

Corpsec Hotline

August 08, 2007

RBI SOUNDS THE 'DEBT KNELL' FOR INDIAN BORROWERS: FURTHER RESTRICTIONS IMPOSED ON FOREIGN CURRENCY BORROWINGS

In what is perceived to be a move to encourage domestic credit off take and keeping in view the current macro economic situation, the Reserve Bank of India ("RBI") through its [circular](#) dated August 07, 2007 ("[Circular](#)") has imposed further restrictions on external commercial borrowings ("[ECBs](#)") being utilized by Indian borrowers for rupee expenditure in India. These restrictions seem to have been imposed by RBI in view of India's increasing foreign exchange reserves. The following are some of the salient features of the Circular:

- ECBs of over USD 20 million per Indian borrowing company permitted only for foreign currency expenditure.
- ECBs up to USD 20 million per Indian borrowing company permitted for foreign currency expenditure under Automatic route. However, if the ECB is for rupee expenditure, prior approval of the RBI would be required.
- These changes which come into effect immediately, would not apply to borrowers who have already entered into loan agreements and who have obtained loan registration numbers from RBI. Borrowers who have taken verifiable and effective steps wherein the loan agreement has been entered into to avail of ECB under the previous dispensation, and not obtained the loan registration number, may apply to the RBI through their Authorised Dealer.

As a result of the above, Indian companies can no longer raise foreign currency borrowings in excess of USD 20 million to meet rupee expenditure in India and would consequently be required to rely on domestic sources for such borrowings. These restrictions thereby effectively bring ECBs for rupee expenditure under a ceiling of USD 20 million and further do away with the concept of ECBs for rupee expenditure under the 'Automatic route' by mandating the requirement of obtaining RBI approval. Prior to the above changes, ECBs were permitted to be utilised by Indian borrowers for funding capital expenditure in India without any ceiling on rupee expenditure.

All other aspects of the [ECB Guidelines](#) such as USD 500 million limit per borrowing company per financial year under the Automatic route, eligible borrower, recognized lender, average maturity period, ECBs to be parked overseas until actual requirement in India, etc remain unchanged. Thus, while individual companies can continue to raise up to USD 500 million through the Automatic route, they will now be able to remit only up to USD 20 million into India to meet expenses in Indian currency and can do so only with prior RBI approval.

Implications:

- Indian companies that hitherto benefited from the interest rate differential between domestic borrowings and overseas borrowings are likely to incur higher borrowing costs as a result of having to resort to domestic borrowings which entail higher interest rates. However, to the extent domestic interest rates soften in the near future, Indian companies may be indifferent to these changes since the softening of interest rates would offset the above negative impact.
- On account of the above restrictions on use of ECBs for rupee expenditure, the ECB proceeds can now be used by Indian companies only for leveraged buy-outs of companies abroad.
- Indian companies will now have to explore alternative sources of funding for raising debt.

It may be noted that apart from the changes discussed above, several other changes have been made to the ECB Guidelines this year, which changes include:

April 30, 2007

Preference shares that are non-convertible or optionally convertible brought within the ambit of ECB guidelines. [Read more here.](#)

May 18, 2007

- Integrated township development as a permissible end-use of ECB withdrawn.
- All-in-cost ceilings reduced to 6 months LIBOR + 150 basis points from 6 months LIBOR + 200 basis points for ECBs with average maturity of 3-5 years
- All-in-cost ceilings reduced to 6 months LIBOR + 250 basis points from 6 months LIBOR + 350 basis points for ECBs with average maturity of above 5 years.

[Read more here.](#)

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Hybrid instruments such as optionally convertible / partially convertible debentures clarified as debt-like instruments and brought within the ambit of the ECB Guidelines.

It was further clarified that only instruments which are fully and mandatorily convertible into equity, within a specified time would be reckoned as part of equity under the FDI Policy. [Read more here.](#)

- [Archana Rajaram](#) & [Nishchal Joshipura](#)
You can direct your queries or comments to the authors

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