Development of Bond Market in India

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Introduction

Bond markets link issuers, i.e., governments, state owned institutions, local bodies and corporates having financing needs, with investors having investible surplus. An efficient bond market is one where the requirements of both issuers and investors are met effectively at a price (interest rates) determined competitively, and where price adjustment to new information is seamless. For this purpose, the basic pre-requisites are: stable macro-economic environment, absence or minimal presence of administered rates, a wide issuer and investor base (which ensures adequate size and activity in the market), intermediaries, infrastructure for smooth and safe trading and settlement of trades, and an enabling regulatory and legal environment.

Government bond markets play an important role insofar as they provide the benchmark yield curve, on the basis of which most other debt instruments are priced. This paper presents the development of the bond markets in India. I will also briefly deal with the corporate debt market.

An Overview of Debt Market in India

There are three main segments of debt market in India, viz., Government securities, Public Sector Units (PSU) bonds and private sector corporate bonds.

India being a federal state, Government securities are issued by Central Government and all the provincial Governments (India has 28 states), although in case of the latter such securities constitute a relatively small portion of their fiscal deficits. In India, banks are required to maintain statutorily a certain percentage of their liabilities in Government securities and other specified liquid assets which creates a captive demand for Government securities. At present, the Statutory Liquidity Ratio (SLR) for banks is 25 per cent. Similar statutory requirements in varying degrees are there for other type of financial institutions, viz., insurance companies, provident funds, non-banking financial institutions etc.

The PSU bonds are generally treated as surrogates of sovereign paper, sometimes due to explicit guarantee of Government, and often due to the comfort of public ownership. Some of the PSU bonds are tax free, a status not enjoyed even by Government securities.

Corporate bonds and debentures have maturities beyond 1 year and generally up to 10 years. Corporates also issue short-term commercial paper with maturity ranging from 15 days to one year.

The matrix of issuers, investors, instruments in the debt market and their maturities are presented in Table 1.

Table 1: Participants and Products in Debt market

Issuer	Instrument	Maturity	Major Investors
Central Government	Dated Securities Treasury Bills	2-30 years 91/364 days	RBI, Banks, Insurance Companies, Provident Funds, Mutual Funds, PDs, Individuals
State Government	Dated Securities	5-10 years	Banks, Insurance Companies, Provident Funds
PSUs (Centre and	Bonds	5-10 years	Banks, Insurance

States)			Companies, Corporate, Provident Funds, Mutual Funds, Individuals
Corporates	Bonds and Debentures Commercial Paper	1-12 years 15 days to1 year	Banks, Mutual Funds, Corporates, Individuals
PDs	Commercial Paper	15 days to1 year	Banks, Corporate, Financial Institutions, Mutual Funds, Individuals
Banks	Bonds issued for Tier II capital Certificates of Deposit,	minimum 5 years 3 months to 1 year	Banks, Corporates

Size of Debt Market

In India, Government securities market is the overwhelming part of the overall debt market, in terms of both outstanding securities, and trading volumes. The total outstanding debt amounts to Rs.8,500 billion[*] and forms 37% of GDP. Of this, Central Government dated securities as on March 31, 2002 amounted to Rs.5,363 billion (23 per cent of GDP) and that of State governments to Rs.1,040 billion (4.5 per cent of GDP). According to informed estimates, PSU Bonds/Private Corporate bonds amount to about Rs.2,000 billion (9 per cent of GDP). Thus, nearly three-fourth of debt instruments is accounted for by Government. Incidentally, the present market capitalization of corporate equities is placed at Rs. 6,300 billion[#]. Of the PSU/ Corporate debt estimated at Rs. 2,000 billion, about 30 per cent is listed on stock exchanges and about 30 per cent held by banks. During 2001-02, the Central Government raised gross market borrowings of Rs.1,142 billion (4.9 per cent of GDP) through marketable dated securities, while State Governments raised Rs.187 billion.

Table 2: Resources Raised from Debt Markets
(Excluding Treasury Bills)

(Rs. billion)

Issuer	1999-00	2000-01	2001-02
Corporate	658	711	710
Public Issues	45	33	61
Private Placement*	613	678	649
Government	1,133	1,285	1,329
Total (as % to GDP)	1,791 (9.3)	1,996 (9.6)	2039 (8.8)

* Includes equity issues of insignificant amount.

