



Module-A Unit-6

CAIIB PAPER-2

BANK Financial Management(BFM)

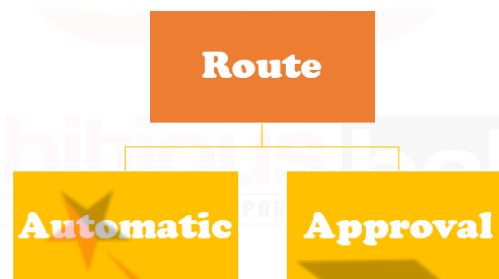


CAIIB BFM Module A Unit 6- External Commercial Borrowings and Foreign Investments in India

Introduction

External Commercial Borrowings (ECBs) are commercial borrowings raised by eligible resident entities from recognized lenders towards medium and long term foreign currency denominated debts including Indian Rupee denominated borrowings with a **minimum average maturity period of 3 years and above.**

The eligible resident Indian entities are also eligible to borrow for periods of less than 3 years, subject to the extant guidelines of the Reserve Bank of India.



Automatic route where the cases will be examined by the Authorized Dealers Category I (AD Cat I Banks).

Approval route, under which prospective borrowers are required to obtain RBI approval by routing their requests through their AD Banks for examination.

FCY Denominated ECB can be in any freely convertible foreign currency and includes bank loans, floating/fixed rate notes/bonds/debentures (other than fully and compulsorily convertible instruments), trade credits beyond 3 years, Foreign Currency Convertible Bonds (FCCBs), Foreign Currency Exchangeable Bonds (FCEBs) and Financial Leases.

INR Denominated ECB, which includes bank loans, floating/fixed rate notes/bonds/debentures (other than fully and compulsorily convertible instruments), trade credits beyond 3 years, Foreign Currency Convertible Bonds (FCCBs), Foreign Currency Exchangeable Bonds.

(FCEBs) and Financial Leases and includes Plain Vanilla Rupee denominated bonds issued overseas which can be either placed privately or listed on exchanges - as per host country regulations.

External Commercial Borrowings – Concepts

Eligible Borrowers

- All entities eligible to receive FDI.
- Entities recognized as Startup by the Central Government as on date of raising ECB.
- Port Trusts, Units in SEZ, SIDBI, EXIM Bank.

- Registered entities engaged in micro-finance activities viz., registered Not for Profit Companies, registered societies/trusts/co-operatives and Non-Government Organizations are permitted only to raise INR ECBs.

End Use

The negative list for which ECB proceeds cannot be utilized would include the following:

- Real estate activities
- Investment in capital market
- Equity investment
- Working capital purposes except from foreign equity holder
- General corporate purposes except from foreign equity holder
- Repayment of Rupee loans except from foreign equity holder
- On-lending to entities for the above activities.

ECBs – Recognized Lenders

- The lender should be resident of FATF (Financial Action Task Force) compliant country or IOSCO (International Organization of Securities Commission) compliant country.
- Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognized lenders.
- Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad.
- Foreign branches/ subsidiaries of Indian banks are permitted as recognized lenders only for FCY ECBs.
- Foreign branches/ subsidiaries of Indian banks, subject to applicable prudential norms, can participate as arrangers/ underwriters/ market-makers/ traders for Rupee denominated Bonds issued overseas. However, underwriting by foreign branches/subsidiaries of Indian banks for issuances by Indian banks will not be allowed

Minimum Average Maturity

Minimum average maturity period (MAMP) will be 3 years, including borrowing by startups.

Category	MAMP
Manufacturing sector companies may raise ECBs up to USD 50 million or its equivalent per financial year.	1 Year
ECB is raised from foreign equity holder and utilized for a. working capital purposes b. general corporate purposes c. for repayment of rupee loans raised domestically for purposes other than capex,	5 years
ECB is utilized for a. working capital purposes or general corporate purposes b. for repayment of Rupee loans availed domestically for non-capex	10 years
ECB is utilized for a. repayment of Rupee loans availed domestically for capex,	7 years
For startups	3 years

All-in-Cost ceiling

- For new ECBs - Benchmark rate plus 500 bps spread.
- For existing ECBs linked to LIBOR whose benchmarks are changed to ARR - Benchmark Rate plus 550 bps spread.
- For INR denominated ECBs - Benchmark rate plus 450 bps spread. Benchmark rate in case of Rupee denominated ECB will be prevailing yield of the Government of India securities of corresponding maturity.
- All-in-cost includes rate of interest, other fees, expenses, charges, guarantee fees, ECA charges, whether paid in foreign currency or INR but will not include commitment fees and withholding tax payable in INR.
- In the case of fixed rate loans, the swap cost plus spread should not be more than the floating rate plus the applicable spread. Additionally, for FCCBs the issue related expenses should not exceed 4% of issue size and in case of private placement, these expenses should not exceed 2% of the issue size, etc.

