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A New Finacial Instrument Masala Bonds

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ABSTRACT

The bond market is a financial market where participants can issue new debt, known as the primary market, or buy and sell debt securities known as the secondary market. This is usually in the form of bonds, but it may include notes, bills and so on. TO pulling the foreign investments to India INTERNATIONAL FINCIAL CORPORATION issued first masala bond in November 2014 when it raised 1000 crore bond to fund infrastructure projects in India. This research paper is conducted with the help of secondary data sources like RBI websites, Wikipedia, and various articles. Though investors get a new financial debt instrument to invest for their long term purposes, they are still not aware about the features and disadvantages of masala bond market. Indian PSBs also facing challenges regarding the issuance of bonds and its taxation process. Depending on the masala bonds for getting foreign investment is good for some extent but too much dependence will lead to a negative exposure and ultimately it affects the investments to India.

1. INTRODUCTION

Masala bonds are bonds issued outside India but denominated in Indian rupees, rather than the local currency. Masala is an Indian word and it means spices. The term was used by the international Finance Corporation to evoke the culture and cuisine of India. Unlike dollar bonds, where the borrower takes the currency risk, Masala bond makes the investors bear the risk. The first Masala bond was issued by World Bank backed IFC in November 2014 when it raised 1000 crore bound to fund infrastructure project in India. Late in august 2015 IFC for the first time issued green Masala bonds and raised rupees 3.15 billion to be used for private sector investments that address climate changes in India

In July 2016 HDFC raised 3000 crore rupees from Masala bonds and thereby become the first Indian company to issue bonds. In the month of august 2016 public sector unit NTPC issued first corporate Green Masala bonds worth 2000 crore rupees.

2. METHODS

Research data is analyzed through primary and secondary data. This article is presented with analysis of secondary data. Secondary data refers to data is collected by someone other than user common sources of secondary data for social science includes censuses, information collected by government departments, organizational records and data that was originally collected for other research purpose. This research paper is analyzed with various articles, RBI websites, and various financial institution websites. The study belongs to descriptive nature.

3. RESULTS

3.1 EVOLUTION MASALA BONDS:

Indian corporations and public sector undertakings use external commercial borrowings(ECB) and foreign currency convertible bonds(FCCB) as an instrument to access loan funds from the foreign markets as an instrument to access loan funds from the foreign markets. Since the funds raised through ECB/FCCB route are in foreign currency. Therefore the interest and the redemption proceeds are also in the foreign currency. The major risk faced by the foreign currency loan borrowed is the currency risk. Moreover in case the borrowers decided to cover his foreign currency exposure, the hedging cost adds to the cost of the funds procured. Whereas, in case the company opts to keep its foreign currency risk unhedged, it has to bear huge risk pertaining to currency rate fluctuation.

The total external commercial borrowings (ECB) for the first six months of the year 2016 amount to around USD 6.96 billion. These borrowings have maturity anywhere between 3-10 years. A study CRISIL in 2013 has shown outstanding foreign currency borrowings by Indian entities at over USD 200 billion. The matter that is the most dangerous and requires immediate attention is that, about half of currency exposure was unhedged. As the Indian rupee is depreciating, the currency risk looms large and this may trigger possible default.

In the earlier years, Indian organisations were able to get rollover of their foreign currency loans owing to the willingness of the lenders. This being mainly result of liquidity eases prevailing in the United States. However with the increased quantitative restrictions by the US fed, such route is no longer available.

This alarming condition forced to think of a solution for growing foreign currency risk. The solution was to issue Rupee Denominated Bonds (RDB's). So that Indian companies and PSU's do not have to bother about currency risk. These Rupee Denominated Bonds (RDB's) are named as "MASALA BONDS".

3.2 CONCEPTUAL FRAMEWORK OF MASALA BONDS;

The Reserve Bank of India has allowed Indian corporations to issue rupee denominated bonds overseas. As per the regulations issued by the RBI on September 29 2015, offshore RDBs would be in the form of plain vanilla bonds. These bonds can be issued any Indian company. Real Estate Investment trusts and Infrastructure investment Trusts that are subject to the regulatory jurisdiction of SEBI are also eligible. In addition to these The RBI on 25th august 2016 permitted banks to raise additional tier-I and tier –II capital through masala bond issues in overseas markets. Such bonds can be issued to any foreign investor from a Financial action Task Force(FATF) complaint jurisdiction for a minimum maturity period of 3 years. The maximum amount which can be raised through RDBs under the automatic route is US$ 750 million per annum.

