



CAIIB PAPER-2

Module-C Unit-3

Bank Financial Management(BFM)



CAIIB Paper 2 (BFM) Module C Unit 3: International Equity and Debt Products

Regulatory Environment

Foreign Investment in India is regulated in terms of clause (b) sub-section 3 of section 6 and section 47 of the Foreign Exchange Management Act, 1999 (FEMA) read with Foreign Exchange Management (Transfer or Issue of a Security by a Person resident Outside India) Regulations, 2017 issued vide Notification No. FEMA 20(R)/2017-RB dated November 7, 2017.

'Foreign Direct Investment' (FDI) is the investment through capital instruments by a person resident outside India (a) in an unlisted Indian company; or (b) in 10 percent or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company. If an existing investment by a person resident outside India in capital 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 will continue to be treated as FDI.

Prohibited Sectors/Persons

Investment by a person resident outside India is prohibited in the following sectors:

- Lottery Business including Government/ private lottery, online lotteries.
- Gambling and betting including casinos.
- Chit funds (except for investment made by NRIs and OCIs on a non-repatriation basis).
- Nidhi company.
- Trading in Transferable Development Rights (TDRs).
- Real Estate Business or Construction of Farm Houses.
- Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes. The prohibition is on manufacturing of the products mentioned and foreign investment in other activities relating to these products including wholesale cash and carry, retail trading etc. will be governed by the sectoral restrictions laid down in Regulation 16 of FEMA 20(R).
- Activities/ sectors not open to private sector investment viz., (i) Atomic energy and (ii) Railway operations.
- Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business and Gambling and Betting activities.

Any investment by a person who is a citizen of Bangladesh or Pakistan or is an entity incorporated in **Bangladesh or Pakistan requires prior Government approval.**

A person who is a citizen of Pakistan or an entity incorporated in Pakistan can, only with the prior Government approval, invest in sectors/ activities other than defence, space, atomic energy and sectors/ activities prohibited for foreign investment.

Global Depository Receipts (GDRs)

GDRs represent Receipts that entitle the holder to convert into specified number of equity shares of Indian Company. The Receipts are issued by a Depository abroad and are traded in overseas markets. They are negotiable Receipts. The underlying shares, issued by the Indian Company, are held by an Indian Custodian on behalf of the Overseas Depository. They are denominated in foreign currency.

The exchange risk on the GDR is borne by the overseas investor. The equivalent number of equity shares is fixed as per pricing norms of SEBI. On issuance of GDR, the equity of the issuing company increases. Therefore, its Debt Equity Ratio is not adversely affected. Dividend is paid out in Rupees to the Depository. The Depository is entitled to voting rights as it holds the equity shares on behalf of the GDR holders.

Important Point

- A limited two way fungibility scheme is in operation by Government of India for ADRs/ GDRs.
- Under this, a SEBI registered Stock Broker can purchase the shares from the market for conversion into ADRs/ GDRs.
- Reissuance of ADR/GDR would be permitted to the extent of ADRs/GDRs that have been redeemed into underlying shares and sold in the domestic market.
- As such, the total outstanding shares under the GDR issuance remains at same level of original issue for which approval would have been obtained from Ministry of Finance.
- American Depository Receipts (ADRs) are traded only in US while GDRs are traded in other overseas markets too. Soliciting investors for ADRs can be done only from US and the disclosure standards of the document must comply with US GAAP accounting standards.

INDIAN DEPOSITORY RECEIPTS (IDRS)

- Issue of IDRs Companies incorporated outside India may issue IDRs through a Domestic Depository, to a person resident in India and a person resident outside India. The issue of IDRs should comply with the Companies (Registration of Foreign Companies) Rules, 2014 and the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
- Any issue of IDRs by financial/ banking companies having presence in India, either through a branch or subsidiary, shall require prior approval of the sectoral regulator(s);
- IDRs shall be denominated in Indian Rupees only;
- The proceeds of the issue of IDRs shall be immediately repatriated outside India by the companies issuing such IDRs. Purchase/Sale of IDRs An FPI or an NRI or an OCI may purchase, hold or sell IDRs NRIs or OCIs may invest in the IDRs out of funds held in their NRE/ FCNR(B) account, maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016. There would be an overall cap of USD 5 billion for raising of capital by issuance of IDRs by eligible foreign companies in Indian markets. This limit would be monitored by SEBI

Purchase/Sale of IDRs

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Transfer, Redemption and Two-Way Fungibility of IDRs

Redemption/ conversion of IDRs into underlying equity shares of the issuing company shall comply with the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004. IDRs shall not be redeemable into underlying equity shares before the expiry of one year from the date of issue.

