White Paper Analysis
MLD – Market Linked Debentures:

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Introduction:

In Financial market, a Debenture is a medium to long-term debt instrument used by large companies to borrow money, at a fixed rate of interest. The legal term "debenture"originally referred to a document that either creates a debt or acknowledges it. Although the money raised by the debentures becomes a part of the company's capital structure, it does not become share capital.

MLDs fall under the category of 'structured products' or 'hybrid instruments. They are linked/ tied tothe performance of an underlying index or security i.e. the return generated from MLDs is dependenton the performance of another instrument. If the underlying performs well, the return on MLDs is higherwhile the return drops where the underlying faces a slump.Theoretically these MLDs can be considered to be a zero coupon bond and an embedded customized payoff that could be an equity option.With attractive payoffs compared to traditional investment options such as fixed deposits, bonds and non-convertible debentures.

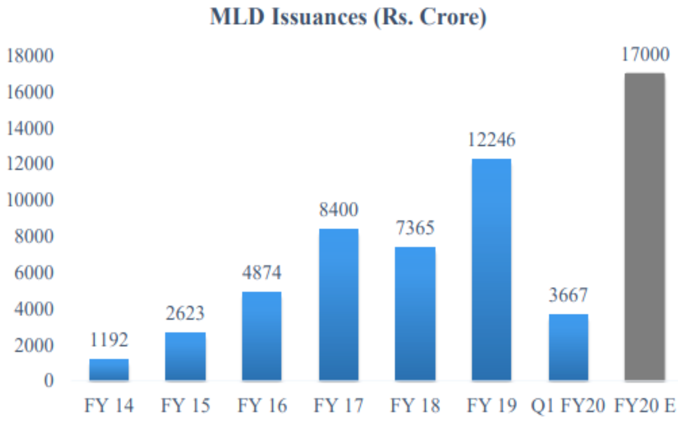
Why it has evolved?

High net worth investors require investment options which can give them possibilities to tailor their exposure to various markets and the potential to make a return in all types of market conditions, with products which respond to falling or rising markets in periods of high or low volatility. MLD is one of the structured products which deliver the handsome returns by applying the concept of capital protection.

MLDs usually offer positive returns at the time of redemption, based on the performance of anunderlying asset/ index or condition, while guaranteeing principal/ investment amount back, even ifthere is a downside in the performance of the underlying asset/index such as NIFTY, equity, bonds, fixed-income securities etc.

History:

In India Market Linked Debentures has been introduced since year 2010-11. Earlier it was specifically tailored for HNIs and UHNIs. Then after gradually this product become popular in market and between all types of investors. Post COVID-19 Investors are become more positive towards the Indian market but along with that fear in market has also been increased and investors are also being cautious in equity. In this type of market scenario MLDs are becoming very popular and so many investors are adding this product in their portfolios.



Source: CARE report on MLDs

Characteristics:

- Capital Protection - MLDs comes mostly with capital protection feature (only listed)
- Potential to earn higher returns than those offered by fixed deposits or other debt instruments
- Risk Return Dynamics – return enhancement through growth assets with calculated level of risk
- Hybrid Exposure – exposure to varied asset class for obtaining stable returns
- Customized view – capitalize on specific market views / theme (eg. Bullish on single stock /sector, near term bearish, etc.)

Structure:

MLDs can either be principal-protected (PP-MLDs) or non-principal protected (NPP MLDs). Under PP-MLDs, the downside to the principal amount is protected. This means that the investor will enjoy the upward movement in the return on MLDs indefinitely but will have downside protection. However, in case of NPP-MLDs, the investors face a risk of losing even the principal amount

There is no specific guideline on the type of underlying that MLDs should be linked to and is generally at the discretion of respective issuers. Thus, the underlying may range from an equity instrument to a government security to an index such as Nifty. The tenure of MLDs ranges between 13 to 60 months depending upon issuers funding requirement. Due to the complexity of structures and higher minimum allocation, these structures are suitable for HNI and UNHI clients who understand the nuances correctly.

Risks associated with Market Linked Debentures:

Like any other bond, MLD too comes with credit risk like,

- Although a majority of structures are principal protected, the ability of the issuer to repay is of huge importance.
- Investors may suffer a capital loss in case the issuer fails to repay on the obligation.

Taxation and Legal:

Since MLDs are linked to market and having directly or indirectly equity exposure, it has equity taxation not debt taxation.

- Listed MLD has to provide principal protection as per SEBI guidelines, taxation is **10% LTCG** after 1 year without indexation
- Unlisted MLD does not provide principal protection, taxation is **20% LTCG** without indexation and to qualify as long-term, you need to stay invested for 36 months (It can offer higher participation, compared to listed MLD)

The issuer of MLDs will have to comply with the provisions of the Companies Act, 2013 and rules framed there under as well as, SEBI (Issue and Listing of Debt Securities) Regulations, 2008 ('ILDS Regulations') in case the MLDs are to be listed on a stock exchange.