3.3 MERITS OF MASALABONDS

3.3.1 TO CORPORATE

- It helps the Indian corporate to diversify their bond portfolio. While the bond issue is in off-shore market it facilitates Indian companies to value a large number of investor base.
- As interest rates in developed countries are much lower compared to India, corporate can borrow from overseas market at low interest rates.
- Being an issuer, Indian entity do not have to bear the risk of currency. That means there is any fluctuations in the currencies, the risk is totally lies with the off-shore investor.

3.3.2 TO INVESTORS

- An investor benefits from the masala bond if the rupee appreciates at the time of maturity.
- Rupees denominated bonds are building interest in the investors who are even unwilling to invest in the off-shore market.
- In order to attract and benefit more foreign investors, the Ministry of Finance has cut the withholding tax on interest proceeds of bonds from 20% to 5% and capital gains from appreciation of rupee are also exempted from tax.

3.3.3 TO INDIA

- As India has ambitious with few many goals like digital India, developing smart cities, Make in India etc, it will need INR 26 lakh crore in next five years. Rupee denominated masala bond is an efficient way to tap foreign capital.

- Masala bonds help in raising up the off-shore investor's confidence and knowledge about Indian economy.
- In India many long term projects like infrastructure and power are hindered due to shortage of capital. Long term Rupee Denominated bond is the best solution for road, power and infrastructure companies.

3.4 DEMERITS OF MASALABONDS

Along with the benefits of the masala bonds there are some risks involved with rapid shifts in capital flows, financial candidness, and the risk that overseas market may portray liquidity away from the domestic market.

4 DISCUSSIONS

The estimation of the capital required by the Indian public sector banks is heavily dependent on the assumed growth of RWAs during the period in consideration. Due to scarcity of capital, some banks may decide to manage their RWA growth in order to minimise their capital requirements and as such the amount of capital required by Indian PSBs as a bank group will also vary accordingly.

Also while many Indian PSBs do have some presence in other markets, some of smaller PSBs don't and they may not be able to attract large amount of investors in Masala Bond market. For such banks, accessing domestic bond market will remain to be a major source of capital raising.

Foreign investors take currency risk when buying masala bonds; in addition to this, there is limited offshore liquidity in rupee and cost of hedging which will be other concerns for investors before going to masala bonds. In order to create confidence among foreign investors for masala bonds following steps can be taken;

- There should be statutory provision of listing masala bonds in at least three international stock exchanges to resolve liquidity issue among investors. Subsequently this will enhance circulation of Indian rupee in world economy.
- Domestic institutional investors shall be allowed to buy and sell these bonds at secondary markets. This funguibilty will result in synchronisation of yields between on shore and offshore markets.
- Withholding tax should be further reduced from 5% to a nominal rate to encourage the Indian entitles to go for masala bonds, which subsequently enhance governments' tax proceeds in years to come.
- Hence it is also suggested to allow domestic institutional investors to buy in secondary market. So that these institutional investors can later sell it
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- insurance companies, pension funds and mutual funds.

5 CONCLUSIONS

With Basel –III capital regulations fully kicking –in by march 2019, the capital requirement for Indian PSBs is huge. While equity raising is definitely a concern for these banks, they have large scope to raise capital through ATI and Tier -2 bonds. In this regard, masala bond market may be the most viable option for these banks to raise capital due to certain inherent characteristics of the market. The masala bond market at present is at a very nascent stage, but has huge potential with a much wider investor base and grater appetite. This could come to the rescue of Indian PSB'S and solve a lot of their capital raising related problems.

The issuance of masala bonds by the RBI could be the major advancement for the Indian economy. The recent opportunity for Indian banks to raise foreign currency through RDBs is also an enlightening step towards the growth. Depending on the masala bonds for getting foreign investment is good for some extent but too much dependence will lead to a negative exposure and ultimately it affects the investments to India.

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