IX

Philippine Bond Market Challenges and Opportunities

This chapter discusses some of the real and perceived challenges facing the bond market in the Philippines and its participants. This chapter also aims to describe possible mitigating factors and market developments that could address these challenges in an appropriate manner.

A. Challenges in the Philippine Bond Market

1. Government Securities Liquidity

A vital contributor to market liquidity would be an environment that boosts the liquidity of issues listed for trading in the organized market. The Government of the Philippines is interested in launching and institutionalizing programs that would rationalize its bond issuances to ensure optimal tradability of its issues.

The BTr has instituted the Domestic Bond Exchange Program to operate as a critical tool in identifying issues that are losing tradability in the market. Under the program, government securities dealers will be provided an opportunity to switch securities that they consider to be losing tradability with more liquid issues of government securities. This mechanism will ensure that untradeable issues are swept out of the market and replaced with more tradable issues. A Continuous Swap Program may also be operationalized to allow dealers to swap illiquid issues with more liquid ones on a scheduled basis.

Securities stripping is another program in the early stages of development that is being designed to enable the creation of new securities from the coupons of outstanding securities (strips), including packaging of strips, so that issues can gain depth and thereby increased attractiveness among the market base.

2. Limited Liquidity in the Corporate Bond Secondary Market

Corporate fixed income securities listed and traded on PDEx have lower trading volumes and lower turnover ratios compared with government securities traded on PDEx. Factors that may contribute to this are the relatively smaller average issue size of corporate issuances, skewed distribution toward buy-and-hold investors, limited market-making activities constrained by the application of the Single Borrower Limit, and the lack of alternative investment outlets for investors.

At the same time, listed corporate fixed income securities benefit from having a central venue for investors of all types to sell or buy such securities, and to obtain regular price transparency.

3. Limited Opportunities to Utilize Bond Holdings in the Repo Market

PDS Repo is open to all government securities. At the same time, the PDS SLTP is currently limited to government securities that comply with specified liquidity criteria.

This inability to utilize corporate bond holdings for repo business and the additional lack of clarity around the tax treatment of repo transactions has led to limited trading volumes in the repo market in the Philippines.

4. Philippine Financial Reporting Standards

Research by ABMF indicates that issuers, intermediaries, and listing places in ASEAN+3 are spending considerable energy on mapping and understanding financial reporting standards in each other's jurisdictions in anticipation of an increase in cross-border bond issuance and investment activities in the region. ABMF has also revealed that the treatment and disclosure of relevant information is often the same or very similar across jurisdictions, particularly with regard to bond and note issuance.

At the same time, however, it was found that the financial reporting standards in some markets have not yet fully adopted the International Financial Reporting Standards (IFRS).[56] This could result in issuers who aim to list or profile list their bonds or notes in specific listing places needing to convert their financial reporting information into a format acceptable to such listing places if their domestic financial reporting standard is not converged with IFRS.

The Philippine Institute of Certified Public Accountants administers the Philippines Financial Report Standards, which, for the purpose of financial markets, are fully converged with IFRS and as such provide no challenge for an issuer to adopt existing financial disclosure information for issuances in the Philippine bond market.

5. Impediments for Timely Issuance of Bonds and Notes to the Public

To receive approval for the issuance of debt securities to the public, the issuer needs to file a Registration Statement with the SEC. The Registration Statement is subject to SEC review and the SEC may ask for additional information or disclosure or require clarification from the issuer prior to rendering the Registration Statement effective. There is a fee payable for the registration of debt securities.

Due to the nature of the process and the potential timeframe it may require, the initial and continuing disclosure requirements, costs related to a registration, and the ease and availability of bank loans and other bilateral financing facilities, corporate issuers preferred bank financing or issuances through exempt securities or transactions. At the same time, the regulations for the shelf-registration of debt securities were limited.

The implementation of the 2015 SRC Rules allowed issuers to pay registration fees in line with actual issuance amounts over a period of 3 years (as opposed to 1 year previously). In addition, the need to file a Registration Statement for each new tranche of debt securities to be issued has been replaced with the need to only update the prospectus, a practice comparable to other regional markets. These regulatory changes have made the issuance window wider and costs easier to bear for corporate issuers.

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[56] ABMF published its Phase 2 Report in April 2014, *Proposal on ASEAN+3 Multi-Currency Bond Issuance Framework*, which included an overview of financial reporting standards in ASEAN+3 in relation to IFRS. The report is available at https://wpqr4.adb.org/LotusQuickr/asean3abmf/Main.nsf/h_Index/4B38375470B78E5748257CA800103914/$file/ASEAN+3%20Multi-Currency%20Bond%20Issuance%20Framework%20(AMBIF),%2029%20April%202014.pdf

One of the remaining points of contention is that registration fees for registered but unsold securities still have to be paid under the 2015 SRC Rules.

B. Opportunities in the Philippine Bond Market

1. General Regulatory Environment

Since the global financial crisis, regulators around the world have been strengthening laws and regulations in many areas of the capital and financial markets, particularly with regard to banking regulations and the focus on risk-weighted capital. The outcome for the financial markets include a limitation of what banks can or are willing to lend, to whom, and under what circumstances. A number of these regulatory initiatives may, in consequence, lead to a rebalancing of funding options for the corporate sector from bank loans to the capital market.

While not unique to the Philippines, this development might positively influence the interest of potential domestic issuers to consider raising funds via bond or note issuance, and to diversify their debt portfolio. Such increased interest might also have a beneficial impact on funding costs.

2. Convergence of Investors' Tax Status

Previously, the tax status of investors in the Philippines played a major role in the limitation of transactions in the market. For regular government securities, separate instruments for a single tenor were issued for tax-withheld and tax-exempt investors, and transfers were allowed only among holders of the same tax category. In contrast, for corporate fixed income securities, only one instrument was issued for all investors and transfers across the tax categories—tax-withheld and tax-exempt—were restricted (e.g., to coupon dates only).

However, in recent years, these restrictions were lifted: first for Multi-Currency Retail Treasury Bonds in 2010, and then for Onshore Dollar Bonds in 2011. In May 2015, these restrictions were lifted on a grander scale when the Non-Restricted Trading Environment was launched, enabling taxpayers at rates of 0% and 20% to trade between each other freely.

3. ASEAN+3 Multi-Currency Bond Issuance Framework

The implementation of AMBIF is expected to benefit not only AMBIF issuances but the Philippine bond market at large (see also Chapter X). ABMI and Philippine policy bodies and regulatory authorities are focused on reaching a suitable balance between bank loan and capital market funding opportunities for corporates. AMBIF has been created to provide an additional bond and note issuance avenue for these corporates. AMBIF in the Philippines focuses on the issuance of private placements to Qualified Buyers.

At the same time, the Philippines generates some of the strongest interest from potential AMBIF bond and note issuers who may already have substantial commercial operations in the country and would like to issue bonds or notes in order to use the peso proceeds, diversify Philippine peso funding options, eliminate FX risk, or more effectively manage their debt portfolio. The nature of AMBIF and its restriction to professional investors is likely to attract investment in AMBIF bonds and notes from new institutional (professional) investor types in the Philippines and from other regional markets.