MEDIUM AND LONG TERM FINANCE

Types of Capital and Debt

Medium and Long Term Finance

- Export Credits
- Forfaiting
- Leasing
- Raising Credit in International Markets:
- Major Borrowers: Major corporates, Government and State Entities, MNCs
- Short Term: Working Capital – less than one year: Bankers Acceptance, Commercial Paper, Euro Commercial Paper
- Medium Term: 1 year to 5 years: capital expenditure
- Long term: above 5 years: acquisition finance, project finance, capital expenditure

Export Credits

- Through official export credit agencies to encourage national exports and investments
- Both political and commercial risk covers: insurance against payment default and political risks such as expropriation or non-transferability of funds
- Home companies are provided interest rate subsidies and guarantees
- Directly through an official export-import bank
- Indirectly through commercial banks
- In some countries private insurers also compete for profitable parts of such business
- Some governments provide development aid with export credits to create mixed credits or soft loans

Export Credits

- Export credit guarantee companies maintain extensive data bases on countries and businesses. Typically they divide countries into several risk categories depending on circumstances.
- The Berne Union acts as an international forum for most of the world’s main credit agencies, while OECD publishes guidelines for member states aimed at reducing subsidies
- In addition to national agencies, the Multilateral Investment Guarantee Agency (MIGA) attached to the World Bank is also a member. MIGA provides political insurance for international investment projects.
- Most insurers expect the exporter to bear a portion of any loss itself. This is intended to encourage prudent behaviour. Percentage losses covered by policies typically range from around 75% to 95% depending on the type of risk and the insurer involved.

OECD “Consensus” on Export Credits

- OECD consensus rates: has reduced subsidy by moving over to CIRR rates (Commercial Interest Reference Rates) tied to government bond rates for comparable periods
- At least 15% of the contract recovered by cash payments
- Max. repayment period 8.5 years. May be increased to 10 years for relatively poor countries and for a limited number of intermediate countries.
- Min. rates of interest are set for credit periods up to 5, 8.5 and 10 years. These minima are referred to as the matrix. They are revised twice a year and are based on a weighted average of major currencies. For determining min. interest rates, countries divided into: I – Relatively rich countries, II – Intermediate countries, III - Relatively poor countries
- Two important sectors – agriculture and defence – have so far been excluded from these guidelines.

Government export financing and national interest lenders

- Export financing from government export agencies is generally available from two sources: an export-import bank and foreign aid.
- Loans and guarantees or a combination of both: Guarantees may be used to secure a loan from the regular commercial banks of the country
- Nearly all such foreign aid must be used to purchase goods and services from the country providing the financing.

Export financing characteristics

- Supplier credit: Here the loan is made to the supplier who in turn quotes financing terms to the purchaser. Supplier credits usually require the supplier to assume some portion of the risk of financing.
- Buyer credit: The loan is provided to the buyer not the supplier
- Typical terms: 5 to 10 years; low interest rate compared to commercial sources; currency normally in the currency of the supplying country but any other currency may be used
- Security: Security arrangements include satisfactory corporate guarantees or mortgages. A guarantee from a central bank or suitable commercial bank may be required
- Fees: A fee of ½ to 1% per annum is typically required

Advantages of Export Financing

- Fixed rate of interest is often available
- A lower rate of interest than usually available from commercial sources
- A loan for a longer term than would be available from commercial sources
- The quasi-government nature of the loan provides some protection against government expropriation or interference in the project

Disadvantages of Export Financing

- Delays in procedures to obtain approvals
- Currency risk for the project as the cash flows may be in a different currency from that of the loan
- The equipment available from the country supplying the credit may not be the most suitable for the project
- The quality of services performed may not be the most suitable
- The equipment used may require expensive maintenance, parts, repairs and servicing, which again will have to be provided by the same supplier.

Export Import Bank of India

- Government owned institution, formed in 1982, for the purpose of financing and promoting foreign trade in India
- Functions include Lending, Guaranteeing, Advisory and Promotional activities
- Focus is on export credits for medium term and long term, both `supplier's credit' and `buyer's credit'
- Technical Assistance to Indian Exporters

Exim Bank of India contd.

