Commissioned Report by Ministry of Finance, Japan

Practical Measures for Developing India’s Bond Market

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1. Issues Concerning the Indian Bond Markets

1.1 Overview of the Asian Financial Markets

Generally speaking, the level of dependence on indirect financing in the countries of Asia is high. The background to this is that there are a great many small and medium size businesses that do not have stable sources of revenue. The prevailing opinion concerning such situation is that this is due to the lack of markets for direct financing. It is also said that in terms of their financial requirement, it would be desirable if the banks would conduct monitoring of the financial condition of these small and medium size businesses given the banks' ability to contact them periodically.

The Asian currency crisis occurred in 1997 caused by the speculative selling pressure on Thai baht. The causes for the crisis were (i) the high level of dependence on indirect financing, and (ii) a two-fold mismatching present in bank lending (referring to the mismatching of both loan terms and currencies).

Regarding the first problem, since Asian companies depended excessively on indirect financing and local banks were also relying on foreign financial institutions for their source of funding, liquidity of local banks dried up when these foreign financial institutions repatriated funds which resulted in a severe contraction of loans from the local banks. This in turn resulted in a severe worsening in the ability of companies to obtain funds and many such companies were driven to the point of insolvency.

Regarding the second problem, although Asian countries have the resources to finance most of their growth from their savings, a large portion of their savings is invested in US dollars or Euros assets. As a result, significant portion of Asia's borrowings is intermediated through foreign capital market. With local banks procuring funds with short term maturities while lending these funds out over the longer term, the cash flow of these local banks themselves experienced pressure (mismatching of loan terms). In addition, since the borrowing was denominated in US dollars while the lending was denominated in local currency, the selling of local currency to buy US dollars for repayment purposes caused the collapse of local currency as well as increase of the amount of the repayment obligation (mismatching of currencies).

In view of this, together with reinforcing the weaknesses of indirect financing, it has been proposed that the importance of direct financing be acknowledged as an alternative means of financing and such measures as the Asian Bond Markets Initiative as policy for activating the bond market were initiated. Recently, we have started to see results such as the issuance of bonds by international organizations denominated in local currencies.

As a result, following the currency crisis, Asian countries have increased their issuances of both government bonds and bonds in the private sector in relation to GDP.

Actually, a significant portion of the increase in the outstanding balance of issuances of government bonds has come from the need for fiscal financing, particularly for the purpose of rebuilding local financial institutions which were adversely affected by the outcome of the currency crisis. Thus, preparations for both the bond issuing market and secondary market to allow for the stable consumption of large volumes of government bonds have made progress.

In the private bond market as well, learning from past mistakes caused by the high level of dependence on indirect financing, the bond market has been utilized much more as an alternative means of financing.

Moreover, Central Banks are also paying greater attention to the bond markets as a means of carrying out financial adjustments.

Although the equity markets experienced a large but temporary decline in the wake of poor corporate performance following the outbreak of the Asian currency crisis, economic conditions subsequently improved for the countries of Asia, and together with rising corporate performance and better evaluations based on high growth, the markets are beginning to thrive.

On the other hand, because of its strict controls on capital, the effects of the Asian currency crisis in China were only minimal. However, at the same time, it can be said that preparations for establishment of financial markets in China is progressing at a slower pace.

1.2 The Financial Markets of India and its Relationship to Infrastructure-related Funds

The current condition of the financial markets in India is one where the level of dependence on indirect financing is approximately 50%. However, the trend over recent years has been a rapid increase of lending relative to deposits, and as a result, it is quite likely that the future will see a situation where lending by itself will be unable to meet the demand for funds. For this reason, in addition to the markets for indirect financing, it will be necessary to establish markets for direct financing as well. Since the equity market is becoming a relatively large component of the direct financial markets, laying the groundwork for the bond markets will be particularly important for attracting investors. Within the Indian bond markets, the scale of the private bond markets is still extremely small, thus leaving room for further expansion in the future.

Also, according to the current government administration in India, the development of infrastructure is indispensable for future stable economic development, and the funding required to achieve this will be US $150 billion over the coming 10 years. Nevertheless, in addition to being confronted with constant fiscal deficits, the government is also limited in its ability to contribute funds because of the Fiscal Responsibility and Budget Management Act (this law obligates the government to hold fiscal deficits within a specific rate of GDP). For this reason, fostering the bond markets will become important from the standpoint of being able to channel a stable source of funds from the private sector to meet the great demand for funds in India so as to address its infrastructure project needs.

In terms of the Asian currency crisis, like China, since India placed strict control on capital regulation, its effects were relatively mild. However, at the same time, progress made toward the establishment of bond markets is still slow.

1.3 Issues Concerning the Indian Bond Markets

The scale of the current Indian bond markets, particularly in the private sector, is small leaving much room for future expansion. The major issues that exist are the following.

(1) Banks

A. Market Prices for Bonds

While banks are obligated to provide market prices for their holdings of bonds, there is no need to do so for their loan portfolio, and with the banks' distaste for posting appraisal profits and losses, banks tend to place priority on measures related to loans. Additionally, particularly in a climate of rising interest rates (i.e., one where bond prices are falling), banks are bound to be reluctant to invest in bonds.

B. High Liquidity at Banks

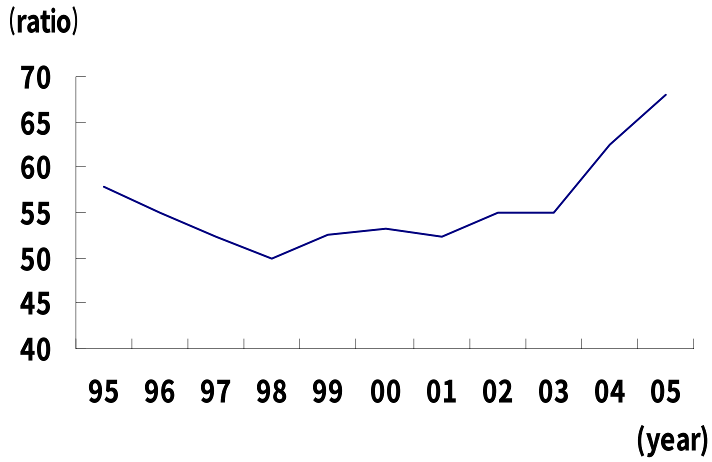
Presently, given the fact that banks have sufficient financing capacity, there is little incentive to place priority on investment into high-liquidity bonds relative to loans where liquidity is lower. However, as mentioned above, the balance of loans at banks has increased in recent years, and if there is any threat of banks encountering a tightening in funding in the future, there will be greater incentive among banks to hold bonds with their higher liquidity.

【Table 1】

Ratio of Credit to Deposits (Credit/Deposits)

（Unit:%）

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
India	57.9	55.1	52.3	49.9	52.5	53.3	52.3	54.9	55.1	62.5	68.1



C. Issuance of Long Term Bonds by Banks

At present, except for infrastructure projects, banks are not allowed to issue bonds with long maturities as a measure to raise funds such as for purpose of long term working capital. This has created a problem in that there are not enough issuers of bonds.

(2) Investors

A. Life Insurers and Mutual Funds as Investors

In India, restrictions have been imposed on investment activity conducted by life insurers and mutual funds, and these restrictions are one of the reasons for the lack of growth in the balance of bond investment. In order to meet the needs for long term investment funds, it will be necessary to bring about greater utilization of the bond markets by relaxing the restrictions imposed on investors such as life insurers, pension and individuals.

B. Upper Limit on Foreign Institutional Investor (FII) Investment

FII investment into private bonds is subject to an upper limit of US$ 500M. While this may be because of concerns related to capital control, although one response would be to set up regulations for other alternative measures that can be taken (e.g., restrictions on speculative transactions by requiring prior notifications and/or prohibiting short term sales), by relaxing the upper limit imposed on FII investment, greater vitality can probably be brought to the bond markets.

(3) The Market and Other Factors

A. Data

Due to the current inadequate maintenance of data concerning bond transaction, there is a need for data sources capable of providing timely and accurate information that allow investors to make informed investment decisions.

B. Complementarity between Private Placement and Public Placement

The costs of public placement of bonds are high, also requiring much time do so, while there are no restrictions on private placement of bonds which occur quite frequently. It is for this reason that the balance of public issues has shown no growth. The following measures should be taken to increase the balance of public issues:

- Reduce the costs for bond issuance through public placement and shorten the time for issuance
- Establish restriction for a certain length of period on frequency of bond issuance through private placement

C. Hedging Mechanisms

With the lifting of existing prohibitions against certain markets such as the Repo and bond futures markets, deregulation which will make it possible to hedge price fluctuation risks of bond holdings will be required. This would allow bondholders to take other hedging approaches besides holding bonds to maturity and also help invigorate trading in the secondary market.

D. Settlement Problems

The presence of settlement risk is particularly apparent since settlement on an one-to-one basis is required for private bonds. By organizing the system for settlements, systems such as Delivery versus payment that do not entail any risk should be allowed.

E. Asset Backed Securities (ABS) not Treated as Securities Under the Law

Since ABS do not fall under the definition of securities under the law, they are imposed with various restrictions such as not being able to be listed for public trading on Exchanges. By treating ABS as securities under the law, restrictions can be lifted and trading can be expected to become more active.

F. Stamp Tax

The stamp tax differs from state to state. It would be desirable to have a uniform stamp tax system.

【Reference】

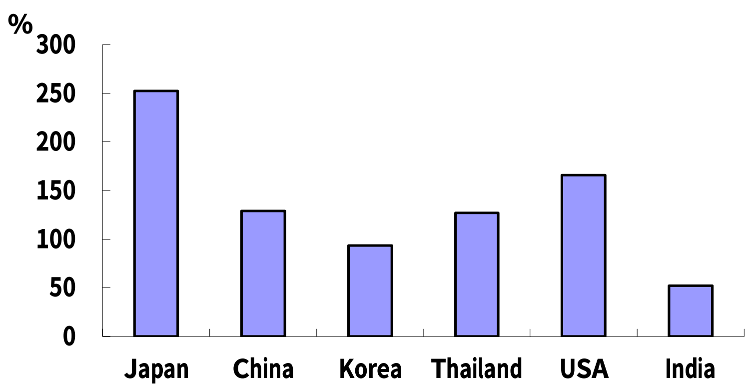
The following shows the comparison between Japan, China, Korea, Thailand, USA and India with respect to the percentages of Exposure / Equities / Government Bonds / Private Bonds balance against GDP. The result shows that India rates relatively high in its percentage of Exposure, Equities, Government Bonds balance against GDP, but extremely low for Private Bonds. Furthermore, from the late 1990's to the present, no increase has been observed in the percentage for Private Bond balance.

【Table 2-1】 Exposure/GDP (%)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	Average
Japan	295.9	295.1	296	139.4	144.0	310.5	317.5	312.5	157.3	252.0
China	90.9	98.0	106.3	120.2	130.6	132.7	140.6	166.4	177.9	129.3
Korea	69.9	74.5	86.1	78.1	96.6	104.0	110.4	116.9	105.6	93.6
Thailand	136.5	98.8	140.4	164.9	141.9	121.7	112.0	116.0	113.0	127.2
USA	132.1	137.5	148.7	162.2	164.2	161.7	163.9	159.4	261.8	165.7
India	48.5	49.8	49.7	45.1	49.6	53.4	54.7	58.5	57.3	51.8

(Source: World Development Indicator)

【Table 2-2】 Exposure /GDP (%) (Average for 1995~2003)

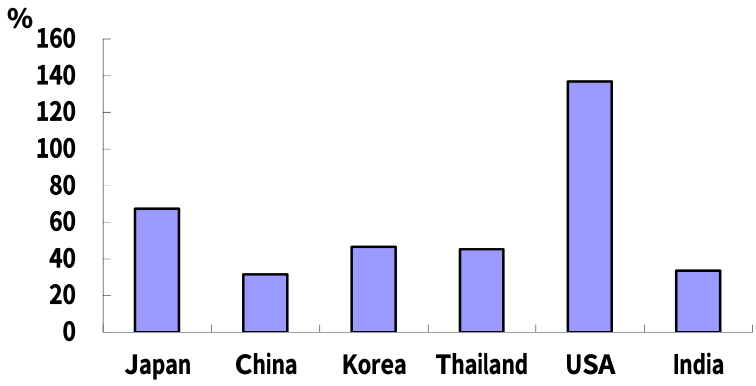


【Table 3-1】 Total Market Value of Equities/GDP (%)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	Average
Japan	71.8	67.2	52.9	66.0	104.6	65.2	54.4	53.2	70.7	67.3
China	6.0	14.0	22.9	24.1	33.4	53.8	45.2	36.6	48.1	31.6
Korea	39.9	28.6	NA	35.7	75.8	32.5	55.0	52.2	54.5	46.8
Thailand	84.7	53.9	15.3	31.4	46.9	24.1	31.7	36.3	83.0	45.3
USA	98.6	115.6	144.4	163.4	181.8	153.5	137.2	106.4	130.3	136.8
India	39.2	34.4	33.7	24.5	41.3	32.4	23.1	25.7	46.5	33.4

(Source: World Development Indicator)

【Table 3-2】 Total Market Value of Equities /GDP (%) (Average for 1995~2003)

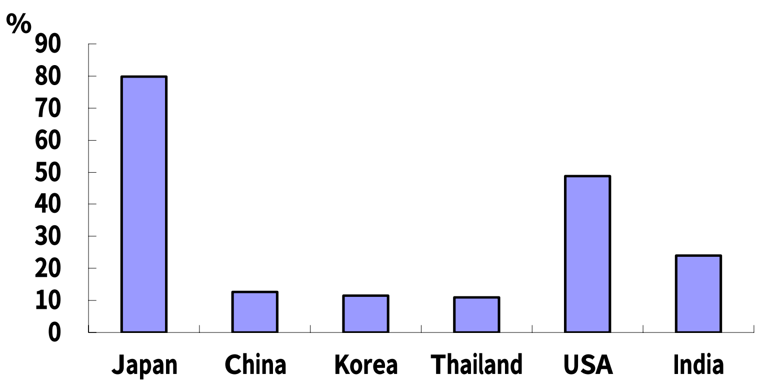


【Table 4-1】 Government Bonds Balance/GDP (Domestic Market) (%)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	Average
Japan	46.7	50.9	52.9	71.8	81.9	76.1	87.2	117.1	135.6	79.7
China	5.6	6.4	7.5	10.1	12.9	15.3	17.1	19.1	20.3	12.7
Korea	6.7	6.7	4.1	12.5	13.9	12.2	13.6	15.1	18.8	11.5
Thailand	1.0	0.4	0.2	10.1	13.3	13.7	16.0	22.9	21.6	11.0
USA	45.6	56.6	53.6	50.6	47.5	41.8	41.4	43.2	45.6	48.7
India	18.6	20.9	17.8	20.4	22.9	24.3	27.2	31.1	33.7	24.1

(Source: BIS Statistics, World Bank)

【Table 4-2】 Government Bonds Balance/GDP(%) (Domestic Market)
(Average for 1995~2003)

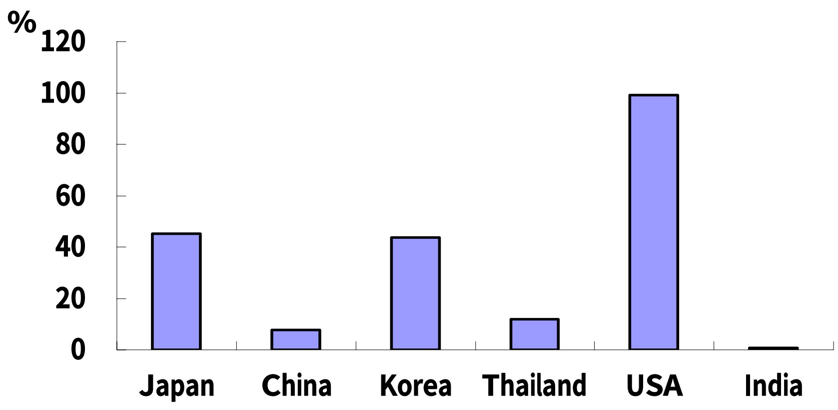


【Table 5-1】 Financial Institution plus Corporate Bonds Balance/GDP (Domestic Market) (%)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	Average
Japan	36.8	43.9	43.2	51.2	52.3	43.8	44.3	47.1	46.2	45.3
China	3.9	4.2	5.4	7.5	8.6	9.2	9.7	10.5	10.8	7.8
Korea	37.1	36.1	20.6	56.5	45.8	40.4	47.1	54.5	54.8	43.6
Thailand	7.9	9.7	6.7	11.2	12.3	11.6	15.1	14.2	19.2	12.0
USA	83.5	86.7	89.3	96.9	102.1	103.9	107.2	109.7	113.1	99.2
India	1.3	1.0	0.8	0.6	0.5	0.4	0.4	0.4	0.5	0.6

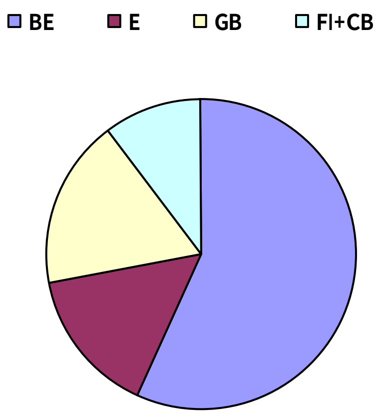
(Source: BIS Statistics, World Bank)

【Table 5-2】 Corporate Bonds Balance/GDP(%) (Domestic Market)
(Average for 1995~2003)

