RBI liberalises norms for investment by foreign portfolio investors in debt

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Summary

Based on feedback from custodians, Foreign Portfolio Investors (FPIs) and other stakeholders, the Reserve Bank of India (RBI) released a Circular[1] on 15 June 2018 to provide operational flexibility as well as transition path for FPIs and custodians to adapt to the changes in the regulation. The two recent circulars[2] issued by the RBI in relation to FPI investment in debt securities stand withdrawn.

As per the Circular, investments made by FPIs till 27 April 2018 have been grandfathered with regard to meeting the minimum residual maturity requirement. In addition, investment by FPIs in security receipts issued by asset reconstruction companies would now be exempt from the minimum residual maturity requirement and investor-wise corporate bond limit. The Circular also provides exemption for pipeline investments in corporate bonds subject to certain specified conditions and to the satisfaction of the custodian.

Salient features of the Circular

The Circular has defined certain terms as under:

- Short-term investments – Investment with residual maturity up to one year
- Related FPIs – 'investor group' as defined in Regulation 23(3) of SEBI (Foreign Portfolio Investors) Regulations, 2014
- Entities related to the corporate – Shall have the same meaning as 'related party' under the Companies Act, 2013[3]. Issuers that are owned or controlled by the

[1] A.P. (DIR Series) Circular No.31 dated 15 June 2018
[2] A.P. (DIR Series) Circular No.24 dated 27 April 2018 and A.P. (DIR Series) Circular No.26 dated 01 May 2018
[3] Section 2(76)(viii) of the Companies Act, 2013

Government of India or state governments are exempted from the definition of 'entities related to the corporate'

- SRs – Security receipts issued by asset reconstruction companies
- Multilateral financial institutions (MFIs) – FPIs which are multilateral financial institutions in which the Government of India is a member

The key changes made by the Circular[1] impacting investments in debt securities by FPIs are as under:

<table>
<tr><th>As per the earlier circulars[2]</th><th>As per the new Circular[1]</th></tr>
<tr><td colspan="2">Revision of minimum residual maturity requirement</td></tr>
<tr><td>Central Government securities (G-secs), and State Development Loans (SDLs) and Corporate Bonds (CBs)
• The circular withdraws the minimum residual maturity requirement for G-secs and SDL.
• The minimum residual maturity requirement for CBs is reduced to one year.
• Investment by FPI in these securities with residual maturity less than one year should not exceed 20% of the total investment of that FPIs in that category at any point of time.</td><td>G-secs including in treasury bills, SDLs and CBs
• No changes have been made in the conditions for investment in G-secs and SDLs. However, the requirement of having residual maturity period of less than one year will be applied on end-of-day basis.
• Investment by FPIs in SRs will be exempt from the minimum residual maturity criteria.
• Investments made prior to 28 April 2018 have been grandfathered, ie short-term investments may exceed 20% of total investments if the short-term investments consist entirely of investments made prior to 28 April 2018.</td></tr>
<tr><td colspan="2">Revision of security-wise limit</td></tr>
<tr><td>• The cap on aggregate FPIs investments in any Central Government security is revised to 30% of the</td><td>• There is no change in this limit.</td></tr>
</table>

<table>
<tr><th>As per the earlier circulars[2]</th><th>As per the new Circular[1]</th></tr>
<tr><td>outstanding stock of that security, from the erstwhile limit of 20%.</td><td></td></tr>
<tr><td colspan="2">Online monitoring of investment in G-sec and SDL categories</td></tr>
<tr><td>With Clearing Corporation of India Ltd (CCIL) commencing online monitoring of utilisation of G-sec limits, the RBI hasdecided to discontinue the auction mechanism with effect from 1 June 2018. Henceforth, the utilisation of investment limits shall be monitored online.</td><td>The RBI has reiterated the same norms.
In addition, any transaction that leads to breach of the investment limit for the category will need to be reversed.
Further, upon sale/redemption of securities (in G-secs and SDLs), the concerned FPIs may reinvest within a period of two working days from the date of sale/redemption (including the date of sale/redemption). If the reinvestment is not made within that time period, reinvestment shall be subject to the availability of limits for that category.
The primary responsibility of complying with all limits shall lie with the FPIs and custodians.</td></tr>
<tr><td colspan="2">Concentration limit</td></tr>
<tr><td>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 the following concentration limits:
Long-term FPIs: 15% of prevailing investment limit for that category</td><td>There is no change in the concentration limit.</td></tr>
</table>

