April 2019

CNK & Associates LLP

Quarterly Insights

This issue

FEMA P.1
RBI P.7

In brief

The e-commerce entity now cannot influence the price of the products and it cannot exercise control over the over the inventory i.e. goods purported to be sold

Foreign Exchange Management Act, 1999 (FEMA)

Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Amendment) Regulations, 2019, vide Notification No. FEMA.20(R) (6)/2019-RB

The Reserve Bank of India(RBI) has vide its above notification dated 1st February, 2019, bought about key changes to the E-commerce sector:

KEY CHANGES

a) E-commerce entity providing a marketplace will not exercise ownership or control over the inventory i.e. goods purported to be sold.
b) If more than 25% of the purchases of the vendor is by e-commerce entity or its group companies, it will deemed to be controlled by e-commerce marketplace entity making it an inventory based model.
c) An entity having equity participation by e-commerce marketplace entity or its group companies or having control on its inventory by e-commerce marketplace entity or its group companies, then such entity will not be permitted to sell its products on the e-commerce platform.
d) E-commerce entities providing marketplace will not influence the sale price of any goods or services, directly or indirectly, and shall maintain level playing field.
e) E-commerce marketplace entity shall not mandate any seller to sell any of their product exclusively on its platform.

In brief

Prior approval from RBI / Central Government is required for foreign entities establishing Branch Office (BO) / Liaison Office (LO) / Project Office (PO) or any other place of business in India for engaging in FCRA activities.

VRR is a new channel of investment available to FPIs to encourage them to invest in debt markets in India over and above their investments through the regular route.

Key Definitions

Establishment of Branch Office (BO) / Liaison Office (LO) / Project Office (PO) or any other place of business in India by foreign entities, vide RBI/2018-19/132 A.P. (DIR Series) Circular No. 20

a) The RBI vide its above Circular No. 20 dated February 27th 2019 in order to regulate the activities of Non-Government Organization, Non-Profit Organization, Body/Agency/Department of a Foreign Government intending opening a branch office or a liaison office or a project office or any other place of business in India, with the object of engaging, partly or wholly, in any of the activities covered under Foreign Contribution (Regulation) Act, 2010 (FCRA).

Such entities will apart from obtaining a certificate of registration under the said Act, will require prior approval from RBI in consultation with the Government of India and shall not seek permission under FEMA 22(R).

Voluntary Retention Route (VRR) for Foreign Portfolio Investors (FPIs) investment in debt, vide RBI/2018-19/135 A.P. (DIR Series) Circular No. 21 and RBI/2018-19/136 A .P. (DIR Series) Circular No. 22 dated 1st March 2019.

a) The RBI vide its above Circular No. 21 dated 1st March 2019 with a view to attract long-term and stable FPI investments into debt markets while providing operational flexibility to FPIs to manage their investments, the RBI, in consultation with the Government of India and the Securities and Exchange Board of India (SEBI), has introduced a separate channel, called the VRR Scheme.
The said VRR scheme will be free of the macro-prudential and other regulatory norms applicable to FPI investments in debt markets, and will be open from 11thMarch, 2019 until end-April.

For Details of the VRR scheme please click on below link:

https://rbi.org.in/Scripts/NotificationUser.aspx?Id=11492&Mode=0

External Commercial Borrowings, vide RBI/2018-19/109 A.P. (DIR Series) Circular No. 17 dated 16th January, 2019

As part of the Central government's aim to improve ease of doing business in India, the RBI on 16th January, 2019 notified a new external commercial borrowings framework (New ECB Framework).

KEY AMMENDED DEFINITIONS

Insertion of following definitions for the New ECB Framework:

- ECB means borrowing by an eligible resident entity from outside India in accordance with the framework decided by RBI

In brief

The track I,II & III has been merged into. 'Foreign Currency Denominated and 'Rupee Denominated ECB.

The definition of eligible borrowers has been expanded to include all entities eligible to receive FDI.

The reduction in Minimum average maturity period to 3 years for eligible borrowers.

The List of Recognized lenders is expanded

A uniform all-in-cost benchmark rate (6 months LIBOR) plus 450 basis points

- External Commercial Lending (ECL) means lending by a person resident in India to a borrower outside India in accordance with the framework decided by RBI
- The definition of Indian Entity is amended to now include Limited Liability Partnership incorporated under the Limited Liability Partnership Act, 2008 (LLP) and excluded a Partnership Firm formed under the Partnership Act, 1932.

