The Australian Corporate Bond Market

Discussion Paper: Current State and Development of the Australian Corporate Bond Market

Economics & Law Research Institute

Web
www.elri.com.au

Phone
+ 61 (0)7 3041 1332

Contact
Professor John Mangan
Filip Milosavljevic

Email
jmangan@elri.com.au

fillip.milosavljevic@uqconnect.edu.au

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Executive Summary

From the 1950s to the 1980s the Australian corporate bond market was small and the financial sector was heavily regulated. In 1973, the first phase of banking reforms began, which dramatically improved the competitiveness of the Australian banking sector relative to capital markets. The banks' domestic balance sheets grew exponentially at an average annual rate of 13 per cent since 1985 (RBA, 2006). The financial system deregulation and capital account liberalisation in the 70s and 80s were key drivers in the development of the domestic corporate bond market. However, this elimination of capital controls also meant that Australian corporates were free to issue in offshore markets (Black *et al,* 2012) and since this time Australian corporate issuance has primarily dominated offshore. 80% issuance in the past decade has occurred in offshore markets, where Australian companies are able to obtain longer tenors, larger sizes, at lower cost, and to lower-rated issuers than domestically (Financial System Inquiry, 2014). This represents a lost opportunity for Australia's financial sector.

By comparison to foreign markets, Australia's corporate bond market is underdeveloped, as measured by size, efficient, access, and stability. Germany is one country which has been successful in developing its corporate bond market, in the wake of the Global Financial Crisis (GFC). However, there are concerns regarding future 'overheating' risk, as well as mixed success in the small and medium size enterprise (SME) bond markets, which have been plagued with high default rates.

From both a demand and supply perspective, equities dominate the Australian investment markets and the corporate bond market is generally absent. Australian superannuation funds globally have one of the highest shares of proportion of funds invested in growth assets and the least in fixed income assets. This is even more pronounced in Australia's growing Self-Managed Super Funds (SMSFs) market, which now account for approximately a third of Australia's retirement savings, and only has 1% is invested in fixed income assets (Rainmaker Roundup, 2014). Despite this, the continued growth of this market provides a large potential for an increased investment base for corporate bonds. However, there are several barriers to the use of the corporate bond market by investors, in order to address equity-bias, including: lack of liquidity in corporate bond markets, very high minimum parcel sizes in OTC markets, low number of available bonds in retail markets, and a lack of transparency in OTC markets.

On average, only 30 bonds are issued in the Australian corporate bond market per year. This low number is partly due to the high level of competitiveness of the Australian banking sector. While bonds may provide a longer tenor and fewer covenants than loans; loans are generally more flexible and have lower fixed costs. On average, the long-run cost of debt is lower in the corporate bond market compared to the syndicated loan market and therefore it is likely the regulatory and tax factors better explain the dominance of loans over bond issuance for Australian corporates (Bayley, 2013). Furthermore, Australian SMEs typically do not have access to capital debt markets and therefore must rely on bank borrowing or issuing equity. Currently, the process for issuing bonds can be prohibitive for many companies; it may be costly and onerous method for raising funds as the law requires the issuing of a full prospectus, often a credit rating is essential, and directors are subject to personal liability for the content of a prospectus.

Development of corporate bond markets results may result in financing which is larger and longer-term than banks are able to provide. This is due to the risk-sharing factors benefits of bonds: the ability to spread the cost of large projects over many stakeholders and their risk-shedding character (i.e. they can be traded on the secondary market where investors can transfer risk when required). Furthermore, the GFC highlighted the lack of a viable term debt funding alternative to the domestic banking system for larger Australian companies, as well as the reliance of the major four Australian banks on offshore debt markets for funding (Bayley, 2014). Economic arguments for the development of the corporate bond market include those that capital markets can act as a ‘spare tire’ in case the banking system becomes impaired. And that the increased market forces reduce systemic risk and the probability of a crisis, as well as increasing economic welfare and having a spillover benefit on the health of the banking sector.

Innovative financing solutions such as social impact bonds also have benefits and risks of development for the Australian economy. For governments, they may see increased innovation, efficiency, quality of service to beneficiaries, and value for money in achieving social goals. However, there are also significant risks in this area such as reputation, financial, operation, and moral hazard risks.

