Corporate Debt Market: Looking Back and Looking Ahead

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The subject of development of Corporate Debt Market (CDM) in the Indian context has been a favorite topic for the financial market players, regulators, and the Government over the last several decades. The significance of a well- as developed, deep and liquid CDM as an important element of the capital market for raising of long-term resources must be understood from multiple perspectives:

— It is an alternative source of finance for the private sector borrowers including for the infrastructure projects; for corporates, as opposed to equity dilution involving IPOs, bond issuances does not result in diminishing their stake in the company.

— It provides macro-financial stability by spreading the risks away from the banking system; it is worthwhile to recall how the commercial banks in India with short duration deposit liabilities had got into the balance sheet mismatch trap through exposure to the long gestation infrastructure assets.

— It helps in efficiently channeling the country's savings to support capital formation, aided by transparency, customized structuring matching the cash flows, quick turn-around time and, often, at a cost lower than bank credit; the discipline of market mechanism, as opposed to the information asymmetry faced by the bankers and borrowers in lending relationship, could be a win- win proposition for the both.

— Corporates will incur lower tax liability as coupon on the bonds is a pre-tax expense while dividends are distributed on a post- tax basis.

— Corporate bonds add to the diversified bouquet of investment options to wide range of investors, retail and institutional, domestic and foreign, with stable income and greater safety.

— It provides the preferred habitat to the long-term investors like the insurance companies and pension funds through long duration assets matching their liabilities; this has now assumed added significance, particularly as insurance penetration is expanding rapidly in the country in the post- Covid phase and in view of the increasing felt needs for annuity products as a social security cover.

— It reduces the risk of foreign exchange rate fluctuations for the corporates who borrow locally in Rupee denominated bonds rather than resorting to foreign currency borrowings from abroad.

Increasing volumes, persisting concerns

Despite the above benefits for decades CDM could not strike deep roots in the Indian context. Hence, several efforts have been made by the Government, SEBI, RBI and the market infrastructure institutions (MIIs). Many useful recommendations have also emanated from several important committees(e.g. R H Patil led High Level Expert Committee on Corporate Bonds & Securitization(2005),Percy Mistry High Powered Expert Committee (2007),Raghuram Rajan Committee on Financial Sector Reforms (A Hundred Small Steps (2009),Reports of City of London, and H R Khan(this author) led inter-regulatory Working Group on the Development of Corporate Debt Market in India (2016) (popularly called the Khan Committee on CDM/KC-CDM).A holistic assessment of the resultant measures will certainly establish that CDM is now showing a lot of traction in terms of volume and vibrancy. Take, for instance, the data for the last 10 years,2015-25. The gross amount of corporate bonds issued has increased at a CGRA of about 10% with highest ever issuance at about Rs.10 trillion in FY 2025 as compared to about Rs.4 trillion in 2015.Corparate debt outstanding is at about Rs. 54 lakh crore as at the end of FY 2025, more than three times over the end-March 2015 outstanding, accounted for more than 17% of our GDP as against at less than 7% of our GDP 10 years back. The outstanding corporate bonds are estimated to touch Rs.100-120 lakh crore in another 5 years. In the secondary markets, during this decade, the average daily trading volumes have increased from about Rs 2600 crore to about Rs. 8,000 crore; in the first two months of the current FY (2025-26) the volumes have been even higher at more than Rs.10,000 crore. There are, of course, structural and qualitative issues which remain hidden beneath this data- still below 20% share of corporate bonds in our GDP as compared to over 50% in many East Asian countries, more than 98% bonds being issued on private placement basis, above 85% issuances in AA or above rating category only, large chunk of bonds floated by Government supported PSUs with implications for price distortions due to implicit sovereign backing and crowding out effects on private sector issuers , miniscule retail participation, the small share of long dated bonds and subdued liquidity in the secondary market with monthly trading turn over accounting for less than 4% of the outstanding bond stock. Nevertheless, the momentum gathered by CDM in the recent years can be considered quite creditable.

