Inbound Foreign flows

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The WIRC of ICAI
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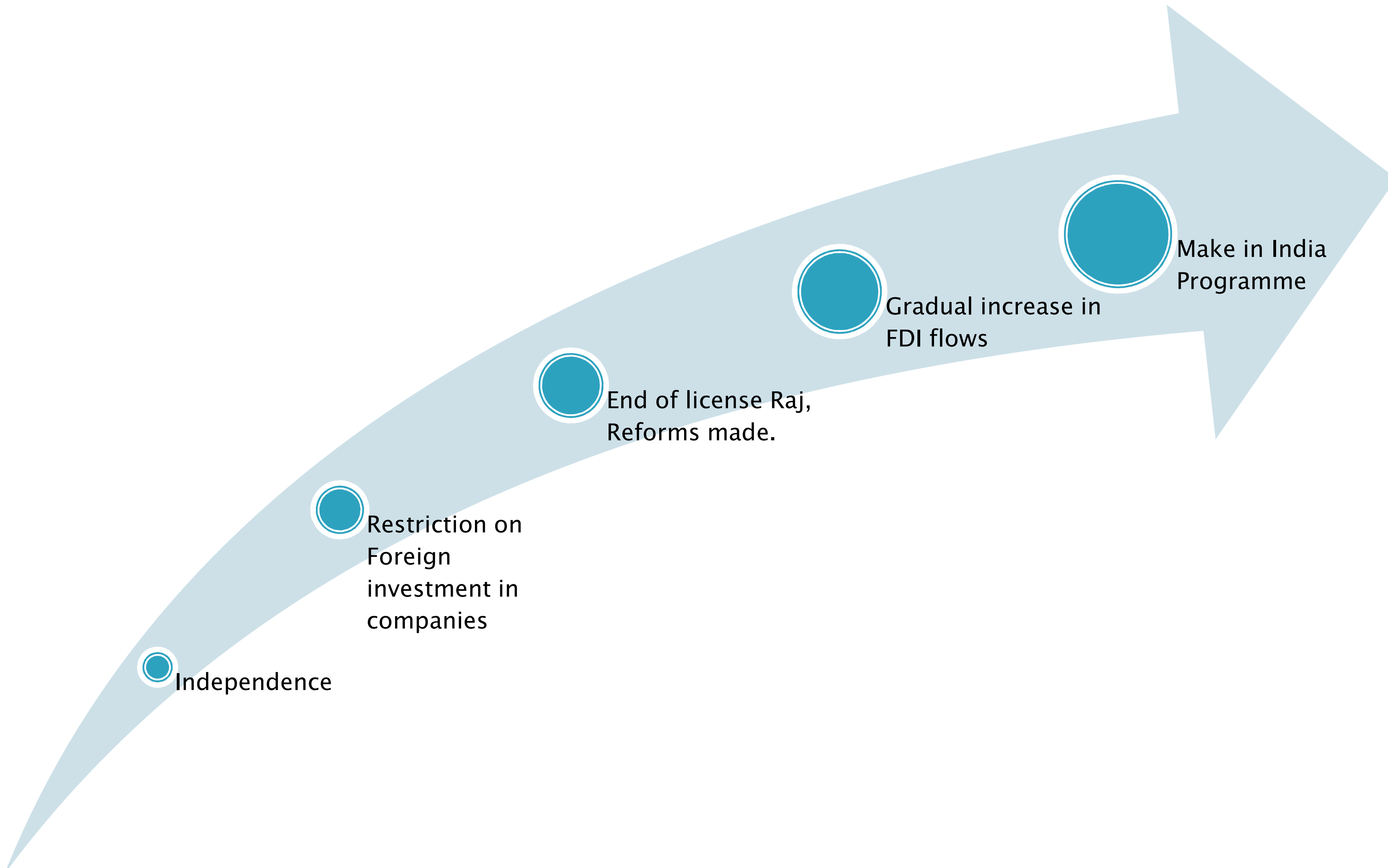
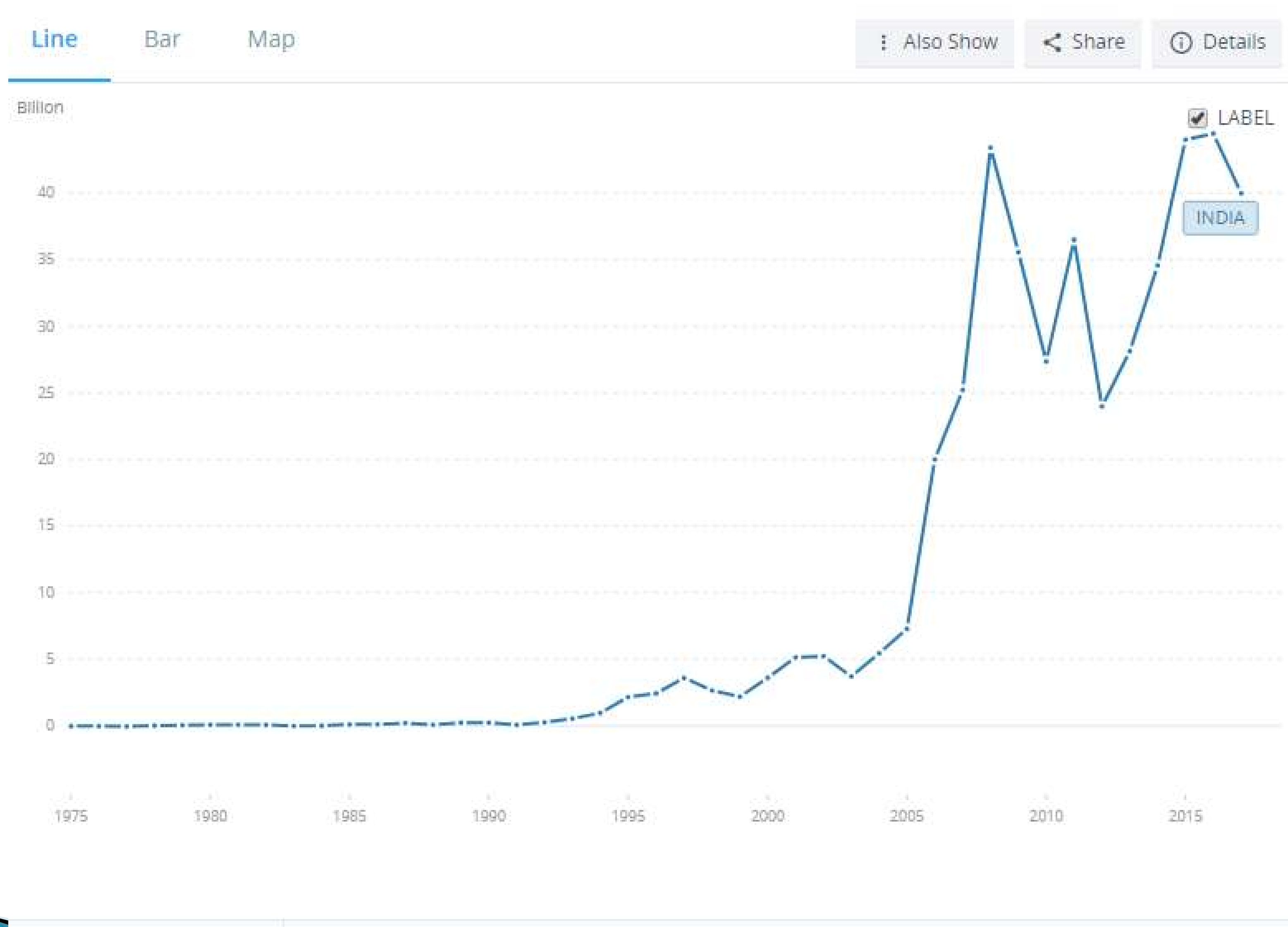

