Corporate Bonds-Need for a new paradigm

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The corporate bonds issuance are witnessing a phenomenal growth at 20% CAGR or so in the last 5 years or so although we are in the nascent stages as a percentage of GDP as compared to our peers in terms of corporate bonds issued.

For better rated clients who do not utilize bank loan limits, bonds can be offered as per the new guidelines as the borrower is expected to draw down the lines or else pay the commitment charges by doing this the good rated corporate will be forced to enter the bond markets due adverse rate in capital markets this guys are still borrowing from the bank lines MCLR's of large banks are in the range of 8.10 to 8.25% (one year MCLR).

For banks as an investor class the benefits are more in case of better rated (AA and above) issuer from LCR perspective thus the demand for good manufacturing assets will keep going up.NCD is the only product available for diversified investors like FII/FPI and mutual funds to invest as they can't do lending activities. Many corporate are increasingly accessing bond markets due to cost effectiveness and ease of execution while large quantum are being raised through short term issuances, long term bonds will be on the rise only during downward bias on interest rates.

Some Corporate's are also looking for raising funds through floating rate bonds in view of expected interest rates in future mirroring the loan product. Appetite for lower rated bonds have been increasingly going up from the mutual funds & in future pension funds might also add to the kitty.The investment in credit substitute is constantly increasing as the franchise for the banks is also preserved and by down selling/trading the bonds can also de-risk the balance sheet. The large exposure framework which restricts the amount that can be lent by way loans & unlisted bonds is forcing pruning very large exposures by way of higher capital charge & thus resulting lower RAROC (Risk Adjusted Return On Capital).

The credit approval process is the same as the loan proposal – only the product is different; the market is maturing for covenants-heavy issuance and the product are more tailor made rather than off the shelf product. The issuance in the last 2 years is till skewed towards AAA & AA+ issuance only with close to 76% (in FY 18) & 70% in (FY 17) & the balance being the other rated bonds.

The MTM depicts more or less the actual situation after considering the rating, financials and industry scenario under the IND AS & as per the new guidelines the transition would be much faster & more transparent. Domestically the retail participation is largely through the mutual fund route and direct participation is largely in form of tax-free issuances or public issuance by NBFC's . In the case of NBFC's its more off refinance demand & diversification of investor base for the issuers as the traditional sources of funds like bank are already exhausted due to challenges being faced by the lenders themselves.

In present scenario there is pressure on corporate bonds spreads due to lack of credit appetite & the fear of unknown norms for valuation of SDL's. Deepening of the corporate bonds is very critical .Due to the shallow corporate bonds volume the other markets like Credit Default Swaps is not taking off. The regulators are trying to lower the rating requirement for various classes of investors like pension funds who can provide much needed balance sheet support for infra financing for a longer duration. This is precarious situation as the bank's in spite of having better understanding of credit & equipped with all the necessary infrastructure & information are not able to recover the dues, will this new set of investor class able to do this feet????

Due to increasing focus on disintermediation & lack of leverage trades the domestic bond markets would always lack the depth. The intermediaries always provide market making & the risk is always distributed amongst various stake holders rather than in the hands of few .Our markets are shallow so the majority of markets will always have a unidirectional play which is very precarious. In government Securities also the PD's are allowed to accept the bids of behalf of clients so there the bidding through intermediaries is optional unlike corporate bonds wherein for more than 15 crs its mandatorily by the investors only . This leads to increasing expectations in terms of YTM by the investors which are evident from the blow off of credit spreads in the corporate bonds in the last 6 months.

In my view the paradigm shift is already happening but the push from the various stakeholders would provide the much needed stable source of funding for the borrowers in terms of pricing , tenor, liquidity etc.