Assistance to Indian companies:

- Direct financial assistance to exporters
- Overseas investment financing
- Pre-shipment credit
- Consultancy and technology services
- Export Marketing Fund
- Export Product Development
- Project Preparatory Services Overseas

Exim Bank of India contd.

- Loans to Foreign Governments, Companies and Financial Institutions:
  - Overseas Buyer's Credit
  - Lines of Credit to Foreign Governments
  - Re-lending Facility to Banks Overseas
- Loans to Commercial Banks in India:
  - Export Bills Rediscounting
  - Refinance of Export Credit
  - Syndication of Risks

Exim Bank of India contd.

Guaranteeing of Obligations:

- The Guarantee programme is available in the case of construction and turnkey contracts. Construction contracts involve erection, civil works and commissioning. In such contracts, an exporter usually requires bid bond, advance payment guarantee, performance guarantee, guarantee for retention money, guarantee for borrowings abroad. Exim Bank participates with commercial banks, in India, in the issue of guarantees.

Examples of Export Financing Agencies

- Australia: The Export Finance & Insurance Corporation (EFIC) is part of the Australian Trade Commission (Austrade)
- Canada: The Export Development Corporation (EDC)
- France: CoFace is a semi-public institution. It covers commercial risk on short-term transactions on its own behalf. For all other transactions, it acts on behalf of the government.
- Germany: Hermes works with Treuarbeit, a publicly held corporation, to provide export credit insurance on behalf of the federal government.
- Italy: SACE is an autonomous section of INA, the state insurance company.

Examples of Export Financing Agencies

- Japan: The International Trade Insurance Division (ITID) of the Ministry of International Trade and Industry (MITI) is the main Japanese insurer. However, the Export-Import Bank of Japan also provides guarantees for bank loans and buyer credits.
- Netherlands: NCM is a private company insuring only up to one year. Other transactions are administered by NCM but reinsured with the Dutch Government.
- United Kingdom: The Export Credits Guarantee Board
- USA: Export Import Bank of the United States; Private Export Funding Corporation (PEFCO); and Overseas Private Investment Corporation (OPIC)

Forfaiting

- Mainly medium term financing of exports of capital goods and equipment where export credit support is not available
- Bank or other institution in the seller’s country can extend credit to buyer backed by the guarantee of a bank in the buyer’s own country
- The buyer accepts a series of drafts or signs a set of promissory notes corresponding to the instalment dates for repayment of the agreed credit. These bills or notes are guaranteed by the importer’s bank

Forfaiting contd.

- The guarantee is in the form of a separate guarantee or of a special endorsement on the bills or notes known as an aval.
- The exporter presents these documents to the forfaiter who buys them at a discount without recourse to the exporter
- For the importer there are extra costs involved on account of the guarantee, but he is able to access funds at a lower rate.

Forfaiting contd.

- Over the years, forfaiting has become a popular means of financing deals such as capital goods imports in many emerging markets.
- Forfaiting initially became popular on account of the increase in trade between the west and countries of eastern Europe coupled with the growing importance of the developing countries.
- Switzerland was one of the earliest centres to develop this new market. London is now also a particularly important centre for this type of trade financing.

Cross Border Leases

- More complicated than domestic leases
- Currency risk
- Exchange controls
- Import and export permits
- Withholding taxes
- Varying accounting and reporting requirements
- Choices of applicable law and enforcement procedures

Role of Development Banks

- Global and regional development banks have become important in the last 50 years
- Provide and generate finance for business and infrastructure projects for improving the living standards in developing countries
- Increasing support for privatisation of state controlled industries and public utilities
- Also increasing emphasis on social sector and community based projects as against financing only large projects.
- Some important Multilateral Development Banks (MDBs) are World Bank, Inter-American Development Bank, Asian Development Bank, African Development Bank, European Bank for Reconstruction and Development and Caribbean Development Bank

World Bank Group

- The most important MDB is the World Bank. The World Bank Group consists of five agencies:
- the International Bank for Reconstruction and Development (IBRD), established in 1945,
- the International Finance Corporation (IFC), established in 1956,
- the International Development Association (IDA), established in 1960,
- the Multilateral Investment Guarantee Agency (MIGA), established in 1988, and
- the International Centre for Settlement of Investment Disputes (ICSID), established in 1966.

