भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

Consultation Paper

Public Issuance of Non-Convertible Debentures having credit rating below Investment Grade

A. Objective:

To solicit the comments/views from public on the consultation paper proposing amendments/clarifications to the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (hereinafter referred as "ILDS Regulations"). The objective of the consultation paper is to seek comments on the proposals with respect to public issuances of Non-Convertible Debentures having below investment grade credit rating-

1. To prescribe a framework for 'Risk-o-meter' with respect to such issuances

2. To enhance disclosure requirements with respect to such issuances

3. Restriction on investment amount in case of Retail Investor and Allocation to Retail Investors in Base Issue Size with respect to such issuances

B. Background:

1. SEBI (Disclosure and Investor Protection Guidelines), 2000 (hereinafter referred as "DIP Guidelines") were issued to regulate the issue of securities (both equity and debt securities) of a company to public, shareholders and institutional investors through the primary market. The erstwhile guidelines made it compulsory for issuers of debt securities to obtain credit rating from not less than two rating agencies and also required that the debt instruments issued through a public/rights issue shall be of at least investment grade.

2. In December 2007, SEBI amended the provisions pertaining to issuances of corporate bonds under the DIP Guidelines as under-

   2.1. Requirement of Credit Rating: With a view to reduce the cost of issuance of debt instruments, SEBI decided that credit rating from one credit rating agency would be sufficient.

   2.2. Below Investment Grade debt instruments: In a disclosure based regime, it should be left to the investor to decide whether or not to invest in a non-investment grade debt instrument.

3. In order to facilitate development of a vibrant primary market for corporate bonds, SEBI notified SEBI (Issue and Listing of Debt Securities) Regulations in June, 2008 to provide for simplified regulatory framework for issuance and listing of non-convertible debt securities (excluding bonds issued by Governments) issued by any company, public sector undertaking or statutory corporations. Further, from the commencement of ILDS Regulations, the provisions of DIP Guidelines, 2000 related to issue and listing of debt securities were rescinded.

4. With respect to the credit rating requirements for public issuance of debt securities, Regulation 4(2) of ILDS Regulations mentions that, an issuer making a public issue of debt securities has to obtain credit rating from at least one credit rating agency registered with the Board and disclose it in the offer document. The ILDS Regulations do not specify any minimum credit rating for such issuances.

C. <u>Growth of Corporate Bond Market:</u>

The corporate bond market has evolved gradually over time due to the various measures taken by SEBI. The total primary issuance has increased from Rs. 1, 18,485 crore in FY 2007-08 to Rs. 4, 91,884 in FY 2015-16 while for FY 2016-17 (till November, 2016) it is Rs. 4, 43,281 crore. Further, the amount raised through public issuance has grown from Nil in 2007-08 to Rs. 33, 811 crore in FY 2015-16 and for FY 2016-17 (till November, 2016) the amount stands at Rs. 23, 893 crore.

<u>Table on amount raised through public and private placement issuances of Corporate Bonds in Indian Debt Market (Listed Securities)</u>

Financial Year	No. of Public Issues	Amount Raised through Public Issue (Rs. Crore)	No. of Pvt. Placement	Amount Raised through Private Placement (Rs. Crore)	Total Amount Raised through Public Issue and Pvt. Placement (Rs. Crore)
2007-08	0	0	744	118,485	118,485
2008-09	1	1,500	1041	173,281	174,781
2009-10	3	2,500	1278	212,635	215,135
2010-11	10	9,451	1404	218,785	228,236
2011-12	20	35,611	1953	261,283	296,894
2012-13	20	16,982	2489	361,462	378,444

2013-14	35	42,383	1924	276,054	318,437
2014-15	25	9,713	2611	4,04,136	4,13,849
2015-16	20	33,811	2975	4,58,073	4,91,884
2016-17#	11	23,893	2365	4,19,388	4,43,281
# As on November 2016					

D. <u>Need for Revision:</u>

1. Credit Ratings are opinions about credit risk. The ratings express an opinion about the ability and willingness of an issuer, such as a corporation or state or city government, to meet its financial obligations in full and on time. Credit ratings also specify the credit quality of an individual debt issue, such as a corporate or municipal bond, and the relative likelihood that the issue may default.

2. Investment Grade refers to the quality of a company's credit and generally indicates a low risk of a credit default. Further, a debt issue is considered as Investment Grade if its credit rating is BBB- or higher. It may be noted that during FY 2015-16, out of 20 public debt issuances of NCDs four issuances were rated BBB or below. Further, in FY 2016-17 (till November, 2016) 3 public debt issuances out of ten were rated BBB or below.

3. Unlike private placement of debt securities, retail investors participate in the public issues. These public issues which are rated below investment grade (i.e. below BBB-) give high coupon rate. The advertisements of such issues also focus mainly on the coupon which lures the retail investors to invest.

