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Regulatory Alert
Tracking change

RBI restricts foreign investment in corporate debt to long term maturities

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Background

The Reserve Bank of India (RBI) wants Foreign Portfolio Investors (FPIs) to invest in longer term debt securities. Accordingly, RBI had in July 2014 mandated that FPI investment in government debt would be permitted only in those securities which have a residual maturity of at least 3 years. However, there were no such restrictions imposed on Corporate Debt as the RBI wanted to encourage larger FPI investments in corporate bonds thereby helping development of corporate debt market. The current cap on FPI investments in government debt is USD 30 billion which is fully utilized and the cap on corporate debt is USD 51 bio of which more than 68% has been utilized.

RBI had in June 2014 permitted FPIs to participate in the exchange traded currency derivatives to hedge the currency risk on their portfolio in India and had also permitted FPIs to take position in foreign currency up to USD 10 million or equivalent per exchange without having to establish existence of any underlying exposure.

Change

In the Sixth Bi-Monthly Monetary Policy Statement issued on 3 February 2015, RBI made following announcements relevant to FPI investments in debt securities:

- On the lines of restrictions in government debt, FPI investment in corporate debt to be also restricted in those securities that have residual maturity of at least 3 years
- FPIs will not be permitted to invest in short term liquid and money market mutual funds
- There will be no lock-in period on investments in debt securities implying that FPIs continue to be free to exit debt investments at any time
- The coupon receipts on government securities by FPIs will be permitted to be invested in government securities even if the limits (USD 30 billion) for investments in government securities are fully utilized
- FPIs will be allowed to take foreign currency positions in the USD-INR pair up to USD 15 million per exchange without having to establish the existence of any underlying exposure. In addition, they shall be allowed to take foreign currency positions in EUR-INR, GBP-INR and JPY-INR pairs, all put together up to USD 5 million equivalent per exchange, without having to establish the existence of any underlying exposure

The RBI has already issued a circular on 3 February 2015 implementing the policy announcements mentioned in 1 to 3 above. With this change in regulation, all investments in debt securities (including government and corporate debt) by FPIs are restricted to securities that have at least 3 years residual maturity, though there is no restriction to hold the investments for a specified period of time.

Conclusion

The RBI's mandate of restricting foreign investment in longer term debt indicates that RBI may be comfortable with the country's foreign exchange reserves and instead RBI may be concerned with the strength of Indian rupee against USD at a time when several global currencies have weakened against the USD. A stronger rupee will have negative impact on the country's exports and the new government's "Make in India" initiative.

The relaxations to permit FPIs to re-invest coupon receipts in government securities in excess of the overall cap and increased limits to undertake foreign currency options on the stock exchanges without underlying exposure would definitely be cheered by FPIs.

Source: Sixth Bi-Monthly Monetary Policy Statement issued by RBI on 3 February 2015, A.P.(DIR Series) Circular No. 71 issued by RBI on 3 February 2015, Debt utilization status available at www.nsdl.co.in

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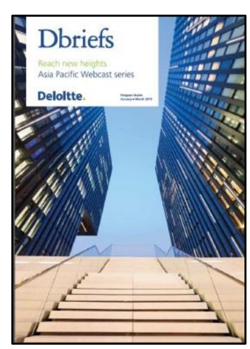

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