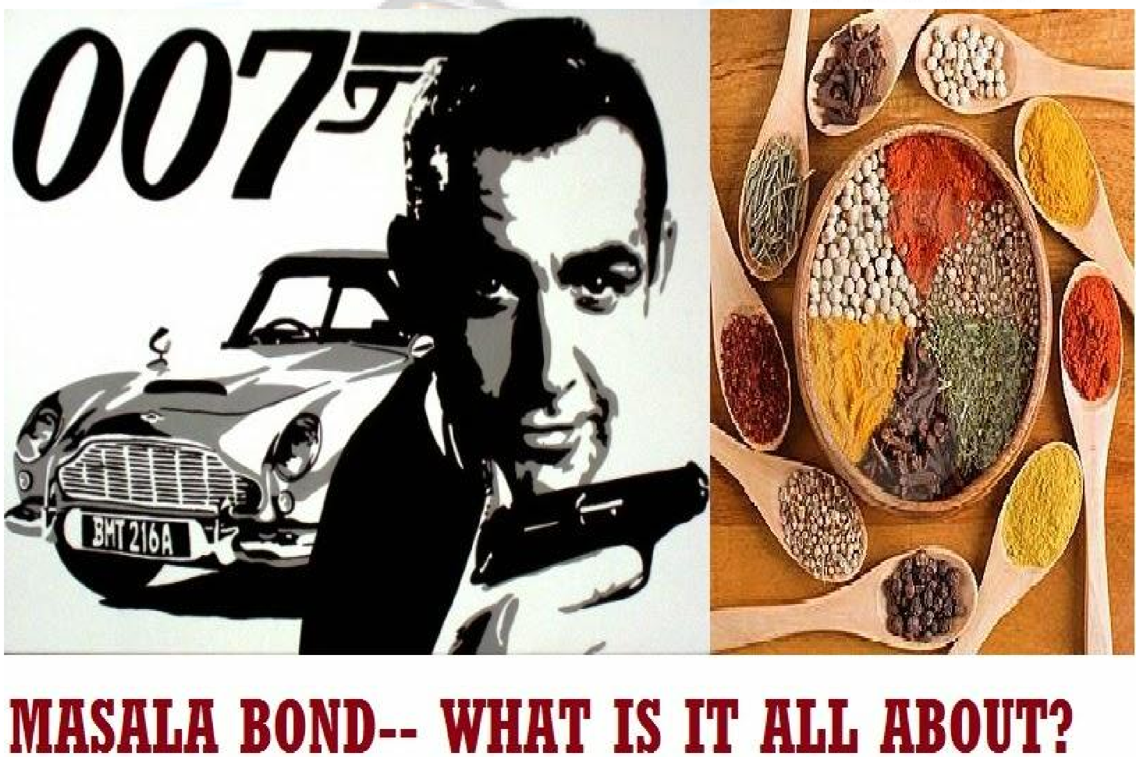
Bonds refer to the financial instrument typically used to raise capital. Bond is an instrument of indebtedness of the bond issuer to the holders. The most common types of bonds include municipal bonds and corporate bonds. It is a debt security, under which the issuer owes the holders a debt and, depending on the terms of the bond, is obliged to pay them interest (the coupon) and/or to repay the principal at a later date, termed the maturity date. Mostly it is carried out through External commercial borrowings i.e. (ECB).But with ECBs there is huge risk involved. This risk is of currency fluctuation. The weakening of rupee during tenure of bond can significantly add to cost at the time of repayment .This risk is borne by issuer completely and not the investor.

Then finally came **MASALA BONDS** .It is as interesting to know about it as its name is.



WHAT ARE MASALA BONDS?????

It is a financial instrument through which Indian firms can raise money from overseas market but then it is issued in terms of Indian currency and settled in foreign currency unlike ECBs, which are issued as well as settled in foreign currency.

It first came into existence in **Nov 2014**,when **International Finance Corporation** which is an investment arm of World Bank issued Rs 1000 crores bond for funding infrastructure projects in India.

IFC named it as **"MASALA BOND"** in order to provide an Indian angle to it and also to reflect Indian culture and cuisine.

In short, Masala Bonds - **"INDIAN RUPEE DENOMINATED BONDS ISSUED IN OFFSHORE CAPITAL MARKET"**

Before the word masala, some names like **Samosa, Ganga, and Peacock** were also in line to be attached to these rupee-denominated bonds.

