

**Report of the Working Group on Development of  
Corporate Bond Market in India  
August 2016**

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**Letter of Transmittal**

Date: August 12, 2016

Dr. Raghuram G. Rajan  
Governor, Reserve Bank of India/ Chairman, Financial Stability and Development Council Sub-Committee (FSDC-SC)  
Mumbai-400001

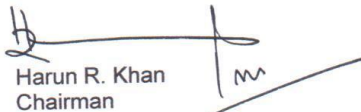
Dear Sir,

**Report of the Working Group on Development of Corporate Bond Market in India**

We hereby submit the Report of the Working Group on Development of Corporate Bond Market in India. The Group has finalised its recommendations based on detailed examination of issues highlighted by earlier committees on corporate bond market and suggestions received from the market participants. As may please be observed, in respect of most recommendations, we have suggested timelines for implementation based on discussions with the regulators and the Government.

2. We take this opportunity to thank you and the FSDC Sub-Committee for entrusting this important task to us. The Sub-Committee may consider placing the Report on the website for wider public dissemination.

Yours sincerely,


  
Harun R. Khan  
Chairman

  
Ajay Tyagi  
Member

  
Praveen Garg  
Member

  
Pankaj Jain  
Member

  
Barnali Mukherjee  
Member

  
S.N. Jayasimhan  
Member

  
Sumeet Kaur Kapoor  
Member

## Chapter 1: Introduction

1. It has been well recognized that a well-developed corporate bond market complements a sound banking system in providing an alternative source of finance to the real sector for its long-term investment needs. An active corporate bond market also helps in the diversification of risks in the financial system. In order to enable public and private sector firms to borrow for longer maturity periods in local currency to meet their investment needs and avoid balance sheet mismatches and foreign currency exposures, there is a need to accelerate the development of local currency bond market. An active corporate bond market could also provide institutional investors such as insurance companies and provident and pension funds with quality long term financial assets, helping them in matching their assets and liabilities.

2. There has been a number of reports by expert Committees on development of corporate bond markets in India viz. Report of High Level Expert Committee on Corporate Bonds and Securitisation in 2005 (R. H. Patil Committee), Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre in 2007 (Percy Mistry Committee), A Hundred Small Steps [Report of the Committee on Financial Sector Reforms (CFSR)] in 2009 (Dr. Raghuram Rajan Committee), Reports of the City of London, etc. These Committees have examined in detail various aspects related to the development of corporate bond market and have made useful recommendations. Many of these recommendations have been implemented. The major recommendations on which action is not complete, broadly grouped under a **7 I** framework of Issuers, Investors, Intermediaries, Infrastructure, Incentives, Instruments and Innovations, are tabulated in **Annex I**.

3. Many of these recommendations have been already implemented by the Government and the concerned regulators. The success of these measures in achieving the intended outcomes has, however, been varied. Impact of some of the measures taken is captured below:

Intended outcomes mostly achieved	Intended outcomes partially achieved	Intended outcomes not yet achieved
<ul style="list-style-type: none"> <li>• Setting up of reporting platform for post-trade transparency</li> <li>• Introduction of DvP in settlement of OTC trades in corporate bonds to eliminate settlement risk</li> <li>• Issue of long-term bonds by banks allowed with a minimum maturity of seven years to raise resources for lending to (a) long term projects in infrastructure sub-sectors, and (b) affordable housing. These bonds have been exempted from computation of net demand and time liabilities (NDTL) and are therefore not been subjected to CRR/SLR requirements</li> <li>• The investment limit for Foreign Portfolio</li> </ul>	<ul style="list-style-type: none"> <li>• Banks and PDs allowed by RBI to become members of stock exchanges to trade in corporate bonds</li> <li>• Investment norms for banks and PDs relaxed by RBI to facilitate investment in corporate bonds</li> <li>• Final guidelines issued by RBI for partial credit enhancements by banks to corporate bonds</li> <li>• Measures taken by SEBI to encourage investor interest/participation in the corporate bond market in terms of liberalizing the listing requirements, simplification of procedures and processes and simplified disclosure norms</li> <li>• Rationalisation of FPI regulations has been put in place by SEBI for easier registration process and operating framework for</li> </ul>	<ul style="list-style-type: none"> <li>• Introduction of Repo in corporate bonds to meet the funding needs</li> <li>• Introduction of Credit Default Swaps to facilitate hedging of credit risk by the holders of corporate bonds</li> <li>• Reissuance of bonds permitted by SEBI</li> </ul>

<p>Investors (FPI) has been increased to Rs. 2443.23 billion. Limit allocation methodology has been rationalized and withholding tax rate has been reduced from 20% to 5%</p> <ul style="list-style-type: none"> <li>• FPIs have been permitted to invest only in corporate debts of at least three years of residual maturity</li> <li>• International financial institutions like IFC were permitted to float rupee linked bond overseas to deepen the off-shore rupee bond market so that IFC and other investors can raise rupees to invest in India. This has facilitated development of benchmark yield for long term corporate bonds</li> <li>• SEBI has allowed setting up of dedicated debt segment on the exchanges</li> </ul>	<p>overseas entities seeking to invest in Indian capital markets</p>	
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4. The Financial Stability and Development Council Sub-committee (FSDC-SC) in its meeting held on September 10, 2015 decided to constitute a Working Group on Corporate Bonds with representation from the Ministry of Finance, Government of India and all the regulators with the remit to guide the implementation of the recommendations made by all the earlier committees and suggest further measures that may be taken to develop the corporate debt market in the light of evolving macroeconomic and financial market conditions within a specific time span. Accordingly, a Working Group was constituted as under:

<b>S. No.</b>	<b>Name</b>	<b>Institution</b>	
1	Shri Harun Rashid Khan	Deputy Governor, Reserve Bank of India <sup>1</sup>	Chairman
2	Shri Ajay Tyagi	Additional Secretary, DEA, MOF	Member
3	Shri Praveen Garg	Joint Secretary, DEA, MOF	Member
4	Shri Pankaj Jain	Joint Secretary, DFS, MOF	Member
5	Smt Barnali Mukherjee	Chief General Manager, SEBI	Member
6	Shri S. N. Jayasimhan	Joint Director (Investment), IRDAI	Member
7	Smt Sumeet Kaur Kapoor	General Manager, PFRDA	Member
8	Shri R. Subramanian	Chief General Manager, RBI	Member-Secretary

5. Shri R. Subramanian, Chief General Manager, Shri. Vaibhav Chaturvedi, General Manager and Shri Vivek Singh, Assistant General Manager, RBI acted as the key resource persons to the Group. The Group had a series of meetings in Mumbai, New Delhi and through Video Conference/exchange of mails where all the issues were comprehensively discussed and various implementable recommendations made by earlier committees were examined in detail. The Group also had a day-long meeting with all stakeholders in Mumbai to get the ground-level feedback regarding all the issues. Based on the initial discussions, some of the

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<sup>1</sup> Since retired on July 4, 2016

preliminary recommendations were made by the Group to the Government of India and they were included in the Union Budget 2016-17. These Budget announcements are in the process of being implemented **(Annex II)**. Dr. Raghuram Rajan, Governor and Shri Harun R. Khan and Shri R. Gandhi, Deputy Governors had a detailed meeting with Shri U.K. Sinha, Chairman, SEBI and Shri Prashant Saran and Shri Rajeev Kumar Agarwal, Whole Time Members, SEBI on possible measures for the development of corporate bond market and in the meeting, it was agreed that both RBI and SEBI would work closely on some of the recommendations falling within their remit.



