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Regulating Debt Capital Market in India: Issues and Challenges

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Abstract

Indian Capital markets provide an important channel of financing through equity capital markets and debt capital markets. They help allocate risk, support growth and promote financial stability of a company or a corporate entity. In the last few years, the debt capital market of India has picked up pace of development propelled by government focus and support from regulators coupled with subdued credit growth from banks, however, it is yet to realize full potential. While globally bond market is much bigger than equity market, however in India, the scenario in not same. Whereas Indian equity capital market is considered equally efficient as compared to some of the most developed markets, bond market is still evolving. Hence, considering the large funding requirements public and private sector for economic recovery and growth, debt capital market holds huge untapped potential Hence the researcher would like to address the market and policy barriers impeding the realization of the full opportunity India presents to finance and vice versa. Present trends in capital markets development and to identify the factors that will encourage the development of a vibrant and resilient debt capital market in India. This dissertation focuses on how companies can excel by debt capital market. The researcher also focuses on applicable laws, new regulations and circulars issued by SEBI which brought a huge change in the Indian debt capital market. To critically analyze the regulatory requirements and also role of the banks in debt capital market.

Keywords: Debt capital market, SEBI, Regulatory framework, Bond Market

1. Introduction

Debt securities are traded on the Debt Capital Market (DCM). In other words, it's a location where businesses may raise money by selling debt to investors, typically in the form of bonds. Although it may seem strange, selling debt is similar to taking out a sizable loan. The business receives a financial infusion. Similar to how a bank would when offering loans to clients like mortgages or vehicle loans, the investor—typically another business or the government—earns interest on the investment. Given that the issuing firm is required to repay the debt securities at a defined interest rate and within a predetermined time frame, debt securities are regarded as low-risk investments. In India, bank loans have historically accounted for a disproportionate amount of debt raising. From a macroeconomic standpoint, bank borrowings are viewed as an ineffective method of obtaining money, particularly when relatively low-risk capital is used through client deposits for long-term business and project loans. Bond offers are quickly

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gaining speed and acceptance as a method of fundraising for business companies as well as governmental agencies, despite not having as much of a history as most OECD (organization for economic co-operation and development) states. SEBI oversees capital market regulation in India.

2. The advantages of a robust Debt Capital Market

Corporate bonds would first help banks recover from the stress of potential non-performing assets. Over time, it has been noted that businesses have depended on shady bank funding for expensive, protracted projects. It causes an unfavorable accumulation of sizable non-performing assets (NPAs), which has a detrimental impact on banking the amount of due diligence into the borrower's ability to return the money is stronger in the case of companies than in the case of banks, which offers them an advantage over banks when it comes to recovering the money they have borrowed to the borrower firm. By using corporate bonds as the preferred method of funding projects for various businesses, depositors' money will be secure in banks. Given the lack of a robust corporate bond market in India, banks and the general government are mainly responsible for funding infrastructure projects including roads, ports, and airports. As a result, pressure is placed on lenders like banks, which is evident in the ballooning of bad loans. For instance, these investments lead to an asset-liability mismatch in banks. In other words, they are investing in long-term assets like a motorway while holding short-term obligations like deposits with maturities between three and five years. In the end, this not only leads to ineffective resource allocation but also deteriorates the balance sheets of the banks. The loans to major enterprises in India are the true issue since they may have a significant impact on the economy. Up until March 2016, when the NPAs (Non-Performing Assets or Bad Loans) hovered at about the Rs. 6 trillion-mark, large corporations made up Rs. 65.47 trillion (58%) of the total bank credit. However, over the past 5 years it has been reduced by 8% i.e., 50% of the total bank credits are by corporate entities. According to this estimate, the lending banks would quickly go out of business if 10% of the loans to significant corporations turned into NPAs. That would seriously harm the economy and be a setback. A productive corporate bond market would assist businesses in obtaining money on the main market and investors in hedging their exposure to risk on the secondary market.

3. Current status

Outstanding debt securities

Comparison of Indian debt capital market with other countries, by residence and sector of issuer, amounts outstanding at end-September 2023, in billions of US dollars.

- United Kingdom - total outstanding debt securities 4,302 and total outstanding domestic debt securities is 0
- United States - total outstanding debt securities 51,313 and total outstanding domestic debt securities is 0
- Japan total - outstanding debt securities 10,972 and total outstanding domestic debt securities domestic is 10,498
- China total - outstanding debt securities 20,886 and total outstanding domestic debt securities domestic is 20,158
- India - total outstanding debt securities 0 and total outstanding domestic debt securities is 1,172.

