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How OBPs leverage Sebi, RBI regulatory ambiguity

Sebi's new guidelines bar online bond platforms from trading in unlisted bonds

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History of online bond platform regulation

2019-2021
OBPs start to pop up; start offering listed & unlisted bonds, venture debt, gsecs & SGBs

Jul 2022
Sebi floats consultation Paper

Nov 2022
Sebi enacts final norms; OBPs start offering "only" listed bonds

Dec-Mar 2023
OBPs start applying for a stock broker (debt segment) license: GoldenPi becomes the first

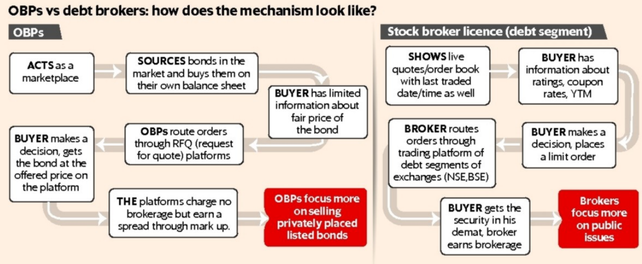
Jun 2023
GoldenPi launches Plus by GoldenPi offering unlisted bonds, gsecs, SGBs

How some online bond platform providers may be in Sebi's crosshairs

	OBPs offering listed corporate bonds	OBPs offering unlisted corporate bonds
Sebi's approval	▶ Only listed bonds to be traded by OBPs	▶ Doesn't approve unlisted bonds to be traded by OBPs
Applicable regulation	▶ Sebi (Issue and listing of non-convertible securities) Regulations, 2021	▶ Section 42 & 62(1) c of Companies Act, 2013
Liquidity	▶ Traded on exchanges like NSE, BSE; hard to find buyers without huge slippage	▶ Traded OTC (over-the-counter) or off market through distributors; illiquid from a retail perspective
Information asymmetry	▶ Some information asymmetry exists	▶ Information asymmetry exists; can lead to arbitrage
Regulatory zone	▶ Strict regulations by Sebi to prevent defaults	▶ No regulations as of today; deemed grey zone
Taxation	▶ STCG as per income slab; ▶ LTCG (>12 months)- **10%** without indexation;	▶ STCG as per income slab; ▶ LTCG (>36 months)- **20%** without indexation;
Default resolution process	▶ Approach DT (Debenture Trustee), it can take legal action against the defaulting entity	▶ Approach DRT (Debt Recovery Tribunal) or initiate insolvency proceedings under IBC
Platforms	▶ WintWealth, GoldenPi, BondsKart*	▶ Plus by GoldenPI

*Owned by JM Financial

OBPs vs debt brokers: how does the mechanism look like?



Online bond platforms (OBPs) such as Golden Pi, Jiraaf or Wint Wealth have gained significant traction in India, providing individuals with a convenient and accessible means to invest in bonds.

During 2019-2021, these platforms offered listed and unlisted bonds, venture debt, government securities (gsec), and sovereign gold bonds (SGBs). However, since July 2022, when the Securities and Exchange Board of India (Sebi) floated a consultation paper on regulating the OBPs, the regulatory environment witnessed some uncertainties.

The new rules allow OBPs to offer only listed bonds, mandating them to get a stockbrokers licence if they wish to facilitate debt investments.

In November 2022, Sebi finalized the guidelines for OBPs, largely along the lines of the proposals floated earlier, with one major exception: OBPs are not allowed to offer unlisted bonds. Sebi refers to these bond platforms as OBPPs

Now, a few OBPs have decided to offer unlisted bonds on a separate platform that does not fall under the purview of Sebi. GoldenPi launched a new platform, Plus, in June, for retail investors to invest in unlisted bonds. Despite Sebi barring OBPs from transacting in these instruments, unlisted bonds have found a new home and will continue to function in a regulatory grey area. That apart, gsecs and SGBs will also find a place on these platforms, even though they are traded on the stock exchanges. This is so, as gsecs and SGBs are regulated by Reserve Bank of India, hence, Sebi does not want them to be on regulated online bond platforms, said two people familiar with the development, seeking anonymity.

Sebi is understood to have asked RBI to clarify on this recent development for gsecs/SGBs, and may eventually allow them on the regulated platforms.