A most significant benefit for investors and issuers from investing in bonds in general is the diversification aspect. For investors, a reduction of equity-bias would result in a more diversified portfolio; and for issuers, bond markets can provide firms with a stable source of funding, at a lower cost of capital, as an alternative to bank finance. Allowing smaller and medium size entities to issue bonds could also provide an additional source of loanable fund currently not available to these companies. However, corporate bond markets have significant risks and would require sound legal and institutional frameworks.

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1.1. Overview and history

Australia today has an established, yet limited, corporate bond market which is a significant source of funds for several Australian corporations, primarily banks. From the 1950s to the 1980s the bond market was small and the financial sector was heavily regulated. Banks were particularly limited to issue bonds in this time and they represented only 3% of the issuer base. Non-bank financial institutions (NBFIs) were at this time not subject to as stringent regulation as the banks and began to compete more aggressively for funding in bond markets. The falling impact of monetary policy due to market share loss from banks to NBFIs was an important factor in the 1973 banking sector reforms (Ballantyne *et al*, 2014), a key driver in banking sector competitiveness and future dominance. The financial system deregulation and capital account liberalisation in the 70s and 80s were key drivers in the development of the domestic corporate bond market. However, this elimination of capital controls also meant that Australian corporates were free to issue in offshore markets (Black *et al,* 2012) and since this time Australian corporate issuance has primarily been focused in offshore markets.

On average, 30 bonds are issued in the Australian corporate bond market per year, as well as a slightly higher number of generally larger offshore issues. In recent years, domestic issuance has been dominated by the major banks (Financial System Inquiry, 2014).In Australia, corporate bonds are issued into the wholesale market and traded over the counter (OTC). Despite this, a small number of public offers of listed corporate bonds are made to investors each year. This small portion of bonds becomes available to retail investors via the Australian Stock Exchange (ASX). In November 2012 there were 5 corporate bonds on issue totaling a market capitalisation of $400m, representing 1.13% of the ASX listed fixed interest securities ($35.31b) (ASX, 2012).

There has recently been considerable discussion into the development of the Australian corporate bond market (The Australian Government the Treasury, 2011), as well as several steps in recent years in order to stimulate the market, including: (Financial System Inquiry, 2014)

- The Australian Office of Financial Management has extended the length of the yield curves for Commonwealth Government Securities (CGS) to 20 years.
- The RBA has begun publishing pricing data for non-financial corporate bonds.
- Australian banks permitted to issue covered bonds, since October 2011.
- The Government has made exchange-traded Commonwealth Government Bonds available for trading on the ASX since May 2013, to provide a visible pricing benchmark for corporate bonds and to encourage retail investors to consider diversifying their asset portfolio to fixed income products.
- From May 2010, listed companies have been permitted to issue ‘vanilla’ bonds under either a short-form prospectus or a two-part prospectus. The two-part prospectus was extended to ‘vanilla’ bonds issued to retail investors and the length of base prospectus eligibility was raised from 2 to 3 years, in March 2013.

In addition, State and Territory governments have been leading implementation of social impact bonds (SIBs), an innovate financing solution for investment in social projects (see **Box 1-1**).

Box 1-1: Social Impact Bonds

What are Social Impact Bonds (SIBs)?

SIBs are an outcome-based contract of social impact investment. They involve the public sector committing to pay for improvements in social outcomes, for example: reduction in offending rates, or in the number of hospital admissions. Private investors provide the capital to launch or expand the public good initiative, and if the expected social benefits are achieved within a given period, investors receive their capital back as well as a rate of return (which is negotiated in the contract and may be varying with the level of benefits achieved by the initiative). If the outcome does not meet agreed outcomes, the investors may not recoup their investment. In addition to providing the necessary capital, SIBs remove the risk of outcome delivery from the public sector, and are therefore a re-allocation of the risk between public and private sectors. (Social Finance, 2012; Davis, 2014)

Financially, SIBs are not bonds, rather future contracts on social outcomes (OECD, 2016).

