LEGISLATIVE STRATEGY FOR SETTING UP AN INDEPENDENT DEBT MANAGEMENT AGENCY

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The Public Debt Management Agency is a body that issues public debt with the objective of keeping long term costs of government borrowing low. In India, the existing legal framework obliges the government to give the task of managing its debt to the Reserve Bank of India. Pursuant to its role as debt manager, the Reserve Bank of India set up market infrastructure, such as an exchange and a depository. Carve-outs were made in the regulation of securities to allow the Reserve Bank of India to regulate the bond market. Over the last twenty years, the proposal to establish an independent Public Debt Management Agency has been repeatedly put forward. In this paper, we work out the legal strategy to set up a Public Debt Management Agency. We show the transition path for the roll out and for the movement of the functions, accounts, records and systems to the new agency in a phased manner.

I. INTRODUCTION

Every government requires an institutional arrangement for its borrowing. The institutional framework involves a clear legislative framework and well-defined organisational arrangements with the mandates of different agencies articulated to ensure that there is no overlap.[1] The borrowing of the government, i.e. the sale of bonds, is enabled by a capable bond market.[2] To the extent that the bond market is liquid and has wide ranging participation, it becomes easier for the government to obtain low cost financing.[3] Resource-raising for governments have a 'public debt manager' for advice and issuance similar to that of a resource-raising of a private firm, that has an 'investment banker' for advice and execution.[4]

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[1] *See* International Monetary Fund, *Revised Guidelines for Public Debt Management*, 19, IMF Policy Paper (April 1, 2014), available at https://www.imf.org/external/np/pp/eng/2014/040114.pdf (Last visited on August 6, 2017).

[2] *See* International Monetary Fund & The World Bank, Developing Government Bond Markets: A Handbook (2001).

[3] *See* International Monetary Fund, *supra* note 1, Box 6.

[4] *Id.*; *See* Ministry of Finance, *Report of Internal Working Group on Debt Management* 4 (October 31, 2008).

In India, the Reserve Bank of India ('RBI') has been the agent for government debt management. It also owns or controls bond market infrastructure (exchange, clearinghouse and depository), and regulates the bond market, as a consequence of this mandate. These arrangements were gradually put into place starting from the RBI Act, 1934, to the amendments in the Act (RBI Amendment Act, 2006).[5] In this period, RBI did not have a clear objective, as was emphasised by the preamble of the RBI Act which described the agency as a 'temporary provision'.[6]

This arrangement came into question from two points of view. On one hand, securities markets underwent legal and institutional reform that improved their market infrastructure and regulatory capacity.[7] In parallel, the objective of inflation targeting was gaining currency as the predominant objective of the RBI.[8] This led to the proposal that the debt management work, which conflicts with monetary policy, be placed in an independent Public Debt Management Agency ('PDMA') and the bond market be merged into a securities markets.[9]

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5 Reserve Bank of India (Amendment) Act, 2006.

6 Reserve Bank of India Act, 1934 (The preamble reads as:

"AND WHEREAS in the present disorganization of the monetary systems of the world it is not possible to determine what will be suitable as a permanent basis for the Indian monetary system;

BUT WHEREAS it is expedient to make temporary provision on the basis of the existing monetary system, and to leave the question of the monetary standard best suited to India to be considered when the international monetary position has become sufficiently clear and stable to make it possible to frame permanent measures;").

7 *See* Ajay Shah & Susan Thomas, *"Policy issues in the Indian Securities Market", in: Reforming India's External, Financial and Fiscal Policies* 129-147, Stanford Studies in International Economics and Development (2003).

8 *See* Reserve Bank of India, Standing Committee on International Financial Standards and Codes and India, *Report of The Advisory Group on Transparency in Monetary and Financial Policies* (September 16, 2000), available at http://trove.nla.gov.au/version/39345706 (Last visited on February 11, 2016); *See* Reserve Bank of India, *Report of The Committee on Capital Account Convertibility* (February 28, 1997); Planning Commission of India, *A Hundred Small Steps, Report of the Committee on Financial Sector Reforms* (September 12, 2008), available at http://planningcommission.nic.in/reports/genrep/rep_fr/cfsr_all.pdf (Last visited on January 6, 2015).

9 *See* Reserve Bank of India, *Report of the Expert Committee to Revise and Strengthen the Monetary Policy Framework* (January, 2014), ¶IV.32 (It expressed the concern that:

"Under the extant monetary policy framework, financing of large fiscal deficits through market borrowings has effectively resulted in the use of open market operations ('OMO') primarily to smoothen G-sec yields rather than being employed as a pure monetary policy tool, contrary to cross-country practices which have increasingly favoured the separation of debt management operations from liquidity management (Table IV.11). In India, on the other hand, transmission has been impeded by: (a) not enforcing enough liquidity management discipline in the banking system; and (b) allowing excessive indirect monetisation of the fiscal deficit which also undermines the credibility of discretionary liquidity management operations.").

Drawing on international guidelines, this paper describes the legislative aspects of implementation of the PDMA, analysing the intricacies of a PDMA Act, which establishes the PDMA as an agency, and merges the bond market with securities markets.

Existing thinking on the subject, such as the Financial Sector Legislative Reforms Commission ('FSLRC'),[10] assumes a clean slate[11] in which the PDMA is created as an agency and a unified financial market system is enacted at one go. In this paper, we work out the complexities of amending existing law, without the assumption of a clean slate. Additionally, we work out the issues of sequencing through which the existing institutional arrangements are transitioned into the new arrangements.

There is an extensive discussion on the determinants of an ideal public debt management framework. The principal components of sound public debt management in countries are having clear debt management objectives, clear articulation of roles between debt management and monetary policy and fiscal policy, prudent risk management framework and a strong operational capacity to execute efficient funding.[12] In addition, there is an emphasis on the need to enhance the liquidity of the domestic bond market and address impediments that inhibit the development of bond market such as limited diversification of investor base.[13] This paper lays the groundwork for implementing a PDMA reform.

