

9.INTERNATIONAL DEBT MARKET:**Unit Structure:**

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9.1 LEARNING OBJECTIVES:

After studying this lesson you are able to:

- Understand International Bond Market
- Understand the difference between Euro Bond And Foreign Bonds
- Understand the various types of Bonds
- Understand the procedure for issue of bonds
- Understand External Commercial Borrowing

9.2. INTRODUCTION:

The following chapter gives an in depth view on international bond market but predominantly from Indian companies' point of view. International bond market has a long history but India's entry to this market is not very old. Since liberalization of Indian capital market many Indian companies have tapped international market and have raised both debt i.e., foreign bonds, Eurobonds, as well as quasi debt instruments like Foreign Currency Convertible Bonds (FCCBs). Many of these bonds and international debts are also issued with differentiating features like Floating Rate Notes (FRNs). These aspects are extensively discussed.

Along with this the chapter also covers in detail the various aspect of International Equity Market and its Instruments, also an introduction the derivatives market.

9.3. INTERNATIONAL BOND MARKET:

International Bond market can be categorized into basic types: 1) Foreign Bond and 2) Euro Bond.

-EURO BOND: In Euro bond, a foreign company issues a bond denominated in a currency which is not the home currency of the investors. For example, an US company issues bond and raises capital in Japan denominated in US Dollar. This will be an example Euro Bond. If the US company issues bond in Pound sterling in Japan, it will also be considered as Euro Bond. In the earlier case, it would be considered as a **Euro Dollar Bond** while in the latter case, it would be known as **Euro Sterling Bond**. Historical development of Eurobond market is attributed to the unfavourable tax

regime in USA during 1960s. This forced companies to issue USD denominated bond outside USA. The First Eurobond was done in 1963.

-FOREIGN BOND:

Foreign Bonds are a bond where foreign company issues bond denominated in the currency denomination of the foreign country. For example, an US company issues bond and raises capital in Japan denominated in Japanese Yen. In other words, the Japanese investors are not exposed to foreign exchange risk while investing in a foreign bond. At this junction it is important to understand that a Japanese company may also issue bond and raise capital in Japan denominated in Japanese Yen. But bonds issued by the Japanese company are termed as **Domestic Bonds**. In case of a foreign bond, the bond issuer is from a foreign country. An Indian company issuing USD bond in any country belonging to Middle East region is an example of foreign bond.

9.4. DIFFERENCE AMONG DOMESTIC, FOREIGN AND EURO BOND:

Issuer Company Nationality	Currency Denomination of the Bond	Bond Category
Domestic	Domestic	Domestic Bond
Foreign	Domestic	Foreign Bond
Foreign	Foreign	Eurobond
Domestic	Foreign	Eurobond

Besides **Foreign Bonds** and **Euro Bonds**, some companies also issue Global Bonds though very few companies have issued these bonds. In a global bond issue, the issuer offers the bonds to investors of many countries at one go. Normally these bonds are denominated in multiple currencies. Global bonds are normally issued by large multinational or transnational companies or as sovereign bonds. **Sovereign bonds** are issued by the government of a country representing bonds issued by a country

-FOREIGN BONDS:

Bonds which are floated in the local currency of the country of floatation by a foreign company are called Foreign Bonds. Thus, if an Indian company floats USD denominated bonds in USA, they will be called Foreign Bonds.

9.5. TYPES OF FOREIGN BONDS:

- (a) **Yankee Bonds** – These are foreign bonds floated in USA
- (b) **Bulldog Bonds** – These are foreign bonds floated in UK
- (c) **Samurai and Shibosai Bonds** –
 - (i) **Samurai** – These are Yen bonds floated in Japan in open market.
 - (ii) **Shibosai** – Yen bonds floated on Pvt Placement basis in Japan.

- (d) **Dragon Bonds**– These are foreign bonds issued in local currencies of the South Asian countries.
- (e) **Maple Bond** -Foreign Bonds sold in Canada.
- (f) **Kangaroo Bond** -Foreign Bonds sold in Australia.

However it is to be noted here that all foreign bonds do not any country specific name associated with these. Many companies have issued foreign bonds in Hong Kong, but there is no specific name associated with foreign bonds issued in Hong Kong. All foreign bonds have to be registered and have to abide by the rules and regulation of the foreign country where these bonds are issued. For example Yankee bonds (foreign bonds issued in U.S.) have to be registered with SEC of US and have to follow the same accounting and disclosure requirement of domestic bonds. In fact, these foreign bonds have to be like domestic bonds in all aspects. All foreign bonds are also rated by credit rating organizations. Though many-a-times, countries have done away with the rating requirement. Among the foreign bond market, the Yankee bond and Samurai bond market attracts the maximum number of issuance. In early part of 2010, there has been lots of activity in the Samurai bond market. In February 2010, the Philippines Government raised Yen 100 Billion of **Samurai** Bond. In June 2010, the state-owned Korea Development Bank has sold Samurai bonds worth 27 billion yen.

