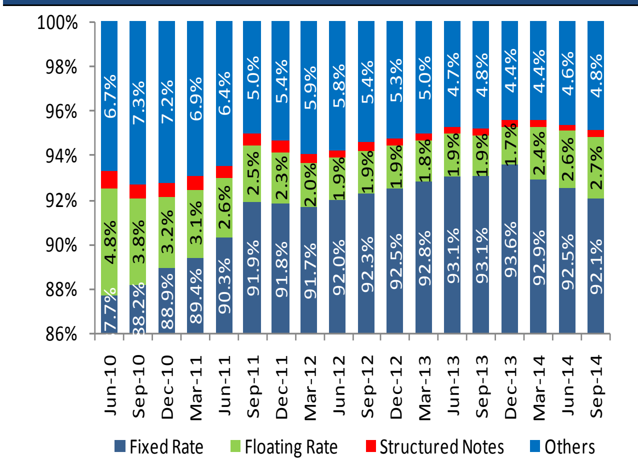
CARE Ratings
Professional Risk Opinion

Structured notes & PP-MLDs market: Reflection of revival

Share of borrowing via structured notes surged for the first time since June-10

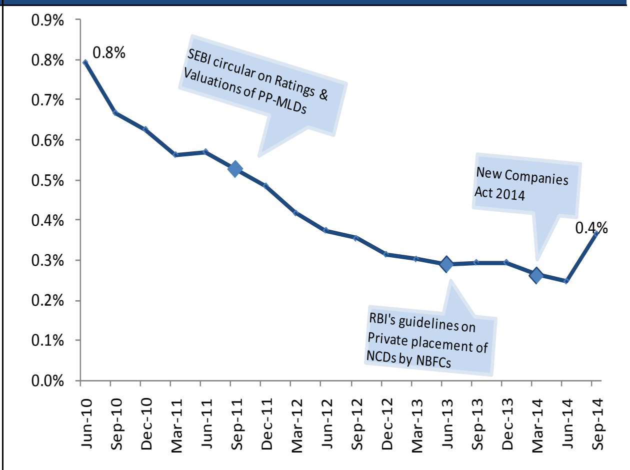
The financial year 2013-14 and 1st quarter 2014-2015 has been the toughest period for the structured notes market. The frequent changes in regulatory landscape (RBI guidelines on private placement & New Companies Act) and lacklustre equity market have severely impacted the issuances of structured notes. The share of structured notes in outstanding corporate debt borrowings fell at its record low level in 1QFY15, however it surged for the first time in last 18 quarters led by new government's economic development agenda, signs of improving economic activity and resultant buoyancy in equity market. The outstanding structured notes market reported 44% of yoy growth in 2QFY15.

Table1: Share of structured notes in total Outstanding Corporate Debt (% of total)



Source: SEBI

Table2: borrowing via structured notes surged post witnessing record low level in June-14



