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RED SIGNAL

The Sebi wrench in Wint Wealth's online bond trading plans

Startups like Wint Wealth and others are bringing the usually-opaque bond market to India's retail investors. But bonds are risky, and unlisted ones offered by these startups, even more so. The regulator has now turned its eye on the sector

Anand Kalyanaraman, 19 Aug 2022

- Nearly a dozen online bond trading platforms mushroomed during the pandemic, making the most of investors looking to beat high inflation and low returns on bank fixed deposits
- But they operate in a regulatory vacuum. Many do not comply with Sebi's KYC requirements, and some offer bonds considered too risky for retail investors
- The regulator is now all set to throw the rule-book at these platforms, recommending multiple guardrails and a tight squeeze on the product offerings
- Platforms like Wint Wealth that depend significantly on 'unlisted bonds' sales could take a knock and be forced to change. Most experts see the rules as short-term pain, long-term gain

In January, Ajinkya Kulkarni, chief executive (CEO) and co-founder of online bond trading platform Wint Wealth, tweeted this eye- catcher.

Getting the whos-who of India’s finfluencer world to act as its brand ambassadors in exchange for equity stakes was a coup of sorts. The Bengaluru-based company is only two-years-old—practically a greenhorn.

And yet, it wouldn’t be the first time that Wint Wealth pulled off a surprise. In early 2021, the company raised money in its first seed funding round from another set of whos-who in India’s fintech space—Nithin Kamath, co-founder of online trading startup Zerodha; Kunal Shah, co-founder of credit card payments startup CRED; Praveen Jadhav, former CEO of payments behemoth Paytm, among others.

The company specialises in bonds, a type of debt security in which the buyer “lends” to the company issuing the bond. Bonds are risky—if the issuer defaults, investors lose money. “If even one company defaults on the debt taken, the trust of the retail investor will be lost for good. Instant gratification will not help in this business. Good businesses take time to develop,” says Ankit Gupta, founder and director of Mumbai-based bond trading platform BondsIndia.

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Wint Wealth, though, seemingly defied the odds, reportedly becoming India’s first debt investment platform to cross over Rs 100 crore ($13 million) in assets under management (AUM) in 2021. Its main allure is the returns it promises. At 9-11%, Wint Wealth’s returns are much better than the sad rates (~5%) that FDs offered. The higher the risk, the better the returns, naturally.

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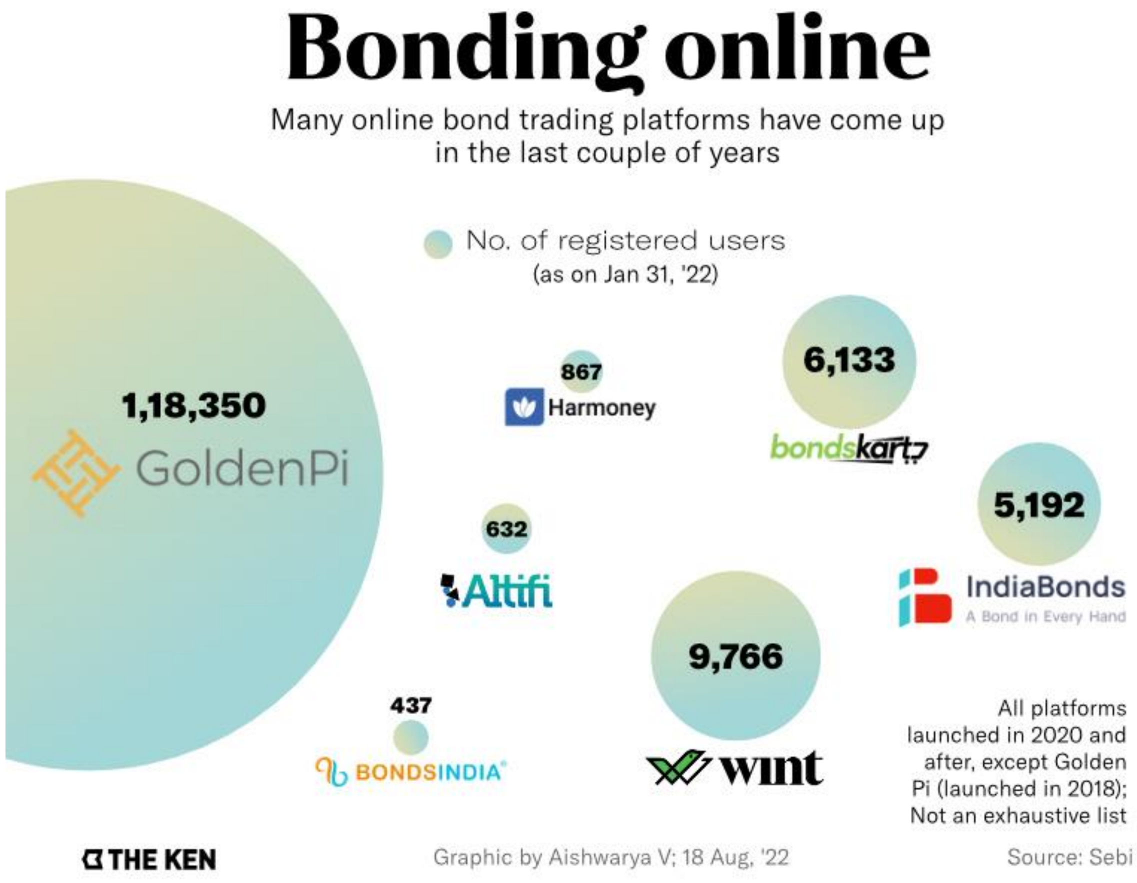
And it's not just Wint Wealth reaping the rewards of a rising interest in alternate avenues of investment. The oldest player in this space is GoldenPi, founded in 2018 by Abhijit Roy and Samir Baran Pratihar. And since 2020, many such similar platforms—BondsIndia, Harmoney, Altifi, Bondskart, Indiabonds, AxisYield, Plutus—have mushroomed. Data gathered by India's markets regulator Sebi from two of these platforms—Sebi hasn't disclosed which ones—show a sharp rise in the number of registered users to nearly 250,000 and a volume of Rs 160 crore ($20 million) in the year ended March 2022, up from zilch two years earlier.



