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Voluntary retention route for FPI debt investment

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This regulatory update has been prepared by **Shardul Amarchand Mangaldas & Co**. to bring to your attention the "Voluntary Retention Route" (the "**VRR Scheme**"), as revised by the Reserve Bank of India ("**RBI**") on May 24, 2019 (the "**May Circular**"), for debt investments by Foreign Portfolio Investors ("**FPIs**") – free of macro-prudential and general investment limits – provided that participating FPIs voluntarily commit to retain a certain percentage of such investments in India for a period, in the manner discussed below. The original VRR Scheme, which had been notified by the RBI on March 1, 2019 stands superseded by the May Circular.

VRR Scheme - Key takeaways:

Who can participate?	Any FPI registered with the Securities and Exchange Board of India ("**SEBI**") is permitted to participate, on a voluntary basis.
How long is the window open?	This window is open for allotments only from May 27, 2019, until the earlier of December 31, 2019, or until investment limits allotted on tap or through auction (see below) are exhausted.
Allotment of investment limits	Investment amounts shall be available 'on tap' and will be allotted on 'first come, first served' basis. The mode of allotment to 'VRR-Govt', 'VRR-Corp' and 'VRR-Combined' categories and the minimum retention period shall be three years. In terms of the May Circular, under the auction mechanism, an FPI shall bid for the amount it proposes to invest and the retention period for that investment, which shall not be less than the minimum retention period applicable for that auction. The primary criterion for allotment for each auction is the retention period bid for in the auction. Bids will be accepted in descending order of retention period, in order to incentivize longer maturity periods.
Investment limits	Investment (in terms of face value) under the VRR Scheme is capped at ₹ 75,000 crore or higher for investment in (i) government debt instruments (VRR – Govt); (ii) corporate debt instruments (VRR- Corp); and (iii) VRR- Combined (instruments eligible under both VRR-Govt and VRR-Corp), as may be decided by the RBI from time to time, over and above general investment limits under the RBI Circular dated April 6, 2018. Further, out of the total investment limit of ₹ 75,000 crore, investment limit under the VRR-Combined category shall be ₹ 54,606.55 crores. FPIs that were allotted investment limits under the tap that was open from March 11, 2019 until April 30, 2019 may, at their discretion, convert their full allotment to 'VRR-Combined' by applying for investment limits online to CCIL through their respective custodians. Such conversion shall not be considered as using up to the investment limit of ₹ 54,606.55 crores.

