

Abstract

The OTC derivatives markets all over the world have shown tremendous growth in recent years. In the wake of the present financial crisis, which is believed to have been exacerbated by OTC derivatives, increasing attention is being paid to analysing the regulatory environment of these markets. In this context, we analyse the regulatory framework of the OTC derivatives market in India. The paper, inter alia, seeks to prove the point that the Indian OTC derivatives markets, unlike many other jurisdictions, are well regulated. Only contracts where one party to the contract is an RBI regulated entity are considered legally valid in India. A good reporting system and a post-trade clearing and settlement system, through a centralised counter party, has ensured good surveillance of the systemic risks in the Indian OTC market.

From amongst the various OTC derivatives markets permitted in India, interest rate swaps and foreign currency forwards are the two prominent markets. However, by international standards, the total size of the Indian OTC derivatives markets still remains small because credit default swaps were conspicuously absent in India until now. It appears that Indian OTC derivatives markets will grow fast once again after the present financial crisis is over. This research paper explores those open issues that are important to ensure market stability and development. On the issue of the much discussed competition between exchange-traded and OTC-traded derivatives, we believe that the two markets serve different purposes and would contribute more to risk management and market efficiency, if viewed as complementary. Regarding the introduction of new derivative products for credit risk transfer, the recent announcement by the RBI that it would introduce credit default swaps is a welcome sign. We believe that routing of credit default swaps through a reporting platform and managing its post-trade activities through a centralised counterparty would provide better surveillance of the market. Strengthening the position of the Clearing Corporation of India Ltd. (CCIL) as the only centralised counterparty for Indian OTC derivatives market and better supervision of the off-balance sheet business of financial institutions are two measures that have been proposed to ensure the stability of the market.

Keywords: Derivatives and Over the Counter Market, Financial Institutions and Services and Government Policy and Financial Regulation

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