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TOWARDS VIBRANT DEBT MARKETS

A *7i* Framework

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Financial Sector and Economic Growth



- Financial development influences the economy through
 - ▣ proportion and rate of savings
 - ▣ efficiency of capital allocation

- Well-developed financial sector leads to
 - ▣ broadening of access to capital
 - ▣ greater economic activity and growth

- Greater financial depth associated with higher level of per capita income and productivity

Importance of debt market



- Channelizes flow of capital
- Acts as systemic risk diversifier
 - ▣ alternate to bank dominated financial system
- Pivotal to economic development
- Facilitates long term commitments

Indian bond & derivatives markets



- Considerable growth and development
 - ▣ Broad based participation
 - ▣ Elongation of sovereign yield curve
 - ▣ Enhanced supply of G-sec and corporate bonds through primary issuance
 - ▣ Increased trading volumes in secondary market

Important initiatives/future directions through the **7i Framework**



7i Framework

7i Framework



- Investors
- Issuers
- Instruments
- Infrastructure
- Intermediaries
- Incentives
- Innovation



INVESTORS

Profile of Investors

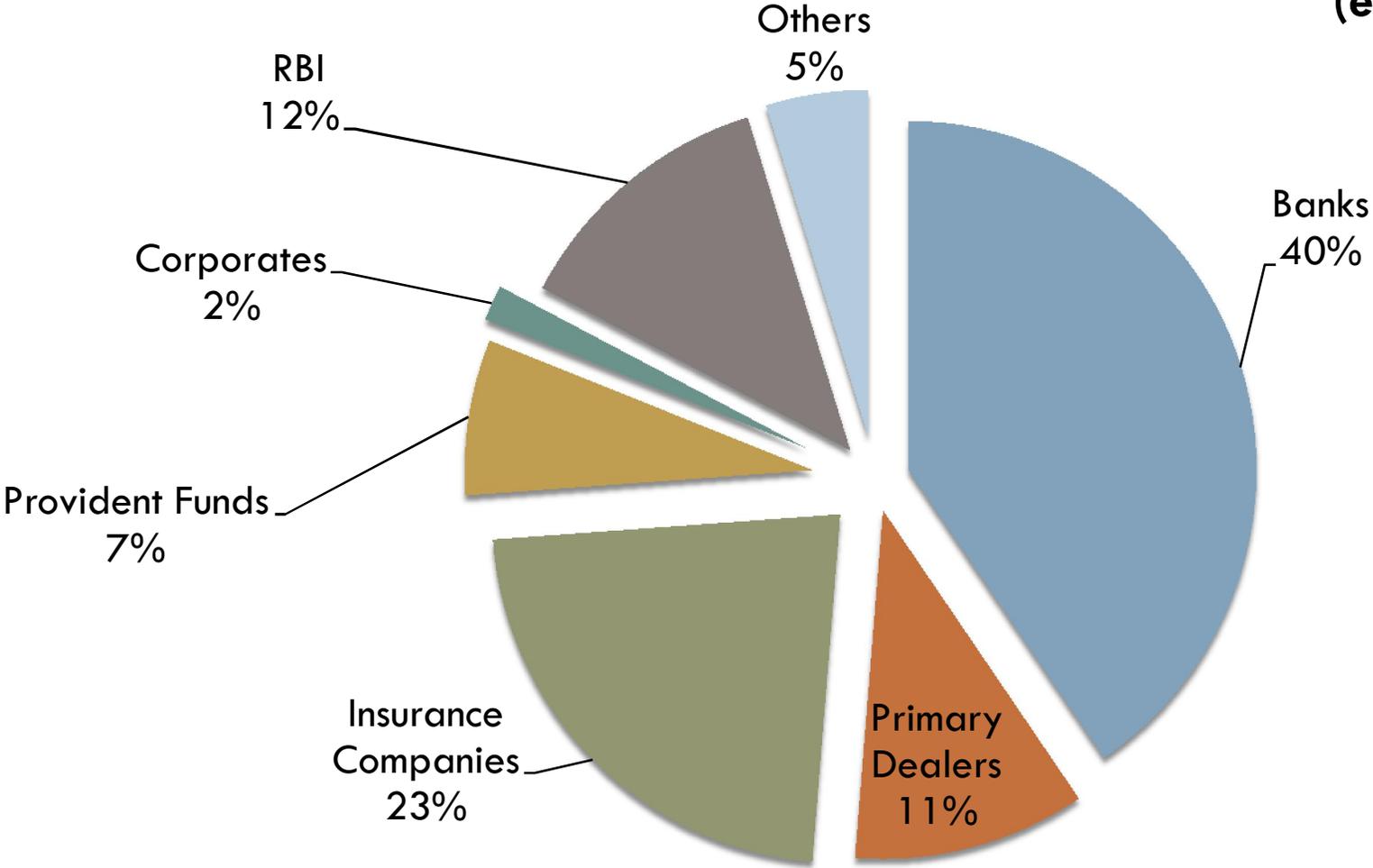


- Plurality of investors - divergent perceptions & different objectives is important
 - ▣ Indian investor base is diverse
- Predominance of institutional and resident investors
