Capital Markets

Financial Markets

Financial Markets

- Centres or arrangements that provide facilities for buying & selling of financial claims & services
- Demands & requirements of participants interact to set a price for such claims
- Corporations, financial institutions, individuals, governments trade in financial products – directly or thru' brokers & dealers

Financial Markets

Financial Markets

One way of classifying Financial market:

Primary Markets(new issue mkts/direct mkts)

-Deal in new financial claims or new securities

- mobilise savings, supply fresh or additional capital to biz units

Secondary markets

- Deal in securities already issued or existing or outstanding
- Render securities issued in primary mrkts liquid (ready mkt for trading)
- 2 Components: OTC mkt(over the counter), Exchange traded mkt

Financial Markets

Financial Markets

- Another way of classifying Financial market: (based on differences in the period of maturity of financial asse issued)

Money Markets

- Deal in short term claims (period of maturity of yr. or less)

- Egs., Treasury bills mkt, call money mkt, commercial bills mkt

Capital/Securities markets

- Deal in long term claims (period of maturity above a Yr.)

- Not only co-extensive with stock market but much wider than it. Egs., Stock mkt, Govt. bonds mkt

- Not always possible to include a given participant in either of the two markets alone.
- E.g., commercial banks, mutual funds belong to both

Financial Markets

Functions of Financial Markets

- Enabling economic units to exercise their time preference
- Separation, distribution, diversification, reduction of risk (e.g., mutual funds)
- Efficient operation of payment mechanism – (buyers & sellers of goods & services should have confidence that instruments used to make payments will be accepted and honoured by all parties)
- Transformation of financial claims so as to suit the preferences of both savers & borrowers
- Enhancing liquidity of financial claims through securities trading
- Portfolio Management

Financial Markets

Financial markets meet various needs of different entities:

- Government:

a) Financial markets help governments meet their borrowing requirements.

b) Taxes collected from the enhanced economic activity promoted by markets help boost finances of the Government

c) Financial markets can force companies to operate under transparent corporate governance standards.

Financial Markets

Financial markets meet various needs of different entities:

- Issuing companies

a) Financial markets make it possible for companies to mobilise money for the projects they want to implement.

b) The yield curve in the debt market sets the tone for the borrowing cost of issuing companies.

c) The markets give companies a benchmark for their valuation and top management to assess their performance.

Financial Markets

Financial markets meet various needs of different entities:

- Issuing companies

d) The financial markets provides companies a currency with which they can reward employees

e) The valuation effect of financial markets helps companies to acquire other businesses without having to pay from the bank account.

f) The financial markets gives company visibilty and raises their profile with investors, customers, government and general public.

Financial Markets

Financial markets meet various needs of different entities:

- <u>Investors</u>

a) The market helps investors benefit from the performance of the economy and the company

b) Price discovery in the markets provide messages to investors on where various companies stand.

c) Markets provide a platform for investors to punish poor management

Financial Markets

Financial markets meet various needs of different entities:

- Economy

a) Financial markets are a barometer of the economy

b) Financial markets help in channelling resources from those who have them to those who need them.

c) New projects and higher activity promoted by financial markets boost the growth of the economy.

Primary Markets

Primary Market

- Market for new issue. Provides the channel for sale of new securities
- Securities may take a variety of forms such as equity, debt etc
- Securities may be issued in the domestic market and/or international market.
- 3 categories of participants in the primary market: issuer of securities, investor in securities, intermediaries
- Funds mobilised through:

 - Public Issue/prospectus (IPO/FPO)
 - Rights issue
 - Private Placement/Preferential Issue

Primary Market

Public Issue

- Securities issued to the public directly. Open to general public
- Where offer or invitation to subscribe for shares or debentures is made to 50 persons or more, then such an offer deemed to be public offer
- Public offer – wide publicity given through media. Merchant bankers come into the picture.
- Merchant Bankers – take issue to the street, get funds (FII, retail, banks), paperwork etc.

Primary Market

What is a Prospectus?

- While floating public issue company needs to disclose certain information:
  - the reason for raising the money
  - the way money is proposed to be spent
  - the return expected on the money etc.

- Also, includes information like:
  - Size of the issue, the current status of the company, its equity capital
  - Current and past performance, the promoters, the project, cost of the project, means of financing, product and capacity etc.

- Purpose – avoid exploitation of the investor, helps investor identify future potential of a company

Primary Market

Rights Issue

- When a listed company which proposes to issue fresh securities to its existing shareholders as on a record date
- The rights are normally offered in a particular ratio to the number of securities held prior to the issue.
- This route is best suited for companies who would like to raise capital without diluting stake of its existing shareholders.
- Right is given in the form of an offer to existing shareholders to subscribe to a proportionate number of fresh, extra shares at a price
- 2:3 rights issue at Rs. 125, would entitle a shareholder to receive 2 shares for every 3 shares held at a price of Rs. 125 per share.

