Development of Corporate Bond Markets in the Emerging Markets

Final Report

EMERGING MARKETS COMMITTEE
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS
IN COLLABORATION WITH THE WORLD BANK GROUP

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Executive Summary

The IOSCO EMC Task Force on Corporate Bond Markets in Emerging Markets was formed to review the current state of development of corporate bond markets in emerging markets (EMs), identify existing impediments which affect the development of efficient corporate bond markets and provide a set of recommendations which regulators in EMs may consider as they build and further develop their respective markets. The Task Force is co-chaired by the Securities and Exchange Board of India and the Securities Commission Malaysia, in collaboration with the World Bank.

The size of EM bond markets is projected to rise significantly in the next few decades given the increased economic growth in EMs, greater local and foreign investments to fund large scale infrastructure projects and the narrowing of gaps in income between EMs and developed markets. While the growth of government bond markets in EMs is encouraging, there remain concerns that currently many corporate bond markets in EMs are still under-developed, and consequently lag behind the banking system and the equity market as a source of funding for the private sector.

Corporate bond markets in EMs are at various stages of development, and tend to be relatively nascent and untapped in many EMs. Other prevalent characteristics include limited quality bond offerings, small issuance size and lack of liquidity in the secondary markets.

Against this background, the Report focuses on the key issues and challenges facing the development of corporate bond markets in EMs. The slower growth of corporate bond markets in many EMs stem from a variety of factors including a relatively underdeveloped regulatory framework, inefficient market infrastructure, a lack of diverse instruments and a narrow investor base.

A robust corporate bond market can act as a source of stability, particularly during periods of financial stress, where the freezing up of credit markets are common. The development of deep and liquid corporate bond markets will help reduce reliance on bank financing and lead to greater diversification of the sources of funding across various asset classes. The corporate bond market also helps to reduce the risk of currency and funding mismatches, particularly for projects with long gestation periods.

This has underscored the need for deeper and broader corporate bond markets in EMs globally. A number of conclusions can be drawn and recommendations can be made to the issues and challenges surrounding the development of corporate bond markets in EMs.

The building of corporate bond markets is a challenging process and may take a considerable amount of time. The following key recommendations may act as guidance and provide direction to EM regulators as they develop and regulate their respective corporate bond markets:

- **Prioritising the development of corporate bond markets as a strategic national agenda**. Given the significance of the macroeconomic environment in influencing the development of the corporate bond market, EM policymakers should provide high-level and long-term strategic direction in the bond market development agenda. Sequencing the corporate bond market implementation strategy is also pivotal to ensure sustained and orderly development of the corporate bond markets.

- **Improving market efficiency.** In order to improve market efficiency, measures identified include broadening the range of primary offering methods, reducing the time for approval or registration of bond issues, standardising bond offering documentation, creating an efficient government benchmark yield curve and having in place a pre-announced auction calendar.

- **Enhancing market infrastructure and widening the investor base.** To complement the growth in the primary market, recommendations to enhance the market infrastructure for corporate bonds include enhancing trading efficiency, developing a market making system, establishing a corporate bond index and creating a specialised third party guarantee institution. The removal of regulatory obstacles which impede the participation of investors in the corporate bond market and the promotion of retail participation are also expected to widen the investor base, and contribute towards the overall development of the corporate bond market in EMs.

- **Developing a wider range of instruments in the corporate bond market.** EMs may wish to develop a wider range of instruments available in the corporate bond market, and these include the development of securitization markets and risk management instruments. These instruments can add depth and breadth to the market and cater to the different needs of issuers and investors.

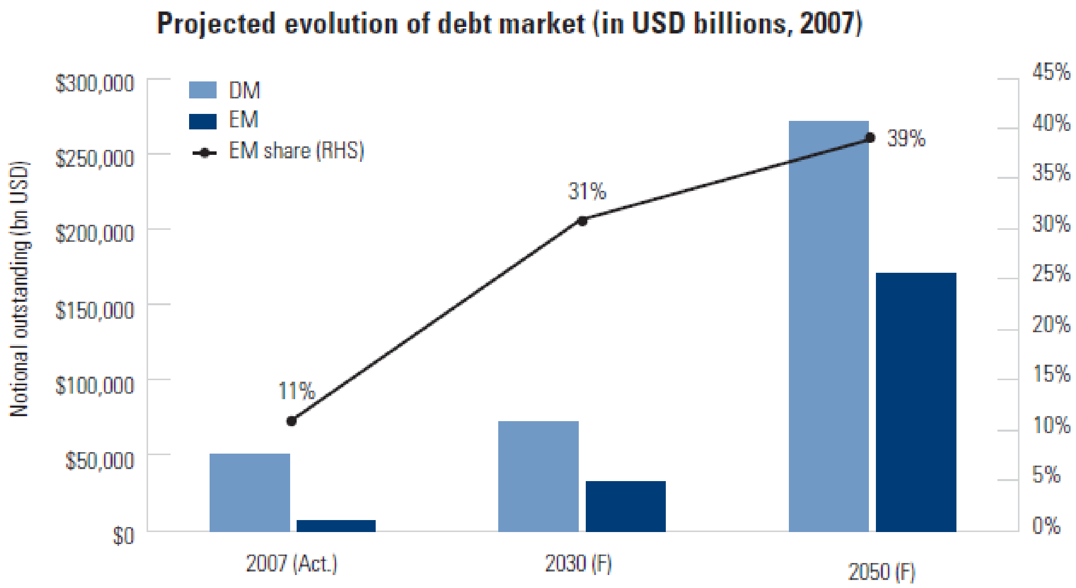
- **Strengthening investor protection**. Measures to deepen and grow the corporate bond markets must be complemented by robust regulatory and supervisory frameworks, and strengthened investor protection efforts. These include enhancing the quality and timeliness of disclosures by issuers, promoting trading and price transparency, strengthening surveillance and supervision, assessing the use of ratings, as well as enhancing bankruptcy and restructuring regulations.

- **Adopting a conducive taxation framework**. EMs should undertake a review of the taxation framework to enable the corporate bond market to operate on a more level playing field with the government bond market and the loan segments within the banking sector.

Chapter 1 Introduction

Since the global financial crisis of 2007-2008, EMs have attracted significant attention due to their increased prospects for higher growth, favourable demographics, manageable fiscal positions and low debt levels in contrast to developed markets[1]. Further, it is envisaged that the growth in EMs will facilitate the development of deeper emerging local bond markets, thus increasing the size of EM debt relative to developed market debt. In 2007, EM bond markets comprised 11% of global bond markets, which totaled over USD55 trillion. By 2030, this is projected to rise to just over 30%, and by 2050 to nearly 40% of the total global bond markets[2]. The projected growth in the bond market can be attributed to increased economic growth in EMs, greater local and foreign investments to fund large scale infrastructure projects and the narrowing of gaps in income between EMs and developed markets(DMs).

This forecast also assumes that EM economies will continue to grow, inflation will be moderate and government deficits sustainable. In other words, EMs will enjoy macroeconomic stability. Such conditions are necessary for bond markets to grow. Potential creditors would demand lower yields if they believe that inflation would not erode their investment returns or that the government, arguably the lowest credit risk of a country, would be able repay their debt. This would lower the costs of debt financing for corporations and encourage bond issuance by the private sector.



Source: Goldman Sachs Asset Management

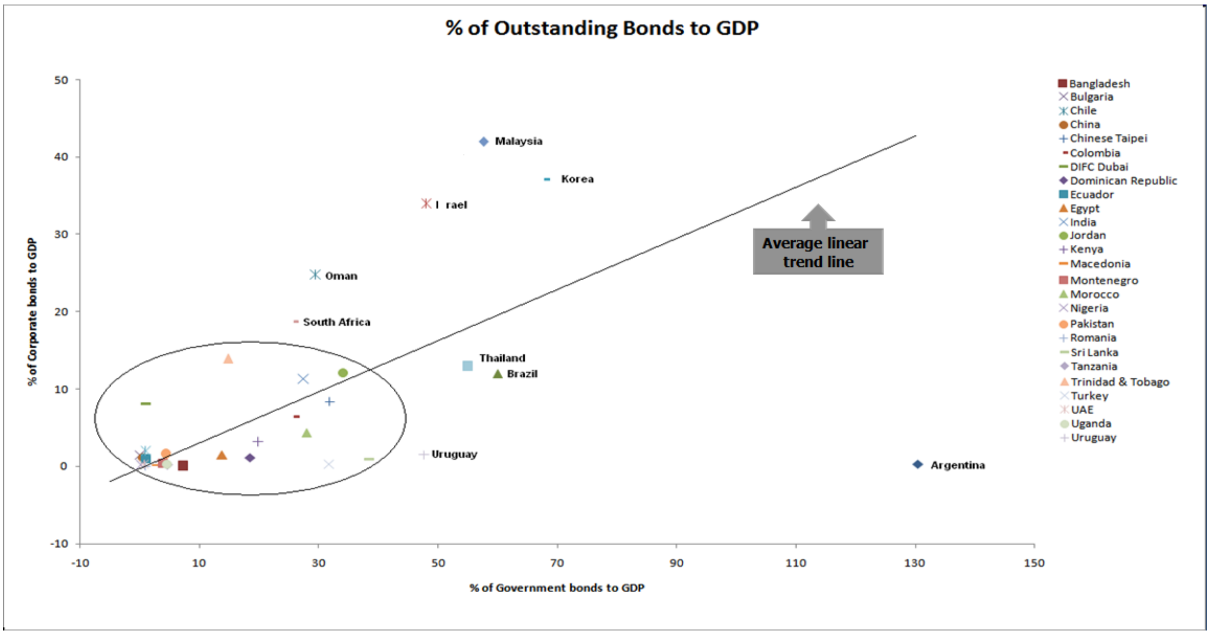
While the growth of government bond markets in EMs has been encouraging, there remain concerns that currently many corporate bond markets in EMs are still underdeveloped, and consequently lag behind the banking system and the equity market as a source of funding for the private sector. Corporate bond markets in EMs are characterised by among others, limited

1 Emerging Market Debt: From 'Niche' to 'Core', Goldman Sachs, April 2010

2 See supra note 1.

quality bond offerings, small issuance size and lack of liquidity in the secondary markets. The slower growth of corporate bond markets in many EMs stem from a variety of factors including the relatively underdeveloped regulatory framework, inefficient market infrastructure and narrow investor base.

Although local corporate bond markets in EMs are currently growing, albeit at a much slower rate than government bond markets, there is significant scope for accelerated growth. This is particularly in light of greater projected financing needs, increasing per capita incomes, evolving capital structures and increasing capital account liberalisation in many EMs. The graph below indicates that there are several EM jurisdictions with significant government bond markets with potential to grow their corporate bond markets further should appropriate developmental policies be adopted.



This diagram only covers countries which have provided complete breakdown of corporate and government bond markets as % to GDP.

Past financial crises have highlighted the importance of developing corporate bond markets. While issuers and investors benefit directly from deep and active corporate bond markets, the development of corporate bond markets from a financial stability perspective is critical. A robust corporate bond market can act as a source of stability, particularly during periods of financial stress, where the freezing up of bank credit is common. Additionally, foreign institutions may be quick to withdraw from EM equity markets rather than diversifying into other asset classes due to the lack of alternative markets such as deep government and corporate bond markets that may have allowed for the retention of funds in domestic markets.

The development of deep and liquid corporate bond markets will help reduce reliance on bank financing and lead to greater diversification of the sources of funding across the various asset classes. Reliance on banks for funding may also result in currency and funding mismatches for projects with long gestation periods, which are particularly relevant for infrastructure projects in many EM jurisdictions. While manageable during times of steady economic growth, such mismatches may be aggravated during periods of volatility. EM regulators have therefore increasingly recognised the need to develop and strengthen domestic corporate bond markets in order to provide an alternative source of long-term financing for private sector issuers and quality investments for investors.

The development of an efficient corporate bond market offers several additional benefits for issuers, investors and the overall economy:

1. Enables corporations to reduce their financing costs and provides for a more efficient allocation of savings;

2. Provides an asset class for portfolio diversification, particularly for investors with long-term liabilities;

3. Facilitates the efficient pricing of credit risk by way of the various continuous disclosure requirements imposed by regulators;

4. Enhances the transparency and disclosure of companies through the access provided by capital markets; and

5. Provides risk management benefits through the introduction of risk management instruments, thus limiting the impact of exposures by borrowers.

Scope and Structure of the Report

In January 2010, the IOSCO EMC Task Force on the Development of Corporate Bond Markets, in collaboration with the World Bank, was tasked to assess the state of development of corporate bond markets in EMs and to identify existing impediments which affect the development of efficient corporate bond markets. Further, it was asked to propose a set of recommendations which regulators in EMs may consider as they set about to build and further develop their respective markets. This Report has benefitted from the close collaboration with the World Bank.

In developing this Report, a comprehensive survey questionnaire was formulated with a view to obtain relevant information relating to EM's corporate bond markets. This included the nature and size of corporate bond markets, the regulatory framework governing corporate bond markets, the primary and secondary markets for corporate bonds, and other relevant issues pertaining to credit rating agencies, risk management and investor protection. Responses were received from thirty-six EMs covering diverse geographical locations[3]. Ten respondents were from the Asia-Pacific region, twelve from Africa and the Middle East, five from Europe and nine from the Inter-American region. In addition, the Task Force also circulated a supplementary questionnaire which specifically sought to gather information on the primary offering regimes in selected developed and EM countries. The results of the

[3] See Appendix C for list of survey respondents.

survey findings primarily form the basis of Chapter 2 on the State of Play of Corporate Bond Markets in EMs.

The Task Force also consulted with global bond market industry participants in Madrid, Spain in May 2011 to garner industry views on the practical challenges currently impeding the development of corporate bond markets[4]. This initiative was unique and represents a first for the IOSCO EMC as a means of incorporating industry feedback into the Report.

In developing the Report, the Task Force noted the earlier work conducted by IOSCO on the development of the corporate bond markets, namely the IOSCO EMC Report on Development of Corporate Bond Markets in Emerging Market Countries (May 2002) and the IOSCO Technical Committee Report on Transparency of Corporate Bond Markets (May 2004), as well as various recent international publications in this area.

The Report is structured as follows: Following on from the Introductory Chapter, Chapter 2 provides a description of the state of play of corporate bond markets in EMs, while Chapter 3 discusses the issues and challenges facing the development of corporate bond markets. Finally, Chapter 4 proposes a set of recommendations and best practices which EM regulators may wish to consider adopting as they build and further develop their respective corporate bond markets. Appendix A contains detailed analysis on the primary market framework and selected jurisdictional case studies.

4 See Appendix C for list of industry participants.

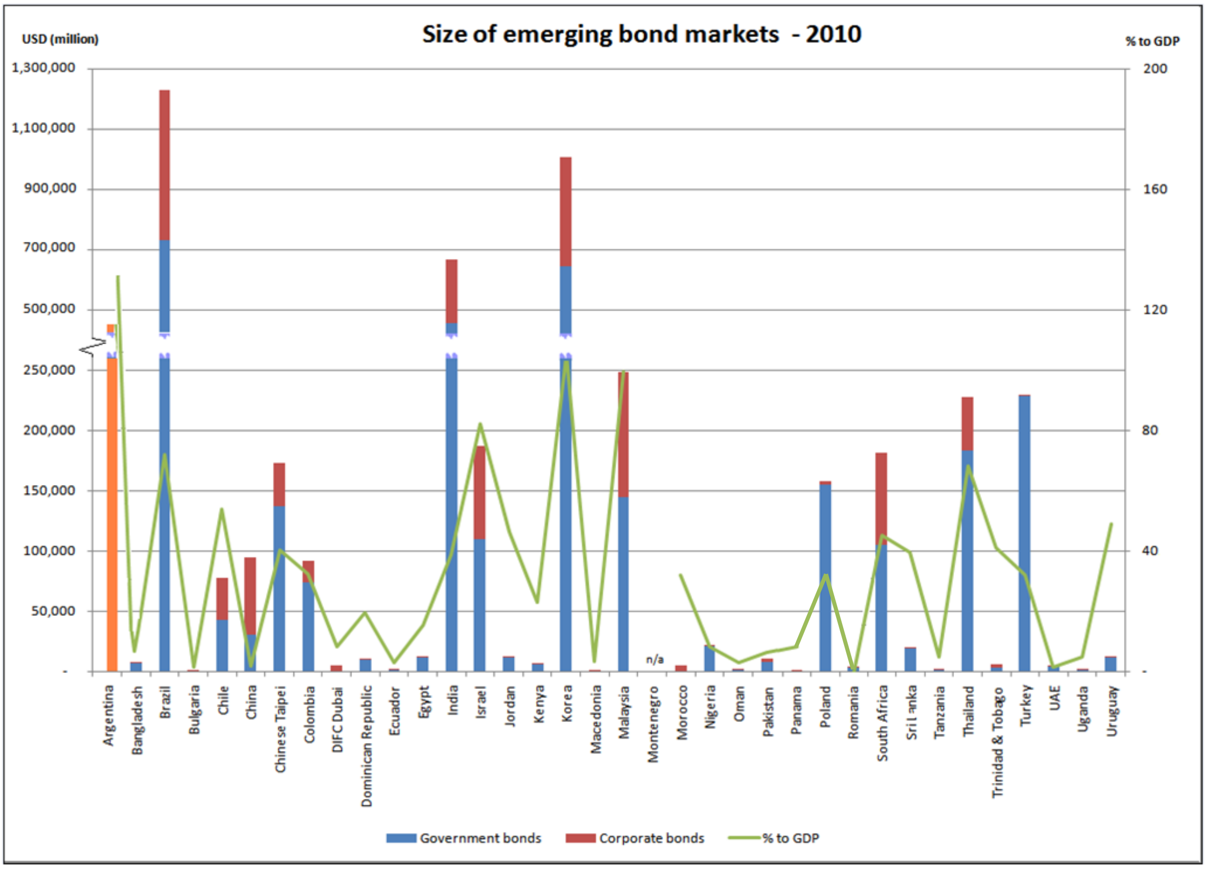
Chapter 2 State of Play of Corporate Bond Markets in Emerging Markets

2.1 Overview of bond markets in EMs

2.1.1 Size of bond markets in EMs

Corporate bond markets in EMs are at different stages of development. The survey results indicate that approximately one-third of EMs have a sizable corporate bond market. These jurisdictions include Brazil, Chile, China, Chinese Taipei, India, Israel, Korea, Malaysia, South Africa and Thailand.

The existing state of EM bond markets surveyed is highlighted in the graph below.



**Data for China represents listed bonds (which are regulated by CSRC) and data for Macedonia is as at end-2009. Data for Argentina includes consolidated figures for its government and corporate bond market.*

At approximately USD5.6 trillion, the combined size of the bond markets of the thirty-six EM jurisdictions is equivalent to almost 23% and 50% of the US and Japanese bond markets respectively. Relative to the size of these economies, the size of bond markets range from 0.2% of GDP in Bulgaria to 130.6% in Argentina. In comparison, bond markets constitute about 175% percent of GDP in the US and 198% in Japan.

