

The Innovative Design of Inter-bank Bond Market System

ZHOU Yunfeng^[a]; FENG Junwen^{[a],*}

^[a] Economic and Management Department, Nanjing University of Science and Technology, Nanjing 210094, China.

*Corresponding author.

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Abstract

Presently, the development of China's capital market is characterized by the slow development of bond market, so the establishment of a multi-level capital market needs more development led by the inter-bank bond market. The content and suggestion of innovative design of inter-bank bond market are discussed from the macro aspects of distribution system, transaction system, market-maker system and regulatory mechanisms.

Key words: Inter-Bank bond market; System; Innovation

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INTRODUCTION

Innovation is the driving force for the development of capital markets, innovation needs to be conducted on both product and market system. The primary cause of the lack of innovation is the system control, a variety of lessons learned show that the improvement in system is the basis of rapid development of financial innovation. To some extent, one of the important contents of financial system innovation is evading system regulation. But if the changes in environment of the system fit the market development, the financial system innovation will provide a development platform for the system innovation

and transport a continuous flow of power to business development and innovation. So in China the innovation of inter-bank bond market should first start from macro system mainly.

1. INNOVATION OF ISSUE SYSTEM

Currently, China's bond market lacks fully market-oriented mechanism, multiple regulators exist. The primary issue market is examined, approved and controlled by National Development and Reform Commission, China Securities Regulatory Commission, National Association of Financial Market Institutional Investors affiliated to the People's, etc. separately. The People's Bank is responsible for interest rate management. The secondary market is managed by the People's Bank, stock exchange, etc. after going public.

We believe the bond issue system should implement market-oriented reforms step by step, according to the macroeconomic index and its change, and let market decide the issue scale, rhythm and variety. The issue system should continue to transition to the form of registration and approval, to reveal the differences of credit of the issue subject and improve the bond's elasticity of supply as well as the price elasticity of demand. First of all, expand the amount of bond issuance and eventually cancel the control of bond issuance amount; Secondly, Relax the restrictions on the use of bonds to raise fund, at the same time ensure that is used in investment of fixed assets, and allow for using it in debt restructuring, asset restructuring and other real legal means; Lastly, concentrate the authority of issuance and approval to avoid multiple regulators, which can help to improve the quality of issuing examination and verification as well as financing efficiency, and optimize the allocation of resources.

Future bond issues should be more and more practiced ratification system and filing system, etc., and management will not make judgments over value and risk

any more, which not only eliminates the cumbersome approval procedures but also enhances the self-restraint of issuers and investors.

2. INNOVATION OF TRADING SYSTEM

The innovation of trading system is mainly related to secondary market, showing achieving Exchange and OTC both exist. At present, the deficiency of China's trading system caused underdeveloped secondary bond market and lacking OTC market caused a serious shortage in market liquidity, thereby constraining the expansion of demand for bonds, which in turn limits the development of primary bond market. Therefore, the innovation of bond market trading system needs to establish OTC market actively, to build an Exchange-centered, OTC market as the subject, complementary and integrated bond circulation system in the meantime of improving Exchange to fully play its function.

2.1 Exchange

International experience shows that the principal bond trading market is the OTC market, but from the historical perspective, bond can be traded not only in the OTC market but also can be traded in the organized exchanges. Exchange market should become China's core corporate bond market system, and this central role is mainly reflected in the price (yield) and price discovery function of guidance, while the dealing function is not the most important. The transaction function should be undertaken by the OTC market, therefore, the exchange mechanism should be innovated.

2.1.1 Determine the Criteria of Listed Bonds

To effectively realize the price discovery function, listed bond yields should be able to reflect the real market rate of return volatility. Require it generally have a higher credit rating, and make every effort to let various types of bond be in a representative and dominant position.

2.1.2 Implement the Exchange Filing System

Bond risk control should be mainly reflected in the stage of issuance, setting up excessive barriers on the fluidity of secondary market can only reduce the efficiency and increase the market transaction costs, so the bonds which meet the criteria of being listed should be implemented the filing system.

2.1.3 Build Mechanism for Mandatory Information Disclosure

Improve information asymmetry and reduce transaction costs. The bond information disclosure should reflect the characteristics of aiming at the creditors, which mainly focuses on the aspects of company operating, financial affairs, the progress and effects of the use of raised funds, new investment and financing plans and schedules, major issue, debt guarantor status and so on.

2.1.4 Build Mechanism for Bond Repurchasing

The bond repurchasing mechanism plays an important role in improving bond investment and financing function, mobility and the development of primary market. Also it is an important aspect of improving inter-bank market as well as filling the void of market system.

2.2 The OTC Market

The OTC market is the main place of bond trading market, though foreign bonds in early stage were once actively traded in organized exchanges, eventually it moved over the counter. Therefore the future development trend of China's bond market will be the OTC market. Securities underwriting agencies should be created in the OTC market as the main part. The basic framework of improved OTC market system includes the following key components: improved hardware and software facilities of the trading platform; interconnected unified, hierarchical system of household registration custody; efficient low-cost fund settlement system; multi-level market makers rule and broker system; authoritative and transparent credit rating system; legal mechanisms of dispute handling and penalties for default; self-regulation mechanisms of independent association, etc.

