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For a liquid secondary market

As bank balance sheets are strained, bonds may have a larger share of incremental funding for corporate balance sheets

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In recent years, fundraising through bond issuances has gained importance for corporate India. Bond issuances have grown at a compounded annual growth rate (CAGR) of 15 per cent over the last five years and outstanding issuance, as on March 2018, stands at ₹27 trillion. In February, the finance minister indicated in his Budget speech that large companies should meet at least 25 per cent of their financing requirements from the bond market and for institutional investors to consider bonds with credit rating "A" as investment grade in order to provide much needed financing at this point in the credit curve.

In the scenario where bank balance sheets are strained, bond issuances are likely to form a greater component of incremental funding for corporate balance sheets. Many noteworthy steps have been taken to bring greater transparency and efficiency to primary markets and while the primary markets serve the economic purpose of bringing together corporates in need of capital and investors with savings, markets deliver their true purpose when primary, secondary and derivatives markets all work effectively together. Adequate attention needs to be paid to the efficient functioning of secondary markets for bonds as it is critical for both corporates as well as investors. A liquid secondary market for any asset class not only facilitates efficient price discovery but can play a vital role in determining fair cost of capital for the issuer in primary markets and attract more investors to both primary and secondary markets. Simply put, an investor who knows that a liquid secondary market is available to exit an investment finds more value in entering that asset class. Conversely, illiquidity in existing bonds gets priced into the subsequent issues and increases the cost of capital for issuers. Unlike the equity issuances (IPO/FPO), that are occasional, the sheer volume of bond issues and reissues could have a large impact on the cost of capital of the issuing firm.

The secondary market for corporate bonds is still evolving in India and various measures have been recommended for its development. While some measures for developing the corporate bond market are already in place, some are in the process of being implemented. The Securities and Exchange Board of India (Sebi) has mandated consolidation and re-issuance of corporate bonds to reduce the number of ISINs that will, over time, bring benefits in pricing and help improve secondary market liquidity. NSE is in the process of launching the tri-party repo on corporate debt securities. We believe access to a repo facility will provide the lubrication to oil the secondary market engine. This has been successfully observed in government bond markets.

While several prerequisites are slowly falling into place, some additional measures could aid in facilitating the pace of change. The secondary market for corporate bonds is both over-the-counter (OTC) as well as on exchange platform. Presently 100 per cent of the secondary market transactions are in OTC and largely among the institutional participants. For these OTC transactions, NSE offers a reporting platform along with the facility for settling the transaction on DVP I basis. (The average daily volumes reported on the NSE's platform are around ₹5,500 crore, which accounts for about 75 per cent of the OTC market). Developing an anonymous order-matching platform in a relatively fragmented privately placed market with largely buy-and-hold investors has not met with success. An alternative approach, which could bring an improvement in the existing structure where pre-trade transparency is absent, could be a request for quote (RFQ) mechanism. In an RFQ facility, a participant can request for a quote from multiple counterparties but has the option to either accept or reject the quote. It allows negotiation with multiple participants on an electronic platform and large deals can be executed at the best bid or ask, thus facilitating price discovery.

To develop liquid secondary markets, the corporate bond market needs to attract a wide and diverse investor class, retail and institutional, resident and foreign. The bond markets are dominated by large institutional investors, primarily with a buy-and-hold investment strategy. Portfolios are not subject to daily mark-to-market as in the case of mutual funds. There is a complete absence of intermediaries or brokers who disseminate information research at large, which is observed in the equities and commodities markets. A lack of a trading community in corporate bonds limits risk transference and price discovery. Availability of re-finance through repo could bring an additional tribe of traders to this market. This much needed intermediary network needs developing.

The retail investor has a large exposure to fixed income through their fixed deposit portfolio. However, retail interest in government or corporate bonds has been muted. Possible reasons could be access, limited awareness, lack of adequate information and limited re-finance options. A recent step where exchanges have been permitted to offer g-sec through the non-competitive bidding route could bring greater retail participation to bond markets. For retail investors in the debt market, government securities are like blue chip stocks as they provide sovereign guarantee. Mutual funds, of course, continue to offer fixed income products to retail. NSE is committed to creating greater awareness among its retail customers for fixed income investment opportunities. Lastly, developing liquid secondary markets will lend to building a meaningful credit default swap market. Availability of credit derivatives allows investors to manage credit risk and enables even the lower-rated firms to access the corporate bond market.

With growing corporate bond issuances, the economic importance of secondary markets is growing. The participation in India's corporate bond market needs to be encouraged by creating an enabling environment for issuers and investors. A priority in this context is to facilitate speedy and cost-effective primary issuances without compromising transparency, improving institutional market, encouraging retail investors to start with simple products like government bonds and creating investor awareness. Collectively, these moves may bring better liquidity and also improve the quality of participation in the secondary market for corporate bonds.

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