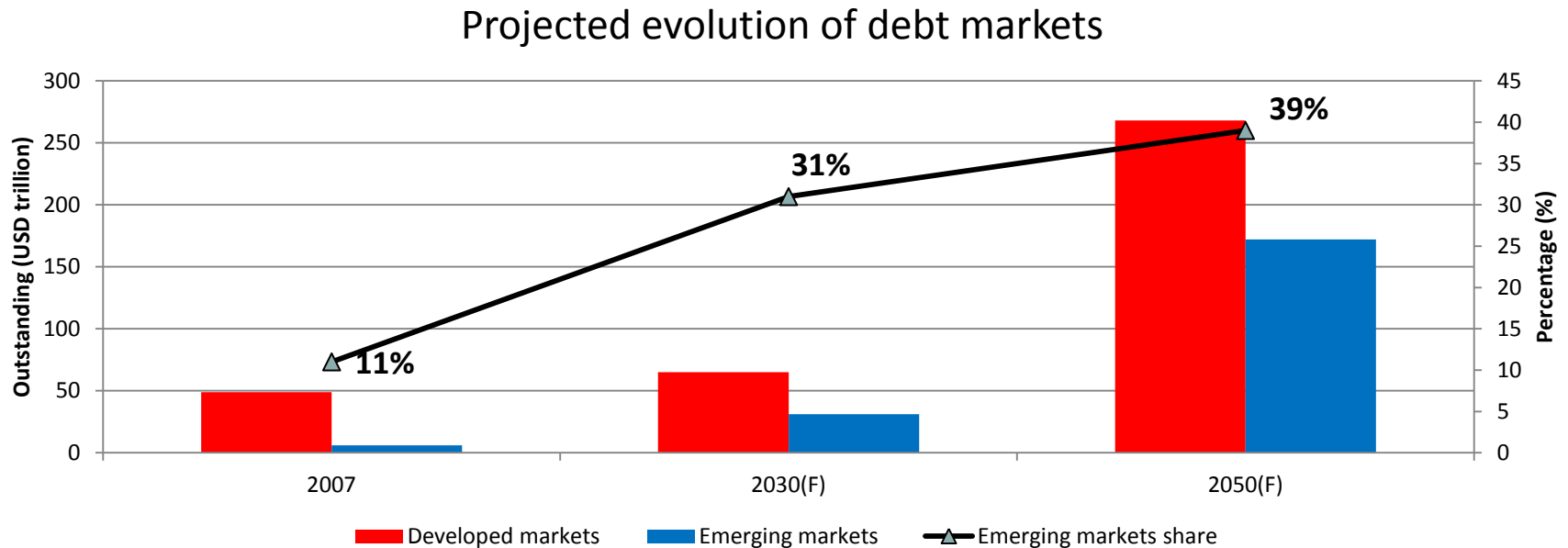

IOSCO EMC –WB Technical Note on the Development of Corporate Bond Markets in Emerging Markets

