

SECURITIES LAWS AND COMPLIANCES

PART B — ISSUE MANAGEMENT AND COMPLIANCES

STUDY XVI - RESOURCE MOBILISATION IN INTERNATIONAL CAPITAL MARKET

LEARNING OBJECTIVES

The study will enable the students to understand

- Concept of Global Depository Receipts
- Overview of FCCB and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993
- Procedure for issuance of GDRs/FCCBs
- External Commercial Borrowings

INTRODUCTION

India Inc. though slowly but surely embarked on the global path leading to the emergence of the Indian multinational companies. An acquisition led strategy coupled with strong performance has become a sustainable strategy for Indian companies going global. The Indian corporate sector has indeed taken a giant leap particularly after globalisation and deregulation. Known only for spices, cotton and cheap labour India has completely transformed its image into one of the fastest growing economies of the world-fourth in terms of purchasing power parity and tenth most industrialized economy. The metamorphosis to globally competitive and fastest growing economy has been fuelled by meticulous strategy and vision of Indian corporate sector and commitment by the Government in providing conducive environment for corporates to develop and grow.

With each passing day, Indian businesses are acquiring companies abroad, becoming world popular suppliers and are recruiting staff cutting across nationalities. This may be exemplified by the fact that Tata Motors sells its passenger-car Indica in the UK through a marketing alliance with Rover and has acquired a Daewoo Commercial Vehicles unit giving it access to markets in Korea and China. Ranbaxy is the ninth largest generics company in the world generating an impressive 76 per cent of its revenues from overseas. Asian Paints is amongst the 10 largest decorative paints makers in the world with manufacturing facilities across 24 countries. Bharat Forge a small auto components company is the world's second largest forging maker. Essel Propack is the world's largest manufacturers of lamitubes – tubes used to package toothpaste, with 17 plants spread across 11 countries and a turnover of Rs. 609.2 crore for the year ended December 2003. The company commands a staggering 30 percent of the 12.8 billion-units global tubes market. About 80 percent of revenues for Tata Consultancy Services comes from overseas operations. Infosys has 30 marketing offices across the world and 26 global software development centres in the US, Canada, Australia, UK and Japan. As far as acquisition led strategies of Indian companies are concerned – the Reliance Industries acquired Flag Telcom Bermuda for US\$ 212 million, and

Trevira, Germany for US\$ 95 million; Tata Motors acquired Daewoo, Korea for US\$ 118 million; Tata Steel acquired Corus Group for US\$ 12.2 billion; Infosys Technologies acquired Expert Information Services, Australia for US\$ 3.1 million; Wockhardt acquired CP Pharmaceuticals UK for US\$ 18 million; Cadila Health acquired Alpharma SAS France for US\$ 5.7 million; Hindalco acquired Straits Ply, Australia for US\$ 56.4 million; Wipro acquired Nerve Wire Inc. US for US\$ 18.5 million; Aditya Birla acquired Doshiquiao Chem, China for US\$ 8.5 million; Allanda based Novelis for US \$ 6 billion and United Phosphorus acquired Oryzalin Hirbicide, US for US\$ 21.3 million.

Having explained the one side of the coin, let us now consider the other one.

The process of economic liberalization has led the markets for consumer products ranging from soft drinks to ice creams to washing machines to refrigerators taken off fuelled by increasing purchasing power and a growing middle class. Indian firms in these industries enjoy tremendous opportunities for long-term growth in sales and profits, for victory on an unprecedented scale. Unfortunately, many Indian firms are managing to snatch defeat from the jaws of victory as they have to compete with MNCs who have deep financial muscles. In this context, Indian companies often argue that they cannot compete against MNCs because the MNCs command much larger resources and have strong financial backing. It is argued that the MNC can afford to and does lose money for a long time in order to develop its long-term competitive position and that the Indian firm cannot sustain.

There are series of problems emanating from this argument. Given the size and efficiency of capital markets, competitive advantage does not come from the accessibility of capital, rather capital flows to those firms with a competitive advantage.

In the past, Indian capital markets were quite thin and meager and access to capital was rather restricted. In that environment, access to capital was a source of competitive advantage. This is one of the major reasons why conglomerates thrived in India. However, today capital markets in India are quite large and much more efficient compared to its earlier days. Indian firms need to better utilize local and foreign capital markets and the firms need to convince the capital markets that they have a strategy for building, sustaining and exploiting competitive advantage which will help them compete MNCs and result in earning their return on investment greater than the cost of capital.

Many Indian companies are themselves responsible for the lack of capital to sustain a fight against MNCs. Indian firms tend to be too diversified and are thus spread out too thinly in terms of financial capital and managerial resources. Indian firms need to restructure and focus their capital on fewer industries where they have a competitive advantage and can compete aggressively in those industries. Indian companies are also probably overestimating the deep pockets of the MNCs. A multinational company may have more capital resources than the Indian company but since it is competing in several countries it cannot concentrate all its resources on India alone.

In this direction, the Government has taken a number of policy initiatives to allow Indian companies to raise resources from the International markets.

Consequently raising funds through Euro Issues has become popular with the

companies and investors both. Indian companies found this route very attractive and today more and more companies are trying this avenue to raise funds. Two principal forms of international offering made by companies for tapping the international capital markets are foreign Currency convertible bonds (FCCBs) and Equity Share through Depository Receipts.

The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company. Interest and redemption price (if conversion option is not exercised) is payable in dollars. Interest rates are very low by Indian domestic standards. FCCBs shall be denominated in any freely convertible Foreign Currency. However, it must be kept in mind that FCCB issue proceeds need to conform to ECB end use requirements.

FCCBs have been popular with issuers. Local debt markets can be restricted with comparatively short maturities and high interest rates. On the other hand straight equity may cause a dilution in earnings, and certainly a dilution in control, which many shareholders, especially major family shareholders, would find unacceptable. Thus the low coupon security which defers shareholder's dilution for several years can be attractive to an issuer.

Foreign investors also prefer FCCBs because of the Dollar denominated servicing, the conversion option and, the arbitrage opportunities presented by conversion of the FCCBs into equity at a discount on prevailing Indian market price.

In addition, 25% of the FCCB proceeds can be used for general corporate restructuring.

The major drawbacks of FCCBs are that the issuing company cannot plan its capital structure as it is not assured of conversion of FCCBs. Moreover, the projections for cash outflow at the time of maturity cannot be made.

Depository Receipt (DR) is a negotiable instrument evidencing a fixed number of equity shares of the issuing company generally denominated in US dollars. Depository Receipts are commonly used by those companies which sell their securities in international market and expand their shareholdings abroad. These securities are listed and traded in International Stock Exchanges. These can be either American Depository Receipts (ADR) or Global depository Receipt (GDR). ADRs are issued in case the funds are raised through retail market in United States. In case of GDR issue, the invitation to participate in the issue cannot be extended to recall US investors but under Rule 144A of Securities Act, 1933 of USA, Qualified Institutional Buyers (QIBs) can participate in such a deal. QIBs are the institutional investors who have atleast USD 100 Million under their portfolio to invest.