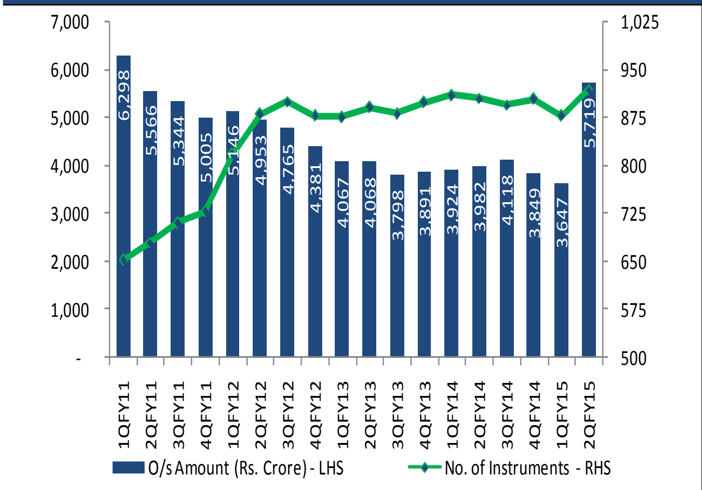
Source: SEBI

Weak market sentiment (until the formation of new government), uncertain regulatory environment and competitive return of debt products/fixed deposits continued to weigh down the new issuance during June2010-June2014. After SEBI's circular on rating and valuation of PP-MLDs in Sep-2011, few lead issuers almost exited the market *(as they have not issued even a single structure in last 2 years)*. Nevertheless, in July 2013, Reserve Bank of India (RBI) introduced stringent guidelines on NBFC's private placement of NCDs by increasing the minimum investment amount (from Rs. 10,00,000 to Rs. 25,00,000) and strict adherence of board approved policy for resource planning.

Again under the New Companies Act, requirement of higher debenture redemption reserve, and restriction on concurrent issuance of multiple structures further impacted the market sentiment and made the market almost numb for 2-3 months. Thereafter some more issuers in the market stopped issuing new structures. This impacted the total asset under management (AUM) of the structured notes segment as the outstanding structured notes market fell to record low level in 1QFY15.

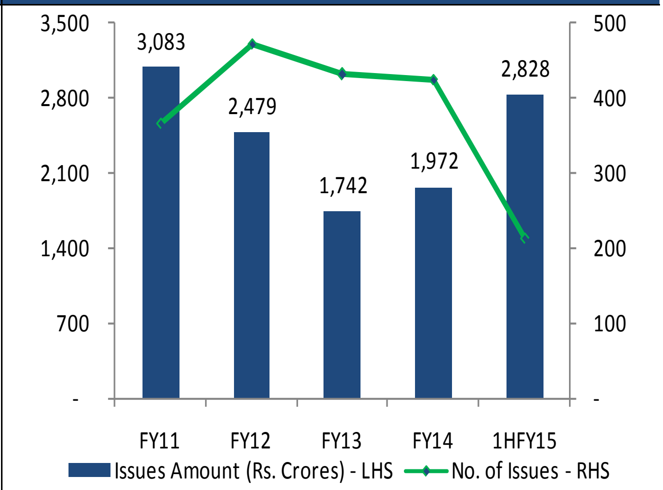
However, formation of new government with economic development agenda, resultant buoyancy in equity market and improvement in overall economic activity has again established the investors' confidence in structured notes and resulted into highest new issuance in 2QFY15 in last 17 quarters. Also, changes with respect to treatment of taxation on debt funds, as per union budget 2014-15, augured well for this market. As per the union budget 2014-15, finance ministry proposed the long term capital gain (LTCG) tax @ 20% with indexation on all non-equity oriented funds and increased holding period (from 12 months to 36 months) for debt funds to avail LTCG benefit. However, capital protected products are listed on the exchange and attract only 10% tax if they are sold/matured after 12 months. In light of this and benefit of market participation, structured notes with a >12 month maturity period is expected to gain preference compared to Fixed Maturity Plans (FMPs) which are popular among manufacturing company's treasury/investment department (Refer table 6).

Table3: O/s structured notes at 14 quarter high on..



