Changing Profile of the Corporate Bond Market

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The total volume of corporate bonds in the domestic debt market has increased considerably over the years, both in terms of fresh issuances and the trading volumes in the secondary market. The market is also undergoing a transition with a beginning made towards securitisation transactions and new structures being accepted by the market.

Volumes in the Primary Debt Capital Markets

Table 1 below shows the total volume in the private placement market in the last 7 years. After many years of high growth in volumes, the private placement debt market slowed down and registered a 5% decline in volume of issuances in 2001-02. This was largely due to lower borrowings by State level Undertakings and Financial Institutions as seen in Table 2 below.

Table 1: Volume of Issuances in the last 7 years

Year	No. of issues	Volume (INR bln)	Increase/ Decrease over Previous year
1995-1996	73	100.35	-
1996-1997	204	183.91	83%
1997-1998	252	309.83	68%
1998-1999	445	387.48	25%
1999-2000	711	550.73	42%
2000-2001	881	624.61	13%
2001-2002	1052	591.27	-5%
CAGR	56%	34%	

Source: Prime Database

Table 2 below shows the segment wise distribution of the private placement debt market over the last 2 years. This excludes issuances with tenors of less than 1 year. Though in absolute terms issuances by All India Financial Institutions and Banks have reduced in 2001-02, this segment comprises roughly 40% of the total volume of debt raised during the period. This is followed by the Private Sector with a 24% share of volume in 2001-02. The debt placements by the private sector showed an increase of 22% over the previous year. Interest rates have been declining over the last 18 months and corporates have been taking advantage by replacing higher cost debt contracted in the past by fresh issuances at lower rates. Some of the highest rated corporates have recently raised 5 year monies at sub 8% p.a. levels.

Table 2: Segment-wise volumes (excludes issues with tenors < 1 year)

Amounts in INR bln

Private Placements*	2000-01		2001-02	
	Amount	%	Amount	%
All-India Fin. Inst. & Banks	216.73	41%	186.03	40%
Private Sector	91.69	17%	111.99	24%
State Level Undertakings	114.66	22%	63.33	14%
Public Sector Undertakings	78.39	15%	83.75	18%
State Fin. Inst.	22.86	4%	17.09	4%
Total	524.33		462.19	

Source: Prime Database

* Please note that the Amounts for 2000-01 & 2001-02 does not include issues with a tenor of less than 1 year

Secondary Market

The secondary market for the high rated debt papers has increased in depth and width. With the introduction of trading in dematerialised form, monthly trading volumes have increased to around INR 20 bln for the last 6 months, as compared to INR 15 bln in the past. In some of the active months, volume upto INR 30 bln have been achieved.

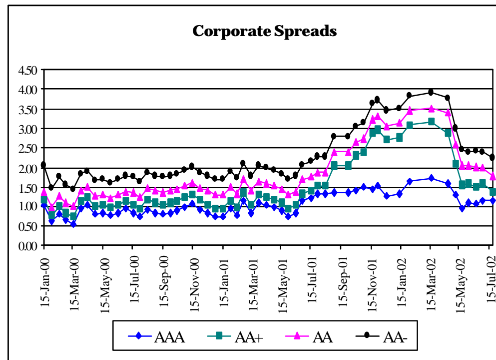
The dematerialisation process was speeded up by the Reserve Bank, who has notified that all new issuances have to be in dematerialised form only. Trading in dematerialised form benefits all the market participants by improving liquidity and reducing transaction cost. Earlier, the transfer of securities in the name of the buyer used to be a time consuming affair and in the interim period, the paper was illiquid as it could not be sold even if a buyer was available. The transaction costs have reduced as stamp duty is not payable on secondary transfers.

During the last 18 months, some of the nationalised banks, who were earlier participating only in the primary market, have begun trading in the secondary market also.

The secondary market is also witnessing increased acceptance of 'AA' and 'AA-' rated papers. Previously, trading interest was limited only to 'AAA' papers. However, with declining interest rates and attractive spread levels available on these relatively lower

rated credits, investors are finding value in these papers. In terms of credit quality, difference between 'AA' rated paper and 'AAA' is marginal. Moreover, in a declining interest rate scenario, players are exploring means of improving returns on portfolio without taking on substantially higher risk.

Graph 1: Corporate spreads for AAA, AA+, AA & AA- rated papers for 5 year tenors



Fillip to Securitisation transactions

The Indian securitisation markets is presently at a nascent stage as compared to the developed markets of Europe or USA. Basic structures such as guarantees, keep-well agreements, letter of awareness, letters of comfort, etc. have been around for quite some-time.