While DRs denominated in any freely convertible Foreign Currency, generally in US dollar, are issued by the depository in the international market, the underlying shares denominated in Indian Rupees are issued in the domestic market by the issuing company. These shares issued by the company are custodised in the home market with the local bank called custodian.

An investor has an option to convert the GDR into a fixed number of equity shares of issuer company after a cooling period. He can do so by advising the depository. The depository, in turn, will instruct the custodian about cancellation

of GDR and release the corresponding shares in favour of the non-resident investor, or being sold directly on behalf of the non-resident or being transferred in the books of accounts of the issuing company in the name of the non-resident. Once the underlying shares are released, the same cannot be recustodised. In addition, shares acquired in open market cannot be custodised.

Until such conversion, the GDRs, which are negotiable, are traded on an Overseas Stock Exchange, entitled for dividend in dollar but they carry no voting rights. On conversion of the GDR into equity shares, the said shares carry voting rights, yield rupee dividend and are tradable on Indian Stock Exchanges like any other equity shares.

ADR/GDR are reckoned as part of Foreign Direct Investment (FDI). Accordingly, such issue would need to confirm to the existing FDI Policy and only in areas where FDI is permissible.

Two way fungibility in ADR/GDR issue of the Indian Company has also been introduced. Two way fungibility implies that an investor who holds ADR/GDR can cancel them with the depository and sell the underlying shares in the market.

The company can then issue fresh ADR/GDR to the extent of shares cancelled.

The key benefit of the two way fungibility are improvement in liquidity and elimination of arbitrage.

Transfer of GDRs is effected through the mechanism of international clearing systems (Euroclear and Cedel). GDRs issued to Qualified Institutional Buyers in the United States of America are to be settled through a Depository Trust Company in New York.

I. FCCB AND ORDINARY SHARES (THROUGH DEPOSITORY RECEIPT MECHANISM) SCHEME, 1993

Important Definitions

In this scheme, unless the context other wise requires,-

- a. Domestic Custodian Bank** has been defined to mean a banking company which acts as a custodian for the ordinary shares or foreign currency convertible bonds of an Indian Company which are issued by it against global Depository receipts or certificates;
- b. Foreign Currency Convertible Bonds** has been defined to mean bonds issued in accordance with this scheme and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments;
- c. Global Depository Receipts** has been defined to mean any instrument in the form of a Depository receipt or certificate (by whatever name it is called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company;
- d. Issuing Company** has been defined to means an Indian Company permitted to issue Foreign Currency Convertible Bonds or ordinary shares of that company against Global Depository Receipts;
- e. Overseas Depository Bank** has been defined to mean a bank authorised by the issuing company to issue global Depository receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing

company;

Eligibility for issue of Convertible Bonds or Ordinary Shares of Issuing Company

An issuing company desirous of raising funds by issuing Foreign Currency Convertible Bonds or ordinary shares for equity issues through Global Depository Receipts is required to obtain prior permission of the Department of Economic Affairs, Ministry of Finance, Government of India.

An Indian company, which is not eligible to raise funds from the Indian capital market including a company which has been restrained from accessing the securities market by the Securities and Exchange Board of India (SEBI) is not eligible to issue Foreign Currency Convertible Bonds and Ordinary Shares through Global Depository Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

Unlisted Indian Companies issuing Global Depository Receipts/Foreign Currency Convertible Bonds are required to simultaneously list in the Indian Stock Exchange(s). The unlisted companies issuing Global Depository Receipts/Foreign Currency Convertible Bonds that have taken verifiable “effective steps,” before 31st August, 2005 have been exempt from the requirement of prior or simultaneous listing provided these companies complete their issues latest by 31st December, 2005. “Effective steps,” for the above purpose, have been clarified to

- a. the company has completed due diligence and filed offering circular in the overseas exchange(s); or
- b. the approval of overseas exchange(s) has been obtained; or
- c. the payment of listing fees is made; or
- d. the approval of the Reserve Bank of India under Foreign Exchange Management Act, 1999, where applicable, for meeting issue related expenses has been obtained.

It is clarified that private placements of issues, where no offering circular was placed before the overseas exchange(s), does not qualify for “effective steps.”

Erstwhile Overseas Corporate Bodies (OCBs) who are not eligible to invest in India through the portfolio route and entities prohibited to buy, sell or deal in securities by SEBI are not eligible to subscribe to

- i. Foreign Currency Convertible Bonds and
- ii. Ordinary Shares through Global Depository Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

An issuing company seeking permission is required to have a consistent track record of good performance (financial or otherwise) for a minimum period of three years, on the basis of which an approval for finalising the issue structure would be issued to the company by the Department of Economic Affairs, Ministry of Finance. On completion of finalisation of issue structure in consultation with the Lead Manager to the issue, the issuing company is required to obtain the final approval for proceeding ahead with the issue from the Department of Economic Affairs.

The Foreign Currency Convertible Bonds shall be denominated in any freely convertible foreign currency and the ordinary shares of an issuing company shall be denominated in Indian rupees.

The term "issue structure" has been defined to mean any of the requirements which are provided in the paragraphs 5 and 6 of this Scheme.

In terms of par (5) & (6) An issuing company issuing ordinary shares or bonds under the Scheme is required to deliver the ordinary shares or bonds to a Domestic Custodian Bank who will, in terms of agreement, instruct the Overseas Depository Bank to issue Global Depository Receipt or Certificate to non-resident investors against the shares or bonds held by the Domestic Custodian Bank. A Global Depository Receipt may be issued in the negotiable form and may be listed on any international stock exchanges for trading outside India.

The provisions of any law relating to issue of capital by an Indian company are applicable in relation to issue of Foreign Currency Convertible Bonds or the ordinary shares of an issuing company and the issuing company is required to obtain the necessary permission or exemption from the appropriate authority under the relevant law relating to issue of capital.

Limits of foreign investment in the issuing company

The ordinary shares and Foreign Currency Convertible Bonds issued against the Global Depository Receipts are treated as direct foreign investment in the issuing company. The aggregate of the foreign investment made either directly or indirectly (through Global Depository Receipts Mechanism) should not exceed 51% of the issued and subscribed capital of the issuing company. However, the investments made through Offshore Funds or by Foreign Institutional Investors do not form part of the prescribed limit.

