Research Digest

Development of Corporate Bond Markets in India - Global Lessons

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Development of Corporate Bond Markets in India - Global Lessons – PART I

With increasing need for formalization of its economy and privatization of its large public sector, it is essential that capital needs to be effectively intermediated to increase efficiency. With Corporate Bonds (CBs) playing a key role in intermediating debt capital efficiently between savers/channelizing institutions and businesses, India needs to have deeper markets with larger issuances and trading of CBs.

Table#1: Corporate Bond Markets – Issuances, Outstanding and Trading – A Global Comparison (2012)

Rank*	Country	Corporate Bond - Issuance *USD Bn (% GDP)*	Corporate Bond - Amount Outstanding * *USD Bn (% GDP)*	Value of Corporate Bond Trading # *USD Bn (% Outstanding)*
1	United States	1385.0 (8.5%)	20908.3 (128.7%)	210776.2 (15219.0%)
2	Spain	467.8 (35.4%)	1450.1 (109.6%)	3290.1 (226.9%)
3	China	335.8 (4.1%)	1039.6 (12.6%)	4343.3 (417.8%)
4	South Korea	364.2 (32.2%)	898.8 (79.6%)	505.9 (56.3%)
5	**India**	**63.4 (3.4%)**	**206.7 (11.2%)**	**115.9 (56.1%)**
6	Malaysia	50.3 (16.5%)	131.1 (43.0%)	52.7 (40.2%)
7	Indonesia	7.1 (0.8%)	19.1 (2.2%)	8.4 (44.1%)

Source: BIS Quarterly Report Dec 2013; Asian Bond Online website; SEBI Website; SIFMA; WFE; World Bank database
**Note: Rank on the basis of Corporate Bond - Amount Outstanding as % of GDP (H to L);CB Amt. Outstanding as on Dec 2012; Value of corporate bond trading for all countries is exchange traded; while for the US OTC is considered.*

With a very low bank lending compared with the size of its economy, large dependence of corporates on bank lending will remain a challenge to our growth aspirations. With globalization of capital flows, bonds can be effective tools of leveraging external capital flows in the most efficient manner.

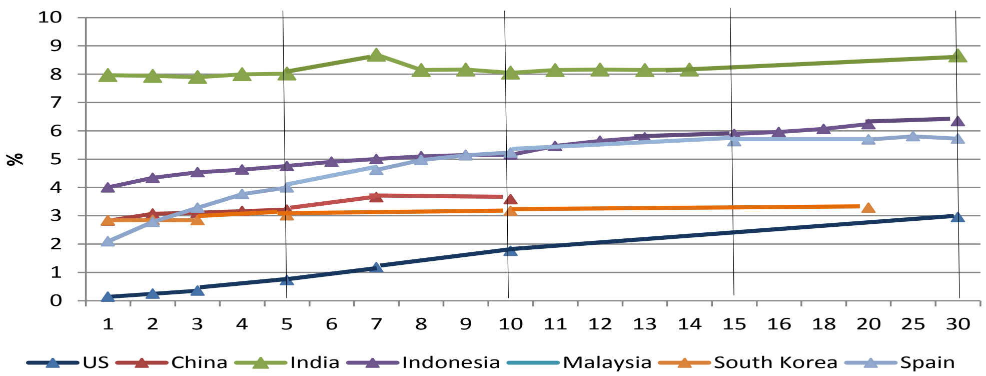
Table#2: Cross Country Comparison - Other sources of funding: Bond Issuance as % of Market Capitalization and Bank Lending (2012):

Rank*	Country	Corporate Bond Issuance as % of Market Capitalization	Corporate Bond Issuance as % Bank Lending	Bank Lending as % of GDP
1	Spain	47.00%	15.65%	225.90%
2	South Korea	30.90%	19.10%	168.70%
3	China	13.20%	2.60%	155.10%
4	Malaysia	10.80%	12.30%	134.00%
5	United States	9.80%	3.70%	229.30%
6	**India**	**5.00%**	**4.50%**	**76.60%**
7	Indonesia	1.60%	1.90%	42.60%

