

External Commercial Borrowing: A Banking Perspective

written by Akshay Ramesh | January 11, 2021



External Commercial Borrowing: A Derivative of Globalisation for Fundraising

Growth and profit making are the ultimate objectives of every business entity. These objectives can only be achieved through sufficient financial resources that will enable them to thrive in the market. Therefore, these entities depend on various sources of finance which may in the form of debt instruments, securities, funding from banks and financial institutions, etc. However, in certain circumstances, the entity wants to expand its operations but it is not feasible to avail funding within borders. It is during such cases, the entity relies on certain other funds from foreign or external sources such as American Depositary Receipts (ADR), European Depositary Receipts (EDR), External Commercial Borrowing, etc.

What Is External Commercial Borrowing?

External Commercial Borrowing or ECB refers to the loans or any other forms of financial assistance provided by foreign enterprises to the Indian entities which may be in the form of commercial bank loans, buyers' credit, suppliers' credit, securitised instruments such as floating rate notes and fixed rate bonds, credit from official export credit agencies and commercial borrowings from the private sector window of multilateral financial institutions such as International Finance Corporation (Washington), ADB, AFIC, CDC, etc.

As per Foreign Exchange Management (Borrowing and Lending) Regulations 2018, external commercial borrowing has been defined as follows^[1]:

“External Commercial Borrowings means borrowing by an eligible resident entity from outside India in accordance with the framework decided by the Reserve Bank in consultation with the Government of India”.

Why Do Entities Rely On External Commercial Borrowing?

Every business entity in India relies on External Commercial Borrowing due to following reasons:

- Gain Advantage Of Foreign Exchange Exposure

Every foreign currency which comes to India is subject to foreign exchange exposure due to which the entities can avail a huge amount of funding from abroad if there has been an increase in the value of the foreign currency.

- Decreased Cost

The cost involved in raising funds from ECB's is lower in comparison with the raising of funds within a domestic market.

- Diversification Of Investor's Base

A business entity can expand itself only when it has sufficient financial resources and one way to avail finance is through diversification of investor base. If the investors of the companies are from different parts of the world then the company can avail funding from different countries and will also gain the advantage of difference in currency value.

- Satisfying Large Requirements

There are circumstances where the entities require a huge amount of funding and those requirements cannot be fulfilled within the boundaries of the country. Therefore, the entities rely on foreign funding.

Who Are The Eligible Lenders For The Purpose Of External Commercial Borrowings?

Any country which is in compliance with the norms of Financial Action Task Force (FATF) or International Organisation of Securities Commission (IOSCO) is considered as an eligible lender; However, the following entities are also considered eligible lenders[2]:

1. Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognised lenders.
2. Individuals as lenders can only be permitted if they are foreign equity holders or if they have subscribed to bonds/debentures listed abroad.
3. Foreign branches/subsidiaries of Indian banks are permitted as recognised lenders only for Foreign Currency ECB (except FCCBs and FCEBs).

Who Are The Eligible Borrowers Under External Commercial Borrowings?

If the External Commercial Borrowings are made in the denomination in foreign currency then the following persons are eligible to avail of loan under ECB[3]:

- All entities eligible to receive Foreign Direct Investment (FDI)
- Port trusts
- Units in SEZ
- SIDBI
- Exim Bank of India

If the same is to be made in denominations of Indian Rupees (INR) then the following persons are eligible:

- All entities eligible to raise ECB.
- Registered entities engaged in micro-finance activities viz registered Not for Profit companies, registered societies/trusts/co-operatives and Non-Governmental Organisations.

Statutory Limits For Raising Loans Under External Commercial Borrowing

In general, eligible borrowers can raise the loans under the ECB up to 750 million USD or equivalent for every financial year under the automatic route and 3 million USD or equivalent for every financial year in case of start-up under the automatic route[4]. However, the said limit can be increased by RBI

in consultation with the Government of India.

Creation Of Charge Under External Commercial Borrowing

As a general rule, an overseas lender can create a charge on movable assets, immovable assets and financial securities of the borrower only after they obtain permission from an Authorised Dealer Category-I Bank in India. The permission will be given by Authorised Dealer Category-I only when they satisfy themselves with the following:[5]

- ECB is in compliance with the extant ECB guidelines.
- A security clause has been incorporated in Loan Agreement under ECB wherein the external borrower can create/cancel the charge in favour of an overseas lender.
- No objection certificate should be obtained from existing lenders in India if required in case of charge creation.

Further, the rules with respect to the creation of charge in the case of ECB will vary depending upon the type of assets. The said rules have been classified in the following manner[6]:

- Creation of charge on immovable assets

A charge can be created on immovable assets subject to the following conditions:

1. Such immovable assets for which charges are created are subject to the provisions of Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2017, as amended from time to time.
2. The permission to create a charge should not be construed as permission to acquire an immovable asset in India.
3. If the charges are enforced with respect to the immovable property then such assets should be sold to a person resident in India and the sale proceeds should be repatriated to liquidate the outstanding ECB.

- Creation of charge on movable assets

If the lender has to enforce the charge on movable then he can exercise his claim only to the extent of outstanding liabilities of the borrower.

- Creation of charge over financial securities

A charge over the financial securities may be in the following forms:

1. Pledge of shares of the borrowing company which may be held by its promoters and other securities such as bonds, debentures, government securities, etc.
2. Security interest over all the present and future current assets and all current assets including cash and cash equivalent can be used as security for ECB.

Guarantee Under ECB

The general rules which are followed in case of security creation are also followed in the case of guarantee which is provided by the borrower in favour of an overseas lender for securing the repayment of a loan under External Commercial Borrowings. However, the following rules are complied with in case of issuance of personal or corporate guarantee of the borrower[7]:

- A copy of board resolution of authorising the company issuing guarantee to provide a corporate guarantee, specifying the names of the officials authorised to execute such guarantees on behalf of the company or in individual capacity should be obtained.
- Specific requests from individuals to issue personal guarantee indicating details of the ECB should be obtained.
- Such security shall be subject to provisions contained in the Foreign Exchange Management (Guarantees) Regulations, 2000, as amended from time to

time.

- ECB can be credit enhanced / guaranteed / insured by overseas party/ parties only if it/ they fulfil/s the criteria of recognised lender under extant ECB guidelines.

Conclusion

External Commercial Borrowing is indeed one of the reliable sources of funding for business entities. However, we also cannot deny the fact it has its own merits and demerits which in turn depend on the form of External Commercial Borrowing. If the ECB is in the form of commercial, the borrower can gain the benefits of foreign exchange exposure and for the lender, it is an investment opportunity outside his own country. On the other hand, it has its own demerits such as the lender may not have the remedies against the borrower in case of default in repayment of loan by the borrower and also the borrower does not have remedy against the exploitation by the lender. This in turn hinders the borrower and lender to enter into the transaction of external commercial borrowing. Therefore, there is a need for the law which enables remedy to the borrowers and lenders under external commercial borrowing.

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- [1] Sec 2(iv) of Foreign Exchange Management(Borrowing and Lending)Regulations 2018
 - [2] https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510
 - [3] https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510
 - [4] https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510
 - [5] https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510
 - [6] https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510
 - [7] https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510

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