Primary Market

Rights Issue

- Companies issue right shares by sending a letter of offer to the s/hders whose names are recorded in the books on particular date

Exercise rights, buy new shares at the offered price

Renounce rights, sell in open mkt

Renounce part of the rights, exercise remainder

Choose to do nothing

Primary Market

Private Placement

- Direct sale of securities by a company to some select people or institutional investors
- No prospectus issued
- Covers equity shares, preferential shares, debentures
- Offers access to capital more quickly than public issue, quite inexpensive as absence of various issue expenses

Primary Market

Pricing of an issue

- Indian primary market ushered in an era of free pricing in 1992.
- The issuer in consultation with Merchant Banker shall decide the price
- There is no price formula stipulated by SEBI. SEBI does not play any role in price fixation
- The company and merchant banker - required to give full disclosures of the parameters they had considered while deciding the issue price.
- Promoters are required to justify the issue price in the prospectus, make material disclosures about risk factors

Primary Market

Pricing of an issue

Two ways of pricing an issue:

1) one where company and Lead Merchant Banker fix a price (called fixed price)

2) where the company and the Lead Manager (LM) stipulate a floor price or a price band and leave it to market forces to determine the final price (price discovery through book building process).

Primary Market

Pricing of an issue

1) Fixed price

- Fixed price issues are issues in which the issuer is allowed to price the shares as he wishes.
- He does it in consultation with the merchant banker
- The basis for the price is explained in an offer document through qualitative and quantitative statements
- Price is known in advance to investor. Demand for the issue is known at the close of the issue.

Primary Market

2) Pricing of an issue - Price discovery through book building process

- It is a Process used in IPOs for efficient price discovery.
- A floor price is arrived at after judging the pulse and demand for the issue by the issuer and the merchant banker. Then a price band is arrived at.
- The upper price of the band (cap) can be a maximum of 1.2 times the floor price.
- During the period for which the IPO is open, bids are collected from investors at various prices, which are above or equal to the floor price
- An order book, in which the investors can state the quantity of the stock they are willing to buy, at a price within the band, is built. Thus the term 'book-building.'

Primary Market

- The demand for the issue can be known everyday as the book is being built.
- Offer price is determined after the bid closing date.
- Every public offer through the book-building process has a book running lead manager (BRLM), a merchant banker, who manages the issue.
- Just Dial IPO, the floor price was Rs 470 and the band was from Rs 470 to Rs 543.

Primary Market

- *Price Band* - The prospectus may contain either the floor price for the securities or a price band within which the investors can bid
- The spread between the floor and the cap of the price band shall not be more than 20%.
- The price band can have a revision and such a revision in the price band shall be widely disseminated by informing the stock exchanges (issuing a press release, indicating the change on the relevant website & the terminals of the trading members participating in the book building process.)
- In case the price band is revised, the bidding period shall be extended for a further period of three days, subject to the total bidding period not exceeding ten days.
- An issue through the book-building route remains open for a period of 3 to 7 days

Primary Market

- *Cut-Off Price*- Once the issue period is over and the book has been built, the BRLM along with the issuer arrives at a cut-off price. The cut-off price is the price discovered by the market. It is the price at which the shares are issued to the investors.

- Investors bidding at a price below the cut-off price are ignored. So those investors who apply at a price higher than the cut-off price have a higher chance of getting the stock

- The cut-off price is arrived at by the method of Dutch auction. In a Dutch auction the price of an item is lowered, until it gets its first bid and then the item is sold at that price.

Primary Market

Cut-Off Price – E.g., company wants to issue one million shares

- floor price for one share is Rs 48 and the band is between Rs 48 and Rs 55.
- At Rs 55, on the basis of the bids received, the investors are ready to buy 200,000 shares
- So the cut-off price cannot be set at Rs 55 as only 200,000 shares will be sold.
- So as a next step, the price is lowered to Rs 54. At Rs 54, investors are ready to buy 400,000 shares.
- If the cut-off price is set at Rs 54, 600,000 shares will be sold. This still leaves 400,000 shares to be sold.
- The price is now lowered to Rs 53. At Rs53, investors are ready to buy 400,000 shares. Now if the cut-off price is set at Rs 53, all one million shares will be sold.
- Investors who had applied for shares at Rs 55 and Rs 54 will also be issued shares at Rs 53.
- The extra money paid by these investors while applying will be returned to them.

