

**The Institute of Chartered Accountants of India
Borivali (Central) CPE Study Circle,**

May, 2007

Borrowing by Residents from Non-residents - FEMA provisions

**Naresh Ajwani
Chartered Accountant**

Preface:

The prospects of borrowings from foreign sources has increased with the change in the outlook towards India. Despite credit ratings at an average level, foreign lenders are willing to lend to Indian businessmen.

External Commercial Borrowing (ECB) remains an important source of foreign exchange finance for a businessman. However for a businessman, loan in any manner is a loan. Hence I have covered the FEMA provisions regarding loans from Non-residents in various manners - Foreign currency loan, Indian rupee loan, etc.

As foreign debt means external liability, there is more regulation than before. This is one sector, where rules are being tightened. Loopholes are being plugged.

Legal provisions and brief history:

Borrowing in Foreign Exchange by a person resident in India is a **Capital Account Transaction** in terms of Section 6(3)(d) of the Foreign Exchange Management Act, 1999 (FEMA). RBI has framed the Regulations called Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations, 2000, which have been notified vide Notification No. FEMA 3 / 2000 - RB dated 3rd May 2000. (Regulation 6 and the Schedule thereto govern the ECBs).

Central government has also issued **ECB guidelines** in Oct. 2005 (amended upto Aug.05). In August 2005, RBI has issued comprehensive circular dated 1st August 2005 (AP no. 5). Both - Central Government guidelines & RBI circular are similar.

RBI has also issued separate notifications for taking rupee loans and deposits from non-residents - Foreign Exchange Management (Borrowing and Lending in Rupees) Regulations, 2000 vide notification no. 4 dated 3rd May 2000, and Foreign Exchange Management (Deposits) Regulations, 2000 vide notification no. 5 dated 3rd May 2000.

Q.1 What are the **different borrowing options** for a resident for taking a loan from a non-resident?

Ans: An Indian resident can borrow funds either in foreign exchange, or Indian rupees from a non-resident. The borrowing can be in different manners:

Loan in foreign exchange – ECBs, trade credits etc.:

- Simple loan (in Foreign currency) – also known as an ECB,
- Foreign Currency Convertible Bonds,
- Securitised instruments (floating rate notes, fixed rate bonds) (in foreign currency),
- Trade credits (short term credit),
- Structured obligations (in rupees),
- Financial leases,
- Loan from relatives,
- Borrowings for projects abroad.

Rupee loans (from NRIs):

- Debentures – Convertible or non-convertible (in Indian rupees),
- Deposits and Rupee loans on non-repatriable basis,
- Commercial papers.

A simple loan is the most frequently used route. ECB being most sought after route, issues relating to ECBs are covered first.

A. **ECBs, Foreign Exchange Loans:**

Q.2 What is an **External Commercial Borrowing (ECB)**?

Ans. There is no specific definition of an ECB in FEMA regulations.

AP circular 5 dated 1.8.05 states that, ECBs refer to commercial loans, [in the form of bank loans, buyers' credit, suppliers' credit, securitised instruments (e.g. floating rate notes and fixed rate bonds)] availed from non-resident lenders with minimum average maturity of 3 years.

RBI circular also clarifies that loans from Foreign Equity Holders are also considered as ECBs.

Thus ECB means **foreign currency loan** raised by residents from recognised / eligible foreign lenders.

Financial leases and Foreign Currency Convertible bonds are also covered by ECB guidelines.

Q.3 Who is the **monitoring agency**?

Ans. ECBs directly affect the external liabilities of India. Hence, the Government lays down an annual cap on total ECBs, which can be raised by Indian residents together. The limit for F.Y. **2006-07 was U.S. \$ 22 billions**. As the ECBs form a key component of India's external debt, the cap is periodically reviewed. RBI is effectively the monitoring authority. It issues periodic circulars for amendments to the ECB policy (obviously in consultation with Ministry of Finance).

Q.4 For what **purposes** can the ECBs be raised?

Ans. There are basically two routes for raising the ECBs – Automatic route and Approval route (see answer 13). Following are the specified purposes for which an ECB can be raised under the two routes.

Automatic and Approval route:

4.1 The ECBs can be raised for investments in "Real sector". RBI circular explains that investment can be in Real sector – i.e. Industrial sector for import of capital goods, new projects, modernisation / expansion of existing units, and in infrastructure. The infrastructure areas include power, telecommunication, roads, etc.

What is "Real Sector"? It has not been defined. However as per RBI, it means investment, for import of capital goods like plant and machinery, factories, etc.

Example:

Is purchase of an office permitted with an ECB? No. If it is factory building, then it is permitted, but not for a commercial office. But if an office building is to be constructed within the factory premises, then it may be permitted. Essentially, if there is a new project for manufacturing or services, ECBs are permitted.

