructure	According to the existing ECB policy, a foreign equity holder, in order to be eligible as a 'recognised	Further clarifications: (a) The term 'debt' in the debt-equity ratio has now been replaced with '**ECB liability**' and the ratio will henceforth be known as	**Circular No. 28[5],** dated 26th September

[4] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/APR230911EC.pdf
[5] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/APD28260911EC.pdf

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sector	lender' for ECBs exceeding USD 5 million under the automatic route, must have a minimum paid-up equity of 25% held directly by the lender and the debt-equity ratio should not exceed 4:1.	the **'ECB liability-equity ratio'**. This change clarifies the position that other borrowings / debt (other than ECBs) will not be considered while determining 'debt' for calculating the 'ECB liability - equity' ratio. (b) For calculating the 'equity' component of the foreign equity holder for ECBs exceeding USD 5 million, apart from paid up capital contributed by foreign equity holders, free reserves (including the share premium received in foreign currency) as per the last audited balance sheet must be taken into account. (i) For multiple foreign equity holders in the borrowing company, the portion of the share premium in foreign currency brought in by the relevant lenders need to be taken into account for calculating the 'ECB liability - equity' ratio. c) For calculating 'ECB liability', outstanding ECBs from the same foreign equity holder need to be in such calculation, together with the proposed ECB. d) Foreign equity holders (direct / indirect) can now provide ECBs under the approval route to service sector units (in addition to those in hotels, and software). This change will benefit borrowings by training institutions, research and development and miscellaneous service companies. Indirect foreign equity holders, proposing to provide ECBs, however, have to ensure at least 51% holding in the borrower. (i) Group companies are permitted to provide ECBs subject to the condition that both the borrower and the group company providing the ECB must be subsidiaries of the same parent. (e) The foreign equity holders submitting these ECB proposals to the RBI for approval need to ensure that the total	, 2011.

		outstanding stock of ECBs (including the proposed ECBs) does not exceed 7 times the equity holding (directly or indirectly) of the lender. (i) Group companies submitting these ECB proposals to the RBI for approval should ensure that the total outstanding stock of ECBs (including proposed ECBs) does not exceed 7 times the equity holdings by the common parent in the Borrower.	
External Commercial Borrowings (ECB) in Renminbi (RMB)	No provision for ECBs in Renminbi	RBI has permitted Indian Infrastructure companies to avail ECBs in RMB **under the approval route,** subject to following: (a) ECB in RMB can be availed **up to the equivalent of USD 1 billion** annually. (b) The RBI approval in this regard will be valid for a period of 3 months from the date of issue of the approval letter and the loan agreement must be executed within this 3 month period. (c) The borrower must obtain the Loan Registration Number from the RBI within the above 3 month time period for the RBI approval to remain valid.	**Circular No. 30[6],** dated 27th September , 2011.

Amendment to FDI Policy

The Department of Industrial Policy and Promotion in review of Consolidated Foreign Direct Investment (FDI) Policy, has issued the new consolidated Foreign Direct Investment (FDI) Policy to be effective from 1st October, 2011. Some of the significant changes in the Policy document are:

1. In the definitions chapter (Chapter 2), the **concepts of entities owned and controlled by non-residents** have been deleted. This is likely to result in confusion because the phrases are used in Chapter 4 regulating the calculation of foreign investment.

2. **Prohibition on Options- para 3.3.2.I**
   a. Only equity shares and fully, compulsorily and mandatorily convertible debentures / preference shares would qualify as eligible instruments for FDI.

[6] http://rbidocs.rbi.org.in/rdocs/notification/PDFs/APD30ECB270611.pdf

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b. No company shall issue equity, CCD, CCP with an in-built option. The same shall be considered as a loan otherwise and the company will have to comply with extant ECB Guidelines. However the same is unclear whether option is restricted to mean call/put option or extends to right of first offer/refusal options.
c. Equity instruments issued / transferred to non-residents having in built options or supported by options sold by third parties would lose their equity character and would need to comply with the External Commercial Borrowing guidelines.

Further, by way of a corrigendum which was issued on October 31, 2011 to the FDI Policy issued on September 30, 2011 ("FDI Policy"), the Department of Industrial Policy and Promotion ("DIPP"), an instrumentality of the Ministry of Commerce and Industry, deleted the contentious Clause 3.3.2.1 of the FDI Policy.

3. **Conversion of advances into equity**

Application is to be made to FIPB for conversion of imported capital goods/pre operative expenses into equity to be made within 180 days of shipment of capital goods or retention of advances against equity.

4. **Recent amendments are also included such as -**

a) Allowing FDI in LLPs subject to conditions listed in para 3.2.5 of the Policy

b) Allowing pledge of an Indian Company's shares by its resident promoters for securing ECB, or by a non-resident shareholder in favour of an AD Bank in India, or even in favour of an overseas bank for credit facilities extended to the non-resident investor / its overseas group companies subject to certain conditions.

c) Clarification that for the purpose of minimum capitalization- share premium to be included when received by a company against issue of shares.

5. **Changes to the sectoral policy:**

a. Construction and development activities in the education sector and to old age homes, exempted from the conditions applicable to FDI in construction and development projects in the real estate.
b. Agriculture activities included in 100% automatic route within permitted activities in agriculture.
c. Basic and applied R&D on biotechnology pharmaceutical / life sciences included within the scope of "industrial activity" under industrial parks for which 100% FDI under automatic route is allowed.
d. Foreign investment up to 26% allowed in terrestrial broadcasting / FM radio as compared with the earlier limit of 20%.

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Review of the policy on Foreign Direct Investment in pharmaceuticals sector

> Foreign Direct Investment (FDI), up to 100%, under the automatic route, is permitted in the pharmaceuticals sector under the existing policy on FDI. The Government of India has reviewed the existing policy and a new paragraph 6.2.25 to *'Circular 2 of 2011-Consolidated FDI Policy'* has been inserted as under:
>
> (i) FDI, up to 100%, under the automatic route, would continue to be permitted for greenfield investments in the pharmaceuticals sector.
> (ii) FDI, up to 100%, would be permitted for brownfield investments (i.e. investments in existing companies), in the pharmaceuticals sector, under the Government approval route.

India enjoys a strong position as a global investment centre with the country registering high economic growth figures even during the peak of financial meltdown. This amendment in FDI policy will definitely upshot the investments in India and seems to have a favourable effect on Indian economy.

Contact us:
Vinod Kothari Consultants Pvt Ltd
1012, Krishna
224, AJC Bose Road
Kolkata -700 017
Ph: 033-2281-7715/3742/1276
Email Ids- vinod@vinodkothari.com; nidhi@vinodkothari.com