India Fixed Income Investing for Foreign Investors

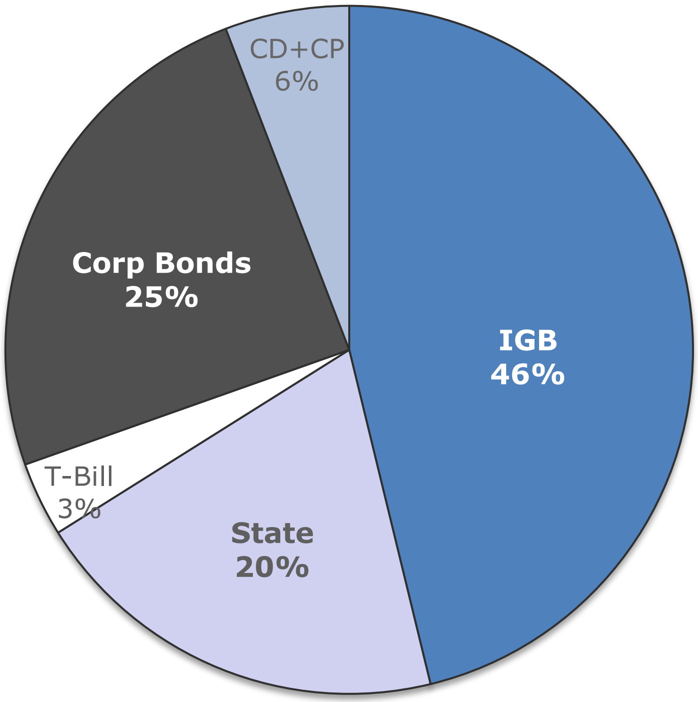
April 2018

Edelweiss
Ideas create, values protect

INR Debt Product Landscape

Outstanding Rupee Debt [Onshore]

Total Onshore Rupee Market Debt – USD 1.70 tn



	Current Outstanding (USD bn)
Govt Bond (IGB)	790
State	340
T-Bill	60
Corp Bonds	420
CD	30
CP	70
Total	**1700**

