SECURITIES LAWS AND COMPLIANCES
PART B — ISSUE MANAGEMENT AND COMPLIANCES
STUDY XV - DEBT MARKETS

LEARNING OBJECTIVES

The study will enable the students to understand

- Development of Debt Market in India
- Debt Market Instruments
- Investors in Debt Markets
- Debt Market Intermediaries/Participants
- Regulatory Framework for Debt Markets in India
- Chronological Developments in the Corporate Bonds and Securitization Markets

INTRODUCTION

Debt markets are markets for the issuance, trading and settlement in fixed income securities of various types and features. Fixed income securities can be issued by almost any legal entity like central and state governments, public bodies, statutory corporations, banks and institutions and corporate bodies.

The debt market in India comprises mainly of two segments viz., the Government securities market consisting of Central and State Governments securities, Zero Coupon Bonds (ZCBs), Floating Rate Bonds (FRBs), T-Bills and the corporate securities market consisting of FI bonds, PSU bonds, and Debentures/Corporate bonds. Government securities form the major part of the market in terms of outstanding issues, market capitalization and trading value.

During the year 2005-06, the government and corporate sector collectively mobilized Rs. 2,611,928 million from primary debt market, a rise of 27.49% as compared to the preceding year. About 69.58% of these were raised by the government (Central and State Governments), while the balance amount was mobilized by the corporate sector through public and private placement issues. The turnover in secondary debt market during 2005-2006 aggregated Rs. 26,053,916 million, 13% lower than that in the year 2004-2005.

The trading of government securities on the Stock exchanges is currently through negotiated dealing using members of Bombay Stock Exchange (BSE) / National Stock Exchange (NSE) and these trades are required to be reported to the exchange. The bulk of the corporate bonds, being privately placed, were, however, not listed on the stock exchanges. Two Depositories, National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) maintain records of holding of securities in a dematerialised form. Records of holding of government securities for wholesale dealers like banks/Primary Dealers (PDs) and other financial institutions are maintained by the RBI.

Negotiated Dealing System (NDS) is an electronic platform for facilitating dealing in Government Securities and Money Market Instruments. NDS facilitates electronic submission of bids/application by members for primary issuance of

Government Securities by RBI through auction and floatation. It will provide an interface to the Securities Settlement System.
In India, there are four Credit Rating Agencies (CRAs). While RBI prescribes a minimum rating for issue of Commercial Paper, SEBI, which regulates CRAs, has stipulated that ratings are compulsory for all public issues of debentures with maturity exceeding 18 months and the government has stipulated investments by Pension funds only in debt securities that have high ratings.

I. DEBT MARKET INSTRUMENTS

Corporate Debenture

A Debenture is a debt security issued by a company, which offers to pay interest in lieu of the money borrowed for a certain period. In essence it represents a loan taken by the issuer who pays an agreed rate of interest during the lifetime of the instrument and repays the principal normally, unless otherwise agreed, on maturity.
These are long-term debt instruments issued by private sector companies, in denominations as low as Rs 1000 and have maturities ranging between one and ten years. Debentures enable investors to reap the dual benefits of adequate security and good returns. Unlike other fixed income instruments such as Fixed Deposits, Bank Deposits, Debentures can be transferred from one party to another.
Debentures can be divided into different categories on the basis of convertibility of the instrument and Security. The debentures issued on the basis of security includes –

— Non Convertible Debentures (NCDs)
— Partly Convertible Debentures (PCDs)
— Fully convertible Debentures (FCDs)
— Optionally Convertible Debentures (OCDs)
— Secured Debentures
— Unsecured Debentures

Fixed Income Products

Deposit : Deposits serve as medium of saving and as a means of payment and are a very important variable in the national economy. A bank basically has three types of deposits, i.e. time deposit, savings deposit and current account.
Fixed Deposit : Fixed Deposits are sums accepted by most of the NBFCs and banks. The amount of deposits that may be raised by NBFCs is linked to its net worth and rating. However, the interest rate that may be offered by a NBFC is regulated. The deposits offered by NBFCs are not insured whereas the deposits accepted by most banks are insured upto a maximum of Rs.1,00,000.

Interest Based Bonds

Coupon Bonds : Coupon Bonds typically pay interest periodically at the prespecified rate of interest. The annual rate at which the interest is paid is known as the coupon rate or simply the coupon. Interest is usually paid half-yearly though in some cases it may be monthly, quarterly, annually or at some other periodicity. The dates on which the interest payments are made are known as the coupon due dates.