COSRA Meeting
Port of Spain , Trinidad & Tobago
October 2012

Bond markets in emerging markets expected to significantly grow

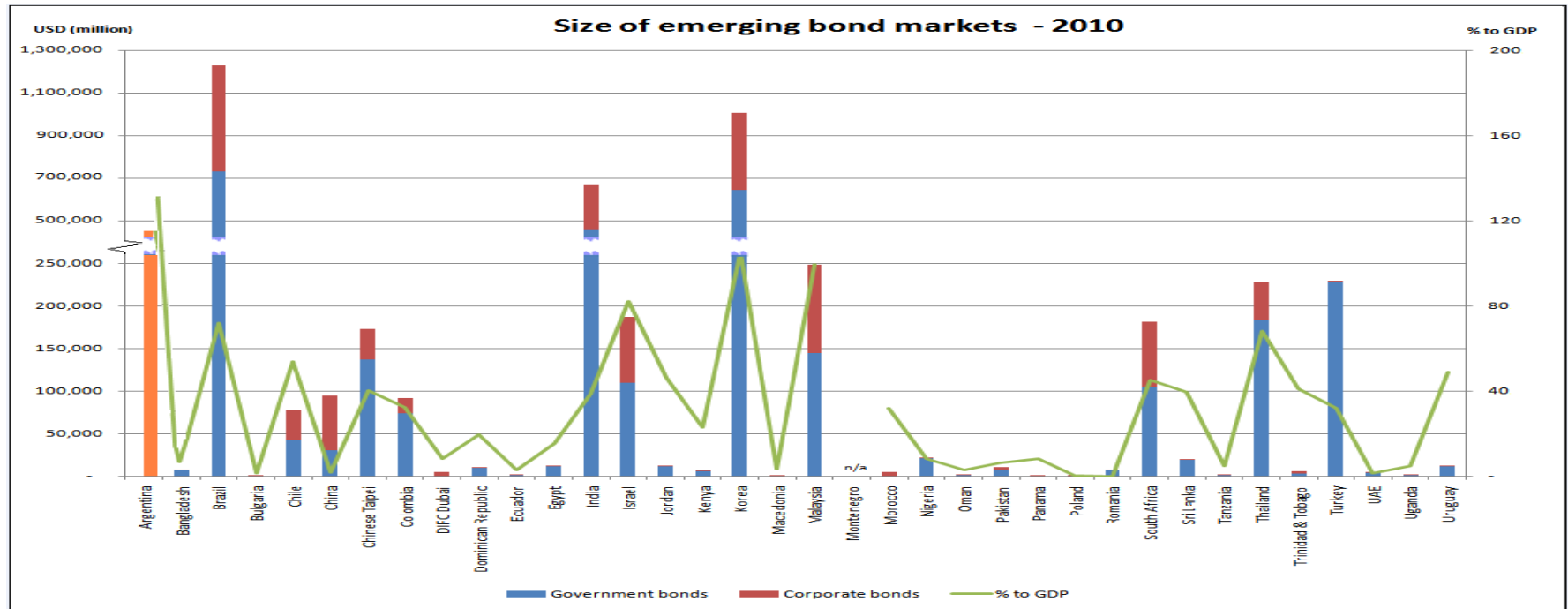


Source:
Goldman Sachs Asset Management

Significant growth of bond markets expected in emerging markets due to:

- Increased economic growth of emerging markets;
- Narrowing of income gaps between emerging markets and developed markets;
- Broadening and deepening of capital markets leading to diversified sources of funding; and
- Greater local and foreign investments to fund large scale infrastructure projects etc.

Overview of emerging bond markets



- Combined size of bond markets of EM respondents is approximately USD5.6 trillion;
- Size of EM bond markets is equivalent to almost 23% and 50% of the US and Japanese bond markets – reflecting the potential for further growth;
- Government bond markets are 2.7 times larger than corporate bond markets;
- As a % to GDP, EM bond markets range from 0.2% to 130.6%

Report is timely – focuses on current constraints for development of bond markets in EMs and provides in-depth discussions for further development. FSB had also identified the development of corporate bond markets to mitigate financial stability risks.

State of play of corporate bond markets in emerging markets

Regulatory approvals are required for corporate bond issuances in almost all EMs. Most adopt disclosure based approval

OTC markets are twice the size of the exchange-traded markets

CRA's are regulated in more than two-third of EMs. Less than half require mandatory credit ratings for corporate bond issuances

Public issuance of corporate bonds is twice the size of private placements (for period 2005-2010)

Plain vanilla bonds dominate the corporate bond market – floating rate bonds, structured bonds including ABS form a small part of the market

Investors tend to be institutional in nature (91%), while retail participation consists of 9% of total investments in corporate bonds

Issues and challenges affecting the development of corporate bond markets in emerging markets

MARKET EFFICIENCY

Benchmark yield curve (BYC)

- More than half of EMs surveyed do not have a BYC due to:
 - Govt. bonds issued in a sporadic and unstructured manner;
 - Availability of more cost effective alternative funding;
 - No immediate necessity to issue govt. bonds due to fiscal surplus.

