Developing a market for corporate bonds

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19th December, 2015

The story so far: financial market development

As % of GDP	1996	2008	2015
Equities	32.1	108.4	80.0
Government bonds	14.3	36.1	34.3
Corporate bonds	0.9	3.9	14.0
Bank assets	46.5	73.8	89.0

Source: SEBI, RBI, IMF World Economic Outlook

- Considerable progress in equity markets. But, trading concentrated in the top 100 – 150 stocks.
- Large government bond market.
  - Government bonds have a captive audience in domestic financial institutions.
  - Few liquid instruments.
  - Only 2y, 5y and 10y benchmark exists.

The story so far: financial market development

- Corporate bonds have lagged behind.
  - However, at $287 bn, fourth largest market in Asia Pacific.
- Mixed results on derivatives market.
  - Equity F&O on exchange.
  - OTC FX derivatives and F&O.
  - Fixed income and credit derivatives nascent/missing.
- Banks are the largest source of domestic credit.

The story so far: firm financing

As % of total	1991-92	2009-10	2012-13
Equity	22.60	34.87	37.21
Retained earnings	10.56	21.05	6.85
Fresh issuance	12.04	13.82	30.36
Depreciation	17.64	9.69	3.56
Borrowing	35.32	29.48	21.57
Banks	17.14	17.83	15.20
Bonds	7.87	3.94	0.96
Inter-corporate	1.28	2.28	3.32
Foreign	5.51	3.22	0.74
Current liabilities	24.42	24.19	37.65
D:E	1.56	0.85	0.58

Source: CMIE Prowess

- D:E ratios of firms have **declined** over time.
- Firms increasingly dependent on **new equity** and **trade credit**.
- Banking sector continues to be the largest source of **long-term financing**.

The story so far: primary market for corporate bonds

Year	Issuance		Issuers					
			Banks		FIs		Others	
	Value (Rs. bn)	No.	Share (%)	Avg. size (Rs. bn)	Share (%)	Avg. size (Rs. bn)	Share (%)	Avg. size (Rs. bn)
2008	1,185	744	17	4.08	41	1.28	42	4.33
2009	1,733	1,041	24	3.80	34	0.79	42	2.54
2010	2,151	1,281	15	6.14	57	1.11	28	0.91
2011	2,282	1,414	3	2.66	67	0.75	29	1.67
2012	2,969	1,973	9	7.13	60	1.09	32	1.87
2013	3,784	2,509	5	9.43	67	1.33	27	2.54
2014	**3,184**	**1,959**	**6**	**9.48**	**63**	**1.89**	**31**	**2.52**

Source: SEBI, Thomson Reuters Eikon

- Recent growth in issuance dominated by non-bank financial firms.
- Large number of issues and smaller issue sizes – frequent private placements.
- 80 – 85% of issuance with AAA and AA rating. Only 2 – 3% in sub-investment grade.
- 75 – 80% of issuance fixed coupon, plain vanilla bonds.

The story so far: secondary market

Year	No. of issues	Value outstanding (Rs. bn)	No. of trades	Traded value (Rs. bn)	Avg.trade size (Rs. bn)	Turnover ratio
2008			19,079	958.9		
2009			22,683	1,481.7		
2010			38,230	4,011.9		
2011	12,155	8,895.1	44,060	6,052.7	0.14	0.68
2012	13,721	10,516.4	51,533	5,937.8	0.12	0.61
2013	15,874	12,901.5	66,383	7,386.3	0.11	0.63
2014	13,104	14,673.9	70,887	9,708.0	0.14	0.70
2015	19,439	17,503.2	75,791	10,912.9	**0.15**	**0.68**

Source: SEBI

- Secondary market largely OTC, illiquid.
- Repo/CBLO equivalent missing in the corporate bond market.

Global bond markets

Country	Bond market Size – 2015 (as % of GDP)				GDP
	Total	Government	FI	Non-FI	(USD bn)
USA	207	90	86	30	17,348
China	60	17	23	19	10,357
Japan	243	182	48	14	4,602
UK	201	88	95	18	2,950
India	**49**	**34**	**10**	**4**	**2,051**
Korea	103	36	32	35	1,410
Indonesia	13	11	1	1	889
Thailand	81	28	32	21	405
Singapore	108	24	53	31	308

Source: BIS Debt Statistics; IMF World Economic Outlook; ADB AsianBondsOnline

- Global bond market size \$ 85 – 90 trillion.
- Corporate bond market dominated by non-financial corporations.

Global bond markets

	Govt. bonds outstanding ($ bn)	Turnover ratio	Corp. bonds outstanding ($ bn)	Turnover ratio
USA	15,614	9.7	20,147	1.6
China	1,779	1.3	4,390	0.9
Japan	8,363	5.3	2,839	0.3
UK	2,598	n.a.	3,327	n.a.
India	704	1.9	287	0.7
Korea	505	3.04	944	0.5
Indonesia	101	2.7	19	0.8
Thailand	112	2.6	215	0.3
Singapore	73	1.9	259	n.a.

Source: ADB AsianBondOnline, BIS Debt Statistics, SIFMA, SEBI, RBI

- Secondary markets are relatively illiquid.
- Large markets for:
  - Interest rate derivatives – OTC$ 434 trillion notional outstanding; exchanges $26.5 trillion open interest
  - OTC credit derivatives – $ 14 trillion notional outstanding

Why care?

- Policy debate globally and in India has focused on the development of local currency bond markets.
- Bond markets can provide long term financing, which banks with ALM issues cannot.
- Banking sector in India is facing challenges – asset quality, capital requirements under Basel III.
- Financing challenges for infrastructure, new businesses, firms in asset light industries.

Developing local currency bond markets

- Conditions required for bond market development:
  - Rule of law
  - Creditor rights
  - Fiscal balance
  - Country size and growth rate
- Similar to conditions required for banking system development.

Diagnosing the problem

- Market weakness of domestic institutional investors – regulatory constraints and institutional capacity.
  - How did India equity markets deal with this?
  - In the US markets, 20% of the corporate bonds outstanding are held by households and corporates, 45% by insurance, pension funds and MFs, 15 – 20% by foreign investors and less than 10% by banks.
- Challenges for foreign investors –
  - Controls on access – investment limits
  - Tax policy – implications of the source based tax regime
  - Frictions – documentation, uneven playing field
- Market infrastructure for trading, clearing and settlement. Globally, bond markets are largely OTC.
  - India's successes in financial markets are all on exchanges.

Diagnosing the problem

- Liquidity problem in primary issuance.
  - The current status reflects demand/supply conditions.
  - How can heterogeneity develop?
- Liquidity problem in secondary trading.
  - Secondary liquidity requires risk ware-housing.
  - Secondary markets in India have developed on the back of tax incentives.
- Interlinked markets – BCD nexus
  - Bond market ecosystem – government bonds, corporate bonds, repo/CBLO in both, securitisation, interest rate derivatives , credit derivatives, currency derivatives.
  - Regulatory coordination – <1 year maturity bonds with RBI and >1 year with SEBI. Securitisation market is with RBI.
- Weak bankruptcy processes.
  - Overt focus on recovery of bank secured credit.
  - Amtek Auto – selective default on bondholders.

Solving the problem

- Everything appears to be a problem.
- Yet we have \$287 bn market.
- What should be done next? For whom? Large corporates, mid-sized corporates, small/new firms, infrastructure, financial firms?
- The answer to the above will determine the priority of actions.
- Interesting new developments – Rupee offshore bonds, FSEZ. What kind of opportunities do these create?

Thank you.