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Indian regulator suspends issuance of ‘masala bonds’

Indian regulator suspends issuance of ‘masala bonds’ Regulators act as foreign holdings of rupee-denominated debt sold offshore nears cap Read next Indian chicken farms found to breed superbugs Masala bonds are bonds issued outside India but denominated in Indian rupees © Bloomberg Share on Twitter (opens new window) Share on Facebook (opens new window) Share on LinkedIn (opens new window) 0 Save JULY 21, 2017 by: Simon Mundy in Mumbai and Kiran Stacey in New Delhi India’s securities regulator has suspended the issuance of offshore “masala bonds”, after strong investment in rupee-denominated debt left foreign holdings pushing up against the legal limit.

India’s government has been keen to encourage the growth of masala bonds, which have enjoyed strong foreign interest since the first corporate issuance last year, with investors attracted by strong yields and robust economic growth.

Along with still-stronger inflows to the domestic corporate bond market, this has pushed foreign holdings to 92.7 per cent of the authorised limit of Rs2.4tn ($38bn), imposed under India’s capital control regime aimed at maintaining currency stability.

Issuance of masala bonds will now be suspended until foreign holdings of rupee-denominated Indian corporate loans fall below 92 per cent of the limit, the Securities and Exchange Board (Sebi) has ordered, putting a sudden brake on the nascent market.

Officials held a series of meetings with investors and issuers on Friday as they looked to clarify the rules. One person involved in issuing masala bonds condemned the move as sudden and disruptive, saying: “We thought they were keen to encourage more such bonds, not stop them.”

But the intervention may have been a prudent move to ensure that new inflows did not push foreign holdings over the legal limit, necessitating still more drastic action by the authorities, said Pratap Amin, former India head for Freshfields, the law firm.

Through several issuances by state-owned companies India's government has fostered the growth of the masala bond market, seen as an important means for companies to access overseas funding without taking on currency risk. During the financial year ending in March, $4.6bn of masala bond issuance was approved, according to ICRA, a rating agency.

But Sebi's intervention is just the latest indication that Indian authorities are now seeking to restrain the market's rapid growth. It comes a month after the Reserve Bank of India ordered that the overall cost to the issuer of masala bonds must be no more than 300 basis points above the yield of Indian sovereign bonds of equivalent maturity — a move seemingly aimed at restricting issuance by lower-rated companies.

The rush of interest in masala bonds was "a nice problem to have," said Deepak Parekh, chairman of Housing Development Finance Corporation. HDFC became the first corporate issuer in the asset class last July, selling Rs30bn ($447m) of three-year rupee bonds in London at an annualised yield of 8.33 per cent. "India's macro fundamentals are all positive, and if the country continues to do well, there will always be demand for masala bonds," Mr Parekh said. As of Thursday masala bonds accounted for Rs402bn of Rs2.3tn in corporate bonds held by foreign investors - up from zero and Rs1.6tn, respectively, a year before. Despite these inflows, India's corporate bond market remains far smaller, relative to its economy, than those of China and other major emerging markets, with companies still relying heavily on bank funding.

Abhinav Harlalka, a lawyer at Nishith Desai Associates, said that the authorities could decide to increase the investment limit, if the foreign interest in Indian corporate bonds is sustainable. "They are waiting and watching to see whether this money is here to stay, and if that is the case, they would increase the limit," he said.