## Chapter 2: Issues and Recommendations

1. The Group recognised some of the structural features of the corporate bond market in India impinging on the development of a deep corporate bond market:

- (i) The corporate bond issuance is dominated by private placements as these account for more than 95% of the total issuance of corporate debt (2014-15);
- (ii) A majority of the issuances are concentrated in the 2-5 year tenor;
- (iii) The investor base is limited/narrow as the investment mandates of institutional investors such as insurance companies, pension funds and provident funds, despite review of the minimum credit rating from time to time, provide limited space for going down the credit curve as the investments are made in fiduciary capacity to protect the interests of subscribers;
- (iv) Small outstanding stock of individual issuances is one of the key factors impacting secondary market trading as reissuances have not picked up inspite of the enabling provisions by SEBI;
- (v) Functional trading platform with Central Counter Party (CCP) facility like NDS-OM in G-Sec is not available; the existing DvP-III settlement introduced by stock exchanges has found no takers;
- (vi) There is total lack of liquidity in credit risk protection instruments like Credit Default Swaps (CDS);
- (vii) Stamp duties on corporate bonds across various states have not been standardised; tax regime for financial instruments remains one of the key drivers of investor interest;
- (viii) There are inherent structural incentives for borrowers to prefer bank financing, e.g., cash credit system and no disincentive for enjoying unutilised working capital limits;
- (ix) As the corporate debt market cannot be looked as totally detached from the sovereign bond market, this market may get a fillip as the interest rates come down with the inflation and fiscal consolidation targets being achieved; and
- (x) In the current context, many large non-financial corporates who should normally be the preferred issuers of bonds are leveraged and hence cannot access either loan from banks or bond financing through market mechanism.

2. Notwithstanding the above limitations, considering the importance of developing this market, particularly as going forward the corporates have to reduce their reliance on bank lending and move, accordingly, to market mechanism for accessing resources, the Group agreed on a set of implementable recommendations, where concerned regulators have agreed to take action and these are grouped under the 7 I framework as under:

## **2.1 Issuers**

### **2.1.1 Reissuance**

The measures taken by RBI, SEBI and Gol have resulted in considerable increase in issuance of corporate bonds. Total corporate bond issuance has increased by around 236% from Rs.1,74,781 crore in 2008-09 to Rs.4,13,879 crore in 2014-15. Similarly, the number of issuances has increased by almost 153% from 1,042 in 2008-09 to 2,636 issuances in 2014-15. Secondary market trading, however, continues to be very limited at around Rs. 2000 crore per day. One of the reasons for the lack of trading volume is non-availability of sufficient floating stock for each International Securities Identification Number (ISIN) as corporates have preferred fresh issuance rather than going for reissuance of bonds. Each new issuance from the same issuer receives a separate ISIN; hence older bonds in the same maturity become illiquid. Reissuance of the same issue for a particular maturity, similar to Government securities, can help maintain liquidity. To augment market liquidity, it is necessary that corporates are encouraged to re-issue existing bonds under the same ISIN code. A major argument against common ISINs is the bunching of liabilities on the same date which can lead to asset-liability mismatch; however, this can be resolved by spreading out the redemption amount across the year through amortizing the payments. Issuers should be encouraged to consolidate their various existing issues into a few large issues which can then serve as benchmarks. This may also help corporates in terms of reduction in the cost of borrowings. Though SEBI has recently allowed reissuances by the corporates, there has not been any reissue of bonds by any corporate due to problems related to bunching of liabilities. The possibility of mandating corporates for reissuances of bonds beyond a threshold limit of Rs. 500 crore in a quarter was discussed and it was observed that the same may not be feasible. Corporates may be permitted to issue bonds under the same ISIN with a flexibility in terms of timing for raising the funds as well as structuring of

the redemption requirements. Re-issuances may also not be treated as a fresh issuance for the purpose of Stamp duty as discussed in para 2.7.2 of this report. SEBI has enabled consolidation and re-issuance with a view to reducing fragmentation in corporate bond market. There are no requirements to file an offer or any other document with SEBI, for the purpose of re-issuance. Even though SEBI has issued such guidelines, it is observed that the issuers of debt securities do not undertake re-issuances due to stamp duty and the bunching of repayment liabilities.

Companies which list only debt securities but not equity are treated as listed companies under the Companies Act and are governed by the corporate governance obligations applicable to listed companies. This is seen as a disincentive to smaller issuers to list their bond issuances.

### **Recommendations**

1. *i. The issuers coming out with frequent debt issues with the same tenor during a quarter may club them under the same umbrella ISIN which in turn would increase the float in the market, thus enhancing its liquidity. These issuers may come out with a feasible maturity structure wherein they can stagger the redemption amount across the year by amortizing the repayments. Necessary changes may be made in the issuance process of ISINs by depositories, viz., NSDL and CDSL to facilitate the same.*
- ii. Re-issuances may not be treated as fresh issuances for the purpose of Stamp duty.*
- iii. The corporate governance norms applicable to companies which have listed only debt securities and not equity may be reviewed to make them less onerous.*

**(Action: NSDL/CDSL/Ministry of Corporate Affairs/SEBI)**

#### **2.1.2 Standardization of corporate bond issuance**

Presently, the secondary market yield of corporate bonds reported on the reporting platforms of the stock exchanges do not follow uniform standard as the market follows different conventions and divergent practices for holiday conventions, day count convention and basis for yield calculation. The yield is calculated based on cash flows of a bond. Cash flow has two components: (1) date of cash flow; and (2) amount of cash flow. Unless the

date of cash flow and the amount of cash flow considered by the buyer and seller are uniform, there will be difference in the yield calculations. Ambiguity in the holiday convention to be followed for corporate bonds also causes differences in the dates of cash flows.

In the Government securities market, the amount of coupon payable on a bond is uniform throughout the tenure of the bond. Coupon is paid semi-annual. The Day Count Convention followed in the case of Government securities is 30/360. SEBI, vide its circular dated April 13, 2007, had advised market participants to follow 'Actual/Actual' day count convention, on the presumption that same convention is being followed for dated Government Securities, for all new issues of corporate bonds. However, Actual/Actual day count convention was not the day count convention followed for dated Government Securities in 2007 or at any other point of time. This has resulted in different day count conventions being followed by the market participants in the bond market. To provide better clarity and facilitate greater trading volume, the Group agreed that the extant guidelines be reviewed to ensure uniformity in basis for yield calculation across issuers. Similarly, parameters like day count convention, holiday convention, shut period, etc. may be standardised for corporate bonds as a class. SEBI has set up a group to look into these issues and suggest uniform approach to calculation of interest and redemption payments.

***Recommendation:***

- 2. As suggested by market participants, SEBI may have a re-look at the guidelines issued in October 2013 so as to clarify on day count convention, shut period, basis for yield calculation, calculation of coupon interest and redemption with intervening holidays with illustrations. The date of payment may be specified as the date on a Mumbai business day, the day on which RBI and money markets function. (Action: SEBI)*

## **2.2 Investors**

### **2.2.1 FPIs investment in corporate bonds**

In terms of Schedule 5 of the “Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000” (FEMA 20), Foreign Portfolio Investors (FPIs) can invest in only following categories of unlisted debt securities:

- a. unlisted Non-convertible debentures (NCDs)/bonds issued by infrastructure companies;
- b. primary issuances of to-be-listed NCDs/bonds, i.e., which are committed to be listed within 15 days of issue on private placement basis

To increase the investor base for companies issuing unlisted and securitised debt instruments, it is announced in the Union Budget 2016-17 that the investment basket for FPIs in corporate debt may be expanded to include unlisted debt securities and pass-through securities (PTCs) issued by securitization SPVs. The Group reiterates that appropriate framework may be put in place by RBI taking into account comments received on the draft circular issued in this regard and necessary amendments may be carried out in FEMA regulations accordingly.

