

## Corpsec Hotline

March 13, 2012

### NO INSIDER TRADING: IF NOT 'ON THE BASIS OF' UNPUBLISHED PRICE SENSITIVE INFORMATION

The Reserve Bank of India ("RBI") recently issued a circular being A.P. (DIR Series) Circular No. 89 dated March 1, 2012 ("Circular 89") whereby it permitted the foreign institutional investors ("FIIs") to invest in primary issuances of non-convertible debentures ("NCDs") / bonds by an Indian company if the listing of such NCDs / bonds is committed to be done within 15 days of such investment.

### BACKGROUND

Schedule 5 of the Foreign Exchange Management (Transfer or Issue of security by a person resident outside India) Regulations, 2000 ("TISPRO") which talks about "*Purchase and sale of securities other than shares or convertible debentures of an Indian company by a person resident outside India*", permits an FII to purchase listed<sup>1</sup> NCDs / bonds. The Securities Exchange Board of India ("SEBI") too had in its Circular No. IMD/FII/20/2006 dated April 05, 2006 clarified that as per the Government of India and the RBI, FII investments shall be restricted to only listed debt securities of companies.

However, vide Circular No. CIR/MD/FII/18/2010 dated November 26, 2010, SEBI allowed FIIs to invest in primary debt issues, if listing of such debt securities was committed to be done within fifteen days. It further said that "*in the circumstances that the debt issue cannot be listed within 15 days of issue for any reasons whatsoever, then the holding of FIIs/sub-accounts if disposed off shall be sold off only to domestic participants/investors until the securities are listed.*" Since, an amendment was not made in TISPRO nor was the relaxation provided by the RBI, there prevailed an ambiguity as to whether debt securities could indeed be issued to FIIs directly, however, the market participants on a more conservative approach continued to use a warehousing entity to hold the NCDs during the transitional period until listing.

### THE CHANGE

Circular 89 as now issued by the RBI has removed this discord, and provides that:

"SEBI registered FIIs/sub-accounts of FIIs can now invest in primary issues of Non-Convertible Debentures (NCDs)/ bonds only if listing of such bonds / NCDs is committed to be done within 15 days of such investment. In case the NCDs/bonds issued to the SEBI registered FIIs / sub-accounts of FIIs are not listed within 15 days of issuance to the SEBI registered FIIs / sub-accounts of FIIs, for any reason, then the FII/sub-account of FII shall immediately dispose of these bonds/NCDs either by way of sale to a third party or to the issuer and the terms of offer to FIIs / sub-accounts should contain a clause that the issuer of such debt securities shall immediately redeem / buyback the said securities from the FIIs/sub-accounts of FIIs in such an eventuality."

### IMPACT AND CONCLUSION

Earlier, as FIIs could only purchase listed NCDs / bonds on the floor of a recognized stock exchange, the Indian companies first issued the debt securities to a warehousing agency in India on a private placement basis, which continued to hold the NCDs until the listing of the debt securities. Subsequent to the listing, the debt securities were purchased by the FII on the floor of the stock exchange. By providing that FIIs can now invest in primary issuance of NCDs / bonds, the requirement of having an intermediate warehousing agency seems to have been done away with. This may not only reduce the costs involved in engaging such a warehousing agency, but should also quicken the process of acquisition of NCDs by FIIs, as FIIs may no longer be required to wait for listing of debt securities. However, on the flip side, if the FIIs are in the process of acquiring debt allocation limits and considering that the fresh debt limits acquired by the FIIs can now be not used for re-investment<sup>2</sup>, the warehousing agency may still be of relevance.

Further, since listing of debt securities post an in-principle approval from the stock exchanges is a fairly simple and quick process, the requirement of committing to list the debt securities within 15 days of issuance, should not be much of an issue. However, in case the issuer fails to list the NCDs, as per Circular 89, the FIIs are required to dispose of the NCDs either by way of sale to a third party or to the issuer, or by way of redemption or buy back of the NCDs by the issuer.

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You can direct your queries or comments to the authors

<sup>1</sup> The term 'listed' was inserted vide Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Second Amendment) Regulations, 2008, Notification No. FEMA.149/2006-RB dated June 9, 2006

<sup>2</sup> Please refer to our hotline titled – SEBI Strips FIIs of Re-Investment Facility in Debt dated January 10, 2012

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