# **Address to FIMMDA PDAI annual conference at New York – April 30th 2018 by MANISH WADHAWAN**

# Dear friends, colleagues and delegates, I extend a warm welcome to you here, in New York for the 19th FIMMDA – PDAI Annual Conference. A special thanks to RBI DG Mr. Viral Acharya for being able to make to this conference and for addressing the gathering. I would also like to welcome Mr. Mahalingam, Whole Time Member, SEBI, for his presence at this conference. My sincere regards to my fellow board members at FIMMDA and PDAI for giving me the opportunity of being a keynote speaker.

I appreciate that you guys are waiting to hear from Mr. Acharya very keenly, so I won’t be long. I would just take a few minutes to address some pertinent issues wrt markets, and hand over to Mr. Acharya.

First of all, here we are, at Times Square in the heart of New York City, the pronounced “capital of the world”. We are surrounded by some of the central financial institutions, and also to a good quarter of India’s tourist population. What better place for us to address the pertinent issues that have been plaguing the markets?

For the past year, we have experienced a significant amount of volatility, and all of us have been impacted by it surely. I know the current mood of the markets is of despair and helplessness. BUT one cannot look at markets from a short-term lens.

Indian fixed income markets have come a long way since 1991, since the advent of economic reform. We saw the first market-based auction in central government security in 1994, and the Institution of Primary Dealers was formed in 1995. PD’s have since played a very important role in the Indian debt markets. I’d like to take a brief moment to highlight the role of PD’s

# PD’s provide a dedicated focus on the auctions as they are committed to underwrite all the auctions of the CGS and TB’s. This lends a major credibility to the stability of the CG and SG auctions.

# PD’s have been the active market makers in the secondary market.

# PD’s provide liquidity in the fixed income markets which help institutions meet their investment needs and manage their interest rate risks.

# I would like to mention that even in the most stressful of times in the recent past (2013), the PDs ensured the success of the borrowing program, and helped the system withstand the FPI selling.

# PD’s have constantly engaged with policy makers to give them market feedback and on market developmental issues.

# I don’t have a doubt that the institution of Primary Dealers has with the test of time, and will continue to evolve accordingly by contributing to the development of the fixed income markets in India.

# In the past two years the Indian banking system has been under pressure due to the rise in NPA’s and huge volatility in the fixed income markets. This has again brought to fore the ability of the financial system to manage and absorb volatility without destabilizing the system.

# I would like to use this opportunity to talk about some trends and issues that are pertinent in the Indian fixed income markets. In my view, they have an important bearing on the next few years, on how the industry shape will up, and how we address them is of high importance.

# The investment decisions at various institutions are governed by regulatory prescriptions, for example the IRDA for insurance companies, EPFO for the provident funds, and for the banking system is SLR, CRR and now the LCR prescriptions for banks from RBI. This leads to investment decisions to fulfil regulatory prescriptions and not for optimum risk adjusted returns. I appreciate that there is an obligation on part of institutions to ensure that adequate resources are available to fund the govt deficits, but it has its own risks of overcrowding and disruptions in markets.

# Uncertainty on the Accounting standards implementation has important implications on the balance sheets of various financial entities. The uncertainty on the accounting standards doesn’t augur well for the risk management for banks.

# There has been a discerning trend of the investors only participating in the primary market and not looking to participate in the secondary markets. This has huge implications with increasing government and quasi government borrowings hitting the system. It undermines the credibility of the secondary markets to reach the optimum price discovery and imparts volatility in the primary market as witnessed in the recent past. This is not in the interest of the issuers or investors as it leads to uncertainty and to risk aversion.

# In the past few years we have seen a new trend in the sovereign finances that the borrowings of the sub sovereigns i.e., state governments and the quasi govt such as PSU’s have increased while central government borrowings have remained stagnant. Though the overall combined borrowing of the government (centre plus state) is growing, this skew has its own implications. The central government security curve is the base curve for any economy and the debt issued by other entities is determined by adjusting the risk premia over the sovereign curve. The artificial shortages in the benchmarks create a premium and leads to mispricing of risks and valuation of other credits. This phenomenon of fiscal consolidation can lead to mispricing of the credit risk and can also compromise the macro stability. We have seen the spreads of SG over Gsec moving from around 20 bps to around 55 bps.

In view of the above-mentioned developments, I think some important pointers for the discussions to follow in this conference are:

1. Strengthening of the institutional framework of the as well as the overall financial system including banks, primary dealers and NBFC’s as its clear that the whole financial system is prone to huge interest rate risk. We definitely need to grow the available products to hedge the interest rate and credit risk in the system, and I hope the various panels in the day will be dedicating their energies towards that give some meaningful suggestions to implement them.
2. Need to diversify the participant base for various new products. Something I think of in regards to this is that when there are no takers for 3 year CG govt bonds at 7.5% and 3 year deposits are returning 6.5 % in a rationale market with diverse participants, this namely would not have happened.
3. Finally the absence of a deep and liquid swap market hits the risk management ability of the system leading to shocks and huge volatility.

I believe that the various panels comprising the best of minds from the industry along with all the participants during the day will introspect and debate fruitfully to create a robust and growing financial market in India.

I extend my sincere thanks again to all of you, and wish you all a successful conference in New York.