In Part II of the paper, we explain the concept of the PDMA. Part III shows the legal foundations of the existing arrangements on mandate, bond market infrastructure and bond market regulation. This helps us to give a sense of what must be changed. Part IV summarises the evolution of policy thinking on this question in India from 1997 onwards, and briefly summarises the rationale provided by various elements of this process.

In Part V, we propose the FSLRC law, with small modifications, for the establishment of the PDMA as a financial agency. We show the legislative steps for merging bond market regulation and infrastructure into the

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[10] The Financial Sector Legislative Reforms Commission ('FSLRC') was constituted by the Government of India, Ministry of Finance, in March, 2011, to review and recast the legal and institutional structures of the financial sector in tune with the contemporary requirements of the sector. The main outcome of the Commission's work was a draft Indian Financial Code – a proposed blue-print of a financial sector law which replaces the bulk of existing financial sector laws. One aspect of the Indian Financial Code was a law on PDMA, drawing on international best practices.

[11] The FSLRC was asked to comprehensively review and redraw the legislations governing India's financial system. The FSLRC submitted the Indian Financial Code which replaces the bulk of the existing financial laws and sets up new agencies. In that sense, it assumes a clean slate – a unified coherent law that governs the financial regulatory system.

[12] International Monetary Fund and World Bank, *supra* note 2.

[13] International Monetary Fund, *supra* note 1.

mainstream financial markets. We work out the specific actions and their sequencing. In Part VI, we discuss the transition from the RBI to the PDMA as the debt management agency. Finally, Part VII serves as a conclusion and summarises our position on debt management.

II. THE CONCEPT OF THE PDMA

At a conceptual level, consider the relationship between a private corporation and an investment banker. Corporations require the lowest cost of capital as this influences their ability to invest and their competitiveness. Capital raising is done by the corporation, through the following steps:[14] firstly, the client and corporation, choose which investment banker is the best service provider suited to serve her needs. Subsequently, the chosen investment banker advises the corporation on the optimal methods of raising resources, which would yield the lowest cost financing for the corporation in the long run. The corporation then evaluates this advice and takes a final decision. This decision goes back as an instruction to the investment banker. Finally, the investment banker uses the best available market infrastructure through which securities are auctioned. It is in the interests of the corporation to ensure trading of these securities using the best possible market infrastructure, so as to achieve high liquidity. This would yield a reduced liquidity premium, i.e., a lower cost of capital, and set the stage for future capital raising.

An identical arrangement is found worldwide, with the problem of financing the deficit of a government. Governments require the lowest cost of capital. Government must choose an investment banker who is the best service provider. This agency is termed as "the public debt manager". The public debt manager must take a comprehensive view of all liabilities of the government. It must form a strategy and based on this, advise the government on the optimal methods of raising resources which would yield the lowest cost financing in the long run. Government must evaluate this advice and take the final decisions about securities issuance, which would go back to the public debt manager as an instruction. The public debt manager must use the best available market infrastructure through which the securities are auctioned. It is in the interests of government to ensure that there is a sound bond market, which would yield a lower cost of capital.

The "public debt manager", in the Indian parlance, is termed the 'Public Debt Management Agency'. There is an extensive literature on the question of whether India requires a PDMA. Almost all the literature has argued in favour of construction of the PDMA. This paper is focused on a narrow

[14] *See generally* Imarticus, *The Role of an Investment Banker*, available at http://imarticus.org/roles-investment-banker (Last visited on August 16, 2016) (An overview of the relation between private corporation and investment banker).

question: working out the legislative and executive actions for the construction of the PDMA.

III. THE EXISTING ARRANGEMENT

A. DEBT MANAGEMENT MANDATE

The RBI is the agent of the government, performing debt management, through two elements of the RBI Act:

1. §17(11), clauses (e) and (f) establish the power of the RBI to act as the manager of public debt and to issue and manage bonds and debentures. Of these, clause (e) was in the original 1934 Act, and the front-office function was added in 1949 in clause (f).[15]

2. §21(2) obliges the government to give the public debt management mandate to the RBI. This was in the original 1934 Act.

3. In 1951, §21A was introduced into the RBI Act. Subsection (1)(b) of §21A gave the RBI the power to manage state debt by agreement between the RBI and the respective state. This is a softer provision when compared with the treatment of debt of the Government of India, as the Constitution of India, Seventh Schedule, Article 246, gives states the power to choose their own debt management arrangement.

In this respect, the Ministry of Finance, Internal Working Group on Debt Management, October, 2008 notes that "the RBI Act respects the Constitutional allocation of State debt to the State List: it does not mandate how State Governments should manage their debt, but gives them the option of asking the RBI to do this."[16] Thus, while for the Central Government, the RBI manages debt as an obligation, the State Governments do so by an agreement under the RBI Act, 1934.

B. BOND MARKET INFRASTRUCTURE

Bond market infrastructure is primarily the exchange, the clearinghouse and the depository.[17] These arrangements were constructed in India flowing from the debt management mandate.[18] In the early decades, there were no computers. The only market infrastructure was paper-based tracking of

[15] Clause (e) authorises the RBI to act as agent of the Central Government or any State Government for the management of public debt. Clause (f) authorises the RBI to issue and manage bonds and debentures as agent of the Central Government or any State Government.

[16] Ministry of Finance, *supra* note 4.

[17] *See* International Monetary Fund, *supra* note 1.

