Journal of Economics, Finance and Management Studies

ISSN(print): 2644-0490, ISSN(online): 2644-0504

Volume 4 Issue 04 April 2021

Article DOI: 10.47191/jefms/v4-i4-08, Impact Factor: 6.228

Page No : - 274-278

Indian Debt Market: Need for More Reforms

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ABSTRACT: The Indian debt market while made out of securities, both Government and Corporate, is really overwhelmed by G-Sec with more than 90 per cent of Indian debt market, leaving little space for corporate securities. The focal government securities are the dominating and most fluid segments of the security market. Nonetheless, regardless of the expanded volumes, the quantity of members is restricted to around two dozen dynamic players. The focal government securities are the dominating and most fluid segments of the security market. Nonetheless, regardless of the expanded volumes, the quantity of members is restricted to around two dozen dynamic players. Since a lion's share of members is AAA – evaluated and 80 per cent of exchange is immediate, there exist settlement hazards. The market would further develop once uniform guidelines on accounting, valuation and so on are in place. Therefore, this paper highlights the need for more reform in Indian debt market.

KEY WORD: debt market, securities, market risk, investors, bond, interest rate.

1.1 INTRODUCTION

The debt market assumes a vital part in the economy as it helps in activating, dispensing, estimating debt reserves, other than financing the formative exercises of the public authority. In that the Corporate Bond markets are vital components of the financial markets, particularly for a developing economy like India, they can act as effective buffers vis-à-vis bank financing in infrastructure and power projects [1]. The Indian debt market while made out of securities, both Government and Corporate, is really overwhelmed by G-Sec with more than 90 per cent of Indian debt market, leaving little space for corporate securities. The focal government securities are the dominating and most fluid segments of the security market. Nonetheless, regardless of the expanded volumes, the quantity of members is restricted to around two dozen dynamic players. Since a lion's share of members is AAA – evaluated and 80 per cent of exchange is immediate, there exist settlement hazards [2]. The market would further develop once uniform guidelines on accounting, valuation and so on are in place.

1.2 THE G-SEC MARKET

The Indian debt market and the government securities specifically, are at a defining moment in India with critical changes occurring in the domestic economic climate alongside different proposed administrative changes. Dr. Rakesh Mohan, Dy. Lead representative says the government securities market before the 1990s was portrayed by regulated interest rates, high SLR necessities that prompted the presence of captive investors and the shortfall of a liquid and transparent secondary market for G-Secs [3]. Moreover, low interest rates were obtainable on Government securities to remain Government borrowing costs downwards, which made real rates of return depressing for a number of years till the mid-1980s.

During the 1980s, the volume of Government debt extended significantly, especially short-term debt, because of programmed convenience to Central Government by the Reserve Bank, through the system of unplanned Treasury Bills. Nonetheless, with a captive investor base and low interest rates, the secondary market for Government securities stayed torpid. Counterfeit yields on Government securities influenced the yield design of financial assets in the framework, and prompted a general high interest rate climate in the rest of the market.

Driven by these impulses, the Reserve Bank's money related administration was portrayed by a system of directed interest rates, and rising Cash Reserve Ratio (CRR) and SLR remedies. High CRR and SLR generally ruled out money related moving. The RBI needed to embrace a long and staged program of changes to make a progress from the present circumstance to one where interest rates would be market decided, Government getting would be market based and would reflect market costs

[4]. The changes were additionally significant for building up the climate for viable money related approach making and financial transmission instruments.

1.3 CURRENT SCENARIO

The G-Sec market is generally prevailing and dynamic part of the debt market. The key instruments that are exchanged this market are fixed rate security, floating rate securities, zero coupon securities and swelling list securities and depository bills. Securities gave by state governments, local bodies and municipal bodies are likewise exchanged here. The market is huge on the grounds that it gives signals regarding where the interest rates are going in the economy. The market participant are institutional investors like banks, financial institutions, mutual funds, provident funds, insurance companies and corporate [5]. Of these, banks are the predominant players because of the legal liquidity proportion necessities. According to the RBI rules, banks need to put 23 per cent of their deposits in G-Sec. When the securities are given, secondary trading G-Sec in dematerialised structure is done on automated request driven arrangement of National Stock Exchange, Bombay Stock Exchange and OTCEI. The everyday turnovers of G-Sec market are around Rs.30, 000 to 50,000 crore.