Source: Bloomberg, BIS Quarterly Report; WFE; World Bank database
**Note: Rank on the basis of Corporate Bond Issuance as % Market Capitalization (H to L)*

Well Developed Indian Benchmark Yield Curve – Consolidation of Exisiting Multiple Maturity Securities - The Way Forward - Not only that Indian yields are much higher in the pack, but also that the yield curve has not been much supported by a few but "Well Anchored Government Securities of a fixed/standard duration" such as the well developed markets of United States, Spain, South Korea and Malaysia. Lack of sufficient volumes in securities other than the 10 year bencmark government security does not bode well for the development of sovereign yield curve. May be consolidation of existing multiple maturities could pave the way.

Chart#1: Benchmark Yield Curve for G-sec Bonds (Dec-2012)



Source: Bloomberg

While the G-Sec traded volumes are picking up, it has to be spread healthy across few "well anchored maturities" that would help establish a well-developed yield curve. Despite having low trading to outstanding ratio existence of few but well focused maturities helps much in the case of South Korea and Malaysia.

Table#3: G-Sec Bond Trading Ratio (2012):

Rank*	Country	Bond Trading Ratio
1	United States	6.09
2	**India**	**1.20**
3	Korea	1.04
4	China	0.70
5	Malaysia	0.66
6	Indonesia	0.32

*Source: RBI, Asian Bond Online, SIFMA; *Rank on the basis of Bond Trading Ratio (H to L) Note: Bond Trading Ratio=Trading Volume/ Amount Outstanding*
**Note: Rank on the basis of Bond Trading Ratio (H to L)*

Development of Well-entrenched ABS/MBS Markets holds the Key to Corporate Bond Market Development Evolutionary pathway of global bond markets suggest that well developed asset backed securities (ABS) markets pre-existed the development of non-securitized bonds such as corporate bonds. Nations with well-developed corporate bond markets have well entrenched ABS markets as well. Well-developed ABS markets not only relieves banks of balance sheet pressures but also provides them with opportunities to further leverage the monetary base enabling it support India's growth aspirations.

Table#4: Cross Country Comparison: ABS as a % of Bank Lending and GDP (2012):

Rank*	Country	ABS/ Bank Lending	ABS/ GDP
1	United States	0.5401%	1.2384%
2	South Korea	0.0017%	0.0029%
3	Malaysia	0.0008%	0.0011%
4	**India**	**0.0003%**	**0.0003%**
5	Spain	0.0001%	0.0003%
6	China	0.0001%	0.0001%

*Source: Respective country's financial supervisory bodies *Note: Rank on the basis of ABS/ Bank Lending (H to L)*

Where are the markets for bonds rated A and below? - While the global discussion about the effect of ratings on pricing of corporate bonds is still on, the example of South Korea and Spain suggest that existence of well functioning markets for A and below markets could help support thriving entrepreneuralism in the country. Active markets for corporate bonds of A and below would help serve the purpose of mitigating the current public burden of subsidized lending to risky and vulnerable corporates.

Table#5: Rating-wise Breakup of Corporate Bond Issuances (2012):

Country	AAA	AA+	AA	AA-	A and Below	Unrated
China*	28.72%	18.55%	24.63%	18.92%	9.18%	-
Malaysia	43.30%	-	34.10%	-	18.30%	4.30%
United States	1.83%	5.67%	34.60%	-	22.26%	35.61%
India	**5.00%**	-	**10.00%**	**-**	**21.00%**	**64.00%**
South Korea	27.00%				73%	-
Spain#	-	-	-	-	54.33%	45.67%
Indonesia#	-	-	-	-	93.33%	6.67%

*Source: SEBI, FINRA, ChinaBond.com, Korea Investor Service; * China data for 2011; #Bloomberg data*

Credit Ratings and Regulation Experimentations – An evolving terrain yet to prove its worth?

