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Masala Bonds: Internationalisation of Indian Rupee

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ABSTRACT

Normally corporate sector issue debentures or bonds to raise money to finance its ongoing operations but now they have one more profitable instrument called rupee denominated bonds (Masala bonds) in their hands to generate funds. Masala bonds have become popular between issuers and investors and has become a source to internationalise Indian rupee in the form of bonds. In this paper author analysed the role of masala bonds in the Indian bond market and how it can help pave the way to the systematic development of Indian corporate debt market.

Keywords: *Masala Bond, Overseas Market, External Commercial Borrowing, Currency risk.*

1. INTRODUCTION

Masala bonds are nothing but debt instruments which are used by corporations to raise money from investors and the price of the bond is denominated in indian currency.The investment finance corporations (IFC) issued bond of rupees 1000 crore in the year 2014 and the purpose of that bond was to finance infrastructure projects in India. "Masala" bond is a name given by IFC just to reflect Indian taste to it because it is the bond which was going to internationalise the Indian rupee. RBI introduced masala bonds with a vision to increase the flow of rupee in foreign markets. The main source for corporations to raise finance overseas have been external commercial borrowing (ECB) before the introduction of masala bonds. External commercial borrowing are a type of loan in the form of offshore currency to the Indian borrower made by a lender who is non-resident of India. ECBs are issued and repaid in the US dollar, in short these are dollar denominated bonds. ECBs are also associated with currency risk, hence corporations are very happy with the masala bonds as there is no currency risk associated withMasala bonds are issued in terms of rupee and are repaid in terms of foreign currency. Basically masala bonds are internationalisation of Indian currency.

There are huge differences between ECBs and masala bonds (i.e.Table-1).

In this study it is being tried to understand the masala bonds in the present domestic scenario meanwhile tried to assess that it might be a sustainable source of financing in India. This study is completely based on the secondary source of data. And the data has been collected from Reports, journals and books.

Table -1 Differences between ECBs and Masala bonds

	Masala Bonds	ECBs
Pricing	Track I: 3-5 Years: L + 300 bps / More than 5 years: L +450bps — Track II: Maximum L +500bps — Track III: In line with market conditions	No pricing restrictions. All-in cost should be commensurate with prevailing market conditions
Tenor	Track I : Upto 50 mn USD: 3 years or more — Trace II: More than 50 mn USD: 5 years or more — Track II: 10 years or more	Minimum maturity of five years (reduced to 3 years since April 2016) — Call/Put option cannot be exercised prior to minimum maturity
Listing	No listing requirement for loans	Can be both listed/unlisted
End Use	End-use restrictions as per RBI guidelines for Tracks I, Track II and Track III	No end-use restrictions except for a negative list, i.e., real estate including purchase of land, on-lending, stock market operations, FDI prohibited activities
Quantum	For all tracks: Upto $750m: Corporates in Infrastructure and Manufacturing Sector / Upto $200m: Software sector / Upto $100m: Micro Finance Entities / Upto $500m: Remaining Entities	Under automatic route, maximum amount permissible is US$750mn per annum per corporate — For amounts greater than US$750mm, RBI approval is required
Documentation	Loan agreement between borrower and lender, RBI approval not required. LRN required before drawdown of ECB — Reg S / Reg S 144A documentation applicable for bonds and LRN required	Reg S / Reg S 144A documentation applicable for bonds and LRN required — Simpler documentation in case of private placement
Hedging	FCY ECBs - borrower has to hedge onshore — INR ECBs - lender can hedge either onshore or offshore	Investors can hedge INR exposure with banks both onshore and offshore
Withholding tax	WHT of 5% on loans issued before April 2017	WHT of 5%
Regulatory requirement	Reporting requirements (e.g., LRN), parking of proceeds, etc., as applicable under RBI guidelines	Reporting requirements (e.g., LRN), parking of proceeds, etc., as applicable under ECB guidelines will continue to apply

1.1 Objective

Objective of the study is to provide an understanding framework of masala bonds and to examine its various benefits for the Indian corporations along with the study of masala bonds issuances. Author also studied the role of masala bonds in the development of the Indian corporate debt market.

1.2 Masala bonds

Masala bonds are debt instruments whose value denominated in rupee and issued to foreign investors. This are a new financial instruments which are listed on the offshore stock exchange and have 37 months as maturity. Basically masala bonds are for those investors who want to invest in Indian assets. Masala bonds made it easy for the Indian corporations to raise finance for their ongoing operations in Indian rupee.

