HNIs scout for new ways to safeguard debt investments

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Wealthy individuals are looking at innovative ways of making sure they get their money back amid record debt fundraising. They are increasingly seeking control over cash generated from certain borrower assets or guarantees against any initial losses, according to people familiar with the matter.

This comes at a time when funds raised through the private placement of debt instruments hit a record for the first half of a financial year, according to PRIME Database's numbers, which go back to 1995-96.

Issuers raised ₹3.7 trillion in the six months ended September 30. This is more than double the ₹1.8 trillion raised in the corresponding period in financial year 2014-15 (FY15).

The average value of a private placement issue has also risen from ₹209.5 crore in FY15 to ₹320.2 crore so far this financial year. As a result, high networth individuals (HNIs) are seeking additional protection for their debt investments, said Rajesh Cheruvu, chief investment officer at Validus Wealth.

The firm is seeing more people look at covenants that were available only to institutions earlier, like first loss default guarantees. Covered bonds are also gaining popularity as many of these investments are not widely traded and it can be difficult to find another buyer if one wants to exit the investment, Cheruvu said.

"These are all closely-held securities," he added. For instance, a unit of a company needs to borrow money for its operations. It meets its monthly payments from its own earnings. Sometimes, the parent company provides a guarantee to its borrowers that it will make good any shortfall in payments up to a certain limit, should the unit's earnings fall short. This is called a first loss default guarantee.

A covered bond provides additional security against default, by giving the investor a right on assets that can cover the amount due if the issuer fails pay. For example, if a company gives car loans, and borrows money from investors for its operations, it can give such investors rights over payments due on existing car loans to cover any default.

Swapnil Pawar, founder at financial services firm Asqi Advisors, said borrowing rate differences between top companies and middling ones have widened after the Covid-19 pandemic. Differences are seen even among the highest AAA-rated companies. "After Covid, even good companies are finding it slightly challenging to raise money," he said.

This has forced firms to offer sweeter terms and innovate to attract investors, Pawar said. There are more innovations that could be imported from global markets, he added. For example, there are profit-linked structures in the west that allow firms to borrow at lower rates while giving investors a higher return if accounting profits increase.

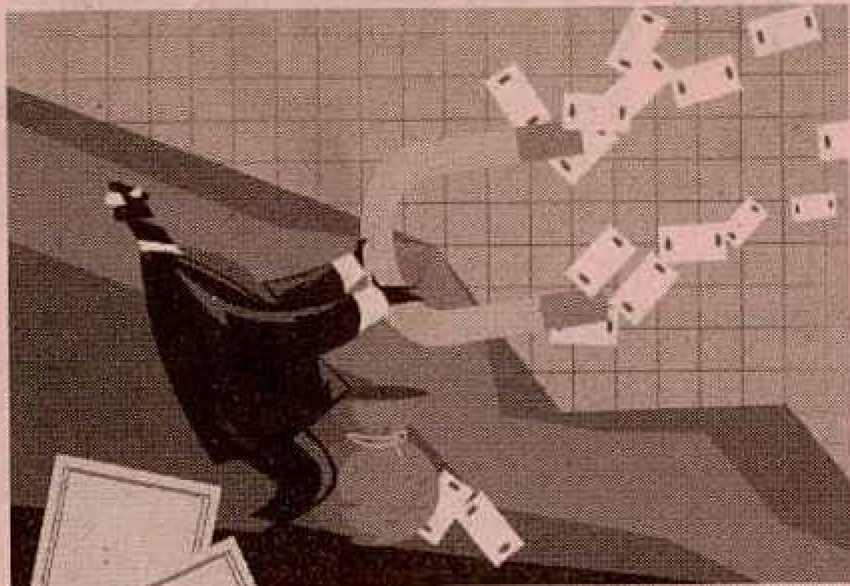
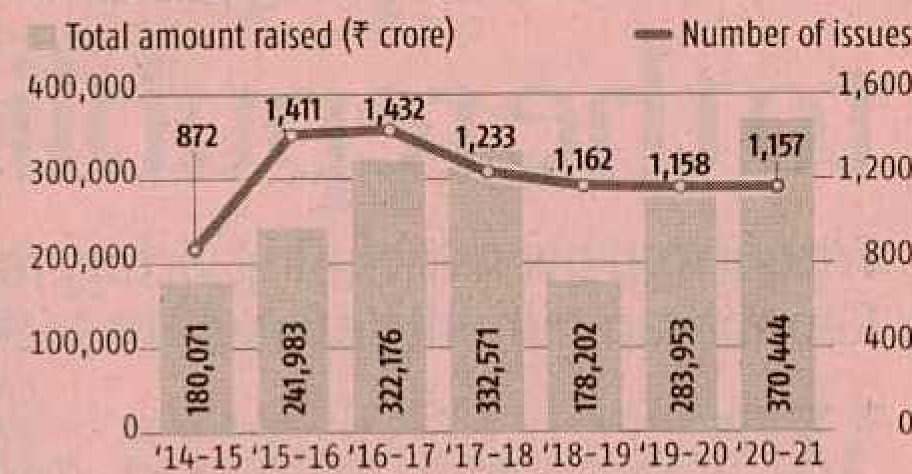


ILLUSTRATION: BINAY SINHA

EXTRA COVER

- HNIs looking at first loss default guarantees, which provide protection against initial losses
- Another option is covered bonds — gives additional rights over assets
- Volatility in debt market triggered need for additional safeguards

ON A HIGH



Note: Chart looks at funds raised in the first half of the year
Source: Prime Database