Changing Profile of the Corporate Bond Market

Vishnu Deuskar
Managing Director
ABN AMRO Securities
(India) Pvt.Ltd.

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.

Large increase in debt issuances through the private placement route

The total fresh issuances of debt has been growing at a rapid pace (CAGR of 48%) over the past few years from INR 129 bn in 1995-96 to INR 624 bn in 2000-01. Most of this debt raised has followed the private placement route, which accounted for more than 90% of the total debt issued in the last 2 years. This has been made possible after the relaxation of the investment norms for banks by RBI and specifically, the removal of the limit of 5% on investments in debentures.

INR bn

	95-96	**%**	**96-97**	**%**	**97-98**	**%**	**98-99**	**%**	**99-00**	**%**	**00-01**	**%**
Public Issues	29.4	23	69.77	28	19.29	6	74.07	16	46.98	8	41.44	6
Private Placements	100.35	77	183.91	72	309.83	94	387.48	84	550.73	92	624.49	94
Total	**129.75**		**253.68**		**329.12**		**461.55**		**597.71**		**665.93**	

Source: Prime Database

INR bn

Private Placements	**1997-98**		**1998-99**		**1999-2000**		**2000-01 (9 months)**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
All-India Fin. Inst. & Banks	127.44	41	186.14	48	145.39	26	230.73	37
Private Sector	77.63	25	72.31	19	125.95	23	170.12	27
State Level Undertakings	67.26	22	101.29	26	167.80	31	113.74	18
Public Sector Undertakings	33.46	11	24.60	6	84.35	15	87.16	14
State Fin. Inst.	4.05	1	3.14	1	27.24	5	22.74	4
Total	309.83		387.48		550.73		624.49	

Source: Prime Database

In 2000-01, the all India Financial Institutions/ Banks regained their position as the largest issuer segment as borrowings by State Level Undertakings declined in percentage terms as compared to 1999-2000.

Development of a vibrant secondary market

The secondary market has also increased in depth and width, with increasing trading volumes and market participants. Moreover, the mutual fund industry has received large inflows into debt schemes thereby expanding the market further. A number of nationalised banks have entered the business of trading in corporate bonds. The introduction and acceptance of trading in dematerialised format has also helped increase trading volumes. This not only results in lower transaction cost (as no stamp duty is payable on secondary transfers), but also faster turn around time. Earlier, the transfer of securities in the name of the buyer used to be a time consuming affair. Hence, traders are able to churn their portfolio more frequently.

The secondary market for corporate bonds remains largely a telephone market, with only a fraction of total deals reported on the National Stock Exchange (NSE). Hence, authentic data on the overall secondary market volumes are not available. However as per estimates, the monthly volumes have increased to INR 15 bn for the last couple of months and May witnessed total volumes of a record INR 25 bn. Though there does exist a Wholesale Debt Segment on the NSE, it is not very popular and only a fraction of the total transactions take place on it. The secondary market would get a boost once a clearing and settlement system is in place, which will encourage trading to take place on the exchange. The resulting transparency is expected to attract new players and thereby increase the liquidity in the market.

Entry of Mutual Funds as an investor class

Mutual funds have become large investors in the private placement market, on account of the large inflows into debt schemes following fiscal sops being offered to them by the Government. The following table shows the net inflows/ (outflows) from debt and equity schemes of mutual funds.

INR bn

	Equity	Debt
Jan-Dec 2000	-6.94	39.99
Jan 2001	-9.03	8.87
Feb 2001	-12.37	6.59
Mar 2001	-3.55	3.79
Apr 2001	-2.93	7.45
May 2001	-4.78	11.42

Mutual funds with their large corpus and quick turn-around times continue to be important market participants of the debt market. Without the drag of statutory requirements (CRR & SLR), the mutual fund threshold for returns on debt investments is much lower than banks. Aggressive bidding for highly rated debt by this segment has also caused spread compression in corporate paper.

