Headline: Wanted: A vibrant corporate bond market	
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Wanted: A vibrant corporate bond market

It would be prudent to bring more transparency before they grow so big that migration to exchanges becomes difficult

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This year marks 20 years since the Asian financial crisis. The 1997-98 crisis demonstrated the vulnerability of short-term external debt financing and the importance of having stable long-term finance for achieving sustainable economic growth. While India is not likely to face financial crisis similar to that faced by the East Asian economies, it is important to learn from past crises. One lesson from the Asian crisis is the need to have multiple channels of finance.

India's economic growth so far fueled by bank finance is now experiencing a slowdown. This is largely because of the twin balance sheet problem that India is facing for some time. While the balance sheets of corporates are stretched, banks are facing issues of resolving stressed assets. In this uncertain environment, bank lending to the industry is declining for the first time in this decade. Banks' share in the flow of credit that was around 50 per cent in 2015-16, declined sharply to 38 per cent in 2016-17 (RBI Financial Stability Report June 2017).

The Indian growth trajectory is dependent on the ability to fund corporates, especially capital-intensive projects, efficiently and effectively. With this backdrop, the importance of non-bank finance is growing. A well-developed domestic capital market can provide an alternative source of funding that can complement bank financing. Capital markets can offer better pricing and longer maturities as well as access to a wider investor base.

Capital markets are efficient when primary and secondary markets work to help raise capital, provide investors the ability to transfer and hedge risk and when information on all these markets is available online in real-time to issuers and investors. While the equity markets would appear to be doing their job of funding corporate India, debt markets continue to be plagued by challenges.

The primary issuance of corporate debt has increased in India with entities raising about ₹6.7 trillion in 2016-17 compared to ₹1.7 trillion in 2008-09 (SEBO Monthly Bulletin). However, liquidity in the secondary market for these bonds remains poor. Price discovery remains opaque though there is post deal reporting on the trade repositories. Regulators have initiated several measures to develop the corporate bond market. Some of the recent measures include the primary electronic bond platform, the corporate bond repo guidelines, consolidation of ISINs, large exposure norms for banks etc. While some of these have been implemented, others are work in progress.

While one school of thought suggests that corporate bonds globally are traded in OTC markets only, there is debate in even the most active bond market (the US) on having electronic trading platforms and transparency. For India, it would be prudent to bring more transparency to our corporate bond markets before they grow to such large proportions in the OTC market that migration to exchanges and therefore greater transparency is harder to achieve.

The introduction of the Electronic Bond Platform (EBP) on the primary market side has brought substantial transparency to these markets. Investors now have intimation of upcoming issues, can choose to participate directly or bid through arrangers, can see the book building process and make investment decisions.

CHANGED OUTLOOK **Since the 1997 Asian financial crisis, bond market development has become a priority for Asian policymakers**

NSE has launched an anonymous order-matching platform for secondary market trades, tht is, the debt segment. This platform provides a guaranteed DVPI-II settlement, clean price based trading, accurate price and yield information; in effect it can do for bond markets what anonymous order matching did for equities. However, market participants have shied away from adopting this. The reasons could be the relatively small issue sizes (leads to transient liquidity), the platform provides access to only corporate bonds which is one part of the fixed income market and a reluctance to move away from an OTC market. The NSE is working with regulators to bring all cash fixed-income products to this platform. This would include commercial papers (CPs), certificates of deposits (CDs) and Corporate Bond Repos in addition to corporate bonds. A combined product delivery providing netted settlement would add more value to end users and hopefully incentivise them to migrate to electronic trading for corporate bonds, leading to better secondary market liquidity.

Another aspect that needs to be examined for bond markets is liquidity. How do we bring more players -- investors and market makers -- to this asset class? While the equity markets see substantial intermediation with several brokers actively engaging the investor classes, the bond market -- whether government or corporate -- sees very few research analysts and brokerage houses that actually reach out to investors. The NSE is committed to bringing in more investors, retail and institutional, to this market and will work towards education and awareness. Regulation needs to encourage intermediation too.

Another missing block that is well addressed in the equity markets but absent in corporate bond markets is funding. The average retail investor in equity can easily raise financing against her investments. However, it is difficult for an investor to raise funds against any government or corporate bond holding. Without adequate liquidity in the secondary markets and with no available options to refinance bond portfolios, investor interest in this asset class remains tepid. If we want more semi-institutional and retail investors to look at this asset class, then funding options need to be made available.

The RBI has recently permitted Corporate Bond Repos with guaranteed settlement on exchange platforms. However, the access to repo is restricted to institutional players. Perhaps brokerage houses, HNIs, AIFs, Pension and Provident Funds can be permitted to access this product.

Since the 1997 Asian financial crisis, bond market development has become a high priority for Asian policymakers. Because of these efforts, the East Asian corporate bond markets have grown significantly in size. For instance, the size of outstanding corporate bonds in Korea is almost 80 per cent of the GDP (Asian Bond Online). However, the outstanding corporate bond market in India is still 17 per cent of the GDP (Sebi Outstanding Corporate Bond Data). A well-diversified economy with a balanced distribution across bank lending and corporate bond markets is less vulnerable to a financial crisis.

We need to continue our efforts as regulators, service providers and market participants to bring greater transparency and balance to our debt financing market structure. A focused approach with tight timelines for all stakeholders is needed for the Indian corporate bond markets to deliver on their true potential.

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