ISDA®

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BY POST AND BY E-MAIL

17 July 2008

Department of Banking Operations and Development
Reserve Bank of India
12th floor, Central Office Building
Shahid Bhagat Singh Marg
Mumbai – 400 001
INDIA

Attention: Dr. Y.V Reddy, Governor
Smt. S. Gopinath, Deputy Governor

Dear Sir,

Deferment of Introduction of Credit Derivatives in India

We refer to the Press Release by the Reserve Bank of India ("RBI") of 19 June 2008 announcing that the RBI did not consider it to be opportune to introduce credit derivatives in India for the present. We also refer to our previous submissions to the RBI dated 7 November 2007 and 15 June 2007 on the Draft Guidelines for Credit Default Swaps.

We noted with regret RBI's decision to defer the introduction of credit derivatives in India. As emphasised by the Finance Minister, Shri P. Chidambaram earlier this year in his annual budget speech, "developing a transparent credit derivatives market with appropriate safeguards" should continue to be a priority. Credit derivatives are important tools that can help organizations to meet their specific risk-management objectives. Specifically, credit derivatives enable organizations to keep those credit risks that they are comfortable with and dispose of those that they do not want and which others are more willing to accept. By enabling the transfer of credit risk, credit derivatives provide a market-driven approach to the efficient distribution of credit risk to those who have a comparative advantage in holding such risks, thereby reducing systemic risk arising from a concentration of credit risk with those parties least equipped to manage such risks.

These benefits of credit derivatives were indeed accepted and explained in the Draft Guidelines for Credit Default Swaps, which stated that the "effective management of credit risk is, therefore, a critical factor in banks' risk management processes and is essential for the long-term financial health of banks". The concerns that have been expressed generally about the existing build-up of loan assets amongst Indian banks, coupled with the projected demand of the Indian economy for debt-based funding of infrastructure projects over the next 10 years, will only accentuate the need to provide an effective means to distribute credit risk prudently and efficiently among a wider universe of market participants both within and outside India. Credit derivatives have served this important credit risk distribution role in the global financial markets.

Of course, like any other tool, it is important for the user to know what it is intended to be used for and how the tool works before actually using it. In the context of credit derivatives, like any other financial derivatives, this requires a guiding set of principles to ensure that derivatives users have a framework for effectively managing and controlling their credit derivative activities. The RBI has demonstrated its ability in this connection vide its Comprehensive Guidelines on Derivatives and we have every confidence, based on the good work already done with regard to the Draft Guidelines for Credit Default Swaps last year, that the RBI will be able to issue appropriate guidelines in the area of credit derivatives.

We would also point out that contrary to some perceptions, credit derivatives were not identified as a cause of the sub-prime crisis and the resulting credit crunch in the March 2008 Policy Statement of the President's Working Group on Financial Markets. Indeed, as noted by both the President's Working Group on Financial Markets and the Financial Stability Forum, the international credit derivatives markets have held up well during the recent market turmoil and have continued to function, allowing parties to continue to efficiently transfer credit risk.

We fully support the RBI in seeking to maintain a balance between the benefits of credit derivatives as a means of permitting a prudent distribution of credit risk and the potential dangers if the development of the product outpaces the user's ability to understand and value the transactions which it has engaged in. However we would respectfully submit that this balance can be achieved through the introduction of credit derivatives as contemplated by the Draft Guidelines for Credit Default Swaps and our submissions.

We would urge RBI to re-consider the introduction of credit derivatives in India and would like very much to continue our dialogue with RBI in relation to this matter. Please do not hesitate to contact Ms Angela Papesch (apapesch@isda.org) or Ms Jacqueline Low (jlow@isda.org) at +65 6538 3879.

Yours faithfully,

For the International Swaps and Derivatives Association, Inc.

Angela Papesch
Director of Policy and
Head of Singapore Office

Jacqueline Low
Senior Counsel Asia

Copy to: Ms Alpana Killawala, Chief General Manager, Department of Communication