Independence
Restriction on Foreign investment in companies
End of license Raj, Reforms made.
Gradual increase in FDI flows
Make in India Programme



Line
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Share
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Billion
LABEL
INDIA
40
35
30
25
20
15
10
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0
1975
1980
1985
1990
1995
2000
2005
2010
2015

FDI Inflows

- FDI Equity inflow between July 2011 and September 2014 was $ 83.1 Billion this rose to $ 135.7 Billion between October 2015 and December 2017
- total FDI inflow was $ 120.8 Billion and this rose to $ 186.9 Billion.
- highest inflow was in the year 2016-17 of $ 60.8 Billion

India’s recognition

- India jumped 30 positions from 130 to 100 in the World Bank’s – Ease of Doing Business Index 2018
- Common Wealth Trade Review 2018 – top recipient of FDI from within the Commonwealth

India's Forex Reserves

- These are holdings of cash, bank deposits, bonds, and other financial assets denominated in currencies other than in Rupees.

- India had a record high of $ 426.082 billion in April 2018. This fell to $ 400.88 Billion in August.

- On 5th October this stood at $ 400.525 Billion.

- A major component of this is the Foreign Currency Assets which is $ 376.243 Billion, followed by Gold, SDR, and IMF Reserves

Some Statistics

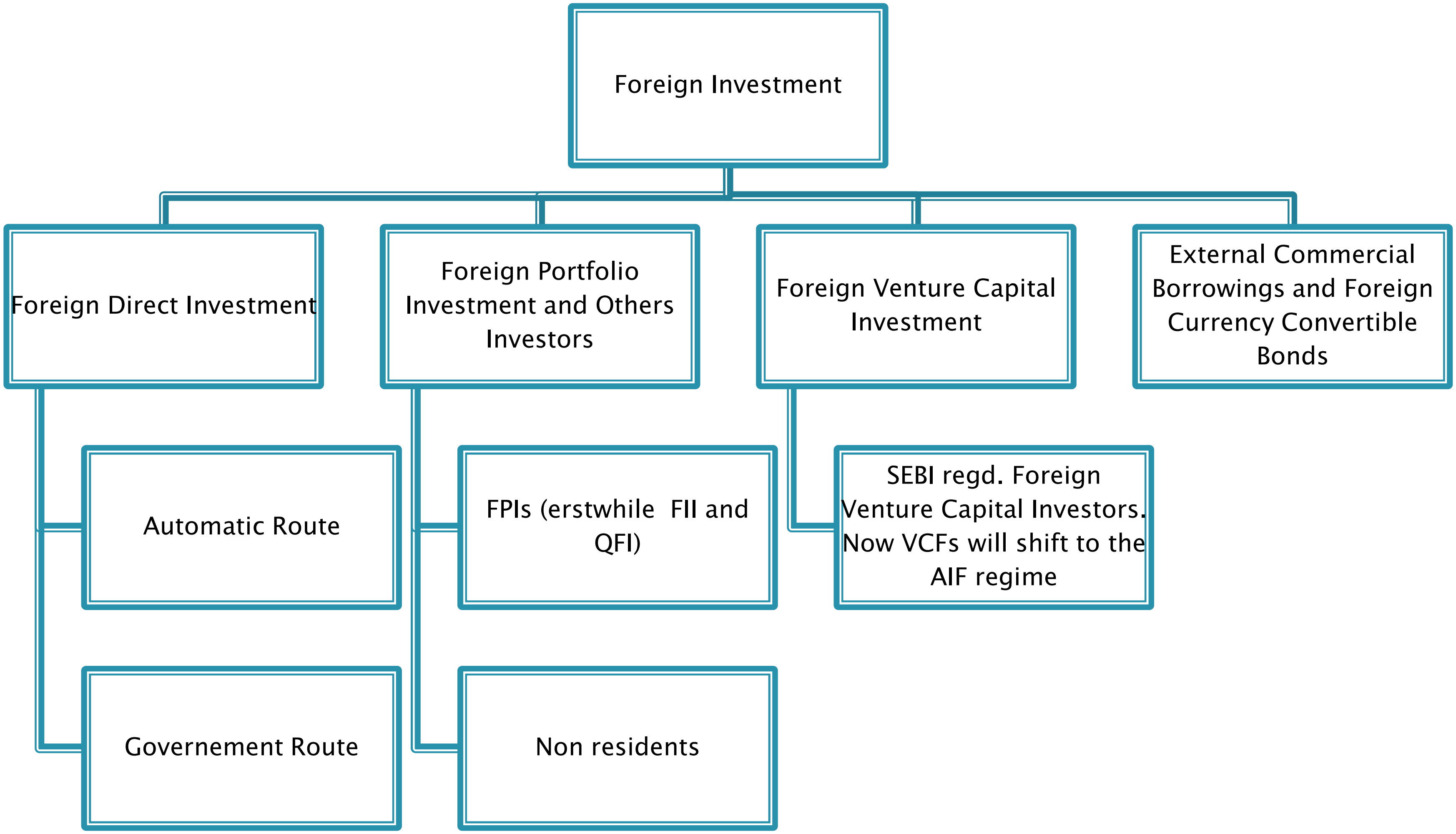
- In 1960, forex reserve covered just 8.6 weeks of imports
- In 1980, India had foreign exchange reserves of over $7 billion, more than double the level of what China had at that time
- In 1990, forex reserve covered just 4.8 weeks of imports
- India reached milestone of $100 billion mark only in 2004.
- India was forced to sell dollars to the extent of close to $ 35 billion in the spot markets in Financial Year 2009 due to 22% depreciation in rupee (against the dollar) in the same fiscal year 2009.
- In 2009, India purchased 200 tonnes of gold from the IMF worth $ 6.7bn