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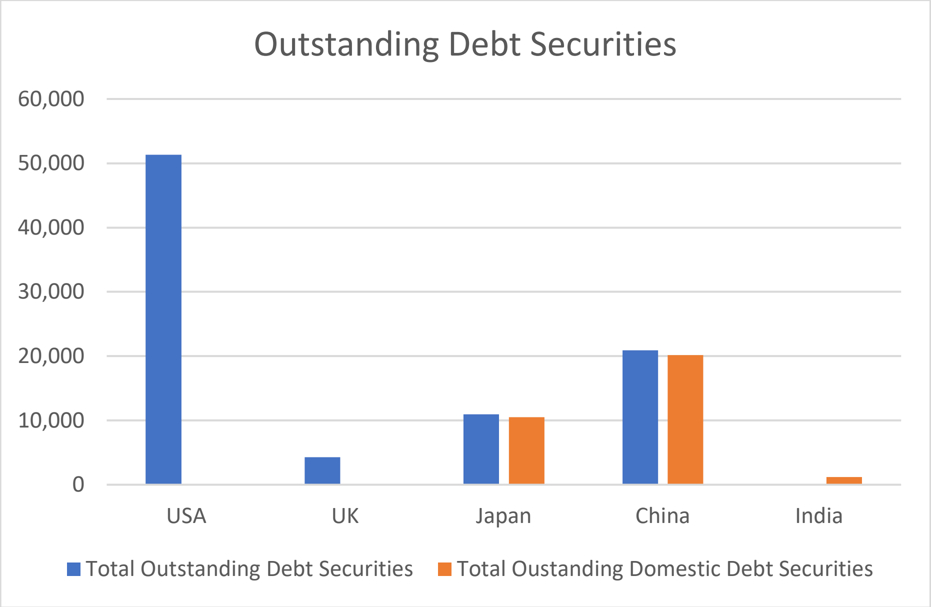

Figure 1

Private vs. public placements in Indian corporate debt market

Factors Restricting the Growth of the Corporate Bond Markets The majority of Issues are Private Placements rather than Corporate Bonds although corporate bonds can be issued publicly, the majority of issues in the corporate bond market are really private placements rather than bonds, and the majority of issues are not made by businesses. Bonds that are sold to a wide variety of investors are considered public issues if they meet the regulatory requirements. They must have a prospectus that has been authorised by SEBI, and they must be available for subscription to investors for a month at a set price. There is a cap of 50 "Qualified Institutional Buyers" (qualified investors) to whom private placements may be made. and demand a lot less paperwork. Renegotiating agreements is generally simple due to the limited number of investors. For instance, if interest rates change, the coupon on a placement made during the currency of the issuance would often be renegotiated. Private placements are hence extremely adaptable.

Column1	Private Placements	Public Placements
2008-09	173281.18	1500
2009-10	212634.92	2500
2010-11	218785.41	9451.17
2011-12	261282.65	35610.71
2012-13	361462	16982.05
2013-14	276054.18	42382.97
2014-15	404136.5	9713.43
2015-16	458073.48	33811.92
2016-17	640715.51	29547.15
2017-18	599147.08	5172.56
2018-19	610317.61	36679.4
2019-20	674702.88	15068.37
2020-21	771839.98	10588.02
2021-2022	588036.94	11589.41