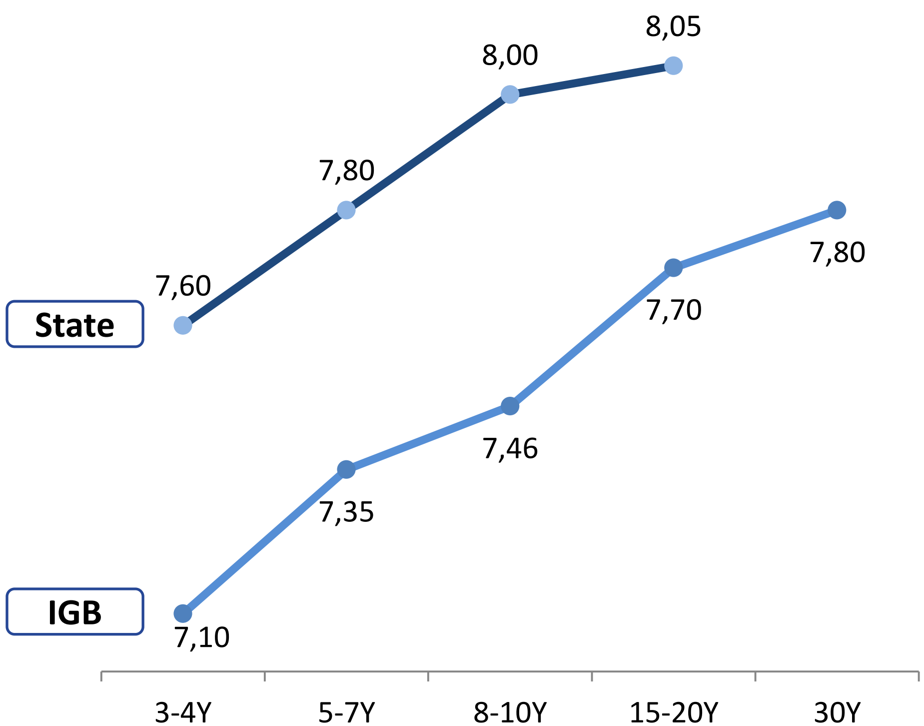
Sovereign

Corporate Bonds growing much faster than IGBs

Share in 2014: IGB – 51%, Corp Bond – 21%

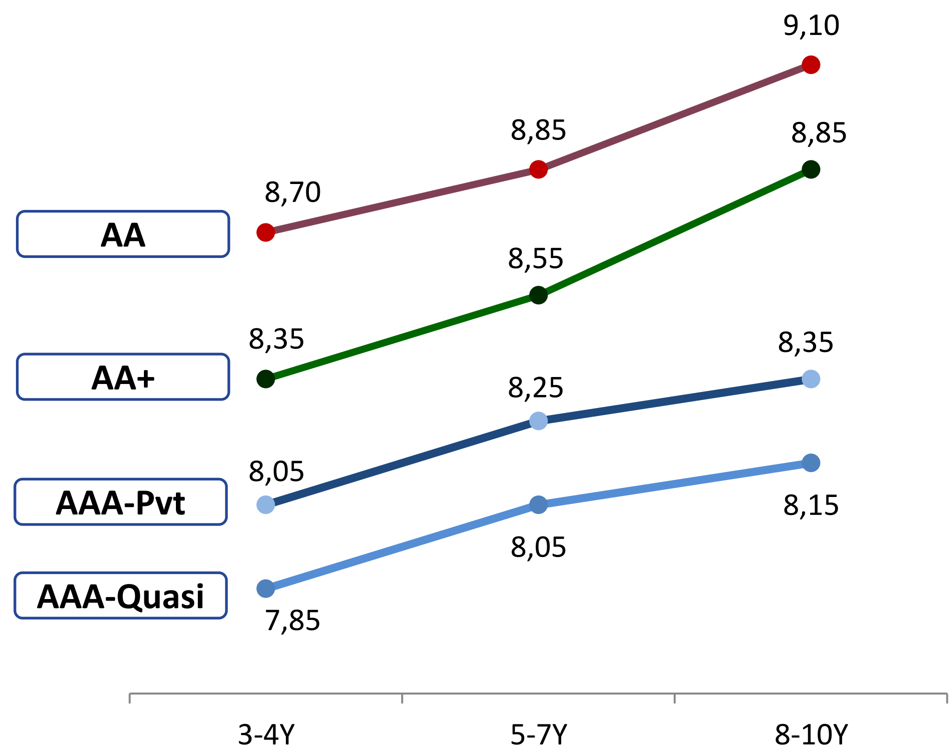
Yield Curve

Sovereign Bonds



- **Off-the-run IGBs offer yield pickup of 15-20 bps**
- **FPIs prefer off-the-run, non-benchmark IGBs**

Corporate Bonds [Domestic Rating]