[18] Ministry of Finance, *supra* note 4.

ownership of government bonds, which would (in the modern parlance) be termed as the depository function.[19] This paper-based system was called the 'Subsidiary General Ledger' ('SGL'), and was run by the RBI. At first, SGL was an informal system without legal foundations.[20] In 1992, the Harshad Mehta scandal involved manipulation of entries in the SGL.[21] This was the impetus for major changes to bond market infrastructure. RBI began improving operational controls and introducing computers in order to improve SGL, in response to the failures of 1991–1992. There were legal impediments in the way to electronic transfer of gilt securities which is not possible under the Public Debt Act, 1944.[22] The Report on Repurchase Agreements (Repo) recommended the move towards a modern market infrastructure through the enactment of a new Government Securities Act to replace the archaic Public Debt Act, 1944. The RBI set up an electronic ledger for holding government securities. This ledger, the SGL, was legally mandated to be the only depository for government securities through the Government Securities Act, 2006 ('GSA').[23] The SGL primarily has banks and financial institutions as members who hold an account in the depository in which they hold government securities.[24] The GSA gave the RBI exclusive powers to oversee, govern and regulate participation in the depository.[25] The events of 1991-1992 also spurred improvements in bond market infrastructure going beyond the depository. By 2002, an exchange was informally built within the RBI, named the 'Negotiated Dealing System' ('NDS'). At the same time, RBI initiated the creation of an informal clearing corporation, the Clearing Corporation of India Ltd ('CCIL'), which was owned

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[19] Depository function implies holding of securities like shares, bonds, government securities in safe form either physical or electronic at the request of the security-holder. One of the key functions of the Depository is to facilitate transfer of ownership of shares from one investor's account to another investor's account whenever a trade is executed.

[20] The SGL was not recognised in the Public Debt Act. The Government Securities Act which came into force in 2007 gave legal recognition to beneficial ownership of the investors in Government securities. The Government Securities Act also gave powers to the RBI to regulate SGL holders.

[21] When a holder of Government securities sells them and wishes to transfer them to the buyer, he fills up an SGL transfer form and gives it to the buyer. This SGL form can be compared to a cheese: the buyer deposits it into his SGL account at the Public Debt Office ('PDO'), and the PDO makes a book entry reducing the holding of the seller and increasing that of the buyer. A large amount of funds were siphoned off, from the banking system because of the inefficiency and laggardly maintenance of the ledger by the PDO; *See* Samir K. Barua & Jayanth R. Varma, *Securities Scam: Genesis, Mechanics and Impact*, 18.1 Vikalpa 3 (1993); Debashis Basu & Sucheta Dalal, The Scam (From Harshad Mehta to Ketan Parekh) (2009).

[22] The Public Debt Act, 1944 (the Act the rules made therein, allowed transactions in Government securities in physical form).

[23] The Government Securities Act, 2006, §4(1) (A subsidiary general ledger account including a constituents' subsidiary general ledger account and a bond ledger account may be opened and maintained by the Bank subject to such conditions and restrictions as may be specified and in such form and on payment of such fee as may be prescribed).

[24] *See* Reserve Bank of India, *Subsidiary General Ledger Account: Eligibility Criteria and Operational Guidelines* (September 13, 2011).

[25] *See* Government Securities Act, 2006, §§27, 29.

by banks.[26] This added up to a parallel exchange – clearinghouse – depository for the purpose of the bond market. The primary objective of developing this parallel market infrastructure was to allow electronic record keeping of government securities.[27] In a parallel development in the securities markets, the Depositories Act, 1996, was passed. This led to the establishments of depositories – National Securities Depository Ltd. ('NSDL'), and Central Securities Depository Ltd. ('CDSL'). In the GSA, which gave legal foundations to SGL, there was a carve out for SGL by including a provision that nothing in the Depositories Act, 1996, would apply to government securities.[28] In essence, the RBI's depository arrangement for government securities is not regulated by the mainstream depository legislation.[29]

1. International experience on bond market infrastructure

International experience highlights that bond market infrastructure (infrastructure for government securities/bonds) is broadly a part of the mainstream financial market infrastructure. Table 1 presents an overview of the Government bond market infrastructure in similarly placed economies.

Table 1. Bond market infrastructure in selected economies

Country	Trading infrastructure	Depository	Settlement of Securities Transactions
Japan	PTS (Proprietary trading system), multiple platforms	Bank of Japan	BoJ-NET
India	NDS-OM	SGL (Subsidiary General Ledger,)	CCIL (Clearing corporation of India)
South Korea	KRX (Korea-Exchange) trading system	Korea Securities Depository	Korea Securities Depository is under supervision of MoSF, FSC and FSS

[26] NDS-OM is a screen based electronic anonymous order matching system for secondary market trading in Government securities owned by RBI. Presently the membership of the system is open to entities like Banks, Primary Dealers, Insurance Companies, Mutual Funds etc., i.e., entities who maintain SGL accounts with RBI. *See generally* Reserve Bank of India, *NDS-OM Web, Frequently Asked Questions*, available at https://rbi.org.in/scripts/FAQView.aspx?Id=86 (Last visited on August 16, 2016).

[27] The Public Debt Act, 1944 (it did not provide a framework for electronic record-keeping of government securities).

[28] *See* The Government Securities Act, 2006, §31 (It provides that nothing in the Depositories Act shall apply to government securities covered by the Government Securities Act, unless an agreement to the contrary is executed between a depository under the Depositories Act, and the Government or the RBI).

[29] Ministry of Finance, *supra* note 4, 16.

