Corporate Bond Market - Budget 2019

Why in news?

In Budget 2019, the Finance Minister has announced fresh measures to boost the development of India's corporate bond market.

What are corporate bonds?

- Corporate bonds are debt securities 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 a specified maturity date, and meanwhile, pays the stated rate of interest.
- Notably, a corporate bond does not involve an ownership interest in the company, unlike when one purchases the company's equity stock.

How has the corporate bond market been?

- The development of the corporate bond market has been only stunted in the last few decades.
- This remains the case in spite of the efforts by policymakers over the last three decades.
- Successive budgets and at least half a dozen committees mandated by the government, the RBI and the SEBI in this regard have largely failed.

What is the reason?

- For years, the investor base in the corporate bond market has been narrow.
- It is only 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.
- But notably, most of these investors do not trade but hold these investments until maturity.
- So, with few buyers in the market or market makers who offer buy or sell quotes constantly, there is little liquidity in this sector.
- There is little or no incentive for market making.

- Also, 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.
- [Foreign investors can now invest up to Rs 3,03,100 crore in these bonds.
- But so far, only a little over 67% of this limit has been utilised.]
- Another limiting factor has been the varied stamp duty in states on debt transactions. This will soon be sorted out with a uniform rate.

What are the implications?

- **Banks** - In most international markets including the US, trading volumes in the debt market are much higher than those in stocks.
- Liquidity, too, is quite high with enough buyers and sellers willing to buy bonds.
- This enables companies to raise funds across different maturities including for infrastructure projects with long gestation periods.
- However, in India, there is an absence of a well functioning corporate bond market.
- So, 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 rise of bad loans.
- E.g. 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 i.e. deposits of 3-5 years maturities.
- Eventually, this results in inefficient resource allocation. Besides, it also weakens the bank balance sheets.

- **Liquidity** - In the Indian equities market, the daily volumes of traded stocks are high, signifying liquidity or enough opportunity for both buyers and sellers.
- Unlike this, 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 are not traded much, due 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 now is to boost the liquidity and volumes and make the debt market more vibrant.

What are the recent proposals?

- An action plan would be put in place to deepen the market for long-term bonds including for deepening markets for corporate bond repos, credit default swaps, etc.
- This will be taken up with a specific focus on the infrastructure sector.
- The Foreign Portfolio Investors (FPIs) will also be allowed to invest in debt securities issued by Infrastructure Debt Funds.
- Also, a Credit Guarantee Enhancement Corporation, for which regulations have been notified by the RBI, will be set up in 2019-20.

How will a Credit Guarantee Enhancement Corporation help?

- The proposed new corporation will help companies boost their credit rating.
- This, in turn, will enable them to raise funds at cheaper rates.
- By allowing repurchase agreements or repos in AA rated bonds or securities, volumes could go up in the corporate bond market.
- [Repos allow a company to raise funds by offering its securities and agreeing to repurchase it later.]
- More importantly, it can help improve liquidity especially if the RBI, like many other central banks, uses it for its repo operations.
- The other measure of allowing FPIs in debt securities for infrastructure could help offer an exit option for such investors and improve liquidity.
- Similarly, policymakers want 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.
- The measure thus offer comfort to an investor willing to take a risky bet.
- This protection, in the process, adds volumes to the market.

What are the other measures at boosting bond market?

- Since 2016, the RBI has been emphasising on the importance of corporate bond market.
- It had asked bigger companies 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% of their incremental or fresh borrowings from the bond market.
- 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.

Source: Indian Express