



भारतीय रिज़र्व बैंक  
RESERVE BANK OF INDIA



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FMRD.DIRD.10/14.03.004/2021-22

February 10, 2022

To,

All Eligible Market Participants

Madam/Sir,

**Master Direction – Reserve Bank of India (Credit Derivatives) Directions, 2022**

Please refer to Paragraph 4 of the [Statement on Developmental and Regulatory Policies](#) announced as a part of the [Bi-monthly Monetary Policy Statement for 2021-22 dated February 10, 2022](#), regarding review of the Credit Default Swaps (CDS) Guidelines.

2. The draft Reserve Bank of India (Credit Derivatives) Directions, 2021 were released for public comments on [February 16, 2021](#). Based on the feedback received from the market participants, the draft Directions were reviewed and have since been finalised. The Master Direction – Reserve Bank of India (Credit Derivatives) Directions, 2022 are [enclosed](#) herewith.

Yours faithfully,

(Dimple Bhandia)  
Chief General Manager

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हिन्दी आसान है, इसका प्रयोग बढ़ाइए



## FINANCIAL MARKETS REGULATION DEPARTMENT

Notification No. FMRD.DIRD.11/14.03.004/2021-22 dated February 10, 2022

### Master Direction – Reserve Bank of India (Credit Derivatives) Directions, 2022

In exercise of the powers conferred under section 45W of the Reserve Bank of India Act, 1934 (02 of 1934) (hereinafter called the Act) read with section 45U of the Act and in supersession of [Circular No. IDMD.PCD.No.10/14.03.04/2012-13 dated January 07, 2013](#), the Reserve Bank of India (hereinafter called the Reserve Bank) hereby issues the following Directions.

A reference is also invited to the Foreign Exchange Management Act, 1999 (42 of 1999), Foreign Exchange Management (Debt Instruments) Regulations, 2019 ([Notification No. FEMA. 396/2019-RB dated October 17, 2019](#)) and [A.P. \(DIR Series\) Circular No. 23 dated February 10, 2022](#) on Transactions in Credit Default Swap (CDS) by Foreign Portfolio Investors – Operational Instructions.

#### 1. Short title, scope and commencement

- (i) These Directions shall be called the Master Direction – Reserve Bank of India (Credit Derivatives) Directions, 2022.
- (ii) These Directions shall apply to credit derivatives transactions undertaken in Over-the-Counter (OTC) markets and on recognised stock exchanges in India.
- (iii) These Directions shall come into force on May 09, 2022.

#### 2. Definitions

- (i) In these Directions, unless the context otherwise requires:
  - (a) 'Auction settlement' of CDS means a settlement process in which the price of the reference/deliverable obligation at which the settlement will happen is determined through an auction mechanism.
  - (b) 'Cash settlement' of CDS means a settlement process in which the protection seller pays to the protection buyer, the notional amount of the CDS contract less the expected recovery value of the reference obligation.
  - (c) 'Central counterparty' means an entity that interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the performance of open contracts.



- (d) 'Company' shall have the same meaning as assigned to it in Section 2(20) of the Companies Act, 2013 (18 of 2013).
- (e) 'Corporate bonds and debentures' mean non-convertible debt securities which create or acknowledge indebtedness and include debentures, bonds and such other securities issued by a body corporate or a trust or any statutory body constituted by virtue of a legislation, whether constituting a charge on the assets of the issuer or not, but excludes money market debt instruments, security receipts, securitized debt instruments and bonds issued by the Central Government or a State Government, or such other persons as may be specified by the Reserve Bank.
- (f) 'Credit Default Swap (CDS)' means a credit derivative contract in which one counterparty (protection seller) commits to pay to the other counterparty (protection buyer) in the case of a credit event with respect to a reference entity and in return, the protection buyer makes periodic payments (premium) to the protection seller until the maturity of the contract or the credit event, whichever is earlier.
- (g) 'Credit derivative' means a derivative contract whose value is derived from the credit risk of an underlying debt instrument.
- (h) 'Credit event' means a pre-defined event in a credit derivative contract, which triggers a settlement under the contract.
- (i) 'Deliverable obligation' means a debt instrument issued by the reference entity that the protection buyer can deliver to the protection seller in a physically settled CDS contract, in case of occurrence of a credit event.
- (j) 'Electronic Trading Platform (ETP)' shall have the same meaning as assigned to it in Paragraph 2(1)(iii) of The Electronic Trading Platforms (Reserve Bank) Directions, 2018 issued *vide* [Notification No. FMRD.FMID.08/2018 dated October 05, 2018](#), as amended from time to time.
- (k) 'Exchange' shall mean 'recognised stock exchange' and shall have the same meaning as assigned to it in Section 2(f) of the Securities Contract Regulation Act, 1956 (42 of 1956).



