Essentials of Investing in Corporate Bonds

A Book on Corporate Bond Market in India

The Associated Chambers of Commerce and Industry of India

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The Associated Chambers of Commerce and Industry of India

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MESSAGE

G. Mahalingam
Whole Time Member
The Securities and Exchange Board of India

ASSOCHAM's book on 'Corporate bond market' comes at a time when there are several focussed initiatives coming forth from the side of regulators / policy makers to develop this market. For a fast growing economy like India, with huge infrastructure funding needs, a liquid and robust corporate bond market is an an absolute must to raise long term funding, reduce the reliance on banking system and achieve a fair dispersal of risks amongst a variety of investors.

ASSOCHAM has played a stellar role in organizing seminars across the country to create awareness amongst the issuers , investors and others about the corporate bond market and the need to develop it. This book is an extension of that commendable effort and I am sure it will hugely benefit all stakeholders.

SECRETARY GENERAL MESSAGE

D S RAWAT
Secretary General
ASSOCHAM

There is an argument that an understanding of any financial market must incorporate an appreciation of the functioning of the bond market as a vital source of liquidity. This argument is true in today's financial markets more than ever before, because of the central role that debt plays in virtually every facet of our modern financial markets.

Still India's Debt Market never comes out from Equity shadow. If you seen the past years data (2013-2017) debt has grown up to Rs. 67493 Cr. still far away from equity. If look at advanced economy such as US, where it is 83% in government Securities and 123% in corporate bonds, as against 35% and 17%, respectively for India.

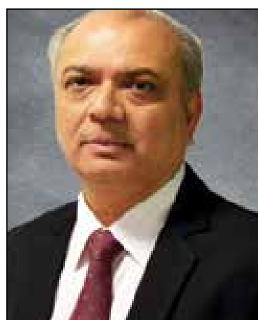
To deepen the debt market regulators (RBI & SEBI) take different steps such as introduction of green bonds, trade repository framework which also gives clues and references to people trading bonds in secondary markets, framework for municipal bonds – Pune Municipal Corporation was the first city in India to issue Municipal Bonds In India.

Anyone who reads this book, either thoroughly or by dipping into the portions that are relevant at the moment, will surely reach new planes of knowledge ability about debt instruments and the liquidity they provide throughout the global financial markets.

I would like to extent my deep personal appreciation to the contributing authors in edition of this book.

D S RAWAT

APAS PREFACE



Ashvin Parekh

Managing Partner

Ashvin Parekh Advisory Services LLP (APAS)

APAS and ASSOCHAM are glad to present to you ‘Corporate Bond market’ – A Book on Corporate Bond Market. As one of the leading knowledge disseminating body in India, ASSOCHAM, with APAS support, has taken the responsibility of spreading awareness about the importance of the corporate bond market in India and its development. The entire initiative has comprised seminars on Corporate Bond Markets in various metro cities like Mumbai, Delhi, Kolkata, Chennai, Hyderabad, Bengaluru and Ahmedabad. The seminars witnessed knowledge experts from various constituents of the corporate bond market, sharing their views. We have plans to cover tier-II cities all over the country as well. For these seminars, APAS had developed a knowledge report ‘Giving debt its due’ along with ASSOCHAM and CRISIL, which was circulated in the seminars. This book ‘Corporate Bond market’, along with the seminars organized by ASSOCHAM and APAS, is an attempt to bring together all the components of the Corporate Bond Market in India. As a part of the same, we are presenting this book, which shares the knowledge and experience of key industry professionals, along with APAS knowledge.

The genesis of the book can be credited to the need to bring together and address all the important constituents of the corporate bond market, understand the difficulties faced by them and solve such concerns with collaborative support of ASSOCHAM and the experts. Another intent behind the initiative extends to educating the retail and institutional investors in these markets, explaining to them all the aspects of a healthy bond market and equipping them to an extent to participate in the corporate bond market.

The main constituents which make up the corporate bond market have been classified as 4Is – Investors, Intermediaries, Issuers and Institutions. The Investors are further classified as retail and corporate. Corporate investors could be banks, mutual funds, etc. based on their awareness of the market. The Intermediaries include brokers, mutual funds, rating agencies, analysts, etc. The Issuers are the Corporate players. The Institutions are the regulators and the government.

The topics that have been covered in the book have been divided into different sections, which are, Introduction to corporate bond markets, Understanding the role of corporate bond markets, Global perspective on corporate bond markets, Need for a vibrant corporate bond market in

India, Evaluating corporate bond market development, Developing corporate bond markets and Accelerating corporate bond market development.

In the first section, we understand the dynamics of corporate bond market, its past and present contribution to the economy and highlight the importance of debt market in the country. In the second section, the focus is on the role that corporate bond markets play in the development of the economy. In the third section, the focus is on the global trends in corporate bond issuances and factors that have contributed to their robust development in these countries. An examination of the successes and the failures witnessed by other markets is discussed in this section. The section 'Need for a vibrant corporate bond market in India', talks about enhancing the economic stability of the country through a vibrant corporate bond market. Further sections focus on how the Indian corporate bond market can be developed and the role that each constituent could play in such an environment. The participation and contribution by each constituent is crucial in this development. In the end, the book focuses on the ways in which the market development can be accelerated.

Thus, we have compiled such kind of a book which contains extracts from every constituent of the market and their views on how they can play a role in its development. A key highlight of the book is that it offers wide ranging perspectives from the market leaders.

As a knowledge partner, APAS has taken this initiative and intends to refresh the knowledge regularly and capture the dynamism of the bond markets under different economic scenarios as they will unfold. In the following edition, we will make efforts to invite global experts to share their approaches and models for retail investors in particular and all the constituents in general. We sincerely hope that this book and the forthcoming editions will measure up to the expectations and requirements of the various stakeholders in the market place.

In conclusion, our task will remain incomplete if we do not thank various individuals and organisations who have contributed to the making of this book. To begin with, the role of ASSOCHAM – particularly Mr. Chandan Kumar and his team – needs to be recognized. His commitment and dedication has helped the making of the book possible. We also recognize the effort placed by the various experts who have contributed to the articles covered in the book. The long untiring hours spent by team APAS – Sujana Hari, Harsh Mirpuri, Ankita Narnaware, Miral Ajmera Shah and Kalpesh Mantri – need not just recognition, but a high order of appreciation as well. We also recognize and thank the participants – about 1700 plus – at the above centres for deliberations which are captured in the book.

CHAIRPERSON PREFACE

Navita Yadav
Chairperson
ASSOCHAM National Council for Bond Markets

Welcome to ASSOCHAM knowledge book – "Corporate Bond market", offering deep insight into the bond market in India. I truly believe we are in exciting times with India moving fast to secure long term economic growth, and key decisions like GST, capital infusion in PSUs, introduction of bankruptcy code, easing of FDI rules in various sectors, renegotiation of the bilateral tax treaties with various countries, move towards digitalization etc., have proved impactful.

The Indian debt market has been dominated by banks, however globally the availability of finance from banks and financial institutions is shrinking. With hardening of the prudential norms under the Basel regime, substantial part of the much needed long term finance, both equity and debt, would have to come from the capital markets.

Bond Markets are super-strong financial backbones that would spur economic growth for many countries. They support the credit needs of the corporate sector, acting as an alternative source of financing to bank lending, that is essential for economic growth. This ensures that funds flow towards productive investments and market forces exert competitive pressure on lending to the private sector.

For India to achieve higher economic growth rate and invest heavily in infrastructure, reliance predominantly on banks will not be adequate. Despite India being one of the fastest growing economies globally and possessing a well-developed equity market, the Indian bond market has a long way to go. Several initiatives to address structural constraints dominance of banks in lending, risk appetite of investors limited to higher ratings, regulatory arbitrage between loans and bonds and prescriptive regulatory limits on investments have been addressed in the recent years. These include Reserve Bank of India favourable regulatory steps last year to broaden bond market, the passage of the bankruptcy law and a nudge by the banks to induce corporates to source some part of their debt from the bond markets. However, for most of the borrowers, domestic bond issuance remains costly and cumbersome compared with bank lending. Lack of retail participation despite huge supply of government paper in the country is also one of the major impediments to penetration of Bond market. Corporates prefer raising funds through private placements, but private placements lack transparency and access is not available to a large pool of investors.

I believe that this is the time for some big bang reforms to rejuvenate corporate bond market to allow efficient flow of capital from the savings to areas where it is most needed. ASSOCHAM has taken first of its kind initiatives in this regard by creating the first 'National Bond Council of India' consisting of diverse stakeholders viz. Bond Issuers, Institutional Investors, Analysts, Investment Bankers, Rating Agencies and other participants. In the last 12 months, ASSOCHAM Bond council has organized 7 conferences on Bond markets in the main financial hubs – Mumbai, Kolkata, New Delhi, Chennai, Bengaluru, Hyderabad and Ahmedabad, with the objectives of creating connect, disseminate knowledge and awareness while keeping investor protection at the core. The events saw large scale participation from issuers, intermediaries, investors and stock exchanges. The council will soon present a strong pitch for next generation reforms in Bond markets.

Meanwhile, I am very happy at the release of the latest repository on Indian Bond markets, 'Corporate Bond market', jointly prepared by ASSOCHAM and APAS. I am sure that it will make an insightful read.

CO-CHAIRPERSON MESSAGE

Sanjeev Kumar

Senior Vice President

Head - Resource Mobilisation (Retail Liabilities), Treasury

Srei Infrastructure Finance Ltd.

A vibrant and deep corporate bond market is essential for a rapidly growing economy like ours. The role of the bond market is indispensable to mitigate financial crises and enhance the financial stability of the country. If India has to continue to grow at a higher pace, it is imperative that the credit needs of the corporate sector have to be met timely and efficiently.

Srei has been involved in nation building for the past 27 years. Being a holistic infrastructure finance institution, we believe that if India is to meet its huge infrastructure investment needs the bond market has to play a vital role in overcoming the limitations of the banking sector of single handedly financing such needs.

A number of policy measures have been taken to develop the corporate bond market in the recent past. These reforms have been able to remove considerable roadblocks and make the bond market more accessible to issuers and investors. A lot more needs to be done to deepen the bond market.

At Srei, we have been engaging with different stake holders in the industry to come up with practical suggestions that positively impact the bond market. We have partnered with ASSOCHAM for a series of events across 8 key cities primarily to create awareness as well as elicit innovative views on removing the barriers that impede growth.

We are glad to be associated with ASSOCHAM for creating this E-book on the bond market. I hope that it will help enrich the readers with a wide perspective on the bond market and in its own way, help in creating a vibrant bond market in India.

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EXECUTIVE SUMMARY

This book 'Corporate Bond market' is compiled by APAS. In compiling the book, the events and seminars organized by ASSOCHAM, with APAS as knowledge partner, have played a significant role. The events and the book are efforts to bring together experts in the corporate bond market to give their views on the current scenario, based on their expertise, and give suggestions and recommendations for developing the corporate bond market. This book is particularly aimed at spreading awareness among the investors and other constituents, who will play a key role in developing the corporate bond market in India.

This book is organized in various sections as articulated below.

Introduction to Corporate Bond Markets

The Indian bond market for debt financing broadly comprises of the public debt market (government securities and public sector bonds) and the private debt market, which is essentially the Indian corporate bond market. Although the private debt markets in India were opened up to foreign investors in the late 1990s, it has been closely regulated by both the RBI and SEBI.

The corporate bond market is worth USD 287 billion, which is around 14% of India's GDP, way lower than the equity market, which is around 80% of GDP.

Compared to our government securities market, corporate bond market still has a distance to go. An economic growth of 8% cannot be achieved without a robust corporate capex cycle. Given this huge requirement, the sole reliance on bank loans is not warranted, particularly when bank lending has been squeezed. In light of the above, a developed corporate bond market is the need of the hour.

Infrastructure Investment Trust (InvIT)is a financial instrument designed to monetize long term infra assets with adequate protections to safeguard investor interest. InvITs provide a high yield financial instrument with a strong credit rating. InvITs would act as long term financing vehicles, while acting as effective tools in solving the immediate issue of overleveraged balance sheets in the infrastructure space. InvIT is also a new alternative for investors with long term prospects.

Understanding the Role of Corporate Bond Markets

Corporate bond markets play an important role in supporting private sector growth through efficient allocation of capital, favourable funding terms, flexible term structures, financing at lower cost and a scalable source of financing.

They also play an important role in supporting economic growth. Given that PSBs continue to face profitability and capital related challenges in the near to medium-term, overall banking sector credit growth is expected to remain subdued. In such a scenario, vibrancy in the debt markets is critical to ensure a steady supply of

credit to the various sectors of the economy.

There is a need to encourage investors to invest in corporate bond market.

Global Perspective

The top global markets for corporate bonds have been relatively stable. The leader among the list is the US, even though its share in the global market has been reducing, which was 51% in 2004, 49% in 2007 and 44% in 2013. Other interesting developments over the years have been the performances of China, South Korea, Russia, Malaysia and Thailand, while the growth by other developed markets has not been significant.

Need for a Vibrant Corporate Bond Market in India

A more developed bond market might allow more firms access to cheaper or more efficient debt capital, through a higher risk-taking culture among investors.

On the policy side, bank lending rates are inefficient in passing through changes in the interest rates by the central bank. Markets reflect interest rate changes more efficiently. Further reforms from the central bank are required if more firms are to gain access to the bond market. The government may attempt to protect the traditional public sector banks and hence, private debt markets.

There is a dire need for a more efficient credit market to pass through shifts in monetary policy.

Developed bond markets would create a new asset class in India that attracts foreign capital. It would be an efficient allocator of capital and bring more firms into the market.

A vibrant corporate bond market will ensure a win-win situation for all.

Evaluating Corporate Bond Market Development

There are certain challenges in developing corporate bond market. One of them is the ability of companies to access the market. Another is perceived risks of the market framework. The various risks are interest rate risk, reinvestment risk, inflation risk, credit/default risk, rating downgrades risk and liquidity risk. Other challenges are determining the relative cost and return of participating in the market and the ability to effectively match supply and demand.

Developing Corporate Bond Market in India

Various initiatives taken by SEBI and RBI to develop the market for corporate bonds over the last few years seem to be bearing fruit now. While the corporate bond primary issuances have increased via the private placement route, the secondary market still appears to be thin and lacks liquidity. The dominance of passive investors is one of the reasons for such a thin secondary market.

For developing the corporate bond market, the aim should be to minimise moral hazard by corporates and increase participation of individuals by reducing their adverse selection.

Banks have an incentive to lend to companies albeit knowing their risks and investors still deposit their savings to banks for a certain return. The presence of a matured and liquid equity market reduces the risk perception of individual investors and their certainty equivalent returns rise to a level that no bank can meet. Thus, they engage in investing in equities. By having a default recovery framework and put/call options embedded in bonds, the risk perceptions of individual investors/issuers can be reduced, so that higher required certain returns would incentivize investing in corporate bonds, till the time more investors come in and Indian corporate bond market attains critical liquidity levels.

All the measures and required regulations should be in place and regulatory authority should focus on minimizing information asymmetry to the extent possible so that price discovery process accelerates.

Accelerating Corporate Bond Market Development

It is important to ensure that the lack of development of a market for debt does not hold back overall economic development of the country.

There is a need to institute robust mechanisms that ensure transparency and continuous information availability about the corporate entities issuing the bonds. Disclosure requirements should ensure adequate, timely and credible information about the financial condition of the issuer. In the short run, intermediaries need to be incentivised to provide market-making services to increase liquidity in the market. It is crucial that the market is as broad-based as possible in terms of issuers, investors and instruments. There needs to be a speedy and smooth recovery process for defaults. Issuance costs need to be contained for volumes to increase and returns to be high for investors.

Deepening of the Indian corporate bond market is critical to meet the funding requirement of the infrastructure sector. Low penetration of insurance and pension products in household savings limits transmission of funds towards the Indian corporate bond market. Increased participation by insurance companies and pension funds can also help deepen the Indian corporate bond market and meet the increasing funding requirement for the infrastructure sector. For that, there is a need to liberalise the investment policy guidelines of insurance companies and pension funds. Enhancing the role of facilitative infrastructure providers/facilitators in the Indian corporate bond market is critical. It is also important to encourage an investment culture through education and financial literacy.

The insubstantial contribution of the bond market has spawned a number of committees to introduce reforms for making the bond market beneficial for investors and issuers. The reforms have resulted in several changes in the past and have led to the removal of considerable roadblocks in the bond market development. Some issues still remain on the regulatory and compliance framework and taxation and disclosure norms, which are being worked on and if resolved, could go a long way in accelerating corporate bond market development.

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Introduction to Corporate Bond Markets

ASSOCHAM INDIA

APAS ashvin parekh advisory services

Understanding the Corporate Bond Markets Landscape in India

Shilpa Mankar Ahluwalia
Partner
Shardul Amarchand Mangaldas

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I. Introduction

- Historically, corporate finance in India has been dominated by bank finance, which is generally more costly than the corporate bond market. Several factors have contributed to the stunted growth of the corporate bond market in India:
    - o **Limited structured products:** on the product side, there is no diversity of instruments. The market is dominated by fixed coupon bonds, unlike more developed markets, where investors have the option of investing in a wide range of structured products
    - o **Credit risk management:** investors do not have access to sophisticated derivative products (like credit default swaps) to manage credit risk
    - o **Investment restrictions:** on the investment side, the market is highly regulated. Investments by non-resident investors is closely monitored and regulated by Securities and Exchange Board of India ("SEBI") and the Reserve Bank of India ("RBI"). Domestic institutional investors such as insurance companies and pension funds are not allowed to invest in bonds below an investment grade rating, leading to a limited demand in the high-yield bond market.
    - o **Inadequate bankruptcy laws:** Until the Insolvency and Bankruptcy Code 2016 came into effect, insolvency laws in India were ineffective and it could take several years for a bankruptcy proceeding to be finally concluded. The Code is still in its early stages of implementation and its impact on the ground is still being tested.
- Over dependence on bank finance places significant pressure on the banking system and is not a viable model in the long run for an economy like India with increasing credit needs, particularly in the infrastructure sector. Bothe the RBI and SEBI have taken steps to develop the Indian bond market to shift a part of the resource allocations to bond financing without impacting aggregate allocative efficiency and economic welfare.[1] SEBI for example, has recently permitted real estate investment trusts to issue debt securities to raise funds, in an attempt to provide an alternate resource pool for infrastructure financing.

1 *RBI Report, Financial Stability Report, Issue No. 15, June 30, 2017, available at https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR_30061794092D8D036447928A4B45880863B33E.PDF.*

- This article aims to summarize the legal framework governing various forms of foreign debt investment in India, the role of foreign debt investment in fueling the growth of Indian economy, and also seeks to highlight some of the regulatory lapses that need reforms in order to improve investor sentiment.

II. Private Debt Market: Brief Overview of the Regulatory Regime

- The Indian bond market for debt financing broadly comprises of the public debt market (government securities and public sector bonds) and the private debt market which is essentially the Indian corporate bond market. Although, the private debt markets in India were opened up to foreign investors in the late 1990s, it has been closely regulated by both the RBI and SEBI. Until recently, when Indian companies were permitted to issue listed rupee denominated bonds to foreign institutional investors, foreign debt was primarily availed in foreign currency under the external commercial borrowing regime. Under Indian law, private debt investment by foreign investors is possible in any one of the following ways:

- FPI Regime: Investment in non-convertible debentures ("NCDs") by entities registered as foreign portfolio investors ("FPIs") with the SEBI:

  (a) FPI investment in NCDs is governed by the SEBI (Foreign Portfolio Regulations), 2014 ("FPI Regulations") and the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000. FPI's are permitted to invest in in listed as well as unlisted rupee denominated NCDs.

  (b) While companies are permitted to issue NCDs to FPIs via both a public issue and a private placement basis, the most common form of FPI debt investment has been through the private placement route. Unlike ECBs, which are highly regulated, no prior approval of any regulatory authority is required for issue of, and subscription to, privately placed NCDs. Further, no sectoral limits have been prescribed for FPI investment in NCDs. FPIs have recently also been allowed to also invest in unlisted NCDs (with a few end use restrictions). The unlisted NCD has been a popular investor product.

  (c) The NCD has become a go-to investment option for both issuers and investors from a pricing perspective. No hard all-in-cost is prescribed for NCD investments under Indian law. Investors and issuers have the flexibility to commercially negotiate pricing given prevailing market practices. Issuer companies also have the ability to offer security over a wide range of own and group entity assets to secure the NCD amounts, which has made it an easy secured lending instrument.

- Foreign Investment in bonds under ECB framework: Investment by eligible foreign investors in non-convertible/ optionally convertible bonds/ foreign currency convertible bonds in the form of external commercial borrowings ("ECBs") in accordance with the Foreign Exchange Management Act, 1999 and the directions, rules and regulations issued by the RBI for regulating borrowing and lending in foreign exchange ("ECB Master Directions"):

  (a) The ECB Master Directions broadly categorize ECBs under 3 tracks:

    (i) Track I for medium-term foreign currency denominated ECBs;

    (ii) Track II for long-term foreign currency denominated ECBs; and

(iii) Track III for medium-term rupee denominated ECBs.

(b) The framework governing ECBs is highly regulated, and each track of ECB has a separate set of eligible borrowers, eligible lenders, specified permitted end uses and prescribed all-in-cost ceiling.[2] Borrowers looking to raise secured ECBs are required to obtain prior approval of the designated AD category I bank. Borrowers looking to issue foreign currency denominated bonds under the ECB regime often try to raise funds by accessing international capital markets. FPI investment in NCDs is not governed by the ECB Master Directions.

(c) Thus, unlike the investment environment for FPIs in NCDs, ECBs are subject to close scrutiny by the RBI / designated AD category I bank, and do not offer a variety of structuring options to the investors. Specifically, banking entities are not permitted to avail financing under the ECB route although they are permitted to raise debt by issue of NCDs to foreign investors.[3]

- **CPs:** Investment by eligible foreign investors in commercial paper ("CP") in accordance with the RBI's directions on issue of CP ("CP Directions"):

  (a) Under the CP Directions, a CP is defined as a short term unsecured money market instrument issued in the form of a promissory note with original tenor ranging between 7 days to 1 year.

  (b) While no end use restrictions are prescribed for investment in CPs; since the tenure of CPs is less than 1 year, FPIs are not permitted to invest.[4] Consequently, the CP as an investment product has not been a real option for portfolio investors.

- **FVCI investment in NCDs:** Investment by entities registered as foreign venture capital investors ("FVCIs") in debt instruments issued by eligible Indian entities pursuant to the SEBI (Foreign Venture Capital Investors) Regulations, 2000 ("FVCI Regulations"):[5]

  (a) The FVCI Regulations do not permit an FVCI to invest in debt instruments of a venture capital undertaking or investee company unless it has made an equity investment in such an entity. Where an FVCI does have an equity investment, the FVCI may invest not more than 33.33% of its investible funds in debt or debt instruments issued by such entity. FVCI investment in debt instruments is permitted in very limited sectors.[6]

  (b) From an investor participation perspective, this route is fairly restrictive and not as accessible as the others.

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2 *The term 'all-in-cost' includes rate of interest, other fees, expenses, charges, guarantee fees whether paid in foreign currency or Indian Rupees (INR) but will not include commitment fees, pre-payment fees / charges, withholding tax payable in INR.*

3 *DBR.No.BP.BC.1/21.06.201/2015-16, Master Circular – Basel III Capital Regulations, July 1, 2015, available at https://www.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9859.*

4 *A.P (DIR Series) Circular No.73, Foreign investment in India by Foreign Portfolio Investors,February6, 2015, available at https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=9554&Mode=0.*

5 *A.P. (DIR Series) Circular No. 7,Investment by a Foreign Venture Capital Investor (FVCI) registered under SEBI (FVCI) Regulations, 2000, October 20, 2016, available at https://rbidocs.rbi.org.in/rdocs/notification/PDFs/APDR07BBAD7968F75544C39400B62F277E065B.PDF.*

6 *A.P (DIR Series) Circular No. 7, Investment by a Foreign Venture Capital Investor (FVCI) registered under SEBI FVCI Regulations, 2000, October 20, 2016, available at https://rbidocs.rbi.org.in/rdocs/notification/PDFs/APDR07BBAD7968F75544C39400B62F277E065B.PDF (last seen October 11, 2017).*

III. Robust Corporate Bond Market – A Necessity

- A well-developed corporate bond market is positively correlated with economic development. A vibrant corporate bond market provides a stable flow of finance in addition to equity and bank financing by diversifying risks to a wide range of investors. It reduces increased dependency on banking institutions. Increased availability of various avenues for funding capital requirements allows long term financing for infrastructure development. The Finance Minister has announced that India needs over $1.5 trillion in investment in the next 10 years to bridge infrastructure gap. Foreign corporate debt becomes more critical and crucial not only given such a large infrastructure funding gap, but also as a means of sustainable and alternate source of funding to bank finance.

- Encouraging foreign investment in the rupee denominated bond market will help in addressing the problems of currency mismatch. Availability of various bond structures in the form of listed/ unlisted, secured/ unsecured and bonds embedded with options, brings diversity in the investment portfolio of the investor – and needs to be encouraged.

- An active corporate bond market is more likely to provide institutional investors such as insurance companies and provident and pension funds with quality long term financial assets, helping them in matching their assets and liabilities. Exposure of small and medium enterprises to the corporate bond market will also address the issue of cost effective resource funding.[7] An impetus to issuance of corporate bonds by urban local bodies/ municipal bodies should also be encouraged as a tool for cheaper urban infrastructure financing.

IV. Challenges and Potential: Corporate Bond Market

- The Indian foreign direct investment market and the portfolio investment regime is significantly more mature and developed in comparison to the Indian corporate bond markets. A principal reason for this difference between debt and equity markets is that market regulators have traditionally and consciously pushed foreign investors into adopting an equity investment route. Apart from being known as a 'borrower friendly' jurisdiction, raising foreign debt in India has always been marked with several regulatory hurdles. Few key regulatory issues have been highlighted below.

- **The Masala Bond Market**

  (a) In 2015 RBI and SEBI introduced the 'masala bond' product i.e. rupee denominated bonds issued in offshore markets by Indian companies. While the Finance Minister (as part of the Union Budget 2017-18) provided several tax relief measures to investors in masala bonds, investor appetite for the product never materialized. Limited liquidity and currency hedging costs were two main reasons. Recently, the RBI imposed further restrictions on issue of masala bonds, further limiting investor (and issuer) appetite for the product (prior approval of the RBI, ceiling on all in costs, prohibition on related party deals).[8]

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7 *Smt. Usha Ananthasubramanian, India's Emerging Corporate Debt Market: Potential and Challenges, Vol. 4, Issue No. 1, FINANCIAL FORESIGHTS, VIEWS, REFLECTION AND ERUDITION, available at http://ficci.in/sector/3/Add_docs/fin-digestpdf.pdf.*

8 *A. P. (DIR Series) Circular No.4, Issuance of Rupee denominated bonds overseas, June 07, 2017, available at https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI31645C0B133C01F41439C8C04E2DE0E2EBE.PDF.*

(b) Recently however, the prudential norms for Masala Bonds were aligned with ECBs, and Masala Bonds were removed from the purview of limits for debt investment by portfolio investors.[9] Since there are no prescribed limits on Masala Bonds, it is expected that more issuers might approach the RBI to tap the overseas market for their funding requirements;[10] although it is too early to predict market response with certainty at this stage.

- **Limits on Debt Investment by Foreign Investors**

(a) FPI investment in NCDs has been the most preferred instrument for debt investment given the flexibility in structures available to investors. However, with the quantitative regulations on limits for debt investment by portfolio investors having almost been exhausted,[11] the Indian corporate bond market has come to an abrupt halt as FPI's can no longer access the combined corporate debt limit on tap basis and have to bid in an auction for allocation of unutilized debt limits.

(b) Further, the move to remove masala bonds from the purview of the investment limits for FPIs, although intended to push further FPI investment, is unfortunately a missed opportunity (given the utilization continues to be at over 95% of the available limits) and has not given any impetus to foreign investment through the NCD route.

(c) ECBs, on the other hand, do not offer the same flexibility as FPI investment in NCDs. Similarly, despite relaxation of norms governing CPs, foreign investors have generally not chosen the CP route due to its short term nature. FVCI investment is also restricted to specified sectors, and therefore debt financing via FVCI route has not been a much used option for both borrowers and foreign investors.

- **Illiquid Secondary Market**

(a) The primary market for corporate bonds is fairly well developed in comparison to the secondary market for corporate bonds. According to a SEBI report, private placement issues had increased by 176.41 % from FY 2007-08 until February 2017.[12] Comparatively, trading of corporate bonds in the secondary markets had increased from INR 1.48 trillion in the FY 2008-09 to INR 11.70 trillion in the FY 2016-17.[13]

(b) In Indian bond markets, investors tend to buy and hold (as opposed to actively trading in the secondary market). Also, some investors, are prohibited from trading debt securities in the secondary market unless the rating of such debt securities falls 2 notches below their initial credit rating.[14]

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9 A.P. (DIR Series) Circular No. 05, "Investment by Foreign Portfolio Investors in Corporate Debt Securities – Review", June 07, 2017, available at https://rbidocs.rbi.org.in/rdocs/notification/PDFs/APDIR522091746D54E9902984BD593836C5064285D70.PDF?wb48617274=FBE5EF98.

10 Bhavik Nair,As RBI separates masala bonds from FPI limits, three firms line up for issues, FINANCIAL EXPRESS, September 26, 2017, available at http://www.financialexpress.com/market/as-rbi-separates-masala-bonds-from-fpi-limits-three-firms-line-up-for-issues/870741/.

11 SEBI IMD/FPIC/CIR/P/2017/81, Investments by FPIs in Corporate Debt, July 20, 2017, available at http://www.sebi.gov.in/legal/circulars/jul-2017/investments-by-fpis-in-corporate-debt_35362.html.

12 SEBI Consultation paper, Consolidation and re-issuance of debt securities issued under the SEBI (Issue and Listing of Debt Securities) Regulations, 2008, February 02, 2017, available at http://www.sebi.gov.in/reports/reports/feb-2017/consolidation-and-re-issuance-of-debt-securities-issued-under-the-sebi-issue-and-listing-of-debt-securities-regulations-2008_34120.html.

13 SEBI Consultation paper, Consolidation and re-issuance of debt securities issued under the SEBI (Issue and Listing of Debt Securities) Regulations, 2008, February 02, 2017, available at http://www.sebi.gov.in/reports/reports/feb-2017/consolidation-and-re-issuance-of-debt-securities-issued-under-the-sebi-issue-and-listing-of-debt-securities-regulations-2008_34120.html.

14 SEBI Consultation paper, Consolidation and re-issuance of debt securities issued under the SEBI (Issue and Listing of Debt Securities) Regulations, 2008,

(c) Unlike equity markets, corporate debt markets do not support continuous disclosure mechanisms which also to some extent hampers secondary trading of corporate bonds. Passive holding of corporate bonds does not add any information on respect of the current credit status of the issuer – which adversely affects the development of the secondary market. An illiquid bond market implies higher costs and in the absence of liquidity, any valuation of the bonds is theoretical.[15]

- **Rating**

(a) The credit rating of a bond assesses the credit worthiness or the ability to meet financial obligations/ commitments of the entity issuing the bond. AAA generally signifies the highest degree of credit worthiness.

(b) In the Indian context, there have been a few instances where corporates with high ratings have committed default in bond repayments and have immediately thereafter been downgraded significantly by rating agencies. Following such instances, last year, SEBI asked the rating agencies to disclose how they rate a company, the rating history and responsibilities of their analysts. SEBI had also directed the rating committee of an agency to explain if there was a sudden downgrade of rating of a company and asked the raters to continue with the rating process through the instrument's life, even in instances where the issuer was being non-cooperative.[16]

(c) While the steps undertaken by SEBI are aimed at curbing 'rating shopping', the efficacy of such norms is yet to be tested against the backdrop of a robust and investor friendly bond market. Strict measures must be implemented to build investor confidence in the rating issued to an issuer company.

V. Conclusion

- A concerted effort to develop corporate bond financing for a mature debt capital market is immediately required, and this can only be achieved by easing the regulatory landscape. Particularly, restrictions on end-use, eligibility criteria for investors and borrowers, administrative costs and general costs of financing are a few areas which may be eased to tap into the wide foreign investor base and adequately meet the financing needs of Indian borrowers.

- Additional measures such as re-issuance of same securities, transparency of information and mechanism for ongoing disclosures, and increased retail participation can help boost the liquidity of the corporate bond market. Tax reliefs must be provided to encourage investor sentiment, particularly in cases such as municipal bonds to encourage urban infrastructure financing.

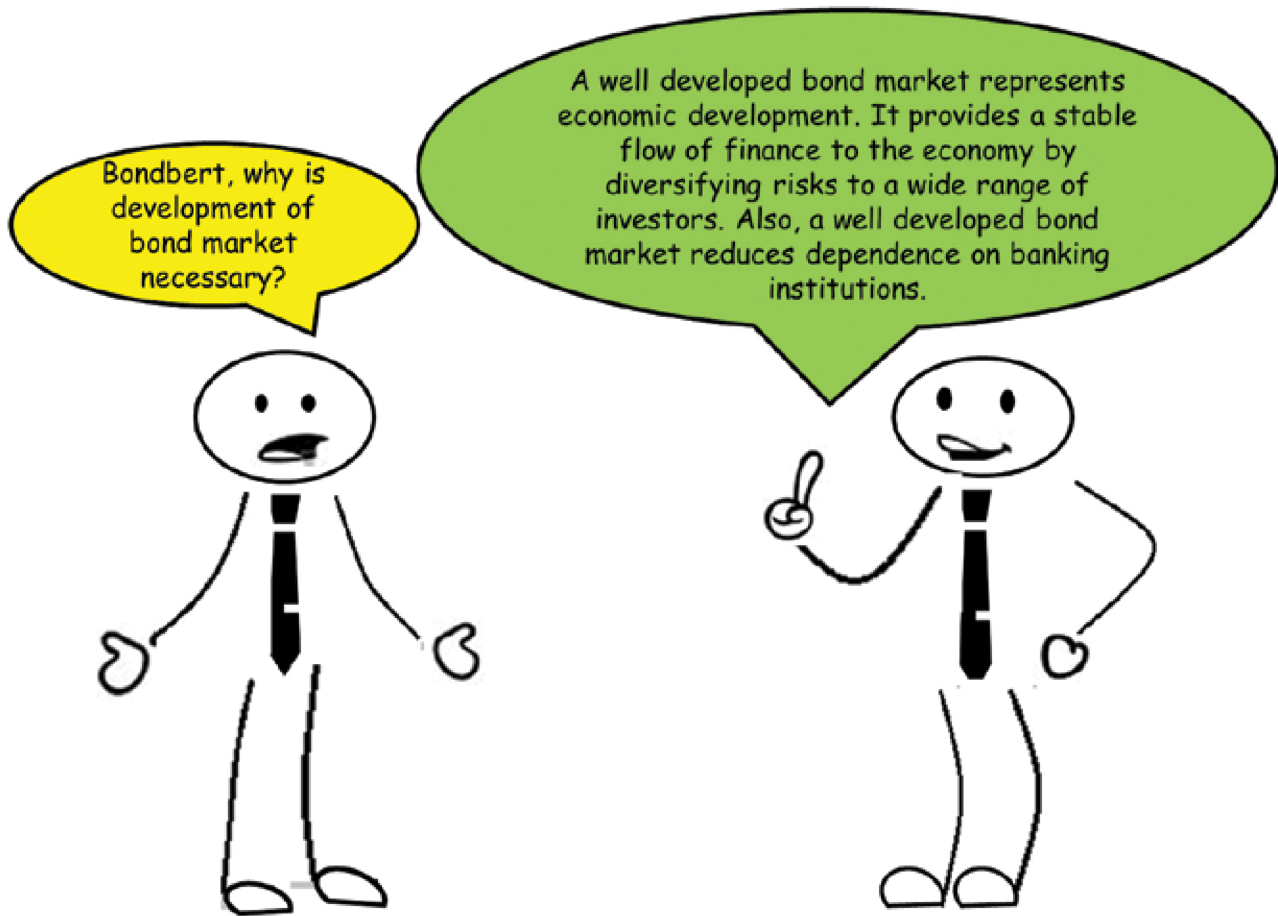
- In the present regulatory scenario, there are significant obstacles to risk-based pricing of corporate bonds— principally, lack of a robust benchmark interest rate and insufficient derivative products

February 02, 2017, available at http://www.sebi.gov.in/reports/reports/feb-2017/consolidation-and-re-issuance-of-debt-securities-issued-under-the-sebi-issue-and-listing-of-debt-securities-regulations-2008_34120.html.

15 *RBI Report, Financial Stability Report, Issue No. 15, June 30, 2017, available at https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/0FSR_30061794092D8D036447928A4B45880863B33E.PDF.*

16 *SEBI/HO/MIRSD/MIRSD4/CIR/P/2016/119, Enhanced Standards for Credit Rating Agencies (CRAs), November 01, 2016, available at http://www.sebi.gov.in/legal/circulars/nov-2016/enhanced-standards-for-credit-rating-agencies-cras-_33585.html.*

available to investors to hedge credit risk.[17] Additionally, broader issues such as crowding of debt markets by government securities also need to be addressed to provide for greater demand for corporate debt securities.



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17 India Needs a Robust Corporate Bond Market, LIVE MINT, October 11, 2017, available at http://www.livemint.com/Opinion/rn5OoH2KhB9RVTGxT8ujEN/India-needs-a-robust-corporate-bond-market.html.

The Incredible Indian Debt markets – Then and Now

Sundeep Kakar
Managing Director
Citi Group

For the Indian Investor, believe it or not, debt has always been a steady financing source. Traders would pool in retail money to safe keep. These funds would then be used for trading and capital use, while the surplus would be lent out by the humble 'IOU' slip of paper, known as the 'hundi'. Over decades, the Hundi Market grew over decades, and through the influence of English law, 'Bonds', 'promissory notes' and 'debentures' came into the market.

In the early 90s, the Government played a small, but important role, in the growth of debt markets by allowing retail investors in India to buy the simple post office saving certificate, which were branded as National Saving Certificates and the Units of US 64 Scheme. At first, the Indian retail investor would park money into these two schemes to save on tax. As time went on, the schemes became instruments to save large portions of one's income for retiring. Personally, I fondly remember every March buying NSC certificates and, in some years, taking loans from banks for following year's purchase. The development of a secondary market in units of US 64 scheme of UTI with monthly buy and sell prices might have been the earliest secondary deals India Inc took part in.

The early days of "capital shortage" in the development of Public Sector Units (PSUs) saw the birth of various public sector bonds, such as NTPC, IPCL, etc., which actually gave you copies of interest checks in advance so that the investor could deposit the same as on the due date. Yes, some of the bonds had tax breaks / incentives attached, but I believe this development played a very important role in shifting to formal organized savings, from the unorganized.

While the Government established an organized market, the private sector jumped in and we saw Indian investors take on the various debentures issued by India Inc. In 1989, I recall the excitement around the Tata Steel issuance, which gave two sets of debentures: one of INR 600, which would get converted to one share of INR100 with an INR500 premium, and the other of INR600 to be redeemed at par after 8 years. Early bond investors recall how equity investors sold the debentures ata discount to fixed income investors, making it a great trade. 1991 / 92 saw a new flavor with Secured Premium Notes (SPN) issued by Tata Steel. Various companies, which had equity warrants attached, became the early stages of the secondary debt market in India, where investors sold the "khoka" which was bought and consolidated by intermediators, then sold to institutional investors.

The later issuance of such SPN with warrants even gave the retail investor the right to see liquidity at application stage by just a tick that he agreed to sell the same to an intermediary. The market was ablaze with such an issuance. It was 1993, when investors saw the icing on the cake for public corporate issuance. RPL's Triple Optional Convertible Debenture (TOCD),net public issue of INR8.62 billion was subscribed by over 2 million investors. This, according to me, was the finest case study in engaging the public for fund raising.

In recent years, Indian investors have taken advantage of market developments and profited from the same. Chit funds, gold saving schemes by the neighborhood gold jewellery shop, fixed deposit markets, subscriptions to financial institutions, Tax-free and mutual fund fixed income, credit funds (which are larger than some banks today) and recently, balance-fund plans all bear testimony to the fact that the Indian investor understands and is willing to partake into debt markets.

The growth of debt markets with particular reference to corporates debt has been a topic for discussion in various media and industry forums over the last decade. While looking at data from a mere approx. 150 issuances in the year 2011, we have seen around +800 issuances totaling INR2.34 trillion and counting … this is a statement that things are looking up in this space. While comparable data in other countries pales, I do believe things are moving in the right direction.

How can we further fuel the development and interest in the debt markets? Develop new products, Investor education, increase financial intermediation, more from foreign investors, encourage more issuance, etc. are some topics that have been debated or written about in detail over the last decade.

Just last year, Dr. H R Khan's report 'Development of Corporate Bond Market in India, gave a frame work for addressing the seven "I's" - issuer, investor, infrastructure, intermediaries, innovation, incentive, and instrument. In my view, this shall report shall serve as a road map to the developments of the corporate bond market.

In addition, I believe some simple changes could go a long way in deepening our markets:

Retail participation

Retail and public participation have always proven their participation increases market size and depth. Take the case of the Equity culture in India. We had a vibrant stock market even before independence, but growth and income were fueled by the wealth made by investors in the listings of various MNCs – such as Hindustan Unilever, Castrol, etc. We then had the NavRatnas, and one can never forget the Reliance Equity story. So, why are retail investors – particularly since this segment of investors started off well with the post office saving certificate and the tax-free NSCs - not digging in deeper? The answer lies in the fact that we need to continuously feed retail demand over a long period of time and at the right price, for markets to sustain.

Currently more than 85% of the corporate bond issuance is undertaken by the high rated (A and above) issuer. Retail investors could absorb the credit risk through wider dissipation. Certain tax incentives, the launch of Infra bonds (such as IDFC), the launch of LONG-dated Zero lakh patti bonds, the launch of special HIGH way bonds or BUILD INDIA bond, go a long way to increase retail participation. While we are glad that

we have made headway with the Public issuance of corporate debt in the recent months, the same has to be sustained. More issuances will lead to more dealing in days to come. The start of the public issuances of Infrastructure Investment Trust (InvITs) and Real-estate Investment Trust (REITs) is a step in the right direction.

Simplification

The old rule of 'keep it simple' will allow a multifold growth in such debt markets. Look at how simple the post office, fixed deposit application form was in comparison with a Public offer document. While disclosures and investor protection is of paramount importance, the industry/ rating agencies and regulators need to find a simpler method to provide information to retail investors and to make issuance / distribution more economical, which would lead to the growth of retail / household participation and eventually to a more liquid secondary markets, Extending the mantra of simplification and with the advent of GST in our country, is this not a right time to look at standardized stamp duty across states as well for example? Why unnecessarily increase the cost of issuance for issuers? Lowering the cost of issuance and compliance could allow the issuer to pay a higher coupon, which would attract more investors and thus start the cycle again.

Overseas investors: time to give them a warmer welcome

Investments are global today and various countries fight/ position for funds from the global liquidity pools. With full respects to our policies, we should quickly tailor make our polices so we can take advantage of global liquidity. Let's debate the 3-year residual maturity requirements for FPI investments in corporate bonds a bit longer. Unlike the sovereign bond market where all the issuance is at the long end, the dynamics of the corporate bond market is different. Corporates borrow across different tenures depending on their requirements and cost of funds. Since investors do not have long tenure credit lines on many corporates, they are not able to tap the longer end of the market. While the objective is to diversify the source of funding for corporates away from banks, the 3-year residual maturity restriction prevents these corporates from tapping this source of funding.