If a software company or a call centre wants to acquire commercial premises for its staff, and acquire computers for its activities, can it raise an ECB? Yes, because for such a company, the building and computers,

are fixed assets. However, RBI states (on personal discussions) that it is better to go by Approval route.

- 4.2 Indian corporates can raise ECB to invest in Joint Ventures and Wholly Owned Subsidiaries abroad.
- 4.3 ECB can be used for first stage acquisition of shares in the disinvestment process, and also in the mandatory second stage offer to the public under the Government's disinvestment programme of PSU shares.
- 4.4 Refinancing of ECB (i.e. raising new ECB at lower interest rate and repaying old ECB at higher interest rate) is also permitted. However outstanding maturity of the old loan should be maintained.

Only Automatic route:

- 4.5 Non-Government Organisations (NGOs) are permitted to raise ECBs for micro credits or lending to self help groups, or bonafide micro finance activity including capacity building.
- 4.6 Conversion into equity shares (FDI). Though not coming out from ECB policy, conversion of all outstanding ECBs into equity shares is permitted under press note no. 5 dated 28.11.2003 of Ministry of commerce and industry.

However, trade credit cannot be converted into equity shares.

Only Approval route:

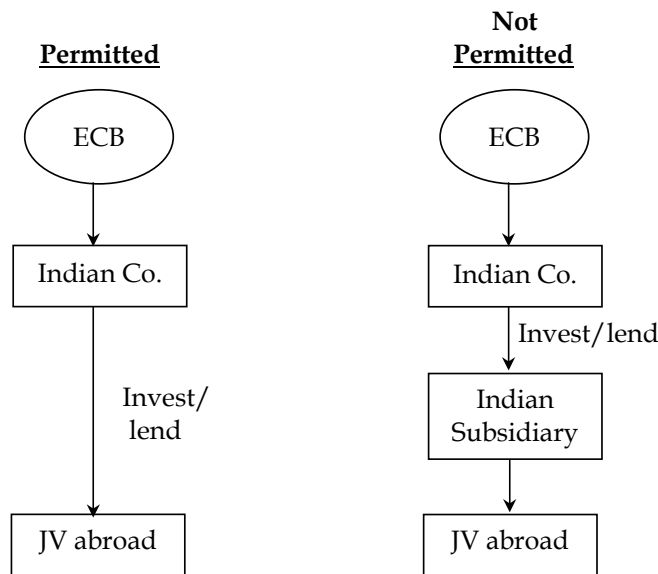
- 4.7 On-lending by Financial institutions dealing in infrastructure and export finance. RBI has clarified that that Special Purpose Vehicles (SPVs) or any other entity, notified by the Reserve Bank, set up to finance infrastructure companies/projects exclusively, will also be treated as financial institutions. ECB by such SPVs will be considered under the Approval Route on a case by case basis. (AP circular 15 dated 4th Nov. 2005).
- 4.8 On lending by banks and financial institutions who have participated in steel and textile sector restructuring package. RBI has clarified that Multi-Fibre Agreement has been phased out. With a view to facilitating capacity expansion and technological upgradation in the Indian textile industry, banks will be allowed to issue guarantees, standby letters of credit, letters of undertaking or letters of comfort in respect of ECB by textile companies for modernisation or expansion of their textile units. Such applications will be considered under the Approval Route subject to prudential norms. (AP circular 15 dated 4th Nov. 2005).

- 4.9 Financing of infrastructure equipment for leasing of such equipment by NBFCs.
- 4.10 FCCBs by Housing Finance Companies.
- 4.11 ECBs by Multi-State Co-op. Societies engaged in manufacturing activity.
- Q.5 Does it mean that if the end-use falls within the approved purposes, he can raise the ECBs? In other words, **are there any specifically prohibited sectors?**

Ans: There are some specifically prohibited sectors. **ECB cannot be utilised for-**

- i. Investment in capital market (except for disinvestment purpose mentioned in answer 4.3 above).
- ii. Acquiring companies (partly or fully).
- iii. On lending (except by Infrastructure companies etc. mentioned in answer 4 above). Thus borrowing by holding companies, to lend to its subsidiaries, is not permitted.

One can borrow for investment in a Joint Venture / Wholly Owned subsidiary. In case of Joint Venture Abroad and Wholly Owned subsidiary, loans also can be given. Thus ECB can be directly used by the borrower to invest abroad, but not through intermediate Indian companies.



- iv. Investment in real estate. However investment in Integrated townships as defined by Ministry of Commerce and Industry, Department of Industrial Policy and Promotion, SIA (FC Division), Press Note 3 (2002 Series, dated 04.01.2002) is permitted.

It should be noted that the meaning of "Integrated township development" is different from "real estate development". Construction by a builder of a residential building or a commercial building is also real estate development. NRI investment is allowed in this sector. But ECB cannot be raised for such purpose. But if there is a project of township development (which means large projects as mentioned in the press note (100 acres with capitalisation of atleast US\$ 5 millions), then ECB can be raised.