Source: SEBI

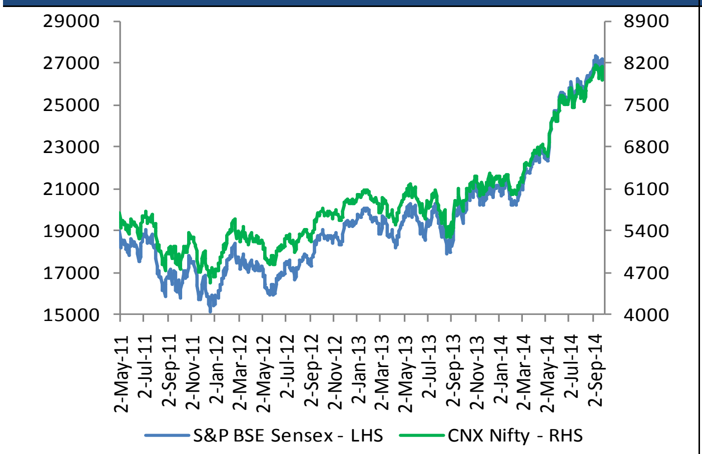
Table4: ...improved new issuances



Source: SEBI

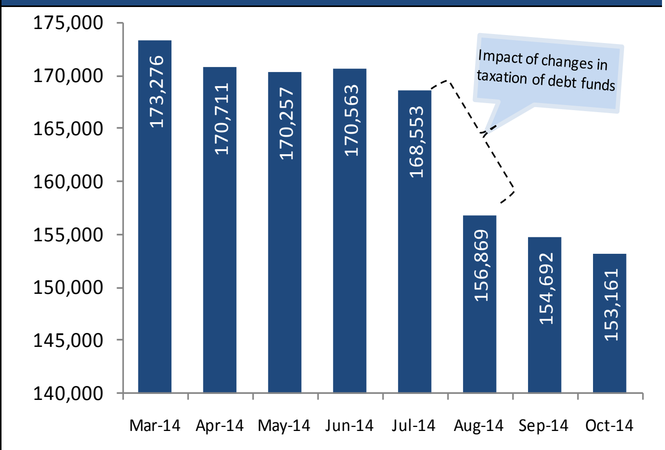
Our interaction with wealth managers and product distributors suggest that post a massive and sustained drive of investment towards debt products in last 4 years, investors have started showing increased interest towards structured notes in order to diversify portfolio and gain from upsides in the market. CARE observes a pick up in the amount of new issuance post June 2014, primarily driven by strong appetite among investors and better underlying performance.

Table5: Positive market/investment sentiment



Source: NSE & BSE

Table6: Falling AUM of FMPs (Rs. Crore)



Source: AMFI

New issuances of structured notes to reach record level (> Rs. 4,000 crore) in FY15e

Our channel check suggests that structured note segment is expected to report strong growth during 2HFY15e and FY16e on account of certainty with respect to stable regulatory policies, improving economic scenario *(falling inflation, better GDP growth and better investment sentiment)*, expectation of rate cuts and buoyancy in equity market. Nevertheless, the structured notes market is expected to witness a sharp revival in 2HFY15 on account of higher new issuance in 2HFY15 and lower redemption due to comparatively lesser amount of structures issued during FY11 and FY12. CARE estimates the new issuances of structured notes to be in the range of 4,000 to 5,000 crore in FY15; the highest in last 4 years.