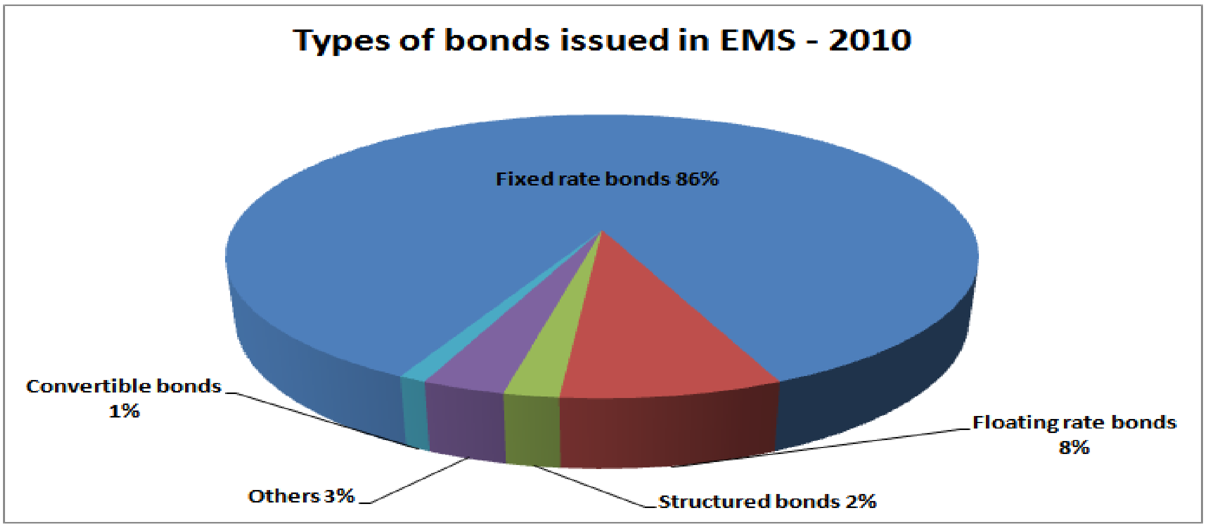
In all EMs surveyed, the government bond markets are larger in size when compared to the corporate bond markets. The government bond market is around 2.7 times that of the corporate bond market.

The size of the corporate bond market varies widely across EMs surveyed. The Korean corporate bond market is the largest with total outstanding corporate bonds amounting to USD373 billion. Korea, Brazil, India and Malaysia dominate the corporate bond market arena and account for more than 80% of the total corporate bond market of EMs surveyed.

2.1.2 Types of bonds in EMs

While the bond markets in EMs surveyed comprised largely of government bonds (around USD3.35 trillion) and corporate bonds (around USD1.25 trillion), other instruments such as repos and reverse repos, certificates of deposits, commercial papers, bills, notes and sukuk (Islamic bonds) also have active markets (around USD1.03 trillion). An interesting point to note is that the municipal bond market size in EMs appears to be negligible. This may be attributed to the lack of familiarity or authority by municipals in raising funds through the bond market.

It has been observed that in 2010, the issuance of plain vanilla fixed rate bonds dominated the market with a share of 86% of all corporate bond issuances. Floating rate bonds form 8% of the total bonds issued, while there appeared to be very little issuances of other types of bonds such as convertible bonds and structured bonds.



2.1.3 Offering methods

Public issuance is more apparent in EMs surveyed compared to private placements. On an aggregate basis, public issuances of bonds have been higher than that of private placements for the period 2005-2010. The value of both public issues and private placements grew significantly within this period with a total of USD1.19 trillion and USD569 billion issued respectively. Korea, China, Brazil, South Africa and Israel have a significant public market, whereas Malaysia, India and Korea dominate the private placement market.

Further, it is noted that many EM jurisdictions, particularly the smaller jurisdictions, tend to have very small issuance sizes. This could be due to the fact that the average size of corporations in several EMs tends to be much smaller than those of the developed markets, making bonds a less viable financing option as the fixed costs associated with raising funds through bonds may make it a more expensive alternative.

It is observed that aside from public issuance and private placements, EMs have introduced hybrid offer regimes[5]. Among the EMs surveyed, the alternative offer regime carries the most importance in Malaysia, India, Brazil, and Thailand, accounting for 99%, 80%, 70% and 36% of total issuance, respectively. The table below outlines the different alternative offer regimes available in EMs.

	Brazil	**Chile**	**India**	**Israel**	**Malaysia**	**Thailand**
Nature of regime	Exempt public offer	Exempt public offer	Private placement which are listed later	Private placement with secondary market trading	Private placement with secondary market trading	Private placement with secondary market trading

2.1.4 Trading Volume

Trading volumes in the EM bond markets as a whole reached an all-time high in 2010[6] where volumes increased by 52% when compared with 2009. Local market trading volumes, on an annual basis, accounted for 70 percent of all trades, a rise of 64 % over volumes recorded in 2009. On the other hand, trading volumes on in the EMs surveyed showed an increase of almost 20% in 2010 when compared with 2009 with several countries such as Korea, India, Malaysia and Colombia accounting for the bulk of volume.

2.2 Legal and regulatory framework

A sound legal and regulatory framework governing corporate bond markets is an important pillar which supports the development of a deeper, broader and more efficient bond market in EMs. EMs surveyed have a basic regulatory framework in place for corporate bond market

[5] Hybrid offer regimes refer to issuance frameworks that contain elements of both public and private regimes. Two key features of these regimes are: (i) exemption from submission of a full prospectus; and (ii) relatively easy access to secondary market trading. Hybrid offer regimes have lighter regulatory requirements and are designed with target investors of corporate bonds in mind – i.e. professional or institutional investors.

[6] Data obtained from the Emerging Markets Trade Association (EMTA) – an association for the emerging markets debt trading industry.

development. This includes having one or more regulatory authorities and laws and regulations in place to govern a well-functioning market for corporate bonds.

2.2.1 Regulatory approvals for corporate bonds

For the majority of EMs, the approving authority for corporate bonds lies solely with the securities regulator. In some EM jurisdictions however, for example, China, Morocco and Sri Lanka, the securities regulator shares the approving authority with either the Central Bank, Registrar of Companies or the Stock Exchange. In Egypt, the approving authority for corporate bonds is the Egyptian Financial Supervisory Authority and for government bonds, the issuer is the Ministry of Finance. A few EMs indicated that regulatory fragmentation has hampered the development of corporate bond markets in their respective jurisdictions.

In terms of the bond approval process, most EMs surveyed have adopted a disclosure based regime for bond issuance. All EMs surveyed require regulatory approval for the issuance of bonds except the Dubai International Financial Centre (DIFC), India and Poland. Merit based approval is currently adopted in only four countries, namely, Egypt, Kenya, Oman and the United Arab Emirates (UAE). Tanzania and Uganda have a combination of both merit and disclosure based regimes. However, it is noted that these jurisdictions do not have large and active corporate bond markets.

The survey findings reflect that the time committed by regulators taken for registration or approval of corporate bonds ranges from 5 days (DIFC and Korea) to 3 months (China). The average taken for approval in EMs surveyed is 25 days.

2.2.2 Transparency and disclosures

In creating an enabling environment to foster the growth and development of corporate bond markets, disclosure and transparency are critical aspects. The survey findings reflect that most EM jurisdictions have fairly comprehensive disclosure requirements for public issues, while disclosure requirements for privately placed issues are less stringent. Similarly, for continuous disclosures, the requirements for public issues are comprehensive, but for privately placed issues, disclosures are not required in several jurisdictions. The types of information required to be disclosed cover issuer details, risk factors, eligible category of investors, credit ratings, financial information, auditor's report, shareholder details, history of default, changes that will affect the rights and obligations of bondholders etc.

Israel has recently enhanced disclosure requirements focusing on data directly relevant to bond issuers' repayment capabilities. This includes projected cash flows for financing the redemption of corporate liabilities which in turn has helped the growth of corporate bonds.

2.2.3 Credit-ratings

Survey findings show that credit rating agencies are present in almost all EMs surveyed except for Tanzania and Uganda, and where they exist, they are regulated in close to 70% of

EMs. Less than half of the EMs require mandatory credit ratings for the issuance of corporate bonds. It is also possible to obtain more than one rating for a corporate bond issuance, and in such cases, all the ratings have to be disclosed.

In 75% of the jurisdictions, ratings provided by international credit rating agencies are permitted, and these include most jurisdictions with sizable corporate bond markets such as India and Malaysia. Further, in half of the EMs, unsolicited ratings are permitted.

In terms of continuous monitoring and updating of credit ratings of bonds by the rating agencies, it is observed most of the EMs require continuous monitoring and reporting of the ratings by the rating agency. The period for updating the ratings is usually six months or one year or when a circumstance warrants a change of rating, and the same is usually required to be submitted to the regulator or the exchange or be made public.

2.2.4 Tax treatment

The regulatory framework on taxation is important in the development of corporate bond markets. In many of the EMs surveyed, while government bonds are tax exempt, corporate bonds are taxed to varying degrees. Almost half of EMs surveyed highlighted that there are different tax regimes between government bonds and corporate bonds as well as between corporate bonds and commercial loans which may have partly contributed towards the lack of interest by the private sector in their respective corporate bond markets. These taxes may include transaction taxes, stamp duties, capital gains tax and withholding tax.

2.2.5 Bankruptcy and restructuring regulations

One of the risks that exist for bond investors is the risk of default. From the survey, bondholders have bankruptcy protection in most of EMs through various laws. The protection is provided via bankruptcy laws and by way of property rights legislation or bond covenants.

In some countries like the Dominican Republic and Macedonia, for example, bond holders have the same status as common stock holders. In few jurisdictions like Ecuador and Uganda, there is no such bankruptcy protection. In several EMs in Asia[7] there is an absence of a reasonably robust bankruptcy process despite widespread reform of bankruptcy laws after the Asian financial crisis.

2.3 Market framework

2.3.1 OTC vs. Exchange traded market

It is observed that in EMs, while corporate bonds are largely traded OTC, the exchange traded market has seen a steady growth in recent years, accounting for half of all bond market

[7] Mangal Goswami and Sunil Sharma, *The Development of Local Debt Markets in Asia*, International Monetary Fund, June 2011.

trades. Survey results show that the largest OTC bond markets are from the Asia-Pacific and Inter American region, with Korea being the largest OTC market, accounting for trades amounting to USD700 billion in 2010 followed by India, Brazil, Colombia and Chile.

In the exchange-traded market, South Africa is the largest followed by Colombia, China, Chile, Israel and India. Colombia, India and Chile are the only three EMs which have active secondary market trading in both OTC and exchange traded markets. In Chile and until recently, in Colombia, institutional investors were required to transact all their trades on the exchange and not on the OTC market.[8] This has therefore led to a more significant share of bond market transactions on the exchange in both these jurisdictions.

The survey results also reflect that Brazil, Korea and India have exchange traded markets, though trades in these countries still continue to be largely OTC. It is possible that the actual OTC trade data may be higher since many EMs do not report OTC trades, and subsequently no data is available.

Among the recent initiatives in this area, India has introduced trading on the exchange, which is primarily utilised by retail investors. Kenya and Tanzania are moving towards the introduction of an OTC market for bonds to stimulate secondary bonds trading along with other East Africa partner states. Malaysia has introduced a framework for the listing of Ringgit and foreign currency bonds and sukuk in December 2008 to facilitate listing of bonds and sukuk on the exchange.

2.3.2 Alternative Trading Systems (ATS) or Electronic Communication Networks (ECNs)[9]

One-third of the EMs surveyed regulate ATS or ECNs. It appears that typically only one or two such platforms exist in each jurisdiction and they usually have an exchange regulatory framework. A few EMs such as Korea and Thailand, however, have a broker regulatory framework for ECNs. Membership requirements are seen to differ widely from one EM to another and there appears to be no standard membership requirement across EMs.

Among the EMs with larger corporate bond markets, information on trading on such ATS or ECNs is publicly available in Korea, while in Malaysia and Thailand, information is available only to members.

2.3.3 Benchmark yield curve

Corporate bond market development has benefitted from the existence of a government benchmark yield curve. The government securities market can provide a yardstick for pricing various debt instruments, including corporate bonds.

8 Colombia has recently repealed this regulation, but Chile still maintains it for pension funds.

9 Commonly referred to as Multilateral Trading Facility in the US.

Survey results show that more than half of the EMs do not have an efficient government benchmark yield curve to price corporate bond issues in the primary and secondary markets. This is seen as a major impediment for the development of corporate bond markets in EMs. It is noted that EMs without a benchmark yield curve have corporate bond market sizes of less than USD2 billion.

Among the reasons for the lack of a benchmark yield curve are governments not having introduced adequate debt management programmes, and governments issuing bonds at irregular intervals to maximise windows of opportunity. This situation is particularly prevalent in some EMs with large fiscal deficits.

Without an efficient benchmark yield curve, pricing in the primary and secondary markets of corporate bonds may be constrained.

2.3.4 Information dissemination systems and historical data

The reporting of bond trades is important in promoting transparency in the secondary markets as it allows for pricing information to be made available to market participants. The reporting of secondary market trades is obligatory in more than half of the responding EMs.

Approximately two-thirds of EMs surveyed report secondary market trades to a regulatory authority or SRO. Those EMs that report trades normally do so within one day from the time the trade occurred. There is also a small number of EMs which collate the trades and report on a periodic basis, for example, on a quarterly basis.

The survey results also show that currently only ten of the responding jurisdictions have price or information dissemination systems, namely Argentina, Brazil, Chinese Taipei, Dominican Republic, India, Israel, Korea, Malaysia, Turkey and Thailand.

Survey results also show that only half of the jurisdictions have a centralized information system for historical trade data as well as complete databases of bond holders. Surprisingly, EM with large corporate bond markets such as Brazil, DIFC, Israel, Korea, Malaysia and Thailand do not have complete databases of bond holders.

2.3.5 Clearing and settlement systems

Slightly less than half of EMs surveyed have a formal clearing system for clearing corporate bond transactions using a central counterparty. On the other hand only one-third of EMs surveyed have a clearing system that is guaranteed by the central counter party where risks involved are managed by affording guarantee funds or setting out membership requirements. Several EMs such as Bangladesh, Brazil, Bulgaria, DIFC, Egypt, India, Montenegro and Pakistan have a central clearing system, which facilitates clearing but does not act as a central counter party. Approximately a third of EMs surveyed primarily clear corporate bond trades through bilateral agreements only.

A majority of the EMs surveyed, particularly EMs with sizeable bond markets, expressed that settlement of corporate bond transactions takes place on a delivery vs. payment basis.

2.3.5 Market-making

Secondary market liquidity can be improved via the introduction of market makers. In EMs such as China and Indonesia, reforms have recently been undertaken in order to facilitate the introduction of market makers in the corporate bond market.

The survey results show that one-third[10] respondents have market making systems in place., However, no data is available to assess the effectiveness of the market making system in these jurisdictions. It is noted that several EMs with sizeable corporate bond markets such as Chile, Chinese Taipei, India, Israel, Korea, Malaysia, South Africa and Thailand do not have a market-making system in place.

2.3.6 Risk management and hedging instruments

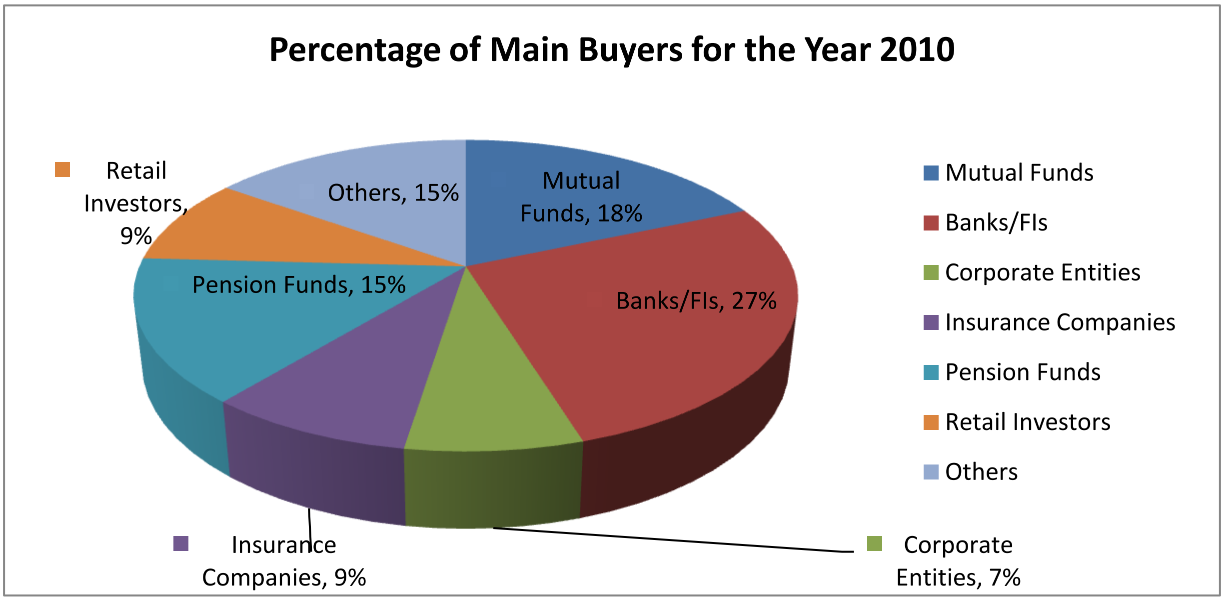
Products such as repos and reverse repos, interest rate derivatives (IRD) and credit default swaps (CDS) aid in bringing about liquidity in the corporate bond markets by introducing mechanisms which manage interest rate risk. The survey results indicate that almost two-thirds of EMs have introduced repo transactions, one third have introduced IRDs and one-sixth have introduced CDSs. Further it is noted that EMs which have introduced repos, IRDs and CDSs are jurisdictions with sizeable bond markets.

2.4 Players in the corporate bond market

2.4.1 Investors

Corporate bond markets in EMs tend to be largely institutional markets with very small retail participation. The graph below shows that from the EMs surveyed, banks and financial institutions form the largest group of investors and account for 27% of buyers in corporate bond markets, followed by mutual funds with an 18% share, pension funds with a 15% share and insurance companies with a 9% share. Retail investors account for only 9% of corporate bond investors.

10 Argentina, Bangladesh, Brazil, China, DIFC, Egypt, Nigeria, Pakistan, Poland, Sri Lanka, Tanzania and Uganda.



In most EMs surveyed, institutional investors are subject to various restrictions for investing in corporate bonds. The restrictions can be in the form of minimum rating requirements or limits on the maximum exposure for investments in corporate bonds. Banks have investment restrictions in terms of (i) capital adequacy, (ii) investment out of own resources, (iii) investment in bonds below a certain grade or unlisted bonds (iv) single-issuer exposure and (v) a percentage of total equity. For example, in Bulgaria, mutual funds cannot invest more than 10% in corporate bonds, while pension funds cannot invest more than 25% and insurance companies cannot invest more than 80%. In contrast, mutual funds in Brazil can invest up to 100% in corporate bonds.

The breakdown in investor base is not necessarily dissimilar to developed corporate bond markets, where the investor base tends to be dominated by institutional investors i.e. banks, pension funds, insurance companies.

Demographic changes, pension reforms and the larger role played by non-bank financial institutions are said to have contributed to the deepening of the domestic institutional base. The growth in the mutual fund industry in many EMs has also allowed households, in effect, to hold local currency bonds in more liquid and easily tradable units[11].

It is observed that foreign investor participation in EMs has also been increasing, primarily through mutual funds, pension funds, hedge funds and sovereign wealth funds. Assets under management for dedicated emerging market bond funds, particularly local currency bond funds, are said to have risen significantly[12].

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11 See supra note 7.

12 See supra note 7.

Non-traditional EMs investors, such as hedge funds and "crossover" investors[13] have also become significant buyers in recent years, drawn to the attractive yields and better risk-return characteristics of the sector. In 2010, it is estimated that crossover investors accounted for approximately 20% of total new issue demand and, for certain investment grade issues, close to 50%[14].

