

Masala Bonds

[UPSC Notes]

Masala Bond's Latest News

Kerala Infrastructure Investment Fund Board (KIIFB) is a Financial Institution. The Government of Kerala owns KIIFB. In 2019, KIIFB listed a masala bond in the London Stock Exchange's International Security Market of ₹ 2,150 crores. It is a 5-year tenure with a secured fixed-rate bond with a coupon of 9.723 per cent.

Since the state has witnessed repeated floods in 2018 and 2019, Kerala requires funds to rebuild the devastated infrastructure. The fund will be used to achieve the aim of rebuilding the state infrastructure.

Along with this, a 10-year Masala Bond was listed by Asian Development Bank for Rs 850 crore on India INX. India INX is a global debt listing platform. These proceeds are subjected to be used in investment in India.

Key Features of Masala Bond

The key features of the Masala Bond are-

- If the fund raised is in the foreign currency, the borrowers must pay a significant amount of servicing debt at the time of depreciating the domestic currency.
- The issuers don't have to deal with the transfer risk because of the fluctuations in the currency.
- **Maturity period:** If Masala Bond is raised to USD 50 million eq in Rs, the financial year should be 3 years, and the minimum maturity period should be 5 years.
- **Recognised Investors:** For a country to issue the Masala Band, it has to fulfil the following Condition-
 1. It has to be a member of FATF (Financial Action Task Force)
 2. The country's securities market regulator must be a signatory to IOSCO's Multilateral Memorandum of Understanding.
- **End-use Prescriptions:** The funds raised should not be used for purchasing land and real estate activities.

Masala Bonds - RBI Mandate

According to the Reserve Bank of India, the Masala Bonds can never be used for the following-

- For Real Estate: The money raised from the Masala Bond can not be exploited for real estate activities like housing projects or the development of integrated townships.
- Along with the real estate activities, these funds are restricted from being used for purchasing land.
- The money cannot be used directly for the actions prohibited by the Foreign Direct Investment guidelines.
- One cannot invest the money in capital market projects. It is also restricted to use for the domestic equity investment proceeds.

Benefits of Masala Bond

Masala Bond has proven to be beneficial for Investors as well as for Borrowers. The benefits are explained as follows-

Benefits for investors

The investors get the following benefits from the Masala Bond-

- Masala Bond requires less need of documentation. Because of less documentation, the investors are not required to register as the FPI (Foreign Portfolio Investment) in India.
- Since there is a gain in Capital from the rupee appreciation, the investors are excused from taxes.
- It provides an assortment from the proportionately shallow domestic bond market.
- Through FPI / FII route, most investors do not have access to the domestic market. Because of the Masala Bond, an investment route for global investors is opened.
- International custodians can be used to set the bond in a foreign country.
- An interest rate can be up to 5% or above the SBI's base rate.

Benefits for Borrowers

The borrowers enjoy the following benefits-

- There is no risk of currency fluctuations.
- The Masala Bond offers an interest rate of less than 7%, and they enjoy a cheaper cost of funds.
- There is no risk of borrowing and paying by the Indian companies as all the transactions happen in Indian rupees after RBI allowed companies to raise rupee resources overseas.
- The proceeds of the Masala bond can be utilised for affordable housing projects, developing integrated townships, refinancing NCDs and rupee loans.

Issues with Masala Bond

Though Masala Bond offers plenty of benefits to the investors and borrowers, certain issues are associated with it. These are-

- With the higher tax possibility, there is a weakening of instrument utilities.
- Since RBI has cut the periodical rates, Masala Bond has less appeal among investors.
- Financial sustainability because of Masala Bond is a challenge for investors.
- There is a constant fear that the Indian rupee might face depreciation pressure.

Masala Bond in India

Masala Bonds are a prime part of the Indian economy. India has gained the following benefits with the introduction of the Masala Bond-

- Since the interest rate for foreign currencies is low, Indian companies are gaining a lot of benefits by raising funds through the Masala Bond.
- Indian Rupee is familiar with international investors, which will ultimately result in the Indian economy's growth.
- When the Masala Bond gains popularity, there will be a fall in the foreign currency-denominated ECB.
- It will help India create a new opportunity for retail investors.