Foreign Currency Convertible Bond - FCCB

Meaning

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. A convertible bond is a mix between a debt and equity instrument. It acts like a bond by making regular coupon and principal payments, but these bonds also give the bondholder the option to convert the bond into stock.

Popularity

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. (Bondholders take advantage of this appreciation by means warrants attached to the bonds, which are activated when the price of the stock reaches a certain point.) Due to the equity side of the bond, which adds value, the coupon payments on the bond are lower for the company, thereby reducing its debt-financing costs.

Advantages of FCCB

1.Flexibility to Convert: The convertible bond gives the flexibility to convert the bond into equity at a price or redeem if price has not met the expectation.

2.Delayed dilution of equity : Companies prefer bonds as it lead to delayed dilution of equity and allows company to avoid any current dilution in earning per share that a further issuance of equity would cause.

3.Easily Mmarketable: FCCBs are easily marketable as investors enjoys option of conversion into equity if resulting to capital appreciation + investor is also assured of minimum fixed interest earnings.

Disadvantages of FCCBs

1.Exchange risk: Exchange risk is more in FCCBs as interest on bonds would be payable in foreign currency .That`s the reason that company with low debt equity with large forex earning potential opt for FCCBs.

2.Creation of more debt: If company opt for FCCBs, there is not only the payment of interest but a forex outgo is also attached to it.

Requirement as prescribed by several provision of Companies Act 1956

FCCBs are bonds issued by an Indian company or any body corporate expressed in foreign currency to non-resident investors, which fall within purview of the definition of Debentures[as per sec 2(12) of companies act 1956], and therefore the process for issue of debentures shall be applicable to the issue of FCCBs.

A. Prior intimation to be given to the Stock Exchange by the issuer company listed at the Stock Exchange, at least 7 days before the date of Board meeting in which the FCCB issue is to be considered.[clause 19(a) of listing agreement]

B. Power to issue FCCBs vests with the Board of Directors of the issuer Company who are obligated to pass a Board resolution pertaining to the issue of FCCBs.[sec - 292 of companies act 1956]

C. Convening a General Shareholders Meeting for procuring the shareholders consent with regard to the enhancement of borrowing powers of the Board,[**Section 293(1)(d) of the Companies Act, 1956**] acquiring authorization for creating mortgage in case of issue of secured FCCBs[**Section 293(1)(a) of the Companies Act, 1956**] or obtaining shareholders approval on the further issue of the capital by way of FCCB issue, without making an offer to the existing shareholders of the company by a Special Resolution[**Section 81 (1 A) of the Companies Act, 1956**].

D. It is mandatory upon the companies intending to make public issue of FCCBs, to constitute a Trust Deed[**Section 117A of the Companies Act, 1956**] for the bonds, to appoint a Trustee[**Section 117B of the Companies Act, 1956**] for the bondholders and to create a redemption reserve account[**Section 117C of the Companies Act, 1956**] respectively as the Company issues these Bonds to the foreign investors in accordance with the provisions of the Trust Deed.

Role of SEBI pre issue and post issue requirement & conditions to be fulfilled by the Issuer company

- ✓ An application for listing of the Bonds has to be made to the stock exchange of the country where the FCCBs are to be issued and traded i.e. international stock exchange.
- ✓ ‘In-principal’ approval has to be obtained from the Indian Stock exchange to list the shares issued upon conversion of bonds, when the bondholder exercises the convertibility option.
- ✓ Filing the Offer Document[Securities and Exchange Board of India (disclosure and investor protection) guidelines, 2000](Offering Circular) with Securities Exchange Board of India, Reserve Bank of India and stock exchanges prior to FCCB issue[*].

* Filing of information with the RBI within 30 days from the issue date including total amount of the Bonds issued, names of the investors resident outside India and the amount

repatriated to India supported by Foreign Inward Remittance Certificates as provided by Notification FEMA No. 120 i.e. The Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004, under Part III - Investments in Foreign Securities other than by way of Direct Investment.

RBI Regulatory Framework

The Government of India considers the funds raised through the FCCB issue as Foreign Direct Investment (FDI).The latest comprehensive RBI guidelines on FCCB are contained in the July 1st, 2008 Master Circular[RBI/Master Circular No. /07 /2008-09 -- Master Circular on External Commercial Borrowings and Trade Credits] on External Commercial Borrowings and Trade Credits that provides the Scheme and Policy to be followed by the issuers of FCCB's as the circular itself very distinctly provides that the Policy laid down for the External Commercial Borrowings are likewise applicable to the issue of FCCBs.

1. The ECB Master Circular lays down those borrowing funds through FCCB issue can be accessed under two routes

(i) FCCBs Issue up to US $ 500 million under the Automatic Route

(ii) FCCBs Issue beyond US $ 500 million with the specific approval of the Reserve Bank i.e. under the Approval Route.

2. The Circular makes available the Eligibility criteria on the numerous kinds of entities & individuals for borrowing and lending during the FCCB issue under the Automatic Route.

Eligibility of the Issuer:
i. Indian Corporates except financial intermediaries such as banks, FIs, NBFCs.
ii. NGOs engaged in micro finance activities.
iii. Individuals, Non Profit making organizations and trusts are not eligible.

Eligibility of the Subscriber:
i. International Capital markets.
ii. International banks.
iii. Multilateral Financial Institutions.
iv. Export credit agencies.
v. Suppliers of equipment.
vi. Foreign collaborator.
vii. Foreign equity holder, subject to

- ✓ minimum holding of equity of 25% in the borrower's company for raising ECB up to USD 5 million;
- ✓ minimum holding of equity of 25% in the borrower's company and a debt equity ratio of not more than 4:1, for raising ECB above USD 5 million.

viii Overseas organizations & individuals (lend to NGO's in micro-finance activities).

3. FCCB issue proceeds need to conform with the 'End-Use' conditions as prescribed by RBI in the above-mentioned ECB Master circular:

Permitted End Use

Ø Investment in 'real-industrial' sector including SMEs and infrastructure sector through expansion, modernization, import of capital goods, new projects etc.
Ø Overseas Direct Investment in joint ventures / wholly owned subsidiaries.
Ø 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 PSUs
Ø 25 % of the FCCB proceeds can be used for general corporate restructuring.

'Prohibited End Use'

Ø Investment in real estate excluding integrated townships.
Ø On-lending.
Ø Investment in capital markets.
Ø Acquisitions.
Ø As working capital.
Ø For general corporate purposes.
Ø For Repayment of Rupee Loans.