Be wary of risks while investing online in bonds

Sebi has disallowed online platforms from selling unlisted bonds, but even listed bonds carry multiple risks.

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by **Sanket Dhanorkar**

Market watchdog Sebi recently introduced norms for online bond platforms (OBP), which were operating in a regulatory vacuum earlier. These platforms can now offer only listed or soon-to-be listed securities, and are barred from offering unlisted bonds even via an affiliated platform or website. They also need to register themselves as stock brokers in the debt segment of the stock exchange.

In accordance with the Sebi diktat, some platforms have now registered as brokers and obtained licences to operate OBPs. These include the GoldenPi, The Fixed Income and IndiaBonds, while a few others are still awaiting issuance of licences. The new guidelines offer a degree of safety for users transacting on such platforms. The critical change is with respect to unlisted bonds offered earlier by a few platforms. Listed bonds formerly carried a prohibitive face value of ₹10 lakh, but unlisted bonds did not, so the latter found many takers among smaller investors. The two segments, however, are like chalk and cheese.

While the listed bond offerings have to adhere to strict disclosure norms, the unlisted bonds do not have to meet such requirements, leaving investors flying blind. Besides, liquidity in unlisted bonds is dicey. Sebi had earlier asked OBPs to limit their offerings to listed securities, but many OBPs were still running links to affiliate platforms or websites for unlisted bonds. The new norms have put a stop to this. Listed bonds are now offered at a lower face value of ₹1 lakh, making these accessible to smaller investors. The norms also require the platforms to issue electronic order receipts instantly on placement of order by investors, along with the deal sheet after the execution of the order.

Even though OBP operations are now streamlined and under the Sebi purview, investors need to remain vigilant. Online bond platforms have opened up a new vista of opportunities to build a diversified fixed income portfolio. These platforms offer bonds across the spectrum of the bond market—government securities, state development loans, municipal and corporate bonds, secured and unsecured bonds, market-linked debentures, and even sovereign gold bonds. These include securities with maturities ranging from 3-6 months and up to 10 years. These differ vastly in credit ratings, from AAA and sovereign bonds to securities rated A and below (up to BBB-).

Vishal Goenka, Co-founder, IndiaBonds, insists investors must get a clear grasp of the risk matrix. "In bonds, risk doesn't simply go up in linear fashion as you go down the credit quality ladder. The lowest rung in the ladder, BBB-rated securities, is priced similar to A-rated bonds, but carries substantially higher credit risk, with a wide dispersion in return profile," he says. The pricing of bonds (as reflected in the yield) within the same rating bucket (such as A-, A, A+ or AA-, AA, AA+) is often very similar. Yet, credit profiles of businesses in the same rating bucket can sometimes differ vastly.

Investors must also consider the bond's seniority in the payment hierarchy. It reflects the order in which bondholders are repaid when the issuer turns insolvent. So, it will determine the chances of you getting back your principal during such an event. Senior secured bonds are placed at the top, enjoying first preference in repayment. Tier 2 subordinated bonds and perpetual (AT1) bonds lie at the bottom of this ladder. "We offer only senior secured bonds on the platform and make no space for subordinated or perpetual bonds where the risk is much greater," says Anshul Gupta, Co-founder and CIO, Wint Wealth.

Liquidity is another potential hazard. Apart from a few prominent corporate bonds, trading volumes in the rest are very erratic. Gupta avers, "Consider these bonds as part of your illiquid portfolio. Even if these are listed, there is no guarantee that you will find a willing buyer on the exchange." For all these reasons, investors must not think of any bond investment as safe. These are not a replacement for your fixed deposits. Kirtan Shah, CEO, Credence Wealth Advisors, insists that in fixed income, one is better off protecting the capital rather than pursuing 1-2% extra yield. "Investors often pursue yield without understanding the risks in terms of credit, liquidity and reinvestment. Retail investors must understand concentration risk while chasing returns on these platforms," he says.

If you must explore, carry out due diligence. The platforms are required to transparently disseminate all information, including price, yield, date of maturity and other related literature. A few OBPs claim to offer a curated selection of bonds, vetting every issuer before listing bonds. For instance, Wint Wealth only lists bonds from NBFCs with a leverage (debt-equity ratio) of less than 4 and those with no adverse rating action in the recent past. It also checks the diversity and quality in the NBFC's lender profile before listing. While this primary screening by the OBP is useful, it should not stop the investor from doing the spadework.

Similar rated bonds may differ materially

While yields from bonds may be similar, their credit profiles may vary substantially.

PARTICULARS	JM FINANCIAL	SHRIRAM TRANSPORT FINANCE COMPANY	ARAGEN LIFE SCIENCES
Coupon rate	9.75%	8.55%	7.75%
Yield to maturity	8.19%	8.47%	8.21%
Credit rating	ICRA AA	CRISIL AA+	CRISIL AA-
Interest payment frequency	Annually	Annually	Annually
Maturity date	7 Jun 2028	8 Sep 2032	11 Feb 2025
Seniority	NA	Senior	Senior
Secured	Yes	Yes	Yes

Source: Bondskart

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