Voluntary Retention Route for Foreign Portfolio Investors

written by Kulin Dave | May 7, 2019

In March 2019, the Reserve Bank of India (RBI) along with Government of India and the Securities and Exchange Board of India (SEBI) introduced a separate scheme called "Voluntary Retention Route"[1] to encourage Foreign Portfolio Investors (FPI) to lock their investments in India for a considerable period. This route has been introduced in an attempt to boost foreign investment in the Indian debt market by such investors, as the market witnessed a sharp decline after the FPIs sold their debt securities worth INR 1900 Crore in February 2019[2].

This scheme was earlier proposed in October 2018 by the RBI through a discussion paper[3] and, following the representations and suggestions from market participants, it released a circular[4] that notified the FPIs regarding the Voluntary Retention Route provided to them to voluntarily invest in both government securities like treasury bills and state development funds as well as corporate debt instruments (specified in schedule 5 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India Regulations, 2017; excluding units of domestic mutual funds and dated government securities) subject to the condition that the investment must be locked in India for a minimum period of three years.

Key Features:

1. The circular notifies that investment through the VRR route shall be free of any regulatory approvals applicable to investments normally made by the FPIs in India in the debt market. This implies that there shall be more freedom than regular foreign debt investors if such route is followed. Also, the "Minimum Residual Maturity Requirements" which are currently applicable on corporate bonds in India (as specified in paragraphs 4(b), (e) and (f) respectively of A.P. (DIR Series) Circular No. 31[5] dated June 15, 2018) shall also not be applicable on the investments made through the VRR, provided the FPI maintains a minimum of 75 percent investment for three years in India. For government bonds, the RBI had earlier in 2018 removed such restrictions on central government securities and state development loan categories subject to the condition that the total investment made by an FPI in any category shall not exceed 20 percent in case these securities have a residual maturity of less than a year.
2. The cap set for investment through the VRR is fixed at INR 40,000 crore for government debt and INR 35,000 crore for corporate debt per annum. An amount higher than this can be invested only with the prior approval of the RBI and the allocation i.e. the "Committed Portfolio Size" (CPS) of each investor

shall be carried out by the Clearing Corporation of India Limited (CCIL) on “first come, first-served” basis.

3. The RBI has again introduced the auction process to allow the FPIs to invest in India in a fair manner. Through the auction, the FPIs have been allowed to place their bids regarding their total investment and the retention period proposed by them in each category of securities. The allocation shall be made to them on the basis of the retention period specified by them i.e. the investor with the highest retention period being allocated the CPS first.
4. After the allocation is made, the investors are required to invest minimum 25 percent of their CPS in the first month of allotment and at least 75 percent of their CPS in the total retention period. Such amount shall be determined on the face value of the securities. The return of money to the cash accounts of such FPIs shall not be allowed if such withdrawal leads to a decline of more than 75 percent of CPS during their retention period.
5. It has been already discussed how volatile investments through FPIs are due to their event-specific nature. Therefore, the RBI, in March 2019 released another circular[6] to reduce the risk of losses that might be caused to the investors due to a change in the exchange rate and associated risks. Through the circular, RBI has now allowed authorized dealers to offer derivative contracts to participants under the VRR and the products available for hedging purposes are forwards, options, cost reduction structures and currency swaps with rupee and one of the currencies. The FPIs are also allowed to freely cancel and rebook the derivate contracts.

Accordingly, amendments were made to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 where a clause was added:

“(5)(a) A Foreign Portfolio Investor or a Non-Resident Indian (NRI) or an Overseas Citizen of India (OCI) may trade or invest in all exchange traded derivative contracts approved by Securities and Exchange Board of India from time to time subject to the limits prescribed by Securities and Exchange Board of India and conditions specified in Schedule 5”.

The RBI has undertaken several measures to address the liquidity concerns from the Indian debt market. Earlier, in January 2019, it revised the “External Commercial Borrowings” (ECB) norms to open the funding doors in India. Through the VRR scheme too, it shall be possible to allow funds

to be invested in the defaulted assets of India, which shall help the banks to
alleviate their concerns over the non-performing assets.

The RBI has also looked into some operational aspects of funding through this route to avoid any difficulty in the future. It requires the FPIs to open one or more separate special non-resident rupee (SNRR) accounts for investment through the route. All fund flows relating to investment through the route shall reflect in such account(s).

Contributed by - Kulin Dave

---

[1] https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR20867E7C97389C0342B7BFC03DD1F4EC87BF.PDF

[2] https://www.businesstoday.in/top-story/foreign-portfolio-investors-pull-out-rs-1900-crore-from-debt-market-in-february/story/321764.html

[3] https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=45165

[4]https://m.rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=11492

[5] https://www.rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=11303

[6] https://m.rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=11493

King Stubb & Kasiva,
Advocates & Attorneys
Click Here to Get in Touch
New Delhi | Mumbai | Bangalore | Chennai | Hyderabad | Kochi
Tel: +91 11 41032969 | Email: info@ksandk.com