ISDA Safe, Efficient Markets

ISDA India Derivatives Markets Forum
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Opening Remarks
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Good afternoon, and a very warm welcome to the India Derivatives Markets Forum.

There seems little doubt that India's derivatives market stands on the cusp of a major change. India's economy is forecast by the International Monetary Fund (IMF) to grow by 6.5% this year and in 2025, which represents the highest predicted rate of growth of any Group-of-20 country. It is also expected to outpace the Asia region as a whole, with the IMF's emerging and developing Asia bucket of countries predicted to grow by 5.2% and 4.8% on average in 2024 and 2025. Given this strong growth, India is forecast to become the third largest economy in the world by 2030, up from fifth place now – a massive achievement.

As it stands, however, India's over-the-counter (OTC) derivatives market is relatively small compared to the size of its economy, with OTC interest rate derivatives turnover accounting for just 0.1% of the global daily average in 2022.

We think there's a significant opportunity here. Derivatives are critical for healthy, competitive financial markets and help spur economic growth. They give companies the ability to raise financing at the best rate and manage their risks, enabling those firms to invest and grow.

The good news is that positive progress has been made in recent years to establish strong foundations for the expansion of India's derivatives market – notably, by passing legislation to ensure the enforceability of close-out netting in 2020.

We commend the Indian authorities for taking this important step and look forward to engaging closely with policymakers as they consider further initiatives to promote a safe and efficient derivatives market. This week, we published a comprehensive whitepaper on this topic that proposes a series of recommendations on next steps, which we hope regulators and market participants in India will review and consider.

In my remarks this morning, I'll briefly explain why close-out netting is so important and the benefits it brings to India's financial markets. I'll then outline some of our recommendations to further develop India's OTC derivatives market.

Netting

If asked to name one single thing a country could do to bolster the safety and efficiency of its financial market, our answer at ISDA would be the same every time: implement legislation to ensure the enforceability of close-out netting.

By allowing parties to compress their obligations to a single net payment due from one party to another, netting drastically cuts credit risk, reducing the potential for market disruption in the event of a default. Managing credit risk on a net basis means more credit is available to firms looking to raise financing or hedge their exposures, improving liquidity and contributing to economic growth.

The lack of netting historically put Indian firms at a competitive disadvantage as they faced higher transaction costs as a result of tougher capital and margin requirements for banks trading with entities in non-netting jurisdictions. This acted as a barrier to international banks increasing their participation in this market.

That's why the passing of legislation confirming the enforceability of close-out netting in September 2020 was so important. It reduces risk and creates more certainty for financial institutions, encouraging greater participation in the local market and ultimately increasing liquidity and credit capacity.

Since then, Indian authorities have introduced a number of additional measures to support the development of India's OTC derivatives market. These include increased access to onshore markets for non-residents, approval for Indian entities to post foreign currency collateral when trading with non-residents, and the introduction of a principle-based regulatory framework.

All of these measures are extremely helpful. But we believe additional changes could further unlock the growth potential, creating deeper and more liquid financial markets – which brings me to the second part of my remarks.

Recommendations

The recommendations in our whitepaper are centered on five key pillars:

- Broaden product development, innovation and diversification;
- Foster adoption of similar market and risk principles across regulatory regimes;
- Enhance market access and diversification of participants;
- Ensure growth in a safe and efficient manner; and
- Encourage greater alignment with international principles and practices.

We think participants should have access to a wide range of derivatives instruments to hedge their various risks fully and effectively – which is particularly important as the economy continues to grow and the diversity of participants increases.

A vital part of that is having robust benchmarks. Our paper recommends that market participants and benchmark administrators work to extend the duration of the benchmark curve to facilitate longer-term hedges, as well as develop standardized term benchmarks to reduce basis risk.

Another critical factor is having an extensive suite of hedging products. As such, we would urge market participants and regulators to consider expanding the scope of the credit default swap (CDS) market beyond the current limited universe of bonds, debentures and money market instruments. We also believe there's a strong rationale for allowing onshore OTC commodity and equity derivatives markets to complement the existing suite of exchange-traded products and increase options for end users that want to customize their hedges.

Similarly, it's important to increase the diversity of market participants. Having the same types of firms with the same types of objectives taking the same types of exposures leads to one-way markets, which increases both costs and risks. Having a diverse base of users with different exposures helps risk transfer and leads to stable, liquid and efficient markets.

We believe market education is critical to increase awareness and attract new user types. ISDA will help in whatever way we can to support this, through conferences like these, collaboration with domestic associations, and the development of educational materials.

We hope these recommendations will result in an expanded universe of products and participants, but it's also essential they are subject to a similar regulatory framework. Having a patchwork of regulators and rules for similar products increases complexity and places unnecessary operational burdens on market participants.

For example, as it stands, the CDS market is overseen by the Reserve Bank of India (RBI), but three other regulators have responsibility for asset management firms, insurance companies and pension funds, each with their own, sometimes conflicting, requirements. We recommend that regulators align their rules and allow buy-side firms to access both exchange-traded and OTC derivatives, giving them flexibility in how they manage risks and execute investment strategies.

We very much believe in the mantra of 'similar business, similar rules'.

These rules should also be aligned with international standards wherever possible to increase harmonization and encourage international participation and investment. As an example, we would recommend the RBI adopt the standardized approach to measuring and managing counterparty credit risk, bringing bank capital rules in India in line with Basel standards.

There are far too many recommendations for me to list in these brief remarks. Fortunately, we have three panels this afternoon that will explore these issues in depth.

Thank you.