

OCTOBER 2017

MASALA BONDS: ISSUING RUPEE DENOMINATED DEBT OVERSEAS

1. INTRODUCTION

Last week, the Reserve Bank of India (the “RBI”) altered certain norms relating to the issuance of rupee denominated bonds (commonly known as ‘*masala*’ bonds) in the overseas market (“**Rupee Bonds**”), pursuant to two circulars dated September 22nd, 2017 (the “**Circulars**”).¹

The RBI had prior to the Circulars, issued a series of circulars allowing eligible resident corporates² (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

Recently pursuant to a circular dated June 7, 2017⁴, the RBI tightened the commercial terms of issuance of Rupee Bonds and harmonized the regime with that of the ECB Policy and on the [21 July 2017] temporarily suspended the issuance of Rupee Bonds in the overseas market and introduced an auction system for foreign investors in the Indian corporate debt market.

Rupee Bonds have become an attractive source of financing for Indian issuers and investment by foreign subscribers. Typically, top-rated government-owned entities, including NTPC, Rural Electrification Corporation, National Highways Authority of India and private players including the Housing Development Finance Corporation have tapped the domestic corporate bond market for funding, and Rupee Bonds have broadened the range of potential investors.

2. REVISED SCOPE

2.1. Exclusion of Rupee Bonds from Limit for Investments by Foreign Portfolio Investors

From October 3, 2017, Rupee Bonds will be *excluded* from the combined corporate debt limit for investments made by Foreign Portfolio Investors (“**FPIs**”) in corporate bonds. Earlier the issuance of Rupee Bonds overseas were included in the calculation of the corporate debt limit and fell within the aggregate limit of INR 2,44,323 crore for foreign investment in corporate debt.⁵

¹ Available at: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11128&Mode=0>
<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11127&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>

⁴ Available at: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10994&Mode=0>

⁵ Refer to paragraph 3.2 of the “*Master Direction - External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers*” dated January 1, 2016, updated as of June 09, 2017 available at https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10204#C48 accessed on September 26, 2017

2.2. Reporting

The e-mail reporting requirement for Rupee Bond transactions for onward reporting to depositories as provided earlier by RBI⁶ has been dispensed with. However the reporting of Rupee Bond transactions shall continue in accordance with the extant ECB Policy.⁷

2.3. Harmonization with the ECB Policy

Prior to the Circulars, the limit for investment by FPIs in corporate bonds was INR 2,44,323 crore and the issuance of corporate debt had reached this ceiling. However with effect from October 3, 2017, Rupee Bonds will be excluded from the calculation of the combined corporate debt limit for FPI investments) and fall under the ECB Policy.

Moving Rupee Bonds under the ECB Policy, will in effect, free up approximately INR 44,001 crore (approximately USD 67 billion) from the combined corporate debt limit, and the Circulars set out the new limits for FPI investments into corporate bonds, which we interpret in the table below.

	Category of Investment	Amount (INR) (Crore)
1	Current FPI limits for corporate bonds (including Rupee Bonds)	244,323
2	Current amount allocated to Rupee Bonds	44,001
3	FPI limit after moving Rupee Bonds under the ECB Policy (1-2)	200,322
4.	Additional limit for the 3 rd quarter of the financial year 2018	27,000
5.	Revised FPI limit (after moving Rupee Bonds) for corporate bonds applicable from 3 rd October, 2017 (3 + 4)	227,322
6.	Additional limit for the 4 th quarter of the financial year, 2018	17,001
7.	Revised FPI limit for corporate bonds applicable from 1 st January, 2018 (5 + 6)	244,323
8.	Amount reserved for investment by long term FPIs in infrastructure	9,500

Essentially, the Circulars provide that an amount of INR 9,500 crore in each quarter will be available only for investment in the *infrastructure* sector by long term FPIs, inclusive of Sovereign Wealth Funds, Multilateral Agencies, Endowment Funds, Insurance Funds, Pension Funds and Foreign Central Banks.

Issuance of Rupee Bonds shall remain the same and an issuer may approach the Foreign Exchange Department of the RBI.⁸

⁶ Refer to paragraph 3.3.9 of the "Master Direction - External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers" dated January 1, 2016, updated as of June 09, 2017 available at https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10204#C48 accessed on September 26, 2017

⁷ Available at : <https://www.rbi.org.in/Scripts/NotificationUser.aspx?id=11128&Mode=0>

⁸ Available at : <https://www.rbi.org.in/Scripts/NotificationUser.aspx?id=11127&Mode=0>

IndusLaw View:

After the first Rupee Bonds were issued last year, the demand for these bonds has consistently remained strong especially in the housing and infrastructure sector. With substantial inflows into the Indian corporate debt market, the FPI limit in corporate bonds became fully utilized, essentially prompting a regime change.

The Circulars give corporates additional space to raise funds from overseas investors, and provides room for FPIs to continue their investments. The rupee had hit a six-month low after a steady rise earlier this year, though stabilization can be expected in the near future after which the sale of Rupee Bonds is expected to further increase. The revised limit should result in higher FPI flows and a predictable compression in corporate bond spreads. The effect may not be immediately visible, as most companies might prefer to wait and see how the market develops.

Earlier, Rupee Bonds fell under both corporate debt and the ECB Policy for FPI investment. Now it will only be counted under the ECB Policy. This provides much needed clarity and should lead to more efficient monitoring, though in this context, it should be pointed out that the ECB Policy is more restrictive in terms of end-use of funds. However the recurring question remains as to why two separate regimes exist in the first place for ECB's and Rupee Bonds?

Authors: Ran Chakrabarti and Prachi Pandit

Date: October 3, 2017

Practice Areas: Banking & Finance | Government & Regulatory | Projects & Project Finance

DISCLAIMER

This alert is for information purposes only. Nothing contained herein is, purports to be, or is intended as legal advice and you should seek legal advice before you act on any information or view expressed herein.

Although we have endeavored to accurately reflect the subject matter of this alert, we make no representation or warranty, express or implied, in any manner whatsoever in connection with the contents of this alert.

No recipient of this alert should construe this alert as an attempt to solicit business in any manner whatsoever.