Currently, Wint Wealth claims to have sold over Rs 400 crore ($50 million) of bonds to about 29,000 investors. Not quite the scorching growth it envisaged in January, but still enough to get on Sebi's radar. In July, it proposed a regulatory framework for online bond trading platforms, recommending multiple guardrails, including a squeeze in the eligible securities that can be offered. The regulator invited public comments on the discussion paper until 12 August and could finalise the rules of the game in the coming weeks.

Cue alarm bells, in all directions. On the one hand, the squeeze in the eligible securities offered extends to a type of bond that makes up nearly half of Wint Wealth's business. Any moves Sebi makes in this direction will simply wipe out a big chunk of the business for those dabbling in these bonds. This is seemingly at odds with the government's own stated objective to deepen the country's bond market. On the other hand, some of these companies' practices have raised eyebrows. For instance, the discussion paper says that many platforms do not comply with Sebi's anti-money laundering guidelines or KYC requirements. There's also a concern that these high-return securities may be relatively lower-rated and investors may fall prey to mis-selling due to a lack of appropriate product disclosures.

Unlisted unease

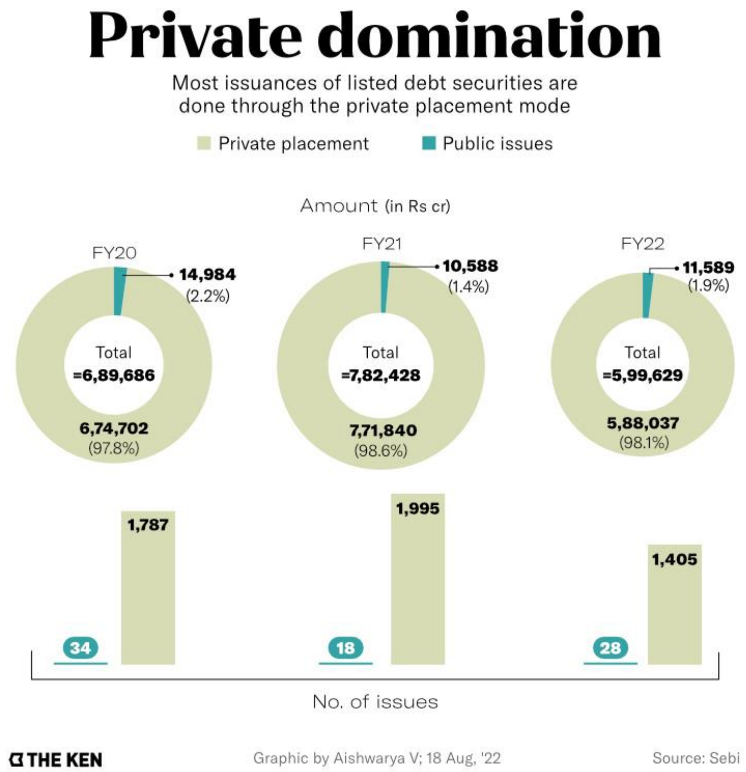
It may be only 11 pages long, but Sebi's discussion paper on the proposed regulatory framework has thrown the rulebook at online bond trading platforms at multiple levels. For instance, it wants mandatory registration for stockbrokers to ensure the industry's processes are standardised. Also, it wants transactions to be channelled through the stock exchanges to guarantee settlement.

