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SBP, SECP joint task force set up to establish vibrant corporate debt market

Mr. Yaseen Anwar, Governor, State Bank of Pakistan (SBP) has disclosed that a joint task force of SBP and Securities & Exchange Commission of Pakistan (SECP) has been set up to draft a frame work for establishing a vibrant corporate debt market.

Delivering his key-note address at a conference on ‘Long Term Debt Financing - Issues and Challenges for Pakistan’ organized by the Institute of Business Management (IoBM) in Karachi today, he outlined the tasks of this joint task force as under:

- Develop guidelines for shelf registration of corporate debt
- Collaboration with credit rating agencies to streamline the issuer and instrument rating process.
- Coordination with provincial authorities on rationalization of stamp duty on transfer and issuance of corporate debt Instruments
- Collaboration with FBR and GoP to rationalize tax treatment of corporate debt instruments
- To encourage the development of corporate debt market, it is essential that taxation issues are addressed in an appropriate manner and communicated to the stakeholders.
- Develop standards for valuation of corporate debt instruments. A document containing all conventions and standards is a need to streamline the approval process of shelf registration with an objective to facilitate the issuer.

Mr. Anwar said that these initiatives are of utmost importance to be above to move from a purely banking loans market towards a vibrant Debt Capital Markets. ‘This will not only facilitate providing diversified investment avenues for various stakeholders, but will also help in improving saving ratios of the country and enable borrowers to raise efficiently price financing for crucial infrastructure projects, he said, adding that in this regard, the Investment Banks as well as Development Finance Institutions should also play a significant role in the development of a vibrant Corporate Debt Market.

SBP Governor said that corporate debt markets are important for several reasons: as a source of long term financing; providing competition to the banking sector; and enhancing financial stability. ‘I believe that we need to develop an alternative avenue of intermediation: corporate debt market. These markets will allow the channeling of funds directly from savers to the private sector – matching the demand for funds for long term investments with the supply of long term savings,’ he added.

He said that the existence of a functioning private bond market serves both borrowers – by broadening access to funding, and by lowering borrowing costs – as well as savers. ‘In Pakistan’s case in particular, it would provide savers with an alternative to bank deposits. It has long been recognized that the presence of such markets is a significant source of competition for the banking system,’ he added.

‘It is a matter of concern, and indicative of potential, that the size of the listed corporate debt market in Pakistan stands at less than one percent of GDP,’ he said, adding that corporate debt market can enhance financial stability by mitigating rollover interest risk for borrowers. He said that corporate debt market can improve the allocation of capital, as market-determined rates provide a clearer measure of the opportunity cost of funds.

SBP Governor said that in an uncertain macro environment, banks are reluctant to advance long-term loans to the private sector, and often resort to short-term lending. This implies that in the absence of corporate debt market, firms will find it difficult to raise funding for long-term investment projects, he said, adding that essentially, the short-term nature of bank lending will bias capital investment in general, and may exacerbate cyclical fluctuations in economic activity. 'This will be particularly true in industries where costs are recovered over a much longer-term. Such industries include construction, power generation, etc,' he added.

He pointed out that in most countries, the government – as the largest issuer of debt securities – provides the volume required for a liquid secondary market. In Pakistan, however, PIBs are unable to serve this for two reasons, he said, and added 'firstly, the market is not sufficiently liquid, and secondly, there is no benchmark for private bonds that are issued for a tenor of between 5 and 8 years - since PIBs are only available in maturities of 5 and 10 years.

Mr. Anwar said that competition from the government for the same pool of savings undermines progress towards greater financial deepening. The risk-free nature of investment in various NSS schemes, their ad-hoc rate adjustment, and the ability to redeem prematurely, dominates any corporate bond in the market, he said, adding that the private sector, therefore, has to issue bonds that carry a higher interest rate than NSS rates to compensate for the risk of default that the private sector carries. 'This makes the issuance of corporate sector debt expensive,' he added.

He suggested that the process for primary issuance of corporate debt should be simpler one and fast track; so that a corporate could raise funds quickly when conditions are favorable for debt issuance. Shelf registration is an efficient way of issuing the debt instruments as it saves the cost and time. Although, in Pakistan we have shelf registration for corporate bonds but it usually takes long time for the approval process, he said and added that considering the persistently thin volumes on BATS developed by KSE, market participants should be encouraged to use Bloomberg EBND, which trades almost 65% of volumes, also trading in corporate debt instruments.

SBP Governor said that the appetite for raising debt on the capital markets is also an issue. Corporates are reluctant to approach the bond market because of the disclosure requirements, and their preference to remain undocumented, he said and added that the corporate culture in the country must change, so that family-owned businesses are not constrained from future growth.

Mr. Anwar recalled that our fiscal deficit is not unmanageable, but we need to deepen our financial markets to ensure that any adverse development on the fiscal side of affairs does not negatively impact the pool of credit available to the private sector. 'There is immense room for improvement when it comes to financial deepening through bond markets,' he added.

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