RBI Eases Hedging Norms for External Commercial Borrowings

The Reserve Bank relaxed norms for external commercial borrowings (ECBs) by reducing the mandatory hedging provision to 70% from the current 100%.

- The **cost of hedging has gone up** in the last six months with the strengthening of the dollar. As a result, the ECB route was becoming unattractive to firms.
- The move will help **bring down the final cost of overseas loans** for Indian firms but could leave them more exposed to volatility in the foreign exchange markets.
- The relaxed norms will apply to the ECBs with a maturity period between 3 and 5 years.

Background

- The push to increase hedging began after the global financial crisis, where unhedged foreign currency exposures led to significant losses for some firms.
- Following that experience, the RBI mandated 100% hedging for medium-term external borrowings. It also asked banks to set aside additional provisions against companies which had unhedged foreign currency exposure.

Hedging

- Hedging is a financial technique that helps to **reduce or mitigate the effects of measurable type of risk** from the future changes in the fair value of commodities, cash flows, securities, currencies, assets and liabilities.
- It is a **kind of an insurance** that do not eliminate the risk completely but mitigate its effect.
- It consists of the purchase or sale of equal quantities of the same or very similar commodities, approximately simultaneously, in two different markets with the expectation that a future change in price in one market will be offset by an opposite change in the other market.

External Commercial Borrowings

- External Commercial Borrowings is a **loan availed by an Indian entity** from a nonresident lender with a **minimum average maturity of 3 years.**
- Most of these loans are provided by foreign commercial banks buyers’ credit, suppliers’ credit, securitized instruments such as Floating Rate Notes and Fixed Rate Bonds etc.
- Advantages of ECBs:
    - ECBs provide **opportunity to borrow large volume** of funds.
    - The funds are available for **relatively long term.**
    - **Interest rate are also lower** compared to domestic funds.
    - ECBs are in the **form of foreign currencies.** Hence, they enable the corporate to have foreign currency to meet the import of machineries etc.
    - Corporate can raise ECBs from internationally recognized sources such as banks, export credit agencies, international capital markets etc.