The dominance of the Government securities in the secondary market is even more as it accounts for more than 90% of the transactions. Average daily transaction volume in the secondary market for government securities during 2001-02 is about Rs.40 billion whereas that for corporate securities including PSUs is only about Rs. 2 to 4 billion. Among the government securities, a very large bulk of volume is accounted for by Central government securities. The turnover ratio (total transaction volume during the year as a multiple of outstanding stock) was about 2.7 for the year 2001-02, as compared with 1.6 in 2000-01 and 0.8 in 1995-96 (Table 3).

Table 3: Secondary Market Transactions in Central Government Securities

(Rs. Billion)

Year	Outright	Repo	Total	Percentage change over previous year	Outstanding (end March)	Turnover Ratio *
1995-96	176	928	1272		1640	0.8
1996-97	599	254	1229	-3	1841	0.7
1997-98	1185	208	1857	51	2166	0.9
1998-99	1431	381	2272	22	2854	0.8
1999-00	4053	757	5393	137	3559	1.5
2000-01	5091	1091	6981	29	4318	1.6
2001-02	11385	3359	14744	111	5363	2.7

*Transactions to Outstanding Volume

While the Reserve Bank of India (RBI) regulates the issuance of government securities, corporate debt securities fall under the regulatory purview of Securities and Exchange Board of India (SEBI). Coordination with Securities and Exchange Board of India (SEBI) is ensured both at a policy level and at operational level. In particular, at a policy level, coordination is ensured through a High Level Committee on Capital Markets 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 an operational level. Currently, amongst other things, RBI and SEBI are working together to devise a regulating mechanism for the issuers of private placements which will address issues of quality, transparency, end-use of funds and listing of such bonds.

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. All the 23 stock exchanges in the country provide facility for trading in corporate debt instruments. The bulk of the corporate bonds, being privately placed, are, however, not listed on 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/PDs and other financial institutions are maintained at the RBI[1].

Government Securities Market

Pre-Reform period Government Securities Market

In India, fiscal policy compulsions rendered internal debt management before 1991-92 passive. To keep government borrowing costs down, low coupon rates were offered on government securities, which made real rates of return negative for several years till the mid-1980s. During the 1980s, the volume of debt expanded considerably, particularly short-term debt, due to automatic accommodation to Central government by the Central Bank (RBI), through the mechanism of ad hoc Treasury Bills. With a captive investor base [through Statutory Liquidity Ratio (SLR) prescription, mostly] and interest below the market rate, secondary market for government bonds remained dormant. Artificial yields on government securities affected the yield structure of financial assets in the system, and led to higher lending rates. Driven by these compulsions, Reserve Bank's monetary management was dominated by a regime of administered interest rates, and rising Cash Reserve Ratio (CRR) and SLR prescriptions. High CRR and SLR left little room for monetary maneuvering. It is against this backdrop, and in the context of the overall economic reforms, that development of the government securities markets was initiated, in the 1990s.

Post-Reforms Developments

The development of government securities market reflects a transition from passive to active debt management by the RBI. The reforms undertaken by the Reserve Bank since 1990s can be briefly viewed as a systematic exercise for the development of the debt market as well as integration of the entire financial markets by making it deep, wide and transparent.

The reforms aimed at increasing the operational autonomy of the RBI by measures, such as, abolition of automatic monetization through ad-hoc Treasury Bills (in 1997) and its replacement by Ways and Means Advances facility, with limits, to meet temporary cash flow mismatches for the Central Government. The elimination of automatic monetisation was considered critical in the stabilization policy.

Secondly, government borrowing was made market based through the introduction of auction system in primary issues.

Thirdly, improvements in institutional infrastructure were sought to be achieved through the setting up of system of Primary Dealers.

Fourthly, the breadth and depth of markets were sought to be improved by introduction of a variety of new instruments viz., Zero Coupon Bonds, Capital Indexed Bonds, Floating Rate Bonds, Call and Put Option Bonds, etc. However, plain vanilla bonds remain the mainstay.

Fifthly, since April 1999, the Reserve Bank has been actively pursuing the consolidation of debt through reissuance/reopenings through price based auctions. This has greatly improved the market liquidity and helped the emergence of benchmark securities.