2.2.1.1 Investment by FPIs in corporate bond is subject to overall limit prescribed by RBI from time to time. The current limit is Rs. 2443.23 billion. Limit monitoring is done through reporting of daily utilisation of limits by each FPI through their custodian banks to the depositories (NSDL and CDSL). In view of availability of a robust mechanism for capture of limits utilised by FPIs, FPIs may be permitted to transact in corporate bonds both in the OTC segment and in the Request for Quote (RFQ) platform of a recognized stock exchange, subject to certain safeguards. This will also enable FPIs to trade directly on electronic trading platforms and thereby help in enhancing liquidity in the corporate bond market. Required changes may be carried out in both FEMA notification and SEBI guidelines to facilitate direct trading by FPIs in corporate bonds without involving brokers.

### ***Recommendations***

3. *Necessary amendments may be made in FEMA regulations to allow investment by FPIs in unlisted debt securities and pass through securities issued by securitizations SPVs /*

*Special Purpose Distinct Entity (SPDE) as announced in the Union Budget 2016-17. Necessary notification, in this regard, may be issued by RBI by end August 2016. (Action: RBI)*

- 4. Amendments may also be carried out in both FEMA notification and SEBI guidelines to facilitate direct trading in corporate bonds by FPIs in the OTC segment and on an electronic platform of a recognized stock exchange, subject to certain safeguards, without involving brokers. (Action: RBI/SEBI)*

#### 2.2.2 Clarification on exposure norms

Banks and PDs have been allowed by RBI to buy and sell protection in the CDS market. Mutual funds, Insurance companies and Pension funds have been allowed to participate in CDS only as buyers of credit protection. Some market participants observed that there was lack of clarity with regard to counting of exposure after buying CDS protection on a particular bond. RBI guidelines on credit default swap (CDS) for corporate bonds dated May 23, 2011 clearly state that the protection buyer shall replace his original exposure to the reference entity, with that of the protection seller.

#### **Recommendation**

- 5. In terms of RBI guidelines on credit default swaps, the credit exposure of a protection buyer shall be on the protection seller. In case of need for further clarification of doubts, if any, market participants may seek the confirmation of the respective regulators. (Action: FIMMDA / Market participants)*

### **2.3 Intermediaries**

#### 2.3.1 Market –Making Scheme

A market making scheme in corporate bond could potentially improve market liquidity. Considering the current state of the corporate bond market where liquidity is very low, availability of market makers can provide both entry and exit options to the investors. SEBI, vide its circular dated January 24, 2013, has allowed stock exchanges to introduce market making scheme subject to its approval. Stock exchanges are, however, yet to come out with their market making scheme. The Group opined that the stock exchanges may quickly

operationalize the market making scheme in consultation with SEBI. Once the market making scheme is put in place, the regulators may examine the possibility of allowing their regulated entities to act as market makers. It was also suggested that trading members of debt segment of exchanges may be allowed to access the repo market to enable them to undertake market making in corporate bonds.

2.3.2 The Group noted the relaxations allowed to PDs in terms of utilisation of borrowings from the call money market for the purpose of investing in corporate bond market and increase in single and group exposure norms to enable their active participation in corporate bond market. The Group also noted that banks and PDs have been allowed to become members of stock exchanges for trading in corporate bonds. As per extant guidelines, they are permitted to deal in corporate bonds and so they can give a buy or sell quote, intermittently or continuously after putting in place appropriate risk management thresholds, either for going long or shorting the bonds for which they will be the market maker. Such risk management arrangements will have to be within the overall risk management guidelines prescribed by the regulator.

### ***Recommendations***

*6. Stock exchanges may operationalize market making scheme in corporate bonds. (Action: SEBI/Stock Exchanges)*

*7. Regulated entities like banks, PDs, in addition to brokers, may be encouraged by the regulators to act as market makers in corporate bond market subject to appropriate risk management framework. RBI may examine allowing trading members of debt segment of exchanges to access the repo market in corporate bonds to enable them to undertake market making. (Action: RBI/SEBI)*

## **2.4 Infrastructure**

### ***2.4.1 Electronic book for private placement of bonds***

Private placements completely dominate the primary segment of the corporate debt market accounting for more than 90% of the total issuance of corporate debt. Corporates prefer raising funds through private placements as against public issues because of operational

ease of issuance, viz. minimum disclosures, low cost of issuance, tailor made structures and the speed of raising funds. Many market participants have indicated that private placements lack transparency and access is not available to a large pool of investors. The Union Budget 2016-17 announced that SEBI may operationalise electronic auction platforms to facilitate transparent private placements. In this regard, guidelines have been issued by SEBI on April 21, 2016 which enable introduction of Electronic Book Mechanism (EBM) by the stock exchanges and mandate that all private placements of debt securities in primary market with an issue size of Rs.500 crores and above, inclusive of green shoe option, if any, should be through such a mechanism. Such EBMs have been operationalized by the Stock Exchanges. Bonds with issue size of less than Rs. 500 crores, are required to disclose the coupon, yield, amount raised, number and category of investors to the Electronic Book Provider and / or to the information repository for corporate debt market. Such issuances should also be covered under EBM over time. SEBI may consider extending the EBM to all its issuances after reviewing the success of the EBM for the existing issues and market feedback.

### ***Recommendation***

*8. The Electronic Book Mechanism for private placement of debt securities, currently mandatory for issuances over Rs.500 crore, may be extended to all primary market issuances. (Action: SEBI)*

#### **2.4.2 Uniform valuation norms**

- a) Currently, RBI and IRDA have advised their regulated entities to follow credit spread matrix published by FIMMDA to value their corporate bond portfolio. FIMMDA publishes spread for different ratings under various issuer segments like banking, NBFC, corporates, etc. It is recognised that FIMMDA, though a quasi self-regulatory organisation, is not a regulated entity. Mutual funds, however, have been, following matrix published by credit rating agencies (CRAs). CRAs are bound by the code of conduct under SEBI (Credit Rating Agencies), 1999 to address possible issues of conflict of interest. Further, Mutual Funds require daily valuations as they have an obligation to publish net asset value of their schemes on a daily basis. However, FIMMDA rates and prices for corporate bonds are calculated on a monthly basis. Use



of different sources for valuation of corporate bond portfolio by regulated entities adversely impact trading in the secondary market.

**Recommendation**

*9. A uniform valuation methodology available on a daily basis may be followed by all the regulated entities for valuation of their holdings of corporate bonds. All regulators may explore an acceptable mechanism for valuation including engaging the Financial Benchmarks India Pvt. Ltd. (FBIL) or credit rating agencies for the same with necessary safeguards and regulatory oversight. (Action: RBI/SEBI/IRDA/PFRDA)*

**2.4.3 Electronic Trading Platform**

An electronic platform for corporate bond trading has been in place for some time without much activity. As per the extant guidelines, currently, there are only about 15 bonds that are available for trading on the platform. SEBI circular CIR/MRD/DP/ 27 /2013 dated 12th September 2013 prescribes the norms for bonds that would be available for screen based trading:

- All publicly issued bonds, irrespective of rating, are permitted to trade on the electronic trading platform with DVP-III settlement.
- In the case of privately issued bonds, all bonds are permitted for trade on the electronic platform with settlement on DVP-I basis.
- For DVP-III settlement, only liquid privately placed bonds are permitted. SEBI has laid down requirements for a bond to be classified as a liquid security.