Primary Market

Categorisation of investors in a book building issue - Each of these categories is allocated a certain percentage of the total issue

- **Retail Investor**
  - applies for stocks for a value of not more than Rs 200,000
  - total allotment has to be at least 35% of the total issue
  - also have an option of applying at the cut-off price
- **Non-Institutional Investor**
  - commonly referred to as high net-worth individuals
  - applies for stocks for a value of more than Rs 200,000.
  - total allotment has to be at least 15% of the total issue
- **Qualified Institutional buyers**
  - institutional investors who posses the expertise and the financial muscle to invest in the securities market.
  - Mutual funds, financial institutions, scheduled commercial banks, insurance companies, provident funds, state industrial development corporations
  - Allotted not more than 50% of the total issue

Some Concepts

Market Capitalisation

- Market value of a quoted company
- Market cap = current share price (market price) X number of shares in issue
- E.g. Company A has 120 million shares in total. The current market price is Rs. 100. The market capitalisation of company A is Rs. 12000 million.
- ITC's Market Cap Rs. 2,68,583.31Cr (5/7/13)

Some Concepts

Index

- Used to give information about the price movements of products in the financial, commodities or any other markets
- Stock market indices are meant to capture the overall behaviour of the equity markets
- The stock market index is created by selecting a group of stocks that are representative of the whole market or a specified sector or segment of the market
- Index of NSE (National stock exchange) is known as Nifty. It comprises of 50 shares or stocks or corporations that's why it is sometimes known as Nifty 50.
- ONGC, Reliance, Infosys, L&T – Included in Nifty

Some Concepts

Index

- Benchmark index of the Bombay Stock Exchange (BSE) is Sensex. Acronym for 'Sensitive Index'
- It comprises of 30 shares or stocks or corporations representing major sectors in India
- The performance of these stocks in BSE is seen to come up with Sensex figure at the end of the day
- ONGC, Reliance, Infosys, L&T – Also part of Sensex

Secondary Markets

Secondary markets

- Secondary market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange
- Majority of the trading is done in the secondary market. Existence of secondary market for financial assets enhances its liquidity
- Secondary market comprises of equity markets and the debt markets.
- Role Of a Secondary market

For the general investor, the secondary market provides an efficient platform for trading of his securities

For the management of the company, serves as a monitoring and control set up

Secondary markets

Exchange Traded Mkt

- Also known as Auction market
- A system in which buyers enter competitive bids and sellers enter competitive offers simultaneously, as opposed to the over-the-counter market, where trades are negotiated.

OTC (Over the counter mkt)

- Also known as dealer market
- A market in which transactions occur between principals acting as dealers buying and selling for their own accounts, rather than between brokers acting as agents for buyers and sellers.

Stock Exchanges

- The stock exchanges in India, under the overall supervision of the regulatory authority, the Securities and Exchange Board of India (SEBI), provide a trading platform, where buyers and sellers can meet to transact in securities.

- The trading platform provided by NSE is an electronic one and there is no need for buyers and sellers to meet at a physical location to trade.

- They can trade through the computerized trading screens available with the NSE trading members or the internet based trading facility provided by the trading members of NSE.

- Operates through a number of electronically linked counters at different locations giving rise to a national trading system

Reforms in the Stock market

- Creation of Market Regulator: Securities and Exchange Board of India (SEBI), the securities market regulator in India, was established under SEBI Act 1992, with the main objective and responsibility for (i) protecting the interests of investors in securities, (ii) promoting the development of the securities market, and (iii) regulating the securities market.

- Screen Based Trading: Prior to setting up of NSE, the trading on stock exchanges in India was based on an open outcry system. The system was inefficient and time consuming because of its inability to provide immediate matching or recording of trades. In order to provide efficiency, liquidity and transparency, NSE introduced a nation-wide on-line fully automated screen based trading system (SBTS)

- Reduction of Trading Cycle: Earlier, the trading cycle for stocks, based on type of securities, used to vary between 14 days to 30 days and the settlement involved another fortnight. It was made mandatory for all Exchanges to follow a uniform weekly trading cycle. In December 2001, scrips were moved to rolling settlement and the settlement period was reduced progressively from T+5 to T+3 days. From April 2003 onwards, T+2 days settlement cycle is being followed.

Reforms in the Stock market - Dematerialisation

- Dematerialisation is the process of converting the physical form of shares into electronic form.

- Prior to dematerialisation the Indian stock markets have faced several problems like delay in the transfer of certificates, forgery of certificates etc.

- Dematerialisation helps to overcome these problems as well as reduces the transaction time as compared to the physical segment.

- The converted electronic data is stored with the depository from where they can be traded. There are two depositories in India, viz. National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL).

- It is similar to a bank where an investor opens an account with any of the depository participants. Depository participant is a representative of the depository .

- The DP maintains the investors securities account balances and intimates him about the status of holdings.

Reforms in the Stock market - Dematerialisation

Procedure for converting the physical shares into electronic form.

- To convert the shares into electronic form the investor should open an account with any of the depository participants. For opening an account the investor has to fill up the account opening form. An account number (client ID) will be allotted after signing the agreement which defines the rights and duties of the DP and the investor wishing to open the account. The client ID along with the DP ID gives a unique identification in the depository system. Any number of depository accounts can be opened.

- After opening an account with the DP the investor should surrender the physical certificates held in his name to a depository participant. These certificates will be sent to the respective companies where they will be cancelled after dematerialization and will credit the investors account with the DP. The securities on dematerialisation will appear as balances in the depository account. These balances can be transferred like the shares held in physical form.