Issue structure of the Global Depository Receipts

1. A Global Depository Receipt may be issued for one or more underlying shares or bonds held with the Domestic Custodian Bank.
2. The Foreign Currency Convertible Bonds and Global Depository Receipts may be denominated in any freely convertible foreign currency.
3. The ordinary shares underlying the Global Depository Receipts and the shares issued upon conversion of the Foreign Currency Convertible Bonds to be denominated only in Indian currency.
4. The following issues are to be decided by the issuing company with the Lead Manager to the issue, namely:
 - i. public or private placement;
 - ii. number of Global Depository Receipts to be issued;
 - iii. the issue price;
 - iv. Listed Companies – The pricing should not be less than the higher of the following two averages:
 - a. The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date;
 - b. The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

The “relevant date” means the date thirty days prior to the date on which the meeting of the general body of shareholders is held, in terms of section 81 (IA) of the Companies Act, 1956, to consider the proposed issue.

(ca) (i) Listed companies – The companies issuing Global Depositary Receipts that have taken verifiable “effective steps,” before 31st August, 2005 has been exempt from the requirement of the above mentioned pricing guidelines provided these companies complete their issues latest by 31st December, 2005.

- v. Unlisted Companies – The pricing should be in accordance with Reserve Bank of India Regulations notified under Foreign Exchange Management Act, 1999.
- vi. the rate of interest payable on Foreign Currency Convertible Bonds; and
- vii. the conversion price, coupon, and the pricing of the conversion options of the Foreign Currency Convertible Bonds.

(a)(i) (a) Listed Companies – The conversion price of the Foreign Currency Convertible Bonds should be in accordance with above mentioned pricing guidelines.

(a)(i) (a) Listed Companies- The companies issuing Foreign Currency Convertible Bonds that have taken verifiable “effective steps,” before 31st August, 2005 would be exempt from the requirement of the pricing guidelines at para 5(4)(e)(i) provided these companies complete their issues latest by 31st December, 2005.

b. Unlisted Companies – The conversion price of the Foreign Currency Convertible Bonds should be in accordance with Reserve Bank of India Regulations notified under Foreign Exchange Management Act, 1999.

- 5. There is no lock-in-period for the Global Depositary Receipts issued under the scheme.

Listing of the Global Depositary Receipts

The Global Depositary Receipts issued under the scheme may be listed on any of the Overseas Stock Exchanges, or Over the Counter Exchanges or through Book Entry Transfer Systems prevalent abroad and such receipts may be purchased, possessed and freely transferable by a person who is a non-resident.

Transfer and redemption

A non-resident holder of Global Depositary Receipts may transfer those receipts, or may ask the Overseas Depositary Bank to redeem those receipts. In the case of redemption, Overseas Depositary Bank shall request the Domestic Custodian Bank to get the corresponding underlying shares released in favour of the non-resident investor, for being sold directly on behalf of the non-resident, or being transferred in the books of account of the issuing company in the name of the non-resident.

In case of redemption of the Global Depositary Receipts into underlying shares, a request for the same is to be transmitted by the Overseas Depositary Bank to the Domestic Custodian Bank of India, with a copy of the

same being sent to the issuing company for information and record. On redemption, the cost of acquisition of the shares underlying the Global Depository Receipts shall be reckoned as the cost on the date on which the Overseas Depository Bank advises the Domestic Custodian Bank for redemption. The price of the ordinary shares of the issuing company prevailing in the Bombay Stock Exchange or the National Stock Exchange on the date of the advice of redemption shall be taken as the cost of acquisition of the underlying ordinary shares.

For the purposes of conversions of Foreign Currency Convertible Bonds, the cost of acquisition in the hands of the non-resident investors would be the conversion price determined on the basis of the price of the shares at the Bombay Stock Exchange, or the National Stock Exchange, on the date of conversion of Foreign Currency Convertible Bonds into shares.

Taxation on Foreign Currency Convertible Bonds

1. Interest payments on the bonds, until the conversion option is exercised, are subject to deduction of tax at source at the rate of ten per cent.
2. Tax on dividend on the converted portion of the bond is subject to deduction of tax at source at the rate of ten per cent.
3. Conversion of Foreign Currency Convertible Bonds into shares does not give rise to any capital gains liable to income-tax in India.
4. Transfers of Foreign Currency Convertible Bonds made outside India by a non-resident investor to another non-resident investor does not give rise to any capital gains liable to tax in India.

Taxation on shares issued under Global Depository Receipt Mechanism

1. Under the provisions of the Income-tax Act, income by way of dividend on shares is taxed at the rate of 10 per cent. The issuing company is required to transfer the dividend payments net after deducting tax at source to the Overseas Depository Bank.
2. On receipt of these payments of dividend after taxation, the Overseas Depository Bank is required to distribute them to the non-resident investors proportionate to their holdings of Global Depository Receipts evidencing the relevant shares. The holders of the Depository Receipts may take credit of the tax deducted at source on the basis of the certification by the Overseas Depository Bank, if permitted by the country of their residence.
3. All transactions of trading of the Global Depository Receipts outside India, among non-resident investors, are free from any liability to income tax on India on Capital Gains therefrom.
4. If any capital gains arise on the transfer of the aforesaid shares in India to the non-resident investor, he will be liable to income-tax under the provisions of the Income-tax Act. If the aforesaid shares are held by the non-resident investor for a period of more than twelve months from the date of advice of their redemption by the Overseas Depository Bank, the capital gains arising on the sale thereof will be treated as long-term capital gains and will be subject to income-tax at the rate 10 per cent under the provisions of Section 115AC of the Income-tax Act. If such shares are held for a period of less than twelve months from the date of redemption

advice, the capital gains arising on the sale thereof will be treated as short-term capital gains and will be subject to tax at the normal rates of income-tax applicable to non-residents under the provisions of the Income-tax Act.

5. After redemption of the Depositary Receipts into underlying shares, during the period, if any, during which these shares are held by the redeeming non-resident foreign investor who has paid for these shares in foreign exchange at the time of purchase of the Global Depositary Receipt, the rate of taxation of income by way of dividends on these shares would continue to be at the rate of 10 per cent, in accordance with Section 115AC(1) of the Income-tax Act. The long term capital gains on the sale of these redeemed underlying shares held by non-resident investors in the domestic market shall also be charged to tax at the rate of 10 per cent, in accordance with the provisions of Section 115 AC(1).
6. When the redeemed shares are sold on the Indian Stock Exchanges against payment in rupees, these shares shall go out of the purview of the Section 115 AC of the Income-tax Act and income therefrom shall not be eligible for the concessional tax treatment provided thereunder. After the transfer of shares of shares where consideration is in terms of rupees payment, the normal tax rates would apply to the income arising or accruing on these shares.
7. Deduction of tax at source on the amount of capital gains accruing on transfer of the shares would be made in accordance with sections 195 and 196C of the Income-tax Act.

