

Banks add leverage to spice up 'masala' bonds for expatriate Indians

Masala bonds are not simply a way to borrow overseas, but an attempt to make the tightly-controlled rupee available in global markets

Reuters | Mumbai/Singapore September 13, 2016 Last Updated at 13:23 IST



Bankers are finding new ways to sell India's "masala" bonds by

structuring this rupee-denominated debt issued abroad into derivatives, and then sweetening the deal with leveraged returns of 12 to 13 per cent after fees and hedging.

Unveiled in 2015, masala bonds are not simply a way to borrow overseas, they are also an attempt to make the tightly-controlled rupee more widely available in global markets, similar to the way in which China has moved to sell more yuan debt to overseas investors.

So far four Indian issuers have sold a combined 78 billion rupees (\$1.18 billion) of the debt. Non-resident Indians (NRIs) living in financial centres such as Hong Kong and Singapore are ideal target investors as they are comfortable with rupee debt.

Some banks, including Credit Suisse and Nomura, are now adding their own ingredient to the mix after turning about 12 billion rupees worth of the debt from HDFC Ltd and Adani Transmission Ltd into "credit-linked notes" derivatives, according to several sources involved in the sales.

Under this arrangement a bank provides funding of 80 per cent and the investor puts in only 20 per cent to buy the derivative. After paying for the dollar funding rate of about 1.5 per cent, a bank fee of 50 basis points, and short-term rupee hedging, the eventual landed return for the investor comes to 12-13 per cent, thanks to the heavy leverage ratio.

The return is much higher than the nominal 8 per cent or so offered by unleveraged masala bonds and the highest for similarly-rated debt, bankers said. These derivatives were then sold in tranches to non-resident Indians.

"The extent of leverage provided to the investor by the private bank varies and can go up to as high as 5 to 1," said Shantanu Sahai, executive director and co-head of debt capital markets at Nomura.

"This serves to significantly improve the returns for these investors. As a result the majority of private banks use this route to place such products with their clients."

Using the leverage to attract high net-worth individuals hungry for yield in a world of zero and negative interest rates could help promote this key initiative from Prime Minister Narendra Modi, at a time when institutional investors are wary because of the lack of secondary trading in the debt.

The key incentive for an issuer is the entire currency risk is borne by the investor apart from credit and market risks. Any sudden plunge in the rupee, or a sudden fall in value of the masala bonds from which they are derived, could wipe out returns.

Still, bankers say the risks are probably contained, given the rupee has traded in a relatively narrow range over the past few years due to India's rapid economic growth and the central bank's efforts to contain inflation.

Bankers also say borrowers with higher ratings will be able to issue masala bonds, making the debt relatively safer.

'NEW BABY'

Non-resident Indians are an ideal target for the masala derivatives, given the high proportion of market-savvy NRI finance professionals living in centres such as Singapore or Hong Kong.

"The immediate interest is from offshore investors who see the good yields available, and the opportunity to participate in the India story through a company that demonstrates strong governance," said Anand Natarajan, head of strategy and business execution at Fullerton India Credit Company Ltd which is owned by Temasek, Singapore's sovereign wealth fund.

The timing works in bankers' favour as well, given the NRIs are keen for an investment that can replace the high-yielding dollar deposits they were offered by Indian lenders under a central bank programme initiated in 2013 to raise dollars when India suffered a currency crisis.

Many institutional investors have shied away from masala bonds because of concerns the premiums on offer are not high enough to compensate for the lack of secondary trading. That has made it important for bankers to tap new potential buyers.

Among companies lined up to sell masala debt are housing finance company Dewan Housing Finance Corp, Shriram Transport Finance Co Ltd, and Fullerton India.

Bankers estimate about a third of these bonds could potentially be turned into derivatives, helping to further boost the young product.

"The masala bond is a new baby, and I am sure that with time it will grow into a vibrant and strong adult one day," said Jingdong Hua, vice-president and treasurer at IFC.