Reforms in the Stock market - Dematerialisation

- Advantages of dematerialisation

  * There is no risk due to loss on account of fire, theft or mutilation.

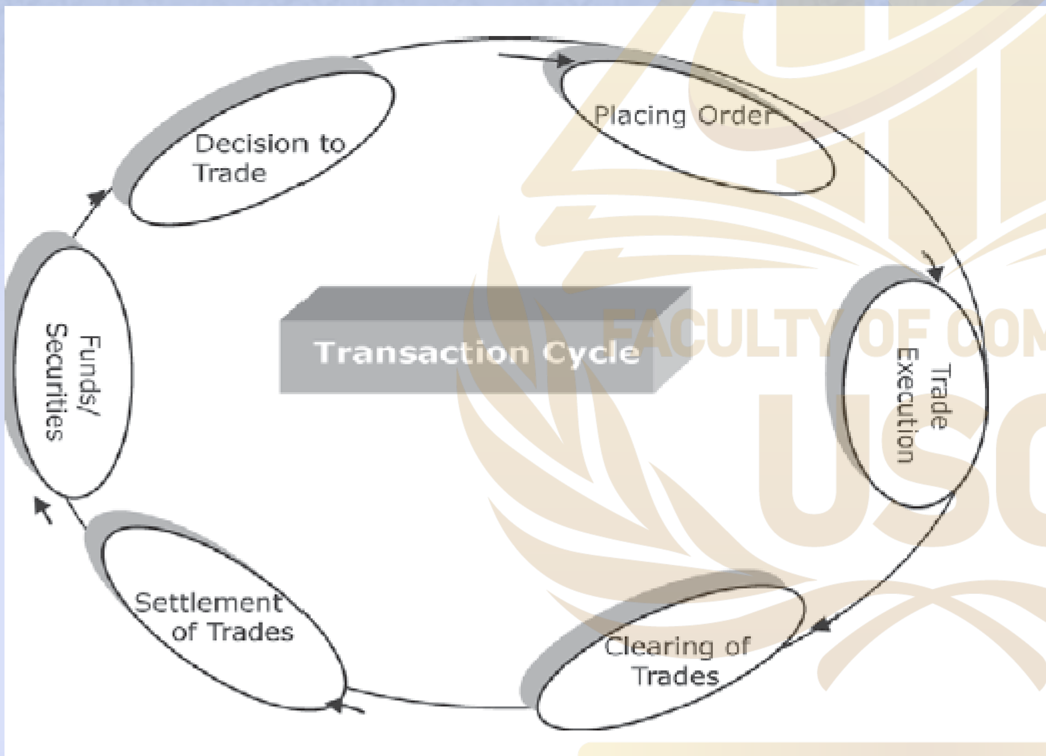
  * There is no chance of bad delivery at the time of selling shares as there is no signature mismatch.

  * Transaction costs are usually lower than that in the physical segment.

  * The bonus /rights shares allotted to the investor will be immediately credited into his account.

  * Share transactions like sale or purchase and transfer/transmission etc. can be effected in a much simpler and faster way.

Steps in Transaction Cycle



(a) A person holding assets (securities/funds) decides to buy or sell the securities.

(b) He selects a broker and instructs him to place buy/sell order on an exchange.

(c) The order is converted to a trade as soon as it finds a matching sell/buy order.

(d) At the end of the trade cycle, the trades are netted to determine the obligations of the trading members to deliver securities/funds as per settlement schedule.

(e) Buyer (seller) delivers funds (securities) and receives securities (funds) and acquires ownership of the securities.

Reforms in the Stock market - Screen Based Trading

Screen based trading

- The trading on stock exchanges in India used to take place through open outcry without use of IT for immediate matching or recording of trades

- This was time consuming and inefficient. This imposed limits on trading volumes and efficiency.

- To provide efficiency, liquidity and transparency, NSE introduced a nationwide, on-line, fully automated screen based trading system (SBTS)

- A member can punch into the computer the quantities of a security and the price at which he would like to transact, and the transaction is executed as soon as a matching sale or buy order from a counter party is found.