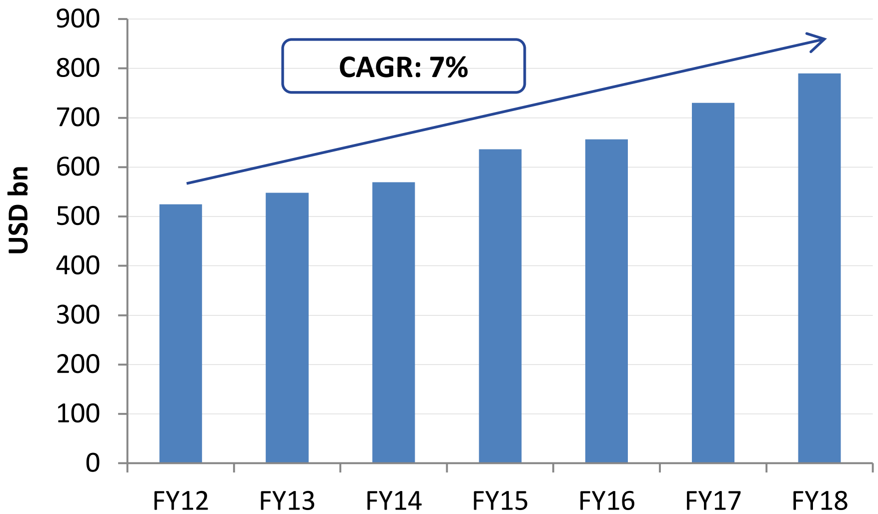


- **Yields vary significantly beyond AA for same rating**
- **Higher yields in structured, collateralized deals**