Sixthly, trading and settlement systems have been improved through introduction of Delivery-versus-Payment (DvP)[2] system and operationalisation of Negotiated Dealing System (NDS) and Clearing Corporation of India Ltd. (CCIL)[3].

Finally, a retail market in government securities is sought to be promoted through a system of non-competitive bidding at primary auctions.

Investor Base

Traditionally, the investor base for government securities in India has been banks, financial institutions, PFs, insurance and pension funds- commercial banks (at present 63.5 per cent) and LIC (18.3 per cent) being the largest holders (Table 4). Most of the holdings of these investors are in the nature of statutorily mandated investments. This category has been further diversified by the entry of co-operative banks, regional rural banks, mutual funds and non-banking finance companies in recent periods. In addition, the entry of 100% Gilt Mutual Funds has broadened the retail investor base. The thrust of policy initiatives in this direction is focused on developing the retail segment of the market. Towards this end, several initiatives have been taken.

Table 4- Ownership Pattern of Government Securities – Major Investors

(Per cent)

	1991	**1995**	**2001**
I. Reserve Bank of India	20.29	2.04	7.72
II. Commercial Banks	59.40	69.57	63.46
III. Life Insurance Corporation of India	12.27	16.19	18.25
IV. Employees Provident Fund (EPF) Scheme	1.21	0.73	2.36
V. Others *	6.84	11.46	8.21
Total	100.00	100.00	100.00

* Others include financial institutions, mutual funds, provident funds (other than EPF) and other insurance companies

In the primary market, to enable small and medium sized investors to participate in the primary auction of Government securities, a Scheme of Non Competitive Bidding has been introduced in January 2002. The Scheme is open to any person including firms, companies, corporate bodies, institutions, provident funds, trusts, and any other entity prescribed by RBI.

The scheme provides for allocation of up to 5 per cent of the notified amount at the weighted average rate of accepted bids. Investors can bid, through banks or PDs, a minimum of Rs.10,000 and maximum of Rs.10 million. To improve liquidity for retail investors in the secondary market, RBI has been encouraging banks/PDs to offer two-way prices to retail investors. A few PDs have already introduced Schemes for retail marketing of Government securities using the network of bank branches/Post offices. Another measure to promote retailing currently under consideration is a Scheme for screen based order-driven trading on the stock exchanges.

Instruments

Prior to the 1990s, most of the government bond issuance was in the form of plain vanilla, fixed coupon securities. For a market to meet the diverse funding and hedging needs of its participants, a wide array of instruments needs to be available. Through the 1990s, various types of instruments have been introduced, like zero coupon bonds, capital indexed bonds, floating rate bonds and bonds with call and put option. But, plain vanilla bonds remain the mainstay. The introduction of STRIPs is being envisaged. These instruments would serve the need of asset-liability management of participants.

Market Intermediaries

The system of Primary Dealers was introduced in 1996. The PDs underwrite as well as bid in auctions of primary issuances of government securities. They are also expected to provide two-way quotes in the secondary market, and thereby help develop the retail market. The Reserve Bank extends concessional finance to PDs. There are currently 18 PDs in operation. Of these, 9 are promoted by public sector banks and public financial institutions, 5 by foreign banks and 2 with the collaboration of foreign security houses and 2 by local non-banking finance companies (NBFCs). RBI has prescribed guidelines to improve the risk management system of PDs. The capital adequacy requirements of PDs take into account both credit risk and market risk. They are required to maintain a minimum capital of 15 per cent of aggregate risk weighted assets, including market risk capital (arrived at using the Value at Risk method). ALM discipline has been extended to PDs. Offsite surveillance of PDs is done on the basis of daily, monthly and quarterly returns. RBI is also vested with the responsibility of on-site inspection of primary dealers. A satellite dealer system was introduced in 1996 to act as a second tier to the Primary Dealers in developing the market. The system, which was in operation for more than six years, was discontinued effective May 2002, as it did not yield the desired results.