Reforms in the Stock market - Screen Based Trading

Screen based trading

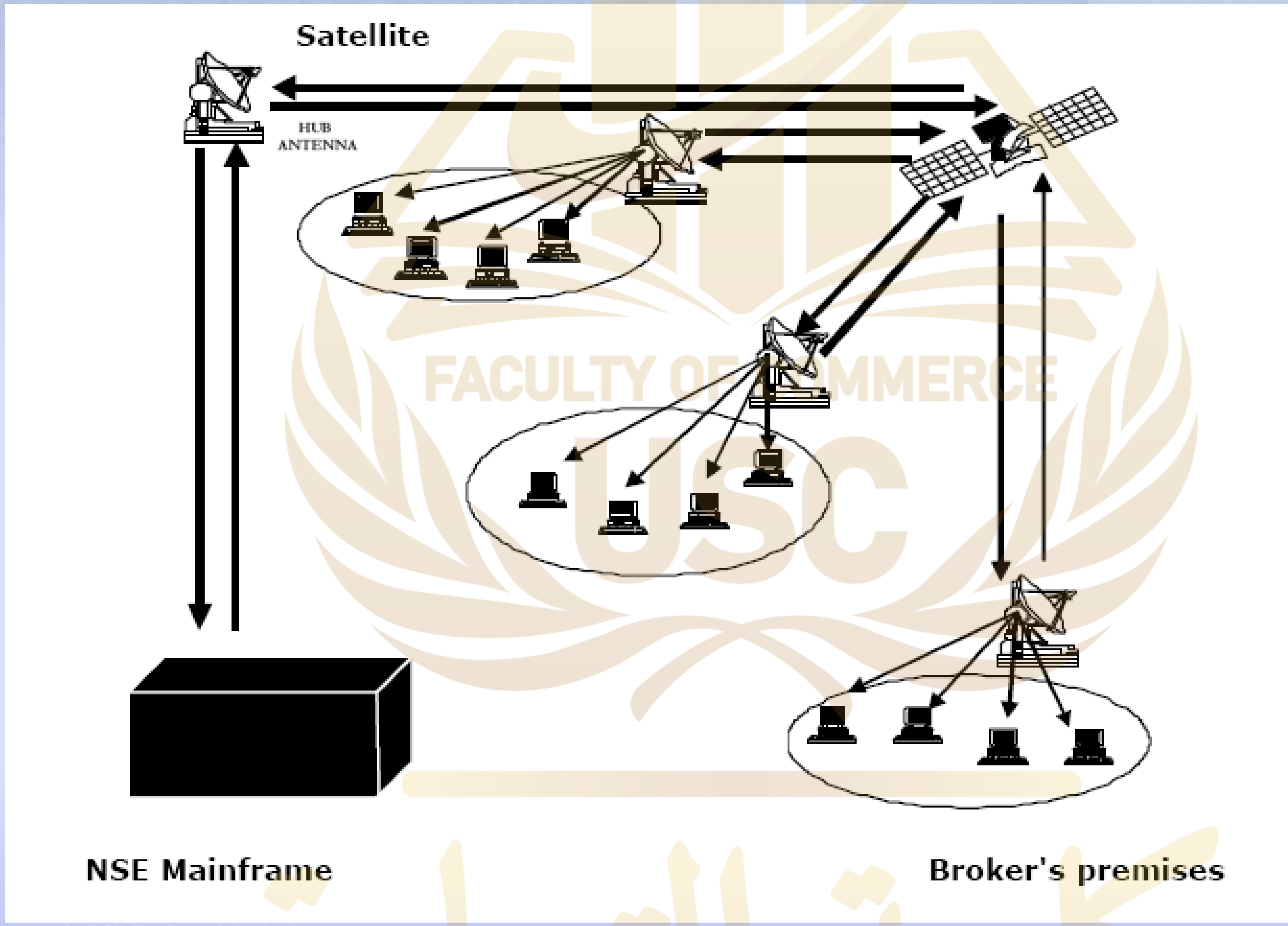
- NSE – One of the first exchanges in the world to use satellite communication technology for trading

- Its trading system, called National Exchange for Automated Trading (NEAT), is a state of-the-art client server based application.

- At the server end all trading information is stored in an in-memory database to achieve minimum response time and maximum system
availability for users.

- For all trades entered into NEAT system, there is uniform response time of less than one second.

