

# News Alert

March 2009

## Liberalisation of External Commercial Borrowing Policy

### Background

The government of India has been constantly reviewing the External Commercial Borrowing (ECB) policy to keep it in line with the evolving macroeconomic situation, changing market conditions, sectoral requirements, the external sector and lessons of experience. The Reserve Bank of India (RBI) has liberalised the extant ECB policy in quick succession over the last few months to align it to the global market opportunities. Another set of liberalisation to the ECB policy have now been promulgated by the RBI.

### Amendments to the ECB policy

The amendments to the ECB policy have been summarised hereafter.

#### 1. All-in-cost ceilings

Keeping in view the credit conditions in the international and domestic financial markets, the RBI has temporarily dispensed the requirement of all-in-cost ceilings on ECBs under the automatic as well as approval route. However, the eligible borrowers proposing to avail ECBs beyond the below mentioned all-in-cost ceilings must obtain prior approval of the RBI.

Average Maturity Period	All-in-Cost ceilings over 6 Months LIBOR*
Three years and up to five years	300 bps
More than five years	500 bps
* for the respective currency of borrowing or applicable benchmark	

#### 2. ECB for development of integrated township

In May 2007, ECB facility available to corporates engaged in the development of integrated township was withdrawn by the RBI. As a temporary measure, RBI has again permitted corporates engaged in the development of integrated township to avail ECB under the Approval Route. For this purpose, integrated township is defined in Press Note 3 (2002 Series) dated 4 January 2002 issued by the Ministry of Commerce & Industry.

#### 3. ECB for NBFCs exclusively engaged in financing of the infrastructure sector

Non-Banking Financial Companies (NBFCs) are permitted to avail ECB for a minimum average maturity period of five years to finance import of infrastructure equipments for leasing to infrastructure in India. The RBI has now permitted NBFCs, which are exclusively involved in such financing activity, to avail ECBs from multilateral/regional financial institutions, for on-lending to borrowers in the infrastructure sector under the Approval Route.

For approving the applications, the RBI will take into account the aggregate commitment of these lenders directly to infrastructure projects in India. Further, the direct lending portfolio of these lenders vis-à-vis their total ECB lending to NBFC at any point of time, should not be less than 3:1.

RBI would review all the above relaxations (stated in paragraphs 1, 2 and 3) in June 2009.

#### 4. ECBs by the service sector companies

Entities in the service sector viz hotels, hospitals and software sector companies were permitted to avail ECBs up to US\$100 million under the Approval Route only for import of capital goods. Such entities are now permitted to avail ECBs up to US\$100 million per financial year for both foreign currency and / or for Rupee capital expenditure for permissible end-use under the Automatic Route. However, ECB proceeds cannot be utilised for acquisition of land.

The above amendments to the ECB policy will come into force with immediate effect. All other aspects of the ECB guidelines have remained unchanged.

## FDI Policy Update

Guidelines for the calculation of total foreign investment in Indian companies and transfer of ownership or control of Indian companies in sectors with investment limits from resident Indian citizens to non-resident entities

In an attempt to make Foreign Direct Investment (FDI) policies simple and transparent, the Department of Industrial Policy & Promotion (DIPP) has issued two Press Notes on the guidelines announced by the Cabinet Committee on Economic Affairs (CCEA) on 11 February, 2009, for the computation of foreign holdings in Indian companies, linking approvals to the concept of control for the first time.

### Existing FDI Policy

Under the current FDI policy, foreign investment is allowed in an Indian company under the automatic route (i.e. without approvals) in almost all sectors, except certain prohibited sectors such as gambling and betting, lottery business, atomic energy, retail trading (except single branded product retailing), or where prior Government approval is required.

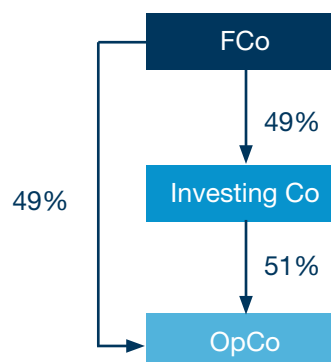
The FDI policy also prescribes caps/conditions for foreign investment in certain sectors. Prior approval of the Government / Foreign Investment Promotion Board (FIPB) is required where prescribed, namely –

- Sectors subject to industrial licensing viz. manufacturing of cigarettes, electronic aerospace or defence equipment;
- Manufacturing of items exclusively reserved for small scale sector;
- Proposals where foreign investor has an existing venture /tie-up in the same field;
- Sectors with FDI caps such as Information & Broadcasting (I&B), Asset Reconstruction Companies, defence, telecom, single brand product retailing, airport, atomic minerals, etc.