It should be noted that Press No. 3/2002 referred to above, has been **superseded** by Press Note 2 (2005 series dated 3.3.2005). The new circular has less stringent conditions (10 hectares / 50,000 square meters). However ECB guidelines continue to refer to the old circular. Can it be said that as the Real Estate FDI guidelines refer to Press Note 2 (2005 series), even the ECB guidelines should be considered to refer to the new circular? I am of the view that ECB in Real Estate should also be considered as per the new press note. However RBI is of a different view. Hence it is safer to take a conservative view, and go by old press note no. 3 of 2002 series.

(After writing the article, the Government has removed the facility of availing of ECBs for Real estate. By AP circular no. 60 dated 21st May 2007, the facility for available ECBs for Integrated township development, has been removed.)

- v. Working capital, general corporate purposes & repayment of existing rupee loans.

Q.6 What are the different kinds of **ECB schemes**?

Ans: Earlier there used to be different schemes, though there were no watertight compartments. Now all the differentiation between schemes have been removed, and there are following broad schemes - or more appropriately, routes under ECB policy:

- i. **Automatic route for ECB upto US \$ 500 million:**

Indian companies are permitted to raise upto US 500 millions from **reputed lenders**. Please see Answer 13.1 also for more details.

- ii. **Approval route:**

Borrowings by residents from non-residents – FEMA provisions

Under Approval route, ECB can be raised by taking approval from RBI. An empowered committee will look into the applications of ECBs under Approval route. Please see Answer 13.2 for details.

iii. **Trade Credit:**

Trade credit includes supplier's credit & buyer's credit. Briefly, supplier's credit refers to the credit facility granted by the supplier of goods. Buyer's credit refers to credit offered by a foreign bank/lending institution for financing import of goods in India. Technically this is not an ECB. It is short term foreign currency loan facility. However practically, it is an ECB for a businessman. ECBs upto US\$ 20 millions per import transaction can be raised. Please see Answer 13.3 for details.

iv. **ECBs by units in Special economic zones:**

Units in SEZs can raise ECBs without limit on maturities. i.e. they can raise ECBs for a period of less than 3 years also. Please see answer 13.4 for details.

Q.7 Can all Indian residents raise ECBs (i.e. including partnerships, and proprietorships)?

Ans. Only Indian companies can raise ECBs under the automatic route. Banks and Financial Institutions can also raise ECBs under the approval route.

NGOs can raise ECBs for micro finance activities under the automatic route. There are additional conditions for NGOs. Such NGOs (i) should have a satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank authorised to deal in foreign exchange and (ii) would require a certificate of due diligence on 'fit and proper' status of the board/committee of management of the borrowing entity from the designated Authorised Dealer (AD).

Housing finance companies can raise ECBs if they satisfy the following conditions - i) the minimum net worth during the previous three years is not less than Rs. 500 crore, (ii) They have a listing on the BSE or NSE, (iii) minimum size of FCCB is USD 100 million, (iv) They should submit the purpose / plan of utilization of funds.

Earlier Co-operative Societies, proprietorship/partnership concerns could raise ECBs. Now they cannot raise ECBs. However, Multi-State Co-

operative Societies engaged in manufacturing activity can raise ECB under the approval route. The basic conditions to be fulfilled are – (i) The Co-op. Soc. is financially solvent; (ii) The co-op. Soc. submits its up to date audited balance sheet. (A.P. Circular 23 dated 23.1.2006.)

Individuals, Trusts and Non-profit making organisations cannot raise ECBs. Though not specified, even partnership firms cannot raise ECBs.

Q.8 Can one raise any amount of ECBs?

Ans. As mentioned above, under the **Automatic route**, upto US\$ 500 millions per financial year can be raised. For ECBs beyond US\$ 500 million, approval is required from RBI.

Vide AP Circular 17 dated 4th Dec., '06 upto U.S. \$ 250 million can be raised under approval route over and above U.S. \$ 500 million under automatic route. Average maturity should be for 10 years. Prepayment, and call /put options are not available.

For suppliers'/ buyer's credit (trade credit), the amount per import transaction is US\$ 20 millions.

NGOs can raise ECBs upto US\$ 5 million per financial year for micro finance activity.

Under **approval route**, there are no ceilings prescribed on the amount of ECBs. However housing finance companies should raise a FCCBs for a minimum of US\$ 100 millions.

Q.9 Are there any restrictions on rate of interest paid on ECBs?

Ans. The interest rate under automatic route and approval route must not exceed the following rates:

Average maturity of 3 to 5 years	2% points over 6 months LIBOR in the respective currency.
Average maturity of more than 5 years	3.5% points over 6 months LIBOR in the respective Currency.