Reforms in the Stock market - Screen Based Trading



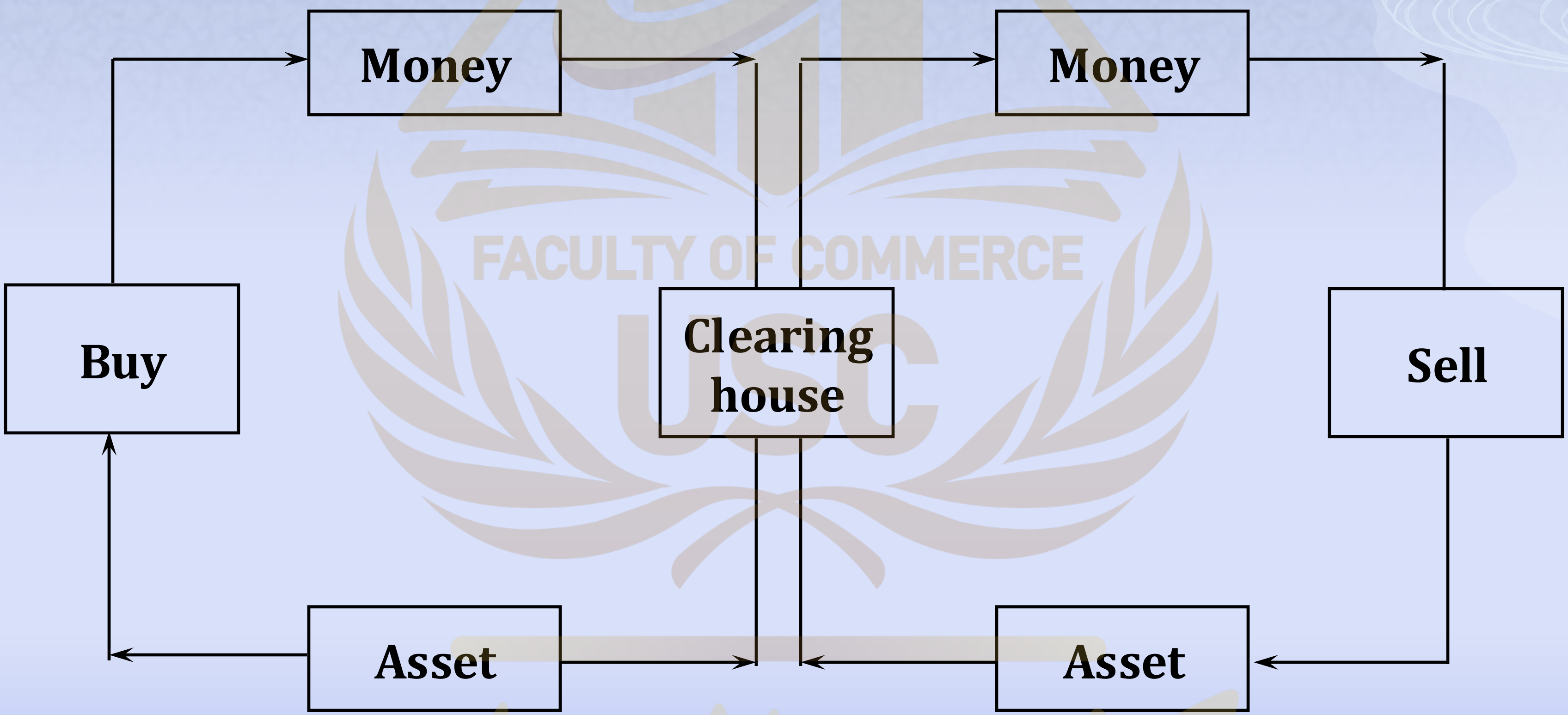
Trading Network

Reforms in the Stock market - Screen Based Trading

Advantages of Screen based trading

- It electronically matches orders on a strict price/time priority and hence cuts down on time, cost and risk of error, as well as on fraud resulting in *improved operational efficiency.*
- It allows faster incorporation of price sensitive information into prevailing prices, thus *increasing the informational efficiency of markets.*
- It enables market participants, irrespective of their geographical locations, to trade with one another simultaneously, *improving the depth and liquidity of the market.*
- It provides full anonymity by accepting orders, big or small, from members without revealing their identity, thus providing *equal access to everybody.*
- It also *provides a perfect audit trail, which helps to resolve disputes by* logging in the trade execution process in entirety.

The Role Of The Clearing House



Stock Brokers

- A stock broker is an intermediary who arranges to buy and sell securities on the behalf of clients (the buyer and the seller)

- According to SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, a stockbroker is member of a stock exchange and requires to hold a certificate of registration from SEBI in order to buy, sell or deal in securities

- Stockbrokers need to become *Trading Members (TM) of NSE in order to help their clients* to trade using the NSE platform

Stock Brokers

Pre-conditions that SEBI looks for before granting a certificate to a stock broker:

- holds the membership of any stock exchange;
- should abide by the rules, regulations and bye-laws of the stock exchange or stock exchanges of which he is a member;
- has the necessary infrastructure like adequate office space, equipment and manpower to effectively discharge his activities;
- should obtain prior permission of SEBI to continue to buy, sell or deal in securities in any stock exchange in case of any change in the status and constitution;
- should pay the amount of fees for registration in the prescribed manner; and
- should take adequate steps for redress of grievances of the investors

within one month of the date of the receipt of the complaint and keep SEBI informed about the number, nature and other particulars of the complaints.

New Membership

The persons eligible to become trading members of Exchange are:

(a) Individuals;
(b) Partnership firms registered under the Indian Partnership Act, 1932.
(c) Institutions, including subsidiaries of banks engaged in financial services;
(d) Banks
(e) Body corporates including companies as defined in the Companies Act, 1956

Broker-Clients Relations

- The trading member (TM)/broker is required to enter into an agreement in the specified format provided by NSE with the client before accepting orders on latter's behalf.
- The agreement is executed on non-judicial stamp paper of adequate value, duly signed by both the parties on all the pages. Copy of the agreement has to be kept with the TM permanently.

Under "Know Your Client (KYC)" requirements, the Trading member should seek information from the client before accepting orders on latter's behalf such as:

- investor risk profile, financial profile, investor identification details, address details, income, PAN number, employment, age, investments experience, trading preference.

