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R&I India Flash Report

CHANGES TO THE EXTERNAL COMMERCIAL BORROWING REGIME – IMPACT ON INTERNATIONAL DEBT FUNDS

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The external commercial borrowing ("**ECB**") regime is one of the central pillars of India's exchange control regime and it tightly regulates loans between international lenders and Indian borrowers. Historically, a number of these requirements presented difficulties for international lenders. On 16 January 2019, the Reserve Bank of India ("**RBI**") announced certain changes to the ECB regime. The impact of these changes on international debt funds and broker-dealers is summarised below.

Access issue addressed

Previously, international debt funds and some pure-play international broker-dealers did not obviously qualify as "recognised lenders" and therefore faced market access issues. These market participants should no longer face these issues as any resident of a FATF or IOSCO compliant jurisdiction will be treated as recognised lenders both for primary and secondary debt investments. Also, the pool of eligible borrowers has been widened to cover any entity eligible to receive foreign direct investment.

Historic issues that still remain

Although the access issue has been addressed as set out above, various restrictions that have historically been viewed as problematic still subsist. For instance, concept of a cap on the all-in-costs of debt remains. The cap is now a spread of no more than 450 basis points over: (a) the 6-month LIBOR or EURIBOR rate for foreign currency loans; and (b) the prevailing yield of the Government of India securities with a corresponding maturity period for rupee denominated loans. This means that the ability to freely price risk is still limited. A limited exception has been provided to the extent of an incremental 2% by way of pre-payment charges or penal interest, which will be excluded from the calculation of all-in-costs of debt, but this does not really address the issue.

Also, the restrictions on the end use of funds in the form of a "*negative list*" remains, including for working capital or general corporate purposes or for repayment of rupee loans (except in respect of loans by foreign equity holders).

Also, other conditions such as the requirement that local borrowers hedge 70% of their loan exposure (where the average maturity of the loan is less than 5 years) continue to apply as before. Therefore, borrowers need to continue to factor in these hedging costs.

ECBs will need RBI approval if they exceed USD 750 million any year or if they result in the borrower's ECB liability-equity ratio exceeding 7:1 (although there is a *de minimis* exception from this leverage ratio if the aggregate of all ECBs does not exceed USD 5 million).

Takeaways

- Direct access possible, but more fundamental concerns remain. Although international debt funds and broker-dealers have much greater leeway to now directly invest or acquire the debt of Indian companies, a number of problematic conditions remain and therefore ECBs remain challenging for international lenders.
- Continued relevance of market access structures. For the reasons set out above, the various routes that have evolved to facilitate market access, such as investments by foreign portfolio investors ("**FPIs**") in security receipts issued by Asset Reconstruction Companies for secondary distressed debt trading and the use of NCDs by FPIs (subject to the RBI's concentration norms) or more evolved alternative investment fund structures, remain relevant.

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