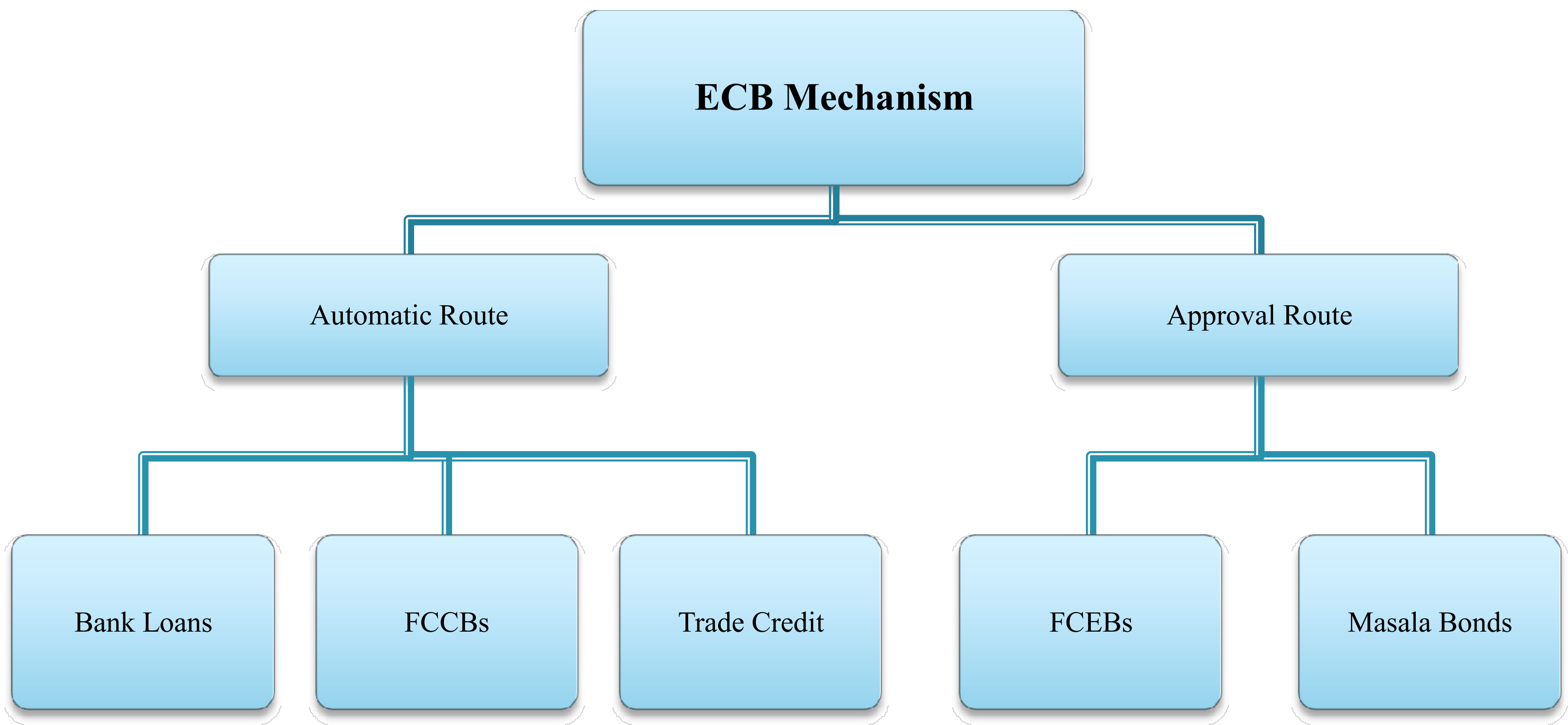
Recent mega deals

- Idea Vodafone merger approved
- Walmart acquired 77% stake in Flipkart for US$ 16 billion
- IKEA announced an investment of US$ 612 million in Maharashtra
- IFC planned an investment of about US$ 6 billion by 2022 in sustainable and renewable energy.