KEY CHANGES

a) Merging of Tracks
   - The New ECB Framework has collapsed the tracks into two options i.e. Tracks I and II are merged as 'Foreign Currency Denominated ECB' and Track III and the Masala Bonds are merged as 'Rupee Denominated ECB'.

b) Expanded list of Eligible Borrowers- All entities eligible to receive foreign direct investment can now borrow under the New ECB Framework irrespective of the type of ECB.

c) Uniform Average Maturity Period-Uniform MAMP of 3 years across all forms of ECB. With following Exceptions:
   - Manufacturing sector companies can raise ECB with MAMP of 1 year for ECB up to USD 50 million in a financial year.
   - ECBs raised from foreign equity holders and utilized for working capital purposes, general corporate purposes or repayment of Rupee loans, must have MAMP of 5 years.

d) Expanded List of Recognized lenders to include:
   - lenders who are resident of an FATF or IOSCO compliant country;
   - Multilateral and Regional Financial Institutions where India is a member country;
   - individuals if they are foreign equity holders or subscribing to bonds listed abroad;
   - foreign branches/subsidiaries of Indian banks only for Foreign Currency Denominated ECB (except FCCBs and FCEBs).

e) All-in-Cost-Ceiling-The New ECB Framework continues to provide for a uniform all-in-cost of benchmark rate (6 months LIBOR or 6-month interbank interest rate of borrowed currency) plus 450 basis points excluding prepayment charges/fees from the all-in-cost ceiling. However, unlike the Old ECB Framework, the new framework now provides for a cap of 2% over and above the contracted rate of interest on the outstanding principal amount in relation to prepayment charges for ECB.

In brief

The scope of negative list has also been expanded

Eligible borrowers can raise ECBs up to USD 750 million in a financial year

Reduction in mandatory hedging requirement from 100% to 70% for 'infrastructure space companies'

The new framework has also introduced a late submission fee for delay in reporting of the drawdown of ECB proceeds before obtaining the LRN or delay in submission of Form ECB.

f) End use for refinancing of domestic Rupee loans is permitted only if the ECB is from foreign equity holders with a MAMP of 5 years.

g) Negative list - The negative list, for which the ECB proceeds cannot be utilized, would include the following:
- Real estate activities.
- Investment in capital market.
- Equity investment
- Working capital purposes except from foreign equity holder.
- General corporate purposes except from foreign equity holder.
- Repayment of Rupee loans except from foreign equity holder. **
- On-lending to entities for the above activities

**ECB proceeds cannot be utilized for repayment of domestic Rupee loans, except when the ECB is availed from a Foreign Equity Holder as defined in the aforesaid framework.

h) Uniform Individual Limits
- All eligible borrowers can raise ECBs up to USD 750 million in a financial year under the automatic route.
- A rule-based dynamic limit of 6.5% of the GDP at current market prices for outstanding stock of ECBs has also been announced through a RBI circular dated 20 December 2018. Details of how such dynamic limits will be implemented are awaited.

i) Reduced Hedging Requirements
- Reduction in mandatory hedging requirement from 100% to 70% for 'infrastructure space companies', 'NBFCs' inter alia includes companies in the infrastructure sector and non-banking finance companies undertaking infrastructure financing under the foreign denominated ECB track.

j) Late Submission Fee (LSF) for delay in Reporting:
- Any borrower, who is otherwise in compliance of ECB guidelines, except for a delay in reporting drawdown of ECB proceeds before obtaining LRN or Form ECB 2 returns, can regularize the delay by payment of a late submission fee, as prescribed.
- However, Form ECB and Form ECB 2 returns reporting contraventions will be treated separately. Non-payment of LSF will be treated as a contravention of reporting provision and shall be subject to compounding or adjudication provisions under FEMA.

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In brief

The new framework is a step forward in the feat to improve the ease of doing business in India and providing a regulated inflow of money in the market.

When the guarantee is invoked, the non-resident guarantor is required to meet the liability

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Trade Credit (TC) refers to the credits extended by the overseas supplier, bank /financial institution for imports into India in accordance with the Trade Credit framework decided by the RBI in consultation with the GOI

k) Standard Operating Procedure (SOP) for Untraceable Entities
- The New ECB Framework introduces a new concept of 'SOP for Untraceable Entities' which provides the action plan to be undertaken by the RBI against untraceable entities who are in contravention of reporting provisions under the New ECB Framework, for eight quarters or more.

l) ECB by Entities under Restructuring
- Entities under a restructuring scheme/corporate insolvency resolution process can raise ECBs only if specifically permitted under the resolution plan.

m) The Revised ECB Framework provides clarity and simplifies borrowing and lending in foreign exchange and Indian Rupee. Now even LLPs, are eligible to raise ECB. Further, restriction on related party to subscribe/invest in RDBs has been done away with.
These changes will improve ease of doing business in India.

n) Structured Obligations for Non-resident giving guarantee for domestic fund based and non-fund based facilities: When the guarantee is invoked, the non-resident guarantor is required to meet the liability under the guarantee by:
- payment out of rupee balances held in India
- by remitting the funds to India
- by debit to FCNR(B)/NRE account maintained with an AD bank in India.

In such cases, the non-resident guarantor may enforce his claim against the resident borrower to recover the amount
In cases where the liability is met by the non-resident out of funds remitted to India or by debit to his FCNR(B)/NRE account, the repayment may be made by credit to the FCNR(B)/NRE/NRO account of the guarantor.

Trade Credit Policy – Revised framework, 2019, vide RBI/2018-2019/140 A.P. (DIR Series) Circular No. 23 dated March 13th, 2019

The highlights of Revised framework Trade Credit (TC) is as under:
- Two Types of Trade Credit (TC) (Regocgnised Lenders)
  1. Suppliers' credit i.e.Supplier of goods located outside India.
  2. Buyers' credit i.e.Banks, financial institutions, foreign equity holder(s) located outside India and financial institutions in International Financial Services Centres located in India.