Inclusion in a global bond index

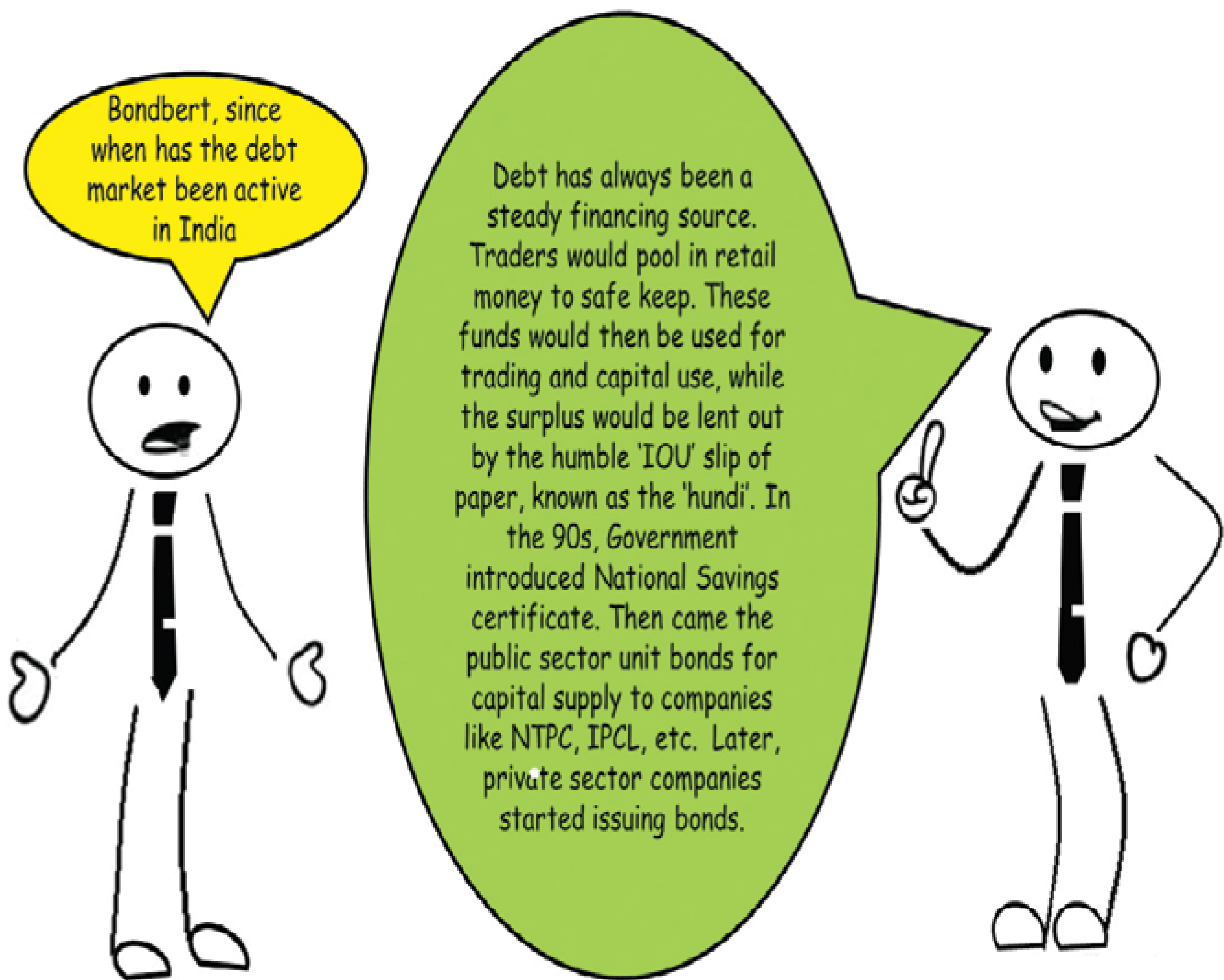
We are all aware of the steps China is taking to attract global liquidity, even while the country has reserves in greater multiples than most countries. We, as a country, need to understand there are significant benefits of being included in an index which gets tracked by a number of long-only fund managers (sticky money). We understand and respect the main concern of the regulators on doing away with investment limits but maybe some understand and work around on the same would help if we want to be a part of the global fund markets.

Credit Default Swaps

While we are all aware about the great financial crisis of the 2008 and the various stories about credit default swaps, we think today is the time to activate and re build such markets as it allows the transfer of risk to the party who understand it the best. While we have regulations in place in India, and with margining become

more acceptable in the Indian markets, the players must take steps to reactivate and look the same. The development of this market will add liquidity and further deepen our debt markets.

While one can write reams of paper on what steps we can take to deepen / expand our markets, all I would like to remind you, my friends, is that the journey has begun and the markets are growing deeper every day and will continue to do so. I also strongly believe that the markets will grow exponentially with the broadening of the market participation and the availability of a wide range of debt securities. The markets will thus attain global standards of safety, efficiency and transparency which will enable the Indian markets to take the rightful place among the leading capital markets in the world. In the end will request to every reader make a beginning by buying one debt in the secondary market and that will go a long way in reinforcing the credibility of this incredible market.



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Awareness on Corporate Bond Market Development

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Introduction

The development of India's corporate bond market is a well recognised and periodically studied topic. Corporate bonds are a pivotal mechanism for creating and sustaining enterprises, businesses, investments and economic growth in a country. The corporate bond market in India needs to be developed further to cater to the requirements of infrastructure and other key sectors of the economy. The corporate bond market is worth $287 billion, ~14% of India's GDP, way lower than the equity market of ~80% of GDP.

Compared to our Govt. Securities Market, Corporate Bond Market has still a distance to go. The Economic growth of 8% (and to sustain at similar levels) cannot be achieved without a robust corporate capex cycle. Given this huge requirement, the sole reliance on bank loans is not warranted, particularly when bank lending has been squeezed. In light of the above a developed corporate market is need of the hour. With the growing household income and the savings rate hovering around 30% of the disposable income (where part of this is invested in MFs and Insurance companies), a huge opportunity lies in tapping the non-traditional source of funding, especially retail monies, Retiral funds and Insurance Companies.

Dr. R.H.Patil's report on Corporate Bonds and Securitization in December 2005 is a stepping stone in relation to the development of debt market in India. It shows the way ahead of what it takes to develop corporate bond market in India. There has been a number of reports by expert Committees on development of corporate bond markets in India, including the latest one released by the working group headed by RBI ex deputy governor H. R. Khan in August 2016. Some of the recommendations of various past committees have been implemented by the govt and other regulatory bodies, while the recommendations of the Khan committee are yet to be implemented.

The impact of these measures has been mixed. Though the market has grown significantly in volume over the years, the issuances are still concentrated in quasi-sovereign and high rated papers. Issuance of unsecured and low rated instruments is the hallmark of a developed corporate bond market. It not only diversifies the risk in the financial system but also allows the corporations to borrow for longer maturities.

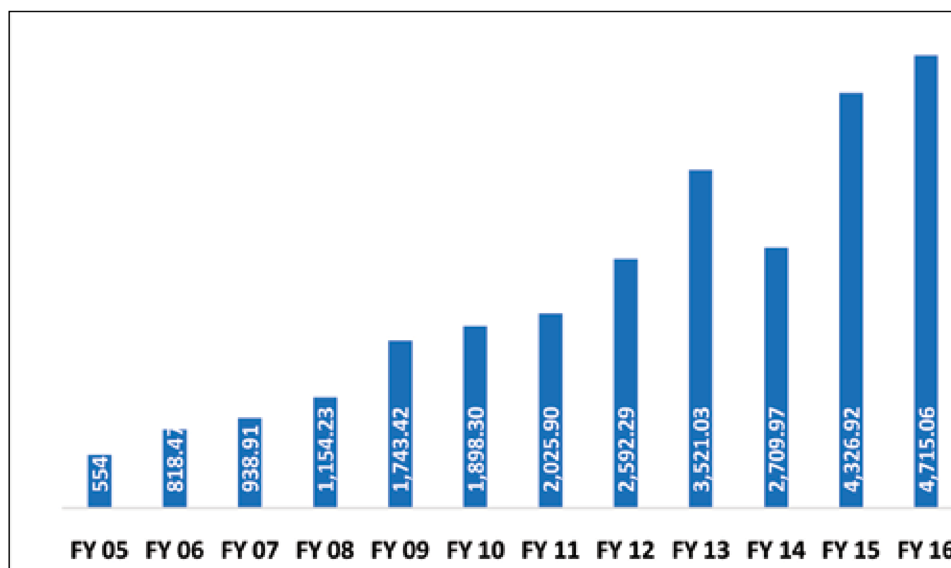
On the contrary, the Indian corporate bond market is trapped in a viscous circle, where majority of the investors are chasing few good names (majority of them being AAA or AA+ rated entities). Some part of it may

be attributed to the respective regulatory requirements. As a result, the real corporate bond (manufacturing/ services sectors) issuances constitute only a small portion of the total issuances. About 90 per cent of the investments in bond market come from the insurance industry in view of safety and predictability of the returns.

While it is true that the Indian corporate debt market has transformed itself into a much more vibrant trading field for debt instruments from the elementary market that it was about a decade ago, several areas like liquidity in secondary market, bringing new names in both the issuer and investor category and creating a more hospitable market for papers rated AA or below are yet to be developed.

Current market scenario

The issuances in the corporate bond segment have grown many folds during the last decade. However, the issuances are dominated by high rated, financial institutions & Quasi-Sovereign instruments, maturity upto five years and on private placement basis.



The following highlights the current standings of the Indian debt market:

1. Over reliance of corporates on the banking system

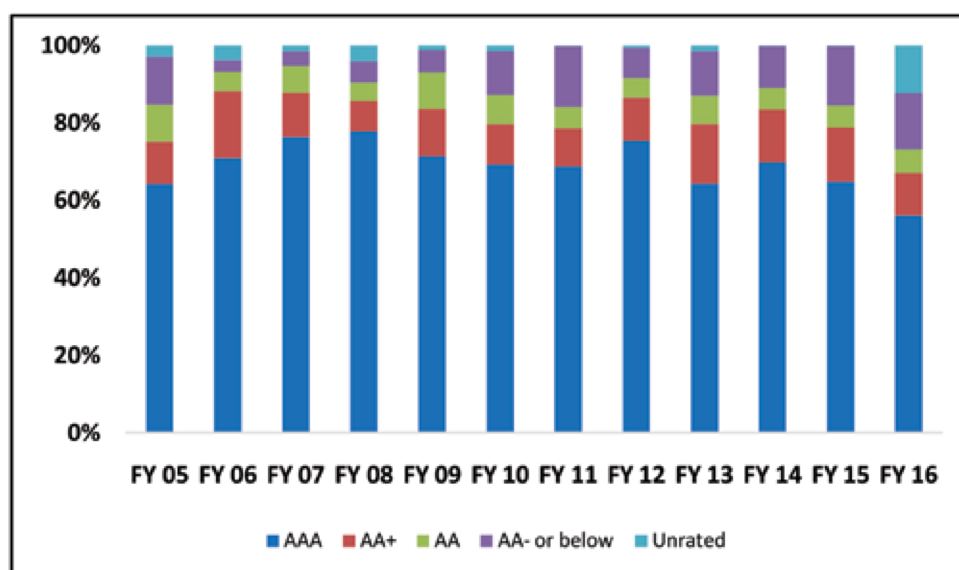
- The bond market has shown appetite predominantly for liquid and high credit rated Issuers. Tenor is another hurdle when it comes to debt market funding, Banks are willing to lend for a relatively higher tenor.
- Recently, the spread between the Bank MCLR and the corporate bond pricing has narrowed. For all practical purposes, the pricing for Corporates rated AA- or below is skewed towards bank MCLR. For AA rated corporates, there is still a small arbitrage opportunity in the bond market, however they are more inclined towards the bank funding because of the flexibility the bank borrowing offers. Hence, in the present scenario debt market provides opportunity only to high rated corporates (i.e. AA+ and AAA).

- Also, the corporates find the cash credit facilities more convenient & flexible as compared to debt market when it comes to working capital funding. This is truer for the low rated corporates. There is no disincentive for enjoying unutilized working capital limits.

However, with RBI Guidelines on Enhancing credit supply for large Borrowers through Market Mechanism applicable from April 2017, we hope more and more entities coming in the market especially blue chips and manufacturing names.

2. **More than 80% of the issuances are concentrated around AAA and AA+ entities. The regulators have mandated a minimum rating criteria for investments, especially for Retiral funds and insurance companies.**

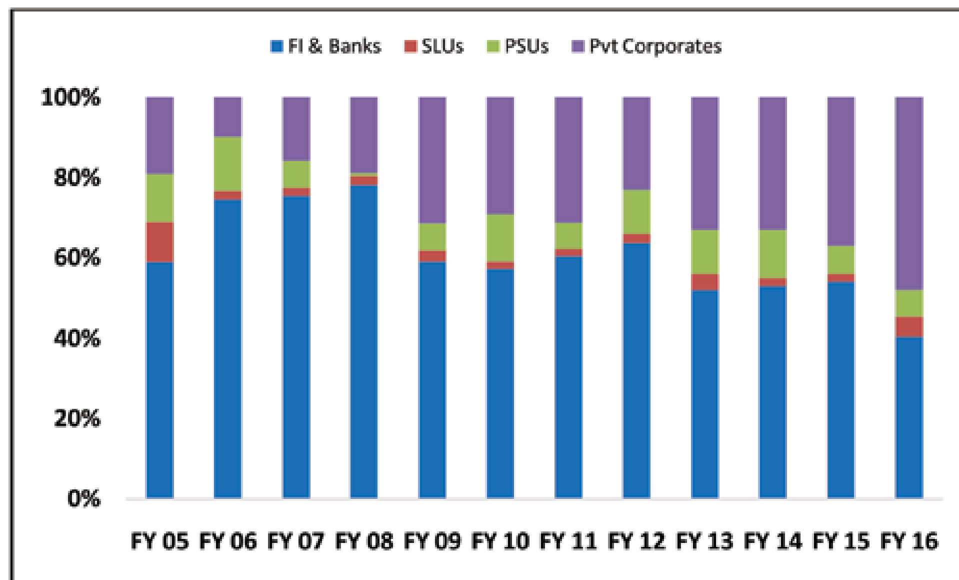
- Investors in the corporate bond instruments are excessively credit safety conscious. Practically the demand for issuers rated A+ or below is hardly witnessed.
- Regulatory restrictions: Retiral Funds and Insurance companies are amongst the largest investors in the bonds. However, they are constrained by their respective regulators. PF & Retiral funds can invest only in AA or above debt instruments (unless backed by CDS). Insurance companies, as per IRDA norms, 75% of the corpus needs to be invested in AAA rated bonds. Second, the insurance companies cannot invest in corporate bonds below AA (unless approved by the Board).



3. **Majority of the issuances are concentrated in the shorter maturity, say 2-5 years tenor.**

- Liquidity in the secondary market is mostly concentrated around AAA and AA+, that too of the regular issuers. Hence, the incentive to hold a longer tenor comparatively illiquid paper is limited by major investor segments like MF, FII, Banks, etc. Investors don't find exit for high duration papers. Hence, they prefer to invest in shorter tenor and roll it over if the interest rate scenarios are favorable.

4. The issuances are dominated by financial institutions & Banks, PSUs and SLUs.



5. Private placements constitute more than 90% of the total issuance, clearly indicating a low participation of retail investors.

- In regard to equity funding, corporate entities invariably prefer the public issue route and have been servicing retail investors even when their numbers are very large. But when it come debt finance the same corporates have shied away from the hassles of servicing large number of investors as they find it highly convenient to meet their requirements of debt finance by relying on a limited number of lenders that provide both short term as well long term funds. A few reasons would be as under:
  1. Faster turnaround time due to Lesser disclosures and regulatory requirements,
  2. Lower costs. Additional costs are involved in public issue in the form of marketing & printing expenses, distribution cost, etc. As a ball park figure, public issuance entails about 1-2% additional cost.
  3. Few of the corporate actions require approval from the majority debenture holders (say 51%). The process cumbersome and time taking in case of publicly placed bonds.
  4. Lower operational hassle in private placements, namely: record keeping, servicing of dues, etc.

6. Lack of committed market makers

- Due to illiquidity in the Corporate bond market, most of the investors are buy and hold type (i.e. insurance and Retiral Funds). Others like MF and Bank treasuries mostly invest in tenor up to 5 years that too in instruments issued by the most frequent issuers. So a liquidity-provider is needed in the market who can give two-way quotes. Merchant Bankers (on similar lines Primary Dealers) should be given the status of market maker by relaxing their capital requirement norms.

7. Almost nil activity in Repo in Corporate Bond

- Interest rate in the Corporate Bond repo market is determined over-the-counter, where the mechanism discovery of prices is not efficient. Hence, participants prefer SLR repos.
- Second, absence of centralized clearing agency like the Clearing Corporation of India (CCIL) has hindered activities.
- Also, the deal has to entered and settled manually, which is cumbersome & time consuming.

8. Lack of credit default protection mechanism – CDS is still a non-starter

- Corporate bonds contain both (i) credit risk and (ii) interest rate risk. With a well-developed and widespread derivatives market, both these risks can be hedged effectively thereby increasing secondary market trading prospects of these papers. The major obstacle is netting of these derivatives contracts.

Recent steps taken by the regulators

1. A portion of large borrowings through debt market

- RBI has laid down that a corporate having bank borrowings above INR 25,000 as on 31stMarch 2017 (This limit will progressively reduce to INR 15,000 crore starting FY19 and INR 10,000 crore from the start of FY20), can raise 50% of its incremental borrowing from banks and the remaining has to be raised through the debt market.

2. Introduction of electronic bidding platform

- In order to streamline procedures for issuance of debt securities on private placement basis and enhance transparency to discover prices, SEBI has mandated that all issuances above INR 500 Cr in a year has to be compulsorily bidded through the electronic bidding platform of the exchanges.

3. Reissuance

- SEBI shall issue guidelines wherein it will allow Companies to reissue bonds and also would restrict the number of ISINs.

4. Partial Credit Enhancement

- In order to boost infrastructure / project financing needs, RBI has allowed banks to offer partial credit enhancement (PCE) to project companies (rated BBB or above) in the form of a non-funded irrevocable contingent line of credit upto 50% (20% cap on an individual bank) of the bond issue size. The PCE would help multiple notches rating upgrade of the Issuer, which would not only enable lower interest rates but also wider the investor base.

5. FPI investments

- FPIs are now allowed to invest in (1) Unlisted bonds of infra companies only (2) Pass Through Certificates (PTCs)

6. Investments by Insurance Companies in Basel III compliant Perpetual Bonds

- Based on certain criteria fulfilled by Banks, the Insurance Regulatory and Development Authority of India (IRDAI) has allowed insurance companies to invest in Additional Tier 1 (Basel III compliant) perpetual bonds. The investment criteria includes (1) the rating of the AT1 bonds should not be less than 'AA' (2) the aggregate value of the AT1 bonds held in any particular bank by an Insurance company cannot exceed 10 per cent of the total outstanding AT1 bonds at any time (3) banks that have declared dividends for preceding two years.

7. Masala bonds

- Masala Bonds: Regulators have allowed the companies and banks to issue offshore INR denominated bonds, opening a new avenue for fund raising. This doesn't entail any form of currency risk to the Issuer.

What can be done?

The Khan Committee report released in August 2016 listed a few recommendations to further strengthen and develop the corporate bond market covering the supply side and demand side issues as well as the secondary market features like instruments, market infrastructure, liquidity etc. We would like to highlight the following areas which are required to aid the development of the debt market.

1. Improve participation of retail investors:

Majority of retail investments park their money in fixed deposits of Banks. General retail investors are risk averse and perceive Banks to be safe entities. Retail investors may be given tax benefits on their investments. The capital gains tax on bonds may be aligned in line with equity, i.e. short term can be taxed (equity is taxed at 15%), while long term can be exempted.

2. Participation of FIIs in longer tenors may be improved:

Currently they prefer to invest in AAA rated securities mostly in 3-5 year segment. To develop the long term financing needs of the Corporates, especially low rated, FIIs need to be enticed. Withholding tax on long term investments (>=5 years) by FIIs (especially by SWF and Retiral Funds) may be relaxed; 3% for AA+ & above and full waiver for AA and below rated securities.

3. Relaxation in Regulations:

Insurance: IRDA allows insurance cos to invest in debt only upto 10% of (net worth plus outstanding debentures) of the investee company. Outstanding Loans may be allowed to be added along with net worth and debentures. IRDA currently requires insurance cos to invest in central and state govt securities: 50% of total investments for life insurers and 30% for general insurers, which may be reduced to 40% and 25% respectively.

Retiral Funds: Below AA rated bonds may be allowed without CDS (For sectors like Infrastructure)

4. Market Making:

Due to illiquidity in the Corporate bond market, only buy and hold type investors (i.e. insurance and Retiral Funds) invest in long term tenor, others like MF and Bank treasuries mostly invest in tenor up to 5 years. So a liquidity-provider is needed in the market who can give two-way quotes. The Merchant Bankers may be made market makers (like Primary Dealers) and capital relaxation may be given for the market making portion. E.g. currently AAA attracts a 20% risk weight, may be waived/reduced.

5. Prepare a centralized database:

A centralized database for Corporate bonds (including but not limited to issue information, financial information, promoter information, etc.) – both primary and secondary transactions should be created. It would act as guidance for the Issuers and investors and improve transparency in the market, which eventually can lead to deepening of the market.

6. Indices and Yield Curves:

Unlike G-sec, there is no corporate bond yield curve and hence it is difficult to price papers rate AA or below. Although FIMMDA publishes the credit spread for each rating class and issuer class, there is no study to test these spreads in market. There are many different types of corporates/institutions in the same rating grade.

Single or multiple indices can be created and bonds of similar maturity or rating can be grouped together to allow investors to gauge the performance of bonds.

FBIL (Financial Benchmark India Pvt. Ltd.) may publish:

1. Yield curves for corporate bonds in each rating grades for uniform valuation.

2. Bond indices which can be used as benchmark (e.g. SENSEX for equity)

7. Development of corporate bond repo market

Repo in corporate bonds will resolve the short term funding issues for the investors. Currently market repo in Gsec takes place on the CROMS platform. Absence of electronic platform is a major issue. NSE is working on building an electronic platform for repo trades with corporate bonds. We have seen only a few corporate bond repo deals till date. The regulator (RBI itself) is contemplating to allow market participants to do corporate bond repo transactions with RBI. However, to implement this suitable amendment in the RBI Act is required.

Conclusion

Even with repeated discussions, committees, forums and initiatives from the govt and regulators, the development of India's corporate bond market has been lagging behind other developed as well as other emerging economies. The domestic corporate debt market suffers from deficiencies in products, participants and institutional framework.

The biggest issue of crowding of debt markets by government securities cannot be addressed by market participants and regulators alone. Fiscal prudence in terms of management of public debt and cash could result in a reduction in the debt requirements of the government, which in turn would provide more market space and improve demand for corporate debt securities.

Lot of awareness is required for the development for corporate bonds as it is likely to be a gradual process as experienced in other countries. It is important to understand whether the regulators have sufficient willingness to shift away from a loan-driven bank-dependent economy and also whether the corporates themselves have strong incentives to help develop a deep bond market. Banks will play a major role in shaping up the debt market as they provide over 50% of the funding needs of corporates today mainly through loans. Only a conjunction of the market players, regulators and corporates can pave the way for the systematic development of a well-functioning corporate debt market in India.

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Taking the Indian Bond Market to the Next Level

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The corporate debt market provides a source of long term finance for companies who often have large investment capital requirements. It serves as an effective tool for creating and sustaining investment, essential for infrastructure development. The corporate bond market can serve financial needs, and promote diversification in allocation of funds in the economy to the most productive uses. Corporate bonds have gained importance in the recent years; particularly as bank lending has been reduceddue to the prevalence of stressed assets on their books.Mounting NPAs and increased capital requirements under Basel III have forced banks to tighten lending to corporates in the aftermath of the global economic slowdownof the last few years.

Benefits of having a vibrant corporate bond market

Given all this, there is a strong need for a well-developed corporate bond market.There are numerous other ways in which a vibrant corporate bond market aids the economy:

- **More avenues of finance -** Cheaper and easier financing to corporates will lead to an increase in efficiency in production and output, and thereby aid economic growth. If economic growth has to be accelerated, massive infrastructure development by the government has to happen. These investments will be long-term in nature, involve huge capex and risks, and are difficult for banks to finance. A well- developed corporate bond market hence becomes indispensable.
- **Lower stress on PSUs -** Giving the private sector regular and fair access to the bond market can ease the pressure on public funding. And as the corporates grow, it will lead to employment generation, which would enhance the working middle class and help reduce the wealth gap.
- **Transparency -** A vibrant corporate bond market ensures that funds flow towards productive investments and market forces exert competitive pressure on lending to the private sector. Information demanded by investors encourages corporates raising funds in the bond market to maintain high standards of transparency and corporate governance. This in turn, improves management and efficiency of the corporates.
- **Insulating the economy -** Corporate bond market facilitates cheaper rates compared with bank loans at least for less creditworthy borrowers. Raising funds from offshore sources and dealing in foreign currency

is vulnerable to abrupt changes in offshore interest rates and at times has led to reduction in the profits of corporates. Lowering the level of borrowing from foreign markets would minimize external shocks that are passed to the domestic market

Not only do corporates benefit from the bond market, investors in the bond market too have many advantages such as:

- **Stable income -** Investors get a stable and secure form of investment with regular income from the corporate bond market. Bonds offer potentially higher returns than banks, predictable investment income and assist in efficient investment of savings. Issuers of bonds are mandated to provide much detailed information and hence risk assessment becomes relatively easier.
- **Reduction in ALM -** Since periodic payments in case of corporate bonds is committed, investors would prefer to invest in debt market than equity market provided it is developed and vibrant. Commercial banks have traditionally been lending to the corporates but in cases when a large loan amount has to be sanctioned for longer tenure, especially in case of financing long-term infrastructure projects the risk of asset liability mismatch for banks increases. Since the liability of commercial banks consists of deposits accepted from the public, which are of shorter tenure, it becomes difficult for the banks to maintain huge amount of long term assets in the form of long-term infrastructure loans. Corporate bonds can help reduce the asset liability mismatch as an alternative financial instrument to bank deposits.
- **Liquidity -** The number of corporate bonds in the market facilitates diversification in maturity, credit quality, rate of return, etc. A more liquid and accessible bond market across sectors, maturities and ratings would create investment opportunities for domestic institutional investors. This will in turn encourage foreign investors to invest in the Indian bond market. The bond market serves to bring investors and borrowers together and maximize the benefits for both, thereby achieving economic goals.

The Indian Bond market in its current avatar

India is one of the fastest growing economies and counted amongst the top equity markets globally, yet its bond market remains relatively underdeveloped. There are various types of bonds in the Indian market. These include government bonds (G-Secs, issued by Government of India), borrowings by state governments (state development loans or SDLs), bonds issued by banks and other financial institutions, tax-saving bonds issued by Government of India, tax-saving infrastructure bonds issued by infrastructure companies approved by the government and corporate bonds. The bond market here is characterized by the dominance of the government securities market. This segment has been growing on a sustained basis and has been registering high investor participation. The corporate bond market on the other hand has been more or less stagnant in the last decade.A closer look at our Asian peersand the developed markets suggests that the corporate bond market in India still comprises of the very small share in the total debt of India. In comparison to India where corporate bonds are around 14% of the GDP, the outstanding amount of corporate bonds is around 21% of GDP in China, 115% in the US, and 110% in the UK.

There are several reasons why corporates in India prefer banks for their financing needs:

- Investors in India are averse to investing in sub-investment grade corporates and such corporates in turn seldom have alternative established routes for credit rating enhancement. This limits the availability of bonds compared with other developed markets.
- India's bond market has not been a preferred investment avenue for FIIs which invest heavily in the equity market. There is insufficient demand from foreign investors and that does not help in liquidity in the bond market.
- There is also a lack of committed primary dealers in India who act as market makers. Market makers could provide the much needed support and exit options to investors. The secondary market of government debt has very thin liquidity. Absence of a liquid corporate bond market acts as a key deterrent for investors to participate.
- In addition to these, factors such as lack of hedging instruments, improper pricing, and unfavorable transaction costs have impeded the growth of the bond market.

How can we take the Indian Bond market to the next level?

Recently many bond issuers have been tapping the market since the past few years. They have also taken some key steps in deepening the bond market and their pursuit in this direction will continue in the right earnest. There is a necessity to take a number of steps to develop the corporate bond market further. Some of them are enumerated below:

- **Widening the investor base -** Policy makers should facilitate creation of investment policies of key market participants by permitting them to take higher exposure to corporate bonds across the rating spectrum. For instance, provident and pension funds, which manage some of the largest corpuses in India, have caps on investments into corporate bonds and that too only in public issuers rated AA and above. In comparison, in developed pension markets, regulators do not impose any investment limits. Even in emerging pension markets, limits have been relaxed. Countries such as Australia, Canada, Korea, Germany and Japan impose no limits for investment in bonds. In countries such as the US, limits are prescribed only for bonds issued by employers.
- **Credit enhancement -** There is a crying need for facilitating of an effective credit enhancement mechanism by creating innovative instruments such as partial guarantees, securitization of annuity on roads, securitization of receivables by municipal corporations etc. This will also allow issuers/ projects with moderate creditworthiness to access the corporate bond market, and also meet investor need for higher credit quality. The existing partial guarantee mechanism permitted for banks since 2015 needs to be revised so that it can be effective. The CDS market is virtually non-existent today, although investments in corporate bonds could be protected by hedging through CDS.
- **Taxation as a catalyst -** An important influencer of investor decision is taxation.Favorable tax regulations often positively impact the development of financial markets in an economy. Compared with equity products, debt products are currently less tax-efficient. Tax incentives have, in the past, helped channel savings to financial assets such as insurance, retirement products, equity-linked savings schemes and

infrastructure bonds. Globally, tax sops have been a successful medium to wean away wealth from unproductive assets andincentivizemovement to investment products. For instance, in the US, the introduction of pre-tax, defined-contribution 401(k) retirement plans in 1978 propelled growth in the mutual fund industry and, consequently, its capital markets. Corporate bonds and debentures could be brought on level grounds with equity as far as tax on long term capital gains is concerned. A tax sop for small investorshelps allocate a part of their savings to tax efficient products and also has a positive psychological impact as investors see it as a benefit extended by the government.

- **Increased participation -** The market needs more participants, both borrowers and lenders. Only then will there be availability of tradable paper. Borrowers should be raising money for long term purposes to reduce the burden of asset liability mis-matches that banks face. Involvement of retail investors is essential as has been the case in the equity markets. Of late the participation of retail segment has increased but it is only a fraction of what exists in the equity market. This can increase once there is more paper in the market and there is more investor education. Market makers assume a lot of risk in the bond market and need to be backed up, both in terms of financial resources and the supply of securities. In addition to bringing in liquidity to the papers, they could also play a significant role in educating the investors.

- **Digitization -** Post demonetization, India has woken to a new reality which is that of digitization. It is not just an option but an inevitable part of our daily lives now. The corporate bond market needs to adopt technology to make its products more accessible to all classes of investors. Regulation in the mutual fund industry has made products accessible to the last mile through direct digital channels and has propelled participation from remote areas. Similarly the efforts of the central bank regarding Electronic Book Mechanism (EBM) should be extended to all types of bond issuance so that there is greater transparency and accessibility of bonds.

- **Uniform valuation -** The HR Khan Committee report emphasized on the need for uniform valuation practices across industry. Across financial markets in India, rules need to be similar for valuation of assets, especially corporate bonds. Valuation norms for held to maturity, held for trading, mark to market and available for sale portfolios needs to be uniform across institutions irrespective of the sector they are in.This will lead to uniformity in the prices used for reporting and the actual realizable value of the asset and enable an efficient price discovery.

- **Development of secondary market -** The link between the primary and secondary bond market can hardly be ignored. When investors find options of profit booking and exiting through the secondary market, interest and participation in the primary market increases. Due to the limited availability of tradable paper in the market and also somewhere due to the tendency of the investors to hold the papers to maturity, trading in the secondary market is restricted. To overcome this problem, investors could be offered tax incentives as is offered on sale of equity in terms of capital gains.

- **Product Innovation -** Returns on fixed-income products tend to be stable compared with other risky asset classes, such as equity. It is equally important for key bond market participants such as mutual funds to develop new products linked to corporate bonds. For instance fixed income ETFs can be popularized as

they have emerged as a preferred vehicle for investment globally.ETFs have inherent advantages like low cost, tax efficient, higher transparency, high liquidity and low ticket size.For those who aspire to get higher returns from their investments, structured products such as market-linked debentures that provide dual benefits of capital protection along with an option to participate in equities could be thought of. Such product innovations are likely to meet varied investor needs and increase investor participation.

- **Dispute resolution -** A strong and stable legal and regulatory framework and simplified process to settle financial disputes, is indispensable for the growth of the corporate bond market. The current legal structures need to be strengthened to reduce delays and high costs involved in legal procedures relating to enforcement of debt contracts and corporate insolvency. Also having a quick and efficient recourse to liquidation in case of a default on a debt instrument can be important in risk mitigation for the investors. A landmark step in enabling this has been the introduction of the new bankruptcy code. Once implemented fully, it is expected to help all the stake holders.

- **Enhancing education& distribution -** Investor awareness is one of the most critical areas to manage. Educating investors about the benefits and risks associated with investment in debt, through direct or indirect channels, requires sustained efforts from policymakers and market participants. Intermediaries need to be provided support in the form of training and development so that a new class of intermediaries specializing in bond advisory should evolve. The existing intermediaries should also be encouraged to look at bonds as an additional source of revenue and an alternative to fixed deposits. This may help bonds emerge as a new asset class.

Infrastructure Finance and Assets Finance companies such as Srei Infrastructure Finance and Srei Equipment Finance have been playing a pivotal role in building the economy. We believe that for the Indian economy and subsequently its citizens to prosper, investments in infrastructure are needed. With the increase in financing requirements in the infrastructure sector and the limitations of the banking sector to single handedly finance such needs, the corporate bond market plays a vital role. Infrastructure Finance Companies (IFCs) who are Public Finance Institutions (PFIs) should be allowed to again issue tax – free bonds to raise resources from public. Pension Funds, Provident funds, ESI Funds and insurance companies should be mandated to invest 5% of their corpus in “A” and above rated bonds of IFC-PFIs. Banks should invest upto 5% of their liabilities in bonds of IFC-PFIs and such exposure must be treated as priority sector lending in books of banks. The corporate bond market in India is at the cusp of a transformation and it will be a decisive factor in building a better tomorrow for India.

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The Indian Corporate Bond – A Case of Curate's Egg?

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Little would have George De Maurier imagined that his cartoon in 1895 published in the British humour magazine "Punch", describing an interaction between a bishop and curate, would add to the English vocabulary the phrase "Curate's egg": implying something which suffers a mix of both good and bad.

The Indian (local currency) corporate bond market, despite the recent buoyancy, continues to be a case of "curate's egg": good in parts.

Here I would try to capture opinion based on a practitioners' insight into the local currency corporate bond market (hence forth, corporate bond market).

Introduction

A vibrant and well developed corporate bond market is essential for a sound financial market: it complements the banking sector by offering alternative finance. It offers financial assets for the institutional investors, helping them in their asset liability management and also acts as a risk mitigant by way of diversification of risks.

The need and urgency to create a well developed bond market was always on a high priority list for all the stakeholders. There have been number of reports on the development of corporate bond markets: From the R.H. Patil report in 2005 to the H.R. Committee Report in 2016; all the committees have had a detailed look into the development of the bond market and have made several recommendations; many of which have also been implemented.

Till some time back, the bond market was behaving almost like the adolescent child: refusing to grow into the teenage. Compared to a more liquid gilt market, the corporate bond market attracted criticism about the lack of development. And despite all such insinuations and skepticism, the bond market was moving forward slowly, with small mini steps.

The Present: An Auroral Glow

In the last three years, the corporate bond markets have seen strong growth in primary market issuances. I present a small table to illustrate the growth in primary issuances:

	NI (GoI)	NI(SDL)	NI(CB)	Bank Credit	CB to GoI	CB to Bank Credit
2012-13	5012	1467	2385	6486	51%	37%
2013-14	4927	1680	1772	7336	39%	24%
2014-15	4663	2160	2829	5423	64%	52%
2015-16	4050	3663	2690	6079	67%	44%
2016-17	3163	4507	3856	3717*	111%	104%

Source: CCIL, SEBI
** till second last fortnight of FY17*

NI-Net issuance, SDL-State Development Loans, CB-Corporate Bonds

The table offers some interesting insights into the primary issuance market:

- On a net issued basis, the corporate bond has seen a steady rise in issuance vis a vis the Government of India (GoI) securities and during the previous financial year there have been more issuances of corporate bond than GoI securities!
- Similarly,it has served as a perfect complement to the banking industry as a source of finance steadily increasing its share vis a vis the banking credit

This growth in the primary market issuances must be celebrated! Yet I, as a market practitioner cannot help but ask a simple question: Is the growth durable?

Is such growth durable?

In order to answer the question, we need to ask a related question "Why did the markets grow in the last three years?"

I seek to answer the question by trying to present an often ignored aspect: the demand side equation of corporate bonds and through it, the possible "why" behind the growth of primary issuance.

I present the demand side equation by presenting the mutual fund's investment in corporate bond:

Year (INRBn)	Net Issuance (NI)				
	Central Govt.	SDLs	Corporate Bond		
			NI	% with MFs of NI	% with MFs of o/s
2016-17	3163	4507	3856	55%	23%
2015-16	4050	3663	2690	31%	17%
2014-15	4663	2160	2829	29%	15%
2013-14	4927	1680	1772	33%	12%
2012-13	5012	1467	2385	15%	9%

Source: CCIL, SEBI

a) Establishment of risk appetite:

I believe that the investors in debt mutual funds have understood the risk associated with investments in debt oriented mutual funds: Having seen losses in liquid funds in July 2013 to some credit events affecting debt mutual funds it is now well understood that there exists volatility in investments in the quaint debt mutual funds too!

b) Establishment of patience capital:

The Finance Act of 2014-2015 moved the time period of long term capital gain in debt mutual fund from one year to three years. With this move, many investors tended to stay for the three year period to avail the capital gains benefit and thus it established an investor "patience capital"

c) The market forces:

The last three years for the corporate bond markets has been helped by the following favorable market forces

i) Fall in interest rates
ii) Benign Liquidity conditions
iii) A Move away from hard assets to financial assets

The corporate bond primary issuance has had a great run in the past three years and complementing this was a strong growth in mutual funds. And I believe if Cinderella (the corporate bond market) has to meet her Prince (a stage of developed phase), she has to lose her shoe! For me the "shoe" represents a potential adversarial opposing market force: represented by tighter liquidity conditions as well as a rising interest rate cycle. I believe the test of durability of the primary market issuance lies in showing strength in an unfavorable market condition; the markets have still to complete a full cycle to establish that the bond markets have come of age.

Beneath the Shine (the other side of the curate's egg)

The phenomenal growth in the primary market too has its darker shades and I attempt to present some of them:

a) Rise in issuances of SDL: State governments have also moved in a big way in issuing marketable securities. This has the potential of crowding out the corporate bonds as an investment avenue with the associated potential of non compression of spreads vis a vis the sovereign yields

b) Bias towards highly rated securities still continues with entities forming AA and above still constituting a sizeable portion of the primary issuances

c) The secondary market volumes as a percentage of outstanding have not picked up: this shows the bias towards buy and hold approach.

Year	Corporate Bonds o/s	Volume (crs.)	Volume/ Outstanding corp
March-12	1051639	591979	56.3%
March-13	1290147	736347	57.1%
March-14	1467397	972156	66.3%
March-15	1750320	1013504	57.9%
March-16	2019296	905333	44.8%
March-17	2404911	1124988	46.8%
Source: CCIL; SEBI			

d) Private placements continue to dominate the primary issuance market

e) The lack of credit insurance acts as deterrence for participation in lower rated credit papers

Suggestion Box

While various committee reports have recommended changes in the present corporate bond market mechanism, there exists scope for some small changes for a healthy market:

The Retail Market

a) A standardized approach to information about the corporate bond structure

b) Bond pricing is a derived number with linkages to the bond's coupon, tenor and discounting rates. An investor is presumed to have bond mathematics skill. All trading platforms should facilitate a price determination system for ease of investors

The Institutional Market

a) Corporate bonds should be allowed (with appropriate haircuts) as a collateral as a security against borrowing under Collateralized Lending and Borrowing Obligation (CBLO) platform

b) Regulators should have a relook at the investment mandates of various institutional investors, largely the long term investors, like provident funds and superannuation funds

The Way Forward

While I have listed down some of the darker sides of the corporate bond market (and there are many more like asymmetric information, events of default etc.), I remain optimistic. Although some of issues may be structural and will take time to resolve, I remain hopeful of a fairly robust corporate bond market. My hope rests on the following:

a) Rise of preference for financial products, mostly mutual funds, as a vehicle for planning the life cycle requirements amongst individuals. While the challenges for individuals in investing in retail corporate

bonds may continue (blame the bond mathematics sometimes!), the indirect approach of investing in mutual funds may gain traction as an asset allocation/life cycle requirement approach.

b) Individuals with different risk appetite and liquidity needs can invest in mutual funds thus corresponding investments in assets can be created thereby helping in the development of the term structure of yield curve

c) Technology has the potential to solve the last mile challenge of investments in financial products and with better financial literacy and media coverage, I do expect the young millennia population participating in retail corporate bonds thereby developing a healthy public issuance market for corporate

d) Regulatory intervention on dependency on bank borrowing may gradually decrease thereby adding more teeth to the corporate bond market

e) The Bankruptcy code and a timely resolution process have the potential to be one of the biggest game changer for the corporate bond market. Cross country empirical evidence has shown strong linkages to the growth in bond market to a strong bankruptcy resolution process

A developed corporate bond market is a holy grail that the financial markets seek. The journey thus far has been painful yet gradually it has inched forwards towards making it much more robust than in the past. As a stakeholder we must all work together to contribute to the development of this market.

A battle has been won, not the war.

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InvITs – Providing the Boost to India's Infra Needs

Swapna Bhandarkar
Head of Corporate Communications
ICICI Securities Ltd.

Introduction to InvITs

Infrastructure Investment Trust or InvIT as a financial instrument is designed to monetize long term infra assets with adequate protections to safeguard investor interest. Infrastructure Investment Trusts (InvITs) are institutions similar to mutual funds that enable investments into the infrastructure sector by pooling money from individual/Institutional investors for directly investing in infrastructure so as to return at least 90% of the income (after deducting expenditures) to unit holders of InvITs.

InvITs provide a high yield financial instrument with strong credit rating:

As per current regulations, a public InvIT has to invest at least 80% of the value of its assets in completed infrastructure projects with a further cap of 10% for under construction projects. This is to shield investors from construction risk and protect their investment from getting stuck in stranded projects which in turn allows investment grade rating for the instrument. Benefits from InvITs to investors are:

a) Diversification tool as it taps India's long term potential for the long term investor.

b) Direct exposure to stable infra assets.

c) Provides 8.5-9% post-tax annuity like returns with upside potential for the individual investor in a low interest rate environment.

d) High credit ratings ensure risk averse funds can invest in high yielding assets – Both, the IRB InvIT and Indigrid InvIT received AAA ratings (IRB by CARE ratings and India Ratings, Indigrid by Crisil, India ratings and ICRA).

e) 90% of net distributable cash flows have to be returned to the investors in the form of half yearly dividends, thereby introducing a high dividend yield instrument in a market starved of such instruments.