Measures to Deepen the Government Securities Markets

To cater to the differing requirements of investors, Reserve Bank has been issuing Government securities of varying tenors ranging up to 30 years. For most part of the 1990s, the maturity of Central government issuance ranged up to 10 years. This has led to redemption pressure and refinancing risk. This factor, as also the need to develop the yield curve for longer tenors, has necessitated elongation of maturity of government bond issuance. Thus, the weighted average maturity of bonds issued during a year, which was around 5.5 years in 1996-97, increased to 14.3 years in 2001-02. As a debt manager, Reserve Bank has the obligation of minimizing the cost of borrowing to the Government. Normally, with an upward sloping yield curve, longer the maturity of the security, higher is the cost; thus there is a trade-off between tenor of borrowing and its cost. However, the falling interest rate scenario in the last two years, has helped Reserve Bank to achieve the twin objectives of elongating the maturity profile of new debt, and reducing the cost of borrowing at the same time. The average cost of issuance of dated securities issued during 2001-02 has come down substantially to 9.44 per cent from 10.95 per cent in 2000-01 and 11.77 per cent in 1999-2000. The weighted average yield and weighted average maturity of the GOI dated securities issued during the current year so far works out to 7.53 per cent and 13.3 years, respectively (Table 5).

Table 5: Weighted Average Yield and Maturity for Market Loans of Government of India

(per cent/years)

Years	Range of YTMs at Primary Issues (%)			Weighted Average Yield (%)	Range of Maturity of New Loans	Weighted Average of Maturity(yrs)	Weighted Average Maturity of outstanding stock
	under 5 years	5-10 years	Over 10 Years				
1	2	3	4	5	6	7	8
1997-98	10.85-12.14	11.15-13.05	-	12.01	3-10	6.6	6.5
1998-99	11.40-11.68	11.10-12.25	12.25-12.60	11.86	2-20	7.7	6.3
1999-00	-	10.73-11.99	10.77-12.45	11.77	5-19	12.6	7.1
2000-01	9.47-10.95	9.88-11.69	10.47-11.70	10.95	2-20	10.6	7.5
2001-02	-	6.98-9.81	7.18-11.00	9.44	5-25	14.3	8.2
2002-03 April-October 9, 2002		6.65-8.14	6.84-8.62	7.53	7-30	13.7	8.6

With a view to improving fungibility amongst the securities and facilitate consolidation of debt, a policy of passive consolidation through reissuance/ reopenings was started in 1999. The larger stock size of securities in question has greatly improved market liquidity, and helped the emergence of benchmark securities in the market. Active consolidation - by merging debts - has not been resorted to so far, in view of administrative costs and legal considerations. The process of passive consolidation itself has helped in more or less containing the number of bonds to a level that was prevailing at the end of 1998-99. Of the 25 loans issued (excluding private placements) during 2001-02, 12 were new loans and the remaining were reissues of existing loans. This ability to 'reissue' or 'reopen' loans is limited by the maximum outstanding amount that is perceived as 'manageable' from the viewpoint of redemption in the year of maturity. However, the drop in yields and resultant steep premia, in many cases, deters 'buy and hold' investors from subscribing to existing securities. As at the end of March 2002, there are 111 Central Government securities with outstanding amount of Rs.5363 billion. Of these, 23 securities with minimum outstanding issues of Rs.100 billion or more account for 50 per cent of the total outstanding amount. The maturity profile of Government of India market loans is presented in Table 6.

Table 6: Maturity Profile of Market loans of Central Government

(Percent to total amount outstanding/ raised)

	Amount Outstanding At end-March			Raised During the Year		
Year	Under 5 Years	5-10 Years	Over 10 Years	Under 5 Years	5-10 Years	Over 10 Years

1996-97	45	29	26	50	50	-
1997-98	41	41	18	18	82	0
1998-99	41	42	16	18	68	14
1999-00	37	39	24	-	35	65
2000-01	27	47	26	6	41	53
2001-02	31	36	33	2	24	74

An additional source of demand for government securities has evolved with the introduction of Liquidity Adjustment Facility (LAF), fully collateralised against government securities. Repo and Reverse Repo operations between RBI and banks under LAF, have developed into the primary mechanism of managing short-term liquidity in the system (Repo for 1 day and 14 days, reverse repo for 1 day). The system is also used for maintaining orderly conditions in money market.

In respect of T-Bills, a pre-announced issuance calendar for auctions is being provided since 1998-99. Further, in an effort to provide further transparency and stability in the Government securities market as well as to enable institutional and retail investors to plan their investments in a better manner, Reserve Bank has started the practice of announcing a half-yearly calendars for issuance of Government of India dated securities in the current fiscal year 2002-03.