Thus if the 6 month LIBOR for US\$ is 4%, then the rate for ECB for average maturity exceeding 5 years cannot exceed 7.5%.

(After writing the article, Government has revised the above cost limits. The revised rates are as under:

Borrowings by residents from non-residents – FEMA provisions

Average maturity of 3 to 5 years	1.5% points over 6 months LIBOR in the respective currency.
Average maturity of more than 5 years	2.5% points over 6 months LIBOR in the respective Currency.)

Earlier there used to be a higher permissible interest for infrastructure projects. Now the same has been removed.

For supplier's / buyer's credit, please see respective paras.

Important:

It should be noted that earlier the guidelines of the Ministry of Finance stated "interest spreads" limit. However now RBI circular speaks of **all-in-costs**. i.e. All fees paid to professionals, merchant bankers, expenses paid in foreign currency are covered in the limit specified. Thus it is **annual cost limit** rather than **interest rate limit**.

However commitment fee, pre-payment fee and expenses in Indian rupees can be over and above the annual cost limit.

Further withholding tax can also be over and above the annual cost limit.

Thus the annual cost limit is net of tax. Though not specified, withholding tax on all expenses, and not just interest, can be borne by the Indian borrower, over and above the annual cost limit.

Again, though not specified, interest for default of loan (penal interest) cannot exceed 2% over the regular rate of interest on the ECB.

These limits apply to both – Automatic route and Approval route.

Q.10 What can be the **period of ECBs**?

Ans. Different maturities have been prescribed for different kinds of ECBs under **Automatic route**.

The ECBs should have minimum average maturity of 3 years for ECBs upto US\$ 20 millions. ECB up to USD 20 million can have call/put option provided the minimum average maturity of 3 years is complied before exercising call/put option.

For ECBs exceeding US\$ 20 millions and upto US\$ 500 millions, average maturity should be at least 5 years. Permissible annual costs differ according to average maturities. See answer 9 above.

Average maturity is not explained in the circular. However, in the earlier Government guidelines, it was explained that "weighted average of all disbursements taking each disbursement individually and its period of retention by the borrower for the purpose of ECBs."

Example

If a resident has borrowed US\$ 10 millions and the repayment is spread over 5 years. The weighted average will be as under:

Year	Principal (at beginning of year)	Repayment (at end of year)	Balance (at end of year)	No. of years the loan repayment installment was outstanding (Weight)	Product (6) = (3)x(5)
(1)	(2)	(3)	(4)	(5)	(6) = (3)x(5)
0	5,00,000 (1 st installment of loan)	0	5,00,000		
1	10,00,000 (2 nd installment of loan)	0	10,00,000		
2	10,00,000	1,00,000	9,00,000	2	2,00,000
3	9,00,000	3,00,000	6,00,000	3	9,00,000
4	6,00,000	3,00,000	3,00,000	4	12,00,000
5	3,00,000	3,00,000	0	5	15,00,000
		-----			-----
	Total	10,00,000			38,00,000
		=====			=====
	Weighted	Average	(38,00,000 / 10,00,000)	3.8	

Thus weighted average period of loan is 3.8 years. This is alright if loan is upto US\$ 20 millions. In the above example, if in the second year, US\$ 4,00,000 was repaid, then the loan would be repaid in 4 years. The weighted average would be 2.9 years. This will not be in the automatic route.

Under **Approval route**, there is no specific time limit. However the basic explanation of an ECB is that it is a loan with a minimum average maturity of 3 years. NBFCs which can raise funds for import of equipment or leasing to infrastructure projects, should raise ECBs with a minimum average maturity of 5 years.

Q.11 In what **form** can ECBs be raised?

Ans. ECBs can be raised in the form of bank loans, buyers' credit, suppliers' credit, securitised instruments (e.g. floating rate notes and fixed rate bonds)]. Financial leases and FCCBs are also considered as ECBs.

Department of Economic Affairs, Ministry of Finance has issued a press release dated 30th April, 2007.

As per the press release, only fully convertible preference shares will be considered as FDI. Other kinds of preference shares (non-convertible, optionally convertible or partially convertible) will be considered as debt & should conform to ECB guidelines.

Q.12 Can ECBs be raised from any **source** / Who can be the lenders?

Ans. Borrowers can raise ECB from **internationally recognised sources** such as (i) international banks, international capital markets, multilateral financial institutions (such as IFC, ADB, CDC etc.), (ii) export credit agencies and (iii) suppliers of equipment, foreign collaborators and foreign equity holders. This applies to both – automatic and approval route.

What is internationally acceptable / recognised lender, has not been specified. However, there are some lenders – some specific individuals, private groups, which are not approved by RBI. While the rules permit persons to raise ECBs on automatic route, it is better to be sure about the credentials of the lenders. For example it may be better to get proper reports from lender's banks. If the amounts are large and lenders relatively unknown, reports from investigative agencies also may be sought. The lenders should be registered in their host countries with appropriate authorities.