Application of Avoidance of Double Taxation Agreement in case of Global Depositary Receipts

During the period of fiduciary ownership of shares in the hands of the Overseas Depositary Bank, the provisions of Avoidance of Double Taxation Agreement entered into by the Government of India with the country of residence of the Overseas Depositary Bank are applicable in the matter of taxation of income from dividends from underlying shares and interest on Foreign Currency Convertible Bonds.

During the period, if any, when the redeemed underlying shares are held by the non-resident investor on transfer from fiduciary ownership of the Overseas Depositary Bank, before they are sold to resident purchasers, the Avoidance of Double Taxation Agreement entered into by the Government of India with the country of residence of the non-resident investor will be applicable in the matter of taxation of income from the dividends from the said underlying shares, or interest on Foreign Currency Convertible Bonds, or any capital gain arising out of transfer of underlying shares.

II. PROCEDURE FOR ISSUANCE OF GDR/FCCBS

A. Approvals Required

The issue of GDRs/FCCBs requires the Approval of a Board of Directors, shareholders, "In principle and Final" approval of Ministry of Finance, Approval of Reserve Bank of India, In-principle consent of Stock Exchange for listing of underlying shares and In-principle consent of Financial institutions.

a. Approval of Board of Directors

A meeting of Board of Directors is required to be held for approving the proposal to raise money from Euro Capital market. A board resolution is to be passed to approve the raising of finance by issue of GDRs/FCCBs. The resolution should indicate therein specific purposes for which funds are required, quantum of the issue, country in which issue is to be launched, time of the issue etc. A director/Sub-Committee of Board of Directors is also to be authorised for seeking government approval in connection with Euro issue and signing agreements with depository, organising road shows for fixation of price of GDRs. The Board meeting shall also decide and approve the notice of Extraordinary general meeting of shareholders at which special resolution is to be considered.

b. Approval of Shareholders

Proposal for making Euro issue, as proposed by Board of Directors require approval of shareholders.

A special resolution under Section 81(1A) of the Companies Act, 1956 is required to be passed at a duly convened general meeting of the shareholders of the company. In case of Euro optionally convertible debentures, resolution is also required to be passed under Section 81(3)(b). Approvals under Sections 94, 16 and 31 of the Companies Act, 1956 may also be obtained, if required. Form No. 23 along with requisite filing fee is to be filed with ROC of the State in which the registered office of the company is situated.

c. Approval of Ministry of Finance—"In Principle and Final"

In case of FCCB issue exceeding US \$ 100 million, the company needs to apply Ministry of Finance for approval.

With respect to ADR/GDR, guidelines issued on the subject dated 19-1-2000 brought ADR/GDR under the automatic route and therefore the requirement of obtaining approval of Ministry of Finance, Department of Economic Affairs has been dispensed with.

Further, private placement of ADR/GDR will also not require prior approval provided the issue is lead managed by investment banker. Where the approval is required, the following procedure is required to be followed:

An eligible issuing company shall make an application to the Government of India, Ministry of Finance, Deptt. of Economic Affairs, New Delhi, for obtaining 'In-principle' approval

The application should set out in detail the following points:

- a. Proposed project or expansion or diversification programme with details of cost of project and means of financing.
- b. The proposed security viz. Global Depository Receipts (GDRs) or American Depository Receipts (ADRs) against underlying shares or Foreign Currency Convertible Bonds.
- c. In the case of Bonds, particulars of redemption period, rate of interest, time of conversion of bonds to equity shares of the company, price at which such conversion will take place.
- d. In the case of GDRs/ADRs, the price at which the equity shares will

be issued.

- e. Justification for the foreign issue.
- f. Other details about the company such as management, financial date, capacity and its utilisation, financial results and management ratios, statutory liabilities, default in respect of interest/installments, of loans from Banks/Financial Institutions. Exports and imports and salient features of the prospective corporate plans and diversification proposals with special reference to foreign exchange requirements.

The Government of India will, if satisfied with the company's proposals, issue an approval in principle granting permission to the company to mobilise foreign currency resources for a specified amount.

On completion of finalisation of issue structure in consultation with the Lead Manager to the issue, the company should obtain the final approval from the Government.

However, in some cases Foreign Investment Promotion Board (FIPB) clearance is necessary before final approval is given by the Finance Ministry.

Both 'in principle and final' approvals are valid for 3 months respectively from the date of issue.

d. Approval of Department of Company Affairs

The issuer company requires approval from Deptt. of Company Affairs under Section 81(3)(b), where the convertible bonds are being issued, which after such conversion are likely to increase the subscribed capital of the company.

Approval as to compliance of Section 187C, non-applicability of provisions relating to prospectus and Section 108 for transfer of shares are also sought for.

e. Approval of Reserve Bank of India

The issuer company has to obtain approvals from Reserve Bank of India under circumstances specified under the guidelines issued by the concerned authorities from time to time.

RBI vide its press release dated January 20, 2000 granted general permissions to make an international offering of rupee denominated equity shares of the company by way of issue of ADR/GDR.

FCCB covered under the automatic route requires no RBI approval.

FCCB issue which exceeds USD 50 million but does not exceed 100 million need to apply to RBI.

f. In-principle consent of Stock Exchanges for listing of underlying shares

The issuing company has to make a request to the domestic stock exchange for in-principle consent for listing of underlying shares which shall be lying in the custody of domestic custodian. These shares, when released by the custodian after cancellation of GDR, are traded on Indian stock exchanges like any other equity shares

g. In-principle consent of Financial Institutions

Where term loans have been obtained by the company from the financial institutions, the agreement relating to the loan contains a stipulation that the consent of the financial institution has to be

obtained. The company must obtain in-principle consent on the broad terms of the proposed issue.

B. Appointment of Intermediaries

The following agencies are normally involved in the Euro issue:

(i) Lead Manager (ii) Co-Lead/Co-Manager (iii) Overseas Depository Bank (iv) Domestic Custodian Banks (v) Listing Agent (vi) Legal Advisors (vii) Printers (viii) Auditors (ix) Underwriter

a. Lead Manager

The company has to choose a competent lead manager to structure the issue and arrange for the marketing. Lead managers usually charge a fee as a percent of the issue. The issues related to public or private placement, nature of investment, coupon rate on bonds and conversion price are to be decided in consultation with the lead manager.

b. Co-Lead/Co-Manager

In consultation with the lead manager, the company has to appoint co-lead/co-manager to coordinate with the issuing company/lead manager to make the smooth launching of the Euro issue

c. Overseas Depository Bank

It is the bank which is authorised by the issuing company to issue Depository Receipts against issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company.

d. Domestic Custodian Bank

This is a banking company which acts as custodian for the ordinary shares or Foreign Currency Convertible Bonds of an Indian company, which are issued by it. The domestic custodian bank functions in co-ordination with the depository bank. When the shares are issued by a company the same are registered in the name of depository and physical possession is handed over to the custodian. The beneficial interest in respect of such shares, however, rests with the investors.