ECBs – Other Operational Concepts

- Change of currency of ECB from one freely convertible foreign currency to any other freely convertible foreign currency as well as to INR is freely permitted.
- The ECB borrower will be required to cover principal as well as coupon through financial hedges. The financial hedge for all exposures on account of ECB should start from the time of each such exposure (ie., the day liability is created in the books of the borrower).
- All eligible borrowers can raise **ECB up to USD 750 million** or equivalent per financial year under Automatic Route.
- However, entities recognized as Startup by the Central Government can **can raise maximum of USD 3 million or equivalent per financial year.**
- In case of FCY denominated ECB raised from direct foreign equity holder, ECB liability-equity ratio for **ECBs raised under the automatic route cannot exceed 7:1.**
- Issuance of any type of guarantee by Indian banks, All India Financial Institutions and NBFCs relating to ECB is not permitted.
- ECB proceeds meant only for foreign currency expenditure can be parked abroad pending utilization.
- Until utilization of ECB proceeds, funds can be invested in liquid assets
 - ✓ Deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/Fitch IBCA or Aa3 by Moody's;
 - ✓ Treasury bills and other monetary instruments of one-year maturity having minimum rating as indicated above.
 - ✓ Deposits with foreign branches/subsidiaries of Indian banks abroad.
- ECB proceeds meant for Rupee expenditure should be repatriated immediately for credit to Lender's Rupee accounts with AD Category I banks in India.

- ECB borrowers are also allowed to park ECB proceeds in term deposits with AD **Category I banks in India for a maximum period of 12 months** cumulatively. These term deposits should be kept in unencumbered position.
- Any draw-down in respect of an ECB should take place only after obtaining the LRN from the Reserve Bank on submission of Form ECB.
- The borrowers are required to report actual ECB transactions in Form ECB 2 Return through the AD Category I bank on monthly basis so as to reach RBI within seven working days from the close of month to which it relates.
- Changes in ECB parameters in consonance with the ECB norms, including reduced repayment by mutual agreement between the lender and borrower, should be reported to the RBI through revised Form ECB at the earliest, in any **case not later than 7 days from** the changes effected. While submitting revised Form ECB the changes should be specifically mentioned in the communication.
- **Refinancing of existing ECB:** Refinancing of existing ECB by fresh ECB is permitted, provided the outstanding maturity of the original borrowing (weighted outstanding maturity in case of multiple borrowings) is not reduced and the all-in-cost of fresh ECB is lower than the all-in-cost (weighted average cost in case of multiple borrowings) of existing ECB.
- Foreign branches of Indian banks are permitted to participate in refinancing of existing ECB, only for highly rated corporates (AAA) and for Maharatna/Navratna Public Sector Undertakings.

Reporting Requirements

Loan Registration Number (LRN) –

- Drawdown of ECBs should happen only after obtention of LRN from the RBI.
- The borrowers are required to submit Form ECB through the AD Category I Bank who in turn will forward the application to RBI, Department of Statistics and Information Management, External Commercial Borrowings Division for their perusal and issuance of LRN.
- The borrowers are required to report the actual ECB transactions through ECB 2 returns through the AD Category I Bank on a monthly basis so as to reach **within 7 days from the close** of the relevant month.
- Changes, if any, in the ECB parameters, after obtention of the LRN should also be incorporated in the monthly returns.
- Any borrower, who is otherwise in compliance of the ECB guidelines, can regularize the delay in reporting by payment of Late Submission Fees (LSF) for the period of delay and the delays may **range from up to 30 days from** the due date of submission to **beyond 3 years from** the due date of submission.
- The late submission may **also range from Rs. 5,000 to Rs. 1,00,000 per year depending** on the extant delayed submission.