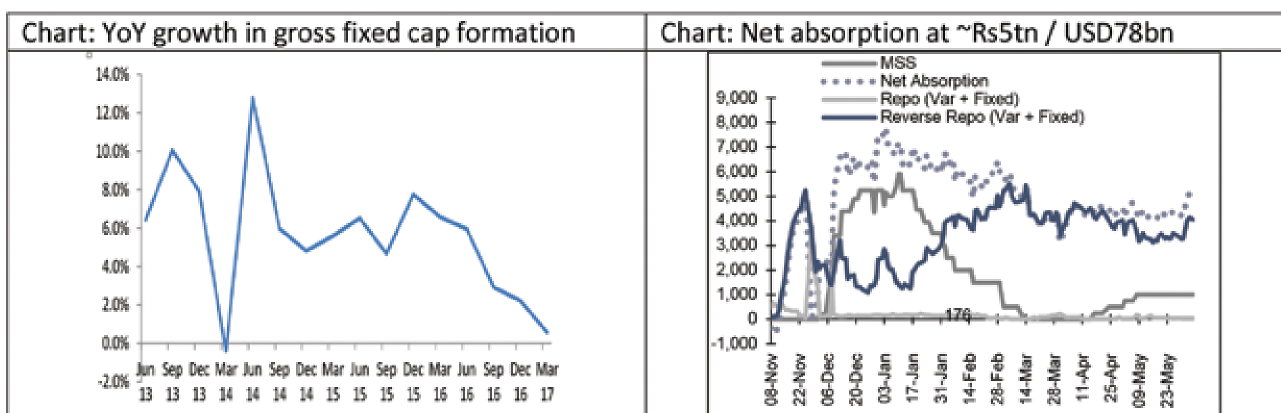
Importance of InvITs in the current economic context

India's Twin balance sheet (TBS) problem and its negative impact on private investment is a pressing issue policymakers are facing currently. In a bid to revive the slow-down in the capex cycle and crowd-in private

investments, the NDA government has been focussing on infrastructure development through higher budgetary allocations but is limited by financial constraints. Also, the RBI has been highlighting the risk exposures banks have to particular sectors such as infrastructure. In the following sections we discuss how InvITs appear as a clear solution in the context of the above issues.

a. **Freeing up cash flows for leveraged corporate balance sheets:** Corporate side of the TBS story revolves around overleveraged balance sheets and legacy stuck projects which have crippled the ability of the private sector to take up new infrastructure projects. By un-locking tied up capital of developers (INR 130bn through InvITs in FY18 as per India Ratings) and supporting financing/refinancing of infrastructure projects by attracting lower cost foreign and domestic public capital, InvITs can immediately strengthen corporate balance sheets involved in infrastructure development.

b. **InvITs to augment government effort towards improving infrastructure by mobilizing surplus liquidity:** The NDA government has been focused on improving the budget allocation towards developing transportation infrastructure (roads, rail etc.), transmission & distribution infrastructure in power sector, urban infrastructure etc. Given the limited financial resources at the government's disposal it is imperative to find alternate sources of funding long gestation projects in the infrastructure sector. Also, given at least part of the surplus liquidity in the system (net absorption by RBI as on 5 June stood at ~INR 5tn) is here to stay, the money must be directed towards new longer term assets. In the above contexts, government is exploring options such as developing municipal bond market for improving urban infrastructure, REITs, along with InvITs. InvITs will help in augmenting government's initiative of reviving the capex cycle by mobilizing funds from the public and institutional investors, both domestic and foreign.



Government and regulatory institutions keen on supporting the initiative

The government and the RBI have shown significant interest and support to InvITs, as evidenced by actions such as:

i) SEBI: Regulations that permit prudent investment by Indian Mutual Funds, Pension Funds and Insurance Funds into InvITs have been announced to enable participation by Domestic Institutional Investors.

ii) RBI made an initial announcement on enabling banks to invest in InvITs on 6 April 2017 and followed it up with detailed guidelines for banks on 18 April 2017.

Experience of the first InvIT success will encourage more launches

ICICI Securities completed the process for IRB InvIT, which was the first ever InvIT of toll road assets in India and the largest offering in the infrastructure space in last 5 years. The issue received a stellar response and was subscribed 8.57x times on an overall basis. Key facts about the issue:

i) IRB InvIT is composed of six toll-road assets, aggregating 3,645 lane kilometers of highways located across the states of Maharashtra, Gujarat, Rajasthan, Karnataka and Tamil Nadu, all of which are operated and maintained pursuant to concessions granted by the NHAI.

ii) IRB retained 15% in the InvIT which is the regulatory minimum to be held by the sponsor, ensuring it gains from the cash flows and potential upside in the InvIT units' price.

iii) Provided a monetization opportunity of ~INR 17bn to IRB Group through repayment of sub debt given to 6 SPVs and sale of trust units.

iv) Offloading of INR 33bn external debt from balance sheet will lead to reduction of consolidated debt for IRB from INR 150bn as of March 2016 to INR 117bn – thereby reducing the leverage to 1.8x from 3x, which could lead to improvement of credit profile, thus enabling lower cost for new debt raise.

v) Cash infusion of INR 17bn would help fund equity requirement for the current greenfield portfolio of projects and prepare a war chest for future projects.

In the pipeline

After IRB InvIT (~INR 50bn) and India Grid InvIT (~INR 22.5bn), two more InvITs are in line for listing in FY18, from Reliance Infrastructure Limited (~INR 25bn) and IL&FS Transportations Networks Limited (~INR 18bn), thus mobilizing close to INR 120bn in these 4 InvITs alone.

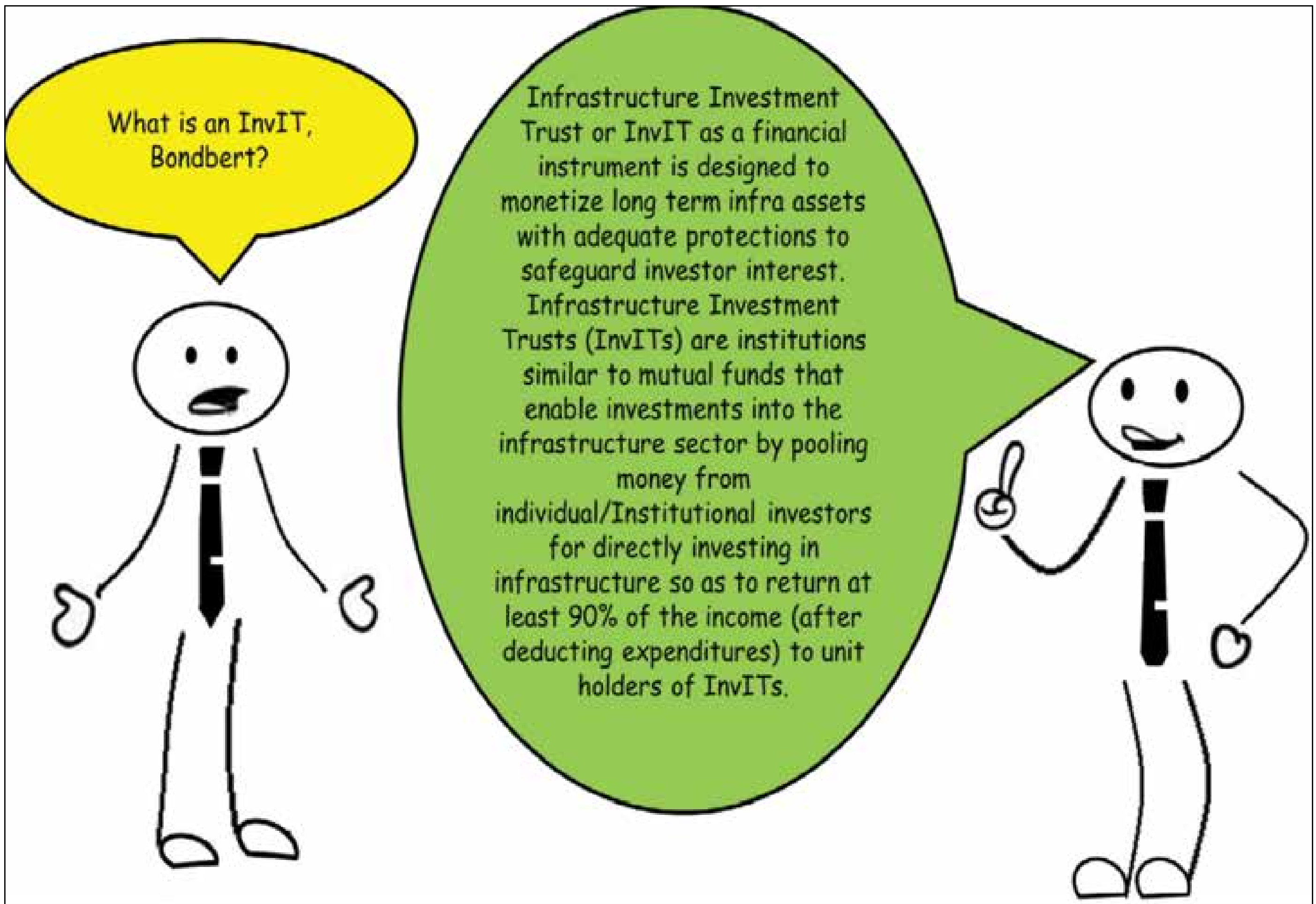
Outlook – InvIT is a new alternative for investors with long term prospects

Successful launch of the first road assets InvIT in India will inspire more players to leverage the opportunity for monetizing infra assets and freeing capital for funding future growth in the infrastructure sector. To get a sense of the opportunity just in the road sector, the state and national highways together constitute 2.28 lakh kilometers in length and carry 80% of the traffic. Of the national highways of around 1 lakh kilometers, 50 thousand kilometers under the NHDP program earned USD1bn in FY16 (as per India Brand Equity Foundation). As yields from traditional fixed income instruments decline, investors will be attracted towards investment vehicles which have stable cash flow generating underlying assets and provide IRR in the range of 11-12%. Investors bullish on India's economic potential could also be eyeing potential upsides apart from the stable yields over the longer term depending on the attractiveness of the underlying asset.

To summarize, InvITs will act as a long term financing vehicle for long gestation projects while acting as an effective tool in solving the immediate issue of over leveraged balance sheets in the infrastructure space.

Table: List of Sectors eligible for InvITs according to Ministry of Finance

Sector	Sub sector
Transport	• Roads and bridges • Ports • Inland waterways • Airports • Railway tracks, tunnels, viaducts and bridges • Urban public transport (except rolling stock in the case of urban road transport)
Energy	• Electricity generation • Electricity transmission • Electricity distribution • Oil pipelines • Oil, gas and liquefied natural gas (LNG) storage facility • Gas pipelines
Water Sanitation	• Solid waste management • Water supply pipelines • Water treatment plants • Sewage collection, treatment and disposal system • Irrigation (dams, channels, embankments, etc.) • Storm water drainage system • Slurry pipelines
Communication	• Telecommunications (fixed network) • Telecommunications towers • Telecommunications and telecom services
Social and commercial infrastructure	• Education institutions (capital stock) • Hospitals (capital stock) • Three-star or higher category classified hotels located outside cities with a population of more than 1 million • Common infrastructure for industrial parks, special economic zones, tourism • Facilities and agriculture markets • Fertiliser (capital investment) • Post-harvest storage infrastructure for agricultural and horticultural produce, including cold storage • Terminal markets • Soil-testing laboratories • Cold chain • Hotels with project cost of more than Rs200 crore (for each) in any place in India and with any star rating • Convention centres with project cost of more than Rs300 crore on each


What is an InvIT, Bondbert?
Infrastructure Investment Trust or InvIT as a financial instrument is designed to monetize long term infra assets with adequate protections to safeguard investor interest. Infrastructure Investment Trusts (InvITs) are institutions similar to mutual funds that enable investments into the infrastructure sector by pooling money from individual/Institutional investors for directly investing in infrastructure so as to return at least 90% of the income (after deducting expenditures) to unit holders of InvITs.

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Missing Links in India's Corporate Bond Market – Role of Bond Pricing Bureaus

Mrugank Paranjape
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Multi Commodity Exchange of India (MCX) Ltd.

With gross NPAs estimated to be about 8.5 per cent of bank loans in March 2017, as per stress tests conducted by the Reserve Bank of India, the banks are under the clear mandate from the policy makers to clean their balance sheets off the toxic assets or to put in extra capital to account for risks. The question that arises is why the entire system did not have prior information or indications that the portfolio that has currently been identified as NPAs could not be forewarned. Despite the fact that a major portion of the current NPA counts are advances to large businesses and banks have dedicated relationship teams to be kept informed of the health of these businesses to take up suitable advance action, 'the wisdom of a few' could not work. If the 'wisdom of a few' could not work, can the 'collective wisdom of the market' work to put all such businesses on an 'Intensive Care' mode as the businesses with credit exposures start showing the initial symptoms? Experience of the developed markets in 'Corporate Bonds' tells us that risk of failure of repayment can very well be taken up by those with risk appetite and accordingly price the same. Well developed 'Junk Bonds' is a clear indication that business do go bankrupt and that such a process is efficiently handled by a well-functioning market for low-rated corporate bonds and banks do not end up burdening its investors or the public finance.

Bond market unable to fill a critical gap

Be so as it may, the repercussions of banks' tightening of their tap of capital flow to the corporate sector is possibly being felt in the corporate bond market in India, which already faces a number of challenges. As noted above, large companies are already heavily leveraged and loans to them form a large part of banks' stressed advances. For these companies, the bond market could have been an alternative source of funds. However, to the extent that bond prices reflect the credit quality of the borrower, companies with high level of NPAs, and therefore low credit standing, may find raising capital difficult in the bond market. Besides, the current dynamics and institutional restrictions restrict capital flow in the domestic corporate bond market. For instance, banks can invest in corporate bonds, but would prefer to hold them to maturity to avoid the mark to market costs. This reduces secondary trading, investor participation and, in turn, new issuance. The result has been the underdeveloped state of bond market in India, compared to even other emerging economies like Brazil or China (Table 1).

Table 1: State of Development of Debt Markets - Debt securities outstanding at end-December 2016 (billion USD)

Countries	Domestic Debt Securities	International Debt Securities
Brazil	2074	130
China	9179	132
Korea	1430	168
India	762	35
Malaysia	274	47
South Africa	203	32
US	-	2348
UK	-	2868
Spain	-	499

Source: Bank for International Settlements

Several market experts and participants have suggested improvements on a number of fronts for the development of the corporate bond market, most of which revolves around fundamental reforms in financial markets, public finance and regulatory governance. Suggestions also include reforms to put in place a basic market infrastructure. Likewise, despite many positive moves to the contrary, foreign investment in rupee bonds still face regulatory headwinds in the form of capital controls and participation frictions.

As a matter of fact, the thinking on integrated financial markets is still at a nascent stage in India. Various elements of what would form the 'bond-currency-derivatives' nexus, as elucidated by the Percy Mistry Committee and other experts more than a decade back, are either missing or are underdeveloped. To start with, there is no reliable and accurate benchmark yield curve, which makes pricing of corporate debt securities difficult. The repo market which enables secondary liquidity and the credit default swaps market which allows credit risk to be traded are hardly attractive enough for participants, despite regulatory guidelines for them being in place. The interest rate derivatives market and the exchange-traded currency derivatives market are fraught with several layers of frictions which have so far prevented them from emerging as significant segments of India's financial market.

One major issue that confronts the development of the corporate bond market is the absence of well-demarcated creditor rights and insolvency laws by way of laws that allow for less costly contract enforcement. Recent legal changes in insolvency and bankruptcy hold good promise, but their enforcement in spirit, would be keenly watched out by the stakeholders.

The problem of bond valuation

Another problem that inhibits the development of India's bond market is the absence of standards and independent valuation norms that can reduce arbitrage on account of pricing. Often in India's financial markets, different rules are laid down by regulators for the valuation of assets which have different purposes and, therefore, different valuations. Banks are known to follow different valuation norms for portfolios

depending on their holding patterns: held-to-maturity, held-for-trading or available-for-sale. Similarly, insurance companies are known to value the same corporate bond differently depending on whether it forms a part of unit-linked or non-unit-linked portfolio. Sometimes, even when mark-to-market valuations are prescribed, approaches vary by participants.

It is a universally recognizable fact that a robust mechanism for correct price discovery is critical to ensure the existence of appropriate risk-to-reward relationship, which is fundamental to create sound markets.

Relevance of a Bond Pricing Bureau

Given the problems with bond pricing, it is possibly desirable to experiment with a Bond Pricing Bureau (BPB) in India. A BPB firstly needs to be registered with the regulators and set up to function under well-documented regulatory guidelines. The regulators, in turn, need to have the full oversight and regulatory responsibility regarding the functioning and compliance of the BPB with the set out norms. The BPB must provide fair prices of at least the Rupee-denominated bonds, at least once daily, which are tradable in the Indian market. Thus, the regulatory guidelines encompassing BPBs must include those parameters which can enable the emergence of an appropriate number of vibrant BPBs, enabling them to provide fair prices for bonds on an independent and at least daily basis.

Eligible entities which can set up BPBs may include an exchange-promoted entity, a separate arm of regulators, a stand-alone entity with no other business function, or an entity with debt market expertise promoted by neutral bodies such as academic institutions.

The proposed BPB may impose a reasonable amount of fee for its bond pricing services which would be proportionate to the costs involved in setting up and operating its bond pricing services. It may also provide auxiliary services which are closely related to the bond pricing activity. This may include training and providing outreach services, apart from the activity of collecting and disseminating all critical pricing related information in the market in order to make the secondary market trading activity more vibrant.

A BPB may also impose special charges on the settled trades on the basis of its calculated prices, to be taken up for the settlement process.

The principal role of the BPB would encompass the following:

1. Provide daily independent and objective fair value for all the Rupee-denominated bonds.
2. Facilitate the mark-to-market valuation of bond portfolios
3. Undertake necessary polling to arrive at the prices, and announce the MIBOR/ MIBID benchmarks
4. Calculate and disseminate the credit spreads for the debt instruments
5. Take up the announced prices for settlement of the secondary market trades till the secondary market develops vibrancy to provide clean settlement prices which cannot be manipulated by any single bond market player.

Operational and risk management framework of the BPB

In terms of the broad framework of the functioning of the BPB, it is essential that the agency must collect all possible relevant data from all reliable sources and use them in determining the fair prices of bonds. In particular, the data on transaction price must be obtained directly or indirectly from a centralized trade reporting system which is recognized by the regulators. It must formulate a transparent, methodologically sound and well-established pricing methodology for pricing the bonds and apply it consistently. It must also disclose, to the extent possible, the broad description and salient features of its pricing methodology to its customers to create trust and a general acceptance among all relevant stakeholders. In case an instrument is being priced by a shareholder having vested interest in them, it must use only the publicly available information for arriving at the fair prices of the bonds. It may seek feedback from its registered subscribers and get the feedback externally verified by a group of pre-identified selected financial institutions.

The BPB must, at all times, maintain its independence and objectivity in pricing the bond issues. To ensure its fully independent operations, there must be adequate segregation between the management and operational resources of the BPB and the shareholders, in order to prevent any shareholder from exerting any significant influence over the BPB.

Finally, the regulators and the government would have to accept the idea of an independent and objective bureau facilitating the right pricing of the bonds, and would have to assign the broader task of pricing to the BPB for this purpose, with clear guidelines for their functioning. Appropriate institutional structures for their oversight would also have to be put in place. The creation of the BPB should be directly linked to the developmental responsibility of the regulators in order to make it more widely accepted amongst all stakeholders of India's debt market. The acceptance of such prices for the settlement of the individual bond transactions always depends on the trust of the market participants, stakeholders and regulators, who may mandate the same even if the market adopts its own model of settlement. More importantly, the policy concerns should neither inhibit innovations in the pricing mechanisms, nor prevent dynamism in the pricing industry.

The information constraints in the pricing of the government securities would vary significantly in terms of the differences in the Yield to Maturity (YTMs) of similar maturity G-secs, absence of a liquid benchmark yield curve, market's instability to factor illiquidity in the pricing of bonds, and lack of investors' confidence in 'credit spread', as is the case with the existing setup that collects and disseminates the same in today's markets. Similar negligence may not occur, if the information constraints are removed in a systematic manner through various policy measures.

BPB: Anchoring Bond Market Development in Malaysia

BPB is not a unique proposal and several countries are known to have experimented with such a structure in some form or other. Pricing agencies exist in some emerging markets as Indonesia, Korea, Malaysia, Mexico and Peru. Colombia is also reportedly establishing a regulatory framework for price vendors in the local markets. The example of Malaysia may be elaborated here.

In Malaysia, the Securities Commission in January 2006, issued guidelines for enabling the formation of Bond Pricing Agencies (BPA). To deliver the pricing and information services exclusively on the domestic currency denominated bond market, the erstwhile Bondweb Malaysia (now Bond Pricing Agency Malaysia SdnBhd) was registered on April 18, 2006, as the first Bond Pricing Agency of Malaysia (BPAM). It was a private-sector led initiative, developed with the support of the key bond market players to complement the government's objective of building a more efficient, sophisticated and liquid bond market. Currently, it provides the pricing, daily evaluated, for nearly 2000 bonds in the domestic market, which is issued by the issuers, traders and the investors. The Bondweb Malaysia adopted a theoretical model, which was hybrid and quote-based. It provided a transparent and widely-accepted pricing for all the liquid and illiquid bonds, which are listed or traded in Bursa Malaysia. Together with the various development initiatives of other bond markets, the BPAM boosted the policy efforts in the development of an exchange-traded bond market in Malaysia. The Exchange-traded bond volumes in Malaysia, after the launch of the BPAM initiative, supported by the regulators in Malaysia, almost doubled in a short period of six months.

Other policy recommendations

Various experts and committees have made a number of suggestions for making the corporate bond market in India more vibrant. The Working Group of the SEBI on Development of the Corporate Bond Market in India (August 2016) had recommended the creation and use of a uniform valuation methodology available on a daily basis, which may be followed by all the regulated entities for valuation of their holdings of corporate bonds. "All regulators may explore an acceptable mechanism for valuation including engaging the Financial Benchmarks India Pvt. Ltd. (FBIL) or credit rating agencies for the same with necessary safeguards and regulatory oversight", said the SEBI Working Group. Besides, the government and the regulators must also create the infrastructure and regulatory norms and popularize the e- issuance of corporate bonds for wider participation. To popularize this form of trading, all type of bonds should be mandated for issuance and trading only through exchanges. The issuance of bonds compulsorily through electronic mode will help the issuer in reducing the cost by the process of distribution to the retail investors. To propagate trading of corporate bonds through exchanges, the SEBI Working Group had suggested that the "penalty structure in place for default in delivery of debt securities for trades subject to CCP clearing by the clearing houses of the exchanges be reviewed in consultation with all the stakeholders with a view to prescribing a penalty which is prudent yet reasonable". It also suggested that alternative mechanisms, such as borrowing through repo in corporate bonds, may be explored for ensuring settlement. The risk management systems at the exchanges trading in bonds may also be re-visited in terms of acceptance of certain corporate bonds as collaterals for margin requirement. This will contribute to increasing liquidity and acceptance of these bonds.

There has been demand made for some time for giving SLR status to investment in corporate bonds. This demand warrants some serious consideration. While SLR status to corporate bond would help banks in terms of higher returns, it would also bring in mark-to-market norms if these bonds are not given the benefit of hold-till-maturity. It would also make the management of Government's borrowing programme difficult. However, for the avowed objective of developing the fledgling corporate bond market in India, this may be experimented with.

Genesis of the missing links

The underdevelopment of India's corporate bond market has some historical perspective. The bigger companies and traders, at the time of opening up of the economy from the late 1980s and especially after 1991, lapped up considerably more benefits from the liberalization of the stock market than that of the bond market, and therefore, supported and demanded more of the former than they did of the latter. It is felt by some that these pressure groups played to the built up of debt in the 1970s and the 1980s, which was in the consciousness of the policy makers, which led them to accord the development of the bond market a secondary importance. Subsequently, with the opening of the economy, there was high inflow of foreign capital which further strengthened the primacy of the equity market.

These political economic considerations apart, there is a near universal concurrence on the need for development of India's corporate bond market, the challenges confronting it and the need to overcome these challenges through suitable institutional interventions. As noted above, a multitude of factors ranging from higher costs, absence of uniform pricing, procedural hassles, to long legal remedies are obstacles in the growth of vibrantly traded corporate bond markets in India. The need of the hour is to bring reform in all the above aspects and allow the corporate bond market to take off. As a first step, policy action on the creation and operationalization of Bond Pricing Bureaus may be given due thought.

The rapid growth of the Indian economy necessitates the existence of a commensurate bond market, possibly in several currencies, in order to channelize public savings towards capital formation. For the market to grow thus, complex products and debt structures will need to be permitted, which, in turn requires an objective, transparent, fair and independent value-setting mechanism. The prices of transaction and those for maintaining mark to market gains/ losses in the books of the bond holders need to be fair and free of manipulation. Especially in the growing stage of the bond market, the difficulty of establishing fair prices of bonds that truly reflect their fair values is exacerbated by the relatively less liquid conditions of the market. The role of Bond Pricing Bureaus (BPB) assumes significance in this context, even if only to break this vicious cycle. It is hoped that a widely-recognized BPB would spur action and vibrancy in an otherwise dormant corporate bond market in India, something that the markets and stakeholders have been waiting for long.

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Understanding the Role of Corporate Bond Markets

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Understanding the Role of Corporate Bond Markets

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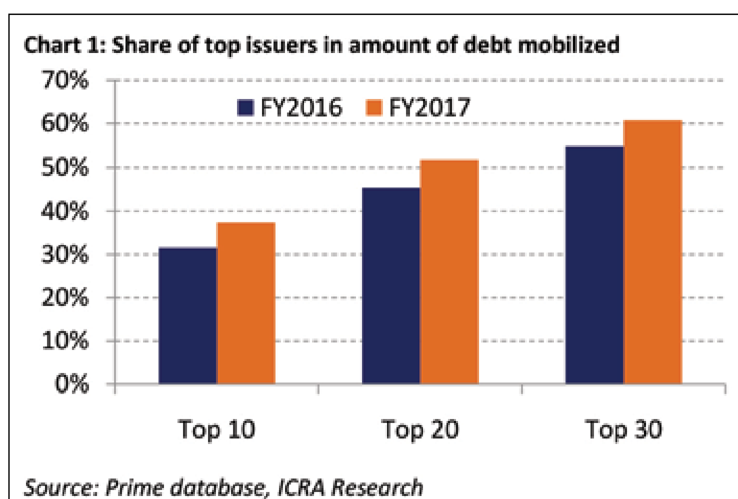
Role of Corporate Bond Markets in Supporting private sector growth:

a) Efficient allocation of capital:

A well-developed capital market is characterised by its depth and breadth across the debt and equity segments. While Indian equity capital markets have achieved a wide level of participation from issuers and investors, the debt capital markets remain limited to a few issuers and investors. This is reflected in the fact that top-30 issuers (out of over 500 issuers) accounted for ~61% of the debt mobilised through capital markets and almost 96% of the debt market issuances in FY2017 were privately placed. The limited participation makes the debt markets illiquid, and effectively makes investments as held to maturity.



While there are numerous reasons for the concentration of the debt capital markets on a few issuers and investors, the key ones are:

1) Limited investor base for issuers/issuances rated below AA category restricts issuances
2) Absence of risk-based pricing by banks results in cheaper bank financing than debt markets, thereby limiting the issuer base.
3) With bank loans not required to be marked to market, banks' participation is mainly through loans in the credit markets and not through debt markets

With banks accounting for a dominant share of the domestic savings, and with their pricing not being adjusted for the underlying risk, capital allocation in the economy is not the most efficient, if the corporate

bond market remains underdeveloped. An inadequately risk-adjusted price not only promotes leverage but also inefficiently channelises capital to projects that may otherwise be unviable. A better risk-adjusted cost of debt capital would also prompt issuers to adopt leverage that is appropriate for their risk profile.

The Reserve Bank of India's (RBI) guidelines during August 2016 for "large exposure framework" and "enhancing credit supply for large borrowers through capital markets regulations" may facilitate banks and borrowers to tap debt capital market route in place of the conventional loans. Though the guidelines are positive for development of debt markets, the proposed definition of a large borrower as an entity with a INR 10,000 crore credit limit from a bank from April 1, 2019 onwards and the allowable exposure limit of 20% of Tier I capital of a bank for a single borrower from April 1, 2019 still remain high and may prompt only a few large borrowers to the tap debt capital markets. A reduction in these limits will improve the granularity of banks' loan books and also force more issuers to tap the debt capital markets.

In another step to improve liquidity in the debt capital markets, Securities and Exchange Board of India (SEBI) recently issued a circular on consolidation of debt securities through reissuance of debt with similar maturities under the existing ISINs. Improved liquidity is expected to result in better price discovery for listed debt securities and hence aid transparency in pricing. Further, to widen investor participation and improve transparency in pricing of private placements, SEBI has also issued a consultation paper on reducing the issue size to INR 50 crore (from the existing level of INR 500 crore) for mandatory issuance of debt securities through electronic book platform (EBP). With EBP, investors and issuers can interact directly; with more investors having simultaneous access to the issuer on EBP, the pricing is likely to be more transparent. However, the issue of larger ticket size of private placement bonds after listing in the secondary markets needs to be addressed for improving investor participation through secondary markets. Usually, while the ticket size of retail issued bonds is as low as INR 1,000 per bond or debenture, the ticket size of privately placed bonds is upwards of INR 1 lakh to INR 10 lakh per bond or debenture. A lower ticket size may also aid in improving liquidity in the secondary markets and hence price discovery.

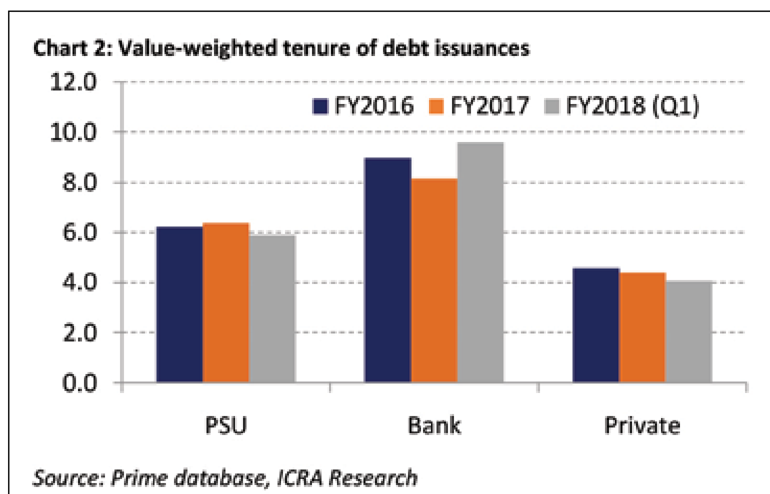
b) Favourable funding terms and flexible term structures:

Apart from efficient allocation of capital, debt capital markets also have the potential to offer better funding terms by aligning the maturity of the debt instruments with that of the underlying issuer cash flows. The issuer can have flexibility to structure the debt in terms of

1) Longer tenures with flexible principal amortisation or call options
2) Quantum of coupon (such as step-up coupons)
3) Frequency of coupon payments (Monthly, quarterly, semi-annually, annually or at maturity)
4) Fixed or floating coupon
5) Eligibility for inclusion as capital instruments in financial sector entities

Apart from offering favourable funding terms, issuers in a developed debt capital market can issue debt securities at frequent intervals as per their funding requirements. This will also result in quicker fund raising

than from banks and other sources, which have to comply with their capital or loan approval criteria. With SEBI allowing issuers to file a shelf prospectus and undertake an issuance in tranches, issuers have gained the flexibility to raise debt in amounts matching their requirements



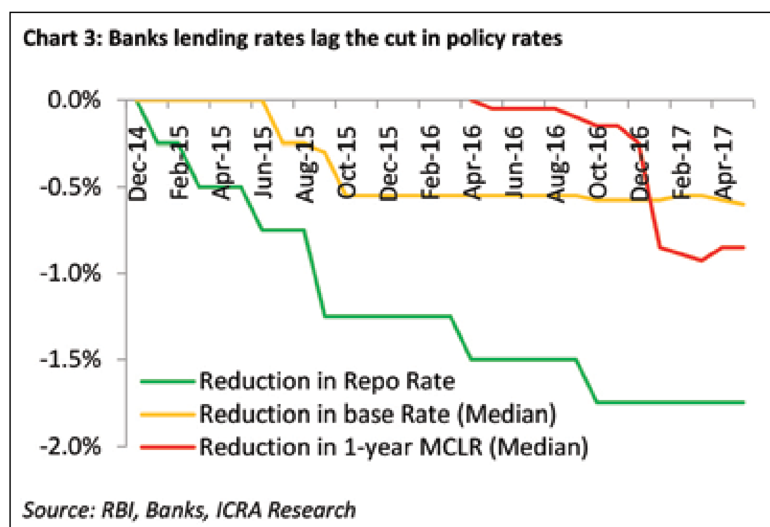
Notwithstanding the above positives, because of the under penetrated insurance and pension fund industries and the relatively shorter tenures of the assets under management (AUM) of the mutual fund industry, Indian debt capital market is mainly skewed toward short-term issuances. The value-weighted average maturity of bond issuances during the last two years stood at 5.3-5.5 years. However, excluding banks which mostly issue 10-year capital instruments, the value-weighted average maturity of corporate bonds issued during FY2017 was low at 4.4 years.

Additionally, a majority of the issuances in Indian markets are fixed coupon due to investor preference, however it suits issuers with relatively stable cash flows (such as take-or-pay contracts or annuity-based toll roads), and may not suit most of issuers in absence of stable cash flows. Hence, apart from constraints of long-term funding availability, in the absence of market-linked borrowing costs, issuers have to opt for fixed coupon payment structures, but with relatively shorter tenure issuances to reduce interest rate risk arising in scenario of declining interest rates.

A relatively predictable and stable interest rate regime driven by prudent fiscal policies, stable inflation and currency levels can make issuers and investors agnostic to fixed and variable coupon payment structures. Reducing interest rate volatility may also lead to elongation of the tenure of debt market issuances by reducing interest rate risks for issuers and investors.

c) Financing at lower cost

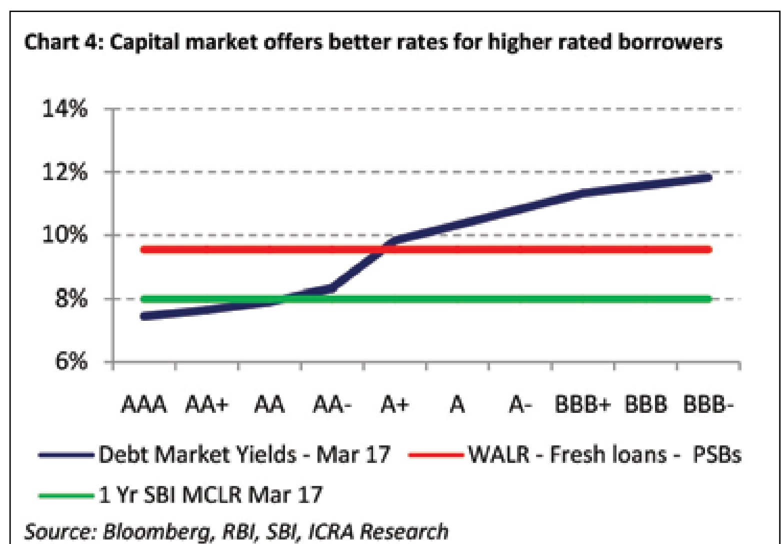
The ongoing rate cut cycle in the Indian economy started with a 25bps cut in repo rates in January 2015 and since then, the RBI has undertaken a cumulative cut of 175 bps in the policy rate till October 2016. While the yield on 10-year G-sec declined by almost 110 bps (lower than repo cut as the expectations of cut was already built before the rate-cut cycle began) during this period, the cuts in benchmark lending rates of banks



was limited to 57 bps in base rates and 15 bps in MCLR. While banks have constraints in the form of gradual repricing of their deposits, in the absence of any similar constraints, transmission was faster in debt capital markets. Similarly, in an increasing interest rate scenario, benchmark lending rates of banks may increase at a relatively slower pace than the yields in debt markets. Hence, a vibrant debt market may result in a faster transmission of policy rates in lending rates and also improve the effectiveness of the monetary policy.

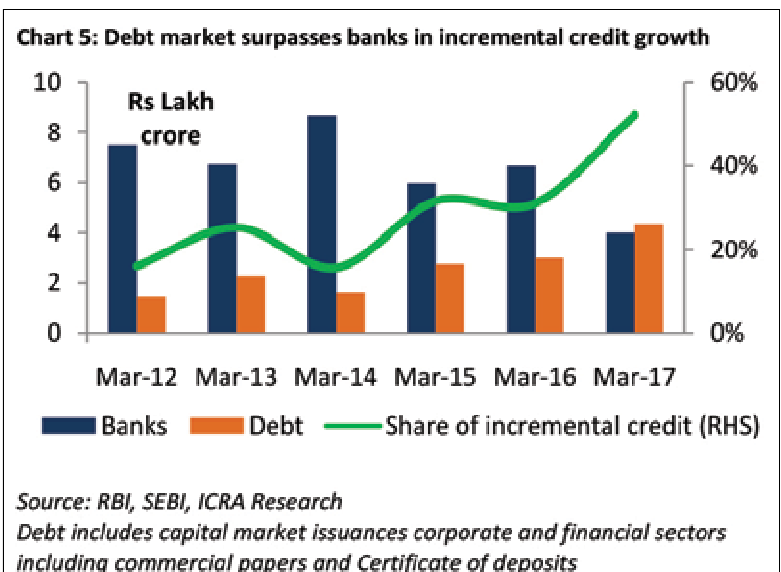
Currently, the benchmark lending rates of banks (as seen in chart 4) are higher than the yields for AAA and AA rated issuers, offering opportunities to better rated issuers to borrow from debt capital markets at lower rates because banks are constrained from lending below their benchmark lending rates even to top rated borrowers.

Because a sharp cut in benchmark lending rates will impact the yields on the entire loan portfolio and hence the profitability of banks, to retain their relationships with better rated issuers, banks have turned active investors in the debt markets. Investments by banks in long-term debt securities and commercial papers increased by 26% and 41% respectively during FY2017. With such an arrangement, issuers are able to raise funds at a lower cost; the option is however restricted to only higher rated issuers. Had the Indian debt capital markets been more developed with wider participation from issuers and investors across rating categories, borrowing costs of even the not-so-highly rated borrowers would have declined more sharply over the past 2 years. Nonetheless, the above trends of banks lending through debt capital market are healthy and positive for the long-term development of debt markets in India.



d) Scalable source of financing

Unlike the bank loan market, where a borrower has to rely on a few banks for their credit requirements, debt capital markets include a diverse set of investors including retail, institutional (financial and corporates), domestic and foreign investors. With direct access to investors, intermediation costs (both upfront and recurring) are likely to lower, thereby offering not only a



competitive but a scalable source of financing. Banks on the other hand, may be constrained by limits on their exposures to a particular sector, company or a promoter group.

While there have been instances of large size public issues of debt securities by public sector undertakings, the issuance of INR 10,000 crore debt securities in a single public issue by a private company during FY2017 reflects the appetite of various classes of investors in large size issues.

The incremental mobilisation of funds through capital markets surpassed the incremental credit growth of the banks during FY2017, for the first time after in the history of Indian financial system as better rated borrowers approach debt markets for their funding requirements.

While there has been a healthy growth in the volume of debt issuances over the last few years, the growth in debt issuances and volume outstanding is a function of the demand and supply of the debt instruments. Apart from the issuers' inclination to approach the debt markets, volumes are also a function of the fund availability with key investor classes like pension funds, insurance companies and mutual funds and the availability (or otherwise) of alternative investment options for retail investors. With subdued credit growth in the banking system and the sharp cut in deposit rates by banks, availability of funds and the demand for debt securities from mutual funds increased significantly during FY2017. The AUM of mutual funds in various debt schemes reached an all time high of INR 11.4 lakh crore as on March 31, 2017 from INR 6.3 lakh crore as on March 31, 2014.

With only ~28% of debt AUM of mutual funds accounted by retail investors as on March 31, 2017 as against 85% of equity AUMs, the granularity and stability of the debt AUMs remains a challenge for sustainable growth of debt funds as well as debt markets. In case of a pickup in their credit growth, banks may offer better rates and bank deposits may again become lucrative for investors and impact the growth of debt fund AUMs and debt market volumes.

Supporting economic growth

The slowdown in the domestic economy and recognition of NPAs has adversely impacted banking sector asset quality with gross NPAs increasing to 9.5% as on March 31, 2017 from 3.9% as on March 31, 2014. This has adversely impacted profitability and capital levels of banks, which coupled with the increasing capital requirements under Basel III regulations has been posing challenges for banks to meet the regulatory capital levels. Public sector banks (PSBs) being the most under pressure, have been reducing their loans outstanding to meet the regulatory capital requirement. With PSBs share of ~70% in the advances as on March 31, 2017, the weak capital position of PSBs has resulting in the credit growth declining to ~5% during FY2017 from ~15% in FY2014 and adversely impacting credit supply to various sectors of economy.

However, the buoyant debt capital market has ensured healthy credit supply to the large corporate sector, which is reflected in overall credit growth of 10.6% during FY2017 for large corporate sector in comparison with the 1.6% increase in bank credit to the large corporate sector during the year.

Given that PSBs will continue to face profitability and capital related challenges in the near- to medium-term, overall banking sector credit growth is expected to remain subdued. In such a scenario, vibrancy in the debt markets is critical to ensure a steady supply of credit to the various sectors of the economy.

Encouraging domestic long-term and diverse investments

Debt markets include a wide range of investors. And, different investors have different investment horizons depending on the composition of their assets under management and their liabilities. This is in contrast to banks, which have short or medium-term liabilities and hence are constrained from offering long-term funding to issuers/borrowers to prevent asset liability mismatches.

Additionally, in the absence of long-term liabilities, the cost of liabilities of the banking system tends to be floating over a period of long-term, which also constrains their ability to offer long-term funds at fixed interest rates. In contrast, investors like pension funds and insurance companies mobilise long-term funds for their subscribers and deploy these funds over a long-term horizon to match the liabilities of their subscribers. While bank deposits can be an alternative investment for pension/insurance funds, the banks may not offer large deposit opportunities for these investors, in the absence of fixed rate long-term liability products in their portfolio.

Debt markets address this challenge by offering an opportunity for issuers to borrow long-term resources to fund the projects capable of generating cash flows over a longer tenure such as infrastructure projects like power plants and roads. Given the high leverage in many infrastructure projects, debt servicing is highly susceptible to movement in interest rates and hence issuers opt for fixed rate borrowings, which is difficult for banks to offer over a longer tenure. These challenges are well addressed by the debt markets, where investors with long-term resources and the flexibility to offer fixed and variable coupons, are able to deploy their funds with issuers with similar funding requirements, mitigating asset liability and cash flow mismatches for both investors and issuers.

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Understanding the Role of Corporate Bond Markets

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Introduction

Corporate bond markets serve a vital economic function, bringing together corporations requiring capital to fund or expand their businesses and investors looking to earn a stable income from their investments. They thus play a vital role in facilitating economic growth, productivity, and employment. As the capacity of banks to provide direct funding to the corporate sector has become challenged, post-crisis, policy makers are beginning to look to capital markets as an ever more important source of financing for the real economy. Furthermore, corporate bond markets provide an alternative to public funding, facilitating private investment and so reducing the burden of government indebtedness, while offering investors, a higher rate of return than government bonds.

