To,

16th December, 2021

Pradeep Ramakrishnan,
General Manager,
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Securities and Exchange Board of India
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Sub: Comments on Consultation Paper for Market Making in Corporate Bonds

At the outset, we, at Indian Association of Investment Professionals (IAIP), a member society of the CFA Institute, appreciate the opportunity to submit our comments to the **Consultation Paper for Market Making in Corporate Bonds.**

IAIP is an association of over 2000 local investment professionals who are CFA charterholders and about 6000+ professionals who have cleared exams, eligible and awaiting charter. The Association consists of valuation professionals, portfolio managers, security analysts, investment advisors, and other financial professionals that promote ethical and professional standards within the investment industry, facilitate the exchange of information and opinions among people within the local investment community and beyond, and work to further the public's understanding of the CFA designation and investment industry.

CFA Institute is a global non-profit association of investment professionals with over 170,000 members in over 165 countries. In India, the community of CFA charterholders is represented by the Indian Association of Investment Professionals(CFA Society India).

Through our global research and outreach efforts, CFA Societies around the world endeavour to provide resources for policy makers, financial services professionals and their customers in order to align their interests. Our members engage with regulators in all major markets.

The recommendations put forth in the consultation paper for market making in corporate bonds is appositive step to enhance liquidity in secondary market for corporate bonds. We support and appreciate SEBI's effort to have vibrant secondary bond market in India but we also have certain concerns on the proposed mechanism, which we have put forth in our comments.

We would be happy to hear and discuss the merits / demerits of suggestions proposed by other practitioners and request to be included in the deliberation process.

A. **Details of our Organisation:**
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B. Key Contributors:

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C. Suggestions / Comments:

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Sr. No.	Paragraph	Suggestion/Comments	Rationale
1.	11.1. Applicability: a. The framework is to be made applicable to every listed issuer which has listed its non-convertible debt security(ies) and has outstanding value of listed non- convertible debt security(ies) of Rs. 500 crore and above, as on the last date of the previous financial year (cut-off date).	We appreciate the SEBI's effort to increase the liquidity in the secondary market for corporate bonds in India. In this endeavor, market making mechanism in corporate bonds seems to be a positive step. We strongly believe that though market making in corporate bonds is positive step to have a vibrant corporate bond market in India, this needs to be combined with other measures like corporate bond repo market and having a backstop facility available in times of crisis. These measures should all come as a package. We believe that the calibrated approach to the mechanism with more comprehensive measures with a more holistic view should be the way forward. Otherwise, there is a risk for mechanism not being accepted by the market,	The rationale for suggesting the applicability to be mandated only for large top rated issuers and voluntary for others is that the mechanism could be a deterrent for lower rated issuers or first time issuers, as it may lead to further increase cost for them. We believe the existing secondary market trading volume are mostly concentrated in AAA issuers with 60% - 70% of trading activity by volume taking place in the AAA papers for the last 5 years, as per CCIL data . This shows the extent of the problem. Further, we believe that the mechanism should initially focus on improving liquidity where there is existing liquidity instead of trying to create liquidity from scratch, as in the case of

		despite all the good intentions, similar to various products in the past i.e. IRF, which are still struggling to have widespread acceptance despite being an essential product in the market. We believe that the applicability of mechanism should initially be only mandatory for AAA issuers and voluntary for lower rated issuers. The outstanding amount may also be increased currently proposed Rs. 500 cr. Also, we suggest that instead of only looking at the outstanding amount, the frequency of the issuance should also be considered. The mechanism should be made applicable for issuers, with large regular issuance. We are also concerned that the mandatory applicability of the mechanism may deter new/first time issuers to access that corporate bond route and instead choose the bank loan route, as it will make the reissuance cumbersome	either lower rate issuers or issuers with irregular issuances.
2.	11.2. Entities eligible to act as market makers: SEBI-registered Stock Brokers or Merchant Bankers (including Scheduled Banks or primary dealers who are registered with SEBI either as stock brokers and/ or merchant bankers), may be authorized by SEBI to conduct	We suggest that the additional amount should be linked through the capital adequacy framework which will be a more comprehensive framework. We are concerned that the additional 10 cr net-worth requirement over and above the minimum net-worth requirement may not be	The market making activity in corporate bonds involves both credit risk and market risk; therefore we are suggesting having a more comprehensive capital requirement framework.