At present the penalty for short delivery of bonds is 5% of the default amount which is considered very high by the market participants given the volatility in bonds and has deterred many of the market participants from executing trades on the trading platform of the exchanges. To encourage market participants to start trading on such platforms, the risk management practices of the clearing houses may be reviewed and a mechanism similar to equity market where the entity involved in delivery failure is given a time period to cover from the market and failing which some penalty is imposed may be considered. It is

suggested that alternative mechanisms, such as borrowing through repo in corporate bonds, may also be explored.

### **Recommendation**

*10. The penalty structure in place for default in delivery of debt securities/funds for trades subject to CCP clearing by the clearing houses of the stock exchanges may be reviewed in consultation with all the stakeholders with a view to prescribing a penalty which is prudent yet reasonable. It is suggested that alternative mechanisms, such as borrowing through repo in corporate bonds, may also be explored for ensuring settlement. (Action: SEBI/Clearing Houses of the Stock Exchanges)*

#### 2.4.4 Credit Rating Agencies

As per extant regulatory framework prescribed by SEBI, credit rating agencies (CRAs) are required to make disclosures about credit rating procedure, rating history and defaults on their website and also to the stock exchanges in case of listed securities. In terms of SEBI Circular CIR/MIRSD/CRA/6/2010 dated May 3, 2010, CRAs are required to disclose the rating movements/ history of credit rating of all outstanding securities on their websites on half-yearly basis. As per Regulation 24(10) of the SEBI (Credit Rating Agencies) Regulations, 1999, the CRAs are required to inform the Exchanges about any changes in ratings, including default, assigned to securities of a client through Press Releases uploaded on their website. The Indian rating industry has been following the global best practices and is IOSCO compliant. Market participants have, however, expressed the view that the level of compliance by the CRAs in adhering to these regulatory requirements is not high. The CRAs may be advised to strictly comply with the prescribed regulatory norms and adhere to international best practices. The CRAs may be advised to publish the credit rating transition matrix on a frequent basis, say, at quarterly intervals, so that market participants are aware of the credit risk in the instruments they are trading. This will bring in greater transparency in the corporate bond market.

The need for CRAs, who are eligible users, to access the information on bank lending to large borrowers under stress from credit information companies (CICs) is also considered

necessary. Currently, banks furnish loan overdue information to CICs on monthly basis; thus there could be a delay of five or six weeks in reporting overdue information to CICs. To ensure timely flow of information to CICs, banks may be encouraged to submit loan overdue information to CICs at least on a weekly basis. RBI may also examine the possibility of allowing CRAs to access the database of the Central Repository of Information on Large Credits (CRILC) based on legal opinion and other relevant factors.

### **Recommendation**

*11. CRAs may be mandated to strictly adhere to the regulatory norms with regard to timely disclosure of defaults on the stock exchanges and their own website. They may also publish the credit rating transition matrix more frequently. CRAs may take up membership of credit information companies to access relevant credit information. (Action: SEBI/CRAs)*

*12. Banks may be encouraged to submit loan overdue information to CICs on a weekly basis to start with. RBI may consider whether CRAs may be allowed access to Central Repository of Information on Large Credits (CRILC) database based on legal feasibility and other relevant factors. (Action: RBI)*

### **2.4.5 Integrated Trade Repository**

It is important to have centralized databases which enable investors to get complete information about corporate debt market at one place. Such database will enhance transparency in the market and enable investors to take an informed decision. In terms of SEBI circular dated October 22, 2013 on creation of centralised database for corporate bond, NSDL and CDSL have created a database for the primary market. There is, however, a need to have an integrated Trade Repository (TR)/database so that the information of both primary and secondary markets, such as, issue wise outstanding size, rating, shut period, price, volume of secondary market trades, rating migration, etc. are available at one place on non-commercial basis. Accordingly, an announcement for introduction of an Integrated TR for primary and secondary market in corporate bond market has been made in the Union Budget 2016-17. This budget announcement may be implemented expeditiously.

### ***Recommendation***

13. As announced in the Union Budget 2016-17, a centralized database for corporate bonds covering both primary and secondary market segments may be established expeditiously in two phases, for secondary market trades by end August 2016 and for both primary and secondary market by end October 2016. **(Action: SEBI & RBI)**

## **2.5 Instruments**

### **2.5.1 Credit Default Swaps (CDS)**

Non-availability of credit risk transfer mechanism in the corporate bond market works as a deterrent. Though CDS has been introduced in India, there is no activity in the market. One of the major constraints is restriction on netting of MTM position against the same counterparty for capital adequacy and exposure norms. Without netting, the trades in CDS have become highly capital intensive as banks and PDs have to provide higher capital charge on gross basis even if they are acting as market makers and having positive and negative position against the same counterparty. Netting has not been allowed by RBI due to lack of legal clarity. In order to encourage participation in CDS, netting of MTM position against the same counterparty for capital adequacy and exposure norms have to be enabled and legal impediments may be addressed quickly. In this direction, if needed, suitable amendments may have to be carried out in the RBI Act, 1934 to provide complete clarity on the legal position relating to netting of OTC derivative contracts. Availability of netting of contracts is essential for smooth and successful implementation of the proposed margin requirements for OTC derivatives and the development of the OTC derivatives which is mostly used by clients for hedging underlying risks. It may be noted that due to lack of legal clarity on netting, RBI has proposed margining for non-centrally cleared derivatives on a transaction-by-transaction basis rather than across the whole portfolio on net basis. This increases the cost of transactions and discourage market participants from trading. Pending amendments to RBI Act, based on expert legal opinion, possibility of permitting netting keeping in view the existing legal provisions and banking practices may be explored.

### ***Recommendation***

14. Amendments may be carried out in the RBI Act, 1934 to provide complete clarity on the

*legal position relating to netting of OTC derivative contracts. Pending amendments to the RBI Act or other enabling legal framework, based on expert legal opinion, possibility of permitting netting keeping in view the existing legal provisions and banking practices may be explored expeditiously. (Action: RBI/GoI)*

### 2.5.2 Repo in corporate bonds

2.5.2.1 RBI has introduced repo in corporate bonds in 2010 as a class of money market instrument. Participation in the corporate debt repo market, however, continues to be very limited. The reasons cited for lack of interest in corporate bond repo include non-signing of the Global Master Repo Agreement (GMRA), non-availability of guaranteed settlement, electronic dealing platform, etc. FIMMDA may consult market participants to develop a commonly acceptable agreement.

2.5.2.2 There is a view that repo in G-Sec through CCIL Repo Order Matching System (CROMS) is far more easily executable compared to corporate bond repo. Further, G-Sec repo is considered risk free as the exposure is guaranteed by CCIL, a qualified CCP. Availability of CROMS platform simplify the overall repo process. Corporate bond repo, however, has to be bilaterally executed and various parameters like security, hair-cuts, rates, amounts, etc. have to be mutually agreed and manually entered. Furthermore, the first leg and the second leg prices have to be manually calculated; this increases the effort required for relatively smaller sized deals. In addition, the small deal-size and lack of convenience are hindering the process of price discovery with many lenders staying away from the market. In the light of these issues, the Union Budget 2016-17 announced that RBI may develop a framework for an electronic platform for corporate bond repos.

