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RBI liberalises norms for investment by Foreign Portfolio Investors in debt

Summary

In an attempt to raise exposure of Foreign Portfolio Investors (FPI) in government securities, Reserve Bank of India (RBI), through its recent circular[1], has liberalised the norms governing investment by FPIs in debt securities. As per the said circular, minimum residuary maturity requirement for FPIs to invest in Central Government securities (G-secs) and State Development Loans (SDL) categories has been withdrawn. The time period is reduced to one year in case of Corporate Bonds.

Other key amendments include increase in cap on aggregate FPI investments in any Central Government security, discontinuance of auction mechanism for allocating limit to FPIs for investment into G-sec, introduction of concentration limit for investments by FPI into Indian debt, etc.

Salient features of the circular

Changes made by the said circular to the operational aspects of FPI investments in debt securities are as under:

A. Revision of minimum residual maturity requirement

- The FPIs were earlier required to invest in G-secs, SDLs and corporate bonds with a minimum residual maturity of three years.
- The current circular withdraws minimum residual maturity requirement for G-secs and SDLs, provided that at any point of time, an FPI investment in these securities with residual maturity less than one year should not exceed 20 per cent of the total investment of the FPI in that category.
- FPIs are permitted to invest in corporate bonds with minimum residual maturity of above one year as against minimum residual maturity period of three years earlier.

[1] A.P. (DIR Series) Circular No.24 dated 27th April, 2018

B. Revision of security-wise limit

The cap on aggregate FPI investments in any Central Government security has been revised to 30 per cent of the outstanding stock of that security, from the erstwhile limit of 20 per cent.

C. Online monitoring of G-Sec utilisation limits

- Currently, FPIs are permitted to invest in G-secs till the limit utilisation reaches 90 per cent, after which the auction mechanism is triggered for allocation of the remaining limit among FPIs.
- With Clearing Corporation of India Ltd (CCIL) commencing online monitoring of utilisation of G-sec limits, RBI has decided to discontinue the auction mechanism with effect from 01 June 2018.

D. Concentration limit

- Investment by any FPI (including investments by related FPIs), in each of the three categories of debt, viz., G-secs, SDLs and corporate debt securities shall be subject to following concentration limit:

  i. Long Term FPIs – 15 per cent of prevailing investment limit for that category

  ii. Other FPIs – 10 per cent of prevailing investment limit for that category

  For FPIs having investment in excess of concentration limit on the effective date (date on which the aforesaid concentration limits comes into existence), the circular provides one-time relaxation to such FPIs to undertake additional investment, subject to fulfilment of certain conditions.

E. Single/Group investor-wise limit in corporate bonds

- FPIs along with related FPIs will now not be permitted to invest in excess of 50 per cent of any corporate bond issue. However, where an FPI along with the related FPIs, has invested more than 50 per cent of any single issue, such FPI should not make further investment in that issue until the aforesaid conditions is met.
- FPIs are not permitted to have an exposure of more than 20 per cent of its corporate bond portfolio to a single corporate (including exposure to entities related to the corporate). However, where an FPI already has exposure in excess of 20 per cent to any corporate, then it should not make further investment in that corporate until the aforesaid condition is met. Further, new FPIs would be required to adhere to this

condition starting not later than six months from the commencement of its investments.

F. Other changes

Investment in partly paid instruments by FPIs has been disallowed.

Our comments

The circular is a welcome move as it would increase FPIs participation in domestic bond market due to increase in the investment limit in G-secs and relaxation in the minimum residual maturity of the corporate bonds, G-secs and SDLs. However, some of the domestic corporates may find it difficult or more time consuming to raise funds due to introduction of the concentration/investor-wise limit in corporate bonds.