As of now total 39 masala bonds have been listed in London Stock Exchange raising an amount equivalent to $5.4 billion

1.3 Features of masala bonds

Common features of masala bonds include:

- Bonds are being issued and payable in rupee but it's redemption is linked to offshore exchange rate.
- Retail investors and institutional investors both can buy the masala bonds.
- Masala bonds are issued in overseas markets.

Masala bonds can only be issued in a country or a resident of a country who fulfil the following criteria:

- That country must be a member of Financial Action Task Force (FATF) or a member of any of FATF-style regional body.
- that country's securities market regulator must be a signatory to the International Organization of Securities Commission's (IOSCO's) Multilateral Memorandum of Understanding.
- public statement of FATF t should not identify that country as:

(1) A jurisdiction which have a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or

(2) A jurisdiction that has not made enough progress in resolving various issues(deficiencies) or has not performed to an action plan grown with the Financial Action Task Force to deal with the deficiencies.

2. REVIEW OF LITERATURE

As Masala bonds are newly introduced bonds By RBI (Reserve Bank Of India) The literature related to masala bonds is very limited.

Anshika (2016) states with the issuance of Masala Bonds, issuer companies can easily diversify their portfolio.About this study based on the secondary data Author says masala bond is a new dish in the Indian bond market platter. Author studied origin and feature of Masala Bonds along with its benefit for the issuer company and to investors.

Challa and Kanakadurga (2016) catagorised Masala Bonds as innovative type of debt instruments which are nothing but rupee denominated bonds. In this study author discussed history and evolution of Masala Bonds along with important guidelines issued by the Reserve Bank Of India (RBI). Further Author also discussed merits and demerits of masala bonds for issuer investor and for the country as a whole.

Verma (2016) argued that masala bonds are nothing but innovation in financing. Author tried to understand the Masala Bonds in detail and discussed it's various benefits to different stackholders. This study also entirely based on the secondary data.

Apart from the papers various reports and articles of RBI, LSE

(London Stock Exchange), SEBI(Securities And Exchange Board Of India), Sumedha Fiscal Services Ltd. , VK Financial consultant have been studied to extract the data and knowledge of Masala Bonds.

3. DATA AND METHODOLOGY

Since Masala Bonds are a new dish in the platter of Indian corporate debt market hence it has a narrow database. Due to this constraints all the data has been taken from secondary resources only. The data for the study was taken from report of London Stock Exchange, RBI,SEBI and Sumedha Fiscal Services Ltd. This is an exploratory study and entirely based on the secondary data.

4. STATE OF THE CORPORATE BOND MARKET

India's corporate bond market is not as developed as it's government bond market and mainly dominated by private placement. Bank borrowing has always been a popular method as compared to bond financing (see Figure-2). If we look at the corporate bond issuance of past 10 years then it is being clear from the data (Table-1) that value of bond has increased till 2013 but with a slow rate. The value increased after 2014 because of RBI's decision announced in 2015 which says NON-Banking financial companies and housing finance corporations can now issue unsecured bonds. This decision gave a boost to India's corporate bond market but still there is a long way to go as there are many fields in which bond market is lacking such as:

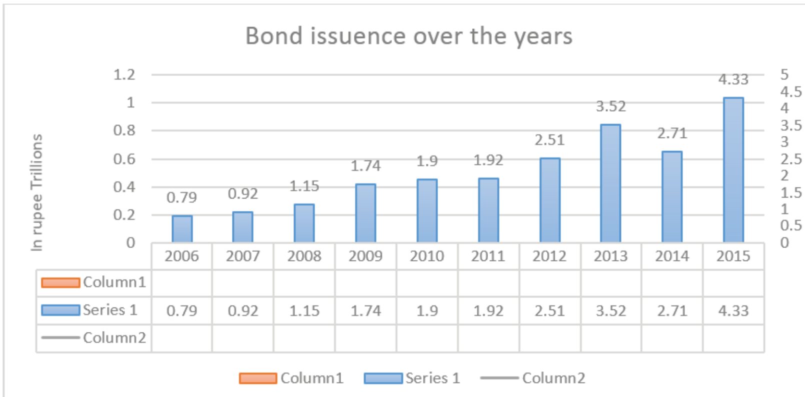
- There is no centralised database for corporate bonds.
- Lack of debt market index.
- There is no rationalisation of stamp duty.
- There is no market making schemes.
- Lack of market robustness.
- Employees provident fund organisations (EPFO), National general provident fund (NGPFs) are not allowed to invest in AT1 securities issued by banking and financial entities.