	market making in corporate bond market subject to the following minimum net-worth requirements: a. SEBI (Stock Brokers) Regulations, 1992 and SEBI (Merchant Bankers) Regulations, 1992 already require a minimum net-worth requirement for stock brokers and merchant bankers, respectively. b. To ensure the capital adequacy of a market maker, only those stock brokers/ merchant bankers may be authorized to act as market makers that have an additional net-worth of Rs. 10 crores over-and-above the requirements of their respective SEBI Regulations.	sufficient for the market making activity. We also suggest that one alternative is to envisage a completely new entity which acts a central market making unit, with the capital being provided by the stakeholders. This will help in having an independent unit with the burden being shared by all the stakeholders. One suggestion to build a corpus for bearing the cost of market making, is that SEBI can mandate certain percentage of each issue as market making fund, similar to Mutual funds keeping aside funds for investor education.	
3.	11.3. Responsibilities of the Issuer: An eligible issuer shall have the following obligations: a. Make arrangements for market making corresponding to at least 25% of the amount to be raised (through fresh issuances – new/ old ISINs) during each quarter. b. Accordingly, the issuer can identify ISINs, for which market making activity will be arranged, based on criteria viz. rating buckets, tenors and liquidity. c. For such identified ISINs, the issuer shall appoint at least two market makers before listing. The details of the market making arrangement shall be disclosed accordingly in the offer document.	We would request clarifications as to how this 25% of amount is calculated, is it based on turnover of volume of two way quotes. Further, there may be a case that certain minimum amount should be kept for each tenor, so that the liquidity is provided across the tenors. The mandatory nature of this requirement may create pressure on issuers to appoint more market makers and which may lead to market makers charging higher fee for such agreement. We would suggest that SEBI should look into this concern from issuer and include some measure to mitigate this concern.	The rationale suggesting certain minimum amount for each tenor is that this will avoid fragmentation of market liquidity and liquidity is provided across the tenor. The concern here is that it will become difficult for issuer, as it may be a cause of concern for merchant bankers.

4.	11.3. Responsibilities of the Issuer: An eligible issuer shall have the following obligations: e. The Issuer shall continue to make arrangements for market making in such identified ISINs for at least 5 years from the date of issuance or the tenure of the bond, whichever is earlier. During this period, if the issuer and/ or market maker decide to discontinue their arrangement, due to contractual issues or otherwise, both the parties shall ensure that their respective obligations are fulfilled.	We suggest that to begin with SEBI may mandate shorter tenor agreement i.e. 3 to 6 month, with an exit clause included with certain conditions. The tenor can be longer depending on both issuer and market marker willingness.	The rationale is that the 5 year arrangement for market making arrangement may be too onerous for issuers and market makers alike. This may act as deterrent for both issuers to access market and also reduce market makers interest to take us this role.
5	11.5. Funds for market making: a. The issuer may make funds available to the market maker in lieu of the ISIN-wise inventory, as per mutually agreed terms and conditions/ agreement; towards this, the issuer shall ensure that the Articles/ necessary resolutions are in place to enable such funding. b. Alternately, market maker may approach Banks or Financial institutions for funds, as per mutually agreed terms and conditions/ agreement. Issuer may also assist in the same.	The concern here is that if the issuer provides funding for market making, then it actually leads to diverting the funds from the primary business to market making, which may actually increase the cost for the issuer instead of reducing the borrowing cost, which was the intended outcome of this mechanism. Further, if the market makers raised funding on its own, this will increase the divergence between market makers with large balance sheet backing and independent market makers. The market share will increasingly shift to market makers where the issuer is not involved in funding	In both the proposed funding mechanism there are some concerns, SEBI may need to rethink and include some guidelines so that neither the cost increase for issuers nor the regulations lead to only certain entities being able to do market making and the market share becomes concentrated with few entities.
6.	11.6. Responsibilities of market maker:	We would need clarity as to market making is intended to	We believe the current proposed mechanism may