4. Further, certain issuers with credit rating below investment grade, have issued both secured and another unsecured NCD through same offer document with different credit ratings. Thus, for a retail investor to differentiate between secured and unsecured tranches within the same offer document and with different credit ratings may be a complex task and may affect their investment decision.

Hence, it is felt that there needs to be an additional layer of protection for the retail investors, who get attracted towards such debt securities which though on one side pay higher coupon but on the other side have a below investment grade credit rating.

E. <u>Recommendations of Corporate Bonds and Securitization Committee (CoBoSAC):</u>

Corporate Bonds and Securitization Committee (CoBoSAC), inter-alia, deliberated on enhancing disclosure requirements with respect to public issuances of Non-Convertible Debentures having below investment grade credit rating and prescribing a 'Risk-o-meter' with respect to such issuances. Based on the recommendations of CoBoSAC, the proposals for public comments are as follows-

F. <u>Proposals:</u>

1. It is proposed to enhance disclosure requirements with respect to such issuances and simultaneously also introduce Risk-o-Meter.

2. **Introduction of 'Risk-o-Meter' or 'Rate-o-Meter'**

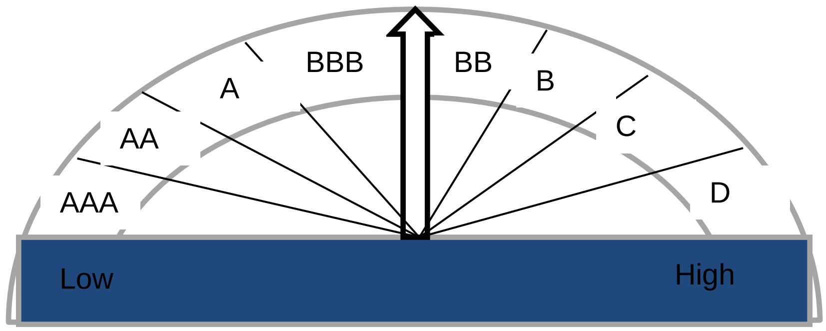
    2.1. Credit Ratings play an important role in the investment decision of the investor. Currently, an issuer indicates the credit rating on the front page of the Offer Document/Prospectus. An example of the disclosure is mentioned below-

CREDIT RATINGS
The NCDs have been rated 'BWR AA+ (BWR Double A plus)'by Brickwork Ratings India Private Limited ("BRICKWORK") pursuant to letters dated June 19, 2013, July 21, 2014 and August 6, 2014 and all of which have been revalidated vide revalidated by letters dated August 23, 2016. Instruments with a rating of 'BWR AA+ (BWR Double A plus) by BRICKWORK are considered to have high degree of safety regarding timely servicing of financial obligations . The rating provided by BRICKWORK may be suspended, withdrawn or revised at any time by the assigning rating agency on the basis of new information etc., and should be evaluated independently of any other rating. The rating is not a recommendation to buy, sell or hold securities and investors should take their own investment decisions. Please refer to the Annexure B of this Shelf Prospectus for the rationale of the above rating.

    2.2. An investor, especially retail investor may miss the abovementioned disclosure on the credit rating easily. Since rating is an important factor to make an investment decision, it is felt that an easier and better alternative would be to introduce the rating in a pictograph or picto-meter format.

    2.3. The pictorial representation may be similar to a "Risk-o-meter" which was introduced in the offer documents/ schemes of mutual funds or like a speedometer in a car (herein after referred to as "Risk-o-meter"). A sample format of the "Risk-o-meter" is shown below:

"<u>Risk-o-meter</u>"



*Refer table on the back side for explanation of ratings

2.4. The concept of the 'Risk-o-meter' would be to draw attention of the investors towards the credit rating of the issue. This form of meter may be more relevant than the text on rating in the prospectus for investors, particularly retail, as it will make things easy to understand for them. The idea is not only to caution the investors but to enlighten them about the risk factor involved with the debt issue.

2.5. The rating to be displayed on the 'Risk-o-meter' would be the latest rating provided by the credit rating agency. Modifiers such as '+' (plus) or '-'(minus) may be included, if applicable, in the meter. Risk-o-meter shall be exhibited prominently on the front page of the offer document/prospectus.

2.6. An asterisk mark shall be put on the 'Risk-o-meter' and an explanation of all the credit ratings provided by the credit rating agency shall be printed on the back side of the front page in tabular format so that the investors can understand the relevance of the credit rating of that issue vis-a-vis other ratings provided by the credit rating agency.

2.7. **Questions for public comments-**

2.7.1. **Which name shall be appropriate '<u>Risk-o-meter</u>' or '<u>Rate-o-meter</u>'?**

2.7.2. **Whether such kind of meter should be introduced for all issuers or should it be introduced only for the issuers who issue below investment grade securities?**

3. **Enhancing Disclosures- Advertisements**

Advertisements in case of issuance of debt securities primarily focus on the coupon rate and not on the credit rating of the issue. Credit rating is an important factor considered by the investor while taking investment decisions. Further, a pictorial representation of the credit rating ('Risk-o-meter' or 'Rate-o-meter', whatever it may be called) as mentioned above attracts the attention of the investor.

