# Corpsec Hotline

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## DEBT FUNDING: INDIA INC. GETS MORE TO CHEER

While debt funding has been the preferred mode of investment, historically India has offered very few routes for offshore debt investment into Indian entities. Over the last 18 – 24 months, the government and the exchange control regulator, the Reserve Bank of India ("**RBI**") have been relaxing regulatory norms around debt funding, especially overseas debt funding. Recently, the regulatory regime for the external commercial borrowings ("**ECB**") was overhauled in a substantially liberalized manner[1].

### BACKGROUND

The Monetary Policy Committee of the RBI on February 7, 2019 issued its 'Sixth Bi-monthly Monetary Policy Statement, 2018-19' and also issued the 'Statement on Developmental and Regulatory Policies'[2] The 'Statement on Developmental and Regulatory Policies' ("**RBI Statement**") has proposed a number of regulatory changes such as permitting ECBs to be raised for refinancing rupee debt in certain cases, removal of certain concentration norms, harmonizing categories of non-banking financial companies ("**NBFC**") and amending risk weightage for NBFC. Some of these changes are expected to have substantial bearing on debt raising options by Indian corporates. In this hotline, we have dealt with some of the important changes proposed in the RBI Statement, and the potential impact of the same.

### REGULATORY CHANGES PROPOSED

- ***Raising of ECBs for companies under the CIRP process***

The RBI under the RBI Statement decided to permitt ECB to be raised for refinancing of Rupee loans of corporates which are under the corporate insolvency resolution process ("**CIRP**") of the Insolvency and Bankruptcy Code, 2016 ("**IBC**"). This was not allowed under the current regulations, and ECB could only be used to retire foreign debt. The RBI has also issued a Circular on February 7, 2019[3] amending the existing ECB framework to permit this.

With the introduction of the IBC, a large number of companies have gone / are undergoing the CIRP. Under the CIRP process, potential bidders prepare and submit resolution plans which are evaluated by lenders of the company under the CIRP process (known as 'corporate debtor'). One of the main features of the resolution plans for large companies has been the manner in which the existing outstanding debt has been dealt with by bidders. These include repayment of existing debt, restructuring existing debt and even refinancing existing debt. In most of the important cases thus far, the amounts owed by the corporate debtor have been substantially large, running into billions of dollars. In these cases, refinancing of existing debt has not been feasible for bidders. Restructuring of loans (where lenders have agreed to re-set interest rate, repayment schedules and moratorium) have been preferred by bidders, but this has faced hurdles by lenders (mainly being banks and financial institutions) wanting to completely exit their exposure from these stressed companies.

The only other option open for dealing with existing debt is refinancing of loans. Considering the quantum of loans involved, funding from resident sources (mainly banks) have been a challenge. This coupled with restriction on Indian banks to lend for acquisition financing restricted borrowing in India by potential acquirers. Borrowing offshore was considered more palatable to bidders, especially to non-resident bidders, since they could raise such leverage on the back of their global financial wherewithal and at more competitive rates. These funds could be raised in two modes – raising acquisition financing offshore and then using the funds to acquire the target in India and repay the existing loan through fresh investment into the target; or by re-financing existing loans. The former was not preferred by bidders, since the inability of the target to benefit from interest expense in India made it tax inefficient. In addition, the funds raised were directly on the books of the acquirers / bidders, instead of the target. The other option of refinancing existing debt is generally preferred by all bidders.

Most of the debt raised from offshore banks and financial institutions are by way of ECBs. However, the ECB norms prohibit ECB to be raised for certain end-uses, which include refinancing of Rupee loans. This restricted the ability of potential bidders to raise ECBs for refinancing debt. To further encourage bids under the IBC, the RBI Statement has now proposed to permit ECBs to be raised for refinancing of Rupee loans of companies under the CIRP process. The RBI has, on February 7, 2019 issued a Circular[4] permitting companies under CIRP to raise funds under the ECB route for the purpose of refinancing existing Rupee loans. These are however, subject to certain conditions, being (i) the company under the CIRP, which shall be the borrower shall be an eligible borrower generally; and (ii) the raising of the ECB shall be under the automatic route.

The relaxation in the end-use restriction for ECB should provide a major fillip to potential bidders under the CIRP process, considering that they are now entitled to raise fresh ECB in the target for refinancing both Rupee and foreign currency loans.

- ***Relaxation of risk-weightage of lending by banks to NBFCs***

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Under the existing regulatory framework applicable, banks lending to NBFCs are required to have a risk-weightage of 100% for all lending to NBFCs. The RBI Statement has proposed to remove the requirement for banks to maintain a risk weightage of 100% uniformly and instead apply a risk-weighted approach based on ratings assigned by rating agencies.