Since a well-developed corporate bond market is an important component of the over-all domestic capital market needed to finance infrastructure projects, some of a nation's basic investment needs may be delayed or inadequately funded in the absence of a proper balance. Conversely, funds that would otherwise find a natural home in corporate bonds end up as investments in foreign securities such as U.S. Treasuries.

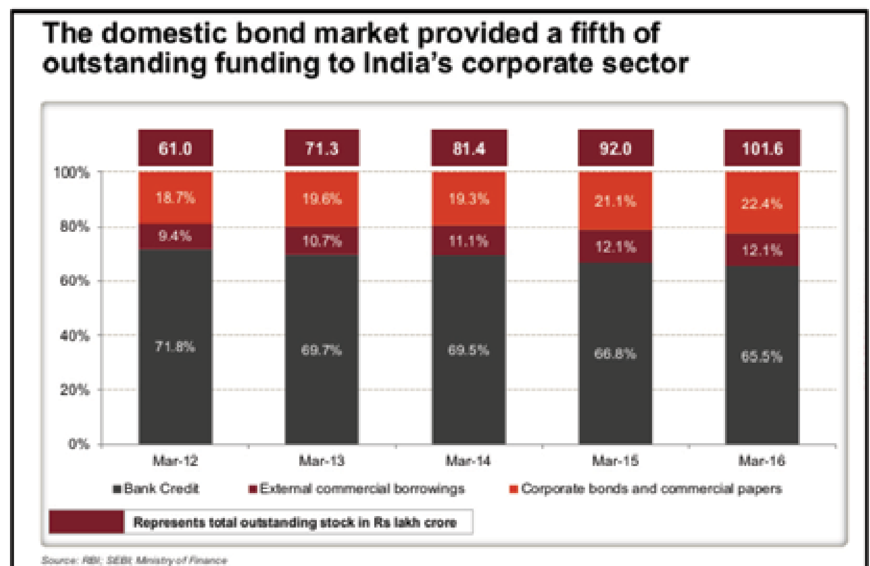
Governments wishing to exercise a high degree of influence over the direction a nation's economic development and growth, sometimes referred to as industrial policy, have discovered that strong control over the banking system is their most effective weapon. Projects viewed as national ambitions can then be readily funded by implementation of appropriate incentives and coercive measures. The natural evolution of an unconstrained corporate bond market can be hindered either by excessive regulation, taxation policy, or other means. This road, sometimes referred to as the Japanese growth model, is the one chosen by many Asian nations in recent decades. According to a recent report, banks hold over 60% of savings in Japan vs. less than 20% in the U.S. for example (Sapsford 1997).

Corporate bond markets around the world are currently undergone rapid change, a phenomenon that is most visible in Europe (see e.g. Iskandar and Luce 1998) and to some extent in Japan (Merchant 1998). The principal force behind the increasing relative size of the corporate bond market is the process known as "disintermediation". Disintermediation simply means that corporations needing (borrowed) funds bypass banks and go directly to the capital market.

Corporate Bond Market – India

In India, corporate bond market has less significant growth for decades. As of now, it contributes to only 14% of the gross domestic product (GDP). When compared this figure with the bank assets (89% of GDP) and equity markets (80% of GDP), it is very small. No wonder, banks and equity markets are dominating sources of capital for business in India. Though, various committees have given recommendations to increase the contribution of corporate bond market very little has changed on the ground.

But recently, Thomson Reuter's data shows new corporate debt issuance by Indian companies rose 57 percent in the first six months of the year. At the current pace, the annual total could hit a record $70 billion in 2017. One reason for the uptick is that banks are stressed and are lending less. At the same time there is a flood of liquidity as India's rising middle class are putting more savings into conventional financial products instead of hard assets like gold and real estate.



Source: CRISIL Analyst Meet Report – February, 2017

A robust corporate bond market is the foremost priority of Government of India to enable funding for fast track implementation of various projects in infrastructure and heavy industries sector. The past 12 months have seen significant public issues of bonds by both public sector and private sector due to important policy measures and notable innovations. However, it is not a one-off affair and the process should continue with proper coordination between the market participants and the regulators to make it truly a global bond market.

Debt Requirement over next 10 years

Infrastructure sector investment to GDP averaged around 7.2% during the same period. Assuming average 8.05% for the period 2015/16 to 2024/25 and considering debt requirement and availability, the potential gap for infrastructure debt has been estimated to be about INR 55 Trillion. Similarly, the gap for non-infrastructure sector has been estimated to be about INR 36 Trillion, total being about INR 91 Trillion. A number of sensitivity cases carried out on 'what if' basis show that a minimum debt requirement of INR 60 Trillion.

GAP ASSESSMENT FOR INFRASTRUCTURE AND NON-INFRASTRUCTURE SECTOR (INR TRILLION)

Particulars	2015-16 to 2019-20		2020-21 to 2024-25	
	Infra	Non- Infra	Infra	Non-Infra
Total debt requirement	**29.34**	**21.63**	**58.33**	**46.29**
Total debt supply	**10.32**	**10.29**	**22.23**	**22.10**
Banks	1.80	4.87	4.33	10.34
NBFCs	3.37	0.98	7.17	2.09
ECBs	4.85	3.91	10.05	8.09
Insurance companies	0.14	0.52	0.42	1.55
Mutual Funds	0.005	0.006	0.00	0.083
Multi-lats /Bi-lats	0.15	0.009	0.23	0.014
Pension Funds	0.003	0.003	0.00	0.000
Gap	**19.02**	**11.34**	**36.09**	**24.19**

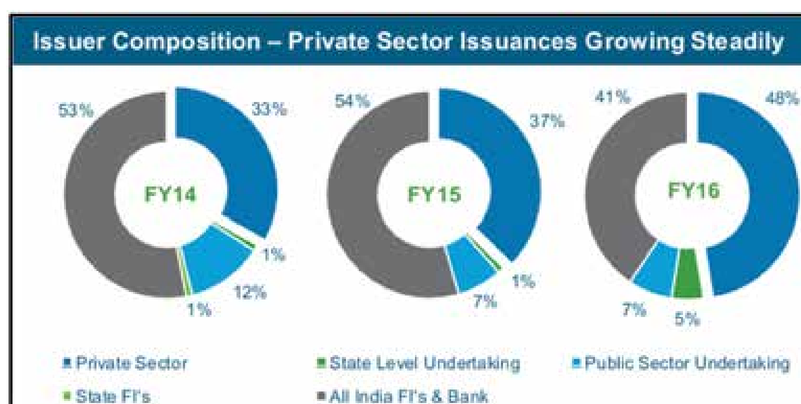
Source: ADB Report

Advantages of Corporate Bond Market Development:

1. Supplements bank financing and reduces banks' risk from asset-liability mismatch
2. Allows insurance and pension funds to invest in corporate bonds
3. Facilitates long term (1 to 30 years) debt finance for infrastructure.
4. Lowers the cost of capital for corporate by market forces based on benchmark
5. Enables a stable financial system by diversifying the risks through a large public issue
6. Enables efficient allocation of funds at corporate level
7. Enables development of the municipal bond market
8. Transparency, liquidity and appreciation through secondary market
9. Freedom from bank monitoring. No influence by lender on the business activities.
10. Tap overseas market via External Commercial Borrowings, with low currency risk.

Corporate Bond Market – Supporting Private-Sector Growth:

a. Corporate bonds provide companies with stable funding:-



Corporate bond markets benefit issuing companies by providing secure, stable and flexible funding for their enterprise, innovation, technological development, economic growth, trade, employment, and wealth creation. Investors (often insurance companies or pension funds

who need to finance long-term cash flow commitments on behalf of retail investors) typically buy to hold to maturity.

b. Lower cost of capital:-

Corporate bonds compete with other sources of capital, such as equity or commercial bank lenders, exerting downward pressure on companies' costs of funding. There is a continuing need to reduce the cost of issuance. But disintermediation between issuers and investors and a high degree of competition between the underwriters and brokers who provide support services mean that corporate bond markets help issuers minimize their cost of capital. This allows efficient allocation of investor funds to corporate enterprise, maximizing economic benefit.

c. Project-tailored funding:-

Bond markets offer flexible funding of ongoing business needs and development, as companies make a succession of bond issues to coincide with budgeted cash flows.

d. Matching of Cash-Flows:-

Bonds have a fixed investment term, determined at the choice of the company, enabling it to match a bond's maturity with expected business cash flows. Bonds can thus avoid maturity mismatches in cash flows more efficiently than is possible through bank loans, and minimize the economic risks of 'maturity transformation' - the risk of mismatch in the timing of flows of money resulting from short-term deposits being used to make long-term loans. By providing a fixed amount of capital for a fixed period on terms tailored to their needs, bonds offer companies flexible and targeted funding by comparison with equity.

e. Efficient exchange risk management:-

International corporate bond markets provide access to a range of different currencies, helping companies to avoid exchange rate risk for foreign projects and international trade. For example, if source materials for an infrastructure project are needed from a particular country, an international bond issue in that country's currency can work better than a domestic bond issue which would require the additional risk of further foreign exchange transactions to guard against currency movements. Where the funds are required in the borrower's own currency, it is often more cost-effective for companies to borrow in a foreign currency and manage the exchange rate risk through derivative markets.

f. Access to an international investor base:-

International corporate bond markets enable issuers to access a global pool of investors' savings: they are not restricted to domestic sources, as bank loans tend to be. This internationality is essential for the scale of funding and foreign exchange management needed by international conglomerates. It is also a vital source of international funding for developing the economies of emerging countries, and it gives corporates in the developed world access to new and growing pools of investment in Asia, South America, and elsewhere.

Supporting Economic Growth

The Government Securities (G-secs) market is fairly developed; about 75% of the Indian market is Government-issued debt. For most other major debt markets, the corporate debt (company issued bonds) portion of it plays a much larger role. Corporate debt markets provide an extensive set of investing opportunities, with a host of debt instruments (bonds and bond derivatives), offering exposure to the Indian economy. Debt markets traditionally offer a less-risky investment than stocks (equity).

In current uncertain times, corporate bond markets harness capital and enterprise in an efficient way that has the potential, with returning confidence, to take strain off public sources of funding. They ease pressure on public funding by growing the private sector. They fulfil key policy objectives of yielding investors income and long-term value, and providing long-term economic sources of funding for issuers.

Corporate bonds are the key

The most important piece of the need for a better developed bond market in India is access to capital for more firms. Currently only the top-rated borrowers have access to the corporate bond market. Further, banking and financial services account for 74% of primary bond issues in the country.

It is important to remember that 95% of debts in India are bank loans. Thus, there is a dire need for a more efficient credit market to pass through shifts in monetary policy. This becomes particularly important for infrastructure projects. If they can get access to cheaper capital at interest rates that better reflect monetary policy through tradable bonds, then they might not choose to get bank loans to finance projects. And when infrastructure projects can be financed more efficiently using publicly traded bonds, more of them are executed.

A whole new asset class

Developed bond markets will create a new asset class in India that attracts foreign capital. It will be an efficient allocator of capital and will bring more firms into the market. To realize these benefits, the RBI took an important step in August 2016 to liberalize bond markets by allowing banks to raise capital through rupee-denominated bonds (Masala Bonds) in foreign markets.

It also allowed both resident and non-resident Indians to maintain big open positions in the bond market. This step will expand the investor base and hence the capital inflow into the economy. With more deposits in banks today than ever before, there is a lot more money available to facilitate this move.

Encouraging Investors

a. Regulatory steps for Bond Market Deepening

To strengthen the Corporate Bond Market, RBI has taken following measures 2016-17

i. Commercial banks were allowed to issue-denominated bonds oversears for their capital requirements

ii. Brokers registered with SEBI and authorized in corporate bond market were permitted to undertake repo/ reverse repo contracts in corporate debt securities

iii. Banks were allowed to increase the partial credit enhancement on corporate bonds from 20% to 50%

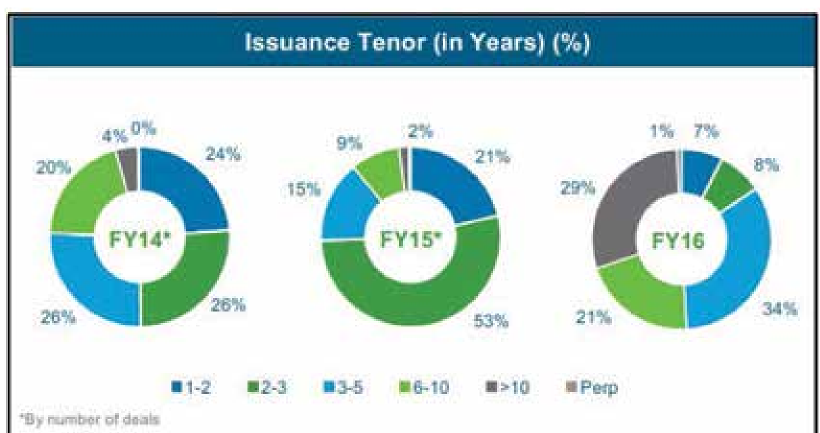
iv. Primary dealers were allowed to act as market makers for government bonds, which made Government securities more accessible to retail investors

v. Entities exposed to exchange rate risks were allowed to take hedge transactions upto a limit of USD 30 million at any given time.

b. Corporate bonds offer investors a stable form of investment:-

Corporate bonds offer investors relatively secure term investment and predictable cash flow - regular income payments through the life of the bond, together with the return of the initial capital at maturity, or the early realization of market value at sale in the secondary market if the investor's cash flow needs change. A bond permits, through its transferable nature, realisation of investment. Bonds offer potentially higher returns than from bank deposits, but with more predictable investment income and capital security than is available with equities. As such they assist efficient investment of savings, particularly for investors needing to generate income.

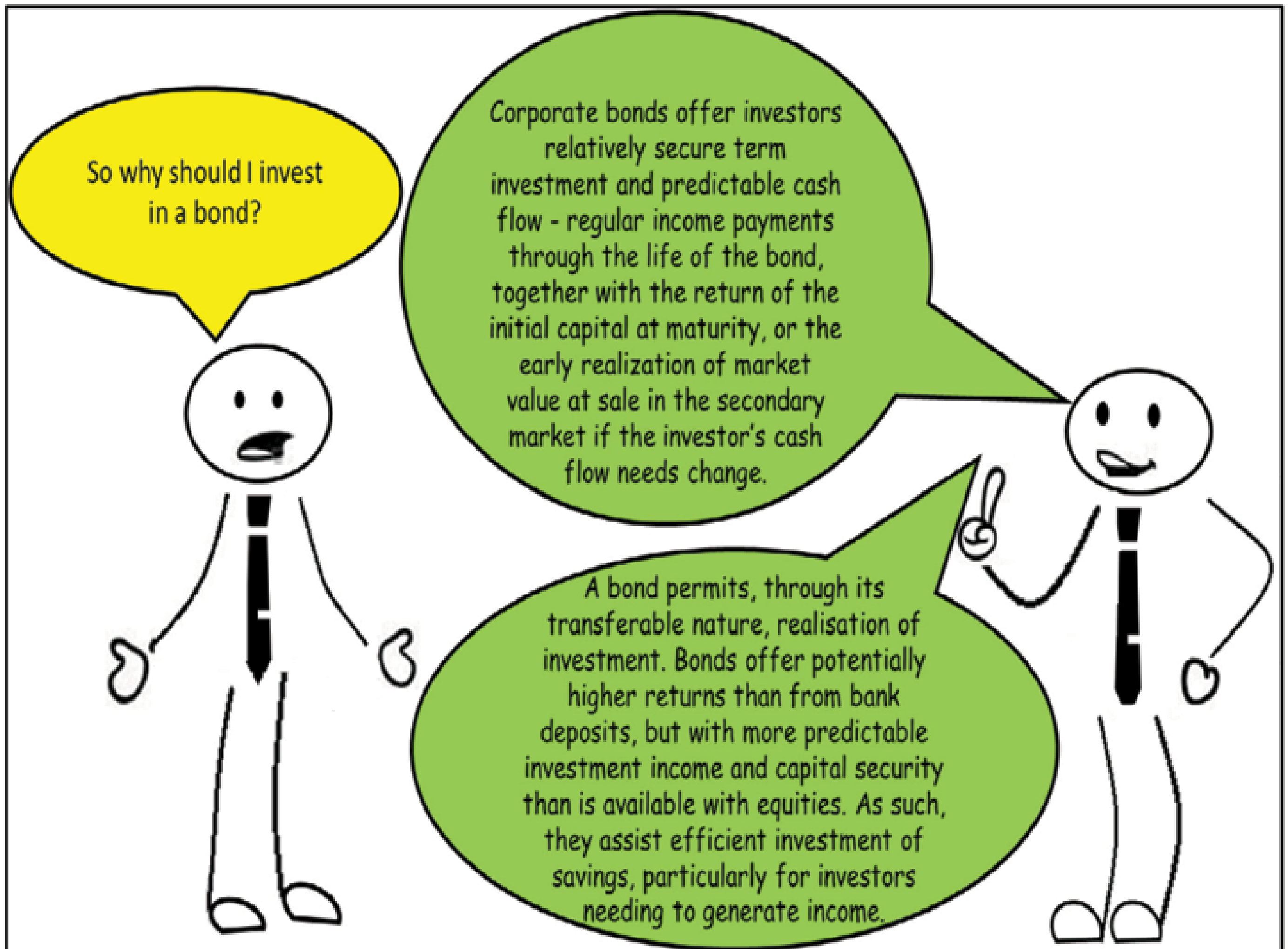
c. International diversification:-



International corporate bond markets facilitate diversification of investment between currencies and countries in different stages of the economic cycle. They enable investors to earn better and more diversified returns by accessing a global pool of investment opportunities.

d. Good matching to cash flow needs:-

The range, number, and frequency of corporate bond issues facilitates diversification and tailoring of maturity, credit quality, interest rate, and currency risk, enabling a close match to investors' needs and risk appetite. They offer institutional investors flexibility and the ability to time flows of funds at maturity to match their payment obligations.


So why should I invest in a bond?
Corporate bonds offer investors relatively secure term investment and predictable cash flow - regular income payments through the life of the bond, together with the return of the initial capital at maturity, or the early realization of market value at sale in the secondary market if the investor's cash flow needs change.
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Global Perspective

Global Scenario

APAS Article

Introduction

Corporate bond markets can be considered an important ingredient in economic growth, financial stability, and economic recovery, particularly in the wake of the crisis. They provide a key capital funding flow to firms allowing them to expand, innovate, offer employment, and provide the goods and services societies demand.

What are Corporate Bonds? Corporate bonds have been defined to include all bonds except those issued by national and local governments, and supranational organizations. Corporate bonds also include those which are issued by either financial and non-financial institutions. The corporate bond market is also broadly classified in to two parts:

a) Primary markets: Cash or capital is borrowed by issuers and lent by bond purchasers,

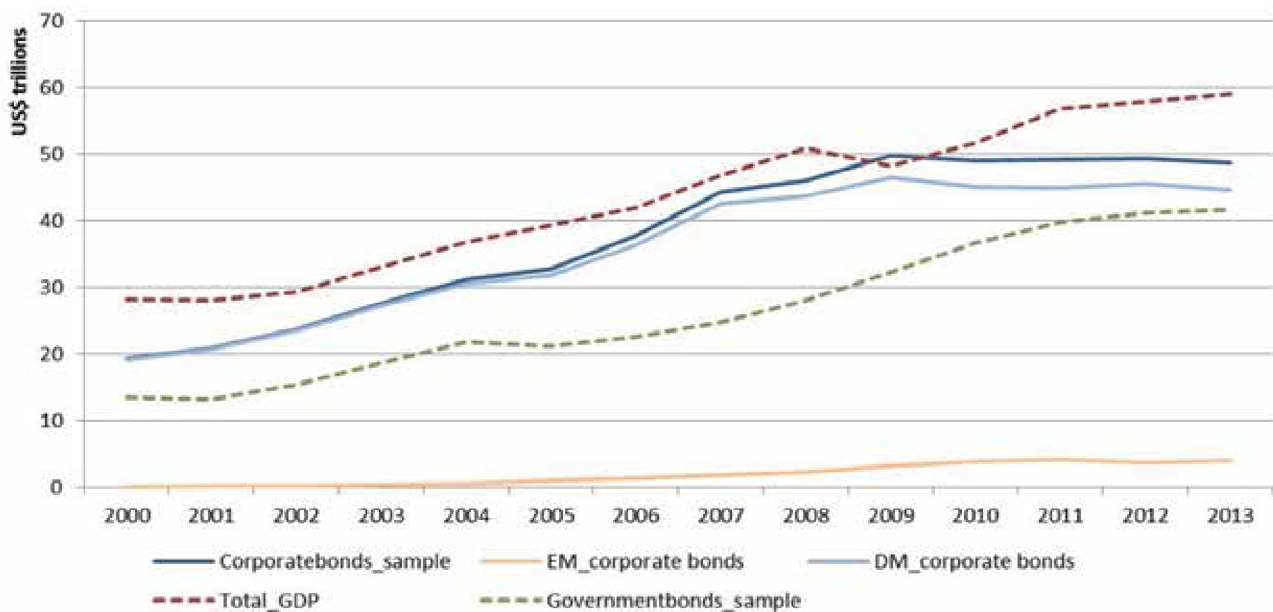
b) Secondary markets: Bonds are traded amongst market participants and investors.

Corporate bonds may be secured or unsecured and can be of various types such as vanilla, zero coupon, payment in kind, sukuk, CoCos and structured.

Primarily, corporate bonds are used to raise capital to invest in business activities, refinancing existing debt and balance portfolios. From an investor perspective, corporate bonds can be invested in individually, as a part of a bond fund or used to underpin structured products as way to diversify counterparty risk. Generally, direct investors in corporate bonds are institutions and both institutional and retail investors choose to invest through bond funds. An investor in bonds has the options to hold the instrument till maturity and receive yield payments or trade them on the secondary market.

A well-developed corporate bond market can be considered an important element in enduring financial stability and economic growth. The global corporate bond markets have almost tripled in size since 2000 and in terms of their importance to the real economy. This growth is not just restricted to the developed markets but also in the emerging markets, where there has been in significant growth and activity.

It is also important to note that the growth in this market has stabilized with onset of the crisis and there has been a general flattening owing to the deleveraging in the financial sector in the developed markets. However, in terms of the real economy the global corporate bond market continues to grow.



Corporate Bonds, government bonds (amount outstanding) and GDP

The above figure compares the total outstanding of corporate bonds from both financial and non-financial institutions. When compared to the GDP it reveals the size and growth of the corporate bonds during this period.

The largest corporate bond markets are located primarily in developed markets, however global concentration is reducing and some emerging markets are catching up. In the year 2013, it was found that developed markets effectively accounted for nearly 92% of global corporate bond market size.

The top global markets for corporate bonds have been relative stable, the leader among the list is the US even though its share in the global market has been reducing, which was 51% in 2004, 49% in 2007 and 44% in 2013. Other interesting developments over the years has been the performance of China, South Korea, Russia, Malaysia, and Thailand. While the growth by other developed markets has not been significant.

Despite these significant developments by the emerging markets, there is a large disparity in size between the larger and smaller markets, for example the average amount outstanding for the top ten markets is $2 billion while for the smaller markets are $18 billion. Good indicators for understanding the bond markets in countries are based on the size of the outstanding market and the depth of the market. The depth of the market is defined as the outstanding size as a percentage of its GDP. This indicator also gives an understanding of the importance of the market in the economy.

	2004			2007			2013	
Ranking	Country	US$, bns		Country	US$, bns		Country	US$, bns
1	United States	15891.1		United States	21492		United States	21036.1
2	Japan	3504.9		United Kingdom	3670.3		Japan	3670
3	Germany	2429		Japan	3497.9		United kingdom	3467.6
4	United Kingdom	2255		Germany	2940.4		France	2396.7
5	France	1340.8		France	2036.2		Germany	2082.1
6	Netherlands	1054		Netherlands	1657.2		Netherlands	1826.7
7	Italy	839.7		Spain	1403.4		Italy	1624.6
8	Australia	611.4		Italy	1249.4		China	1572.4
9	Canada	491.8		Australia	1103.8		Australia	1428.6
10	Denmark	457.5		China	1060.9		Spain	1365
11	Spain	448.8		Denmark	665.1		South Korea	1142.7
12	China	336.8		Canada	664.5		Ireland	1119.3

Size and ranking of top corporate bond markets in the world

Market depth for corporate bond markets globally averaged at 57% of the domestic GDP at 2004, increasing to 64% in 2007 and then to 98% in 2013. On average, developed markets had the deepest bond markets with a depth of 169% in 2013. While the scenario is a bit different in the emerging markets, it has been improving significantly with the depth equaling 12% in 2004, 21% in 2007 and 24% in 2013. The outliers in the emerging markets have been Malaysia, Thailand and South Korea which have a bond market depth greater than 50%, while developed markets of Canada and Greece have lower than 50%.

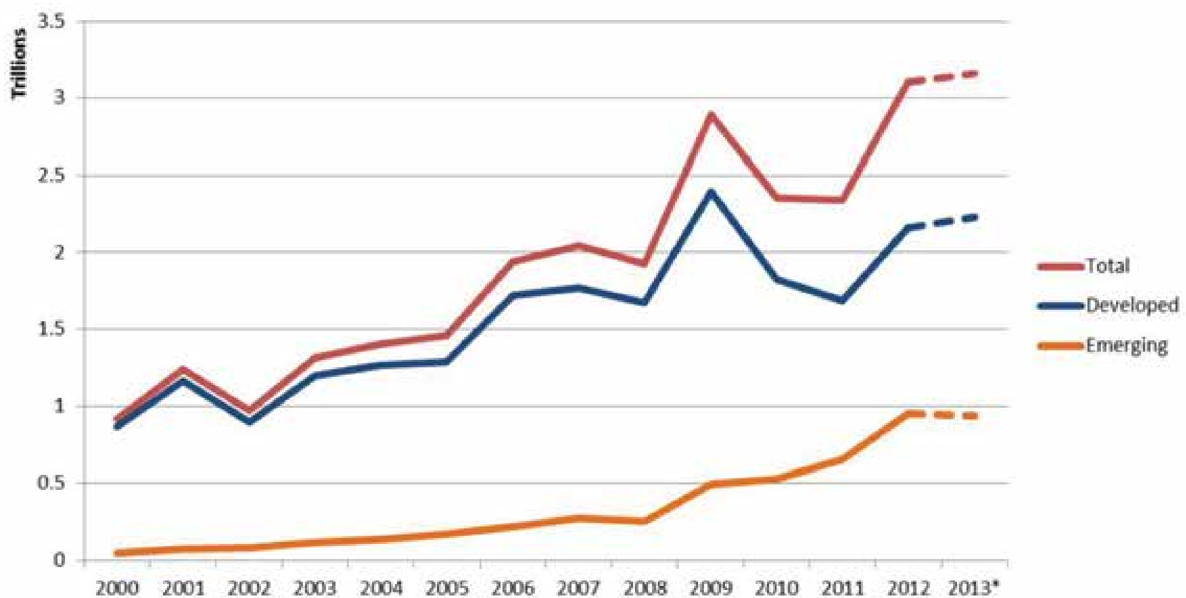
It is evident from the above figures that larger market size does not necessarily mean deeper market and vice versa.

	2004			2007			2013	
Ranking	Country	% of GDP		Country	% of GDP		Country	% of GDP
1	Luxembourg	307.10%		Luxembourg	268%		Luxembourg	1195.60%
2	Denmark	186.90%		Denmark	213.60%		Ireland	506.70%
3	Netherlands	172.60%		Netherlands	211.50%		Netherlands	228.20%
4	United States	129.40%		United States	148.40%		Denmark	209.80%
5	United Kingdom	101.50%		Ireland	143.90%		United Kingdom	139.30%
6	Australia	93.30%		United Kingdom	128.40%		United States	125.80%
7	Germany	89%		Australia	116.80%		Sweden	111.80%
8	Ireland	86.20%		Austria	101.20%		Spain	100.70%
9	Austria	81.30%		Spain	97.20%		Portugal	99.60%
10	Japan	75.30%		Sweden	94.20%		Australia	96%
11	Sweden	66.10%		Germany	88.30%		South Korea	95.40%
12	France	65.10%		Japan	80.30%		France	87.50%

Market Depth and Ranking

Market Access and issuance Activity

Despite witnessing a dip in the bond market activity in the 2009-2020 period, primarily in the last decade there has been an increasing activity globally. The issuance volume provides a good indication of the activity in the primary market. Even though corporates generally issue bonds to meet financing needs and not periodically, which indicate sporadic numbers. Generally, a high level or an increasing number is good indicator of the market development.



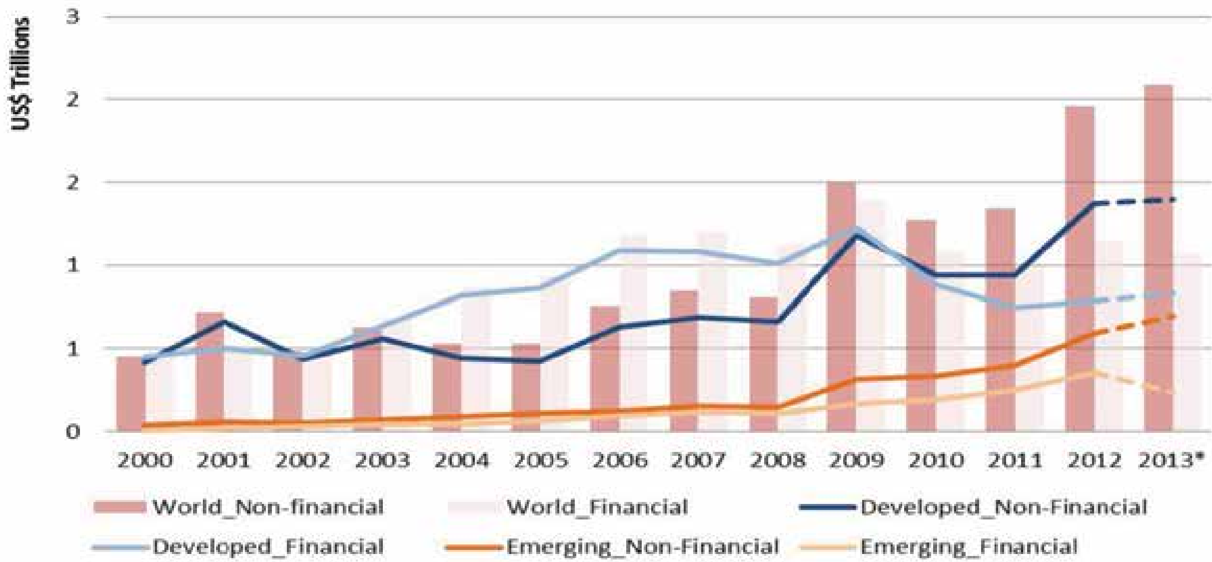
Corporate bond issuance volume, US$

The figure explains that while the issuance volume in the year 2000 was around $0.9 trillion, while it reached $3.2 trillion around 2013. Based on available statistics, during this period bond market activity was recorded for over 27 new economies, which were particularly from the emerging markets. The total issuance raised from 54 countries in 2004 to 81 countries in 2013, indicative of significant development.

This figure also indicates the flattening of growth during the crisis period in the developed markets, while there has been a jump in activity and more volatility in the emerging markets. To confirm the globalization of the bond activity, the issuance as a percentage of global share was just 5% in 2000, while it accounted for nearly 30% in 2013.

Issuer Characteristics

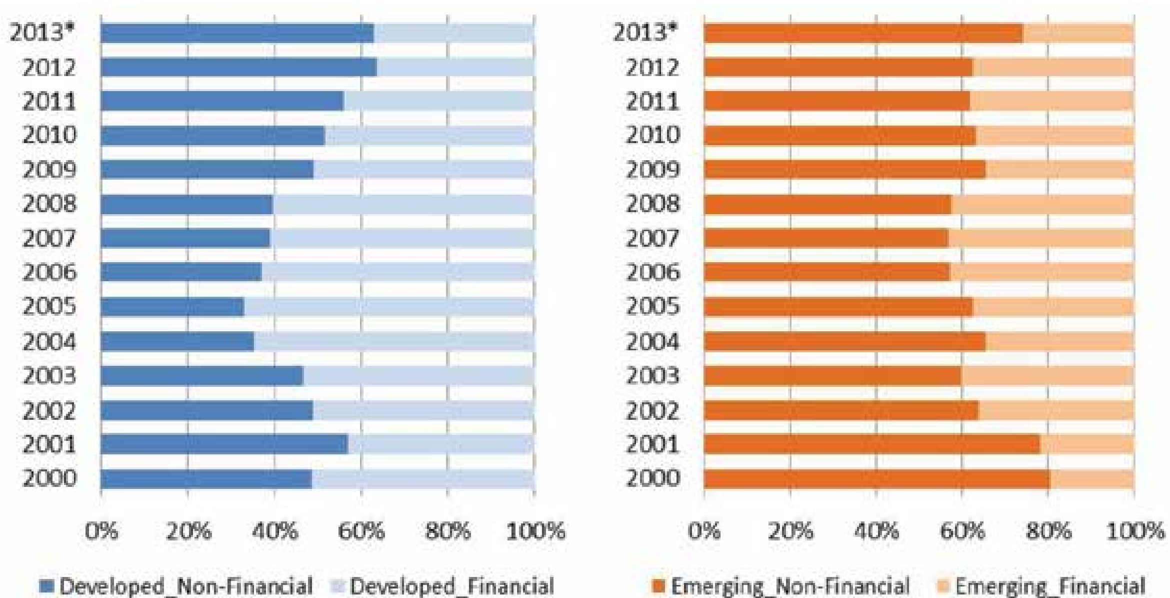
A diverse issuer base, including non-financial and financial participants is an important element of a well-developed corporate bond market.As corporate bond markets provide a stable source of funding for non-financial, it is also important source to the financial issuers, as it helps them serve the economy better by providing financial services. The market statistics also show us that the issuance from non-financial has risen fast while the issuance by the financial issuer has been muted.



Non-financial issues compared to financial issues

The figure indicates the levels of issuance volumes from both financial and non-financial issuers, which was at a 50/50 ratio and during 2007 the financial issuances were made up of 59%. But during 2007 to 2013 period the non-financial issuance doubled from level of $1.1 trillion in 2007 to $2.1 trillion in 2013. This indicates the changing scenario in the markets with regards to the issuer base.

While in the emerging markets, both the financial and non-financial issuances have seen significant growth in the given period. In the emerging markets in the year 2000, Financial issuers accounted for 20% of total issuance. This level increased to 43% in 2007, and between 2007-2013 the issuance doubled reaching$241 billion. The non-financial players also grew at a faster pace reaching a level of $692 billion in 2013.



Issuance of Developed and Emerging Markets

The above figure gives the split between the financial and non-financial issuers in both the developed and the emerging markets.

Secondary Corporate Bond Markets

While the importance of the primary bond market in facilitating economic growth, productivity and employment has been examined in the above sections. Here, the secondary markets and its functions are discussed. The secondary market provides a means to sell existing holdings, perhaps bought in the primary markets, as well as source new investments where the primary market is not available. An important attribute of the secondary market is the option of immediacy it provides for investors who need buy or sell their portfolio, given the nature of the bond market where the probability of matching buyers and sellers of a specific bond is relatively low.

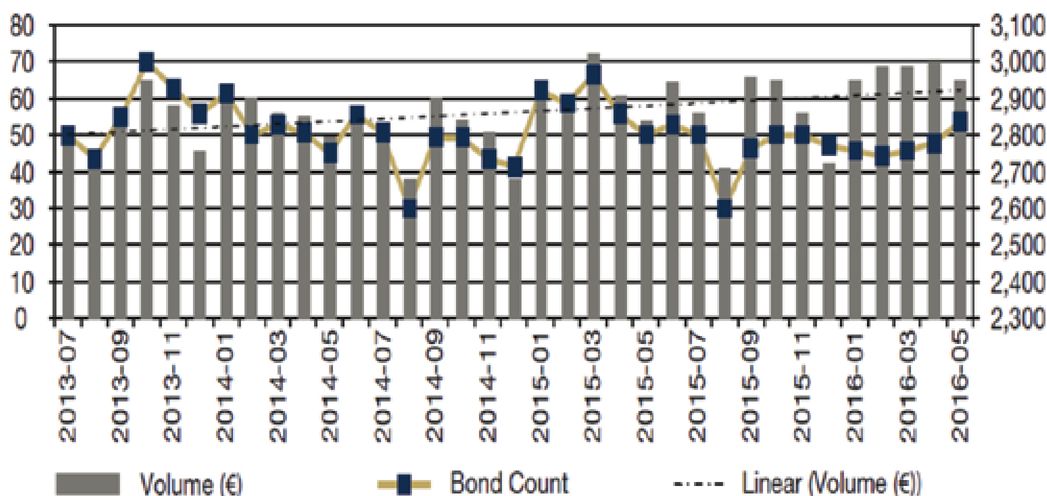
Hence, to provide this service, the secondary market has relied upon the intermediation services by market-makers. The market-makers are usually banks or broker dealers who provide two-way pricing to their clients in a range of corporate bonds, even if they do not hold that bond. In order complete the delivery of sale, they will borrow the securities via the repo market. Usually, the market makers in a particular bond are the same banks who are involved in the issuance of the bond. Another, key function of the secondary market comes when there is an issuance of new bond and the cost at which they borrow. As there is need for the issuer to balance the issuing price and interest rate, the secondary market sets a good precedent and acts as a good guide. With a stable and liquid secondary market, it is easier to establish appropriate prices for new issues.

Measuring Liquidity

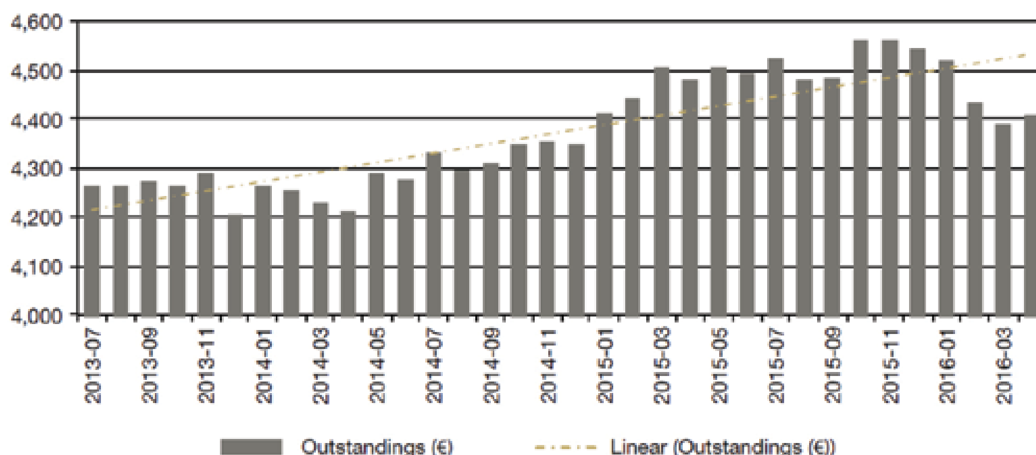
Liquidity is the center point of discussions when we speak about the secondary bond markets. It is broadly measured in terms of the ability to successfully complete buy or sell orders, when required in the expected size without any significant impact on the market price. Though this definition is largely qualitative and is open to different interpretations. To measure liquidity better, we discuss some commonly used measures and the profile they provide.

Trade Volumes:

Trading volumes are usually discussed when there are discussions regarding measuring liquidity, it is seen in conjunction with the total outstanding debt. The relation between the two is the turnover ratio. The below figures highlight the trade data of European IG corporate Bond Market and compare it with the growth in the outstanding Euro IG corporate debt over the same period, we will see that in relative terms that the trading volumes are lagging. Yet, volumes are not totally considered an indication of liquidity, since other factors drive them such as investor behavior and not just capacity.



Euro IG Corporate Bond Volumes: July 2013 – May 2016 (Euro billions)



Eurozone Corporate Debt Outstanding July 2013 – April 2016 (Euro billion)

Bid-ask spreads:

The Bid-ask spread is considered another important measure in measuring liquidity. It has also been witnessed over the years that spreads have tightened since the crisis. It is also important to note that price at which the trades are executed are relative to the posted bid-ask spread. It is seen that there is a trend of transaction prices moving away from indicative prices across all segments. This suggests increasingly impaired liquid conditions.

Trade Sizes:

Trade sizes are also commonly used as an indicator of liquidity, as the indication of larger sizes of trade is a healthy sign. It also seen post crisis, there has been a dip in the trade sizes. Hence, it is accepted that when there is a reduction in the average trade sizes, it shows that investors are splitting orders into smaller trades to lessen prices. However, there is a contrasting argument trade sizes may not be indicative of illiquidity as the frequency volume has nearly doubled since the crisis.

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Lessons for Lending Institutions from the 'Panic of 1907'

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The run on the banks of New York in 1907 or the 'Panic of 1907' (as it is popularly called), was a watershed moment in the financial history of the United States of America. It led to the establishment of the U.S. Federal Reserve in 1913. Besides the establishment of the central bank, the Panic of 1907 brought to the fore certain systemic weaknesses that remain relevant even today. This write-up attempts to understand these systemic weaknesses and derive lessons for the Indian Financial System, especially the lending institutions.

The trigger

The panic was triggered by the failure of speculative maneuvers of a prominent financial market speculator – F. Augustus Heinze. Heinze, a copper magnate and promoter of United Copper Company, owned a copper mine, called Rarus Mine, in Butte, Montana. In 1895, Hienze sued a rival copper mining company – Amalgamated Mines, over the ownership of copper extracted by it. Heinze claimed that the veins of copper from his mine extended under the land owned by Amalgamated. A strange law, called the 'apex law', allowed owners of a surface outcrop to mine the vein even if the vein ran beneath someone else's property. After a prolonged legal battle, in February1906, Heinze agreed for an out-of-court settlement offer by Amalgamated and sold the disputed copper reserves to Amalgamated for a reported sum of 25 million dollars.

Shortly after the settlement, Heinze arrived in New York with his new-found fortune to pursue banking. He associated himself with bankers like C. F. Morse and E.R. Thomas and became a known name in the banking circles. Soon Heinze bagged board seats in eight banks and two trust companies. He was also elected as the President of the Mercantile Bank. His brothers, Otto and Arthur Heinze also got involved with financial services and set up a brokerage house in New York.

The panic precipitated when Heinze brothers attempted a 'corner and bear squeeze' strategy (probably on the advice of Morse) on the shares of United Copper – a company owned by the Heinze family. On 14th October, Heinze purchased large quantities of shares of United Copper through his brothers' brokerage firm at escalated levels. As a result, the price of United Copper shares surged from $39 to $62 within 15 minutes of trading.

Next morning, convinced that he owned majority of the shares of United Copper, Heinze tried to execute a 'bear squeeze' by issuing a call for short sellers to return the 'borrowed' United Copper shares. Heinze had

expected that brokers would have 'shorted' the United Copper stock as the price soared the previous day. Shorting involves borrowing a stock to sell at a given price since a short seller does not own the stock he is selling. Once a call on borrowed shares is exercised, the short seller buys back the stock at market price to honour the delivery. Heinze presumed that the short-sellers would not find an avenue to procure the shares of United Copper from (as shares had already been cornered) and would turn to him for a settlement which would allow him to make a handsome profit.