Zero Coupon Bonds : A plain bond is offered at its face value, earns a stream of interest till redemption and is redeemed with or without a premium at maturity. A zero coupon bond is issued at a discount to its face value, fetches no periodic interest and is redeemed at the face value at maturity.

Derived Instruments : These instruments are not direct debt instruments. Instead they derive value from various debt instruments. Mortgage bonds, Pass Through Certificates, Securitised Debt Instruments etc. fall under this category.

Mortgage Bonds : Mortgage backed bonds is a collateralized term-debt offering. Every issue of such bonds is backed by a pledged collateral. Property that can be pledged as security for mortgage bonds is called eligible collateral. The terms of these bonds are like the bonds floated in the capital market, semi-annual or quarterly payments of interest and final bullet payment of principal.

Pass Through Certificates : When mortgages are pooled together and undivided interest in the pool are sold, pass-through securities are created. The pass-through securities promise that the cash flow from the underlying mortgages would be passed through to the holders of the securities in the form of monthly payments of interest and principal.

Participation Certificates : These are strictly inter-bank instruments confined to the Scheduled Commercial Banks. This instrument is a money market instrument with a tenure not exceeding 90 days. The interests on such participation certificate are determined by the two contracting banks.

Benchmarked Instruments : There are certain debt instruments wherein the fixed income earned is based on a benchmark. For instance, the Floating Interest rate Bonds are benchmarked to either the LIBOR, MIBOR etc.

Floating Interest Rate : Floating rate of interest simply means that the rate of interest is variable. Periodically the interest rate payable for the next period is set with reference to a benchmark market rate agreed upon by both the lender and the borrower. The benchmark market rate is the State Bank of India Prime Lending Rate in domestic markets and LIBOR or US Treasury Bill Rate in the overseas markets.

Inflation linked bonds : A bond is considered indexed for inflation if the payments on the instrument are indexed by reference to the change in the value of a general price or wage index over the term of the instrument. The options are that either the interest payments are adjusted for inflation or the principal repayment or both.

Money Market Activities

Call money : Call/Notice money is an amount borrowed or lent on demand for a very short period. If the period is more than one day and upto 14 days it is called 'Notice money' otherwise the amount is known as Call money'. No collateral security is required to cover these transactions. The call market enables the banks and institutions to even out their day to day deficits and surpluses of money. Commercial banks, Co-operative Banks and primary dealers are allowed to borrow and lend in this market for adjusting their cash reserve requirements.

Treasury Bills : In the short term, the lowest risk category instruments are the treasury bills. RBI issues these at a prefixed day and a fixed amount. These include 91-day Tbills, 182-Day Tbills, and 364-day Tbills.

A considerable part of the government's borrowings happen through Tbills of various maturities. Based on the bids received at the auctions, RBI decides the cut off yield and accepts all bids below this yield.

The usual investors in these instruments are banks who invest not only to part their short-term surpluses. These Tbills, which are issued at a discount, can be traded in the market. The transaction cost on Tbills is non-existent and trading is considerably high in each bill, immediately after its issue and immediately before its redemption.

Term Money Market : Inter bank market for deposits of maturity beyond 14 days and upto three months is referred to as the term money market.

Certificates of Deposits : After treasury bills, the next lowest risk category investment option is the certificate of deposit (CD) issued by banks and Financial Institutions. Allowed in 1989, a CD is a negotiable promissory note, secure and short term in nature i.e. upto one year. A CD is issued at a discount to the face value. The discount rate is negotiated between the issuer and the investor.

CDs are issued by banks and FIs mainly to augment funds by attracting deposits from corporates, high net worth individuals, trusts, etc. The foreign and private banks, especially, which do not have large branch networks and hence lower deposit base use this instrument to raise funds.

Commercial Papers : CPs are negotiable short-term unsecured promissory notes with fixed maturities, issued by well rated companies generally sold on discount basis. Companies can issue CPs either directly to the investors or through banks / merchant banks (called dealers). These are basically instruments evidencing the liability of the issuer to pay the holder in due course a fixed amount i.e. face value of the instrument, on the specified due date. These are issued for a fixed period of time at a discount to the face value and mature at par.