Australia and SIBs:

In Australia, SIBs, also known as social benefit bonds in NSW, were pioneered in NSW by implementing two SIBs:

1. Newpin bond: the bond aims to restore children in out-of-home care to the care of their families by creating and supporting safe family environments. The bond was shown to achieve social benefits and investors received a 12.2% return in 2016 as a result (Social Ventures Australia, 2016)
2. Benevolent Society bond: the bond aims to support families at risk of having their children placed in out-of-home care. The success of the bond will be measured at the end of the 5 year evaluation period; however it has currently achieved a 12% performance percentage to June 2015. (The Benevolent Society, 2015)

Furthermore, the Australian Government published a discussion paper in 2016 entitled '*Social Impact Investing: Discussion Paper*' which explores the role for the Federal Government in developing the SIB market. (The Australian Government the Treasury, 2016)

Table 1-1: Benefits and risks of SIBs

Party	Benefits	Risks
Government	• Increased innovation, quality of services, transparency, collaboration with industry, and efficiencies. • Shared risk with the private sector	• Financial risk and moral hazards • Negative or ineffective intervention • Reputational and operational risk
Investors	• Diversification and aligning investment with values	• Financial risk • Philanthropy vs. investment tradeoff
Service providers	• Increased funds and flexibility to achieve objectives	• Reputational risk and altered incentives

1.2. International context

According to the Australian Government the Treasury (2011), overseas experience "suggests that, compared to Australia, Europe, the United States, and to a lesser extent New Zealand and the United Kingdom, all have thriving retail corporate bond markets." Over the last decade, bond issuance from Australian corporates has been growing steadily, and 80% of this issuance has occurred in offshore markets. In offshore markets Australian companies are able to obtain longer tenors, larger sizes, at lower cost, and to lower-rated issuers than domestically (Financial System Inquiry, 2014). Furthermore, this tendency to issue in offshore markets has been growing, as can be seen in Figure 1-1. This represents a lost opportunity for Australia's financial sector.

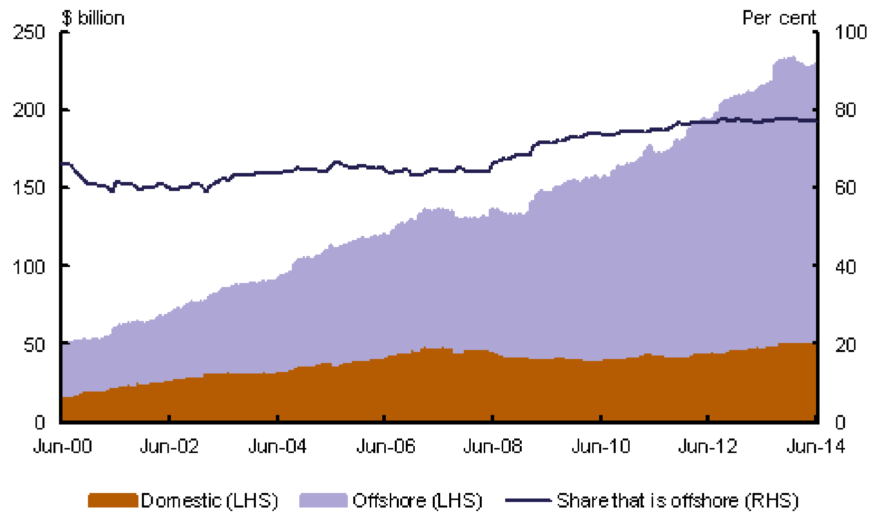


Figure 1-1: Corporate bond issuance

Source: RBA, 2014

As can be seen from **Figure 1-2**, Australia's corporate bond market has been underdeveloped when compared to foreign markets, as measured by size, efficient, access, and stability:

Figure 1-2: World Bank (2006) Bond Market Composite Index

Recently, corporate bond markets in the US and Europe have become a focus of attention. Debt capital has had an increased role in financing relative to prior to the Global Financial Crisis (GFC) (Deutsche Bank, 2013; Tendulkar and Hancock, 2014). There are several reasons for this shift including; deleveraging requirements due to higher capital requirements, spreads between corporate bonds and bank bonds have narrowed, investor demand for corporate bonds has increased as the result of low government bond yields and a shift in investor preferences from financial bonds to investment grade corporate bonds, and firms and their management are more open to using capital-market-based financing (Deutsche Bank, 2013). An analysis of the German experience with corporate bond market expansion is in **Box 1-2**.