Country	Trading infrastructure	Depository	Settlement of Securities Transactions
Indonesia	FITS (Fixed income trading system) by Stock Exchange	Central bank	SSSS (Scripless Security Settlement System) run by Bank Indonesia
Israel	TACT (Tel-Aviv Continuous Trading) run by stock exchange (Tel Aviv)	TASE clearing house	TASE clearing house
Vietnam	EBTS run by HNX	Vietnam Securities Depository	Vietnam Securities Depository
Malaysia	Fully Automated System for Issuing (FAST)	Bursa Malaysia Depository	STSS (Scripless Securities Trading and Settlement) Bank by the Central Bank
Taiwan	EBTS run by TPEX	TDCC (Taiwan Depository and Clearing Corporation)	CGSSS (Central Government
Nepal	NATS (NEPSE automated trading system)	NRB (Nepal Rastra Bank)	CDS and Clearing Limited
Thailand	Stock Exchange of Thailand	Thailand Clearing House	Thailand Clearing House Thailand Securities Depository
South Africa	OTC and the Johannesburg Stock Exchange	Central securities depository	Strate

The first column presents an overview of the trading infrastructure, the second column provides information on depository arrangements and the third column describes the framework for settlement of bond market transactions. The first column shows that in most of the countries, the bonds are traded on the platform provided by the stock exchange. Government bond issuance and trading is a part of the unified framework of securities trading. Malaysia is the only country other than India where trading of bonds takes place on a platform owned by the Central Bank. As far as the infrastructure of depository is concerned, the Central Bank is the responsible authority in Japan, Indonesia and Nepal. In all the other countries, the depository infrastructure for Government bonds is part of the unified infrastructure for other securities.

The settlement of government securities is overseen by the securities market regulator with a few exceptions. As an example, in Malaysia, the settlement of the primary and secondary market transactions in government securities and unlisted corporate debt securities take place through the Scripless Securities Trading System ('SSTS'), which is part of the Real Time Electronic Transfer of Funds and Securities ('RENTAS') system. In summary, an overview of bond market infrastructure arrangements in other economies suggests that:

1. Government bond issuance and trading is part of the unified framework of securities trading.

2. The depository infrastructure for Government bonds is part of the depository infrastructure for the financial market with a few exceptions.

3. The settlement of government securities is overseen by the securities market regulator. India is the only country where all the three elements of bond market infrastructure are owned, controlled and managed by the Central Bank.

C. BOND MARKET REGULATION

At first, the bond market was unregulated. The first milestone towards the evolution of a framework of bond market regulation came about in 1944 with the enactment of the Public Debt Act, 1944. The Preamble of the Act read as follows, "An Act to consolidate and amend the law relating to Government Securities and to the management by the Reserve Bank of India of the public debt of the Government."

Over time, the RBI demanded enhanced regulatory powers over the bond market. A large number of legal changes were undertaken in order to achieve this.[30]

§16 of the Securities Contracts (Regulation) Act, 1956, empowers the Central Government to prohibit securities contracts in certain cases. Through a notification dated June 27, 1969 issued by the Government of India under §16 of the Securities Contracts (Regulation) Act, 1956, all forward contracts in securities were banned.

In August, 1999, the Report on Repurchase Agreements (Repo) recommended that to develop the repos in Government securities, it is necessary that the 1969 Notification issued under§16 of the Securities Contracts

[30] *See* Reserve Bank of India, *Summary of Recommendations*, *Report on Repurchase Agreements* (August 6, 1999).

(Regulation) Act, 1956,[31] be rescinded and the full powers over repos (repurchase transactions) be vested with the RBI.[32] In the absence of this, the RBI would have to keep coming to the Government to seek exemption for banks in order to make them eligible for undertaking repos. Government of India rescinded the 1969 notification in 2000. Consequently, by a 2000 SCRA Notification, the Central Government has delegated powers to the RBI under §16 of the Securities Contracts (Regulation) Act, 1956, for regulating contracts in government securities, money market securities, gold related securities and derivatives based on these securities.[33]

The Report on Repurchase Agreements (Repo) further recommended that the RBI should acquire regulatory powers under §29A[34] of the Securities Contracts (Regulation) Act, 1956. The Report recommended:

> "As expansion of the repo market with wider participation and variety of instruments would require RBI to have enhanced regulatory powers over the debt market there is need to amend §29A of SCR Act to enable the Government to delegate regulatory powers for of trading in Government Securities and other debt instruments."

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[31] The Securities Contracts (Regulation) Act, 1956, §16 (It gives powers to the Central Government to prohibit contracts in certain cases. The text of the section reads as:

"If the Central Government is of opinion that it is necessary to prevent undesirable speculation in specified securities in any State or area, it may, by notification in the Official Gazette, declare that no person in the State or area specified in the notification shall, save with the permission of the Central Government, enter into any contract for the sale or purchase of any security specified in the notification except to the extent and in the manner, if any, specified therein").

[32] *See Reserve Bank of India*, *Ready Forward Contracts*, IDMC.No.PDRS.3346/10.02.01/99-2000 (notified on March 29, 2000), (This notification issued under §16 of the Securities Contracts (Regulation) Act stated that:

"In the territory to which the Act extends, no person can except with the permission of the Central Government enter into any contract for the sale or purchase of securities other than such spot delivery contract or contract for cash or hand delivery or special delivery in any security as is permissible under the Act and the Rules and bye-laws and the regulations of the recognised stock exchange").

[33] *Id*. (The operative part of the 2000 SCRA Notification states:

"Provided the powers exercisable by the Central Government under the said §16 of the said Act, in relation to any contracts in Government securities, money market securities, gold related securities and in securities derived from these securities and in relation to ready forward contracts in bonds, debentures, debenture stock, securitised debt and other debt securities shall also be exercisable by the Reserve Bank of India constituted under §3 of the Reserve Bank of India Act, 1934 (2 of 1934)").

[34] The Central Government may, by order published in the Official Gazette, direct that the powers (except the power under §30) exercisable by it under any provision of this Act shall, in relation to such matters and subject to such conditions, if any, as may be specialised in the order, be exercisable also by the Securities and Exchange Board of India or the Reserve Bank of India constituted under §3 of the Reserve Bank of India Act, 1934 (2 of 1934).

These developments marked the beginning of a shift of the regulatory powers over government securities to the RBI. Later in 2006, the RBI Act was amended and a new chapter III D was added to vest the RBI with overarching powers to regulate interest rate products and to give directions to all agencies dealing in 'securities', 'money market instruments', 'derivatives' and certain other instruments.[35]

The RBI also derives regulatory powers through certain provisions of the GSA. §29 of the GSA, gives powers to the RBI to call for information, cause inspection and issue directions. §30 confers power on the RBI to impose penalty on any person who contravenes any provision of the GSA, or contravenes any regulation, notification or direction issued under the GSA. §32 empowers the RBI to make regulations to carry out the purposes of the GSA.