Banks lending to NBFCs are required to assign a 100% risk weightage to such loans, thereby requiring banks to provision for such loans. This meant that a substantial portion of the bank's capital was blocked. This was considered to be a harsh requirement, considering some of these NBFCs were strong financially and did not merit a 100% risk weightage. To ensure that the risk-weightage was aligned to the actual risks involved, the RBI Statement now proposes that the risk weightage of loans to NBFCs by banks be linked to the actual risks involved, based on the ratings assigned to such NBFCs by accredited rating agencies. This is in line with the risk-weightage involved in lending by banks to corporates. This is a positive move and would free up additional capital on the balance sheet of banks, encouraging more lending by banks. The change however, excludes core investment companies ("**CIC**") from its purview, thereby meaning that banks would still need to assign a 100% risk weightage for loans offered to CICs.

The official circulars to effect such changes are awaited.

- ***Relaxation in concentration norms for FPI investments***

Foreign Portfolio Investor ("**FPI**") investments into non-convertible debentures ("**NCD**") issued by Indian corporates have been subjected to certain credit concentration norms since 2018 whereby no FPI was permitted to invest in excess of 20% of its total debt portfolio into a single corporate group. The RBI Statement has now proposed to remove this 20% restriction.

One of the most widely used routes for debt investments into India till early 2018 was investment through NCD under the FPI regime. In April – May 2018, the SEBI and the RBI introduced credit concentration / diversification norms to provide for the maximum portion of a debt issuance that a single FPI can invest, and also concentration norms for an FPI, i.e. the maximum portion of an FPI's portfolio that it can invest in a single corporate entity, along with its group entities.

RBI's circular No. 24 dated April 27, 2018 ("**FPI Circular**") prescribed that an FPI cannot invest more than 20% of its debt portfolio in a single corporate entity (along with its group companies). FPIs were required to comply with this requirement effective March 31, 2019.

However, FPIs were facing substantial challenges to meet this diversification requirement. The introduction of the 50% limitation on FPIs to invest in a single debt issuance has already resulted in substantial reducing of debt inflows into Indian corporates. Further, the requirement to diversify meant that FPIs were compelled to invest in multiple deals in a short span of time to ensure that the 20% restrictions are not breached. This requirement was putting further strain on FPIs to invest into India. The removal of this restriction is going to provide a major push to NCD investments by FPIs into India.

While the removal of the 20% concentration norm is an extremely positive move, the 50% limit is proving to be a much greater impediment to FPIs for their investments into India. The removal of this restriction would provide FPI-NCD investments the shot in the arm they seek.

The formal notification of the RBI and SEBI removing the credit concentration norms are still awaited.

- ***Harmonization of NBFCs***

The RBI Statement also proposes to harmonize various NBFCs to shift form an NBFC based regulatory regime to an activity based regulatory regime.

There are various categories of NBFCs under the RBI guidelines[5] and the rationale for the categorization has been questioned time and time again. The RBI Statement proposes to now harmonize the NBFCs based on activities. Accordingly, the RBI Statement has proposed to harmonize NBFCs in credit intermediation, vis-a-vis asset finance companies, loan companies and investment companies into a single category. The final notification in this regard is still awaited and it is to be seen how the RBI decides to implement these NBFCs, considering these categories has different requirements and regulatory framework. It is likely that the RBI would prefer a phased approach whereby it requires the NBFCs being merged into a single class to start complying with the applicable regulations over a period of time. Further, it is also to be seen how RBI looks at investment companies which do not raise funds from external sources, namely, core investment companies.

## CONCLUSION

The changes proposed by the RBI Statement would provide debt inflows into India a major push. Further, the changes to the risk weightage is also expected to encourage further lending by banks into NBFCs. While certain concerns have been addressed, the RBI Statement falls short in certain areas, such as removal of the 50% requirement, relaxing end-use restrictions for Rupee refinancing for companies not under the CIRP.

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You can direct your queries or comments to the authors

[1] For a detailed analysis on this, please refer to our hotline available here. [Link: http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/external-commercial-borrowings-regulatory-framework-substantially-relaxed.html?no_cache=1&cHash=225df0a15bad7dc66b993edb783fe9f8 ]

[2] Available here and here respectively [links https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=46235 and https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=46237 ]

[3] A.P. (DIR Series) Circular No. 18 dated February 7, 2019 available online at https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11472&Mode=0

[4] A.P. (DIR Series) Circular No. 18 dated February 7, 2019 available online at https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11472&Mode=0

[5] Asset finance companies, investment company, loan company, infrastructure finance company, core investment company, infrastructure debt fund, NBFC – micro finance institution, NBFC – factors, mortgage guarantee companies and NBFC – Non-operating financial holding companies

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