Inter-Corporate Deposits : Apart from CPs, corporates have access to another market called the inter corporate deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. This market allows funds surplus corporates to lend to other corporates. As the cost of funds for a corporate is much higher than a bank, the rates in this market remain higher than those in the other markets. As ICDs are unsecured, the risk inherent is high.

Commercial Bills : Bills of exchange are negotiable instruments drawn by the seller of the goods on the buyer of the goods for the value of the goods delivered. These bills are called trade bills. These trade bills are called commercial bills when they are accepted by commercial banks.

II. INVESTORS IN DEBT MARKET

Investors are the entities who invest in such fixed income instruments. The investors in such instruments are generally Banks, Financial Institutions, Mutual Funds, Insurance companies, Provident Funds etc. The individual investors invest to a great extent in Fixed Income products.

Banks : Collectively, all the banks put together are the largest investors in the debt market. They invest in all instruments ranging from T-Bills, CPs and CDs to GOISECs, private sector debentures etc. Banks lend to corporate sector directly by way of loans and advances and also invest in debentures issued by the private corporate sector and in PSU bonds.

Insurance Companies : The second largest category of investors in the debt market are the insurance companies.

Provident funds : Provident funds are estimated to be the third largest investors in the debt market. Investment guidelines for provident funds are being progressively liberalized and investment in private sector debentures is one step in this direction.

Most of the provident funds are very safety oriented and tend to give much more weightage to investment in government securities although they have been considerable investors in PSU bonds as well as state government backed issues.

Mutual funds : Mutual funds represent an extremely important category of investors. World over, they have almost surpassed banks as the largest direct collector of primary savings from retail investors and therefore as investors in the wholesale debt market. Mutual funds include the Unit Trust of India, the mutual funds set up by nationalized banks and insurance companies as well as the private sector mutual funds set up by corporates and overseas mutual fund companies.

Trusts : Trusts include religious and charitable trusts as well as statutory trusts formed by the government and quasi government bodies. Religious trusts and Charitable trusts range from the very small ones to large ones. There are very few instruments in which trusts are allowed to invest. Most of the trusts invest in CDs of banks and bonds of financial institutions and units of Unit Trust of India.

Corporate Treasuries : Corporate treasuries have become prominent investors only in the last few years. Treasuries could be either those of the public sector units or private sector companies or any other government bodies or agencies.

The treasuries of PSUs as well as the governmental bodies are allowed to invest in papers issued by DFIs and banks as well as GOISECs of various maturities. However the orientation of the investments is mostly in short-term instruments or sometimes in extremely liquid long term instruments which can be sold immediately in the markets.

In complete contrast to public sector treasuries, those in the private sector invest in CDs of banks and CPs of other private sector companies, GOISECs as well as debentures of other private sector companies. Of late, preference shares of DFIs and open-ended mutual funds have also become popular with these treasuries.

Foreign Institutional Investors : India does not allow capital account convertibility either to overseas investors or to domestic residents. Registered FIIs are an exception to this rule. More than 300 FIIs invest in Indian equities while the number of FIIs investing in Indian domestic debt is less than 20. FIIs have to be specifically and separately approved by SEBI for equity and debt. Each debt FII is allocated a limit every year up to which it can invest in

Indian debt securities. They are also free to disinvest any of their holdings, at any point of time, without prior permission.

Retail Investors : Since January 2002, retail investors have been permitted to submit non-competitive bids at primary auction through any bank or PD.

III. DEBT MARKET INTERMEDIARIES/PARTICIPANTS

Primary Dealers : Primary dealers (PDs) are important intermediaries in the government securities markets. There were 18 PDs operating in the market at the end of August 2007. They act as underwriters in the primary market, and as market makers in the secondary market. PDs underwrite a portion of the issue of government security that is floated for a pre¬determined amount. The underwriting commitment of each PD is broadly decided on the basis of its size in terms of its net owned funds, its holding strength, the committed amount of bids and the volume of turnover in securities.

Brokers : Brokers play an important role in secondary debt market by bringing together counterparties and negotiating terms of the trade. It is through them that the trades are entered on the stock exchanges. The brokers are regulated by the stock exchanges and also by the SEBI.