Sub-Brokers

- Sub broker is an important intermediary between stock broker and client in capital market segment.

- The trading members of the Exchange may appoint sub-brokers to act as agents of the concerned trading member for assisting the investors in buying, selling or dealing in securities

- The sub-brokers are affiliated to the trading members and are required to be registered with SEBI

- The trading member has to ensure the settlement of all deals entered into by a trading member even if the deals may have originated from its sub-broker.

- A sub-broker may be an individual, a partnership firm or a corporate

SEBI

- SEBI Act, 1992 provides for establishment of Securities and Exchange Board of India (SEBI) with statutory powers for (a) protecting the interests of investors in securities (b) promoting the development of the securities market and (c) regulating the securities market.

- Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market.

SEBI

Functions of SEBI:

- Regulating the business in stock exchanges and any other securities markets.
- Registering and regulating the working of stock brokers, sub–brokers etc.
- Prohibiting fraudulent and unfair trade practices relating to securities markets.
- Calling for information from, undertaking inspection, conducting inquiries and audits of the Stock exchanges, mutual funds and other persons associated with the securities market and other intermediaries and self–regulatory organizations in the securities market.
- Performing such functions and exercising according to Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government.

Secondary markets – Products

- The main financial products/instruments dealt in the Secondary market may be divided broadly into Shares and Bonds

- Shares

Equity Shares	Rights Issue	Bonus Shares	Preference shares	Cumulative pref shares	Cumulative Convertible Pref shares
• Commonly referred to as ordinary share, represents the form of fractional ownership in a business venture.	• An existing shareholder of a company XYZ can sell his “right” in the secondary market	• Shares issued by the companies to their S/Hers free of cost based on the number of shares the shareholder owns.	• Owners of these kind of shares are entitled to a fixed dividend or dividend calculated at a fixed rate to be paid regularly before dividend can be paid in respect of equity share.	• Type of preference shares on which dividend accumulates if remained unpaid. • All arrears of preference dividend have to be paid out before paying dividend on equity shares.	• Type of preference shares where the dividend payable on the same accumulates, if not paid. • After a specified date, these shares will be converted into equity capital of the company.

Secondary markets – Products

Factors that influence the price of a stock

(1) **Stock specific** - people's expectations about the company, its future earnings capacity, financial health and management, level of technology and marketing skills.

(2) **Market specific** - depends on the environment rather than the performance of any particular company. Events favourable to an economy, political or regulatory environment like high economic growth, friendly budget, stable government etc. can result in a boom in the market.

Unfavourable events like war, economic crisis, communal riots etc. depress the market irrespective of certain companies performing well. However, the effect of market-specific factor is generally short-term. Despite ups and downs, price of a stock in the long run gets stabilized based on the stockspecific factors.

Secondary markets – Products

Bonds

- Debt Instruments in which one party lends money to another on pre-determined terms with regard to rate of interest to be paid by the borrower to the lender, the periodicity of such interest payment, and the repayment of the principal amount borrowed (either in installments or in bullet).
- In the Indian securities markets, we generally use the term 'bond' for debt instruments issued by the Central and State governments and public sector organisations, and the term 'debentures' for instruments issued by private corporate sector.

Secondary markets – Products

Principal Features of a Bond

a) Maturity - refers to the date on which the bond matures, or the date on which the borrower has agreed to repay (redeem) the principal amount to the lender. Bond ceases to exist after that date.

b) Coupon - Coupon rate is the rate at which interest is paid, and is usually represented as a percentage of the par value of a bond.

c) Principal - amount that has been borrowed, and is also called the par value or face value of the bond. Coupon is the product of the principal and the coupon rate

Secondary markets – Products

Principal Features of a Bond

- Typical face values in the bond market are Rs. 100 though there are bonds with face values of Rs. 1000 and Rs.100000 and above
- All Government bonds have the face value of Rs.100
- In many cases, the name of the bond itself conveys the key features of a bond. E.g., GS CG2019 11.40% bond refers to a Central Government bond maturing in the year 2019, and paying a coupon of 11.40%.
- Since Central Government bonds have a face value of Rs.100, and normally pay coupon semi-annually, this bond will pay Rs. 5.70 as six- monthly coupon, until maturity, when the bond will be redeemed.
- The general day count convention in bond market is 30/360 which assumes total 360 days in a year and 30 days in a month.

Secondary markets – Products

Some types of Bonds

Zero Coupon Bond

- Bond issued at a discount and repaid at a face value
- No periodic interest is paid
- The difference between the issue price and redemption price represents the return to the holder
- The buyer of these bonds receives only one payment, at the maturity of the bond.

Convertible Bond

- Bond giving the investor the option to convert the bond into equity at a fixed conversion price.