The majority of the offshore issuance by Australian corporates is destined for US markets, which plays a significant role in the US financial system. According to the Financial System Inquiry (2014), the factors explaining the large US corporate bond market include;

- a fragmented banking system,
- a long history of credit ratings agencies,
- the large size of the funds management industry,
- an investor base familiar with fixed income assets,
- the most liquid government debt market,
- the status of the US dollar as the world's reserve currency, and
- public transparency in the over-the-counter (OTC) bond markets.

Box 1-2: German corporate bond market experiences

Bond issue by firms, including medium and smaller sized firms has emerged in Germany and other EU countries as a means of raising capital in an era of less easily available bank finance. The traditional downside (from the demand point of view) of bond purchase has been the perception that equities offer better medium term returns.

The recent upsurge in private sector bond issues in Germany has attempted to address the issue of effective organisational controls in corporate bond markets. Stock exchanges in Germany, with the exception of the stock exchange in Hamburg/Hannover, require the issuer to be rated by Fitch, Moody's, S&P, Credit reform, Euler Hermes or PSR Rating (unless the company is already listed on a regulated stock exchange. In addition the Düsseldorf stock exchange requires a minimum BB rating (Bishopsfield Capital, 2012).

The German experience has been largely positive with remarkable growth in debt capital markets pointing to structural change in corporate finance. However, there are concerns regarding future 'overheating' risk, where if the strong demand were to sour it could cause higher defaults and losses (Deutsche Bank, 2013). Furthermore, the German small and medium enterprise (SME) bond market has suffered a default rate of 17%. The reasons for this include: structural problems in the renewable energy sector, fraud allegations, unduly risky investments, and a lack of strict financial covenants limiting the ability of creditor-friendly debt protection measures. As a result, there has been pressure and changes relating to greater transparency and listing requirements (Scope Ratings, 2015).

It is also significant to note a distinction between Australian and global corporate bond markets is that Australian issuance tends to be dominated by financial corporations, while in 2013, two thirds of global issuance came from non-financial issuers (Tendulkar and Hancock, 2014). While outside of the purpose of this paper, to achieve development of the corporate bond market, it would be crucial to know what factors have led to this inconsistency.

1.3. Corporate bonds and the investor

The Australian market for loanable funds is currently characterised by an over-reliance on the equity market, both from a demand and supply perspective. **Table 1-2** highlights that Australian superannuation funds, one of the largest investment sectors in the country, have the highest share of proportion of funds invested in growth assets and the least in fixed income assets.

Table 1-2: Proportion of pension fund assets invested in fixed income assets

Country	Proportion invested in growth assets (%)	Proportion invested in fixed income (%)
Australia	68	25
Canada	57	40
Chile	43	45
China	20	80
Denmark	20	65
Japan	39	50
South Korea	6	95
Netherlands	24	70
Switzerland	51	45
UK	53	45
USA	53	40

Source: Mercer (2014)

Australian investors' low proportion of investment relative to global shares in fixed income is represented in **Table 1-2** above. With respect to Australia's growing number of Self-Managed Super Funds (SMSFs), which now account for approximately a third of Australia's retirement savings, only 1% is invested in fixed income assets (Rainmaker Roundup, 2014). However, the continued growth of this market provides a large potential for an increased base for corporate bonds.

Currently a relatively low proportion of superannuation assets are in the retirement phase, this may be a large factor as to why superannuation funds are more heavily invested in equities than in corporate bonds. Therefore, as a greater proportion of the population enters retirement, there could be an increased demand for fixed interest investment options.

Davis (2012) has identified several factors which are potentially causing this equity bias:

- The Australian tax system is a dividend imputation system, which increases the attraction of high-dividend equity for superannuation funds (and only applies to stocks paying franked dividends).
- The dividend imputation tax system reduces tax-driven corporate incentives to higher leverage. Combining this with the fact that bank borrowings have typically dominated financing relative to debt capital market issues by companies, means that there are relatively fewer capital market debt instruments for investment.
- The current equity preference may have evolved over time and become the new norm for the method of investing in Australia. In this case, very good equity returns for a number of years, combined with lack of commitment to rebalancing of portfolios, led to an upward drift in the equity share of portfolios.
- The superannuation fund industry may be less risk adverse than in other nations. Australia may have a younger population (and more risk tolerant) investing in superannuation.