As a consequence of the above changes, regulation of the bond market, like its market infrastructure, was separated from India's securities markets, where corporate bonds, shares and derivatives were transacted. This, as we shall discuss in the next section, had consequences for financial market development in India.

1. International experience on bond market regulation

Table 2 and Table 3 present an overview of institutional arrangements governing debt management and regulation of debt market. A key finding emanating from the Tables is that the agency responsible for management of debt, including issuance of Government securities is distinct from the agency regulating bond market. The location of debt management agency varies. In some countries, there are specialised agencies responsible for issuance and management of public debt such in Germany. In some others, the responsibility for management of debt is vested in an Executive Agency of the Ministry of Finance such as in the UK and Australia. In some other countries, the responsibility of debt management is vested in a Department within the Ministry of Finance such as in Brazil, France and Argentina. In India and China, the public debt is managed by the Central Bank. The unified regulator of financial market serves as the regulator of Government bond market. We do not see examples of countries where the regulator of Government bond market is distinct from the overall securities market regulator. Even in countries where the Central Bank manages public debt, the regulation of Government bond market is not solely vested with the Central Bank. India stands out as the only example where the

[35] Reserve Bank of India Act, 1934

("The Bank may, in public interest, or to regulate the financial system of the country to its advantage, determine the policy relating to interest rates or interest rate products and give directions in that behalf to all agencies or any of them, dealing in securities, money market instruments, foreign exchange, derivatives, or other instruments of like nature as the Bank may specify from time to time.").

Central Bank is the issuer and manager of Government debt as well as the regulator of Government debt.

Table 2. Institutional arrangements for debt management and bond market regulation: Advanced economies

Country	Regulator-Bond Market	Public Debt Management
Australia	Australian Securities and Investment Commission (ASIC)	Australian Office of Financial Management
France	Autorite Des Marches Financiers (AMF)	Agence France Tresor
Canada	Investment Industry Regulatory Organization of Canada (IIROC)	Canadian Ministry of Finance
Italy	CONSOB	Italian Treasury-Public Debt Directorate
Japan	Financial Services Agency	Ministry of Finance and Bank of Japan
U.S.A.	Securities and Exchange Commission (SEC)	The Office of Debt Management, US Treasury
Germany	Federal Financial Supervisory Authority (BaFin)	German Federal Republic Finance Agency (Gmbh)
UK	Financial Conduct Authority (FCA)	UK DMO (Executive agency of HM treasury)

Table 3. Institutional arrangements for debt management and bond market regulation: Emerging economies

Country	Regulator-Bond Market	Public Debt Management
Argentina	Comision Nacional de Valores (CNV)	Ministry of Economy and Public Finances
Saudi Arabia	Capital Markets Authority (CMA)	Central Bank
South Africa	Financial Services Board (FSB)	National Treasury
India	Central Bank	Central Bank
China	China Securities Regulatory Commission (CSRC) and Central Bank	Central Bank (Internal debt), Ministry of Finance (External debt)
Mexico	National Banking and Securities Commission (CNBV)	Mexican Ministry of Finance and Public Credit
Russia	Federal Financial Markets Service (FFMS)	Central Bank

Country	Regulator-Bond Market	Public Debt Management
Brazil	Brazilian Securities and Exchange Commission	Public debt Undersecretariat
Indonesia	Financial Services Authority (FSA)	Directorate of Government Securities Management, Ministry of Finance
Turkey	Capital Markets Board (CMB)	Undersecretary of Treasury
South Korea	Financial Supervisory Service (FSS) under Financial Services Commission (FSC)	Ministry of Strategy and Finance, Government Bond Policy Division

IV. TOWARDS AN INDEPENDENT DEBT MANAGEMENT AGENCY

In the previous section, we have described India's journey to the present debt management arrangement. In parallel, there was a process of policy analysis, which analysed these arrangements and evaluated reforms. The areas of concern were the success of reforms of the mainstream financial markets,[36] the failure of bond market development,[37] the conflict of interest between monetary policy and debt management[38] and the need for an agency that would serve the interests of state governments.[39]

The preceding sections have described the steps through which the mandate for RBI of debt management led to RBI's construction of bond market infrastructure and RBI's regulation of the bond market. In parallel, the mainstream financial markets of India were experiencing dramatic reforms. With extensive legislative activism including one Constitutional Amendment, and the establishment of securities market regulator: Securities and Exchange Board of India (SEBI), stock exchanges: National Stock Exchange (NSE), Bombay Stock Exchange (BSE), depositories: National Securities Depository Limited (NSDL), Central Depository Services Limited (CDSL) and commodities exchanges: National Commodity & Derivatives Exchange Limited (NCDEX), Multi Commodity Exchange of India Limited (MCX), etc., revolutionary gains were achieved in financial market infrastructure and in financial markets regulation.[40] There was a contrast between the operational capabilities,

[36] *See* Shah & Thomas, *supra* note 7.

[37] *See* the recommendations in Planning Commission of India, *supra* note 8.

[38] *See* Reserve Bank of India, *Report of the Expert Committee to Revise and Strengthen the Monetary Policy Framework*, (January 2014).

[39] *See* Ministry of Finance, *supra* note 4.

[40] *See* Shah & Thomas, *supra* note 7 (NSE initiated many important innovations in market design in India. The most important of these included nationwide electronic trading (1994), the clearing corporation as a central counterparty (1996) and paperless settlement at the depository (1996). NSE was a pioneer amongst securities exchanges in the world in using a "demutualised" structure, where brokerage firms did not own the exchange.).

regulatory sophistication and the end outcome (a deep and liquid market) of these markets when compared with the difficulties of the bond market.[41] It became increasingly attractive to solve the problem of bond market development by merging bonds into the mainstream financial market system in terms of both market infrastructure and regulation.