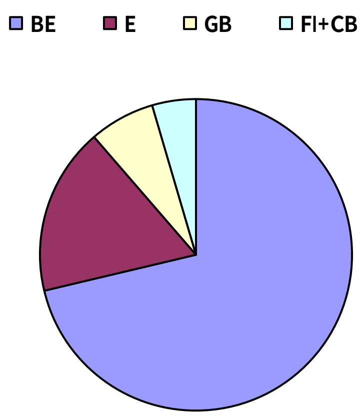


【Table 6】 Structure of Sources of Funding in Each Country (Average for 1995~2003)

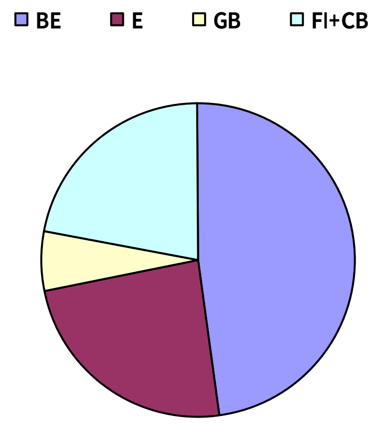
Japan



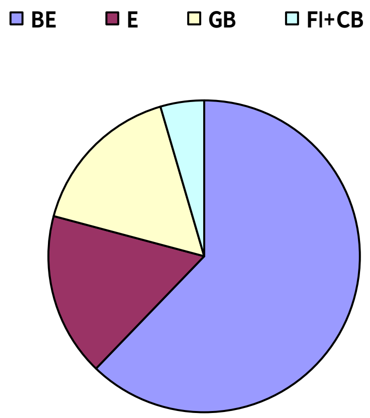
China



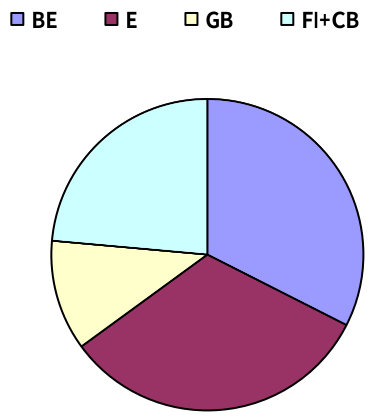
Korea



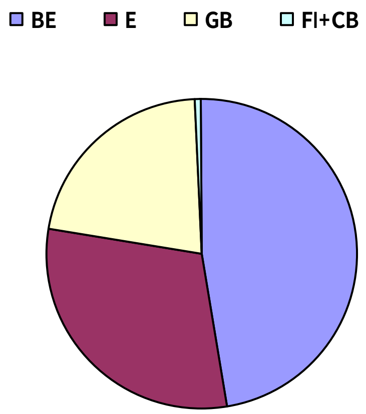
Thailand



USA



India



BE＝Bank Exposure　E＝Equities　GB＝Government Bonds　FI+CB＝Financial Institution+Corporate Bonds

2. Japan's Approaches to the Indian Bond Markets

We shall examine the approaches that Japan should adopt with respect to the Indian bond markets.
First, the history of the Indian bond market will be reviewed from both domestic and international perspectives. Secondly, study will be made on four proposals as to how Japan can contribute to the invigoration of the Indian bond market by introducing specific case studies and focusing on the advantages of each proposal.

2.1 History of Bond Issuances in Foreign Currencies by Indian Financial Institutions and Corporations

(1) Before Asian Currency Crisis

A. History of Issuances in Foreign Currencies (excluding Samurai bonds)

Bond issuances in India occurring before the Asian currency crisis were concentrated mostly in financial institutions with ties to the government. The term was generally centered around 7 years with the majority denominated in US dollars. In addition, forms of issuances were varied such as the Yankee 100-year bond issuance and ICICI issuance of subordinated bonds in 1997.

【Table 7】Breakdown of Bonds Denominated in Foreign Currencies in India (Before Asian Currency Crisis)（excluding Samurai bonds）

Issuer	Issue type	Mkt type	type	Closing date	Mty date	Yrs to Mty	Currency	Cur Amt m	US$ equiv nominal Amt m	Iss price	Final coupon	Spread at Lch (bp)
Industrial Development Bank of India - IDBI	FRN	E		07 Jul 1994	07 Jul 1999	5 years	US$	100.000	100.000	99.7300	3-mth Libor+1.00%	
Essar Gujarat Ltd	FRN	E		15 Jul 1994	15 Jul 1999	5 years	US$	200.000	200.000	100.0000	6-mth Libor+2.65%	
Essar Gujarat Ltd	FRN	E		08 Sep 1994	15 Jul 1999	4 yrs 10m	US$	50.000	50.000	100.0000	6-mth Libor+2.65%	
Industrial Finance Corp of India Ltd - IFCI	FRN	E		15 Aug 1995	15 Aug 2002	7 years	US$	100.000	100.000	99.6500	6-mth Libor+0.875%	
Industrial Development Bank of India - IDBI	FRN	E		20 Sep 1995	20 Sep 2002	7 years	US$	250.000	250.000	99.5700	6-mth Libor+0.75%	
Reliance Industries Ltd	FX	E		27 Sep 1995	27 Sep 2005	10 years	US$	150.000	150.000	99.8300	8.1250	190.00
SCICI Ltd	FRN	E		10 Oct 1995	10 Oct 2002	7 years	US$	150.000	150.000	99.5700	6-mth Libor+0.80%	
SBI European Bank Ltd (London)	FRN	E		30 Nov 1995	30 Nov 1996	1 year	US$	30.000	30.000	100.0000	6-mth Libor+0.20%	
Industrial Credit & Investment Corp of India	FX	E		07 Feb 1996	07 Feb 2003	7 years	US$	150.000	150.000	99.4040	7.1250	170.00
Indian Railway Finance Corp	FRN	E		28 Mar 1996	28 Mar 2003	7 years	US$	50.000	50.000	100.0000	6-mth Libor+1.15%	
Indian Railway Finance Corp	FRN	E		11 Apr 1996	28 Mar 2003	7 years	US$	20.000	20.000	100.0000	6-mth Libor+1.15%	
Reliance Industries Ltd	FX	FP	YK	24 Jun 1996	24 Jun 2016	20 years	US$	100.000	100.000	99.7910	10.3750	325.00
Reliance Industries Ltd	FX	FP	YK	24 Jun 1996	24 Jun 2026	30 years	US$	100.000	100.000	99.9640	9.3750	
SCICI Ltd	FX	E		29 Jul 1996	30 Jul 2001	5 years	US$	150.000	150.000	99.9440	8.0000	125.00
Reliance Industries Ltd	FX	E		06 Aug 1996	06 Aug 2046	50 years	US$	100.000	100.000	99.2950	10.5000	350.00
Great Eastern Shipping Co Ltd (GE Shipping)	FRN	E		30 Oct 1996	30 Oct 2003	7 years	US$	50.000	50.000	99.8500	6-mth Libor+1.35%	
Reliance Industries Ltd	FX	FP	YK	16 Jan 1997	15 Jan 2097	100 years	US$	100.000	100.000	99.1290	10.2500	355.00
Reliance Industries Ltd	FX	FP	YK	16 Jan 1997	15 Jan 2027	30 years	US$	214.000	214.000	100.0000	8.2500	175.00
Industrial Credit & Investment Corp of India Ltd	FRN	E	SU	26 Mar 1997	26 Mar 2007	10 years	US$	100.000	100.000	100.0000	6-mth Libor+0.80%	
Industrial Development Bank of India - IDBI	FRN	E		24 Apr 1997	24 Apr 2004	7 years	US$	150.000	150.000	99.4600	6-mth Libor+0.60%	
CESC Ltd	FRN	E		06 May 1997	06 May 2007	10 years	US$	70.000	70.000	100.0000	6-mth Libor+1.50%	
Tata Engineering & Locomotive Co Ltd	FX	FP		16 Jul 1997	15 Jul 2007	10 years	US$	200.000	200.000	99.5980	7.8750	168.00
Indian Railway Finance Corp	FRN	E		31 Jul 1997	31 Jul 2004	7 years	US$	150.000	150.000	100.0000	6-mth Libor+0.75%	
Power Finance Corp Ltd	FX	E		31 Jul 1997	31 Jul 2009	12 years	US$	100.000	100.000	99.9600	7.5000	135.00
Industrial Credit & Investment Corp of India	FX	FP		15 Aug 1997	15 Aug 2007	10 years	US$	150.000	150.000	99.3740	7.5500	160.00
Tata Electric Companies Ltd	FX	E		19 Aug 1997	19 Aug 2007	10 years	US$	150.000	150.000	99.6110	7.8750	160.00
Tata Electric Companies Ltd	FX	E		19 Aug 1997	19 Aug 2017	20 years	US$	150.000	150.000	99.3540	8.5000	193.00

FX＝Fixed rate, FRN=Floating Rate Note, D=Domestic Public Placement, DP=Domestic Private Placement, E=Euro Public Placement, EP=Euro Private Placement, F=Foreign Public Placement, FP=Foreign Private Placement, G=Global Public Placement, GP=Global Private Placement, YK=Yankee, SU=Subordinate

(Source) Bondware

B. Issuances of Samurai Bonds

The first issuance of Samurai bonds in India occurred in 1988 and consisted of a 10-year issue for JPY 20 billion conducted by the ONGC (Oil and Natural Gas Corporation of India). This was followed by another by the IDBI (Industrial Development Bank of India) bond issuance. Before the outbreak of the economic crisis in India in 1991, there were 5 issuances involving 2 issuers.

In both cases, although the enterprises concerned have been privatized, at the time of issuance, it was the government who owned the share entirety and Japanese investors bought these as sovereign issues.

These issuances were followed by the economic crisis in India in 1991 and the Asian currency crisis in 1997. In such an environment, it was not until exactly 15 years later in February 2006 that the next Samurai bond issuance took place. This consisted of a Samurai bond issuance conducted by the Export-Import Bank of India (EXIM Bank).

【Table 8】Breakdown of All Samurai Bonds in India

Date of Issuance	Issuer	No.	Issuance Amount	Term	Coupon	Underwriters	Lead Trustee/FA
1988/08/24	ONGC	1	JPY 20 billion	10Yr	5.9%	(Lead): Nomura / (Co-lead): Daiwa, Nikko, Yamaichi	BOT
1989/04/05	ONGC	2	JPY 20 billion	10Yr	5.5%	(Lead): Nomura / (Co-lead): Yamaichi, Nikko, Daiwa	BOT
1989/10/13	IDBI	1	JPY 20 billion	10Yr	5.7%	(Lead): Daiwa / (Co-lead): Nikko, Nomura, Yamaichi	IBJ
1990/12/04	ONGC	3	JPY 30 billion	10Yr	8.5%	(Lead): Nikko / (Co-lead): Nomura, Daiwa, Yamaichi	Sanwa
1991/02/08	IDBI	2	JPY 30 billion	10Yr	8.2%	(Lead): Nomura / (Co-lead): Daiwa, Nikko, Yamaichi	Fuji
2006/02/22	EXIM Bank	1	JPY 23 billion	5Yr	1.75%	(Lead): Mizuho / Nikko Citigroup	FA: Mizuho CB

(Source) Bondware

(2) After the Asian Currency Crisis

A. Shift in Credit Ratings in India and Trends of Foreign Investors

At one point in time, both Moody’s and S&P had rated India’s sovereign rating unsuitable for investment, and time was necessary to get back to the foreign bond markets after the Asian currency crisis.

Foreign-bond issuance came to an end in 1998, when Moody’s rated the bonds as speculative grade. Preceding the upgrade to the sovereign rating investment grade in January 2004, foreign-bond issuance was revived by the ICICI (listed on the NYSE) which was rated Baa3 (see Table 9).

In other words, India’s foreign-bond issuance was interrupted between 1997 and 2003. As shown in Table 10, “Shift of Credit Ratings in India,” India’s foreign-bond issuance has been essentially swayed by Moody’s rating upgrades and downgrades.

In contrast to the period before the currency crisis, the term for bond issuance has seen a sharp decline in 7-year bonds, with investors focusing on the medium-term zone of 3 to 5 years.

Two of Japan's rating institutions, Japan Credit Rating Agency, Ltd. (JCR) and Rating and Investment Information, Inc. (R&A) deserve special mention for continuing to grant investment grade rating during this time. Apparently, the debate on the necessity of Asian rating institutions having different perspectives from Moody's and S&P can also be considered as highly significant.

Since that time, together with the recovery of India's economy and the restoration of its rating to investment grade (Moody's; Jan. 2004), spreads have continued to narrow down lately.

After India's rating was restored to investment grade, not only investors in Europe and the US but those in Singapore and Hong Kong, as well, actively purchased India-issued US-dollar-denominated bonds and euro-denominated bonds. However, Japanese investors, who are traditionally conservative, were also impacted by the Argentinean crisis of September 2001, and on the grounds of the lack of the former investment grade from the S&P, engaged in extremely limited purchase of India's issues.

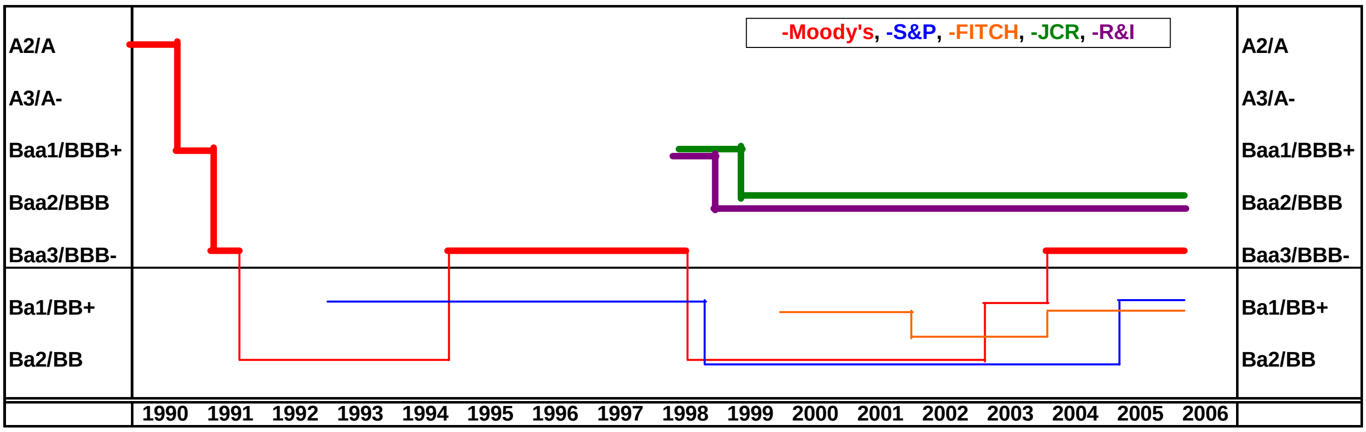
Then in early 2005, the "India Boom" occurred in Japan. This brought with it a shift in investor sentiment from investment in solely China, which had been the dominant trend until then, to a more diversified approach into the so-called BRICs. Even so, in 2005, this boom was confined to investment in Indian equity funds by individual investors with only very limited inflow of money from Japanese institutional investors into Indian issues.