2.4.2 Issuers

Many EM corporations, such as natural resource companies, utilities and quasi-sovereign entities are the typical bond issuers in EMs. The largest issuing sectors from emerging corporate bond markets have been basic materials, energy, oil and gas, telecoms and property construction[15].

With rapid development in several EMs, many companies are finding opportunities to grow and facilitate the development of their economies. For example in 2011, Brazil's Petrobras sold USD6 billion of bonds in Brazil's largest corporate bond offering while China's Shanghai International Port Group, its biggest port operator, sold USD750 million of bonds, setting a landmark in the jurisdiction's corporate bond market with the first deal under a new fast-track system.

2.4.4 Pricing vendors

Pricing vendors only exist in a handful of EMs, such as Indonesia, Korea, Malaysia, Mexico and Peru. These entities provide fair value bond prices for government and corporate bonds for investors such as mutual funds. Colombia is presently establishing a regulatory framework for price vendors in the local markets. Pakistan on the other hand, has recently announced plans to develop a bond pricing agency to invigorate its bond market.

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13 Investors who do not have emerging markets corporate bonds in their benchmarks.

14 *Emerging Markets Corporate Debt: Opportunities in a Large and Maturing Asset Class*, Prudential Fixed Income, February 2011.

15 See supra note 14.

Chapter 3 Issues and Challenges[16]

3.1 Market Efficiency

3.1.1 Primary market issuance[17]

Expeditious and efficient offering methods can minimise issuers' expenses and reduce potential risks. A pure public offer may be regarded as the most common issuance regime providing the most investor protection, but its initial and ongoing requirements can be onerous and costly for issuers, discouraging the use of bond financing, especially for smaller, less established issuers. The pure private placement regime may be regarded as a regime with the least amount of investor protection. While it grants issuers the quickest access to bond financing, its limited information disclosure and restricted trading, reduces its investor appeal. Therefore, in order to further expand access to bond capital, striking a balance between investor protection and issuers' cost which include burdensome disclosure requirements, is an important consideration.

As highlighted in the survey findings, most EMs have in place public and private placement methods of offering. Studies have shown that the preference between public and private placement methods of offering may be determined by regulation or cost. For example, in Poland, a number of regulatory and cost obstacles make private placements the only cost efficient way to issue corporate bonds. In a public placement, a prospectus has to be issued for each bond issue, ruling out medium-term note programs, and prospective issuers must wait a long time for the approval of the authorities, in addition to paying high fees for issuances. Similarly, the cost of public issuance in Hong Kong Special Administrative Region is estimated to be four times that of a private placement. Yet, in other jurisdictions, particularly in many medium-size and smaller EMs that have a more dominant public offer mentality, private placements are not widely recognized by institutional investor regulators,[18] resulting in limited investor interest in private placements and, in turn, hesitation by issuers to take advantage of this issuance channel.

In addition to pure public and private offer channels, it may be worthwhile to consider other offering methods which include hybrid offering. Hybrid offer regimes, which can take many forms, aim to minimize the regulatory burden and cost of accessing the bond market, while maintaining a degree of investor protection and secondary market trading to maximize their attractiveness to target investors. The adoption of lighter regulations as part of hybrid offer regimes is related to relatively simple corporate bond instruments, which tend to be highly overregulated in EMs, due to the fact that many EMs tend to follow a one-size-fits-all

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16 Reference to EMs surveyed in this section refer to the sample of EMs surveyed by the Task Force, unless otherwise stated.

17 Analysis from the World Bank study. See Appendix A for more details.

18 In some countries, this is due to explicit regulatory restrictions that prohibit or significantly limit investments in privately placed securities; in others, it is due to a lack of private placement culture and bias against any investments that are not subject to full regulatory supervision.

approach and apply regulations designed for public equity markets to all securities instruments.

It is necessary to keep in mind two important distinctions: First, lighter regulatory requirements do not mean absence of all disclosures; indeed, most hybrid offer regimes require limited disclosures and, regardless of regulatory requirements, issuers do provide information to target investors on a contractual basis, usually following industry standards, which tend to be relatively similar to those defined by regulation. Second, the move towards lighter regulatory requirements in EMs for offers targeted at professional investors does not contradict, as it might initially seem, the recent trend in developed markets towards increased regulatory disclosures in light of the global financial crisis. Importantly, hybrid offer regime-type regulations, which already existed in many developed markets (e.g. the US and EU), are not being reversed following the crisis. Rather, they are regarded as key elements of attracting and facilitating corporate bond issuance.

In terms of requirements for submission and approval of documentation, jursidictions that have a hybrid regime exempt alternative offer regime issuers from filing a full prospectus with the regulator and/or exchange. However, most jurisdictions require submission of some kind of notification or basic information about the issuance either to the regulator or the exchange. This serves to ensure minimum transparency about the offer for investors and/or regulators. For example, Chile and Thailand require submission of a simplified prospectus to the regulator. Malaysia requires issuers to submit to the regulator Principal Terms and Conditions and an Information Memorandum (IM), if the issuer chooses to prepare an IM. In India, simplified disclosures need to be submitted to the relevant exchange. In Brazil, a conclusion announcement including the results of the sale should be filed with the regulator within 5 days following the sale.

The jurisdictional experiences reflect that to stimulate growth in the corporate bond market, it is important to introduce regulatory flexibility and broaden the range of offering mechanisms in the primary market to accommodate diverse needs of corporate issuers, depending on their size, industry, and length of operation, and whether they are recurring, first-time, or one-time only issuers (for example infrastructure projects). This variety of issuance options represents a critical factor in facilitating access to bond markets by a greater number and diversity of companies. At the same time, regulators should also aim to improve the overall efficiency of the public offer regime by streamlining the registration or approval processes to reduce the time it takes the regulator to approve public issues.

3.1.2 Time to market

Corporate bond issuance typically involves authorisation by the issuer, documentation process (including prospectus review), registration or approval by the regulator and offering to the market etc. The issuance of corporate bonds in EMs may be challenging for many corporations, as they may be subject to onerous and time-consuming primary market issuance process.

The lengthy approval process in many EMs is largely attributable to inefficiencies in the approval framework governing the issuance of corporate bonds. For example, multiple authorities may be involved in the registration or approval of corporate bond issuance. This can lead to duplication of information being prepared and submitted to the authorities, and the issuer having to respond to several rounds of queries raised by these different authorities. In addition, the information required to be disclosed by the issuer to the authorities may be excessive and may lack actual relevance for the purposes of the authorities' review. EMs have cited that inadequate or incomplete proposals submitted for bond issuances also contribute to the lengthy approval process.

Further, given that many EMs are still in the process of developing their corporate bond markets and greater emphasis tends to be placed on the development of the equity market, the level of technical skills and expertise on the part of the regulator to effectively review corporate bond market applications may be lagging. For example, it may take a while for the regulator to fully analyse a corporate bond proposal, particularly where the structure has unique features which are new to the market.

In some EMs, regulators have sped up their registration or approval process by differentiating a first-time or regular issuer and by the type of issuer and investor. For example, in Thailand, the offering of corporate bonds to institutional investors and high net worth individuals is approved the next business day from the date of filing the prospectus. For the offering of public bonds on the other hand, it is a fourteen day period. In Malaysia, in respect of high quality issuers, approval is granted within a day. In Europe, the Eurobond market differentiates between new or infrequent issuer and frequent issuer. A public offering for new issuers takes 8 weeks whereas frequent issuers only have to wait for a few days if not hours.[19]

The process of time-to-market may be further lengthened where the regulator uses a merit-based approval regime. For example, EMs which have a relatively nascent corporate bond market tend to apply a merit-based approval regime. A merit based review requires a comprehensive assessment by the regulator to determine the merit of the corporate bond issuance, including its viability. The state of development of EMs and the level of investor sophistication may be important considerations in determining whether to adopt a merit-based approach in the regulatory approval process.

It is imperative therefore that securities regulators in EMs assess their primary market efficiency and consider ways to facilitate corporate bond issuances. Too long an approval period or an overly cumbersome approval and review process may cause the issuer to miss the window of opportunity for the planned bond issuance, and may add to issuance costs.

[19] Tadashi Endo, *Broadening the Offering Choice of Corporate Bonds in Emerging Markets: Cost-Effective Access to Debt Capital*, The World Bank Policy Research Working Paper 46555, June 2008.

3.1.3 Benchmark yield curve

The existence of a benchmark yield curve with a set of wide cross-section of tenors is required to provide an efficient pricing mechanism in the corporate bond market, and is one of the key factors that contribute to the growth of the corporate bond market. Typically, a benchmark yield curve is developed through an active government bond market which provides a natural source of reference upon which a yield curve can be built.

The challenge for many EMs in building a benchmark yield curve could be due to several reasons, namely: (i) lack of supply of government bonds possibly due to more cost-effective alternative funding, a lack of domestic demand or a fiscal surplus in the economy, (ii) government bonds tend to be issued in a sporadic and unstructured manner, particularly when governments do not have proper debt management programmes and an auction calendar in place, and (iii) in EMs with large fiscal deficits, the government may prefer to achieve more cost-effective funding by optimising the window of opportunity and issuing at irregular intervals, rather than prioritising the construction of a yield curve.

Corporate bond issuers in EMs that do not have a benchmark yield curve rely on their respective interbank lending rates as the nearest benchmark, which tend to be short-term in nature and may not be as effective as a benchmark yield curve built of government issues. Without an efficient benchmark yield curve, pricing in the primary and secondary markets of corporate bonds may be constrained. In addition, without the regular or scheduled issuance to create this benchmark yield curve, issuers and investors will not be able to plan their issuances and investments appropriately.

There are several instances where jurisdictions having constraints in issuing government bonds, have instead relied on the issuance of quasi-sovereign bonds to build the benchmark yield curve. For example in Hong Kong in 1990, the Hong Kong Monetary Authority issued Exchange Fund Papers to facilitate the creation of a benchmark yield curve. The securities were issued on a regular basis with up to 3-year maturities and are actively traded[20]. Similarly in Malaysia, during the fiscal surplus period, an initiative was implemented to enable the government investment arm, Khazanah Nasional, to issue benchmark bonds.

3.1.4 Liquidity

The lack of liquidity in the secondary market for corporate bonds is prevalent across both developed and EM jurisdictions, but the issue may be more acute in EMs. This is largely due to the buy-and-hold investment strategy adopted by corporate bond investors. Insurance companies and pension funds, which are an important investor segment, typically require returns at fixed rates over the long-term to match their liabilities.

Further, corporations in EMs are normally smaller relative to developed markets and as such tend to issue bonds in smaller sizes. This contributes to the lack of corporate bonds, including

[20] Ismail Dalla, *The Emerging Asian Bond Market*, Chapter 2, p. 23, 1995.

quality papers, available in the market to be traded. As such, investors who hold quality corporate bonds, may decide to remain invested in the paper until maturity, reinforcing the buy and hold attributes associated with corporate bond markets. In addition, the scarcity of corporate bonds does not incentivise market participants to actively provide two-way price quotations, which can play an important role in enhancing liquidity in the corporate bond market.

Liquidity in the corporate bond market is also affected by investors' preference to trade in government bonds as these are more readily available and are perceived to be a safer form of investment. Government bonds are typically issued in a market-based, sizable, widely distributed, regular, predictable and transparent manner, and are often accompanied by an active market-making mechanism. In addition, government bonds are normally sought after by foreign institutional investors, thus contributing to a higher level of liquidity in the government bond market.

Market infrastructure surrounding the trading of corporate bonds in EMs is not sufficiently well-developed to promote liquidity. For corporate bonds that are traded on electronic trading platforms, the trading systems may be inadequate and inefficient to encourage market participants to actively trade corporate bonds. For example, some electronic trading platforms do not have a market making facility, while others are not linked to the clearing and settlement system. In addition, the inefficient price discovery process in many OTC markets makes it difficult for investors to trade corporate bonds.

Other factors that contribute to lower liquidity include a narrow investor base, low market transparency and a lack of timely information on corporate bond issues. EMs have adopted various mechanisms to address the low levels of liquidity in their corporate bond markets[21].

Liquidity is not only a challenge facing EMs, but is an ongoing concern in corporate bond markets globally. Industry views are that there should not be an inordinate amount of effort made by EMs to create greater liquidity, as this is a pervasive feature of this asset class. Focus should continue on developing the fundamental building blocks in both the primary and secondary market for corporate bonds.

3.2 Market Structure

3.2.1 Trading, clearing and settlement

Robust and efficient trading, clearing and settlement and depository systems can lead to lower trading costs and price volatility, reduce market fragmentation, facilitate order flow, improve price discovery and ensure wide dissemination. It is observed however that while EMs with significant corporate bond markets have exchange traded markets, trades in these jurisdictions still continue to be mainly executed on the OTC market. This is due to the large

[21] For example, in Brazil, ANBIMA (Brazilian Financial and Capital Markets Association) has proposed the establishment of a Liquidity Improvement Fund, which would act as a market maker, as well as a Liquidity Guarantee Fund, which will perform the function of a lender – particularly for illiquid bonds.

size of corporate bond transactions which tend to be traded by institutional investors who prefer to be able to trade and negotiate directly with the counterparty.

Recent developments globally suggest a move towards greater reliance on electronic trading platforms, rather than bilaterally over the telephone. This is mostly the case for more standardized and less risky corporate bonds, such as blue chips and investment grade bonds. In the European markets, three new bond platforms have been introduced. This will allow all types of euro-denominated bonds by non-sovereign issuers to be traded across Europe, regardless of their place of issue. BondMatch and Galaxy were launched in July 2011 and MTS Credit is expected to be launched in the last quarter of 2011. They are operated by NYSE Euronext, TradingScreen, and the MTS Group respectively. These three platforms were launched as part of the Paris financial market's Cassiopeia[22] project, to enhance activity and liquidity of the secondary market and to offer issuers new possibilities for managing their debt.

Moreover, in the US, the number of corporate bonds traded through the NYSE Bond system has grown significantly since its launch in April 2007. The main driver for the setting up the platform was to enhance trading transparency and address unethical practices among market players.

From the perspective of EMs, there are constraints in the establishment of electronic trading platforms (ETPs). These may include the costs associated with the setting up and maintenance of the platform and the lack of demand by market players which continue to have preference to trade bilaterally. Further, while ETPs can be relied upon to provide for the trading of corporate bonds, market experts[23] are of the view that there is a need to ensure sufficient liquidity in the corporate bond market before ETPs are introduced. In the absence of a sufficient level of liquidity, ETPs introduced may not be able to achieve economies of scale and maximise efficiencies given the fixed costs involved in operating the platforms. As such, it is observed that there is a growing trend among EMs to enhance the transparency of OTC trades using, among others existing information technology without necessarily having to resort to ETPs.

In respect of clearing and settlement, the reliability of clearing and settlement systems is critical to ensure the orderly settlement of the obligations between market participants. Further, bond market liquidity is closely linked to the reliability of bond clearing and settlement systems and investors are generally more confident to trade bonds on a regular basis if they have certainty on the settlement of their trades.

22 The Cassiopeia Committee was formed by the French Economics Ministry and includes representatives from major issuers, sellers and investors to express views on the consistency of projects with the "Expression of Needs," published by the Cassiopeia Working Group on 26 April 2010. Among the requirements for an electronic trading platform for corporate bonds are open order matching and detailed pre and post-trade reports.

23 Views obtained from the industry consultation in Madrid, Spain, May 2011.

It is clear therefore that EMs which do not have a formal clearing system are not able to reap the benefits that are associated with a clearing system, and by extension, possibly a central counter party (CCP). CCP has the potential to reduce risks to market participants through the multilateral netting of trades and by imposing more effective risk controls on all participants. The effectiveness of CCP's risk controls and the adequacy of its financial resources are therefore important aspects of the overall market infrastructure governing corporate bonds[24].

3.2.2 Investor base

A narrow investor base is among the limiting factors for corporate bond market development in EMs. A diverse and deep pool of investors, including institutional, foreign and retail investors, can act as a key enabler for the development of deep and liquid corporate bond markets, and is viewed as critical for advancing corporate bond market activity. For example, institutional investors can facilitate an efficient pooling of long-term funds, risk mitigation and diversification and financial innovation. Additionally, foreign investors can introduce positive influences in terms of market best practices, including improved processes and standards in line with international standards. Aside from adding depth and breadth to the corporate bond market, a widened investor base has a role to play in promoting higher governance and disclosure standards.

One of the reasons for the lack of depth of the investor base in the corporate bond markets within EMs is due to greater familiarity in investing in equity and government bonds, given that these markets typically have been established longer. For example, pension funds, banks or financial institutions and insurance companies have a higher propensity to invest in government bonds as part of their investment portfolio. The growth of the investor base is also constrained given the limitations imposed on some institutional investors, such as bond funds to access retail investors.

Further, investors are often required by their authorities to hold a minimum and often significant proportion of their assets in government bonds. In some instances, the preference to invest in government bonds in EMs is driven by favourable tax treatments compared to corporate bonds. Additionally, other investors such as mutual funds, corporate entities and retail investors tend to be more equity-centric. In several EMs, there may exist an underdeveloped credit culture, which includes a lack of knowledge and skills of how to evaluate different types of credit.

Another reason for the narrow investor base is due to the investment restrictions in place. These restrictions may be in the form of minimum rating requirements or limits on the maximum exposure for investments in corporate bonds. For example, in Bulgaria, mutual funds cannot invest more than 10%, pension funds cannot invest more than 25% and insurance companies cannot invest more than 80% in corporate bonds. Further, it is observed that while pension fund portfolio diversification in Asia has improved in recent years, asset

[24] For additional information on CCPs, refer to *Principles for Financial Market Infrastructures*, Consultative Report of CPSS-IOSCO, March 2011, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD350.pdf.

allocations in many of these jurisdictions are still heavily concentrated in government securities, primarily due to the investment regulations and criteria in place[25].

Foreign investor participation has also been low in many EMs due to a wide range of factors, including the macro-economic environment, the regulatory framework and processes in the corporate bond market. Capital controls, taxation, investment restrictions, lack of domestic funding, hedging markets and established benchmark indices, coupled with cumbersome administrative requirements may not encourage foreign investors to invest in corporate bonds. For example in some EM jurisdictions, rules on shorter-term holdings by foreign investors have been seen to be a barrier to the development of their local corporate bond market[26].

EMs have however taken steps to liberalise investment limits to improve foreign investor participation. For example, in April 2011, India introduced several measures to increase its foreign investor base which includes raising the overall limit available to foreign institutional investors in corporate bonds to USD40 billion from USD20 billion. In Malaysia, foreign investor interest in the local markets has been higher with the government taking new initiatives to make investments into local markets easier and more attractive, and to improve the market infrastructure.

While corporate bond markets in most jurisdictions globally are primarily institutional markets with less retail participation, the lack of retail investors in EMs is considered as one of the constraints cited by EMs in the development of their corporate bond markets. This is attributed generally to the limited opportunity for retail investors to participate in corporate bond markets due to nature of the offerings which are tailored towards institutional investors. In addition, the low level of retail participation is also due to their general lack of knowledge of investing in this segment of the market.

However, to the extent that it is appropriate, retail participation can contribute to the depth of the corporate bond market. This can be achieved through both a direct offering to retail investors, and indirectly through the offering of bond funds. Some developed markets have been encouraging greater retail bond participation. For example, in Australia, the regulator is examining ways to shorten prospectuses for corporate bonds to reduce costs as an incentive for more companies to offer to the retail market. In Hong Kong, the Central Money Markets Unit Bond Price Bulletin website was introduced in January 2006 to provide retail investors with convenient online access to indicative bond prices quoted by major banks.