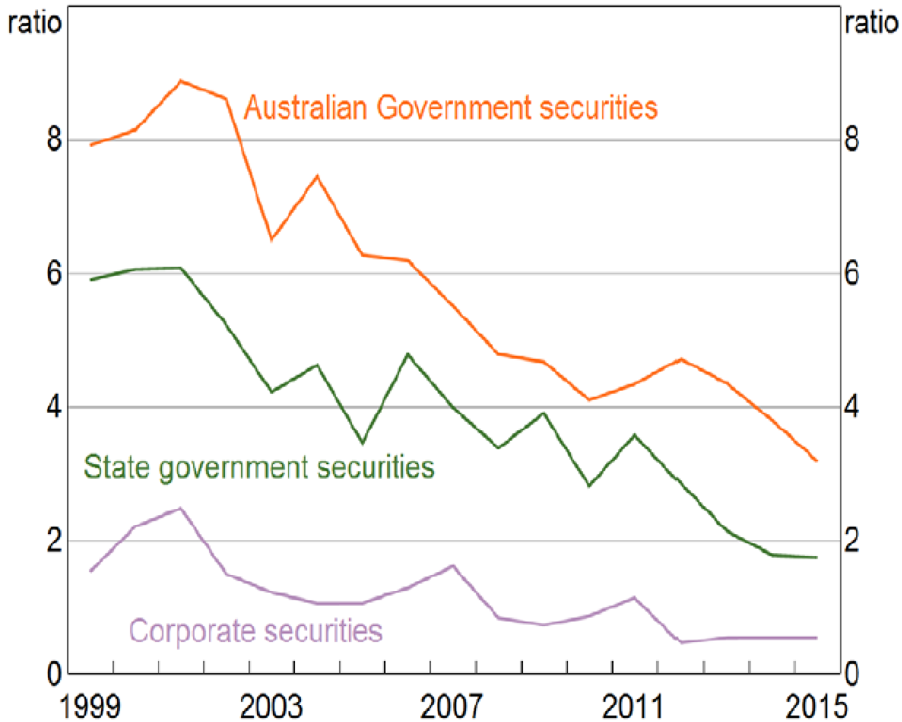
The characteristic of equity over-reliance both limits the opportunities for small to medium sized firms to raise investment funds as well as reducing the opportunities for investors, particularly older superannuants, to diversify their portfolios and bring greater certainty into their income stream in retirement. The dangers of over-reliance on equities within a superannuation portfolio were graphically demonstrated during the recent GFC, with a substantial decline in the value of share portfolios.

Fixed interest assets such as bonds are generally considered to be lower risk than equities. The bond holders are prioritised higher than stakeholders in the event of a default and market price of bonds is generally less variable than stock market volatility. Therefore, bonds can play a role for investors with a lower risk profile and could play an important role in diversification of a portfolio. Furthermore, corporate bonds generally have relatively low correlation between returns of the asset and market returns (beta of asset), partly due to relatively low price variability. Their inclusion in a portfolio can result in greater expected returns for an equivalent level of portfolio risk. (Davis, 2013)

Despite the potential benefits of investing in corporate bonds, there is a near complete absence of corporate debt accessible by retail investors. The following sections elaborate on several of the barriers to investing in corporate bonds for investors:

Liquidity

There is often significantly less liquidity in corporate bond markets than equities (Davis and Jenkinson, 2015). This may result in what is known as a ‘liquidity spread’, where the bid-offer spread is greater as it contains a larger premium paid by the investor demanding liquidity. According to **Figure 1-3**, the turnover ratio, a measure of liquidity, is low and appears unlikely to change greatly in the future (Debelle, 2016). According to Debelle (2016), this is not necessarily an issue as the Australian corporate bond market has predominantly been a buy and hold market, and participants are aware of this. Further, Debelle does note that the fall in liquidity has not translated into higher bid-ask spreads either, with spreads falling overall over this period.



