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COMPLIANCE CHALLENGES IN EXTERNAL COMMERCIAL BORROWINGS UNDER FEMA: A CRITICAL ANALYSIS

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1. INTRODUCTION

Indian enterprises have raised funds through the financial markets, through the process of increasing integration of financial markets. External Commercial Borrowings (ECBs) is one such channel in the field of cross-border finance, which allows for borrowing from non-resident lenders for various purposes by qualified Indian entities. The distinction between FDI and ECB is that the latter are debt, which means there are contractual repayment obligations and foreign exchange risks, unlike equity and ownership investment which is foreign direct investment. ECBs have become a popular means of financing long-term projects for corporations in India, especially those facing high upfront capital expenses, due to their comparatively low-interest rates and longer repayment periods.

The extent of external borrowing and the foreign exchange position of the country, the condition of external debt and the macroeconomic stability of the country make ECBs a subject of a detailed regulatory regime as per Foreign Exchange Management Act, 1999 (FEMA) and regulations/directions issued by Reserve Bank of India (RBI). The regulatory provisions go beyond the simple aspects of a business transaction to attempt to strike a balance between facilitating access to foreign capital and implementing prudential safeguards, including requiring conditions on eligible borrowers and lenders, end-uses, maturity periods, borrowing costs, reporting requirements, and regulatory oversight.

Notwithstanding the liberalisation of ECB framework, compliance with regulations is still cumbersome due to new directions issued by the RBI, heavy disclosures and stringent operating conditions for cross border borrowings. In this background the present article critically reviews the legal regime applicable to ECBs under FEMA, and examines the key compliance issues of the borrowers, and whether the existing legal regime is able to balance the aims of encouraging foreign capital inflows with the need to maintain financial and exchange rate stability.

2. REGULATORY FRAMEWORK GOVERNING ECB

External Commercial Borrowings is largely governed by the Foreign Exchange Management Act, 1999[1] – the main statute governing capital account transactions with the outside world in India. FEMA had been enacted with the aim of liberalizing the foreign exchange regime that had been in operation earlier and facilitating foreign trade and payments, and had replaced it with a regulatory and management approach instead of a control approach. The ECB transactions are classified as capital account transactions as they involve borrowing from persons outside India as per the provisions of the Act.

The statutory powers for regulating ECBs are vested in the Reserve Bank of India pursuant to S. 6[2] of FEMA, which gives the RBI the power to regulate capital account transactions and determine the classes of transactions which may be carried out under the regulations and conditions. In exercise of this power, the RBI had enacted the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018[3] which are the main subordinate laws that define borrowing and lending arrangements between persons resident in India and persons resident outside India. The Regulations provide the definition of "External Commercial Borrowings", which are borrowings that are taken by "eligible borrowers" from "recognised lenders" and specify the framework within which such borrowings are allowed and the legal parameters that are applicable. In addition, FEMA sets up the institutional structure for implementation and enforcement of the ECB regime.

S. 10[4] gives permission to banks and other entities to be Authorised Dealers in foreign exchange and S. 11[5] empowers the RBI to give directions to any Authorised Dealer, which have binding effect on them, in relation to foreign exchange transactions. As such, the Authorised Dealer Category-I Banks play a pivotal role in processing ECB transactions, upholding regulatory compliance and monitoring reporting requirements as outlined in the RBI framework.

The RBI Master Direction – External Commercial Borrowings, Trade Credits and Structured Obligations provides for a set of guidelines which supplements the statutory framework related to ECB transactions. The Master Direction sets out the regulatory framework on eligible borrowers, recognised lenders, currencies, borrowing limit, minimum average maturity periods, all in cost ceiling, end use restriction, creation of security, reporting requirement and the role of the Authorised Dealer banks. The Master Direction is a living document and is updated periodically in RBI circulars to keep pace with the changing economic and financial landscape, thereby providing the key to the implementation of the ECB Framework. The law further is supported by the enforcement mechanisms within FEMA.

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[1] Foreign Exchange Management Act, 1999, No. 42, Acts of Parliament, 1999 (India).
[2] Foreign Exchange Management Act, 1999, § 6, No. 42, Acts of Parliament, 1999 (India).
[3] Foreign Exchange Management (Borrowing and Lending) Regulations, 2018, Gazette of India, pt. III sec. 4 (India).
[4] Foreign Exchange Management Act, 1999, § 10, No. 42, Acts of Parliament, 1999 (India).
[5] Foreign Exchange Management Act, 1999, §11, No. 42, Acts of Parliament, 1999 (India).