【Table 9】List of Foreign Bond Issuances (excluding Samurai bonds)

Issuer	Issue type	Mkt type	Programme type	Closing date	Mty date	Yrs to Mty	Currency	Cur Amt m	Iss price	Final coupon	Spread at Lch (bp)
ICICI Bank Ltd	FX	E		22 Oct 2003	22 Oct 2008	5 years	US$	300.000	99.9430	4.7500	
Industrial Development Bank of India - IDBI	FX	E		03 Mar 2004	03 Mar 2009	5 years	US$	300.000	99.6530	4.7500	185.00
National Thermal Power Corp Ltd - NTPC	FX	E		10 Mar 2004	10 Mar 2011	7 years	US$	200.000	99.3700	5.5000	205.00
Export-Import Bank of India	FX	E		14 Jul 2004	14 Jul 2009	5 years	US$	250.000	99.4470	5.3750	185.00
ICICI Bank Ltd	FX	E		18 Aug 2004	18 Aug 2009	5 years	US$	300.000	99.4680	5.0000	168.00
State Bank of India	FX	E	EMTN	08 Dec 2004	08 Dec 2009	5 years	US$	400.000	99.5740	4.7500	117.50
Industrial Development Bank of India - IDBI	FX	E		23 Dec 2004	23 Dec 2009	5 years	US$	250.000	99.6950	5.1250	162.80
Indian Railway Finance Corp	FX	E		23 Mar 2005	23 Mar 2010	5 years	YEN	13,000.000	100.0000	1.4300	77.50
State Bank of India (London)	FX	E		05 Aug 2005	05 Aug 2010	5 years	EUR	100.000	100.0000	3.5000	
Bank of India (London)	FX	E	EMTN	04 Oct 2005	04 Oct 2010	5 years	US$	250.000	99.7620	5.3750	130.80
ICICI Bank Ltd (Singapore)	FX	E		16 Nov 2005	16 Nov 2010	5 years	US$	500.000	99.5720	5.7500	130.00
State Bank of India (London)	FRN	E	EMTN	23 Dec 2005	23 Dec 2010	5 years	US$	100.000	100.0000	6-mth Libor+0.60%	

EMTN=Euro MTN Program (Source: Bondware)

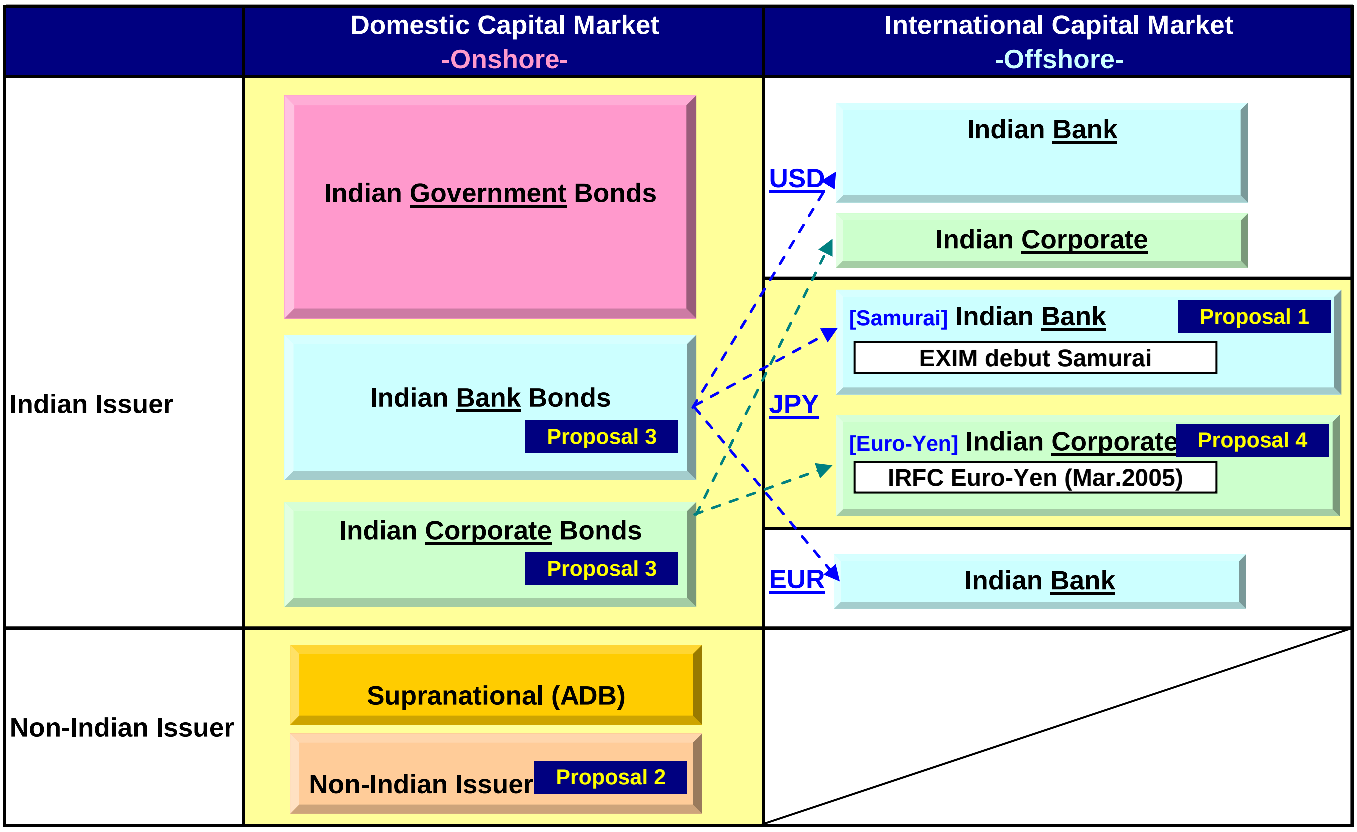
◆ 【Table 10】Shift of Credit Ratings in India



(Source: Prepared by Mizuho Securities based on reference material from various credit rating agencies)

2.2 Prospects of Specific Products

【Table 11】



（Source: Prepared by Mizuho Securities）

The left side of the above table represents India's domestic bond markets, the right side its international (offshore) bond markets, the upper section Indian issuers (the majority of the issuers are the India government, followed by Indian financial institutions and some companies), and the bottom section non-Indian issuers [Asian Development Bank (ADB) and other international organizations]. The matrix shaded yellow indicates the areas in which Japan's government and financial institutions could possibly make specific contributions to the vitalization of India's bond markets.

Below are four specific proposals.

(1) Support Indian issuers' foreign-bond issues, particularly Samurai bonds (Proposal 1 in the table above).
(2) Promote non-Indian issuers' bond issues denominated in local currency (Proposal 2 in the table above).
(3) Promote Indian issuers' bond issues denominated in local currency (Proposal 3 in the table above).
(4) Support Indian issuers' foreign-bond issues, particularly Euro-Yen bonds (Proposal 4 in the table above).

Presented next for each proposal are actual cases of the bond issuance of India and other countries and the related significance of such cases.

2.3 Proposal ① Issuance of Samurai Bonds (Export-Import Bank of India)

The issuance of Samurai bonds conducted by the Export-Import Bank of India ("EXIM Bank") in February 2006 serves as a good example of the revitalization of the Indian bond market because in the Japanese market, which boasts the largest presence of institutional investors in Asia, the issuance of Samurai bonds represents an expansion of the class of investors and a diversification of the measures available to raise funds.

(1) Summary of Issue: First Issue of Samurai Bonds by EXIM Bank

Date of Issuance	Issuance Amount	Term	Coupon	Lead Underwriters	Remarks
2006/2/22	JPY 23 billion	5Yr	1.75% (J L+62bp)	Mizuho Securities / Nikko Citigroup	First issue of India's Samurai bonds in 15 years

Fiscal Agent (FA): Mizuho Corporate Bank

Rating: Moody's: **Baa3** stable / S&P: **BB+** stable / JCR: **BBB** stable (= same as ratings for Indian sovereign debt)

Subscription Date: February 22, 2006 / Redemption Date: February 22, 2011

(2) Significance

Despite the India Boom occurring in recent years, this issuance of India's Samurai bonds represents the first of its kind in 15 years since 1991.

Also, this issuance became the "First Samurai Resurrection Bond" from among the "BRICs" nations. As a result, more than 70% of the total amount has been sold to investors in Japan (pension funds, insurance companies and banks) and in keeping, this issuance can be said to be highly significant in that in addition to the investment into Indian equities originating from individual investors that has been taking place thus far, "this has provided institutional investors in Japan with a genuine opportunity to channel funds into India."

Several other Indian issuers are also expressing interest in issuing Samurai bonds, and the success of the EXIM Bank's issuance of Samurai bonds should do much to bolster the confidence of Indian issuers with respect to funding in the Japanese market.

2.4 Proposal ② Bond Issuance and on-lending Conducted by International Organizations

In the context of the growing importance of Asian Bond Markets Initiative (ABMI), there has been more and more activity among the countries of Asia involving the issuance of bonds by international organizations that are denominated in local currencies. Such issuances of bonds by international organizations are contributing to the greater utilization of the bond markets of various countries by expanding the base of issuers as well as investors.

Although funds procured are frequently used for on-lending, such on-lending is considered advantageous from the borrower-side, because the borrowing is made in local currencies and does not entail any exchange risks. Also, due to the creditworthiness of international organizations, it is expected that long-term bonds can be issued for on -lending to clients with the need for long-term borrowing and to large-scale projects, should there be restrictions on the amount that could be extended to a single company,.

As indicated in Table 12 below, in India, in February 2004, the ADB was the first international organization to conduct a successful issuance of bonds denominated in the Indian rupee.

【Table 12】Bond Issuances Denominated in Asian Currencies by International Organizations: (excluding NTD/HKD)

Issuer	Gtr	Closing date	Mty date	Yrs to Mty	Currency	Cur Amt m	US$ equiv nominal Amt m	Iss price	Final coupon
Asian Development Bank		01 Sep 1995	01 Sep 2002	7 years	WON	80,000.000	105.146	100.0000	12.1500
International Finance Corp - IFC		10 Apr 1997	10 Apr 2002	5 years	PSO	2,600.000	98.775	100.0000	10.2500
International Bank for Reconstruction & Development - World Bank		11 Apr 1997	11 Apr 2002	5 years	PSO	4,000.000	151.961	101.4140	10.2500
European Bank for Reconstruction & Development - EBRD		22 Mar 1997	22 Apr 1998	1 yr 1m	PSO	3,000.000	113.928	100.8500	9.0000
International Bank for Reconstruction & Development - World Bank		23 Apr 1997	23 Apr 2002	5 years	WON	23,500.000	26.316	100.0000	9.8000
European Bank for Reconstruction & Development - EBRD		02 May 1997	02 May 2002	5 years	WON	23,700.000	26.439	100.2500	10.0000
International Finance Corp - IFC		28 Oct 1998	29 Oct 2001	3 years	S$	300.000	178.147	99.4460	4.5000
Nordic Investment Bank		31 Mar 1999	31 Mar 2004	5 years	S$	150.000	87.108		4.1250
Nordic Investment Bank		30 Mar 1999	30 Mar 2004	5 years	S$	150.000	87.108		4.7500
European Bank for Reconstruction & Development - EBRD		08 Apr 1999	08 Apr 2004	5 years	S$	150.000	87.108	99.8000	4.1250
Nordic Investment Bank		29 Jul 1999	31 Mar 2004	4 yrs 8m	S$	50.000	29.427	99.4710	4.1250
International Finance Corp - IFC		23 Sep 1999	23 Sep 2004	5 years	S$	100.000	59.659	100.0000	4.2800
African Development Bank - AfDB		11 Jul 2001	11 Jul 2004	3 years	S$	129.000	70.801	100.0000	2.6400
TelecomAsia Corp pcl	IFC	15 Oct 2002	03 Feb 2011	8 yrs 4m	BHT	6,750.000	155.476	100.0000	-
Asian Development Bank		27 Feb 2004	27 Feb 2014	10 years	RUP	5,000.000	110.619	100.0000	5.4000
Asian Development Bank		23 Jun 2004	25 Jun 2007	3 years	S$	200.000	117.592	100.0000	1.8450
Asian Development Bank		10 Nov 2004	10 Nov 2009	5 years	M$	400.000	105.263	100.1800	3.9400
International Finance Corp - IFC		13 Dec 2004	02 Dec 2007	3 years	M$	500.000	131.579	100.0000	0.0000
International Bank for Reconstruction & Development - World Bank		12 May 2005	12 May 2010	5 years	M$	760.000	200.000	100.0000	0.0000
Asian Development Bank		24 May 2005	24 May 2010	5 years	BHT	4,000.000	101.042	100.0000	3.8700
Central American Bank for Economic Integration - CABEI		06 Jul 2005	06 Jul 2010	5 years	S$	100.000	59.119	100.0000	2.6400
International Finance Corp - IFC		14 Oct 2005	14 Oct 2015	10 years	RMB	1,130.000	139.644	100.0000	3.4000
Asian Development Bank		14 Oct 2005	14 Oct 2015	10 years	RMB	1,000.000	123.579	100.0000	3.3400
Asian Development Bank		09 Nov 2005	10 Nov 2010	5 years	PSO	2,500.000	45.102	65.3100	0.0000

(Source) Bondware

Sections (1) and (2) below introduce press releases on the following: (1) “Summary of Issue” provided by ADB at time of issuance of Indian rupee denominated bonds and (2) “Summary of Issue” provided by Japan Bank for International Cooperation (“JBIC”) at time of issuance of Thai baht denominated bonds and the significance of such bond issuances.

In line with the advantageous points indicated above, by promoting international organizations to issue bonds, further revitalization of the Indian bond market will become possible in the future.

(1) Proposal ②-①

Issuance of Bonds Denominated in Indian Rupee by Asian Development Bank (ADB)

~ First Issuance of Bonds Denominated in Indian Rupee by an International Organization and Non-Indian Issuer ~

(Source：ADB/Feb. 27, 2004)

In February 2004, the Asian Development Bank (ADB) became the first international organization to conduct an issuance of bonds denominated in the Indian rupee. At the same time, this was also the first such issuance conducted by a non-Indian issuer. The term was 10 years and the issuing amount was Indian Rupee (INR) 5 billion. The issuing price was 100% and the coupon was 5.4%, which was 17bp over government bonds. It was listed for public trading on the NSE, with HSBC and ICICI Securities acting as lead arrangers and the Bank of India and Union Bank of India participating in the syndicate. 60% of the investors were local banks, 21% were life insurers and 19% were mutual funds.

◆Potential deal study on JBIC

Following the Indian rupee (INR) bond issuance in February 2004, it was anticipated that INR bond issuances would also be conducted by the International Finance Corporation (IFC), JBIC and others. In the case of JBIC, it was assumed that it would choose one of the two courses consisting either of the regular course of fund on -lending in US dollar floating rate or on-lending in local currency. In India’s case, in consideration of the government preference for on-lending in local currency rather than swapping into US dollars, it seems more attractive for JBIC to choose the scenario of on-lending the INR funds to Japanese companies. The use of the funds was to be consistent with the so-called “Japan Interest” (i.e., to benefit Japanese companies). Japanese companies that were making inroads into India could easily borrow money over the medium term from Japanese and local banks up to a period of about 5 years, due to the banks’ abundant liquidity. However, there were also restrictions on the amount that banks could extend to a single company, with the upper limit of the loan at 15% of capital. Thus, it was anticipated that JBIC’s on-lending in this manner would prove advantageous with respect to the borrowing conducted in the long-term intended for large-scale projects.

(2) Proposal ②-②

JBIC Issues Thai Baht Bonds
~ First Asian Currency Bond Issue under ABMI ~

(Source：JBIC／Sep. 1, 2005, Sep.15, 2005)

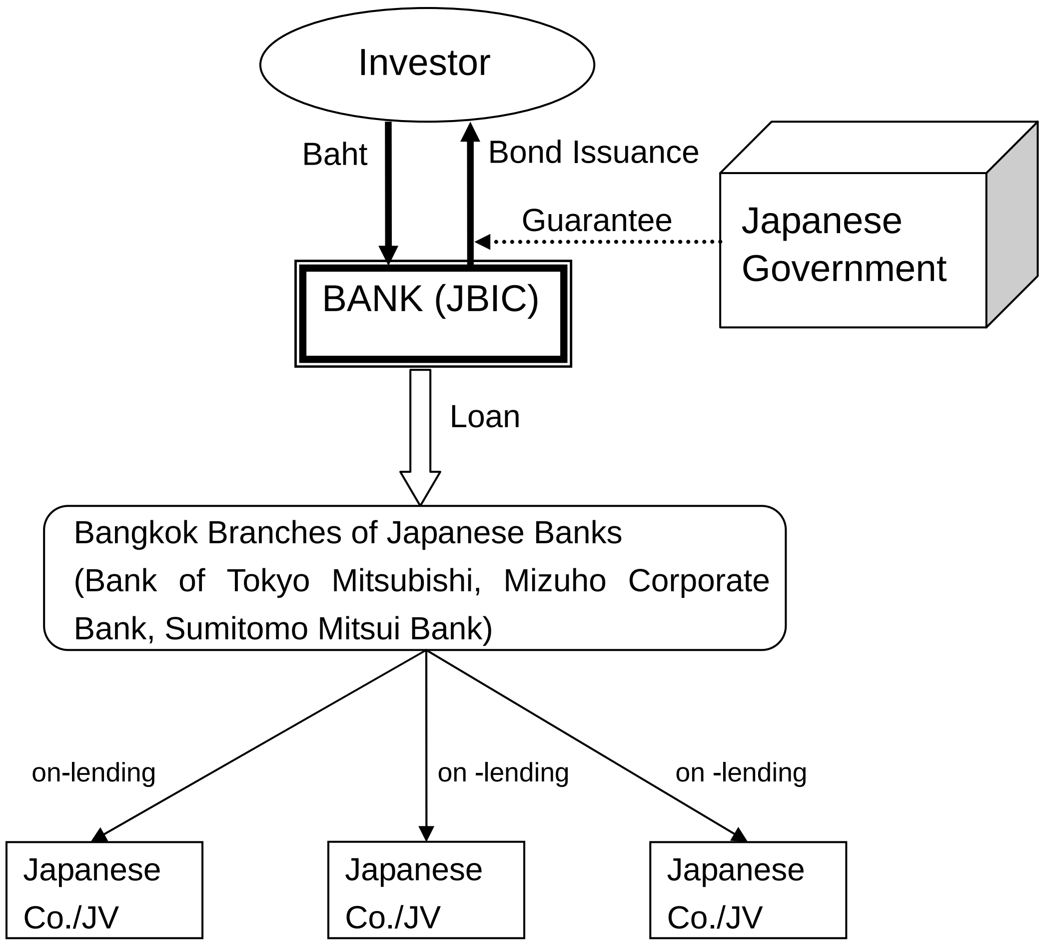
A. Summary of Issue

Amount	: 3.0 billion THB
Market	：Thai market
Maturity	：5 years (bullet repayment due on September 7, 2010)
Coupon Rate	：4.78%
Issue Price	：100%
Guarantor	：Government of Japan
Listing	：The Thai Bond Dealing Centre
Syndicate	: Citicorp Securities and Siam Commercial Bank (Lead Arrangers), Capital Nomura Securities and TISCO Securities (Co-Managers)

B. Significance

The baht bonds were issued under the Asian Bond Markets Initiative (ABMI) being promoted by the Japanese government under the framework of ASEAN+3 (Japan, China, Korea). This is the first Asian currency bond issuance undertaken by the Japanese issuer in line with the ABMI. This is the first Asian currency bond issuance by a foreign government or government agency in line with the ABMI.

The loan will provide baht funds for Japanese firms conducting business operation in Thailand to finance their capital investments and related long-term working capital through Bangkok branches of Japanese commercial banks. Among ASEAN member countries, Thailand is increasingly becoming home to manufacturing industry clusters. This cluster effect has increased the country’s presence as a production base. This has reaffirmed the importance of the country as a strategic base for Japanese firms seeking to enhance their global business development and such firms are increasing their investments in Thailand, in light of the economic partnership agreement (EAP) between Japan and Thailand and the progress being made toward a comprehensive economic partnership agreement between Japan and ASEAN. Thus local currency financing without exchange rate risk is expected to meet the extensive financial needs of local Japanese affiliates.