- (l) 'Government-related entity' shall have the same meaning as assigned to it in Paragraph 9 of Indian Accounting Standard (Ind AS) 24: Related Party Disclosures.
- (m) 'Hedging' means the activity of undertaking a credit derivative transaction to reduce credit risk of a particular debt instrument or a portfolio of debt instruments.
- (n) 'Infrastructure company' means a company engaged primarily in activities related to specific infrastructure sub-sectors listed under the Harmonized Master List of Infrastructure Sub-sectors notified by Department of Economic Affairs, Ministry of Finance, Government of India, via gazette notification no. F.No.13/6/2009-INF dated April 08, 2016, as amended from time to time.
- (o) 'Market-maker' means an entity which provides prices to users and other market-makers.
- (p) 'Money market debt instruments' mean commercial papers as defined under the Reserve Bank Commercial Paper Directions, 2017, issued *vide* [Notification No. FMRD.DIRD.2/14.01.002/2017-18 dated August 10, 2017](#) as amended from time to time, certificates of deposit as defined under the Master Direction – Reserve Bank of India (Certificate of Deposit) Directions, 2021, issued *vide* [Notification No. FMRD.DIRD.03/14.01.003/2021-22 dated June 04, 2021](#) as amended from time to time, and non-convertible debentures of original or initial maturity up to one year as defined under the Master Direction on Money Market Instruments: Call/Notice Money Market, Commercial Paper, Certificates of Deposit and Non-Convertible Debentures (original maturity up to one year), issued *vide* [Notification No. FMRD. Master Direction No.2/2016-17 dated July 07, 2016](#) as amended from time to time.
- (q) 'Net worth' shall have the same meaning as assigned to it in Section 2(57) of the Companies Act, 2013 (18 of 2013).
- (r) 'Non-resident' shall mean a 'person resident outside India' and shall have the same meaning as assigned to it in Section 2(w) of Foreign Exchange Management Act, 1999 (42 of 1999).



- (s) 'Over-the-Counter (OTC) markets' mean the markets where transactions are undertaken in any manner other than on exchanges and shall include electronic trading platforms (ETPs).
  - (t) 'Physical settlement' of CDS means a settlement process in which the protection buyer delivers any of the eligible deliverable obligations to the protection seller against the receipt of notional amount of the CDS contract.
  - (u) 'Reference entity' means an entity, against whose credit risk, a credit derivative contract is entered into.
  - (v) 'Reference obligation' means a debt instrument issued by the reference entity and specified in a CDS contract for the purpose of valuation of the contract and for determining the cash settlement value or the deliverable obligation in case of occurrence of a credit event.
  - (w) 'Related party' shall have the same meaning as assigned to it under Paragraph 9 of Indian Accounting Standard (Ind AS) 24 – Related Party Disclosures.
  - (x) 'Resident' shall mean a 'person resident in India' and shall have the same meaning as assigned to it in section 2(v) of the Foreign Exchange Management Act, 1999 (42 of 1999).
  - (y) 'Single-name CDS' means a CDS contract in which the underlying is a single reference entity.
  - (z) 'Substitution event' means any event that results in the reference obligation being replaced by another obligation issued by the reference entity.
  - (aa) 'Succession event' means any event that results in the reference entity no longer being the primary obligor for the reference obligation.
  - (bb) 'User' means a person that undertakes derivative transactions other than as a market-maker.
- (ii) Words and expressions, used but not defined in these Directions, shall have the same meaning as assigned to them in the Act.