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25 See supra note 7.

26 Pipat Luengnaruemitchai and Li Lian Ong, *An Anatomy of Corporate Bond Markets: Growing Pains and Knowledge Gains*, International Monetary Fund, 2005.

3.3 Market Instruments

3.3.1 Securitization

Securitization can contribute to the development of corporate bond markets by overcoming the problems of the small size and low credit quality of most emerging market issuers[27]. However, with the exception of a few jurisdictions, for example Korea, securitization in EMs has been relatively underdeveloped mainly due to the lack of a facilitative legal, regulatory and market framework for the securitization of assets[28]. This is especially so with regards to bankruptcy and taxation frameworks, as well as rules relating to the transfer of assets.

The global financial crisis has also severely impaired confidence in asset-backed securities (ABS) as regulators, credit rating agencies (CRAs), and markets re-evaluate the entire securitization process[29]. Shortcomings that arose include the misalignment and inconsistent incentives and remuneration of the securitization value chain, which has resulted in underwriters not conducting appropriate levels of due diligence. There was also a tendency for investors to rely solely on CRAs without conducting their own risk assessment and risk management. Further, some participants in the securitization value chain were not appropriately regulated such as the CRAs.

3.3.2 Other types of corporate bonds

The trend in EMs in issuing fixed-rate plain vanilla bonds may be largely due to the level of expertise on the part of the originating advisor, and the level of familiarity on the part of bond dealers and investors in respect of these plain vanilla bonds.

Enhancing the types of corporate bonds will add to the depth and breadth of the market and will provide a set of diverse instruments to cater for the different needs of issuers and investors. Other types of corporate bonds include zero-coupon bonds, convertible bonds, callable bonds, covered bonds, sukuk etc.

It is observed that in many EMs globally, the issuance of sukuk has been gaining greater traction. As at 2010, global outstanding amount of sukuk stands at approximately USD 150 billion compared to USD 60 billion in 2006, reflecting tremendous growth opportunities in this market segment[30]. Among EMs, corporate sukuk have been issued in DIFC, Indonesia,

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27 Refers to the issuance of new bonds collateralized by a pool of assets which can be other bonds, loans, or any receivables with a regular cash flow. This is usually done via a Special Purpose Vehicle (SPV) specifically set up to own and receive the income from the pool of assets, with which to service the bonds it issues in its name. The proceeds from the bond issue are used to pay the original owner or owners to acquire the pool of assets. The SPV can be set up by the original owner or owners of the assets, or by a third party.

28 *Securitization and Securitized Debt Instruments in Emerging Markets*, Final Report, Report of the Emerging Markets Committee of IOSCO, October 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD334.pdf.

29 See supra note 28.

30 Source: Malaysia International Islamic Financial Centre.

Malaysia, Qatar, Saudi Arabia and United Arab Emirates. Sukuk are highly in demand given their scarcity coupled with increasing investor mandates to invest in these instruments. The challenge for EMs to develop the sukuk market however, lies primarily in having the appropriate legal, regulatory and tax environment in place.

In widening the range of instruments, due consideration should also be given to ensure some form of standardisation of the instrument such as interest rate conventions, bond tenors, lot sizes etc. This will facilitate comparability of instruments as well as investor understanding of corporate bonds, which in turn can lead to greater liquidity in the market.

3.3.3 Credit spectrum

Presently, EMs are characterised as markets with a large proportion of high rated bonds with very little or no lower rated issues including non-investment grade bonds. Lower rated issuers tend to stay away from corporate bond markets due to the prohibitive structuring costs as well as the high premium demanded by investors. Moreover, in some EMs with relatively underdeveloped credit culture, institutional investors tend to be much more risk averse towards lower rated and less established companies and, therefore, lack interest in investing in such issues. In some instances, this absence of interest results in financial advisers not investing adequate resources and providing commitment to build up this part of their advisory business.

The existence of a wide credit spectrum in EMs is important not only to provide greater diversity for investors, but also to enable smaller corporations to raise funding through the corporate bond market. Given the fact that banks do provide financing to these smaller corporations, this seems to suggest that there is appetite to extend credit to lower-rated corporations.

One of the ways in which lower-rated or unrated issuers are able to tap the corporate bond market is by way of obtaining third party guarantees. Through third party guarantees, investors are able to invest in these corporations without taking on their credit risk. The experience in investing in such corporations may also lead to investors being more inclined to invest in the same corporation should it issue corporate bonds without a financial guarantee in the future.

Multilateral institutions such as the International Finance Corporation and some banks in EMs have been providing third party guarantees to lower-rated corporations. The amount of guarantees provided by these institutions may not be sufficient to fulfil the demand in the market. In the case of banks the provision of a third party guarantee does not typically form a major part of the banks' business.

Given the limitations faced by banks in extending third party guarantees, some EMs have introduced financial guarantee agencies that specialise in providing financial guarantees to lower-rated corporations only. For example in Malaysia, the government has established Danajamin Nasional Berhad, Malaysia's first Financial Guarantee Insurer. It provides financial guarantee and credit enhancements for corporate bond issuances by facilitating non-AAA rated companies to access the corporate bond market.

3.3.4 Risk management and hedging instruments

The derivatives markets enable both issuers and investors to efficiently transfer risks arising out of adverse conditions such as sudden interest rate movements. Bond market participants require diversified financing tools beyond banks and equity markets in order to cope with the risk management problems inherent in corporate bond markets.

Though well functioning markets exist in EMs such as India, Korea and Malaysia for certain derivative products such as interest rate swaps and interest rate futures, the number of participants as a whole in EMs is limited and markets are not sufficiently broad and deep and they face some of the common developmental impediments such as non-conducive tax framework, the lack of liquidity in the underlying cash markets and insufficient operational infrastructure. For example, the development of onshore foreign exchange swap markets in certain EMs has been limited by capital controls and various restrictions on non-residents[31].

3.4 Investor protection and regulation

3.4.1 Transparency and governance

Transparency of information and governance in the corporate bond market play an important role in enhancing investor confidence and promoting efficiency. This mainly relates to transparency of the issuer, and trading activities in the market. The level of disclosure by the issuer will, among others, facilitate investors' assessment of the issuer, including its creditworthiness, price discovery and valuation of the bond issue. Transparency in trading covers both pre-trade and post-trade information, which has the effect of enhancing liquidity, lowering spreads and attracting greater investor participation in the corporate bond market.

While most EMs have fairly comprehensive primary and continuous disclosure requirements in terms of the range of information required, the quality, adequacy and timeliness of these disclosures may not be sufficiently meaningful to allow investors to make informed investment decisions in the corporate bond market. This is particularly critical as more sophisticated types of bonds are being introduced in EMs, including those issued by SPVs. Further, major incidents involving disclosures by large corporate bond issuers in the last decade such as Enron and Parmalat have reinforced the importance of ensuring high levels of transparency in the corporate bond markets. The lack of transparency in some EMs has also been cited as an impediment by investors, including domestic and foreign investors, in investing in the corporate bond market.

Transparency may have an effect on overall governance of corporate bond markets in EMs. Due to the generally high concentration of control in corporate issuers in EMs, which are normally owner-managed, and may not lend itself to good governance practices. In some instances, the disclosure by the issuer to investors particularly in the OTC market are not as

[31] See supra note 14.

forthcoming as compared to disclosures made to the issuer's shareholders, which is not reflective of the priority of claim that bondholders as creditors enjoy.

In respect of trading transparency, there are several EMs that do not have in place a trade reporting framework in the OTC market[32], or where there is one in place, it may be inadequate such that market participants do not have access to timely information and are not able to appropriately assess market sentiment. This poses challenges to EMs in growing their corporate bond markets as market participants would face challenges in gauging the level of interest both on the demand and supply side, and may avoid trading in the market or face difficulties in valuing their portfolio.

Developed markets have increased trading transparency of their corporate bond markets by introducing trade reporting and trade publication systems. For example, the US introduced TRACE[33] in July 2002, which facilitates the mandatory reporting of OTC secondary market transactions in eligible fixed income securities[34] to enhance price transparency. Besides enhancing transparency of information to investors, the trade reporting system enables a comprehensive database to be maintained, as well as enhancing regulators' surveillance of the corporate bond market activities.

The lack of transparency in EMs has led to the perception of weaker governance levels in the corporate bond market.

3.4.2 Credit rating agencies

Credit rating agencies (CRAs) typically opine on the credit risk of issuers of corporate bonds and their financial obligations. Given the underdeveloped nature of many corporate bond markets in EMs, CRAs may play a role in helping investors better analyse the credit risks of corporate bond issuances. In addition, the role of a CRA is further emphasised as many regulators in EMs have made it compulsory for institutional investors such as banks, insurance companies, mutual funds etc. to invest in corporate bonds which have been rated by a CRA.

Mandatory ratings of corporate bonds exist in these EMs as regulators have recognised the importance of building a strong credit culture among market players. Moreover, credit ratings can act as an independent and additional source of information on the credit-worthiness of the issuer particularly in the case of nascent corporate bond markets. It can also act as a mechanism to ensure that issuers adhere with the terms and conditions of the corporate bond issue. In EMs with a more developed corporate bond market however, the requirement for

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32 Please refer to *Implementing OTC Derivatives Markets Reforms*, Financial Stability Board, October 2010 and *Report on OTC Derivatives Data Reporting and Aggregation Requirements*, Consultative Report of CPSS-IOSCO, August 2011, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD356.pdf.

33 Trade Reporting and Compliance Engine.

34 This covers investment grade, high yield and convertible corporate debt.

credit ratings tend to be driven by market demand reflecting the higher level of sophistication of players.

CRAs have gained considerable negative attention globally over the past few years as a result of the questionable ratings accorded to many corporate bonds and structured finance issues. The reason for such ratings are said to be due to, among others, conflicts of interest, inability of CRAs to fully comprehend complex bond structures, weak objectivity of the rating process, lack of transparency of rating criteria, inadequate supervision of CRAs and overreliance of investors on credit ratings. The absence of a proper regulatory framework for CRAs to a certain extent reflects the lack of overall appreciation of their influence in the corporate bond market. On the other hand, concerns have also been raised on the over-reliance by investors on CRA ratings and the need for market participants to establish stronger internal credit risk assessment practices.[35]

Given the gaps which exist in EMs in relation to the supervision of CRAs, regulators are now reviewing their respective frameworks to be in line with the IOSCO's Objectives and Principles of Securities Regulation and the IOSCO's Code of Conduct for CRAs. EMs are also adopting the IOSCO *Common Core Examination Model for Credit Rating Agencies* which will foster consistency in the examination process.

3.4.3 Market oversight

The focus of many EMs has been on the development of corporate bond markets, and less emphasis has been placed on building the appropriate regulatory capacity to oversee this segment of the market. Given the evolution of the corporate bond markets, and in particular their growing complexity, EM regulators may not have the requisite experience, skills and expertise to effectively regulate the corporate bond market. Further, many EM regulators tend to focus their attention on the regulation and supervision of the equity market, given the higher level of participation of retail investors.

The key issue appears to be related to the natural function of the corporate bond market, which tends to be traded OTC. Generally, the information flow from the OTC market is considerably less than an exchange-traded market, which therefore makes the surveillance and supervision of the corporate bond market a challenge. Further, as the major players in the corporate bond market are banks or financial institutions, pension funds and insurance companies, there is a tendency for their activities and conduct in the corporate bond market to be monitored by their relevant supervisors, whose focus would primarily be in relation to the prudential regulation of these entities.

In addition, as there are many intermediaries in the corporate bond market, the regulatory framework has not sufficiently recognised the importance of the role played by these intermediaries, and whether these entities need to be subject to regulatory supervision. This would include bond trustees, pricing vendors, and other players whose role may have a major

[35] See Financial Stability Board: *Principles for Reducing Reliance on CRA Ratings*, October 2010.

impact on the market. For example, the effects of the global financial crisis have witnessed several regulators globally extending their supervisory scope to cover credit rating agencies.

3.4.4 Bankruptcy

A crucial aspect of a well-functioning corporate bond market is to ensure that there are effective bankruptcy laws in place. While bondholders have some form of bankruptcy protection in EMs, the implementation may not be adequate and effective and does not ensure adequate legal protection of bondholders' rights.

There are some instances where bondholders are given less priority than other creditors. Even in jurisdictions where there are bankruptcy laws that provide for the resolution of interests of creditors and debtors, there are certain deficiencies in the judicial process which impose challenges on the effective enforcement of bankruptcy laws. This includes high costs, lengthy proceedings, difficulties in instituting class actions and the lack of specialised courts or expertise in handling bankruptcy cases. This may lead to situations where the protection of creditor rights cannot be effectively implemented or are very protracted.

It has been observed that in Mexico, intercompany debt has the same voting rights as external company debt, which has been recently challenged in Mexican courts. In some other jurisdictions, foreclosing on property used as collateral on defaulted debt may not be possible or is a very lengthy and arduous process[36].

3.5 Taxation

Taxation is an important issue faced by many regulators in EMs as they develop their respective corporate bond markets. Bond markets and many other forms of fund raising are susceptible and sensitive towards the imposition of taxes. In the context of EMs, the tax regime is often imposed to maximise government revenue and in some cases, the tax policies may not take into account issues surrounding corporate bond market development.

Taxes may come in the form of transaction taxes, stamp duties, capital gains and withholding tax. However, it is noted that there are different tax treatments being accorded to different types of fixed income instruments in EMs, such as government bonds, bank loans and corporate bonds. This may be due to the fact that government bonds and banks loan were in existence well before corporate bonds, and would have had tax issues addressed earlier. Further, the lack of appreciation and understanding of the role of the corporate bond market in the overall development of the economy may lead to tax issues on corporate bonds being accorded less priority.

As such, disproportionate or excessive taxes imposed on the corporate bond market vis-à-vis other funding avenues may result in corporations avoiding issuing corporate bonds and turn their attention to other sources of funding such as banks and the equity markets. At the same

[36] Prudential Fixed Income: *Emerging Markets Corporate Debt: Opportunities in a Large and Maturing Asset Class*, February 2011.

time, investors may choose to invest in other financial assets which operate in a more tax-friendly environment. The presence of disproportionate or excessive taxes may also lead financial institutions refraining from offering advice and structuring bonds to their clients as this may impact on structuring and issuance costs.

3.6 Other challenges

3.6.1 Crowding out by government bonds

The development of a successful corporate bond market in EMs warrant the pre-existence of a well-developed government bond market as it provides the foundation upon which the corporate bond market can leverage on such as the benchmark yield curve, trading convention and practices, trading and settlement infrastructure etc. However, excessive government bond issuances may have a crowding out effect and can hinder the growth of the corporate bond market.

Government bonds are typically issued in a market-based, sizable across a wider tenor, regular and transparent manner making them highly attractive to investors. In addition, government bonds are normally deemed to be less risky, which will again appeal to long-term investors, such as pension funds and insurance companies.

Governments in EMs tend to play a bigger role in infrastructure development than the private sector. They usually finance such large, long-term projects by issuing bonds. Hence EM government bond markets are typically bigger than those of the corporate bonds. Government bond issuance is also likely to be higher in economies where governments are pursuing expansionary fiscal policies.

3.6.2 Competition from alternative financing

Besides government bonds, the development of corporate bond markets in EMs also faces competition from alternative financing, particularly bank financing.

Subject to prevailing market conditions, size of borrowings and issuers' credit standing, bank loans may be cheaper compared to the issuance of corporate bonds as issuers will incur issuing expenses, such as regulatory fees, listing fees, advisory fees, credit rating fees, legal fees as well as risk premiums demanded by investors. Moreover, as the banking system in many EMs is relatively well-established and has preceded the existence of the corporate bond market, this explains the relatively high bank dependence of corporate borrowers in EMs.

Further, relationship banking is particularly strong in some EMs, and the long-term relationship between the banks and their clients creates incentives for companies to continue relying on bank financing[37]. In addition, as companies in EMs are typically smaller than in developed markets, they may find it challenging to access the corporate bond market due to their small size. However, while bank loans are normally relied upon to fund relatively small

[37] Views expressed by the International Banking Federation to IOSCO, 18 April 2011.

amounts and to meet short to medium-term needs, corporate bond markets will be able to provide financing to borrowers for much larger amounts and longer durations.

Chapter 4 Recommendations

The development of corporate bond markets in EMs should be accorded priority given its important role in financing corporate growth and facilitating the overall expansion of the economy. As the building of active corporate bond markets is challenging and requires considerable time and effort, many of the obstacles that can hinder or delay the development of these markets in EMs can be overcome by the commitment and concerted efforts on the part of the government and securities regulators. Holistic policy direction, sound regulatory and supervisory framework and efficient market infrastructure is pivotal, and can lead to the accelerated and sustainable development of corporate bond markets.

The following recommendations have been developed based on findings from survey questionnaires circulated to EMC members, feedback obtained from an industry consultation with global bond market participants, as well as additional research conducted. The recommendations are intended to highlight measures that may be considered by EMs in their corporate bond market development agenda.

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

1. **Establish a national platform for high-level policy and strategic direction.** Given the significance of the macroeconomic environment in influencing the development of the corporate bond market, EMs policymakers should provide high–level and long-term strategic direction in the bond market development agenda. This can be done through the setting up of a dedicated body comprising senior representatives from the government and regulatory authorities, and industry experts capable of addressing challenging issues and impediments. This will help spur the overall and long-term development of the corporate bond market, align the priorities of the different domestic authorities, and ease the implementation of specific action plans.

2. **Develop a sequenced strategy for corporate bond market development.** For EMs with non-existent or very nascent corporate bond markets, the relevant authorities should establish the fundamental building blocks for corporate bond market development to ensure sustained and orderly growth. These include putting in place the necessary regulatory and market infrastructure, tax framework, establishing a core issuer and investor base and facilitating the entry of strategic bond market intermediaries.

   For EMs with more developed corporate bond markets, there is a need to examine ways to deepen the market and stimulate its growth to the next level. Among others, this includes encouraging greater foreign investment, widening the credit spectrum for corporate bonds, making available a broader range of fixed income instruments with more sophisticated structures, providing tax incentives and facilitating cross-border issuances.

3. **Streamline and coordinate the regulatory framework for corporate bond markets**. Where there are multiple regulators involved in the bond market, EMs are encouraged to put in place effective coordinating mechanisms among the various regulatory authorities by setting up inter-agency coordinating committees or through Memoranda of Understanding (MOU). To minimize regulatory arbitrage and regulatory gaps, EMs should review and streamline the various policies and guidelines administered by these regulatory entities with the aim of maximizing efficiency. Where appropriate, EMs may even wish to consider the possibility of designating a single regulatory authority with a clear mandate to regulate and supervise the corporate bond market.

Improving market efficiency

4. **Broaden the range of offering mechanisms in the primary market.** EMs should consider putting in place an offering method conducive to their respective jurisdictions taking into consideration the particular economic, market and overall regulatory context, and to accommodate diverse needs of corporate issuers, depending on their size, industry, and length of operation, and whether they are recurring, first-time, or one-time only issuers.

   This can be done by increasing available issuance options both within and outside the public offer framework, namely: (i) introducing fast-track public offer initiatives, such as shelf-registrations and automatic approvals, and (ii) introducing alternative issuance regimes, such as private placements and hybrid offer regimes.

   In a study conducted by the World Bank, hybrid offer regimes are key towards increasing the flexibility of the primary market regulatory framework and can play a role in attracting and facilitating corporate bond issuances in EMs. Further detailed information can be found in Appendix A.

