Corpsec Hotline

February 11, 2009

DEBT IS THE FLAVOR OF THE SEASON

Introduction

High interest rates coupled with the extreme volatility in the secondary markets have made debt an attractive investment option for many investors. As investors revisit the asset allocation of their portfolios at this stage, an increased exposure to debt has been recommended.

In order to address this growing demand for debt investments by Foreign Institutional Investors (**"FII"**), the Securities and Exchange Board of India (**"SEBI"**) vide Circular No. IMD/FII & C/ 37/2009 dated February 6, 2009 increased the cumulative debt investment limit for FII investments in corporate debt to USD 15 billion, which was earlier pegged at USD 6 billion. This move by SEBI is also in accordance with the Government of India's earlier announcement that "in order to give a boost to the corporate bond market, the FII investment limit in rupee-denominated corporate bonds in India would be increased from $6 billion to $15 billion".

Notably, as opposed to the "first come first served" method that was used for the allocation of the earlier limit of USD 6 billion, SEBI has, for the first time, introduced an open bidding process for allocation of USD 8 billion of the additional USD 9 billion.

New open bidding process

As stated above, SEBI has decided that USD 8 billion of the USD 15 billion shall be allocated to the FII or sub-accounts, as the case may be, in an open bidding platform. Successful bids shall be based on the bid price (which will be expressed in basis points) and within that time priority. The initial bidding platform shall be offered by the National Stock Exchange of India Ltd. (**"NSEIL"**) and subsequently the bidding shall be done on Bombay Stock Exchange Limited (**"BSE"**), and thereafter by turns. The bidding session shall be for two hours and the FII or sub-accounts, as the case may be, shall provide the mandate to the existing trading members, who in turn shall bid for the limits. The minimum bid amount shall be Rs 250 crore and allocation of limits below that amount (up to Rs 249 crore) shall take place on a "first come first served basis" for which requests shall be called for at a later date. The allocated amount on the first come first serve basis shall be utilized within 11 working days from the date of the allocation. The minimum tick size for bids in excess of Rs. 250 crore shall be Rs 100 crore and the minimum bid price shall be Rs 1000. Under the bidding process, no single entity shall be allocated more than Rs 10,000 crore (Rs. 100 billion) of the investment limit and the allocated amount shall be utilized in 45 days. The limits shall be translated into rupee terms at the Reserve Bank of India reference rate as on the date the bidding takes place. Here it is pertinent to note that the other modalities of the bidding platform shall be announced by the NSEIL and the BSE, as the case may be.

Remarks

As mentioned above, SEBI's move to increase the cumulative debt investment limit for FIIs is aimed at addressing the increased demand for debt, which is an obvious outcome of the current volatility in the equity markets. It is not difficult to ascertain SEBI's intention behind introducing the new bidding process for allocation of a major part of the increased debt limits. As we noted, under the erstwhile "first come first serve basis", there was always a lengthy queue of FIIs waiting to be allocated a portion of the debt investment limit and the allocation may or may not coincide with the considerations of such FIIs, thus leading to a lapse of the allocation. We believe that the new bidding process is the need of the hour that would help the FIIs in getting the required allocation on a speedier basis and would additionally address the liquidity crunch in the Indian markets through infusion of additional funds. In addition to solving the problems attached to the "first come first served method", another possible justification is that the new bidding process (and the consequent payment of fees) could determine the sincerity of FIIs to utilize the debt amount allocated to it.

Source: SEBI's Circular No. IMD/FII & C/ 37/2009

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You can direct your queries or comments to the authors

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