Developments in Market Infrastructure

Securities Settlement System: Settlement of government securities and funds is being done on a gross trade-by-trade Delivery vs. Payments (DvP) basis in the books of Reserve Bank, since 1995. A Special Funds Facility from Reserve Bank for securities settlement has also been in operation since October 2000 for breaking gridlock situations arising in the course of DvP settlement.

With the introduction of Clearing Corporation of India Ltd (CCIL) in February 2002, which acts as clearing house and a central counterparty, the problem of gridlock of settlements has been reduced. To enable Constituent Subsidiary General Ledger (CSGL) account holders to avail of the benefits of dematerialised holding through their bankers, detailed guidelines have been issued to ensure that entities providing custodial services for their constituents employ appropriate accounting practices and safekeeping procedures.

Negotiated Dealing System : A Negotiated Dealing System (NDS) (Phase I) has been operationalised effective from February 15, 2002. In Phase I, the NDS provides on line electronic bidding facility in primary auctions, daily LAF auctions, screen based electronic dealing and reporting of transactions in money market instruments, facilitates secondary market transactions in Government securities and dissemination of information on trades with minimal time lag. In addition, the NDS enables “paperless” settlement of transactions in government securities with electronic connectivity to CCIL and the DvP settlement system at the Public Debt Office through electronic SGL transfer form.

Clearing Corporation of India Limited : The Clearing Corporation of India Limited (CCIL) commenced its operations in clearing and settlement of transactions in Government securities (including repos) with effect from February 15, 2002. Acting as a central counterparty through novation, the CCIL provides guaranteed settlement and has in place risk management systems to limit settlement risk and operates a settlement guarantee fund backed by lines of credit from commercial banks. All repo transactions have to be necessarily put through the CCIL, while all outright transactions up to Rs.200 million have to be settled through CCIL (Transactions involving larger amounts are settled directly in RBI).

Transparency and Data Dissemination

To enable both institutional and retail investors to plan their investments better and also to providing further transparency and stability in the Government securities market, an indicative calendar for issuance of dated securities has been introduced in 2002. To improve the information flow to the market Reserve Bank announces auction results on the day of auction itself and all transactions settled through SGL accounts are released on the same day by way of press releases/on RBI website. Statistical information relating to both primary and secondary market for Government securities is disseminated at regular interval to ensure transparency of debt management operations as well as of secondary market activity. This is done through either press releases or Bank's publications viz., (e.g., RBI monthly Bulletin, Weekly Statistical Supplement, Handbook of Statistics on Indian Economy, Report on Currency and Finance and Annual Report).

The Reserve Bank is the initial signatory of Special Data Dissemination Standards of IMF and places substantial information and statistics on its website. The data on trades negotiated/reported on NDS will also be available shortly on RBI's website.

Corporate Bond Markets

The Reserve Bank's role in the development of corporate bond markets is indirect and is governed by its interest in monetary policy transmission and in the stability and efficiency of the financial sector as a whole. Besides, banks, whose financial health is the responsibility of the central bank, have a large exposure to the corporate bond market with more than 80 per cent of such investments being in privately placed corporate securities. Activity in the secondary market is thus rather thin. As the non-transparent practices in this market is a matter of concern, Reserve Bank issued guidelines in June 2001 specifying the due diligence to be undertaken, disclosures to be obtained and credit appraisal to be made by investing banks. Subsequently a Working Group set up by RBI (February 2002) went into the detailed disclosure norms and data collection measures on private placements. Currently, RBI and SEBI are working together to devise a regulating mechanism for the issuers of private placements which will address issues of quality, transparency, end-use of funds and listing of such bonds.

There is no comprehensive database source for outstanding stock of corporate debt issuance in India. An analysis of the flow data (issuances) in recent period indicates dominance of private placement (Table 7).

Table 7: Growth of Indian Corporate Debt Market - Issuances

(Rs. billion)

Year	Total Corporate Debt	Private Placement	Public Issues
1999-00	658	613 (93.2)	45 (6.8)
2000-01	711	678 (95.4)	33 (4.6)
2001-02	710	649 (91.4)	61 (8.6)

Figures in brackets indicate percentage share to Total.

The trends in the issuance pattern of privately placed debt during the last three years is presented in Table 8, which reveals the following trend-

i) The share of the private sector in total private placement market has been growing vis-à-vis the public sector.
ii) The share of financial entities, both public and private has come down partly because of the limit imposed on raising of Tier 2 capital by banks.
iii) Of late, there appears to be an increase in private placements by the private non-financial sector.

