

The Bond Market

Where did we go wrong

NIFPF
New Delhi
March 15, 2011

Background

- Global Crisis
 - Equity markets symptom; BCD source of crisis

- Implications for India
 - 1997 Asian crisis; lost decade for Indian BCD markets

- Bond Markets?

Issues

Gilt Market
(20-25% PSU, Pvt, PD, FB)

Bundled Trading,
Clearing &
Settlement

Liquidity
Concentration

Electronic
Monopoly

No short Selling

Order Book vs.
OTC format

Accounting
Issue; MTM

PDs not
market
makers; no
institutions

Issues

Corporate Bonds

(44% MFs)

Lack of gilt
arbitrage free
yield curve

FII Limits/
Offshore
markets

Non DVP Bilateral
Settlement

Stamp Duties,
TDS

Ban on Repos

Plumbing; day
count, shut
period, listing,
database

Risk
Weightage for
Banks

Issues

IRS Markets

(80% FBs)

Lack of arbitrage
free yield curve/
term money

Missing Link-
Bond futures

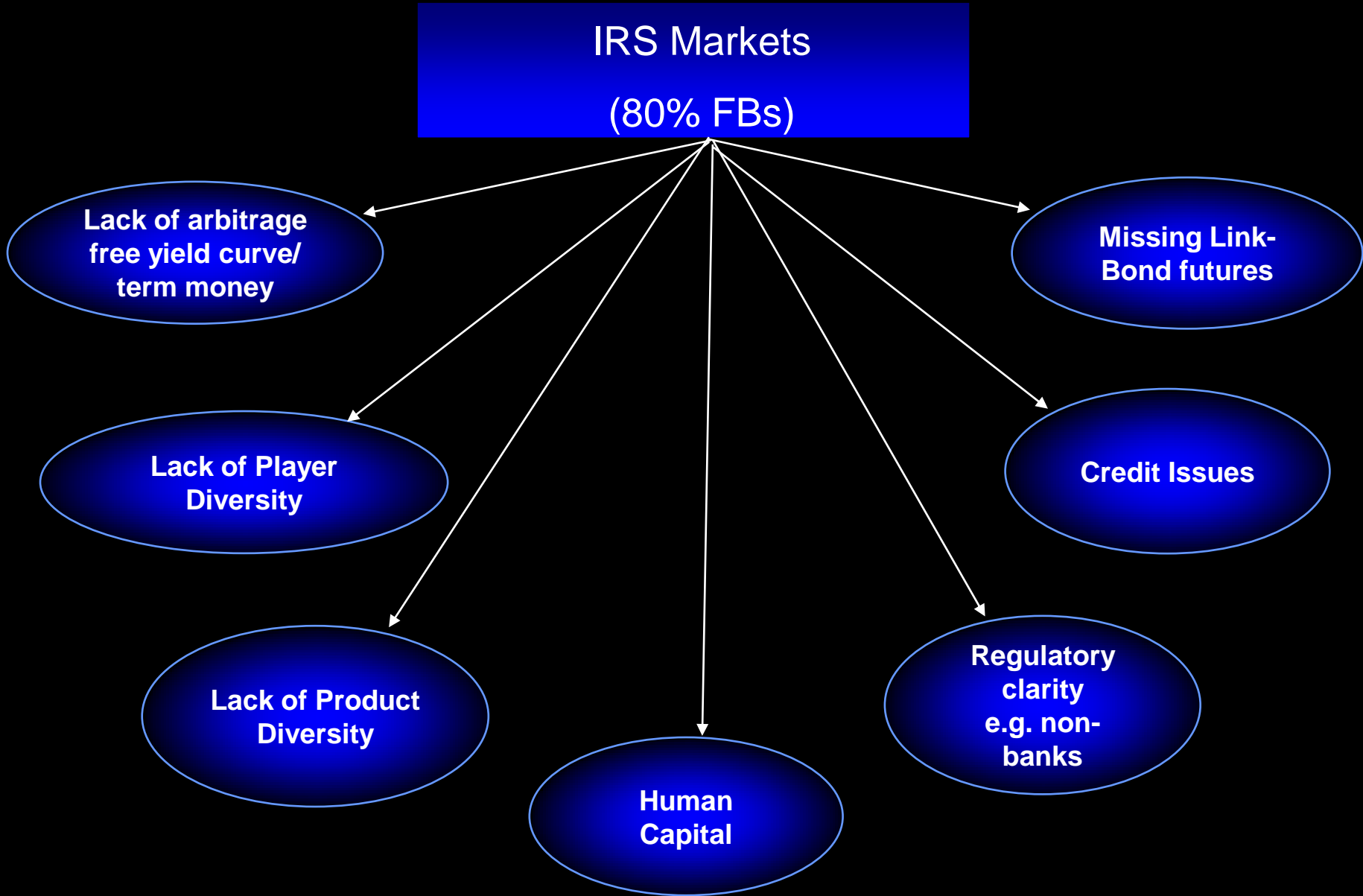
Lack of Player
Diversity

Credit Issues

Lack of Product
Diversity

Regulatory
clarity
e.g. non-
banks

Human
Capital



NDS

- The Government Bonds Negotiated Dealing System (NDS OM)
 - Electronic Exchange for Gilts (not order matching)
 - Owned by RBI
 - Operated by CCIL
 - Participants; (All RBI regulated entities; Banks and PDs)
- Progress?

Is NDS sabotaging the emergence of an arbitrage free yield curve?

(% of total volume)

	02/03	03/04	04/05	05/06	06/07	07/08	08/09	09/10	10/11
Top	21	26	25	23	33	47	43	25	35
Top 2	39	38	42	37	50	60	50	44	68
Top 3	55	45	52	50	65	71	57	58	76
Top 4	64	53	59	62	71	77	63	68	83
Top 5	72	60	65	70	75	83	67	73	88
Top 6	77	66	71	77	80	87	71	78	91
Top 7	81	71	75	82	84	90	75	82	94
Top 8	84	75	79	84	88	92	78	85	95
Top 9	87	79	82	87	90	94	81	88	96