1.4 CORPORATE BOND MARKET

Economists observe the part of corporate security market as a channel that joins countries savings into investment opportunities if of fundamental significance for a few reasons. For the issuer (borrower) it gives low cost funds which authorize them to keep away from intermediary role of a bank. In spite of the fact that corporate require to go through intermediaries like brokers, underwriters in the debt market as well, the severe competition between them push down the cost of fund raiser [6]. Presence of security subsidizes gives the corporate an extra methods for raising long term capital. For the investor (lender) there provide premium possibility in resemblance to traditional deposits at banking institutions. It additionally expands the investment opportunities in various sorts of instruments and tailors hazard reward profile agreeing their inclinations. It is intriguing despite tremendous latent potential the corporate bond has not shown the promised growth for various reasons. The key factors inhibit the growth of corporate security market are:

- The regulatory limits on institutional investors
- Non consistent stamp duty
- mainstream issue being private placement and not public issue
- TDS on corporate security
- deficiency of un-rated or deprived rated/sub-investment rank securities
- extremely low down retail involvement
- deficiency of market maker

The government is previously addressing the key issues describing to instant revitalization of corporate security market. New technique start as the kick-off of 2004 are yet to make principle result despite the fact that it guarantee better action in the corporate security market. The RBI report features a major advancement by the presentation of the Real Time Gross Settlement System which will encourage better liquidity management [7]. The DvP III method of settlement has been empowered which grants net settlement of the both funds and securities legs.

The DvP III method of settlement has additionally allowed the rollover of repos. Another huge advancement was the presentation of the Market Stabilization Scheme which has extended the instruments accessible to the Reserve Bank for dealing with the surplus liquidity in the framework. These changes can be momentarily seen as an efficient exercise for the improvement of the debt market just as reconciliation of the whole financial markets by making it profound, wide and transparent [8]. In glancing back at the succession and speed of these changes that have been set up longer than 10 years, one starts to value the complexity and difficulty that is characteristic for the advancement of a productive debt market we actually have far to go.

These changes were connected to operational self-sufficiency of the RBI, measures for example, the cancellation of planned adjustment throughout ad-hoc Treasury Bills (in 1997) and its replacement by Ways and Means Advances facility, with restrictions, to convene temporary cash flow befuddle for the Central Government were view as basic for the change of monetary policy. We are also aware that these measures have been taken in close collaboration with the market players. RBI report also highlights other measure it had adopted since then:

1.5 INTEREST RATE FUTURES (IRFS)

Consequent upon the decision to introduce IRFs on NSE, guidelines in respect of RBI regulated entities were formulated to enable their participation. NSE introduced three futures instruments on June 3, 2003, futures contracts on notional 91 day Treasury Bill, futures contracts on notional 10 year coupon bearing bond and futures contracts on notional 10 year zero coupon bonds. While banks were permitted to utilize futures just to fence their G-sec investments in Held for Trading (HFT) and Available for Sale (AFS) classes, PDs were permitted to interest rate derivatives (IRDs) for both hedging and trading. Nonetheless, because of the absence of liquidity of the exchange traded futures market, Securities and Exchange Board of India (SEBI) in meeting with FIMMDA improved on futures contracts on a 10-year notional bond, which is evaluated based on the Yield To Maturity' (YTM) of a bushel including three securities with development going from 9 to 11 years [9]. The exchanges are currently dispatching another product.

1.6 LEGALITY OF OTC DERIVATIVES – AMENDMENTS TO SCRA

OTC interest rate derivatives are offered in 1999, banks could embrace essential FRA and IRS contracts for their possess balance sheet management and as well for market making intention, if they assurance acceptable structure, risk management system and internal control system [10]. The quantity in the market has developed detectably with the outstanding notional sum at around Rs. 6, 40,000 crore. In any case, there has been a number of apprehension in hold to authority of OTC derivatives with section 18A of the Securities Contracts (Regulation) Act, 1956 (SCRA), formation just derivatives contracts that are carry out on exchanges legal and suitable [11]. As desires assured adjustment via beneficial actions to the future change are being talk about with the Government of India to guarantee that the projected revision don't put at risk the legal status of OTC derivatives.

In particular, it has been suggested that section 18A be amended so as to make contracts of the group and nature as give notice by RBI legally appropriate, even if they are not traded on any recognized stock exchange. Exchange traded derivatives have their own role to take part in in the debt market but by their immensely nature they have to be standardised products. OTC derivatives, on the other hand can be customized to the requirements of the trading entity [12]. Consequently both OTC and exchange traded derivatives are essential for market development. In particular, it has been recommended that segment 18A be corrected in order to make agreements of the class and nature as informed by RBI lawfully legitimate, regardless of whether they are not exchanged on any perceived stock trade. Trade exchanged subsidiaries have their own task to carry out in the obligation market - however by their very nature they must be normalized items [13]. OTC subsidiaries, then again can be altered to the necessities of the exchanging elements. Hence both OTC and trade exchanged subsidiaries are fundamental for market advancement.

1.7 ROLLOVER OF REPOS

Rollover of Repos: With the choice to move progressively towards an unadulterated between bank call/term currency market, there is a need to eliminate the operational/administrative limitations in the repo market. One of the noticeable obstacles in the development of the repo market is the weakness to rollover contracts [14]. To make powerful constant access to assets from the repo market, it was selected to allow rollover of repos which will be empowered alongside DvP III. DvP III Mode of Settlement: In request to diminish the price risk expected by market participants, sale of securities recently bought is proposed to be allowed with specific shields worked in to forestall short sales [15]. To empower this just as to empower rollover of repos, net settlement in securities is required. In this manner, it has been selected to progress the settlement method to DvP III.