So far so good. Industry players *The Ken* spoke to, including Wint Wealth, give a thumbs-up to these proposals, hoping these would attract more retail investors to the platforms.

Where the regulator has stumped the sector—or at least a section of it—is on two key aspects. One, the proposal that only 'listed debt securities' can be offered by the online bond platforms. Two, a lock-in period for listed debt securities issued on a private-placement basis, where bonds can't be sold for six months from the date of allotment.

Listed public debt securities are some of the safest among bonds and can be issued only by public companies. These are also relatively easily available. Private companies, if they don't borrow from banks, raise debt through private placement. While these can be both listed and unlisted, private listed bonds have a minimum face value of Rs 10 lakh ($12,500)—not exactly suited for retail investors.

Of the listed issues of nearly Rs 6,00,000 crore ($75 billion) in the year ended March 2022, only about Rs 11,600 crore ($1.45 billion) were public issues. The bigger chunk was bonds sold via private placement. And according to Sebi data, the mix hasn't quite changed in the past three years.



Unlisted private bonds, though, are some of the riskiest—the ones that Sebi has the most issue with. “Unlisted bonds are a very limited part of the bond markets, accessed mainly in the institutional space. To actually offer something like that to retail clients where some of regulations don’t apply is fraught with risks,” says Ajay Manglunia, managing director and head of Investment Grade Group, JM Financial, the firm that runs the Bondskart platform.

The size of this market is also unclear—any private company looking to raise money can issue a bond through one of these platforms. It’s this market that Wint Wealth and some of its peers have tapped into.

Until now, about 30% of Wint’s offerings in terms of value has been ‘listed public’ debt such as Incred and Ugro, according to Anshul Gupta, the company’s co-founder and chief information officer (CIO). About 30% is ‘listed private’ debt such as Kogta, Kanakadurga, while the remaining 40%-odd is ‘unlisted private’ debt such as Slice, Aryadhan, and Oxyzo. These entities are mostly non-banking financial companies (NBFCs), some such as Slice and Oxyzo being startups too.

Wint Wealth’s website shows that of 20 bonds sold so far on the platform, as many as 10 were ‘unlisted private debt’. Most of the recent issues were in this category.

In short, with Sebi’s new recommendations, nearly half of Wint Wealth’s business volume is at risk of going away. Besides, the ~30% ‘listed private’ business could also suffer due to the proposed six-month lock-in period.

Blowing with the Wint

hough the industry has several platforms dealing with bonds, Wint Wealth has been squarely in the regulator’s crosshairs, say representatives from online bond platforms and debt market experts *The Ken* spoke to.

“During its discussion with the bond platform, Sebi often showcased Wint Wealth’s practices as undesirable and said it was not comfortable,” says a senior executive at a rival bond platform. The senior executive and others *The Ken* spoke to requested anonymity as they aren’t authorised to speak to the media. Sebi’s discomfort mainly seemed to stem from the platform’s practices, they add.

Gupta, in response to this, says, “I would like to categorically deny any such conversation between the regulator and Wint Wealth.”

A common refrain among those *The Ken* spoke to is that Wint Wealth pushed the envelope a bit too far. “They advertised aggressively, engaged finfluencers, underplayed risk, and pitched high-risk bonds to retail investors,” the senior executive adds. In the past, the company also used to offer ‘covered bonds’—a complex, risky debt investment—that it eventually stopped after the central bank RBI cracked the whip on the product.

“We advertise responsibly, offer suitable products, and highlight risks. There have been no defaults so far,” says Gupta. While he acknowledges that NBFC and startup bonds often carry higher risk, he also adds, “The bonds on Wint Wealth are investment-grade (with ratings of BBB and above).” And in case of default from borrowers, the bonds are ‘senior secured’—that is, backed by priority payments from secured assets, he adds.

In addition, many of the loans offered on the platform are amortising (paid back at periodic intervals) and of short durations (one to two years) to reduce default risk and impact.

Meanwhile, those in the industry are concerned that the 9-11% return offered by Wint Wealth falls short compared to the risk taken. “Working capital loans and such to loss-making funded startups is akin to ‘junk credit’, and should carry much higher interest rates,” says a lawyer-cum-investment expert who dabbles in debt platforms. Ditto for loans to small NBFCs that lend to risky segments. Executives at other bond platforms *The Ken* spoke to agree with this argument.