* Annual turnover divided by average monthly value of long-term bonds outstanding

Sources: ABS; AFMA; Austraclear; RBA

Figure 1-3: Annual Bond Turnover Ratios*

Minimum parcel size

Corporate bonds must be issued into the wholesale market and traded OTC, with minimum investment parcels of typically $500,000. Furthermore, regulatory requirements on issuance disclosure arrangements limit participants to sophisticated investors (those with at least $250,000 in gross income in the previous two years, or a net worth of over $2.5m) and institutional investors (Davis, 2013).This does not allow any retail investors to invest directly in the OTC market and it also effectively precludes many sophisticated investors from participating due to the size of investment and its potential share of a portfolio. Furthermore, bonds must be traded OTC for a minimum of a year before being permitted to be sold to retail investors, further limiting the potential bonds available for investment.

Transparency

A barrier for infrequent and non-specialist sophisticated/institutional investors is the risk they will be quoted and trading at price at a wide margin to current market prices in OTC markets (Davis and Jenkinson, 2015). The Financial System Inquiry (2014) identified that unlike in the US; there is limited public transparency in the Australian OTC corporate bond market which limits the attractiveness of investors from investing in corporate bonds.

1.4. Corporate bonds and the issuer

The high level of competitiveness of the Australian banking sector has resulted in a good access to finance for corporations. As can be seen from **Figure 1-4** below, the rate of interest on BBB-rated bonds is similar to business loan rates. However, bonds may provide a longer tenor and fewer covenants than loans. Conversely, loans are generally more flexible and have lower fixed costs. Bayley (2013) found that on average, the long-run cost of debt is lower in the corporate bond market compared to the syndicated loan market. Therefore, Bayley argues that factors other than price affect the dominance of syndicated loans. This section also considers other regulatory and tax factors which explain this inconsistency.

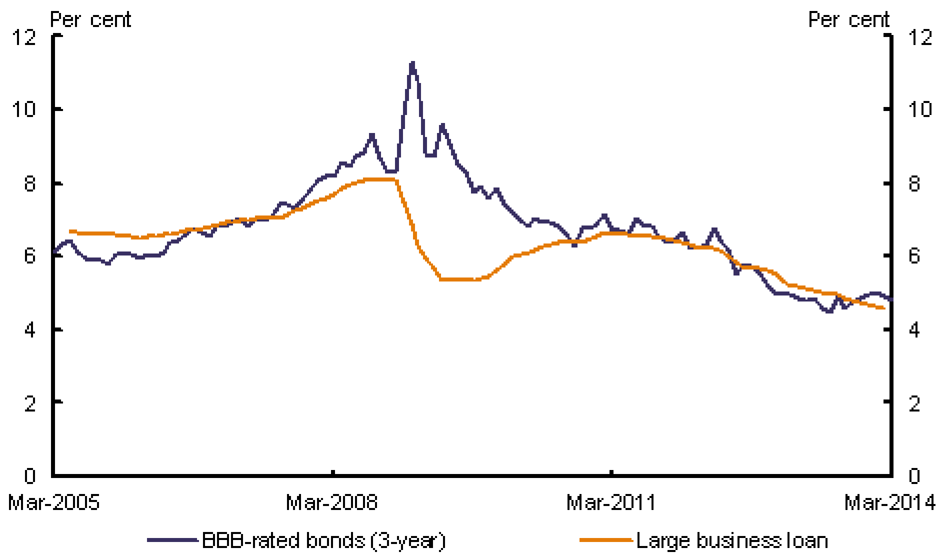


Figure 1-4: Interest comparison of bonds and bank finance

Source: RBA, 2014

As well as the benefits to investors, a deeper and more liquid corporate bond market would provide diversification to both issuers also. Historically, non-financial corporations have largely not relied on the domestic bond market and financing was done through bank loans. Regulatory changes as a result of the increased scrutiny on banks following the GFC have increased the relative cost of bank intermediation. There may be an increased shift towards market-based sources of finance, particularly bond issuance, as the costs of bank intermediation rise; this increases the attractiveness of market financing.

In offshore bond markets the major source of competitive advantage over syndicated loans is the ability to provide longer term funding than can be provided by the banking system, however this advantage is not currently present in the Australia corporate bond market, with the average term to maturity of a corporate bond being 4.7 years compared with 4.1 for large business loans (Bayley, 2013).