e. Listing Agent

One of the conditions of Euro-issue is that it should be listed at one or more Overseas Stock Exchanges. The appointment of listing agent is necessary to coordinate with issuing company for listing the securities on Overseas Stock Exchanges.

f. Legal Advisors

The issuing company should appoint legal advisors who will guide the company and the lead manager to prepare offer document, depository agreement, indemnity agreement and subscription agreement.

g. Printers

The issuing company should appoint printers of international repute for printing Offer Circular.

h. Auditors

The role of issuer company's auditors is to prepare the auditors report for inclusion in the offer document, provide requisite comfort letters and reconciliation of the issuer company's accounts between Indian GAAP/UK GAAP/US-GAAP and significant differences between Indian GAAP/UK GAAP/US.

i. Underwriters

It is desirable to get the Euro issue underwritten by banks and syndicates. Usually, the underwriters subscribe for a portion of the issue with arrangements for tie-up for the balance with their clients. In addition, they will interact with the influential investors and assist the lead manager to complete the issue successfully

C. Principal Documentation

The following principal documents are involved: (i) Subscription Agreement (ii) Depository Agreement (iii) Custodian Agreement (iv) Agency Agreement (v) Trust Deed

a. Subscription Agreement

Subscription agreement provides that Lead Managers and other managers agree, severally and not jointly, with the company, subject to the satisfaction of certain conditions, to subscribe for GDRs at the offering price set forth. It may provide that obligations of managers are subject to certain conditions precedent.

Subscription agreement may also provide that for certain period from the date of the issuance of GDR the issuing company will not (a) authorise the issuance of, or otherwise issue or publicly announce any intention to issue; (b) issue offer, accept subscription for, sell, contract to sell or otherwise dispose off, whether within or outside India; or (c) deposit into any depository receipt facility, any securities of the company of the same class as the GDRs or the shares or any securities in the company convertible or exchangeable for securities in the company of the same class as the GDRs or the shares or other instruments representing interests in securities in the company of the same class as the GDRs or the shares.

Subscription agreement also provides, an option to be exercisable within certain period after the date of offer circular, to the lead manager and other managers to purchase upto a certain prescribed number of additional GDRs solely to cover over-allotments, if any.

b. Depository Agreement

Depository agreement lays down the detailed arrangements entered into by the company with the Depository, the forms and terms of the depository receipts which are represented by the deposited shares. It also sets forth the rights and duties of the depository in respect of the deposited shares and all other securities, cash and other property received subsequently in respect of such deposited shares. Holders of GDRs are not parties to deposit agreement and thus have no contractual rights against or obligations to the company. The depository is under no duty to enforce any of the provisions of the deposit agreement on behalf of any holder or any other person. Holder means the person or persons registered in the books of the depository maintained for such purpose as holders. They are deemed to have notice of, be bound by and hold their rights subject to all of the provisions of the deposit agreement applicable to them. They may be required to file from time to time with depository or its nominee proof of

citizenship, residence, exchange control approval, payment of all applicable taxes or other governmental charges, compliance with all applicable laws and regulations and terms of deposit agreement, or legal or beneficial ownership and nature of such interest and such other information as the depository may deem necessary or proper to enable it to perform its obligations under Deposit Agreement.

The company may agree in the deposit agreement to indemnify the depository, the custodian and certain of their respective affiliates against any loss, liability, tax or expense of any kind which may arise out of or in connection with any offer, issuance, sale, resale, transfer, deposit or withdrawal of GDRs, or any offering document.

Copies of deposit agreement are to be kept at the principal office of Depository and the depository is required to make available for inspection during its normal business hours, the copies of deposit agreement and any notices, reports or communications received from the company.

c. Custodian Agreement

Custodian works in co-ordination with the depository and has to observe all obligations imposed on it including those mentioned in the depository agreement. The custodian is responsible solely to the depository. In the case of the depository and the custodian being same legal entity, references to them separately in the depository agreement or otherwise may be made for convenience and the legal entity will be responsible for discharging both functions directly to the holders and the company.

Whenever the depository in its discretion determines that it is in the best interests of the holders to do so, it may, after prior consultation with the company terminate, the appointment of the custodian and in such an event the depository shall promptly appoint a successor custodian, which shall, upon acceptance of such appointment, become the custodian under the depository agreement. The depository shall notify holders of such change promptly. Any successor custodian so appointed shall agree to observe all the obligations imposed on him.

d. Agency Agreement

In case of FCCBs, the company has to enter into an agency agreement with certain persons known as conversion agents. In terms of this agreement, these agents are required to make the principal and interest payments to the holders of FCCBs from the funds provided by the company. They will also liaise with the company at the time of conversion/redemption option to be exercised by the investor at maturity.

e. Trust Deed

In respect of FCCBs the company enters into a Covenant (known as Trust Deed) with the Trustee for the holders of FCCBs, guaranteeing payment of principal and interest amount on such FCCBs and to comply with the obligations in respect of such FCCBs

D. Pre and Post launch – Additional Key Actions

Apart from obtaining necessary approvals, appointment of various agencies and proper documentation, the following additional key actions are necessary for making the Euro-issue a success.

(i) Constitution of a Board Sub-Committee; (ii) Selection of Syndicate Members; (iii) Constitution of a task force for due diligence; (iv) Listing; (v) Offering Circular; (vi) Research papers; (vii) Pre-marketing; (viii) Timing, pricing and size of the issue; (ix) Roadshows; (x) Book building and pricing of the issue; (xi) Closing of the issue; (xii) Allotment; (xiii) Investor Relation Programme; and (xiv) Quarterly Statement.

a. Constitution of a Board Sub-Committee

To launch a Euro-issue, the issuing company has to take a large number of decisions in time. These decisions normally fall within the power of Board of Directors. It is usually difficult to call Board Meetings frequently and to ensure presence of adequate Board Members. Thus, it is normally advisable to constitute a sub-committee of the Board with full delegation of powers with regard to Euro-issue. The delegation of powers to the Board sub-committee should normally include the following:

- Appointment of agencies
- Authority to make applications for seeking various approvals
- Authority to finalise and execute documents and agreements.
- Decisions about the timing, size and pricing of the issue
- Allotment of shares

b. Selection of Syndicate Members

The success of any Euro-issue depends upon the well planned and coordinated efforts of the syndicate members and the company. The selection of the Syndicate members should be made depending upon the strength and capabilities of each member in different areas of specialisation such as marketing, financial research, distribution etc. The lead manager may be entrusted with the work of selection of syndicate members. The lead manager while selecting the above members, in addition to their strength and capability, should also evaluate their standing, image, reputation, infrastructure, past experience in handling Indian Euro-issue, etc.

c. Constitution of a task force for due diligence

The due diligence is a process in which a team consisting of legal, technical and financial experts of the lead manager meets top executives of the company and visits the sites of the company in order to understand the strengths, weaknesses, problems and opportunities of the company. The team also studies and analyses the balance sheet of the company and its subsidiaries, its financial arrangement with the group, investment pattern and also the future prospects of the company.