However, Heinze's calculations went awry as short sellers discovered other sources of United Copper shares to replace the shares they had shorted. Heinze had insufficient capital to honour all the purchases he had made. Broking house Gross and Kleeberg were forced to sell United Copper shares to pay for the shares purchased by Heinze on margin. Share price of United Copper plummeted to $10 as short sellers made a killing by buying replacement stocks at very low prices. Some reporters attributed the availability of shares of United Copper to Heinze's rival – Amalgamated Mines. As per reports, Heinze's rival had advance information about the corner and was waiting with significant quantities of United Copper shares to play spoilsport. Heinze was ruined. He lost 50 million dollars in less than 24 hours.

The consequence

The failed corner attempt and the collapse of the United Copper shares had a ripple effect. The stock market fell on account of the collapse of United Copper shares and the market value of New York Stock Exchange fell by over 50 per cent from the peak of the previous year. The failure was so spectacular that people grew anxious and started withdrawing their money from the banks and trusts associated with Augustus Heinze. People suspected that Heinze and his associates - Charles W. Morse, E. R. Thomas and Charles Barney, would have embezzled funds or committed fraud to fund the corner. The run on banks started with Heinze's bank in Butte, spread to banks and trusts associated with him and his friends and threatened to derail the finances of New York City.

The panic lasted for about six weeks and resulted in the closure of several banks and trust companies before it was eventually quelled by liquidity support by J. P. Morgan (and others) and the federal government.

Lessons from the Panic

i. A 'lender of last resort' is a must

Stress often catches a lending institution by surprise and does not allow much reaction time. A quick and definite liquidity intervention is required to contain the effects of the stress. This nature of stress necessitates support from a 'lender of last resort' to the lending institution.

The 'Panic of 1907' paved the way for the constitution of the US Federal Reserve as it was felt that a 'lender of last resort' is required to prevent and/ or bail out lending institutions from liquidity shocks. In the Indian context, the Reserve Bank of India (RBI) is a 'lender of last resort' for the banks. Lending institutions that do not enjoy the RBI assurance should endeavour to cultivate a reliable 'lender of last resort' to sail through liquidity shocks. These 'lenders of last resort' could be 'resourceful' promoters, equity investors with 'deep pockets', multilateral entities etc.

ii. Investor/ depositor outlook is dynamic

Economic environment is a dynamic environment. Certain unforeseen and unexpected events could cause a sudden reversal in the views and outlook of investors and depositors. In the ten years preceding 1907, assets of New York trust companies grew by 244 per cent in comparison to a 97 per cent growth in the assets of national banks. Investors, in the lure of high interest rates, increasingly deposited their life savings with trust companies. However, overnight, misfortunes of a prominent speculator undermined public confidence in these trust companies.

iii. In times of distress 'shadow banks' are the least trusted

There existed three types of lending institutions in New York in 1907 – The National Banks, The State Banks and the Trusts. Out of these three institutions, the Trusts were the least regulated. While National Banks had a reserve requirement of 25 per cent, Trusts were required to maintain a reserve of only 15 per cent (only one–third of that in cash). Further, unlike Banks, Trusts were allowed to invest in real estate and stocks.

The relatively riskier portfolio, lack of access to a clearing house and lower reserve requirements made Trusts perceptively riskier than Banks. As a result, the New York Trusts faced the most severe run amongst all the lending entities. This mistrust was despite the fact that there was no evidence of direct involvement or connivance of these trusts with the orchestrators of the corner. The anxiety was based solely on suspicion. A study by Moen and Tallman indicates that the panic caused a tremendous contraction in deposits and loans of trusts while state and national banks, on the whole, remained largely unaffected.

iv. Tread carefully during low systemic liquidity

There was a severe liquidity crunch in New York prior to the crisis. Liquidity dipped during autumn, as cash flowed out of New York to fund the transportation of crops from the interiors of United States to New York. Besides the seasonal causes, the San Francisco earthquake and fire of 1906, the relatively weak cotton harvest of 1907 and the export of large quantities of gold to London owing to the suspension of U. S. finance bills further intensified the liquidity shortage. The run on the banks prolonged owing to drying up of liquidity in the system.

Almost all panics feed on low liquidity and the panic of 1907 was no different. It is, therefore, very important that lending institutions tread cautiously during times of low liquidity. Switching a portion of asset book to liquid government securities, embedding deposit lock-ins and exit loads, inviting subscriptions to closed-ended investment schemes etc. could be some of the steps to enhance liquidity buffers during low liquidity periods.

v. Avoid institutional panic during investor panic

During a panic it is critical that lending institutions avoid acting in a frenzy. Investors, take cue from every move that the institution under stress makes. Any action that is not well thought out could have disastrous repercussions. A case in point was the dismissal of Charles T. Barney, the president of Knickerbocker Trust during the 'Panic of 1907'. When Knickerbocker depositors withdrew large amounts of money following the

corner attempt (on suspicions of connivance of Barney with Heinze and Morse), the trust dismissed Charles T. Barney from the office of its Presidency, because of his "personal position in the directorate of certain institutions recently under criticism," and "in particular because of his connection with Mr. Morse."

The trust felt that a prompt action would stall the heavy withdrawal of funds. On the contrary, the dismissal gave an impression to depositors that Barney would have misused the funds of Knickerbocker to help finance the speculative schemes of Morse and Heinze. This aggravated the situation and a severe run ensued, ultimately forcing the trust to shut down.

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Some Interesting Global Markets

APAS Article

GERMANY

Bond market in Germany is reasonably well developed. The majority of bond market participants are institutional investors, such as pension funds, insurance companies and banks. Individual investor holdings of bonds comprise 10-15% of total financial holdings.

An important feature of the corporate bond market is that, most of the bonds are listed in exchanges, but a significant proportion of trading takes place through OTC platform. In such cases, listing is preferred not to facilitate trade through exchanges, but to enable institutional investors and fund managers who are restricted to invest in unlisted bonds.

There are several trading platforms, like EUROMTS, EUREX-BOND, in European markets that efficiently provide trading solutions to all such OTC trades. MTS Group is the first wholesale electronic market in the euro area which has promoted the integration of the euro denominated bond market by broadening the range of securities traded and services offered and by extending its platform to other European countries. The EUREX-BOND provides participants with an electronic platform for OTC wholesale trading in European bonds, ensuring higher liquidity for European bonds and thereby increasing transparency for all market participants.

SME bonds

Since the inception of the German SME bond market in 2010, there were 26 corporate defaults and 4 selective defaults, impacting 34 corporate bonds in total with a total debt volume of EUR 1 bn out of a total invested volume of around EUR 7 bn. This translates to a default rate of 17% by number of bond issues and 15% by bond volume. The interest rate spreads range between 5% and 7%.

The likelihood of further corporate and bond defaults remains high, especially given the size of refinancing needs for issuers with a volume of EUR 1.4bn in 2017 and a current peak of EUR 2.1bn to be refinanced in 2018. With the increase in credit spreads for very low rated issuers over the last 12 months, there is a question whether all issuers can succeed in refinancing. Refinancing is likely to become even more difficult for the lower rated entities.

Reasons for high default rate

- ***Half of defaults related to structural issues:*** Almost one half of the issuer defaults and more than half of the bond volumes have been related to sector-specific developments in the renewable energy market – an industry that has been distressed since 2009. Component or equipment suppliers in the solar and wind industry such as 3W Power S.A., Rena GmbH or SIAG Schaaf Industrie AG have been exposed to severe pricing pressures, resulting in several corporate defaults. Moreover, project developers in the renewable energy industry such as CarpeVigo AG, BKN Biostrom AG face ongoing regulatory changes, which jeopardised their business models.
- ***Serious fraud allegations:*** While the remaining half of corporate or bond defaults are linked to other corporate or industry developments, there have also been serious fraud allegations against some of the defaulted issuers regarding misrepresentation of financial accounts (e.g. MIFA MitteldeutscheFahrradwerke AG or Penell GmbH) and embezzlement (getgoods.de AG).
- ***Bond market lender of last resort:*** The credit quality of many issuers was already weak at the time of issuance. For some entities, the issuance of an SME bond was the last resort to receive external financing as banks had already rejected financing requests. Moreover, many issuers did not use proceeds from bond issues as a substitute for a bank loan, but as a substitute for mezzanine or equity capital in order to finance risky investment projects, or to avoid short-term bankruptcy.
- ***Retail market with limited creditor protection from covenants:*** In hindsight, the high proportion of retail investors in the German SME bond market who were impresssed by high coupons and seemingly safe issue offered by issuers with an established brand, overlooked the accompanying risks of such investments. Institutional investors – which had invested in the SME bond market to a limited extent only (10-20% of overall invested debt volume) – had traditionally avoided such risky debt instruments. Creditors' protection through meaningful covenant structures such as financial covenants were not established in the early stages of the market. Such covenant structures that are usually requested by professional institutional investors, and are a standard in other high yield bond markets or in conventional loan contracts, were largely ignored. However, such covenants could have protected creditors against risky developments, as well as from the misuse and misinvestment of proceeds from the debt instruments.

Often the SME bond market was seen as the last resort of financing for weaker debt issuers. This trend was further accelerated by the expansive monetary policy of the European Central Bank, catalysing the provision of capital through private placements or the traditional banking system.

The average credit ratings assigned at issuance indicated a low investment-grade or high non-investment grade credit quality of the segment, while the actual default rate suggests an average credit quality of mid sub-investment-grade in this market.

Lessons learnt

- All market participants adjusting to the new SME bond world: Given the loss of confidence in the bond market segment, it will take time to regain its credibility and for the market's maturity to evolve. All

relevant market participants have already adjusted to these circumstances, either by amending investment behaviour or taking appropriate measures.

- Investors and debt advisors more selective: Investors have become increasingly selective. Many planned bond issues were cancelled either during the conception stage of a new bond issue or due to a lack of investors' demand. Investors are conducting more thorough reviews on their investments, recognising the need for in-depth credit analysis of an international standard, even if this results in ratings well below the investment-grade threshold.

Successful new issues or tap issues tend to come from:

- comparably large new issuers;
- returning issuers which have already convinced the market with improving financial results; and
- issuers from sectors with less industry-inherent credit risks such as real estate.

Finally, recent successful bond placements are characterised by stronger creditor protection.

- Stronger creditor protection through covenants and asset pledges: The market has matured considerably in terms of creditor protection. The introduction of meaningful covenants – which have been the exception rather than the rule in the early stages of the market – is becoming the norm for new bond issues.

  This can be seen in comprehensive covenant packages comprising the full range of common covenants such as negative pledge, paripassu, cross default, change of control clauses or payout or (dis)investment restrictions. Financial covenants ensuring adherence to important debt protection measures, such as leverage or interest coverage, are still an exception in less than 10% of all outstanding bonds. Nevertheless, such financial covenants can be observed in the newer bond issues rather than issues seen at the early stages of the market.

  There is also a more frequent provision of recoverable assets as collateral. One third of all new bond issues in 2014 and 2015 had provided collateral, against only 20% of bond issues in the earlier years. Such pledges in the form of real estate, inventories, brand rights, power plants or shares in other companies can be seen as measures designed to secure a successful placement of the bond issue, but which also put pressure on the management of the issuers to protect the company's asset base or brand value.

- ***Issuers – Change of financing with other financing instruments:*** Issuers have opted for different financing alternatives to avoid the stressed market sentiment in public SME bonds. In particular, privately placed bonds with institutional investors have been favoured by midsized issuers such as Grand City Properties S.A., HELMA Eigenheimbau AG or Semper idem Underberg GmbH. The same trend has been seen in tap issues of existing public SME bonds (such as Metalcorp B.V. or Adler Real Estate) that directly address institutional investors.

- ***Rating agencies – Adaption of rating approaches:*** Rating agencies focused on small and midsized corporates have reacted accordingly by amending their rating approaches and methodologies towards a more forward looking view. While in the early phases of the market, corporates were rated based predominantly on balance sheet ratios of past financial years, amended rating methodologies incorporate

important cash flow and liquidity-based indicators. Such financial metrics focus on the future development of the rated entities, reflecting financial risks in a more accurate and realistic fashion.

- ***Sector's rating migration from BB+ to B+ on average:*** In conjunction with the adjusted rating approach, the amended rating perspective is reflected in the rating migration after the assignment of an initial rating. There is a strong tendency to rating adjustments with an average of 3 notches down with the average credit rating in the sector now standing at B+.
- ***Exchanges – Best practice guide and stricter listing requirements:*** Bond exchanges have launched measures to steer against the battered image of the market segment. While 'Deutsche Börse' has published a best practice guide giving advice to issuers and intermediaries on bond listings, the specialised bond exchange 'Mittelstandsbörse Düsseldorf' has restructured its bond segment. The latter sharpened its listing requirements regarding transparency with the timely publication of interim reports and key financial metrics. Such guidances are sorts of soft laws to provide orientation and a more standardised approach, it may protect the segment from additional bond issues from issuers too weak or not yet mature enough to enter the capital markets.

Outlook

Although successful issuance volumes for German SME bonds dropped significantly in 2014 and 2015, the market will likely overcome these birth pangs. However, it may take time for a complete recovery of investors' confidence. With the execution of measures listed above, the market will regain its importance and provide an improved credit protection to investors looking for high yields.

SOUTH KOREA

The bond market in the Republic of Korea is one of the largest markets in Asia. Various reforms have led to its rapid development, including gradual market liberalization. All fixed-income instruments are available to foreign investors.

Bonds in the Republic of Korea can be classified into two main types: government and corporate. Securitization has become an important financing tool in the Republic of Korea since it was first used to restructure banks' nonperforming loans following the 1997–98 Asian financial crisis. Collateralized bond obligations and collateralized debt obligations accounted for the bulk of securitized transactions. The market has since expanded to include securitization of residential mortgages, credit card receivables, future trade receivables, and various types of leases and loans.

In the local currency (LCY) corporate bond market, outstanding bonds grew 0.8% QoQ and 3% YoY to reach KRW 1220.8 trillion at the end of September 2016, fueled by relatively fast growth in financial debentures.

Instruments

Debt instruments include issues from both the government and corporate sectors. A repurchase agreement (repo) market was established in 2002. The short selling of bonds is allowed in the Republic of Korea, provided

it is backed by a guarantee. Futures and options contracts were also formed in 1999 and 2002, respectively.

Corporate bonds include special public bonds issued by state-owned entities; financial debentures other than those issued by Korea Development Bank (KDB); and other corporate issues, which may be guaranteed or non-guaranteed. Most corporate bonds are non-guaranteed with three-year maturities.

Corporate issues also include asset-backed securities, which may be in the form of mortgage-backed securities, collateral debt obligations, and asset-backed securities.

Mortgage-backed securities are issued by the Korea Housing Finance Corporation. The Korea Asset Management Corporation (KAMCO) and the Korea Deposit Insurance Corporation also issue asset-backed securities to recapitalize troubled financial institutions.

Asset-backed securities issued by financial institutions and non-financial private companies include securities backed by credit card receivables, future trade receivables, and various types of leases and loans. Cross-border asset-backed securities (asset-backed securities issued in foreign currencies) are also an emerging type of securitization.

Participants

Several participants are involved in the bond market including

- issuers from both the government and corporate sectors;
- investors consisting of financial institutions, and asset pooling industries;
- intermediaries involving securities companies, investment houses, and dealers;
- rating agencies; and
- market associations

Regulatory agencies

The Republic of Korea's Ministry of Strategy and Finance (MOSF) is responsible for policies involving medium- to long-term economic and social development, including taxation, finance, national treasury, and state-owned properties. MOSF's responsibilities also include foreign exchange and debt, external economic cooperation, and stabilizing the livelihoods of Koreans.

The Korea Financial Investment Association (KOFIA) was formed as the result of the merger of Korea Securities Dealers Association (KSDA), the Asset Management Association of Korea (AMAK), and the Korea Futures Association (KOFA). KOFIA comprises securities companies, investment advisors, and futures firms. It aims to strengthen the global competitiveness of the financial investment industry.

Korea Exchange (KRX) is responsible for the operation of the stock market, KOSDAQ, and the futures market.

The Korea Securities Depository (KSD) is the country's sole central securities depository.

The Bank of Korea (BOK) determines and monitors currency exchange controls and administers securities payments systems. BOK also manages the issuance and redemption of treasury and foreign exchange equalization fund bonds.

The Korea National Tax Service oversees all taxation affairs.

Policy initiatives and reforms

- ***Securities Class Action Suit Law:*** The Securities Class Action Suit Law became effective on 01 January 2005. Under the Law, class action suits can be initiated for unfair trading involving the use of inside information and market manipulation. Companies can also be open to a class action for a deliberate falsification of financial statements and disclosure violations.
- ***Financial Supervisory Regulation Rationalisation Plan:*** The Financial Supervisory Commission (FSC) announced in December 2003 a set of initiatives to streamline and rationalize the regulatory framework of the Financial Supervisory Service (FSS). The plan contains 123 initiatives that emphasize the deregulation of businesses, increase transparency in capital markets, bolster self-regulation, and deregulate foreign financial service providers. Specifically, the initiatives were to:
    - raise the ceiling on privately-placed bond holdings for investment of trust funds, and repeal the ceiling on privately-placed bond holdings for mutual funds;
    - expand the range of firms eligible to issue commercial papers and engage in asset securitizations as originators;
    - enhance the effectiveness of short-sale regulations by incorporating these into the Securities and Exchange Act; and
    - enhance regulatory equity between domestic and foreign market participants, and address the concerns of foreign financial institutions.
- ***Financial Market Stabilisation Plan:*** The Korea Securities and Futures Exchange Consolidation Bill was passed in January 2004. The Bill is the legal framework for the merger of the Korea Stock Exchange, Korea Futures Exchange, and the KOSDAQ Stock Market to establish an integrated and demutualized exchange. In January 2005, the Korea Exchange (KRX), was incorporated, a consolidation of the three spot and futures exchanges. The establishment of the KRX was part of the Financial Market Stabilization Plan under Korea's Economic Policy Direction for 2004. Other policy reforms in the Plan include outlining the legal procedures and responsibilities for electronic financial transactions.
- ***Foreign Exchange Liberalisation Plan:*** On 19 May 2006, the government announced it was accelerating foreign exchange liberalization to attract investment capital for new infrastructure, and to promote foreign exchange market development. The foreign exchange liberalization plan was completed in 2009. The first phase of the two-phase program was in 2006-2007.

The plan aimed to

- internationalize the won;

- liberalize foreign exchange transactions, including Korean overseas investments; and
- accelerate development of the foreign exchange market.

- Consolidation of securities and capital market laws: The Financial Investment Services and Capital Markets Act (FSCMA) became effective on 04 February 2009. Major changes in this new legislation include:
  - Financial services deregulation: The removal of restrictions strictly separating securities, futures, asset management, trust services, and other financial services businesses (excluding banking) to integrate their financial services business.
  - Broadening the scope of financial investment products: The meaning and scope of financial investments and products offered reversed from the previous system of enumerating what is allowed to a system, defining what is illegal.
  - Deregulation of indirect investment: Those restrictions were removed, that recognized only trust investments (in the form of beneficiary certificates), corporate-type investment companies (mutual funds), and private equity funds as indirect investment vehicles. Thus, other entities recognized under the Commercial Code could be included as indirect investment vehicles.

VIETNAM

Vietnam first started issuing bonds in 2005. From 2006, issuing of convertible bonds also started. This progress was marked consistent with the introduction of electronic bidding system on government bonds in 2012 and started its operations at the Hanoi exchange. The efforts were backed by the government through an agenda to develop the bond market to an extent, to deepen the bond market to 38% of the GDP by 2020.

The journey hasn't been smooth though. Vietnam started with its bonds outstanding accounting for less than 1% of GDP at the start of 2000s. Currently, the percentage stands at 20%. As of June 2016, the bonds outstanding comprised government bonds (74%), government-guaranteed bonds (21%), central bank bonds (1%) and corporate bonds (4%).

The government is ramping up efforts to increase investments from insurance companies and pension funds in sovereign bonds. The corporate bond market in Vietnam is at an early stage of development. The number of issues remained at 19 at end-June 2016, with most of them placed privately. The perception of Vietnam's bond market can be seen from the improvement in the ratings. Fitch upgraded Vietnam's credit rating from 'B+' to 'BB-'. Moody's also upgraded Vietnam's rating from 'B2' to 'B1'.

The government has decreased the issuance of bonds with shorter maturities. As a result, the share of government bonds by maturity was accounted for by 40% for 'less than three years', 10% for 'over three years to less than five years', 10% for 'over five years to less than 10 years', and 10% for 'longer than 10 years'. Compared with end-2013, the share of 'less than three years' decreased 30% while that of 'longer than 10 years' increased 10%. The average maturity of government bonds increased from 2.8 years at the end of 2013 to five years at the end of June 2016.

However, about 80% of bonds are still held by banks, which prefer government bonds with shorter maturities, and it is expected that the government's efforts to solicit the investors of insurance and pension funds to expand their share and thereby lengthening of government bond maturities will continue. Reports predict that the banks' share can decrease to around 50%, if all of the government's borrowing from the Vietnam Social Security is turned to bonds.

Unlike India, Vietnam does not have an independent professional rating agency and most of the rating work may be carried out by the foreign rating agencies. However, on account of high development of the bond markets, the government is taking initiatives to develop its own rating agency and improve the market infrastructure. Thus, Vietnam signifies a story of proper congruence of the regulator, government and corporates' efforts in the development of bond market.

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Need for a Vibrant Corporate Bond Market in India

Creating a Vibrant Economy in India

APAS Article

The overall growth of any economy depends largely on growth of financial sector. The two important pillars of financial sector are bond and equity market. Corporates rely on various sources of financing and funds are raised either in the form of debt or equity or hybrid instruments. Although, banks and equity markets are the dominant sources of financing and has experienced tremendous growth in past few decades, a well-developed and active corporate bond market provides an alternative source of finance for the long term needs of the public and private sector firms. Also, in order to enable these corporates to avoid balance sheet mismatches and foreign currency exposures, a need of local currency bond market arises. It could also provide institutional investors such as insurance companies and pension funds with quality long term financial assets, helping them in matching their assets and liabilities and diversification of risks. Bonds are less risky than equity and therefore it is expected to get priority over equity market, at least for the risk-averse investors. Therefore, the less risky debt market is anticipated to be developed before the development takes place in the equity market. But, in India, equity market has developed significantly and the corporate debt market is still at the nascent stage, however, it has shown growth over past few years which can be seen below:

Year/Month	BSE		NSE	
	No. of trades	Traded value (INR Crores)	No. of trades	Traded value (INR Crores)
2010-11	4448	39528	8006	155951
2011-12	6424	49842	11973	193435
2012-13	8639	51622	21141	242105
2013-14	10187	103027	20809	275701
2014-15	17710	204506	58073	886788
Apr 15 – Dec 15	12469	161880	39471	605499

Trading in the Corporate Debt Market (Source: SEBI)

Reasons Behind Inadequate Growth of Bond Market in India:

It is very important for the growth of an economy to address the factors causing insufficient growth of bond market.

A. Unpopularity of Debt Financing among the Corporates

Significant supply and demand are prerequisite for efficient bond market. Sufficient supply can be ensured by enhancing issuer base. Unlike corporates in developed economies who prefer to bond market for their financing needs, corporates in India prefer banks. Inefficient market might be the important reason behind this.

B. Popularity of Private Placements

Private placements in India are popular and dominated by Financial institutions, PSUs and banks. This route is popular because of its operational flexibility and ease, which significantly affect the growth of bond market.

C. Insufficient Supply & Lack of Variety

Investors in India are restricted to invest in any sub-investment grade corporates, due to these restrictions availability of bonds in the Indian market is very less as compared to other developed markets.

D. Insufficient Demand in Domestic Market and Restriction for Foreign Investors

Foreign Institutional Investors (FIIs) invests in equities as well as debts in emerging markets. Therefore, they help in growth of those segments provided the markets are efficient.

Presence of Foreign Institutional Investors' (FIIs) in any segment of the financial market of an economy makes a significant difference for the growth of that segment. Although, India's equity market is top ranked and FIIs invest heavily in the segment, bond market is not one of their favorite for investments.

E. Lack of Committed Market Makers

Market makers like Primary dealers (PDs) play a significantrole in developing the market at nascent stage. They can provide required support and exit options to the investors.

F. Illiquidity in Govt. Debt Market

Government debt market in India is quite big in case of primary segment, however, the secondary market for the public debt issues in India is very thin. This has made the secondary Govt. debt market very illiquid.

Apart from the above discussed factors, Improper Pricing, Clearing and Settlement System, risk averting investors and lack of hedging instrument, stringent norms and higher transaction cost (Stamp Duty) are also reasons behind insufficient growth of the bond market.

The Need for Growing Bond Market

There are various types of bonds in the Indian market such as Government bonds which are issued directly by the government of India, the so called G-Sec, Borrowing by state governments, Tax free bonds which are issued directly by quasi-sovereign companies allow market expansion for investors, Corporate bonds, Banks and other financial institutions bonds, Tax-savings bonds which are issued directly by the government of India, they provide investors with tax rebates, in addition the normal rate of interest, Tax-saving infrastructure bonds which are issued directly by infrastructure companies approved by the government, they offer tax rebates along with a decent rate of interest.

The need for well-developed corporate bond market can be explained from the view point of investors, borrowers, and also of the whole economy. Investors in corporate bond consists of Institutional investors (Domestic and Foreign), and Retail investors (Domestic and Foreign). On the other hand, borrower or the bond issuer would be the corporate bodies expected to get their projects financed. At the end, the growth of an economy, depends on the developments of each segment of its financial sector in general, and of corporate bond market in particular.

1. **Financial needs:** Corporate bond market can serve financial needs and help bring significant economic benefits and minimizes cost of intermediation between issuers and investors. It promotes diversification in allocation of funds in the economy to the most productive uses. It also eases the pressure from public funding by growing private sector. Regular and fair access to the bond market for the corporates would boost economic growth. As the corporates grows, it will create a strong foundation for employment which in turn would contribute to the enlargement of middle class and help reduce the wealth gap.

2. **Advantages to companies:**

- **Stable funding at low cost:** Companies get secure and stable funding for their growth and value creation. The cost of funding from the bond market is lesser than equity and bank loans. This will improve efficiency of use of capital, maximizing economic benefits. Bond funding acts as an alternative to bank finance and will enable continuous finance even when bank loans are not available and corporates would not need to hoard cash in their balance sheet. Therefore, bond market eases stress from banks to lend to big corporates for a longer tenor. It will also offer flexible funding for businesses needs and development. Also, bonds have fixed term which is determined by the corporates and hence enables them to match bond's maturity with expected cash flows from operations. Mounting NPAs and increased capital requirements under Basel III have forced banks to tighten lending to corporates. In such a situation, bond markets become pivotal in supporting the diverse financing requirements of the growing Indian economy. Especially so for small and medium enterprises and infrastructure projects, which carry higher risks or require longer-term financing that banks with their asset-liability constraints cannot provide.

  - **Financial instruments:** Bond market can provide various types of instruments to serve corporates' funding needs. It will provide mechanism for SMEs to grow into international markets.

  - **Transparency in governance:** To raise funds in the bond market, information demanded by investors encourages corporates to maintain high standards of transparency and corporate governance. This will in turn improve management and efficiency of the corporates.

  - **Cheaper rates:** Corporate bond market facilitates cheaper rate than bank loans at least for a less credit worthy borrowers. At the same time, this cost effectiveness between loan and bond route is meaningful only when the corporate bond market is well developed with complete standardization.

  - **Foreign exchange risk:** Corporates which are raising funds offshore and dealing in foreign currency, become vulnerable to abrupt changes in offshore interest rates. The recent volatility in currency market and devaluation of Indian rupee has squeezed corporates' profits. Lowering the level of borrowing from foreign markets would insulate domestic market from currency and liquidity volatility. Bond market would block a channel through which external shocks can be passed to the domestic market.

3. **Advantages to investors:**

- **Secure and predictable cash flows:** Corporate bonds provide investors a stable and secure form of investment with regular income. Bonds offers potentially higher returns than banks, predictable investment income and assist in efficient investment of savings.Issuers of bonds provide much detailed information and hence informed assessment of risk. Investors would prefer to invest in debt market than equity market because of more committed periodic payments in case of debt market provided it is developed and vibrant. Even though commercial banks can lend to the corporates, the difficulty arises when a large loan amount has to be sanctioned for longer tenor, especially in case of financing long term infrastructure projects. Since the liability of commercial banks consists of deposits accepted from the public which are of shorter tenor in nature, it is difficult for the banks to maintain huge amount of long term assets in the form of long term infrastructure loans. Asset-liability mismatch of banks can be reduced if banks act as investors and fund raisers in the bond market, but it makes banks more vulnerable to market crisis. Hence, existence of bond market in bank dominated financial sector is a successful substitute of bank loans. In current scenario when banks are under severe pressure of stressed assets, inadequate capital requirements to comply with Basel III norms and hence have tightened their lending, the developed bond market comes to the rescue of an economy and acts as a cornerstone for keeping the economy going, by providing an alternative of financing.

- **Diversification:** Corporate bonds acts as an alternative financial instrument to bank deposits, equity markets and public sector bonds. The number of corporate bonds in the market facilitates diversification in maturity, credit quality, rate of return, etc. A more liquid and accessible bond market across sectors, maturities and ratings would create investment opportunities for domestic institutional investors. This will in turn encourage foreign investors to invest in Indian bond market.

4. **Mechanism to link Investors and borrowers:** The bond market serves the purpose of bringing investors and borrowers together and maximize the benefits for both and achieve greater economic goals. Easing investment restrictions would help broaden investor base which could ultimately function as a shock absorber.

5. **Infrastructure Financing:** The government plans for massive infrastructural developments which play a significant role in the growth of an economy are long term in nature, have huge investments and involve several risks. Therefore, as discussed earlier, it is very difficult for banks to finance such projects. But the growth in infrastructure is essential to keep the pace in growth of an economy. Therefore, it is very important also for an economy to have a well- developed corporate bond market, in order to maintain a reasonable growth.

Above all, there is a strong need for a well-developed corporate bond market for the growth of an economy. The growth of an economy depends on the development of its real and financial sector, which are interlinked. Cheaper and easier financing to the corporate will lead to the increase in efficiency in production and output and in turn will lead the economy as well to achieve significant growth.

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ASSOCHAM
INDIA

Enhancing Stability of Financial System

A. K. Mittal
CEO
A. K. Capital Services Ltd.

"A vibrant, deep and robust corporate bond market is essential to enhance stability of the financial system of a country, mitigate financial risks and support credit needs of the corporate sector, which is vital for economic growth. The size of Indian corporate bond market has more than doubled, from INR 3,58,683crores to INR 7,24,499 crores, over past five years and has a potential to grow manifold with increased investor awareness and participation. AK Capital relentlessly strives towards fulfilling its vision of "A bond in every hand" ***- Mr. A. K. Mittal***

India has withstood the note ban worry and demonstrated a record GDP growth of 7.00%with a forecast of 7.1% in FY'17. Retail inflation is also seen within the target rate set by MP Cenabling adequate liquidity in the system. Bank's bank loans are set to be addressed at an accelerated pace with higher transparency ensuring financial stability. Indian corporates as well as offshore investors are finding conducive investment climate for capex in capacity building / enhancement on account of Government's thrust on infrastructure development, affordable housing and recent path breaking reform initiatives such as demonetization, GST, RERA, bankruptcy code etc. Being on a high-growth trajectory, foreign investors are gaining a favorable outlook for fixed income investments in India for higher yielding and better risk-rewarding opportunities.

Overall, the performance of global economic growth and business has been mixed. The IMF has revised its global growth forecast for the year 2017 to 3.5%, which is a notch up from its earlier projections that were raised owing to manufacturing and trade gains in Europe, Japan and China. It also warned that protectionist policies may pose as a threat and choke a broad-based recovery. India offers attractive debt investment opportunities than the West and hence higher returns, but any tightening of monetary policy rates by the European Central Bank (ECB) and the Fed could potentially pose competition to Indian markets.

Globally, debt market comprises of large portion of the financial markets. With an outstanding of $40,000 billion, debt market size is almost 1.6 times the size of the equity market in the US. India contributes 2.99% towards the total global GDP, while its share of debt market capital is less than that of 2.00% of the global outstanding debt (Source: IMF) and with an approximate 90% of the total share, the equity market dominates the Indian capital market.

India's total debt outstanding is INR 1,03,922 billion (Source: RBI & SEBI), comprising 77% of sovereign securities and 23% of corporate bonds. Currently, Government bonds dominate the debt market with an advantage of being more liquid and risk free vis-à-vis corporate bonds. Also, 93% of corporate bonds are privately placed to institutional investors restricting development of healthy secondary markets. Crowding out by government bonds is one of the potential obstacles to healthy corporate bond markets. A high level of public debt crowds out corporate borrowing by reducing the appetite of financial institutions. However, on a progressive basis the volume of corporate debt has been rising substantially over past few years. Further, the dominant profile of issuers i.e. central & state government entities, quasi-government entities, banks and government sponsored financial institutions is getting diluted in favor of private companies.

Financial Year	Total Amount of Corporate Bonds issued (INR in crores)		Total Amount of Bonds issued by Government sponsored entities (INR in crores)		Total Amount of Bonds issued by Private Corporates (INR in crores)	
	Through private placement route	Through public issue route	Through private placement route	Through public issue route	Through private placement route	Through public issue route
2016-17	6,94,952	29,547	2,71,595	0.00	4,23,356	29,547
2015-16	4,68,997	33,812	1,83,383	31,098	2,85,615	2,714
2014-15	4,57,032	9,713	1,97,387	1,972	2,59,645	7,741
2013-14	2,67,652	42,383	1,28,281	36,514	1,39,371	5,869
2012-13	3,41,701	16,982	1,60,918	14,765	1,80,783	2,217

(Source: PRIME database)

Indian corporate bond market is dominated by private placements mode. Over 95% of the total amount of corporate bonds raised in FY'17 of INR 7.24 lakh crores was issued through the private placement route. The popularity may be attributed to the operational flexibility, low issuance costs and the ease of implementation. Most of the corporate bonds issued through private placement mode carry a face value of INR 10 Lacs which is much higher than the average annual income of citizens of the country. Issuers, regulators and intermediaries need to put their acts together to ensure reach of debt financial products to the larger section of society through public offerings. On the positive side, the public offerings have seen a quantum jump from INR 2,714 crore in FY 2015-16 to INR 29,547crorein FY 2016-17. Going forward the growth needs to be sustained to achieve the objective of broad basing the reach of debt financial products.

Around 80-90% of debt in India is in form of bank loans. Absence of an adequately sized corporate bond market leads to an oversized banking system. Often bank lending rates are inefficient in passing through changes in the interest rate by the central bank while bond markets reflect interest rate changes more efficiently. Thus, there is a dire need for a more efficient credit market to pass through shifts in monetary

policy. This becomes particularly important for infrastructure projects. If they can get access to economical capital at interest rates that better reflect monetary policy through tradable bonds, then they might not opt for funding through bank loans. A recent regulatory intent to encourage large borrowers to access a certain portion of their financing needs through market mechanism instead of the banks is also a positive step towards diversifying debt profile.

A thriving corporate bond market offers host of benefits to issuers and investors alike. It helps corporates avoid balance sheet mismatches and foreign currency exposures and secure and stable funding for growth and value creation. On the other hand, it assures investors of quality long-term financial fixed income generating assets, liquidity, risk diversification and effective management of assets and liabilities. Funding from bond market eases pressure on banks' lending to corporates and conserve capital for exposure to much desired sectors. It also offers flexible funding mode for businesses needs as it enables the issuers to match their bond's maturities with expected cash flows from operations.

There are three main pillars that make up the corporate bond market ecosystem – the institutions, participants and the instruments. The 'institutions' comprise of the securities market regulator, the banking regulator, the credit rating agencies, clearing houses, stock exchanges and the regulations and governance norms prescribed by these institutions. The 'participants' comprise of the market players - investors on the demand side and issuers on the supply side. The term 'instruments' indicates the form and features of securities issued in the corporate bond market. Development of corporate bond market essentially revolves around the roles, responsibilities and actions of these three pillars.

Currently all the micro and macro-economic factors such as benign inflation, promising economic growth, strengthening rupee, sliding bond yields, industrial recovery etc. support the growth of corporate bond markets. Healthy corporate bond market is characterized by participation of all classes of investors including mass retail investors. Percolation and reach to retail masses leads to reduction in intermediation resulting in cost saving to the issuers. The Government and the regulators such as SEBI and RBI have been consistently initiating measures to boost growth of domestic corporate bond markets such as simplification of disclosures for debt public issues, allowing FPIs to transaction corporate bonds directly without involving brokers, allocation of tax free bonds to Government sponsored entities, allowing FPI's investment in unlisted corporate bonds, increase in FPI limits,introduction of delivery versus payment (DvP) system to nullify the risk of settlement, electronic bidding platform in private placement for transparent price discovery, market making, re-issuance of debt securities, repo in corporate bonds, municipal bonds, masala bonds, green bonds, infrastructure bonds, partial credit enhancement,introduction of credit default swaps, setting up of dedicated debt trading segment on the exchanges etc.

Presently mounting NPAs and increased capital requirements under Basel III is limiting banks' lending to corporates. In such a situation, bond markets can play a pivotal role in supporting diverse financing requirements of the growing Indian economy especially for small and medium enterprises and infrastructure projects that carry higher risks or require longer-term financing which banks generally do not find feasible due to asset-liability constraints.

Towards conservation of bank's capital and providing impetus to the corporate bond markets, RBI has provided for increase the aggregate partial credit enhancement (PCE) from the earlier level of 20% to 50% of the bond issue size subject to the PCE provided by any single bank not exceeding 20% of the bond issue size including the extant exposure limits.

In order to encourage activity in the corporate bond market, brokers authorized as market-makers have been allowed to participate in the corporate bond repo market. This measure is aimed towards meeting their funding and securities requirement arising out of market making activities.

To facilitate direct trading incorporate bonds by FPIs in the OTC segment and on an electronic platform of a recognized stock exchange, FPIs have been permitted to transact in corporate bonds directly without involving brokers.

To promote development of the corporate bond markets following emerging international practice, RBI is proposing to consider corporate bonds as eligible collateral for liquidity operations. The process to make necessary amendments to the RBI Act has commenced.

With a view to develop the market for rupee denominated bonds overseas, it is proposed that banks may be permitted to make offshore issuance of Perpetual Debt Instruments (PDIs) qualifying for inclusion as Additional Tier1 capital and debt capital instruments qualifying for inclusion as Tier2 capital, in form of rupee denominated bonds. It is an lso proposed to allow banks to issue rupee denominated Masala bonds overseas under the extant framework of incentivizing issuance of long term bonds by banks for financing infrastructure and affordable housing.

SEBI has released the much awaited guidelines and framework for Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs). The markets have witnessed widening of instruments within the structured financial products in the current financial year with the maiden launch of InvITs. So far2 InvIT funds have raised close to INR 7,000 crore while another InvITis likely to come up shortly with an approx. issue size of INR 3,750 crore. Going forward, the markets expect traction in REITs as well.The move will provide a positive push to the Indian capital markets, introduce a different asset class to investors and enable the real estate and infrastructure developers to unlock value in their operational projects and focus on their core strengths of project development.

Desired impetus to growth of corporate bond markets can be provided through balanced efforts of all the stakeholders including regulators, issuers, rating agencies, stock exchanges and intermediaries by playing a responsible role in ensuring transparency, investor education, protection of investors' rights and effective distribution to add different class and stable income bearing assets to all the investors in the country.

Note

A. K. Capital Services Ltd. ("AK Capital"), founded in 1983, operates as a specialized boutique in domestic corporate bond market encompassing almost all spheres such as investment banking, private placement and public issue of debt, underwriting, market making, financial advisory, retirement trust solutions, retail distribution, portfolio management, financing against debt securities, hybrid debt structuring and syndication, G-Sec trading and broking, venture capital, project financing etc. Against debt private placements of INR 8,067 crores handled in FY 1999-00, AK Capital has handled debt issues aggregating approx. INR 1,19,249crores in FY 2016-17. In its journey of over a decade, AK Capital has pioneered and introduced numerous debt and hybrid debt instruments including perpetual bonds, optionally convertible debentures, redeemable preference shares, asset backed debentures, escrow based debentures, unsecured structures, rating linked structures, accelerated redemption structures, zero coupon structures, tax paring structures, loss absorbency embedded structures, discretionary coupon structures, covenant embedded structures etc. Besides institutional syndication, AK Capital has also been instrumental in retail penetration of debt instruments through public offerings.

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Win-Win Situation for All

Sunil Kewalramani
Chief Investment Officer, Chief Research Strategist
Global Money Investor

Eight years have passed since the 2008 financial crisis and the United States is finally showing signs of recovery. Unemployment is down and job creation is growing. With the Federal Reserve on a rate rising spree, it is believed capital is headed back towards the United States.

However, there is still a chance for Indian markets to attract global investors.

Unlike most other major economies, India is on a high-growth trajectory. Capital that is seeking riskier investments for higher returns is actively looking for better risk-reward opportunities.

India is a net importer of oil and could benefit immensely if oil continues to hold at lower levels or fall dramatically as I anticipate (My Book **'2017 Outlook for Stocks, Bonds, Oil, Gold, Trump Presidency, Modi Rule, Brexit, Frexit, Italexit and German Elections'** explains how oil will fall sharply from August 2017 and put India in a **'Sweet Spot').**

As oil price falls, India could benefit immensely from lower inflation. This would immensely benefit Corporate Bond Investors and issuers of Corporate Bonds alike.

Investors will benefit from falling Corporate Bond Yields. Corporates will be able to improve their profitability from falling oil prices and they will be able to issue more Corporate Bonds and service them effectively as well; thus, resulting in a win-win situation for all.

The current NPA mess that Indian banks are in could also be effectively addressed by a vibrant Corporate Bond market.

Indian markets, just like most Emerging Markets, are riskier than the Developed markets of the West. However, as the European Central Bank (ECB) and the US Federal Reserve (Fed) slowly normalize (tighten) monetary policy, Indian companies will have to face tough competition overseas.

Federal Reserve currently has a $ 4.4 Trillion Balance Sheet and is aiming to reduce the size of the Balance Sheet to pre-Great Recession levels of below $ 1 Trillion. However, the size of liquidity and size of economy are quite different now. So, the size of the Balance Sheet cannot reduce to Pre-Great Recession levels. Yet, reducing the size of the Balance Sheet seems imperative for the US Federal Reserve.

The Reserve Bank of India

The Indian economy relies on government debt

One way that Indian firms and the Government of India (GoI) can attract foreign capital more effectively is through the development of the bond market. Bonds can offer a useful set of securities for investors and allow them to diversify their portfolio of investments in India.

Corporate debt markets provide an extensive set of investing opportunities, with a whole host of debt instruments (bonds and bond derivatives), offering exposure to the Indian economy which is among the fastest growing economies in the world.

The Government Securities (G-secs) market is fairly developed; about 75% of the Indian market is Government-issued debt. This is unusual. For most other major debt markets, the corporate debt (company issued bonds) portion of it plays a much larger role. Corporate debt markets provide an extensive set of investing opportunities, with a host of debt instruments (bonds and bond derivatives), offering exposure to the Indian economy. Debt markets traditionally offer a less-risky investment than stocks (equity).

Currently, it is mostly only large Indian banks and the government that issue tradable bonds in the market. Most other entities use private placements (loans from banks) as debt. India lacks a centralized database for information about tradable bonds and a functional trading platform. There are inconsistencies in how bond prices and yields are calculated and listed.

Corporate bonds are the key

The most important piece of the need for a better developed bond market in India is access to capital for more firms. Currently, only top-rated borrowers have access to the corporate bond market. Further, banking and financial services account for 74% of primary bond issues in the country.