In practice, foreign investment into Indian Companies has been made either directly by a non-resident entity, or by Indian Companies having non-resident shareholders. In sectors like telecom, I&B and banking, both FDI and FII investments were counted towards sectoral caps.

Further, while FDI policy in certain sectors – where sectoral caps applied – (like telecom, I&B, etc.), prescribed a methodology for computing effective direct and indirect FDI into the operating company, there was no uniform policy across sectors. This is illustrated through the schematic representation below:

### Current Methodology for counting FDI



Effective FDI in OpCo is 74% (viz. 49% + 49% of 51%)

### New FDI Policy

The fundamental principle emerging from the Press Notes issued by DIPP is that so long as an Indian company is owned and controlled ultimately by resident Indian citizens, it will be able to attract foreign capital to make downstream investment across sectors. This is a significant shift from the existing FDI policy.

### Press Note 2 of 2009

#### Definition of FDI in an Indian company

Under the new policy, foreign investment in the Indian investing company shall include all types of foreign investment, namely FDI, Non-resident Indians (NRIs), portfolio investment by foreign institutional investors (FII)/NRIs, American depositary receipts (ADRs)/global depositary receipts (GDRs), foreign currency convertible bonds (FCCBs), convertible preference shares/convertible debentures, and foreign venture capital investors (FVCIs). However, NRI investments made on non-repatriation basis will not be counted as FDI for this purpose.

#### Computation of FDI

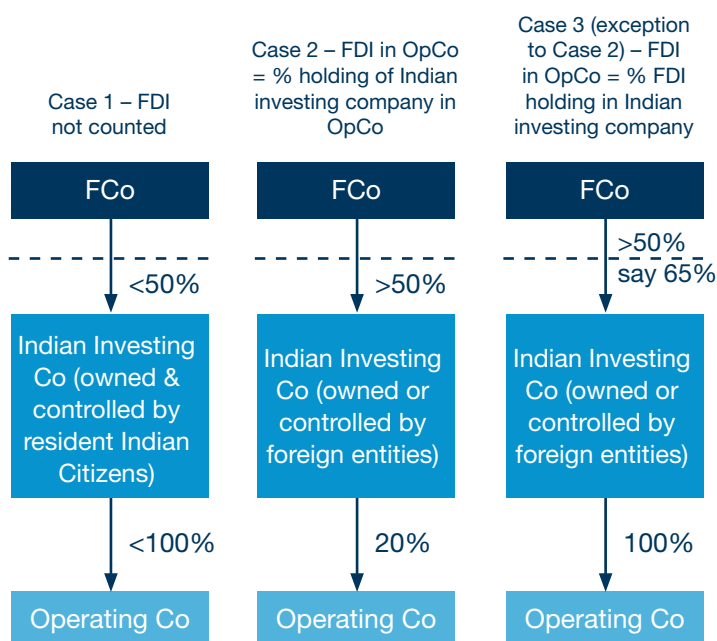
Calculation of total foreign investment i.e. direct and indirect, in Indian companies will be as under:

- (i) All investment directly by a non-resident entity into the Indian operating company will be counted towards foreign investment.
- (ii) Foreign investment through an investing Indian company will not be considered for calculation of indirect foreign investment in the case of Indian companies which are “owned and controlled” by resident Indian citizens and Indian companies which are owned and controlled ultimately by resident Indian citizens.

(iii) If the investing company is either owned or controlled by “non-resident entities”, the entire investment by the Indian investing company in the Indian company will be considered as indirect foreign investment.

(iv) As an exception to (iii) above, where an Indian investing company has 100% ownership of the downstream company, FDI in the downstream company will be a mirror image of the FDI in the Indian investing company if the investing company is owned or controlled by non-resident entities. As a corollary, in case the Indian investing company is neither owned nor controlled by foreign entities, there will be no FDI in the downstream company even if it is 100% owned by the Indian investing company.

The following charts illustrate the computation methodology for indirect FDI.