5. **Adopt a facilitative process and reduce the time taken to approve or register corporate bonds.** EMs should review existing approval or registration process and disclosure requirements with a view to adopting a differentiated approach depending on certain considerations. This may be dependent on the type of issuers (frequent vs. infrequent issuer), issuance rating (highly-rated or otherwise), the type of investors (institutional vs. retail) and the type of corporate bonds issued (plain vanilla vs. complex structures). Further, EMs regulators should consider making public an upfront commitment in terms of approval timeframes, and hold themselves accountable to the time charter.

6. **Standardise bond offering documentation.** A standardized format on the bond offering documentation may be put in place to facilitate the better understanding and preparation of such documents by issuers as well as ease investors' decision making process. The standardization of these offer documents may also increase the tradability of these corporate bonds among players and can support secondary market liquidity. In nascent

corporate bond markets, EM regulators may consider taking the lead in designing the standardized format for the bond offering documents. Adopting international bond offering documentation standard can also be used to expedite this process.

7. **Create an efficient benchmark yield curve and a pre-announced bond auction calendar.** One of the fundamental areas which EMs need to actively develop, in particular those with nascent bond markets, is a benchmark yield curve that is based on regular and structured government bond issuances - normally emanating from a debt management programme. Where there are constraints on the part of the government to regularly issue sovereign bonds, EMs may consider issuing quasi-sovereign bonds to build the benchmark yield curve. For more mature corporate bond markets, authorities may consider lengthening the tenor of the yield curve (beyond the typical 3,5,10 years) to 15 years and above.

   In addition, EMs should publish in advance an annual auction calendar for the benchmark bonds to further enhance market transparency and provide greater certainty to market players.

Enhancing market infrastructure and widening investor base

8. **Enhance trading efficiency in the market.** Where the pre-requisites[38] are in place and where appropriate to enhance trading efficiency, EMs may consider promoting the use of electronic trading platforms (ETPs)[39]. The ETP, with its combination of electronic trading and centralized price dissemination, can provide bond dealers a more complete and efficient platform for cost competitive trade execution. It can also lead to more effective price discovery and greater access by wider range of investors, including retail investors. To optimise economies of scale, EMs may consider leveraging off the existing trading systems such as those operated by their respective exchanges where appropriate.

9. **Develop a market making system for corporate bonds.** EMs should consider putting in place mechanisms that would incentivise bond dealers to make markets for corporate bonds. For example, where the bonds are traded on an exchange, trading fee incentives can be provided for such market makers. Further, EMs may consider establishing a "league table" highlighting market makers that actively provide two-way price quotations as a means of encouraging greater market making activity. However, market-makers in EMs may need to have sufficiently large balance sheets and easy access to funding to be able to successfully make markets. Market makers should also be subject to conduct and

38 See discussion in 3.2.1

39 Of importance is the necessity for oversight over these trading platforms to avoid fragmentation of the market, particularly where the size of the market is relatively small. As these markets tend to be dominated by institutional investors, regulatory intervention is necessary to promote access and investor protection, and to ensure that these platforms operate in a regulated environment to enhance investor confidence.

prudential regulation to ensure continuous provision of liquidity and risk management requirements, and to limit the amount of risk they assume.

10. **Establish corporate bond index.** Indices can be an important contributing factor to the development of the corporate bond market. EMs should encourage the formation of corporate bond indices to create greater visibility, to enable fund managers to track their performance against the index and to promote greater liquidity. Further, a corporate bond index may drive issuers to address any gaps and impediments that prevent their bonds to be included in the index.

11. **Consider setting up a specialised third party guarantee institution**. In efforts to widen participation and deepen liquidity in the corporate bond market, EMs may wish to establish a third party guarantee institution. This is to help to diversify and introduce first time lower-rated issuers to the marketplace, in addition to credit guarantee that may be provided by banks. A key consideration in setting up a financial guarantee institution is to ensure adequate financial strength and resources, an effective governance structure and appropriate risk management capabilities. In this regard, EMs may wish to seek the initial financial support from the government to provide capital for this third party guarantee institution. The government's stake in the third party guarantee institution may be divested in the future once this entity has built up a strong track record and gained market confidence in terms of its performance and capabilities.

12. **Scale up markets through regionalisation efforts.** Where the development of domestic corporate bond markets may be economically or practically challenging for individual EMs, they may wish to consider leveraging off the synergies and infrastructure resulting from regional bond market cooperation. It may be useful to identify ways as to how regionalisation of corporate bond markets can be designed and implemented to facilitate greater efficiency, economies of scale and market access.

13. **Broaden and diversify the investor base**. EMs should consider broadening and diversifying its investor base to include a larger segment of domestic and foreign institutional investors, and if appropriate, retail investors. For institutional investors, this may be achieved by liberalizing investment and regulatory restrictions currently in place[40], and enhancing overall market efficiency. To encourage wider foreign institutional investor participation, EMs can look at addressing regulatory obstacles, cost of access, taxation and capital control issues. The active participation from foreign investors can provide EMs greater exposure of international practices and standards. Retail participation in the corporate bond market can be expanded through direct retail bond issuance or through the establishment of bond funds. This should be supported by enhanced retail investor education efforts.

[40] This should be supplemented with appropriate controls, such as adopting a robust governance structure, risk management framework, compliance functions, disclosure mechanisms, as well as having in place an Investment or Credit Committee.

Developing a wider range of instruments in the corporate bond market

14. **Develop securitization markets.** Securitization enables issuers, including lower-rated corporations with high quality assets, to raise financing. EMs which do not have securitization markets should consider introducing securitization as one of the means of promoting corporate bond market development. Measures would include having in place a clear and robust legal, regulatory and market framework (particularly bankruptcy, accounting and taxation framework), and mechanisms to address potential conflicts of interest and misalignment of incentives. For EMs with an existing securitization market, they are able to deepen the market by encouraging trading of securitized financial products on exchanges, enhancing disclosure, establishing a minimum framework for participants in the securitization process and strengthening business conduct obligations[41].

15. **Encourage the development of risk management instruments**. A robust and well developed underlying cash market is a prerequisite for the development of risk management instruments. The existence of risk management instruments such as forwards, futures, swap, and option markets can help protect intermediaries against adverse market movements, interest rate risk and other risks inherent in corporate bond markets. This can be achieved by improving the product design of these instruments to meet the needs of users, introducing product specialists (for example, the entry of foreign specialists), addressing the tax issues and investment restrictions. EMs may also wish to build greater operational expertise and infrastructure in the use of risk management instruments.

Strengthening investor protection

16. **Enhance the quality and timeliness of disclosures by issuers.** EM regulators should have a framework that encourages the disclosure of clear, comprehensive and accurate information by issuers on a timely basis. This will enhance the overall quality and timeliness of information disseminated to investors. EM regulators can work on developing a standardized template with a prescribed minimum content in the disclosure document. Effective initial disclosures through a prospectus should be followed by robust continuous disclosures made through exchanges, registering authorities or through trustees etc.

17. **Promote trading and price transparency.** EMs should have in place a trade reporting framework in the OTC market. Where there is a trading reporting framework already in place, EMs should ensure that there is adequate reporting so that market participants have

[41] For further discussion on the development of securitization markets in EMs, refer to *Securitization and Securitized Debt Instruments in Emerging Markets*, Final Report, Report of the Emerging Markets Committee of IOSCO, October 2010, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD334.pdf.

access to timely information[42]. This may include providing a centralized information dissemination system to ensure there is an effective price discovery process which would facilitate greater trading activities. As a by-product of a trade reporting system, EMs would be able to build a comprehensive database that captures trading activities on the primary and secondary market that would be useful to investors as well as regulators in supervising the market. However, a key consideration in setting up a trade reporting system is to ensure effective governance structure, confidentiality requirements, system capacity etc.

Additionally, regulators with more developed corporate bond markets may wish to introduce and regulate independent pricing vendors to increase transparency in secondary markets and at the same time support the valuation of corporate bonds. The corporate bond pricing provided by these entities can be used as pricing reference by investors and traders in addition to other references such as the last traded prices for comparable corporate bonds. Bond pricing vendors should also continue to improve their valuations, for example by using more sophisticated valuation methodologies to enable investors to mark-to-market their investments appropriately. While pricing vendors may strengthen pricing transparency, they however need to achieve a critical mass of users and subscribers in order to be commercially viable.

18. **Strengthen surveillance and supervision.** Given the increasing importance of corporate bond markets in financing growth of EM economies, regulators need to review their surveillance and supervisory focus and priorities to preserve market integrity and ensure adequate investor protection in this segment of the market. In this regard, EMs should enhance regulatory capacity including ensuring adequate skills, experience and technical knowledge, as well as technology and systems and internal processes to effectively regulate the bond market. This will help increase investor confidence and at the same time enhance standards of professionalism and governance among market intermediaries, such as bond traders, CRAs, trustees, pricing vendors, etc. Where market players are co-regulated by more than one authority, it is imperative that there be robust coordination and intensive sharing of information to facilitate oversight of the market.

    Further, where appropriate, EM regulators may rely on self-regulatory organizations (SROs), comprising bond market participants, to complement its regulatory function in terms of supervision of market players. SROs may also play a role in providing training and education in the corporate bond market, as well as enhancing professionalism via certification programs.

19. **Strengthen the professional standards of bond market intermediaries.** Efforts should be made to enhance the business conduct and standards of professionalism of corporate

[42] *Transparency of Corporate Bond Markets*, Final Report, Report of the Technical Committee of IOSCO, May 2004, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD168.pdf, highlighted that trade reporting requirements should take into account the types of trading methods used and regulatory capacity to analyse the data in a meaningful way.

bond market intermediaries such as bond trustees, pricing vendors etc. Bond trustees in particular, have an important role to play in the corporate bond market as they are tasked to enforce the terms of a bond issuance by ensuring for example, that bond interest payments are made on schedule and by protecting the interests of the investors should the issuer default. EMs should assess the current roles and responsibilities of bond trustees in their jurisdictions and expand their scope if necessary, in order to ensure that the interests of bondholders are consistently upheld. In some EMs, the enhancement of business conduct and standards professionalism of these intermediaries has been achieved via relevant rules and regulations governing their duties, role and responsibilities, and by encouraging the industry to develop their own best practices. This will help enhance investor confidence and provide assurance that their interests will be protected.

20. **Strengthen bankruptcy and restructuring regulations.** In light of the deficiencies in the bankruptcy regulations and processes in many EMs, it is imperative that authorities consciously pursue appropriate reform to ensure adequate bondholder protection, as well as efficient and effective implementation of bankruptcy laws. Further, there is a compelling case for greater emphasis to be placed on restructuring mechanisms to provide for fair and efficient reorganization of the distressed issuer. This may allow the issuer to plan for restructuring and resolution. As a result, investors are able to rationally assess the risk of investing in bonds and the likelihood of a resolution, whether in part or in full.

Adopting a conducive taxation framework

21. **Adopt a taxation regime that does not disadvantage corporate bonds.** EMs should undertake a review of the taxation framework to enable the corporate bond market to operate on a much more level playing field with the government bond market and the loan segments within the banking sector. In the review process, EMs should address the differential tax treatment between the different market segments by having closer engagement with their respective tax authorities, including proposing the adoption of a tax neutral framework.

22. **Examine viability of introducing tax incentives.** Given the natural motivation for corporations to obtain financing from the banking sector, there is a need for EMs to explore ways to neutralize the imbalances vis-à-vis the corporate bond market. EMs may find it feasible to introduce tax incentives should they consider it appropriate[43]. Tax incentives need not be perpetual, but can be in place for a stipulated period of time to stimulate further corporate bond issuances and investment activities in the market. Examples of these incentives include removing or reducing withholding taxes imposed on income distributions by corporate bonds and transaction taxes, real property gains taxes or stamp duties. Other tax incentives can cover the interest and fee income earned from holding, arranging, underwriting and distributing bonds.

[43] The World Bank however, is not a proponent of tax incentives given the distortions it may create, and believes that efforts should be focused on creating a level playing field.

Appendix A - Lessons from Jurisdictional Experiences in Primary Market Regulations and Selected Jurisdictional Cases[44]

1. Introduction

Given the importance of the primary market in corporate bond market development, the main focus of this study is on the analysis of primary market regulatory regimes of selected jurisdictions that have been successful in developing their corporate bond markets or have made notable improvements consistent with international best practices, even if the improvements have been too recent to see tangible results.[45] The jurisdictions include two developed market cases – the United States and European Union[46] –and eight emerging market cases – Brazil, Chile, India, Israel,[47] Korea, Malaysia, Thailand, and South Africa. The analysis of the latter was based on a survey that was conducted with these jurisdictions' securities regulators.

A number of developed and emerging markets have been successful in developing their corporate bond markets through a variety of regulatory and market actions that have stimulated market growth. Underlying those measures were prudent macroeconomic policies, such as low and stable inflation and controlled government deficits, as well as a positive growth cycle, which were fundamental in creating favourable conditions for the growth of these markets. Within this economic context, specific micro-level interventions were implemented to facilitate market development. Many of these measures were centered on improving access to primary markets by simplifying issuance regulations and reducing the costs and time involved in raising capital through bonds. Other factors, such as the existence of a liquid government yield curve, derivatives markets, and a well-developed intermediary sector, were also important for their market development.

Because of the relatively illiquid nature of corporate bonds due to high fragmentation and low fungibility, efficient operation of primary markets, with emphasis on increasing the supply of instruments, is one of the most important building blocks of developing the corporate bond market.

While some of the jurisdictions included in this study do not necessarily have sizeable corporate bond markets from a global perspective, they exhibit interesting regulatory frameworks that provide additional examples for EMs to consider as they decide on the appropriate path for developing their bond markets. Moreover, many of the EMs adopted improvements too recently to show a meaningful impact on the size and diversity of their corporate bonds; though, some do show important positive trends.

44 Analysis by the World Bank.

45 The analysis is based on the ongoing research of the World Bank Group.

46 We focus our analysis on the EU-wide securities regulatory framework instituted by the Prospectus Directive (2003) and Transparency Directive (2004).

47 Israel is classified as a developed market in the MSCI and FTSE indexes.

All jurisdictions discussed in this analysis have come to realize that providing flexibility and choice in the offer mechanisms is critical for meeting the diverse fixed-income needs of corporate issuers, whether they are well-established, large companies, smaller firms accessing capital markets for the first time, or projects (e.g. infrastructure) accessing the market on a one time only basis. In addition, they have also realized that the level of protection that the securities regulator needs to provide investors cannot be the same across all instruments but rather needs to be customized based on the level of target investor sophistication. For this reason, most jurisdictions have introduced a menu of issuance options, ranging from public offers to private placements, with hybrid alternatives, such as listed private placements and institutional offerings, in between. Moreover, they have also introduced additional choices within their public offer frameworks to facilitate the issuance process for recurring issuers, such as shelf-registrations and automatic approvals for well-known seasoned issuers (WKSI), and implemented improvements, such as pricing through book-building.

It is this availability of multiple options within the primary market framework – whether within or outside the public offer regime – that has been particularly valuable for companies considering raising capital through bond markets. In this study we focus our discussion on alternative offer regimes that encompass private placements and hybrid offer channels, with a particular attention to the latter, given their relevance to corporate bond markets, large variety, and relatively new inroads into EMs.

Hybrid offer regimes (see Section 2 below for a detailed definition as used in this report) have lighter regulatory requirements and are designed with target investors of corporate bonds in mind – i.e. professional or institutional investors. (Henceforth, we refer to these regimes as “professional” or “hybrid,” interchangeably). By combining and tailoring key elements of the more traditional public and private offering frameworks, professional offer regimes strive to maximize securities’ appeal for target investors while minimizing the time and cost of accessing bond financing for issuers. Thus, by fine tuning various regulatory requirements, regulators can aim to achieve the ideal balance between these two dimensions, which can help to facilitate increased issuance of corporate bonds. It is, however, essential to ensure that the target investors indeed have the level of sophistication and knowhow to make investment decisions about corporate bond instruments. As such, adoption of hybrid offer regimes is often paired with efforts to strengthen the professionalism of institutional investors.

It is necessary to keep in mind two important distinctions. First, lighter regulatory requirements do not mean absence of all disclosures; indeed, most hybrid offer regimes require limited disclosures and, regardless of regulatory requirements, issuers do provide information to target investors on a contractual basis, usually following industry standards, which tend to be relatively similar to those defined by regulation. Second, the move towards lighter regulatory requirements in EMs for offers targeted at professional investors does not contradict, as it might initially seem, the recent trend in developed markets towards increased regulatory disclosures in light of the global financial crisis. The latter concerns highly sophisticated instruments (e.g. OTC derivatives) that were previously unregulated and which were widely regarded to have contributed to the developments that led to the financial crisis. On the contrary, adoption of lighter regulations as part of hybrid offer regimes is related to relatively simple corporate bond instruments, which tend to be highly overregulated in EMs due to the fact that many EMs follow a one-size-fits-all approach and apply regulations designed for public equity markets to all securities instruments. Importantly, hybrid offer regime-type regulations, which already existed in many developed markets (e.g. the US and EU), are not being rolled back following the crisis. Rather, they are regarded as key elements of attracting and facilitating corporate bond issuance. Thus, it is important not to mix the lessons from the recent financial crisis with older notions about the importance of differentiating the degree of regulations between retail and professional investors, which still hold true today.

The next section provides a definition of a professional issuance regime as used in this report along six key elements – investors, offer documentation to the regulator or SRO, regulatory approval, secondary market trading, continuous disclosure, and antifraud provisions– vis-à-vis the more traditional pure public offer and pure private placement regimes. Section 3 provides an overall analysis of the jurisdictional cases along the key elements of the issuance framework. Section 4 concludes the analysis by drawing key messages from the jurisdictions' experiences.

2. Definition of a Professional (Hybrid) Regime

It is important to establish that "professional" or "hybrid" offer regimes as referred to in this report do not legally exist under these names in the countries that have such issuance channels. Each jurisdiction has its own official law or regulation, as well as a practical name, for an issuance framework that allows simplified requirements for offers that meet certain conditions, with the most common one being when offers are targeted solely at qualified investors. These issuance channels are typically a variation of either public or private offers, which are usually the two main officially recognized issuance regimes. The names "professional" and "hybrid" are used here solely for conceptual purposes to highlight the distinction between traditional public offer and pure private placement regimes. "Hybrid" effectively conveys that this type of offer includes a mix of public offer and private placement features, whereas "professional" refers to target investors (institutional or high net worth) that are typically allowed to invest in securities issued under this framework.

Moreover, key elements that are relevant to the hybrid offer regime may not all be contained within the same regulation. Thus, the combination of specific conditions stipulated in various laws and regulations that satisfy the hybrid offer definition explained below is what constitutes a jurisdiction's hybrid offer regime for the purposes of this study. For simplicity we collectively refer to these conditions as a "regime" even though the jurisdictions' legal frameworks may not define them as such. Finally, within the hybrid offer regime, in the context of specific requirements and available protections, our focus is specifically on non-public issuers utilizing this offering channel, for whom having lighter regulatory requirements may make a large difference in deciding to tap the bond markets. Whereas, publicly registered companies do not present such a clear case in this respect, since they are already complying with costs and regulatory requirements associated with traditional public offers.

Professional offer regimes refer to issuance frameworks that contain elements of both public and private regimes (e.g. a private placement with secondary market trading). While there is a great deal of variation across such issuance channels in terms of specific conditions and requirements, a regime must have the following two attributes in order to qualify as hybrid: (i) exemption from submission of a *full* prospectus and (ii) access to secondary market trading, albeit subject to certain investor eligibility conditions. Table 1 below outlines key characteristics of professional offer regimes as compared to pure public and private regimes.