2022-2023	754467.06	9211.64
2023-2024	**736689.18**	**19167.88**

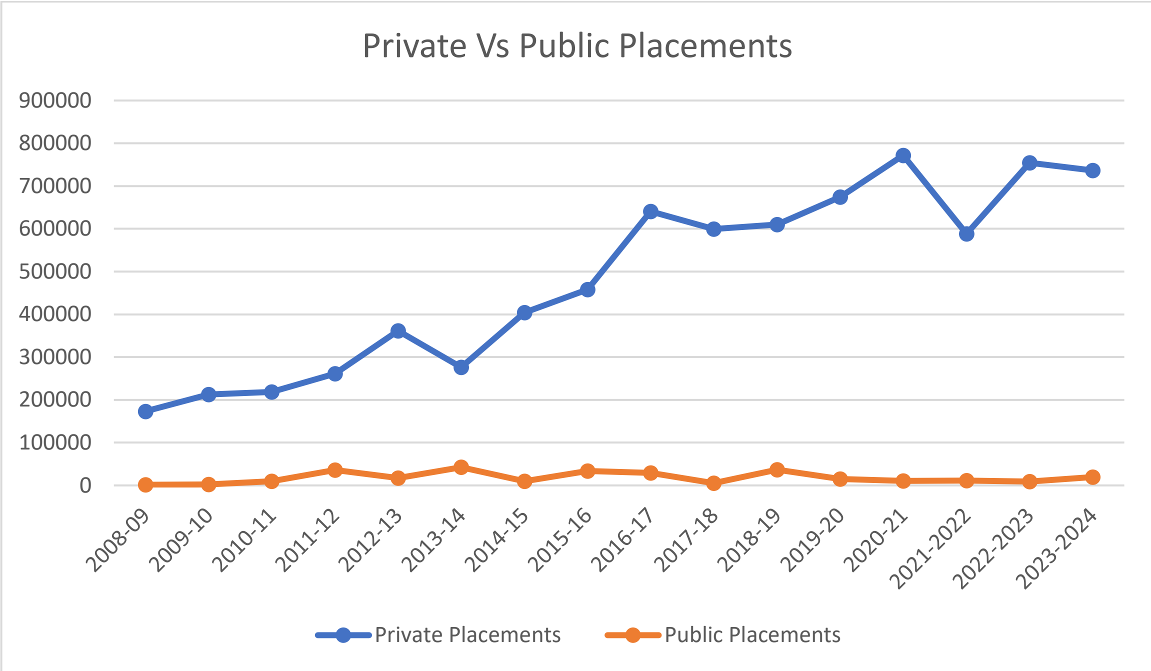

Figure 2

Value in crores*

Due to the onerous disclosure requirements, public concerns are uncommon; new SEBI measures are intended to streamline the procedure. Potential market players consider the disclosure requirements for public problems to be excessive: • Bond prospectuses are reportedly several hundred pages lengthy. • Regardless of whether the firm is already listed or not, disclosure obligations are the same, which is contrary to worldwide practise. • Shelf registration, in which a programme of tranches is covered by a single prospectus, is not an option.

Public problems are said to be particularly expensive because to the lengthy issue procedure, which takes many months, as well as hefty marketing and other expenses. Since the price is locked for the duration of the offer time, the lengthy process also makes things dangerous. Contrarily, private placements need little in the way of paperwork, notwithstanding recent increases. Placements may be made fast, and pricing and book building are typically finished in a single day. According to the Patil report's recommendations, SEBI and stock exchanges have agreed to revised listing agreements, which were released for public comment in August 2008. Key characteristics include (i) Companies publicly listed on an Indian exchange would only need to make a small amount of additional disclosures for a public offering or a private placement; and (ii) Unlisted companies would need to make more extensive disclosures, though fewer than needed for an equity offering.

4. Corporate debt contribution to GDP

Debt has been a major factor in economic growth across the world. In short, given the size of its economy, India has room to raise its overall debt. Beyond the needs now provided by the corporate bond market and banks, there is still a demand for business credit in India. For the next 20 to 30 years, India has a huge runway for raising leverage in order to spur development by closing the credit gap, or 200 to 300 bps of annual GDP growth. In India, the ratio of private debt to GDP is low. The World Bank estimates that India's domestic lending to the private sector in 2020 will be 55% of GDP, which is much less than the global average of 148% and the lowest among its Asian counterparts, China (182%), South Korea (165%), and Vietnam (148%). India should make better use of its two main sources of private debt, the corporate bond market and bank lending.

The laws governing the Debt Capital Market in India are very complex and procedural to understand. The debt capital market in India is governed by both laws and regulations, such as the Companies Act, 2013, Securities Contract (Regulation) Act 1956, etc., which are covered in detail in this chapter, and regulations issued by SEBI. SEBI is continuously working on this area, i.e.., debt capital or pro forma to issue debt securities. As a result, there are new regulations made by SEBI. Apart of this SEBI also issues circulars that apply to debt capital market and debt securities.