From the viewpoint of debt management, there was a conflict of interest between RBI's objective as a central bank (to deliver a target rate of inflation) and RBI's objective as a debt manager (to deliver a low cost of borrowing).[42] There was also a problem of fragmentation of the overall debt management problem between multiple agencies, which resulted in the lack of a single view and the lack of a debt management strategy.[43] The Reserve Bank of India ('RBI') carries out the market borrowing plan for the Central and State Government. Central Government directly manages the negotiated external debt. Cash management is the responsibility of the RBI in consultation with the division under the Ministry of Finance. A substantial part of the small savings function is performed by post offices and banks. Contingent and other liabilities are fragmented across various departments and in the Ministry of Finance ('MoF'). The function of managing Government loans to others is overseen by various Ministries. Hence, government debt in India is not consolidated hindering the ability to get a holistic picture of the total government liabilities at one place and in near real time.[44]

These difficulties led to a large number of calls for the establishment of an independent PDMA. RBI was the original proponent of debt management reform, having first recommended it two decades ago. The RBI in the Working Group on Separation of Debt Management from Monetary Management (December 1997), recommended that a company be established

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41 Asifma, *India Bond Market Roadmap*, available at http://www.asifma.org/uploadedFiles/News/ASIFMA%20-India%20Bond%20Market%20Roadmap%20Draft_wCover.pdf (last seen on August 2, 2017) (while recognising RBI's efforts to promote government securities trading in the secondary market reports that the market is still illiquid and in need of a significant change).

42 Numerous expert committees have recommended separation of monetary management and debt management function. *See* recommendations of RBI, *Report of The Committee on Capital Account Convertibility*, (February 1997); RBI, *Report of The Advisory Group on Transparency in Monetary and Financial Policies*, (September 2000); RBI, *Report of The Committee on Fuller Capital Account Convertibility*, (July 2006).

43 *See* Ministry of Finance, *Report of the Comptroller and Auditor General of India on Public Debt Management,* (*Performance Audit*), Report No. 16 of 2016, (July 2016) (for an overview of the inadequacies in the legal framework pertaining to management of public debt. It recommends that the legal framework should be consistent and should require the preparation of a debt management strategy.).

44 The Ministry of Finance, *Report of the Internal Expert Group on the Need for a Middle Office for Public Debt Management*, (2001) (discussed the need for a comprehensive strategy for public debt management, with an integrated approach towards domestic and external public debt management).

under the Indian Companies Act to take over the government's debt management function.

Further in the Report of The Committee on Capital Account Convertibility (February 1997) the RBI recommended that:

> " […] steps should be initiated to separate the debt management policy from monetary management and to this effect the Government should set up its own Office of Public Debt; RBI should totally eschew from participating in the primary market of Government borrowing."[45]

Several subsequent reports and publications issued by the RBI have repeated the need for hiving out its public debt management function to a separate agency. For instance, the RBI in the Report of The Advisory Group on Transparency in Monetary and Financial Policies, (September 2000) recommended that, "The government should set up its own independent Debt Management Office to take over, […] the present debt management functions discharged by the RBI". The RBI in the Report of The Advisory Group on Transparency in Monetary and Financial Policies (September 2000) stated that,

> "There should be well calibrated legislative measures to separate debt management and monetary policy functions. The government should set up its own independent Debt Management Office to take over, in a phased manner, the present debt management functions discharged by the RBI. The Advisory Group recognises that separation of debt management and monetary policy is a necessary but not a sufficient condition for an effective monetary policy which would also require a reasonable degree of €fiscal responsibility."[46]

The RBI Annual Report for 2000-2001, also recommended the separation of the functions of debt and monetary management in the medium-term,

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[45] Fiscal Responsibility and Budget Management Act, 2003, §5 (prior to 2006, the RBI used to participate in the primary issuance of Government securities. With a view to promote prudential debt management framework, the FRBM Act provided that the Central Government shall not borrow from the RBI in the form of subscription to the primary issues by the RBI except under special circumstances).

[46] RBI, *Report of The Advisory Group on Transparency in Monetary and Financial Policies,* (September 2000) (notes that with large fiscal deficits, and consequent market borrowing programme in recent years, there has been an overarching of debt management policy on monetary policy. The monetisation of fiscal deficit and issuance of government securities at below market interest rates attenuated the effectiveness of monetary policy. With RBI being the statutory debt manager of the Government, there could be pressure to lower the interest rates to reduce the cost of borrowing for the Government. Therefore, fiscal prudence and limits on borrowing from RBI is also required for an effective functioning of monetary policy.).

and the explicit removal of the debt management function from the RBI.[47] The RBI, Report of The Committee on Fuller Capital Account Convertibility, July, 2006, emphasised the separation of monetary and debt management functions of RBI.[48] The recommendation for a separate debt management function can similarly be found in several reports commissioned by the government. For instance, the Ministry of Finance in the Report of the Internal Expert Group on the Need for a Middle Office for Public Debt Management (2001) discussed the need for a comprehensive strategy for public debt management, with an integrated approach towards domestic and external public debt management.[49] It recommended establishing a centralised middle office in the Department of Economic Affairs to develop a comprehensive risk management framework as the first stage of this process, and establishing an autonomous Public Debt Office as the second stage.[50]

Ministry of Finance in the Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre (February 2007) and the Report of the Internal Working Group on Debt Management (October 2008) similarly recommended setting up an independent debt management office.[51] The Planning Commission in the Report of the Committee on Financial Sector Reforms (September 2008) discussed the issue of financial repression and articulated need for a separate debt management agency as "This is also a good time to carefully think about changing the structure of public debt management, particularly in a way that minimizes financial repression and generates a vibrant government bond market."[52]

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47 Reserve Bank of India, *Annual Report* (2000-2001).