Important

Though not specifically coming out the Rules, the lenders should be corporates. There is an exception for individuals if they are equity shareholders. The rules mention that equity holders can be lenders. So if the equity holder is an individual, he/she can lend. Earlier this facility was only for NRIs. However now RBI permits NRI individuals and non-NRI individuals to lend, if they are equity holders.

Equity holders:

Under automatic route, the equity holders should hold directly at least 25% of the equity shares if the ECB sought to be given is upto US\$ 5 million. If the ECB exceeds US\$ 5 million, then apart from the equity limit

of 25%, the ECB cannot exceed 4 times the direct equity holding. If it exceeds 4 times the equity, then one has to go under the approval route.

It should be noted however that Overseas Corporate Bodies (OCBs) are barred from investment. Some OCBs who have made investments before they were barred, continue to be equity holders. However they cannot lend funds, even if they are equity holders. (A. P. circular 34 dated 12.5.06.)

Lenders to NGOs engaged in micro finance:

Overseas organisations should furnish a certificate of due diligence from overseas bank. The overseas bank should be subject to regulation of host country regulator & adheres to Financial Action Task Force guidelines.

The certificate of due diligence should state that – (i) the lender maintains an account with the bank for atleast 2 years; (ii) the lending entity is organised as per local law & held in good esteem by business / local community; & (iii) there is no criminal action pending against it.

Individuals are also required to obtain due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence / documents such as audited statement of account and income tax return which the overseas lender may furnish need to be certified and forwarded by the overseas bank. Individual lenders from countries wherein banks are not required to adhere to Know Your Customer (KYC) guidelines are not permitted to extend ECB.

Equipment suppliers / technical collaborators:

Equipment suppliers can also give ECBs. However it should be noted that they cannot give “funds”. They can sell equipment on long credit period on terms as specified in the ECB guidelines. But funds cannot be given. Similar is the issue in case of technical collaborators. They can finance the technology by giving credit period, but not funds.

Q.12 Are any **approvals** required for raising ECBs?

Ans. As explained above, broadly there are two categories of ECBs as far as approvals are concerned:

- i.) ECBs which can be raised under automatic route upto US\$ 500 millions per financial year – i.e. corporates can raise ECBs without prior approval from RBI.

ii.) **ECBs where approval from RBI is required:**

Approval is required from RBI for ECBs exceeding US\$ 500 millions, or if the criteria for automatic route is not satisfied.

The details are dealt with under appropriate questions.

Q.13 What are the **other features of different ECB Schemes?**

Ans. The salient features of different schemes are explained below:

13.1 **Automatic route for ECB upto US \$ 500 millions:**

- i. ECBs are permitted to be raised on automatic basis upto US\$ 500 millions per financial year from reputed lenders. NGOs can raise ECB upto US\$ 5 million for micro finance activities.
- ii. Corporate borrowers do not need any prior approval from RBI. However financial intermediaries require approval from RBI. Borrowers can enter into ECB agreements. They are required to file Form No. 83 in duplicate (duly certified by a company secretary or a Chartered Accountant); One copy will be forwarded by the bank to the Director, Balance of Payments Statistics Division, Department of Statistical Analysis and Computer Services (DESACS), Reserve Bank of India, Bandra-Kurla Complex, Mumbai – 400 051.

The form has to be filed within 7 days of the agreement being entered into.

Please note – It is no longer necessary to file the agreement with the bank. Only form 83 is required.

Also the loan can be taken after the RBI gives loan registration number. Earlier the loan could be taken and then documents and forms had to be submitted. **Now the loan can be drawn down only after obtaining the registration number. To some extent this becomes a prior approval for taking the loan. RBI would normally consider whether the loan falls under the automatic guidelines and then grant a registration number.**

Kindly note that each loan requires a separate registration number. Having obtained the registration number, the loan can be drawn in parts.

- iii. The loan should be taken for a minimum average maturity of 3 years if the ECB is upto US\$ 20 millions. If the loan exceeds US\$ 20 millions, the minimum average maturity period should be 5 years.

13.2 Approval route:

The government has authorised RBI to approve ECBs upto US\$ 500 millions.

Financial institutions dealing exclusively with infrastructure or export finance such as IDFC, ILFS, Power Finance Corporation, Power Trading Corporation, IRCON and EXIM Bank can apply to RBI for raising ECB. The applications will be considered on a case by case basis.

Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government can also raise ECBs to the extent of their investment in the package and assessment by RBI based on prudential norms. Any ECB availed for this purpose so far will be deducted from their entitlement.