Table-2 Corporate bond issuance in past ten years

Financial Year	Value of bond in Rs.(trillion)
2006	0.79
2007	0.92
2008	1.15
2009	1.74
2010	1.90

2011	1.92
2012	2.51
2013	3.52
2014	2.71
2015	4.33

Figure- 1 Corporate bond issuance in past ten years

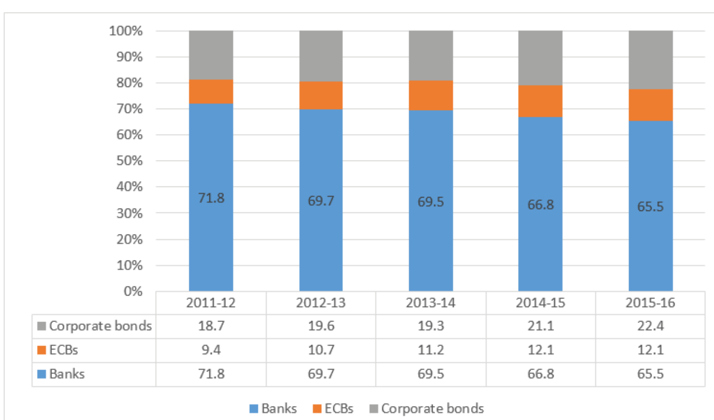


There is an increase in the issuance that is because in 2015 NBFCs and Housing finance companies has got permission from Reserve bank of India and National Housing Banks to issue unsecured debentures.

Table -3 Bond market as a part of corporate funding

Financial year	Banks(in %)	ECBs (in %)	Corporate bonds (in %)
2011-12	71.80	9.40	18.70
2012-13	69.70	10.70	19.60
2013-14	69.50	11.20	19.30
2014-15	66.80	12.10	21.10
2015-16	65.50	12.10	22.40

Figure-2 Bond market as a part of corporate funding



Bank borrowing is a popular method of borrowing in India which is shown in the figure-2 that is because of inadequacy of security on borrowings. Trends in the foreign countries are opposite.

5. MARKET SCENARIO OF MASALA BONDS

Masala bonds are at its initial steps, though it has all the prospective of going forward and can be very beneficial for our economy.With International Finance Corporation (IFC), Inter American Development Bank (IDB) and Europion bank for reconstruction and development (EBRD) , 13 rupee denominated bonds has been listed on London stock exchange which has increased primary market activity between 2014 and 2015. On 30th March 2017 , world's largest rupee denominated masala bond has been accepted by London Stock Exchange. Bond listing on London srock exchange (Table-4) is increasing with the passage of time and Masala bonds are now taking stock of the development in the corporate market.

Table-4 Masala Bond on London stock exchange

a) Active Masala bonds

Issuer name	**Coupon (%)**	**Amount raised (Rs.)**	**Issue date**	**Maturity Date**
Housing Development Finance Corporation Ltd.	7.875	30,000,000,000	21/07/16	21/08/19
International Finance Corporation	7.1	2,000,000,000	21/03/2016	21/03/2031
European Bank for Reconstruction & Development	6.4	5,000,000,000	04/03/2016	04/03/2019
International Finance Corp	6.45	3,150,000,000	10/08/2015	10/08/2020
International Finance Corp	6.45	18,000,000,000	30/04/2015	30/10/2018
European Bank for Reconstruction & Development	5.1	3,111,000,000	02/02/2015	02/02/2017
International Finance Corp	6.3	10,000,000,000	17/11/2014	25/11/2024
European Bank for Reconstruction & Development	5.625	5,500,000,000	28/10/2014	15/03/2017
European Bank for Reconstruction & Development	5.75	3,000,000,000	19/09/2014	19/03/2018
Inter-American Development Bank	6	8,500,000,000	05/09/2014	05/09/2017
Inter-American Development Bank	6.1	4,000,000,000	02/09/2014	02/09/2016
Inter-American Development Bank	8.25	1,500,000,000	15/05/2007	15/05/2017