Investment under the professional offer regime is typically restricted to qualified investors, which can include either only institutional investors or both institutional and high net worth investors knowledgeable about securities markets. By contrast, the pure private regime typically restricts the *number* of investors (e.g. less than 50) rather than the type; though, sometimes the latter is also stipulated. The pure public regime has no investor restrictions.

While some professional offer regimes have done away with all requirements to submit offer documentation to the regulator or SRO and eliminated regulatory approvals – an approach closer to the private placement regime, others may include submission of a simplified offer document or information notice to the regulator, which either does not require any approval or is essentially granted an automatic approval; still others require submission of some documentation and approval only if the issuer decides to list the bond on the exchange. In comparison, the pure private regime typically does not require any documentation to be submitted to the regulator; in rare cases, a basic information notice may be required, though, not for approval but for the purposes of simply lodging information with the regulator. The pure public regime requires submission of a full prospectus along with a thorough review and approval by the regulator. Importantly, regardless of regulatory requirements, issuers under both hybrid and private placement regimes, provide offer documentation to target investors based on prevailing market practice and specific demands of relevant investors.

Another key feature of professional offer regimes is easy access to secondary market trading, as mentioned above. Though trading is usually restricted among the same class of investors that was eligible for initial securities purchase in the primary market – i.e. qualified, institutional, or high net worth investors – within this investor segment, there is typically an active secondary market. By contrast, pure private regimes have very limited and highly restricted trading provisions (though, in some emerging markets, these restrictions are poorly enforced), whereas pure public regimes allow unrestricted trading. Trading is typically conducted over-the-counter (OTC) for hybrid and pure private regimes and OTC or on-exchange for pure public regimes.

Issuers of hybrid offers typically need to comply with simplified continuous disclosure requirements; though, if listing on the exchange, compliance with full requirements may be necessary similar to issuers of pure public offers. Pure private placements usually do not require any continuous disclosure.

Table 1: Comparison of Private, Public, and Professional (Hybrid) Regimes

	Issuance Regime		
Characteristics	Pure Private	Pure Public	Professional (Hybrid)
Investors	Typically restricted in number. Sometimes also restricted according to level of professionalism.	No restrictions in number. Open to institutional, professional and retail investors.	Typically restricted according to level of professionalism. Often only qualified or institutional investors are eligible. Sometimes also restricted in number.
Offer documentation to the regulator or SRO	Typically none.[2]	Submission of a full prospectus.	Exemption from submission of a full prospectus. Sometimes simplified or short-form prospectus or a basic information notice is required.
Regulatory approval	None.	Required. Timing of approval varies but requires thorough review by the regulator.	Typically none. If required, typically automatic or only a few days.
Secondary market trading	Highly restricted. If any, OTC.	Unrestricted. Exchange and OTC.	Typically restricted to qualified investors, but freely tradable among this group of investors. Usually OTC.
Continuous disclosure requirements	None.	Full requirements.	Typically simplified requirements.
Antifraud provisions[1]	None.	Apply.	Typically apply.

Note 1: Antifraud provisions refer to responsibilities of issuers and intermediaries, enforced by the regulator, to present accurate and truthful information during the offering process and in offering documents so as not to mislead investors.

Note 2: While issuers of private placements are typically not required to file anything with the securities regulator, they do provide offer documentation to target investors. The content of such documentation is based on market practice and is typically agreed upon between the issuer and its investors rather than mandated by the regulator.

Finally, professional offer regimes, like pure public regimes, typically maintain antifraud provisions related to false or misleading statements made in offering documents or during the offering process (e.g. US SEC Rule 10b-5). This is usually reflected in specific regulations, enforceable by the securities regulator that make issuers and intermediaries accountable for the accuracy and truthfulness of information provided in offering materials. These provisions provide important protections and are particularly valuable for institutional investors, such as pension and mutual funds that have fiduciary duties with their end investors and are highly cautious about investing in instruments that do not provide some degree of protection. They are especially valuable in jurisdictions, where the judicial system is inefficient and enforcement of contracts is difficult. Pure private regimes usually do not provide such protections; thus, investors cannot rely on the regulator to investigate potential fraud cases and can only file grievances through local courts and available judiciary processes.

To summarize, *pure public offer* represents an issuance regime with the widest distribution and greatest investor protections, but its initial and ongoing requirements can be onerous and costly for issuers, discouraging the use of bond financing, especially for smaller, less established issuers. The *pure private placement* regime offers the smallest distribution and the least amount of investor protections. While it grants issuers the quickest access to bond financing, its limited information disclosure and restricted trading, reduces its investor appeal. The *hybrid offer* regime aims to minimize the regulatory burden and cost of accessing the bond market while maintaining a degree of investor protection and secondary market trading to maximize its attractiveness for target investors.

3. Alternative Offer Regimes - Select Jurisdictional Practices

In this section, we highlight key characteristics of the alternative offer regimes – pure private placements and hybrid offer frameworks – of the selected countries reviewed in this study.

The analysis is presented along eight different elements: (i) Existence, nature, and time of adoption; (ii) Key conditions; (iii) Requirements for submission and approval of documentation; (iv) Listing; (v) Conditions for secondary market trading; (vi) Continuous disclosure requirements; (vii) Antifraud provisions; and (viii) Relative importance.

3.1 Existence, nature, and time of adoption

Table 2: Year of Adoption and Nature of Alternative Offer Regimes

	Hybrid Regimes								Pure Private Placement	
	US	**EU**	**Brazil**	**Chile**	**India**	**Israel**	**Malaysia**	**Thailand**	**Korea**	**South Africa**
Year of adoption	1990	2003	2009	2001	2008	2005	2007	2009	2009	No law / regulation
Nature of regime	Private placement with secondary market trading	Exempt public offer	Exempt public offer	Exempt public offer	Listed private placement	Private placement with secondary market trading	Private placement with secondary market trading	Private placement with secondary market trading	Pure private placement	Pure private placement

As seen in Table 2, all the jurisdictions reviewed have some kind of alternative offer regime. Eight of the ten countries have a hybrid offer regime as defined in the section above, while the other two (Korea and South Africa) have only a pure private placement regime. All the regulations except for that of the U.S. are fairly recent, adopted in the last ten years.

We have identified three types of hybrid offer regimes: private placement with secondary market trading, exempt public offer, and listed private placement. The US, Israel, Malaysia, and Thailand refer to their hybrid offers, whether officially or in practice, as private placements, whereby a hybrid offer clearly constitutes a *non-public* offering. In EU, Brazil, and Chile, while hybrid issues are exempt from filing a full prospectus, they are still considered *public* offers. Finally, India has a unique hybrid regime of listed private placements, whereby privately issued bonds are listed on an exchange to increase their transparency and appeal for institutional investors (see section 3.4 on Listing below).

3.2 Key conditions

Table 3: Key Conditions for Alternative Offer Regimes

	Hybrid Regimes								Pure Private Placement	
	US	**EU**	**Brazil**	**Chile**	**India**	**Israel**	**Malaysia**	**Thailand**	**Korea**	**South Africa**
Key Conditions	QIBs	5 possible conditions	Max. 20 QIBs	Qualified investors	Max. 50 investors	Qualified investors	HNW and sophist. investors	HNW institut. investors	Less than 50 investors	None

QIBs = qualified institutional buyers
HNW = high net worth

As seen in Table 3, the majority of the countries (six out of ten) define the main condition for the alternative offer regime as the type of investor that can purchase the offer. Broadly speaking, all of these countries require that the offer be made to qualified investors, whose definition varies across countries – i.e. some are stricter, including only institutions, while others also include high net worth individuals. The EU includes the condition of qualified investors in addition to four other possible conditions that can also qualify an offer for the exemption, including an offer made to fewer than 100 investors[48] and an offer with a €50,000 minimum denomination per unit.[49] The latter, which serves to prevent retail investors from purchasing exempt issues,[50] is the easiest to control as it takes the guess-work out of the process since the condition is hard-wired into the security itself.

India is the only hybrid offer regime jurisdiction that specifies a number instead of type of investors, which is more common to pure private placement regimes (e.g. Korea); however,

48 Increasing to 150 by July 2012.

49 The minimum denomination is being increased to €100,000. The other two conditions are: (i) Offer addressed to investors who acquire securities for a total consideration of at least €50,000 (increasing to €100,000) per investor, for each separate offer; and (ii) Offer with a total consideration of less than €100,000 (increasing to €150,000) calculated over a period of 12 months.

50 Though, it does not provide an absolute guarantee that leakage to the retail sector will not occur.

the typically large denomination of INR 10 million (approximately USD 222,000) results in securities issued via the hybrid offer regime being purchased and traded exclusively by institutional investors. South Africa has no specific regulations related to private placements, which take place purely outside the regulatory purview and are based on market practice.

3.3 Requirements for submission and approval of documentation

As seen in Table 4 below, all countries exempt alternative offer regime issuers from filing a full prospectus with the regulator and/or exchange. However, most countries require submission of some kind of notification or basic information about the issuance either to the regulator or the exchange. This serves to ensure minimum transparency about the offer for investors and/or regulators. For example, Chile and Thailand require submission of a simplified prospectus to the regulator. Malaysia requires issuers to submit to the regulator Principal Terms and Conditions and an Information Memorandum (IM), if the issuer chooses to prepare an IM. In India, simplified disclosures need to be submitted to the relevant exchange. In Brazil, a conclusion announcement including the results of the sale should be filed with the regulator within 5 days following the sale. In the US, a notice claiming the exemption and providing limited information must be filed with the regulator after the first sale.

Five of the eight hybrid offer regime countries, in addition to Korea and South Africa that have pure private placements, do not require regulatory approval of the submitted documents. In the remaining three countries, maximum approval timeframe is 1 business day (Thailand), 5 business days (India), and 14 business days (Malaysia). Notably, the timeframe for approval is shorter in Thailand and India but is the same in Malaysia when compared to that for public offers.

Table 4: Submission and Approval of Documents for Alternative Offer Regimes

	Hybrid Regimes								Pure Private Placement	
	US	**EU**	**Brazil**	**Chile**	**India**	**Israel**	**Malaysia**	**Thailand**	**Korea**	**South Africa**
Full prospectus approval by regulator / SRO	No	No	No	No	No	No	No	No	No	No
Submission of any kind of offer document to regulator / SRO	Yes	No unless the security is listed on a RM	Yes	Yes	Yes	Yes	Yes	Yes	No	No
Type of document to be submitted	Notice claiming exemption must be filed with regulator	N/A	A conclusion announcement should be filed with regulator	Simplified prospectus and ads have to be submitted to regulator	Simplified disclosures have to be filed with exchange	Description of the securities and trust deed need to be submitted to the exchange	Principal Terms and Conditions and IM, if issued	Registration statement and short-form prospectus	N/A	N/A
Timing of submission	After the first sale	N/A	Within 5 days after the sale	At least 2 days before the first sale	Prior to listing	Prior to listing securities on TACT Institutional	Prior to issuance	At least 1 day before the first sale	After the first sale	N/A
Approval required by regulator / SRO	No	N/A	No	No	Yes by the exchange	No	Yes	Yes	No	N/A
Max. time frame for approval	N/A	N/A	N/A	N/A	5 business days	N/A	14 business days	1 day	N/A	N/A

Notes:
RM: regulated market, which constitutes a major EU exchange. Other, alternative markets, referred to as "exchange-regulated markets" do not trigger prospectus obligations.
IM: Information Memorandum
TACT (Tel-Aviv Continuous Trading) Institutional: a standalone trading system within the Tel-Aviv Stock Exchange for trading securities offered without a prospectus among qualified investors.

3.4 Listing

In most of the countries reviewed, listing of securities issued via a hybrid offer regime is allowed but typically requires the company to comply with the same disclosure obligations as required for public offers. As such, a company willing to list its hybrid offer would only be delaying compliance with full prospectus disclosures, assuming it decides to list some time after the primary offering. Yet, this approach may still be advantageous, as it would allow the company to raise capital relatively quickly (i.e. with limited or no regulatory approval) and take advantage of favourable market conditions; later, if the goal is to make the issue more widely accessible to investors, it can comply with full public offer requirements and list the security on the exchange. This is a widely used practice in South Africa, among others, a market driven by listings and the exchange, where many securities issued via the pure private placement regime end up listing either immediately or some time after the initial placement of securities. Interestingly, though South Africa does not have a dedicated issuance regime for corporate bonds that are targeted at institutional investors, it does recognize the inherent difference between bond and equity investors by adopting lighter listing and continuous disclosure requirements for debt issuers in general, including within the pure public offer framework.

Notable exceptions to the above practice are India and the EU, where hybrid offer regime issuers can list bonds and still benefit from somewhat lighter disclosure requirements and faster approval time compared to those for pure public offers. For example, in India, as mentioned above, exchange listing is a key element of the hybrid offer regime, which otherwise would be more akin to a pure private placement regime. India introduced listed private placements in 2008 as an effort to increase transparency and investor appeal for privately issued bonds that traditionally represented a rather opaque market. The measure was widely embraced by the market, with listed private placements representing about 80% of total corporate bond issuance in 2010 (see section 3.8 below)

In the EU, exchange listing is also prevalent mainly to make the offer eligible for investment by certain institutional investors, whose investment guidelines allow only limited investments in securities that are not listed on an exchange. Interestingly, independent of a security's offering method, all corporate bonds with a minimum unit denomination of €50,000 (increasing to €100,000) are subject to lighter listing requirements, consistent with the notion that a larger denomination translates into institutional investor rather than retail participation in the trading of a security.

3.5 Conditions for Secondary Market Trading

Table 5: Conditions for Trading Securities Issued Via Alternative Offer Regimes

	Hybrid Regimes								Pure Private Placement	
	US	**EU**	**Brazil**	**Chile**	**India**	**Israel**	**Malaysia**	**Thailand**	**Korea**	**South Africa**
Conditions for trading	QIBs	Same as initial exemption conditions	QIBs after 90 day holding period	Qualified investors	None, but typically large denominat.	Qualified investors on standalone trading syst.	HNW and sophist. investors	HNW and institutional investors	No splits; transferred only to 1 investor within 1year.	None, but typically large denominat.

QIBs = qualified institutional buyers
HNW = high net worth

As seen in Table 5, most countries reviewed require that securities offered via an alternative offer regime meet the same conditions for trading as they did for initial placement. For six of the ten countries, this means that trading of hybrid offer securities must take place solely among qualified investors. In Korea, securities are prohibited from going through splits and can only be transferred to one investor within 1 year, ensuring that the number of investors remains less than 50 at all times. Such requirements are typical for pure private placement regimes, as noted in section 2 above, under which resale and trading of securities is typically highly cumbersome.

India and South Africa do not have any specific regulations; though, importantly, the unit denomination of securities is high enough in India, as mentioned above, to keep retail investors from buying exempt securities.

3.6 Continuous Disclosure Requirements

Table 6: Continuous Disclosure Obligations for Securities Issued Via Alternative Offer Regimes

	Hybrid Regimes								Pure Private Placement	
	US	**EU**	**Brazil**	**Chile**	**India**	**Israel**	**Malaysia**	**Thailand**	**Korea**	**South Africa**
Continuous disclosure	No	Yes if listed, but lighter if denomination is €100,000 (recently increased from €50,000)	Yes, but lighter	Yes, similar to public offers	Yes, similar to public offers	No	Yes, but lighter	Yes, but lighter	No	No

As seen in Table 6, the application of continuous disclosure obligations to alternative offer regimes varies across countries. They do not apply in the two pure private placement regimes (Korea and South Africa), as well as in the US[51] and Israel.[52] Four of the remainder countries (EU, Brazil, Malaysia, and Thailand) impose ongoing disclosure obligations but in lighter form, while Chile and India have the same requirements as for public offers.

3.7 Antifraud Provisions

Table 7: Application of Antifraud Provisions to Alternative Offer Regimes

	Hybrid Regimes								Pure Private Placement	
	US	**EU**	**Brazil**	**Chile**	**India**	**Israel**	**Malaysia**	**Thailand**	**Korea**	**South Africa**
Antifraud provisions	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No

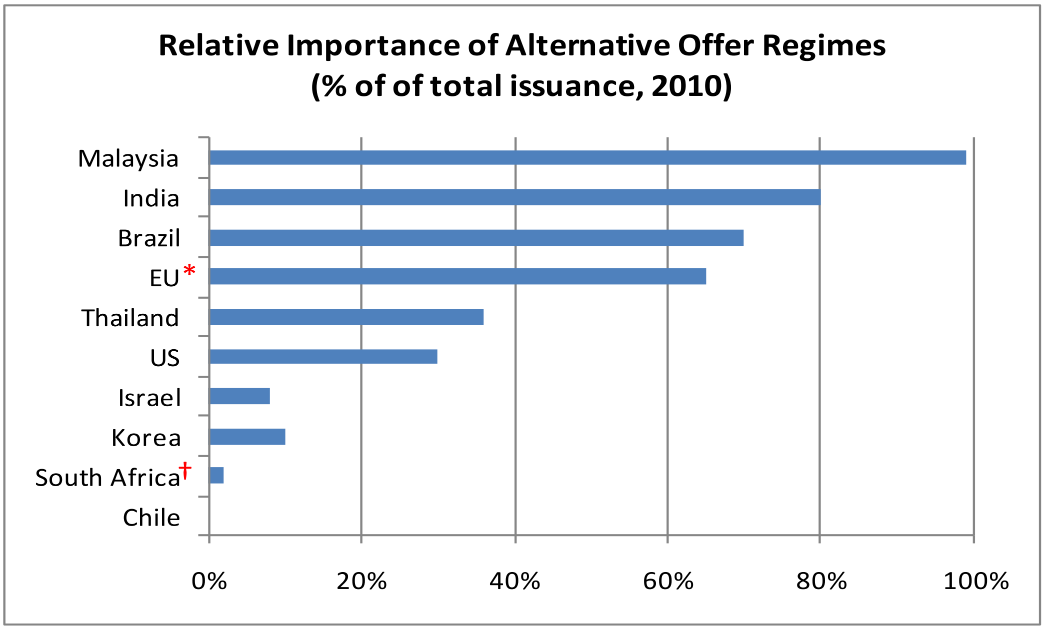
51 However, holders or prospective purchasers of hybrid securities in the U.S. (i.e. issued via Regulation D and Rule 144A) have the right to obtain from the issuer: (i) a brief description of the issuer's business, products, and services; (ii) the issuer's most recent balance sheet, profit and loss statement, and retained earnings statement; and (iii) similar financial statements for the two preceding fiscal years.

52 This is the case with regards to non-reporting corporations that issue securities via the hybrid offer regime, which are the focus of our analysis. However, reporting corporations are subject to continuous disclosure requirements.

As seen in Table 7, all the hybrid offer regime countries enforce the same level of antifraud regulations related to information presented by issuers and intermediaries on hybrid offers as they do for public offers. The two pure private placement regimes of Korea and South Africa do not provide these protections.

3.8 Relative Importance

Figure 1



* Estimate based on a proxy of offers with a minimum unit denomination of €50,000.
† Estimate based on anecdotal evidence.

Finally, Figure 1 above shows the relative importance of the alternative issuance channel as a proportion of total value of issuance. In general, data on non-public offerings – private placements and hybrid offer regimes – is not easily available, particularly in the more developed markets of EU and US, which do not require registration with the regulators, making these issuances more difficult to track. With regards to EMs, data on hybrid offer issues was available from securities regulators, who are more keen and able to monitor these issues, given the relative novelty of the regimes in their countries and the fact that regulators tend to be more involved in the hybrid offer issuance process than those in the EU and US.