Road travelled: looking back & looking ahead

It is, therefore, worthwhile to closely look at the initiatives that have contributed to CDM reaching these heights. Here, we could look at how some of the important measures taken have helped in the development of CDM under a seven I's framework as adopted by KC- CDM focused on- **Issuers, Infrastructure, Investors, Instruments, Incentives, Innovations and Intermediaries**. We should also look at the some of the well thought out suggestions which have been implemented but have not resulted in any positive outcome. We also need to reflect on some of the suggestions not yet implemented and new ideas for further development of the CDM under this framework.

Issuer/Issuance: Consolidation and reissuances by decreasing the number of ISINs and increasing the outstanding volume per security for reducing fragmentation and enhancing market liquidity have gathered some momentum with SEBI now requiring maximum number of securities to be issued in a year as nine. There is, however, scope for further increasing the reissuances by building up redemption reserves matching the future liabilities. Variety of issuer types add to the depth of the market. Several efforts have been made in this direction (e.g. Municipal Bonds, ReITs, InvITs, Covered Bonds, ESG and Green bonds). In the case of Municipal Bonds, the comprehensive regulatory framework on their issue and listing with focus on accounting, performance evaluation and disclosures has been put out by SEBI; some large municipalities have recently shown interest in resorting to market-based financing. Issuer/investor education and nudge by the Central and State Governments can spur enhanced activity in this space. Similarly for the hybrid securities emanating from real estate (ReIT) and the infrastructure sector(InVIIT) SEBI has been laying down comprehensive issuer and investor friendly regulatory frameworks with emphasis on corporate governance, investor protection, detailed disclosures, minimum holdings by the sponsors, etc. Of late this segment is showing quite a bit of activity. The suggestions to facilitate bond issuances by top rated multi-lateral institutions for infrastructure financing in India need a fresh look. A more conducive environment for issues with lower ratings can be enabled with credit enhancements and usage of credit risk insurance as discussed later.

Infrastructure: Important initiatives for development of an efficient and resilient market infrastructure have resulted in best-in- class market microstructure- Delivery versus Payment (DvP) for mitigation of settlement risk, integrated trade reporting platform for enhanced transparency , Electronic Bidding Provider(EBP) platform introduced in 2016 for issuances of privately placed bonds(they account for close to 99% of the issuances) for online price discovery, introduction of the long awaited Request for Quotes (RFQ) system by the exchanges for secondary market trading in an electronic trading platform away from the opaque OT- based trading and the introduction of registration framework for the Online Bond Platform Providers(OBPPs) linked to RFQ in 2022 for ease of transactions by the retail investors have had hugely beneficial impact. The requirements of issuances beyond Rs. 20 crore, from Rs. 50 crore earlier, mandatorily through EBP and increasing obligations on market players like the Mutual Funds, FPIs, etc. to transact certain minimum percentage of their trades through RFQ have further added to the effectiveness of these transformative reforms. The advent of insolvency and bankruptcy code has also come as a boon to tackle corporate defaults and, thereby, boosting the confidence of the investors. A stricter regulatory regime for the Credit Rating Agencies (CRAs) following some high-profile corporate defaults close on the heels of sound ratings accorded by them has some salutary effect. Of course, the issue of conflict of interest when issuer pays rating fees has been a hard nut to crack and there is need for fresh thinking here including encouraging investors sharing the cost. To further enable availability of quality data to the CRAs the suggestion of giving them access to the loan overdue information on a regular basis from the Central Repository of Information on Large Credit (CRILIC) of the RBI given by KC-CDM may be considered. Creation of an unfragmented market with netting benefit across various trading and settlement systems through an inter-operable /single clearing structure is an idea worth serious evaluation