- Pre-dominance of buy and hold investors
- Corporate bond investor base similar to G-Sec

Holding Pattern of G-Sec



(end-Sept 2011)



IRS – category wise share

Investor profile in interest rate derivative skewed

- limited participation resulting in shallow markets

(in percentage)

	Buying		Selling	
	IRS-MIBOR	IRS-MIFOR	IRS-MIBOR	IRS-MIFOR
Foreign Banks	79.91	91.84	79.64	79.36
PDs	7.42	0.00	7.22	0.00
Pvt. Banks	11.84	7.93	11.97	20.54
Public Sector Banks	0.84	0.23	1.17	0.10

(Source: Fact Book of CCIL 2011-12)

Measures taken



- Calibrated access to foreign investors
 - Enhanced limits
 - US\$ 45 billion in corporate bond
 - US\$ 15 billion in G-sec

- Improved access to G-Sec market for mid segment retail investors
 - Mandates to PDs for minimum targets
 - Web based access

Issues

G-sec

- Need to broad base participation
 - ▣ Retail participation
 - ▣ Mid segment participation
 - ▣ Nascent pension funds – potential large investor
- HTM – an illusion?
 - ▣ Impacts liquidity
 - ▣ Inhibits hedging
 - ▣ Almost never Held To Maturity
 - ▣ Post IFRS scenario
- Enhancing foreign participation
 - ▣ Considered in the light of CAC, exchange rate volatility, etc.

Issues



Corporate Bonds

- Enabling investments by institutions by credit enhancement
 - through banks or otherwise

Derivatives

- Lack of participation in derivatives market
 - ▣ Active treasuries – foreign and private banks
 - ▣ Muted participation by public Sector banks
 - ▣ Documentation issues