IBRD

- IBRD is owned by the governments of the member countries (184), all of which are also members of the IMF. As members, the countries contribute to the capital of both the Bank and the IMF. Subscriptions to IBRD’s capital vary according to each member’s quota in the IMF.
- In recent years the World Bank Group has been moving from targeting economic growth in general, to aiming specifically at poverty reduction. Projects involving education, clean water, sustainable development and small scale local enterprises have gained importance.
- The World Bank, through its main affiliates, IBRD and IDA, lends approximately $20 billion each year to promote economic growth and social progress in the developing world.

IBRD

- The IBRD lends largely to middle-income and credit worthy developing countries and finances its operations primarily through bond sales on world capital markets.
- The IBRD's original mission was to finance the reconstruction of nations devastated by World War II. Now, its mission has expanded to fight poverty by means of financing states.
- Most of the IBRD's funds come from borrowing on the capital markets of the world, repayment of loans, and earnings. The IBRD provides loans to governments and public enterprises, always with a government (or "sovereign") guarantee of repayment. World Bank bonds are rated AAA because they are backed by member states' share capital, as well as by borrowers' sovereign guarantees.

IBRD

- As most developing countries have considerably lower credit ratings, the IBRD can lend to countries at interest rates that are usually quite attractive to them, even after adding a small margin (about 1%) to cover administrative overheads.
- Each project financed by the IBRD has to meet economic, financial and technical requirements.
- Investment project loans include loans to finance agricultural development, transportation, education, health and nutrition projects, and industrial development. On the other hand, adjustment loans are linked to reform, and are usually released in tranches as structural reforms are implemented. Some loans, known as hybrid loans, involve a blend of investment and adjustment activities.

IBRD Loan Terms

- IBRD loans are made either directly to a member government or to an entity guaranteed by that government. IBRD loans are generally repayable over 15 to 20 years, with a grace period of 3 to 5 years. Loan repayments are due semi-annually.
- The interest rate paid by borrowers is related to the cost of the Bank's borrowings. Borrowers benefit directly from the Bank's strong credit rating in the international capital markets. To arrive at the interest rate charged on loans, the Bank adds a margin of 0.5% to the cost of its borrowings. Interest rates are adjusted semi-annually. An annual commitment charge of up to 0.75% is levied on the undisbursed balances.

IBRD

- Bidding for projects are usually on international competitive bidding (ICB) basis, with local suppliers sometimes eligible for price preference.
- Co-financing arrangements with other loans possible with cross-default clauses. Such loans endorses the credit for other potential lenders
- Lengthy approval process with in-built delays
- The World Bank follows a currency pooling system while disbursing loans and credits. The currency pooling system equalises the risks of currency fluctuations: (i) By pooling all currencies disbursed and outstanding on participating loans, (ii) By expressing the outstanding principal amount of each loan as a share of the pool.
- The currency pool system does not eliminate the exchange risk. It only assumes the exchange rate changes affect all loans and borrowers equally.

International Development Association (IDA)

- IDA finances projects in the world's poorest countries and lends on concessional terms, drawing largely on contributions from its wealthier member countries.
- IDA lends to those countries that had an income in 2004 of less than $965 per person and lack the financial ability to borrow from IBRD. Some "blend borrower" countries like India and Indonesia are eligible for IDA loans because of their low per person incomes but are also eligible for IBRD loans because they are financially creditworthy. Eighty-one countries are currently eligible to borrow from IDA.
- Donors get together every three years to replenish IDA funds. Donor contributions account for more than half of the US$33 billion in the fourteenth replenishment of IDA's resources (IDA 14), which finances projects over the three-year period ending June 30, 2008.