Among the EMs, the alternative offer regime carries the most importance in Malaysia, India, Brazil, and Thailand, accounting for 99%, 80%, 70% and 36% of total issuance, respectively. Notably, in Thailand, the hybrid offer regime makes up 81% of total issuance in terms of number of issues. In Brazil, where the alternative offer regime was only recently introduced (2009), there was an observable increasing trend in hybrid regime issuance from the first quarter to the last quarter of 2010, with the expectation that the issuance will continue to shift in favour of the hybrid offer regime going forward.

Interestingly, Chile does not have any issuance under the hybrid offer regime despite its introduction in 2001 for two possible reasons: (i) it has not introduced matching flexibilities in investment regulations for institutional investors; and (ii) issuers and intermediaries have an inertial preference to continue preparing full prospectus disclosures. For example, while the hybrid offer regime eliminated the credit rating requirement, major institutional investors, such as pension funds, are still required by regulation to invest only in securities with a credit rating. Nevertheless, Chile is included in the above analysis, as it serves as an important example, highlighting the need for appropriate regulatory amendments to take place on the investment side in order to enable issuers to take advantage of benefits provided by the hybrid offer regime.

The US and EU hybrid offer regimes also account for a sizeable portion of total issuance – 30%[53] and 65%,[54] respectively. Notably, in the US, the hybrid offer regime has seen most usage from high yield corporate bond issuers, with, on average, 70% of high yield issues over the last 15 years occurring under the hybrid regime.[55] This attests to the regime's particular appeal for less established, riskier issuers that do not find value in going through the public offer regime requirements, given their natural focus on institutional as opposed to retail investors.

4. Conclusion

The jurisdictional experiences analyzed in this study show that to stimulate growth in the corporate bond market it is important to introduce regulatory flexibility and broaden the range of offering mechanisms in the primary market to accommodate diverse needs of corporate issuers, depending on their size, industry, and length of operation, and whether they are recurring, first-time, or one-time only issuers (e.g. infrastructure projects). This can be done by increasing available issuance options both within and outside the public offer framework, namely: (i) introducing fast-track public offer initiatives, such as shelf-registrations and automatic approvals for seasoned issuers; and (ii) introducing alternative issuance regimes, such as private placements and hybrid offer regimes. In designing these regulations, policy makers should be mindful of the types of investors that predominantly invest in corporate bonds – institutional or high net worth – who do not require the same level of protections that are needed for retail investors and equity instruments.

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53 Source: Thomson Financial (Thomson One Banker-Deals Module), SIFMA, and World Bank calculations.

54 Comprehensive issuance data by offer type (public vs. exempt) within the EU region is not currently available. As an attempt to determine a best estimate, a representative proxy was used based on Eurobond offers with a minimum unit denomination of €50,000 that were listed in 2010 on the Luxembourg Stock Exchange (LuxSE), one of the largest Eurobond listing venues in Europe. Thus, the data tries to capture offers taking advantage of prospectus exemptions based on the minimum denomination condition, i.e. offers with a denomination of €50,000 or greater. The data includes only euro denominated offers. The main caveats of the analysis are that the data does not take into account: offers in other currencies, exempt offers based on conditions other than the minimum denomination, and offers made on a national basis outside the Eurobond markets. *Source:* LuxSE, International Capital Market Association (ICMA) consultations, and World Bank calculations.

55 See supra note 53.

This variety of issuance options represents a critical factor in facilitating access to bond markets by a greater number and diversity of companies. In parallel to these efforts, regulators should aim to improve the overall efficiency of the public offer regime by streamlining the registration process to reduce the time it takes the regulator to approve public issues.

Alternative issuance regimes, such as professional or hybrid offer regimes, which were the focus of the above analysis, are a key part of increasing the flexibility of the primary market regulatory framework. They seem to achieve the desired balance between *sufficient flexibility for issuers* to encourage greater access to bond financing and *adequate investor protections* to stimulate investment interest from target investors, such as regulated institutions (e.g. pension funds and insurance companies). While there is a great deal of variation among such regimes across jurisdictions, the following key features seem to emerge from the above jurisdictional analysis:

- (i) Investment limited to qualified investors, usually institutional investors and/or high net worth individuals;
- (ii) Reduced initial and ongoing disclosure requirements;
- (iii) Limited role of the regulator, if any, in the approval process;
- (iv) Unrestricted access to secondary market trading, usually OTC, for eligible investors (i.e. professional); and
- (v) Continued provision of antifraud protections by the regulator against false or misleading statements in initial or ongoing disclosures.

Importantly, the entire hybrid approach is predicated on the notion that chief investors in corporate bonds are highly sophisticated and mostly institutional investors that have sufficient knowledge and resources to analyze opportunities and risks related to corporate bond issues. As such, ensuring the professionalism of institutional investors is a necessary step in adopting a hybrid offer regime, including investing resources, if needed, in their development. It is also important to prevent leakage of hybrid offer securities to retail investors (without prior registration with the regulator) by enacting measures such as: (i) requirements for intermediaries to conduct thorough assessments to ensure suitability of investors for particular investments; (ii) clear definitions of different investor types; and (iii) clear rules on which types of investors are eligible to purchase which securities.

It is important to keep in mind that regardless of their sophistication, institutional investors place significant value on having regulator's continued involvement in the provision of antifraud protections, such as the US SEC Rule 10b-5. The latter is particularly valuable for investors in emerging markets, where courts and judicial systems may not be functioning efficiently.

Further, existence of antifraud provisions typically places specific responsibility on intermediaries involved in the issuance process, such as investment banks and legal advisors, to conduct robust due diligence and prepare high quality disclosure documents. Hence, it is also important to ensure a certain level of professionalism in the intermediary community.

Finally, it may be necessary to introduce matching flexibilities in the regulatory frameworks of institutional investors (e.g. investment guidelines for pension funds) in order to allow these investors to purchase securities issued via a hybrid offer regime.

There is no one-size-fits-all model when introducing flexibility into the primary market issuance framework. The great diversity of regimes and options reviewed in this study suggests that regulations need to be tailored, taking into consideration the particular economic, market, and overall regulatory context of a given jurisdiction, while keeping in mind the critical elements discussed above.

Primary Market Framework for Corporate Bonds – Selected Jurisdictional Cases[56]

In this section, hybrid offer regime is referred to and analyzed according to the definition and descriptions put forth in Section 2 of this appendix above. As stated there, such regimes do not officially exist in the legal framework of the jurisdictions analyzed; rather they are identified and analyzed based on specific jurisdictions in the countries' various laws and regulations that satisfy the hybrid offer regime definition formulated in Section 2.

The analysis focuses specifically on hybrid offers made by companies that are not already publicly registered, reporting companies, given our interest in examining the ability of the hybrid offer regime to facilitate access to bond financing for non-public, less established, and new issuers. This focus is made particularly in the context of specific requirements for issuance and available protections; in estimating the volume of issuance under the hybrid offer regime, in most cases, it was not possible to separate out issuance only by non-public companies.

Securities issued under the hybrid offer regime are referred to as "hybrid offer securities."

Brazil
Brief Description of the Primary Market Framework
The primary market regulatory framework in Brazil is characterized by pure public, pure private, and hybrid issuance regimes. For public offerings, there is a unique dual registration system that requires separate registration of the issuing company and the securities offer. The company registration is a more arduous and lengthy process of the two that can take up to 90 business days. As a result, often companies register with the securities regulator, CVM, even before they decide to make a securities offer in order to speed the process when the market conditions are right for issuance; though, the two registrations can be done simultaneously. The pure private placement regime falls under the Corporation Law and is completely outside the purview of CVM. There are no specific conditions or requirements stipulated for this regime, but, in practice, the number of investors tends to be small, submission of an offer document or compliance with continuous disclosure obligations is not required, and trading is fairly limited. The hybrid regime was introduced in 2009 as a result of a long-term study that concluded that the market needed a faster and less bureaucratic system for issuance. In 2010, the first year after its introduction, corporate bond issuance markedly shifted towards the hybrid regime,

56 Analysis by the World Bank.

which accounted for nearly 70% of total issuance. Preliminary analysis also suggests that new issuance in absolute terms experienced a healthy boost, indicating positive appeal of the hybrid regime.	
Key Features of the Hybrid Offer Regime	
Official name of the hybrid regime or regulation, year of adoption, and nature of the regime	"Restricted Efforts Offering" stipulated by Instruction 476 adopted in 2009. Securities issued under this regime are considered exempt public offers.
Relative importance (% of total issuance)	70%
Key conditions	Offers made to maximum 20 Qualified Institutional Buyers (QIBs).
Submission and approval of documentation, if any, to the regulator or SRO	The regulation allows for prospectus exemption without any ex-ante notification or approval of the regulator. The only requirement is for the issuer to notify the regulator of the sale results in a "conclusion statement" within 5 days from the end of the sale. Importantly, hybrid issuers are exempt from the company registration requirement of the dual registration system that exists for public offers.
Trading and listing of hybrid offer securities	Hybrid offer securities can be traded among QIBs after a 90 day holding period. They are not allowed to be listed or traded on the stock exchange unless the issuer is a public company registered with CVM. Thus, hybrid offer securities predominantly trade over-the-counter (OTC).
Continuous disclosure requirements	Issuers of hybrid offer securities are subject to continuous disclosure requirements, but they are lighter than those for public companies. For example, hybrid issuers are not required to disclose quarterly financial statements and notification of material events can be done electronically.
Existence of antifraud provisions in the law or regulation or regulator's mandate related to information presented by issuers and intermediaries on hybrid offer securities.	CVM has the mandate to intervene in case of fraud related to securities issued under the hybrid regime. By contrast, it does not have this mandate for securities issued via the pure private placement regime.

Chile
Brief Description of the Primary Market Framework
Chile introduced a number of regulatory amendments to its securities market framework, beginning in 2001. Among others, these included: • Introduction of a shelf registration scheme • Elimination of the requirement to pay stamp taxes on each tranche under shelf registration • Elimination of the requirement to obtain two credit ratings • Introduction of the exemption from filing a full prospectus for offers made solely to qualified investors (hybrid regime) Chile has two issuance regimes for corporate bonds: pure public offer and exempt public offer, or hybrid regime. It does not have a pure private placement regime. Interestingly, despite its relatively early introduction into the regulatory framework (2001), the hybrid offer regime has yet to see any issuance. This is possibly due to two reasons, as explained by the securities regulator, SVS: (i) Regulations governing institutional investors, particularly pension funds, have not been amended to match the flexibilities allowed under the hybrid offer regime, such as, for example, the elimination of the credit rating requirement. Thus, even though the hybrid regime does not require a credit rating, institutional investors do, resulting in issuers having to continue providing a rating. (ii) According to an industry consultation conducted by SVS, issuers and intermediaries do not find it more difficult or costly to file a detailed prospectus, and prefer to do so even if it is not required by regulation. While this may be true for larger issuers, it may not be the case for smaller, especially first-time, issuers. Though, SVS believes that for these issuers, challenges lie more in the upstream preparatory work for bond issuance (e.g. complying with accounting and corporate governance standards) rather than in the preparation of a prospectus. While there could be other reasons for this phenomenon, Chile serves as an important example, highlighting the need for appropriate regulatory amendments to take place on the investment side in order to enable issuers to take advantage of benefits provided by the hybrid offer regime.

Key Features of the Hybrid Offer Regime	
Official name of the hybrid regime or regulation, year of adoption, and nature of the regime	Capital Market Reform No. 1 (MK1), 2001, which introduced amendments to the Securities Market Law of 1981. Securities issued under this regime are considered exempt public offers; they are considered registered securities similar to pure public offers.
Relative importance (% of total issuance)	0%
Key conditions	Offers made to qualified investors
Submission and approval of documentation, if any, to the regulator or	The regulation exempts the issuer from filing a full prospectus; issuers also do not have to provide a credit rating. However, a simplified prospectus must be submitted to SVS at least 2 days before the first sale. Issuer must indicate on

SRO	the filing that the offer will be made solely to qualified investors and will thus be eligible for prospectus exemptions. The document does not need to be approved by SVS.
Trading and listing of hybrid offer securities	Hybrid offer securities must be traded solely among qualified investors. Broker dealers are responsible for not allowing retail investors to purchase exempt securities. The regulation allows hybrid offer securities to be listed on the exchange. Issuers do not need to meet any additional requirements for listing. The regulation allows trading to take place both on the exchange and OTC. Trades do not have to be reported.
Continuous disclosure requirements	Issuers of hybrid offer securities are subject to continuous disclosure requirements, which are very similar to those for public offers.
Existence of antifraud provisions in the law or regulation or regulator's mandate related to information presented by issuers and intermediaries on hybrid offer securities.	SVS has the mandate to hold issuers and intermediaries accountable in case of fraud related to hybrid offer securities.

European Union	
Brief Description of the Primary Market Framework	
The primary market framework for corporate bonds in the EU is characterized by two main offering regimes: public offers and exempt public offers, or hybrid regime. A form of hybrid regime was first introduced in 1980 by the EU Council Directive (80/390/EEC), followed up with the 1989 Council Directive (89/298/EEC) and finally replaced by the most comprehensive framework laid out in the Prospectus Directive of 2003, which went into effect in 2005. There is no pure private placement regime at the EU-legislative level; though particular member states may have such regimes at the national level. Although the exempt offer regime does not differentiate between debt and equity, the most natural users of this issuance channel are issuers of corporate debt. The particularly interesting feature of the EU hybrid offer regime is the condition that stipulates that offers with a minimum denomination of €50,000 or greater are exempt from filing a prospectus. Though, there are four other possible conditions for prospectus exemption, this is the most commonly used and preferred condition because it is the easiest to control, since the requirement is basically "hard-wired" into the offer. The high denomination serves to prevent the securities from being purchased and traded by retail investors.[57]	
Key Features of the Hybrid Offer Regime	
Official name of the hybrid regime or regulation, year of adoption, and nature of the regime	Prospectus Directive (2003/71/EC). Securities issued under this regime are considered exempt public offers.
Relative importance (% of total issuance)	65%[58]
Key conditions	Any of the following 5 conditions qualify an issue to be exempt from submission of a prospectus. 1. An offer of securities addressed solely to qualified investors 2. An offer of securities addressed to fewer than 100 natural or legal persons per Member State, other than qualified investors[59] 3. An offer of securities whose denomination per unit amounts to at least €50,000[60] 4. An offer of securities addressed to investors who acquire securities for a total consideration of at least €50,000[61] per investor, for each separate offer

57 Though, it does not provide an absolute guarantee that leakage to the retail sector will not occur.

58 See supra note 54.

59 The 100 person threshold is scheduled to be increased to 150 persons by July 2012.

60 The €50,000 threshold is scheduled to be increased to €100,000 by July 2012.

	5. An offer of securities with a total consideration of less than €100,000, which limit shall be calculated over a period of 12 months[62]
Submission and approval of documentation, if any, to the regulator or SRO	Issuers are exempt from filing a prospectus unless they decide to list the security on a regulated market, which constitutes a major EU exchange. Alternative markets, referred to as "exchanged-regulated markets" (e.g. AIM in London) do not trigger this obligation (though, they may have other requirements of their own). If the security is listed on a regulated market, the issuer must submit a simplified prospectus to the regulator and/or exchange for approval. (In some member states, regulators may delegate this function to the exchange). In addition, issuers of debt securities with a minimum denomination of €50,000 are not required to submit a "summary prospectus,"[63] further alleviating the burden for debt issuers targeting institutional investors. This stipulation applies to any debt securities regardless of the offer method. The simplified prospectus must be approved within maximum 10 business days (or 20 business days if the company is a first-time issuer).
Trading and listing of hybrid offer securities	Hybrid offer securities are allowed to be traded as long as one of the 5 exemption conditions continues to apply. If this is no longer the case, the holder of the security will need to produce a prospectus at the time of the sale. There is considerable debate about the feasibility of doing this in practice. Many exempt offer securities are listed on an exchange mainly for the purpose of becoming eligible for investment by certain institutional investors that face restrictions on investing in unlisted securities. Notably, listing on exchange-regulated markets, which fall outside of the EU Prospectus and Transparency Directives and have lighter disclosure requirements, can, in many cases, satisfy the *listing* condition required by institutional investors. Despite many of the exempt offer securities being listed, trading is almost exclusively conducted OTC.
Continuous disclosure requirements	Issuers of hybrid offer securities are subject to continuous disclosure requirements, as stipulated by the Transparency Directive of 2004, if the securities are listed on a regulated

61 See supra note 60.

62 The €100,000 threshold is scheduled to be increased to €150,000 by July 2012.

63 Though, member states may require such summaries through national law.

	market. However, securities with a minimum denomination of €100,000[64] are subject to lighter requirements – independent of the offer method.
Existence of antifraud provisions in the law or regulation or regulator's mandate related to information presented by issuers and intermediaries on hybrid offer securities.	In general, issues related to information contained in offer documents are governed by civil liability laws of member states. There is no harmonized EU regulation in this regard. Typically, in case of intended deceit, securities regulators or relevant authorities are likely to have a mandate to investigate the matter. Whereas cases involving failure of due diligence are typically just handled in civil courts.

64 The denomination limit was increased from €50,000 to €100,000 as of December 31, 2010. All debt securities issued prior to Dec 31, 2010 with a denomination of €50,000 or higher would continue to be able to take advantage of the lighter disclosure requirements.

India	
Brief Description of the Primary Market Framework	
India's primary market framework is characterized by public offers, listed private placements, and unlisted private placements, which make up about 1%, 85%, and 14% of total issuance, respectively. Listed private placements, which were introduced in 2008, represent India's effort to create a type of hybrid regime that can have the relative flexibilities of a private placement but still provide a degree of protections and transparency to investors and regulators. It was also an attempt to increase transparency of the overall corporate bond market, which was already dominated by private issues but was opaque with very limited information availability. India has also made a number of improvements to the public offer regulations for debt securities. The securities regulator, SEBI, has removed itself from the review and approval of the offer document, as companies are no longer required to file a draft offer document with SEBI for its comments. Instead, issuers make the draft offer document available for public comment for a period of 7 days on the website of the exchange where they plan to list the security. The issuer's intermediary is then required to submit to SEBI a due diligence certificate stating that all public comments have been incorporated. Despite these process improvements, initial disclosure norms for public debt issues have remained identical to those of public equity securities; these requirements are set by the Companies Act and are outside of SEBI's purview and ability to change. However, in 2009, recognizing debt instruments' institutional nature when compared to equity, SEBI adopted differentiated continuous disclosure requirements for public debt securities as a move to lighten public debt issuers' regulatory burden.	
Key Features of the Hybrid Offer Regime	
Official name of the hybrid regime or regulation, year of adoption, and nature of the regime	SEBI (Issue and Listing of Securities) Regulations, 2008. Securities issued under this regime are regarded as listed private placements.
Relative importance (% of total issuance)	85%
Key conditions	Offers made to maximum 50 investors, which can be retail or institutional. Financial institutions issuing debt securities are exempt from this limit of 50 investors.
Submission and approval of documentation, if any, to the regulator or SRO	Issuers of listed private placements are exempt from filing a full prospectus; however, they must file simplified disclosures, including a mandatory credit rating, with a relevant stock exchange prior to listing. These disclosures are less onerous than those required for public offers. The exchange reviews and approves the disclosures within 5 business days.