Policy changes

- 100% FDI allowed for real estate sector
- 100% FDI in retail sector
- Mandating clearance of all proposals requiring approval within 10 weeks after the receipt of application.
- ‘Standard Operating Procedure’ (SOP) to process FDI proposals
- Liberalization of foreign investment into Core Investment Companies


Foreign Investment
Foreign Direct Investment
Foreign Portfolio Investment and Others Investors
Foreign Venture Capital Investment
External Commercial Borrowings and Foreign Currency Convertible Bonds
Automatic Route
Governement Route
FPIs (erstwhile FII and QFI)
Non residents
SEBI regd. Foreign Venture Capital Investors. Now VCFs will shift to the AIF regime


ECB Mechanism
Automatic Route
Approval Route
Bank Loans
FCCBs
Trade Credit
FCEBs
Masala Bonds

Foreign Borrowings

- RBI has issued extensive guidelines on ECB borrowing to completely regulate the inflow.
- These have divided the borrowing into 3 broad categories viz. Track 1, Track 2 and Track 3

TRACK I	TRACK II	TRACK III
Minimum Average Maturity Period		
3 years for ECB up to US$ 50 million and 5 years for beyond US$ 50 million. 5 years for Companies in infrastructure Sector, NBFC (IFC), NBFC (AFC), Holding Companies and CIC, Housing Finance Companies and Port Trusts	10 years	Same as Track I
Eligible Borrowers		
- Companies in manufacturing , software development sector, shipping and airlines companies - SIDBI, Units in SEZ, EXIM Bank - Companies in infrastructure Sector, NBFC (IFC), NBFC (AFC), Holding Companies and CIC, Housing Finance Companies and Port Trusts	- All entities under Track I - REITs, INVITs, regulated by SEBI	- All entities under Track I - All NBFCs - NBFC - Micro Finance Institutions, NPO, Societies, trusts and cooperatives, NGO engaged in micro finance activity - Companies in miscellaneous services viz. R&D, training (other than educational institute), companies supporting infrastructure, providing logistics services
Recognised Lenders		
- International banks - Multilateral financial institutions - Export credit agencies - Suppliers of equipment - Foreign equity holders - Overseas long-term investors i.e. Overseas branches / subsidiaries of Indian banks	- All entities under Track I excluding Overseas branches / subsidiaries of Indian banks	- All entities under Track I excluding Overseas branches / subsidiaries of Indian banks - In case of NBFCs- MFI, other eligible MFI, NPO and NGO- ECB can be availed from overseas organisations and individuals (subject to conditions)

TRACK I	TRACK II	TRACK III
	All – in – Cost	
- 6 months USD LIOBR + 450 bps - Penal interest - max 2% above contracted rate.	- 6 months USD LIOBR + 450 bps - Other conditions are same as Track I	- Prevailing G-Sec yield +450 bos
	End Use Restrictions	
- Same as Track II And also: Except when raised from Direct/Indirect Equity Holders or from Group Company and the min. maturity is 5 years: - Working Capital - General Corporate Purpose - Repayment of Rupee Loans	- Investment in real estate or purchase of land except when used for affordable housing as defined in Harmonised Master List - Investment in Capital Market - Equity Investment - For on-lending for the above activities and also: Working Capital General Corporate Purpose Repayment of Rupee Loans	Same as Track I

ECB

- ECB can be raised in any freely convertible foreign currency as well as Indian Rupee.
- Change of currency of ECB from one convertible foreign currency to any other convertible foreign currency as well as to INR is freely permitted (at an exchange rate prevailing on the date of agreement or less than prevailing rate).
- Change of currency from INR to any foreign currency is, however, not permitted

How much can you borrow

- Under automatic route per FY for all the three tracks are set out as under:
- Up to US$ 750 million for the companies in infrastructure and manufacturing sectors, NBFC-IFCs, NBFC-AFCs, Holding Companies and Core Investment Companies;
- Up to US$ 200 million for companies in software development sector;
- Up to US$ 100 million for entities engaged in micro finance activities; and
- Up to US$ 500 million for remaining entities.

Is there any Security to be created

- Security can be created on
- immovable assets,
- movable assets,
- financial securities and
- issue of corporate and/ or personal guarantees in favour of overseas lender / security trustee

Hedging Requirements

- Hedge refers to entering into transactions to reduce risk.