IV. DEBT MARKET IN INDIA – REGULATORY FRAMEWORK

The Union government and the State Governments have been empowered under Articles 292 and 293 of the Constitution of India to borrow money upon the security of the Consolidated Fund of India and the States within permissible limits. The Constitution also empowers the Union and the State Governments to give guarantees within such limits as may be fixed. The Union Government debt consists of three components,—internal debt, external debt and “other liabilities”. Similar debt structure exists in case of State Government also, except for external debt component as States are not supposed to borrow directly from foreign countries/ sources. This system of classification in three components has been adopted by the Ministry of Finance, Government of India, for statistical reporting purposes in line with SDDS (Special Data Dissemination Standard) of IMF.

Internal debt and external debt constitute the public debt of the Union Government and are secured under the Consolidated Fund of India. On the other hand, “other liabilities” of the Union Government form part of the Public Account of India. The Indian Constitution under Article 292 provides for placing a limit on the public debt secured under the Consolidated Fund of India. This does not include “other liabilities” covered in the “Public Account”. There is also a similar position under Article 293 of the Indian Constitution with respect to borrowing by the States, wherein the State legislatures have powers to fix limits.

The Reserve Bank of India manages the public debt and issues new loans on behalf of the Union and the State Governments under the powers derived from the Reserve Bank of India Act. It also undertakes cash and liquidity management for the Government of India and State Governments and administers the scheme of Ways and Means Advances.

Internal Debt Management Department of the RBI manages internal debt. This involves auctioning the Government debt from time to time, introduction of new instruments, smoothening the maturity structure of debt, placing of debt at market related rates and improving depth and liquidity of Government securities by developing active secondary market for them. The Public Debt Act, 1944 governs Government debt market. This legislation is proposed to be replaced by a new Government Securities Act in the near future.

Internal debt of the Union Government includes Market Loans, Special Securities issued to RBI and others, Gold Bonds, Compensation, Relief and other bonds, Treasury Bills of different maturities issued to the RBI, State Governments, commercial banks and other parties, WMA, Securities issued to International Financial Institutions, Marketable Securities and Special Union Government Securities issued against small savings. The internal debt is classified into market loans, other long and medium term borrowings and short-term borrowings and shown in the receipt budget of the Union Government.

External debt of the Union Government comprises both long-term and short-term debt consisting of multilateral and bilateral borrowings of Government, borrowings from IMF, etc.

The liabilities other than internal and external debt include other interest and non-interest bearing obligations of the Government such as Post Office Savings Deposits, deposits under small savings schemes, loans raised through Post Office cash certificates, Provident Funds, interest and non-interest bearing reserve funds of departments like Railways, Telecommunications and others and other deposits and advances, both interest and non-interest bearing.

The “other liabilities” of governments arise in government accounts more in the capacity as a banker rather than as a borrower. Hence, such borrowings are shown as part of Public Account and are not secured under the consolidated fund.

The Reserve Bank of India is, therefore, the main regulator for the Money Market. Reserve Bank of India also controls and regulates the G-Secs Market. Apart from its role as a regulator, it has to simultaneously fulfill several other important objectives viz. managing the borrowing program of the Government of India, controlling inflation, ensuring adequate credit at reasonable costs to various sectors of the economy, managing the foreign exchange reserves of the country and ensuring a stable currency environment.

RBI controls the issuance of new banking licenses to banks; the manner in which various scheduled banks raise money from depositors; and deployment of money through its policies on CRR, SLR, priority sector lending, export refinancing, guidelines on investment assets etc.

Another major area under the control of the RBI is the interest rate policy. Earlier, it used to strictly control interest rates through a directed system of interest rates. Each type of lending activity was supposed to be carried out at a pre-specified interest rate. Over the years RBI has moved slowly towards a regime of market determined controls. RBI provides negotiated dealing system which is an electronic platform for facilitating dealing in Government Securities and money market instruments.

The Securities and Exchange Board of India (SEBI) controls bond market and corporate debt market in cases where entities raise money from public

through public issues.
It regulates the manner in which such moneys are raised and ensure a fair play for the retail investor. The issuers are required to make the retail investor aware, of the risks inherent in the investment, by way of disclosure. Being regulator for the Mutual Funds in India SEBI regulates the entry of new mutual funds in the industry and also the instruments in which mutual funds can invest.
Apart from the two main regulators, the RBI and SEBI, there are several other regulators specific for different classes of investors. The Central Provident Fund Commissioner and the Ministry of Labour regulate the Provident Funds. Religious and Charitable trusts are regulated by some of the State governments of the states, in which these trusts are located.
Co-ordination between RBI and Securities and Exchange Board of India (SEBI) is ensured both at policy level and at operational level. In particular, at policy level, coordination is ensured through a High Level Committee on Capital Markets (HLCC) presided by Governor - RBI, and consisting of Chairman - SEBI, Chairman - Insurance Regulatory and Development Authority (IRDA) and Finance Secretary, Government of India. The Deputy Governor of RBI is on the Board of Directors of SEBI. Further, the Standing RBI – SEBI Technical Committee consisting of officials from RBI and SEBI assists the HLCC at operational level.