IDA

- IDA credits have maturities of 20, 35 or 40 years with a 10-year grace period before repayments of principal begins. IDA credits approved before June 30, 1987 were repayable over 50 years. IDA funds are allocated in relation to their income levels and record of success in managing their economies and their ongoing IDA projects. There is no interest charge, but credits carry a service charge, currently 0.75 percent on funds disbursed and outstanding. There is also an annual commitment charge of up to 0.5% on the undisbursed balance.
- In fiscal year 2005 (which ended June 30, 2005), IDA commitments totalled $8.7 billion. India continues to be the largest beneficiary of IDA lending with total commitments exceeding US$ 1 billion during fiscal year 2005.

International Finance Corporation

- IFC, a member of the World Bank Group, is the largest multilateral source of loan and equity financing for private sector projects in the developing world. It promotes sustainable private sector development primarily by:

  - Financing private sector projects located in the developing world.

  - Helping private companies in the developing world mobilize financing in international financial markets.

  - Providing advice and technical assistance to businesses and governments
- IFC has 178 member countries.

International Finance Corporation

- IFC's equity and quasi-equity investments are funded out of its net worth. Triple-A ratings, and the substantial paid-in capital base have allowed IFC to raise funds for its lending activities on favourable terms in the international capital markets.
- As a rule, the enterprises IFC finances must be majority private sector owned and controlled. Exceptions can be made for state-owned enterprises which are in the process of being privatized. Although IFC does not take any government guarantees for its financing, IFC's work often requires close cooperation with government agencies in developing countries.
- IFC operates on a commercial basis. It invests in profit generating projects and charges market rates for its products and services.

International Finance Corporation

- IFC offers fixed and variable rate loans for its own account to private sector projects in developing countries. These loans for IFC's own account are called A-loans
- Most A-loans are issued in leading currencies, but local currency loans can also be provided. The loans typically have maturities of 7 to 12 years. Grace periods and repayment schedules are determined on a case-by-case basis, in accordance with the borrower's cash flow needs.
- Loans from IFC finance both greenfield companies and expansion projects in developing countries. The Corporation also extends loans to intermediary banks, leasing companies, and other financial institutions through credit-lines for further on-lending. The credit lines are often targeted at small and medium enterprises or at specific sectors.

International Finance Corporation

- To ensure the participation of other private investors, A-loans are usually limited to 25% of the total estimated project costs for greenfield projects, or, on an exceptional basis, 35% in small projects. For expansion projects IFC may provide up to 50% of the project cost, provided its investments do not exceed 25% of the total capitalization of the project company. Generally, A-loans range from $1 million to $100 million.
- Quasi-Equity Financing: C-loans
- IFC offers a full range of quasi-equity products with both debt and equity characteristics to private sector projects in developing countries. These products are called C-loans. Among other instruments, the Corporation provides convertible debt and subordinated loan investments, which impose a fixed repayment schedule.

International Finance Corporation

- To ensure the participation of other private investors, the Corporation generally subscribes to between 5% and 15% of a project's equity. IFC is never the largest shareholder in a project and will normally not hold more than a 35% stake. The Corporation does not take an active role in company management.
- An essential part of IFC's mandate is to mobilize financial resources from the private sector to benefit borrowers in developing countries. The syndication or “B loan” programme allows participants, primarily commercial banks, to benefit from IFC’s preferred creditor status. The B loan helps mitigate country risk for banks.

MIGA

- **MIGA's** role is to provide non-commercial or political investment risk insurance and technical services and help promote investment flows.
- MIGA cannot provide export credit guarantees and is limited to covering investment projects
- MIGA was established to promote foreign direct investment into developing countries. Being part of the World Bank Group, the presence of MIGA acts as a potent deterrent against government actions that may adversely affect investments.

The International Centre for Settlement of Investment Disputes (ICSID)

- Provides conciliation & arbitration services for disputes between foreign investors and host governments

Official Development Assistance (ODA)

- This comprises both bilateral aid and assistance provided through replenishment of both resources of multilateral soft lending agencies like IDA, funds of regional development banks, the EU, the UN agencies, etc. Some of the assistance comes in the form of grants as well.
- India in recent years has started prepaying costly bilateral debt on account of burgeoning reserves. Tied aid is usually more costly and comes with strings.

