Corpsec Hotline

June 15, 2017

RUPEE DENOMINATED BONDS: TWO STEPS BACKWARD!

- ECB framework for rupee denominated bonds amended;
- All-in-costs ceiling amended from 'prevailing market conditions' to 'G-Sec yield + 300 bps'
- Related parties not permitted to fund RDBs

INTRODUCTION

The Reserve Bank of India ("**RBI**"), in 2015, introduced rupee denominated bonds ("**RDB**") (also known as 'masala bonds') as instruments through which funds can be raised by Indian corporates.[1] RDBs were notified as a form of fund raising under the extant external commercial borrowing ("**ECB**") route. Like any other fund raising under the ECB route, the RDB were subject to certain conditions, including eligible borrowers, eligible lenders, minimum maturity, all-in-costs ceilings, etc.. In order to further encourage usage of RDBs, corporates have been provided leeway against a number of requirements under the Companies Act, 2013.

The RBI has, on June 7, 2017, issued a circular ("**June Circular**") amending the ECB framework, with respect to certain conditions applicable to RDB.[2] The RBI press release in this regard states that the changes have been included with "*a view to harmonising the various parameters of the extant framework with ECB guidelines*".[3] We have detailed the changes and analyzed the same below.

CHANGES AND ANALYSIS

1. Minimum maturity: Under the ECB framework, offshore raising of funds are to comply with a minimum maturity period, the calculation for which is provided under the ECB framework.

Existing position (prior to June Circular)	Revised position (pursuant to June Circular)
RDBs to have minimum maturity of 3 (three) years	RDB to have minimum maturity as follows: · For RDB up to the INR equivalent of USD 50 million – 3 years; · For RDB for an amount above the INR equivalent of USD 50 million – 5 years;

The minimum maturity for RDB was originally 5 (five) years. This was later amended to 3 (three) years in April 2016.[4] The 2016 change was incorporated to align the minimum maturity requirement with the minimum residual maturity requirement of non-convertible debentures issued by Indian corporates.

However, the RBI has now decided to align the minimum maturity with ECB requirements. Currently, ECB can be raised under 3 tracks (other than through RDBs) and the maturity for such ECB (being medium term ECB or rupee denominated ECB) is 3 years (where amount raised is up to USD 50 million (or its Rupee equivalent)) or 5 years (where the amount raised is greater than USD 50 million (or its Rupee equivalent)).

While it is likely that RBI would look at each issuance / allotment of RBI individually, it is not clear whether corporates can issue multiple series of RDBs at a single instance / in tranches to get away with a higher minimum maturity requirement.

2. All-in-cost ceiling: Under the ECB framework, there is a cap, termed as 'all-in-cost ceiling', on the amount that can be paid by the Indian borrower for servicing the loan. The all-in-cost ceiling includes interest, other fees, expenses, charges, guarantee fees, but excludes commitment fees, pre-payment fees / charges and withholding tax payable.

Existing position (prior to June Circular)	Revised position (pursuant to June Circular)
All-in-costs ceiling for RDBs to be 'commensurate with prevailing market conditions'.	All-in-costs ceiling to be 300 basis points over the prevailing yield for government securities for corresponding maturity period.

Currently, the coupon on government security ranges from 6.5% (for 3 years) to 6.75% (for 10 years). Accordingly, the all-in-cost ceiling for RDBs has now been fixed at 9.5% (3 year maturity RDB) to 9.75% (10 year maturity RDB). RDBs were issued earlier with all-in-cost ceilings which were commensurate with market conditions. Although this was ambiguous and confusing, it was seen that RBI was comfortable with a rate at par with lending rates of banks.

While, all public issuances of RDBs would have anyway adhered to the new limits set herein [5], issuance of RDBs through private placement (generally to offshore shareholders) were above the limits specified herein, and were in the range of 10% - 12% p.a.. The low cost ceiling, coupled with hedging costs (which ranges from around 4% - 6%) could make RDBs even more unattractive for foreign investors.

While it seems that the all-in-costs ceiling would be applicable at the time of the issuance only, the June Circular does not clarify if the coupon on the RDB can be a floating rate, linked to the prevailing government securities.

3. Recognised lenders: The ECB framework prescribes entities which can be lenders under the ECB framework. These lenders vary depending on the form of ECB being raised. In the case of RDBs, the requirements have been clarified in the ECB framework.[6]

Existing position (prior to June Circular)	Revised position (pursuant to June Circular)
No such provision	Parties classified as 'Related party' under the Indian Accounting Standards cannot subscribe or invest in or purchase RDBs

Related party has been defined very broadly under the relevant Indian Accounting Standard[7]. As such, parent entities/ holding companies/ majority shareholders/ sister concerns would all be prohibited from investing in / subscribing to RDBs. This would be a major concern, since a large number of RDB issuances (through the private placement route) were captive issuance, i.e. issuance where the parent entity used this route to fund the Indian corporate.

The introduction of the restriction for related parties to invest in / subscribe the RDBs seems to be disconnected with the entire purpose of the June Circular, to align the same with the other ECB tracks. The other ECB tracks permit foreign equity holders to lend to Indian corporates. This change blocks this avenue for Indian companies to raise funding.

The intent for the change seems to be to prevent cash extraction from Indian companies. If any offshore parent raises funds offshore and decides to invest in India through RDBs, the difference between the borrowing costs and returns from India (despite the hedging costs to be incurred) could convince offshore parents to use this route. This is difficult in other ECB tracks, since the all-in-cost ceiling in all other tracks is much lower in the other tracks, thereby making this unviable (when coupled with the hedging costs).

CONCLUSION

The June Circular is silent on this, but it seems that the changes introduced would only apply prospectively, and not retrospectively. Even applied prospectively, the changes seem to be quite regressive at a time where the government is trying to encourage the use of RDBs by various measures, including providing it relaxation from certain requirements of the Companies Act, 2013.

While the intent of the changes introduced by the June Circular may be to only further public issuance of RDBs, the changes would serve as a major dampener for the RDB route in the larger scheme of things.

– Abhinav Harlalka & Ruchir Sinha
You can direct your queries or comments to the authors

[1] External Commercial Borrowings (ECB) Policy - Issuance of Rupee denominated bonds overseas, A.P. (DIR Series) Circular No.17, available online at https://rbi.org.in/Scripts/NotificationUser.aspx?Id=10049&Mode=0

[2] Issuance of Rupee denominated bonds overseas, A. P. (DIR Series) Circular No.47, available online at https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10994&Mode=0

[3] Statement on Developmental and Regulatory Policies, Reserve Bank of India, dated June 7, 2017 available online at https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=40684

[4] A.P. (DIR Series) Circular No.60 available online at https://rbi.org.in/Scripts/NotificationUser.aspx?Id=10350&Mode=0

[5] HDFC, Adani and NTPC are some of the borrowers who have raised funds by issuance of RDBs.

[6] RDB could be issued in and be subscribed only by a resident of a country that:
(i) is a member of Financial Action Task Force ("**FATF**") or a member of a FATF-Style Regional Body; and
(ii) whose securities market regulator is a signatory to the International Organization of Securities Commission's (IOSCO's) Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with the Securities and Exchange Board of India (SEBI) for information sharing arrangements; and
(iii) should not be a country identified in the public statement of the FATF as:
a. A jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or
b. A jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

[7] IndAS 24 (Related Party Disclosures)

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