Conversion Of ECB Into Equity

- The activity of the borrowing company is covered under the automatic route of FDI. Conversion should be with the lender's consent and without any additional cost and adhering to the sectoral cap as per the FDI Policy.
- If the borrower has availed any credit facilities from the Indian banking system, all prudential guidelines issued by the Department of Banking Regulation of RBI to be complied with, including consent of other lenders.

Foreign Investments

Objectives

Foreign Investments (FDI & FPI)

- Different modes of Foreign Investments
- Restrictions on Foreign Investments
- Control and reporting

Foreign Investments – Revised Framework

Relevant regulators under the NDI Rules

- Department of Economic Affairs, Fin. Min. notifies Non-Debt Instruments (NDI) rules.
- RBI – Nodal authority for Valuations & Reporting.
- Various Government Ministries – Cases requiring approvals (earlier FIPB)
- DIPP and Ministry of Commerce – formulates FDI Policy

Key changes in the above context

- FIPB abolished in 2019.
- On-line reporting to RBI through AD Banks - filing SMF through FIRMS portal)
- Late submission fee introduced.
- FEMA 20 of 2000., FEMA 20(R), Master directions, replaced with the NDI rules (33 Rules and 10 Schedules)

Key Concepts

Foreign Direct Investment

- Any investment in Equity instruments
- Made by a Person Resident Outside India (PROI)
- On a repatriable basis

(a) In an unlisted Indian company

(b) 10% or more of the paid up equity capital, on a fully diluted, basis in a listed company

(c) In an LLP towards capital contribution [Fully diluted basis means the total number of shares that would be outstanding if all possible sources of conversion are exercised].

- In case an existing investment by a PROI in equity instruments of a listed Indian company falls to a level below 10 percent of the post issue paid-up equity capital on a fully diluted basis, the investment shall continue to be treated as FDI. Once an FDI, always an FDI.

Foreign Portfolio Investment

- Investment made by a PROI in less than 10% of the paid-up equity capital, on a fully diluted basis of a listed company.
- Foreign Portfolio Investor (FPI) means a person registered in accordance with the Provisions of SEBI (FPI) Regulations 2019 wherein FPIs can invest in securities in the primary and secondary markets including shares, debentures and warrants of companies, listed or to be listed on a recognized stock exchange in India.
- The 10 percent limit for foreign portfolio investors shall be applicable to each foreign portfolio investor or an investor group as referred in Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014.

Downstream Investments (Indirect Foreign Investments)

- Investments in the equity instruments of **another Indian company by an Indian entity (including an LLP)** which has received foreign investment and is not owned and not controlled by resident Indian citizens. In other words, is owned or controlled by person resident outside India.
- Downstream investments also mean Investment by an Investment Vehicle whose sponsor or manager of investment manager is not owned and not controlled by resident Indian citizens. In other words, is owned or controlled by persons resident outside India.
- **Sectoral Cap** - Is the ceiling limit up to which a PROI can subscribe to the Paid-up capital of Indian Investee Company as prescribed under Sector-wise/Activity-wise by Department of Industrial Policy & Promotion, Govt. of India
- If the foreign investment in the investing entity is 50% or more, then the entire downstream investment will be regarded as indirect foreign investment.

Foreign Venture Capital Investments (FVCI) – FVCI is incorporated outside India and can invest in Domestic Venture Capital Fund or a Venture Capital undertaking (Domestic unlisted Company).

They are SEBI registered Investment Vehicle.

- ✓ Foreign investment in Investment Vehicle means it is an entity registered under SEBI., eg,
- ✓ Real Estate Investment Trusts (REITs) governed by the SEBI (REITs) Regulations, 2014,
- ✓ Infrastructure Investment Trusts (InvIts) **governed by the SEBI (InvIts) Regulations, 2014.**

- ✓ Alternative Investment Funds (AIFs) governed by the SEBI (AIFs) Regulations, 2012.

Start-up Company - Start-up Company means a Private Company incorporated under the Companies Act, 2013 or a Registered Partnership Firm or an LLP, recognised as such by the DIPP, Ministry of Commerce and Industry, *Government of India and complying with following conditions:*

- ✓ Start-up recognition will be restricted to 7 years from the incorporation/registration.
- ✓ In case of bio-technology sector, start-up recognition will be up to 10 years.
- ✓ Turnover for any FY since incorporation/registration does not exceed INR 100 crores.
- ✓ The entity is working towards innovation, development or improvement of product or processes or services, or operating on a scalable business model with high potential for employment generation/ wealth creation.