Time to market

- Approval time by regulators – average 25 days due to:
 - Approvals required from multiple authorities;
 - Technical skills and expertise to effectively review corporate bond issuances.

MARKET INSTRUMENTS & STRUCTURE

Lack of diverse bond instruments

- Lack of a diverse set of corporate bonds such as municipal bonds, callable bonds, sukuk etc. that will enhance the depth and breadth of corporate bond markets
- Lack of alternative channels for issuance (private placements, semi-private, etc)

Investor base

- Narrow investor base due to:
 - Greater familiarity investing in equities & govt. bonds;
 - Investment restrictions e.g.: minimum rating requirements, limits to exposure for investments in corporate bonds.

Issues and challenges affecting the development of corporate bond markets in emerging markets (cont)

INVESTOR PROTECTION & REGULATION

Transparency & governance

- Quality, adequacy & timeliness of information disclosure need to be improved;
- Insufficient transparency may affect overall governance of corporate bond markets.

Market oversight

- Insufficient emphasis on building regulatory capacity to oversee corporate bond markets;
- Inadequate supervision of corporate bond market intermediaries eg: trustees, pricing vendors etc.

TAXATION AND OTHER CHALLENGES

Differential tax treatments between govt. and corp. bonds

- In many EMs, government bonds are tax exempt, while corporate bonds are taxed to varying degrees

Crowding out by government bonds

- Excessive government bond issuances may have a “crowding out” effect.

Competition from alternative financing

- Corporate bond markets face competition from alternative sources of financing:
 - Lower fees;
 - Existing relationships between banks and corporates.

Recommendations for the development of corporate bond markets in EMs

Prioritising the development of corporate bond markets as a strategic national development agenda

1. Establish a national platform for high-level policy and strategic direction, e.g. a National Bond Market Committee
2. Develop a sequenced strategy for corporate bond market development
3. Control the crowding out via healthy public finances..

Improving market efficiency

4. Broaden the range of offering mechanisms (private placements, hybrid regimes)
5. Reduce the approval or registration time for corporate bonds
6. Standardise corporate bond offering documentation
7. Develop an efficient benchmark yield curve and pre-announced auction calendar

Recommendations for the development of corporate bond markets in EMs (cont)

Enhancing market infrastructure & widening the investor base

8. Enhance trading efficiency
9. Develop a market making system
10. Establish a corporate bond index
11. Consider the establishment of a third party guarantee institution
12. Scale up markets through regionalisation
13. Broaden and diversify the investor base

Develop a wider range of instruments

14. Develop securitization markets
15. Encourage the development of risk management instruments

Recommendations for the development of corporate bond markets in EMs (cont)

Strengthening investor protection

16. Enhance the quality and timeliness of disclosures by issuers
17. Promote trading and price transparency
18. Strengthen surveillance and supervision
19. Strengthen the professional standards of bond market intermediaries
20. Strengthen bankruptcy and restructuring regulations

Develop a wider range of instruments

21. Adopt a taxation regime that does not disadvantage corporate bonds
22. Examine the viability of tax incentives

Thank you

Respondents to the survey

Argentina	Dominican Republic	Malaysia	South Africa
Bangladesh	Ecuador	Montenegro	Sri Lanka
Brazil	Egypt	Morocco	Tanzania
Bulgaria	India	Nigeria	Thailand
Chile	Israel	Oman	Trinidad & Tobago
China	Jordan	Pakistan	Turkey
Chinese Taipei	Kenya	Panama	UAE
Colombia	Korea	Poland	Uganda
DIFC Dubai	Macedonia	Romania	Uruguay