It also scrutinise the minutes of the company, various arrangements entered into by the company with regard to marketing, purchase, technology, ancillary units, employment, etc. and analyse the impact of litigations on the profitability of the company.

The purpose of above exercise is to draft the offering circular (prospectus) and work out marketing strategies for the Euro-issue.

d. Listing

One of the conditions of Euro-issues is that the securities are to be listed on one or more Overseas Stock Exchanges. The issuing company has to fulfill all the requirements particularly disclosure and documentation as prescribed by the Overseas Stock Exchanges. The company shall take the help of the listing agent in getting its Euro-issue instruments listed on the Overseas Stock Exchanges.

The issuing company shall prepare the requisite documents as prescribed by the Overseas Stock exchange authorities and submit the same along with application to it after scrutinizing the application and obtain the formal listing approval shall be issued by the Overseas Stock Exchange.

The underlying shares against GDRs are to be listed on one or more Indian Stock Exchange(s) on which the company's existing shares are already listed. For this purpose, the company has to apply to the stock exchange authorities to get the shares represented by GDRs listed on the Indian Stock Exchanges. Trading of such shares on Indian Stock Exchange(s) will not commence until the period specified in the guidelines after the date of issue of the GDRs.

e. Offering Circular

Offering Circular is a mirror through which the prospective investors can access vital information regarding the company in order to form their investment strategies. It is to be prepared very carefully giving true and complete information regarding the financial strength of the company, its past performance, past and envisaged research and business promotion activities, track record of promoters and the company, ability to trade the securities on Euro capital market.

The Offering Circular should be very comprehensive to take care of overall interests of the prospective investor. The Offering Circular for Euro-issue offering should typically cover the following contents:

- i. Background of the company and its promoters including date of incorporation and objects, past performance, production, sales and distribution network, future plans, etc.
- ii. Capital structure of the company-existing, proposed and consolidated.
- iii. Deployment of issue proceeds.
- iv. Financial data indicating track record of consistent profitability of the company.
- v. Group investments and their performance including subsidiaries, joint venture in India and abroad.
- vi. Investment considerations.
- vii. Description of shares.
- viii. Terms and conditions of global depository receipt and any other instrument issued along with it.
- ix. Economic and regulatory policies of the Government of India.

- x. Details of Indian securities market indicating stock exchange, listing requirements, foreign investments in Indian securities.
- xi. Market price of securities.
- xii. Dividend and capitalisation.
- xiii. Securities regulations and exchange control.
- xiv. Tax aspects indicating analysis of tax consequences under Indian law of acquisition, membership and sale of shares, treatment of capital gains tax, etc.
- xv. Status of approvals required to be obtained from Government of India.
- xvi. Summary of significant differences in Indian GAAP, UK GAAP and US GAAP and expert's opinion.
- xvii. Report of statutory auditor.
- xviii. Subscription and sale.
- xix. Transfer restrictions in respect of instruments.
- xx. Legal matters etc.
- xxi. Other general information not forming part of any of the above

A copy of the Offering Circular is required to be sent to the Registrar of Companies, the Securities Exchange Board of India and the Indian Stock Exchanges for record purposes.

f. Research Papers

Research analysts team of lead manager/co-lead manager prepares research papers on the company before the issue. These papers are very important marketing tools as the international investors normally depend a lot on the information provided by the research analysts for making investment decisions.

g. Pre-marketing

Pre-marketing exercise is a tool through which the syndicate members evaluate the prospects of the issue. This is normally done closer to the issue. The research analysts along with the sales force of the syndicate members meet the prospective investors during pre marketing roadshows. This enables the syndicate members to understand the market and the probable response from the prospective investors. The pre-marketing exercise helps in assessing the depth of investors' interest in the proposed issue, their view about the valuation of the share and the geographical locations of the investors who are interested in the issue. The response received during pre-marketing provides vital information for taking important decisions relating to timing, pricing and size of the issue. This would also help the syndicate members in evolving strategies for marketing the issue.

h. Timing, pricing and size of the Issue

After pre-marketing exercise, the important decisions of timing, pricing and size of the issue are taken. The proper time of launching the issue is when the fundamentals of the company and the industry are strong and the market price of the shares are performing well at Indian Stock Exchanges. The timing should also not clash with some other major issues of the Indian as well as other country companies. The decision

regarding the size of issue is inversely linked with the pricing i.e. larger the size, the comparatively lower the price or vice-versa.

i. Roadshows

Roadshows represent meetings of issuers, analysts and potential investors. Details about the company are presented in the roadshows and such details usually include the following information about the company making the issue:

- History
- Organisational structure
- Principal objects
- Business lines
- Position of the company in Indian and international market
- Past performance of the company
- Future plans of the company
- Competition - domestic as well as foreign
- Financial results and operating performance
- Valuation of shares
- Review of Indian stock market and economic situations.

Thus at road shows, series of information presentations are organised in selected cities around the world with analysts and potential institutional investors. It is, in fact, a conference by the issuer with the prospective investors.

Road show is arranged by the lead manager by sending invitation to all prospective investors.

j. Book building and pricing of the Issue

During road shows, the investors give indication of their willingness to buy a particular quantity at particular terms. Their willingness is booked as orders by the marketing force of lead manager and co-lead manager. This process is known as book building.

Price is a very critical element in the market mix of any product or service. This is more so in case of financial assets like stocks and bonds and specially in case of Euro issues. The market price abroad has a strong correlation to the near future earnings potential, fundamentals governing industry and the basic economic state of the country. Several other factors like prevalent practices, investor sentiment, behaviour towards issues of a particular country, domestic market process etc., are also considered in determination of issue price. Other factors such as the credit rating of the country, interest rate and the availability of an exit route are important.

k. Closing of the Issue and Allotment

Closing is essentially an activity confirming completion of all legal documentation and formalities based on which the company issues the share certificate to the depository and deposits the same with the domestic custodian. Once the issue is closed and all legal formalities are over, the allotment is finalised. Thereafter, the company issues shares in favour of the Overseas Depository Bank and deposits the same with the domestic custodian for custody. The particulars of the Overseas Depository Bank are required to be entered into the Register of Members of the company.

I. Investor Relation Programme

The international investors expect that the issuing company maintains contact with them after the issue. These investors always like to be informed by the company about the latest developments, the performance of the company, the factors affecting performance and the company's plans. It is, therefore, essential for the GDR issuing company to set up an investor relation programme. Good investor relation ensures goodwill towards the company and it would help the company in future fund raising efforts.