Eligible Foreign Investors

- PROI - Non resident entities, NRIs, OCIs, Foreign Nationals
- NRIs resident in Nepal and Bhutan subject to the inward remittances received in free foreign exchange
- Erstwhile OCBs who are not under the RBI caution list
- Foreign Portfolio Investors
- Foreign Venture Capital Investors

Eligible Investee Entities

- Indian companies as defined under the Companies Act 2013
- Trusts being Venture Capital Funds regulated by SEBI
- LLPs
- Special Investment Vehicles
- Start-up companies

Eligible Investment Instruments

- Fully paid Equity shares.
- Partly paid Equity shares, provided 25% of total consideration is received upfront and balance within 12 months.
- Fully, Compulsorily and mandatorily convertible debentures/Preference shares.
- Share warrants provided at least 25% of consideration is received upfront and balance within 18 months of issuance.
- Convertible notes issued by Startup entities, repayable at the option of the holder or converted into equity within a period not exceeding 5 years from the date of issue of the CN.
- Bonus Shares/Rights Shares/ESOPs.
- Swap of equity instruments (FDI & ODI structure) - NRI owned companies.
- Import of capital goods/machinery.

- Conversion of ECB into equity shares.

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- Import of capital goods/machinery.
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- Conversion of ECB into equity shares

Prohibited Sectors

Lottery business including Government, Private and On-line	Gambling and betting including Casinos	Chit Funds	Nidhi Business
Trading in Transferable Development Rights	Real Estate Business, Construction of Farm Houses, etc.	Manufacturing of Tobacco, Cigarettes & tobacco substitutes	Sectors not open to Private investments, eg., Atomic Energy, Railways
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Rules Governing Pledge of Shares

Any person resident outside India holding equity instruments in an Indian Company may pledge in favor of a Bank in India

- To secure credit facilities being extended to such Indian company,,
- For genuine business purposes.,
- Submission of a declaration/annual certificate from the statutory auditor of the investee company that the loan proceeds will be utilized for the said purpose.

Any person resident outside India holding equity instruments in an Indian Company may pledge in favor of Overseas Bank

- To secure credit facilities being extended to PROI who is the promoter of such Indian company or the overseas group company,,
- Loan is availed only in an Overseas bank.,
- Loan is utilized for genuine business purposes and not for **investments.**,
- Loan proceeds should not result in any capital inflow in to India.,
- Submission of a declaration/annual certificate from the statutory auditor of the investee company that the loan proceeds will be utilized for the said purpose.

Operational Guidelines

Transfer of non-debt instruments

Foreign Direct Investment – Transfer of Non-debt Instruments

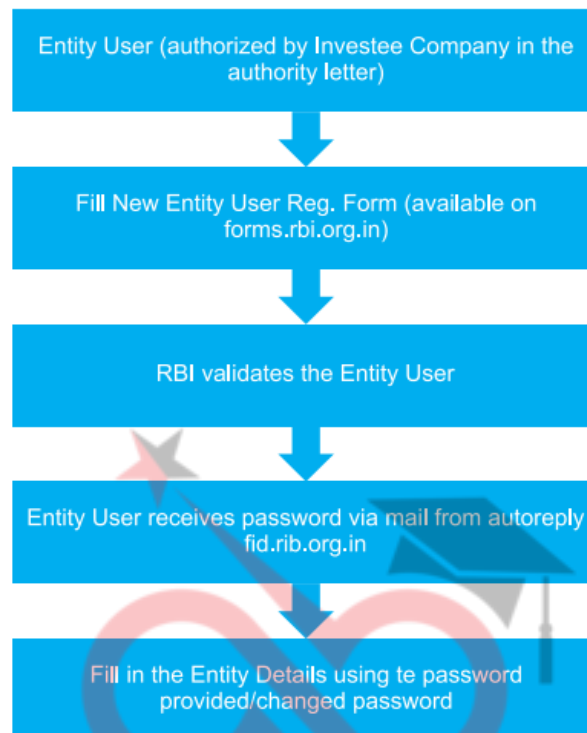
Nature of Transfer	Mode of Transfer	Rule	Pricing Guidelines	Reporting
NR to NR (Excl. NRI/OCI/ OCB)	Sale or Gift	Automatic route (if the FDI is allowed under automatic route)	NA	NA
NR to R	Sale or Gift	Automatic route	Yes	FCTRS
R to NR	Sale	Automatic route. Should comply with FDI guidelines	Yes	FCTRS
R to NR	Gift (Relatives)	RBI approval. (Shall not exceed 5% of paid up capital \$50000 max)	NA	FCTRS
R to NR lender	Pledge	Under ECB; (AD NOC)	NA	NA
NR to R (Bank/ Lender/NBFC)	Pledge	Automatic	NA	NA
NR to NR (Overseas lending bank)	Pledge	Automatic	NA	NA