Table 8: Composition of the Private Placement Market

(Per cent to total)

Private Placement	**2001-02**	**2000-01**	**1999-2000**
1. Private Sector	44	34	32
a)Financial	24	20	18
b) Non-financial	20	14	14
2. Public Sector	56	66	68
a) Financial	27	39	29
b) Non-financial	29	27	39
3. Total (1+2)	**100**	**100**	**100**

A very large proportion of the debt being issued of late is being rated. In the year 2000-01, 80% of the debt (in volume terms) was rated, while the proportion of rated debt rose to 91% during 2001-02 (April-September). From the rating distribution, it emerges that more than half of the total issuance (52 to 53%) in this period is rated AAA, while another 15% is having a rating of AA+ in 2001-02 as against 2% in 2000-01, a pointer perhaps that a growing number of investors are beginning to factor the rating rationale as a key input into their investment decisions. Currently, about 75 per cent of privately placed corporate issuance is AA rated or better.

Until 1992, interest rate on corporate bond issuances was regulated and was uniform across credit categories. In the initial years, corporate bonds were issued with "sweeteners" in the form of debt-equity convertibility clause, or equity warrants. Most corporate bonds were plain coupon paying bonds, though a few variations in the form of zero coupon securities, deep discount bonds and secured promissory notes were issued. After the deregulation of interest rates on corporate bonds in 1992, a variety of instruments in the corporate bond markets have been introduced, including bond strips, floating rate instruments with floors and caps. In recent years, there has been an increase in issuance of corporate bonds with embedded put and call option.

Other aspects for development of corporate bond markets which are under consideration are- availability of information and transparency of the market, increased securitization and increased dematerialisation in corporate bonds and consideration of Repo for corporate bonds

Institutional Issues

Role of Self-Regulatory Organisations

In the context of Indian debt market, self-regulatory bodies like the Fixed Income Money Market and Derivatives Association of India (FIMMDA) and the Primary Dealers Association of India (PDAI) have been encouraged in the recent past, as part of reform process to give an impetus to the development of the bond and money markets in India. These bodies have served as crucial layers between the regulator and market and have contributed to developing new benchmarks and products besides providing training and development support to participants. They have formulated guidelines for dispute resolution mechanisms and are also involved in the process of developing standard practices and codes of conduct. Both PDAI and FIMMDA are represented in the Technical Advisory Committee (TAC) of the Reserve Bank of India meant for deliberating and advising RBI, on issues pertaining to Government Securities and Money Markets. TAC is constituted by Reserve Bank and includes, apart from RBI officials, important market participants, academicians and policy makers. FIMMDA is involved in the task of valuation of all Central Government Securities. The daily FIMMDA yield curve of Central Government bonds is fast emerging as an accepted benchmark to price securities. In addition to this, FIMMDA has also been contributing to developing guidelines for documentation of repo, securitised debt and several other debt market instruments.

Banks and Bond Markets

In India, the banking system which incidentally has been dominated by the public sector, played a pioneering role in initiating growth of mutual funds, merchant banking and other financial services. Structurally, banks have been permitted to operate through subsidiaries as asset management companies, PDs, merchant banks and mutual funds. The Development Financial Institutions also played a role but they dominated in promoting credit rating agencies, sponsoring national stock exchanges, depositories, etc. In regard to Government Securities segment of the market, which accounts for about 75 per cent of the stock, about 60 per cent of the stock is held by the banking system. As regards the corporate debt segment, both private placement and public issue, over half of the issuance is by banks and financial institutions.

Role of Credit Rating Agencies

In India, there are four Credit Rating Agencies (CRAs)[+] and each of them has collaboration with internationally renowned CRAs to supplement the local knowledge and skills. The RBI prescribes a number of regulatory uses of ratings. Of those related to the money and debt markets, a corporate must get an issue of Commercial Paper rated and may issue such paper subject to a minimum rating. Securities and Exchange Board of India (SEBI), which is the regulator of CRAs has stipulated that ratings are compulsory on all public issues of debentures with maturity exceeding 18 months. Pension funds can only invest in debt securities that have high ratings, as per the stipulations of Government.