2.5 Proposal ③ Credit-Enhancement of Bonds Denominated in Indian Rupee (INR)

Since ratings are required for the issuance of INR denominated bond market, the majority of the bonds are offered through private placement. Local banks are presently restricted in their guarantee activity, but if such restrictions on guarantee are relaxed, this would enable the creation of a market for guaranteed bonds among local Indian banks, and the scope of issuers could be expanded to include small and medium size businesses. (Refer to APPENDIX for "List of INR-Denominated Bond Issuances")

On the other hand, when focusing on the bond issuance of Japanese companies that have established a presence in India, there are cases where such issuances can be accompanied by a guarantee provided by JBIC or insurance provided by Nippon Export and Investment Insurance (NEXI).

In other Asian countries, in 2004, Thailand witnessed the debut of ① JBIC Guaranteed Bonds and ② NEXI insured bonds. Due to the rarity of Japanese issues available, they were sold to local investors in Thailand.

Japanese companies who have set up operations overseas look to procuring funds in local currency from the point of view of avoiding exchange rate risk. In many cases, fund procurement by Japanese companies in Asia depends on loans from banks. If they are able to raise funds through the bond market, they will be able to diversify their methods of funding. In addition, funding through the bond market can be an effective way of preparing for emergency situations, such as the Asian currency risk.

However, even highly creditworthy foreign-affiliated companies are not necessarily well-recognized in local bond markets. Therefore, bond issuance often requires the guarantee and insurance coverage of the aforementioned two organizations, by which contribution to the invigoration of a country's bond market is also made possible.

Sections (1) and (2) below introduce press releases on the following: (1) "Summary of Issue" at time of issuance of Thai baht denominated bonds guaranteed by JBIC and the significance of such issuance and (2) "Summary of Issue" at time of issuance of Thai baht denominated bonds covered by NEXI's Overseas Untied Loan Insurance and the significance of such issuance.

In line with the advantageous points indicated above, by promoting bonds provided with JBIC's guarantee and NEXI's Overseas Untied Loan Insurance in the future, it would become possible to further revitalize the Indian bond market and at the same, to diversify the measures for funding of Japanese companies which have expanded overseas.

(1) Proposal ③-①

Guarantee for Baht-Denominated Bond Issued by Japanese Affiliate in Thailand
~ First Bond Issue Guarantee under the ABMI ~

(Source: JBIC/June 21, 2004)

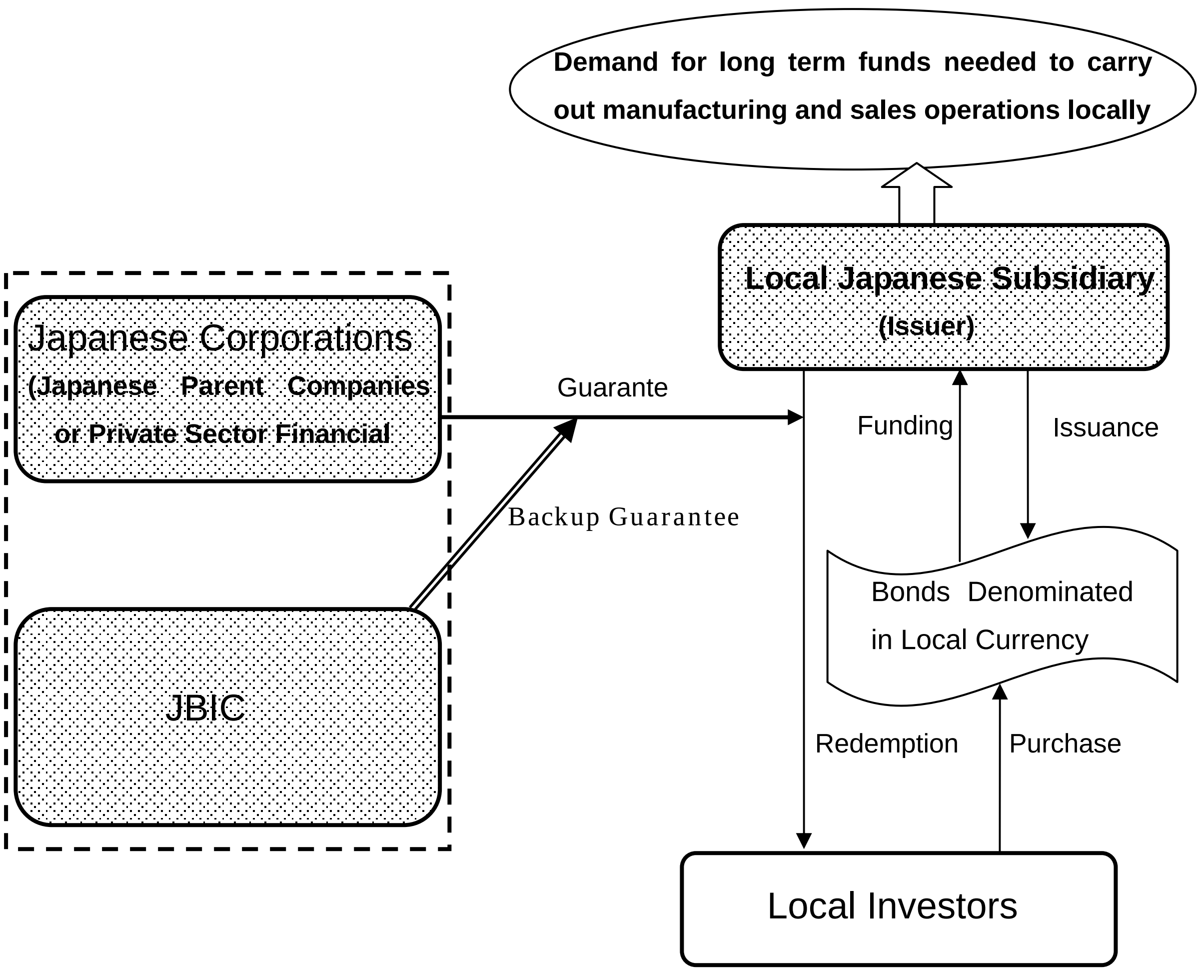
A. Summary of Issue

JBIC signed an agreement providing a guarantee for a baht-denominated debenture issued by TRI PETCH ISUZU SALES CO., LTD ("TIS"), a Thai joint venture of Mitsubishi Corporation and Isuzu Motors. Under this agreement, JBIC will provide a secondary guarantee on the principal amount for a primary guarantee on the principal and interest amount offered in a 3.5 billion-baht (equivalent to 10 billion yen) corporate debenture issue of TIS by Mitsubishi Corporation, one of TIS's parent companies. The funds raised from this issue will be used for manufacturing and sales Isuzu-brand pickup trucks in Thailand. This is the first debenture issue of TIS in the Thai capital market.

B. Significance

Japanese firms operating in Asian countries need to fund their business operations in local currencies to avoid exchange risks. However, their funding instruments are limited in many of these countries, as undeveloped securities markets make it difficult for them to issue local currency securities. Since even Japanese firms with good credit standing do not necessarily have high name recognition in local securities markets, there is a need for JBIC, a Japanese governmental financial agency, to complement their efficient bond issuances. To meet such needs of Japanese local firms operating in Asian countries, JBIC is supporting this firm in its efficient bond issuance in the local capital market by utilizing its guarantee facility.

The Government of Japan proposed the ABMI in December 2002. As part of efforts to advance ABMI, JBIC launched a new guarantee facility intended for local currency-denominated corporate bonds by Japanese firms operating locally. This is the first guarantee JBIC has provided through this facility.



(2) Proposal ③-②

Underwriting of Insurance for Bond Issuances in Local Currencies by Japanese Companies
~ First Instance of Assistance Based on ABMI ~

(Source: NEXI/April 8, 2004)

A. Summary of Issue

Type of Insurance	: Overseas Untied Loan (guarantee obligation) Insurance
Policyholder / Insured Party	: Mizuho Corporate Bank
Subject of Insurance	: Principal of JPY 2.7 billion + interest
Coverage Ratio	: Emergency risk 95%, Credit risk 95%
Period of Coverage	: 3 years
Issuer of Corporate Bond	: ISUZU (Thailand) Co., Ltd.
Financial Advisor	: TISCO Securities Co., Ltd.

B. Significance

Fund raising for Japanese corporations operating in Asia depend mostly on bank loans guaranteed by the parent company or remittance from the parent company. In these situations, when issue of bonds in local currency is facilitated, means for fund raising are diversified. As a result, even if the bank's liquidity declines, a company operating locally can raise funds. Also by enabling medium and long term fund raising in local currency, exchange risks in their business will be eliminated.

With insurance provided by NEXI to back bonds issued by Japanese companies in Asia, funding can be made easier for these Japanese companies and greater vitality can be brought to local investment. Accordingly, this move will contribute to the development of the Asian Bond Market Initiative.

2.6 Proposal ④ Credit-Enhanced Bonds Denominated in Foreign Currencies

India's commercial banks engage in short-term funding. Deposit maturity of banks in India as at 2004 is as follows. Within 1year:38%, 1-3years:34%, 3-5 years:20% and 5 years or more: 8%. For this reason, it is difficult to accommodate long-term fund needs, owing to Asset Liability Management (ALM)-related problems. This makes it natural to utilize the bond markets for such needs.

Although there are many foreign bond issuances including a 100-year bond by Reliance, generally the cap is 5 to 7 years. For the composition of long-term (10 years or more) or ultra-long-term bonds, it will be beneficial to issue credit-enhanced bonds with the credit enhancement of the World Bank, ADB, IFC and other international organizations, or JBIC and NEXI, in international bond markets with large investor bases, such as those for Samurai, global, and euro bonds.

Particularly in Japan, the need for long-term bonds, coupled with long-term low-interest-rate policy, is strong.

Actual cases of bond issuance employing credit enhancement include those in the Philippines featured in the table below.

【Table 13】Credit-Enhanced Bonds in the Philippines

	JBIC (Japan Bank for International Cooperation)	NEXI (Nippon Export and Investment Insurance)	ADB (Asian Development Bank)
Launch	June 2000	Dec. 2001	Dec. 2002
Issuer	Philippine National Oil Company –Energy Development Corporation (PNOC-EDC)	Republic of the Philippines	PSALM (Power Sector Assets & Liabilities Management Corp.)
Counter -Guarantor	Republic of the Philippines	-	Republic of the Philippines
Guarantor /Insurer	JBIC	NEXI Overseas United Loan Insurance	ADB
Type	Samurai Bond / Private Placement	Samurai Bond / Private Placement	Euro Yen Bond
Amount	JPY22bn	JPY50bn	JPY61.75bn (2-tranche) Tr. A) JPY24.75bn / Tr. B) JPY37bn
Tenor	10 year	10 year	Tr. A) 18 year / Tr. B) 20 year
Coupon	N.A	1.8845%	Tr. A) 3.2% at Re-offer Price 99.457 Tr. B) 3.55% at Re-offer Price 99.645
Arranger	Nomura / Mitsubishi -Tokyo	Mizuho (formerly Fuji)	Nomura
Cover Ratio	1) Principal: 100% 2) Interests: 100% for year 6-10 only	1) Political Risk: 97.5% of Principal & Interests 2) Commercial Risk: 90.0% of Principal & Interests	1) Principal: 100% 2) Interests: Tr. A) 100% for year 9-18 only Tr. B) 100% for year 11-20 only

Sections (1) and (2) below introduce press releases on the following: (1) "Summary of Issue" at time of issuance of Yen denominated bonds guaranteed by JBIC and the significance of such issuance and (2) "Summary of Issue" at time of issuance of Yen denominated bonds covered by NEXI's Overseas Untied Loan Insurance and the significance of such issuance.

By promoting bonds provided with guarantee by JBIC, ADB, and IFC and covered with NEXI's Overseas Untied Loan Insurance in the future, it would become possible to expand the base of investors, by raising the recognition of Indian banks and companies to overseas investors, including Japan, which in turn is expected to facilitate bond issuance henceforth.

(1) Proposal ④-①

JBIC Guarantees Private Placement Bonds by Philippine National Oil Company – Energy Development Corporation

~ First Bond Guarantee by JBIC ~

(Source: JBIC/June 15, 2000)

1. Main Features of the Bond Guaranteed by JBIC

(1)	Issuing Corporation	: Philippine National Oil Company - Energy Development Corporation ("PNOC-EDC") (See below for a profile of PNOC-EDC)
(2)	Guarantor	: The Government of the Republic of the Philippines (100% guarantee of principal and interest) and JBIC (See below for partial guarantee)
(3)	Lead Managers	: Nomura Securities Co., Ltd., Bank of Tokyo Mitsubishi Ltd., and Tokyo Mitsubishi Securities Co., Ltd.,
(4)	Place of Issue	: Tokyo
(5)	Purchaser	: Qualified Institutional Investors
(6)	Amount	: 22 billion yen
(7)	Use of Funds	: Funds necessary for PNOC-EDC's geothermal development projects to improve the geothermal heat recycling capacity and for environmental policy related issues
(8)	Maturity	: 10 years
(9)	Principal Redemption Method	: Lump sum redemption
(10)	Date of Signing	: June 15, 2000
(11)	Funding Date	: June 26, 2000 (scheduled)

2. Outline of JBIC's Guarantee

(1)	Guarantee Coverage	: Any non-payment of principal and interest from the Philippine Government-guaranteed bond (except for the interest for the first five years)
(2)	Effective Date of the Guarantee	: June 26, 2000 (scheduled)

3. Profile of the Bond Issuer

(1)	Company Name	: Philippine National Oil Company - Energy Development Corporation ("PNOC-EDC")
(2)	Date of Establishment	: March 1976
(3)	Business Operations	: Development of geothermal and other non-oil energy resources

B. Significance

This guarantee is extended under the framework of the second stage of the New Miyazawa Initiative, which aims to encourage the flow of private funds to Asian region. This is also the first guarantee of bonds provided by JBIC since the extension of guarantees to public bond offerings became a part of its international financial operations at the time of JBIC's establishment. The extension of this guarantee will support PNOC-EDC in procuring funds from the international capital markets and it is also expected to facilitate the recycling of long-term private sector funds and further revitalize the Tokyo bond market. Also, since the Philippines is promoting structural reform in the power sector under the auspices of multilateral institutions and JBIC, this project is important as it supports the diversification of domestic energy use.

(2) Proposal ④-②

Overseas Untied Loan Insurance Provided for Privately Placed Bonds Denominated in Japanese Yen Issued by the Government of the Republic of the Philippines

~ First instance of Overseas Untied Loan Insurance provided by NEXI for insuring bond issuance ~

(Source: NEXI / November 26, 2001)

A. Summary of Issue

(1) Lead Managers:
Fuji Bank (now Mizuho Corporate Bank) (Joint lead arranger and Coordinator)
Nomura Securities (Joint lead arranger)
Daiwa SMBC Securities (Co-arranger)

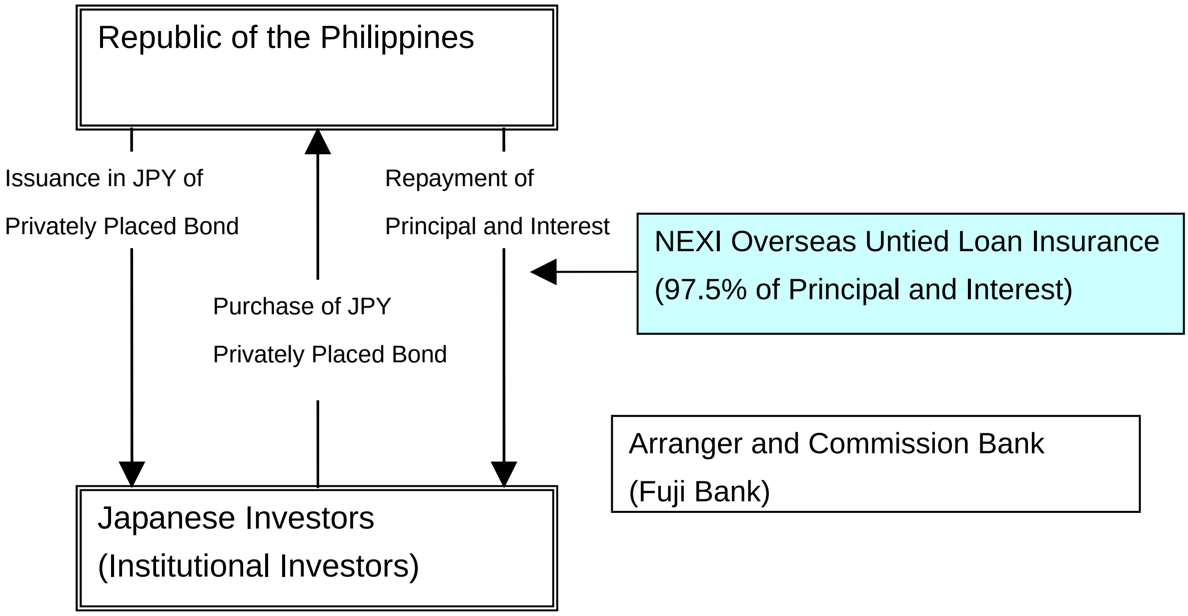
(2) Terms of Bond Issuance

Amount of Issue	: JPY 50.0 billion
Term	: 10 years
Interest Rate	: Fixed 1.8845%
Redemption	: Lump sum at maturity
Public vs. Private Offering	: Private placement to be limited to qualified institutional investors
Issuing Currency	: JPY

(3) Description of Insurance

Content of Insurance Policy	: Insurance for loan of a foreign business (loan claims, etc.)
Insured Value	: Principal of JPY 50 billion + interest
Scope of Coverage	: Emergencies and credit risk in Philippines
Percent Coverage	: Emergencies 97.5% : Credit 90.0%
Term of Insurance Coverage	: 10 years

＜Scheme Diagram＞



B. Significance

In a climate where investment into newly emerging markets and countries had slowed in response to the terrorist attacks in the US, NEXI facilitated the flow of private sector funds in Japan by providing insurance coverage for both emergencies and credit risk for the government of the Philippines. Also, for the Philippines, funding costs could be reduced by 3% relative to the funding costs for Samurai bonds issued by the Philippine Government. The funds were for the purpose of industrial infrastructure within the Philippines, and this action is expected to spur future trade and investment between Japan and the Philippines.

