External Commercial Borrowings: An Analysis of the Liberalisation Policy

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Abstract- ***External Commercial Borrowings are commercial loans raised by eligible resident entities from recognized non-resident entities. External Commercial Borrowings are governed by the Foreign Exchange Management (Borrowing or Lending in Foreign Currency) Regulations, 2000 issued by Reserve Bank of India and these regulations have been amended from time to time considering changes in India's macro-economic scenario. Apart from issuing Regulations, Reserve Bank of India has been issuing Master Directions on various aspects connected with foreign exchange management. Reserve bank of India though its circulars issued on 19.9.2018 and 3.10.2018 has amended its Master Direction. By these circulars External Commercial Borrowing policy has been liberalied. All the measures have been aimed at raising foreign exchange inflow, which is a part of a larger strategy to bring the bridge the current account deficit and the depreciation of the Indian currency.***

Index Terms- ***Depreciation, External Commercial Borrowings, Foreign Exchange, Liberalization, Rupee***

I. INTRODUCTION

External Commercial Borrowings are commercial loans raised by eligible resident entities from recognized non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in cost ceiling, etc. The parameters apply in totality and not on a standalone basis.

Framework for raising loans: The framework for raising loans through External Commercial Borrowings comprises the three tracks: Track I is the medium term foreign currency denominated External Commercial Borrowings with minimum average maturity of three to five years; Track II is long term foreign currency denominated External Commercial Borrowings with minimum average maturity of 10 years and Track III is the Indian Rupee denominated External Commercial Borrowings with minimum average maturity of three to five years.

Forms of borrowings: The External Commercial Borrowing Framework enables permitted resident entities to borrow from recognized non-resident entities in the following forms: i. Loans including bank loans; ii. Securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares / debentures); iii. Buyers' credit; iv. Suppliers' credit; v. Foreign Currency Convertible Bonds; vi. Financial Lease; and vii. Foreign Currency Exchangeable Bonds. However, External Commercial Borrowing framework is not applicable in respect of the investment in Non-Convertible Debentures in India made by Registered Foreign Portfolio Investors.

II. BACK GROUND

External Commercial Borrowings are governed by the Foreign Exchange Management Act, 1999, Foreign Exchange Management (Borrowing or Lending in Foreign Currency) Regulations, 2000 issued by Reserve Bank of India and these regulations have been amended from time to time considering changes in India's macro-economic scenario. Apart from issuing Regulations, Reserve Bank of India has been issuing Master Directions on various aspects connected with foreign exchange management by consolidating related Notifications and AP (DIR Series) Circulars. Reserve Bank of India vide its AP (DIR Series) Circular No. 9 dated September 19, 2018 has amended above mentioned Master Direction and brought the below discussed changes. Reserve Bank of India vide its AP (DIR Series) Circular No. 10 dated October 3, 2018 has further amended above mentioned Master Direction and brought the below discussed changes.

III. ANALYSIS AND DISCUSSION

1. Reserve Bank of India vide its AP (DIR Series) Circular No. 9 dated September 19, 2018 has amended its Master Direction. The impacts of the amendment are:

a. Companies engaged in manufacturing sector can now raise External Commercial Borrowings up to USD 50 Mn or its equivalent with a minimum average maturity period of one year, as opposed to three year period applicable to others.

b. Indian banks are now permitted to participate as arrangers/underwriters/market makers/traders in Rupees Denominated Bonds issued overseas, subject to applicable prudential norms. And the condition of holding not more than five percent of issue size after six months of issue is removed.

2. Reserve Bank of India vide its AP (DIR Series) Circular No. 10 dated October 3, 2018 has further amended its Master Direction. The impacts of the amendment are:

a. Public Sector Oil Marketing Companies, like Indian Oil Corporation Limited, Bharat Petroleum Corporation Limited, Hindusthan Petroleum Corporation Limited, etc, are now permitted to use External Commercial Borrowing proceeds raised from any recognized lenders for working capital purposes with minimum average maturity period of 3/5 years. In case of others, as mentioned above, External Commercial Borrowing proceeds from direct or indirect equity holders only can be used for working capital purposes.

b. The individual borrowing limit of USD 750 million or equivalent and mandatory hedging requirements as per the External Commercial Borrowings framework have also been waived for Oil Marketing Companies. However, Oil Marketing Companies should have a Board approved forex mark to market procedure and prudent risk management policy, for such External Commercial Borrowings.

c. The overall ceiling for such External Commercial Borrowings by Oil Marketing Companies has been increased to USD 10 billion equivalent with effect from October 3, 2018.

- Earlier, ECB up to USD50 million or its equivalent could be raised by eligible borrowers with minimum average maturity period of three years. Now the ECB borrowers who are into manufacturing sector are permitted to raise ECB up to USD50 million or its equivalent with minimum average maturity period of 1 year.

- Earlier, domestic banks can act as arranger and underwriter for rupee denominated bonds, also called masala bonds, issued overseas, and their holding cannot be more than five per cent of the issue size after six months of issue as an underwriter. Indian banks are now permitted to participate as arrangers/underwriters/market akers/traders in rupee denominated bonds issued overseas subject to applicable prudential norms.

IV. ISSUES

While the external commercial borrowings help companies take advantage of the lower interest rates in international markets, the cost of hedging the currency risk can be significant. If unhedged, adverse exchange rate movements can cost heavy to the borrower.

V. BENEFITS

1. The decision to reduce the tenure was taken to arrest the impact of a depreciating rupee as most manufacturing companies are buying dollars due to lack of financing options from banks and other financial institutions.

2. The one-year maturity reduces the borrowing costs as compared to the three-year maturity, which also saves on the interest payment for three years at a higher rate.

3. The Indian currency has fallen over since the beginning of this year as investors remain concerned over sustained foreign capital outflows. If foreign investors eagerly invest in Masala Bonds or bring money into India, this will help in supporting the rupee. In the case of Masala Bonds, the cost of borrowing can work out much lower. If the value of Indian currency falls, the foreign investor will have to bear the losses, not the issuer which is an Indian entity.

4. Now, companies can raise shorter period money and roll it over and use the cheaper funds to retire high-cost External Commercial Borrowings.

VI. CONCLUSION

All the measures have been aimed at raising foreign exchange inflow, which is a part of a larger strategy to bring the bridge the current account deficit (CAD) and the depreciation of the Indian currency. Having said that, the government and the central bank need to work together on a long-term solution to shield the country from worsening external factors.

REFERENCES

[1] The Foreign Exchange Management Act, 1999

[2] The Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000