Market Trends – Size

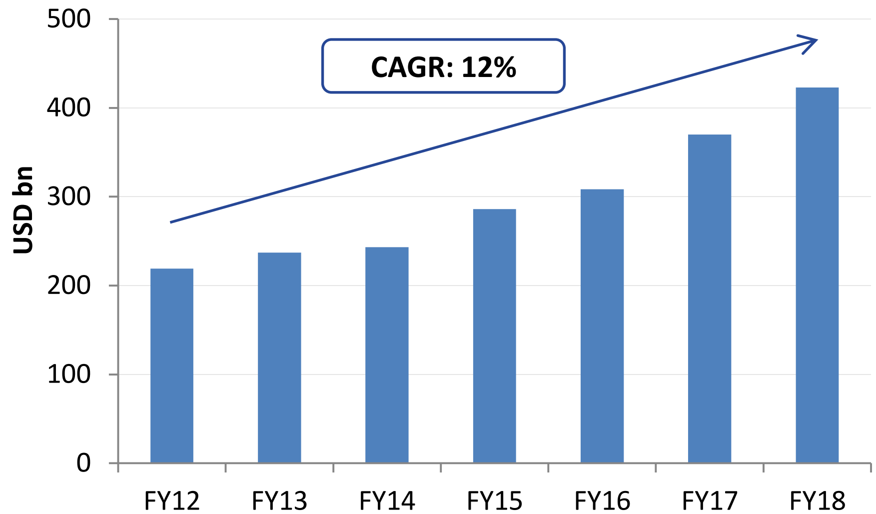
Government Securities – Outstanding

Source: RBI



Corporate Debt – Outstanding

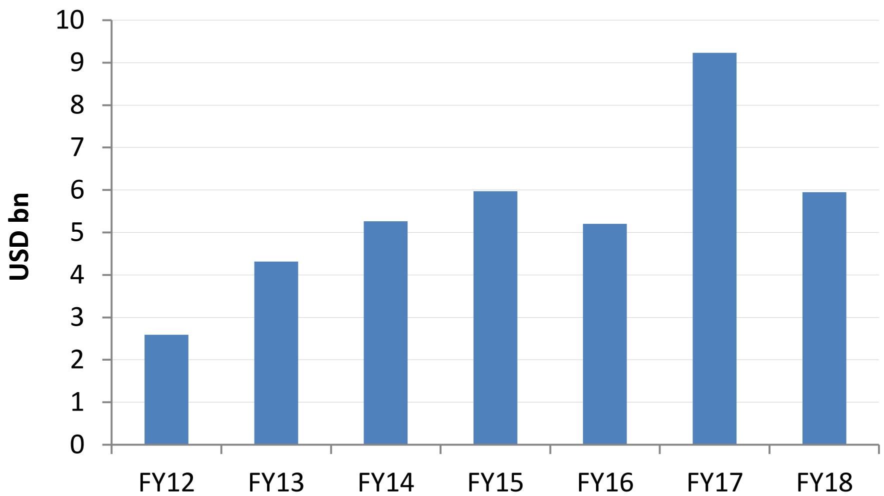
Source: SEBI



Market Trends – Liquidity

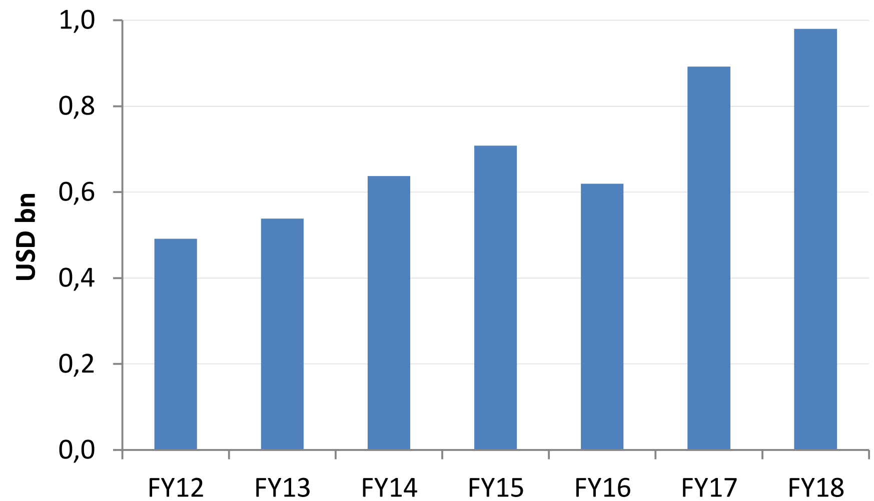
Government Bonds – Secondary Market Transactions

Average daily traded volume in G-Secs, Source: RBI

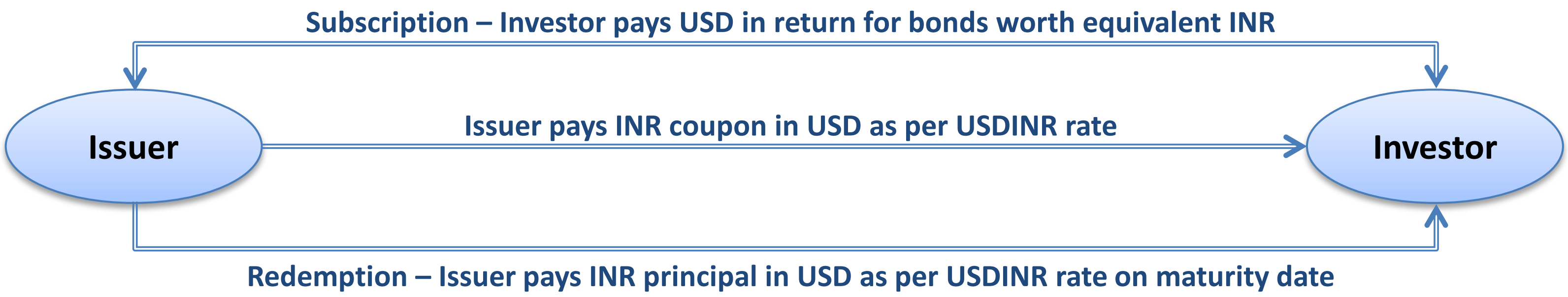


Corporate Bonds – Secondary Market Transactions

Average daily traded volume in Corp Debt, reported on NSE & BSE



Offshore Rupee Bonds *[Masala Bonds]*



Parameter	Criteria
Denomination	INR denominated – offers local currency exposure for investors
Settlement Currency	Subscription, coupon payments & redemption may be foreign currency settled
Instrument	Plain vanilla bonds
Borrowers	All Indian corporates (public & private sector) permitted to issue such bonds
Investors	Any investor from a FATF compliant jurisdiction
Maturity	Minimum 3 years for issue size of USD 50 mn per year, 5 years for issue size > USD 50 mn
All-in-Cost Ceiling	300 bps over IGB yield of corresponding maturity
End Use Restriction	Real estate other than affordable housing; Investing in capital markets; Activities prohibited under FDI; On-lending for these objectives; Purchase of land
Withholding Tax	5% – On par with onshore bonds and other ECB borrowing

Masala Bonds – Key Issuances

- Relatively slow progress on issuance despite strong and willing private sector pipeline

