Consultative Paper

on

Draft Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008

3rd January 2008

Introduction

1. Concern has been raised in the recent past over the relatively limited success of primary corporate bond offerings. Almost all the primary issuances are by means of private placement rather than public offer of such securities. Further concern has also been raised with respect to secondary trades, whether on exchange or off exchange in such securities. In view of the lack of an active secondary market, and therefore liquidity only investors who intend to hold the debt to maturity are interested in investing in such instruments. In addition, absence of adequate trading in corporate bonds also has resulted in lack of transparency in pricing of such securities. These developments have drawn the attention of the government and the Securities and Exchange Board of India as the creation of a vibrant market for corporate bonds is the key to raising resources required for meeting the infrastructure development requirements of the country. While several issues relate to areas outside the domain of SEBI, like withholding tax, stamp duty, Companies Act requirements etc., SEBI has been continuously dealing with areas within its domain. The various actions taken by SEBI over the past two years in this area have been documented and updated on the SEBI website. In addition SEBI has also been coordinating with the Ministry of Finance and the Reserve Bank of India with regard to areas where their cooperation is

needed and seeking their assistance where further measures of reforms are required.

Historical background

2. The recent Indian growth story has necessitated raising long term resources for funding of India's infrastructure growth where corporate bond market would be playing a pivotal role.

3. In 2003, based on the recommendations of the Secondary Market Advisory Committee (SMAC), SEBI specified the regulatory framework for issuance and trading of all corporate debt securities including those issued on private placement basis. This step was taken in order to provide greater transparency to such issuances and to protect the interest of investors in such securities. Certain norms were then prescribed for issuance, listing and trading of corporate debt securities issued by listed companies on a private placement basis and listed on a stock exchange. However, not much of increase in the activity was seen as a result.

4. Subsequently, the Central Government set up a High Level Expert Committee on Corporate Bonds and Securitization to look into legal, regulatory, tax and market design issues in the development of the corporate bond and securitization markets. In December 2005, the Committee submitted its report providing a plethora of recommendations for the development of the corporate bond and securitization markets in India which was accepted by the Hon'ble Finance Minister, in his Budget speech of 2006-07.

5. Subsequently, SEBI has initiated a number of steps towards creating a dynamic corporate debt market in India. The steps taken include:

- Mandatory reporting of Over-The-Counter (OTC) trades in corporate bonds on reporting platforms of BSE and NSE w.e.f. Mar 2007.

- Setting up of trading platforms at BSE and NSE in July 2007.
- Directing exchanges to provide services for clearing and settlement of trades undertaken if the parties so desire.
- Reducing shut period in corporate bonds to align it with that applicable for Government Securities.
- Making it mandatory for all new issues of corporate bonds to have an actual day count convention similar to that followed in respect of dated Government Securities.
- Extending services of Electronic Clearing Service, Direct Credit and Real Time Gross Settlement, for payment of interest and redemption amounts as per applicable norms of the RBI along with other existing facilities.
- Placing Draft Regulations for "Public Offer and Listing of Securitized Debt Instruments" on its website for public comments, which are currently being finalized.
- Ensuring preparedness of BSE and NSE to go in for introduction of repos in corporate bonds
- Issuing letters indicating no objection to entities which approached SEBI for setting up of electronic systems to facilitate price discovery and bringing about transparency into corporate bond trading.
- Amending the provisions pertaining to issuances of debt instruments. Accordingly, issuers now need to obtain rating from only one credit rating agency instead of from two. Likewise, the requirement of at least investment grade has been removed and structural restrictions such as those on maturity, put/call option, on conversion, etc have been done away with.

6. In this Consultative Paper and the draft regulations, SEBI is aiming at simplification of the debt issuance process with a view to reducing costs and enhancing transparency.

Broad principles behind these draft regulations

7. The draft SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (**the draft regulations**) reflect SEBI's approach towards making a rationalized and stand-alone regulation for providing an enabling regulatory framework to develop the corporate debt market. The draft also provides for rationalized disclosure requirements and a reduction of onerous obligations erstwhile attached to such issues. Modifications have been aimed at reducing time and unnecessary burden of issuance of these securities and according flexibility to issuers to structure their instruments, without diluting areas of regulatory concern.

Instruments

8. These Regulations cover issuance and listing of debt securities which are not convertible, either in whole or in part into equity instruments.

9. Issuers making public offers of debt securities will continue to file draft offer documents in line with Schedule II of the Companies Act 1956 through a SEBI registered merchant banker, who will be responsible for exercising due diligence in the issue process. Such draft documents will be put up on the websites of SEBI and the exchanges for a period of 7 working days for dissemination to the public. Private Placements which will be listed need not file an offer document but will only be required to comply with the disclosure norms specified in the regulations and the listing conditions. These listing agreements will be bifurcated into a more detailed one and a simplified one depending on whether the <u>equity securities</u> of that issuer are already listed or not.

