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Masala Bonds: One Year On

RBI's Regulatory Framework for Masala Bonds

The Reserve Bank of India (the "**RBI**") established the framework for borrowing by Indian companies through the issuance of Indian Rupee ("**INR**") denominated, U.S. dollar ("**USD**") settled bonds overseas ("**Masala Bonds**") through its September 2015 circular as well as in paragraph 3 of its January 2016 Master Direction on External Commercial Borrowings. Our initial client alert on the Masala Bonds framework is available here.

After a lukewarm start, there have now been several successful masala bond offerings, including by HDFC, NTPC, Indiabulls, Adani Transmission, and most recently, ECL Finance (on which Baker & McKenzie.Wong & Leow acted as international legal counsel to the joint lead managers). Over the course of the last year, the RBI has made certain amendments to the Masala Bonds framework to make these instruments more marketable to investors, while also trying to regulate the investor pool.

On 13 April 2016, the RBI issued a circular amending the regulatory framework for Masala Bonds (the "**April Amendment**"). Set out below is a summary of the key changes.

Tenor

The minimum maturity period for Masala Bonds has been reduced from five years to three years, which aligns the tenor of these bonds with that of domestic Indian corporate bonds that foreign portfolio investors can invest in.

Amount

The maximum amount which can be borrowed by an entity in a financial year under the automatic route by issuance of Masala Bonds, which was earlier USD 750 million, has now been translated to INR and fixed at INR 50 billion. Borrowings beyond INR 50 billion in a financial year require prior approval of the RBI.

Investor Base

Eligible Jurisdictions: Previously, any investor from a Financial Action Task Force ("**FATF**") compliant jurisdiction could invest in Masala Bonds. Following the April Amendments, Masala Bonds cannot be subscribed by a resident of any country:

- which is not a member of FATF or a member of a FATF-style regional body; or
- whose securities market regulator is not a signatory to the IOSCO's "Multilateral Memorandum of Understanding (Appendix A Signatories)" or a signatory to a bilateral memorandum of understanding with the SEBI for information sharing arrangements; or

- which is identified in the public statement of the FATF as:
  - a jurisdiction having strategic Anti-Money Laundering (AML) or Combating the Financing of Terrorism (CFT) deficiencies to which counter measures apply; or
  - a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the FATF to address the deficiencies;

A jurisdiction must satisfy **all** the above criteria to make it possible to market Masala Bonds to an investor in that jurisdiction.[1] Key jurisdictions such as the United States, the United Kingdom, Singapore, Hong Kong and Australia continue to be eligible.

Transfer Restrictions: The April Amendment requires the implementation of transfer restrictions which restrict the transfer of Masala Bonds to investors that satisfy the eligibility criteria set out above.

Identity of Investors: The April Amendment also requires that the documentation for the issuance of Masala Bonds include provisions that enable Indian issuers to obtain the list of "primary" bondholders and also authorise Indian issuers to share this list with regulatory authorities in India.

As a practical matter, the issuer will likely be able to only obtain the list of primary bondholders from the lead managers to the offering. Identifying holders of bonds that clear through the international clearing systems (the "**ICSDs**"), such as Euroclear Bank S.A./N.V. and Clearstream Banking, société anonyme, is dependent on such holders agreeing to identify themselves. The ICSDs protect the identity of their accountholders and do not share their details with issuers or any external parties.

Issuance of Masala Bonds by Indian Banks

On 3 November 2016, the RBI announced that, in consultation with the Government of India, banks are permitted to issue (i) perpetual debt instruments that qualify for inclusion as Additional Tier 1 capital, and (ii) debt capital instruments that qualify for inclusion as Tier 2 capital, by way of Masala Bonds. Such issuances must comply with the requirements of the RBI master circular on Basel III Capital Regulations.

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1 Example: **Mauritius**

The Republic of Mauritius is an eligible jurisdiction because:

- While it is not a member of FATF, it is a member of the Eastern and Southern Africa Anti-Money Laundering Group, which is an FATF-style regional body.
- It is also an Appendix A signatory to the IOSCO Multilateral Memorandum of Understanding.
- Finally, it does not appear in the last FATF public statement (dated 21 October 2016) as being a jurisdiction that has strategic deficiencies.

Banks are now permitted to also issue long term Masala Bonds to finance infrastructure and affordable housing, subject to compliance with the "Guidelines on Issue of Long Term Bonds by Banks – Financing of Infrastructure and Affordable Housing" issued by the RBI.

Underwriting by the overseas branches or subsidiaries of Indian banks for such issuances will not be allowed.

Baker & McKenzie.Wong & Leow recently acted as international legal counsel to the joint lead managers on the offering of INR 5,020,000,000 9.05 per cent. Senior Secured INR Denominated USD Settled Notes due 2019 by ECL Finance Limited. ECL Finance Limited is a member of the Edelweiss group.

This client alert is provided for general information purposes only, is not meant to be exhaustive, comprehensive or authoritative and does not constitute legal advice. Baker & McKenzie does not practice Indian law and the summaries of Indian laws or regulations contained herein are derived from discussions with Indian legal counsel. The various aspects of Masala Bonds discussed in this client alert can be developed in greater detail on request and we can further analyse issues specific to a proposed transaction, on a case by case basis.