ISSUERS

Issuer

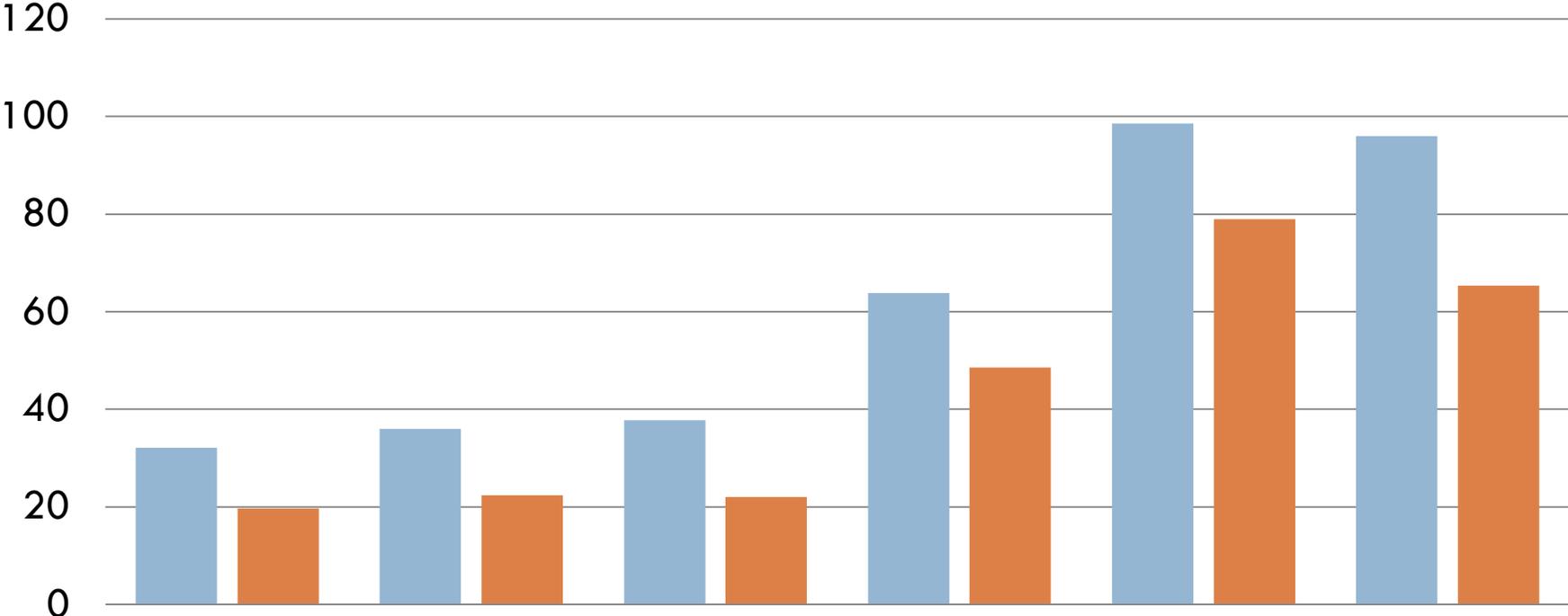


- Governments committed to rule based fiscal consolidation
 - ▣ Market borrowings have increased due to varied reasons
 - Global financial crisis and need for stimulus
 - Huge market borrowing could crowd out private investments
 - ▣ Enhanced borrowings enabled creation of benchmark securities with large outstanding stock
 - Many securities have small outstanding stocks

Government bond issuance



(in USD billion)



2005-06

2006-07

2007-08

2008-09

2009-10

2010-11

■ Gross ■ Net

Issuer



Corporate Bond Segment

- Thin issuer base
- Corporate bond issuer profile dominated by banks & public sector companies
 - ▣ Private non financial issuers miniscule
 - ▣ Issuers largely AAA rated
 - ▣ Difficult for lower rated corporates
- Complete domination of private placements
- Increased issuance at short term (1 to 2 years)

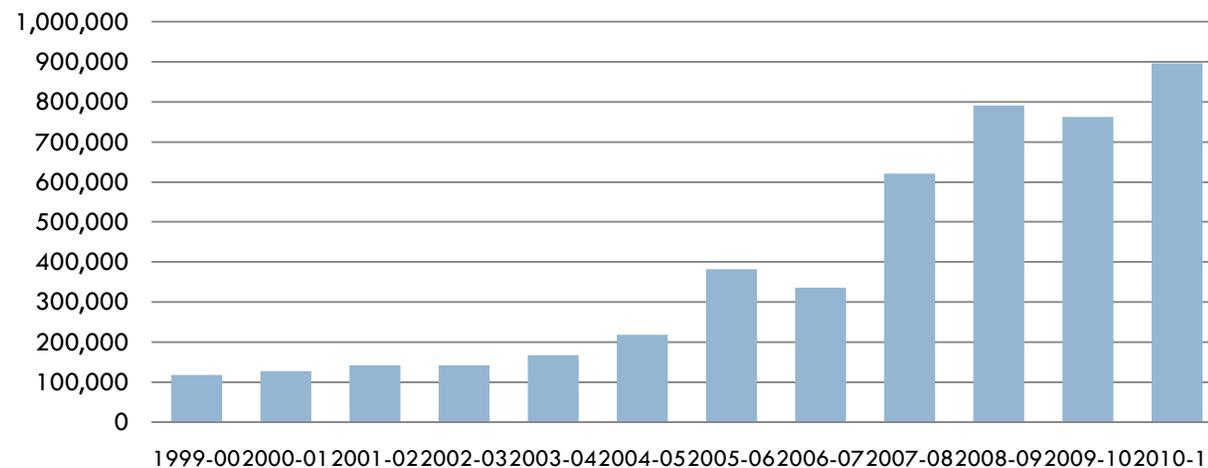
Corporate bond issuance

(in Rs. Billion)

	AAA	AA	A	BBB	Non-Investment Grade
2007-08	4,542	1,202	357	95	16
2010-11	5,116	1,826	904	693	427

Corporate Bonds

(Amount outstanding in Rs. crore)



Issues



G-sec

- Need to focus on fiscal consolidation
- Promotion of liquidity
- Consolidation of Government securities

Corporate Bonds

- Preference to bank finance
- Continuous feedback from market participants
- Need for rationalization of costs
 - ▣ stamp duty, transaction cost, etc.
- Lack of effective debenture trustee mechanism
 - ▣ for enforcement of securities



INSTRUMENTS

Instruments



- Wide array enables
 - ▣ Diversification in the portfolio.
 - ▣ Better asset-liability management.
 - ▣ Hedging interest rate risk, balance sheet risk and inflation risk.