1.8 MARKET STABILIZATION SCHEME

As a reaction to the large-scale capital inflows lately and the subsequent issues looked in overseeing liquidity, the Reserve Bank presented the Market Stabilization Scheme (MSS) in the wake of consulting the Government of India for wiping up liquidity of a really suffering nature in March 2004. Under this plan, the Government would give existing instruments, for example, Treasury Bills as well as dated securities via auctions under the MSS, notwithstanding the normal borrowing prerequisites, for engrossing liquidity from the framework. The expectation of MSS is basically to separate the liquidity assimilation of a seriously suffering nature via sanitization from the everyday normal liquidity management tasks [16]. To provide transparency and constancy to the financial markets, a expressive schedule for issuance of Treasury Bills/ dated securities on a periodical basis is being reported.

1.9 CAPITAL CHARGE FOR MARKET RISK

With a sight to guarantee even modify to the standards under Basel II, banks were positive to stay on up capital charge for market risk more than a two year time period as under: (i) Banks would be essential to stay on up capital charge for market risk in observe of their trading book exposure (including derivatives) by March 31, 2005. (ii) Banks would be essential to remain up capital charge for market risk in observe of the securities incorporated below obtainable for sale (AFS) categorization by March 31, 2006.

1.10 PRIMARY DEALERS AND THEIR ROLE

As we know, PDs are expected to promote retailing in the G-Sec, active market making in G-Secs and price discovery. While the institution of PDs has led to improved liquidity in the secondary market, retailing of G-Secs and promoting a retail market has not been undertaken by the PDs on the scale and intensity that was expected [17]. With the proposed order driven trading G-Secs on the NDS, PDs are required to assume a huge part in building up the retail market on trades. PDs should also improve their market making in interest rate derivatives, particularly with a larger category of institutions like insurance companies coming into the market.

Thus, in order to fulfil their obligations, Primary Dealers will have to assume a greater role and responsibilities for market making and retailing of G-secs. On the benefits side, the long pending demand of the PDs for exclusivity in the auctions of G-Secs in a limited way has been under the active consideration of RBI. In addition, the Standing Technical Advisory Committee on Money, Government Securities and Forex Markets has formed a Sub Group to look into the issue of broad basing the PDs portfolios by permitting them to invest in the sovereign securities abroad, setting up of overseas joint ventures, wholly owned subsidiaries, and the like. Because of every one of these measures, the Indian G-Sec market has been changed significantly throughout the most recent ten years [18]. A major outcome of this development is that the market is becoming increasingly broad based: with the market now looking well diversified with the participation of banks, financial institutions, provident funds, insurance and pension funds, primary dealers, 100 per cent gilt mutual funds, corporate bodies, provident funds, trusts, individuals, foreign institutional investors (FIIs) and non-resident Indians (NRIs).

The consolidation of securities accomplished throughout the long term, has brought about the improvement of dynamic benchmark securities. Subsequently we presently see that the auctions for Government protections have built up a serious level of refinement. There is an always narrowing hole between the cut-off cost and the weighted normal cut-off price; the bid at the essential closeout is almost completely associated with the secondary market yield bend showing great price revelation [19]. A sensibly smooth and stretched yield bends of as long as 30 years development has arisen, which is likely tantamount with those in created economies. Volumes of trading the secondary market are expanding and offer asks spreads are narrow. The annual turnover in the secondary market for G-Secs now is more than twice the GDP of the country and that, after Japan, India's G-Sec market is probably the largest in Asia.

In fact in the process of reaching where we are today in developing the G-Sec market, several issues had to be addressed and problems were faced in the areas of broadening the primary market with appropriate auction methodology, promoting depth and liquidity in the secondary market, fostering market intermediaries and market making, setting up of reliable trading and settlements systems, ensuring adequate institutional, legal and risk management systems and facilitating data dissemination and transparency [20]. It is gratifying to note that despite these challenges, we could develop a deep and liquid market for government securities in India.

1.11 CONCLUSION

It could be concluded from above discussions the several changes have helped strengthen the debt market in India, but, still it remain under-developed relative other developing countries. The prominent economist actually feels that securitisation has a long history in India however the improvement has been moderate and restricted to a couple of resource types. They likewise comment that corporate borrowers keep on relying upon bank credits, equity markets, and private arrangement to meet their extra capital prerequisites. To conclude based on an evaluation of the successful bond market across the world, as well as analysis of pitfalls plaguing Indian debt market, the RBI and other participants need to ensure speedy reforms towards developing the debt market in India.

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