2.5.2.3 The following measures would address these operational issues and encourage participation in the repo market:

a. An electronic dealing platform with CCP facility similar to the CROMS platform for G-sec may be introduced for repo in corporate debt. Since trades executed by such platforms would be cleared through the clearing houses of the stock exchanges, RBI, in consultation with SEBI, may authorise entities to provide such platforms. Due to illiquidity and

heterogeneity in corporate bonds, it would not be possible to provide guaranteed settlement for all categories of bonds. Hence, electronic dealing platform for repo in corporate debt may also be introduced without CCP facility.

b. FIMMDA may consult market participants to develop a commonly acceptable agreement for execution among the market participants.

c. Keeping in view the challenges involved in providing guaranteed settlement in an illiquid and heterogeneous corporate bond market, tripartite repo may also be considered. This would also help market participants in collateral management services.

d. Liquid Mutual Funds have a maturity restriction of three months. A few MFs raised the question whether this restriction applied to securities purchased under a repo transaction. In a repo transaction, the underlying security is held by the repo buyer as a collateral against the risk of default by the repo seller and not as an investment. As per RBI guidelines dated March 23, 2010, during the repo period, repo sellers continue to have economic interest in the underlying security. Therefore, the underlying security of the repo transaction may not be taken into account while computing credit exposure limits prescribed under SEBI (Mutual Funds) Regulations, 1996 and circulars issued thereunder. Liquid schemes can be a repo buyer with an underlying corporate bond having maturity of more than 91 days. However, in case of a default by the repo seller and the second leg of repo transaction fails, MFs would have to consider such underlying security while computing credit exposure towards single issuer, sector, etc. and ensure compliance with all investment restrictions prescribed under SEBI (MFs) Regulations, 1996 and circulars issued thereunder. MFs need to ensure compliance with investment mandate of the concerned scheme and sell the collateral if the repo seller defaults in the second leg of the repo transaction.

e. Currently, repo in corporate bond is permitted only in the OTC market and the trades executed are settled on DVP-I basis through clearing houses of the stock exchanges. Since repo is a leverage product, participation in the corporate debt repo market has been restricted to regulated entities as a systemic risk mitigant measure. Moreover, enforcement

of mandatory adherence to the repo guidelines may be difficult in case of non-regulated entities. The Group was of the view that all entities authorized as market makers in corporate bond market, including the brokers, may be allowed to participate in the repo market executed on an electronic platform linked to guaranteed settlement as risk management of these platforms would ensure that risk is managed. This will enable market makers to meet their temporary funding requirements.

### **Recommendations**

*15. An electronic dealing platform with CCP facility with appropriate risk management framework similar to the CROMS platform for G-sec may be introduced. Electronic dealing platform without CCP facility may also be introduced for bonds for which CCP facility may not be feasible. Necessary guidelines may be issued by end September 2016. (Action: RBI & SEBI)*

*16. FIMMDA may consult market participants to develop a commonly acceptable market repo agreement for execution among the market participants by end September 2016. (Action: RBI/FIMMDA)*

*17. Guidelines on Tripartite repo on corporate bonds may also be introduced by depositories/other entities in consultation with SEBI by end September 2016. (Action: RBI)*

*18. Entities authorized as market makers in corporate bond market, including the brokers, may be allowed to participate in the repo market executed on electronic platform linked to guaranteed settlement. (Action: RBI)*

### **2.5.3 Basel III compliant Perpetual Bonds**

Given that the public sector banks would be required to raise around Rs.80,000-85,000 crore by way of issuance of AT-1 instruments, there is an implicit need to broaden the investor base and make these instruments more attractive to the investors. In financial year 2015-16, only one bank (viz. United Bank of India) was able to raise AT 1 perpetual bond for a very small size of Rs.150 crores with (A-) rating and at a very high cost of 11.95% p.a. coupon rate. Though RBI has relaxed stipulations to make them attractive for investors, the AT-1 issuance in financial year 2015-16 has practically been nil, because a number of public sector banks deferred their issuances due to lack of demand and high cost of raising AT-1

bonds. A number of factors as mentioned below have adversely impacted the wider acceptance of these instruments:

- a. The Insurance Regulatory Development Authority (IRDA) has not yet given its clearance for insurance companies to invest in AT-1 bonds. As such the insurance companies (one of the major investor segments) is not investing in this segment.
- b. Employees' Provident Fund Organisation (EPFO) is yet to formulate its guidelines for investment in these bonds and as such they are not participating as an investor.
- c. The non-Government Provident Funds (PFs) have been significantly investing in these bonds. However, the notifications by the Ministry of Finance dated 2<sup>nd</sup> March, 2015 and the Ministry of Labour dated 9<sup>th</sup> June 2015, regarding the investment pattern to be followed by these PFs with effect from the financial year 2015-16, have, inter alia, stipulated a maximum investment limit of 2 % of the total portfolio of the funds in AT-1 instruments. Further, a minimum credit rating of AA from two credit rating agencies has also been prescribed for these instruments. These stipulations would lead to negligible investment from this segment in the immediate future.
- d. The Union Budget for the Financial Year 2015-16 has reintroduced allocation of tax-free bonds for some select infrastructure companies. These tax-free issuances would be far more attractive an investment option, especially for the HNIs and cash surplus corporates, and could eventually lead to total diversion of their investment away from the AT-1 segment.

In light of the above it is suggested that some measures may be taken to rejuvenate the demand for AT-1 bonds going forward. The following measures may be considered:

- a. IRDA may consider formulating guidelines for investment in these instruments by insurance companies. Ministry of Finance may also advise EPFO to formulate guidelines for investment in AT-1 instruments of banks.



- b. The existing investment ceiling of 2% stipulated by the Ministry of Finance in the Investment pattern for PFs may be relaxed.
- c. Since, the AT-1 instruments being/to be issued by a majority of the public sector banks have a credit rating of AA- and below, the eligibility criterion for PFs and Insurance companies should allow investments in these instruments with credit rating up to investment grade in case of these banks.

### **Recommendations**

19. Insurance companies and EPFO may be allowed to invest in AT-1 bonds of banks subject to prudential limits with credit rating upto investment grade. **(Action: IRDA/ EPFO)**

20. The maximum investment ceiling of 2% of the total portfolio of the funds in AT-1 instruments stipulated for non-Government PFs may be reviewed for relaxation. **(Action: MoF)**

#### **2.5.4 Bond Index**

Though equity indices such as Nifty 50 and the BSE Sensex serve as popular benchmarks for equities, designing debt indices has posed challenges in India as the market lacks breadth and depth. Market participants, however, need a debt market index as benchmark. SEBI is in dialogue with stock exchanges to design a suitable debt market index. Stock exchanges/other entities may design a suitable corporate bond index to serve as a benchmark.