Issuer	Size	Tenor
HDFC – Tranche I	INR 30 bn	3Y 1m
NTPC – Tranche I	INR 20 bn	5Y
Adani Transmission	INR 5 bn	5Y
HDFC – Tranche II	INR 20 bn	4Y
Indiabulls Housing Finance	INR 13.3 bn	3Y 1m
Fullerton India	INR 5 bn	3Y 1m
ECL Finance	INR 5 bn	3Y 2m
Shriram Transport Finance	INR 11.5 bn	3Y 1m
HDFC – Tranche III	INR 33 bn	3Y 1m
NTPC – Tranche II	INR 20 bn	5Y
NHAI	INR 30 bn	5Y
IREDA	INR 19.5 bn	5Y
HDFC Bank	INR 23 bn	7Y

Cash Settled Interest Rate Futures [Bond Futures]

Parameter	Specification
Contract	Futures contracts based on • **IGB 6.79, 2027** • **IGB 7.17, 2028** • Other tenors (2022, 2023, 2026, 2029, 2030, 2031) are very illiquid
Trading Hours	Monday to Friday 9:00 A.M. to 05:00 P.M. IST
Expiry Day	Last Thursday of the month
Contract Cycle	Monthly - 3 serial months, Current, Mid & Far months Quarterly – 3 serial quarters
Contract Size	Face Value per contract = INR 200,000 equivalent to 2000 bonds with face value of INR 100 each
Price Quotation	Similar to the quoted price of underlying GOI security
Contract Value	Quoted price * 2000

Salient Features

- Cash settled, exchange traded
- Single traded liquid bond is the benchmark as against a notional basket in the earlier avatar
- Underlying is the most liquid instrument – hence no pricing uncertainty
- Low margin requirement (< 4%)

Strategies

- View based
- Arbitrage
- Portfolio Hedging

Trading Statistics

- Average Daily Trading Volume: INR 15 bn
- Current Open Interest: INR 45 bn

Dedicated INR 50 bn limit available for FPIs

Regulations, Limits & Trends
in
FPI Debt Investments

FPI Investment Overview

Who can invest?

- Any investor registered with SEBI as **Foreign Portfolio Investor (FPI)** can invest in the Indian Fixed Income space

Eligible Instruments

- Government Securities (dated securities with residual maturity > 3 years)
- Non Convertible Debentures / Bonds issued by Indian Companies (residual maturity > 3 years)
- Units of Debt-oriented mutual funds – except Money Market MFs

Taxation

- Interest and Capital Gains are subject to taxation
- Base tax rates are as follows:
  - Coupon: **5% withholding tax**, for interest accruing between Jun 2013 and Jun 2020 (eligible only if coupon less than SBI base rate + 500 bps)
  - Short term capital gains (< 1Y): 30%
  - Long term capital gains: 10%
- Favorable tax rates will override the above rate in case of applicable tax treaty with the country of domicile

Investment Limits for FPIs – Sovereign Bonds (as of 12th Apr)

	IGB	
	All FPIs	Long-term FPIs
Current Limit (USD bn)	**32**	**12**
Current Investment (USD bn)	**29**	**8**
% Free Limit	**9%**	**34%**

- **Residual maturity to be 3 years or higher at the time of investment in all categories**
- No lock-in or holding period restriction
- **Limits will be increased to 5.5% of outstanding IGB stock by Mar-2019 & 6% of outstanding by Mar-2020**
- Settlement Cycle: T+1 or T+2
- **Generic FPIs: Limits available on-tap till 90% of limit is utilized; Auction mechanism to be followed post 90% util**
- Dedicated limit available on tap for "Long Term FPIs" – SWFs, Multilateral Agencies, Endowment Funds, Insurance Funds, Pension Funds & Foreign Central Banks

