Voluntary Retention Route for FPIs

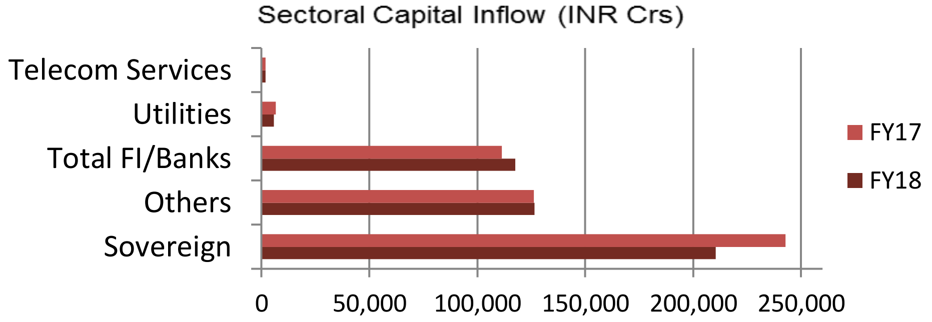
The regulatory framework for FPI investment in debt has evolved over the years, influenced by trade-offs in encouraging capital inflows and attendant macro-prudential considerations. Investments by Foreign portfolio investors (FPIs) in corporate debt was in the range of $8 billion to $9 billion between January 2014 and June 2017. However, the trend was reversed in 2018 with FPIs having sold $9,740.6 million worth of debt instruments in the year so far. Additionally, fresh inflows dried up after introduction of concentration norms in April 2018 where upper limits were placed categorically on investors. In order to encourage capital inflows from FPIs, the RBI has proposed introduction of the **Voluntary Retention Route** (VRR) channel to attract long-term and stable FPI investments into debt markets while providing FPIs with operational flexibility to manage their investments.

Voluntary Retention Route

Voluntary Retention Route (VRR) is a channel to attract long-term and stable FPI investments into debt markets while providing FPIs with operational flexibility to manage their investments. Any entity registered as an FPI with SEBI is eligible to participate through this route and would have to stay invested for the minimum retention period of three years, or as decided by RBI for each auction.

Allocation of Funds

The total amount that may be invested shall be decided by the Reserve Bank from time to time, based on the health, soundness and vulnerabilities



Source: NSDL

of the financial system and assessment of investment demand. Investments through this route shall be in addition to the FPI investment limits and shall be individually allocated to FPIs through an auction process and termed as Committed Portfolio Size (CPS). This amount shall be separately indicated for Government securities as VRR-Govt and for corporate debt as VRR-Corp. The criterion for allocation of investment amount to each FPI shall be the retention period proposed by the FPI in the bid. Bids shall be accepted in descending order of retention period with the highest being first, until the amount of accepted bids adds up to the auction amount. In case there are multiple bids at the cut-off retention period, the investor with the largest amount would win the bid and if the amounts are same, the amount will be allocated equally.

Management of portfolio

Successful bidders will be given a period of one month, starting from the date of announcement of auction results, to invest. FPIs shall invest the allocated CPS in debt instruments with the minimum investment during the retention period at 67% of the CPS within the one-month period. The minimum investment would be in terms of face value, checked at end-of-day basis and not include cash or deposits. Any investments between 67% - 100% of CPS are intended to enable FPIs to adjust their portfolio composition as per their investment philosophy. Any income received from investments of the CPS may be reinvested at the discretion of the FPI and permitted beyond the CPS. The securities eligible under VRR-Govt are any government securities, including treasury bills and under VRR-Corp, corporate debt instruments, including commercial papers. FPIs coming via VRR are exempt from regulatory provisions such as the cap on investments in G-secs, SDLs and corporate debt securities of 15% for Long-term FPIs and 10% for other FPIs. Additionally, caps on exposure to a corporate group at 20 per cent of portfolio size and 50 per cent of a single issue have been relaxed.

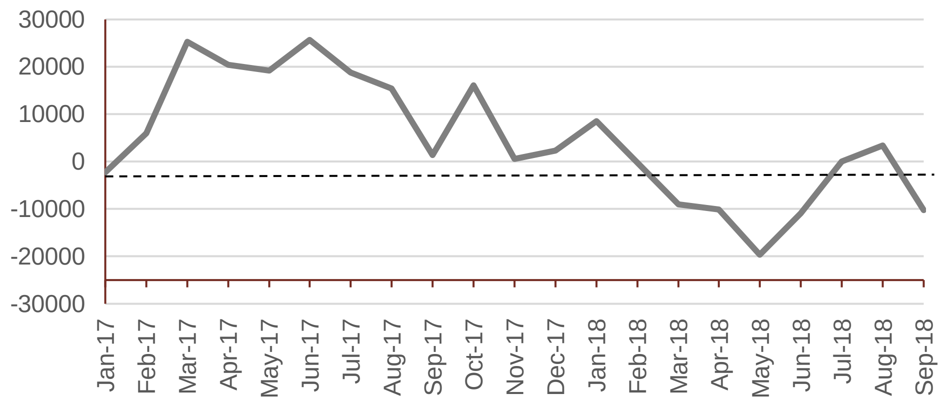
Access to other facilities

Any FPI using the VRR facility would be eligible to participate in repos for liquidity management with an upper limit of 10% of the total amount of the CPS. Additionally, any transaction of the repos would be independent of the minimum holdings below 67% of the CPS. FPIs would also be eligible to participate in currency and interest rate derivative instruments to hedge their interest rate or currency risk.

Termination of VRR

An FPI will exercise its choice to continue investments under this Route one month prior to the end of the committed retention period, by opting for an additional identical retention period. In case an FPI decides not to continue under VRR at the end of the retention period, it may choose to liquidate its portfolio and exit, or it may shift its investments to the 'General Investment Limit'. However, shifting of the portfolio would be subject to availability of the General Investment Limit. Additionally, if an FPI exits from all its activities in India, wish to liquidate their investments under the Route prior to the end of the retention period, may do so by selling their investments to other FPI or FPIs. An FPI that violates any of its commitments under this Route shall be deregistered by SEBI.

FPI Net Inflows/Outflows (INR Cr)



Source: NSDL

Conclusion

Though this is currently a discussion paper by the RBI and further amendments could possibly be made, the proposed relaxation can have significant impact on the dollar flows into the country, which will partly help to ease pressure on the depreciating rupee. The relaxation will also encourage investment in stressed companies, where there is a great need of fresh capital to turn them around. Additionally, these steps will further help in deepening of the debt market in India and ensure retention of funds, preventing volatility.

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