To, 15th March 2021

The Chief General Manager, Reserve Bank of India
Financial Markets Regulation Department
9th Floor, Central Office Building
Shahid Bhagat Singh Marg, Fort
Mumbai – 400 001
Via email to: fmrdfeedback@rbi.org.in

Sub: FEEDBACK ON DRAFT - RESERVE BANK OF INDIA (CREDIT DERIVATIVES) DIRECTIONS, 2021

At the outset, we, at the Indian Association of Investment Professionals (IAIP), a member society of the CFA Institute, appreciate the opportunity to submit our response to the **DRAFT - RESERVE BANK OF INDIA (CREDIT DERIVATIVES) DIRECTIONS, 2021.**

IAIP is an association of over 2000 local investment professionals who are CFA charter holders and about 4000+ professionals who have cleared exams, eligible and awaiting charter. The Association consists of valuation professionals, portfolio managers, security analysts, investment advisors, and other financial professionals, that; promote ethical and professional standards within the investment industry, facilitate the exchange of information and opinions among people within the local investment community and beyond, and work to further the public's understanding of the CFA designation and investment industry.

CFA Institute is a global non-profit association of investment professionals with over 164,000 members in over 165 countries. In India, the community of CFA charter holders is represented by the Indian Association of Investment Professionals (CFA Society India).

Through our global research and outreach efforts, CFA Societies around the world endeavour to provide resources for policy makers, financial services professionals and their customers in order to align their interests. Our members engage with regulators in all major markets.

With regards to the above-mentioned draft paper, we would like to propose a few suggestions consistent with our objective to promote fair and transparent global capital markets and to advocate for investor protection.

We would be happy to hear and discuss the merits / demerits of suggestions proposed by other practitioners and request to be included in the deliberation process.

Our responses to the proposed initiatives by RBI are mentioned below:

A. Details of our Organisation:

1. **Name:** Indian Association of Investment Professionals (CFA Society India)
2. **Contact number:** +91 98196 30042
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B. Key Contributors:

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C. Suggestions / Comments:

Name of entity/person:	Indian Association of Investment Professionals (CFA Society India)
Contact Number	+91 98196 30042
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Sr. No.	Clause	As per the Draft Direction	Comments/ Suggestions	Rationale
2(v) & 5(ii)	Deliverable Obligation	Currently permissible being debt instruments – Non-convertible debentures (NCDs), Commercial Papers (CPs)	CDS for other instruments should be permissible only if it has been specified in the term sheet accordingly. Thus, to permit CDS covering deliverable obligations such as: Bank capital securities – Tier 1 and Tier 2 securities; Non-convertible debentures (NCDs)/Bonds/Notes of Infrastructure Investment Trust (InvITs) and REITs; Municipal bonds; Term loans; Sub-debt securities of corporate / NBFC	Almost all types of credit products can be enabled for market development. Norms clearly needs to distinguish Reference Entity's CDS contract referencing senior debt instruments vis-à-vis CDS contract referencing other securities. These will have differential premium/pricing. Hence, enabler clause will be needed.
2(xvii) & 5(ii)	Reference Obligation	Debt instruments	In addition to debt instruments, the list should be expanded to senior secured loans of the reference entity for all CDS. And similarly, based on specifics, reference obligation may include - Bank capital securities – Tier 1 and Tier 2 securities; Non-convertible debentures (NCDs)/Bonds/Notes of Infrastructure Investment Trust (InvITs) and REITs; Municipal bonds; Term loans; Sub-debt securities of corporate / NBFC	Keeping a wide set of the reference obligation categories helps in identifying any credit event early enough. The credit event may happen even if the reference entity defaults on loan servicing, as interest servicing on bank loans is on a monthly basis. It will remove any arbitrage that reference entity may try to exploit between its lenders and bond-investors.