48 The RBI, *Report of The Committee on Fuller Capital Account Convertibility*, (July 2006) states:

"For an effective functional separation enabling more efficient debt management as also monetary management, the Committee recommends that the Office of Public Debt should be set up to function independently outside the RBI."

49 Ministry of Finance, *supra* note 16.

50 Ministry of Finance, *supra* note 43, states:

"The second stage would involve a phased approach for setting up an autonomous Public Debt Office (PDO) under a Public Debt Act of the Parliament. The debt office would gradually integrate the debt management responsibilities performed by different wings of Ministry of Finance and RBI in the present dispersed structure of public debt management. The need for an autonomous PDO stems mainly from the concern regarding conflict of objectives between debt management and monetary management. Constraints imposed by the present public sector regulations in attaining sufficient professionalism in a PDO set up are another consideration."

51 The Ministry of Finance, *Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre*, *February*, (2007) states:

"Looking ahead, a sound public borrowing strategy for India would incorporate three elements. . . An independent Indian debt management office - operating either as an autonomous agency or under the Ministry of Finance - that regularly auctioned a large quantum of INR denominated bonds in an IFC in Mumbai. The size of these auctions would be substantial by world standards and would enhance Mumbai's stature as an IFC."

52 Planning Commission, *Report of the Committee on Financial Sector Reforms* (September 2008).

In the present framework, as banking regulator RBI requires banks to hold a share of their deposits under the Statutory Liquidity Ratio ('SLR').[53] Emphasising on the need for minimising financial repression by creating a vibrant government bond market to ensure low cost financing of Government debt, the report stated:

> "The government will also need a vibrant government bond market to provide it low cost financing, as it relies less on forcing banks through statutory requirements to hold its debt. A deep government debt market across all maturities will provide the benchmarks that the private sector needs for pricing corporate debt, and various kinds of hedging instruments."[54]

More recently, the Ministry of Finance in the Report of the Financial Sector Legislative Reforms Commission (March 2013) recommended the creation of a specialised debt management agency and also provided a draft law which would govern its function.[55] The RBI in the Report of the Expert Committee to Revise and Strengthen the Monetary Policy Framework (January 2014) also emphasised the need to separate debt management from monetary management.[56] The recently released Report of the Comptroller and Auditor General of India on Public Debt Management, Report No. 16 of 2016 (Performance Audit) (July 2016) of the Ministry of Finance raised concerns about the state of the debt management framework in India and emphasised the need for a specialised debt management agency as recommended by expert committees.[57]

In parallel, a stream of expert committee reports (e.g. the Ministry of Finance, Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre (February 2007), the Planning Commission, Report of the Committee on Financial Sector Reforms (September 2008), the Report of the Inter-Ministerial Task-Force on Convergence of Securities and Commodity Derivatives Market (August 2003), etc.) argued in favour of 'convergence' of financial markets. For example, the Planning Commission in the

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53 Banking Regulation Act, 1949, §24.

54 RBI, *Report on Currency and Finance: Fiscal-Monetary Co-ordination* (2009-2012).

55 Ministry of Finance, *Report of the Financial Sector Legislative Reforms Commission* (March 2013).

56 The RBI, *Report of the Expert Committee to Revise and Strengthen the Monetary Policy Framework*, (January 2014) (presents an overview of debt management arrangements in some emerging market economies wherein the Central Bank is not responsible for debt management, though it may act as an agent for administering the debt management regulations).

57 *Id*. (The report notes as follows:

"In this regard it is to be noted that while some measures had been taken for the setting up of a PDMA, the task force for the setting up of an independent PDMA was established only in September 2014, six years after the setting up of the Middle Office (MO) and there was no clarity on the proposed establishment of the PDMA despite several statements made by the Finance Minister in Parliament.")

Report of the Committee on Financial Sector Reforms (September 2008) noted that:

> "A key defect of financial markets lies in the separation between RBI, SEBI, and FMC. The Committee deliberated on this issue at length and emerged with two main conclusions: (a) there is a lot to be gained by unification of these functions; and (b) the right agency into which these functions should be unified is SEBI.
>
> […] In order to widen the ambit and functions of SEBI, the SEBI Act should be amended by the insertion of chapters which confer upon it the powers of other regulators to the extent that such other regulators regulate trading."[58]

In all countries, there are economies of scale and scope[59] from unification of the regulation and of the market infrastructure of all financial markets.

The framework discussed in the preceding paragraphs of having an independent debt management agency and a unified financial market regulation alongside a unified financial market infrastructure in the form of unified exchange, depository and settlement system was also recommended by the Report of the Financial Sector Legislative Reforms Commission, Volume I: Analysis and Recommendations, which envisaged full unification of all financial market infrastructure, with regulation by the 'Unified Financial Authority', and the establishment of the PDMA.[60] The legal framework proposed is a single law, the Indian Financial Code, proposed by FSLRC to replace all existing financial sector laws.[61] This paper proposes a solution where the outcome of an PDMA is obtained under the present legal framework through a PDMA law and a roll back of those laws and amendments such as the GSA or amendments to the RBI Act that were a consequence of its role as debt manager.

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58 Planning Commission of India, *supra* note 52.

59 In the present context economies of scope and scale arise when there are reduction in costs and improvement in efficiency through unification of financial market regulation and infrastructure across equities, bonds, derivatives and currencies; The Planning Commission of India, *supra* note 8 (argues that there are strong commonalities between all kinds of trading: an electronic order-matching system for currencies or index futures or gold futures or interest rate swaps is largely the same. Government, exchanges and financial firms would be able to harness economies of scale and economies of scope by undertaking, or dealing, with all organised financial trading under a single roof).

60 *See* Indian Financial Code, 2014.

61 *Id*.

V. THE SOLUTION

In this section, we work out the steps through which responsibility of debt management shifts from RBI to PDMA. This requires the construction of a new agency and a roll back of the amendments made consequential upon RBI's role as debt manager. We also propose a transition path for which some additional amendments may be required before the repeal of some sections of the law.