Increased trading interest in lower rated credits

Trading interest has also moved towards AA and AA- rated credits on account of the paucity of assets and need for funds to protect returns for investors considering the fact that leaving aside a few blips, overall yields have been coming down over the years. Corporate spreads too have been narrowing. Yields on AAA 5 year paper have now touched the record low levels of sub 10% p.a. In this scenario, demand for AA and AA- rated credits is once again rising from a need to protect absolute returns, given the relatively high effective cost of funds of banks. Moreover, liquidity for such paper has improved with trading in dematerialised form, and the width and depth of the market.

Structured Obligations to Securitisation

Debt instruments with structured obligations have been around for quite some time in the Indian debt market. Many corporates have managed to borrow at lower rates backed by structures such as guarantees, keep-well agreements, letter of awareness and letters of comfort. Multinational companies have used this route widely to raise money for their Indian subsidiaries. One point of particular interest is the increasing number of borrowings by central government entities / PSUs backed by Letters of Comfort from their respective Ministries and state government entities backed by guarantees by the state governments.

The securitisation market has also made a modest beginning. The year 2000-01 witnessed the market launch of a few securitisation transactions. Most of the securitisation transactions previously were bilateral transactions and involved securitisation of auto loan receivables. As per our estimates, the total volume of such paper issued in the last 3-4 years was around INR 30 bn, with only 2-3 investors participating in such transactions.

The year 2000-01 also witnessed the first market launch of a mortgage backed securities (MBS) transaction facilitated by National Housing Bank (NHB). A total of 4 issues were launched with NHB acting as the Trustees to the transaction. These issues received a lukewarm response in the market. With National Housing Bank taking the leading role in developing the market for MBS, more activity is expected in the current years. Some of the other innovative structured finance transactions, which have been concluded in recent times, are securitisation of aircraft lease receivables and student loan receivables.

More activity is expected on the securitisaion front once the securitisation bill is passed by the Parliament. Presently, many potential investors are keeping away from the market pending clarifications on the following issues – high stamp duties which differ across states, legal implications of true sale, legal acceptance of the securitisation instrument and many related issues. 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 market continues to innovate with respect to new structures being successfully launched. The year 2000-01 saw the launch of the first Tenor Book Building issue through the French auction route. In this issue, the coupon was fixed and investors had to bid for the tenor, unlike the conventional book-building process where the tenor is fixed and investors bid for the coupon. The other point of difference was that each successful investor received allotment for the tenor they bid, unlike the Dutch auction normally followed whereby each successful bidder receives allotment at the cut-off rate.

During the year, a new benchmark was used for a floating rate issue, the Reuters 90 day CP reference rate. This product based on a transparent benchmark, holds a large potential for future issues.

The year also saw the launch of two issues with a partial guarantee by multi-lateral financial institutions. In the first such issue, the paper had a tenor of 10 years with interest payments on a semi-annual basis and repayment of principal in 15 equal half-yearly installments commencing at the end of third year. IFC Washington provided a rolling guarantee for two semi-annual installments of interest and principal payments, through the first 9 semi-annual payment dates; and a back-ended guarantee covering the principal and interest during the last 11 semi-annual installments. The initial response to this structure has been lukewarm.

In future, the Indian market is expected to develop with the introduction of several more structures and instruments. The development of the local derivatives market will go hand-in-hand with introduction of new and innovative products.

Regulatory changes introduced in 2000-01

With a view to strengthen the debt market and protect the interest of debenture holders, the Companies (Amendment) Act, 2000 has inserted a new section 117C stipulating that all companies issuing debentures are required to create a Debenture Redemption Reserve (DRR). The DRR shall be created specifically for the re-payment of such debentures. Contributions to the DRR shall be made out of profits every year till the redemption of the debenture. This is applicable to both public issues & private placements of debentures. The net effect of DRR supposedly is to keep a check on highly leveraged companies declaring excessive dividend on shares.

The criteria to distinguish between public and private placements have now been made more stringent. Private placements would now have to be restricted to 49 persons or less. In case, the offer to subscribe for shares or debentures is made to fifty persons or more, the issue would be classified as a public issue. This measure is likely to take away a large part of the flexibility which the private placement market offered.

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. Securitisation is also expected to take off in a bigger way once the securitisation bill is passed by Parliament.

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