V. CHRONOLOGICAL DEVELOPMENTS IN CORPORATE BONDS AND SECURITIZATION MARKETS*

In December 2005, the High Level Expert Committee on Corporate Bonds and Securitization submits its report giving a plethora of recommendations for the development of the corporate bond and securitization markets in India. The Government had set up this committee to look into legal, regulatory, tax and market design issues in the development of the corporate bond and securitization markets. Implementation of the recommendations warrants coordinated action by Government, Reserve Bank of India(RBI) and Securities Exchange Board of India,(SEBI).
In February 2006, Finance Minister in his Budget speech of 2006-7 announces that the Government has accepted the recommendations of the Report of the High Level Expert Committee on Corporate Bonds and Securitization and that steps would be taken to create a single, unified exchange traded market for corporate bonds.
In March 2006, Chairman, SEBI constitutes an internal Committee to prepare an action plan for the purpose of implementation of the Budget proposals on development of the corporate bond market in India.
In May 2006, the SEBI internal Committee submits its report giving a broad plan for implementation of the budget proposals on development of the corporate bond market in India.
In May 2006, a copy of the report of the SEBI internal Committee is forwarded to RBI for their perusal and comments.
In May 2006, in its Annual Policy Statement for the year 2006-07, RBI announces constitution of a Working Group to examine the relevant recommendations of the High Level Expert Committee, having a bearing on

Reserve Bank's responsibilities in regard to development of the corporate debt market to suggest a roadmap for implementation.

In July 2006, RBI's "Working Group to examine recommendations of High Level Expert Committee on Corporate Bonds and Securitization involving RBI and suggest a roadmap for implementation" submits its Report.

In December 2006, Government issues clarifications on regulatory jurisdiction over corporate bond market as the confusion over the same was attributed to be a reason for slow progress in implementation of the High Level Expert Committee's recommendations on corporate bonds and securitization. After hearing the views of RBI and SEBI and perusing the provisions in SCRA, SEBI Act and the RBI Act, Finance Minister desired that the necessary clarifications may be provided to RBI and SEBI so that they could implement expeditiously the announcement in the Budget that steps would be taken to create a single, unified exchange traded market for corporate bonds.

In December 2006, SEBI permits BSE to set up a reporting platform from January 1, 2007 to capture all information related to trading in corporate bonds as accurately and as close to execution as possible. SEBI also announces its intention to permit recognized stock exchanges having nationwide access to set up corporate bond trading platform to enable efficient price discovery and reliable clearing and settlement in a gradual manner. The access to the platform for the purpose of reporting was given to all market intermediaries. Non-members of the Exchange were provided connectivity through Virtual Private Network (VPN).

In January 2007, Government discusses the relevant issues of regulatory jurisdiction and market design further and decides as under:

a. **Clarity on the agency responsible for different segments of the corporate debt market**
    i. SEBI will be responsible for primary market (public issues as well as private placement by listed companies) for corporate debt;
    ii. RBI will be responsible for the market for repo/reverse repo transactions in corporate debt. However. If it is traded on exchanges, trading and settlement procedure would be determined by SEBI.
    iii. SEBI will be responsible for the secondary market (OTC as well as Exchange) for the corporate debt;
    iv. The above framework would apply irrespective of the parties (bank or non bank involved in a transaction;
    v. The views in respect of trading of unlisted securities and derivatives on corporate debt (other than repo/reverse repo) would be taken as and when the need arises.

b. **The market design for the secondary market of corporate debt market**
    i. OTC as well as exchange based transactions need to be reported to reporting platforms(s);
    ii. All the eligible and willing national stock exchanges need to be allowed to set up and maintain reporting platforms if they approach SEBI for the same. SEBI needs to coordinate among such reporting platforms and assign the job of coordination to a third agency;
    iii. The trades executed on or reported to an Exchange need not be

reported to a reporting platform;

iv. The participants must have a choice of platform. They may trade on OTC or any exchange trading platform;
v. Existing exchanges could be used for trading of corporate debts. NSE and BSE could provide trading platforms for this purpose. There is no need to create a separate infrastructure;
vi. There would be no separate trading platforms for different kinds of investors. Institutional and retail investors would trade on the same platform;
vii. Only brokers would have access to trading platform of an Exchange. Banks would have the option of becoming a broker or trading through a broker. RBI, may if considered necessary restrict a bank to trade only on proprietary account as a broker.

