INFOLEX
NEWSALERT

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MASALA BONDS: ISSUING RUPEE DENOMINATED DEBT OVERSEAS

1. INTRODUCTION

Earlier this month, the Reserve Bank of India (the "**RBI**") published certain norms relating to the issuance of rupee denominated bonds (also commonly known as the *'masala'* bonds) in the overseas market ("**Rupee Bonds**"), pursuant to a circular dated June 7, 2017 (the "**Circular**").[1]

The Circular essentially tightens the commercial terms of issuance for Rupee Bonds. The RBI had prior to the Circular, issued a series of circulars allowing eligible resident corporates and/or body corporates[2] (including multilateral and regional financial institutions where India is a member country) to issue Rupee Bonds under India's external commercial borrowing policy (the "**ECB Policy**").[3]

Rupee Bonds are becoming an increasingly attractive source of financing for Indian issuers with several Rupee Bond financings recently launched to fund infrastructure and housing projects. The RBI has therefore published the Circular in an attempt to harmonise the commercial terms of Rupee Bonds with the ECB Policy.

2. REVISED SCOPE

2.1. Approval or notification?

Pursuant to the Circular, all proposals for issuing Rupee Bonds will now require *examination* by the RBI's foreign exchange department. Whether this means that formal consent or a no objection certificate needs to be issued by the RBI in connection with the proposed Rupee Bond issue is unclear.

2.2. Minimum Maturity Period

While the minimum maturity period for Rupee Bonds up to USD 50 million (equivalent in Indian Rupees) per fiscal year, remains 3 (three) years, the RBI has increased the maturity period for Rupee Bonds over USD 50 million (equivalent in Indian Rupees) per fiscal year to 5 (five) years.

2.3. All-in-Cost Ceiling

The Circular states that the all-in-cost ceiling for such bonds *will* be 300 basis points over the prevailing yield of Government securities of corresponding maturity. The language used in the Circular raises the question as to whether the all-in-cost will be fixed, or otherwise capped? The RBI will no doubt need to clarify this in the future. Previously, the all-in-cost ceiling was uncapped and determined by prevailing market conditions.

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[1] Available at: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10994&Mode=0

[2] Refer to paragraph 3 of the *"Master Direction - External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers"* updated as of November 15, 2016 available at https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10204#C48 accessed on February 17, 2017

[3] Available at https://rbi.org.in/Scripts/NotificationUser.aspx?Id=10049&Mode=0

2.4. Related Party

Further, while the list of eligible investors remains the same,[4] the RBI has clarified that such investors should not be *related parties* within the meaning of Indian accounting standard 24 ("**Accounting Standard 24**").

Broadly, Accounting Standard 24 states that a *related party* is a person or entity that is related to the entity that is preparing its financial statements which is usually referred to as the "**Reporting Entity**". A person or an entity is related if that person or entity: (a) has control or joint control of the Reporting Entity; (b) has significant influence over the Reporting Entity; or (c) is a member of the key management personnel of the Reporting Entity or of a parent of the Reporting Entity.

This means the issuer now has to be extremely cautious in issuing Rupee Bonds to overseas investors, making sure it does not trigger the *related party* issue.

IndusLaw View:

Rupee Bonds have gained momentum in the past year with the country's largest mortgage lender, HDFC Ltd, hitting the market first. The National Highways Authority of India too have sold such securities. Besides, non-banking finance and housing companies, including ECL Finance, Shriram Transport and Indiabulls Housing Finance, have also tapped (or are planning to tap) this market to raise money.

While the Circular provides some clarity for fund mobilization in overseas markets, it does potentially restrict the flexibility to access debt funding, essentially excluding subscribers who are group entities (and such lenders will need to revert to the normal ECB route). We should further point out that harmonizing the rules governing the issue of Rupee Bonds with the ECB Policy raises the question as to why there are two separate regimes in the first place.

Adding RBI *examination* for the proposed Rupee Bond issue will raise further questions as to whether a formal consent or no objection is required in order to consummate the fund raising and if so, likely add to the complexity and the timeline for accessing foreign capital markets.

Historically, the RBI has been wary of relaxing norms governing the ability of Indian corporates to access foreign debt markets for a number of reasons: the rush to access cheaper foreign funds and its potential inflationary consequences; and foreign investors holding secured or guaranteed Indian debt, being among them.

Authors: Ran Chakrabarti, Arijit Sarkar and Chhavi Jhanji

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