### **Recommendation**

21. Corporate bond index may be introduced by the Stock Exchanges/other entities. **(Action: Index Providers/Stock Exchanges/SEBI)**

## **2.6 Incentives**

### **2.6.1 Credit enhancements of bonds**

- a. RBI Guidelines on Partial Credit enhancements (PCE) of INR bonds issued by infrastructure companies, restricts the extent of PCE provided by banks to 20% of the bond issue size. Since bond investors normally desire at least AA rating on a bond, a 20% PCE may be inadequate to raise the rating of bonds issued by infrastructure

companies. It is observed that though RBI had issued guidelines on PCE in September 2015, no such PCE has been provided till date by the banks. In order to encourage corporates to avail of this facility, especially by infrastructure companies, it is desirable that during the initial phase the upper limit for PCE by the banking system as a whole may be enhanced to a higher limit with no single bank having exposure of more than 20 per cent. It is also felt that the capital required to be maintained by banks on account of PCE should be lower if the base rating of the project improves. This would incentivise banks to provide PCEs on projects which are expected to perform better with passage of time.

- b. A cap of 20 % of the bond issue size may be inadequate for NBFCs set up for providing credit enhancement. A separate regulatory framework for providing credit enhancement by NBFCs may be necessary so as to help bolster bond ratings that can attract investors.
- c. As announced in the Union Budget 2016-17, setting up of a separate dedicated fund may be expedited by entities like LIC to provide credit enhancement to infrastructure projects.

### **Recommendations**

*22. During the initial phase the upper limit for PCE by the banking system as a whole may be enhanced to a higher limit with no single bank having exposure of more than 20 per cent of the bond issue size by end August 2016. (Action: RBI)*

*23. It may be clarified that the capital required to be maintained by banks on account of PCE would be reduced if the base rating of the project improves during the credit enhancement period. Guidelines in this regard may be issued by end August, 2016. (Action: RBI)*

*24. A separate regulatory framework may be formulated for providing credit enhancement of corporate bonds by NBFCs engaged in such activities. Necessary guidelines, in this regard, may be issued by end August, 2016. (Action: RBI)*

### **2.6.2 Encouraging corporates to tap capital market**

One reason for bank finance being preferred by corporations is the prevalence of the cash credit system where the burden of the cash management of the corporations falls on the

banks. This facility impedes the development of corporate bond market. On March 27, 2015, RBI has issued a Discussion Paper (DP) on the Large Exposures (LE) Framework containing proposals for aligning the extant exposure norms for banks in India with the standards on 'supervisory framework for measuring and controlling large exposures' published by BCBS in April 2014. The DP also solicits views of the stakeholders on restricting the proportion of borrowings of large corporates from banks and making such corporates use the market mechanism (corporate bonds, Commercial Paper and other similar instruments) to meet a part of their short term as well as long term financing needs. With the objective of encouraging alternative sources of funding to bank credit for the corporate sector to finance growth and to de-risk the balance sheets of banks, it was announced in the Union Budget 2016-17 that RBI will issue guidelines to encourage large borrowers to access a portion of their financing needs through market mechanism instead of the banks. The Group reiterates the importance of this announcement.

### ***Recommendation***

*25. Large corporates with borrowings from the banking system above a cut-off level may be required to tap the market for a portion of their working capital and term loan needs. Necessary guidelines may be issued by RBI taking into account market conditions by September 2016. (Action: RBI)*

### ***2.6.3 Rating Based Credit Risk Charge for investment by PDs in corporate bonds***

Standalone PDs are at a distinct disadvantage regarding capital charge for credit risk. Standalone PDs have a 100% risk weight even for AAA rated bonds (barring a few corporates which are part of PSU/FIs category and non-capital instruments of scheduled banks) compared to 20% which banks have for investing in AAA bonds. The differential capital requirement for similar rated bonds put PDs at a disadvantage compared to banks. It was suggested that the treatment of credit risk charge for standalone PDs may be made similar to banks to improve standalone PDs participation in the corporate bond market. Accordingly, RBI has issued guidelines in this regard on April 28, 2016.

## 2.7 Innovations

### 2.7.1 Acceptance of corporate bonds under LAF repo of RBI

RBI has been taking only Government securities as collateral for undertaking its LAF operations. Acceptance of corporate bonds as collateral under Central bank's liquidity management framework may incentivize banks and PDs to invest in corporate bonds and thereby create demand for corporate bonds. Internationally, many central banks <sup>[1]</sup>accept corporate bonds as collateral for their liquidity operation. It is not uncommon for central banks to take a lead with a view to developing the financial market. However, it is desirable that such a step is taken after the market repos gain some traction on their own. Depending upon the development of the repo market in some form, Reserve Bank may explore the possibility of accepting corporate bonds as collateral subject to suitable risk management framework in terms of rating and haircut. To begin with, RBI may consider accepting corporate bonds for overnight LAF operations as risks related to rating downgrade and change in market price of the underlying collateral would be minimal. Based on experience gained, it may be extended for long term repos. The legal framework laid down in the RBI Act may be looked into and if required, necessary amendments may have to be carried out for enabling such operations involving corporate bonds.

#### **Recommendations:**

26. *After the measures like introduction of tripartite repo and repo on electronic dealing platform with CCP facility gain some traction, RBI may explore the possibility for accepting corporate bonds for LAF operations with suitable risk management framework including rating requirements and appropriate haircuts. (Action: RBI)*

27. *Legal basis may be examined expeditiously to remove the technical obstacles for RBI to accept corporate bonds as collateral under LAF repo as and when the Scheme is introduced. (Action: RBI)*

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<sup>[1]</sup> Central banks in Australia, Canada, Eurosystem, Japan, Mexico, Sweden, Switzerland, UK and US accept corporate debt as collateral

### 2.7.2 Rationalisation of Stamp Duty

Stamp duty paid by issuers is an important element in the cost of issue of bonds. In terms of the provisions of entry 91 of the Union List, the Central Government has the power to levy stamp duty on issue of debentures. Some state stamp laws, however, also provide for entries pertaining to payment of duty on issue of debentures. Stamp duty can be levied by state governments on transfer of debentures. Currently stamp duty varies across states. To provide incentives to the issuers, Group agreed with the long standing suggestion to rationalize stamp duty across states and fix it on the basis of tenor and issuance value of the bond and also introduce a suitable provision which stipulates the maximum amount of stamp duty that is payable in respect of any single issue. Further, re-issuance of the same security should be included for the purpose of the cap suggested for stamp duty to encourage re-issuances. This issue has been pending for quite some time.

#### **Recommendation**

*28. The stamp duty on debentures should be made uniform across states and be linked to the tenor of securities within an overall cap. Re-issuance of the same security should be included for the purpose of the cap, in order to encourage re-issuance. As this issue has been pending for quite some time, this may be resolved expeditiously. (Action: **Gol/State Governments**)*

### 2.7.3 Investor Protection: Revamp Bankruptcy Act and SARFAESI Act

A robust, timely and effective bankruptcy regime is critical to the development of corporate debt market from investors' point of view. Steps, such as, reforming bankruptcy law, early resolution of bankruptcy cases and streamlining the procedures relating to insolvency would go a long way in achieving the same. The issues of insolvency of financial institutions established under statutes and bi-lateral netting among them during bankruptcy also need resolution. The recently passed Insolvency and Bankruptcy Code, 2016 is expected to ensure recovery for creditors and address the concerns of investors in corporate bonds by providing new time bound recovery and resolution framework. The Code has been gazetted on 28<sup>th</sup> May 2016 and rules under the Code are expected to be issued shortly. There are, however, many challenges in terms of actual implementation of the Code: speedy establishment of institutional framework of revamped DRTs and the National Company Law Tribunal (NCLT)

and informational utilities, IT backed work processes for ensuring the timelines, skill upgradation and reorientation of the approach of the judges, development of multi skilled insolvency resolution professionals who will be playing very important role under the code and addressing the transitional issues as the new regime evolves.

