Debt Funding in India Series

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OFFSHORE FUNDING ROUTES: EXTERNAL COMMERCIAL BORROWINGS

External commercial borrowings (“**ECB**”) under RBI framework is one of the traditional sources of offshore debt financing into India. Debt financing via ECB is regulated by the Reserve Bank of India (“**RBI**”). The regulatory framework with respect to ECBs govern various aspects, including the eligible lenders and borrowers, maximum outflow on the funds availed, the end-use restrictions, and minimum maturity. Details of the ECB regime is provided in **Annexure A**.

We have listed down a few FAQs which will help understand the debt investments under the ECB route into India better.

1. ***What is the general process for availing ECBs?***

   For availing ECBs, the borrower and the lender need to determine the terms of the facility, ensuring that the various conditions under the ECB framework are complied with. Once finalized, the borrower needs to obtain through its authorized dealer bank (“**AD Bank**”), the loan registration number (“**LRN**”). Once the LRN is obtained, the parties can proceed to undertake the borrowing under the ECB regime. The security documents can be executed and security can be created in favor of the lender as well. Once the loan is availed, the reporting obligations need to be complied with.

2. ***What security can be created for loans availed under the ECB route?***

   Security creation is permitted freely under the ECB regulations, and can be created in favor of the non-resident lender directly or in favor of a resident security trustee. These include mortgage over immovable properties, charge over current assets, pledge of shares and personal / corporate guarantees. In addition to these, credit enhancement / guarantees by non-residents are also permitted, subject to such non-resident party being an eligible lender under the ECB guidelines.

   Enforcement is also permitted, subject to certain conditions under the ECB policy. For instance, immovable property can be sold under enforcement only to a resident entity.

3. ***ECB is permitted in both INR and foreign currency. What is better and why?***

   The decision to undertake an INR or foreign currency (“**FCY**”) ECB is largely dependent on the lending entity. Certain banks offshore are not willing to lend in INR and hence for such banks FCY is preferred. Further, while it may be preferable for an Indian borrower to borrow in INR to avoid any currency risk, investors, especially bond investors (generally undertaken on a public issuance basis) are not willing to bear the currency risk, and FCY becomes more marketable for the Indian borrowers in such cases. However, from an Indian borrower’s perspective, in addition to bearing the currency risk, the FCY ECB regime requires the Indian borrower to hedge its position mandatorily to the extent of 70% of the exposure if the maturity of the FCY ECB is less than 5 years, by way of one year financial hedges, renewed annually. While natural hedges maturing within the same accounting year are permitted, the mandatory hedging requirement adds an additional level of burden on Indian companies. Further, change of currency from one FCY ECB to any other FCY ECB (including INR) is freely permitted, however, change from INR ECB to FCY ECB is not permitted.

4. ***What is the all-in-cost ceiling?***

   The all-in-cost ceiling is the maximum amount of returns that can be paid to an ECB lender. The all-in-cost includes all charges, expenses, fees (including guarantee fees). However, the all-in-cost ceiling does not include the withholding tax paid by the borrower in India, and does not include commitment fees. In addition, default fees / penalty of up to 2 percent is also permitted, and is not computed within the all-in-cost ceiling. The all-in-cost ceiling is currently at 450 bps spread over the ‘Benchmark Rate’. All-in-cost ceiling is to be considered at the time of the investment / lending being made.

5. **What is the minimum average maturity period? Can repayments be made prior to the expiry of the minimum average maturity period?**

   The minimum average maturity period (“**MAMP**”) is the minimum tenure requirements for loans availed under the ECB route. MAMP is computed on a weighted average basis on a day to day basis assuming a 360-day year. The mechanism for computation of the MAMP denotes that return of principal can be permitted even prior to the expiry of the time provided as the MAMP, as long as the MAMP exceeds the requirement. For instance, if the MAMP for a loan is 3 years, repayment of principal can be made from year 1, as long as the weighted average tenure of the ECB loan exceeds 3 years. Interest payouts prior to the 3 year period are permitted without reference to the MAMP.

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6. ***What's the entire noise around 'masala bonds' or 'Rupee denominated bonds'?***

   Under the erstwhile ECB regime, a special window was created for issuance of Rupee denominated bonds ("**RDB**") by Indian companies. This was akin to a Rupee denominated ECB issued under the ECB policy, but certain relaxation on compliances were provided to such bonds, in an attempt by the government to externalize the Rupee denominated lending. Benefits such as easier corporate law procedures, and reduced withholding taxes made this option lucrative for both lenders and borrowers. While the route has now been merged under the INR ECB route itself, the relaxations continue.

7. ***Can non-residents guarantee ECBs availed by resident borrowers or any other loans availed of by Indian borrowers?***

   Yes. Non-residents can guarantee or give credit enhancement for loans availed by Indian borrowers. This can be done for borrowings from residents as well as non-residents.