### **3. Eligible participants**

- (i) The following persons shall be eligible to participate in credit derivatives market:
  - (a) Residents; and



- (b) Non-residents, who are eligible to invest in corporate bonds and debentures under the Foreign Exchange Management (Debt Instruments) Regulations, 2019 dated [October 17, 2019](#), as amended from time to time.

#### **4. Permitted products in the OTC market**

- (i) Market-makers and users may undertake transactions in single-name CDS contracts.

#### **5. Market-makers and users in the OTC market**

##### **5.1 Market-makers**

- (i) The following entities shall be eligible to act as market-makers in credit derivatives:
  - (a) Scheduled Commercial Banks, except Small Finance Banks, Payment Banks, Local Area Banks and Regional Rural Banks;
  - (b) Non-Banking Financial Companies (NBFCs), including Standalone Primary Dealers (SPDs) and Housing Finance Companies (HFCs), with minimum net owned funds of ₹500 crore as per the audited balance sheet as on March 31 of the previous financial year and subject to specific approval of the Department of Regulation, Reserve Bank; and
  - (c) Export Import Bank of India, National Bank of Agriculture and Rural Development, National Housing Bank and Small Industries Development Bank of India.
- (ii) In case an NBFC, an SPD or an HFC, fails to meet the eligibility criteria subsequent to the receipt of approval for acting as a market-maker, it shall cease to act as a market-maker. The NBFC, SPD or HFC shall continue to meet all its obligations under the existing contracts till the maturity/termination of such contracts.
- (iii) At least one of the parties to a credit derivative transaction shall be a market-maker or a central counterparty authorised by the Reserve Bank for the purpose.

##### **5.2 User Classification Framework**

- (i) Users shall be classified by market-makers either as retail or non-retail for the purpose of offering credit derivative contracts.
- (ii) The following users shall be eligible to be classified as non-retail users:
  - (a) NBFCs, including SPDs and HFCs, other than market-makers;



- (b) Insurance Companies regulated by Insurance Regulatory and Development Authority of India (IRDAI);
  - (c) Pension Funds regulated by Pension Fund Regulatory and Development Authority (PFRDA);
  - (d) Mutual Funds regulated by Securities and Exchange Board of India (SEBI);
  - (e) Alternative Investment Funds regulated by Securities and Exchange Board of India (SEBI);
  - (f) Resident companies with minimum net worth of ₹500 crore as per the latest audited balance sheet; and
  - (g) Foreign Portfolio Investors (FPIs) registered with SEBI.
- (iii) Any user who is not eligible to be classified as a non-retail user shall be classified as a retail user.
- (iv) Any user who is otherwise eligible to be classified as a non-retail user shall have the option to get classified as a retail user.

#### **6. Protection buyers and sellers for Credit Default Swaps in OTC market**

- (i) Retail users shall be allowed to buy protection only for the purpose of hedging.
- (ii) Non-retail users shall be allowed to buy protection for hedging or otherwise.
- (iii) The following non-retail users shall be eligible to act as protection sellers:
  - (a) Insurance Companies regulated by IRDAI;
  - (b) Pension Funds regulated by PFRDA;
  - (c) Mutual Funds regulated by SEBI;
  - (d) Alternative Investment Funds regulated by SEBI; and
  - (e) Foreign Portfolio Investors (FPIs) registered with SEBI.
- (iv) Insurance Companies, Pension Funds, Mutual Funds and Alternative Investment Funds mentioned under Paragraph 6(iii) shall be permitted to act as protection sellers subject to approval of their respective regulator.
- (v) Participation by FPIs shall be subject to the provisions of [A.P. \(DIR Series\) Circular No. 23 dated February 10, 2022](#) on Transactions in Credit Default Swap (CDS) by Foreign Portfolio Investors – Operational Instructions.