- Here risk may be on account of the currency fluctuation or interest rate fluctuation

- Popular avenues of currency risk mitigation are:
  - Principal Only Swap
  - Futures
  - Forwards
  - Options

- Popular avenues of currency risk mitigation are:
- Coupon Only Swaps
- Futures
- Options
- Cross Currency Swaps

Hedging Requirements

- Certain companies should have a Board Approved Risk management policy
- Their ECB should be hedged at all times
- Bank is required to verify this through the monthly returns
- Borrower is required to report this on a monthly basis in the ECB 2 Returns
- On 26/11/2018, RBI relaxed the hedge cover from 100% to 70% for ECB under Track 1 for a maturity period of 3-5 years.

FCCBs

- These came into the ECB guidelines from 2005. In addition to compliance with sectoral caps, following should be complied:

- minimum maturity of 5 years without any warrants attached

- the call & put option, if any, shall not be exercisable prior to 5 years

- The issue related expenses not exceeding 4 per cent of issue size and in case of private placement, not exceeding 2 per cent of the issue size

Foreign Currency Exchangeable Bonds (FCEBs)

- FCCBs are issued by a company to non-residents giving them the option to convert them into shares of the same company at a predetermined price.

- FCEBs are issued by the investment or holding company of a group to non-residents which are exchangeable for the shares of the specified group company at a predetermined price.

Foreign Currency Exchangeable Bonds (FCEBs)

- These can be issued only under Approval Route and should have minimum maturity of 5 years
- All -in cost should be in line with the ECB guidelines

Procedure before drawing the loan

- Drawdown of the ECB or any payment of fees/charges should be only after obtaining the Loan Registration Number in Form 83

- Incase of revision in terms, a revised form should be submitted within 7 days of the change.

Liberalisation – September 2018

- ECB borrowers who are into manufacturing sector to raise ECB up to USD 50 million or its equivalent with minimum average maturity period of 1 year.

- Presently, Indian banks can act as arranger and underwriter. In case of underwriting an issue, their holding cannot be more than 5 per cent of the issue size after 6 months of issue.

- RBI permitted Indian banks to participate as arrangers/underwriters/market makers/traders in RDBs issued overseas subject to applicable prudential norms.

Accounting

- Till now, the accounting was simple. You would only pass an entry for the actual loan inflow.

- The interest, if payable in foreign currency was also be recorded at actuals

- Any fees paid upfront would be taken to the Balance Sheet and would be routed to the profit and loss accounted proportionately over the life of the loan

Accounting

- In line with the IFRS, India introduced Ind-AS
- Accounting underwent a drastic change under this regime
- This uses the Effective Interest Rate (EIR) method to calculate the actual cost of the instrument
- takes into account the differences caused on account of the changes in Fair Value of the instrument, which may be caused on account of the change in the interest rate or the exchange rate.
- all the associated costs such as issue costs, discount etc. are built into the coupon rate of the instrument

Accounting

- Till now, all derivative instruments were off balance sheet and never reported.

- Ind-AS uses Fair Value Methodology. Under this, the movement between the actual trade and the value of the insturment as on the reporting date will be reported in the P/l Account.

- This accounting system brings on the face all the actual position and also gives some guidance on the future outlook.

Taxation

- Tax is a major cost component
- loans raised outside India in foreign currency – TDS is at the rate of 5%. Most of the times, this is to be grossed up by the borrower and adds to his interest cost

- In case of FCCBs the interest is taxed under section 115AC at the rate of 10% and so is the long term capital gains taxed at 10% under the same section.

Masala Bonds

- This was novel concept introduced by the Government.

- This allowed Indian companies to raise money abroad in INR as compared to other currencies till now.

- The main advantage is that the risk of currency fluctuation is passed on to the lenders. This was a major concern incase of a depreciating Rupee

Masala Bonds

- These are plain vanilla bonds issued in foreign markets, but all the settlements are made in INR.
- Any corporate, including Indian Banks subject to certain conditions can borrow by issuing plain vanilla bonds issued overseas in a Financial Action Task Force (FATF) compliant financial centres.
- IFC was the first one to issue these bonds in November 2014 for financing infra projects in India.
- In July 2016, HDFC was the first Indian Company to raise these bonds and were listed in London. Companies like NTPC followed.

