Regulatory Framework for Online Bond Platform Providers

For Prelims: SEBI, Online Bond Platform Providers, Bonds, Debt.

For Mains: Need for a Regulatory Framework for Online Bond Platform Providers.

Why in News?

Securities and Exchange Board of India (SEBI) has come out with a regulatory framework for online bond platform providers in a bid to **streamline their operations.**

- **Online Bond Platform Providers (OBPPs)** would be companies incorporated in India and they should register themselves as stock brokers in the debt segment of the stock exchange, as per the framework that would be effective immediately.

What is the Need for a Regulatory Framework?

- With the bond market offering tremendous scope for development, particularly in the non-institutional space, there is a **need to place checks and balances in the form of transparency in operations** and disclosures to the investors dealing with such **Online Bond Platforms (OBPs)**, measures for mitigation of payment.
- During the past few years, **there has been an increase in the number of OBPPs** offering debt securities to non-institutional investors. Most of them are fintech companies or are backed by stock brokers.
- There has been a significant increase in the number of registered users who have transacted through them.
- Operations of OBPs **were outside SEBI's regulatory purview.**

What are the New Rules?

- After obtaining registration as a stock broker in the debt segment of a stock exchange, an entity would have to apply to the bourse to act as an OBPP.
- The new rules mandate **registration certificate as a stock broker from SEBI** to act as an online bond platform provider.
- Those acting as an online bond platform provider without registration certificate provider prior to 9^{th} november 2022 continue to do so for a period of three months.
- People will have to comply with the conditions of registrations as specified by the SEBI from time to time.
- The entity would have to ensure compliance with the minimum disclosure requirements. It would also have to disclose on its platform all instances of conflict of interest, if any, arising from its transactions or dealings with related parties.

What Is the Bond Market?

- **Bonds:**

- Bonds are units of corporate debt **issued by companies and securitized as tradeable assets.**
- A bond is referred to as a **fixed-income instrument since bonds traditionally paid a fixed interest rate** (coupon) to debtholders.
- Variable or floating interest rates are also now quite common.
- Bond prices are inversely correlated with interest rates: when rates go up, bond prices fall and vice-versa.

- **Types of Bonds:**
  - **Convertible Bond:**
    - Unlike regular bonds that are redeemed upon maturity, a **convertible bond gives the purchaser a right or an obligation to convert** the bond into shares of the issuing company.
    - It features a fixed tenure and **pays out interest payments periodically** at predetermined intervals.
  - **Fixed Coupon Rate Bonds:**
    - In these types of bonds, the interest is fixed from the date of issue. Most of the corporate and government bonds are of fixed coupon rate and the interest or coupon is provided annually, semi-annually, quarterly or monthly till the redemption date.
  - **Floating Coupon Rate Bonds (FRB):**
    - In these bonds, the coupon rate fluctuates at a predefined time till the date of maturity. Here interest rate depends on a benchmark which it follows to determine the coupon rate in each coupon payment. In the case of FRB Bond, the coupon rate depends on the **T-bills** yield.
  - **Zero Coupon Bonds**:
    - These bonds are those bonds where the issuer does not provide any coupon payment to the holder till the maturity date. Here the bonds are issued below the face value amount and on the date of redemption or maturity. Bonds are redeemed on the face value amount. Here the difference between the redemption price and the issue price is the return for an investor. In India, Treasury-Bills are the Zero-Coupon Bonds.
  - **Cumulative Coupon Rate Bonds:**
    - These bonds are issued with a coupon rate but the coupon payment is done at the time of redemption. Usually, corporates issue these types of bonds.
  - **Inflation Indexed Bonds:**
    - These bonds provide protection from inflation. It is primarily issued by the government. Here the coupon rate is dependent on the inflation rate. Usually, the coupon rate equals the inflation rate and the additional rate provided over the inflation rate.
  - **Sovereign Gold Bonds (SGBs):**
    - As per the Reserve Bank of India **SGBs** are government securities denominated in grams of gold.
    - These are the substitutes for holding physical gold. Investors have to pay the issue price in cash and the bonds will be redeemed in cash on maturity.
- **Bond Market:**
  - The bond market broadly describes a **marketplace where investors buy** debt securities that are brought to the market by either governmental entities or corporations.
  - National governments generally use the proceeds from bonds to finance infrastructural improvements and pay down debts.
  - Companies issue bonds to raise the capital needed to maintain operations, grow their product lines, or open new locations.
  - Bonds are either issued on the **primary market, which rolls out new debt, or traded on the secondary market**, in which investors may purchase existing debt via brokers or other third parties.
- **Online Bond Platform:**
  - As per SEBI, it is an electronic system other than a recognised stock exchange or an electronic book providing platform, on which debt securities are listed or proposed to be listed are offered and transacted.
    - The online bond platform provider means any person operating or providing such a

platform.

UPSC Civil Services Examination Previous Year Question (PYQ)

Q1. With reference to India, consider the following statements: (2021)

1. Retail investors through demat account can invest in ‘Treasury Bills’ and ‘Government of India Debt Bonds’ in primary market.
2. The ‘Negotiated Dealing System-Order Matching’ is a government securities trading platform of the Reserve Bank of India.
3. The ‘Central Depository Services Ltd.’ is jointly promoted by the Reserve Bank of India and the Bombay Stock Exchange.

Which of the statements given above is/are correct?

(a) 1 only
(b) 1 and 2 only
(c) 3 only
(d) 2 and 3 only

Ans: (b)

- The RBI has allowed retail investors with online access to the government securities market – both primary and secondary – directly through the Reserve Bank. The facility of buying government securities directly through RBI is called RBI Retail Direct. Under it, retail investors can open and maintain a Retail Direct Gilt (RDG) account with the RBI through the dedicated online portal. The account can be opened singly or jointly with another retail investor.
- Gilt account is opened by the bank for individuals who wish to invest in government securities and treasury bills. Banks in effect maintain a Demat account for these instruments in the name of the individuals. **Hence, statement 1 is correct.**
- Negotiated Dealing System-Order Matching (NDSOM) is RBI’s screen-based, anonymous electronic order matching system for trading in government securities in the secondary market. **Hence, statement 2 is correct.**
- Central Depository Services Ltd (CDSL), is the first listed Indian central securities depository based in Mumbai. CDSL is promoted by BSE Ltd. jointly with leading banks such as State Bank of India, Bank of India, Bank of Baroda, HDFC Bank, and Standard Chartered Bank. **Hence, statement 3 is not correct.**
- **Therefore, option (b) is the correct answer.**

Q2. With reference to the Indian economy, consider the following statements: (2020)

1. ‘Commercial Paper’ is a short-term unsecured promissory note.
2. ‘Certificate of Deposit’ is a long-term instrument issued by the Reserve Bank of India to a corporation.
3. ‘Call Money’ is a short-term finance used for interbank transactions.
4. ‘Zero-Coupon Bonds’ are the interest-bearing short-term bonds issued by the Scheduled Commercial Banks to corporations.

Which of the statements given above is/are correct?

(a) 1 and 2 only
(b) 4 only
(c) 1 and 3 only
(d) 2, 3 and 4 only

Ans: (c)

Q3. With reference to Convertible Bonds, consider the following statements: (2022)

1. As there is an option to exchange the bond for equity, Convertible Bonds pay a lower rate of interest.
2. The option to convert to equity affords the bondholder a degree of indexation to rising consumer prices.

Which of the statements given above is/are correct?

(a) 1 only
(b) 2 only
(c) Both 1 and 2
(d) Neither 1 nor 2

Ans: (c)

Source: MINT