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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

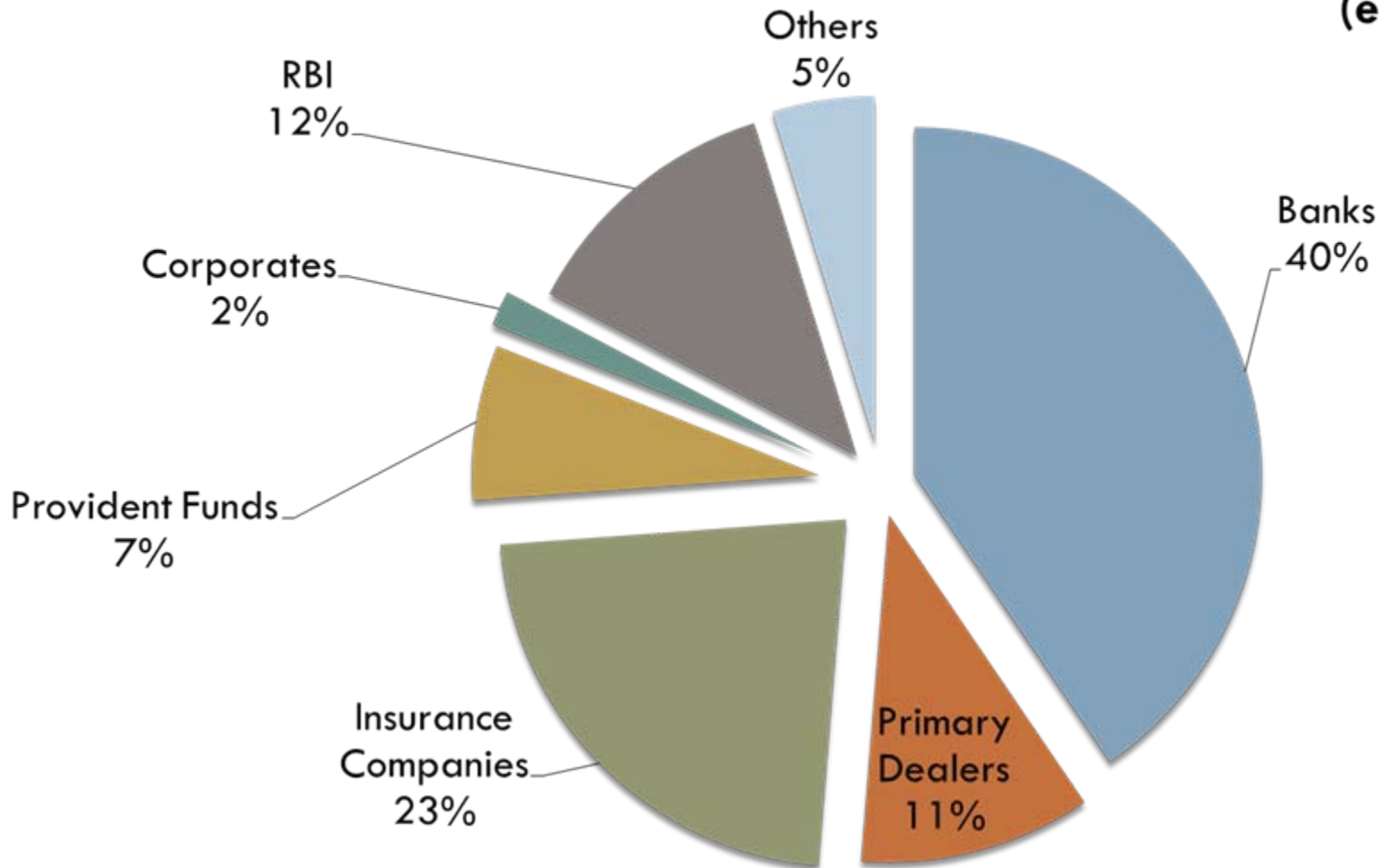
# Profile of Investors

- 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

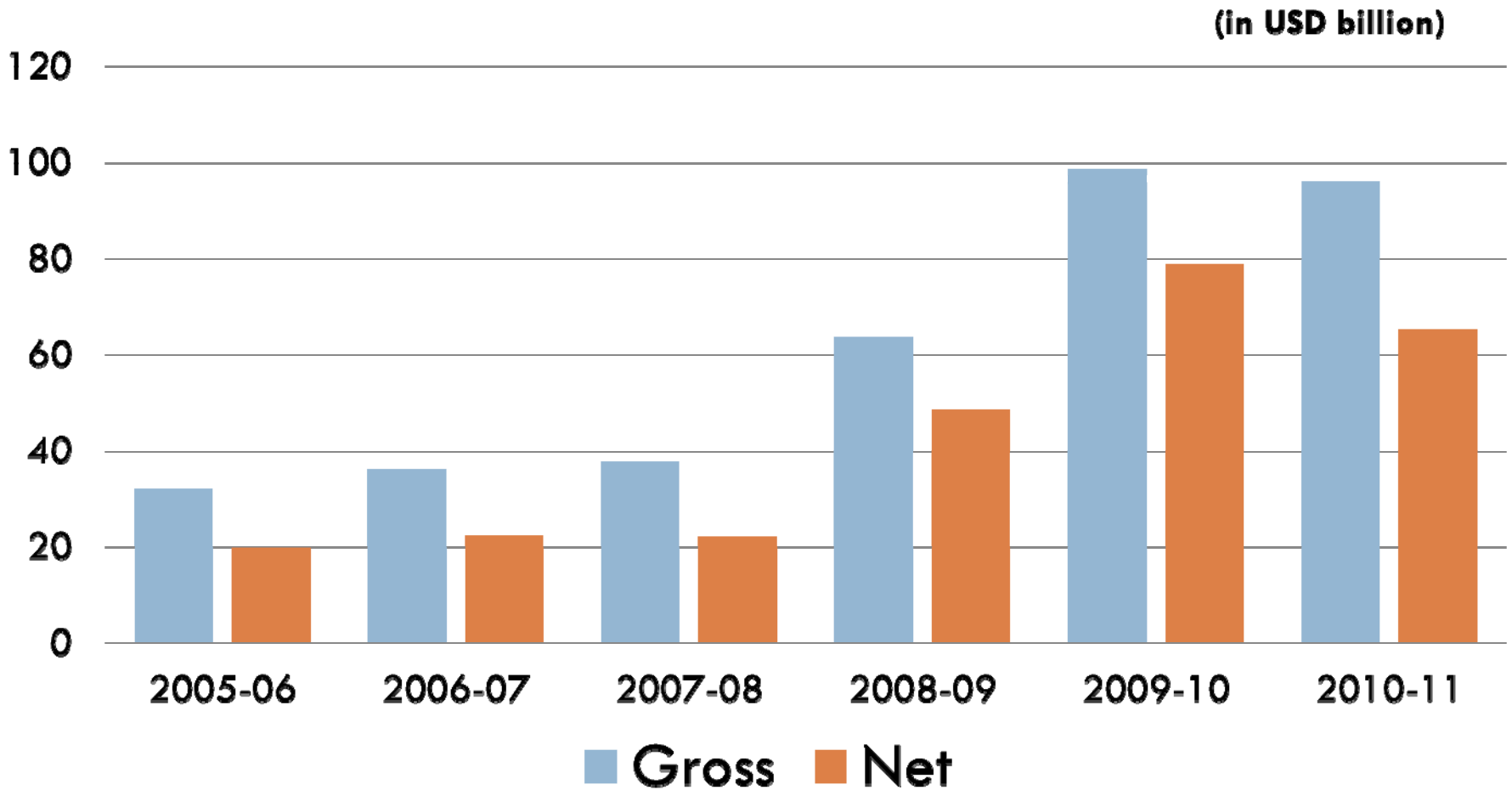


# ISSUERS

# 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





# 