What if in the funding winter, the startup to which you have lent cannot repay? Everything looks good when the markets are good.

—FOUNDER OF A BOND TRADING PLATFORM

The investment expert also doesn't place much store by the investment-grade ratings assigned to these bonds, pointing to examples in the past where even the highest AAA rated debt of finance companies Infrastructure Leasing & Financial Services (IL&FS) and DHFL defaulted. BBB is much down the rating curve and up the risk curve. "People don't fathom the disproportionate amount of risk they are taking as they go down the rating scale. There is a daylight difference between a AAA paper and single B or BB or BBB paper," a corporate finance expert tells *The Ken*.

Eventually, the borrower gets the loan at a relatively cheap rate, the bond platform gets up to 2% of the loan amount for its service, while the retail investor gets the short end of the stick, the lawyer-cum-investment expert says. "Comparing the returns on these bonds against FDs makes them look good. They then become an easy sell to retail investors who do not often understand the nuances of debt investing such as credit spreads and risks," they say.

Sebi seems to agree with this assessment, going by the tone and tenor of the discussion paper. In particular, unlisted private bonds, that helped Wint Wealth scale up fast, could now become its Achilles heel.

This, in turn, could impact Wint Worth's financials and valuation. The company is expected to post a loss in the year ended March 2022 too, say those in the know. This would be in continuation of its loss of Rs 30 lakh ($37,600) in the year ended March 2021 when it began operations.

And with the expected change in the regulatory framework, Wint Worth's bottomline could remain in the red this year, too. Its latest capital raise of Rs 112 crore ($14 million) in May gave it a valuation of Rs 536 crore ($67 million), up from Rs 216 crore ($27 million) last November, shows data from information provider Tracxn. But the headwinds could dampen the mood.

At odds

Wint Wealth seems to be pushing back, understandably so. Kulkarni, in a note on Twitter after Sebi's discussion paper was out, indicated that the company would be reaching out to Sebi with proposals to solve what it calls a 'structural problem'. Besides, Gupta suggests that the face value of listed private debt be reduced from Rs 10 lakh ($12,500) to a reasonably lower amount to make it accessible to retail investors. Whether the Sebi will oblige is anyone's guess.

If the proposed regulations are implemented as-is, Wint Wealth's volumes will suffer at least initially, Gupta concedes. "But over time, we will have to focus on creating supply of public listed debt securities and expanding this 2% market," he says. With retail investor demand on its platform, the company hopes to reach out and convince companies/entities to issue public listed securities.

This may be easier said than done though. "A public issue comes with significant costs, including preparation of detailed offer documents and other exchange related and regulatory compliance," explains the lawyer-cum-investment expert who dabbles in debt platforms.

Sebi's recommendations seem to be at odds with the Indian government's attempts to infuse more liquidity and depth in the country's corporate bond market. The idea is to get companies—even beyond the top rated ones—borrow more from the bond market rather than from banks.

In 2020, the government had increased the ceiling for foreign investor participation in corporate bonds from 9% to 15%. Also, it is said to be working on setting up a 'backstop facility' to buy investment-grade debt securities both in stressed and normal times; this was proposed in Budget 2021. But some think that retail investor participation in a meaningful measure is necessary to deepen the market.

In fact, those in the industry *The Ken* spoke to think Sebi's framework will help the cause rather than hinder it. This, despite many of the platforms having reservations about certain clauses – especially the six-month lock-in for listed private bonds that they think will impact liquidity in the bond and discourage small players.

"The regulations are a prudent step given that the end user is retail and needs to be protected at an early stage of direct investment in bond markets," says JM Financial's Manglunia. "Standardisation of norms will encourage more retail customers to access the bond markets directly."

While there is broad consensus in favour of regulations, concerns remain about the extent of Sebi's involvement in managing the retail investors' investment choices. "Equities are also risky. Are retail investors not allowed to invest there?," asks another investment expert.

Sebi, as always, has a fine balancing act to perform.

Image credit: RickJbrown/Pixabay

Altifi | BondsIndia | Bondskart | corporate bonds | GoldenPi

Harmoney | Indiabonds | Online bond platforms | SEBI | Wint Wealth

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A certified Chartered Accountant, Anand chose to pack the power of numbers with words when he left a career of seven years in accounting, putting together MIS reports, and investment research to enter journalism. Before joining The Ken, Anand was Deputy Editor at The Hindu BusinessLine, a newspaper he worked at for 11 years.