Masala Bonds

- Until July 2017, the issuances were under Automatic Route for upto Rs. 5000 crore.

- Post this, they were brought under approval route.

- The proceeds can be used for all the purposes except for Real estate activities other than development of integrated township / affordable housing projects, investing in capital markets, FDI prohibited activities and on-lending for these purposes.

- The All in cost has been specified at a maximum of 450bps over the G-Sec yield of the same maturity.

Masala Bonds

- There is no requirement to hedge this, since they are denominated in INR

- The overseas investor can hedge them in India.

- In September 2018, the government removed the 5% withholding tax. This was done with a view to check the depreciation of Rupee and the current account deficit.

Accounting

- Although the bonds are raised in INR, they are settled in equal $.

- Eg. If a company is raising INR 740 crore, the settlement would be made for $ 10 crore. Similarly, if the they were to pay an interest of say INR 51 crore, they would actually pay $ ~ 0.70 crore.

- Generally, this conversion from INR happens using the RBI (now FBIL) reference rate, which is the benchmark. It may happen so, that the actual movement in the bank happens at a different rate (since this will be the actual rate offered by the settling bank). This may result into an element of profit or loss.

FCNR (B) Deposits

- Started in 1993, FCNR(B) is a fixed deposit held in foreign currency.
- An investment option for NRI/ PIO/ OCIs looking to retain their money in foreign currency for good returns
- Interest earned is tax free in India
- Principal and interest is freely repatriable
- Banks, generally use these funds to lend onward in foreign currency, thereby mitigating their risk.
- The interest payable is generally LIBOR + spread

FCNR (B) Deposits

- In terms of Ind-AS, since these loans are denominated in foreign currency, need to be fair valued.

- The resultant gain or loss gets recognised in the Profit and Loss Account

- A novel concept in 2013 – FCNR Swap.

Participatory Notes

- Commonly known a P-Notes.
- In 1992, SEBI allowed FIIs to register and participate in Indian markets
- instruments issued by registered FIIs to overseas investors, who wish to invest in the Indian stock markets without registering themselves with SEBI
- The absolute value of P-Notes investments rose to a record of Rs 4.5 lakh crore in October 2007. However, mainly due to SEBI's strengthening of the regulatory framework for P-notes, their investments fell to a record low of Rs 80,341 crore
- The amount of Foreign Portfolio Investments (FPI) via P-Notes decreased from a high of 55% (October 2007) to 4.1% (August 2017)

Participatory Notes

- In 2007, SEBI proposed curbs on P-Notes. Because the proposals were not very clear, SENSEX crashed 1744 points on 17/10/2007. This was the biggest fall in absolute terms.