Table7: Structured notes market statistics

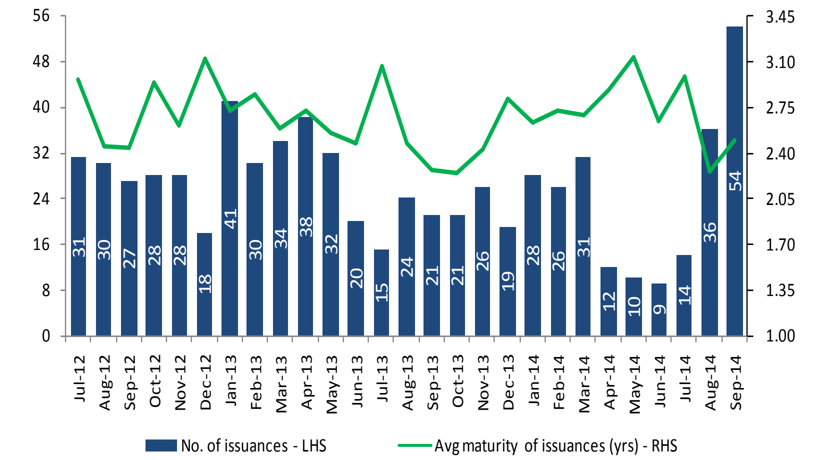
		Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Opening No. of Instruments Outstanding		634	653	680	729	880	817	880	900	878	876	891	881	898	910	905	895	904	878
Opening Outstanding Amount (Rs. Crore)		6,456	6,298	5,566	5,344	5,005	5,146	4,953	4,765	4,381	4,067	4,068	3,798	3,891	3,924	3,982	4,118	3,849	3,647
Issue During the Quarter	No. of Issues	83	82	109	93	154	155	104	59	79	105	109	138	126	104	90	105	72	142
	Issues Amount (Rs. Crore)	580	437	753	1,313	839	824	504	313	275	471	355	641	505	728	841	424	377	2,452
Redemption During the Quarter	Number of Redemptions	137	198	251	162	156	120	131	58	119	143	193	241	177	184	188	165	212	217
	Redeemption Amount - (Rs. Crore)	722	1,189	1,160	969	610	891	707	292	603	488	622	564	502	653	746	681	631	473
No. of Instruments Outstanding		653	680	711	729	817	880	900	878	876	891	881	898	910	905	895	904	878	918
Net Outstanding Amount (Rs. Crore)		6,298	5,566	5,344	5,005	5,146	4,953	4,765	4,381	4,067	4,068	3,798	3,891	3,924	3,982	4,118	3,849	3,647	5,719

Source: SEBI

Monthly issuance of PP-MLDs at 36 month high (Since Oct-2011)

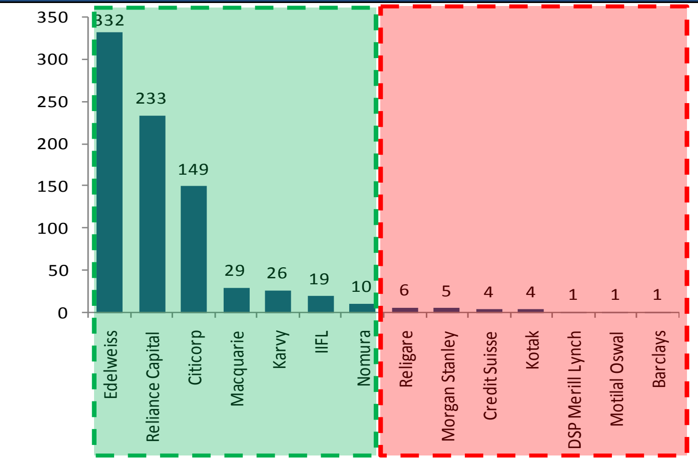
The total issuances of principal-protected market linked debentures (PP-MLDs) improved to 54 in September 2014 with the average maturity of 2.50 years v/s. 21 issuances in September 2013 with average maturity of 2.27 years. The issuances in September 2014 were primarily driven by Reliance Capital, Edelweiss, Karvy and Citicorp. CARE finds that ~815 PP-MLDs have been issued in the market during Oct 2011-September 2014. In September 2014, Reliance led the issuances with 23 term sheets, followed by Edelweiss with 17, Citicorp with 12 and Karvy with 2 term sheets (refer table 10). As of now, we find that only Edelweiss, Reliance, Karvy, India Infoline and Citi have been active out of 14 well known issuers (refer table-9). In FY14, Edelweiss emerged as the lead issuer of PP-MLD market amounting for Rs. 460 crore, followed by Reliance Capital with issuances worth Rs. 350 crore. Nevertheless, in 1HFY15 also, Edelweiss continued to be the leader with issuances worth ~Rs. 400 crore (refer table-11).