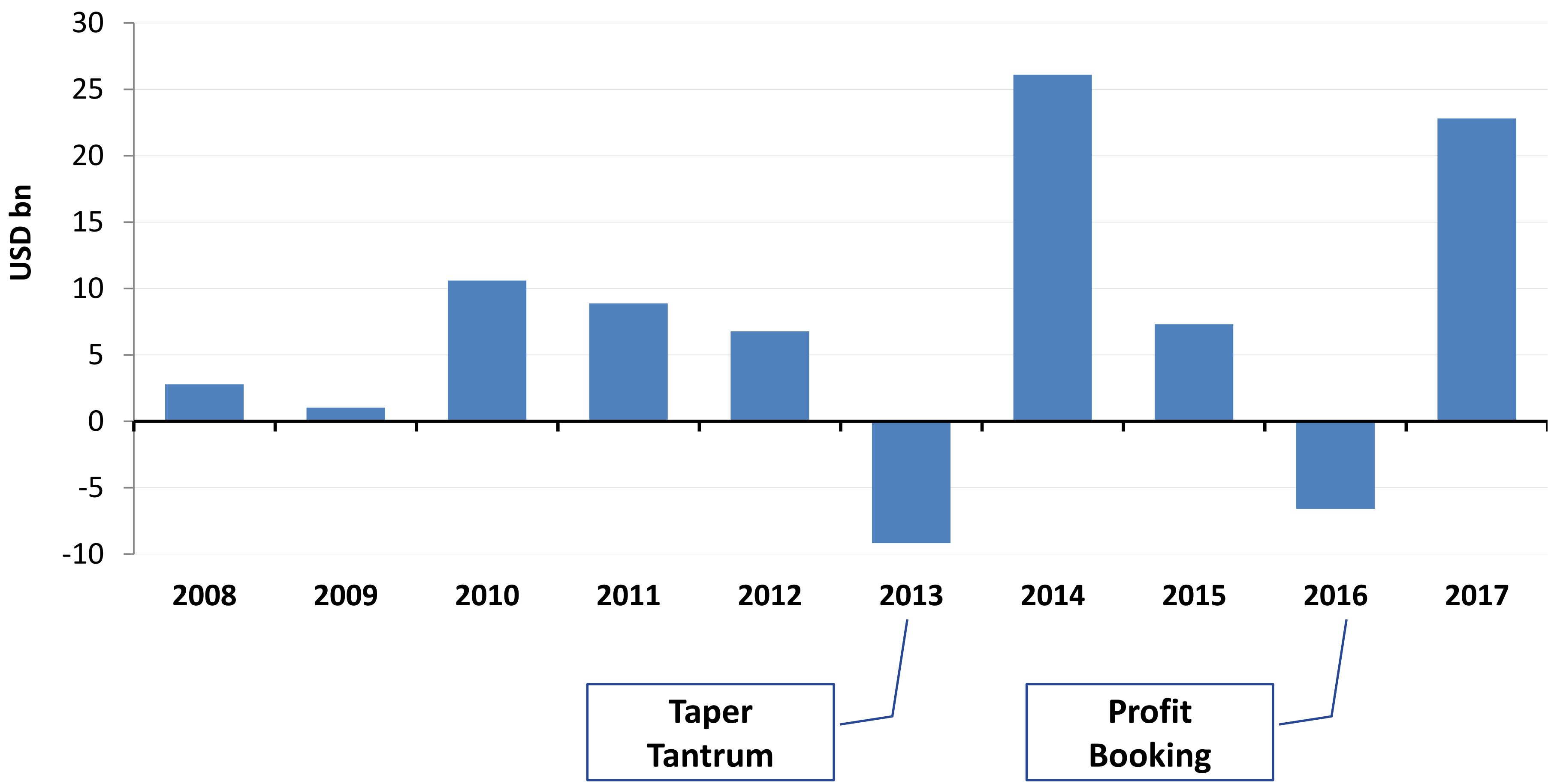
Investment Limits for FPIs – Corporate Bonds (as of 12th Apr)