In January 2007, BSE operationalises its reporting platform to capture information related to trading in corporate bond market.

In March 2007, SEBI permits NSE also to set up and maintain a reporting platform on the lines of BSE. It is also decided that BSE and NSE shall coordinate among themselves to ensure that the information reported with BSE and NSE is aggregated, checked for redundancy and disseminated on their websites in a homogenous manner. As an integral part of development of a data base the two exchanges were advised to provide data pertaining to corporate bonds comprising, issuer name, maturity date, current coupon, last price traded, last amount traded, last yield (annualized) traded, weighted average yield price, total amount traded and the rating of the bond and any other additional information as the stock exchanges think fit.

In March 2007, the Fixed Income Money Market and Derivatives Association of India (FIMMDA) proposes to set up a reporting platform for corporate bonds and also provide value added dissemination of information on corporate bonds as in the case of government securities. SEBI decides that till such time that FIMMDA sets up such a platform, it shall disseminate information made available on bond trading by the two exchanges with appropriate value addition.

In March 2007, SEBI rationalizes the provisions of continuous disclosures made by issuers who have listed their debt securities and not their equity shares on the stock exchanges.

In March 2007, NSE operationalises its reporting platform for corporate bonds and starts disseminating information as desired by SEBI.

In April 2007, SEBI permits both BSE and NSE to have in place corporate bond trading platforms to enable efficient price discovery and reliable clearing and settlement facility in a gradual manner. To begin with, the trade matching platform shall be order driven with essential features of OTC market. It is also announced that eventually a system of anonymous order matching shall be established. BSE and NSE were advised to make use of the existing infrastructure available with them for operating the trade matching platforms for corporate bonds with necessary modifications. The exchanges were also advised that on stabilization of the trade matching system, they may move to an anonymous order matching system for trading of bonds within an appropriate period of time. Accordingly. both the exchanges will indicate to SEBI an expected date on which they could move to anonymous order matching system for trading in corporate bonds. With the introduction of anonymous order matching platform, the clearing and settlement facility shall be provided by BSE and NSE with a multilateral netting facility for trades executed on the platform. It is also simultaneously decided that orders executed through trading platforms of either BSE or NSE shall not be required to be reported again on the reporting platforms.

In April 2007, SEBI while permitting both the exchanges viz. BSE and NSE to set up trading platforms advises them that the stock exchanges may provide their services for clearing and settlement of corporate bonds traded or the entities trading in listed corporate debt securities may settle their trades bilaterally.

In April 2007, SEBI decides to reduce the shut period in corporate bonds to align it with that applicable for Government Securities.

In April 2007, SEBI decides to reduce tradable lots in corporate bonds in respect of all entities including Qualified Institutional Investors to Rs.1 lakh and advises exchanges to have a limited segment for transactions in similar market lots.

In April 2007, SEBI decides to make it mandatory for all new issues of corporate bonds to have an actual day count convention similar to that followed in respect of dated Government Securities.

In April 2007, SEBI makes amendments to the listing agreement for debentures to ensure that services of ECS (Electronic Clearing Service), Direct Credit, RTGS (Real Time Gross Settlement) or NEFT (National Electronic Funds Transfer), are used for payment of interest and redemption amounts as per applicable norms of the RBI along with other existing facilities.

In April 2007, SEBI makes amendment to the listing agreement for debentures to ensure that no material modification shall be made to the structure of the debentures issued in terms of coupon, conversion, redemption or otherwise without prior approval of the stock exchanges where they are listed. The stock exchanges shall also ensure that such information relating to modification or proposed modification is disseminated on the exchange website.