Table8: PP-MLDs monthly issuances



Source: India's Credit Rating Agencies websites

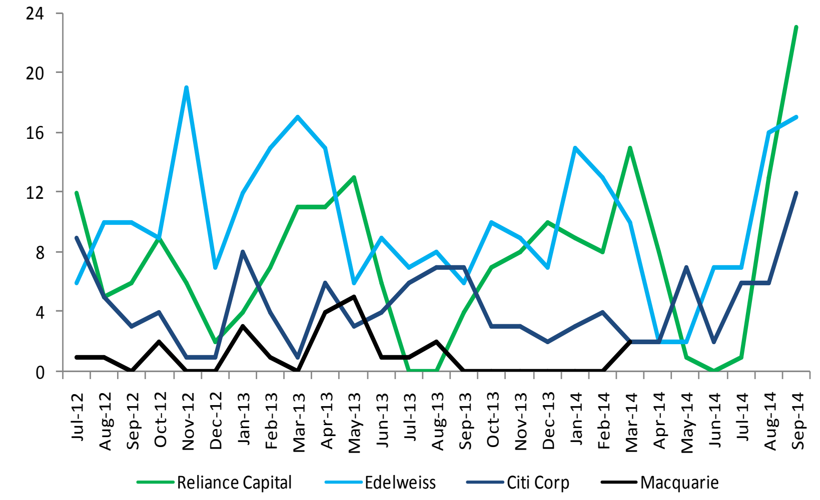
Table9: Issuer-wise no. of term sheets (Apr-11 to Sep-14)



Source: India's Credit Rating Agencies websites

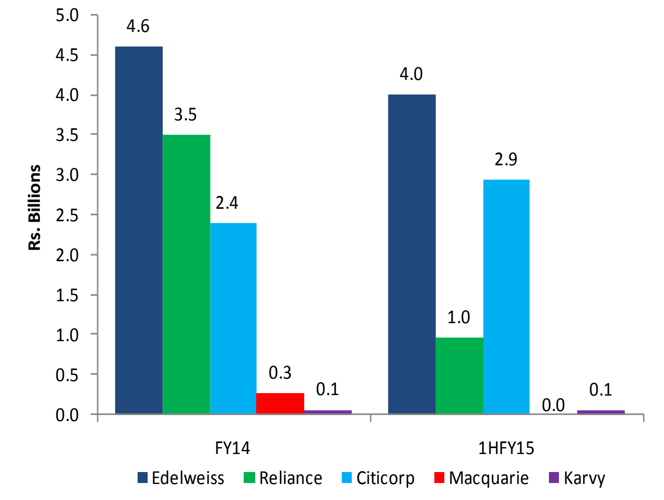
CARE observes that during sluggish/volatile equity market, certain type of PP-MLDs such as range accruals and golden cushion became favourite among investors. During FY14 (high volatility in the stock markets and elevated fixed income yields) binary and digital structures witnessed increased interest of investors. These are linked to fixed coupon and give some participation in equities to generate further upside. These structures yield an alpha over other fixed income products. During 1HFY15, the PP-MLD market witnessed 6 structures with other than nifty underlying i.e. Bank Nifty (issued by Edelweiss), stock (issued by Reliance Capital) and S & P 500 (issued by Citicorp). However, structures with Nifty underlying continue to have more acceptability among investors as against gold or specific stocks as Nifty is more diversified and liquid.

Table10: Issuances improved significantly during 2QFY15



Source: India's Credit Rating Agencies websites

Table11: Edelweiss emerged as lead issuer



Source: Issuers' term sheet disclosures on BSE/NSE

Robust equity market sentiments, expectation of falling interest rates in FY16e, changes in taxation of debt fund and new government willingness to undertake structural reforms is expected to augur well for the structured notes market. CARE channel check suggests that the structured notes market may witness entry of new issuers and revival of the overall market in FY16e. Also, market may observe issuance of structures linked to new securities or asset classes (G-sec, sectoral indices, commodities etc.) in FY16e.

Contact:

Ramadasu Bandaru
Group Head-Manager
+91-22-6754 3402
ramadasu.bandaru@careratings.com

Mukund Upadhyay
Dy. Manager
+91-22-67543669
mukund.upadhyay@careratings.com