Corpsec Hotline

July 16, 2008

SECURITY CLEARANCE FOR ECB

Touted as one of the fastest growing economies in the world, India's global economic dominance started in the year 1991 when the government relaxed the norms and liberalized the economy. The Reserve Bank of India ("**RBI**") on July 11, 2008 took a step further in India's process of liberalization vide A.P. (DIR Series) Circular No. 01 through which it relaxed the existing procedures for creating a charge on assets for an external commercial borrowing ("**ECB**"). With regards to the same, this hotline would cover the pre and post change scenario and the effect which the relaxation might have.

Previous position- Approvals

- Provisions for providing Guarantee and Security were provided under the Approval Route.
- Choice of security to be provided to the overseas lender/supplier for securing ECB left to the borrower.
- Creation of charge over immovable assets and financial securities in favor of overseas lender was subject to Foreign Exchange Management Act, 1999 ("**FEMA**") notifications.
- Thus, proposals for creation of charge on immovable assets, financial securities and issue of corporate or personal guarantees, on behalf of the borrower in favor of the overseas lender were considered by the RBI on a case by case basis.

Amendments Made

Through A. P. (DIR Series) Circular No. 01 dated July 11, 2008, RBI has relaxed the procedure for creation of a charge for securing the ECBs. Thus, instead of going through the entire approval process, RBI has now allowed AD Category - I banks to convey '*no objection*' under FEMA for creation of charge on immovable assets, financial securities and issue of corporate or personal guarantees in favor of an overseas lender or security trustee, to secure the ECB to be raised by the borrower, albeit certain conditions as detailed below are fulfilled.

General Conditions:

1. The underlying ECB is strictly in compliance with the extant ECB guidelines;
2. There exists a security clause in the loan agreement requiring the borrower to create charge on immovable assets / financial instruments / furnish corporate or personal guarantee;
3. The loan agreement has been signed by both the lender and the borrower; and
4. The borrower has obtained Loan Registration Number (LRN) from the RBI.

Specific Conditions:

(a) Creation of Charge on Immovable Assets

Conditions for '*no objection*' for creation of charge on immovable assets may be conveyed in favor of the lender or the security trustee:

(i) '*No objection*' shall be granted only to a resident ECB borrower.

(ii) The period of such charge on immovable assets has to be co-terminus with the maturity of the underlying ECB.

(iii) Such 'no objection' should not be construed as a permission to acquire immovable asset (property) in India, by the overseas lender / security trustee.

(iv) In the event of enforcement / invocation of the charge, the immovable asset (property) will have to be sold only to a person resident in India and the sale proceeds shall be repatriated to liquidate the outstanding ECB.

(b) Creation of Charge over Financial Securities

Conditions for '*no objection*' to the resident ECB borrower for pledge of shares of the borrowing company held by promoters as well as in domestic associate companies of the borrower to secure the ECB:

(i) The period of such pledge shall be co-terminus with the maturity of the underlying ECB.

(ii) In case of invocation of pledge, transfer shall be in accordance with the existing FDI policy.

(iii) A certificate from the Statutory Auditor of the company that the ECB proceeds have been / will be utilized for the permitted end-use/s.

(c) Issue of Corporate or Personal Guarantee

Conditions for '*no objection*' to the resident ECB borrower for issue of corporate or personal guarantee:

(i) Obtaining a board resolution for issue of corporate guarantee from the company issuing such guarantee, specifying names of the officials authorized to execute such guarantees individually or on behalf of the company.

(ii) Specific requests from individuals to issue personal guarantee indicating details of the ECB.

(iii) Ensuring that the period of such corporate or personal guarantee is in consonance with the maturity of the underlying ECB.

Interpretation of 'no objection'

The 'no objection' certificate as issued by the AD Category – I banks may have certain specific caveats like:

1. It should not be construed as an approval by any other statutory authority or Government under any other laws / regulations.
2. In case further approval is required from any other regulatory / statutory authority or Government under the relevant laws / regulations, the applicant would abide by the provisions before undertaking the transaction.
3. It should not be construed as regularizing or validating any irregularities, contravention or other lapses, if any, under FEMA or any other laws or regulations.

Implications

Akin to the automatic route, the procedural easing of norms signify that the Indian borrower companies may not have to go through the RBI approval route for creating a charge on immovable assets, financial securities and guarantee for overseas lenders and thus would save a lot of time that was previously required for getting a clearance from RBI.

Though this has simplified the procedure for securing the ECB by Indian borrower, however this may not be significant from a global scenario. In many instances we have seen that overseas companies which have their wholly owned subsidiaries in India or companies/funds who have invested in India, wish to pledge their holdings in Indian companies for overseas borrowings. Currently, transfer by way pledge of any Indian securities mandates the prior approval of RBI. Since, the transfer of Indian securities by way of sale from a non-resident to another non-resident is under the automatic route otherwise, we believe that the RBI while formulating the instant relaxation should have taken into account such transactions and lifted the embargo on pledge of Indian securities by a non-resident investor to another non-resident.

Source: RBI Circular

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You can direct your queries or comments to the authors

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