S. 13[6] prescribes penalties for contraventions of FEMA and its regulations and S. 15[7] provides for compounding of specified contraventions for purposes of voluntary compliance. Further, S. 42[8] holds companies and individuals accountable for the actions of their businesses where contraventions are made by the business. These measures create a robust legal toolkit that allows Indian parties to secure foreign funding but also imposes ongoing regulatory oversight and enforcement of such loans, which is the core of the compliance obligations discussed in the next chapter.

3. COMPLIANCE AND FRAMEWORK CHALLENGES

3.1 Eligibility and borrowing conditions: ECB Framework

The Foreign Exchange Management Act, 1999 provides for the External Commercial Borrowing (ECB) mechanism which is regulated in nature, and allows access to external borrowing for overseas loans, provided certain statutory and regulatory requirements are met. The power to regulate ECBs is vested in the authority under S. 6[9] of FEMA which has been exercised by the Reserve Bank of India (RBI) in the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 and further supplemented by the Master Direction on External Commercial Borrowings, Trade Credits and Structured Obligations. These, in combination, regulate the legal framework for who can be a borrower and who can be a lender, the terms of the borrowed and the use of the borrowed money.

Persons, resident in India, other than individuals, incorporated or established under a Central or State law, are permitted to raise ECBs as per Schedule I to the Regulations, 2018 which is in accordance with the relevant statutory provisions. Borrowers who have been restructured or brought under FEMA proceedings could also avail ECB provided they make the necessary disclosure in the prescribed forms as mandated by the approved restructuring plan or FEMA proceedings. Similarly, the Regulations include the recognition of persons resident outside India, overseas branches of regulated financial institutions and institutions operating in the International Financial Services Centres as recognised lenders, thereby ensuring that the borrowings come from the regulated lenders.

The framework also specifies substantive borrowing conditions that are supposed to ensure financial stability. The ECBs can be issued in foreign currency or in Indian Rupees and the norms of borrowing, minimum average maturity periods and market based all-in-cost norms, along with the arm's length principle in related party transactions, apply to ECBs. The borrowers are able to avail loan proceeds after availing Loan Registration Number (LRN) from the designated Authorised Dealer Category-I Bank. Apart from this, the Regulations also restrict the use of borrowed money for certain activities such as chit funds, nidhi

[6] Foreign Exchange Management Act, 1999, § 13, No. 42, Acts of Parliament, 1999 (India).
[7] Foreign Exchange Management Act, 1999, § 15, No. 42, Acts of Parliament, 1999 (India).
[8] Foreign Exchange Management Act, 1999, § 42, No. 42, Acts of Parliament, 1999 (India).
[9] *Supra* note 2.

companies, certain specified real estate activities, repayment of domestic loans and other specific end uses.

Together, these conditions indicate that the ECB framework does not only govern the 'borrowing transaction' but the 'overseas borrowing process' as a whole. These measures provide for the prudent regulation and orderly handling of foreign exchange but also create a comprehensive compliance framework that must be monitored on an on-going basis by borrowers and authorised dealers as well.

3.2 Operational Compliance Challenges

While the ECB framework aims to ensure ease of access to international capital for the Indian markets, it crucially depends on the continuous compliance of the market with its norms. The framework contains obligations more stringent than those of the implementation of the borrowing agreement, with the requirement for borrowers to meet eligibility criteria, follow borrowing parameters, comply with end-use restrictions and observe a wide range of reporting requirements during the term of the loan.

As a result, one of the biggest practical difficulties with the FEMA regime has been compliance. One of the key issues is the complexity of eligibility and borrowing requirements. The constant challenge for borrowers will be to continuously ensure compliance with regulatory requirements regarding recognised lenders, borrowing limits, minimum average maturity periods, all in costs ceilings and permissible borrowing structures. Failure to comply with these prescribed conditions may lead to regulatory contraventions even if the underlying commercial transaction may be valid. Further procedural burden is being imposed on the requirement for obtaining Loan Registration Number prior to drawdown of funds and transactions to be routed through a designated Authorised Dealer Category-I Bank. Strict end-use restrictions and reporting requirements make compliance difficult. The borrower is required to implement its own internal controls to ensure that proceeds from the ECB are spent for the purposes of the loan and to keep records that can be presented to regulators if they conduct an audit. At the same time, the banks called Authorised Dealer have to ensure adherence to RBI guidelines before doing the transactions, thereby creating a significant reliance on regulatory interpretation exercised by the banks. However, there are discrepancies in documentation and compliance procedures between Authorised Dealers, which often lead to delays and higher transaction fees. Another big hurdle is the constantly evolving nature of the regulatory environment of the RBI.

The RBI periodically updates it with RBI circulars in response to economic changes and hence borrowers need to keep an eye on regulatory changes impacting the borrowing rates, reporting requirements, and operational requirements. While regular amendments are a key part of responding to the market, they do lead to uncertainty and put additional pressure on compliance, especially for those with long-term borrowings over successive regulatory changes.

