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EASING OF NORMS FOR LONG TERM FOREIGN PORTFOLIO INVESTORS (FPIS) - VOLUNTARY RETENTION ROUTE NOW AVAILABLE

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Introduction

The Reserve Bank of India (RBI), in its Statement on Developmental and Regulatory Policies dated 5 October 2018 recognised that while several measures had been undertaken in the recent past to facilitate foreign portfolio investment (FPI) in the Indian debt market, additional liberalized regimes were required to encourage FPIs willing to undertake long-term investments in India to invest into India and in this backdrop, a special route called 'Voluntary Retention Route' (VRR) was announced by the RBI. The VRR scheme was finalized by the RBI through a circular dated 1 March 2019 (VRR Circular) pursuant to comments received on the discussion paper titled ''Voluntary Retention Route' (VRR) for investments by Foreign Portfolio Investors (FPIs)' released by the RBI on 5 October 2018

The key highlights of the VRR scheme are as follows:

Who can participate?

Any FPI which is registered with SEBI is eligible to participate through this route.

Eligible instruments

VRR- Govt: FPIs can invest in any Government Securities i.e., Central Government dated Securities (G-Secs), Treasury Bills (T-bills) as well as State Development Loans (SDLs);

VRR-Corp: Under this, FPIs can invest in all instruments listed under Schedule 5 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 (FEMA Regulations) (which includes NCDs/ bonds issued by an Indian company/ NBFCs (categorized as 'Infrastructure Finance Companies'), commercial papers issued by an Indian company, Security Receipts (SRs) issued by Asset Reconstruction Companies, credit enhanced bonds, etc.), except for dated Government securities/treasury bills and units of domestic mutual funds.

Investment Limits and Minimum Investment

The aggregate cap on investments is INR 40,000 crore per annum for VRR-Govt and INR 35,000 crore per annum for VRR-Corp or such other higher amount, as the RBI may decide from time to time. Although the investment through this route is in addition to the general investment limits applicable to FPIs, in case there is a demand for more than 100% of the amount offered by tap or auction, no FPI (including related FPIs) will be allotted an investment limit greater than 50% of the amount offered for each allotment.

Under this regime, the FPI is required to have a minimum investment of 75% of the committed portfolio size (CPS) i.e. the amount allotted to the FPI for investment, during the entire retention period. Further, out of this, a minimum of 25% of the CPS has to be invested within one month of the date of allotment and the balance amount will have to be invested within three months from the date of such allotment. For the purpose of calculating the investment amounts, the face value of the securities would be considered and investments in cash holdings in Rupee accounts would also be included.

Manner of Allocation

Under the VRR route, allocation of investment amount to FPIs will be made on tap or through auctions (in accordance with the process for the auction as detailed in the VRR Circular). In the auction process, FPIs are permitted to place multiple bids and FPIs which have got CPS allocated under an auction will still be eligible to participate in subsequent auctions.

Minimum Retention Period

The minimum retention period for investments under VRR scheme has been fixed at 3 (three) years, or as may be decided by the RBI for each allotment by tap or auction.

Exit prior to expiry of the voluntary retention period

An FPI may opt to continue investments under this route for an additional identical retention period, prior to the end of the committed retention period. For FPIs that wish to liquidate their investments under this route prior to the end of the retention period, they are permitted to sell their investments to other FPIs and the entities buying such investments are required to comply with all the conditions applicable to the selling FPI as per the VRR.

Other Relaxations

In order to attract long term investors into India under the VRR regime, the RBI has introduced significant relaxations under this route, such as no minimum residual maturity requirement for investments under VRR, non-applicability of the concentration limits or single/group investor-wise limits applicable to corporate bonds under the FPI-NCD route. Further, the investors are also permitted to reinvest the income from VRR investments in excess of the CPS.

In addition, FPI which have invested under the VRR scheme will have the option to participate in repos for their cash management, provided however that the amount so borrowed or lent under the repo is not in excess of 10% of their investment under VRR. Further, FPIs are also permitted to participate in any currency/interest rate derivative instrument, over-the-counter/exchange traded, to address current/interest rate related risks.

Hedging

To enable the FPIs participating in the VRR scheme to hedge their interest rate and exchange rate risks related to their investments under the VRR scheme and to undertake repo/reverse repo transactions to meet their liquidity requirements, the RBI has permitted hedging of exchange rate risk by FPIs under VRR scheme for products like forwards, options, cost reduction structures and swaps with Rupee as one of the currencies, on the terms and conditions contained therein. Further, authorised dealers are permitted to allow FPIs to freely cancel and rebook the derivative contracts.

Comments

The RBI has in the recent past undertaken various steps to attract foreign funds in India including the revision of the ECB norms and liberalization of the 20% single/group investor-wise limits applicable to corporate bonds under the present norms for FPIs. The introduction of the VRR scheme is a step in such direction which is aimed at increasing the inflow of foreign currency funds in the Indian debt market. While the limits under this scheme have been capped for government and corporate securities, the very fact that the same are in addition to the existing general investment limit highlights the RBI's intention to open the Indian markets to foreign funds. The VRR scheme is conducive to FPIs as it waives the existing minimum residual maturity requirement (3 years in case of central government securities and more than 1 year in case of corporate bonds), concentration limits (long term FPIs, 15% of prevailing investment limit for that category and for short term FPIs, 10% of prevailing investment limit for that category) or single/group investor-wise limits applicable to corporate bonds under the present norms. To further facilitate the FPIs look at Indian markets for investment purposes, the RBI has also protected their investments from the fluctuating exchanges rates providing the FPIs hedging of exchange rate risk under VRR scheme. With these conscious steps from the regulator which grants greater operational flexibility to FPIs, in terms of instrument choices besides exemptions from stringent regulatory requirements, the Indian debt market is set to get the added boost that would strengthen the economy.

- *Manisha Shroff (Partner), Ahana Sinha (Principal Associate) and Jessica Gandhi (Associate)*

For any queries please contact: editors@khaitanco.com

Mumbai
One Indiabulls Centre, 13th Floor
Tower 1 841, Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
E: mumbai@khaitanco.com

New Delhi
Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
E: delhi@khaitanco.com

Bengaluru
Simal, 2nd Floor
7/1, Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
E: bengaluru@khaitanco.com

Kolkata
Emerald House
1 B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
E: kolkata@khaitanco.com