International Financial Instruments

Bankers’ Acceptance

- A banker’s acceptance starts as an order to a bank by a bank's customer to pay a sum of money at a future date, typically within six months. At this stage, it is like a postdated check. When the bank endorses the order for payment as "accepted", it assumes responsibility for ultimate payment to the holder of the acceptance. At this point, the acceptance may be traded in secondary markets much like any other claim on the bank.
- Bankers' acceptances are considered very safe assets, as they allow traders to substitute the bank's credit standing for their own. They are used widely in foreign trade where the creditworthiness of one trader is unknown to the trading partner. Acceptances sell at a discount from face value of the payment order.

Commercial Paper

- **Commercial paper** is a money market security issued by large banks and corporations. It is generally used not to finance long-term investments but rather it is used for purchases of inventory or to manage working capital. It is commonly bought by money funds (the issuing amounts are often too high for individual investors), and is generally regarded as a very safe investment. As a relatively low risk option, returns are not high.
- Commercial paper maturities don't exceed nine months.
- There are two methods of issuing paper. The issuer can market the securities directly to a buy and hold investor. Alternatively, they can sell the paper to a dealer, who then sells the paper in the market.
- **Eurocommercial Paper:** An unsecured, short-term loan issued by a bank or corporation in the international money market, denominated in a currency that differs from the corporation's domestic currency.

Bonds and Notes

- Traditionally, the U.S. Treasury uses the word *bond* only for their issues with a maturity longer than 10 years, and calls issues between one and ten year *notes*. Elsewhere in the market this distinction has disappeared, and both *bonds* and *notes* are used irrespective of the maturity. Market participants use *bonds* normally for large issues offered to a wide public, and *notes* rather for smaller issues originally sold to a limited number of investors. There are no clear demarcations.
- Underwriting and legal costs can be high.
- Issuers of bonds include Supranational agencies (say Asian Development Bank), National Governments, Provincial, State or Local Authorities (Municipalities), Government sponsored entities and Companies.
- Special purpose vehicles (SPVs) are companies set up for the sole purpose of containing assets against which bonds are issued, often asset-backed securities

Types of Notes

- **Floating-Rate Note - FRN**
- A note with a variable interest rate. The adjustments to the interest rate are usually made every six months and are tied to a certain money-market index. Also known as a "floater".
- **Note Issuance Facility - NIF**
- A syndicate of commercial banks that have agreed to purchase any short to medium-term notes that a borrower is unable to sell in the eurocurrency market.
- The NIF acts as an underwriting arrangement. Should the borrower be unable to sell all notes, the syndicate is obligated to purchase all the remaining notes from the borrower, essentially providing credit. Note issuance facilities are useful in reducing risk and costs for both the borrower and the lender.

Medium Term Note - MTN

- A note that usually matures in five to 10 years.
- A corporate note continuously offered by a company to investors through a dealer. Investors can choose from differing maturities, ranging from nine months to 30 years.
- This type of debt program is used by a company so it can have constant cash flows coming in from its debt issuance; it allows a company to tailor its debt issuance to meet its financing needs. Medium-term notes allow a company to register with the SEC only once, instead of every time for differing maturities.
- MTNs are a series of bond issuances and are preferred by corporates and banks with long-term funding needs. Corporates save money on recurring expenses like legal charges as against normal bond issuances.

NTPC – Proposed MTN Issue

- NTPC to set up a MTN issuance programme of $1bn. This makes it the first Indian corporate after the markets opened up in 2003 to set up an MTN programme. Banks such as ICICI Bank, SBI, Bank of India and UTI Bank have set up MTN programmes in the last couple of years.
- The power major will raise the first tranche of around $200-250m by March 2006. The **notes** will have a tenure of 10 years. Barclays and Deutsche Bank have been mandated as the lead arrangers for the issue. NTPC has received a BB+ rating, equivalent to the sovereign rating, which should allow the corporate to get very fine rates on their borrowings.
- The MTN is likely to be listed on the Singapore Stock Exchange. NTPC`s issue is likely to be placed between 90-105bp above Libor.

Revolving Underwriting Facility (RUF)

- A form of revolving credit in which a group of underwriters agrees to provide loans in the event that a borrower is unable to sell in the Eurocurrency market. These loans are generally provided through the purchase of short-term Euronotes.
- A revolving underwriting facility differs from a note issuance facility (NIF) in that the underwriters provide loans instead of purchasing the outstanding notes that failed to sell. In either case, both RUF and NIF provide short- to medium-term credit in the Eurocurrency market.