Escrow a/c is permitted under transfer lending Inward/BG

Process of reporting on FIRMS (Foreign Investment Reporting and Management Systems)

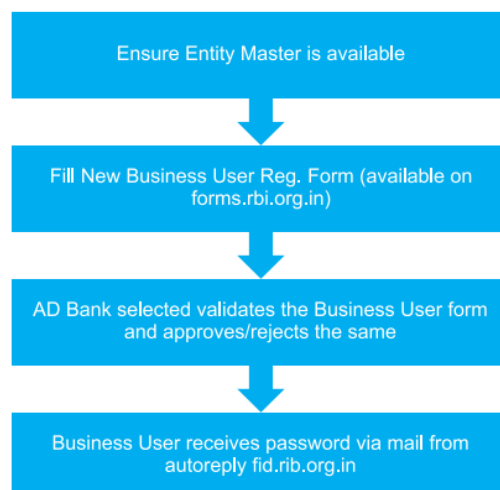
- Process of Reporting on FIRMS – Entity Master
- Entity master creation is independent of AD Bank.
- One entity can have one Entity user only. Changes in entity user will require contact with help desk in “Contact Us” tab of FIRMS portal.
- Email provided in the form should be correct since all communications will be via email from FIRMS system.
- Entity user named in Authorization Letter himself/herself cannot sign the same.

- RBI office having jurisdiction over registered address of the entity will be the governing office approving the Entity User as well as Forms reported in FIRMS.
- Figures of existing shareholding should be correctly captured on fully diluted basis.
- For any technical assistance contact email: helpfirms@rbi.org.in



Process of reporting on FIRMS (Foreign Investment Reporting and Process of reporting on FIRMS – SMF (Single Master Form)

- Process of Reporting on FIRMS – SMF Business User
- Business User creation can happen only if Entity Master is in place.
- Ensure correct IFSC code of the bank is available.
- Authority letter for Business User is not same as that for Entity Master.
- Board Resolution is not required for Business User creation.
- For any resolution in Business User creation, entity has to contact the concerned bank to whom the application was made.
- Forms are available - FC-GPR, FC-TRS, LLP I, LLP II, CN, ESOP, DI, DRR and InVi.



Process of reporting using various reporting forms

Various Reporting Forms			
FORM	PURPOSE	RESPONSIBILITY FOR FILING	TIMEFRAME
Foreign Currency - Gross Provisional Return (FC-GPR)	<ul style="list-style-type: none"> Reporting of capital instrument issued to a person resident outside India and where such issue is reckoned as Foreign Direct Investment. Reporting of conversion of ECB into Equity. 	Investee Entity	Within 30 days from the date of issue of capital instruments
Annual Return of Foreign Liabilities and Assets (FLA)	Annual reporting by Indian company which has received FDI or LLP which has received capital contribution in the previous year(s) including the current year.	Investee Entity	On or before the 15th of July
Foreign Currency-Transfer of Shares (FC-TRS)	Transfer between resident to NR Sale of shares on Stock Exchange *	Resident transferor/ transferee or the person resident outside * Responsibility of the NR	Within 60 days of transfer of capital instruments of receipt/remittance of funds whichever is earlier. In case of transfer as per Regulation i.e. deferred payment transfer, reporting be done on receipt of every tranche of payment.
Employees' Stock Option (ESOP)	Stock option to persons resident outside India	Issuing Indian Company	Within 30 days from the date of issue