- While SEC and Federal Banking Regulators recently rescinded mandatory rating references, India needs one and South Korea mandates two.
- While countries like the US and India provides for wider option of rating agencies to choose from, other nations such as South Korea (four credit rating agencies) and Malaysia (two) have restricted options. Having a few is good or mandating none or more than one is?
- Despite having established private players providing rating services, Malaysia went ahead to level the playing field with two new domestic government established rating agencies in the past.
- Would letting stakeholders a larger say in the regulation and functioning of credit rating agencies lead to increased transparency and fulfill the mandate behind rating a security e.g. South Korea.

Scope for Improvement - With the US and Malaysian experience on reporting mandate and a platform for its compilation and dissemination in the past, Indian experimentation with mandatory reporting and dissemination began with F-TRAC which became operational during October 2011. A comparative look into these experiments reveal that identification of the executing broker by their type and real time dissemination would further serve the intended objective behind information dissemination i.e. anchoring further transactions in markets for corporate bonds.

Table#7: Reporting Norms on Trading Platforms:

Platform	Launch Date	Mandatory	Transaction Information to be reported			Market Hours:	Reporting Timing:	
			Description	Capacity	Executing Broker		Within (minutes)	Real Time
FIMMDA's F-TRAC	Oct 2011	Yes	ISIN	NA	NA	8 – 9	15	No
FINRA's TRACE	July 2002	Yes	CUSIP	Principal or Agent	Yes	10.30	15	Yes
Malaysia ETP	Mar 2008	Yes	ISIN	NA	NA	11	10	Yes

Bond Pricing Agencies to Anchor Development of Corporate Bond Markets: As Asian economies shifted to 'mark-to-market' accounting of portfolio valuations, it gave rise to Bond Pricing Agencies which provides daily evaluated pricing of securities under their purview. BPAs are an important means for the price finding process in less liquid domestic bond markets especially in cases where little trading occurs and daily quotes are missing.

Table#8: Bond Pricing Agencies– A Comparative Study

Bond Pricing Agency	Year	Regulatory Authority	Initiative by	Information available	Model
Indonesia Bond Pricing Agency	Sep-07	Bapepam-LK Regulation	Government Mandated	• Government Bond, Sukuk Prices and Yields • Corporate Bond (CB), Sukuk Prices and Yields - CB Yield Curves by Ratings, Credit Spread Matrix, Bond-related News. • Government Bond, Corporate Bond, Sukuk Pricing Information.	Nelson-Siegel Svensson, which is based on parametric modeling and optimization process in order to generate best-fitted yield curve.
Malaysia Bond Pricing Agency	Apr-06	Securities Commission	Initiative of the Securities Commission	• News and Research & Market Opinion • Primary Market Information related to - Facility, Stock, Issuer Financial, Credit Rating, Issue Statistics, Tender • Secondary Market - Daily Trading, Trade Statistics, Trading Charts, Historical Data • Yield Analysis & Other Market Information	Hybrid of quote-based and theoretical model
Korea Bond Pricing Agency *(3 Agencies, KIS, NICE & KPB)*	2000	-	Initiative of the Government	• Daily Bond pricing information • Zero Curve for illiquid Bonds • Generating Price & YTM • Weekly Credit Rating Changes • Weekly & Monthly Analysis Report • Current Bond market issues	Fair Valuation

MOOT POINTS:

- As India grows and globalized rapidly, debt capital would have to be efficiently intermediated to fuel its economic aspirations. Development of Corporate Bond Markets is an essential task on that front.
- Despite healthy issuance of Corporate Bonds in India, a lot of it happens privately and its trading remains limited having implications for development of secondary markets as well.
- Focused efforts to develop the benchmark sovereign yield curve, enablement of ratings as a pricing facilitator than remain a cost burden on issuers, real time dissemination of transaction critical information while protecting the privacy of transactors and setting up of pricing agencies to enable marking to the market and pricing of debt securities and its efficient transaction will go a long way in corporate bond market development.

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