Limited two way fungibility of IDRs is permissible.

- Listed Indian companies may either sell or continue to hold the underlying shares subject to compliance with the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004.
- Indian Mutual Funds, registered with SEBI may either sell or continue to hold the underlying shares subject to compliance with the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004.
- Other persons resident in India including resident individuals are allowed to hold the underlying shares only for the purpose of sale within a period of 30 days from the date of conversion of the IDRs into underlying shares. The FEMA provisions shall not apply to the holding of the underlying shares, on redemption of IDRs by the FPIs.

External Commercial Borrowings

External Commercial Borrowings are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and nonpermitted end-uses, maximum all-in-cost ceiling, etc. The comprehensive guidelines are collectively referred to as ECB Framework, as detailed in Master Direction RBI/FED/2018-19/67 dated 26th March 2019, updated up to 12th April 2021.

No	Description	ECB in Foreign Currency	ECB in Indian Rupee
1	Currency	Any freely convertible Foreign Currency	Indian Rupee
2	Instrument Type	Loans including bank loans; floating/ fixed rate notes/ bonds/ debentures (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; FCCBs; FCEBs and Financial Lease.	Loans including bank loans; floating/ fixed rate notes/bonds/ debentures/ preference shares (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; and Financial Lease. Also, plain vanilla Rupee denominated bonds issued overseas, which can be either placed privately or listed on exchanges as per host country regulations.
3	Eligible Borrower	All entities eligible to receive FDI. Further, the following entities are also eligible to raise ECB: i. Port Trusts; ii. Units in SEZ; iii. SIDBI; and iv. EXIM Bank of India.	a) All entities eligible to raise FCY ECB; and b) Registered entities engaged in micro-finance activities, viz., registered Not for Profit companies, registered societies/ trusts/ cooperatives and Non-Government Organisations.
4	Recognised Lenders	The lender should be resident of FATF or IOSCO compliant country, including on transfer of ECB. However, a) Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognised lenders; b) Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad; and c) Foreign branches / subsidiaries of Indian banks are permitted as recognised lenders only for FCY ECB (except FCCBs and FCEBs). 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.																			
5	Minimum Average Maturity Period (MAMP)	<p>MAMP for ECB will be 3 years. Call and put options, if any, shall not be exercisable prior to completion of minimum average maturity. However, for the specific categories mentioned below, the MAMP will be as prescribed therein:</p> <table border="1"> <thead> <tr> <th>Sr.No.</th> <th>Category</th> <th>MAMP</th> </tr> </thead> <tbody> <tr> <td>(a)</td> <td>ECB raised by manufacturing companies up to USD 50 million or its equivalent per financial year.</td> <td>1 year</td> </tr> <tr> <td>(b)</td> <td>ECB raised from foreign equity holder for working capital purposes, general corporate purposes or for repayment of Rupee loans.</td> <td>5 years</td> </tr> <tr> <td>(c)</td> <td>ECB raised for (i) working capital purposes or general corporate purposes (ii) on-lending by NBFCs for working capital purposes or general corporate purposes</td> <td>10 years</td> </tr> <tr> <td>(d)</td> <td>ECB raised for (i) repayment of Rupee loans availed domestically for capital expenditure (ii) on-lending by NBFCs for the same purpose</td> <td>7 years</td> </tr> <tr> <td>(e)</td> <td>ECB raised for (i) repayment of Rupee loans availed domestically for purposes other than capital expenditure (ii) on-lending by NBFCs for the same purpose</td> <td>10 years</td> </tr> </tbody> </table> <p>For the categories mentioned at (b) to (e) – (i) ECB cannot be raised from foreign branches / subsidiaries of Indian banks (ii) the prescribed MAMP will have to be strictly complied with under all circumstances.</p>		Sr.No.	Category	MAMP	(a)	ECB raised by manufacturing companies up to USD 50 million or its equivalent per financial year.	1 year	(b)	ECB raised from foreign equity holder for working capital purposes, general corporate purposes or for repayment of Rupee loans.	5 years	(c)	ECB raised for (i) working capital purposes or general corporate purposes (ii) on-lending by NBFCs for working capital purposes or general corporate purposes	10 years	(d)	ECB raised for (i) repayment of Rupee loans availed domestically for capital expenditure (ii) on-lending by NBFCs for the same purpose	7 years	(e)	ECB raised for (i) repayment of Rupee loans availed domestically for purposes other than capital expenditure (ii) on-lending by NBFCs for the same purpose	10 years
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6	All-in-Cost ceiling per annum	Benchmark Rate plus 550 bps spread: For existing ECBs linked to LIBOR whose benchmarks are changed to ARR. Benchmark rate plus 500 bps spread: For new ECBs.	Benchmark Rate + 450 basis points																		