Consequently, the new FDI policy allows foreign companies to invest in Indian companies (which are owned and controlled by Indian resident citizens directly or through Indian companies) in all sectors through downstream investments, thereby allowing foreign capital in sectors such as retail trading, real estate, telecom, defence, information & broadcasting (I&B), in which FDI is either restricted or prohibited.

It should also be noted that this methodology for computation of foreign investment does not apply to sectors which are governed specifically by a separate statute such as insurance sector.

### Definition of ownership and control

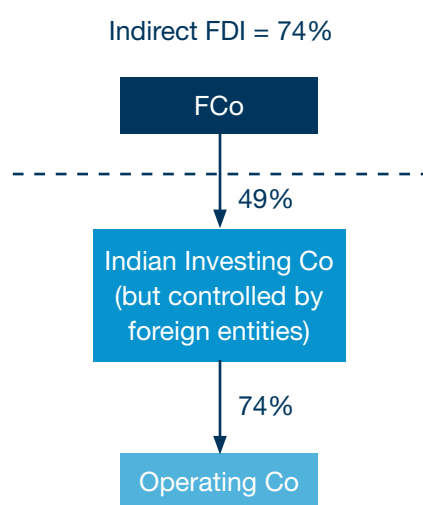
For the purposes of the above-mentioned computation, an Indian investing company will be deemed to be owned by resident Indian citizens if resident Indian citizens beneficially own more than 50% of the equity interest in the Indian investing company, either directly or through Indian companies.

For this purpose, any shareholding held by Indian residents under beneficial ownership of a foreign entity (for which declaration under section 187C of Companies Act, 1956 has been filed) will be counted as foreign investment.

Further, the Indian investing company will be deemed to be controlled by resident Indian citizens if they have the power (either directly or via Indian companies owned and controlled by resident Indian citizens) to appoint a majority of directors of the Indian investing company.

This effectively means that where an Indian investing company is owned or controlled by non-resident entities, entire investment by such investing company will be considered as indirect FDI into the downstream company.

The following chart illustrates the above:



### Inter-se shareholders agreements

In sectors where FDI is subject to FIPB approval, the applicant will need to disclose details of inter-se shareholder agreements which have an effect on factors such as appointment of the Board of Directors, differential voting rights and such other matters.

Further, in all sectors having FDI caps, the balance equity beyond the sectoral cap would need to be beneficially owned by resident Indian citizens directly or through Indian companies.

### Sector specific guidelines for I&B and defence

In I&B and defence where the sectoral cap is less than 49%, the company will need to be owned and controlled ultimately by resident Indian citizens either directly or through Indian companies.

Further, the largest Indian shareholder will need to hold at least 51% if the issued equity capital, excluding equity held by public sector banks and public financial institutions.

## Press Note 3 of 2009

This Press Note applies to all cases involving transfer of ownership or control from Indian resident citizens to non-resident entities in sectors / activities which either have a FDI cap or require prior FIPB approval i.e. it does not apply to sectors where 100% FDI is allowed under the automatic route.

In these sectors, FIPB approval will now be required for transfer of ownership or control of Indian companies either directly to foreign entities or to an Indian company set up with foreign investment and which is owned or controlled by non-resident entities, irrespective of whether such transfer is taking place through merger, amalgamation, acquisition, etc.

## Definitions

### Resident Indian citizen

The term 'Resident Indian Citizen' shall be interpreted in line with the definition of 'person resident in India' as per FEMA, 1999, read in conjunction with the Indian Citizenship Act.

### Non resident entity

A 'non resident entity' means a 'person resident outside India' as defined under FEMA 1999.

### Indian company

The term 'Indian Company' means a company registered or incorporated in India as per the Indian Companies Act, 1956.

### Investing company

'Investing Company' means an Indian Company making equity / preference / CCD investment into another Indian company.

### Largest Indian shareholder

The term 'largest Indian shareholder', includes any or a combination of the following:

- I. In case of an Individual shareholder,
  - a) The individual shareholder;
  - b) A relative of the shareholder as defined in section 6 of the Companies Act, 1956
  - c) A company / group of companies in which the individual shareholder / Hindu Undivided Family (HUF) to which he belongs has management and controlling interest.
- II. In case of an Indian Company,
  - a) The Indian company;
  - b) A group of Indian companies under the same management and ownership control.

**For further information, please contact PricewaterhouseCoopers' India Desk in Singapore.**

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The content in this news alert was sourced from PwC India newsletters dated 6 January and 16 February 2009.