RISKS OF UNLISTED BONDS

Privately placed bonds, also known as unlisted bonds, are debt securities issued by companies or entities that are not listed on recognized exchanges. These bonds are typically offered to a select group of investors through a private placement rather than being made available to retail investors for trading.

Sebi allowed OBPs to exclusively trade in listed bonds, while unlisted bonds are not authorized for trading on these platforms. OBPs offering listed corporate bonds must adhere to Sebi's (Issue and Listing of Non-Convertible Securities) Regulations, 2021, which impose stringent guidelines to prevent defaults and safeguard the interests of investors.

Listed corporate bonds are typically traded on exchanges such as the NSE and the BSE. However, due to limited liquidity, finding buyers for the bonds without significant slippage can prove to be challenging. Conversely, OBPs dealing in unlisted corporate bonds operate within a regulatory grey area, as there are no specific regulations governing their trade. This lack of oversight creates information asymmetry, potentially leading to arbitrage opportunities.

Moreover, in accordance with Sebi regulations and the Companies Act, privately placed bonds can be offered to only 200 individuals in a financial year, excluding qualified institutional buyers and employees of the issuing company. This threshold ensures that bond offerings remain classified as private placements and do not trigger the requirements of a public issue.

To list unlisted bonds, issuers must comply with regulations set by recognized stock exchanges in India. This process typically involves meeting specific criteria and obtaining necessary approvals from the stock exchange. By listing these bonds, issuers can provide investors with both liquidity and potential access to the market.

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However, the move by OBPs to offer unlisted bonds carries the risk of inadvertently triggering a deemed public issue if the number of investors exceeds 200 (excluding QIBs and employees) after the initial private placement. This situation could arise if holders of unlisted bonds on OBP platforms decide to sell them to new investors, thereby increasing the number of investors beyond the permissible limit.

The occurrence of a deemed public issue can have repercussions, as seen in the Sahara fiasco. In the Sahara case, the Supreme Court of India ruled that the issuance of optionally fully convertible debentures (OFCDs) by the group to over 49 individuals without adhering to the public issue regulations was deemed to be a public issue. The court also imposed penalties on the company for regulatory violations and ordered it to return the funds with interest.

For defaults, the resolution process also differs, depending on whether the bonds are listed or unlisted. In the case of listed bonds, OBPs may seek assistance from debenture trustees, who can take legal action against the defaulting entity. On the other hand, for unlisted bonds, the resolution process involves approaching Debt Recovery Tribunals (DRT) or initiating insolvency proceedings under Insolvency and Bankruptcy Code (IBC).

Taxation on both listed and unlisted bonds varies on duration of the investment. Short-term capital gains are taxed according to the investor's applicable tax slab. For long-term capital gains, listed bonds held for over 12 months are taxed at 10% without indexation, whereas unlisted bonds held for over 36 months are subject to a higher rate of 20% without indexation.

OBPs VS DEBT BROKERS

With Sebi now requiring OBPs to get a brokerage licence for trading in listed bonds, it is important to understand the distinctions between OBPs and traditional debt market brokers. While both facilitate investor participation in the bond market, they differ in several aspects. Under the new regulations, OBPs have to register as stock brokers with Sebi. However, unlike traditional brokers, OBPs have the flexibility to purchase and hold bonds on their own balance sheets before selling them to the investors at a mark-up.

In terms of providing information to buyers, both OBPs and debt brokers furnish key details such as ratings, coupon rates, yield-to-maturity, and fair prices. That said, the process of placing orders varies. Debt brokers enable buyers to place limit orders, specifying the desired price they are willing to pay, in comparison, OBPs present customers with a single offer price.

The order routing mechanisms also differ for OBPs and brokers.OBPs utilize Request for Quote (RFQ) platforms to route orders. In contrast, debt brokers leverage the trading platforms of debt segments on exchanges like the NSE and BSE for trade execution. The NSE RFQ platform can offer improved price discovery for illiquid or less liquid debt securities, as investors can request quotes from multiple participants and compare prices. However, this practice raises concerns over transparency, as the quotes are not visible to other market participants.

In terms of bond acquisition, OBPs allow buyers to get bonds at the offered price on their platforms, but debt brokers act as intermediaries, purchasing bonds on behalf of investors and transferring them to their demat accounts.

Besides. OBPs do not charge brokerage fees, instead generating revenue through a spread,while debt brokers derive their revenue from brokerage fees charged for their services.