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ISSUANCE OF RUPEE DENOMINATED BONDS OVERSEAS: MULTILATERAL AND REGIONAL FINANCIAL INSTITUTIONS AS INVESTORS

1. BACKGROUND

Eligible resident corporates and/or body corporates¹ had earlier been permitted to issue rupee denominated bonds (also commonly known as the ‘*masala*’ bonds) in the overseas market (“**Rupee Bonds**”) under India’s external commercial borrowing policy pursuant to the terms of A.P. (DIR Series) Circular No.17 dated September 29, 2015 (the “**Original Circular**”).²

Under the Original Circular, read with A.P. (DIR Series) Circular No.60 dated April 13, 2016 (the “**2016 Circular**”),³ only residents of countries that are Financial Action Task Force (FATF) compliant jurisdiction were permitted to invest in such Rupee Bonds.

2. REVISED SCOPE

The scope of the Original Circular and the 2016 Circular has now been modified pursuant to A. P. (DIR Series) Circular No.31 dated February 16, 2017 (the “**2017 Circular**”),⁴ effective immediately, to include new eligible investors in the form of multilateral and regional financial Institutions where India is a member country, to invest in these Rupee Bonds. This modification has been made in order to provide a greater choice of subscriber options to Indian entities issuing such Rupee Bonds.

3. EFFECT OF THE REVISION ON THE RUPEE BOND MARKET

3.1 DIRECT EFFECT

As a result of the revision by the 2017 Circular, multilateral agencies such as the Asian Development Bank (ADB) and the BRICS led New Development Bank (NDB) can now also invest in Rupee Bonds, serving to increase the acceptability of the Indian Rupee in global markets which will lead to a *broad-basing* of the Indian corporate bond market.

3.2 OTHER BENEFITS

Traditionally, low interest rates offered in the international financial markets have made it more cost effective for Indian entities to borrow in the international market. Further, a gradual decline in net inflows from multilateral Institutions⁵ has

¹ 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

² Available at <https://rbi.org.in/Scripts/NotificationUser.aspx?id=10049&Mode=0>

³ Available at <https://rbi.org.in/Scripts/NotificationUser.aspx?id=10350&Mode=0>

⁴ Available at <https://m.rbi.org.in/Scripts/NotificationUser.aspx?id=10865&Mode=0>

⁵ For further background, see <http://www.livemint.com/Home-Page/RqZufrukbqv0ALHoelrXFI/Is-it-time-for-an-offshore-sovereign-bond-issue.html> accessed on February 18, 2017

encouraged the government to further facilitate debt contributions from multilateral institutions to maintain a reasonable mix of domestic and external debt.⁶

Coupled with the benefit that Rupee Bonds are issued and settled in Rupees, (thereby allowing Indian entities to diversify their funding sources without bearing currency risk),⁷ together with the benefit of listing on the London Stock Exchange,⁸ broadening the class of investors to expressly permit multilateral institutions to subscribe for these bonds is a logical step forward.⁹

IndusLaw View:

It has been observed that investors often demand higher coupon rates to mitigate currency risk and seemingly low liquidity on Rupee Bonds, which erodes the benefits of seemingly less expensive borrowing by resident Indian entities.

It will take some time before market reaction to the 2017 Circular filters through, but the obvious criteria for measurement will be the extent that multilateral institutions take up the opportunity and subscribe for such bonds.

While the amendments brought in by the 2017 Circular will most definitely give access to a new pool of debt providers for eligible entities to tap into, the beneficiaries of the new policy will inevitably be restricted to large Indian entities with experience of the overseas bond markets.

Considering that all other terms and conditions of issuance in the overseas Rupee Bond market shall remain the same, coupled with the fact that there are no major end use restrictions (except the standard negative list of activities provided in the Original Circular), the revised policy certainly seems to be a step in the right direction in further opening up the Indian debt market to foreign participation, hopefully providing major Indian corporates with more competitive options for debt financing.

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⁶ Ibid

⁷ Supra 1

⁸ For further background, see <http://economictimes.indiatimes.com/markets/bonds/rbi-allows-multilateral-agencies-to-invest-in-masala-bonds/articleshow/57190529.cms> accessed on February 18, 2017

⁹ For further background, see <http://www.livemint.com/Money/1ZEYenE7i90s4dILQ9MK2N/RBI-moves-to-liberalize-bond-markets.html> accessed on February 18, 2017