Treasury Bills

- Short-term (up to one year) security issued by government as a means of financing their cash requirements.
- Available with maturity period of 91/182/364 days

Secondary markets – Products

Issuers of Bonds

- The issuers of bonds could be Government, Public Sector units (PSUs), Corporates
- Power Finance coporation, National highway authority, SBI bonds – These are bonds issued by PSUs…
- Corporate bond markets comprise of commercial paper and bonds. Tata Sons, HDFC, Reliance – Corporate bonds
- T-bills issued by government. On similar lines as Govt bonds in capital market
- Commercial Papers/bills – issued by private companies. On similar lines to T-Bills issued by the government

INSTRUMENT	ISSUER	MATURITY
T-Bills	Central Government	Upto 1 yr
Commercial paper	Corporates	Upto 1 yr
Certificate of Deposit	Scheduled Commercial banks	Upto 1 yr
Dated Securities	Central Government	2-30 yrs.
Dated Securities	State Government	5-13 yrs.
Bonds	PSUs	5-10yrs
Bonds, debentures	Corporates	1-12 yrs

Secondary markets – Products

Issuers of Bonds

- Some of the PSU bonds are tax free, while most bonds including government securities are not tax-free. The coupon is the taxable component

- Fin. Year 12-13 tax free bonds availability 60,000crs. – app. 30,000crs. raised. This yr 50,000crs.. Typically the main issuers are PFC, HUDCO, IIFCL, REC, IRFC, JNPT, NHAI

- The RBI also issues tax-free bonds, called the RBI relief bonds, which is a popular category of tax-free bonds in the market.

- A less dominant segment comprises of short term paper issued by banks, mostly in the form of certificates of deposit. (CD is similar to commercial paper. If corporate then commercial paper, if bank then CD)

- The market for government securities is the oldest and most dominant in terms of market capitalisation, trading volume and number of participants

Secondary markets – Products

Issuers of Bonds

- Government Securities - provides resources to the government for meeting its short term and long term needs, fund budgetary deficits, sets benchmark for pricing corporate paper of varying maturities, used by RBI as an instrument of monetary policy.

- PSUs bonds - The gradual withdrawal of budgetary support to PSUs by the government since 1991 has compelled them to look at the bond market for mobilising resources.

- The preferred mode of issue has been private placement, barring an occasional public issue. Banks, financial institutions and other corporates are major subscribers

- Tax-free bonds, which constitute a substantial proportion of PSU bonds, are quite popular with institutional players.

- PSUs are also investors in bonds issued in the debt markets.

Secondary markets – Products

Issuers of Bonds

Corporate Bonds- corporate debt securities caught momentum since early 1980s.

- Till 1992, interest rate on corporate bond issuance was regulated and uniform across credit categories.
- In the initial years, corporate bonds were issued with "sweeteners" in the form of convertibility clause or equity warrants.
- Most corporate bonds were plain coupon paying bonds initially
- After the de-regulation of interest rates on corporate bonds in 1992
  - variety of structures and instruments in the corporate bond markets
  - variety of floating rate instruments with floors and caps
- The major part of the corporate debt is privately placed with tenors of 1-12 years. Corporate debt market comprise of bonds and Commercial Papers (CPs)

Indian Debt Market

- Indian debt markets, in early 90s, characterised by entry barriers, low levels of liquidity, limited number of players, near lack of transparency, and high transactions cost.

- Now most debt instruments are priced freely on the markets

- Innovation in the structure of instruments and significant improvement
in the dissemination of market information have happened off late

- Information on the size of the various segments (Gov, PSU, Corporates) of the debt market in India is not readily available. This is due to the fact that many debt instruments are privately placed and therefore not listed on markets

- RBI regulates the issuance of government securities, while corporate debt securities fall under the regulatory purview of SEBI

Indian Debt Market

- The periodic reports of issuers and investors are therefore sent to two different regulators. Therefore, aggregated data for the market as a whole is difficult to obtain.
- However, NSE provides a trading platform for most debt instruments issued in India but does not cover every debt instrument
- The debt markets also have a large segment which is transactions based where players are able to lend and borrow amongst themselves. (Call money market, markets for inter-corporate loans)
- The debt market in India is pre-dominantly a wholesale market with dominant institutional investor participation
- The smaller number of large players has resulted in the debt markets being fairly concentrated, and evolving into a wholesale negotiated dealings market.

Indian Debt Market

- Most debt issues are privately placed or auctioned to the participants (public issue which is few). Secondary market dealings are mostly done on telephone, through negotiations.
- Banks are the largest investors in the debt markets. Other major players are financial institutions, mutual funds, provident funds, insurance companies and corporates
- Banks have a statutory requirement to hold a certain percentage of their deposits in approved securities (all government bonds qualify) to satisfy the statutory liquidity requirements.
- Mutual funds are not permitted to borrow funds, except for very short-term liquidity requirements. Therefore, they participate in the debt markets pre-dominantly as investors, and trade on their portfolios quite regularly.
- The short-term instruments in the debt market are used by RBI as instrument of monetary policy.