In addition, issuance, trading and settlement will also have a significant impact on the efficiency of the market.

The bond market has two ways of issuance: public offering and private placement. Private placement has its own advantages, such as convenient operation and high fundraising timeliness for the issuer; saving a lot of corresponding public underwriting fees and issuing costs; favor of protecting issuer's financial information and the right of control, etc. In other countries, the bonds issued to institutional investors often tend to adopt private placements. Specific bonds such as assets backed security, high-yield bonds, mergers and acquisitions (M&A) bonds, and etc. also tend to adopt private placements. Consequently, China's inter-bank bond market may also initiate to adopt private placements in developing new types of bonds. Besides, public offering should change the condition that paying attention to declaration, audit and supervision, but ignoring the supervision over the issuing process and the structural construction of issuing mode. Calling for bids, book-building and other ways are recommended to use more to achieve market-oriented interest rate pricing.

From the way of bond trading, it also needs further diversification. At present the ways of Inter-bank bond trading are cash bonds transaction, forward transaction, repo trade (pledge-style repo and buyout repo) and etc., although the repo market especially pledge-style repo business developed rapidly, there still exists problems such as the determination of pledge ratio is extensive, excessive and insufficient pledge. So the types of securities may be pledged need to be expanded and pledge scale need to be further developed in order to meet market demand. In

addition, short selling can be considered on the premise of risk control. Short selling is also an important device to improve the market fluidity and efficiency from the experience of developed countries.

From the ways of payments, the inter-bank Delivery Versus Payment (DVP), Straight Through Processing (STP) and so on have been successively implemented. Infrastructure is increasingly improved. In the next step, the forms of settlements can be further innovated such as multilateral netting, day batch settlement and etc., in order to improve settlement efficiency as well as reduce settlement risk.

3. THE MARKET MAKER SYSTEM INNOVATION

Now the profit of market maker in inter-bank bond market is relatively low. Banks are mostly for the obligations of the market and there is not much driving force. Besides, the existing businesses are mostly among the financial institutions, less are involved in non-financial institutions and retail markets. The real needs are not discovered and market levels are not evident yet. In addition, the further development of market maker is also hindered due to lack of bond market trading varieties, same properties of investors, limited hedging tools and other factors. Therefore, the market maker system should be further improved and developed to promote the inter-bank bond market innovation.

To develop China's bond market maker system should start from the following ways: First, improve the entry and exit mechanisms of market maker, to let more financial institutions have the chance to become market makers, and make strict supervision and appraisal system of in order to regulate and urge the market makers to implement market-making obligations; Second, improve the rules to select the bond types of market making, adjust the differences in prices and amount of quotes, improve the term structure of quoted bond types, encourage market makers to actively offer and raise the offer quality; Third, strengthen support to market-making policy, such as providing more convenience on margin trading, bond underwriting and so on, and appropriately reducing related costs to encourage a deal made by market making; Last, accelerate the pace of related institutional improvement and products innovation, and provide the market maker with inventory management and hedging tools of risk control.

4. THE SUPERVISION MECHANISM INNOVATION

The International Organization of Securities Commissions (IOSCO) proposed three objectives on securities market: to protect investors; to ensure the market fair, efficient and transparent; to reduce systematic risk. The regulators

of bond market include government, self-regulatory organizations and intermediary agencies. Proven by facts, only relying on the collaboration of the three aspects and fully expressing of respective advantage, the effective regulation over the bond market can be achieved.

The governmental regulators of inter-bank bond market consist of the National Development and Reform Commission, People's Bank and China Securities Regulatory Commission. Multiple regulators, imperfect system and disjointed parts are the primary causes of the phenomenon such as inefficient management, fraud, payment arrears and so on. Besides, complex approval procedures lead to a long period of issuance and inefficient issuance. Given the current stage and degree of development, when authorizing the power to government's regulatory agencies, we should aim at strengthening the unity of the regulatory power and increasing law enforcement. Therefore, we can learn from the mature experience of US debt market regulation that integrating the power of government regulation into the Securities Regulatory Commission only. Let mature experience and organizational guarantees in the stock market of the Commission ensure the management on the aspects of examining and verifying the issuer, market development and regulation, investor protection and so on. Put the existing corporate bonds, financial bonds, municipal debt and other types of corporate securities under the regulation of the Commission. Change multiple regulations to unified regulation, in order to improve management efficiency. It is obvious on the premise that Commission centralized regulates the bond market, there still exists the need for the People's Bank, the Ministry of Finance, China Banking Regulatory Commission and other departments to establish the relevant market risk regulatory coordination, so that to achieve information sharing, which is good for resource integration.

CONCLUSION

The inter-bank bond market plays an important part in capital market. It has broad development prospects and shoulders heavy responsibilities. And it has great significance in promoting the development of China's financial market. Problems such as inadequate financial innovation in the development of China's inter-bank bond market restrict the speed and capacity of further development of the market. In order to solve the potential problem in the development of inter-bank bond market and maintain the sustained, healthy and stable development trend of the market, we should enhance the research in the bond market theory to establish a complete set of market entry and exit mechanisms, and steady push forward the innovation of trading tools of China's inter-bank bond market from the aspects of issuance system, trading system, market maker system and regulatory mechanisms.

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