***Recommendation***

*29. In order to achieve the objective behind the Bankruptcy Code, issues such as early notification of the rules, development of insolvency professionals, tribunal/court infrastructure and information utilities and quick redressal of the transitional problems may be addressed with priority. (Action: Go!)*

### 3. Summary of Recommendations

#### Issuers

##### Reissuance

1. i. The issuers coming out with frequent debt issues with the same tenor during a quarter may club them under the same umbrella ISIN which in turn would increase the float in the market, thus enhancing its liquidity. These issuers may come out with a feasible maturity structure wherein they can stagger the redemption amount across the year by amortizing the repayments. Necessary changes may be made in the issuance process of ISINs by depositories, viz., NSDL and CDSL to facilitate the same.

ii. Re-issuances may not be treated as fresh issuances for the purpose of Stamp duty.

iii. The corporate governance norms applicable to companies which have listed only debt securities and not equity may be reviewed to make them less onerous. **(Action: NSDL/CDSL/Ministry of Corporate Affairs/SEBI)**

##### Standardization of corporate bond issuance

2. As suggested by market participants, SEBI may have a re-look at the guidelines issued in October 2013 so as to clarify on day count convention, shut period, basis for yield calculation, calculation of coupon interest and redemption with intervening holidays with illustrations. The date of payment may be specified as the date on a Mumbai business day, the day on which RBI and money markets function. **(Action: SEBI)**

#### Investors

##### FPIs investment in corporate bonds

3. Necessary amendments may be made in FEMA regulations to allow investment by FPIs in unlisted debt securities and pass through securities issued by securitizations SPVs / Special Purpose Distinct Entity (SPDE) as announced in the Union Budget 2016-17. Necessary notification, in this regard, may be issued by RBI by end August 2016. **(Action: RBI)**

4. Amendments may also be carried out in both FEMA notification and SEBI guidelines to facilitate direct trading in corporate bonds by FPIs in the OTC segment and on an electronic

platform of a recognized stock exchange, subject to certain safeguards, without involving brokers. **(Action: RBI/SEBI)**

5. In terms of RBI guidelines on credit default swaps, the credit exposure of a protection buyer shall be on the protection seller. In case of need for further clarification of doubts, if any, market participants may seek the confirmation of the respective regulators. **(Action: FIMMDA / Market participants)**

## **Intermediaries**

### Market –Making Scheme

6. Stock exchanges may operationalize market making scheme in corporate bonds. **(Action: SEBI/Stock Exchanges)**

7. Regulated entities like banks, PDs, in addition to brokers, may be encouraged by the regulators to act as market makers in corporate bond market subject to appropriate risk management framework. RBI may examine allowing trading members of debt segment of exchanges to access the repo market in corporate bonds to enable them to undertake market making. **(Action: RBI/SEBI)**

## **Infrastructure**

### Electronic book for private placement of bonds

8. The Electronic Book Mechanism for private placement of debt securities, currently mandatory for issuances over Rs.500 crore, may be extended to all primary market issuances. **(Action: SEBI)**

### Uniform valuation norms

9. A uniform valuation methodology available on a daily basis may be followed by all the regulated entities for valuation of their holdings of corporate bonds. All regulators may explore an acceptable mechanism for valuation including engaging the Financial Benchmarks India Pvt. Ltd. (FBIL) or credit rating agencies for the same with necessary safeguards and regulatory oversight. **(Action: RBI/SEBI/IRDA/PFRDA)**



### Electronic Trading Platform

10. The penalty structure in place for default in delivery of debt securities/funds for trades subject to CCP clearing by the clearing houses of the stock exchanges may be reviewed in consultation with all the stakeholders with a view to prescribing a penalty which is prudent yet reasonable. It is suggested that alternative mechanisms, such as borrowing through repo in corporate bonds, may also be explored for ensuring settlement. **(Action: SEBI/Clearing Houses of the Stock Exchanges)**

### Credit Rating Agencies

11. CRAs may be mandated to strictly adhere to the regulatory norms with regard to timely disclosure of defaults on the stock exchanges and their own website. They may also publish the credit rating transition matrix more frequently. CRAs may take up membership of credit information companies to access relevant credit information. **(Action: SEBI/CRAs)**

12. Banks may be encouraged to submit loan overdue information to CICs on a weekly basis to start with. RBI may consider whether CRAs may be allowed access to Central Repository of Information on Large Credits (CRILC) database based on legal feasibility and other relevant factors. **(Action: RBI)**

### Integrated Trade Repository

13. As announced in the Union Budget 2016-17, a centralized database for corporate bonds covering both primary and secondary market segments may be established expeditiously in two phases, for secondary market trades by end August 2016 and for both primary and secondary market by end October 2016. **(Action: SEBI & RBI)**

## **Instruments**

### Credit Default Swaps (CDS)

14. Amendments may be carried out in the RBI Act, 1934 to provide complete clarity on the legal position relating to netting of OTC derivative contracts. Pending amendments to the RBI Act or other enabling legal framework, based on expert legal opinion, possibility of permitting netting keeping in view the existing legal provisions and banking practices may

be explored expeditiously. **(Action: RBI/Gol)**

#### Repo in corporate bonds

15. An electronic dealing platform with CCP facility with appropriate risk management framework similar to the CROMS platform for G-sec may be introduced. Electronic dealing platform without CCP facility may also be introduced for bonds for which CCP facility may not be feasible. Necessary guidelines may be issued by end September 2016. **(Action: RBI & SEBI)**

16. FIMMDA may consult market participants to develop a commonly acceptable market repo agreement for execution among the market participants by end September 2016. **(Action: RBI/FIMMDA)**

17. Guidelines on Tripartite repo on corporate bonds may also be introduced by depositories/other entities in consultation with SEBI by end September 2016. **(Action: RBI)**

18. Entities authorized as market makers in corporate bond market, including the brokers, may be allowed to participate in the repo market executed on electronic platform linked to guaranteed settlement. **(Action: RBI)**

#### Basel III compliant Perpetual Bonds

19. Insurance companies and EPFO may be allowed to invest in AT-1 bonds of banks subject to prudential limits with credit rating upto investment grade. **(Action: IRDA/ EPFO)**

20. The maximum investment ceiling of 2% of the total portfolio of the funds in AT-1 instruments stipulated for non-Government PFs may be reviewed for relaxation. **(Action: MoF)**

#### Bond Index

21. Corporate bond index may be introduced by the Stock Exchanges/other entities. **(Action: Index Providers/Stock Exchanges/SEBI)**

## **Incentives**

### Credit enhancements of bonds

22. During the initial phase the upper limit for PCE by the banking system as a whole may be enhanced to a higher limit with no single bank having exposure of more than 20 per cent of the bond issue size by end August 2016. **(Action: RBI)**

23. It may be clarified that the capital required to be maintained by banks on account of PCE would be reduced if the base rating of the project improves during the credit enhancement period. Guidelines in this regard may be issued by end August, 2016. **(Action: RBI)**

24. A separate regulatory framework may be formulated for providing credit enhancement of corporate bonds by NBFCs engaged in such activities. Necessary guidelines, in this regard, may be issued by end August, 2016. **(Action: RBI)**

### Encouraging corporates to tap capital market

25. Large corporates with borrowings from the banking system above a cut-off level may be required to tap the market for a portion of their working capital and term loan needs. Necessary guidelines may be issued by RBI taking into account market conditions by September 2016. **(Action: RBI)**