## **7. Reference Entities and Obligations for Credit Default Swaps in OTC market**

- (i) The reference entity in a CDS contract shall be a resident entity who is eligible to issue any of the debt instruments mentioned under Paragraph 7(ii).
- (ii) The following debt instruments issued in India shall be eligible to be a reference obligation in a CDS contract:
  - (a) Money market debt instruments;
  - (b) Rated INR corporate bonds and debentures; and
  - (c) Unrated INR corporate bonds and debentures issued by the Special Purpose Vehicles set up by infrastructure companies.
- (iii) Bonds with call/put options shall be eligible to be reference obligations.
- (iv) Asset-backed securities/mortgage-backed securities and structured obligations such as credit enhanced/guaranteed bonds, convertible bonds, etc. shall not be permitted as reference obligations.
- (v) The reference obligation/deliverable obligation shall be in dematerialised form.

## **8. Operational Directions for Credit Default Swaps in the OTC market**

### **8.1 Buying, Unwinding and Settlement**

- (i) Market participants shall not enter into CDS transactions if the reference entity is a related party to either the protection buyer or the protection seller. However, two (or more) government-related entities shall not be deemed as related parties for the purpose of these Directions. Market-makers shall establish appropriate controls to ensure that transactions with related parties are carried out on an arm's length basis.
- (ii) Market participants shall not buy/sell protection on reference entities if there are regulatory restrictions on such participants assuming similar exposures in the cash market or in violation of any other regulatory restriction, as may be applicable.
- (iii) Market participants can exit their CDS contract by unwinding the contract with the original counterparty or assigning the contract to any other eligible market participant through novation<sup>1</sup> subject to the provisions of the circular on Novation of

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<sup>1</sup> Novation is the replacement of a contract between two counterparties to an OTC derivative transaction (the transferor, who steps out of the existing contract, and the remaining party) with a new contract between the remaining party and a third party (the transferee). The transferee becomes the new counterparty to the remaining party.



OTC Derivative Contracts dated December 9, 2013 issued *vide* [Notification No. DBOD.No.BP.BC.76/21.04.157/2013-14](#). However, provisions under Paragraph 2, Paragraph 5.1 and Paragraph 5.2 of the above circular shall not apply to CDS transactions undertaken in terms of these Directions.

- (iv) Market participants shall settle CDS contracts bilaterally or through any clearing and settlement arrangement approved by the Reserve Bank.
- (v) CDS contracts can be cash settled, physically settled or settled through auction. The procedure for cash settlement and auction settlement shall be determined by the Credit Derivatives Determinations Committee as specified under Paragraph 9 of these Directions.

## **8.2 Transactions with retail users**

- (i) Market-makers shall ensure that all CDS transactions by retail users are undertaken for the purpose of hedging, *i.e.* retail users buying protection:
  - (a) shall have exposure to any of the eligible reference obligations;
  - (b) shall not buy a CDS contract(s) with notional amount higher than the face value of the reference obligation held by them; and
  - (c) shall not buy a CDS contract with a tenor later than the maturity of the reference obligation held by them or the standard CDS maturity date immediately after the maturity of the reference obligation.

To ensure compliance with the above, market-makers may call for any relevant information/documents from the retail user, who, in turn, shall be obliged to provide such information.

- (ii) Retail users shall exit their CDS position within one month from the date they cease to have underlying exposure.
- (iii) CDS contracts involving retail users shall be mandatorily physically settled.

## **8.3 Standardisation**

- (i) Fixed Income Money Market and Derivatives Association of India (FIMMDA), in consultation with market participants and based on international best practices, shall devise standard master agreement/s for the Indian CDS market which shall, *inter-alia*, include credit event definitions and settlement procedures.



- (ii) FIMMDA shall, at the minimum, publish the following trading conventions for CDS contracts:
- (a) Standard maturity and premium payment dates;
  - (b) Standard premiums;
  - (c) Upfront fee calculation methodology;
  - (d) Accrual payment for full first premium;
  - (e) Quoting conventions; and
  - (f) Lookback period for credit events.

