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FPI DEBT LIMITS - THE WAY AHEAD

With corporate debt investments in India reaching over 92% of the total Combined Corporate Debt Limit (of INR 244,323 Cr.) (CCDL), the Securities and Exchange Board of India (SEBI) had, on July 20, 2017 issued a circular increasing the 'on tap' availability of debt limits to 95% of the CCDL (Circular), with the remaining limits to be allocated through auction. An auction soon followed on the Bombay Stock Exchange and saw aggressive bidding from several foreign funds - with bids being made for much more (INR 10,442 Cr.) than the limits put for auction (INR 7,418 Cr.). This auction saw greater participation and interest from FPIs than the auction conducted for government securities just a day before - proving yet again that the Indian corporate debt market is one of the most attractive destinations for foreign investors.

As of third week of September, the depositories' websites showed as much as 99.68% of the CCDL being allocated. Following this, RBI and SEBI have taken steps to ease the standstill. Thus, with limited availability now, we analyse below what lies ahead for an investor seeking to park money in Indian debt market and the approach adopted by the regulators in this regard.

Aftermath of the Circular and the Road Ahead

The Circular, in partial modification of an earlier 2013 SEBI circular which rationalised the debt limits system, increased the 'on tap' limit to 95% from 90%. However, since the CCDL included foreign investments even in rupee-denominated bonds, the Circular ceased issuances of such rupee-denominated bonds overseas - popularly known as 'Masala Bonds' - until the limit utilisation falls to below 92%.

With Masala Bond issuances halted, and no 'free limits' available, a possible increase of the overall investment limits was expected. Considering the positive inflow of investments in the debt market, it was quite possible that the regulators increase the overall debt limits (including government debt). Quarter 1 of 2017-18 saw the highest inflows in corporate and government bonds from FPIs in any quarter in the last 10 years.

Apart from the industry push, a major factor pointing in this direction was the depreciation in the value of Rupee, which was around INR 50 to 1 USD when the limits were fixed. At INR 64 to a Dollar now, there is a gap of around INR 80,000 Cr., which may prompt the Reserve Bank of India (RBI) to hike the investment limits. It was also speculated that bankers and other interested players have approached the RBI for the same.

The regulators, however, adopted a different route. CCDL, as it was, included all rupee-denominated bonds, even those issued overseas. However, it was expected that the hugely popular Masala Bonds be segregated from the overall FPI investment limits, thereby allowing issuances to be made regardless of the FPI investments. As mentioned above, up until September 29, 2017, such bonds had been halted until the overall utilisation limits fall below 92%.

In line with this vision, the RBI on September 22, 2017, released a notification, which sought to harmonise norms for Masala Bond issuances with the External Commercial Borrowings (ECBs) guidelines, and notified that - (i) with effect from October 3, 2017, Masala Bonds will no longer form a part of the CCDL, but will form a part of the ECBs and will be monitored accordingly; (ii) an amount of INR 44,001 cr. (which is the issued and undrawn amount of Masala Bonds) arising from shifting of Masala bonds will be released for FPI investment in corporate bonds over the next 2 quarters of the financial year 2017-18 (being Q3 and Q4).

Subsequently, SEBI issued a circular on September 29, 2017 which confirmed the changes made in the abovementioned RBI notification and clarified that - (i) foreign investments in Masala Bonds shall no longer be reckoned against the CCDL, and the CCDL shall be renamed as the Corporate Debt Investment Limits (CDIL) for FPIs; and (ii) the total amount of issued and undrawn amount of Masala Bonds of INR 44,001 cr., which had till now been reckoned within the CCDL of INR 244,323 cr., will now be carved out of the erstwhile CCDL and will be added to the new limit of CDIL.

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Government efforts towards deepening the bond markets will be effective only if the positive investment trend continues. To replicate quarter 1 results, it is important that the market doesn't appear restrictive to investors. As such, it is important that the regulators aim at increasing the investment limits. A rider, however, seems to be the strengthening Rupee itself - quite notably due to the massive debt inflows (approx. USD 16.8 Billion in the last year). With the Rupee appreciating in the last few days, it is debatable whether the RBI will consider raising the limits. Further, to aid investments, the move of the Government to exclude Masala Bonds from the CCDL will prove to be lucrative to Indian companies, considering they are a very attractive instrument from an investee point of view. While the investment limit breach is an indicator of the strength of the Indian debt markets - for their continuing interest, it is very important that we provide a sustainable regulatory environment to the investors. As such, we expect the regulators to take more conscious steps like this at the earliest.

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