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Pushing bond & currency mkt development

Work by regulators, market infrastructure institutions and market participants needs to continue to ensure these markets move to the next phase of development

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The fixed income and currency markets in India have operated primarily over the counter (OTC). While government bonds trade on an electronic platform, corporate bonds are mainly OTC traded with reporting and settlement on clearing corporations. Currency spot and forwards trade primarily in OTC markets, whereas futures are exchange traded. What measures could then be adopted to accelerate the pace of growth in these key markets?

Government bonds are very actively traded on the Negotiated Dealing System — Order Matching platform. However, liquidity is concentrated largely in the 10 year bucket. While the average daily traded volume is large at ₹38,650 crore for the last financial year, liquidity is not easily available across the curve. In 2018, for the first time, stock exchanges were permitted to distribute government bonds through the non-competitive bidding route to retail participants. The NSE has seen good interest from retail participants. In India, retail investors are very active participants in direct equities and can potentially be large participants in government bonds too. The large sums of money invested by retail investors in bank fixed deposits clearly indicates a preference for risk free fixed returns.

Government bonds compare favourably to FDs in many ways. They provide longer maturity, are much safer investments and provide an exit opportunity through secondary markets. Further, with some of the recent credit situations observed in the corporate bond space, government bonds would be the ideal asset class. Bringing in newer classes of investors to the government bond market is key to enhancing depth and liquidity. To incentivise investments in government bonds, these instruments need to be brought on par with investments in other fixed income products. For retail investors, interest income up to a certain threshold may be made exempt from tax.

The NSE is proposing to introduce some new proposals to facilitate secondary market liquidity, which would further aid in building this market. The RBI, in its last policy, had announced that stock exchanges will be permitted to offer State Development Loans (SDLs) through non-competitive bidding route. This will be an additional fixed income product that will widen the offering to meet varying investor needs and risk appetites. Appropriately incentivising interest income on this asset class could see substantial investment being channelised to government securities and SDLs. Taking the learnings from equities market, another potential avenue to explore could be unifying wholesale and retail markets. Currently, institutional participants

trade on NDS-OM and retail participants have a separate segment on NDS-OM and on the stock exchanges. Having a seamless and connected trading and settlements infrastructure could help in developing this market.

Corporate bonds have seen the most policy measures in the last five years to aid transition from a bank loan dominated market to a balanced distribution between market borrowing and bank funding. More corporate entities have started looking at capital markets for debt raising and the Securities and Exchange Board of India (Sebi) too has nudged corporate India towards capital markets.

Importantly, recent instances of default and the markets inability to price these risks satisfactorily, has created more uncertainties around corporate bonds. With more default resolution experience with the bankruptcy code in operation, pension and insurance companies could be directed to widen their investment horizon to slightly lower rated paper in a phased manner.

Sebi's recent initiative of credit rating agencies providing disclosures on liquidity and default indicators is a welcome step. Additionally, India could look at developing a junk bond market. As international investors gain more confidence in IBC, we could see foreign investment in this space, which has more experience in trading and dealing in these assets. It is time for India given the IBC framework to more actively promote this new class of investors — domestic and foreign; who could help grow this market.

Most international markets actively trade credit spreads, that is, a spread over the sovereign curve. However, given that India does not have a liquid sovereign curve across maturities and an underdeveloped derivatives market, it is tougher to price credit risk. While steps are being taken to develop the cash markets, derivatives markets can't be ignored. Regulators especially for mutual funds, insurance and pension need to facilitate this participation as current regulations are excessively restrictive. Perhaps regulators of all institutional investors need to take a combined view to develop the credit markets.

Coming to currency markets, an urgency in permitting longer trading hours at domestic trading venues is needed. Onshore markets operating for eight hours as against offshore trading venues being accessible for 16 to 23 hours creates a distinct disadvantage for onshore venues. India is perhaps among the fewer regimes where domestic currency transactions are still mired in substantial documentation requirements. Documentation may only be sought when an actual remittance takes place, to ensure regulatory compliance. For trading and hedging without delivery, proof based documentation could be eliminated. Another measure that needs evaluation is permitting stock exchanges to offer a spot FX platform to SMEs.

Financial market regulators have taken several measures to accelerate the pace of development of bond and currency markets. Many recent steps will bear fruit in the years to come. The stock exchange distribution network which has largely distributed equities, is now being utilised for increasing access points for fixed income products. Currency futures and options that are offered by stock exchanges have expanded the number of participants in this asset class. Work by regulators, market infrastructure institutions and market participants needs to continue to ensure these markets move to the next phase of development.

The author is managing director & CEO, National Stock Exchange of India Ltd. Views are personal