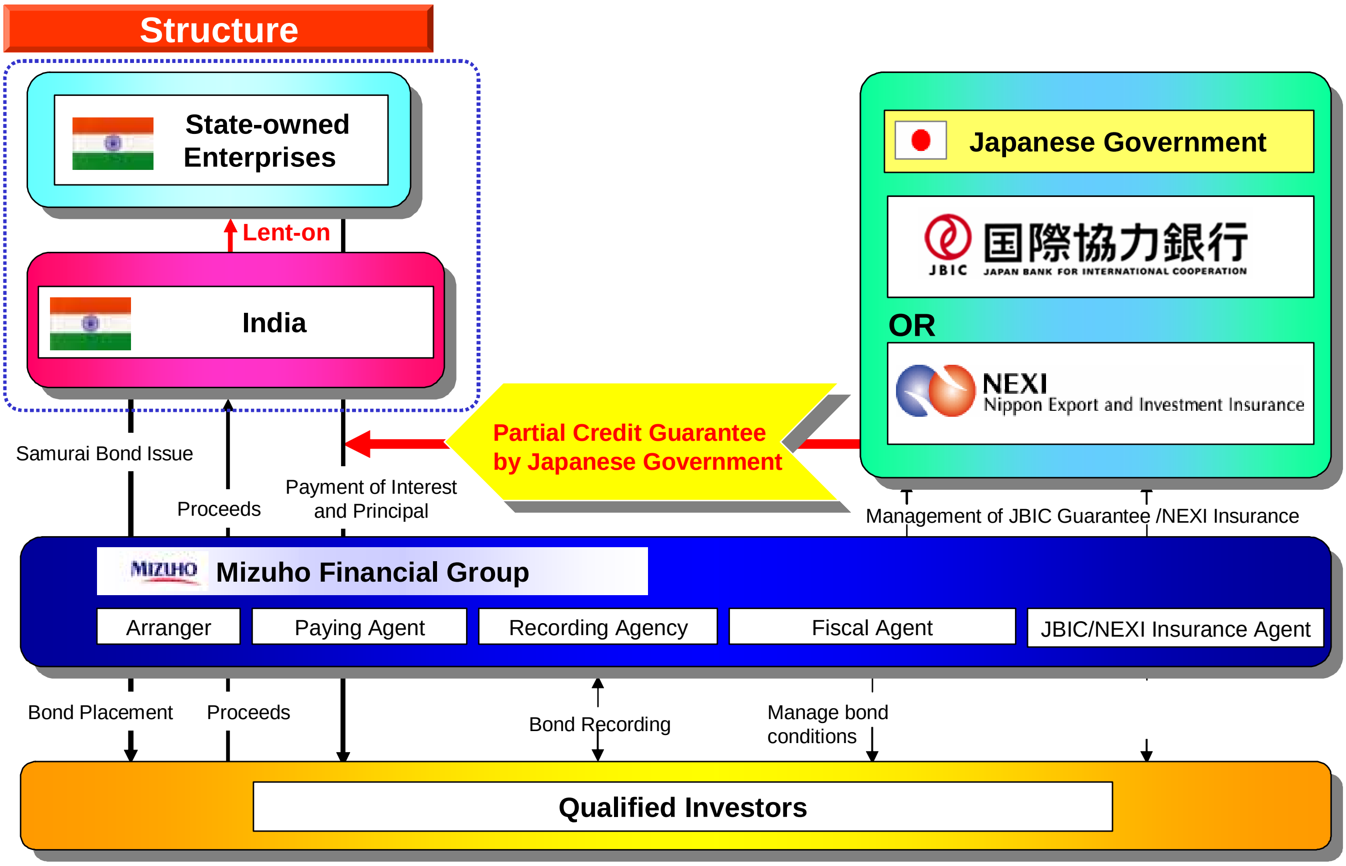
The funds raised through bond issue can be earmarked for the Philippine's domestic industrial infrastructure projects, such as for roads.

2.7 Proposal for Issuance of Indian Credit-Enhanced Bonds

Based on the above-mentioned case in the Philippines, it is proposed that long-term bonds enhanced by JBIC, NEXI or ADB credit be made available, although guarantee by the Government will also become essential. Tables 14 and 15 show how such structures work. There are deep-rooted investment needs of such bonds in Japan. Also, for the Indian side, even when guarantees fee payment is taken into consideration, such bonds would be a favorable means for long-term funding.

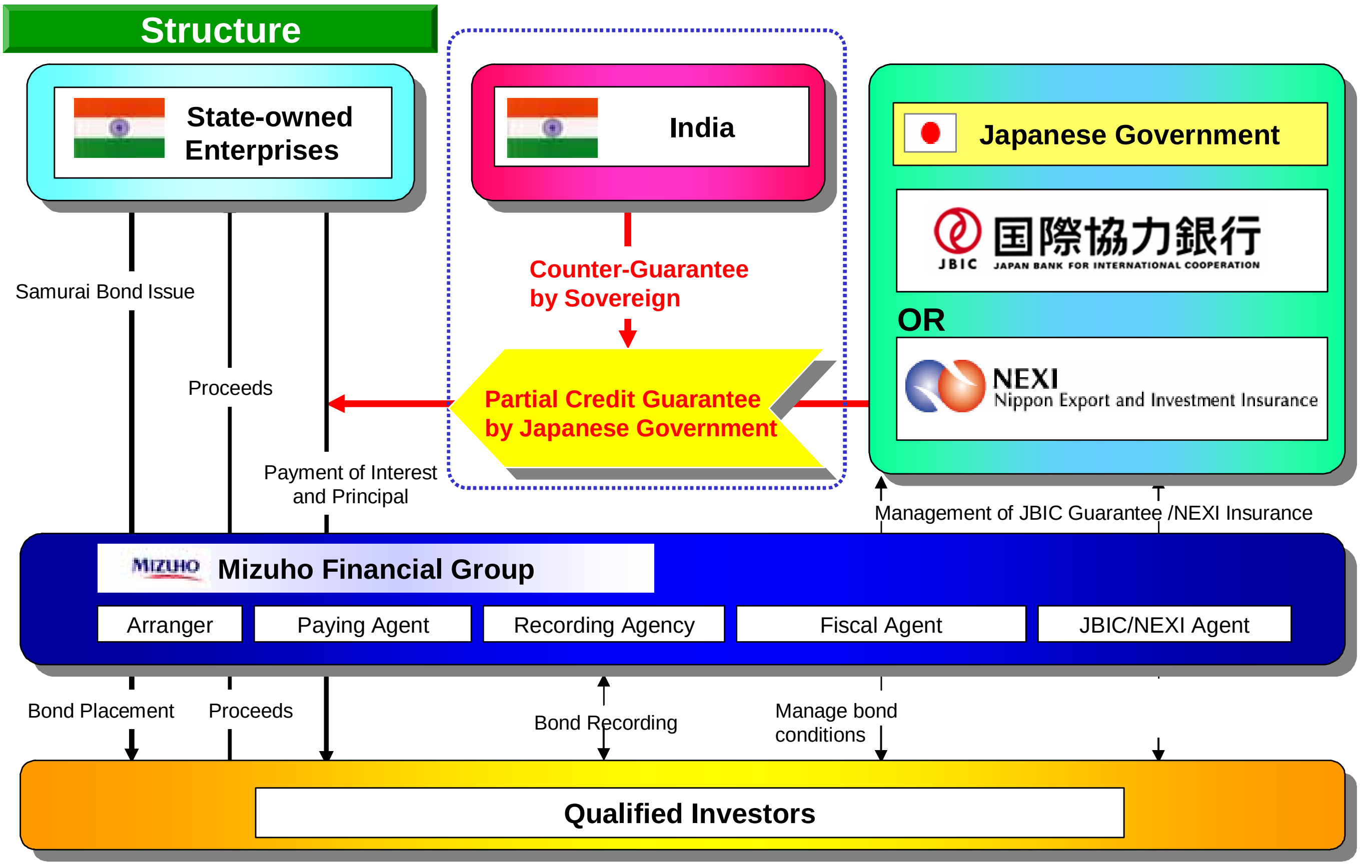
(1) A case in which the Indian government itself becomes the issuer of long-term bonds and on-lends to organizations requiring long-term funds.

【Table 14】



(2) A case in which the borrower becomes the issuer of long-term bonds and guarantee is provided by the Indian government.

【Table 15】



2.8 Summary

India has experienced brisk economic growth since introducing economic reforms in 1991. Real GDP growth rate for 2005 is expected to be posted at 8.1% and is expected to continue growing at around 8% from 2005 onward. Particular attention is being paid to India as member of the BRICs and fresh demand is expected for infrastructure and capital investment as India continues to experience sustainable economic development.

Given these conditions, when Prime Minister Koizumi visited India in April 2005, in the "Eight-fold Initiative for Strengthening Japan-India Global Partnership" signed with PM Manmohan Singh, a series of measures were agreed upon to expand and deepen economic and trade relations as well as cooperation between Japan and India. These measures are expected to help bring about fresh expansion and diversification of trade between the two countries.

On the other hand, the trend toward expansion of India-related business among Japanese companies is quite conspicuous, and in the report entitled "Survey of Expanding Overseas Business Operations by Japanese Manufacturing Companies" released by JBIC in 2005, India is also ranked second behind China as one of the leading countries in which to set up business operations over the medium and long term.

With such background, Japan will be able to contribute in many ways for revitalizing the Indian bond markets.[1] In this report, proposals for four products were attempted, which were ultimately organized as described below.

1. Support Indian issuers' foreign-bond issues, particularly Samurai bonds (Proposal 1)
   = Arrange additional Samurai bonds issued by India to expand Japanese institutional investors' investment in India.
2. Promote non-Indian issuers' bond issues denominated in local currency (Proposal 2)
   = Have international organizations issue INR-denominated bonds.
3. Promote Indian issuers' bond issues denominated in local currency (Proposal 3)
   = Have Japanese companies advancing into India issue INR-denominated bonds
   (Issue JBIC guaranteed bonds and NEXI guaranteed bonds covered by insurance).
4. Support Indian issuers' foreign-bond issues, particularly Euro-Yen bonds (Proposal 4)
   = Issue bonds guaranteed by JBIC, etc. for Indian issuers (particularly for long-term funding).

3. Financing and Bond Market Utilization for Infrastructure Development

3.1 India's Need for Funds for Infrastructure

As stated previously, for India's current government administration, the provision of infrastructure will be indispensable for its stable economic development. For that purpose, funds on the order of US$ 150 billion will be necessary over the next ten years. However, in addition to having a constant budget deficit, the government is limited in its fund raising owing to the Fiscal Responsibility and Budget Management Act (this law obligates the government to hold fiscal deficits within a specific rate of GDP).

For this reason, the development of the bond market is also crucial from the point of view of stable provision of private funds for India's long-term fund requirements for infrastructure.

3.2 Providing Funds for Infrastructure Projects in India

(1) Infrastructure Leasing & Financial Services

Infrastructure Leasing & Financial Services (IL&FS) was established in 1987 as the India's first financial institution to serve as a conduit for channeling funds for infrastructure projects. The first group of shareholders was comprised of the Central Bank of India, Unit Trust of India and Housing Development Finance Corp. Ltd. After the capital injection by International Finance Corporation, ORIX Corporation-Japan and others in 1993, IL&FS is presently a financial institution that is 60% owned by Indian financial institutions and 40% owned by foreign parties. As of the end of March 2005, after 20 years of operation, IL&FS maintains a capital account worth more than INR 7.3 billion, has asset size valued at INR 61.0 billion and is earning stable revenues. For investment in infrastructure projects, there are many cases where IL&FS has promoted the project as the core equity provider through its subsidiaries. IL&FS's investments have attracted funds from the private sector, especially from institutional investors. When selecting projects for investment, IL&FS's criteria is not whether

[1] Although it may be difficult at present, "utilization of Indian bond investment trust" can also be considered as one form of contribution in the future. Currently, marketing of Indian bond investment trust to Japanese investors poses difficulty based on the following reasons:
- Investor base is narrow since capital gain can not be anticipated, as with equities.
- Liquidity risk remains due to lack of liquidity.
- Difficulty of managing sufficient portfolio, since private bond market in India is still on a very small scale.

the financing from the central or regional governments would be available, but rather depends on whether the project can obtain funds from the private sector. Though it has been involved in many urban infrastructure projects such as airports, ports and subways, its capital base is simply too small to be the main provider of funds needed for infrastructure projects over the next ten years, estimated at US dollar 150 billion.

(2) Infrastructure Development Finance Company Limited

In addition to IF&FS, the Infrastructure Development Finance Company Limited (IDFC) was founded under the leadership of Indian Government in 1997. Within the Indian financial system, IDFC is classified as a Development Financial Institution. The role of a Development Financial Institution is to foster industries by involving in the management of business operations as one of the shareholders, as well as providing medium and long term funds. In many cases, the necessary funds originate from bonds issued with government guarantees or long term operating funds from the central bank. The present Finance Minister Chidambaram is said to have been a key advocate for the establishment of IDFC. In addition to the Finance Ministry of India being the largest shareholder with more than 20% ownership, its list of shareholders also includes names among Indian commercial banks, International Finance Corporation, Asian Development Bank, Government of Singapore Investment Corporation and Commonwealth Development Corporation. Its purpose for establishment overlaps in many ways with that of IL&FS, and it serves as a source of long term funds and offers advantageous guarantee facilities for infrastructure projects to fill gaps left by the government and private sector.

More than 80% of IDFC’s assets are lending to infrastructure projects and a relatively small sum of INR 2.2 billion is capital contributions. Broken down by sectors, 34% of this investment to infrastructure is to energy (primarily electric power), 27% into communications and 26% to transportation. Recently, in addition to these three sectors, there has also been a focus on real estate for commercial and factory use. Since its establishment, there was also a time when questions were raised about the “Identity” of IDFC because of the lack of any clear distinction between it and IL&FS and also because for a considerable time, the two institutions shared a common chairman. Specifically, there was strong criticism that IDFC was consistently cautious in its stance toward infrastructure projects, that significant amounts of time were required for it to make investment and lending decisions, that it lacked any dynamism, and that its primary merit for existing was to function merely as a think tank to provide advisory services. As a result, there has been very small percentage of bad assets and its finances are regarded as being in sound condition, i.e., as of the end of March 2005, its capital account stood at INR 18.9 billion, assets were INR 84.3 billion and it had an after-tax profit of INR 3.0 billion (ROE of 15.9%). Yet despite its soundness as an enterprise, IDFC has also received criticisms as being a “Brahmins of Infrastructure” in that it lacks the sense of mission and business approach which, ostensibly, is to be proactive in providing funds for infrastructure development. Accordingly, given the scope of its assets, and similar to IL&FS, it is difficult to imagine IDFC being a principal player in furnishing the large amounts of infrastructure finance that India will need in the future.

Thus, given this approach to infrastructure financing, the debate about the significance of establishing IDFC and the stronger control that the Finance Ministry would like to exercise over IDFC, there have been media reports of a merger between IDFC and IL&FS or having IDFC put under the control of a bank with close ties to the government such as the State Bank of India.

(3) India Infrastructure Finance Company Ltd.

While conjecture still flies around regarding the future of IDFC, in November 2005, the government of India decided to establish the India Infrastructure Finance Company Ltd. (IIFC) as a financial institution to be dedicated solely to providing new infrastructure financing[2]. The IIFC was formally established in January 2006, and although five of its directors from the government have been announced, the CEO appointment has yet to be decided. According to speech with the Minister of Information and Communications, the IIFC is planned to be 100% government owned with an initial paid up capital of INR 100 million that will later be increased to INR 10 billion. It will raise long term fund (10 years or longer) to provide financing for infrastructure projects. Borrowing is expected to be from bilateral or multilateral lending agencies such as the World Bank and Asian Development Bank as well as private sector banks both within India and outside the country. Where necessary, it will be backed by government guarantees. For FY 2005, the federal government established a guarantee line of INR 100 billion[3].

Both IDFC and IL&FS are strongly inclined to private businesses and their criteria for making investment and loan judgments are generally based on the cash flows of the projects concerned. On the other hand, it has been reported so far that IIFC is expected to be more oriented towards the lending policy that of public sector.