Top 10	89	83	84	89	93	95	83	90	97

NDS - Sept 2010

- Market Volumes
 - (Only 60 of 126 securities traded - 52%)
- Market Breath
 - (15 securities accounted for 96% of volume)
- Pricing liquidity rather than risk
 - Benchmark 7.80% 2020 traded at discount (Rs 98.99), 11.60% 2020 was trading at a premium (Rs 124).
- Unintended consequences
 - Disincentive for market making across spectrum
 - Monopoly in settlement linkage means no competing systems
 - No 5% limit, stamp duty; differential execution costs
 - Not so subtle regulatory nudge; clients?

Structural Issues

- Divergent destinies; Equity & BCD
 - Regulatory Accelerators; Harshad/ BSE. Omission vs. Commission
 - Skipped learning; electronic formats
 - Small government presence; no conflict as regulator and shareholder (orphan)
 - Tabula Rasa vs. Established Regulator; SEBI vs. RBI
 - Smaller retail or FII participation; no clients for regulator
 - Asian Crisis
- Exchanges vs. OTC
 - Order vs quote driven
 - Small Number of players doing large volumes and ticket sizes
 - Execution vs Settlement vs Clearing
 - Agnostic regulation and biodiversity; Woody Allen
- Crisis vs. Underperformance
 - Innovation, Competition, Risk

A tale of two ventures; ICAP vs. Teamlease

- Baby vs. Dwarf
 - ICAP
 - Teamlease
- Binding constraint; Regulatory Cholesterol
- Change?
 - Similar case of Omission
 - Size today
- Why such different outcomes?
 - Satyagraaha argument, hypothesis testing, 5 min
 - Fountainhead for BCD vs. Labour
 - Other side defined his and our position; CNBC debate
 - No beheading but death by a thousand cuts
 - Ability to take innovate and take risk; green lights, Calvin

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