3.1. **Questions for public comments-**

3.1.1. **Whether the advertisements of public issue of debt securities shall mandatorily contain the 'Risk-o-meter' or 'Rate-o-meter', (whatever it may be called)?**

4. **Restriction on Investment Amount- Retail Investor and Allocation to Retail Investors for Below Investment Grade Debt Issuances**

Below investment grade debt issuances have a relatively higher credit risk but offer high coupon rate due to which retail investors are attracted towards these. Hence, it is felt that there needs to be an additional layer of protection for the retail investors who subscribe to these debt securities.

4.1. Classification of an Investor as "Retail Investor":

ILDS Regulations allow issuance of debt securities through public issue. The regulations do not differentiate between the types of investors and do not prescribe any maximum or minimum limit for any investor (Retail / Institutional).

However, with regard to issuance of tax-free, secured, redeemable, non-convertible bonds, Income Tax Act, 1961 mentions that, Retail individual Investors means those individual investors, Hindu Undivided Family (through Karta), and Non Resident Indians (NRIs), on repatriation as well as non-repatriation basis, applying for upto rupees ten lakhs in each issue and individual investors investing more than rupees ten lakhs shall be classified as High Net Worth Individuals.

It may also be pertinent to note that, in case of an Initial Public Offering (IPO) of equity securities, all investors are allowed to invest in the IPO. Though SEBI (Issue of Capital and Disclosure Requirements) Regulations ("ICDR Regulations") do not exclude any investor on the basis of a maximum or minimum investment amount from investing in IPO but it does prescribe an allocation bucket across investor categories. ICDR Regulations, however, define "retail individual investor" as an investor who applies or bids for specified securities for a value of not more than two lakh rupees.

4.2. Allocation to Retail Investors:

Secured NCDs constitute secured and senior obligations of the issuer and generally have first ranking pari passu with the existing secured creditors on all loans and advances/ book debts/ receivables and subject to any obligations under applicable statutory and/or regulatory requirements.

Unsecured NCDs constitute unsecured and subordinated obligations of the issuer and rank pari passu inter se, and subject to any obligations under applicable statutory and/or regulatory requirements. The claims of the Unsecured NCD holders are subordinated to those of the other creditors of the issue, subject to applicable statutory and/or regulatory requirements. It may be noted that there is no regulatory requirement in ILDS Regulations with respect to the allocation limits in investment by retail investors.

Certain issuers with credit rating below investment grade have issued both Secured and Unsecured NCDs through same offer document/prospectus with same/different credit ratings. For retail investors to differentiate between secured and unsecured tranches within the same offer document and with different credit ratings may be a complex task.

4.3. **Questions for public comments-**

4.3.1. **Whether the investment in such issuances shall be allowed without putting restrictions on investment by retail investor but with the additional disclosures like Risk-o-meter etc. as mentioned above?**

OR

4.3.2. **Whether a limit shall be prescribed on the investment amount by a retail investor, i.e. defining "Retail Investor"? The definition of Retail Investor shall be as under,**

a. **Option A- An investor who subscribes to the debt securities for a value of a minimum prescribed amount, say two lakh rupees.**

OR

b. **Option B- An investor who subscribes to the debt securities for a value of not more than a prescribed amount, say two lakh rupees.**

Further, it may be observed from pt. 4.2 that there is a stark difference in the priority of claims of the Secured and Unsecured NCD holders. **In case Option B is accepted and considering the participation and interest of retail investors in the below investment grade issuances which contain relatively high risk, it is proposed to limit the investment in such issuances by retail investors as follows-**

i. **For Secured NCDs, the allocation in the Issue to Retail Investor shall not be more than a certain maximum amount, say 10%, of the Base Issue Size.**

ii. **As Unsecured NCDs contain higher risk than Secured ones, for Unsecured NCDs, the allocation in the Issue to Retail Investor shall not be more than a certain maximum amount, say 5%, of the Base Issue Size.**

OR

4.3.3. **Whether the investment in such issuances shall be allowed with both i.e. the limits on investment by retail investor as mentioned at pt. 4.3.2 and with the additional disclosures like Risk-o-meter etc. as mentioned at pt. 2 above?**

G. Any other suggestions for enhancing the disclosures and advertisement guidelines with regard to the Public Issuance of Non-Convertible Debentures having credit rating

below Investment Grade.

H. Public Comments:

In light of the above, public comments are invited on the proposals contained in the consultation paper. Comments/ suggestions may be provided in the format given below:

Name of entity / person / intermediary/ Organization			
Sr. No.	Pertains to Point No.	Suggestions	Rationale

The comments may either be forwarded by email to ilds@sebi.gov.in or may be sent by post to the following address latest by **January 29, 2017**.

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