ECBs v/s MASALA BONDS

While **ECBs** help Indian companies raise debt capital internationally by **taking advantage of the lower interest rates in international markets, the cost of hedging the currency risk can be significant and has to be borne by the issuer** — if not hedged, adverse exchange rate movements can have significant negative impact to the borrower and thus the “all – in” cost of borrowing through ECBs land up will be much higher than the international market rates. However, in the case of Masala Bonds, as the currency risk is borne by the investor, the cost of borrowing can work out much lower compared with ECBs.

Though raised in Indian currency, these bonds are considered as part of foreign borrowing by Indian corporate and hence would have to follow the RBI norms in this regard.

Let us know about some of the guidelines laid by RBI in terms of masala bonds

What has been the regulator's stance on this?

The Reserve Bank of India has issued guidelines allowing Indian companies, non-banking finance companies (HDFC, India Bulls Housing Finance are examples of such companies) and infrastructure investment trusts and real investment trusts (investment vehicles that pool money from various investors and invest in infrastructure and real estate sectors) to issue rupee-denominated bond overseas.

- The rule put the issue limit to $750 million and also has a pricing cap for various tenures of issue.
- The minimum **maturity period** was five years but now RBI **reduced it to three years.**
- Can only be issued to investors originating from countries that are listed in the Financial Action Task Force (FATF) or a member of a FATF-style regional body.

Now we have seen that issuer's risk gets reduced in the case of MASALA BONDS then **why should investors invest in the same????**

What is there for the investors??

With India's GDP and national income rising ,and it is projected to grow at fast clip over the next few years. It is one of those rare fast-growing large economy, and masala bonds is one way for investors to take advantage of this. The investors would like to join this party to **earn higher returns** as compared to US and Europe where interest rates are still on the lower side.

- To make the bond attractive to the investor, the issuer **offers a significantly high yield** (coupon rate) — much higher than otherwise available in the market to compensate for the risk arising out of currency depreciation. The high returns therefore serve as an attraction to investors to invest in such bonds.
- For example, the HDFC issue offers an ‘all – in’ annualised yield of 8.33% per annum as against the average yield of just under 2% per annum of 10-year securities in the UK market.

The additional return in the order of 6% covers for both default risk as well as the currency risk. Interestingly, the demand for such bonds seems to be very high — the HDFC issue for example was about four times oversubscribed.

What is there for Govt and RBI????

- As external balance sheet point of view it is beneficial for both RBI and government.
- It is a sign of acceptance of INDIAN CURRENCY in trading and settlement overseas.
- It will shield corporate Balance sheets from exchange rate risks
- The success of masala bonds would demonstrate overseas investors' confidence on Indian currency
- Masala bonds can give major boost to economy by attracting major foreign investment with government ambitious plans such as MAKE IN INDIA,DIGITAL INDIA etc

According to one of the world's leading stock exchanges, currently, as many as 30 offshore Indian rupee bonds have listed in total on the LSE, raising an approximate amount $3.5 billion. The major Masala Bond issues till date are:

*Rs 10 billion ($150 million) issue in November 2014 by IFC to fund infrastructure projects in India

* Rs 3.15 billion ($47.25 million) issue in August 2015 by IFC to be used for private sector investments that address climate change in India.

* Rs 30 billion ($450 million) issue in July 2016 by HDFC — the first Indian company to issue Masala Bonds

* Rs 20 billion ($300 million) issue in August 2016 by NTPC — the first corporate Green Masala Bonds

<u>Some of the companies data of the amount raised with their coupon rates :</u>

Company	Maturity	Amount raised (₹cr)	Coupon (%)
HDFC Ltd	3-year	3,000	8.33
NTPC Ltd	5-year	2,000	7.40
Adani Transmission Ltd	5-year	500	9.10

Sources: Companies

The most recent news on Masala bonds was that **Canada's Province of British Columbia has become the first foreign government entity to issue a masala bond** by floating 500 crore rupee denominated overseas bonds on the London Stock Exchange. This issue clearly demonstrates British Columbia's position to participate in internationalization of INR.

With its increasing influence everybody is keeping an eye on it, various investors are having an interest of investing in them

BUT, they are best in **MODERATION**. What if there is too much of MASALA. As it is not preferred in food same is the scenario over here.

Too much of reliance on external debt (including rupee denominated) aided by the issue of Masala Bonds apart from the traditional ECBs can lead to serious negative impact on the sovereign ratings of India, and thereby creating a problem of attracting investments to India.

In conclusion, **Masala Bonds are a good idea to protect the issuers from exchange rate risks, but like anything else, overexposure to the same could lead to undesired adverse outcomes**.

Compiled by -

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