In June 2007, SEBI puts up Draft Regulations for “Public Offer and Listing of Securitized Debt Instruments” on its website for public comments. SEBI Draft Regulations provide for a system of special purpose distinct entities which could offer securitized debt instruments to the public or could seek listing of such instruments. The Draft document also elaborates on the permissible structure for the special purpose distinct entity, conditions for their assignment of debt or receivables from any originator, procedure for launching of schemes, obligation to redeem securitized debt instruments, credit enhancement and liquidity facilities which could be availed by the entity, conditions for appointing servicers, procedure to be followed for public offer of securitized debt instruments, their listing, rights of investors, inspection and disciplinary proceedings and action in case of default.

In July 2007, BSE and NSE trading platforms become operational. Initially,

trade matching platforms at BSE and NSE are order driven with the essential features of OTC market.
In August 2007, SEBI starts placing information on secondary market trades (both exchange and OTC trades)on its website on the basis of data provided by the two Exchanges.
In August 2007, SEBI makes it mandatory that the companies issuing debentures and the respective debenture trustees/stock exchanges shall disseminate all information regarding the debentures to the investors and the general public by issuing a press release and also displaying the details on their respective websites, in the event of:

i. Default by issuer company to pay interest on debentures or redemption amount;
ii. Failure to create a charge on the assets;
iii. Revision of rating assigned to the debentures.

In August 2007, SEBI makes it mandatory to make public, information/reports on debentures issued including compliance reports filed by the companies and the debenture trustees by placing them on websites of the companies and the debenture trustees. The same is also required to be submitted to the stock exchanges for dissemination through their websites.
In August 2007, SEBI grants approval to FIMMDA for starting Corporate Bond Trade Reporting Platform.
In September 2007, FIMMDA reporting platform becomes operational as the third reporting platform after BSE and NSE. Accordingly, for reporting of OTC trades the concerned parties could opt to report their trades on any one of the three reporting platforms.
In September 2007, SEBI advises BSE and NSE to confirm their preparedness for going in for introduction of repos in corporate bonds so that it could request RBI to issue appropriate guidelines for the purpose as suggested by the High Level Expert Committee on Bonds and Securitization.
As at end September, 2007 as per information collected from BSE and NSE, primary issuances by corporates in the form of private placement during the current fiscal stood at Rs. 68,457 crore whereas secondary market trades (both OTC and exchanges) stood at Rs.41,925 crore. Private placement also includes issuances by Public Financial Institutions and NBFCs under Section 67(3) of the Companies Act, which provides exemption from restricting the issue to less than 50 investors, these issues thus being “deemed public issues”.
In October 2007, SEBI obtains confirmations from BSE and NSE on their preparedness for introduction of repos in corporate bonds. Since repos in corporate bonds falls under the regulatory purview of RBI, SEBI has requested RBI to initiate action as required.
In November 2007, letters indicating no objection have been issued by SEBI to entities which have approached SEBI for setting up of electronic systems to facilitate price discovery and bringing about transparency into corporate bond trading. The systems will help display of buy sell quotes of counter parties involved so that the buyers and the sellers in the corporate bond market could strike deals at best prices before they go in for order matching either at the

exchange or bilaterally.

In December 2007, SEBI vide circular dated December 03, 2007 amends the provisions pertaining to issuances of Corporate Bonds under the SEBI (Disclosure and Investor Protection) (DIP) Guidelines, 2000. The Changes to the Guidelines are as below:

a. For public/rights issues of debt instruments, issuers now need to obtain rating from only one credit rating agency instead of from two. This is with a view to reduce the cost of issuances.
b. In order to facilitate issuance of below investment grade bonds to suit the risk/return appetite of investors, the stipulation that debt instruments issued through public/rights issues shall be of at least investment grade has been removed.
c. Further, in order to afford issuers with desired flexibility in structuring of debt instruments, structural restrictions such as those on maturity, put/call option, on conversion, etc have been done away with.

“In January 2008, SEBI framed the Draft Regulations on Issue and Listing of Debt Securities and the same is placed on the website along with a consultative paper for Public Comments. Salient features of the draft regulations include rationalization of disclosure requirements, enhanced responsibilities of merchant bankers for exercising due diligence and mandatory listing of private placement of debt issued as per exemption under S.67(3) of the Companies Act. The paper also makes provisions for e-issuances of corporate debt and proposes introduction of rationalized listing requirements for debt of a listed issuer.”