Foreign Bond

- A bond that is issued in a domestic market by a foreign entity, in the domestic market's currency.
- Foreign bonds are regulated by the domestic market authorities and are usually given nicknames that refer to the domestic market in which they are being offered.
- Since investors in foreign bonds are usually the residents of the domestic country, investors find them attractive because they can add foreign content to their portfolios without the added exchange rate exposure.
- Types of foreign bonds include bulldog bonds, matilda bonds, and samurai bonds.
  Bulldog Bond: A sterling denominated bond that is issued in London by a company that is not British.
- **Matador Bond:** A foreign bond denominated in pesetas and issued in Spain by a non-Spanish co.

Types of Foreign Bonds

- **Dragon Bond:** A bond that is issued in Asia but denominated in U.S. dollars.
- **Samurai Bond:** A yen-denominated bond issued in Tokyo by a non-Japanese company.
- **Matilda Bond:** An bond denominated in the Australian dollar and issued on the Australian market by a foreign entity.
- **Yankee Bond:** A bond denominated in U.S. dollars and issued in the United States by foreign banks and corporations
- **International Bond:** Bonds that are issued in a country by a non-domestic entity. International bonds include eurobonds, foreign bonds and global bonds.

Eurobond

- A bond issued in a currency other than the currency of the country or market in which it is issued.
- Usually, a eurobond is issued by an international syndicate and categorized according to the currency in which it is denominated. A eurodollar bond that is denominated in U.S. dollars and issued in UK by a Japanese company would be an example of a eurobond. The Japanese company in this example could issue the eurodollar bond in any country other than the U.S.
- Eurobonds are attractive to investors as they have high liquidity.
- **Sushi Bond:** A Eurobond that is issued by a Japanese issuer and does not count against a Japanese institution's limits on the holdings of foreign securities.

Foreign Currency Convertible Bond – FCCB

- A type of convertible bond issued in a currency different than the issuer's domestic currency. In other words, the money being raised by the issuing company is in the form of a foreign currency. These bonds also give the bondholder the option to convert the bond into stock.
- These types of bonds are attractive to both investors and issuers. The investors receive the safety of guaranteed payments on the bond and are also able to take advantage of any large price appreciation in the company's stock. This is done by means of warrants attached to the bonds, which are activated when the price of the stock reaches a certain point. Due to this benefit coupon payments on the bond are lower for the company, thereby reducing its debt-financing costs

Foreign Currency Convertible Bond – FCCB

- Foreign Currency Convertible Bonds (FCCBs) are required to be issued in accordance with the scheme viz., "Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993”, 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. The policy for ECB is also applicable to FCCBs.

Tata Power FCCB Issue

- The Tata Power Company Limited, India’s largest private power company, launched a US$ 200 million, 5 year Foreign Currency Convertible Bond (FCCB) issue carrying a 1 per cent coupon. The offering was subject to fulfillment of certain conditions to the closing of the issue.
- The bonds were convertible at 50 per cent premium over the closing share price of February 8, 2005 and bear a yield to maturity of 3.88 per cent compounded semi-annually.
- These bonds were listed on the Singapore Stock Exchange. JP Morgan was the sole underwriter and bookrunner to the offering. The offering was launched after the stock exchange trading hours on February 8, 2005.

Qualified Institutional Buyer – QIB

- Primarily referring to institutions in the US that manage at least $100 million in securities including banks, savings and loans institutions, insurance companies, investment companies, employee benefit plans, or an entity owned entirely by qualified investors. Also included are registered broker-dealers owning and investing, on a discretionary basis, $10 million in securities of non-affiliates.
- QIBs are eligible to participate in the Rule 144A market.

Rule 144A

- A Securities & Exchange Commission rule modifying a two-year holding period requirement on privately placed securities to permit qualified institutional buyers to trade these positions among themselves.
- This has substantially increased the liquidity of the securities affected because institutions can trade these securities amongst themselves, side-stepping limitations that are imposed to protect the public.