   - Non-resident borrowings: For any loans availed by Indian companies under the ECB route, any non-resident entity can provide a guarantee or credit enhancement, provided such non-resident entity satisfies the conditions to be a lender under the ECB route.
   - Resident borrowings: While a resident to resident loan does not create any cross-border / non-resident lending transaction, non-residents are permitted to guarantee or provide credit enhancement in case of such borrowings as well. In such cases, the non-resident may discharge the liability / obligation of the Indian debtor, and proceed to enforce its claim against the Indian borrower. The amounts payable by the Indian borrower to the offshore guarantor / credit enhancer shall be permitted under the automatic route, and the funds can be repatriated, if the payment to the lender was made by way of inward remittance by the guarantor / creditor enhancer. The amount paid by the resident borrower to the guarantor / credit enhancer should not exceed the amounts paid by the guarantor / credit enhancer in INR terms.

8. ***What distinguishes the ECB route from the other investment routes for debt investments into India?***

   ECB offers certain benefits above other modes of investment, and is disadvantageous on certain counts.

   The main benefit of the ECB route is the lack of any registration for the lender, and simplified eligibility for the lender. Under any other offshore debt options in India (FVCI or FPI), the lender entity needs to be registered with SEBI as an FVCI or FPI. However, ECB permits unregistered entities to lend to Indian entities without registration, subject to the lending entity being from an FATF or IOSCO compliant jurisdiction. For foreign equity holders, certain exemptions / relaxations are provided within the ECB framework as well.

   Further, from a reporting perspective, the ECB process is relatively easier and less cumbersome compared to the FPI / FVCI regime. In addition, the reporting requirements are also less cumbersome and easier from an administrative perspective.

   On the other hand, compared to the other routes for investment, ECB suffers some major drawbacks. First, all ECB must comply with minimum maturity requirements which are quite long. This generally rules out any short-term funding options under the ECB route. Second, the ECB route has all-in cost ceilings imposed, which are not very attractive. For INR ECB, the ceilings imposed are slightly higher than the available bank lending rates. While the rates are higher in case of FCY ECB, the hedging requirements are a dampener. In effect, the all-in cost ceilings discourage any distressed funding or any lending to stressed borrowers, since lenders are unable to obtain a higher return for the higher risk being undertaken. However, the ECB policy permits borrowers in manufacture / infrastructure sectors to borrow under ECB to repay INR loans availed for capital expenditure. In addition, banks are also permitted to transfer their loans to eligible ECB lenders providing the conditions under the ECB route are complied with.

9. ***Considering the pros and cons of the ECB route, where is ECB a good alternative?***

   Given the pros and cons mentioned above, the ECB route is an extremely helpful option in some situations.

   - Captive lending: Where offshore entities have Indian subsidiaries, engaged in various activities, ECB offers a good option to capitalize the subsidiary. Being an equity holder, the end use restrictions are relaxed and the end-use restrictions are also less cumbersome. Instead of capitalizing the subsidiary by way of equity investment, ECB offers a good option for extraction of cash on an ongoing basis, as well as easy repatriation of funds, both in a tax efficient manner.
   - Bond issuances: For sectors requiring funds for a longer timeline, such as the infrastructure sector (where gestating periods are longer), ECB offers a good mode of fund raising by way of bond issuances. A large number of infrastructure companies have issued bonds (both in INR and FCY) to public under the ECB route at cheap rates (around 5% – 7%). These issuances have been subscribed by a large number of global funds, including sovereign funds and multilateral financial institutions.
   - Social impact lending: In recent times, a large number of global social impact funds or ESG funds have looked at ECB as the preferred mode of funding to Indian borrowers. Considering that these funds generally have a long-term horizon, and are not looking at substantially high returns, the drawbacks of the ECB route (mentioned in Query 8 above) suit these investors. The lack of any registration requirements in India makes the option all the more attractive to these investors.
   - Offshore bank borrowing: Indian companies find the ECB route quite convenient when borrowing from offshore banks, especially to retire existing Rupee debt. The rates offered by offshore banks are generally lower than the onshore lending rates, and considering the minimum maturity (being at least 7 years), the mandatory hedging requirements also do not apply.
   - Distressed play: While ECB is not looked at favorably by distressed lenders as mentioned above, the ECB framework provides for eligible ECB lenders to acquire INR loans from lender banks in India, providing the borrower is in the infrastructure / manufacturing sector, and the loans have been raised for capital expenditure. Distressed / control funds prefer to acquire such loans, and attempt to undertake an entire restructuring / resolution of the borrower's capital structure to obtain control over the borrower.

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For the reasons mentioned above, while Indian borrowers have looked at ECB for meeting their borrowing needs, lenders, especially debt and credit funds have looked to stay clear of funding under the ECB route.

Debt Funding Team