Update

Leasing to get impetus with ECB doors under automatic route opening up for NBFC-AFCs

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Reserve Bank of India vide its circular[1] dated 8th July, 2013 has granted access to External Commercial Borrowings (ECBs) to Non-banking Financial Companies (NBFCs) categorized as Asset Finance Companies (NBFC-AFCs) under the automatic route. Typically NBFC-AFCs[2] are one of the categories of NBFCs in India carrying out asset backed lending business.

So long NBFC-AFCs availing ECBs with a minimum average maturity of 5 years to finance import of infrastructure equipment for leasing of infrastructure projects came under the approval route. With this circular, NBFC-AFCs can avail ECBs under automatic route to finance import of infrastructure equipment for leasing to infrastructure projects with minimum average maturity period of five years. ECB can be availed under the automatic route upto 75% of owned funds of NBFC-AFCs, subject to a maximum of USD 200 million or its equivalent per financial year and currency risk of such ECBs is required to be hedged in full. Availing ECBs above 75% of NBFC-AFCs owned funds will be considered under approval route by RBI.

The new opportunity has 2 very significant points:

- While the tenure of the ECB funding is minimum 5years, the tenure of a lease transaction may or may not be 5 years. Even if the end-to-end term of the lease is 5 years, the average term of leases is generally not 5 years.
- Sure enough, during the term of the lease, the lessor collects lease rentals, which partly includes repayment of principal. This would mean, the payment of lease rentals, collected by the lessor, may go the normal corporate funds of the lessor.

[1] http://rbi.org.in/scripts/NotificationUser.aspx?Id=8219&Mode=0

[2] Asset Finance Companies has been defined as any company which is a financial institution carrying on as its *principal business* of financing of physical assets supporting productive/ economic activity. Principal business for this purpose is defined as aggregate of financing real/ physical assets supporting economic activity and income arising there from is not less than 60% of its total assets and total income respectively.

Both the points above substantively mean that at least a part of the ECBs may go towards normal corporate purposes of the lessor, something which is not generally permitted in case of ECBs.

NBFCs account for 12.7% of the assets of the financial system and have been acting as engines of growth in India and are integral part of the Indian financial system. NBFCs have been enhancing competition, bringing diversification in the financial sector, spreading risks specifically at times of financial distress and are increasingly recognized as complementary of banking system at competitive prices.

However, the recent macroeconomic lull, strained funding due to exclusion of bank loans to NBFCs from priority sector lending, restrictions on direct assignments and capping of mutual funds funding to NBFCs have impacted its growth and funding cost. The recent amendment by RBI is welcomed as ECBs may be periodically beneficial to tap; also while currently the rupee is weakening this may be one of the ways for the government of tap foreign funding. This may not be the best time to borrow by way of ECBs, as rupee is going very weak, if lessors are able to hedge their currency exposure at reasonable costs, the ECB funding option may provide an additional long term funding option for lessors.

Foreign vendors may also see this as an opportunity to increase their sales volumes in India, the net impact is lease financing business in India and specifically for construction equipment segment is certainly looking upbeat with this RBI circular. Though it appears dedicated for infrastructure leasing, the inflows from such leases may be used for general corporate purpose.