Structured Finance

- A service offered by many large financial institutions for companies with very unique financing needs. These financing needs usually don't match conventional financial products such as a loan. Structured finance generally involves highly complex financial transactions.
- Collateralized Bond Obligations (CBOs) and syndicated loans are examples of structured finance.

Syndicated Bank & Euro Dollar Loans

- Large amounts of debt can be raised. Flexible and cheap to arrange. The syndicated loan market is the largest source of international capital
- Loans are mainly in USD. However, other major currencies are available
- Number of participants can be substantial
- Draw-downs can be flexible
- Prepayment is usually permitted
- Banks participating in syndicated loans are sophisticated and able to understand the complex credit risks associated with project finance
- Syndicated loans are usually non-negotiable and remain on the banks' books till maturity. The risks may, however, be assigned to other banks.

Syndicated Bank & Euro Dollar Loans

- The major disadvantage of the syndicated loans market is that the interest rate is floating
- Most syndicated loans are unsecured, but have numerous covenants and default provisions
- Syndicated loans are often made to borrowers in developing countries, whereas bond issues are normally restricted to industrialised nations.
- Syndicated loans are usually structured as term loans with a grace period before repayment starts
- Group of Banks consisting of Arranger/Lead Managers, Underwriters, Managers, Co-Managers, Participants

Credit Syndication

- Fees Payable: includes management fee, commitment fee (payable on undrawn portion of the loan during availability period), and agency fee to cover administration costs
- Arranger's Fees: usually percentage of total loan
- Underwriting fee – expressed as a percentage
- Management fee appropriate to funds actually provided – expressed as a percentage
- Share of any residual pool in proportion to its underwriting. The loan arrangement may be on `best efforts' basis.
- Mark up over LIBOR for amount actually loaned: depends upon credit risk, length of loan, etc.
- A multicurrency option may be provided to the borrower from rollover to rollover

External Commercial Borrowings Policy

- External Commercial Borrowings (ECBs) refer to commercial loans [in the form of bank loans, buyers' credit, suppliers' credit, securitised instruments (e.g. floating rate notes and fixed rate bonds)] availed from non-resident lenders with minimum average maturity of 3 years. ECB can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route.
- **Automatic Route**:
- ECBs for investment in real sector -industrial sector, especially infrastructure sector-in India, will be under Automatic Route, i.e. will not require RBI/Government approval.

ECBs

- **Eligible borrowers:**
- Corporates registered under the Companies Act except financial intermediaries (such as banks, financial institutions (FIs), housing finance companies and NBFCs) are eligible. Individuals, Trusts and Non-Profit making Organisations are not eligible to raise ECB. Further, Non-Government Organisations (NGOs) engaged in micro finance activities are eligible to avail ECB.
- **Recognised Lenders:**
- Borrowers can raise ECB from internationally recognised sources such as (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions (such as IFC, ADB, CDC etc.,), (iv) export credit agencies, (v) suppliers of equipment, (vi) foreign collaborators and (vii) foreign equity holders.

ECBs

- **Amount and Maturity:**
- a) ECB up to USD 20 million or equivalent with minimum average maturity of three years
- b) ECB above USD 20 million and up to USD 500 million or equivalent with minimum average maturity of five years
- c) The maximum amount of ECB which can be raised by a corporate is USD 500 million during a financial year.
- d) NGOs engaged in micro finance activities can raise ECB up to USD 5 million during a financial year.
- e) ECB up to USD 20 million can have call/put option provided the minimum average maturity of 3 years is complied before exercising call/put option.
- NGOs engaged in micro finance activities can raise ECB up to USD 5 million during a financial year.

ECBs

- **All-in-cost ceilings:**
- All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees. Moreover, the payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost.
- The all-in-cost ceilings for ECB are indicated from time to time. Presently they are:
- **Minimum Average Maturity Period:**

  (All-in-cost Ceilings over six month LIBOR for the respective currency of borrowing or applicable benchmark. payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost).
- Three years and up to five years: 200 basis points
- More than five years: 350 basis points

ECBs

- **End-use:**
- a) ECB can be raised only for investment (such as import of capital goods, new projects, modernization/expansion of existing production units) in real sector - industrial sector including small and medium enterprises (SME) and infrastructure sector - in India. b) 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.
- c) 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.