10. The broad principles of these draft regulations are:

    a) where the equity of a company is listed, and such company wishes to issue debt instruments (whether by way of public offering of private placement), as large amount of company related information is already in public domain and material developments are available as per the equity listing agreement on a nearly continuous basis minimal incremental disclosures are sufficient;

b) where the equity of the issuer is not listed, and such a company raises debt capital (whether by way of public offering of private placement) detailed disclosures, (fewer than equity securities disclosures though), are required.

Disclosure chart

Equity already listed	Type of offering	Manner of disclosures
Yes	Public offering	• Material disclosures from Sch II of Companies Act 1956 • Sch I of the draft Regulations • Simplified debt listing agreement
Yes	Private placement with listing	• Sch I of the draft Regulations • Simplified debt listing agreement • (reference to) last annual report
No	Public offering	• Material disclosures from Sch II of Companies Act 1956 • Sch I of the draft Regulations • Debt listing agreement
No	Private placement with listing	• Sch I of the draft Regulations • Debt listing agreement • (reference to) last annual report

11. While due diligence, proper disclosures and credit rating will be key elements of corporate debt issuances, these will be ensured by SEBI mainly through certifications issued by the merchant bankers, although the draft offer documents will be filed with SEBI and placed on its website (and of the exchange) for a period of 7 working days.

12. Obligations imposed by the Companies Act, 1956 on all public offers (to 50 or more persons) are maintained but made principle based. This provision has to be retained till the time the Companies Act 1956 itself is amended as has been recommended.

13. Presently, Public Financial Institutions and Non-Banking Financial Companies are exempted from the limit of forty nine offerees in their private placements as per the second proviso to section 67(3) of the Companies Act, 1956. This enables them to make private placements to fifty or more persons without making substantial disclosures in terms of Schedule II of the Companies Act, 1956 or the SEBI (DIP) Guidelines, 2000. In order to develop the corporate debt market further, it is envisaged that issuances to fifty or more persons shall require mandatory listing and specific disclosures in terms of the proposed Regulations and the corresponding listing agreement. Such disclosures may be made on the websites of stock exchange(s) where the debt securities are sought to be listed

14. An unlisted company making private placement of debt securities may list its securities on a recognized stock exchange in accordance with the relaxation granted in terms of Rule 19(7) of the SCRR as proposed in the draft Regulations.

15. It is proposed to create an enabling mechanism for e-issuances of debt securities to the public, details of which are being worked out and will be notified by means of a circular.

16. Since SEBI has direct jurisdiction over issuers, it shall be the issuers' responsibility to provide adequate disclosures to the exchanges/ public. The Merchant Banker will however retain its role of certifying the due diligence process and other intermediaries associated with issue of debt securities shall be responsible for their related activities.

Regulatory Impact Assessment

17. It is assessed that the proposed regulations will impose a lower regulatory burden on issuing companies without compromising on the rights of investors. The proposed regulation implements a consequence of the efficient capital market hypothesis (ECMH) which states that once any information about a company is put in public domain, the information is captured in the price of such security. The corollary of the ECMH is that no useful purpose can be served by putting information in public domain already made available when the equity of an issuer is listed. Since vast amounts of company information is already in public domain on issuance of equity the additional quantum of information needed when the same company comes out with a debt issue will be marginal.

18. In view of the fact that equity is the residual interest of shareholders in the company, high levels of disclosure of the workings of the company including its profitability and turnover to the last rupee are important. The owners of debt instruments are by contrast, satisfied with timely payment of interest and capital and on a broader plane, the solvency of the issuing company. Thus, there is a departure from the erstwhile treatment of debt securities and equity securities similarly, towards recognizing the fact that such equal treatment in fact causes a

disclosure burden on the issuer company and which the investor himself/herself does not find material in making an investment decision.

19. Comments are invited from the public on the draft regulations. The comments may be sent by e-mail upto 23 January 2008 to the following addresses –

Satyarp@sebi.gov.in (Mr. Satya R Prasad, General Manager)
santoshs@sebi.gov.in (Mr. Santosh Shukla Dy. Legal Adviser)
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Comments may also be sent physically to the following address, so as to reach latest by January 19, 2008 – **Mr. Santosh Shukla, Deputy Legal Advisor, Legal Affairs Department, Securities and Exchange Board of India, SEBI Bhavan, C-4A, G-Block, Bandra Kurla Complex, Mumbai – 400051**