The following is a summary of the financing for infrastructure projects by the IIFC that have been announced thus far:

A. Financing will be limited to infrastructure projects that are commercially viable (including those projects which become viable after receiving Viability Gap Funding mentioned below).
B. The amount of financing provided by the IIFC is to be limited to a maximum of 20% of the project cost. If the government is to provide grants through VGF, the amount of such grants shall be first deducted and the IIFC's financing shall be 20% of the remaining balance.[4]
C. The IIFC may either conduct direct lending to infrastructure projects or on-lending through commercial banks.
D. In principle, the IIFC will not carry out independent appraisals and reviews of infrastructure projects, but rather, will depend on those prepared by the leading banks of the syndicate that handle the financing for such projects. However, this would be limited to cases where the level of commitment by the leading managing bank for a project is 25% or more of all debt financing.
E. The types of infrastructure projects for which the IIFC is expected to provide financing are as followings:
   (a) Roads, bridges, railways, seaports, airports inland waterway and other transport projects;
   (b) Power;
   (c) Urban transport, water supply, sewage, solid waste management and other physical infrastructure in urban areas;

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[2] IIFC was established on the assumption that it is to provide financing for infrastructure projects, not investment in equities.

[3] India's government officials are assuming that this guarantee quota by the government will be available over the next 10 years. The 10 years' amount is equivalent of US$ 30 billion, and accounts for 20% of the total of US$ 150 billion necessary to India over the next ten years as funds for building infrastructure and is consistent with IIFC's providing of financing with 20% of project cost as the upper limit.

[4] Comment from the officer in charge at Ministry of Finance, Department of Economic Affairs

(d) Gas pipelines;
(e) Infrastructure projects in Special Economic Zones; and
(f) International conference centres and other tourism infrastructure projects.

Up to the present time, the IIFC has not started full operations and there are no projects for which financing has been approved. Nevertheless, since it is a institution that is 100% government owned and established for the purpose of conducting long-term funding for infrastructure projects with government guarantee, a number of organizations such as the World Bank, ADB, JBIC and other members of the international financial industry, including some Japanese banks, are showing greater interest in providing funds to the IIFC, and some have even submitted proposals. Since the amount of financing by the IIFC in its first fiscal year alone is expected to exceed the asset size of both IL&FS and IDFC, the impact on infrastructure financing in India would be substantial. Financial Industry will closely monitor the activities of the IIFC as to what stance it will take toward infrastructure financing.

(4) Viability Gap Funding

Viability Gap Funding (VGF) is a measure proposed by the government of India around 2003 to promote India's Public Private Partnership in Infrastructure (PPP), and the general outline of this policy was announced in May 2005. The main objectives of VGF are to provide financial support to bridge the viability gap of the infrastructure projects undertaken through PPP by offering government grant. Such government grant, in principle, is to be limited to 20% of the project cost.[5] The government has set aside INR 15 billion for this purpose in the FY 2005 budget and INR5 billion in the FY 2006 budget respectively.

The following is a summary of the VGF announced by the India Ministry of Finance, Department of Economic Affairs:

A. While the normal course will be for the government to provide grants during the period of construction, exceptions will be permitted with the consent of a Committee (i.e., Empowered Committee) under the Chairmanship of the Secretary (Economic Affairs), and including Secretary Planning Commission, the Secretary (Expenditure) and the Secretary of the line ministry dealing with the subject.
B. Applications for funds under VGF will be approved by different organizations based on the amount, i.e., amounts less than INR 1 billion, amounts of INR 1~2 billion, and amounts of more than INR 2 billion.
C. In the first two years of operation of the VGF program, projects meeting the eligibility criteria will be funded on a first-come, first-served basis. In later years, if need arises, funding may be provided based on an appropriate formula, to be determined by the Empowered Committee, that balances needs across sectors in a manner that would make broad base the sectoral coverage and avoid pre-empting of funds by a few large projects.
D. Although the infrastructure projects for which VGF is expected to be available will be almost entirely the same as those for the IIFC, gas pipeline projects are not to be included.

Certain problems have been pointed out regarding VGF such as the fact that there is still lack of clarity regarding the criteria to be applied when making decisions to provide grants and the fact that the amount

5 If the main sponsor of a project is the government or a government organization, the sponsor at its discretion will be able to grant an additional amount of up to 20% of the project cost.

to be provided is extremely small relative to the amounts needed for India's infrastructure. As such, there are doubts about its actual effectiveness. There are many hurdles one has to face while implementing an infrastructure project in India, such as land acquisition, harassment by environmentalists and plethora of litigations in the name of public interest. With the creation of the VGF scheme, it may be fair to say that projects that have received visible assistance in the form of grants from the government would have a much greater ability to go forward, since they will be regarded as projects that have obtained strong support from the government.

3.3 Specific Product Proposals

In terms of ways to utilize the bond markets to procure funds for infrastructure, the following three products are conceivable as a result of investigating cases in India and other countries.

(1) Utilizing the bond markets as a method for funding through IIFC
(2) Utilizing the bond markets through securitization of existing projects (ABS)
(3) Utilizing the bond markets to repay existing project financing by issuing corporate bonds

Each product will be explored below.

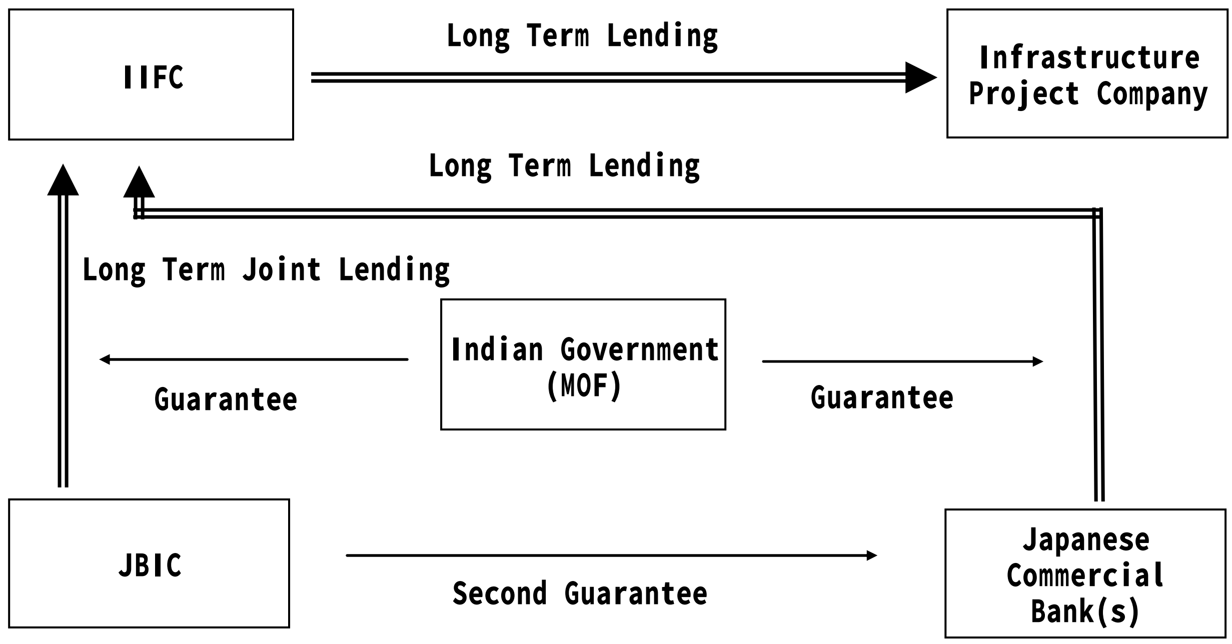
3.3.1 Utilizing the Bond Markets as a Method for Funding through IIFC (loans and bonds)

With government guarantees provided for IIFC's liability, financing should be done by exploiting its creditworthiness to the maximum in order to keep funding costs as low as possible. On-lending schemes for infrastructure projects will be in line with the purpose of IIFC's establishment. As mentioned previously, in terms of sources of funding, many variations are conceivable, including those involving the World Bank and ADB. Here, we would like to focus on product proposals with cases limited to those in which the participation of Japan's financial institutions would be possible.

A. Co-financing by JBIC and Commercial Banks

This scheme would involve having JBIC and commercial banks jointly lend long-term funds to IIFC, which IIFC would on-lend to infrastructure projects. The government of India would provide guarantees to JBIC and commercial banks for the total sum IIFC procures. JBIC would provide the commercial banks with a second guarantee for the portion they have loaned. At present, the general view on Indian risk among Japanese commercial banks is that although sovereign risk of up to 5 to 7 years can be taken, long-term lending exceeding 10 years for the purpose of providing infrastructure, which IIFC is hoping to raise, will require credit enhancement from export credit agencies such as JBIC. Reflecting this market view, in these product proposals, JBIC's guarantee of the portion loaned by commercial banks has been incorporated into the scheme. In the event that it is somehow difficult for JBIC to provide guarantees, as a modification of this product proposal, it would be possible to shorten the maturity of the portion loaned by commercial banks to 5 to 7 years and not commence repayment of loan from JBIC until said portion has been redeemed. In order for JBIC to advance loans to IIFC and also to provide guarantee for IIFC's payment to commercial banks, the involvement of the Japanese government and Japanese corporations in some form (Japan interest) in the aforementioned infrastructure projects will be essential.

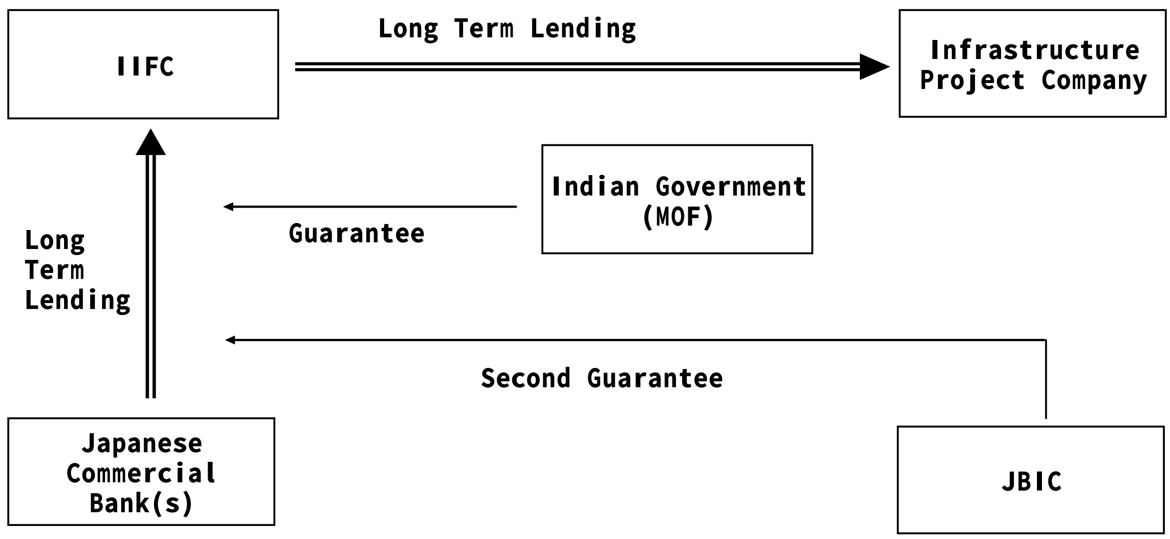
A, Long-Term Joint Lending by JBIC and Japanese Commercial Bank(s)



B. Joint Lending by Private Banks with the Joint Guarantee of JBIC and the Indian Government

Although this scheme is similar to Scheme A, financing to IIFC would be done by joint lending through commercial banks with the guarantee of the Indian government. JBIC's function would be to provide commercial banks with a second guarantee (in this case, with a ceiling at 97.5% of the amount of the commercial banks' loans). The difference between B and A, described above, would be the difference in the extent of JBIC's involvement in the relevant cases.

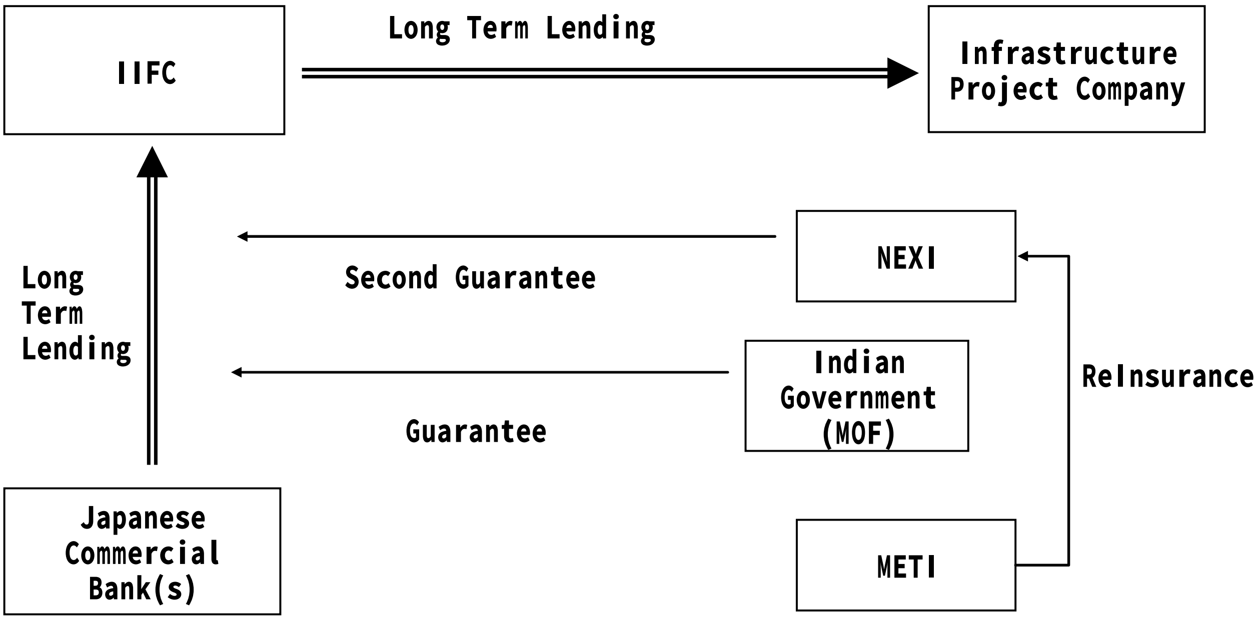
B, Long-Term Joint Lending by Japanese Commercial Bank(s) Guaranteed by JBIC



C. Lending with Overseas Untied Loan Insurance (OULI) from Nippon Export and Investment Insurance (NEXI)

This option is the same as B in terms of commercial banks making long-term loans to IIFC with the Indian government's guarantee, but instead of JBIC's second guarantee, it would be assumed that NEXI would provide OULI. OULI divides the causes of borrowers going into default in terms of emergency risk (restrictions on or prohibition of currency trading; war, revolution, or civil war; etc.) and credit risk (borrower's bankruptcy or delay in fulfilling obligations by 3 months or more). As a rule, this system provides 100% coverage of the amount of loans in the former case and 95% in the latter case.

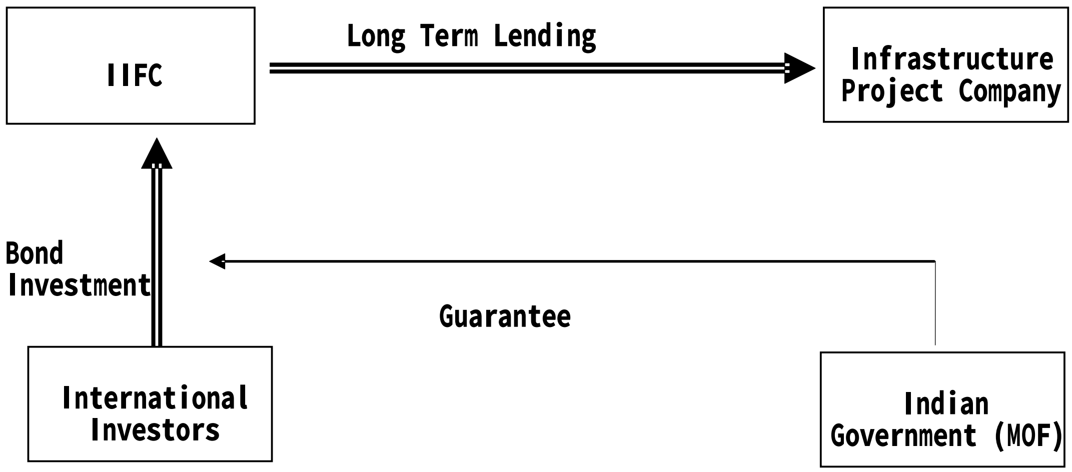
C, Long-Term Joint Lending by Japanese Commercial Bank(s) with Overseas Untied Loan Insurance by NEXI



D. IIFC's Issuance of Bonds Guaranteed by Indian Government in the International Bond Market

In the case of funding in the capital market, it is conceivable that IIFC will engage in long-term fund procurement in the Euro or Global bond markets with the government's guarantee. With the guarantee from the Indian government (long-term sovereign rating: Moody's Baa3; S&P BB+), IIFC should be given the same credit rating as the government. India's considerable economic growth and attention worldwide, and the fact that there has not been any issue by the government nor any government agencies, it is highly possible that IIFC's issue will attract attention because if its scarcity. Therefore, a bond issue even in excess of 10 years may be possible. As project completion time and anticipated cash flows will be reflected to a certain extent in repayment, it would also be meaningful to have tranches layered and issue bonds with different maturities, such as 5, 7 and 10 years.