Regulations are guidelines or instructions that are set out by a regulating organization, institution, or authority to regulate and control particular actions or behaviours inside a given area. They are intended to safeguard interests, uphold law and order, assure compliance, and advance equity in the regulated environment. The Securities and Exchange Board of India, or SEBI, is the Indian securities market's regulating agency. The SEBI Act of 1992, which gives SEBI the jurisdiction to safeguard the interests of securities investors and to encourage the growth and regulation of the Indian securities market, is the main source of its regulatory authority. In order to formulate and implement regulations pertaining to several facets of the securities market, including trading, securities listing, investor protection, corporate governance, and market intermediaries, SEBI uses its regulatory authorities. Power to make regulations by SEBI is enshrined under section 30 of The SEBI Act of 1992.

Through a systematic process that involves stakeholder participation, including market players, industry experts, and the general public, SEBI develops regulations. To make sure they continue to be applicable and efficient in the face of a changing market, these laws are routinely reviewed and modified. Investor trust and market stability are fostered by the openness, integrity, and efficiency that SEBI's regulatory structure upholds in the Indian securities market.

Formal notifications on regulatory matters, policy changes, clarifications, and procedural guidelines are sent to market players, intermediaries, and other stakeholders through SEBI circulars. These circulars aid in understanding regulatory laws, guaranteeing adherence to current regulations, and provide direction on a range of securities market-related topics.

Circulars are released by SEBI on a variety of subjects, including regulatory framework modifications, investor protection initiatives, reporting standards, market behaviour standards, and compliance requirements. In order to preserve regulatory compliance and advance market integrity, market participants are expected to follow the rules and instructions included in these circulars. It is significant to note that circulars, although not legally binding in the same manner as regulations, are considered official communications from SEBI and are generally expected to be complied with by market participants unless specifically amended or replaced by regulations or subsequent circulars.

5. Applicable laws and Regulations for Debt Capital Market

The Indian debt capital market is governed by a number of laws and regulations. Some significant laws and regulations that govern the Indian debt capital market include the following:

Acts applicable are:
- The Securities and Exchange Board of India Act, often known as the SEBI Act of 1992
- Securities Contracts (Regulation) Act of 1956
- Companies Act, 2013
- The Reserve Bank of India Act of 1934
- The Foreign Exchange Management Act of 1999
- The Income Tax Act of 1961

Regulations applicable are:
- SEBI (Issue and Listing of Debt Securities) Regulations, 2008
- SEBI (Issue and Listing of Non-Convertible Securities) 2021
- SEBI (Debenture Trustees) Regulations, 1993
- SEBI (Credit Rating Agencies) Regulations, 1999
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

Emerging regulations

SEBI Circular on 19th October 2023 (Circular No - SEBI/HO/DDHS/DDHS - RACPOD1/P/CIR/2023/172) **Ease of doing business and development of corporate bond markets – revision in the framework for fund raising by issuance of debt securities by large corporates (LCs)**

1. **Background:**

Regulation 50B of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (NCS Regulations) along with Chapter XII of the NCS Master Circular on 'Fundraising by issuance of debt securities by large corporates' (LC Chapter) mandates LCs to raise a minimum of 25% of their incremental borrowings through issuance of debt securities over a contiguous block of three years from FY 2022 onwards.

2. **Revisions in Framework:**

Considering prevailing market conditions and feedback from market participants, the framework for fundraising by issuance of debt securities by LCs is being revised as outlined below.

3. **Applicability of the framework:**

The revised framework is applicable from April 01, 2024, for LCs following April-March as their financial year, and from January 01, 2024, for LCs following January-December as their financial year.

4. **Criteria for Large Corporates (LCs):**

LCs are entities meeting the following criteria:
Listed entities (except Scheduled Commercial Banks)
Listed on recognized Stock Exchanges under LODR Regulations
Outstanding long-term borrowings of Rs. 1000 crore or above
Credit rating of "AA"/"AA+"/AAA" (unsupported bank borrowing or plain vanilla bonds)

5. **Framework Details:**

LCs must raise not less than 25% of qualified borrowings through debt securities in subsequent financial years. Qualified borrowings exclude certain categories like External Commercial Borrowings, Inter-Corporate Borrowings involving related entities, etc. Compliance is evaluated over a contiguous block of three years, with incentives for exceeding borrowing targets and disincentives for shortfalls.

6. **Responsibilities of Stock Exchanges and Limited Purpose Clearing Corporation (LPCC):**

Stock Exchanges identify LCs and calculate incentives/disincentives.
LPCC implements changes and coordinates with Stock Exchanges for compliance.