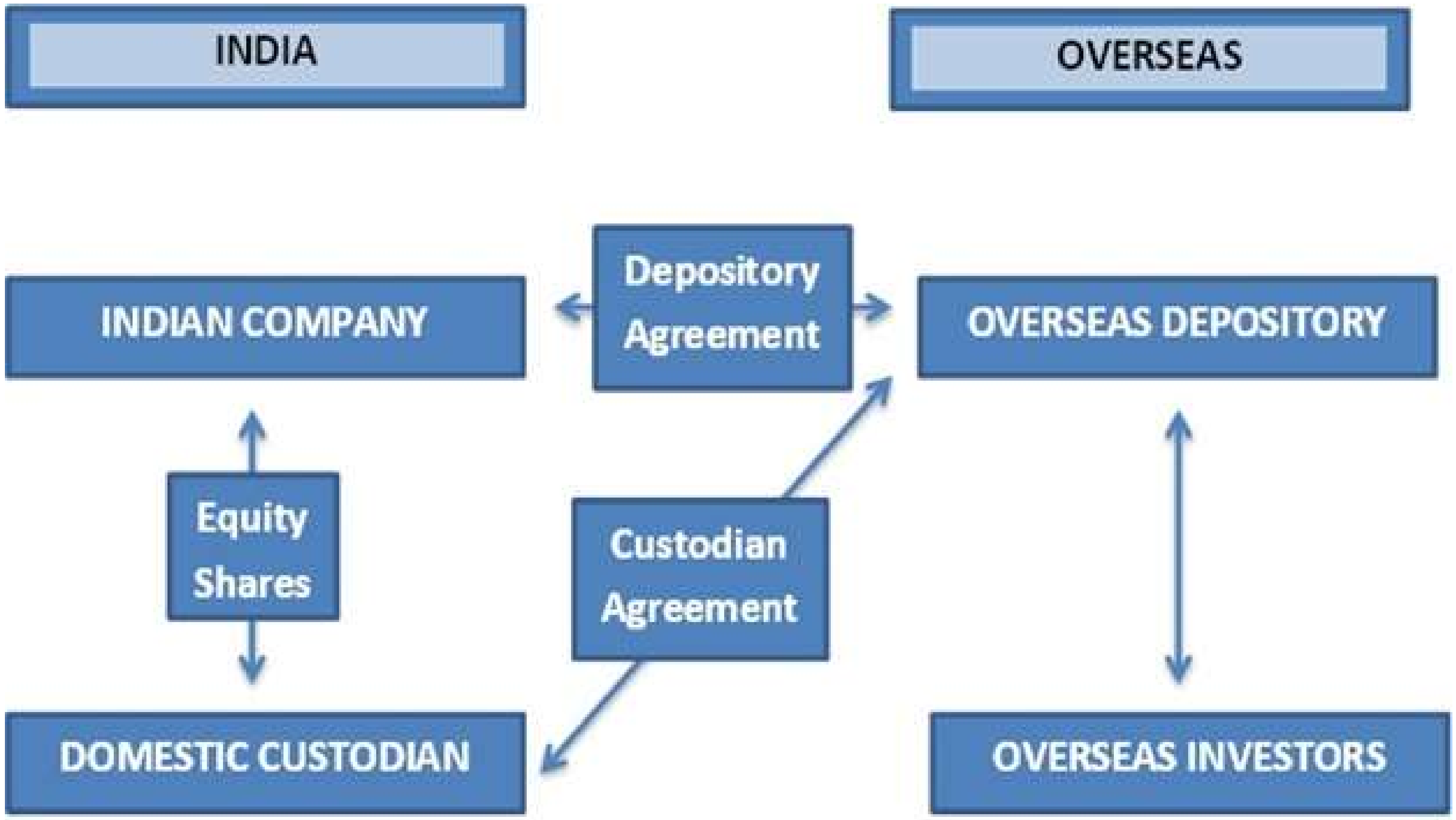
- SEBI had barred resident Indians, NRIs and entities owned by them from making investment through P-notes.

- As at end of June 2018, the P-Note investments plunged to a 9 year low of Rs. 83,688 crore from ~ Rs. 1 lakh crore in April.

Depository Receipts

- A Depository Receipt is a negotiable financial instrument that allows investors of any country to trade or invest in the shares of a company in any other country, entitling the shareholders to partake in the dividend and capital gains of that foreign company.

- ADR – Traded on US exchanges ; GDR – Traded on Non US exchanges


INDIA
OVERSEAS
INDIAN COMPANY
Depository Agreement
OVERSEAS DEPOSITORY
Equity Shares
Custodian Agreement
DOMESTIC CUSTODIAN
OVERSEAS INVESTORS

Depository Receipts

- Prior to 2014 and coming into force of Depository Receipts Scheme, 2014, any scheme going for issue of ADRs or GDRs was required to simultaneously list on Indian stock exchanges. This is not mandated in the current regieme.

- Companies Act, 2013, Depository Scheme, 2014 allows majorly all types of public listed or unlisted companies, private companies or any other issuer or holder of the permissible securities to issue DR

- A Special Resolution is required under the Companies Act, 2013 for raising DR

Depository Receipts

- Impact of Depository Receipts
  - This gives rise to arbitrage possibility
  - Indian markets are no longer independent of the world markets
  - Sensitivity to world markets increases

Other avenues

- Euro Bonds
- Foreign Bonds
- Floating Rate Bonds

Future Outlook…..

- India thus needs a high level of economic growth, job creation and infrastructure development

- Given the slow growth of domestic fund flow and recent issues in the finance space, it is necessary for the government to continue to give a boost to foreign capital.

- Planned $1.5 Trillion of investments in the infrastructure space over the next 2 decades

- A study has estimated that about 350 million Indians will move into cities over the next three decades

Future Outlook…..

- Despite India's favorable demographics, there have been instances such as UAE's Etisalat getting entangled into legal issues or the Vodafone matter casting a huge tax liability.

- Despite the government's push for reforms and policy changes, there are various factors that still need attention such as corruption, lack of basic infrastructure, black money etc.

Thank you