Corporate Bond Market

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Why in news?

- The Finance Minister in her 2019 Budget had announced fresh measures to boost the development of India’s corporate bond market.

What are corporate bonds?

- Corporate bonds are debt securities (akin debt papers) issued by private and public corporations.
- Companies issue corporate bonds to raise money for a variety of purposes.
- A buyer buys a corporate bond and lends money to the “issuer,” the company that issued the bond.
- In exchange, the company promises to return the money (“principal”) on specified maturity date, and meanwhile, pays the stated rate of interest.
- A corporate bond does not involve an ownership interest in the company, unlike when one purchases the company’s equity stock.

What is the importance of a corporate debt market?

- Raising long term debt (especially that of Infrastructure related companies) → reduced burden on regular banks In most international markets including the US, trading volumes in the debt market are much higher than those in stocks(like shares). Liquidity, too, is quite high with enough buyers and sellers willing to buy bonds with low credit ratings in the hope of receiving a big payoff.
- This liquidity enables companies to raise funds across different maturities including for infrastructure projects with long gestation periods.
- In India, given the absence of a well-functioning

corporate bond market, the burden of financing infrastructure projects such as roads, ports, and airports is more on banks and the general government.

- This, in turn, puts lenders such as the banks under pressure as reflected in the ballooning of bad loans.
- For instance, in banks, such investments create an asset-liability mismatch. In other words, they are buying into long-term assets, such as a highway, with short term liabilities, that is deposits of three- to five-year maturities.
- Eventually, this not only results in inefficient resource allocation but also weakens the bank balance sheets.

What are the measures announced?

- In her Budget speech, the FM had said that an action plan to deepen the market for long term bonds including for deepening markets for corporate bond repos, credit default swaps etc, with a specific focus on the infrastructure sector, will be put in place.
- She said Foreign Portfolio Investors (or FPIs) will also be allowed to invest in debt securities issued by Infrastructure Debt Funds.
- The FM also stated that a Credit Guarantee Enhancement Corporation, for which regulations have been notified by the RBI, will be set up in 2019- 20.

How will some of these measures help?

- Unlike the Indian equities market where the daily volumes of traded stocks are high, signifying liquidity or enough opportunity for both buyers and sellers, the debt market is dominated more by trading in government bonds or securities.
- Most of the demand for these securities is from investors such as banks that have to mandatorily hold these bonds as part of regulatory norms.

- Over time, more Indian companies —both listed and unlisted ones — have started issuing bonds that offer semi-annual interest payments to investors.
- But these bonds aren’t traded much, thanks to a limited investor base and low liquidity.
- This, in turn, leads to lower volumes of their trades compared to the other segment of the capital market.
- The aim of the government and regulators is to boost the liquidity and volumes and make the debt market more vibrant.

How will a Credit Guarantee Enhancement Corporation help?

- The proposed new corporation will help companies to ***boost their credit rating***, which, in turn, will enable them to raise funds at cheaper rates.
- By allowing repurchase agreements or Repos (that allow a company to raise funds by offering its securities and agreeing to repurchase it later) in AA rated bonds or securities, volumes could go up in the corporate bond market.
- It can help ***improve liquidity*** especially if the RBI, like many other central banks of the world, uses it for its repo operations.
- The other measure —of allowing investments made by FPIs in debt securities issued by Infrastructure Debt Funds to be sold to a domestic investor within a specified lock-in period — should help ***offer an exit option*** for such investors and ***improve liquidity.***
- Govt wants to develop the segment for credit default swaps. This will mean protection against the possibility of a company or issuer defaulting on a repayment option and thus offering comfort to an investor willing to take a risky bet and, in the process, adding volumes.

Beyond the Budget, what else has been done to boost the bond market in the recent past?

- Since 2016, the RBI has made the point that the bigger companies would have to raise part of their long-term borrowings from the corporate bonds market rather than from banks.
- New norms since then make it mandatory for companies with large exposures to raise 25 per cent of their incremental or fresh borrowings from the bond market.
- This policy has been put in place to force corporates to go to the bond market and to ease the pressure on banks.
- Regulatory rules also make it necessary for any company that plans to raise debt funds of over Rs 200 crore to execute it on an electronic platform. This is expected to improve transparency as well.

Why has the Indian corporate bond market failed to take off?

1. **Limited Buyers→ less liquidity**

- For years, the investor base in the corporate bond market has been narrow — marked by banks, insurance companies, pension retirement funds and now mutual funds.
- The FPIs are now prominent buyers of top-rated bonds given the attractive returns especially in the backdrop of a strong rupee.
- Most of these investors do not trade but hold these investments until maturity.
- With few buyers in the market or market makers who offer buy or sell quotes constantly, there is little liquidity. There is little or no incentive for market making.

2. **Private Placement:**

- A majority of the bonds issued by companies are privately placed with a select set of investors in India rather than through a public issue; this is done to both save time as well as avoid greater disclosures.

3. **Less of interest of foreign Investors:**

   - Foreign investors can now invest up to Rs 3,03,100 crore in these bonds and so far only a little over 67 per cent of this limit has been utilized.

4. **Stamp Duty:**

   - Another peeve has been the varied stamp duty in states on debt transactions. But this will soon be sorted out with a uniform rate.

Any defaults? Yes, the recent, IL&FS crisis