G-sec

- Instruments viz., zero coupon bonds, floating rate bonds, STRIPS and bonds with call and put options, plain vanilla fixed coupon bonds issued.
- Issuance of inflation index bonds with new product design under consideration

Instruments



Corporate Bonds

- Repo in corporate bonds

Derivatives

- Interest Rate Futures
- Interest Rate Swaps/Forward Rate Agreement
- CDS

Measures taken



- Improving liquidity through
 - ▣ passive consolidations
 - ▣ re-issuances and
 - ▣ issuances of benchmarks of substantive size

- Introduction of new products
 - ▣ Interest Rate Futures (IRFs)
 - ▣ repo in corporate bonds
 - ▣ issuance of Floating Rate Bond (resumed)
 - ▣ Credit Default Swaps

Issues



G-sec

- Low liquidity due to lack of consolidation

Derivatives

- Lack of liquidity
 - in the underlying bond market
- A weak market response to these products
- Tricky “Chicken and Egg problem”



INFRASTRUCTURE

Infrastructure



- State of the Art primary issuance process with electronic bidding
- Efficient Primary Dealer System
- Efficient depository system for G-Secs within the Central Bank
- Electronic trading platform
 - NDS and NDS-OM
- Delivery Vs. Payment
 - safe settlement
- Real Time Gross Settlement

Infrastructure



- Central Counterparty (CCP) Clearing
 - Clearing Corporation of India Ltd.
- Reporting platforms for CP/CD, corporate bond, IRS/FRA and CDS
- Trade repository for CDS
- Settlement Systems & CCP arrangement compliant with IOSCO-CPSS recommendations

Issues



G-sec

- Broad based access to investors
 - web based auction module
 - wider access to NDS-OM

Corporate Bond Market

- DvP III ?
- Screen based order matching

Issues

Derivatives

- Better settlement infrastructure for OTC derivatives
- Use of bilateral collateral in OTC derivative products to be encouraged
- Lack of participation in non-guaranteed settlement
- Mitigating systemic risks
 - CCP-based clearing and settlement, margining, collateralization
 - Promoting transparency and market integrity
 - Protecting against market abuse



INTERMEDIARIES

Intermediaries



- PDs
 - Sound prudential norms
 - Market making responsibilities
- Industry associations - FIMMDA /PDAI
 - Model prices for valuation of G-sec, Corp bonds, CDS
 - Model code of conduct
 - Broker accreditations in OTC
 - Reporting platforms for CP, CD and Corporate bonds

Intermediaries



- Infrastructure Development Funds
 - Regulatory relaxations to enable investments in infrastructure
- Gilt Mutual Funds
 - Indirect avenue for retail investors

Issues



- Lack of sophistication in terms of strategy & risk management
 - Wider use of derivatives
- 'Lazy Treasuries' ?
- Strengthening of PD system
 - Support to Government borrowing programme
 - Active participation in new products
 - Enhancing retail and mid-segment participation
 - Exclusivity to PDs ?
- Promoting investment by MFs in G-Sec
- IDFs - Implementation issues

Issues



- FIMMDA/PDAI
 - Wider and more active role
 - Build financial and technical competencies
 - Ultimate objective – SRO?



INCENTIVES

Incentives



Do incentives lead to market development ?

Variety of products with regulatory approval to incentivize markets

- tax incentives for MFs, insurance
- CDS

G-sec

- HTM category

Corporate bond

- Restrict access to bank loans?
- Private placement
- Stamp duty and tax structures

Issues



- Regulatory incentives for market development
- Curbing perverse incentives
 - ▣ Naked CDS not allowed
- Different incentive structures in different treasuries



INNOVATION

Innovation



Innovate or Perish old dictum replaced with
Innovate with caution or perish.

- Essential for development of financial system and markets
 - NDS-OM and CBLO
- Results in over-complicated products and dubious social value
- Put to use without detailed analysis and understanding

Issues



- Not an objective but a process
- Benchmark with the best-practices
- Provide products to the felt need of the markets
- Done in a manner which does not pose risk to financial stability
- Should add to market efficiency
- Embark on innovations along with
 - adequate risk management
 - Corporate governance



CONCLUDING THOUGHTS

Concluding thoughts...

- Development of new products, markets not easy for EMEs
 - ▣ Requires hand-holding and fine-tuning according to eco-system
- Increased supply to debt market is a reality for the present
- Market liquidity is a result of active participation from members
 - ▣ Look within
- New products need more nurturing in the early stages before they become self sufficient
- FIMMDA needs to play a more important and an active role in development

THANK YOU