“During the fiscal year from April to December, 2007 secondary market trades (both OTC and exchanges) stood at Rs. 69,018 crore whereas primary issuances by corporate in the form of private placement during the same period stood at Rs. 93,989 crore as per information collected from BSE and NSE. The data for Private placement also includes issuances pursuant to offers made to 50 persons or more under exemption provided to certain issuers under S.67(3) of the Companies Act.”

Thus, the role of a healthy corporate debt market as a channel that links society’s savings into investment opportunities is of vital importance for several reasons. For the issuer, it provides low cost funds. For the investor, there exists a yield premium opportunity in comparison to traditional deposits at banking institutions and increases the investment opportunities in different type of instruments. The basic philosophy of developing a diversified financial system with banks and non-banks operating in equity market and debt market is indeed that it enhances risk pooling and risk sharing opportunities for investors and borrowers.

In many countries, debt market is larger than equity markets. In fact, in matured economies debt market is three times the size of the equity market. Investment in equity being riskier, certain class of investors choose to invest in debt, based on their risk appetite and liquidity requirements. A vibrant debt market thus enables investors to shuffle, reshuffle their portfolio depending upon the expected changes. Debt market, in particular, provides financial resources for the development of infrastructure. Hence, a well functioning

debt market becomes significant for all the market participants.
The debt market in India reforms aims at among other things, making available an active secondary market for operation of monetary policy through indirect instruments like Open Market for operations and repos. They can also be viewed as a systematic exercise for the development of the debt market as well as integration of financial market by making it deep, wide and transparent.
It appears that the Indian debt market, and the Government securities market in particular, is at a turning point on account of the various reforms and changes that are taking place in the system. The reforms have been linked to the operational autonomy of the RBI. Stabilization of the monetary policy was the aim. In 1997 there was the abolition of the automatic monetization through the issue of ad-hoc treasury bills. This system was replaced by Ways and Means Advances facility, within limits, to meet temporary cash flow mismatches for the Central Government.
The effect of the reforms over the years shows the complexity and difficulty that is intrinsic to the development of an efficient debt market. The development is not made by the regulator alone. It requires collaboration between the regulator and the market players. It also requires consultation between the two. In India, associations like Fixed Income Money Market and Derivatives Association of India (FIMMD) and Primary Dealers Association of India (PDAI) have helped this process well. There is also in existence an active Public Debt system wherein Primary Dealers have acted as a linking mechanism between the market and the Regulator. The heterogeneity of the market participants, some of whom have brought in to the Indian market the best international technology, risk management practices, know-how of the instruments, especially derivatives has also helped greatly.
Last but not the least the compliances emerged as a pre requisite for healthy development of debt market. Participants must therefore develop compliance management system. To do this they need to have designated compliance professional with specific and individual responsibility for compliance. The compliance management team should have access to the top management and periodically report the status of compliances with top management of the firm.

LESSON ROUND-UP

- Debt markets are markets for the issuance, trading and settlement in fixed income securities of various types and features. Fixed income securities can be issued by almost any legal entity like central and state governments, public bodies, statutory corporations, banks and institutions and corporate bodies.
- The debt market in India comprises mainly of two segments viz., the Government securities market consisting of Central and State Governments securities, Zero Coupon Bonds (ZCBs), Floating Rate Bonds (FRBs), T-Bills and the corporate securities market consisting of FI bonds, PSU bonds, and Debentures/Corporate bonds.
- Investors in debt market are the entities who invest in such fixed income instruments. The investors in such instruments are generally Banks,

Financial Institutions, Mutual Funds, Insurance companies, Provident Funds etc.

- Primary dealers (PDs) act as underwriters in the primary market, and as market makers in the secondary market. PDs underwrite a portion of the issue of government security that is floated for a pre¬determined amount.
- Brokers play an important role in secondary debt market by bringing together counterparties and negotiating terms of the trade. It is through them that the trades are entered on the stock exchanges.
- The Reserve Bank of India is, therefore, the main regulator for the Money Market. Reserve Bank of India also controls and regulates the G-Secs Market.The Securities and Exchange Board of India (SEBI) controls bond market and corporate debt market in cases where entities raise money from public through public issues.Apart from the two main regulators, the RBI and SEBI, there are several other regulators specific for different classes of investors. The Central Provident Fund Commissioner and the Ministry of Labour regulate the Provident Funds. Religious and Charitable trusts are regulated by some of the State governments of the states, in which these trusts are located.

FOOTNOTES

* reproduced from SEBI website.