#### **8.4 Documentation**

- (i) The CDS contracts shall, *inter-alia*, mention the following:
- (a) reference entity, reference obligation and deliverable obligation(s);
  - (b) credit event definitions; and
  - (c) the method and procedure of settlement.
- (ii) The CDS contract shall represent a direct claim on the protection seller. The contract shall not have any clause that may:
- (a) allow the protection seller to unilaterally cancel the contract, except in case of a default by the protection buyer under the terms of the contract;
  - (b) prevent the protection seller from making the credit event payment in a timely manner, after occurrence of the credit event and completion of necessary conditions and requirements under the terms of contract; or
  - (c) provide the protection seller any recourse to the protection buyer for credit event losses.

#### **8.5 Customer protection**

- (i) Market-makers in OTC markets shall comply with the Master Direction – Reserve Bank of India (Market-makers in OTC Derivatives) Directions, 2021 issued *vide* [RBI Circular No. FMRD.FMD.07/02.03.247/2021-22 dated September 16, 2021](#), as amended from time to time and Reserve Bank of India (Prevention of Market Abuse) Directions, 2019 issued *vide* [RBI Circular No. FMRD.FMSD.11/11.01.012/2018-19 dated March 15, 2019](#), as amended from time to time.



## **8.6 Reporting**

- (i) Market-makers shall report all OTC CDS transactions within 30 minutes of the transaction, to the trade repository of Clearing Corporation of India Ltd. (CCIL).
- (ii) Market-makers shall report all unwinding, novation, settlement transactions, and any credit, substitution or succession event to the trade repository of CCIL.

## **9. Credit Derivatives Determinations Committee**

- (i) FIMMDA shall set up a Credit Derivatives Determinations Committee, consisting of market-makers and users in credit derivatives as voting members. FIMMDA shall ensure that users are adequately represented in the Committee. The Committee may also include central counterparties as observer members and legal/audit/consultancy firms as consultative members.
- (ii) FIMMDA shall establish rules for governing the activities of the Credit Derivatives Determinations Committee in line with international best practices.
- (iii) The Credit Derivatives Determinations Committee, when approached by market participants, shall make factual determinations regarding key provisions of credit derivative contracts including, but not limited to, the occurrence of a credit event, substitution event, succession event, determining the identity of successor reference entity, etc.
- (iv) The Credit Derivatives Determinations Committee shall, in consultation with market participants, develop a standard procedure for cash settlement of CDS contracts.
- (v) The Credit Derivatives Determinations Committee, when approached by market participants, may conduct an auction to determine the reference price for settlement of CDS contracts. In case an auction is conducted, the Credit Derivatives Determinations Committee shall put in place procedures/safeguards to ensure that the reference price is determined in a fair and transparent manner.
- (vi) The decisions of the Credit Derivatives Determinations Committee shall be binding on the market participants.

## **10. Directions for exchanges**

- (i) Exchanges may offer standardised single-name CDS contracts with guaranteed settlement.
- (ii) Exchanges shall obtain prior approval of the Reserve Bank for product design, changes in product design, eligible participants and other details of CDS contracts.



