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TAX FLASH NEWS

19 July 2022

RBI announces measures to enhance source of forex funding for Indian financial markets

Background

The Reserve Bank of India (**'the RBI'**) has been closely and continuously monitoring the liquidity conditions in the forex market amid rupee depreciation of 4.1 percent against the US dollar during the current financial year so far (upto July 5). The RBI on 06 July 2022 announced[1] a slew of measures to boost foreign exchange (forex) inflows amid a slump in the value of rupees.

The RBI has stepped in with the new measures with the objective to further diversify and expand the sources of forex funding to mitigate volatility, alleviate dollar tightness and dampen the global spillovers.

In order to enhance forex inflows while ensuring overall macroeconomic and financial stability, the RBI has introduced following key measures:

1. Liberalise Regulatory Regime Relating to External Commercial Borrowing ('ECB')

At present, the eligible borrowers are allowed to raise funds under the automatic external commercial borrowing **('ECB')** route, without approaching the RBI up to US$ 750 million. The said limit is subject to the borrowing being in conformity with the prescribed prudential parameters of the ECB framework such an all-in cost, minimum maturity requirements and the overall dynamic ceiling.

The RBI has decided to temporarily increase the limit under the automatic route from US$ 750 million or its equivalent per financial year to US$ 1.5 billion. Further, the all-in cost ceiling under the ECB framework is also being raised by 100 basis points, subject to the borrower being of investment grade rating.

The above dispensations are available up to 31 December 2022.

2. Foreign Currency Lending by Authorised Dealer Category I (AD Cat-I) Banks

The RBI has announced[2] changes in Foreign Currency Lending by Authorised Dealer Category I **('AD Cat-I')** Banks. At present, AD Cat-I banks can undertake overseas foreign currency borrowing **('OFCB')** up to a limit of 100 percent of their unimpaired Tier 1 capital or $10 million, whichever is higher. The funds so borrowed cannot be used for lending in foreign currency except for the purpose of export finance.

The RBI has now provided that AD Cat-I banks can utilise OFCBs for lending in foreign currency to entities for a wider set of end-use purposes, subject to the negative list set out for ECBs.

The measure is expected to facilitate foreign currency borrowing by a larger set of borrowers who may find it difficult to directly access overseas markets. This dispensation for raising such borrowings is available till 31 October 2022.

3. Liberalise Regulatory Regime Relating to FPIs Investment in Debt Instruments

Foreign Portfolio Investors **('FPIs')** can invest in government securities and corporate bonds through three channels: (a) the Medium-Term Framework **('MTF')** introduced in October 2015;

[1] RBI Press Release on Liberalisation of Forex Flows (Revised) dated 6 July 2022

[2] A. P. (DIR Series) Circular No. 08 dated 7 July 2022 read with RBI Press Release on Liberalisation of Forex Flows (Revised) dated 6 July 2022

(b) the Voluntary Retention Route **('VRR')** introduced in March 2019; and (c) the Fully Accessible Route **('FAR')** introduced in April 2020.

In order to encourage foreign portfolio investment, the following changes to the regulatory regime relating to FPI investment in debt flows are being put in place -

Investments through Fully Accessible Route

To liberalise the norms governing FPI flows, in March 2020, the RBI announced a Fully Accessible Route that gives unlimited access to FPIs to a select group of government securities, specified by the RBI from time to time. At present, all government securities with 5-year, 10-year and 30-year tenors are eligible securities under the FAR route.

As per the recent announcement of the RBI[3], it has been decided that all new issuances of G-secs of 7-year and 14-year tenors, including the current issuances of 7.10% GS 2029 and 7.54% GS 2036, will be designated as 'specified securities' under the FAR. Accordingly, these securities will, henceforth, be eligible for investment under the FAR.

Investments in Corporate Bonds

Currently, FPI investment in debt instruments under the MTF is subject to below restrictions –

- short-term investments by an FPI in government securities (Central Government securities, including Treasury Bills and State Development Loans) and corporate bonds shall not exceed 30% of the total investment of that FPI in any category; and

- FPI investments in corporate bonds were subject to a minimum residual maturity requirement of one year.

RBI has decided[4] to relax the aforesaid restrictions for investments by FPIs between 08 July 2022 till 31 October 2022 in the following manner:

- FPIs in government securities and corporate bonds between the aforesaid period shall be exempted from the limit on short-term investments till maturity or sale of such investments.

- FPIs can invest in corporate money market instruments, commercial paper and non-convertible debentures with an original maturity of up to one year. These investments shall be exempted from the limit on short-term investments till maturity or sale of such investments.

4. Exemption from Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) on Incremental FCNR(B) and NRE Term Deposits

RBI has announced[5] a temporary exemption on the incremental Foreign Currency Non-Resident (Bank) [**'FCNR(B)'**] and Non-Resident (External) Rupee deposits **('NRE')** from maintenance of Cash Reserve Ratio **('CRR')** and Statutory Liquidity Ratio **('SLR')**

The RBI announced that the incremental FCNR (B) and NRE deposits with reference base date of 1 July 2022, will be exempt from the maintenance of cash reserve ratio and SLR from 30 July 2022 onwards. This relaxation, will be available for deposits mobilised up to 4 November 2022. Further, transfers from Non-Resident (Ordinary) **('NRO')** accounts to NRE accounts shall not qualify for the relaxation.