SMEs typically do not have access to capital debt markets and therefore must rely on bank borrowing or issuing equity. The high degree of bank intermediation raises the risk of Australian companies having difficulty raising funds when there is a tightening in bank lending (The Australian Government the Treasury, 2011). Australian small and medium size enterprises (SMEs) would benefit from being able to issue corporate bonds to Australian investors to address this risk and diversify funding sources. Currently, the process can be prohibitive for these companies; they may not be able to issue in the wholesale markets and issuing corporate bonds to retail investors is “costly and onerous compared to other avenues for raising funds as the law requires the issuing of a full prospectus and directors are subject to personal liability for the content of the prospectus.” (The Australian Government the Treasury, 2011)

Bond issuance can also be a challenge particularly if the companies wishing to obtain finance are lower-rated or unrated corporates, particularly for long tenors. However, since 2013 there has been an increase in the number and tenor of Australian dollar BBB-rated bonds (Debelle, 2014). Despite historical strong performance, the lower rated corporate bonds and fixed income markets in Australia were greatly affected by the global loss of investor confidence during the Great Recession. However, recently these lower-rated corporate bonds (BBB+ to BBB−) have recorded their strongest issuance on record and at longer maturities (Debelle, 2014). However, these tenors remain significantly below offshore tenors. This is reflected in corporate issuance in **Figure 1-5**, below:

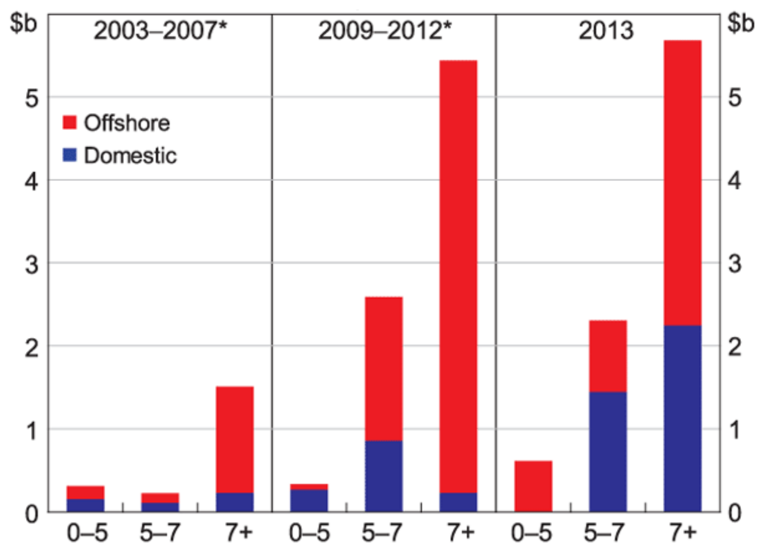


Figure 1-5: Australian corporate bond issuance by tenor

Source: RBA, 2014

The following sections elaborate generally on several of the barriers to issuing bonds in the Australian corporate bond market:

Taxation of debt vs. equity

In offshore markets there is a tax advantage to using debt to fund companies, however in Australia the opposite situation exists (Davis and Jenkinson, 2014). In these overseas economies, interest paid on debt can be paid against taxable income and dividends are taxed both at the company and individual level. However, in Australian the tax system does not double tax dividends or capital. As a result, Australian capital markets will be disadvantaged relative to offshore debt markets.

Credit ratings and information asymmetry

Investors frequently use credit ratings to assess the credit risk of the companies they are investing in; however, some of the cost of obtaining a credit rating can act as an additional barrier to issuing corporate bonds. This adds to the fixed cost of obtaining the debt and reduces the viability of corporate bonds as a financing mechanism.

Reporting, liability, and governance

With the exception of 'vanilla' bonds which go through a simpler process, all securities in Australia must create a prospectus and submit to the Australian Securities and Investments Commission (ASIC), which is a formal disclosure through the Corporations Act, 2001. This process can be expensive, time-consuming, and include director liability and governance implications. Directors can be liable if prospectus information is found to be inaccurate or misleading, and the conditions of the bond issue provide for bond-holders to have control rights in certain financial distress or not meeting bond terms. Furthermore, some credit ratings in Australia are not permitted or do not consent to provide critical risk information to retail consumers due to their lack of an Australian Financial Services License, which is needed to provide financial advice to retail customers. (Davis and Jenkinson, 2014)

2.0. Bond Market Reform

2.1. Economy-wide benefits and risks of reform

According to the Financial System Inquiry (2014), Australia has an established corporate market but further development is limited due to a range of regulatory and tax factors. The more efficiently a financial market channels funds from savers to borrowers, the lower the cost of capital to the real sector, which will affect the rate of economic growth. This is particularly true for bond markets which play an important part in financing large investment projects. Bond markets have risk-sharing factors in spreading the cost of large projects over many stakeholders and risk-shedding character. They can be traded on the secondary market where investors can transfer risk when required. According to the IMF (2011), "the combination of these two characteristics – the scope for risk-sharing and risk-shedding – means that bond investors are much more willing to make large, long-term commitments than banks, which are constrained by limits on how much maturity transformation they can engage in."