Investors: Expansion of the investor base and sophistication in their trading strategy are critical to sustainable development of CDM. As the insurance and pension sector is growing rapidly the demand for long term corporate bonds are increasing although their focus remains on only highly rated papers based buy and hold strategy .Given our cautious approach to capital account convertibility foreign investors' share been very miniscule compared most of the emerging economies but in the last few years the changes in regulatory framework, well-developed market infrastructure, growth potential of our economy and fiscal management have resulted in higher FPI flows in the debt market, both sovereign and corporate, although the limits available to them still remain highly underutilized. Recent changes, such as, removal of the ceiling on holding of short-term securities and removal of concentration limits under the General Route and more relaxed norms in the Voluntary Retention Route (VRR) of the RBI may increase the investment appetite of the FPIs. Some more regulatory relaxation for FPIs investing in corporate bonds on the lines of the plans mooted for FPIs dedicated to G-sec may hold greater attraction to them. It, however, needs to be noted that foreign participation in Indian bond market is more driven by macro-economic factors including exchange rates and interest rate differential. Retail participation is not only an issue in India but even in the advanced markets due to complexities of the process, lack of liquidity and awareness but the recent efforts of the OBPPs, advent of debt ETFs and lowering of the face value of privately placed securities to Rs.10,000 could prove to be pull factors for this class of investors. Additionally, easy market access facility on the lines of "Retail Direct" introduced for Government bonds by the RBI may be examined. More issuance of simple retail products like zero-coupon bonds and clarity on taxation issue around them may also spur greater participation by retail investors.

Instruments: Variety of products add to the depth and breadth of the market by attracting diverse issuers and investors. In the recent times Green/ESG bonds have assumed some prominence but products like covered bonds have not been tried much yet. Efforts at activating repo in corporate bonds with attendant benefits for market liquidity on the exchange platforms have been tried but have not been successful. The recent initiative for relaunch of Tri Party repo product by creating a Limited Purpose Clearing Corporation(LPCC), i.e. the AMC Repo Clearing Corporation (ARCL) sponsored by the AMCs of

Mutual Funds has the potential of impacting the market liquidity even as we have to be cognizant of the fact that given the wider acceptability of repo in Government securities this product may not pick up large volumes in the near future. Currently daily volumes at about Rs.1500 crore seem promising although number of trades and players remain insignificant. Endorsement of the Qualified Central Counter Party (QCCP) status for ARCL, which is being considered by the RBI, may attract some volumes from the banks due to substantial capital charge benefit. Complementary products like the Credit Default Swap (CDS), which increases investor's interest in lower rated bonds by transferring credit risk to CDS selling counter party, is an effective tool for managing credit risks of bonds, thereby bringing volumes for such securities. Several measures including the long-awaited enactment of the legislation for netting of bilateral contracts by the Government in 2020 for reducing the capital charge burden of the counterparties and the revised comprehensive CDS guidelines issued by the RBI in 2022, providing for, among others, enlarged universe of users and sellers, have not shown any traction yet. Further nudges to the insurance sector players, who are natural protection sellers with some safeguards, may result in activity for such credit insurance product. It may also be worthwhile to evaluate introduction of other hedging products like bond futures and bond forwards.

This may also be the time to consider the long-standing suggestion of creating the legal framework for acceptance of corporate bonds with safeguards relating to tenor, rating, etc. by RBI under its Liquidity Adjustment Facility (LAF) repo transactions; it will be an impactful signal of the regulator's commitment to the development of CDM and thereby spur liquidity in the market.

Incentives: Among the several measures considered for incentivizing the issuance of corporate bonds in place of reliance on bank loans and dis-incentivization of the latter in favour of greater use of bonds one important one has been tried by the RBI through the framework of mandatory requirement of 50% of the incremental resources to be mobilised through market mechanism by the specified large borrowers (i.e. borrowers having sanctioned limits / outstanding of Rs. 10,000 crore or more from the banking system. This came into effect in 2017-18; it entailed higher risk weights and additional provisioning needs if bank's exposure to such borrowers exceeds the permitted limit of bank borrowings. Although available information is limited the prescription seems to have had impact. The recent RBI norms of 2023 on classification and valuation of the investment portfolios of banks have incentivized them to hold their corporate bonds in Held- till-Maturity (HTM) category without mart-to-market requirement if the bonds meet 'SPPI' (Solely Payments of Principal and Interest) criterion.

SEBI has, with effect from April 1, 2019, introduced a framework of incentive-disincentive for large, listed companies with "AA and above ratings" to raise 25% of their incremental long-term funds through bonds; as its compliance was poor the framework has again been revised in 2023 with the changed guidelines being effective from April 1, 2024, providing that large corporates with outstanding term borrowings of Rs. 1000 crore or above must raise a minimum of 25% of the incremental borrowings through debt securities and the those with surplus borrowings through bond route will get concession in payment of listing fees. Its efficacy is yet to be established and hence there is need for thorough review.