		All-in-cost ceiling has been temporarily increased by 100 bps for ECBs raised till December 31, 2022. The enhanced all-in-cost ceiling shall be available only to eligible borrowers of investment grade rating from Indian Credit Rating Agencies (CRAs). Other eligible borrowers may raise ECB within the existing all-in-cost ceiling as hitherto.	
7	Other Costs	Prepayment charge/ Penal interest, if any, for default or breach of covenants, should not be more than 2 per cent over and above the contracted rate of interest on the outstanding principal amount and will be outside the all-in-cost ceiling.	
8	Negative List for End Use	The negative list, for which the ECB proceeds cannot be utilised, would include the following: a) Real estate activities. b) Investment in capital market. c) Equity investment. d) Working capital purposes, except in case of ECB mentioned at (b) and (c) above. e) General corporate purposes, except in case of ECB mentioned at (b) and (c) above. f) Repayment of Rupee loans, except in case of ECB mentioned at (d) and (e) above. g) On-lending to entities for the above activities, except in case of ECB raised by NBFCs as given at (c), (d) and (e) above.	
9	Exchange Rate	Change of currency of FCY ECB into INR ECB can be at the exchange rate prevailing on the date of the agreement for such change between the parties concerned or at an exchange rate, which is less than the rate prevailing on the date of the agreement, if consented to by the ECB lender.	For conversion to Rupee, the exchange rate shall be the rate prevailing on the date of settlement.
10	Hedging Provisions	The entities raising ECB are required to follow the guidelines for hedging issued, if any, by the concerned sectoral or prudential regulator in respect of foreign currency exposure. Infrastructure space companies shall have a	Overseas investors are eligible to hedge their exposure in Rupee through permitted derivative products with AD Category I banks in India. The investors can also access the domestic market through branches / subsidiaries of

	<p>Board approved risk management policy. Further, such companies are required to mandatorily hedge 70 per cent of their ECB exposure in case the average maturity of the ECB is less than 5 years. The designated AD Category-I bank shall verify that 70 per cent hedging requirement is complied with during the currency of the ECB and report the position to RBI through Form ECB 2. The following operational aspects with respect to hedging should be ensured:</p> <p>a. Coverage: The ECB borrower will be required to cover the principal as well as the coupon through financial hedges. The financial hedge for all exposures on account of ECB should start from the time of each such exposure (i.e. the day the liability is created in the books of the borrower).</p> <p>b. Tenor and rollover: A minimum tenor of one year for the financial hedge would be required with periodic rollover, duly ensuring that the exposure on account of ECB is not unhedged at any point during the currency of the ECB.</p> <p>c. Natural Hedge: Natural hedge, in lieu of financial hedge, will be considered only to the extent of offsetting projected cash flows / revenues in matching currency, net of all other projected outflows. For this purpose, an</p>	Indian banks abroad or branches of foreign banks with Indian presence on a back to back basis.
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		ECB may be considered naturally hedged if the offsetting exposure has the maturity/cash flow within the same accounting year. Any other arrangements/ structures, where revenues are indexed to foreign currency will not be considered as a natural hedge.	
11	Change of Currency of Borrowing	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.	Change of currency from INR to any freely convertible foreign currency is not permitted.

Limit and leverage:

- Under the aforesaid framework, all eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year under the automatic route.
- Further, in case of FCY denominated ECB raised from direct foreign equity holder, ECB liability-equity ratio for ECB raised under the automatic route cannot exceed 7:1.
- However, this ratio will not be applicable if the outstanding amount of all ECB, including the proposed one, is up to USD 5 million or its equivalent. Further, the borrowing entities will also be governed by the guidelines on debt equity ratio, issued, if any, by the sectoral or prudential regulator concerned.
- The automatic route limit stands increased from USD 750 million or equivalent to USD 1.5 billion or equivalent. This relaxation is available for ECBs to be raised till December 31, 2022.