<table>
<tr><td>Eligible instruments</td><td>Under the corporate route, an FPI may invest in a range of Rupee denominated instruments - non-convertible debentures or bonds (whether listed or unlisted), listed non-convertible redeemable preference shares, credit enhanced bonds, or commercial papers issued by an Indian company;
Rupee denominated bonds or units issued by infrastructure debt funds, or security receipts issued by Indian asset reconstruction companies.
Under the government route, an FPI may invest in central government dated securities, treasury bills or state development loans.</td></tr>
<tr><td>Exposure limit</td><td>Investments made under the VRR Scheme shall not be subject to any minimum residual maturity requirement, concentration limit or single/group investor-wise limits applicable generally under the June 15, 2018 RBI circular.
However, no FPI (including its related FPIs) shall be allotted an investment limit greater than 50% of the amount offered for each allotment by tap or auction in case there is demand exceeding 100% of the amount offered.</td></tr>
<tr><td>Minimum retention</td><td>The minimum retention period under the VRR Scheme shall be three years, or as decided by the RBI for each allotment or tap.
FPIs shall have the option to liquidate their investments prior to the end of the applicable retention period, by selling their investments to another FPI, who shall abide by the terms and conditions applicable to the selling FPI.</td></tr>
<tr><td>Management of Committed Portfolio</td><td>Successful allottees are required to invest 75%of amount allocated during the voluntary retention period (the “committed portfolio size”, or “CPS”) within 3 months from the date of allotment. The retention period will commence from the date of allotment of limit.
FPIs shall invest a minimum of 75% of the CPS at all times in the eligible instruments (see above).
The operational flexibility to modulate investments between 75%-100% of CPS is intended to enable FPIs to adjust their portfolio as per their investment philosophy.
At the end of the initial voluntary retention period, the FPI has the following flexibility:
liquidate its portfolio and exit, or
shift its investments to the ‘General Investment Limit’, subject to availability under the ‘General Investment Limit’, or
hold its investments until its date of maturity or until it is sold, whichever is earlier.
<table><tr><th>Option to Continue Identical Retention Period</th><th>Option to Exit or Shift to General Investment Limits</th></tr><tr><td>The FPI may continue investments under this route for an additional identical retention period.</td><td>Alternatively, the FPI may liquidate its portfolio and exit, or it may shift its investments to the general investment limit prescribed under the RBI Circular dated April 6, 2018, subject to availability.</td></tr></table></td></tr>
<tr><td>Repatriation</td><td>Custodians shall not permit any repatriation from the cash accounts of an FPI, if such transaction leads to the FPI’s assets falling below the minimum stipulated level of 75% of CPS during the retention period.</td></tr>
<tr><td>Compliance</td><td>FPIs shall open one or more separate Special Non-Resident Rupee (SNRR) accounts for investment under the VRR Scheme.
Utilisation of limits and adherence to other requirements of the VRR Scheme shall be the responsibility of both the FPI and its custodian.
Taking cognizance of operational difficulties that may arise in the course of portfolio management, FPIs have been permitted by the RBI, with the approval of the custodian, to regularize any minor violations immediately upon notice, and in any case, within five working days of the violation.</td></tr>
<tr><td>Access to Other Facilities</td><td>FPIs investing under the VRR Scheme are eligible to participate in repos for cash management, provided that the amount borrowed or lent under repo shall not exceed 10% of their investment under the VRR Scheme.
In addition, FPIs investing under the VRR Scheme are eligible to participate in any currency or interest rate derivative instrument, over the counter or exchange traded, to manage interest rate risk or currency risk. The products available for hedging purposes are forwards, options, cost reduction structures and currency swaps.</td></tr>
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SAM View

The VRR Scheme comes in the face of large FPI sell-offs of Rupee denominated debt, following a June 15, 2018 notification by the RBI, wherein the RBI had reduced the minimum residual maturity period for FPI debt investments from three years to one year, and introduced exposure norms for FPI debt investments, capping investments by FPIs at 50% for any corporate bond issuance (the limit notified on June 15, 2018 on exposure of a FPI to a single corporate at 20% of its corporate bond portfolio was withdrawn through a circular on February 15, 2019).

We are hopeful that the now extended VRR Scheme will encourage and facilitate substantial offshore participation in a wide variety of products in the Rupee debt market, given the significant operational flexibility under the VRR Scheme for FPIs to create and manage the committed portfolio size ("CPS"), including related hedging, liquidity and risk management requirements.

FPIs desirous of investing under the VRR Scheme may apply online to CCIL through their respective custodians. FPIs who were previously allotted investment limits on tap under the VRR Govt. or VRR Corp. tracks under the March 1, 2019 circular may also now convert and combine their full CPS into VRR Combined by applying to CCIL via custodians.

FPIs that have received allotment under the VRR Scheme must retain at least 75% of the allocated amount of the CPS (in the respective track) in India during the retention period, and custodians would not permit repatriation beyond the relevant limit during the retention period.

FPIs that may have missed the allotment window under the VRR Scheme initially may also have the opportunity to benefit from the operational flexibility available under the VRR Scheme, by buying the stake of an exiting FPI, upon acceptance of the retention period applicable to that CPS under the VRR Scheme.

The VRR Scheme also affords an opportunity to Indian issuers to attract long term funding, particularly stressed issuers in need of very large influx of investment to allow a turnaround. Longer term effects may include an easing of Rupee depreciation and a boost to more innovative and structured products in the Indian debt market.

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