An application for an ECB has to be made in form ECB. The application should be made through the banks to Chief General Manager-in-Charge, Foreign Exchange Department, Reserve Bank of India, Central Office, External Commercial Borrowings Division, Mumbai – 400 001. Alongwith the form, (i) a copy of offer letter from the overseas lender/supplier furnishing complete details of the terms and conditions of proposed loan/credit arrangement; and (ii) A copy of the import contract, proforma/commercial invoice/bill of lading, should be enclosed.

A Loan agreement is not required to be submitted.

The application is referred to an empowered committee to consider the applications.

13.3 Supplier's / buyer's credit (now known as Trade credit):

Supplier's / buyer's credit are essentially short-term credit facilities. No approval is required from RBI; approval is required only from banks for short-term credits provided that:

- a. The credit is being extended for a **period of less than one year**. If the import is of **Capital goods**, then the period of credit can be of **3 years**. The period of 1 / 3 years is considered from the date of **shipment if goods**. The banks cannot extend the time beyond the period prescribed. For import of **gold**, trade credit is not permitted.
- b. The amount of credit **does not exceed USD 20 million**, per import transaction.

- c. The 'all-in-cost' per annum, payable for the credit does **not exceed LIBOR + 50 basis points for credit upto one year and LIBOR + 125 basis points for credits for periods beyond one year but less than three years**, for the currency of credit.
- d. The bank cannot issue any guarantee, letter of comfort or letter of undertaking without taking an approval of RBI. [See A. P. Circular No. 87 dt. 17.4.2004]. However the Master Circular states that Authorised Dealer can issue guarantee for trade credit. (Master Circular No. RBI/2006-07/33 DBOD Dir. BC. 17/3.3.00/2006 dt. 1st July, 06.)

13.4 ECBs by units in Special Economic Zones:

Units in SEZs can raise loans for any maturity period (even for less than 3 years.) "Isolation from domestic markets" is something which one should note. i.e. units in SEZs can raise ECBs on "stand alone basis". As there is a special policy, the important paras from the policy are being reproduced below.

Deleted: ¶

"By "stand alone" it is meant that units in the SEZs would be completely isolated from financial contacts with their subsidiaries or their parent in the mainland or within the SEZs as far as repayment of ECB interest/principal is concerned. Therefore, in effect only those units, which are either subsidiary/branch of a company registered outside India or where a company is registered independently for operating in one or more zone in the country, would qualify for stand along criteria. Borrowers in the SEZs are to be allowed to raise ECB under the special window as announced in the EXIM Policy. They would service the loan (principal + Interest + any other fee, charge etc.) out of proceeds generated by the SEZ units."

Deleted:

An annual cap of US\$ 500 million has been prescribed.

The paragraph on treatment of debt is also important. The same is reproduced below.

"Treatment of debt:

- i. *According to IMF classification the debts incurred by units in SEZs would be treated as external debt of India.*
- ii. *However, this debt would be separately and uniquely identified while explaining that the units in SEZs will not have access to the foreign exchange reserves of India for purposes of servicing the debt. "*

Thus the entire borrowing by units in SEZs does not impact foreign exchange reserves.

Q.14 Can the borrower offer **security / guarantee** from Indian Financial Institutions to the lender? Can hedges be considered for ECBs?

Ans.

14.1 **Security** - Yes, the borrower can offer security to the lender. Any kind of security can be considered. It is left to the lender and the borrower.

However, creation of charge over immovable assets and financial securities, such as shares, in favour of overseas lender is subject to Regulation 8 of Notification No. FEMA 21/RB-2000 dated May 3, 2000 and Regulation 3 of Notification No. FEMA 20/RB-2000, dated May 3, 2000, respectively.

In case of immovable property, a non-resident is not permitted to acquire immovable property except in limited circumstances. Therefore for offering immovable property as a security, prior approval should be taken.

Similarly for shares being offered as security, while it is possible for a non-resident to acquire shares under automatic route, in case of security being enforced, the acquisition of shares may, or may not be under automatic route.

Therefore depending on the situation, ECB may be taken under automatic route or approval route.

14.2 **Guarantee** - Guarantee/standby letter of credit or letter of comfort by banks, financial institutions and NBFCs relating to ECB is not permitted. However under the Approval route, applications for providing guarantee/standby letter of credit or letter of comfort by banks, financial institutions relating to ECB in the case of Small and Medium Enterprises will be considered on merit subject to prudential norms. Further in case of textile industry, guarantees can be given by the banks (see answer 4.7 above).

14.3 **Hedging** - In cases where ECBs have been raised for meeting rupee expenditure under Automatic Route, the Authorised Dealer has to ensure at the time of draw down that the forex exposure of the borrower is hedged unless there is a natural hedge in the form of uncovered foreign exchange receivables. [A.P.(DIR Series) Circular No. 36 dated 14th November, 2003] In case of ECB by NGO also, the ECB should be hedged. [A. P. circular 40 dated 25.4.05].