Import Financing Buyer's Credit (open account)			
Various Reporting Forms			
FORM	PURPOSE	RESPONSIBILITY FOR FILING	TIMEFRAME
LLP (I)	LLP receiving amount of consideration for capital contribution and acquisition of profit shares	Investee Indian LLP	Within 30 days from the date of receipt the amount of consideration
LLP (II)	Disinvestment/transfer of capital contribution profit share between a resident and non resident (or vice versa)	Investee Indian LLP	Within 60 days from the date of receipt funds
Depository Receipt Return (DRR)	Reporting of issue/transfer of depository receipt issued in accordance with the Depository Receipt Scheme, 2014 by the Domestic Custodian	Domestic Custodian	Within 30 days of close of the issue/program
Downstream Investment (Form DI)	An Indian company making downstream investment in another Indian company which is considered indirect foreign investment for the investee company	Indian Entity or Investment Vehicle making DI	Within 30 days of such investment
Form InVi	An investment vehicle which has issued its unit person resident outside India	Indian Investment Vehicle	Within 30 days of issuance of units in Investment Vehicle
Form Convertible Notes (CN)	Issuance & Transfer of CNs by Indian startup company	Issuing company/ Transferor/ Transferee	Within 30 days of issuance/ transfer

Table on late submission fee (current scale)

Late submission fee (LSF) ...		
Amount involved in reporting	LSF as % of amount	Max. LSF
Up to INR 1Cr	0.05%	INR 10 lakhs or 300% of amount involved (whichever is lower)
More than INR 1Cr	0.15%	INR 1Cr or 300% of amount involved (whichever is lower)

- % of LSF doubled for every 12 months of delay
- Includes Sundays/Holidays
- The period shall begin from ... day after due date till preceding day of reporting

Snap Shot of Non-Debt Instruments (NDI) Rules

- Rules 1 & 2 – Short title, definitions, etc.
- Rule 3 – Restrictions on investments in India by PROI
- Rule 4 – Restrictions on receiving investments
- Rule 5 – Permission for making investment by a PROI
- Rule 6 – investment by person resident outside India – Sch. I, VI, VIII, IX
- Rule 8 – Issue of ESOPs & SWEAT Equity shares
- Rule 9 – Transfer of equity instruments of an Indian company by or to a person resident outside India.
- Rule 10 – Investments by SEBI registered FPIs Sch. II & X
- Rule 12 – Investments by NRI or OCI – Sch. III, IV, X
- Rule 16 – Investments by FVCI -Sch. VII
- Rule 20 – Reporting requirements
- Rule 21 – Pricing guidelines
- Rule 23 – Downstream investments
- Rules 24 to 33 – Acquisition & transfer of immovable property in India by NRIs/OCIs/purpose of acquiring property, etc., including miscellaneous provisions

List of Documents for Obtention of Foreign Investments (Illustrative List)

- Application (for Inward) along with FEMA declaration signed by Investee Company.
- Brief profile of Investee Company providing main business activities of the entity with 5-digit NIC code as per NIC 2008 list.
- Copy of MOA of Indian Investee Company.
- Copy of MOU/share purchase agreement or declaration that there is no such agreement.
- 6 Point KYC SWIFT of the remitter/investor as per RBI format.
- NOC from joint account holder if shares are being issued on single name (applicable for remittances received from joint accounts only).
- Declaration stating Capital instruments against this remittance would be issued within 60 days in accordance with the provisions.
- Scan email acknowledgement received by the investee company from FIRMS helpdesk w.r.t to Entity master.

- Undertaking from customer confirming FCGPR & related documents will be reported in FIRMS portal within 30 days from date of allotment of shares.

List of Documents for Refund of Foreign Investments (Illustrative List)

- Application (FCTRS Outward) + Form A2 signed by Investee Company.
 - FIRC in original obtained and endorsed and retained along with the records.
 - Copy of UIN letter/ FIRMS FCGPR reporting Ref Number.
 - Letter from the Company mentioning reason for return of funds.
 - Board resolution from the company confirming excess funds have been received as share application money and the excess funds are being repatriated back to the investor.
 - Letter confirmation that no interest element involved in refund of excess share application funds.
 - Branch has to intimate to RBI about refund, once refund transaction is processed.
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