At present, banks are required to include all FCNR(B) and NRE deposit liabilities for computation of Net Demand and Time Liabilities **('NDTL')** for maintenance of CRR and SLR.

5. Temporary withdrawal of interest rates ceiling on FCNR(B) Deposits

The RBI has also decided[6] to temporarily permit banks to raise fresh FCNR (B) and NRE deposits without reference to the extant regulations on interest rates, with effect from 7 July 2022. This relaxation will be available for the period up to 31 October 2022.

At present, interest rates on FCNR(B) deposits are subject to ceilings of Overnight Alternative Reference Rate **('ARR')** for the respective currency/swap plus 250 basis points for deposits of 1 year to less than 3 years maturity and overnight ARR plus 350 basis points for deposits of 3 years and above and up to 5 years maturity.

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[3] RBI Circular no. RBI/2022-23/86 FMRD.FMID.No.04/14.01.006/2022-23 dated 7 July 2022 read with RBI Press Release on Liberalisation of Forex Flows (Revised) dated 6 July 2022

[4] A.P. (DIR Series) Circular No.07 dated 7 July 2022 read with RBI Press Release on Liberalisation of Forex Flows (Revised) dated 6 July 2022

[5] RBI Circular No. RBI/2022-23/83 DOR.RET.REC.54/12.01.001/2022-23 dated 06 July 2022

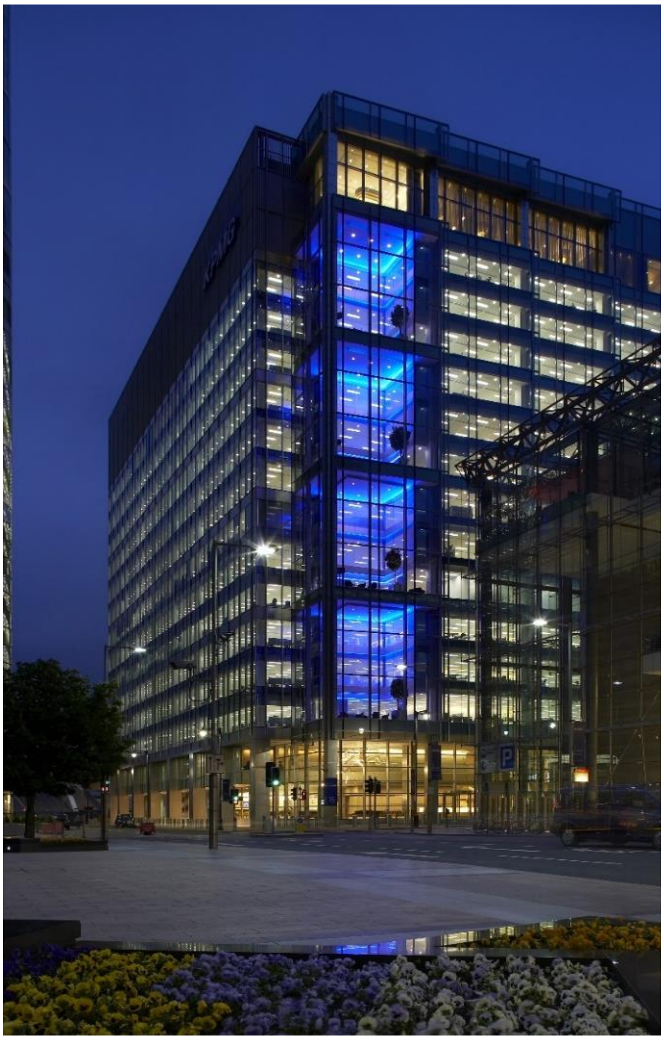
[6] Master Direction on Interest Rate on Deposits - Foreign Currency (Non-resident) Accounts (Banks) Scheme [FCNR(B)] and Non-Resident (External) Rupee (NRE) Deposit dated 06 July 2022

In the case of NRE deposits, as per extant instructions, interest rates shall not be higher than those offered by the banks on comparable domestic rupee term deposits.

Our comments

As per RBI, the global outlook is clouded by recession risks. Consequently, high risk aversion has gripped financial markets, producing surges of volatility, sell-offs of risk assets and large spillovers, including flights to safety and safe haven demand for the US dollar. As a result, emerging market economies are facing retrenchment of portfolio flows and persistent downward pressures on their currencies.

In view of the aforesaid challenges, the measures to expand and diversify the flow of forex are a welcome move and may help improve foreign inflows in the short and medium term. However, the temporary nature of these measures could limit their attractiveness for foreign investors. Therefore, these measures need to be followed by more fundamental policy reforms providing greater certainty, simplification and reducing discretion in the overall regime governing foreign inflow of funds.



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