## **Innovations**

### Acceptance of corporate bonds under LAF repo of RBI

26. After the measures like introduction of tripartite repo and repo on electronic dealing platform with CCP facility gain some traction, RBI may explore the possibility for accepting corporate bonds for LAF operations with suitable risk management framework including rating requirements and appropriate haircuts. **(Action: RBI)**

27. Legal basis may be examined expeditiously to remove the technical obstacles for RBI to accept corporate bonds as collateral under LAF repo as and when the Scheme is introduced. **(Action: RBI)**

### Rationalisation of Stamp Duty

28. The stamp duty on debentures should be made uniform across states and be linked to the tenor of securities within an overall cap. Re-issuance of the same security should be

included for the purpose of the cap, in order to encourage re-issuance. As this issue has been pending for quite some time, this may be resolved expeditiously. **(Action: GoI/State Governments)**

Investor Protection: Revamp Bankruptcy Act and SARFAESI Act

29. In order to achieve the objective behind the Bankruptcy Code, issues such as early notification of the rules, development of insolvency professionals, tribunal/court infrastructure and information utilities and quick redressal of the transitional problems may be addressed with priority. **(Action: GoI)**

**List of key recommendations of earlier Committees/Reports not fully implemented**

S. No	Recommendations	Reference Group <sup>2</sup> /Committee	Relevant authority
<b>Issuers</b>			
1	There should be a guideline limiting the number of fresh issuances that would include re-issuance of the existing bonds by a corporate in a given time period (say over a quarter). Any new issue should preferably be a reissue so that there are large stocks in any given issue, thereby helping to create secondary market liquidity.	RH Patil Committee	SEBI
<b>Investors</b>			
2	Systematic Disclosure of Debt Servicing Performance Information: Banks, NBFCs and all institutional investors may be mandatorily required to report for listed entities to the exchanges a non-payment of debt by a listed borrower within 15 days.	City of London Report	SEBI/IRDA/PFRDA
3	Restriction on FPIs to invest in bonds with maturities of up to 3 years (a segment largely confined to lower	India – UK Financial Partnership	RBI/GOI

<sup>2</sup> The reports examined by the Group are: (1) High Level Expert Committee on Corporate Bonds and Securitisation, 2005 (Chairman: RH Patil); (2) Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre, 2007 (Chairman: Percy Mistry); (3) A Hundred Small Steps: Report of the Committee on Financial Sector Reforms, 2009 (Chairman: Raghuram Rajan); (4) Reports of the City of London on Development of India's Corporate Debt Market, 2008-14; (5) Report of India UK Financial Partnership on development of India's Corporate Bond Market, 2015; (6) ASIFMA report on India Bond Market Roadmap, 2013; and (7) IFMR report on Corporate Debt Market in India, 2014

	rated issuers), constrains investment by FPIs in bonds rated below AAA.		
4	FPIs are currently not permitted to invest in securitisation PTCs which may be allowed.	India – UK Financial Partnership	RBI
<b>Intermediaries</b>			
5	Encourage growth of professional Debenture Trustees (DTs).	RH Patil Committee	SEBI
6	The role of debenture trustees to be strengthened.	RH Patil Committee	
<b>Infrastructure</b>			
7	Creation of a centralized database of all bonds issued by corporates. It should also track rating migration. Database should be made available free of cost to all the investors.	RH Patil Committee	SEBI/NSDL/CDSL
8	The introduction of a DVP3 mechanism, where funds and securities are settled on a net basis, will give a significant boost to the domestic corporate bond market, and make it easier for domestic and foreign institutional investors to trade in rupee corporate bonds.	IUKFP	RBI/SEBI
<b>Incentives</b>			
9	<ul style="list-style-type: none"> <li>The stamp duty on partly secured, and unsecured debentures should be made uniform across states and be linked to the tenor of securities, within an overall cap.</li> </ul>	RH Patil Committee	Gol and State Govts.

	<ul style="list-style-type: none"> <li>To promote healthy growth of securitization market, the central government should consider establishing an appropriate institutional process to evolve a consensus across States on the affordable rates and levels of stamp duty on debt assignment, PTCs, security receipts (SRs).</li> </ul>		
10	Create 'credit event infrastructure' on all multiple debt holder obligations, whether in the form of bonds or loans – reporting and dissemination of a credit event across all creditors.	IFMR	RBI/SEBI
11	To create a more attractive environment for investments, the credit rating industry must adhere to international best practices. By doing so, investors can take advantage of an international standardized rating, which will in turn make the market more transparent and reliable which will attract both domestic and foreign investors.	ASIFMA Report	SEBI
12	If pension funds/other institutions were to use CDS to hedge their exposures to individual issuers, credit risk should be counted as an exposure to the hedge counterparty rather than the issuer.	ASIFMA Report	IRDA/PFRDA
13	Smoothing out tax discrepancies	ASIFMA Report	Gol

	between equities taxed at 0 % compared to bonds taxed at 10 / 20 % may help retail investors get involved in the bond markets.		
14	Guidance be developed to provide clarity that GAAR rules do not apply to FII capital market transactions where the main purpose of these transactions are to provide investment products to international investors rather than the derive a tax benefit.	ASIFMA Report	Gol
<b>Instruments</b>			
15	Municipal bonds may be given some fiscal support with such support taking the form of bond insurance or providing credit enhancement so that municipalities are encouraged to issue such bonds for development of urban infrastructure either on stand alone or on pooled basis. A plan should be drawn for developing this market in India.	RH Patil Committee	Gol
16	Launch of corporate bond index products by exchanges.	IFMR, ASIFMA	SEBI/RBI
17	Restrictions on participation in repo markets may be relaxed.	ASIFMA Report	RBI
<b>Innovations</b>			
18	<b>Market makers</b> A market-making scheme for corporate bonds should be evolved by	RH Patil Committee	SEBI & Stock Exchanges



	the market participant(s) willing to do so, including large intermediaries – such as banks, primary dealers and investment banks.		
19	Bridging the local settlement system with International Central Securities Depository (Euroclear/Clearstream), ICSDs now allow easier movement of global collateral across borders via their “collateral highway” would constitute a further step in the development of the bond market. Combined with offshore settlements could create the basis for using local bonds as collateral in the event that market participants need access to USD cash.	ASIFMA Report	RBI/SEBI
20	A clear change to Indian law is required to recognize close-out netting, an established practice in all advanced financial markets, and to establish an efficient recovery mechanism.	ASIFMA Report	RBI/GoI

**Union Budget 2016-17**

**MEASURES FOR DEEPENING OF CORPORATE BOND MARKET**

- a. LIC of India will set up a dedicated fund to provide credit enhancement to infrastructure projects. The fund will help in raising the credit rating of bonds floated by infrastructure companies and facilitate investment from long term investors.
- b. RBI will issue guidelines to encourage large borrowers to access a certain portion of their financing needs through market mechanism instead of the banks.
- c. Investment basket of foreign portfolio investors will be expanded to include unlisted debt securities and pass through securities issued by securitisation SPVs.
- d. For developing an enabling eco system for the private placement market in corporate bonds, an electronic auction platform will be introduced by SEBI for primary debt offer.
- e. A complete information repository for corporate bonds, covering both primary and secondary market segments will be developed jointly by RBI and SEBI.
- f. A framework for an electronic platform for repo market in corporate bonds will be developed by RBI.

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