The market has also progressed towards securitisation transactions through true sale of assets to a Special Purpose Vehicle, which in turn issues 'Pass Through Certificates' to investors. The common transactions which have been taking place through this route include securitisation of housing loan receivables, auto loan receivables, etc. Earlier, most of the deals of this nature were done bilaterally as very few investors had interest in such paper. However, 2001-02 saw successful placement of such transactions, wherein a large cross-section of investors participated. The market has also witnessed successful secondary market trading in such paper, though the volumes are still quite small as compared to the potential.

The Government has recently promulgated the Securitisation and Asset Reconstruction Ordinance, which addresses some of the issues which have impeded the development of the securitisation market.

Securitisation Ordinance

The President of India recently promulgated the Securitisation & Asset Reconstruction Ordinance. The ordinance serves two important purposes – (a) provides legal sanctity to securitisation transactions by defining Securitisation and security receipts, and (b) provides enhanced protection to secured lenders.

The key features of the ordinance, which will help securitisation are as follows:

Defined securitisation & security receipts: The ordinance defines securities and security receipts (instrument which is held by investors) under the Securities Contracts (Regulation) Act. Earlier, there was a lot of ambiguity on this count. As a result a number of large institutions were staying away from the securitisation market. Now that legal validity is explicitly provided to securitisation transactions, the market is set to expand with the entry of more participants.

Enhanced protection to lenders: The ordinance also provides a framework which is more conducive towards recovery of security in cases where secured loans have turned bad. The legal recourse available earlier to the lenders was borrower friendly and proved ineffective in making recoveries. Legal cases have been known to take extremely long to be resolved by the courts. As a result, over the last few years, the credit off-take had become skewed towards the higher credit-worthy borrowers, thereby even the deserving companies lower down in the credit spectrum were not able to obtain institutional funding. With higher lender protection in place, banks would be more comfortable giving secured credit to such companies and thereby improving returns on their loan portfolio. This would also expand the scope of the debt capital markets as lower rated credits such in the 'A' category would have access to the capital markets.

Though there are many issues which need to be addressed, such as high stamp duty rates, differential rates across states, etc. Once these issues are sorted out, the Indian market is also expected see the introduction of new structures. In the international markets of Europe and US derivative structures, such as credit default swap and credit linked notes have been successfully used. These derivative structures have specifically caught on due to ease of documentation and structuring. Through these derivatives, originators without selling the assets have been able to sell the risk and thus reduce capital requirements.

New structures in the Bond Markets

The Indian bond markets have progressed from the plain vanilla bond issues to bond issues embedded with derivative structures. Such structures enable issuers to hedge their currency/ interest rate risk or take a view on the same through market acceptable instruments. The following examples illustrate some of the structures that have been successfully placed.

Example 1: An issuer may want to issue floating rate paper in the market based on a view that interest rates are expected to decline. However, investors

may be un-willing to invest in floating rate paper. In such a scenario, issuer may issue fixed rate paper and embed the issue with an interest rate derivative. As a result, issuer would pay the floating rate to the swap counterparty and at the same time investors would receive a fixed rate. In 2001-02, a large number of issuers took advantage of this structure, using the 5 year GoI security as a benchmark, and benefited from the secular decline in interest rates.

Example 2: An issuer wants to take advantage of lower interest rates prevailing in USA, but investors want a fixed rate in Rupee terms. In this scenario, issuer can embed the bond issue with a currency derivative structure, whereby issuer pays a floating rate linked to LIBOR to the swap counterparty, and investors receive fixed interest rate in Rupee terms.

These are just some of the common structures that have been successfully placed. The development of the local derivative market will go hand in hand with introduction of new and innovative products.

Conclusion

The Indian Debt Capital Markets have progressed a long way over the past few years, not only in size but also in sophistication. The primary markets are expected to witness surge in volumes with the entry of new players from the insurance industry and with introduction of new instruments / products. Market growth would be driven by:

i) Securitisation – Increase in size and type of assets to be securitised,
ii) Derivatives – Increasing use of derivatives embedded in new bond issues, or stand-alone structures to hedge risk of bonds already issued or invested in,
iii) Widening category of issuers to include issuers with credit rating below AA,
iv) Surge in volumes of secondary trading as a consequence of better settlement procedures, and
v) With the setting up of CCIL, corporate bonds will also be permitted for Repos.

Overall, one can expect all round development and exponential growth in the Indian debt markets in the years to come.