ECBs

- d) NGOs engaged in micro finance activities may utilise ECB proceeds for lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building.
- e) 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.
- f) Utilisation of ECB proceeds is not permitted in real estate. The term ‘real estate’ excludes development of integrated township as defined.
- g) End-uses of ECB for working capital, general corporate purpose and repayment of existing Rupee loans are not permitted.

ECBs

- **Guarantees:**
- 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 permitted.
- **Prepayment:**
- Prepayment of ECB up to USD 200 million is permitted without prior approval of RBI, subject to compliance with the stipulated minimum average maturity period as applicable for the loan.
- **Refinance of existing ECB:**
- Refinancing of existing ECB by raising fresh loans at lower cost is permitted subject to the condition that the outstanding maturity of the original loan is maintained.

ECB – Approval Route

- **Eligible borrowers:**
- a) Financial institutions dealing exclusively with infrastructure or export finance such as IDFC, IL&FS, Power Finance Corporation, Power Trading Corporation, IRCON and EXIM Bank will be considered on a case by case basis.
- b) Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government will also be permitted to the extent of their investment in the package and assessment by RBI based on prudential norms. Any ECB availed for this purpose so far will be deducted from their entitlement.
- c) Cases falling outside the purview of the automatic route limits and maturity period indicated earlier

Indian External Debt *(in USD million)*

End March	2006	2005	2004
Multilateral	32,558	31,702	29,288
Bilateral	15,784	16,930	17,278
IMF	-	-	-
Trade Credit	5,326	4,980	4,680
Commercial Borr.	25,560	27,024	22,101
NRI Deposits (>1yr)	35,134	32,743	31,216
Rupee Debt	2,031	2,301	2,721
Total Long Term	116,393	1,15,680	1,07,284
Short Term (<1yr)	8,788	7,524	4,431
Total Debt	125,181	1,23,204	1,11,715

Total External Debt of Developing Countries

$ billions	2002	2003
All Developing Countries	2336.6	2554.1
Argentina	150.0	166.2
Brazil	228.6	235.4
China	168.3	193.6
India	106.3	113.5
Indonesia	131.8	134.4
Mexico	140.2	140.0
Poland	78.5	95.2
Russian Federation	147.4	175.3
Turkey	131.2	145.7
External Debt of All Developing Countries in 2004: $ 2597.1 billion		

International Investment Position of India

A. Assets	*31/3/2004*	*31/3/2003*	*31/3/1997*
1. Direct Investment Abroad	6,592	5,054	617
2. Portfolio Investment	731	709	282
2.1 Equity Securities	396	374	172
2.2 Debt Securities	335	335	110
3. Other Investments	15,697	12,878	10,097
3.1 Trade credits	1,251	1,097	973
3.2 Loans	1,758	1,412	548
3.3 Currency & deposits	9,548	7,517	5,287
3.4 Other assets	3,139	2,853	3,288
4. Reserve Assets	112,959	76,100	26,714
Total Foreign Assets	**135,979**	**94,741**	**37,710**
Of which: Banks	11,442	9,158	7,271

International Investment Position of India

B. Liabilities	*31/3/2004*	*31/3/2003*	*31/3/1997*
1. Direct Investment in India	38,678	30,827	10,630
2. Portfolio Investment	43,856	32,410	18,744
2.1 Equity Securities	33,954	20,089	13,631
2.2 Debt Securities	9,902	12,321	5,113
3. Other Investments	102,044	92,146	89,388
3.1 Trade credits	6,497	4,761	5,698
3.2 Loans	62,622	61,103	67,743
3.3 Currency & deposits	32,136	25,569	15,300
3.4 Other Liabilities	789	714	646
Total Foreign Liabilities	**184,576**	**155,383**	**118,762**
Of which: Banks	39,109	36,864	18,383
C. Net Foreign Liabilities (B-A)	**48,597**	**60,642**	**81,052**
Of which: Banks	27,667	27,706	11,112