D. **International Bond Issuance by IIFC Guaranteed by Indian Government**

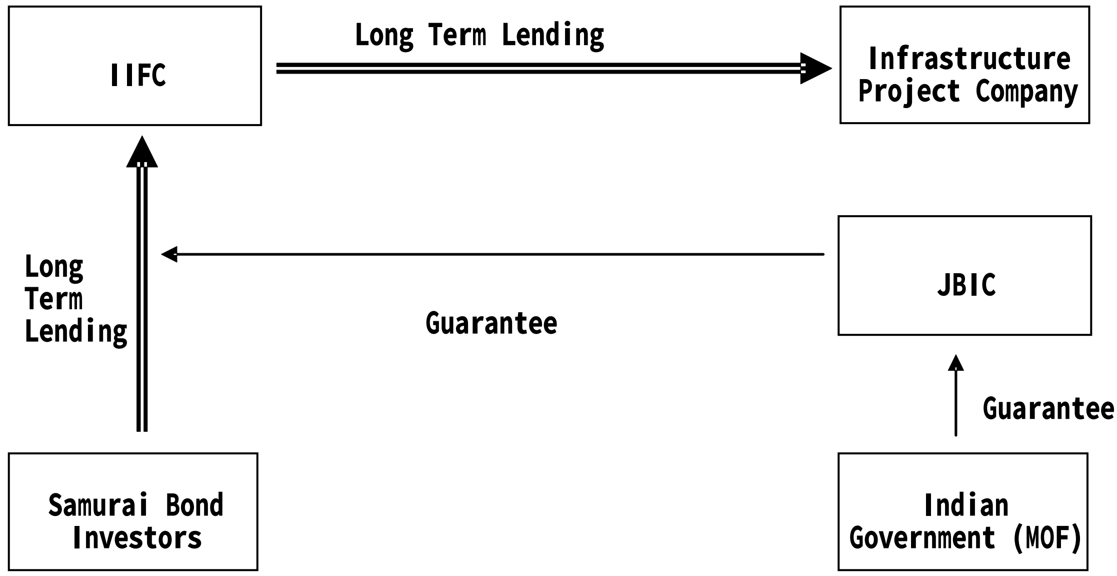


E. Samurai Bond Issuance (Guaranteed by JBIC) in Japan's Capital Market

Over the past few years, non-Japanese issuers' issuance of yen-denominated (Samurai) bonds in Japan's capital markets has shown sound growth, going from 25 cases of such issuance and the amount raised of ¥624.5 billion in 2002 to 49 cases and ¥1.789 trillion of amount raised in 2005. As a peculiar phenomenon in Japanese domestic corporate-bond market, relations between issuers' credit ratings and the credit spreads paid are becoming distorted. Risk-return relation may not necessarily be on an appropriate level. At the same time, for Samurai bonds issued by non-Japanese issuers, appropriate credit spreads are paid in line with the international market, based on the principle of fair risk, fair return. This is said to be one of the factors for the increase of Samurai bond issuance. In addition, because of the narrowing of the dollar-yen swap basis, when issuers swap funds procured in yen for US dollars, the market environment makes it possible to bring the post-swap, US dollar-basis funding cost to attractive levels. Coupled with this fact, the Samurai bond market has grown from one centering on issuers whose creditworthiness was somewhat of a concern, as in the second half of the 90s, to one in which numerous issuers over wide range of credit spectrum, including highly rated issuers to high yield issuers to participate.

With fund procurement through Samurai bonds from IIFC envisioned, the general view by Japanese investors that there is some concern on India's long-term risk in excess of 10 years, makes JBIC's guarantee necessary. As in cases A and B, if funding through Samurai bonds were limited to a medium term of 5 to 7 years, bond issuance would be possible with the guarantee of the Indian government alone.

E. **Samurai Bond Issuance by IIFC Guaranteed by JBIC**



[Reference Materials]

IL&FS Website
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The Japan Center for International Finance, Report
Financial Express, 2005.11.7
Businessworld

3.3.2 Utilizing the Bond Markets through Securitization (ABS) of Existing Projects

Investment for the construction of infrastructure necessitates major fund procurement and generally involves long-term payback period. With infrastructure projects, which are constructed by means of government investment and loans, funds can not be recovered for a long time after such projects have been completed and this makes it inevitable for such investment to become fixated.

If the operating revenue generated by infrastructure following construction can be securitized and private funds procured by using it as collateral, the funds from government investment and loans invested in the construction of said infrastructure can be recovered and new infrastructure investment implemented.

When private investors look into investing in infrastructure projects still in the planning or construction stage, they must prudently judge not only completion risk but whether the public nature of the project as social infrastructure will be maintained following completion and into the future. They must also determine the extent to which events could affect the creditworthiness of fund procurement entities. Moreover, consideration must be given to the fact that from the perspective of public interest, the essential profitability of social infrastructure projects tends to be low.

Even when government credit is granted, fund procurement from the private sector for investment in infrastructure projects prior to the operation stage could involve increased funding costs, accelerated funding timeframes and limited sums.

In comparison, for social infrastructure projects for which a set operating time has passed, it is possible to provide private investors with data on operability and profitability. It will also become somewhat easier to determine project continuity and the accompanying future profitability.

Specifically, a government can invest 100% to establish a new special purpose company (SPC) that will issue bonds ("SPC bonds") to be sold to private investors. With SPC bond issue proceeds, the government can recover the government funds invested in the infrastructure projects concerned. Correspondingly, the fees that users of government-owned toll roads, bridges, tunnels and other target public facilities have conventionally paid to the government will be applied to SPC bond principal and interest payment funds.

With the government issuing bonds that securitize the right retained by the government to receive fees (government bonds) and having the SPC hold them, the SPC bond principal and interest payments can be secured for private investors who have bought SPC bonds. SPC bond issue proceeds will be applied for the SPC's purchase of government bonds. In other words, this means that the government has procured new funds from private investors who have purchased SPC bonds. Such private funds concerned can thus be applied to other infrastructure investment and loans.

Furthermore, in setting up the above scheme, rules must be organized to regulate the systems for managing deposits made to SPC accounts as infrastructure usage-fees, the cost burden in cases when additional capital expenditure becomes necessary or when any change has been made, such as usage-fee rates.

One case that can be cited in which such a scheme was applied and private funds were procured through the securitization of existing infrastructure projects was for the Cross-Harbour Tunnel, a transit facility between the Kowloon area and Hong Kong Island. This project is one of six infrastructure projects that the Hong Kong government has securitized. With toll revenues as collateral, bonds were issued through Hong Kong Link 2004 Limited and sold to private investors. Such case is introduced below.

"Hong Kong Link 2004 Limited" Schematic Overview

【Hong Kong Link 2004 Limited（Issuer）】

Being a special purpose company (SPC) established through the government of Hong Kong's 100% investment, this SPC will issue SPC bonds for institutional and personal investors ("notes" for the former; "retails bonds" for the latter). These SPC bonds will be secured with toll revenue bonds that securitize the right to receive revenues pertaining to infrastructure projects (net toll revenues).

【Toll Revenue Bond】

By purchasing from the government of Hong Kong and holding the toll revenue bonds that the government issues, the SPC will retain the right to receive the sum of money equal to the net toll revenues of the target infrastructure project. It should be noted that future funds for major capital expenditure (CAPEX) for the relevant infrastructure project will be funded separately by the government of Hong Kong and shall not be paid out of the "net toll revenues."

【Tolled Facilities 】

All of these six transport infrastructure facilities retained by the government of Hong Kong demonstrated solid business results within a reasonable period after they began operating. Setting up of scheme targeting multiple key infrastructure facilities enabled the decentralization of operation risk.

（Units: km, HK$, & no. of vehicles/day）

	Began operating	Distance	Toll	Traffic volume
Aberdeed Tunnel	1982	1.9	5	57,000
Cross-Harbour Tunnel	1972	1.9	8~30	120,000
Lion Rock Tunnel	1967/1978	1.4	8	88,000
Shing Mun Tunnels	1990	2.6	5	53,000
Tseung Kwan O Tunnel	1990	0.9	3	65,000
Lantau Link(Bridge)	1997	4.1	20~80	41,000

【Notes and Retail Bonds】

The SPC issues bonds (SPC bonds) targeting institutional investors and personal investors. From the bond issue proceeds, the SPC purchases and holds the "toll revenue bonds" issued by the government of Hong Kong. "Net toll revenues" are appropriated to the bond principal and interest payment funds made to institutional investors and private investors.

Retail Tranche

Total value of issue: HK $2,470M (Units: year, HK$ 1 million, & %）

Tranche	Period	Value of issue	Coupon (spread)	Investment yield
A	3	880	2.75(45bp)	3.180
B	5	800	3.60(60bp)	4.128
C	7	790	4.28(75bp)	4.803

Institutional Tranche

Total value of issue: HK $3,530M (Units: year, HK$ 1 million, & %）

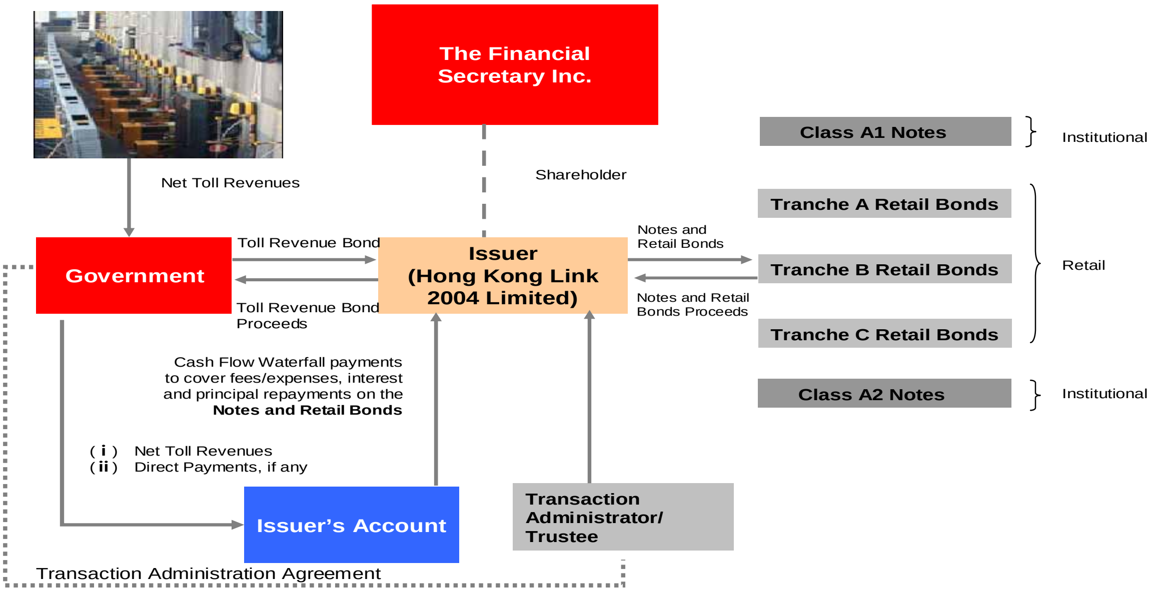
Tranche	Period	Value of issue	Coupon (spread)	Investment yield
A1	1	450	1.19(4bp)	NA
A2	12	3,080	3month Hibor＋36bp	NA

Note: Coupon (spread) figures are estimates. A2 redemption is with amortization. Bond coupon rate will be reviewed after six years. At the same time, the issuer (SPC) will have the right to call and bonds can be redeemed from the sixth year on until final maturity. Assumed average life: 3.4 years.

The total value of the call for purchase from institutional investors and personal investors substantially exceeded estimated issuance, and sales status was highly favorable. A1 institutional tranche placement was on the order of 32% for the central bank, 17% for commercial banks, and 17% for pension funds and insurance companies, while 90% of A2 tranche was for commercial banks.

Along with being the first case of transit facility securitization in Asia, this scheme amounted to the largest scale of securitization project for Hong Kong.

With securitization of well-performing existing projects, as explained above, it will also be possible for India to consider on-lending funds to other projects.



[Reference Materials]
IFR No. 1531, IFR No.1532
Hong Kong Link 2004 Limited Web(www.hklink2004.com.hk)

3.3.3 Utilizing the Bond Markets to Repay Existing Project Financing by Issuing Corporate Bonds

"Project financing" will be interpreted as follows: a method for financing a specific project in which resources for the interest payments on and the repayment of those finances are limited to the cash flow generated by the relevant project, with the assets of said project relied upon entirely as the collateral for said financing.

In addition, the function of project financing shall be to make rational risk allocation among the parties concerned possible by segregating only the project, as a SPC, from the sponsor entity and stipulating all related rights in individual contracts between the SPC and the parties concerned.

For this purpose, it will be explained to banks and other creditors that (i) while they take a high risk in providing non-recourse or limited recourse loans, (ii) risk allocation will be rationalized by collateralizing all assets of the project.[6]

[6] *Corpus Juris Finance*

When risk is taken on prior to a project's completion, the borrowing rate will be higher for the part of the risk equivalent to whether the project will be completed or not. For social infrastructure projects for which a set period of operation has elapsed since completion, data on operability and profitability can be provided. In addition, because project continuity and accompanying future profitability can be readily judged to a certain extent, the high borrowing rate at time of the initial borrowing can sometimes be mitigated through refinancing.

In general, refinancing of project loans is done by means of additional project loans (with rates lower than the initial one). In Thailand, however, corporate bonds are sometimes issued for refinancing.

Cases in which refinancing through corporate bonds is possible are special ones in which contracts have been entered so that the risk can be regarded as sovereign, such as when the project's product is electric power and the other party to the sales contract is an electric power corporation which is wholly owned by the Government.

In terms of the period for issuing corporate bonds and repayment methods, various arrangements can be introduced such as layering of tranches in light of the project's cash flow prospects.

Even with project financing in India, as in cases like Thailand in which a project that prospers following completion can be regarded as a sovereign risk, refinancing through corporate bond issuance is possible. This could simultaneously expand the investor base, reduce interest on infrastructure funds and vitalize the bond markets

4. Methods for Japan's Cooperation

An overview of India's corporate-bond market would first reveal that the outstanding balance is extremely low in terms of ratio to GDP. Next, concerning secondary markets, stamp tax is levied against each trade. In addition, clearing systems are underdeveloped. These are issues that remain. For those who participate in the market, the life insurers and mutual funds limits on investing in corporate bonds is imposed, making such corporate bonds unattractive as investment vehicles. As long as this current state of the bond market prevails, it will be difficult to expect the corporate bond markets to function as the major supplier of funds for infrastructure investment.

So far, financial systems, whose role is to act as the financial intermediary, have depended heavily on banks and on the classic method of taking deposits and providing loans. However, keeping in pace with the growth of the Indian economy and manufacturing industry, funding demand from the manufacturing industry would increase. With the banks' credit-deposit ratio reaching a low of 49.9% in 1998 and then rising to 68.1% by 2005; in future, bank lending could become stringent.

It is natural to turn to the domestic bond market for long-term funds for infrastructure investment. Even among India's financial experts, efforts are underway geared to attracting life insurance, pension funds and private funds to the corporate bond markets. In particular, the modernization of settlement systems, the provision of trustee systems that operate from the perspective of protecting the bond holder's rights especially in the event of defaults and debt collection systems are some of the issues which need to be addressed.

Now, we would like to consider what Japan can do to supply funds for infrastructure development, with special focus on private banks, government-run financial institutions, such as JBIC and NEXI, and securities companies.

4.1 Private Banks: Long-Term Lending for IIFC

Japanese leading private banks and major regional banks have nearly completed the lengthy process of writing off bad assets. As a result, banks can be more positive about providing new financing. They are particularly interested in new lending to overseas borrowers. Despite India's considerable economic growth, Japanese banks have had little involvement with its major financing projects up until now. Major growth in financing from Japanese banks will thus be possible henceforth.[7] Under the Japan-India Tax Treaty, when banks make direct loans from Japan, 10% withholding tax would be charged on interest. However, for the forthcoming loans from Japanese banks to IIFC, an exemption of the withholding tax rate is thought to be indispensable. In addition, when Japanese banks with branches in India make loans for IIFC from their branches in India, they must conform to local regulations such as single and group exposure limits. However, in view of the purpose of establishing IIFC and in consideration of the huge sums required for projects, measures that would ease the limits on single and group exposure would be desirable, at the very least.

4.2Guarantees from JBIC and NEXI

In expectation of providing a complementary function to private banks, it would be desirable to have government-affiliated financial institutions such as JBIC and NEXI to provide guarantees to mitigate long-term investment risks to India that would be difficult for private banks to undertake. In particular, when IIFC engages in long-term funding, both parties would shoulder the sovereign risk for India over the long term that it is difficult for Japanese private bank to undertake. If guarantees were provided for loans to IIFC exceeding 5 to 7 years, private banks would be able to make active efforts in terms of loans for India's infrastructure projects.

Similar efforts would also be possible in case of IIFC's issuance of yen-denominated bonds in Japanese capital markets. If IIFC were to issue long-term (10-year) bonds in Japan, the existence of JBIC and NEXI's credit enhancement will be the key to the successful placement to Japanese investors.

4.3 Securities Companies Functioning as Intermediaries

Envisioning that IIFC procures funds in capital markets with the Indian government's guarantees, mention should be made on securities companies fulfilling the intermediary functions of bond underwriting and sale. In case of Euro or Global bonds, even with maturities exceeding 10 years, as long as the bond issued by IIFC is carrying the guarantee from the Indian government, they should be able to attract interest from a wide range of international investors. In the international markets, if bonds issued were indexed by credit rating with pricing done in line with spreads that should be paid,

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[7] Japan's domestic banks purchased about 1/3 of the sum of the Export-Import Bank of India's Samurai bond issuance of February 2006.

they should be basically acceptable to investors.