-OTHER TYPES OF BONDS:

To make a bond attractive to issuers of these bonds have issued bonds with wide variety of features. Some of these bonds are:

1. **Straight Bonds:** These are plain vanilla bonds with fixed rate of interest and fixed date of maturity.
2. **Floating Rate Bonds:** These are LIBOR linked variable interest rate bonds wherein interest rate is adjusted every 6 months.
3. **Convertible Bonds:** These bonds convert into equity share after the specified period of time. In this category, there could be fully convertible or partly convertible bonds.
4. **Floating Rate Bond with Collars:** These floating rate bonds have upper and lower limits of interest rate variation. Thus, the max and min interest payable are capped irrespective of movement of interest rate in the market.
5. **Bonds with Warrants:** These are the bonds which are accompanied by an option to the buyer to buy specified number of equity shares for a specified price at some specified time in future, often prior to expiry of the bonds. He may or may not exercise this option depending on the market price of the share Vis a vis offer price at the time of buy. He may even sell this option to some one else at a premium. These are not same as Convertible Bonds. There is a minor variation from convertible bonds. In case of convertible bonds, the money which was paid as bond price is not paid back and shares are issued in lieu. In case of warrants, additional money is paid for exercise of option

while bond money is paid back on maturity. Warrant option is used as a sweetener to float bonds with lower interest rate. In case the probability of share price appreciation is very high, they could be even at Zero interest rate.

6. Zero Coupon Bonds: These are also called Deep Discount Bonds. These bonds are issued as zero per cent interest rate bonds but at a discount to the face value. Bonds are paid back at face value on maturity. Thus, the discount on the face value actually represents the interest component. However, this trick is played to beat the tax system of the countries where interest income is charged to tax.

7. Callable Bonds: These are the bonds wherein the company reserves the option to call back the bonds prior to maturity but after the lock-in period. Such bonds are issued when

(a) It is a fixed rate bond and there is strong probability of softening of interest rates in future.

(b) It is a floating rate bond and there is strong probability of hardening of the interest rate in future.

8. Puttable Bonds: These are bonds wherein the buyer has option to sell back to company any time after the lock-in period. Such bonds are issued if the company does not enjoy very good credit rating in the market to give some confidence to the investors.

9. Dual Currency Bonds or Hybrid Bonds: These are bonds which are sold in one currency and payment of interest or principal or both is done in another currency. Eg. An Indian company may float a USD bond in US and pay the interest and principal back in INR.

9.6. BOND ISSUE PROCEDURE:

1. Issuing company takes the approval of the Board of Directors.
2. Issuing company appoints Lead Manager.
3. In consultation with the issue manager, the company appoints CoManagers, under writers, Brokers to the issue.
4. The Lead manager prepares the draft document for the bond issue and the bond rate is decided.
5. The draft prospectus is discussed and is given the final shape.
6. Listing formalities are completed by the company and the Issue Manager.
7. Announcement of the issue is made.
8. Investor response is monitored.
9. Final bond issue is made.
10. Tombstone advertisement is published – It is in the form of Thanks advertisement detailing the response and money collected.

9.7. EXTERNAL COMMERCIAL BORROWINGS:

There are two routes for raising ECB:

(a) Automatic Route:

- (i) Corporates – up to USD 20 million for 3 years and up to USD 750 million for 5 years and above.
- (ii) NGOs – Allowed micro credit of up to USD 5 million.

(b) Approval Route: Even though limit are same but banks and financial institutions have to take prior approval.

However, ECB cannot be raised from just anybody. Like the banks have to follow KYC (Know your customer) norms, ECB borrowers have to follow KYL (Know your lender) norms. The borrower needs to get a due diligence certificate from an approved overseas bank that the lender has held a satisfactory account with it for at least 2 years.

-FORMS OF EXTERNAL COMMERCIAL BORROWING:

Following credits are deemed to be ECB

- (a) **Buyers' Credit**– The advances received from a buyer are deemed ECB.
- (b) **Suppliers' Credit**– The credit period allowed by supplier is deemed ECB
- (c) **Short Term Borrowings**–Loans raised for one year or less.

Commercial papers, issue of Certificates of Deposits.

(d) Fixed rate and Floating rate bonds.

(e) **Loans from International Financial Institutions**– Various international financial institutions like Asian Development Bank, The International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) and including World Bank (But not IMF) lend for various projects.

(f) **Syndicate Loans**– These are large loans for which no single bank wants to take full exposure. Thus, a group of banks join together and lend as a group.

Thus, the risk is spread out. Loan to Enron Corporation for Dabhol Power Project is one example of syndicated loan.

-PROCEDURE OF SYNDICATE LOANS:

1. Borrower prepares Information Memorandum (IM).
2. IM carries details of the borrower, the amount of loan needed, proposed maturity period of the loan, purpose of the loan etc.
3. Borrowers send invitations to the international banks along with the IM.
4. Borrower receives credit proposals and analyses them.
5. It enters into agreement with lead syndicate bank which deals with other banks in the syndicate.
6. Information of the deal is submitted to the Ministry of Finance and to the Reserve Bank of India.