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SEBI PROPOSES REGULATORY FRAMEWORK FOR ONLINE BOND PLATFORMS

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INTRODUCTION

Issuance of listed debt securities in India is currently by way of: (a) public issuance through the Stock Exchanges and Depositories; and (b) private placements to an identified set of mostly institutional investors. Over the last 3 financial years, the Securities Exchange Board of India (*SEBI*) has observed that the volume of private placements has far exceeded that of public issuances. It has also noted that, within private placements, the investor class has largely been restricted to institutional investors. This has resulted in an increase in the number of online bond platforms which facilitate investments in both listed and unlisted debt securities by non-institutional investors. So far these bond platforms were not under any regulatory purview.

On 21 July 2022, SEBI released a consultation paper on 'Online Bond Trading Platforms - Proposed Regulatory Framework' (*Consultation Paper*), making the case for the regulation of online bond trading platforms. In its assessment, SEBI has also evaluated the market share of the current players in online bond trading, some of which operate in a manner akin to organized avenues for trading; bringing together buyers and sellers to trade in debt securities.

SEBI'S RATIONALE FOR REGULATING ONLINE BOND PLATFORMS

SEBI is looking to bring online bond platforms within the regulatory fold to address issues arising out of: (a) lack of regulatory oversight and accountability for the bond platform; (b) absence of standards for know your client Know Your Customer (*KYC*) norms; (c) ambiguity in redressing investor grievances; (d) possibility of misrepresentation; (e) conflict of interest, product offerings, information availability and possible mis-selling; (f) concerns regarding deemed public issuances; (h) reporting of trades; and (i) inconsistencies in clearing and settlement.

PROPOSED FRAMEWORK

An overview of proposed regulatory framework is set out below:

- <u>SEBI stock-broker registration</u>: Online bond platforms play the role of facilitators, where they facilitate transactions by the registered investors on their platforms. Accordingly, SEBI has proposed that all online bond platforms must mandatorily register themselves as stockbrokers (in the debt segment) with SEBI or be run by SEBI registered brokers.

- <u>Eligible securities</u>: To mitigate a risk of a deemed public issue, where debt securities issued on private placement basis are down sold by the bond platforms to a large number of investors (i.e., more than 200 persons), SEBI has proposed that online bond platforms must offer only listed debt securities for purchase / sale to their registered investors.

- Lock-in period: A lock-in period of 6 months from the allotment date of the debt securities is proposed to address the issue of a deemed public issue.

- Channelizing transactions through specified platforms: SEBI has proposed that the transactions executed on the online bond platforms can either be routed through the trading platform of the debt segment of the exchanges, or through the Request for Quote Platform (*RFQ*) of the stock exchanges where the transactions will be cleared and settled on a Delivery Versus Payment (*DVP-1*) basis (in terms of the settlement requirements therein). It has also been clarified that the bond platforms can continue to maintain their front-end or their present web interface (displaying the available list of debt securities, ratings, associated risks, among others).

Comment:

The proposed regulatory framework is an anticipated outcome of recent meetings of SEBI's Corporate Bonds & Securitization Advisory Committee (*CoBoSAC*) around the issues regarding bond platforms. CoBoSAC had observed that there is a need to govern the operations of online bond platforms to ensure enhanced regulatory oversight and governance. The committee had concluded that there will be multiple benefits of regulation of bond platforms as stockbrokers under SEBI regulations, such as:

- applicability of standard KYC requirements at the time of onboarding clients on bond platforms;

- eligibility norms on net worth and deposit requirements akin to those prescribed for stockbrokers will ensure stable financial health of bond platforms;

- the applicability of code of conduct mandated for stockbrokers will ensure fairness in their dealings with clients; and

- regulatory inspection and oversight would ensure appropriate checks and balances towards creating safe and transparent investment platforms for investors.

Further, routing of transactions through trading platform of exchanges will ensure: (a) robust risk management framework and surveillance mechanism; (b) fair and transparent pricing; (c) guaranteed settlement; (d) exit opportunity to the investors; and (e) augment market making.

This framework will be instrumental in the development of the secondary market for debt securities, where the market participants would adopt investor-centric business models and would be under much-needed regulatory oversight. That said, excluding unlisted debt securities from the purview of online bond trading platforms could potentially impact the secondary market for sale of bonds.

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