- (iii) Exchanges shall ensure that the participants on exchanges are made adequately aware of the risks associated with CDS.
- (iv) The reference entities and reference obligations for exchange-traded CDS shall be as specified under Paragraph 7 of these Directions.
- (v) Participants who are retail users, as defined under Paragraph 5.2 of these Directions, shall undertake transactions in exchange-traded CDS only for hedging and such users
  - (a) shall have exposure to any of the eligible reference obligations;
  - (b) shall not buy a CDS contract(s) for notional amount higher than the face value of the reference obligation held by them; and
  - (c) shall not buy a CDS contract with a tenor later than the maturity of the reference obligation held by them or the standard CDS maturity date immediately after the maturity of the reference obligation.
- (vi) Participants shall not buy/sell protection on reference entities if there are regulatory restrictions on assuming similar exposures in the cash market or in violation of any other regulatory restriction, as may be applicable.
- (vii) The CDS contracts traded on exchanges can be cash settled or settled through auction. The procedure for cash settlement and auction settlement shall be determined by the Credit Derivatives Determinations Committee as specified under Paragraph 9 of these Directions.
- (viii) The determinations made by Credit Derivatives Determinations Committee shall be applicable to exchange-traded CDS contracts.
- (ix) Foreign Portfolio Investors (FPIs) may transact in exchange-traded CDS as protection sellers and/or protection buyers. Participation by FPIs shall be subject to the provisions of [A.P. \(DIR Series\) Circular No. 23 dated February 10, 2022](#) on Transactions in Credit Default Swap (CDS) by Foreign Portfolio Investors – Operational Instructions. Exchanges shall report the gross notional amount of protection sold by FPIs to CCIL on a daily basis by the end of the day, or on an intra-day basis if required by the Reserve Bank.
- (x) Exchanges shall report all CDS transactions to the trade repository authorised for the purpose by the Reserve Bank on a daily basis by the end of the day, in the form and manner prescribed by the Reserve Bank.



- (xi) Exchanges shall furnish any information relating to CDS transactions to the Reserve Bank or any other agency as may be specified by the Reserve Bank in the manner and format and within the time frame as may be specified by the Reserve Bank.

### **11. Valuation methodology**

- (i) Market-makers shall put in place appropriate and robust methodologies for marking to market credit derivative contracts.
- (ii) Market-makers shall use the daily CDS curve published by FIMMDA or any other benchmark recommended by FIMMDA, or a proprietary model, to value their CDS positions.
- (iii) Market-makers using their proprietary model for valuing the CDS positions shall disclose the valuation as per the proprietary model, including the rationale for using that model and an explanation of the valuation methodology in the Notes to Accounts in their financial statements. The disclosure shall also include the valuation as per the CDS curve published by FIMMDA or a benchmark recommended by FIMMDA.<sup>2</sup>

### **12. Prudential norms, accounting and capital requirements**

- (i) Market participants shall follow the applicable prudential norms and capital adequacy requirements for credit derivatives issued by their respective regulators.
- (ii) The accounting of credit derivative contracts by market participants shall be as per notified and applicable accounting standards read with regulatory guidelines/instructions issued by the respective regulators. In case the notified applicable accounting standards or the respective regulator have not prescribed the accounting treatment for credit derivative contracts, guidance, if any, issued by the Institute of Chartered Accountants of India shall be followed in this regard.

### **13. Obligation to provide information sought by the Reserve Bank**

- (i) The Reserve Bank may call for any information or statement or seek any clarification, which in the opinion of the Reserve Bank is relevant, from persons or agencies dealing in credit derivatives contracts, including eligible participants, and

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<sup>2</sup> The requirement to disclose valuation as per the CDS curve published by FIMMDA or a benchmark recommended by FIMMDA shall be effective once FIMMDA starts publishing the CDS curve or recommends a valuation benchmark.



such persons, agencies and participants shall furnish such information, statement or clarification in the manner and format and within the time frame as may be specified by the Reserve Bank.

#### **14. Dissemination of data**

- (i) The Reserve Bank, or any other person or agency authorised by the Reserve Bank, may in public interest, publish any anonymised data related to transactions in credit derivatives market.

#### **15. Violation of Directions**

- (i) In the event of any person or agency violating any provision of these Directions or the provisions of any other applicable law, the Reserve Bank may, in addition to taking any penal or regulatory action in accordance with law, disallow that person or agency from dealing in the credit derivatives market for a period not exceeding one month at a time, after providing reasonable opportunity to the person or agency to defend its actions, and such action will be made public by the Reserve Bank.

**16.** These Directions shall apply to all credit derivative transactions entered into from the date the Directions come into effect. Existing Directions will continue to be applicable to the credit derivatives transactions undertaken in accordance with the said Directions till the expiry of those contracts.