Thus, the main compliance problem with the ECB framework is not getting finance from abroad, but helping to keep conforming with an evolving regulatory regime. The complexity of the procedures highlights the importance of enhancing the transparency, implementation and streamlining of compliance processes, whilst maintaining the goals of foreign exchange management.

3.3 Reporting Challenges under the ECB Framework

The External Commercial Borrowing (ECB) regime is known for its comprehensive reporting requirements, which enable continuous monitoring of cross-border borrowings by regulatory authorities. Whilst reporting requirements may be different from eligibility or even the terms of the loan, it remains a separate compliance requirement under the Foreign Exchange Management Act, 1999, which is in force during the entire period of ECB. Thus, it is possible for procedural failures in reporting to result in regulatory consequences regardless of the validity of the underlying borrowing transaction.

The reporting process starts from the assigning of a Loan Registration Number by the designated Authorised Dealer (AD) Category-I Bank, which is required to be obtained before one can draw the ECB proceeds. Thereafter, borrowers will have to make statutory returns on monthly basis in Form ECB 1, Revised Form ECB 1 and Form ECB 2 so that the Reserve Bank of India (RBI) can keep a check on drawdowns and repayment, among other transactions related to borrowing. The reporting framework had been significantly amended by A.P. (DIR Series) Circular No. 23[10] dated 18 February 2026, Reporting under Foreign Exchange Management Act, 1999 – Returns relating to External Commercial Borrowing (ECB) (Prescribed Forms of Reporting) which replaced the existing reporting formats to be consistent with the Foreign Exchange Management (Borrowing and Lending) (First Amendment) Regulations, 2026.

Further, Form ECB 1 and Revised Form ECB 1 were prescribed as non-flow returns and LSF under the compliance framework was to be paid on delayed returns of Form ECB 2 per Loan Registration Number (LRN) in A.P. (DIR Series) Circular No. 25[11] dated 30 March 2026, which also directed designated AD Category-I Banks to submit duly certified non-flow returns to RBI within seven calendar days of receipt and also passed on the responsibility of monitoring payments of applicable LSF to AD Category-I Banks.

A.P. (DIR Series) Circular No. 16[12] dated 30 September 2022, Late Submission Fee for Reporting Delays under the Foreign Exchange Management Act, 1999 has introduced uniform LSF mechanism across the FEMA reporting requirements and clarified that if the reporting defaults persist in the future, it will invite penal action under the FEMA. Together, these have made it clear that the reporting regime has transitioned from being a mere

[10] Reserve Bank of India, A.P.(DIR Series) RBI/2025-26/223, Circular No. 23 (Feb 18, 2026).
[11] Reserve Bank of India, A.P.(DIR Series) RBI/2025-26/253, Circular No. 25 (March 30, 2026).
[12] Reserve Bank of India, A.P.(DIR Series) RBI/2022-23/223, Circular No. 16 (Sep 30, 2026).

procedural requirement to a compliance requirement, and that continuous reporting is a part of the RBI's supervisory regime.

3.4 Recent developments in the regulatory landscape and new compliance trends

To adapt to the changing dynamics of international financial markets, the RBI has been progressively taking a risk responsive and dynamic approach to regulation of ECB by revising the framework of ECB from time to time. The reforms not only improve the financial stability of banks, but also increase the compliance requirements banks must meet for borrowers and Authorised Dealer Category-I Banks, on the other hand.

A major regulatory change was made in the form of A.P. (DIR Series) Circular No. 19[13] on the External Commercial Borrowings (ECB) and Trade Credits (TC) Policy – Changes due to LIBOR Transition. The Circular has also revoked the definition of the London Interbank Offered Rate (LIBOR) benchmark as the rate used for foreign currency ECB, and introduced a higher borrowing cost ceiling for new ECB borrowings that will be linked to widely used Alternative Reference Rates (ARRs) or other recognised interbank rates, and included a one-time adjustment for the existing borrowings of foreign currency ECBs to make the transition orderly. The amendments brought the Indian ECB framework in line with the latest international best practices and kept the disruption to existing borrowing arrangements to a minimum.

Additionally, the foreign currency borrowing regime was bolstered with the introduction of a Forex Swap Facility for the ECBs raised by specified Public Sector Undertakings denominated in US Dollar–Rupee in FMOD, MAOG. No. S-57/01.06.016/2026-27 dated 8 June 2026. The facility will allow the eligible borrower to manage foreign exchange exposure by participating in swap facility arrangement with RBI without coming under the purview of the existing regulatory framework by the RBI for ECB.