2(xvi) & 5(i)	Reference Entity	Legal entity	It's important to explicitly clarify that Reference Entity may include: Companies registered under Companies Act; government institutions set under the Act of the Parliament (e.g. Exim Bank, NHAI); Municipal bodies; public sector banks (e.g. State Bank of India); Registered trusts in the nature of Infrastructure Investment Trust (InvITs) & REITs, etc.	Almost all types of borrower entities can be included in the list. Increasingly, it is witnessed that various borrower entities like municipal corporations, Infrastructure Investment Trust (InvITs), banks are raising reasonable amounts of debt funds (& quasi-debt funds) from investors. These measures will truly deepen the debt markets.
4	Permitted products	Single-name CDS	The list of permitted products may be extended to: 1. Single-name Loan CDS (deliverable obligation being specifically stated as loans) 2. First-to-default, from basket of reference entities, CDS 3. CDS on credit indices (Agencies may set up a credit index in that case, CDS referencing credit indices may also be permitted) under cash-settlement basis only. The above products may be introduced in a calibrated manner and a detailed roadmap of product introduction calendar should be laid out in advance.	Extending the list will help in development of the market. Exchange-traded CDS of credit indices can be very effective and liquid. Highlighting through the following example – debt mutual funds (open-ended, closed-ended, fixed maturity plans) are very prevalent by retail investors. Credit indices will have significant correlation with many corporate and credit funds. Exchange traded CDS of credit indices, which are cash settled, will provide an effective hedging mechanism to retail investors.
4 (ii)		Ability to issue structured notes	Structured notes/ debentures should be allowed to be issued with embedded CDS. Market makers like banks & NBFCs (including infrastructure finance companies and infrastructure debt funds in form of NBFCs) should be permitted to issued debt securities with embedded CDS. This will be similar to Market-linked Debentures (MLDs) being issued by NBFCs.	Structured notes may serve as efficient tools for market makers to mitigate counterparty risk of protection sellers. Also, such products may be applied for liquidity, counterparty risk mitigation general risk management, and wider participation. This will also help in deepening and widening of

				the market, while helping market makers to release risk limits. A condition can be stipulated that such structured notes can only be issued with minimum face value of instrument at INR 2.5 million
5 (iv)	Reference Entities & Obligations for CDS	-	The enabling clause should be kept for a wider range of Reference entities, Reference obligations and Deliverable obligations Also, it may be useful to clarify that cumulative and zero-coupon bonds should be included as permissible for RO & DO We would also like the regulators to include instruments with symmetrical put/call options, and only callable and only puttable instruments, etc., for the purpose of reference obligations (which is necessary) and deliverable options.	Indian corporate bond markets have very significant proportion of securities with symmetrical put and call options, hence should be included. Should credit event occur, different securities qualifying under Deliverable Obligation will be calibrated on their equalizing valuations.
6	Market Makers & Users		RBI may also exclude coop banks from being market makers To clarify that in the category of NBFCs – along with HFCs to include infrastructure finance companies, infrastructure debt funds (in the form of NBFC) We suggest that all the enabling guidelines by various regulators, such as SEBI, IRDAI, PFRDA and Ministry of Labour – EPFO, be pre-coordinated and issued simultaneously.	
6.2 (ii)	User Classification	Retail and non-retail user	For sake of clarity, do also include the following in the list of non-retail users: (a) all entities that are eligible to be market makers, though do not choose to be market makers are classified as non-retail users (b) Small Finance Banks, Payment Banks, Local Area Banks and Regional Rural Banks (c) Cooperative banks (d) NBFCs – along with HFCs to include infrastructure finance	Sufficiently wider participation to map and align with participation in domestic bond markets.