As per the earlier circulars[2]	As per the new Circular[1]
– Other FPIs: 10% of prevailing investment limit for that category • For FPIs having investment in excess of the concentration limit on the effective date (date on which the aforesaid concentration limits come into existence), the circular provides a one-time relaxation to such FPIs to undertake additional investment subject to the fulfilment of certain conditions.	
Single/Group investor-wise limit in CBs	
• FPIs along with related FPIs are not permitted to invest in excess of 50% of any issue of corporate bond. However, where an FPI along with the related FPIs has invested more than 50% of any single issue, such FPI should not make further investment in that issue until the aforesaid condition is met. • FPIs are not permitted to have an exposure of more than 20% of their corporate bond portfolio to a single corporate (including exposure to entities related to the corporate). However, prior to 28 April 2018 where an FPIs has exposure in excess of 20% to any corporate, it should not make further investment in that corporate until the aforesaid conditions are met. Further, new FPIs would be required to	• The same investment norms have been reiterated by the RBI. However, existing investments have been grandfathered and transitional provisions have been introduced. • In case investment has been made by an FPI to any corporate (including exposure to entities related to the corporate) in excess of 20% of its corpus prior to 28 April 2018, it has been grandfathered. However, the FPI shall not make further investments in that corporate. • Further, new investments made by existing FPIs after 27 April 2018 would be exempted from this requirement till 31 March 2019. These 'new' investments will, however, have to comply with this requirement thereafter.

As per the earlier circulars[2]	As per the new Circular[1]
adhere to this condition starting not later than six months from the commencement of investments.	• FPIs registered after 27 April 2018 are permitted to comply with this requirement by 31 March 2019 or six months from the date of registration, whichever is later. • The above requirement would not be applicable to investments by MFIs and investments by FPIs in SRs.
Pipeline investment in corporate bonds	
• There were no such norms in the earlier circulars.	• Investment transactions by FPIs in corporate bonds that were under process but had not materialised as on 27 April 2018 shall be exempt from the requirement of investor-wise limit in corporate bonds subject to the satisfaction of the custodian, based on the following conditions**:** – The major parameters such as price/rate, tenor and amount of the investment have been agreed upon between the FPI and the issuer on or before 27 April 2018. – The actual investment will commence by 31 December 2018. – The investment is in conformity with the extant regulations governing FPI investments in corporate bonds prior to 27 April 2018. • Custodians may permit the pipeline investments by FPIs based on their assessment of adherence to the

As per the earlier circulars[2]	As per the new Circular[1]
	above conditions without reference to the RBI.
Other changes	
• FPIs would not be allowed to make investment in partly paid instruments.	• No change in this condition.

The directions contained in AP (DIR Series) Circular No. 24 dated 27 April 2018 and AP (DIR Series) Circular No. 26 dated 01 May 2018 stand withdrawn and the directions as per the Circular dated 15 June 2018 would be applicable with immediate effect.

Our comments

The Circular is a welcome move as the RBI has addressed some of the concerns of the stakeholders and provided for a smooth transition to the new regulations. It brings the much needed relief to FPIs as well as Indian corporate borrowers as it allows an FPI to hold its existing short-term debt investments till maturity subject to credibility conditions. Also, the Circular allows FPIs to subscribe up to 100% of the corporate bond issue where they had either signed a term sheet or reached such a similar understanding with the Indian borrower company before 28 April 2018.

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