Hence,a more developed, unregulated bond market might allow more firms access to cheaper or more efficient debt capital, through a higher risk-taking culture among investors.

On the policy side, bank lending rates are inefficient in passing through changes in the interest rate by the central bank. Markets reflect interest rate changes more efficiently. Further reforms from the central bank are required if more firms are to gain access to the bond market. The government may attempt to protect the traditional public sector banks and hence private debt markets.

It is important to remember that 95% of Debt in India are bank loans. Thus, there is a dire need for a more efficient credit market to pass through shifts in monetary policy. This becomes particularly important for infrastructure projects. If they can get access to cheaper capital at interest rates that better reflect monetary policy through tradable bonds, then they might not choose to get bank loans to finance projects. And when infrastructure projects can be financed more efficiently using publicly traded bonds, more of them are executed. This will thus address the acute Infrastructure Deficiency that India is currently facing.

A whole new asset class is required

Thus, there is a dire need for a more efficient credit market to pass through shifts in monetary policy.

Developed bond markets will create a new asset class in India that attracts foreign capital. It will be an efficient allocator of capital and will bring more firms into the market. To realize these benefits, the RBI took an important step in August 2016 to liberalize bond markets by allowing banks to raise capital through rupee-denominated bonds (Masala Bonds) in foreign markets.

It also allowed both resident and non-resident Indians to maintain big open positions in the bond market. This step will expand the investor base and hence the capital inflow into the economy. With more deposits in banks today than ever before, there is a lot more money available to facilitate this move. And for you, it's a

chance to earn high returns on otherwise immobilized money. Especially in an environment where interest rates are headed downward and bond prices headed higher.

The Genesis of a vibrant Corporate Bond Market is falling oil prices internationally.

Global Oil supply rebalancing still continuing

Oil price expected to fall in 2017

According to the **Commodity Futures Trading Commission's weekly commitment of traders report,** large speculators, meaning money managers, were holding a net long position of 525,000 futures contracts just before oil dropped recently. They were betting on a huge spike in the price of crude.

Remember that when too many speculators lean to one side of the trade, it's best to run the other way and take the others side of the trade.

Back when oil was in the $50s, producers were selling oil to raise funds for drilling plans. With oil in the $40s, which is breakeven for a lot of producers, companies can cut back on all but for the most lucrative patches in the Permian Basin and Oklahoma.

OPEC's latest monthly report is showing Saudi Arabia continuing to provide the lion's share of the cartel's coordinated production cuts while many members continue to pump above their quotas. This means the OPEC accord struck in late 2016 is not working and this could impact energy stocks.

OPEC also says oil inventories had continued to rise despite the start of a global deal to cut supply.

Finally, OPEC has also raised its forecast of production in 2017 from outside the group, suggesting complications in the effort to clear a supply glut.

I believe this fall in Oil Prices should continue for most of 2017. Minor pullbacks could be seen between April-June 2017.

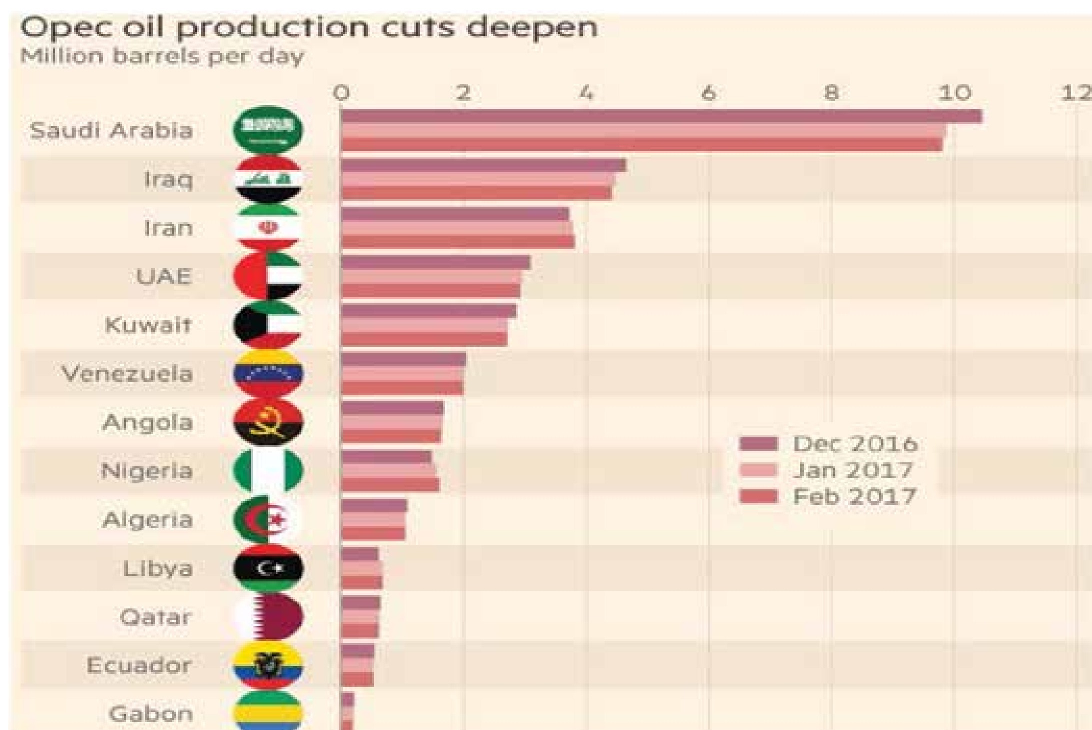
Five things to watch as oil prices fall

Here are five factors contributing to the renewed bout of selling that could dictate whether Brent crude can hold above $50 a barrel.

Fight between OPEC and US shale contributing to renewed bout of selling

Oil prices have fallen almost 10 % since the beginning of the year to their lowest level since OPEC agreed to cut output in November of 2016.

Shale: The US shale industry has come back with a bang, with oil prices back above $50 a barrel. After two years of contraction, the US Energy Information Administration sees output rising 300,000 barrels a day to 9.2m b/d in 2017 before adding a further 500,000 b/d next year. Those are already big numbers but only tell half the story. The industry has squeezed down costs during the two-year downturn and executives are talking up efficiency and production gains that lead many to forecast an even bigger rebound. The speed of shale's recovery is a reminder that the industry has to adapt to a big structural shift rather than just a short-term glut. Oil companies are directing spending towards the most productive plays such as the Permian Basin in Texas. Drilling rigs in the US are at the highest level in 18 months. Other producers, such as those focused on Canadian tar sands, have also squeezed down costs. Given the constant improvement in Permian production-type curves and strength in Canadian production of late, it would not be entirely inconceivable to see combined US and Canadian output rising by 1m b/d in 2017.



OPEC:

Stronger than expected North American production poses a serious threat to OPEC. The 13-member cartel successfully boosted prices after they agreed supply cuts late last year, bringing other big producers from outside the group — such as Russia — onboard. But after the initial rally in December prices flat lined above $50 a barrel for the first two months of 2017, despite signs the group was collectively coming close to its output target.

OPEC faces a difficult decision when it next meets on May 25. It could roll over the existing cuts, which many analysts believe will see inventories finally start to draw down in the second half of the year. It could agree to cut deeper to give the price a further boost, but knowing it would almost certainly give up more market share to other producing countries. Or it could abandon attempts to manage the market and revert to an all-out price war — a strategy the group only fully embraced during 2015 before the pain of low prices became too much for their oil-dependent economies to accept. The first option may be most likely — unless cohesion among participating countries starts to unravel should the current price drop endure. Saudi Arabia, the world's biggest exporter, has been consistent in saying it will not do all the heavy lifting on its own. The kingdom rushed out a statement saying it remains committed to the cuts and "stabilising the global oil market" with its partners, as Brent slipped towards $50 a barrel. Russia, the largest crude exporter outside OPEC, has however been lukewarm so far to the possibility of further action given the recovery in shale. Moscow says it is "too early" to decide, saying higher prices meant shale producers "are putting pressure on the oil market".

Inventories:

The biggest short-term problem for OPEC is that US inventories keep on rising. The sell-off really got going recently after the EIA reported crude stocks had gone up for the ninth consecutive week to an all-time high of more than 528m barrels. While some analysts argue stocks are tightening elsewhere in the world, the US has by far the best — and most timely — data, giving it an outsized influence over the market. The US also remains the world's biggest oil consumer, making it the key battleground between shale and OPEC. Terms of the OPEC agreement.

Hedge funds:

Investors had lined up to back OPEC's cuts, amassing the biggest ever bet on rising prices in the first two months of this year. Across Brent and US benchmark West Texas Intermediate their net long position — the difference between bets on rising and falling prices — had reached 951m barrels, or the equivalent of 10 days of oil demand, by February 21. But oil's failure to break higher in 2017 meant that position was getting more expensive to defend. Traders say it is not surprising funds have started to scale back their position — a move that probably accelerated after the recent 10% drop in a single week of March 2017. We saw a situation that speculative traders held almost 12 lots of longs per short. Such a scenario reduces traders' ability to provide a solid bid into a falling market with the majority being sellers.

Demand:

If the supply picture has many moving parts, demand should be easier to track, and may provide some comfort to OPEC. The group raised its estimates and predicts growth at almost 1.3m b/d to average 96.3m b/d in 2017.

While the rise of electric cars has led some big players in the industry to warn of peak oil demand in the near future, others are far more skeptical. The conventional global car fleet is increasing by 40m a year, net of scrapping. That alone should account for about 600,000 b/d of growth, or half the 10-year average. Higher use in planes, freight and petrochemicals will also boost consumption. Oil is a mature energy source and efficiency is improving. But 'Peak Demand' is still some time off.

An accord signed in 2016 will spell the beginning of the end for OPEC

The cartel cannot enforce this pact. The oil price will probably soon fall back

The deal agreed by OPEC members late 2016 will come to symbolise the passing of one of the world's most powerful cartels. After 50 years in control of the oil price, OPEC has submitted to the economic power of a much-changed global market. The deal represents the recognition of their own impotence by a group of countries that once held unchallenged power.

The agreement to cut production from January by 1.2m barrels a day raised prices on the world market by almost 10 per cent. The net result was a global price for Brent crude, the international benchmark, of $52 a barrel — up a few dollars from the previous day but still down almost 50 per cent from two years ago.

Khalid al-Falih, Saudi oil minister, is much more realistic than his predecessors

What should investors and consumers make of all this? First, consider the modesty of the increase in prices. This is not a deal capable of lifting prices to the level of $60 or $70 a barrel that is supposed to be OPEC's target. The market is obviously sceptical about delivery. Will Iran limit its production when it desperately needs increased output and revenue to sustain its economy? Will Russia actually cut output by 300,000 b/d? When did Russia last participate in an OPEC quota exercise? Answer: never.

Second, take stocks — which, according to the International Energy Agency and every other independent organisation that follows the oil market, will take at least a year (probably more) to run down. If the OPEC production cut were considered in isolation, this surplus might be expected to fall. But there is a surge of production coming in the next 12 months from new fields in countries outside OPEC, such as Brazil, Canada and Kazakhstan. It is perfectly possible that total global production — from OPEC and non-OPEC states combined — will be higher next year than in 2016.

Third, consider the US shale business, which has every incentive to use the price rises to maintain and increase production. Contrary to the prophets of doom, the industry has been remarkably resilient in the past two years. There has been no collapse. Costs have been cut radically. Some companies have shut down production, but they will use every opportunity to bring it back on. And the advances made in technology and productivity will spread across the world, further increasing output.

Finally, there is the view from Riyadh. The strategy of swamping the market with extra supplies to squeeze out production from competitors and to maintain Saudi Arabia's share of the world market has failed.

What next? For all these reasons, the current deal is inadequate and will fail. The cuts will not be implemented in the true sense of the word. Too many of the promises, especially from the non-OPEC states, are too vague

and the incentive to cheat is too high. OPEC has no enforcement mechanism against those who break the agreement. The price will fall back, perhaps quite quickly.

Then the real choice comes for Khalid al-Falih, the new Saudi oil minister, who is much more realistic than his predecessors. To lift prices to anything close to $70 a barrel, Saudi Arabia, and Saudi Arabia alone, will have to cut production dramatically — by another 1m to 1.5m b/d, and to hold it down at that level for a year or more.

Cartels need a swing producer that has the capacity to vary production to the degree necessary to control the market and which can absorb the pain of such a move. That is what they would have done in the past, but it may now be impossible, economically and politically. Saudi Arabia cannot sustain such a sacrifice, particularly given its weak security situation and its failure to diversify its economy. If that is true, the $50 price we have today is a ceiling. OPEC as a cartel is over and everyone will have to get used to the new reality.

Oil prices will remain subdued in 2017—and fall sharply after August 2017

Leaner and meaner: US shale greater threat to OPEC after oil price war—

Workers with Raven Drilling line up pipe while drilling for oil in the Bakken shale formation outside Watford City, North Dakota

In a corner of the prolific Bakken shale play in North Dakota, oil companies can now pump crude at a price almost as low as that enjoyed by OPEC giants Iran and Iraq.

Until a few years ago it was unprofitable to produce oil from shale in the United States. The steep slide in costs could encourage more U.S. shale output if OPEC members cut supplies, undermining the producer group's ability to boost prices. OPEC ministers meet Wednesday to weigh output cuts to end a two-year glut that has pressured global oil prices.

In shale fields from Texas to North Dakota, production costs have roughly halved since 2014, when Saudi Arabia signaled an output free-for-all in an attempt to drive higher-cost shale producers out of the market.

Rather than killing the U.S. shale industry, the ensuing two-year price war made shale a stronger rival, even in the current low-price environment.

In Dunn County, North Dakota, there are around 2,000 square miles where the cost to produce Bakken shale is $15 a barrel and falling, according to Lynn Helms, head of the state's Department of Mineral Resources.

The success in Dunn County has been fantastic.

Dunn County's cost is about the same as Iran's, and a little higher than Iraq's. Dunn County produces about 200,000 barrels of oil a day, about a fifth of daily production in the state.

It is North Dakota's sweet spot because it boasts the lowest costs in the state, yet improved technology and drilling techniques have boosted efficiency for the whole state and the entire U.S. oil industry.

The breakeven cost per barrel, on average, to produce Bakken shale at the wellhead has fallen to $29.44 in 2016 from $59.03 in 2014, according to consultancy Rystad Energy. It added that in terms of wellhead prices, Bakken is the most competitive of major U.S. shale plays.

Wood Mackenzie said technology advances should further reduce breakeven points.

Landlocked Bakken producers still need a substantially higher international price than their breakeven cost to make a profit, since they pay more to transport crude to market than producers in most other U.S. regions.

International oil prices of $45 a barrel are enough for some Bakken producers to profit, Ness said, and $55 would encourage production growth.

Benchmark Brent prices plummeted from nearly $116 a barrel in mid-2014 to just $27 earlier in 2016. Prices then recovered to nearly $46. That is still too low for members of the Organization of the Petroleum Exporting Countries, whose state budgets depend on petrodollar revenues that plummeted during the price war.

For OPEC ministers meeting in Vienna, a major concern is that an output cut would encourage a quick response from U.S. shale producers, who have slashed costs and have been steadily adding drilling rigs.

Right now, OPEC understands we're in a push-and-pull experiment with the United States.

Two years ago, we thought prices hovering around $50 to $60 meant that non-OPEC production growth would end. But U.S. production came back stronger.

In a recent earnings call, Hess Corp said it has improved its cost performance in the Bakken, with well costs falling and initial production rates rising, though it did not give more details.

Everybody is drilling wells faster and completing them better--It's not just a Bakken phenomenon.

I prefer shale stocks in the Permian basin in Texas, where I am expecting more big gains in production next year. I am eyeing firms such as Parsley Energy Inc, Ring Energy Inc and Matador Resources Co.

Oil companies are already investing big money to benefit from shale's resurgence. Tesoro Corp recently snapped up Western Refining Inc in a $4 billion deal to bulk up its exposure in Texas.

Separately, trading firm Castleton Commodities International LLC bought more than $1 billion in assets from Anadarko Petroleum Corp to increase its stake in East Texas.

Occidental Petroleum Corp's top executive recently said that company has enjoyed steady improvement in well productivity and lower drilling and completion costs in the Permian Basin.

Simply put, we can deliver more production with fewer wells.

The Way ahead for 'Corporate Bond Market in India'

To sum up, Lower Oil Prices puts India in a sweet spot and assures it gets the benefit of falling oil prices in improving its fiscal situation.

Lower Oil Prices will lead to lower Inflation and lower Interest rates—a good situation for Bond Investors.

Lower Oil Prices will also lead to Corporates improving their profitability from lower input costs and this could augur well for their Net Profit Margins. Healthy Balance Sheet of Corporates will ensure they service their loans effectively and on time. It also ensures Corporates get all loans they need to expand their business.

A Healthy and Vibrant Corporate Bond Market will ensure all this happens and will result in a win-win situation for all!

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Evaluating Corporate Bond Market Development

Evaluating Corporate Bond Market Development

V Muralidharan
CEO & Whole Time Director
SBI Cap Trustee Company Ltd.

Bonds can be considered a good investment product for investors who are looking at investments from a short-term perspective. Bonds are generally considered a less risky investment compared to equity and hence many investors who do not have high appetite for risk go for investing in bonds. The primary goal of the bond market is to provide a mechanism for long term funding of public and private expenditures. The most important advantage of investing in bonds is that it helps diversify and grow your money.

Challenges with Corporate Bond Market Development

1. Ability to access:

When companies or other entities need to raise money to finance new projects, maintain ongoing operations, or refinance existing other debts, they may issue bonds directly to investors instead of obtaining loans from a bank. The indebted entity (issuer) issues a bond that contractually states the interest rate (coupon) that will be paid and the time at which the loaned funds (bond principal) must be returned (maturity date).

Most bonds share some common basic characteristics including:

- Face value is the money amount the bond will be worth at its maturity, and is also the reference amount the bond issuer uses when calculating interest payments.
- Coupon rate is the rate of interest the bond issuer will pay on the face value of the bond, expressed as a percentage.
- Coupon dates are the dates on which the bond issuer will make interest payments. Typical intervals are annual or semi-annual coupon payments.
- Maturity date is the date on which the bond will mature and the bond issuer will pay the bond holder the face value of the bond.
- Issue price is the price at which the bond issuer originally sells the bonds.

Two features of a bond – credit quality and duration – are the principal determinants of a bond's interest rate. If the issuer has a poor credit rating, the risk of default is greater and these bonds will tend to trade a discount/ higher interest rate. Credit ratings are evaluated and issued by credit rating agencies. Bond maturities can

range from a day or less to more than 30 years. The longer the bond maturity or duration, the greater the chances of adverse effects due to adverse change in interest rates/credit rating etc. Longer-dated bonds also tend to have lower liquidity. Because of these attributes, bonds with a longer time to maturity typically command a higher interest rate.

When considering the riskiness of bond portfolios, investors must typically consider the duration (price sensitivity to changes in interest rates) and convexity (curvature of duration).

Corporate bonds: Corporate bonds are issued by corporations to raise capital. They are considered safer than equities. The bondholders get a specified return every period.

Government bonds: Government bonds are issued by Government to finance their activities. In India, the Government bond market size is much larger than the corporate bond market size. They are also known as G-Sec. The bonds' return depends on the prevailing interest rate.

2. Perceived Risk of the Market Framework:

Bonds can be a great tool to generate income and are widely considered to be a safe investment, especially when compared to stocks. However, investors need to be aware of some potential pitfalls and risks to holding corporate and/or government bonds. In this article, we'll expose the risks that wait to steal your hard-earned profits.

- **Interest Rate Risk**

Interest rates and bond prices carry an inverse relationship; as interest rates fall, the price of bonds trading in the marketplace generally rises. Conversely, when interest rates rise, the price of bonds tends to fall. This happens because when interest rates are on the decline, investors try to capture or lock in the highest rates they can for as long as they can. To do this, they will scoop up existing bonds that pay a higher interest rate than the prevailing market rate. This increase in demand translates into an increase in bond price.

On the flip side, if the prevailing interest rate were on the rise, investors would naturally jettison bonds that pay lower interest rates. This would force bond prices down.

- **Reinvestment Risk**

Another danger that bond investors face is reinvestment risk, which is the risk of having to reinvest proceeds at a lower rate than the funds were previously earning. One of the main ways this risk presents itself is when interest rates fall over time and callable bonds are exercised by the issuers.

The callable feature allows the issuer to redeem the bond prior to maturity. As a result, the bondholder receives the principal payment, which is often at a slight premium to the par value.

However, the downside to a bond call is that the investor is then left with a pile of cash that he or she may not be able to reinvest at a comparable rate. This reinvestment risk can have a major adverse impact on an individual's investment returns over time.

To compensate for this risk, investors receive a higher yield on the bond than they would on a similar bond that isn't callable. Active bond investors can attempt to mitigate reinvestment risk in their portfolios by staggering the potential call dates of their differing bonds. This limits the chance that many bonds will be called at once.

- **Inflation Risk**

When an investor buys a bond, he or she essentially commits to receiving a rate of return, either fixed or variable, for the duration of the bond or at least as long as it is held.

But what happens if the cost of living and inflation increase dramatically, and at a faster rate than income investment? When that happens, investors will see their purchasing power erode and may actually achieve a negative rate of return (again factoring in inflation).

Put another way, suppose that an investor earns a rate of return of 3% on a bond. If inflation grows to 4% after the bond purchase, the investor's true rate of return (because of the decrease in purchasing power) is -1%.

- **Credit/Default Risk**

When an investor purchases a bond, he or she is actually purchasing a certificate of debt. Simply put, this is borrowed money that must be repaid by the company over time with interest.

Investors must consider the possibility of default and factor this risk into their investment decision. As one means of analyzing the possibility of default, some analysts and investors will determine a company's coverage ratio before initiating an investment. They will analyze the corporation's income and cash flow statements, determine its operating income and cash flow, and then weigh that against its debt service expense.

- **Rating Downgrades**

A company's ability to operate and repay its debt (and individual debt) issues is frequently evaluated by major ratings institutions such as Standard & Poor's or Moody's. Ratings range from 'AAA' for high credit quality investments to 'D' for bonds in default. The decisions made and judgments passed by these agencies carry a lot of weight with investors.

If a company's credit rating is low or its ability to operate and repay is questioned, banks and lending institutions will take notice and may charge the company a higher interest rate for future loans. This can have an adverse impact on the company's ability to satisfy its debts with current bondholders and will hurt existing bondholders who might have been looking to unload their positions.

- **Liquidity Risk**

While there is almost always a ready market for government bonds, corporate bonds are sometimes entirely different animals. There is a risk that an investor might not be able to sell his or her corporate bonds quickly due to a thin market with few buyers and sellers for the bond.

Low interest in a particular bond issue can lead to substantial price volatility and possibly have an adverse impact on a bondholder's total return (upon sale). Much like stocks that trade in a thin market, you may be forced to take a much lower price than expected to sell your position in the bond.

3. Relative Cost and Return of participating in the market:

The primary purpose of most bond funds is to provide investors with income. But those who focus exclusively on a bond fund's yield are only seeing part of the picture. Investors must also consider the fund's total return, which is the combination of yield and the return provided by principal fluctuation.

In addition to the return provided by yield, the fluctuations in the bond prices (or "net asset value") also make a contribution to total return. In a given year, these fluctuations can cause the total return to be higher or lower than the fund's yield. If a fund that yields 5% also has a 5% increase in its bond prices, its total return is 10%. If the same fund experiences a 5% decline its bond prices, the total return is 0%.

Depending on the type of fund, these fluctuations can have varying degrees of impact on return. For instance, high-yield and emerging market bond funds tend to have much greater volatility than short-term bond funds that invest in higher-quality securities. Before investing in a fund, investors need to be sure they are comfortable with the potential volatility.

While a fund that invests in high yield bonds will usually have a higher yield than another bond fund that invests in higher-quality securities, the amount of principal fluctuation may not be appropriate for investors with low risk tolerance or who may need the money in the near future.

Investors need to take care not to confuse yield with total return. Just because a fund has a reported yield of 7% doesn't mean that's the actual return on your investment. In a given year, fluctuations in the bond fund's portfolio price, the fund's capital gains distribution to its shareholders and the particulars of your own tax situation mean that your after-tax return will likely differ.

4. Ability to effectively match supply and demand:

Wealth determines the overall demand for assets. An asset (something owned) is any store of value, including financial assets like money, loans (for the lender), bonds and equities (stocks). As wealth increases, so too does the quantity demanded of all types of assets, though to different degrees.

Calculating return is not terribly difficult and neither is comparing returns among a variety of assets. What's tricky is forecasting future returns and making sure that assets are comparable by controlling for risk, among other things. Risk is the uncertainty of an asset's returns. It comes in a variety of flavors, all of them unsavory, so as it increases, the demand decreases. Two major types of risk are default risk (i.e. credit risk), the chance that a financial contract will not be honored, and interest rate risk, the chance that the interest rate will rise and hence decrease a bond or loan's price. An offsetting risk is called reinvestment risk, which bites when the interest rate decreases because coupon or other interest payments have to be reinvested at a lower yield to maturity. To be willing to take on more risk, whatever its flavor, rational investors must expect

a higher relative return. Investors who require a much higher return for assuming a little bit of risk are called risk-averse. Liquidity risk occurs when an asset cannot be sold as quickly or cheaply as expected, be it for idiosyncratic, sectoral, or systemic reasons. This, too, is a serious risk because liquidity, or (to be more precise) liquidity relative to other assets, is the third major determinant of asset demand. Because investors often need to change their investment portfolio or dis-save (spend some of their wealth on consumption), liquidity, the ability to sell an asset quickly and cheaply, is a good thing. The more liquid an asset is, therefore, the further right the demand curve for it will shift, all else being equal.

During the financial crisis that began in 2007, the prices of a certain type of bond collateralized by subprime mortgages, long-term loans collateralized with homes and made to relatively risky borrowers, collapsed. In other words, their yields had to increase markedly to induce investors to own them. They dropped in price after investors realized that the bonds, a type of asset-backed security (ABS), had much higher default rates and much lower levels of liquidity than they had previously believed.

Figure below summarizes the Variables that influence demand for bonds

Variable	Change in Variable	Change in Quantity Demanded	Shift in Demand Curve
Wealth	Up	Up	Right
Expected relative return	Up	Up	Right
Expected interest rate	Up	Down	Left
Inflation expectations	Up	Down	Left
Relative risk	Up	Down	Left
Relative liquidity	Up	Up	Right

Why does the supply curve for bonds shift to and fro? There are many reasons, but the three main ones are government budgets, inflation expectations, and general business conditions. When governments run budget deficits, they often borrow by selling bonds, pushing the supply curve rightward and bond prices down (yields up). When governments run surpluses, and they occasionally do, believe it or not, they redeem and/or buy their bonds back on net, pushing the supply curve to the left and bond prices up (yields down), all else being equal.

The expectation of higher inflation, other factors held constant, will cause borrowers to issue more bonds, driving the supply curve rightward, and bond prices down (and yields up).

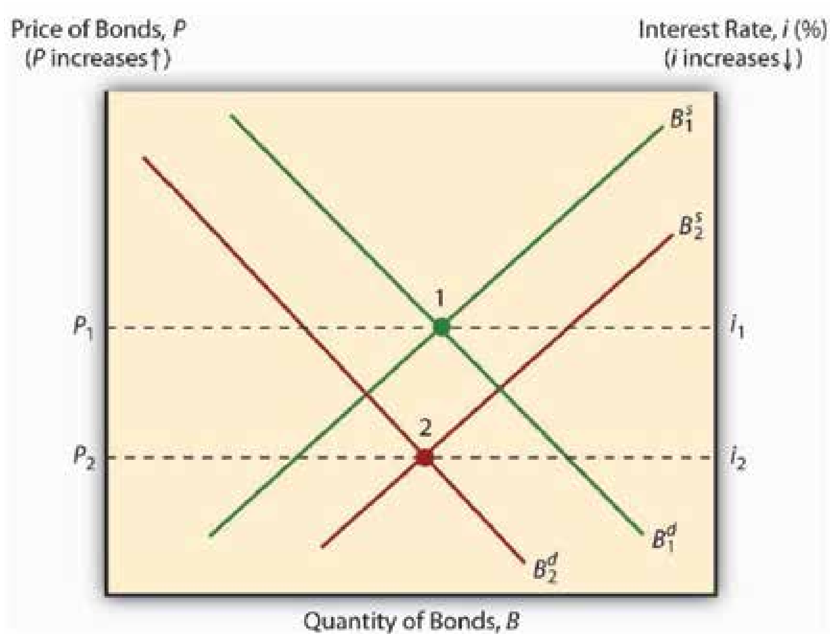
Borrowing also becomes more attractive when general business conditions become more favorable, as when taxes and regulatory costs decrease or the economy expands. Although individuals sometimes try to borrow out of financial weakness or desperation, relatively few such loans are made because they are high risk. Most economic entities borrow out of strength, to finance expansion and engage in new projects they believe will be profitable. So when economic prospects are good, taxes are low, and regulations are not too costly, businesses are eager to borrow, often by selling bonds, shifting the supply curve to the right and bond prices down (yields up).

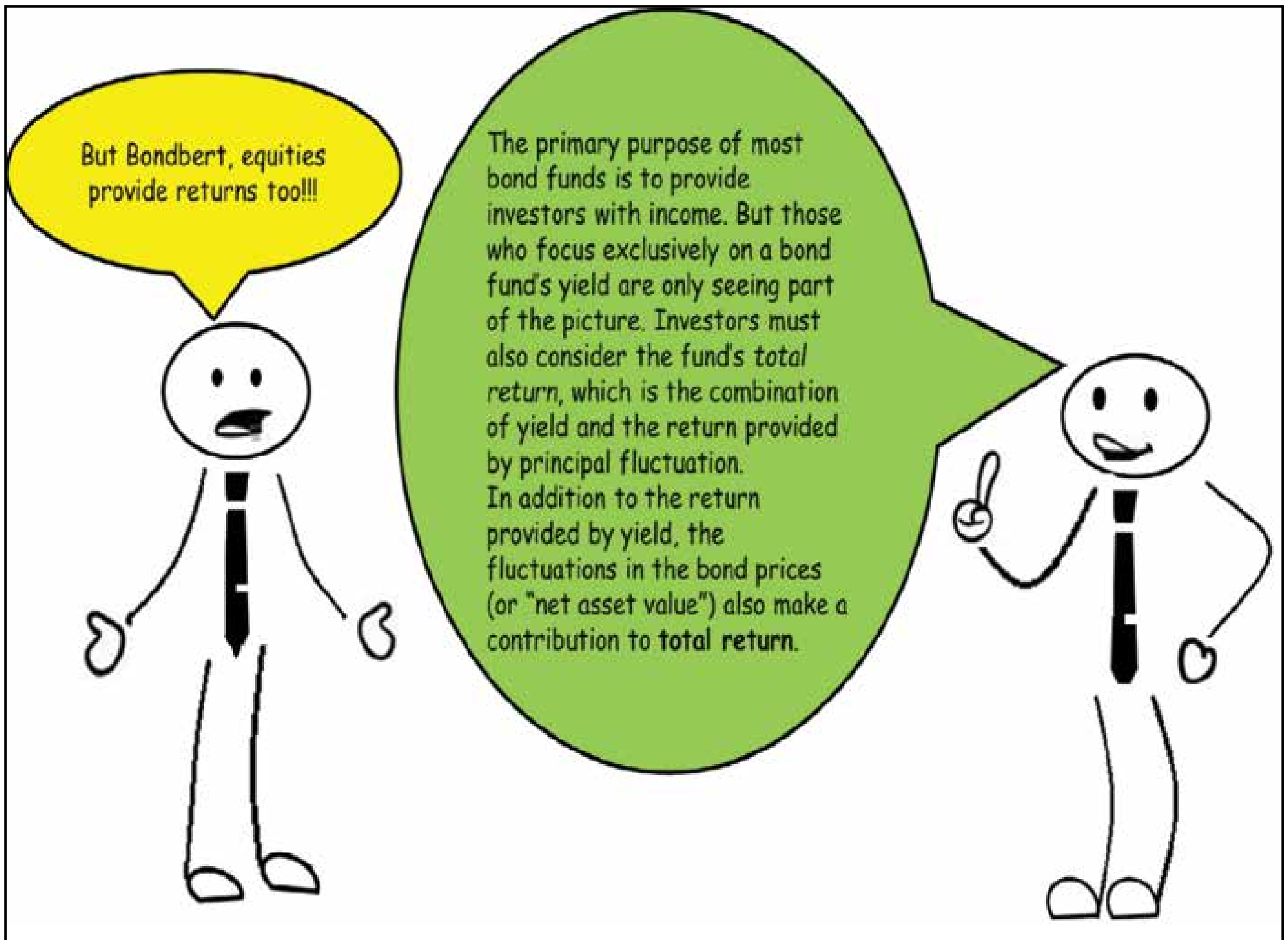
Figure below summarizes Variables that determine the supply of bonds

Variable	Change in Variable	Change in Quantity Supplied	Shift in Supply Curve
Government budget	Deficit/Surplus	Up/Down	Right/Left
Inflation expectations	Up/Down	Up/Down	Right/Left
General business conditions	Up/Down	Up/Down	Right/Left

Expected inflation and bond prices

If you notice, the response of bond prices and yields to a business cycle expansion is indeterminate. As noted above, a boom shifts the bond supply curve to the right by inducing businesses to borrow and thus take advantage of the bonanza. Holding demand constant, that action reduces bond prices (raises the interest rate). But demand does not stay constant because economic expansion increases wealth, which increases demand for bonds (shifts the curve to the right), which in turn increases bond prices (reduces the interest rate).




But Bondbert, equities provide returns too!!!
The primary purpose of most bond funds is to provide investors with income. But those who focus exclusively on a bond fund's yield are only seeing part of the picture. Investors must also consider the fund's *total return*, which is the combination of yield and the return provided by principal fluctuation.
In addition to the return provided by yield, the fluctuations in the bond prices (or "net asset value") also make a contribution to **total return**.

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Developing Corporate Bond Markets in India

Developing Corporate Bond Markets in India

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Introduction

One of the main functions of a financial system is to promote the efficient allocation of capital. Financial economists have identified several basic functions of a financial system such as providing ways of making payments to facilitate trade; providing ways of pooling capital resources and subdividing of public and private debts as well as shares of enterprises into units attractive to investors; providing ways to transfer economic resources through time, across geographical boundaries, and among economic sectors and industries. More importantly, financial markets provide price information to coordinate decentralized decision-making and manage risk in an economy.

According to the renowned financial historian Richard Sylla, building blocks of a well-developed financial system include: sound public finances and public debt management; stable monetary and payments arrangements; sound banking systems (more generally, institutional lenders); an effective central bank; good securities markets for debt, equity, and money-market instruments; and sound insurance companies.

The purpose of developing a large liquid corporate bond market is in line with this historical importance, attached to this market. It has been well recognized that a well-developed corporate bond market complements a sound banking system in providing an alternative source of finance to the real sector for its long-term investment needs. An active corporate bond market also helps in the diversification of risks in the financial system. In order to enable public and private sector firms to borrow for longer maturity periods in local currency to meet their investment needs and avoid balance sheet mismatches and foreign currency exposures, there is a need to accelerate the development of local currency bond market. An active corporate bond market could also provide institutional investors such as insurance companies and provident and pension funds with quality long term financial assets, helping them in matching their assets and liabilities.

There have been a number of reports by expert Committees on development of corporate bond markets in India viz. Report of High Level Expert Committee on Corporate Bonds and Securitisation in 2005 (R. H. Patil Committee), Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre in 2007 (Percy Mistry Committee), A Hundred Small Steps [Report of the Committee on Financial Sector

Reforms (CFSR)] in 2009 (Dr. Raghuram Rajan Committee), Reports of the City of London, A Working Group in 2016 (Chairman: Harun R. Khan), set up under the aegis of the Financial Stability and Development Council Sub-committee etc. These Committees have examined in detail various aspects related to the development of corporate bond market and have made useful recommendations. Many of these recommendations have already been implemented.

Corporate bond markets in India

India does not have a well-developed corporate bond market. However, not as well recognized is the fact that even in developed economies, corporate bond markets are not as developed and as liquid as Government bond markets. In terms of Government debt to GDP ratio, an indicator of maturity of debt market, barring Russia, other BRICS nations have relatively deep Sovereign debt markets. The ratio ranges from 66% in Brazil to 18% in Russia. India has a Govt. debt to GDP ratio of 66%.

China's bond market in recent times has seen rapid growth, making it the third largest bond market of the world after US and Japan. China's bond market size is about $10 trillion. In comparison to China, India's bond market is estimated to be about $ 1.5-2 trillion. With the exception of the US, where the corporate debt market is bigger than the Government debt market, India and China have bigger sovereign debt segments with Sovereign debt to corporate debt ratio at 2.7 and 2.1 respectively.

Indian Corporate Bond market has seen some growth in recent years, both in terms of number of issues and amounts. The outstanding issues, which were at 12,155 as at the end of March 2011,increased to 22,374 by the end of March 2016. During the same period, the amount of outstanding debt increased from INR 8,895 billion to INR 20,193 billion. While the nature of instruments issued included fixed rate bonds, floating rate bonds, structured notes and others, fixed rate bonds were predominant, both in number and value.

A peculiar feature of our corporate bond market is that private placements are the norm. Private placements, which were INR 2,187.85 billion in FY 2011, were INR 4,580.73 billion in the year FY 2016. These have increased sharply in FY 2017 crossing INR 6000 billion levels. More than 95% of total issues in the corporate bonds space are privately placed. This is not, per se, a shortcoming as long as there is transparency regarding such issues. Hence, the efforts of the authorities have been towards building a trade repository of both primary and secondary activities.

In India, another characteristic of the corporate bond market is that it is a thin secondary market. In 2015-16 the public issuances increased to INR 338 billion which were INR 94.51 billion in 2010-11. The secondary market trading which was at INR 6053 billion in 2010-11, was at INR 10,224 billion in 2015-16 and the same jumped by 44% to INR 14,700 billion in FY 2017. Thus, only 45% of the outstanding stock is available as free float indicating the predominance of passive investors in Indian bond markets. Trading volumes have been increasing, from about INR 5 billion (average daily) in FY 2009 to about INR 45 billion in FY 2015 (CRISIL IDM 2015). Turnover in the corporate bond market declined by 6.3% in FY 2016 in relation to the previous year but has shown a sharp rise of 26% in FY 2017.Ofcourse, this is considerably less than the volumes in the G-sec market.

Another significant character of India's corporate debt market is the dominance of financial institutions. Bulk of the issuance is in the so-called BFSI Sector (Banking, Financial Services and Insurance). Banking and financial services account for 74% of all primary issues in FY 2015. Non-financial corporates account only for 19% of all outstanding issuance. Most of the corporate issuance in India is of top credit quality, with AA- or better accounting for about 80% of all the issuance while BBB or worse accounted for only 14% in FY 2016. This shows that the corporate bond market is still largely accessible to the top rated borrowers. Thus, lower rated corporates and MSMEs have no recourse to the corporate bond markets in India.

Some of the other major bottlenecks towards developing corporate bond markets in India include:

- Indian market has traditionally been a bank dominated system with corporates relying more on loan financing compared to bond financing. Weaning corporates away from banks has proved to be a difficult task. However, once the corporate bond yields declined following easing of g-secs yields during 2016-17, taking advantage of low yields vis- à-vis bank lending rates, corporates did raise more resources from the bond market in the recent times.
- Internationally, insurance companies are among the largest participants in the corporate bond markets. However, in India, institutional investors like Insurance companies, PFs, EPFO who have large assets under their management, still have several constraints in the nature of investment mandates resulting in limited participation of such entities. Pension Funds and Insurance companies prefer Government securities as they have to provide safe and guaranteed returns.
- Unavailability of credit risk transfer mechanism in the corporate bond market also works as a deterrent. Though CDSs have been introduced in India, there is no activity in the market. One of the major constraints is the restriction on netting of MTM position against the same counterparty for capital adequacy and exposure norms.
- The absence of robust bankruptcy laws was also reckoned as one of the major reasons for lack of investor interest in corporate bonds. However, with the new Bankruptcy code now operational, it needs to be seen if this translates into visible activity in the corporate bond market.
- Lack of centralised database which enables investors to get complete information about the corporate debt market at one place.
- Lack of functional trading platform with CCP facility. This aspect is under the consideration of RBI in consultation with SEBI.

The RBI has taken notable steps to increase the length and breadth of the corporate bonds markets. The most recent steps include the following:

- Allowing banks to extend partial credit enhancement to corporate bonds as an irrevocable contingent line of credit to be drawn to fund a shortfall in servicing of bonds, if any.
- Raise the investment ceiling in AAA- rated corporate bonds by standalone PDs from 25% to 50% of the latest audited net owned fund for a single borrower/counterparty and from 40% to 65% for a group

borrower.

- Notify the 'Framework for Enhancing Credit Supply for Large Borrowers through Market Mechanism'. Under this 'specified borrower' is assigned a 'normally permitted lending limit' (NPLL) on global banking system basis. The mechanism proposed a disincentive mechanism for incremental borrowing by such a borrower from the banking system beyond NPLL.

Way forward

Various initiatives taken by SEBI and RBI to develop the market for corporate bonds over the last few years seem to be bearing fruit now. While the corporate bond primary issuances have increased via the private placement route, the secondary market still appears to be thin and lacks liquidity. The dominance of passive investors is one of the reasons for such a thin secondary market.

How the corporate bonds market will fare in coming years is difficult to predict. But in a country where cultural factors frown upon debt, developing a debt market is not just a financial policy issue but also a cultural conditioning issue.

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Creating Corporate Bond Market in India – Minimizing Moral Hazard and Mitigating Adverse Selection

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Liquid Corporate bond market is very important for an economy to thrive. Especially in case of emerging economies like India, where banking system provides most of the debt financing, corporate bonds can make the system more competitive and favourable for growth. In India, corporate debt financing is mostly done by banks and financial institutions. At a juncture, when banks are burdened heavily with bad debts and Non-Performing Assets (NPA), a push to establish a strong corporate bond market seems to be the order of the day.

Financial system of a country, under regulation and legal framework using the services of financial Institutions (mostly Banks) through trade of financial securities, provides three main services. First, they act as aggregator of fund and provider of liquidity; second, they maintain a portfolio of debts and hence share risks at a lower cost due to lower transaction cost and economies of scale; and third, they reduce asymmetric information and thus lowers moral hazard (in the part of borrowers) which in turn lowers Adverse Selection (of the savers) and encourages people to put their hard-earned money into financial system. It is the savings that in turn flows from banks to corporate sector to support their financing needs and for creation of productive capital, which is vital for the growth of an economy.

The other way savings can be transformed into capital is by direct private placement of savings by the people (savers) into firms in form of debt and equity shares. While secondary equity stock market is vibrant and liquid in India, and hence to some extent efficient as well, the secondary corporate debt market in India is not as mature, liquid, and efficient. Since, the main purpose of secondary market is price discovery through high trading volume and liquidity, Indian corporates have lower chance of discovering the fair value of their bonds and hence shy away to some extent from raising capital from bond market. On the other hand, presence of efficient and liquid stock market has enabled Indian corporates to raise equity capital by initial or subsequent public offerings, because of the trust in price discovery and hence valuation. Thus, there has been adverse selection in the part of both investors (cause) and corporates (effect) to engage in corporate bond market. This essay tries to address three issues: first the reliance on bank financing and its shortcomings; second, the role that can be played by corporate bond market by its presence alongside equity market; and third, the risks in corporate bonds and ways to mitigate them. Our discussion will be based on utility of risk averse investor. Our aim will be to minimise moral hazard (by corporates) problem and subsequently to increase corporate bond market participation of individuals by reducing their adverse selection.