- Person resident in India and acting as an importer are considered as 'Eligible borrower'

- The limts of TC under automatic route for oil/gas refining & marketing, airline and shipping companies is USD 150 million or equivalent per import transaction. For others, its up to USD 50 million or equivalent per import transaction.

- Period of TC is to be reckoned from the date of shipment, and shall be up to three years for date of import of capital goods. For non-capital goods, this period shall be up to one year or the operating cycle whichever is less. For shipyards / shipbuilders, the period of TC for import of non-capital goods can be up to three years.

- All-in-cost ceiling per annum-Benchmark rate plus 250 bps spread.

- The exchange rate and hedging provisions are same as the ECB framework

- TC can be also be raised by a unit or a developer in a Special Economic Zone(SEZ) including Foreign Free Trade Warehousing Zone(FTWZ) for purchase of non-capital and capital goods within an SEZ including FTWZ.

Reserve Bank of India (RBI)

In brief

RBI defers implementation of Ind AS till further notice as the legislative amendments recommended by the RBI are under consideration of the Government.

Some banks, on account of low or negative net profit after tax, are required to disclose divergences even where the additional provisioning assessed by RBI is small, which is contrary to the regulatory intent that only material divergences should be disclosed. Hence, RBI has laid down conditions for disclosure of divergences

RBI defers implementation of Ind AS till further notice

RBI vide its circular dated 11th February 2016 had mentioned that Scheduled Commercial Banks (SCBs), excluding Regional Rural Banks (RRBs), were required to implement Indian Ind AS from 1st April 2018.

However, RBI vide a press release dated 5th April 2018, deferred the implementation of Ind AS by 1 year i.e. 2019-20. Implementation of Ind AS was deferred by 1 year pending necessary legislative amendments to the Banking Regulation Act, 1949 as also the level of preparedness of many banks.

Vide its notification dated 22nd March 2019, RBI has decided to defer the implementation of Ind AS till further notice as the legislative amendments recommended by the RBI are under consideration of the Government of India.

Disclosure in the 'Notes to Accounts' to the Financial Statements- Divergence in the asset classification and provisioning.

Notification No. RBI/2016-17/283 dated 18th April 2017 required disclosures by banks where divergences from prudential norms on income recognition, asset classification and provisioning exceed certain thresholds. These disclosures were to be made in the Notes to Accounts under the sub-head Asset Quality (Non-Performing Assets) in the Financial Statements (FS).

Some banks, on account of low or negative net profit after tax, are required to disclose divergences even where the additional provisioning assessed by RBI is small, which is contrary to the regulatory intent that only material divergences should be disclosed. As a result the RBI has decided that henceforth, banks should disclose divergences, if either or both of the following conditions are satisfied:

- the additional provisioning for NPAs assessed by RBI exceeds 10% of the reported profit before provisions and contingencies for the reference period, and
- the additional Gross NPAs identified by RBI exceed 15% of the published incremental Gross NPAs for the reference period.

In brief

Miscellaneosues notifications

The following miscellaneosues notifications have been also been issued by the RBI:

1. The format of Form-A2 has been revised for capturing the required country code of ultimate exporter/importer videA.P. (DIR Series) Circular No. 25 dated 20th March, 2019.

2. In order to avoid circulation of old currency it has now been decided that an individual travelling from India to Nepal or Bhutan may carry RBI currency notes in Mahatma Gandhi (New) Series of denominations Rs. 200/- and/or Rs. 500/- subject to a total limit of Rs. 25,000/- vide A.P. (DIR Series) Circular No. 24 dated 20th March, 2019.

3. The RBI/ has vide its A.P.(DIR Series) Circular No.28 dated 28th March, 2019 has now allowed:
    - FPI's registered with the SEBI to open non-interest bearing foreign currency account for the purpose of making investment in accordance with the Foreign Exchange Management.
    - Citizen of Bangladesh or Pakistan, belonging to minority communities in those countries, namely Hindus, Sikhs, Buddhists, Jains, Parsis and Christians, residing in India and who has been granted a Long Term Visa LTV by the Central Government to open one NRO Account.
    - SNRR accountcan now be opened for period of more than seven years subject to RBI approval.

Key Take Away

- In line with the government's continuing objective of ease of doing business in India, and to rationalize the existing FEMA regulations in Indian debt market, the RBI has introduced the new ECB Framework, by simplifying the existing ECB regulation.
- The VRR Scheme has also been introduced by RBI, to bring operational flexibility to FPI's in Indian debt market and to attract foreign investments.
- The deferral of Ind AS will bring huge relief to the banks which are still to recognise stressed assets and make necessary provisions as that would require higher capital. The new accounting standards would require banks to make provisions when they judge that a loan is likely to turn bad , rather than waiting for the borrower to start missing payments. However, this will have an impact when financial statements have to be compared with their global counter parts

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