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)

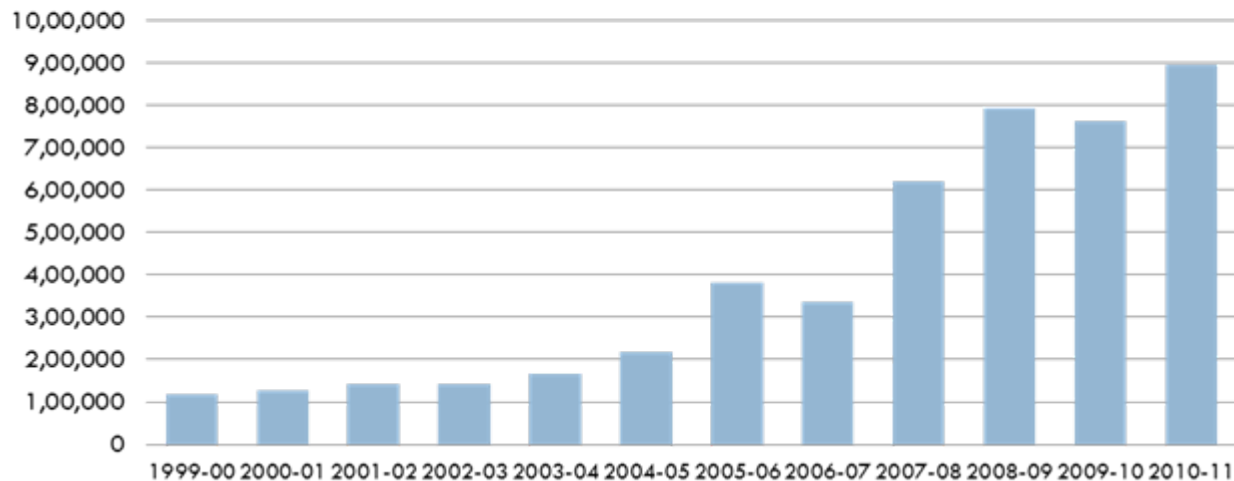
# Corporate bond issuance

(in Rs. Billion)

	AAA	AA	A	BBB	Non-Investment Grade
<b>2007-08</b>	4,542	1,202	357	95	16
<b>2010-11</b>	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

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## 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**