1. Reliance on Bank Financing and its Shortcomings:

In India equity financing and bank financing are the two major sources of financing for the companies. We have collected data for all BSE listed companies from CMIE database and found that roughly 70% of financing comes from internal fund or equity source, while among the rest 30% debt, 13% comes from banks and a meagre 1% from non-banking financial institutions. Roughly 6.5% of debt is through corporate bonds and debentures and similar amount comes from foreign debt. Also, it is evident from the data presented in table-1 that, the reliance on non-equity portion of financing is on a steady rise over the last 5 years and increase in bank debt and domestic debentures & corporate bond can explain the same.

Table 1: Sources of Financing for BSE listed Companies

FY Ending	Net worth	LT Bank Debt	LT FI Debt	LT Govt Debt	LT Deben-tures & Bonds	LT Forex Debt	LT Debt Prom, Dir, SH	LT inter-corp. loans	LT fixed depo-sits
01-03-2012	73.00%	12.10%	1.06%	0.37%	6.08%	6.32%	0.05%	0.76%	0.27%
01-03-2013	71.17%	13.09%	1.07%	0.31%	6.49%	6.68%	0.04%	0.90%	0.25%
01-03-2014	70.78%	13.55%	1.12%	0.27%	6.37%	6.72%	0.05%	0.90%	0.24%
01-03-2015	69.46%	13.85%	1.22%	0.25%	7.24%	6.96%	0.05%	0.77%	0.20%
01-03-2016	69.89%	13.88%	0.98%	0.26%	7.58%	6.56%	0.05%	0.60%	0.20%
Note: LT Stands for Long Term > 1 Year. See Exhibit 1 for graphical representation									

As happened with Korea during the South Asian financial crisis, huge reliance on the banking system for transforming savings into corporate loans puts banks under pressure and any contagion effect can ruin the banks profit margin resulting in NPA and written off bad debts. To explain this let us take one simple example.

Suppose, investor(s) have a utility function: $U(x)={}^{1}/_{r}(1-e^{-rx})$, where x is the payoff and r is the degree of risk aversion of investor(s). This function is very common in finance and for a value of $r > 0$, the choice of constant absolute risk averse (CARA) investor(s) can be modelled. Let us take a case where there is an investment opportunity of notional capital of Rs.100, in which 50% return can be obtained in case the company pays back the loan to investor, with a probability of 70% and there is a 30% chance that the investor will only be able to recover 50% of the capital.[18] Here we assume upside and downside to be symmetric for ease in modelling and understanding but we can argue that even in real life scenarios, the firm with higher risk would offer a compensatory high risk premium on its debt and in case of default, the recovered debt value will be proportionately less.

For example, suppose, the investor(s) has a risk aversion coefficient r=0.01, his certainly equivalent[19] will be Rs.108.43. That means she will settle for a risk-free rate of return of 8.43% from the bank and will not put her investment privately in the company. The bank in turn takes the risk and profits Rs.11.57, since its Expected

18 This is basically gamble of winning 50% or losing 50%, that can be generalized to any symmetric or asymmetric probability.

19 Certainty Equivalent is the amount if given to the investor for certain (risk-free) he will prefer the risk-free rate and will not indulge in investing in risky assets (or gambling). If the risk-free return offered is less, then the investor is better off investing in risky assets.

Payoff is Rs.120 by investing in the risky company. We can generalize this in a two-way table (table-2) where the rows represent the probability of the company to pay back the loan and columns represent the return contracted through the loan security.

It is quite clear from table-2 that banks have an incentive for choosing companies with moderate risk so as to profit from their higher contracted return. Of course, banks can not lend total 100% of deposits they receive due to regulations and they don't invest in a single company, rather have a portfolio of loans varying in risks and duration. Still the incentive for risky loans in the part of banks and incentives for certainty equivalent (risk-free) rate of return in part of the savers can be understood.

Table-2: Bank's Profit from risk taking

Return	Probabilities of not-defaulting									
	100%	90%	80%	70%	60%	50%	40%	30%	20%	10%
10%	0.00%	0.19%	0.33%	0.43%	0.49%	0.50%	0.47%	0.41%	0.31%	0.17%
20%	0.00%	0.80%	1.38%	1.76%	1.96%	1.99%	1.86%	1.59%	1.18%	0.65%
30%	0.00%	1.90%	3.22%	4.04%	4.43%	4.43%	4.10%	3.46%	2.54%	1.38%
40%	0.00%	3.56%	5.92%	7.31%	7.89%	7.80%	7.12%	5.94%	4.33%	2.34%
50%	0.00%	5.86%	9.54%	11.57%	12.31%	12.01%	10.85%	8.97%	6.48%	3.47%
60%	0.00%	8.86%	14.12%	16.83%	17.65%	17.01%	15.22%	12.47%	8.95%	4.76%
70%	0.00%	12.66%	19.69%	23.05%	23.84%	22.73%	20.14%	16.38%	11.67%	6.17%
80%	0.00%	17.31%	26.26	30.20	30.83%	29.08%	25.55%	20.63%	14.61%	7.68%
90%	0.00%	22.88%	33.81%	38.22	38.52%	35.98%	31.37%	25.18%	17.74%	9.28%
100%	0.00%	29.40%	42.32%	47.05%	46.85%	43.38%	37.56%	29.97%	21.01%	10.96%
See Exhibit 2 for graphical representation										

Thus, when economy takes a downturn, banks accumulate NPAs, but they have to pay the depositors their small fixed interest because bank licence (bank charter) is valuable. Further, as seen in Korea[20], there can be nexus with the bank and the corporates in which in spite of knowing that the loan is risky banks might be under pressure from its environment to grant loans to them[21].

We can conclude this section saying that, reliance on only banks for corporate debts is risky and may result in moral hazard in part of the banks. They have incentive to invest in risky loans either for more profit or for exogenous pressure. This will create a persisting problem of NPA in the economy and hinder the smooth functioning of the financial system. While, by having Corporate Bonds in the market, banks will have to compete with direct (corporate bond) investors and find a secondary market for the loans which will allow

20 See the Harvard Business School Case Korea Stock Exchange

21 See analysis on Loan Commitments (Avery & Berger, 1991)

them to know the market price of the debt and get out of the loan if required so. That brings us to the second section.

2. Role of Corporate Debt Market alongside Equity Market

Corporate bonds are debt securities issued by private and public corporations. Companies issue corporate bonds to raise money mostly for capital expenditures. While a corporate bond gives an IOU from the company, it does not give an ownership interest in the issuing company, unlike the company's equity stock.

CNN reported on June 12, 2014, that only 27% of retail investor shares were voted during the fall 2013 proxy election season in USA. We can believe that the number, although not reported, is no higher in India. Thus, the fact that equity (stock) market in India is quite vibrant is not explained by the demand of the investors to have a say in the policies of the company through voting. Hence, there must be other drivers behind the affinity of Indian investors towards the equity (stock) market. Let us again go back to our utility model and present the case for an investor. How much will she demand as risk-free (certainly equivalent) return from the banks? Table-3 lists the same.

Table-3: Required risk free certainty equivalent return for the investor of risky asset

Expected Return	Probabilities of not-defaulting									
	100%	90%	80%	70%	60%	50%	40%	30%	20%	10%
10%	10%	7.81%	5.67%	3.57%	1.51%	-0.50%	-2.47%	-4.41%	-6.31%	-8.17%
20%	20%	15.20%	10.62%	6.24%	2.04%	-1.99%	-5.86%	-9.59%	-13.18%	-16.65%
30%	30%	22.10%	14.78%	7.96%	1.57%	-4.43%	-10.10%	-15.46%	-20.54%	-25.38%
40%	40%	28.44%	18.08%	8.69%	0.11%	-7.80%	-15.12%	-21.94%	-28.33%	-34.34%
50%	50%	34.14%	20.46%	8.43%	-2.31%	-12.01%	-20.85%	-28.97%	-36.48%	-43.47%
60%	60%	39.14%	21.88%	7.17%	-5.65%	-17.01%	-27.22%	-36.47%	-44.95%	-52.76%
70%	70%	43.34%	22.31%	4.95%	-9.84%	-22.73%	-34.14%	-44.38%	-53.67%	-62.17%
80%	80%	46.69%	21.74%	1.80%	-14.83%	-29.08%	-41.55%	-52.63%	-62.61%	-71.68%
90%	90%	49.12%	20.19%	-2.22%	-20.52%	-35.98%	-49.37%	-61.18%	-71.74%	-81.28%
100%	100%	50.60%	17.68%	-7.05%	-26.85%	-43.38%	-57.56%	-69.97%	-81.01%	-90.96%

See Exhibit 3 for graphical representation.

Clearly, if investor(s) estimates a risk of default less than 20%, then the required certainty equivalent risk-free return she demands cannot possibly be matched by the banks. In that case she is better off investing in risky equity. But then the puzzle remains, what prompts her to believe that risk will not be more than 20%? It is the vibrancy of equity markets and the liquidity. Since, in BSE or NSE, at least 500 stocks are liquid and can be traded at any time, investors believe that if things go wrong, they can at any time liquidate their positions and

get out of the equity exposure. Further, presence of derivative instruments like options and futures allows them to hedge their risk if they are invested in a diversified portfolio[22].

Investors also create a portfolio of equity and risk-free securities provided by banks or other FIs and Government to suit their specific utilities. Thus, there is demand in the eye of investor, for risk-free securities and equities.

When corporates issue bonds, although at premium yield that risk-free rate, investors fear that if something goes wrong, due to the illiquidity of Indian corporate bond market, they will not be able to get out of the position and they estimate their loss to be more than 20%(for example). We can see from table-3 that in this case the risk-free rate that is prevailing currently is a better option. Hence for their part they do an Adverse Selection by staying away from the corporate bond market.

But with changing economic scenario, risk-free rates are going down. Bank lending is also on decline.[23] At this juncture if there is a liquid corporate bond market then given some risk hedging mechanisms present, investors can take positions in corporate bond market. Once the participants in corporate bond market reaches a critical level, the market will turn liquid and the adverse selection will vanish.

Once corporates start getting money from the market issuing bonds, two important changes should happen. First, the corporates get another way to fund their business rather than only relying on banks. That will fuel further economic growth by removing the limit of lending that is provided by banks. Second, since the bonds starts trading in the market, corporates should be able to know the price (hence yield) and perceived riskiness of their debt. Being an open market, where efficiency prevails at least to some extent, corporates will be under pressure not to engage in activities (Moral Hazard) that will make them riskier and lead to decrease in their price of bonds (increasing yield). If this happens next time they issue bonds to raise capital the market will want that increased yield and the fund raising will be costly.

Banks also will be able to know the risk associated with the loans they have provided if the same company has a bond in the market. Instead of providing loans directly banks can also demand to subscribe to tradable bonds, that they can sell if things go wrong and limit their NPAs. This way the mutual dependence and hence nexus of the banks and corporates and moral hazard in both of their parts will decrease substantially.

But the crux is to get a critical size of corporate bond market so as to set things rolling and getting enough investors to trade so that liquidity comes forth. The third section deals with such issues.

3. The Risks in Corporate Bonds and How to Mitigate Them

Corporate bonds are riskier than their government bonds due to presence of default risk. But we have seen in the last two sections that presence of liquidity and opportunity to square off the position if things go wrong is important in the eyes of investor to judge her perceived risk.

22 Since in India stock options and futures are not liquid but index options and futures are liquid.

23 "Bank financing to the infra sector is declining, making it imperative for investors and developers to scout for alternate sources of funding such as masala bonds, InvITs," India Ratings and Research, a Fitch group company said in a recent report, Source Bloomberg, May 24, 2017

The first measure that could be helpful is defining the seniority an unsecured corporate bond will enjoy in case there is a default. This calls for a framework (just like the recent NPA framework) through which the investors can get their money back, at least a portion of it.

Second measure should be to mandatorily issue the corporate bonds with an embedded Put option. That is at stipulated date(s), or at any time depending on the risk rating of the company, the holders of the bond can sell it back to the issuer at stipulated price. Surely, if the issuing company is doing well and prices of the bonds are higher, the holder will not exercise her Put option. But if the price goes below, the holder will. Thus, this option will be useful in reducing the adverse selection till the point in time when corporate bond market in India becomes liquid.

To illustrate out point we have exhibited Table-4 through the same utility framework. It demonstrates the certainty equivalent required rate of return by an investor in case she can exercise her put option at (suppose) 20% stop loss[24] i.e. if the price of corporate bond bought at INR 100 goes down to INR 80 or below. Evidently, her certainty equivalent will increase and she may be willing to subscribe to corporate bonds even in the absence of a matured market.

Table-4: Required Risk free certainty equivalent return for the investor in presence of PUT option at 20% stop loss

Expect-ed Return	Probabilities of not defaulting									
	100%	90%	80%	70%	60%	50%	40%	30%	20%	10%
10%	10%	6.56%	3.24%	0.02%	-3.10%	-6.12%	-9.06%	-11.9%	-14.7%	-17.37%
20%	20%	15.20%	10.62%	6.24%	2.04%	-1.99%	-5.86%	-9.59%	-13.2%	-16.65%
30%	30%	23.71%	17.80%	12.22%	6.93%	1.91%	-2.88%	-7.44%	-11.8%	-15.99%
40%	40%	32.10%	24.78%	17.96%	11.57%	5.57%	-0.10%	-5.46%	-10.5%	-15.38%
50%	50%	40.34%	31.54%	23.45%	15.96%	9.00%	2.49%	-3.63%	-9.39%	-14.83%
60%	60%	48.44%	38.08%	28.69%	20.11%	12.20%	4.88%	-1.94%	-8.33%	-14.34%
70%	70%	56.38%	44.39%	33.68%	24.01%	15.20%	7.10%	-0.39%	-7.37%	-13.88%
80%	80%	64.14%	50.46%	38.43%	27.69%	17.99%	9.15%	1.03%	-6.48%	-13.47%
90%	90%	71.73%	56.29%	42.92%	31.13%	20.58%	11.04%	2.33%	-5.68%	-13.10%
100%	100%	79.14%	61.88%	47.17%	34.35%	22.99%	12.78%	3.53%	-4.95%	-12.76%

See Exhibit 4 for graphical representation.

But in the above case, the corporates may have an adverse selection because they will have to cough up the money unilaterally. Hence, a call option embedded in the corporate bond, where if the yield falls and

24 This stop loss percentage again can be generalized. The gap between par value of INR 100 and Put strike of INR 80 can be thought of as Put Premium in generality.

the bond is priced higher than the call strike price the corporate issuer will be able to call off the bond at stipulated price at stipulated time or any time.

Once the market attains maturity and a critical level of liquidity, bond indices can be created and futures and options can be traded in the market. This will help to create a market closer to completeness and adverse selection from the part of investors and issuers will be mitigated to the extent possible.

Conclusion

We have discussed over the course of this essay, how banks have incentive to loan companies albeit knowing their risks and why knowing this all investors still deposit their savings to banks for a certain return. We also discuss how presence of matured and liquid equity market reduces the risk perception of an individual investor and her certainty equivalent return rises to a level that no bank can meet. Thus, she engages in investing in equities. In the last section, we discussed how by having default recovery framework and put / call options embedded in bonds, the risk perceptions of individual investors / issuers can be reduced, so that higher required certain return would incentivize investing in corporate bonds, till the time more investors come in and Indian corporate bond market attains a critical liquidity levels.

We conclude by saying they all the measures and required regulations should be in place and regulatory authority should focus on minimizing information asymmetry to the extent possible so that price discovery process accelerates. We believe that the discovery of fair price of corporate bonds is the single most important aspect, if attained will catapult the Indian corporate bond market to new heights.

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Exhibit 1: Sources of Financing for BSE listed Companies

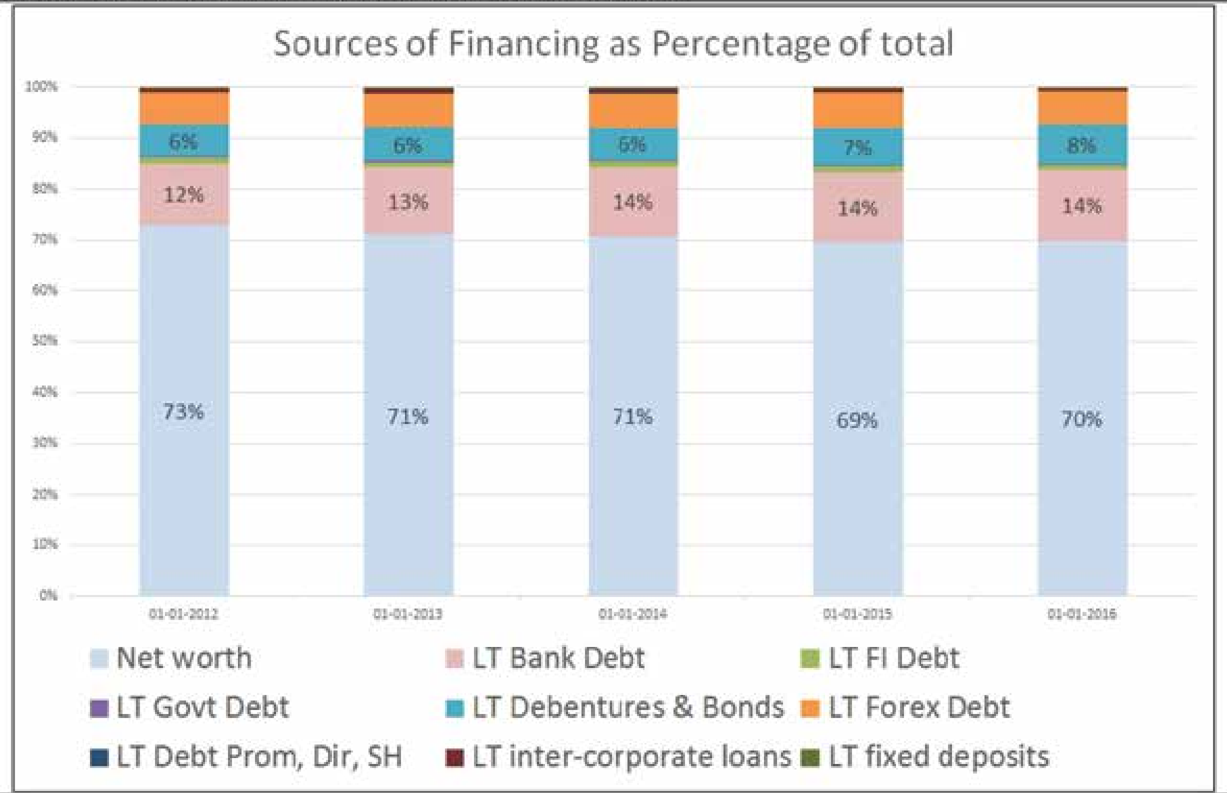


Exhibit 2: Bank's Profit from risk taking

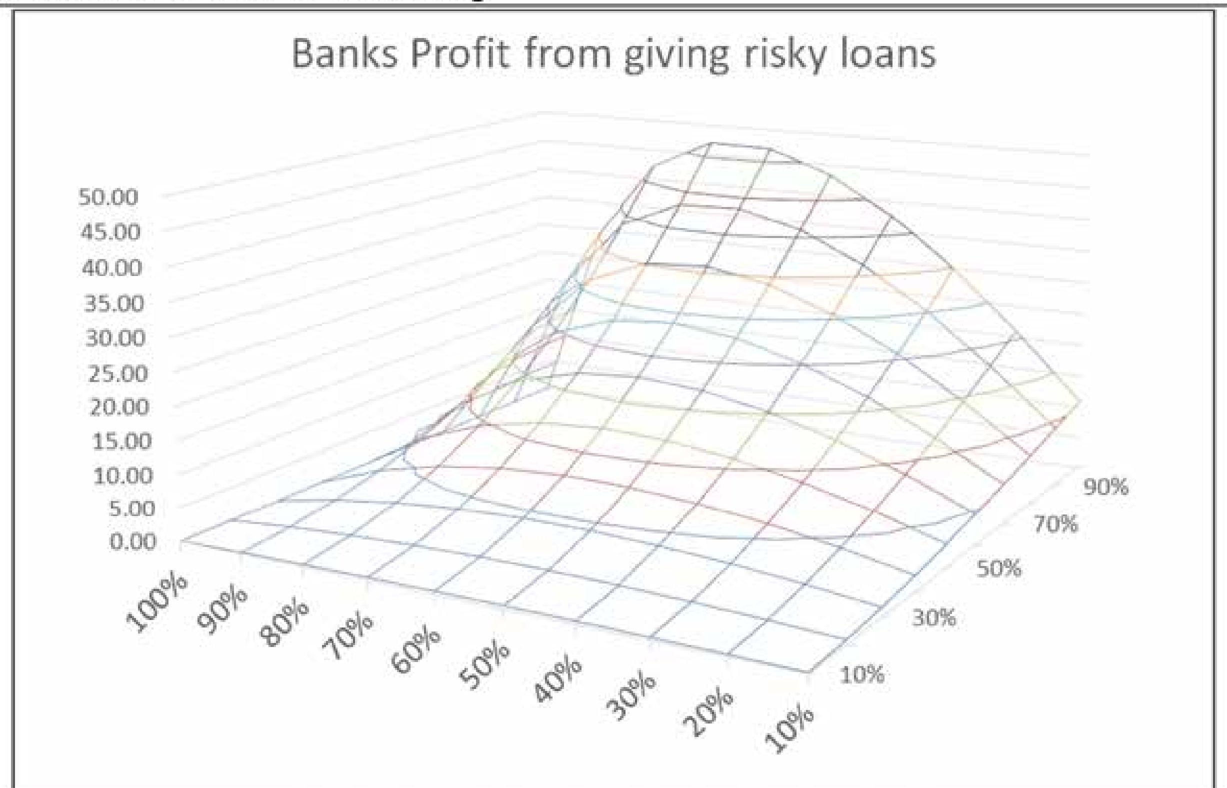


Exhibit 3: Required risk free certainty equivalent return for the investor of risky asset

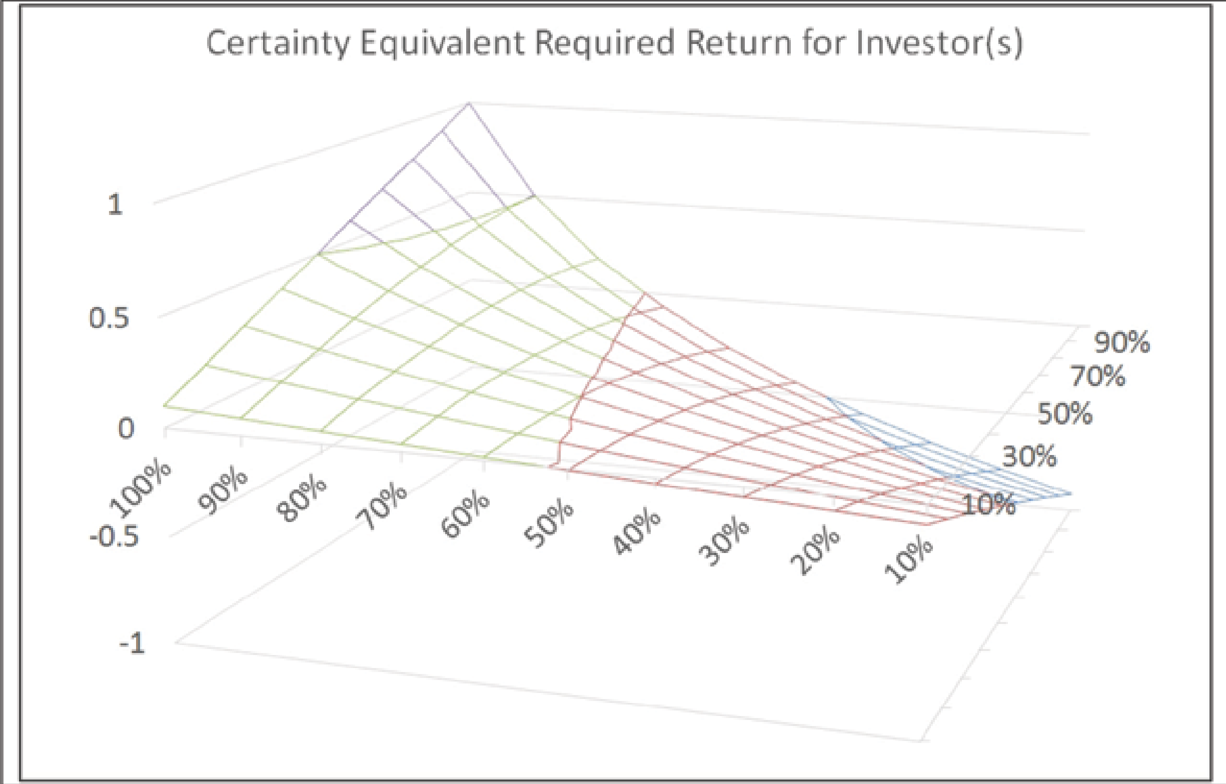
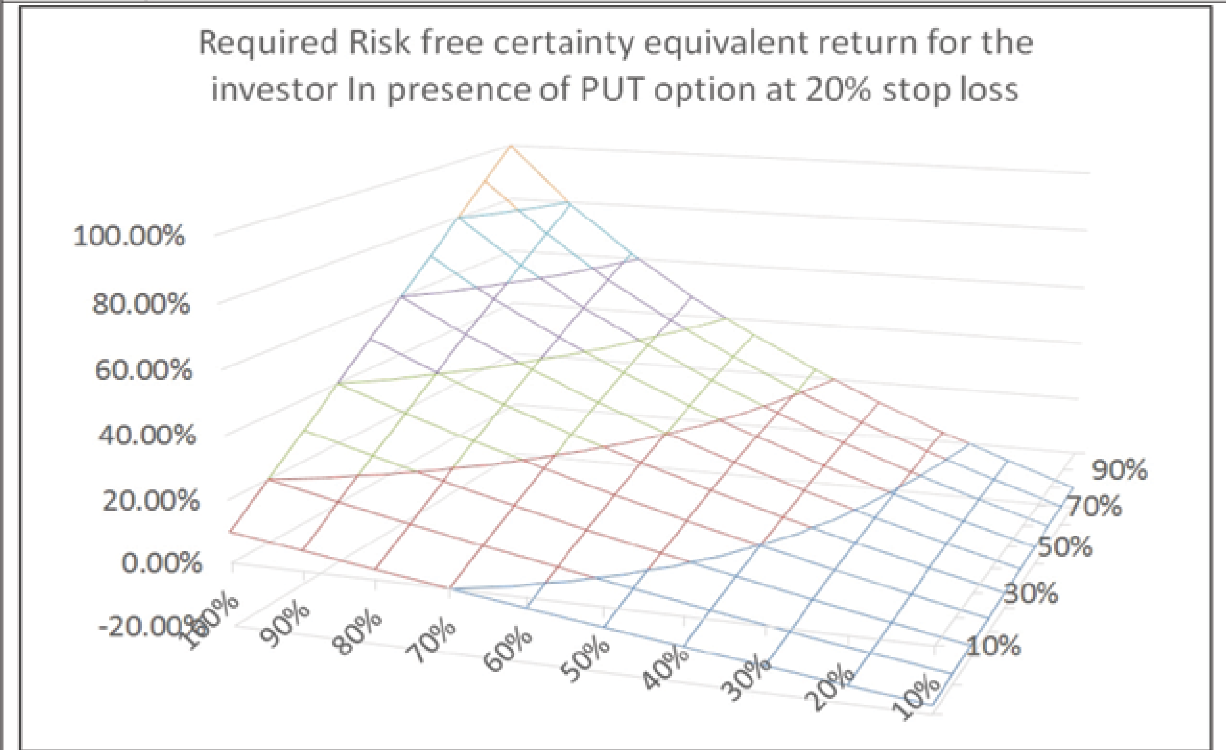


Exhibit 4: Required Risk free certainty equivalent return for the investor in presence of PUT option at 20% stop loss



Accelerating Corporate Bond Market Development

Accelerating Corporate Bond Market Development

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Corporate business decisions pertain to the asset side of the balance sheet (capital expenditure decisions, working capital decisions, etc.), the income statement (decisions regarding prices, sourcing, taxation, wages and salaries, etc.) or the liability side of the balance sheet (the funding decision). Businesses, small and large, are increasingly investing more time and effort on the funding, or capital structure, decision. The wider availability of sources of funding, coupled with the increased sophistication of the investors, has made the funding decision far more technical and complex.

At the broadest level, the corporate business has a choice between equity and debt. Debt clearly allows greater customization than equity. It is far more possible to design or engineer a financing structure/contract or financial instrument that is optimal- in the sense of meeting the objectives of both the issuer and the investor- with debt than with equity. Therefore, historically the world has witnessed far more innovations and engineering in the debt markets than in the equity markets.

It is therefore important to ensure that the lack of development of a market for debt does not hold back overall economic development of the country. Debt itself comes broadly from two sources: banks and the capital markets. The banking sector in India has seen significant developments; past efforts have yielded results and measures to improve the functioning of the sector continue. It is necessary now that the focus shifts to the debt capital markets. The two broad segments in the debt capital markets are the market for government debt and the corporate bond market. A number of measures have been introduced over the years to improve the functioning of the primary and secondary market for government debt. Changes in auction procedures, creation of entities like Primary Dealers, experimenting with instruments like Zero Coupon Bonds and Floating Rate Bonds, introducing settlement procedures like Delivery-versus-Payment, broadening of market by allowing entities like FIIs to participate, introducing the Liquidity Adjustment Facilities, creating the Negotiated Dealing System (NDS), and the Clearing Corporation of India Limited (CCIL) and so on. The next logical step is to accelerate the development of the market for corporate debt.

Is This an Opportune Time?

To be fair, there have been attempts in the past too to kick-start the corporate bond markets; but these attempts did not yield the desired results. In fact, The Working Group on Development of Corporate Bond

Market in India set up by RBI, in their Report of August 2016, has helpfully listed (in Annex I of the Report), the major recommendations of the earlier Committees on which implementation is still not complete. So are the circumstances any different now? Will there be a greater urgency in setting up enabling mechanisms to get the corporate bond market off the ground? Indeed, three major factors might be working together this time around to make this the most opportune time to propel the growth of the corporate bond markets in India.

Two factors might combine and prove to be the biggest boost for the corporate bond markets: a. on the demand side, the massive requirement of funds to fund the infrastructure growth and b. on the supply side, the limitations of the banking sector to provide these funds.

Estimates vary, with a CRISIL Report of 2016 estimating a requirement of INR 8.6 lakh crores per year over the next 5 years and Finance Minister Shri Arun Jaitley talking about a requirement of $1.5 trillion over the next ten years. Therefore, the infrastructure funding requirements alone might amount to INR 8 lakh crores to INR 10 lakh crores per year, over the next decade. The banking sector, affected by stretched profitability, provisioning pressures and capital limitations will find it difficult to maintain its share of contribution to the funding requirements. Fortunately, bond markets are now well positioned to cover up this slack. From a tiny INR 0.79 lakh crores in 2005-06 bond issuance has grown to a huge INR 4.14 lakh crores in 2014-15 (RBI Working Committee, 2016). Along with Commercial Paper Issuance, bond markets now account for 20% of the outstanding funding to the corporate sector; and more importantly, the share of bond markets in incremental annual funding is now as high as 35% (CRISIL Report, 2016). The momentum attained by bond markets will maybe now put pressure on the system to take action on the various aspects that require attention.

Apart from the boost expected from the demand and supply side factors as described above, there is increasing and widespread confidence on the macroeconomic front; there is widespread belief that the country has finally entered a period of stability on the macroeconomic front. The fortuitous alignment of these three forces is what probably makes this the most opportune time to put in place a few measures to accelerate the development of the corporate bond market in India.

What Needs to Be Done?

There is consensus among stakeholders on a number of measures that need to be undertaken to hasten the development of the corporate bond market. The Working Group of the RBI has used a 7 I framework of Issuers, Investors, Intermediaries, Infrastructure, Incentives, Instruments and Innovations to list the areas already identified by earlier committees and to add other aspects to this list. Without going into the details of the Working Group's recommendations, but drawing from it and building on it, what are the key things that need to be done?

In order to answer this question, instead of focussing on each of the entities- the seven Is- separately, it might be useful to focus on the key distinguishing features that characterize corporate bonds, identify concerns that arise from these characteristics and highlight a few important things that need to be done to address these concerns.

Distinguishing Features of Debt: Risk-Return

The corporate debt investor, unlike the equity investor, does not participate in the upside business potential of the issuing corporation, but is exposed to the downside risk. Given the asymmetric nature of payoffs bond investors are naturally concerned more about the downside risk possibilities than about upside potential possibilities. However, what is important to note is that bond investors are not only concerned about risks but also about the uncertainty of risks. In other words, bond investors do not shy away from taking risk; what they abhor is the uncertainty about the risk itself, the second-degree risk.

For the corporate bond issuer, debt- unlike equity- legally commits the issuer to debt servicing obligations. On the other hand, debt is attractive because it offers the possibility of structuring the terms of the contract to meet the needs of both the issuing corporation and the investing entity. The customization that this structuring achieves can help issuers target specific segments of investors and thus potentially lower costs of capital. Issuers would be interested in debt offering only if the benefits- in terms of lower costs of capital- offsets the relative inflexibility of debt servicing.

The above concerns of the corporate debt investor and issuer have to be addressed to ensure that this opportunity to accelerate the development of the corporate debt market in India. So what specific actions have to be undertaken to address these concerns?

1. Information

India's rating in global markets is just above investment grade. However, as highlighted above, debt investors abhor ambiguity, or the second-degree risk or the uncertainty about uncertainty, as much as they dislike risk. One major source of this ambiguity in developing markets arises from uncertainties about macroeconomic stability and lack of clarity about macroeconomic policies. India has moved ahead well on this front; macroeconomic fundamentals have strengthened and there is far greater transparency and information flow. For example, the creation of the Monetary Policy Committee has been a step in this direction.

At the micro level, corporate governance is perceived to be weak especially in smaller promoter driven companies. Agencies like SEBI that have the responsibility of protecting investor interests through proper and adequate disclosure have till now discharged their responsibilities well. In hindsight, the bond market has dodged many bullets by restricting activity to papers rated above AA. Though the volatility in the real economy over the last two decades, globally and locally, has affected banks and other segments of financial markets, the Indian corporate bond markets have had few isolated cases of defaults. Elaborate checks and controls have protected the bond markets from these effects. However, this has obviously come at a cost: the market has not grown on the issuer side. Maybe it is time now to allow more issuers to come to the market but focus more on the information availability post-issuance. Reforms taking place on the bankruptcy front will also complement the shift from strict regulation at the issuance stage to better management of the post-issuance phase.

What needs to be done now is to institute robust mechanisms that ensure transparency and continuous information availability about the corporate entities issuing the bonds. To reiterate, it is not risk alone that

debt investors dislike but the uncertainty about risk. Disclosure requirements should ensure adequate, timely and credible information about the financial condition of the issuer. Especially in the case of the smaller issuers, the absence of a well-regulated disclosure mechanism results in the information being available only to a selected few players; this asymmetric information availability will drive away potential bond investors.

Intermediaries like rating agencies can mitigate this problem. However, for a first time issuer the cost of getting a rating is high and therefore many of the smaller companies prefer the bank route. To compound the problem, non-uniform credit opinion among credit rating agencies currently leads to greater ambiguity. Since adequate, timely and credible information is at the heart of these markets, the government should act as a catalyst to facilitate this flow of information. Creation of a centralized credit information repository that quickly disseminates information of material change in companies' positions would help in building trust among investors.

2. Liquidity in the Secondary Markets

Availability of adequate, timely and credible information is worthless if investors cannot trade based on this information. Investors should be able to get in and out of their corporate bond investments with ease. With very little secondary market trading in corporate bonds today, liquidity is a big problem in the markets; this problem is acute for the smaller issuers whose issue sizes are small. In the absence of liquidity, issuers have to pay a premium to compensate for the risk; and since the lack of liquidity is more acute for smaller issuers, the higher costs will them away from the market. In the short-run, at least, intermediaries need to be incentivized to provide market-making services, as was done with the Primary Dealer scheme for Government Securities.

Even within the existing set-up, liquidity can be enhanced, through standardization of procedures. Even though settlement has moved to DVP III, counterparties currently have elaborate KYC procedures that limit their ability to deal with a large number of counterparties. Even greater potential lies in the possibility for encouraging the development of repo markets in corporate bonds. It is difficult today for non-bank companies to fund their bond holdings because the haircut/margin required is high: it is for minimum of 7 days and rates charged are high as well.

The secondary market activity has also been affected in the past by the lack of connect between the primary and secondary markets. A reason for this has been the unhealthy competition among arrangers to participate and underwrite in primary issues, in order to figure among the top arrangers' league tables. This in turn is motivated by the fact that PSU issuers invite only the top arrangers to underwrite their new issues. As a result, most of the time, primary issue yield cuts off at an artificially lower yield; lower than the yields in the secondary market for similar paper. Primary market yield cut offs at market levels would prompt more active secondary market trading.

3. Heterogeneity of Market

For the bond markets to set off firmly on a growth path it is crucial that the market is as broad-based as possible in terms of issuers, investors and instruments. Narrow markets are fragile; lack of heterogeneity on the investors' side for example can lead to one-sided markets that freeze. It is important therefore

to expand aggressively the base of issuers and investors. Doing this will naturally lead to innovation and experimentation in the type of structures and instruments used as the vehicle for funding. Finding investors for lower rated debt and floating rate debt, for example, is difficult in the market currently. The issuer base should be expanded by taking some of the steps described above to attract issuers of all sizes. The retail domestic investor base should be expanded by linking interest rates on other savings vehicles to prevailing interest rates so that they are not artificially high. Banks can be encouraged to invest by suitably modifying some of the liquidity and risk-weighting guidelines. The non-domestic investor base has to be developed further by providing them greater flexibility in hedging currency and credit risks.

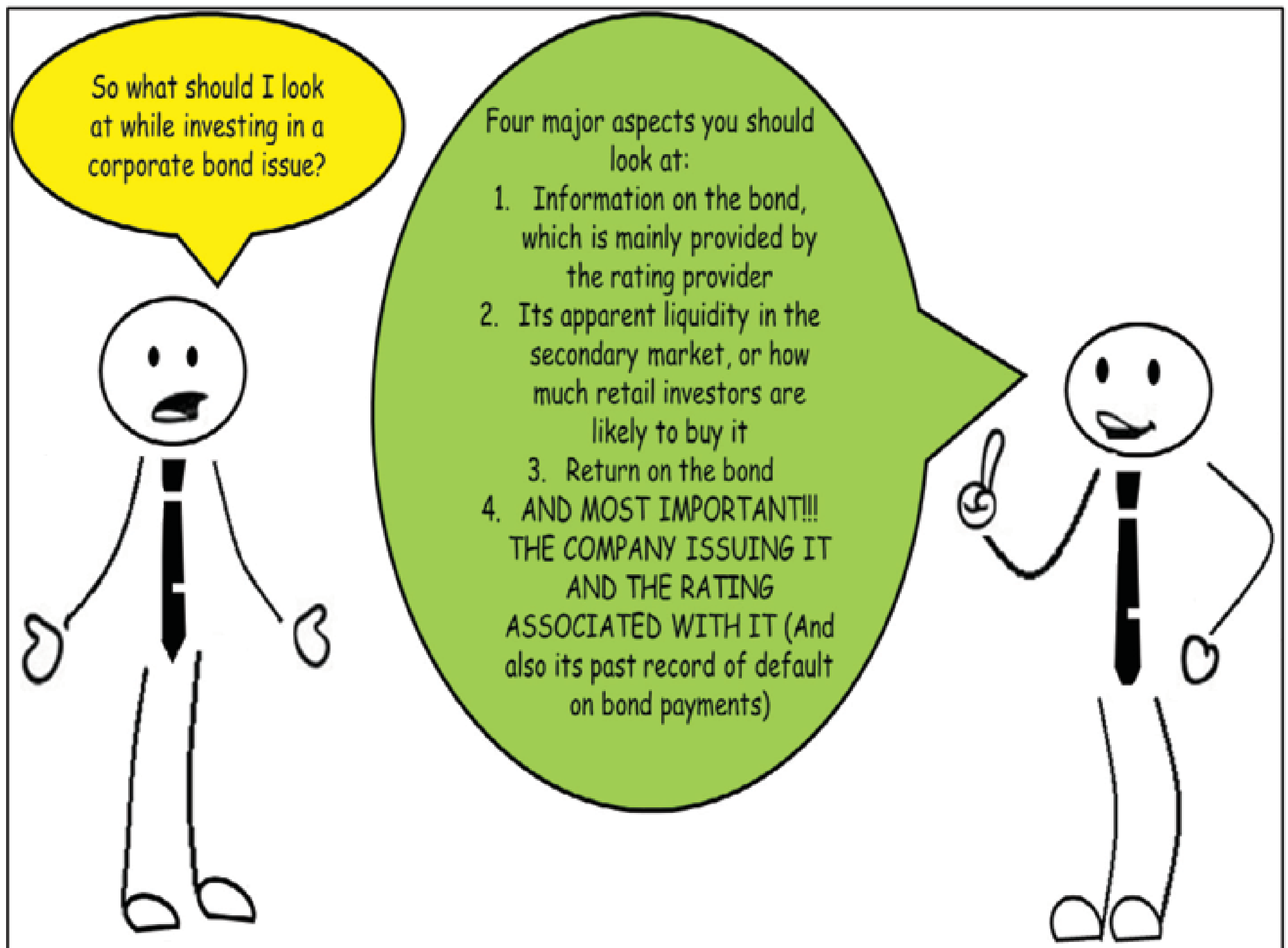
4. Recovery Processes

Even with adequate information and liquidity, by the very nature of the market, there will always be defaults by some issuers. At this stage, what bond investors want is a speedy and smooth recovery process. The newly introduced bankruptcy code and parallel measures are bound to have a very positive impact on the markets. Historically, companies with strong recovery processes (like the USA) have been able to build the large (relative to their GDP) corporate debt markets. India has set off well on this path; all that is needed is to ensure that the process continues in the right direction. Other BRIC countries have been able to double the size of their corporate bond markets after the initiation of bankruptcy related reforms and there is no reason India should not see similar results.

5. Return/ Costs

Indirect costs associated with bond issuance flow to third parties; thus, it increases the cost for the issuer and reduces the return for the investor. Small and medium issuers shy away from the bond markets because the costs of raising funds as a proportion of the total amount raised is very high for them. This is a chicken and egg problem and the issuance costs might come down as the volumes increase; but for volumes to increase the issuance costs should be contained. Payment of stamp duty and merchant bank charges are two heads that account for a large share of these costs.

*With inputs from Sandeep Bagla, Associate Director, TRUST Group and Dwijendra Srivastava, Chief Investment Officer-Debt, Sundaram Asset Management Company Limited.


So what should I look at while investing in a corporate bond issue?
Four major aspects you should look at:
1. Information on the bond, which is mainly provided by the rating provider
2. Its apparent liquidity in the secondary market, or how much retail investors are likely to buy it
3. Return on the bond
4. AND MOST IMPORTANT!!! THE COMPANY ISSUING IT AND THE RATING ASSOCIATED WITH IT (And also its past record of default on bond payments)

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Improving Value Proposition for Investors

Nipa Sheth
Founder and Director
TRUST Group

Introduction

Given the increase in funding requirement for infrastructure sector and other economically important sectors, the banking sector alone will not be able to meet the investment needs. It has become imperative to develop and deepen the Indian corporate bond market and make it a viable alternative to bank financing.