7. **Transitional Arrangements for Existing LCs:**
Existing LCs must comply with the revised framework for borrowings during FY 2022, FY 2023, and FY 2024 by March 31, 2024, or provide explanations.
Implementation and Effective Date: The circular is effective immediately and replaces the existing Chapter XII of the NCS Master Circular from FY 2025 onwards.
8. **Regulatory Authority:** Issued under relevant provisions of SEBI Act, NCS Regulations, and LODR Regulations.

SEBI Circular on 4th September 2023 (Circular No-SEBI/HO/DDHS/POD1/P/CIR/2023/150) **New format of Abridged Prospectus for public issues of Non-Convertible Debt Securities and/or Non-convertible Redeemable Preference Shares**

1. **Definition and Regulatory Basis:**
The circular begins by referencing the legal definitions and regulatory requirements for an abridged prospectus as defined under Section 2(1) of the Companies Act, 2013 and Regulation 2(1)(a) of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.
2. **Mandatory Accompaniment:**
It reinforces that an abridged prospectus must accompany any application form for the purchase of securities, as mandated by Section 33(1) of the Companies Act, 2013.
3. **Format and Contents:**
The circular highlights that the abridged prospectus format must adhere to Regulation 32(3) of the NCS Regulations, specifying that it should follow the format specified in Part B of Schedule I of the NCS Regulations.
4. **Revised Format:**
It introduces a new format for disclosures in the abridged prospectus, aimed at simplifying, providing clarity, ensuring consistency across documents, and including critical information for investors.
5. **Applicability and Effective Date:**
The circular specifies that the new format will be applicable for public issues opening on or after October 1, 2023.
6. **Availability and Disclosure:**
Issuers, merchant bankers, and other involved parties are required to make the abridged prospectus available on their respective websites. Additionally, a QR code must be inserted for easy access to the full prospectus.
7. **Compliance and Accuracy:**
Emphasis is placed on ensuring that the information in the abridged prospectus is adequate, accurate, and free from any misleading or incorrect statements.
8. **Quantitative Disclosure:**
There's a directive to substantiate qualitative statements with quantitative factors and to avoid making qualitative statements that cannot be supported by quantitative data.
9. **Communication and Dissemination:**
Stock exchanges are tasked with informing listed entities about the circular and disseminating the information on their websites.
10. **Legal Authority and Incorporation:**
The circular is issued under the legal powers conferred by the Securities and Exchange Board of India Act, 1992 and relevant SEBI regulations. It also mentions the intention to incorporate its contents into the

existing Master Circular.

6. Conclusion and suggestions

Today, most equities markets employ automated order display and execution. However, emerging nations often try to emulate Europe and North America to learn from them. Structures that operate for huge, complicated markets in affluent countries with many goods and investors are less viable (or prohibitively costly) for less developed markets. Thus, neighboring rising nations in a similar stage of development should be sought for support. Markets may be able to propose innovative solutions to difficulties that have been tried and successful in analogous markets, stimulate local market innovations based on their success elsewhere, and learn from other markets' mistakes. India must develop its financial markets to sustain economic growth and fund social and infrastructure projects. To support its broad economic and social development initiatives, including stabilizing the economy, increasing credit availability, funding municipal infrastructure projects, creating social safety nets, and promoting urbanization, government policies must encourage capital market growth. Strong capital markets mobilize private and public resources for development, social safety nets, productivity, and high economic growth. India needs liquid, transparent bond markets. Off-the-run offers lack liquidity despite cash bond and derivatives market growth. Indian bonds in global bond indices would boost long-term inflows in a passive investment environment. With Basel III's tighter capital requirements, India's bond market will better serve public and private sectors. Strong bond markets are essential for the Indian banking industry since corporate capital is scarce.[3] Municipal bonds must thrive in India. SEBI's 2015 revenue and general obligation municipal bond rules are a good start. Some municipal bonds are tax-free. Another trend is the major Indian rating agencies' municipal bond structure. Given the market's size, more incentives and information on municipal bond issuance are needed to expand it. India's financial regulators must be more transparent when drafting and implementing new laws. Indian regulators use bylaws to increase regulatory consistency, transparency, market consultation, notification of new regulations, and public response time. Financial markets need clear, uniform laws, market consultation, proper notice of new rules, and public comment.

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