Issuance of Guarantee, etc. by Indian banks and Financial Institutions:

Issuance of any type of guarantee by Indian banks, All India Financial Institutions and NBFCs relating to ECB is not permitted. Further, financial intermediaries (viz., Indian banks, All India Financial Institutions, or NBFCs) shall not invest in FCCBs/ FCEBs in any manner whatsoever.

Trade Credits

Trade Credits (TC) refer to the credits extended by the overseas supplier, bank, financial institution and other permitted recognised lenders for maturity, as prescribed in this framework, for imports of capital/ non-capital goods permissible under the Foreign Trade Policy of the Government of India. Depending on the source of finance, such TCs include suppliers' credit and buyers' credit from recognised lenders. TC for imports into India can be raised in any freely convertible foreign currency (FCY denominated TC) or Indian Rupee (INR denominated TC), as per the framework given in the table ahead:

Sr. No.	Parameters	FCY denominated TC	INR denominated TC
i	Forms of TC	Buyers' Credit and Suppliers' Credit.	
ii	Eligible borrower	Person resident in India acting as an importer.	
iii	Amount under automatic route	Up to USD 150 million or equivalent per import transaction for oil/gas refining & marketing, airline and shipping companies. For others, up to USD 50 million or equivalent per import transaction.	
iv	Recognised lenders	1. For suppliers' credit: Supplier of goods located outside India. 2. For buyers' credit: Banks, financial institutions, foreign equity holder(s) located outside India and financial institutions in IFSCs located in India. Note: Participation of Indian banks and non-banking financial companies (operating from IFSCs) as lenders will be subject to the prudential guidelines issued by the concerned regulatory departments of the Reserve Bank. Further, foreign branches/subsidiaries of Indian banks are permitted as recognised lenders only for FCY TC.	
v	Period of TC	The period of TC, reckoned from the date of shipment, shall be up to three years for import of capital goods. For non-capital goods, this period shall be up to one year or the operating cycle whichever is less. For shipyards / shipbuilders, the period of TC for import of non-capital goods can be up to three years.	
vi	All-in-cost ceiling per annum	¹² Benchmark Rate plus 350 bps spread: For existing TCs linked to LIBOR whose benchmarks are changed to ARR. Benchmark rate plus 300 bps spread: For new TCs.	Benchmark rate plus 250 bps spread.
vii	Exchange rate	Change of currency of FCY TC into INR TC can be at the exchange rate prevailing on the date of the agreement between the parties concerned for such change or at an exchange rate, which is less than the rate prevailing on the date of agreement, if consented to by the TC lender.	For conversion to Rupee, exchange rate shall be the rate prevailing on the date of settlement.
viii	Hedging provision	The entities raising TC are required to follow the guidelines for hedging, if any, issued by the concerned sectoral or prudential regulator in respect of foreign currency exposure. Such	The overseas investors are eligible to hedge their exposure in Rupee through permitted derivative products with AD Category I banks in India. The investors can also

		entities shall have a board approved risk management policy.	access the domestic market through branches / subsidiaries of Indian banks abroad or branches of foreign banks with Indian presence on a back to back basis.
ix	Change of currency of borrowing	Change of currency of TC from one freely convertible foreign currency to any other freely convertible foreign currency as well as to INR is freely permitted.	Change of currency from INR to any freely convertible foreign currency is not permitted.

Rupee Denominated Bonds

RBI, vide circular dated November 3, 2016, permitted banks to issue Rupee Denominated Bonds overseas for the following purposes. These shall be subject to all applicable prudential norms and FEMA guidelines.

- Perpetual Debt Instruments (PDI) qualifying for inclusion as Additional Tier 1 capital under the extant Basel III Capital Regulations
- Debt capital instruments qualifying for inclusion as Tier 2 capital under the extant Basel III Capital Regulations
- Financing of infrastructure and affordable housing

The “eligible amount” for purpose of issue of PDIs in foreign currency shall be, as on March 31 of the previous financial year, the higher of:

- 1.5% of Risk Weighted Assets (RWAs) and
- Total Additional Tier 1 capital Not more than 49% of the “eligible amount” can be issued in foreign currency and/or in rupee denominated bonds overseas. However, RDBs issued have to be excluded from the limit for investments by FPIs in corporate bonds.
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