For the benefit of the students, we are giving a list of circulars issued regarding FCCBs at the end of the chapter.

III. EXTERNAL COMMERCIAL BORROWINGS (ECB)

External Commercial Borrowings are one of the modes for sourcing of funds for corporates.

External Commercial Borrowings (ECB) include commercial bank loans, buyers' credit, suppliers credit, securitised instruments such as floating rate notes and fixed rate bonds. The other categories would include credit from Official Export Credit Agencies and commercial borrowings from the private sector window of multi-lateral financial institutions such as International Finance Corporation, Asian Development Bank, AFIC, CDC etc.

Guidelines on policies and procedures for ECBs were issued by the Ministry of Finance (ECB) Division on 30th June 1997.

Detailed guidelines on ECB were announced in July 1999. Thereafter various modifications had been made in the Guidelines by the government.

Taking into account changes in external financial markets, requirements of Corporates, access to international capital markets and with a view to liberalising further ECB approvals, the Government decided to make further changes in the ECB guidelines with effect from 14th June, 2000.

In September 2000, government operationalised the automatic route for fresh ECB approvals upto USD 50 million and for all refinancing of existing ECBs with effect from 1st September, 2000.

In July 2002, Government allowed, ECB proceeds to be used in the first stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public, in view of their strategic importance.

In September 2002, modifications were announced relating to prepayment of External Commercial Borrowings (ECBs), end-use restrictions in respect of investments in real estate Sector and eligibility under auto-route and corresponding maturity.

In the Foreign Trade policy for 2004-2009 units in SEZs to avail all ECBs for their own requirements.

How to Access ECB

ECB can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route. ECB for investment in real sector, industrial sector, especially infrastructure sector, are under Automatic Route, i.e. it does not require RBI/ Government approval.

A. AUTOMATIC ROUTE

Who can Access ECBs

1. Corporates (registered under the Companies Act except financial intermediaries (such as banks, financial institutions (FIs), housing finance companies and NBFCs) are eligible to raise ECB. Individuals, Trusts and Non-Profit Organisations are not eligible to raise ECB.
2. Non-Government Organisations (NGOs) engaged in micro finance activities are eligible to avail ECB. Such NGO should have a satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank authorised to deal in foreign exchange and require a certificate of due diligence on 'fit and proper' status of the board/committee of management of the borrowing entity from the designated Authorised Dealer (AD) bank.
3. Units in Special Economic Zones (SEZ) are allowed to raise ECB for their own requirement. However, they cannot transfer or on-lend ECB funds to sister concerns or any unit in the Domestic Tariff Area.

Recognised Lenders

1. Borrowers can raise ECB from internationally recognized sources such as international banks, international capital markets, multilateral financial institutions (such as IFC, ADB, CDC etc.), export credit agencies, suppliers of equipment, foreign collaborators and foreign equity holders (other than erstwhile OCBs).

A "foreign equity holder" to be eligible as "recognized lender" under the automatic route requires minimum holding of equity in the borrower company as below:

- i. For ECB up to USD 5 million - minimum equity of 25 per cent held directly by the lender,
 - ii. For ECB more than USD 5 million - minimum equity of 25 per cent held directly by the lender and debt-equity ratio not exceeding 4:1 (i.e. the proposed ECB not exceeding four times the direct foreign equity holding).
2. Overseas organisations and individuals complying with following safeguards may provide ECB to Non-Government Organisations (NGOs) engaged in micro finance activities.
 - i. Overseas organisations proposing to lend ECB are required to furnish a certificate of due diligence from an overseas bank which in turn is subject to regulation of host-country regulator and adheres to Financial Action

The certificate of due diligence should comprise

 - i. that the lender maintains an account with the bank for at least a period of two years,
 - ii. that the lending entity is organised as per the local law and held in good esteem by the business/local community and
 - iii. that there is no criminal action pending against it.
 - ii. Individual Lender is required to obtain a certificate of due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence /documents such as audited statement of account and income tax return which the overseas lender may furnish need to be

certified and forwarded by the overseas bank. Individual lenders from countries wherein banks are not required to adhere to Know Your Customer (KYC) guidelines are not eligible to extend ECB.

Amount and Maturity

1. The maximum amount of ECB which can be raised by a corporate is USD 500 million or equivalent during a financial year.
2. ECB up to USD 20 million or equivalent in a financial year with minimum average maturity of three years
3. ECB above USD 20 million and up to USD 500 million or equivalent with a minimum average maturity of five years.
4. NGOs engaged in micro finance activities can raise ECB up to USD 5 million during a financial year. Designated AD bank has to ensure that at the time of drawdown the forex exposure of the borrower is hedged.
5. ECB upto USD 20 million can have call/put option provided the minimum average maturity of 3 years is complied with before exercising call/put option.

End-use

1. ECB can be raised only for investment [such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), new projects, modernization/expansion of existing production units] in real sector, industrial sector including small and medium enterprises (SME) and infrastructure sector in India. Infrastructure sector has been defined as power, telecommunication, railways, road including bridges, sea port and airport, industrial parks and urban infrastructure (water supply, sanitation and sewage projects);
2. ECB proceeds can be utilised for overseas direct investment in Joint Ventures (JV)/Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/WOS abroad.
3. Utilisation of ECB proceeds is permitted in the first stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public under the Government's disinvestment programme of PSU shares.
4. NGOs engaged in micro finance activities are allowed to utilise ECB proceeds for lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building.

Restrictions on End Use

Utilisation of ECB proceeds is not permitted for on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate, real estate, working capital, general corporate purpose and repayment of existing Rupee loans.

Guarantees and Security

Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, Financial Institutions and Non-Banking Financial Companies (NBFCs) relating to ECB is not permitted.

The choice of security to be provided to the lender/supplier has been left to the borrower. However, creation of charge over immoveable assets and financial securities, such as shares, in favour of the overseas lender is

conditional.

Parking of ECB proceeds overseas

ECB proceeds can be parked overseas until actual requirement in India.

ECB proceeds parked overseas can be invested in the 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; deposits with overseas branch of an Authorised Dealer in India; and Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

Prepayment and Refinancing of ECB

Prepayment of ECB up to USD 400 million may be allowed by AD banks without prior approval of RBI subject to compliance with the stipulated minimum average maturity period as applicable to the loan.

The existing ECB may be refinanced by raising a fresh ECB subject to the condition that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained.

B. APPROVAL ROUTE

The following types of proposals for ECB are covered under the Approval Route.