	A market maker shall have the following responsibilities: a. Make market, through trades, only on the Request for Quote (RFQ) platform, through their proprietary accounts. b. Provide two-way quotes during such minimum time frame (say 75% of the time during market hours on a trading day). c. Be present in the best buy/ sell order/ quotes for e.g. top 5 buy/ sell order/ quote. This will ensure that a balance is maintained between the supply and demand in the bond market. The stock exchanges shall assist in providing necessary systems for implementing the same. d. Guarantee execution of orders at quoted yield and quantity for quotes given by it. Market maker shall be responsible to ensure successful completion of the settlements. e. For each below AAA rated ISIN that market maker makes, it can make market in maximum two AAA rated ISINs, on half yearly basis. The said requirement can be fulfilled by it across issuers with whom it enters into an arrangement with. f. The market maker also has the option of selecting ISINs across varied maturity buckets viz. 1-3 years, 3-5 years, 5-7 years and over 7 years.	provide liquidity to institutional investor or retail participants. The large players may repeatedly hit market maker on one side in large amounts thereby deterring market making and widen the quotes. We propose that SEBI should include certain single order limit and counterparty limits to avoid such occurrence, so that at least Market makers can buy/sell the amount at a price. The RFQ platform at the moment is largely only used by selected institutional players, the benefit of proposed structure maybe widespread only if we have market wide adoption of participants. But, having said that the corporate bond market globally has been OTC market with little or no adoption of platforms. We also suggest that there should be some proposal or threshold provide by SEBI, at which market makers have the option to stop quoting similar to circuit breaker in stocks We also suggest that applicability of the ongoing consultation paper to limit the number of ISINs issued by an issuer will help the market makers as the securities issued will be liquid for longer duration. We however understand the concerns of issuers that large maturity at	only bring liquidity to certain limited section of market as RFQ platform is not broad based. The trading in smaller lots will help market makers to avoid getting stuck with positions and provide liquidity to market without disruptions.

		particular date, makes it risky for issuers to rollover the debt in case of any macro event, which has market wide impact. However, there can be some solution to this i.e. issuer maintain excess liquidity close to maturity but all the solutions have cost associated with them .	
7.	11.7. Compliance requirements for a market maker: a. Risk Management: i. A market maker should aim to minimize the risk taken while at the same time being able to maintain an active market. ii. A market maker shall ensure development of adequate infrastructure especially pertaining to Risk Management System iii. All risks to which the market maker is exposed on account of its market making business in corporate bonds shall be identified and risk tolerance level should be set. iv. Processes shall be established to manage such risks and a clear and comprehensive set of limits shall be established to manage such risks. v. Stress testing of risk positions shall be conducted.	As there are entities involved in market making i.e. PDs, Banks, which are also regulated by other regulators, there is a need to have a uniform regulations i.e. single borrower, group borrower limits, capital adequacy, so that there is a level playing field. The current large exposure norms for banks and PDs acting as market makers may act as a deterrent as it will be blocking the exposure on the entities and they will have to generate return on exposure to justify the exposure. We suggest that alternatively SEBI can discuss with RBI and propose to have additional exposure allowed for market making activity.	

8	11.8. Incentives, dissemination and monitoring by stock exchanges: a. Incentives: Stock exchanges may consider providing incentives/ relaxation in transaction charges as an incentive for market makers. Any scheme on waiver/ rebate of fees given by the stock exchanges to market makers/ issuers shall be adequately disclosed prior to offering the same.	We believe that issuers can be incentivized to take up market making by allowing certain regulatory relaxations. SEBI may provide exemptions from certain FPI guidelines on VRR, residual maturity, and debt quotas for issuers supporting market making on their bonds. Maybe additional ECB limits by RBI	The rationale for this proposal is that there will be cost associated with issuers adopting market making initially which can be balanced by these regulatory relaxations.

Thank you again for the opportunity to comment on this important regulatory framework. If you or your staff have questions or seek further clarification, please do not hesitate to contact Mr. Ravi Gautham, CFA at +91 99021 17087 or at advocacy@iaipirc.org.

Sincerely yours,
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Director - Research and Advocacy Committee
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