Corpsec Hotline

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SEBI STREAMLINES THE FII DEBT LIMIT AUCTION PROCESS

In line with the spirit of the erstwhile circulars[1] in relation to the allocation of debt limits to foreign institutional investors (“**FIIs**”), the Securities and Exchange Board of India (“**SEBI**”) vide Circular No. CIR/IMD/FIIC/12/2012 dated April 27, 2012 (“**New Circular**”) has provided that henceforth auction of FII debt limits shall be conducted on 20th of every month, based on availability of free limits at the end of respective previous month, and no bidder shall be entitled to bid for more than INR 250 crores.

BACKGROUND

SEBI vide Circular dated February 6, 2009 (“**2009 Circular**”) introduced an open bidding process for allocation of a cumulative debt investment limit of USD 15 billion for FII investments in corporate debt. Thereafter vide Circular dated November 26, 2010, SEBI increased the corporate debt limit to USD 20 billion and government debt limit to USD 15 billion and provided that the time period of utilization of corporate debt and government debt shall be 90 days and 45 days respectively.

However, there was no provision for the expiry of the debt limits once an investment was made, and to that extent procuring debt allocation limits was getting increasingly challenging for new players willing to participate in the debt market. Though circular dated January 3, 2012removed the facility of re-investment of the corporate debt limits available with the FIIs2, with the SEBI proposing that debt limits would expire upon the redemption or sale of the debt investment, there was not much clarity on when such debt limits would return to the pool and be made available to the other FIIs.

PROPOSED AMENDMENTS

The New Circular streamlines the allocation process, gives certainty as to the timing of the auction and more importantly, sets the framework that is likely to prevent concentration of debt limits in the hands of a few FIIs and broadbases participation in the debt market.

Timing of auction

The New Circular provides that going forward, the auction shall be conducted on the 20th of every month, if the free limit in any category (Government debt old, Government debt long term, corporate debt old and corporate debt long term infra with one year lock-in and one year residual maturity clause) exceeds INR 1,000 crore.

Amount of bid

Whilst the minimum size was reduced from INR 250 crores to 1 crore vide SEBI circular dated November 18, 2011, the minimum ticket size was not specifically reduced from INR 100 crores. The New Circular clearly provides that even the minimum ticket size will now be INR 1 crore.

Allocation method

- SEBI Circular dated November 26, 2010 brought down the maximum limit that any FII could bid for from INR 10,000 crores to INR 2000 crores. The New Circular further shrinks this limit and provides that no single bidder shall be allocated more than INR 250 crore or one-tenth of free limit whichever is higher.
- Para 7 of SEBI Circular dated November 26, 2010 permitted a single bidder to bid for more than one entity if it provided due authorization to act in that capacity on behalf of those entities and also provided the stock exchanges, the allocation of the limits inter-se for the entities it has bid for. The New Circular adds on to the existing provision and provides that if a single entity bids on behalf of multiple entities, then such bid would also be limited to INR 250 crore or one-tenth of free limit for every such single entity.

ANALYSIS

In a move to develop a vibrant debt market SEBI has vide the New Circular lent transparency and certainty to the process of allocation of free debt limits to FIIs, timelines and procedure thereof. The proposed reduction in the maximum amount of bid from INR 2000 crore to INR 250 crore is likely to witness an enhanced participation of FIIs who were keen to invest in the Indian debt market, however were unable to do so owing to larger FIIs accumulating the debt limits. In fact, in the context of the global economy, where investors are inclined to move towards a debt based regime, this move by SEBI shall be viewed positively by the international investor community.

On the flipside, the new auction process coupled with the January 3, 2012[3] circular may not look as appealing to the bigger players in the debt market who modeled their investment strategies on the assumption of large accumulated debt limits. FIIs looking to park their debt limits in captive NBFCs for downstream lending may also now need to

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analyze that model (as elucidated in detail in our Realty Check titled '*Realty Debt Funding in India - Offshore and Onshore Debt Funding (with Special Focus on NBFCs', which also discusses the advantages/ disadvantages of the debt portfolio regime over the FDI route*) considering the maximum limit of INR 250 crores that can be acquired by an FII.

– Harshita Srivastava, Ruchir Sinha & Siddharth Shah
You can direct your queries or comments to the authors

[1] Circular No. IMD/ FII & C/ 37/ 2009 dated February 6, 2009; Circular No. CIR/IMD/FIIC/20/2011 dated November 18, 2011;
[2] Circular No. CIR/IMD/FIIC/1/2012 dated January 3, 2012
http://www.nishithdesai.com/New_Hotline/CorpSec/Corpsec%20Hotline_Jan1012.htm
[1] SEBI Circular No. CIR/ MD/ FIIC/ 1/ 2012

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