Q.13 Once the ECB is taken, is any further approval required for making **payment of loan installment and interest?**

Ans. No further approval is required for making payment of loan installment and interest. In fact under proviso to S. 6(2), RBI cannot impose any restriction for payment due on account of amortisation of loan. Interest payment is also a Current Account Transaction (S. 2(j)(ii)). No restriction can be imposed (except the limit of rate of interest discussed above).

Q.14 Can ECBs be **pre-paid?**

Ans. Pre-payment can upset the foreign exchange reserves. Hence normally there are restrictions. However RBI has permitted pre-payment of ECB up to USD 400 million, subject to compliance with the stipulated minimum average maturity period as applicable for the loan. (A P Circular 44 dated 30.04.07.) If more than US\$ 400 millions have to be repaid, RBI approval is required.

Q.15 Can **funds raised through ECBs be kept outside India** till the same are required to be used?

Ans. The funds should be retained abroad which are not required for immediate use. ECB proceeds parked overseas can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA(-) by Standard and Poor/Fitch IBCA or Aa3 by Moody's; (b) deposits with overseas branch of an authorised dealer in India; and (c) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

Q.16 There may be other **expenses** which may have to be incurred **for raising ECBs** like traveling, professional fees, merchant banker's fees, out of pocket expenses, etc. _Can the same be incurred? Is any approval required from RBI?

Ans. Yes the expenses can be incurred within the overall annual cost as mentioned in answer 9. Primarily there are no limits on amount of expenses.

Q.17 Are there any **periodic formalities** to be complied with?

Ans. After the approval is obtained, monthly returns have to be filed in form ECB2. This is under both categories – Automatic and Approval routes. The form has to be filed through the banks so as to reach RBI (Director, Balance of Payments Statistics Division, Department of Statistical Analysis and Computer Services (DESACS), Reserve Bank of India, Bandra-Kurla Complex, Mumbai – 400 051) within 7 days from month end. The form has to be signed by the company secretary or a Chartered Accountant.

For providing greater transparency, information with regard to the name of the borrower, amount, purpose and maturity of ECB will be put on the RBI website by the next working day of the approval under Approval Route and on a monthly basis with a lag of one month to which it relates under Automatic Route.

Q.18 Can residents in India raise **loans from relatives**? Say Mr. Rajesh Desai, an Indian resident, requires funds for building a house in his hometown. His brother is an NRI. Can the brother give a loan? If yes, what are the rules:

Ans: Under FEMA, apart from the loan facilities discussed above, there is a loan facility from the relatives. The conditions are:

- i. The loan can be taken in foreign exchange upto US\$ 2,50,000 or its equivalent:
- ii. The minimum maturity of the loan is 1 year.
- iii. The loan is **interest free**.
- iv. Amount should be received from abroad, or from NRE account. Funds in NRO account cannot be used.
- v. The loan should be received from close relatives as defined under the Companies Act.

Q.19 Are there any restrictions on **use the funds**?

Ans: Surprisingly, there are no restrictions. Earlier the restrictions were there. These have been removed completely from 1st Nov. 2002 vide notification 75.

Q.20 An Indian resident can **execute projects abroad**. What are the loan facilities available to such exporters?

Ans: These projects are approved by a special working group. If the approval is obtained for the loan, then the project exporter can borrow from a foreign bank.

Q.21 What are the rules regarding **Foreign Currency Convertible bonds (FCCBs)**?

Ans: FCCBs are issued as per the rules given in the Joint Venture rules. One doesn't know why these rules are prescribed under the Joint Venture rules. These could have been prescribed under FDI rules or ECB rules. Primarily, ECB guidelines have to be followed for issue of FCCB.

B. Rupee loans:

Q.22 If an Indian resident wants to **borrow in Indian rupees**, what are the options available?

Ans: It is possible to borrow in Indian rupees from NRIs on non-repatriable basis. The loan can be a rupee loan, or a deposit, or a commercial paper. RBI has issued separate rules for "loan" and "deposit". It is also possible to issue debentures to NRIs.

Q.23 What are the basic **rules for a rupee "loan"**?

Ans: A person **other than a company**, can borrow from an NRI as a loan subject to the following conditions:

- i. The funds are given from abroad, or from NRE / NRO / FCNR account.
- ii. The loan period does NOT exceed 3 years.
- iii. The rate of interest does not exceed 2% over the bank rate prevailing on the date of loan.
- iv. The repayment is on non-repatriable basis. i.e. repayment is done on NRO account.

Q.24 Are there any restrictions on the **use of loan**?

Ans: The loan cannot be used for the following purposes:

- i. use in business of chit fund, nidhi, agricultural activities, real estate trading, trading in TDRs. The loan can be used for other businesses.
- ii. use the funds for investment – whether in shares, or partnership firm, proprietary concern.
- iii. relending.

Q.25 Is there any **reporting requirement** – one time or annual?