			companies, infrastructure debt funds (both – NBFC & Mutual fund formats) (e) Exempt provident funds, registered with EPFO (f) Registered family offices, either as LLC or LLP, with AUM/capital higher than INR 5 billion	
6.3(i)	Protection sellers	Eligible categories	A common list of all non-retail users may be made eligible as protection seller. That is, in addition to the proposed list, the following categories should be included: (a) that are eligible to be market makers, though do not choose to be market makers are eligible to be protection sellers (b) 6.2(ii)(e), 6.2(ii)(f) & 6.2(ii)(g) (c) Small Finance Banks, Payment Banks, Local Area Banks and Regional Rural Banks (d) Cooperative banks (e) NBFCs – along with HFCs to include infrastructure finance companies, infrastructure debt funds (both – NBFC & Mutual fund formats) (f) Exempt provident funds, registered with EPFO (g) Registered family offices, either as LLC or LLP, with AUM/capital higher than INR 5 billion	Sufficiently wider participation will help map and align with participation in domestic bond markets.
7.1(iv)	Buying, unwinding, settlement	Retail users of CDS contract	Retail users are permitted to unwind their CDS contract with their market-maker anytime during the life of the contract. So, the market maker will be responsible to publish unwinding pricing, provide settlement calculations. However, this requirement may lead to situation wherein 'retail users will be at mercy of their respective market maker for providing competitive unwinding price in a transparent manner'. In extreme situations, retail users may be permitted to obtain a competitive quote from another	Enabler clause and ability to execute countertrades will keep all the involved parties within reasonable commercial pricing elements.

			market maker to enter into a countertrade.	
7.1(v)	Buying, unwinding, settlement	Market participants	It's important to clarify as to who all are qualified as market participants as all non-retail users	For abundant clarity and to align the role, responsibility, purpose, permitted activity for non-retail users
8	Credit Derivatives Determination Committee (FDDC)	Role, function, responsibility, etc.	The FDDC may be empowered to function as arbitrator in cases of disputes. All participants – retail, non-retail and market makers – should be permitted to approach FDDC for seeking redressal to their grievances in a time-bound manner.	We believe such a framework will build confidence of all potential and interested parties to participate in the debt markets and credit derivatives markets.
9(i) & 9(ii)	Directions for Exchanges	Type of CDS	In addition to single name CDS, only exchanges should be permitted to offer CDS on credit indices. Retail investors may be permitted to participate for hedging or for taking credit risk through the exchange-traded products. It's also important to clarify that all categories of market makers & users - both retail and non-retail - are eligible to transact in exchanged traded credit derivatives as protection buyers and protection sellers. However, contract sizes of exchange-traded credit derivatives should be INR 2.5 million and higher, with commensurate margin structure.	Availability of CDS on credit indices will provide the necessary mechanism to take credit exposures or hedge credit exposures in a holistic manner. A certain minimum contract size will ensure entry-barriers for mass-retail category.
Additional Point - 1	Training & Education		SROs should conduct workshops & detailed training sessions for the market makers and users. A list of agencies should be created that can train broker dealers, clearing members, etc.	It's important to impart training and education for effective functioning of this segment of the market

Additional Point – 2	6.1(iv) – introduces Central Clearing Party (CCP)	Not specific	In order to mitigate the buildup and transmission of systemic risk in the derivatives market: Early adoption of Central Counterparty (CCP) framework amongst market makers will significantly mitigate counterparty risk. As CCP is efficient and mitigates counterparty risk, it has its own limitations of handling only standardized contracts. Hence, we may have to continue the dual system of CCP and direct settlement.	Based on our learnings from international markets, lack of transparency regarding market participants' exposures makes it difficult to manage counterparty risk. To the extent that a counterparty failure of a large CDS market participant can result in sequential counterparty defaults that will send shock waves throughout the swap market, the ensuing contagion can become systemically important.
Additional Point - 3	Participation of Retail investors		For sufficiently high entry barrier, It may be mandatory to keep contract sizes both on OTC framework as also Exchange Traded framework at a minimum of (say) INR 2.5 million	It would be ideal to have a calibrated approach for participants ability to transact in credit derivatives, given the complexity and the need for investor protection
Additional Point 4	Funded / partly funded / CDSs		Credit derivatives contracts may be structured such that protection seller may be required to partly or fully fund or place collateral / margin upfront or during the contract term. Such a proviso shall help market makers in reducing risk of protection sellers' inability to fulfill commitments under CDS in a credit-event scenario	Risk mitigation for market makers

Thank you again for the opportunity to comment on this important regulatory framework. If you or your staff have questions or seek further clarification, please do not hesitate to contact Mr. Rajendra Kalur, CFA at +91 98196 30042 or at advocacy@iaipirc.org.

Sincerely yours,

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