The GFC highlighted the lack of a viable term debt funding alternative to the domestic banking system for larger Australian companies, as well as the reliance of the major four Australian banks on offshore debt markets for funding (Bayley, 2014). An often cited theory in favour of the development of capital markets is the 'spare tire' argument. That is, Greenspan argued (1999), that capital markets can act as a 'spare tire' in case the banking system becomes impaired. Greenspan cites the Japanese example, where the keiretsu conglomerate system has exposed Japan to high risk of a credit crunch; however he argues that it has been avoided due to sufficient nonbank lending. Spiegel (2009) argues that the 'spare tire' theory has been disproven during the GFC where capital markets faced large disturbances as well as the banking sector.

However, arguments in favour of the ‘spare tire’ theory remain as a mechanism to reduce the risk of such crises’, as when a “full-fledged corporate bond market is present, market forces have a much greater opportunity to assert themselves, thereby reducing systemic risk and the probability of a crisis.” (Hakansson, 1998) Furthermore, Hakansson argues that increase of market forces increase economic welfare and will have a strong spillover effect to the health of the banking sector.

Innovative financing solutions such as SIBs also have benefits and risks of development for the Australian economy. For governments, SIBs may see increased innovation, efficiency, and value for money in achieving social goals; collaboration with industry and state governments would increase ties and allow for future improved outcomes; beneficiaries may see an increased quality of service. However, there are also significant risks in this area including: reputational risk whether it succeeds or fails (for example, there is a perceived distain for tying philanthropy to profit); there may be significant financial risk if the venture does not succeed for both governments and investors; there may be negative or ineffective intervention which may have been a substitute for more effective government practices. (The Australian Government the Treasury, 2016; The Centre for Social Impact, 2012)

2.2. Benefits and risks for investors and issuers

A most significant benefit for investors and issuers from investing in bonds in general is the diversification aspect.

For investors, a reduction of equity-bias would result in a more diversified portfolio. Bond market returns are generally correlated negatively with equity returns, particularly if the bonds selected have low correlation with equities in an investor's portfolio (Leung and Rieger, 2014). That is, equity market return declines often tend to result in increased bond values. However, the recent strong performance of bonds may reflect the downward trend in interest rates over recent years, due to the inverse relationship between interest rates and the market value of bonds (Davis, 2013). Therefore, the risk exists that the disappearance of a low interest rate world presents risks for corporate bond market attractiveness (Debelle 2014).

For issuers, bond markets can provide firms with a stable source of funding, at a lower cost of capital, as an alternative to bank finance. For companies, this may result in a cost saving, allow for efficient use of working capital, more efficient exchange rate risk management, and access to an international investor base (International Capital Market Association, 2013). Allowing smaller and medium size entities to float bond issues could also provide an alternative source of, potentially, higher yield returns to these investors as well as broadening the source of loanable funds to entrepreneurs. However, markets such as this are not without risk as seen in **Box 1-1** and would require sound legal and institutional frameworks.

2.3. Pathways to reform

In summary, the analysis indicates that corporate bond issue can be an effective means for diversifying and deepening a financial sector, however the regulatory environment needs to be right. For international successes to be successfully translated into the Australian experience requires a number of issues to be solved:

1. On the demand side, investors need to be offered the correct mix of risk and return to justify switching from equities.
2. Complementing this is an appropriate regulatory structure to safeguard investor interests.
3. Companies need to become aware of the potential for bond issues to solve the development capital issue and able to access the capital market.
4. Requirement (3) will call for the services of financial advisers with bond issue experience.
5. There is a case for a role to be played by high yield non-investment grade bonds supported by appropriate legislative frameworks.

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