	Corporate Bonds [Quasi-Sovereign & Private Sector]
	All FPIs
Current Limit (USD bn)	**41**
Current Investment (USD bn)	**33**
% Free Limit	**19%**

- **Residual maturity to be 3 years or higher at the time of investment in all categories**
- No lock-in or holding period restriction
- **Limits to be announced / fixed in rupee terms at 9% of outstanding stock of corporate bonds**
- Settlement Cycle: T+0, T+1 or T+2
- **Generic FPIs: Limits available on-tap till 95% of limit is utilized; Auction mechanism to be followed post 95% util**

Foreign Investor Inflows into INR Bonds

Net Debt Flows into India (Source: SEBI)



FPI Checklist

- FPI registration with SEBI (Securities and Exchange Board of India) ✓
- Appointment of custodian (for trade settlement) ✓
- Investor registration with clearing houses of exchanges (for Corp Bonds) & CSGL (for IGBs) ✓
- Appointment of intermediary for trade execution ✓
- KYC formalities with counterparties ✓

Macro-economic / Interest Rate Outlook

Key Projections for FY19	
GDP Growth	7.20-7.30%
CPI Inflation	4.5-4.7%
Currency	65-67
CAD (% of GDP)	2.0-2.1%
Fiscal Deficit (% of GDP)	3.30%
Repo Rate	6.00%
10Y Benchmark	7.10-7.50%

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- Distressed Credit

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- Wealth Management
- Asset Management
- Capital Markets

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- General Insurance

Bank-like business model

Multiple vectors of growth

Consistent growth and profitability

Reduction in volatility

Growth aligned with market tailwinds

Career opportunities and retention of management

Comprehensive Research Support

Periodic Updates

* Daily report, briefly covering day's activity along with key data points
* Monetary Policy Preview and Review

Analytic Update

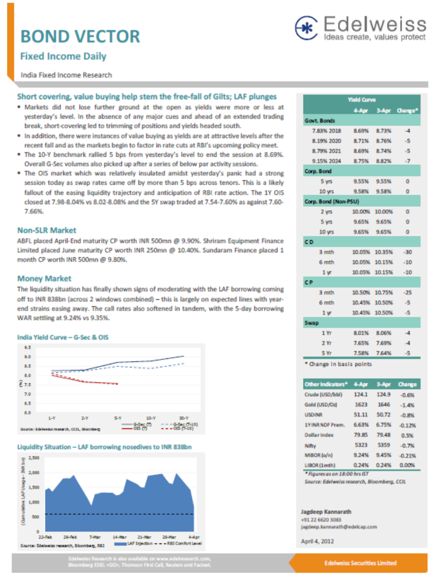
* Weekly Statistical Supplement (WSS) to understand changing deposit, lending and investment pattern of the banking system

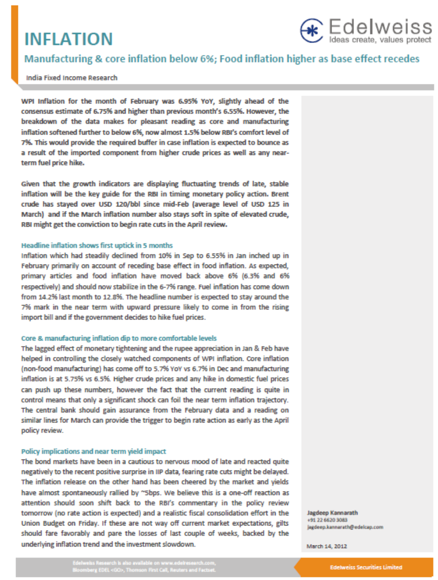
Special Reports

* Liquidity Jigsaw - Analysis of the systemic liquidity deficit drivers
* State Development Loans – A trend analysis
* Tax-free Bonds – Landscape & Outlook
* US Fed Rate Hike – Timing, Implications, Hangover
* FII Debt Flow Monitor
* G-Sec Auctions: Key Influencers

Macroeconomic Research

* Macro data analysis - Inflation, IIP, GDP, Budget





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