Source: Report of London stock exchange, data as on 26th July 2016

b) Matured Masala bonds

Issuer name	Coupon (%)	Amount raised	Issue date	Maturity Date
European Bank for Reconstruction & Development	6.3	1,900,000,000	24/06/2015	24/06/2016
European Bank for Reconstruction & Development	6	25,000,000,000	03/09/2014	03/03/2016
European Bank for Reconstruction & Development	6.2	8,000,000,000	27/06/2014	27/06/2015
European Bank for Reconstruction & Development	7.65	10,350,000,000	18/02/2014	18/02/2015
Inter-American Development Bank	7.125	1,000,000,000	24/01/2014	24/07/2015
European Bank for Reconstruction & Development	8	2,250,000,000	12/11/2013	12/11/2014
European Bank for Reconstruction & Development	5	12,000,000,000	28/05/2013	28/05/2015
European Bank for Reconstruction & Development	5.25	8,750,000,000	07/02/2013	07/02/2014
European Bank for Reconstruction & Development	5	2,000,000,000	04/02/2013	24/07/2015

European Bank for Reconstruction & Development	4.75	1,040,000,000	25/10/2012	25/10/2015
European Bank for Reconstruction & Development	5.25	5,000,000,000	06/06/2011	06/06/2014
European Bank for Reconstruction & Development	5.5	2,000,000,000	19/04/2011	19/10/2012
European Bank for Reconstruction & Development	5.25	2,700,000,000	15/02/2011	15/08/2012
Morgan Stanley	7	70,000,000	11/02/2011	11/02/2014
Inter-American Development Bank	4.75	17,000,000,000	10/01/2011	10/01/2014
Inter-American Development Bank	3	2,000,000,000	25/03/2010	25/03/2014
European Bank for Reconstruction & Development	7	1,000,000,000	30/07/2007	30/07/2012
Barclays Bank PLC	-	2,000,000,000	10/04/2007	17/01/2017

Source: Report of London stock exchange, data as on 26th July 2016

6. REWARDS OF MASALA BONDS

a) Indian corporations can diversify their bond portfolio with the help of masala bonds in addition to corporate bonds and ECBs.

b) Indian corporations can cut down cost with the help of masala bonds.i.e. to issue bonds in India the interest rate should be between 7.5%-9% whereas masala bonds can be issued at an interest rate of below 7%.

c) A large number of investors can be tapped as masala bonds are issued in the overseas market.

d) Indian corporations can increase the confidence of foreign investors' in Indian economy and currency and this can lead to strengthen the offshore investments in the country.

e) Foreign investor can earn better returns by investing in Masala Bonds in spite of investing in his own home country that is because minimum assured masala bond yield of 5% to 7%.

f) More of foreign funds can be pooled by masala bonds for infrastructural development in India.

g) Masala bond can help to enhance internationalisation of Indian currency.

7. DOWNSIDE OF MASALA BONDS:

To issue rupee denominated debt instrument abroad is indeed a welcome sign, but such kind of borrowing considered as a part of India's foreign borrowings. To ample amount of masala bonds can ruin India's image as masala bond is after all a debt instrument. In non-deliverable forward market overseas the hedgers (investors) may hedge their investments in masala bonds and RBI will not be able to control such hedging activities. These rupee bonds can create a negative impact on the growth of Indian Banks and also on the Indian Corporate Bond Market, because in masala bonds currency risk is being borne by the investors hence they examine it by each angle before its' subscription.

Finance specialists are recommending to country and corporations not to rely too much on masala bonds because it can lead country to downgrading by various rating agencies.

8. CONCLUSION

Rupee denominated bonds "Masala Bond" has definitely begun a new era in the field of corporate debt issuance. By issuing bonds in rupee in the foreign countries India has internationalise the Indian currency at world level and have created a win win situation for all i.e. corporations, investors. In the near future masala bonds can pool a large amount of foreign funds into the country and can develop infrastructure which is the pressing need of time. These bonds will also strengthen the road of deep corporate bond market.

The market of corporate bonds in India has always been on the road of gradual process as compared to other countries in the world. It is really important to comprehend whether the regulators have enough willingness to shift away from a loan-driven bank-dependent economy and also its time to check whether the corporations themselves have strong incentives to develop a deep robust bond market.

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