1. Financial institutions dealing exclusively with infrastructure or export finance such as IDFC, IL&FS, Power Finance Corporation, Power Trading Corporation, IRCON and EXIM Bank are considered on a case by case basis.
2. Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government are also permitted to the extent of their investment in the package and assessment by Reserve Bank based on prudential norms.
3. ECB with minimum average maturity of 5 years by Non-Banking Financial Companies (NBFCs) from multilateral financial institutions, reputable regional financial institutions, official export credit agencies and international banks to finance import of infrastructure equipment for leasing to infrastructure projects.
4. Foreign Currency Convertible Bonds (FCCB) by housing finance companies satisfying the following minimum criteria:
 - i. the minimum net worth of the financial intermediary during the previous three years shall not be less than Rs. 500 crore,
 - ii. a listing on the BSE or NSE,
 - iii. minimum size of FCCB is USD 100 million,
 - iv. the applicant should submit the purpose / plan of utilization of funds.
5. Special Purpose Vehicles, or any other entity notified by the Reserve Bank, set up to finance infrastructure companies / projects exclusively, are treated as Financial Institutions and ECB by such entities are considered under the Approval Route.
6. Multi-State Co-operative Societies engaged in manufacturing activity satisfying the following criteria

- i. the Co-operative Society is financially solvent and
- ii. the Co-operative Society submits its up-to-date audited balance sheet.

7. Cases falling outside the purview of the automatic route limits.

Recognised Lenders

1. Borrowers are allowed to raise ECB from internationally recognized sources such as international banks, international capital markets, multilateral financial institutions (such as IFC, ADB, CDC etc.), export credit agencies, suppliers' of equipment, foreign collaborators and foreign equity holders (other than erstwhile OCBs).
2. From 'foreign equity holder' where the minimum equity held directly by the foreign equity lender is 25 per cent but debt-equity ratio exceeds 4:1 (i.e. the proposed ECB exceeds four times the direct foreign equity holding).

Amount and Maturity

Corporates can avail of ECB of an additional amount of USD 250 million with average maturity of more than 10 years under the approval route, over and above the existing limit of USD 500 million under the automatic route, during a financial year. However, other ECB criteria such as end-use, all-in-cost ceiling, recognized lender, etc. need to be complied with. Prepayment and call/put options, however, are not permissible for such ECB up to a period of 10 years

End-use

1. ECB can be raised only for investment [such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), new projects, modernization/expansion of existing production units] in real sector - industrial sector including small and medium enterprises (SME) and infrastructure sector - in India. Infrastructure sector is defined as power, telecommunication, railways, road including bridges, sea port and airport industrial parks and urban infrastructure (water supply, sanitation and sewage projects);
2. ECB proceeds can be utilised for overseas direct investment in Joint Ventures (JV)/Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/WOS abroad.
3. Utilisation of ECB proceeds is permitted in the first stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public under the Government's disinvestment programme of PSU shares.

Restrictions on End Uses

Utilisation of ECB proceeds is not permitted for on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate except banks and financial institutions eligible (b), real estate, working capital, general corporate purpose and repayment of existing Rupee loans.

Guarantee and Security

Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, financial institutions and NBFCs relating to ECB

is not normally permitted.

Applications for providing guarantee/standby letter of credit or letter of comfort by banks, financial institutions relating to ECB in the case of SME are considered on merit subject to prudential norms.

With a view to facilitating capacity expansion and technological upgradation in Indian Textile industry, issue of guarantees, standby letters of credit, letters of undertaking and letters of comfort by banks in respect of ECB by textile companies for modernization or expansion of textile units are considered under the Approval Route subject to prudential norms. The choice of security to be provided to the lender / supplier has been left to the borrower. However, creation of charge over immovable assets and financial securities, such as shares, in favour of the overseas lender is conditional.

Parking of ECB proceeds overseas

ECB proceeds can be parked overseas until actual requirement in India.

ECB proceeds parked overseas can be invested in the 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; deposits with overseas branch of an AD bank in India; and Treasury bills and other monetary instruments of one year maturity having minimum rating.

The funds are required to be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

Prepayment and Refinancing of ECB

Prepayment of ECB up to USD 400 million may be allowed by the AD bank without prior approval of Reserve Bank subject to compliance with the stipulated minimum average maturity period as applicable to the loan. However, Pre-payment of ECB for amounts exceeding USD 400 million is considered by the Reserve Bank under the Approval Route.

Existing ECB may be refinanced by raising a fresh ECB subject to the condition that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained

Compliance with ECB guidelines

The primary responsibility to ensure that ECB raised/utilized are in conformity with the ECB guidelines and the Reserve Bank regulations/directions has been cast on the concerned borrower and any contravention of the ECB guidelines is viewed seriously and shall invite penal action under FEMA 1999.

Conversion of ECB into equity

Conversion of ECB into equity is permitted subject to the following conditions:

- a. The activity of the company is covered under the Automatic Router for Foreign Direct Investment or Government approval for foreign equity participation has been obtained by the company,
- b. The foreign equity holding after such conversion of debt into equity is within the sectoral cap, if any,
- c. Pricing of shares is as per SEBI and erstwhile CCI guidelines/regulations in the case of listed/unlisted companies as the

case may be.

Reporting of Conversion

Conversion of ECB may be reported to the Reserve Bank as follows:

- a. Borrowers are required to report **full conversion of outstanding ECB into equity** in the form FC-GPR to the concerned Regional Office of the Reserve Bank as well as in form ECB-2 submitted to the DESACS, RBI within seven working days from the close of month to which it relates. The words "ECB wholly converted to equity" should be clearly indicated on top of the ECB-2 form. Once reported, filing of ECB-2 in the subsequent months is not necessary.
- b. In case of **partial conversion of outstanding ECB into equity**, borrowers are required to report the converted portion in form FC-GPR to the concerned Regional Office as well as in form ECB-2 clearly differentiating the converted portion from the unconverted portion. The words "ECB partially converted to equity" should be indicated on top of the ECB-2 form. In subsequent months, the outstanding portion of ECB should be reported in ECB-2 form to DESACS.

LESSON ROUND-UP

- Foreign Currency Convertible Bonds means bonds issued in accordance with this scheme and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments.
- Global Depository Receipts means any instrument in the form of a Depository receipt or certificate (by whatever name it is called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company
- Domestic Custodian Bank means a banking company which acts as a custodian for the ordinary shares or foreign currency convertible bonds of an Indian Company which are issued by it against global Depository receipts or certificates
- Overseas Depository Bank means a bank authorised by the issuing company to issue global Depository receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company
- The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company.
- The issue of GDRs/FCCBs requires the Approval of a Board of Directors, shareholders, "In principle and Final" approval of Ministry of Finance, Approval of Reserve Bank of India, In-principle consent of Stock Exchange for listing of underlying shares and In-principle consent of Financial institutions.
- External Commercial Borrowings (ECB) include commercial bank loans, buyers' credit, suppliers credit, securitised instruments such as floating rate notes and fixed rate bonds.

- External Commercial Borrowings (ECB) can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route.