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ALL ABOARD THE BOND WAGON: SEBI BOARD MEETING DECISIONS

24 October 2018

The Securities and Exchange Board of India (SEBI) in its meeting held on 18 August 2018, besides reviewing the total expense ratio of the mutual fund schemes and agreeing to introduce united payment interface with ASBA facility for public issues, has also paved the way for further stimulating the bond market by removing the requirement of having 1% security deposit for public issue of debt securities and laying down the framework for enhanced market borrowings by large corporates through the bond route.

A brief overview of the changes affecting the bond market is provided below:

Framework for enhanced market borrowing by large corporates

The Finance Minister in the Union Budget of 2018-19 announced that "*SEBI will also consider mandating, beginning with large Corporates, to meet about one-fourth of their financing needs from the debt market.*". Pursuant thereto, SEBI released a consultation paper in July 2018 on "Designing a Framework for Enhanced Market Borrowings by large Corporates" which framework (Framework) was approved by SEBI in its board meeting. Contours of the Framework are as follows:

Applicability: The Framework provides that a 'large corporate' shall raise 25% of its incremental borrowings for that year through the bond market. The Framework categories a corporate as 'large corporate' if it has listed its specified securities or debt securities or non-convertible redeemable preference shares, and fulfils the criteria of a) outstanding borrowing of Rs 100 crores or above; b) credit rating of "AA and above"; and c) intends to finance itself with long term borrowings (i.e. borrowings above 1 year, as on March 31st of a financial year). The Framework specifically excludes scheduled commercial banks from its compliance. A large corporate is required to intimate the stock exchange whether they will be covered under the Framework.

Implementation: The Framework shall be in effect from 1 April 2019 onwards after the final guidelines are issued by SEBI

Borrowings coverage: The term "borrowings" as used in the Framework refers to borrowings which have original maturity period of more than 1 year i.e. only long-term

borrowings. The expression excludes external commercial borrowings and inter-corporate borrowings between a parent and subsidiaries.

Testing: Adherence to the Framework, for the initial block of two years from the date of commencement i.e. from 1 April 2019 to 31 March 2021, an approach of 'comply or explain' shall be followed. In the event of non-compliance, the large corporate is required to provide reasons as part of the 'continuous disclosure requirements' to the stock exchanges. From 1 April 2021, the compliance shall be tested for every block of two years.

Penalty: If there is any deficiency in the requisite bond borrowings post 1 April 2021, a penalty of 0.2% of the shortfall amount shall be levied.

Removal of 1% security deposit for Public Issue of Non-Convertible Debentures, Non-Convertible Redeemable Preference Shares and Securitised Debt Instruments

In accordance with the SEBI (Issue and Listing of Debt Securities) Regulations, 2008, as amended (SEBI ILDS), SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013, as amended (SEBI NCRPS) and SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008, as amended (SEBI SDI), any company undertaking a public issue of debt securities, non-convertible redeemable preference shares and securitised debt instruments was required to deposit with the designated stock exchange before the issue opens, an amount calculated at the rate of 1% of the amount of securities offered for subscription to the public. Such security deposit was refundable or forfeitable in the manner as specified by SEBI.

SEBI vide in its circular no. CIR/DDHS/P/121/2018 dated August 16, 2018 made it mandatory for the investors applying in a public issue to use only ASBA facility for making payments. As a result, in case of allotment, investors have to authorise the self-certified syndicate banks to make payment by signing the application forms. The investors will not face any challenges in seeking refunds, as in case of ASBA, the money required for allotment of securities is only deducted from the bank accounts of investors when their applications are selected for allotment.

Since, the rationale of the security deposit was to address the complaints of the investors relating to, *inter alia*, the refund of application monies, which risk has been addressed due to the mandatory ASBA facility, SEBI has decided to remove the requirement of 1% security deposit from the SEBI ILDS, SEBI NCRPS and SEBI SDI.

Going forward, SEBI will most likely notify the amendments to the aforesaid regulations and thereafter, the companies will not be required to make any security deposit of debt instruments.

Comment

The requirement to deposit 1% of the issue amount as security deposit increased the costs involved in undertaking the public issue of debt securities. With the removal of security deposit, the burden on the issuer will be considerably reduced and will encourage more public issue of debt instruments. Furthermore, with the introduction of the Framework, large corporates would need to compulsorily raise funds through the bond market and rely less on bank borrowings which will in turn allow a deeper and more liquid bond market to develop. With the introduction of Insolvency and Bankruptcy Code in 2016, the default risk of bonds will be substantially reduced since under the liquidation waterfall stipulated under the Code, bond holders are at a higher

pedestal than even government dues. With diversification of borrowing sources, the concentration risk on the banks will significantly reduce.

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