Ans: There are no reporting requirements at all.

Q.26 What about **companies**? Can they borrow?

Ans: Companies can issue non-convertible debentures (NCDs) to NRIs subject to the following conditions:

- i. issue of NCDs is by way of a public offer. Thus private offers are ruled out. Privately, only deposits can be taken by the companies.
- ii. the rate of interest does not exceed 3% above the SBI prime lending rate, as on the date of passing the resolution at the shareholders' meeting.
- iii. the period of debentures shall not be less than 3 years.

Q.27 Are there any **reporting requirements**?

Ans: Within 30 days of receipt of funds, the details about the receipt, bank etc. have to be filed with RBI.

Within 30 days from allotment, details of investors have to be filed with RBI.

Q.28 Can the **debentures** be issued on repatriable or non-repatriable basis?

Ans: The debentures can be issued on both - repatriable and non-repatriable basis. However in case of repatriable debentures, the ratio of repatriable debentures to total debentures in each series, shall not be more than the FDI limit prescribed for shares.

Q.29 Are there are restrictions on **use of funds**?

Ans: Similar restrictions apply as stated in answer 25 for rupee loans.

Q.30 Can **convertible debentures** be issued?

Ans: Yes, even convertible debentures can be issued. However the rules are governed by FDI policy. Fully convertible, and partly convertible debentures can be issued.

Partly convertible debentures need to be converted into shares to some extent. No limit is prescribed. The non-convertible portion can be redeemed. This route can be used by for raising a loan even from outright foreigners, and not just NRIs. The only things is that convertible debentures are primarily governed by FDI policy. Hence if debentures are to be issued to foreigners, the same can be done only on repatriable basis.

Q.31 What are the basic **conditions** for taking a “**deposit**”?

Ans: A deposit can be taken by a “proprietary concern”, firm, or a company from a NRI. An individual is not allowed to take a loan. Under FEMA, a “proprietor”, and a “proprietary concern” are treated differently.

The deposit can be taken subject to following conditions:

- i. The deposit cannot be for more than 3 years.
- ii. A company can accept the deposit by way of public or a private offer. (In case of debentures, a public offer is necessary.)
- iii. If it is a NBFC, it should be registered with RBI and should have the required credit rating.
- iv. The deposit cannot be for more than 3 years.
- v. If the deposit accepting company is a NBFC, the rate of interest payable on deposits shall be in conformity with the guidelines of RBI. In other cases, the rate of interest payable on deposits shall not exceed the ceiling rate prescribed from time to time under the Companies (Acceptance of Deposit) Rules.
- vi. The deposit can be taken only on non-repatriable basis. The amount should be received from NRO account. It cannot be received from NRE account. Further, the funds cannot be received from NRE account, transferred to NRO account, and then a deposit can be kept. Thus even funding from NRE account is not permissible. This condition is not there in case of a “loan”! So loan can be taken from NRE account, but a deposit cannot be taken.

Q.32 Are there any restrictions on **use of funds**?

Ans: The funds cannot be used for:

- i. re-lending (not applicable to a NBFC),
- ii. undertaking agricultural activities, real estate trading,
- iii. investing in any other concern or firm or company engaged in or proposing to engage in agricultural activities or real estate trading business.

Q.33 What are the rules for issue of **commercial papers**?

Ans: Commercial papers can be issued to NRIs & FIIs subject to following conditions:

Borrowings by residents from non-residents – FEMA provisions

- i. The issue can be on non-repatriable basis. (There is a lacunae. Non-repatriable schemes are open only for NRIs. Foreigners are not allowed non-repatriable investment. FIIs rules in FEMA notification 20, schedule 5 clearly state that FIIs can invest or repatriable basis. The overall limit for FIIs in corporate debt including commercial papers in U.S. \$ 1.5 billion.)
- ii. Appropriate rules for issue of commercial paper should be complied with.
- iii. The commercial paper is not transferable.
- iv. Payment is received from abroad or from NRE / NRO account.

Q.34 Can a resident borrow funds from Indian banks, on security of funds sent by non-residents?

Ans: It is possible to borrow funds from banks, based on security of deposits placed by NRIs. Outright foreigners cannot keep deposits in India.

Loans can be taken based on NRO / NRE / FCNR deposits. Loans can be taken only for personal or business purpose. They cannot be taken for re-lending, or agricultural or real estate activities.

In case of NRE / FCNR deposits, RBI has put a restriction of loan of Rs. 20 lakhs (A P Circular 29 dt. 31.1.07). There is no limit for NRO deposits. The restriction was brought quite abruptly. Those who have kept deposits of crores of rupees, have had to restructure their business.

Summary:

Today the Indian businessman has a good choice of availing foreign capital by way of equity and loans. However, as loan affects the external liabilities of India, there are strict regulations. This area will always be regulated to some extent.