Although the demand for tax concessions for investors will not be in sync with the new regime focused on reducing concessions/waivers some liberalization and rationalization by way alignment of tax treatment between equity and debt instruments and between direct holding and holding through debt funds , revision of the recent norms relating to applicability of single of taxation without looking at short/long term holdings in debt mutual funds, and TDS reduction for the FPIs may be looked at.

Innovation: As an innovative measure the Partial Credit Enhancement (PCE) facility, particularly after the RBI regulatory framework for banks providing PCE was put in place in 2015, has the potential to uplift the credit profile of the lower rated bonds (BBB-/higher) through the availability of a contingent credit line to be used in case of default due to cash flow shortage. In the recent budget announcement of extension of PCE for the infrastructure sector bonds by the National Bank for Financing Infrastructure and Development (NaBFID) has been announced. Due to various reasons including the ceiling on individual bank's exposure and high capital charge for the facility this has not really taken off. RBI has since issued a set of draft guidelines in April 2025 aimed at addressing some of the constraints (e.g. increasing the individual bank's threshold to 50%, significant reduction in the capital charge and expanding the universe of the PCE providers to AIFIs, large NBFCs/HFCs). It is expected that once implemented PCE scheme may get desired traction. Pursuant to the liquidity challenges resulting in Franklin Templeton Mutual Fund closing down six debt funds in 2020 introduction of a systemic liquidity backstop facility in the form of Credit Debt Market Development Fund (CDMDF) has become a source of comfort for the market players although its true efficacy will emerge in the next round of liquidity crisis.

Intermediaries: As suggested by KC-CDM exchanges introduced and later refined the schemes for market making by brokers but they did not take off. Similarly the proposal to give the additional responsibility of market making in corporate bonds to the Primary Dealers (PDs) in G-sec market did not receive positive response, even though PDs have exposure to CDM by way of acting as the arrangers/ underwriters, mainly due to apprehensions that it could dilute their primary obligations towards the Government securities. It is, therefore, time now to think of PD like intermediaries in CDM with funding support from banks on the back of quasi-sovereign guarantee; we have now the example available for this in CDMDF. Even a scheme of separate funding lines for market making activities of PDs in CDM could be explored. Enhanced access to Tri- Party repo to high net-worth brokers could be an alternative source of funding. They could also access the call option window made available by the issuers of corporate bonds

New Dawn for CDM!!

At the current juncture of India's financial journey, it looks like a new dawn with enormous possibilities for uplifting the CDM is round the corner. There are several tailwinds which may propel CDM into a new orbit where the share of corporate bonds in GDP could at least double from the current level of about 17%. We have seen how some well-thought out, transformative measures have brought out a lot of changes in terms of volumes and vibrancy in CDM. We are now at an inflexion point of further and faster development of CDM -strong macroeconomic fundamentals of high GDP and benign inflation outlook despite global headwinds; fiscal consolidation providing scope for private sector borrowings; increasing depth and liquidity of the sovereign bond market with yield curve stretching up to 50 years alongside the recent positive developments like inclusion of Indian G-sec in global bond indices and increasing participation of FPI under more relaxed regimes providing back-up support to CDM; sharply increasing capital market orientation of the retail investors in India; humongous needs for resources for rapidly expanding infrastructure including alternative energy projects from the private sector; the new demands for long terms bonds are emanating from the insurance sector and pension fund(e.g. EPFO) players with increasing footprints ; increasing bond finance related requirements of the bourgeoning NBFC sector; the emergence of online electronic bond platforms and other instant , convenient and world-class digital payment solutions like the mobile banking and UPI; upgradation of credit profile of Indian corporates and IBC providing a strong resolution framework for corporate defaults. Thus, CDM can and should reach further heights if some of the well thought out measures which have not yet had the desired traction and the further suggestions outlined above are looked at with a greater focus by all the stakeholders-the market players, intermediaries, regulators and the Government-in a concerted and collaborative manner.

Views expressed are personal.