Tax Regime and Debt Markets

The removal of tax deduction at source (TDS) on Government Securities resulted in ending the practice of voucher trading in the Government Securities market and thus removing pricing distortions in the market. The amendments to the Indian Stamp Act, 1899 have exempted debt instruments dealt in demat form from the applicability of stamp duty (Government Securities as such are exempted from the stamp duty). This encouraged demat holding/transactions in debt instruments, as also trading in debt instruments.

The recent amendments to Section 47 of the IT Act, facilitating securities lending and borrowing operations will ensure safe and smooth settlement through the recently established CCIL.

The recent notification issued by Central Board of Direct Taxes (CBDT), Government of India in bringing about rationalisation in the tax treatment for the deep discount bonds (where marked-to-market gains are to be reckoned for tax purpose), apart from removing the distortions will keep the market in readiness for the development of STRIPS in Government Securities and facilitate a zero coupon yield curve.

For the financial system as a whole, the Expert Committee to Review the System of Administered Interest Rates (2002) and other related Committees[4] have made certain recommendations on the tax regime, which if implemented would remove some distortions and ensure a level playing field among participants and instruments in the financial markets. These measures coupled with the decision to align the administered interest rates with market rates of interest should pave the way for significant improvement in the environment for debt markets.

Road Ahead for Indian Debt Markets

Debt management in India has clearly come a long way from a passive system to a market driven exercise with developed institutions, instruments and markets.

In terms of international benchmarks, India ranks on par with some of the developed countries in areas like institutional framework, risk management set-up, market development, clearing and settlement procedures and transparency in debt management operations

The artificially administered interest rate system of government securities market has transformed into a market determined one, and an inactive thin secondary market has grown into an actively traded and reasonably liquid market.

Settlement systems have already developed significantly. RBI is also working towards the development of a system for Real Time Gross Settlement (RTGS), which is expected to be operational in about a years' time.

Some of the major issues relating to Government debt need to be highlighted:

Firstly, separation of Government debt management from RBI has been, in principle, considered desirable. However, this would be dependent on the fulfilment of three pre-conditions, viz., development of financial markets, reasonable control over fiscal deficit and necessary legislative changes. The feasibility and further steps for separation of government debt management from Reserve Bank is proposed to be taken up once Fiscal Responsibility Bill (which is pending before Parliament) is enacted.

Secondly, measures to widen the base of the repo market including extending it to CSGL account holders, introduction of longer term repo, rollover of repos, taxation and standardised accounting are the major areas to be focussed in the near future.

Thirdly, the feasibility of a "When Issued" market for Government securities, which would help efficient price discovery in the primary auctions, is being examined.

Fourthly, operational modalities are being finalised for the introduction of STRIPS.

Fifthly, order driven screen based anonymous trading in government securities on the stock exchanges is under consideration.

Sixthly, dematerialised holding of all bonds, corporate as well as government bonds, is sought to be achieved.

Finally, the implementation of the next phase of the PDO-NDS project involving integration with security settlement system and primary markets operations, automation and inter-connectivity of PDOs, electronic maintenance of record of ownership, etc. is under way.

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[*] **Paper presented in the JSEPA Workshop on the Development of Bond Markets in Asia at Singapore held on October 17-18, 2002.**

[*] Exchange Rate at present is Rs. 48.33=1 US $

[#] Market capitalization at NSE, Mumbai. Market capitalization at BSE, Mumbai is also of the similar order. Generally most of the companies are listed on both the exchanges. The data on market capitalization excludes equities which are unlisted or are listed on other small exchanges.

1. Subsidiary General Ledger (SGL) Accounts are Government Securities Accounts in book form held with Reserve Bank of India by eligible entities like banks, financial institutions, PDs etc. The securities held by these

entities on behalf of constituents are reflected in Constituent SGL (CSGL) Accounts which are also held with RBI in a separate consolidated account of the concerned institution.

2. DvP introduced in 1995

3. NDS and CCIL Operationalized from February 15, 2002; Discussed later in detail

4. Report of the Advisory group on Tax Policy & Tax Administration for the Tenth Plan (May 2001); Planning Commission, Government of India

[+] ICRA Limited (formerly named as Investment Information and Credit Rating Agency),The Credit Rating Information Services of India Limited (CRISIL), Credit Analysis and Research Limited (CARE) and Duff and Phelps