On the other hand, for many investors in Japan, the criteria for judging whether or not bonds are attractive investment products, do not necessarily have a direct link to whether a fair level of return is procured in return to the risk that is undertaken by the investors. In Japan, whether the issuer is rated BBB or above is a major factor. If IIFC were to issue a Samurai bond with the Indian government's guarantee, we anticipate that wide acceptance by the investors may only be up to 7 years' maturity. On the other hand, for Japanese issuers, acquiring a BBB or above, will make it possible to procure funds at low cost that may not be possible in the international market. This means that if a Japanese issuer were down graded to below BBB, financing in the bond market will be difficult. Such distortions evident in Japanese bond markets are expected to be corrected somewhat through the briskness by which recent issues of Samurai bonds have been increasing.

Securities companies acting as intermediaries in Japanese financial market should make efforts to foster an environment where issuers with a rating lower than BBB could raise fund as long as spreads reflecting the issuer's credit standing is paid. While continuing to maintain close connections with issuers, providing opportunities in the form of road shows and giving investors detailed company overviews are considered to be necessary efforts.

4.4 Conclusion

Although the scale of India's bond market, and particularly its private bond market, is extremely small, bond market vitalization will be indispensable for procuring long-term funds from the private sector including infrastructure-related funds.

As presented in this report, countries in Asia have been aiming to vitalize their bond markets through the cooperation of international organizations and Japan's government-affiliated financial institutions.

In India, efforts to expand the investor base through the gradual improvement of bond-market systems and active composition of projects, in which private financial institutions can also engage in investments and loans, will likely be the most crucial element in vitalizing the bond market henceforth.

The enlightenment of issuers and investors through international organizations mentioned in this report and through the issuance of bonds with the credit enhancement of international organizations would likely be an apt beginning. If the products are appropriate, as demonstrated by the success of EXIM Bank's issuance of Samurai bonds, Japanese investors will be more than ready to accept such products.

APPENDIX

Proposal ① Export-Import Bank's ("EXIM Bank") Samurai Bond
(Comments made by Mizuho Securities)

*Having repeatedly investigated whether domestic institutional investors' funds could be channeled to India through Samurai bonds, in October 2004, Mizuho Securities hosted a non-deal road show in Tokyo for the ICICI Bank, which is listed on the NSE. Meanwhile, with investors inclined to resume investment in India through Sovereign issue, the EXIM Bank's non-deal road show was held in August 2005.

Thereafter, references of India were introduced in research reports and relevant informational activities were held for domestic investors, leading to the bank's long-awaited first Samurai bond six months later when Mizuho Securities served as lead manager.

*Briefing sessions held for investors in Japan, without presenting specific cases.
The briefing session for investors on February 7, 2006 was also attended by Ambassador Tripathi and Minister Thakur (Economic & Commercial) from The Embassy of India, and the favorable state of India's economy was explained to domestic institutional investors.

At the social gathering following the briefing session for investors on February 7, guest speaker Eisuke Sakakibara, former Vice Minister of Finance for International Affairs and currently a professor at Keio University, commented, "With India, the interest for investment trust seems somewhat overheated, but it is significant for Japan's investors to have various opportunities to invest in India, including EXIM Bank's Samurai bond."

Proposal ②-①（Comments made by ADB）

ADB Issues Indian Rupee Bonds

MANILA, PHILIPPINES (February 27, 2004) - The Asian Development Bank (ADB) issued today its debut Indian rupee (INR) bonds in the domestic capital market of India. The issue has a principal amount of INR 5 billion and a bullet maturity of 10 years. The lead arrangers of the issue were HSBC and ICICI Securities, with Bank of India and Union Bank of India participating in the syndicate as co-arrangers.

Priced at par, ADB's rupee bonds carry a semiannual coupon of 5.4% per annum to yield 17 basis points over the 7.37% Indian G-Sec due April 2014. Before launching the issue, ADB and the lead arrangers conducted an extensive road show to present the deal to key institutional investors in Mumbai, New Delhi, and Kolkata.

Offered through a bookbuilding process, the issue generated strong demand with total bids amounting to over INR10 billion or double the issue amount. The issue achieved a broad distribution with up to 60% of the bonds placed with banks, 21% with insurance companies, and 19% with mutual funds. The bonds will be listed on the National Stock Exchange.

ADB's rupee bond issue represents many firsts in the Indian capital market: first issue by a foreign entity, first supranational issue, and first issue rated triple-A by Fitch, Moody's and Standard & Poors. Just as importantly, the issue also marks the first time that ADB has tapped the domestic bond market of a developing member country. ADB Vice President Liqun Jin said, "This pioneering transaction will enable ADB to accomplish a key developmental goal. ADB will be able to offer private sector borrowers in Indian rupee loans for projects in need of long-term local currency financing. These rupee loans provide the most effective protection against exchange rate risk, particularly as most ADB-financed projects generate revenues in local currency. In 2003, ADB's local currency lending in India totalled about INR 5 billion for 3 private sectors projects in priority sectors such as infrastructure, health care, and housing finance".

The bond issue underscores ADB's confidence in the Indian capital market. This, together with the new standards created through this issue in respect of regulatory framework, documentation, disclosure, clearing and settlement, and pricing benchmark, will facilitate issuance by other foreign borrowers. In addition, the issue would help enhance liquidity in the domestic swap market, particularly as ADB plans to undertake interest rate swap transaction for asset and liability management purposes.

Thierry de Longuemar, ADB Treasurer, said "The issue is the first step in ADB's strategy to tap the domestic bond markets of its developing member countries. ADB will consider issuing other local currency bonds particularly in those developing member countries where the bond markets are sufficiently developed and suitable projects with local currency financing needs can be identified.

Proposal ②-②（Comments made by JBIC）

1) On August 30, Japan Bank for International Cooperation (JBIC) held a signing in Bangkok for a baht-denominated fixed-rate bond guaranteed by the Japanese government.

2) The issue of this baht-denominated bond was based on ABMI that the Japanese government is promoting within the ASEAN+3 (Japan, China and Korea) framework. The Japanese issue will be the first bond issue denominated in an Asian currency in line with the same concept. Concerning the bond issuance of non-Thai issuers in the Thai market, in May of last year, the Thai government presented guidelines, based on ABMI, to make it possible for foreign governments and their financial institutions to obtain permission individually to issue bonds. In keeping, JBIC has consulted closely with Thailand to acquire permission in July of this year for the issue of baht-denominated bond and has advanced preparations in kind. It has issued the bond under this time frame, based on the market environment. The issuing of this bond represents the first time for a foreign government or its financial institution to issue a bond denominated in Asian currency in line with ABMI.

3) Baht-funds procured through the issue of this bond will be granted to Japanese companies conducting business in Thailand through the branches of Japanese financial institutions in Bangkok（Mizuho Corporate Bank, Bank of Tokyo-Mitsubishi and Sumitomo Mitsui Banking Corporation）for capital expenditure and long-term operating funds. Among ASEAN countries, manufacturing industries continue to concentrate in Thailand. With the country's increasing presence as a manufacturing base, Japanese companies are actively investing in Thailand once again, based on the Free Trade Agreement between Japan and Thailand and the progress of the ASEAN-Japan Comprehensive Economic Partnership, as a strategic base for global business expansion. By making financing possible in local currency, with no exchange risk, it is expected that a wide range of fund needs of local Japanese companies will be satisfied

4) Through the issuing of bonds denominated in Asian currency, JBIC views the following as crucial issues; (i) the supporting of the development of the bond market in ASEAN countries, China and Korea, within the ABMI framework, and (ii) the flexible accommodation of the diversifying fund needs of Japanese companies through financing procured in local currency. JBIC's policy in future will be one of actively promoting efforts to issue bonds denominated in Asian currency and procure financing in local currency, based on such fund needs and through deliberation with the authorities concerned in each country.

Proposal 2 Additional（Comments made by ADB）

ADB Prices 1 Billion Yuan Panda Bonds in China

MANILA, PHILIPPINES (13 October 2005) - ADB today priced its debut renmimbi-denominated bonds ("Panda") in the domestic capital market of the People's Republic of China (PRC). The issue has a principal amount of RMB 1 billion and a bullet maturity of 10 years.

"ADB would like to thank the PRC Government for its extensive support in making this market-opening transaction possible," ADB Treasurer Mikio Kashiwagi says. "ADB is particularly pleased to have been given the opportunity to be the first foreign issuer, together with International Finance Corporation, in PRC's bond market. We hope this pioneering transaction will contribute to the further development of PRC's bond market."

Priced at par, the Panda bonds carry an annual coupon of 3.34% per annum and have a maturity date of 14 October 2015. Prior to pricing, ADB and the sole lead manager, Bank of China International (BOCI) Ltd, conducted road shows in Beijing and Shanghai to present the deal to over 100 institutional investors.

Offered through a book-building process with a price guidance of 3.30% to 3.39%, the issue generated strong demand with total bids amounting to almost RMB3 billion or three times the issue amount.

The issue achieved a broad distribution with up to 39% of the bonds placed with domestic banks, 31% with foreign banks, 15% with insurance companies, and 15% with other investor types such as fund management companies, credit cooperatives, and social security funds. The bonds will be traded in the interbank market with clearing and settlement through The China Government Securities Depository Trust & Clearing Co., Ltd.

"We are pleased to be able to successfully price ADB's inaugural Panda bond issue," says Mr.

Kashiwagi. "The strength of the order book allows ADB to price the issue at the tighter end of the price guidance. The tight pricing reflects investors' understanding of ADB's high quality credit and the diversification opportunity offered by this pioneering transaction."

ADB will use the proceeds of the Panda bonds to fund its development projects in PRC. The objective is to help reduce currency mismatches for borrowers that have no foreign exchange earnings. After India and the Philippines, PRC is the third country where ADB plans to undertake local currency financing.

The issuance represents another milestone in ADB's quest to develop the region's bond markets. Since early 2004, ADB has completed three other market-opening transactions in the region's local currency bond markets, including India, Malaysia, and Thailand.

With these landmark issues, ADB continues its role as a pioneer in regional bond markets, providing local and international investors with the highest quality debt securities supported with best practice issue standards and role model disclosure and documentation. ADB's other market-opening transactions in the region include a Samurai bond issue in Japan 1970, an Arirang bond issue in the Republic of Korea in 1995, and a New Taiwan Dollar issue in Taipei,China in 1995.

The issuance of Panda bonds will have an important development impact on the PRC's bond market. One of the key benefits involves the promotion of more diversity in bond issuers, a key element in product innovation. As an issuer with AAA credit ratings, ADB, through its Panda bonds, will offer domestic investors in the PRC an excellent opportunity to add new debt securities of the highest quality to their bond portfolio. At 10 years, the bonds will also respond to the needs of institutional investors such as pension funds and insurance companies for longer maturity assets to better match their long-dated liabilities.

"The Panda bonds will represent a step toward adopting best international standards particularly in documentation, disclosure, and deal management," Mr. Kashiwagi adds.
The Offering Circular for the Panda bonds follows ADB's standard information memorandum, which complies with the disclosure requirements of all the markets that ADB has issued bonds, including EU countries, Japan, and the United States. It provides domestic market participants with a model for high quality and transparent disclosure documents.

ADB issued the Panda bonds using a bookbuilding process and sole bookrunner to ensure a market clearing price as well as uniform pricing to all investors. The transaction documents will also facilitate future bond issuance by other foreign borrowers.

Another benefit is that the Panda bonds will have a strong signaling effect to the international community. ADB's Panda bonds will represent the readiness of PRC's bond market infrastructure for participation by international institutions, particularly with respect to the depth of investor base, capabilities of market intermediaries, transparency and liquidity of risk free benchmark yield curve, and efficiency of depository, clearing, and settlement system.

Proposal ③-①（Comments made by JBIC）

1. JBIC signed a guarantee contract for a baht-denominated corporate bond issued by Tri Petch Isuzu Sales Co., Ltd. (TIS), a Thai corporation jointly managed by Mitsubishi Corporation and Isuzu Motors (with its head office located in Bangkok). Under this guarantee, TIS will issue corporate bonds in the amount of 3.5 billion bahts (around ¥10 million) guaranteed by Mitsubishi Corporation, the parent company. JBIC will provide a backup guarantee to Mitsubishi Corporation. The funds obtained from this corporate bond issue will be applied to the long-term funds necessary for the local manufacture and sale of Isuzu-brand pickup trucks. This is the first time for TIS to issue a corporate bond in Thailand's capital market.

2. From the perspective of exchange risk avoidance, local Japanese corporations advancing into Asia must procure business funds in the local currency. Because the bond market is underdeveloped in many of these countries, the situation for issuing bonds has been a difficult one, and means of funding have been limited. Under these circumstances, even in Thailand, where the bond market is comparatively developed, highly creditworthy Japanese companies are not necessarily highly recognized in the local bond market. Thus, for smooth bond issuing, complementarity from JBIC, as a financial institution of the Japanese government, is being sought. Based on the needs of such Japanese companies, the bank's guarantee function will be applied to support smooth bond issuing of Japanese companies in local markets.

3. In December 2002, the Japanese government proposed ABMI. At present, deliberations are underway among ASEAN and the relevant governmental authorities for Japan, China, and Korea. To prevent a recurrence of Asia's currency crisis, ABMI is being discussed with the aim of developing and activating the bond market in every Asian country to apply funds from within Asia, with a high savings rate, for development within the region. Recently, as part of the efforts to promote ABMI, JBIC established a new guarantee system for corporate bonds issued in local currencies by local Japanese corporations (see the attached schematic diagram); this will be the first case of actual application.

Proposal ③-② (Comments made by NEXI)

Concerning bonds denominated in local currency issued by Japanese companies advancing into Asia, independent administrative institution Nippon Export and Investment Insurance (NEXI) will provide Overseas Untied Loan Insurance（with guarantee obligation）for the corporate bonds denominated in bahts issued by Isuzu Motor's local Thai corporation.

At present, the funding of Japanese companies advancing into Asia frequently takes the form of loans from financial institutions backed by the parent company in Japan or dependence on remittances from the parent company. Under these circumstances, if a mechanism for issuing bonds is established, it will diversify fund procurement means for Japanese companies advancing into Asia. As a result, it will be possible to procure funds, even if the liquidity of bank funding decreases. Moreover, making medium and long-term funding possible in local currency will eliminate exchange risks and contribute to operation stability.

By providing coverage for the bond issues of Japanese companies advancing into Asia, NEXI will both be making it easy for these Japanese companies to procure funds and will be activating intraregional investment. Consequently, it will be of help in the development of ABMI, currently under deliberation.

1. Isuzu Motors has a share of about 40% of the market for one-ton pickup trucks in Thailand. Since 2003, it has been consolidating its manufacture of one-ton pickup trucks in Thailand, where it plans to expand its export base, as well. The Thai corporation, Isuzu (Thailand) Co., Ltd., will issue １ billion bahts (around ¥2.7 billion） in bonds denominated in the local currency, targeting Thailand’s domestic investors, to procure some of the capital expenditure funds for reinforcing product development and production capability for the one-ton pickup trucks it currently manufactures in Thailand.

2. Accompanying its provision of guarantees for the aforementioned bonds denominated in local currency, for the guarantee obligations that it bears, Mizuho Corporate Bank will have NEXI underwrite its Overseas Untied Loan Insurance (guarantee obligation), with Mizuho Corporate Bank being the policyholder and the insured.

Proposal ④-①（Comments made by JBIC）

1) JBIC resolved to guarantee the ¥22 billion in 10-year, yen-denominated, privately placed bonds that Philippine National Oil Company - Energy Development Corporation (PNOC-EDC） issued for the purpose of procuring the necessary funds for the Philippine’s geothermal heat development projects. The various related contracts between the Philippine government and PNOC-EDC were signed in Tokyo. With these bonds, the Philippine government will guarantee the principal and interest over the entire period, and JBIC will guarantee the principal and interest over the latter five years.

2) PNOC-EDC engages in geothermal and other non-oil energy source development projects. The funds procured through these bonds are slated to be applied to the reinforcement of geothermal heat recovery capability in geothermal development projects that PNOC-EDC is conducting in such regions as Leyte and Mindanao, as well as to environmental measure.

3) This guarantee will be provided based on the Resource Mobilization Plan for Asia, which the Japanese government announced last year as the Second Stage of the New Miyazawa Initiative and will be the first case of applying the guarantee on publicly offered bonds; a function that was included to the role of JBIC at the time of its establishment. The bank’s provision of the guarantee will support PNOC-EDC’s procurement of funds from the international finance and capital markets. It is expected to accelerate the back-flow of the long-term private funds from Japan to the Philippines and to further activate the Tokyo market. In addition, with the support of international institutions and JBIC, this project will be significant for the Philippines, which is currently engaged in structural reform of its electricity sector, as it will assist with the diversification of domestic energy utilization.

Proposal ④--②（Comments made by NEXI）

Independent administrative institution Nippon Export and Investment Insurance (NEXI) has resolved to provide Overseas Untied Loan Insurance, with 97.5% of the principal and interest as the limit, for the ¥50 billion in 10-year, yen-denominated, privately placed bonds issued by the government of the Republic of the Philippines. The funds procured through bond issue can be earmarked for the Philippine’s domestic industrial infrastructure projects, such as for roads.

Amid the downturn in investment in emerging market economies since the terrorist attacks in the US, NEXI’s coverage of the Philippine political risk and the Philippine government’s credit risk has made the circulation of Japan’s private funds possible. In addition, this has made a reduction of fund procurement costs on the order of 3%, compared with the current negotiable price for the Philippine Samurai bond, possible for the Philippines. Through these funds, the Philippines will be provided with domestic industrial infrastructure, and Japan-Philippines trade and investment will likely continue to accelerate henceforth.

This case marks the third in which Overseas Untied Loan Insurance has been provided for bond issuing, following that involving the Malaysian government in December 1998 and that involving Thailand’s PTT Exploration and Production Public Company Limited in April 1999. It is the first such case for NEXI.