The RBI issued A.P. (DIR Series) Circular No. 15[14] , Reporting of FCNR (B) Deposits, ECB and OFCB Mobilized under Reserve Bank's Swap Facility to make the implementation of the Swap Facility easy for the Authorised Dealer Category-I Banks to report the transaction-wise data of eligible ECBs on daily basis by the stipulated date and report NIL where no relevant transactions are made. The measures will continue the RBI's focus on real-time regulatory monitoring and on-going supervision. In tandem with these developments, the RBI has moved towards a dynamic and risk-based regulatory framework and the innovations are paralleled by an increased level of supervisory oversight and increasingly tougher compliance requirements for CBOs.

[13] Reserve Bank of India, A.P.(DIR Series) RBI/2021-22/135, Circular No. 19 (Dec 08, 2021).
[14] Reserve Bank of India, A.P.(DIR Series) RBI/2026-27/144, Circular No. 15 (June 19, 2026).

4. CRITICAL ANALYSIS

The ECB framework provided under the Foreign Exchange Management Act, 1999 is a carefully designed framework that strives to reconcile two conflicting goals: ease the availability of foreign capital and protect India's foreign exchange reserves and macroeconomic stability. RBI has over the years gradually eased the ECB regime by broadening the scope of borrowers, raising limits and synchronizing with global financial developments. However, the focus has become not just from regulatory approval to continuous compliance, it has also brought more burden to the borrower's procedure.

The current regime is well prudential, with the requirement for eligibility, end-use restrictions, reporting and periodic supervision. Such measures foster transparency and the proper management of external liabilities, but also impose compliance costs that are not merely part of the borrowing process itself, but additional costs. Frequent amendments in RBI circulars, extensive documentation requirements, and reliance on Authorised Dealer Category-I Banks for implementing the amendments can lead to a lot of uncertainty in operations and lack of uniformity in compliance practices. This liberalisation of borrowing norms may prove to be more challenging for smaller entities in particular to keep up with changing regulations.

With this in mind it is no longer access to foreign capital that is the main concern under the ECB framework, but compliance over the entire life cycle of the borrowing has become more complicated. This highlights the importance of keeping regulatory flexibility and legal certainty from unnecessarily obstructing legitimate commercial financing through prudential supervision.

5. SUGGESTIONS

There is a need to make the ECB framework more robust by implementing some changes that would ease the compliance process while not impacting on the prudential goals of FEMA. The primary need is more certainty in the applicable regulatory regimes in the form of a periodic consolidation of the RBI Master Direction and subsequent A.P. (DIR Series) Circulars into a new and comprehensive compliance regime. A single regulatory instrument would minimize ambiguity with interpretation and help borrowers to more easily see what obligations they have.

Secondly, the reporting requirements should be incentivised with a comprehensive digital compliance system with automated filing, validation and monitoring of statutory returns. This would help reduce the chances of errors in the procedures, better reporting and would cut down on the time delays that come with manual compliance processes. Improved documentation and verification standards across the Authorised Dealer Category-I Banks would enhance the uniformity in regulatory implementation and minimize transaction costs from different compliance standards.

Finally, regulatory changes should be risk based, with borrowers who have good compliance histories having more streamlined procedures for compliance, and more intense supervision for borrowers in risky transactions. This would be consistent with both regulatory principles of proportionality and efficient supervision and transparency relating to foreign exchange management. The ECB framework can continue to foster responsible utilisation of external finance while preserving external borrowing's stability and integrity, through a combination of regulatory flexibility and procedural certainty.

6. CONCLUSION

External Commercial Borrowings (ECB) are also a crucial source of cross-border financing to help Indian borrowers raise funds in foreign markets for long-term commercial and infrastructure needs. The legal framework under the Foreign Exchange Management Act, 1999, Borrowing and Lending Regulations, 2018 and the RBI's Master Direction provides a comprehensive regulatory structure for all aspects of the borrowing process, namely eligibility, utilization of funds, reporting obligations and regulatory supervision.

The analysis shows that the main problem with the ECB regime is not that finance cannot be sourced abroad but rather that compliance with the regulations becomes more complex. The extensive eligibility conditions, strict end-use requirements, changing reporting obligations and regular changes in regulations have put compliance on a continuous agenda and the need for ongoing legal and institutional follow-up. These measures are warranted by the necessity to protect the stability of foreign exchange and the prudent management of debt, but they also raise borrowing costs and uncertainty for borrowers.

For the ECB framework to remain effective, therefore, it will be important to find the right balance between effective regulation and ease of compliance. A clear, transparent and streamlined compliance process would help to improve the regulatory clarity, responsible cross-border borrowing and deepen India's developing foreign exchange management framework.