Trading and listing of hybrid offer securities	There are no stipulated restrictions for trading hybrid offer securities, but the typically large denomination of INR 10 million (approximately USD 222,000), coupled with brokers' high costs and lack of desire to distribute to retail investors, results in these securities being traded exclusively by institutional investors. By nature, listed private placements are listed on an exchange, in a special segment. Virtually all trades are conducted OTC and reported on designated reporting platforms.
Continuous disclosure requirements	Issuers of listed private placements must provide ongoing disclosures to the exchange, where they are listed. These requirements are the same as those for public offers. However, since 2009, debt securities, in general, have been subject to lighter ongoing disclosure requirements than equity securities, attesting to the regulator's acknowledgement of the institutional nature of debt instruments and hence the need for less stringent disclosure requirements.
Existence of antifraud provisions in the law or regulation or regulator's mandate related to information presented by issuers and intermediaries on hybrid offer securities.	The SEBI (Issue and Listing of Debt Securities) Regulations, 2008 cast responsibility on issuers and merchant bankers to ensure that false or misleading statements are not made. SEBI has the powers under the SEBI Act to enforce these regulations.

Israel	
Brief Description of the Primary Market Framework	
Israel's primary market issuance framework for corporate bonds is characterized mainly by a pure public offer regime, accounting for about 88% of total corporate bonds listed in the Tel-Aviv Clearing House by volume in 2010. The remainder is represented by private placement issuance, which includes the hybrid offer regime and private placements by reporting (public) companies.[65] In addition, there are also pure private placements, data on which is not widely available, since they are not listed on any trading venue or clearing house and are completely outside the regulatory purview. The hybrid offer regime, which is based on the private placement regulation, was introduced in 2005 and created an outlet for institutional investors to trade bond securities offered via a private placement (i.e. without a prospectus) in a fast and efficient manner in a specialized trading system – TACT Institutional. The addition of this feature to the private placement framework is what constitutes this a hybrid offer regime. Despite its introduction 6 years ago, the hybrid offer regime still accounts for a relatively small share of total issuance[66] and the market appears to continue to be dominated by a culture of public offers and exchange trading. Other measures that have been important for strengthening the primary market framework in Israel include: • Enhancements to disclosures related to protecting bond holders; • Amendment to the Companies Law imposing corporate governance requirements for bond issuers (companies who issue bonds but do not issue equity); and • Amendment of the Securities Law strengthening the role and obligation of bond holder trustees to better serve bond holder interests (still in the enactment process).	
Key Features of the Hybrid Offer Regime	
Official name of the hybrid regime or regulation, year of adoption, and nature of the regime	Securities Law, 1968, Section 15A. Specific sections related to the hybrid offer regime were amended in 2000, 2004, 2005, and 2011. Securities issued under this regime are considered private placements with easy access to an active secondary market.
Relative importance (% of total issuance)	8%[67]

[65] Those with at least some securities being held by the public.

[66] Private placement securities trading on TACT Institutional make up 8% of total corporate bonds listed in the Tel-Aviv Clearing House. However, because these include offers by both reporting and non-reporting corporations, the actual share of non-reporting corporations (i.e. hybrid regime) is estimated to be somewhat smaller than 8%.

[67] See supra note 66.

Key conditions	Offers made to institutional investors.
Submission and approval of documentation, if any, to the regulator or SRO	Issuers of hybrid offer securities are exempt from filing a full prospectus and do not need to file any document to the securities regulator for review or approval. The only requirement is to submit to the exchange a description of the securities and details regarding the trust deed. The submission must be made prior to listing the securities on TACT (Tel-Aviv Continuous Trading) Institutional, a standalone trading system within the exchange.
Trading and listing of hybrid offer securities	Hybrid offer securities can be traded among institutional investors on TACT Institutional. Securities are not subject to any holding period; thus, trading can begin immediately following the issuance. Hybrid offer securities are not listed on the exchange, as this would require submission of a full prospectus. Though OTC trading is allowed, the vast majority of hybrid offer securities are traded through TACT Institutional and the OTC market is very small. The latter is the case, in general, for all bonds in Israel, where exchange trading dominates. OTC trades in securities listed on TACT Institutional or the exchange must be reported to the clearing house.
Continuous disclosure requirements	Issuers of hybrid offer securities are not subject to any continuous disclosure requirements. (Only reporting companies must meet these obligations).
Existence of antifraud provisions in the law or regulation or regulator's mandate related to information presented by issuers and intermediaries on hybrid offer securities.	Section 54 of the Securities Law includes a general provision on fraud, which requires issuers and intermediaries to be accountable for the truthfulness and accuracy of the information disclosed as part of the offer of securities. This provision applies to securities issued via both public and private issuance channels.

Malaysia	
Brief Description of the Primary Market Framework	
Malaysia implemented significant regulatory enhancements to its primary market framework beginning in 2000, including: • Introducing a disclosure based approval framework • Introducing shelf registration • Eliminating the minimum rating requirement (though, obtaining a rating remained mandatory) • Removing the underwriting requirement • Eliminating restrictions on utilization of proceeds from corporate bond issuance The introduction of the disclosure based framework significantly reduced the time it took to approve new issues from 1-3 months to 14 business days. Malaysia has two main issuance regimes for corporate bonds: public offer and hybrid regime, which represent 1% and 99% of total issuance, respectively. The hybrid offer regime has led to overwhelming level of issuance indicates its widespread appeal among issuing companies. Though, there is a very subtle difference between the hybrid offer regime and the pure public offer regime – mainly in the amount of information that needs to be disclosed, with regulatory approval applying to both regimes equally – possibly explaining such a wide use of the hybrid issuance channel.	
Key Features of the Hybrid Offer Regime	
Official name of the hybrid regime or regulation, year of adoption, and nature of the regime	"Excluded offers," "excluded invitations" or "excluded issues" – defined in Schedules 6 and 7 of the Capital Markets and Services Act 2007 (CMSA). The hybrid offer regime is also interchangeably referred to as private placements or institutional offerings. It can be characterized as a private placement with easy access to active secondary market trading. Though, because of certain features (e.g. submission and approval of documents), the regime is actually closer to pure public offers rather than private placements.
Relative importance (% of total issuance)	99%
Key conditions	Offers made to high net worth (HNW) and sophisticated investors.
Submission and approval of documentation, if any, to the regulator or SRO	Issuers of hybrid offer securities are exempt from filing a full prospectus; however, they must file with the Securities Commission (SC) Principal Terms and Conditions, whose information requirements are considerably lighter than those of a full prospectus, along with a mandatory credit rating. In addition, if an issuer chooses to provide an Information Memorandum (IM) to investors, they are required to also deposit a copy with the SC. However, issuance of an IM is

	voluntary (except for asset-backed securities and certain classes of sukuks) and the SC does not prescribe its contents. The documents require a review and approval of the SC, which can take up to 14 business days, the same as for public offers.
Trading and listing of hybrid offer securities	Hybrid offer securities can be traded among HNW and sophisticated investors. Listing of hybrid offer bonds by non-public companies was introduced in 2008. Prior to this, only public companies listed bonds that were predominantly equity-linked in nature. While this initiative has increased issuers' interest to list exempt issues, still the predominant practice of issuers is not to list. In general, there are no additional requirements for listing beyond the disclosures required for initial issuance. The majority of trades are transacted OTC and all OTC trades are reported to the Electronic Trading Platform operated by the exchange.
Continuous disclosure requirements	Issuers of hybrid offer securities are subject to continuous disclosure requirements, though they are generally lighter if the issue is not listed. For example, there are no periodic disclosure requirements, only a requirement to report to the trustee and the SC on the occurrence of material events. If hybrid offer securities are listed, the issuer is subject to disclosure requirements of the exchange. For issues made under the Medium Term Note (MTN) program, continuous disclosure requirements are governed by market practice.
Existence of antifraud provisions in the law or regulation or regulator's mandate related to information presented by issuers and intermediaries on hybrid offer securities.	The CMSA 2007 holds parties involved in the issuance process, including that for hybrid offer securities, accountable for any misrepresentation of information. In addition, the SC practices strong supervision over bond market intermediaries, such as credit rating agencies, bond trustees, and bond pricing agencies, to ensure their competence and compliance with relevant guidelines and requirements.

Thailand	
Brief Description of the Primary Market Framework	
Thailand began introducing regulatory flexibility to its primary market framework for corporate bonds beginning in 2002. Among others, this included: • Introducing a shelf registration scheme • Permitting international credit ratings • Reducing the time frame for approval and disclosure of information for public bonds from 30 to 14 calendar days and from 3 to 1 business day for subsequent public offers • Reducing filing fees for all long-term debt securities and for short-term debt offered to institutional and high net worth (HNW) investors. The primary market framework is characterized by three offering channels: pure public offer, pure private placement, and hybrid regime, each representing 42%, 22%, and 36% of total issuance by volume in 2010, respectively. Notably, the hybrid regime, which was introduced in 2006, is available exclusively for debt securities, recognizing its particular applicability to fixed income instruments, whose predominant investors are institutional or HNW. Despite its short existence, the hybrid regime appears to be widely embraced by issuers, representing 61% of total number of issues in the first year after its introduction and 81% in 2010. The pure private placement regime is characterized by standard private placement elements, such as limited number of investors (10) and strict conditions on transferability but has the least amount of disclosure requirements. In addition, unlike the hybrid regime, the SEC does not have the mandate to protect investors in case of fraud associated with a privately placed issue, delegating this function to the courts.	
Key Features of the Hybrid Offer Regime	
Official name of the hybrid regime or regulation, year of adoption, and nature of the regime	Notification of Capital Market Supervisory Board No. TorChor 10/2552 Re: Filing of Registration Statement for Offer for Sale of Debt Securities, Dated March 31, 2009, which replaced Notification of the Securities and Exchange Commission No. KorYor. 40/2549 Re: Filing and Exemption from Filing of Registration Statement for Offer for Sale of Debt Securities, Dated November 15, 2006. The hybrid offer regime can be characterized as a private placement with easy access to active secondary market trading. Though, because of certain features (e.g. submission and approval of documents), the regime is actually closer to pure public offers rather than private placements.
Relative importance (% of total issuance)	36%
Key conditions	Offers made to institutional and high net worth (HNW) investors.
Submission and approval of documentation, if any,	Issuers of hybrid offer securities are exempt from filing a full prospectus; however, they must submit a registration statement and draft prospectus, both in short-form, as well

to the regulator or SRO	as mandatory credit rating, with the securities regulator and the Thai Bond Market Association (ThaiBMA). The filing must be done to the regulator at least 1 business day before the first sale and to ThaiBMA within 30 days after the first sale. The documents require regulatory approval; however, this is essentially granted automatically, as the registration becomes effective in 1 business day.
Trading and listing of hybrid offer securities	Hybrid offer securities can be traded among institutional and HNW investors. Listing is technically allowed, but no hybrid issues are listed in practice. All trading of hybrid offer securities takes place OTC.
Continuous disclosure requirements	Issuers of hybrid offer securities are subject to continuous disclosure requirements, but they are less onerous than those for pure public offers.
Existence of antifraud provisions in the law or regulation or regulator's mandate related to information presented by issuers and intermediaries on hybrid offer securities.	The regulation provides antifraud provisions but for a limited time following an offer. Investors' claim for compensation must be made within 1 year from the date on which fraudulent information was revealed but not exceeding 2 years following the effective date of the registration statement and draft prospectus.

United States
Brief Description of the Primary Market Framework

The US primary market issuance framework is characterized by pure public offer, pure private placement, and hybrid offer regimes. The public offer framework includes shelf registrations, automatic approvals for "well-known seasoned issuers," and simplified registration requirements for small businesses.

Though a form of private placement regime was incorporated into the Securities Act of 1933, which stipulated a prospectus exemption for nonpublic offerings, the language of the Act lacked specificity and created much uncertainty among issuers willing to take advantage of this exemption. Following a number of court cases on this subject, the US SEC finally adopted in 1982 Regulation D (Reg D) – a non-exclusive "safe harbor"[68] rule for private offerings, which put in place definitive requirements for issuing securities under the private offering exemption.

Rule 506 of Reg D allows companies to raise unlimited amount of capital without filing a prospectus if securities are sold to an unlimited number of *accredited* and up to 35 *sophisticated* investors.[69] Securities issued under Reg D are classified as restricted, are subject to a holding period of 1 year, and may not be freely traded unless fully registered.

To facilitate resale of privately placed securities under Reg D, the SEC introduced in 1990 Rule 144A, which allowed resale of restricted securities to *qualified institutional buyers (QIBs)*, which constitutes institutional investors with at least $100 million invested in securities, a definition that is stricter than that of *accredited* investors and thus would satisfy the Reg D requirement as well.

Together, Reg D and Rule 144A, in essence, represent the hybrid offer regime of the US: Reg D provides provisions for issuance without a prospectus (private placements) and Rule 144A for resale of privately placed securities. Thus, issuers willing to take advantage of the resale option usually limit investors to QIBs (rather than accredited investors) at the time of issuance to make sure that their issue satisfies the Rule 144A requirements.

The hybrid offer regime gained much popularity among issuers, especially for high yield and more complex structured issues, for which preparing and registering a retail prospectus with the SEC did not add much value, given their natural focus on institutional as opposed to retail investors. While overall 144A issuance has accounted for about 20-30% of total corporate bond issuance over the last 15 years, in the high yield segment, 144A issuance represented an average of 70% of total issuance.[70] The regime has added considerable liquidity to the private placement market, maintaining certain investor protections while facilitating speed to market, all of which has contributed to the growth of the US corporate bond market.

68 Safe harbor usually refers to a provision in a law or regulation that provides protection from liability or penalty if certain conditions are met.

69 Rules 504 and 505 of Regulation D provide non-exclusive safe harbor from registration for offers of up to US$ 1 million and US$ 5 million of securities over a 12 month period, respectively.

70 Source: Thomson Financial (Thomson One Banker-Deals Module), SIFMA, and World Bank calculations.

Key Features of the Hybrid Offer Regime	
Official name of the hybrid regime or regulation, year of adoption, and nature of the regime	Regulation D, 1982 and Rule 144A, 1990. The hybrid offer regime can be characterized as a private placement with easy access to active secondary market trading.
Relative importance (% of total issuance)	30%[71]
Key conditions	Offers made to qualified institutional buyers (QIBs).
Submission and approval of documentation, if any, to the regulator or SRO	The regulation exempts issuers of hybrid offer securities from filing a full prospectus. The only requirement is to submit Form D, which is a notice claiming prospectus exemption and providing limited issuer information; the notice must also state the date of the first sale. The document does not require regulatory approval, as it can be submitted after the first sale; thus it is provided for information purposes only. Nevertheless, regardless of the regulatory requirements, most hybrid offer issuers provide investors an offering memorandum that is often comparable to the amount of information contained in a public offering. This is in part because issuers and intermediaries involved in a hybrid offering are still subject to antifraud regulations (US SEC Rule 10b-5).
Trading and listing of hybrid offer securities	Hybrid offer securities can be traded among QIBs. They are usually not listed on the exchange, since it typically requires fulfilment of appropriate listing requirements, which are the same as for public offers. 144A securities are predominantly traded OTC but are subject to trade reporting requirements under the Trade Reporting and Compliance Engine (TRACE) rules, which requires that all OTC transactions in debt securities be reported within 15 minutes from the trade.
Continuous disclosure requirements	The regulation does not subject issuers of hybrid offer securities to continuous disclosure requirements. However, holders or prospective purchasers of hybrid securities designated by the holders have the right to obtain from the issuer: (i) a brief description of the issuer's business, products, and services; (ii) the issuer's most recent balance sheet, profit and loss statement, and retained earnings statement; and (iii) similar financial statements for the two preceding fiscal years.

[71] Source: Thomson Financial (Thomson One Banker-Deals Module), SIFMA, and World Bank calculations.

Existence of antifraud provisions in the law or regulation or regulator's mandate related to information presented by issuers and intermediaries on hybrid offer securities.	Issuers and intermediaries are subject to the US SEC Rule 10b-5, which prohibits fraud or deceit in connection with the purchase or sale of any security. The rule provides the SEC with the mandate to intervene in both public and private cases.

Appendix B - List of Task Force Members

Core Team Members

Co-Chairs

Prashant Saran	Securities and Exchange Board of India
Ranjit Ajit Singh	Securities Commission Malaysia

The World Bank

Clemente del Valle
Tamar Loladze

IOSCO General Secretariat

Isabel Pastor
Alp Eroglu
Youngki Kim

Securities and Exchange Board of India

Maninder Cheema

Securities Commission Malaysia

Kamarudin Hashim
Neetasha Rauf
Imran Shah Hakkam Ali
Eileen Wong

Capital Markets Board Turkey

Ozlem Eraslan
Aydin Haskebabci

Task Force Members

Argentina	Comisión Nacional de Valores
Brazil	Comissão de Valores Mobiliários
Chile	Superintendencia de Valores y Seguros
Dubai	Dubai Financial Services Authority
Egypt	Egyptian Financial Supervisory Authority
Israel	Israel Securities Authority
Jordan	Jordan Securities Commission
Kenya	Capital Markets Authority
Korea	Financial Services Commission
	Financial Supervisory Services
Nigeria	Securities and Exchange Commission
Pakistan	Securities and Exchange Commission
Panama	National Securities Commission
Peru	Comisión Nacional Supervisora de Empresas y Valores
Poland	Polish Financial Supervision Authority

South Africa	Financial Services Board
Sri Lanka	Securities and Exchange Commission
Thailand	Securities and Exchange Commission
UAE	Emirates Securities & Commodities Authority
Uganda	Capital Markets Authority
Uruguay	Banco Central del Uruguay

Appendix C

List of Survey Respondents

Argentina	Comisión Nacional de Valores
Bangladesh	Securities and Exchange Commission
Brazil	Comissão de Valores Mobiliários
Bulgaria	Financial Supervision Commission
Chile	Superintendencia de Valores y Seguros
China	China Securities Regulatory Commission
Chinese Taipei	Financial Supervisory Commission
Colombia	Superintendencia Financiera de Colombia
Dominican Republic	Superintendencia de Valores
Dubai	Dubai Financial Services Authority
Ecuador	Superintendencia de Conpanias
Egypt	Financial Supervisory Authority
India	Securities Exchange Board India
Israel	Israel Securities Authority
Jordan	Jordan Securities Commission
Kenya	Capital Markets Authority
Korea	Financial Services Commission Financial Supervisory Services
Macedonia	Securities and Exchange Commission
Malaysia	Securities Commission
Montenegro	Securities Commission
Morocco	Conseil deontologique des valeurs mobilieres
Nigeria	Securities and Exchange Commission
Oman	Capital Market Authority
Pakistan	Securities and Exchange Commission
Panama	National Securities Commission
Poland	Polish Financial Supervision Authority
Romania	Romanian National Securities Commission
South Africa	Financial Services Board
Sri Lanka	Securities and Exchange Commission
Tanzania	Capital Markets and Securities Authority
Thailand	Securities and Exchange Commission
Trinidad and Tobago	Securities and Exchange Commission
Turkey	Capital Markets Board
UAE	Emirates Securities & Commodities Authority
Uganda	Capital Markets Authority
Uruguay	Banco Central del Uruguay

List of Industry Participants

AIAF[72], Spain	Gonzalo Gomez Retuerto
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BNP Paribas Investment Partners	Jane Yu
Hong Kong Shanghai Bank (HSBC)	Antoine Maurel
International Banking Federation	Sally Scutt
Istanbul Stock Exchange	Ercan Kiran
MTS Group	Angelo Proni Carlos Winzer
Moody's Investors Service	Neil Acres
Pacific Investment Management Company (PIMCO)	Tim Haaf

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