VOLUNTARY RETENTION ROUTE RELAXES SUBSCRIPTION NORMS FOR CORPORATE DEBT BY FOREIGN PORTFOLIO INVESTORS

1. INTRODUCTION

In the spring of 2018, the Reserve Bank of India (the "**RBI**") issued two circulars in late April[1] and early May[2] (together, the "**Spring Circulars**"), tightening up the regime for the subscription of corporate debt by foreign portfolio investors ("**FPIs**"), impacting foreign capital inflows into India through this route.

Although the Spring Circulars liberalised the minimum residual maturities for FPI subscriptions, they also introduced controversial concentration limits mandating a portfolio spread and further, made it impossible for a single FPI to subscribe for a particular corporate debt issue.

Reflecting on some of the macro-economic consequences flowing from the Spring Circulars and feedback on a policy paper published in October 2018,[3] the RBI announced a new *voluntary retention route* for FPI corporate debt subscriptions on March 1, 2019 (the "**Voluntary Retention Route**").[4]

We set out our thoughts on the Voluntary Retention Route below.

2. THE VOLUNTARY RETENTION ROUTE

Any FPI registered with the Securities Exchange Board of India may participate in the scheme, which comes into effect on March 11, 2019. The Voluntary Retention Route sets out aggregate debt available under the scheme, of up to INR 40,000 Crores for government securities and INR 35,000 Crores for corporate debt (which is in *addition* to and *separate* from the corresponding limits under the existing policy and the general limits set out therein).

Available debt shall be made available on tap, or otherwise auctioned in tranches by the Clearing Corporation of India Limited until 30 April 2019, or otherwise, until the limits are exhausted (whichever occurs first).[5]

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[1] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11266&Mode=0

[2] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11268&Mode=0

[3] https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=45165

[4] https://rbi.org.in/Scripts/NotificationUser.aspx?Id=11492&Mode=0

[5] See paragraph (d) of the accompanying RBI press release below
https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=46444

No FPI (including related FPIs) shall be permitted to subscribe for more than 50 per cent of the available debt under a particular allotment or auction in cases where there is demand for more than the amount offered.

The minimum investment period for FPIs under this route is three (3) years, or as otherwise decided by the RBI at the time of allotment or auction and the FPI shall remain invested in at least 75 per cent of the committed investment during the minimum investment period.

FPIs shall be required to commit 25 per cent of the allotted amount within one month and the outstanding 75 per cent within three (3) months of the date of allotment.

The minimum retention period under the regime is 3 years (commencing, we assume from when the balance of the subscription under the allotment is received), during which period the FPI will be required to maintain a minimum of 75 per cent of its investment.

During the minimum retention period, FPIs wishing to liquidate their investment under this route may do so by selling their investments to another FPI or other FPIs, subject to the transferee complying with the regime.

Critically, subscriptions made under the Voluntary Retention Route are *exempt* from any minimum residual maturity requirements, concentration limits and the requirement for at least two subscribers for a single corporate debt issue, introduced by the Spring Circulars and restated in the RBI's circular on investment by FPIs in June 2018.[6]

The appendix to the Voluntary Retention Route sets out the process for the auction of available limits, which requires FPIs to bid on the basis of the retention period of their investment and the amount to be invested and it should be noted that those bids with higher retention periods will be allocated priority.

FPIs may also make multiple bids at a particular auction and the committed portfolio amount shall be reckoned for each bid separately.

3. INDUSLAW VIEW

The Voluntary Retention Route should go some way to re-calibrate debt inflows which were curtailed following the Spring Circulars, introducing controversial concentration limits, which required FPIs to diversify their investment spreads to ensure that no single investment exceeded 20 per cent of the portfolio.

Theoretically, this meant that an FPI had to have exposure to at least 5 subscriptions in order to comply with the requirement. The Voluntary Retention Route makes it clear that this no longer applies, as long as the other conditions are met.

Critically, the requirement of at least two (2) FPI subscribers for a particular corporate debt issuance is also suspended, for those FPIs subscribing under this route. This should provide FPIs with welcome flexibility in the context of their investment strategies.

[6] https://rbi.org.in/Scripts/NotificationUser.aspx?Id=11303&Mode=0

Clarification, however, might be required in relation to the value of the portfolio committed during the minimum retention period.

On the one hand, the Voluntary Retention Route suggests that the FPI can liquidate 25 per cent of its committed portfolio during that period, yet on the other hand, the transfer regime seems to suggest that FPIs can transfer their *entire* holding to other FPIs, subject to the transferee complying with the terms of the regime.

The language in paragraph 6(d) of the Voluntary Retention Route seems to suggest that FPIs can transfer their *entire* committed portfolio size invested under the new regime.

However, we stress that this is an interpretation, based upon the absence of any qualifying language in paragraph 6(d) about the amount that can be transferred, or the continued requirement for the transferor to retain the minimum 75 per cent of its committed portfolio size.

While the Voluntary Retention Route should encourage debt inflows under this route, we would point out that FPIs generally look for regulatory stability and predictability over the course of their investment before committing funds; and the risks of continued periodic tinkering to the policy will, in all likelihood, remain.

Authors: Ran Chakrabarti

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

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