One of the foremost ways to do this is through reforms/measures to facilitate and incentivize higher savings both directly in the corporate bond market and indirectly in the form of insurance and pension products. These funds can then be channelized towards the corporate bond market. However, these measures also need to be accompanied by enabling regulatory changes that can increase the allocation of insurance and pension funds towards the corporate bond market, and ultimately towards meeting the long-term investment requirement for India's infrastructure build-out.

It is also equally important to enhance the role of facilitative infrastructure providers (or facilitators) in the market as they play a critical role in channelizing the funds towards the optimal usage. From a long-term perspective, implementation of comprehensive education programmes to create financial literacy about financial products is required to create a structural shift in household savings and investment behaviour in India.

Deepening of the Indian bond market critical to meet the funding requirement of the infrastructure sector

It is a well-known fact that efficient and good quality infrastructure can boost economic growth and that the lack of supportive infrastructure acts as a drag on our Gross Domestic product (GDP) growth rate. Estimates suggest that aggregate infrastructure funding requirement in India is around USD 1.5 trillion over the next decade. While bank financing is by far the most preferred mode of financing infrastructure projects in India, we believe that it would be difficult for banks to fund this requirement alone. (Bank's exposure to infrastructure stood at around 12.7% of their Gross bank credit as on March 31, 2017).

With increasing regulatory capital requirement under the BASEL III regime, weak profitability for public sector banks on account of high credit costs, limited capital infusion by Government of India in relation to capital

requirements, we believe that it is the need of the hour to develop the Indian bond market. This will facilitate the channelization of long-term funds from insurance companies and pension/provident funds to meet the increasing infrastructure funding requirement. Infra financing presents an ideal investment opportunity for insurance companies, pension funds and provident funds, which have strong appetite for long-term assets.

Current status of Indian Bond Market

The corporate bond market penetration is high in developed countries and even in some emerging market economies such as China, Brazil, Thailand, Malaysia and Korea. However, in India, despite various efforts and measures taken to develop and deepen Indian bond market over the years, it is still dominated by government securities (G-Sec). In terms of size, the market for corporate bonds is less than a third than that of government securities (refer to Table 1).

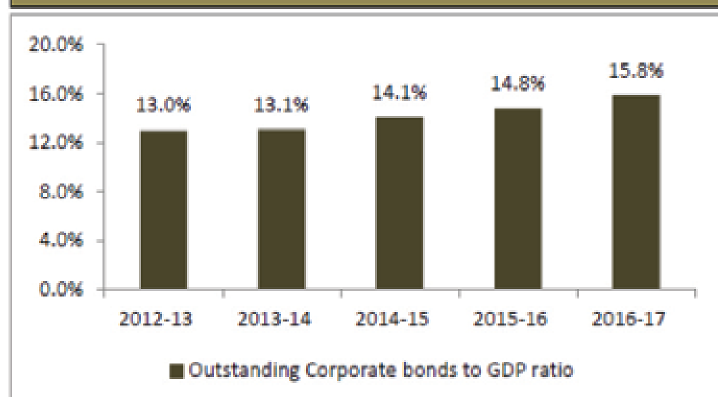
Table 1: Size of Government Securities and Corporate Bonds Market

Sr. No.	As on March 31,	Outstanding Government Securities (Rs. Crore)	Government Securities as a % of GDP	Outstanding Corporate bonds (Rs. Crore)	Outstanding Corporate bonds as % of GDP
1	2013	44,56,263	44.8%	12,90,147	13.0%
2	2014	51,16,974	45.6%	14,67,397	13.1%
3	2015	57,99,353	46.6%	17,50,320	14.1%
4	2016	65,70,710	48.0%	20,19,296	14.8%
5	2017	73,37,670	48.3%	24,04,911	15.8%

Source: SEBI, CCIL, RBI

While the market penetration in India, measured by corporate bonds outstanding to GDP, has increased marginally to 15.8% in 2016-17 from 13.0% in 2012-13 (refer to chart 1), it is still quite low compared to other developed and emerging economies as reflected in Table 2.

Chart 1: Trend of Corporate bonds outstanding to GDP ratio in India



Source: SEBI, RBI

Table 2: Corporate bonds/GDP across countries

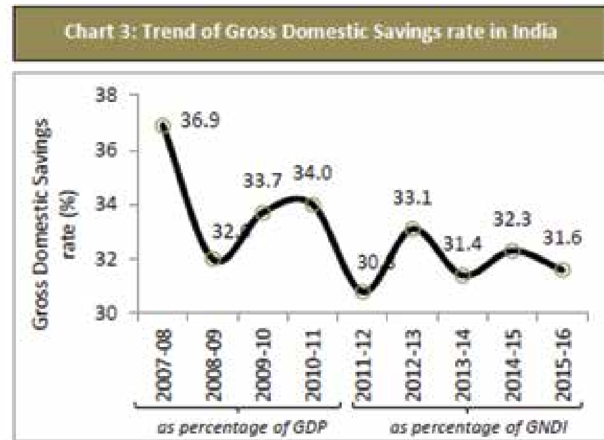
Sr. No.	Country	Corporate Bonds to GDP Ratio (%)
1	US	115%
2	UK	114%
3	Japan	68%
4	China	46%
5	Brazil	42%
6	Russia	20%
7	India	16%

Source: CRISIL report, SEBI, RBI

Low penetration of insurance and pension products in household savings limits transmission of funds towards the Indian corporate bond market

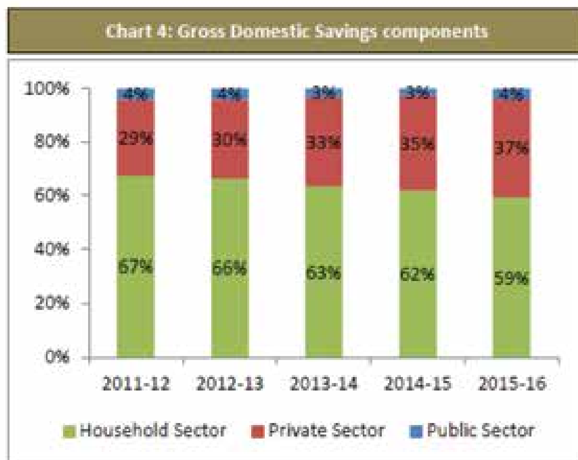
As per the economic data published by RBI, India's Gross Domestic Savings (GDS) rate stood at 31.6% in 2015-16 (as a percentage of Gross National Disposable Income). While the savings rate in India has followed a downward trajectory after 2008 (GDS rate as a percentage of GDP was 36.9%) with household savings as the biggest drag, it still remains relatively well placed amongst the Asian Countries (refer to chart 2 and chart 3).

Source: World Bank, OECD; * as on 2015

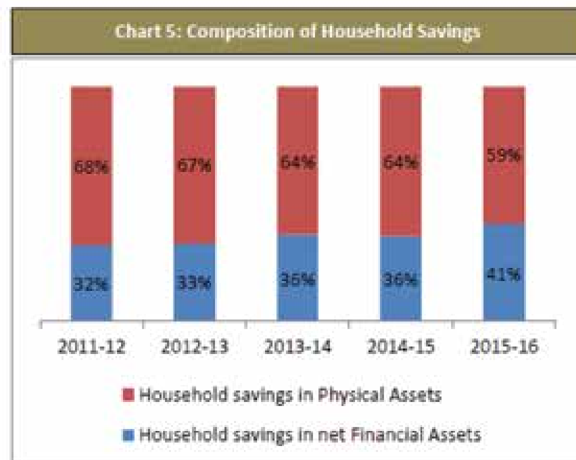


Source: RBI

Household savings accounted for ~60% of Gross Domestic Savings in India in 2015-16. However, the point to note is that only ~40% of the household savings were in financial assets and balance 60% in physical assets such as gold, property etc. (refer chart 4 and chart 5).



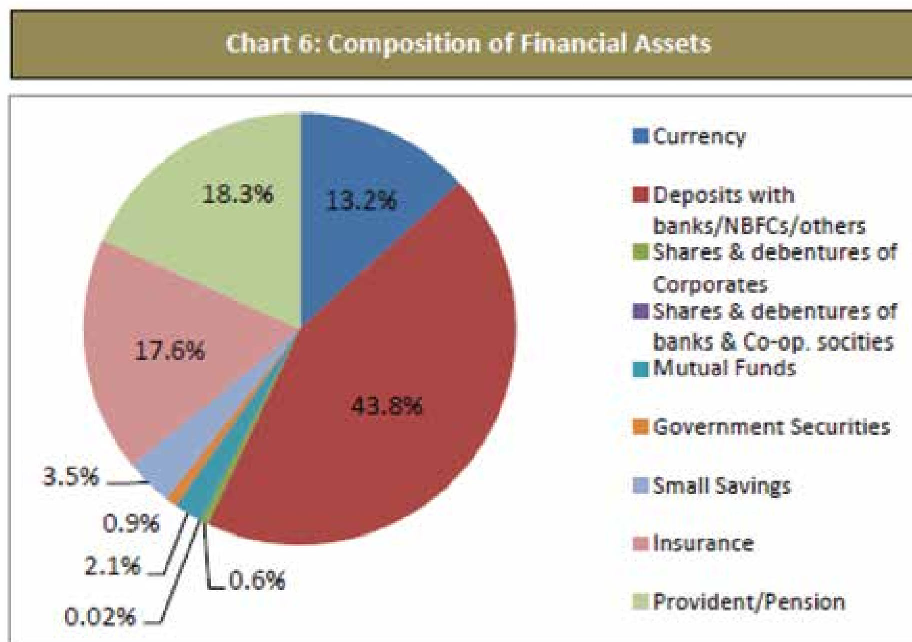
Source: RBI, government savings included in public sector



Source: RBI, saving in the form of valuables included in physical assets

Further, if we analyse the composition of the gross financial savings of the household sector in 2015-16, only 3% of the savings were invested in shares/debentures and mutual funds whereas fixed deposits have the lion's share at ~44% (refer to chart 6). While bonds/debentures also offer similar characteristics of

regular income accrual as in case of fixed deposits, they do not hold the same appeal for investors. Also, only 36% of savings is in insurance and pension products. Therefore, it is critical to encourage investments across the spectrum of financial products implementing comprehensive educational programmes and creating greater awareness.



Source: RBI

Increased participation by insurance companies and pension funds can also help deepen the Indian corporate bond market and meet the increasing funding requirement for the infrastructure sector

Measures to improve the household savings rate and allocation of savings towards insurance and pension products need to be accompanied by regulatory changes that can facilitate the transmission of these funds towards the corporate bond market.

Currently, investments in corporate bonds as a percentage of assets under management (AUM) of large institutions such as EPFO, insurance companies and mutual funds, is nothing comparable to that of the developed countries like US and UK.

Table 3: Institutions investment in corporate bonds in India

Sr. No.	Institution	Assets under Management (AUM) (Rs. Crore)	Investment in Corporate bonds (Rs. Crore)	Investment in Corporate bonds as % of AUM
1	EPFO (including exempt PF)	12,88,081	2,65,419	20.6%
2	Insurance Companies (Life & General Insurers)	31,35,432	5,22,435	16.6%
3	Mutual Funds	18,29,583	3,62,507	19.8%

Source: EPFO, IRDA, AMFI, data is as on March 31, 2017 for Mutual Funds and Insurance Companies; Trust estimates of exempt PF

In order to improve this, the Government needs to adopt a supportive role by liberalising the investment guidelines for insurance companies and pension funds to channelize the funds under their management to meet the funding requirements of infrastructure assets via bonds/debentures route.

On one side, RBI and Ministry of Finance may come up with some guidelines for banks to follow "Originate to refinance model" in case of infrastructure assets. Based on this model, banks can focus on their core competence of funding under-implementation/under-construction infrastructure projects by following appropriate risk-based pricing models and allow operational/matured projects to tap the bond market to get their project loans refinanced at competitive rates. This will not only help banks to utilise their capital blocked in operational/matured projects to fund new infrastructure projects, but also address the potential asset-liability mismatch problem for the banks.

Further, the bond market route will help in the efficient price discovery for matured infrastructure assets while providing opportunities for investors (such as Insurance Companies and Pension/Provident funds) to enjoy healthy returns based on stable and predictable cash flows of operational projects.

Currently, investment norms for Insurance companies and Pension Funds are heavily skewed towards government and public sector bonds. Easing of such norms resulting in their increased participation is the need of the hour for the development and deepening of the Indian corporate bond market. We strongly believe that the following measures can be explored to improve the value proposition for investors:

- Liberalisation of investment guidelines for Insurance Companies and Pension Funds to allow them to take higher exposure to corporate bonds across the credit rating spectrum rather than having credit rating linked investment restrictions. This would, in turn, reduce the funding constraints for lower rated corporates or infrastructure projects to avail long-term funds at optimal cost from these Institutional investors compared to their sole reliance on banks. It would lead to better profitability for corporates due to lower cost of borrowings and therefore, enhance the private corporate savings rate.
- The other options available for the regulators is not to impose any investment limits for corporate bonds as in case of developed countries. Instead of capping investments in corporate bonds, a floor can be introduced for investments in corporate bonds. For example, countries such as Australia, Canada, Korea, Germany and Japan impose no limits for investment in bonds.
- Restrictions such as dual rating requirement should be relaxed to only single rating for investment in corporate bonds.

Given the significant deployable funds available with Insurance companies and Pension/Provident funds, it is imperative for the government to liberalise the investment guidelines to channelize funds from these Institutions to meet the debt funding requirement of infrastructure and other sectors important for the economic activity to accelerate in the country.

Enhancing the role of facilitative infrastructure providers/facilitators in the Indian corporate bond market is critical

The three important pillars that make up the Indian Corporate bond market ecosystem are – the Institutions (Regulators, Stock Exchanges, Credit Rating agencies and others), the participants (Issuers on the supply side, investors on the demand side and the facilitative infrastructure providers (or facilitators) to match the needs and expectations of issuers and investors) and the instruments (fixed rate, floating rate, credit enhanced bonds etc.). Facilitative infrastructure is a key to the success of any financial product including corporate bonds/debentures. The timely communication and advice by facilitators in Indian debt market can play an important role to make investors understand about the suitability of bonds/debentures in line with their risk-return appetite.

We believe that facilitators in Indian corporate bond market need to assume a bigger role of market making instead of just performing the role of intermediation. In case of corporate bond market, various valuation techniques/approaches are used across participants and sometimes it leads to difference between the prices used for reporting and the actual realisable value of asset. Besides, mispricing of investments leads to anomalies that hinder the efficient price discovery mechanism, which is critical for the investors to take investment decisions.

With the help of facilitators, the regulators can create an information database for corporate bonds covering both primary and secondary market segments along with valuations. Similarly, role of facilitators becomes very important to create awareness among the investors about the new products such as Masala bonds, Green/Climate bonds, Infrastructure bonds etc. in order to provide clear understanding of risk-return trade-offs of such new debt instruments and generating investor interest in them.

We believe the way facilitators' role is encouraged by the regulator in the equity capital market, the same approach can be followed by the regulators in case of the Indian Corporate bond market. They can encourage and incentivise facilitators appropriately to reach out to the larger investor base and channelize their savings into corporate bond market.

Encourage an investment culture through education and financial literacy

Finally, it is important to encourage an investment culture in the country and create investor demand for financial products such as insurance/pension products by implementing comprehensive education programmes across the country to make investors aware of the benefits and risks associated with investments in financial products.

Currently, in rural areas, which remain largely unbanked till date, gold remains an important savings mode. While demonetisation has brought savings out from the shadow economy into the banking system and has paved the path of institutionalising banking habit among the rural and semi-urbanpopulation, the penetration of financial products besides bank deposits will have to improve in order to route household savings in financial assets from physical assets.

However, building an investment culture through financial literacy is not an easy task and is an agenda for the long term. Financial literacy campaigns need to be conducted across the length and breadth of the country in a periodic manner. This can be done through various means including:

- **Public-private partnership:** Government should collaborate with the private sector to develop comprehensive financial literacy programmes and standardise content for delivery through multiple mediums such as mobiles, plays in rural regions, documentaries in semi-urban regions etc.
- **Mandatory programmes among the youth:** Government should make it mandatory to have a module on financial literacy and investment tools in high school (e.g. Financial education has been made compulsory in UK for children aged between 11 to 16 years). Use of creative adult learning techniques and adequate investment in financial literacy programs can benefit the country in terms of mobilisation of funds into financial assets, which in turn gets channelized into funding of economic growth.

Conclusion

The government has already taken various measures to develop and deepen the bond market. However, the penetration of Indian corporate bond market is still at its infancy. To change this, it is time for the government to finally do what has been a longstanding demand – of liberalising the investment policy guidelines of insurance companies and pension funds. This is the only way to channelize their long-term funds into infrastructure and other economically important corporate sectors via the bonds/debentures route. Over the long-term, the most critical requirement is to build the savings and investment culture in the country through various forms of financial literacy programmes. This is no easy task, but is the only way to move India ahead along the path of financial progress.

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Regulatory/Compliance Framework and Improvements Required

APAS Article

Participation

Banks and equity markets are the dominant sources of capital for businesses in India, even as the corporate bond market has languished for decades now. Today, corporate bonds are a $287 billion (about INR 19 trillion) market – around 14% of GDP. This is large on an absolute basis, but small compared to bank assets (89% of GDP) and equity markets (80% of GDP). Also, in comparison to India, outstanding corporate bonds are around 115% of GDP in US, 60% in Japan and 110% in UK.

Currently, it is a market for highly rated, plain vanilla instruments, issued by financial firms and public sector enterprises. Also, issuance is fragmented and trading dries up within a few days of issuance.

In India, infrastructure companies, PSUs and NBFCs are dominating the corporate bond market and frequently issue debentures.

Recent years have seen a slew of measures from the government and the Reserve Bank of India (RBI) to give the moribund corporate bond market a new lease of life. However, much more needs to be done, for the market to grow to its full potential. A look at the recent announcements reveals the issues.

Measures proposed in Budget 2016-17

Budget 2016-17 had proposed six measures for corporate bond market development:

1. An electronic platform for private placement
2. An electronic platform for corporate bond repurchase agreement (repo)
3. A consolidated reporting platform
4. Extend foreign investment to unlisted debt securities and pass-through securities
5. RBI to encourage bond financing by large borrowers
6. LIC to set up a credit enhancement fund for infrastructure projects

However, these measures are neither new nor likely to have any significant impact.

Electronic platforms for issuance, trading, settlement and reporting were first recommended by the R. H. Patil Committee in 2005. SEBI had mandated the listing of bond private placements in 2008, so there are no new unlisted bonds to allow foreign investment into. The securitization market is languishing due to regulatory and taxation challenges and just permitting foreign investment will not help revive it.

It would be difficult for RBI to encourage bond financing by large borrowers. Large companies are already heavily leveraged. Loans to them form a large part of banks' stressed advances. Hence, such companies will not seek additional financing through bonds as traded bonds reflect the credit quality of the borrower and both companies and banks may not want this to become transparent. Also, domestic capital available for this market is limited.

It would also be difficult for LIC to set up a credit enhancement fund for infrastructure projects as LIC is being called into action to support everything from disinvestment to railways' capital expenditure. Pension fund investment mandates are biased towards government bonds. Banks can invest, but they would prefer to hold these bonds to maturity to avoid mark to market costs. This reduces secondary trading, investor participation and therefore, new issuance.

The development of this market requires fundamental reforms in financial markets, public finance and regulatory governance.

1. The basic market infrastructure needs to be put in place. Lack of regulatory action and inter-regulator coordination have been hampering this. For example, a platform for corporate bond repo, similar to collateralized borrowing and lending obligation, had been proposed by SEBI, but was not approved by RBI till recently.

2. The government uses financial institutions as a captive investor pool for government bonds to finance its deficit. On top of that, there are governance problems of public sector banks and financial institutions. This constrains domestic financial development and crowds out private sector financing needs.

3. Foreign investment in local currency bonds is not favored. There are capital controls, such as the $50 billion investment limit and participation frictions, such as the ban on investment in less than three-year residual maturity instruments, which work against it.

4. The thinking on integrated financial markets is still at a nascent stage in India. There is a need for a bond-currency-derivatives nexus, for which the required elements are either missing or under developed. There is a lack of a reliable and accurate benchmark yield curve, which makes it difficult to price corporate debt securities. Despite regulatory guidelines being in place, there do not exist a repo market which enables secondary liquidity and a credit default swaps market which allows credit risk to be traded. In terms of the derivatives markets, the interest rate market is in its early stages and the currency market is fraught with frictions in the form of documentation requirements.

5. Creditor rights is a big missing piece. Contract enforcement and judicial efficiency are areas that need significant improvement. The bill related to insolvency and bankruptcy, was recently passed by Parliament.

All these are structural reforms which require a long-term commitment. Even as work is underway on the Indian Financial Code, proposed by FSLRC, many more reforms such as dismantling capital controls and comprehensive thinking on financial market architecture need to be implemented.

This will help in developing the corporate bond market in India.

Measures announced by RBI

In August 2016, the Working Group on Development of Corporate Bond Market in India submitted its report with some recommendations. Based on that, RBI announced a slew of measures for the corporate bond market, which will further market development, enhance participation, facilitate greater market liquidity and improve communication in the market.

1. **PCE ceiling raised to 50%:** The aggregate partial credit enhancement (PCE) that may be provided by the financial system for a given bond issue has been increased from the previous level of 20% to 50% of the bond issue size subject to the PCE provided by any single bank not exceeding 20% of the bond issue size and the extant exposure limits.

2. **Brokers in repo corporate bonds:** Brokers have been authorized as market makers and have been allowed to participate in the corporate bond repo market. This measure is expected to meet their funding and securities requirement arising out of market making activities.

3. **Direct trade in corporate bonds for FPIs:** To facilitate direct trading in corporate bonds by FPIs in the OTC segment and on an electronic platform of a recognised stock exchange, it is now allowed for FPIs to transact in corporate bonds directly without involving brokers.

4. **Corporate bonds for LAF:** Following emerging international practice, RBI has allowed corporate bonds as eligible collateral for liquidity operations.

These measures are expected to give a boost to the Indian corporate bond market.

Status of recommendations by previous committees

There have been a number of reports by expert Committees on development of corporate bond markets in India. Many of their recommendations have already been implemented by the government and the concerned regulators. However, the success of these measures in achieving the intended outcomes has been varied. Impact of some of the measures taken is captured below:

Intended outcomes mostly achieved

- Setting up of reporting platform for post-trade transparency
- Introduction of DvP in settlement of OTC trades in corporate bonds to eliminate settlement risk
- Issue of long-term bonds by banks allowed with a minimum maturity of seven years to raise resources for lending to (a) long term projects in infrastructure sub-sectors, and (b) affordable housing. These bonds

have been exempted from computation of net demand and time liabilities (NDTL) and are therefore not subjected to CRR/SLR requirements.

- The investment limit for foreign portfolio investors (FPIs) has been increased to INR 2443.23 billion. Limit allocation methodology has been rationalized and withholding tax rate has been reduced from 20% to 5%.
- FPIs have been permitted to invest only in corporate debts of at least three years of residual maturity.
- International financial institutions like IFC were permitted to float rupee linked bonds overseas to deepen the off-shore rupee bond market so that IFC and other investors can raise rupees to invest in India. This has facilitated development of benchmark yield for long term corporate bonds.
- SEBI has allowed setting up of dedicated debt segment on the exchanges

Intended outcomes partially achieved

- Banks and PDs allowed by RBI to become members of stock exchanges to trade in corporate bonds
- Investment norms for banks and PDs relaxed by RBI to facilitate investment in corporate bonds
- Final guidelines issued by RBI for partial credit enhancements by banks to corporate bonds
- Measures taken by SEBI to encourage investor interest/participation in the corporate bond market in terms of liberalizing the listing requirements, simplification of procedures and processes and simplified disclosure norms
- Rationalisation of FPI regulations has been put in place by SEBI for easier registration process and operating framework for overseas entities seeking to invest in Indian capital markets

Intended outcomes not yet achieved

- Introduction of Repo in corporate bonds to meet the funding needs
- Introduction of Credit Default Swaps to facilitate hedging of credit risk by the holders of corporate bonds
- Reissuance of bonds permitted by SEBI

Compliance

The Public Issue of Corporate Bonds/ NCDs is governed by the Companies Act, 2013 and SEBI (Issue and listing of Debt Securities) Regulations, 2008 (SEBI Debt Regulations). Issuers that are NBFCs, are also subject to compliance of regulations framed by the RBI.

Certain key aspects of the SEBI Debt Regulations are as under

- The minimum base issue size of the public issue should be Rs. 100 crores
- Option to retain over-subscription money up to a maximum of 100% of the base issue size
- Obtain in-principle approval for listing of its debt securities on the recognized stock exchanges, where the application of listing has been made

- Create 100% security on assets for the NCDs. NBFCs are permitted to issue unsecured NCDs having a maturity of more than 5 years and these shall be eligible as tier II capital.
- Minimum subscription of 75% of the base issue size, failing which, the amount procured will have to be repaid along with interest
- Specific disclosures with regards to 'objects of the issue' are required to be made in the prospectus
- Credit rating from at least one credit rating agency for the proposed public issue
- Appoint a merchant banker and a SEBI registered debenture trustee

Additional compliances by NBFCs

In addition to the above, NBFCs are required to comply with the guidelines/regulations of RBI, which require systemically important NBFCs to maintain capital to risk-weighted assets ratio (CRAR) of 15% and adhere to strict corporate governance requirements. Further, for all NBFCs, unsecured NCDs are considered as subordinate debt and qualify for tier II capital for the purpose of calculating CRAR. However, tier II capital can only be 50% of the tier I capital. Accordingly, issues of unsecured NCDs are restricted to that extent.

Some measures that need to be implemented

1. **Awareness with retail investors:** An incentivized distribution channel can create awareness among retail investors on investment in corporate bonds, which shall help retail participation in the market.
2. **Simplified stamp duty provisions:** There is inconsistency in stamp duty provisions in primary issuances and secondary market transactions. Clarity on this front and alignment with international practices will contribute towards deepening the market participation.
3. **Taxation:** FIIs and QFIs are required to pay withholding tax on interest paid by Indian corporates, which acts as a deterrent.
4. **Wider role and power to the debenture trustees (DTs):** A strengthened role of DTs with powers to enforce contracts and security kept in trust, shall help in enhancing the confidence of retail and institutional investors.
5. **Other measures:** There are several other measures, namely, mechanism for credit enhancements by credit/liquid facilities, roll over or re-issue of debt securities with minimal legal requirements, extending policy and regulatory support, clarity on issue of partly paid NCDs, could help in developing the corporate bond market in India.

Other recommendations by the latest Working Group

- Issuers

Reissuance

- The issuers coming out with frequent debt issues with the same tenor during a quarter may club them under the same umbrella ISIN which in turn would increase the float in the market, thus enhancing its

liquidity. These issuers may come out with a feasible maturity structure wherein they can stagger the redemption amount across the year by amortizing the repayments. Necessary changes may be made in the issuance process of ISINs by depositories, namely, NSDL and CDSL to facilitate the same.

- Re-issuances may not be treated as fresh issuances for the purpose of Stamp duty.
- The corporate governance norms applicable to companies which have listed only debt securities and not equity may be reviewed to make them less onerous.

Standardisation of corporate bond issuance

As suggested by market participants, SEBI may have a re-look at the guidelines issued in October 2013 so as to clarify on day count convention, shut period, basis for yield calculation, calculation of coupon interest and redemption with intervening holidays with illustrations. The date of payment may be specified as the date on a Mumbai business day, the day on which RBI and money markets function.

- Investors

In terms of RBI guidelines on credit default swaps, the credit exposure of a protection buyer shall be on the protection seller. In case of need for further clarification of doubts, if any, market participants may seek the confirmation of the respective regulators.

- Infrastructure

Uniform valuation norms

A uniform valuation methodology available on a daily basis may be followed by all the regulated entities for valuation of their holdings of corporate bonds. All regulators may explore an acceptable mechanism for valuation including engaging the Financial Benchmarks India Pvt. Ltd. (FBIL) or credit rating agencies for the same with necessary safeguards and regulatory oversight.

Electronic trading platform

The penalty structure in place for default in delivery of debt securities/funds for trades subject to CCP clearing by the clearing houses of the stock exchanges may be reviewed in consultation with all the stakeholders with a view to prescribing a penalty which is prudent yet reasonable. It is suggested that alternative mechanisms, such as borrowing through repo in corporate bonds, may also be explored for ensuring settlement.

Credit rating agencies

- CRAs may be mandated to strictly adhere to the regulatory norms with regard to timely disclosure of defaults on the stock exchanges and their own website. They may also publish the credit rating transition matrix more frequently. CRAs may take up membership of credit information companies to access relevant credit information.
- Banks may be encouraged to submit loan overdue information to CICs on a weekly basis to start with. RBI

may consider whether CRAs may be allowed access to Central Repository of Information on Large Credits (CRILC) database based on legal feasibility and other relevant factors.

- **Instruments**

Credit Default Swaps (CDS)

Amendments may be carried out in the RBI Act, 1934 to provide complete clarity on the legal position relating to netting of OTC derivative contracts. Pending amendments to the RBI Act or other enabling legal framework, based on expert legal opinion, possibility of permitting netting keeping in view the existing legal provisions and banking practices may be explored expeditiously.

Bond index

Corporate bond index may be introduced by the Stock Exchanges/other entities.

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Taxation and Disclosure Norms

APAS Article

The Indian corporate bond market has cumulative capitalization of USD 287 billion has till 2015. In comparison to USD 1413 billion worth of equity markets capitalization, this seems a comparatively miniscule amount.

Major factors that have led to such kind of skewness have been rigid taxation structures for income from bonds, disclosure norms for the companies seeking to list bonds, etc. Relatively, other avenues of debt markets have been easier to access in terms of both taxation and disclosure norms.

In the following parts, we take a look at taxation structure for the investors in the secondary market, reasons for preference to institutional debt rather than issuing corporate bonds, suggested reforms to increase penetration of bond markets, as a preferred class of investment for various classes of investors and finally recommendations from the R H Patil committee report which have been enacted upon, in concern with taxation and disclosure norms for issuers.

Current taxation norms for investment in bonds for investors in secondary markets

For investors looking to invest in corporate bonds, important taxation norms are as follows:

For listed bonds and debentures, long term capital gains are taxed at 10%. There is no benefit of indexation available for such securities.

For some assets, such as zero coupon bonds and select listed securities, investors have an option to select between two rates: Flat 10% without indexation or 20% with indexation. Investor can choose the method to get lower tax liability.

Need for reforms

From the global experience, it has been widely acknowledged that favourable tax regulations often positively impact the development of financial markets in an economy. India's efforts to develop the corporate debt markets could enjoy a similar success story by replicating the liberal tax mechanism provided to the equity market. Tax reforms, particularly stamp duties, and a revamping of disclosure requirements for corporate public offers, could help develop the corporate bond markets.

As a step to explain the need for reforms in the corporate bond markets in India, we start on with the discussions with the basics of debt markets, and reasons for preference to debt issued by the banks over issuance of corporate bonds:

Reasons for preference to loans from banks over issuance of bonds

Issuance of higher amounts of debts need approvals from the board members or board committees. However, private placement investments are not subject to the same scrutiny (or delay), again, giving banks an incentive to grant loans.

Absence of stamp duties from issuance of loans, make them desirable for tax sensitive borrowers.

Similarly, corporations tend to regard loans and bonds as interchangeable. This occurs to some extent in most markets. But in India there is a strong focus on managing or arbitraging micro features. The level and complexity of stamp duty encourages the arbitrage-based approach to corporate finance, so decisions are often tax-driven rather than strategy-driven. Concentrated efforts for reforming the stamp-duty structures across the states are being focused upon, as a part of recommendation of the R H Patil committee report.

Other factors that have a limiting impact on trade include (i) tax deducted at source—which complicates trades between tax-exempt and non-exempt entities; (ii) no single database of bonds; and (iii) no universal conventions for day count or interest calculation, for example.

Suggestivetax reforms for various classes of Investors

a) For Retail Investors:

Currently, only infrastructure-related bonds qualify for tax-exemption for retail investors under Section 80C of Income Tax Act. The scope could be expanded to include corporate bonds related to other industries seeking long-tenure funding as well. Alternatively, a separate window like the one created for infrastructure bonds under section 80CCF could be created for corporate debt investments. Till the time Indian corporate debt markets are conducive to direct retail participation, such investments could be mandatorily through debt mutual funds (on the lines of tax exemptions to ELSS) with a 3 to 5-year lock-in period. This creates an alternate route for risk-averse retail investors, an alternative apart from bank fixed deposits.

b) For Foreign Investors:

Currently, interest payments to FIIs have tax deduction at source at the rate of 5 per cent in rupee denominated corporate bonds. The amendment was made in May 2013, prior to which the tax rates stood as high as 20 per cent. It may be worthwhile to grant exemption to foreign investors from withholding tax, to reward their participation in corporate bonds. The trend till date suggests that FIIs have generally been partial toward investing in equities and government securities, both of which provide better liquidity. Hence such incentives might be necessary to make corporate bonds seem better as an investment option. This will not only improve non-resident participation in the domestic market but also create the way for increased offshore corporate bond issuances in the Indian bond market.

c) For all investors:

Corporate bonds and debentures could be brought on level grounds with equity as far as tax on long term capital gains is concerned. As per existing regulation, a long-term equity share (held for more than 1 year and on which Securities Transaction Tax (STT) is paid) is exempt from tax (section 10(38) of the Income Tax Act); however, the same provision is not applicable for corporate bonds. A similar provision for listed corporate debt securities will improve participation from all investors.

These reforms have been held back by the Centre on account of estimated loss of revenues from the above exemptions, in the bond markets. However, in the long-term these measures are bound to increase due to additional STT (due to increased turnover).

The distinction between a public offering and private placement of securities is specified under the Companies Act. Any offer or invitation made specifically to less than 50 investors is considered a private placement, while a more general invitation is considered a public offering. A substantial part of bond offerings are bought by institutional investors (limited in number), making the issuers find it attractive to choose private placement over public issuance of bonds. This could be attributable to the lack of standardization and transparency in the bonds market. The private placements are less opaque and subjected to statutory disclosure requirements that apply to them. Due to limited number of the institutional investors and likeliness to be repeat players in the private placement segment, aspects of mutual trust and reputation play a greater role than matters of disclosure mandate by statute or regulation.

Hence, it can be inferred that lack of standardization, transparency and wider availability of shelf prospectus are major reasons for absence of liquidity in the secondary markets in the Indian corporate bond markets.

Reforms to be introduced in the bond markets

Reforming the stamp duty

The stamp duty is a significant barrier to the development of both the corporate bond and securitization markets. Stamp duties are typically 0.375% for debentures and, as they are strictly ad-valorem, there is no volume discount.The rate of duty varies from state to state). R H Patilcommittee report bring uniformity in the stamp duties across states and other such reforms suggest states waiving off the stamp duties from the bond issuance. However, any such reform is yet to materialize. Rates also vary with the nature of the issuer; and with the nature of the initial purchaser (for example, promissory notes bought by commercial and some other banks are subject to only 0.1% duty, compared with 0.5% if issued to other investors). Interest payments are taxable as income and capital gains are taxable. The Patil report recommends that there should be a uniform low rate across all states and that the maximum amount payable should be capped. Plans are being drawn up to address this, but the timescale is unclear.

Reform disclosure for public offers of corporate bonds

A kind of riskiness is perceived by the issuers in process of issuance of bonds. Existing regulations could be reformed to allow for disclosures that are appropriate for public issues into a largely professional market by entities that are already well-known to the investment community. Regulations could also be changed to allow techniques such as shelf registration. The public issue process is also unduly long to allow for postal

submissions—a recent proposal by the RBI to allow online applications might help by shortening the time an issuer is on risk. If current SEBI proposals are implemented, they should address some of the burdensome nature of issuance by rationalizing disclosure requirements especially for companies already listed.

One of the ways, suggested for the bond market's development is encouraging securitization. The stamp duty is a major barrier to the development of securitization. India began securitization early among Asian markets, with transactions going back to the early 1990s. However, the securitization market has not yet developed. Volumes tend to be low and asset types limited. Volumes are mainly influenced by tax or regulatory arbitrage considerations rather than by underlying financial factors. The market is also subject to regulatory, legal, and tax uncertainties.

List of recommendations from the R H Patil committee report that have been acted upon by the authority:

Sr. No.	List of recommendations	Action taken by the authority
1.	**TDS (Tax Deductions at Source)** TDS rules similar to Government securities or G-Secs. TDS applicable to corporate bonds to be removed.	The February 2008 Union Budget removed taxes on interest from corporate bonds.
2.	**Increasing the issuer base** Simplify and reduce disclosure and listing requirements for private placements. Reduce the cost and time for public issues.	SEBI Notification in May 2009 simplified the listing procedure and reduced disclosure requirements for listed entities (whether by way of public issue or a private placement), thereby reducing the cost and time for public issues.
3.	**Listing of Issues** Abridge the disclosure requirements for listed entities; only incremental disclosures needed. Stringent disclosure norms for unlisted entities. Stringent action against promoters of firms not complying with listing agreement. Role of debenture trustees to be strengthened. Privately placed bonds listing to be made compulsory within 7 days of placement. Mandatory guideline to credit the dematerialised account within 2 days from the date of allotment.	SEBI circular dated May 11, 2009 on Simplified Listing Agreement of Debt Securities provides for minimal incremental disclosures related to the debt security issuance for listed issuers. Entities with privately placed bonds or no prior issues are required to provide detailed disclosures. The Securities Contract Regulation Act (SCRA) has been amended empowering SEBI to take action against the promoters of firms' not complying with the listing agreement. SEBI has included these suggestions in its Disclosure and Investor Protection (DIP) guidelines. Circular informing the same for privately placed bonds was also issued.

4.	**Enhancing the investor base** Retail participation to be encouraged through exchanges, and mutual funds investing in corporate bonds. Separate FII investment limit in corporate bond market.	SEBI has implemented an investor education program to address this issue. All FIIs and QFIs have been categorised as Foreign Portfolio Investors (FPI). FPIs are currently allowed a limit of $30 billion in government securities and $51billion in corporate bonds.
5.	**Stamp Duty on partly / unsecured debt** The stamp duty on partly secured, and unsecured debentures should be made uniform across states and be linked to the tenor of securities.	Actions required: Rationalisation of stamp duties across all states.
6.	**Stamp duty on securitized debt** Consensus across states to be evolved to develop affordable rates for stamp duty on securitized products.	There is a need to rationalise the stamp duty across all states and the Ministry of Finance will need to work with State Governments on this. Currently the hindrance is the loss of revenue concerns from state governments.
7.	**Taxation** Explicit tax pass for securitized Special Purpose Vehicles (SPVs) and Non-Performing Assets (NPA) securitization for central government, similar to the SEBI registered Venture capital funds. Reduction in withholding tax (WHT) on interest earned from 20% to 5%	Securitized SPVs and NPA securitization could benefit from a tax pass through treatment and place them on par with SEBI recognized VC funds. This is being considered by Ministry of Finance. In May 2013 reduced the WHT rates to 5%

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ABOUT APAS

Ashvin Parekh Advisory Services LLP (APAS) was founded in June 2013 and is headquartered in Mumbai, the finance capital of India. APAS is a leading financial advisory firm, providing a wide range of consulting services to a diversified client base, including financial conglomerates, business houses, banking companies, life, general and health insurers, financial institutions, regulators and the government.

Our focus is primarily on business development through advisory services in strategy, processes and people areas. In strategy areas, we focus on diversification, strategic alliances, mergers and acquisitions and business restructuring. We also offer services in the areas of transformation and value creation. In the operation strategy areas, we also render services at product and product design, intermediation and distribution areas, business risk management and governance aspects of the management.

In keeping with the services we offer, we have experts in business and transaction advisory areas. We have teams drawn from the industry to offer services to our clients in business and operation areas in the financial services space.

We have teams focusing on the new banking reforms including the formation of the new banking companies arising out of the new licenses. We will offer operational support in the areas of financial inclusion, holding company structures and project management services. We also have focus on the new reforms in the areas of subsidiarisation of foreign banks. In addition, we also conduct high level diagnostic studies for public sector and private sector banks.

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ASSOCHAM initiated its endeavour of value creation for Indian industry in 1920. Having in its fold more than 400 Chambers and Trade Associations, and serving more than 4,50,000 members from all over India. It has witnessed upswings as well as upheavals of Indian Economy, and contributed significantly by playing a catalytic role in shaping up the Trade, Commerce and Industrial environment of the country.

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We would heartily appreciate your valuable inputs / issues related to above subject matters, kindly send your inputs to Department of Banking and Financial Services (ASSOCHAM):

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Fax : 91-33-4000 1149
Mobile : 9674312234
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kolkata@assocham.com

ASSOCHAM Regional Office, Tamil Nadu
International Law Centre,
61-63, Dr. Radhakrishnan Salai
Mylapore, Chennai – 600 004
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intellect@lawindia.com

ASSOCHAM North Eastern Regional Office
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E-mail : ner@assocham.com

ASSOCHAM Western Regional Office
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Ahmedabad – 380014, Gujarat
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Mobile : 9810825894
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ASSOCHAM Regional Office, Ranchi
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ASSOCHAM Regional Office, Uttarakhand
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Uttarakhand
Phone : 05947-226146
E-mail : assocham.uttarakhand@gmail.com

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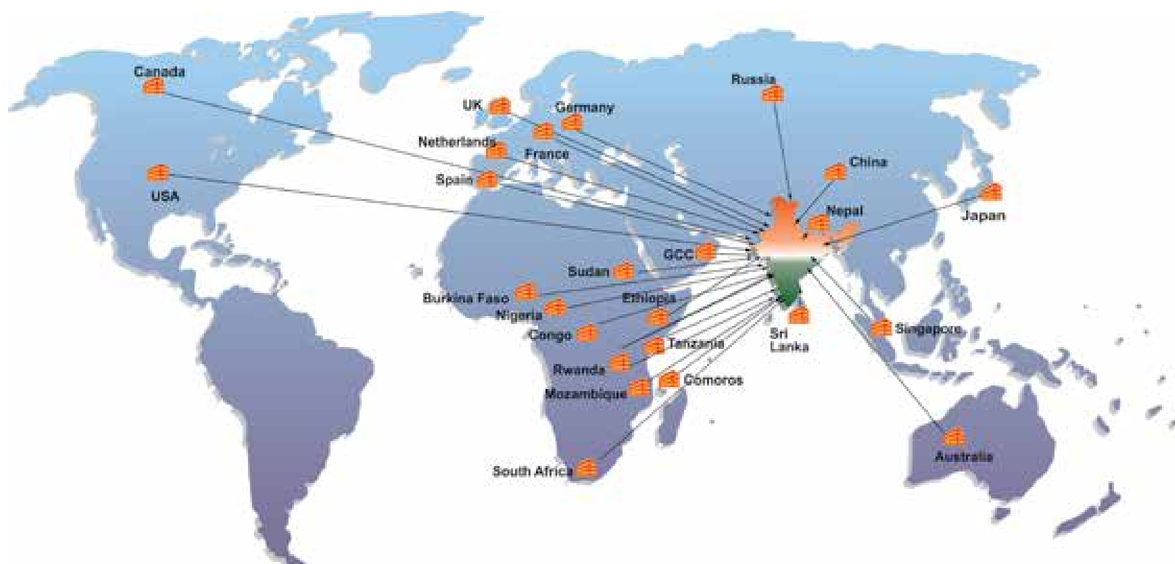

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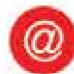

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