A. AGENCY CONSTRUCTION

The work-process leading up to the setting up of a unified and independent debt management agency requires the following steps:

1. The First Step is to Draft a Law that Establishes the Agency

Drawing on international guidelines[62] the FSLRC has provided a blue print of the law governing the establishment and functioning of an independent PDMA.[63] The key features of the law dealing with PDMA under the Indian Financial Code are as under:

> "*Objective of the PDMA*: The law provides an explicit objective to the PDMA i.e. to minimise the cost of raising and servicing public debt over the long term and to keep public debt within an acceptable level of risk at all times.[64]
>
> *Functions of the PDMA*: The law envisages the following functions to be performed by the PDMA:
>
> (a) issuance and management of government securities;
>
> (b) management of public debt, contingent liabilities and cash, of the Central Government."

The law lays down the detailed procedure which the PDMA must follow towards managing the debt of the Central Government. The management

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[62] Elsie Addo Awadzi, *Designing Legal Frameworks for Public Debt Management*, IMF Working Paper, Paper No. 15/147, 2015.

[63] This law is referred to as the Indian Financial Code. It covers all aspects of financial regulation. Part XV of this law deals with PDMA.

[64] *See* Financial Sector Legislative Reforms Commission, *supra* note 55 (§352 of the Revised Indian Financial Code, FSLRC lays down the objective of the PDMA. The text of the section is as under:

"The objective of the Debt Agency is to:

(a) minimise the cost of raising and servicing public debt, over the long-term; and

(b) keep public debt within an acceptable level of risk at all times.").

of public debt involves formulation of a medium term public debt plan[65] and an annual debt plan.

The medium term public debt plan must be formulated at the end of three calendar years and submitted to the Central Government for approval. The law envisages that the annual debt plan must be formulated at the end of each calendar year. The plans must be submitted for approval by the Central Government and must be executed after modification and approved by the Central Government. The annual public debt plan must take into account the medium-term plan, the forecasts of revenue and expenditure, the evolving market conditions and other factors.[66]

At present §17(11) and §21 of the RBI Act provides define the role of the RBI in managing public debt of the Central Government. However the RBI Act does not provide the mechanism for management of public debt. The Internal Debt Management Department ('IDMD') of the RBI formulates half-yearly/annual calendar for primary issuance of the government securities, decides the size, timing and maturity of issuances and conducts auctions, taking into account the government's needs, market conditions and preference of various investor segments. The salient features of the issuance procedures have been codified through a Government notification called General Notification.[67]

The law also lays down procedure for managing cash balances of the Central Government.[68]

> "*Power of Central Government to issue directions to PDMA*: The law empowers the Central Government to issue directions to the PDMA on policy from time to time.[69]
>
> *Payment of fees to PDMA*: The Central Government must pay fees to the PDMA for the services rendered by the PDMA."[70]

To be a stand-alone law governing all aspects of debt management, the above described FSLRC law on PDMA requires certain modifications. The law should require the PDMA to put in place a register recording the ownership of all securities, internal and external, issued by the PDMA. The register should, ideally also maintain a record of all the guarantees issued

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65 The medium-term plan is to achieve the desired composition of public debt for the immediately following three years.

66 *See* §354, Revised Indian Financial Code, FSLRC.

67 *See* Ministry of Finance, Government of India, *Revised General Notification for issue of Government of India Dated Securities*, 2008, F.No.4(13)-W&M/2008 (notified on October 8, 2008).

68 *See* §361, Revised Indian Financial Code, FSLRC.

69 *See* §367, Revised Indian Financial Code, FSLRC.

70 *See* §366, Revised Indian Financial Code, FSLRC.

by the Government. This register becomes a key document to understand the magnitude of debt by the Government. This register is then linked to the register and an index of beneficial owners maintained under the Depositories Act.[71]

> "The register and index of beneficial owners maintained by a depository un- der section 11 of the Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purposes of this law."[72]

This harnesses the legal and institutional foundations of the mainstream financial markets.

Another modification required in the law is to place an obligation on part of the RBI to provide all information and render all assistance that the PDMA may require in the initial stages. The following provision must be introduced:

> "Notwithstanding anything contained in any other law for the time being in force, the Reserve Bank shall provide all information and render all assistance as the Agency may require it to provide and render, so that the Agency is able to discharge its functions, with minimal interruption."

2. The Second Step is to Amend the Provisions that Confer Debt Management Function to the RBI

Consequential amendments to the RBI Act for debt management mandate are discussed in the subsequent paragraphs:

> "(a) Deletion of clauses: Currently, §§17(11)(e) and 17(11)(f) of the RBI Act authorises the RBI to act as an agent for the central government for public debt management and issuance of bonds and debentures. These clauses can be deleted. However, in the transition the clauses will be used, and hence will need to be initially amended to specify that RBI will perform this function if the Central Government issues a notification under §21(2) of the RBI Act entrusting the RBI with the function of managing public debt and issuing and managing bonds and debentures of the Central Government.[73]

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[71] The Depositories Act, 1996.

[72] *Id*., §152A.

[73] The following proviso shall be inserted after §17(11)(f) of the RBI Act:

> "Provided that the Bank may exercise the functions specified in clauses (e) and (f) of this sub-section for the Central Government, if the Central Government issues a notification

> (b) Deletion of section: Further, §21(2) obligates the central government to entrust the debt management function to RBI. This section can be deleted. But again, for the purpose of transition, the clause will need to be amended so that Government can entrust this function to the RBI until the PDMA is set up."[74]

Once the PDMA is fully operational, these sections will be deleted.[75]

B. BOND MARKET INFRASTRUCTURE

§4 of the GSA empowers the RBI to open and maintain a SGL, constituents' SGL account and a bond ledger account.[76] The provisions of the GSA also exclude the applicability of the Depositories Act to government securities. As part of the PDMA reform, the GSA will need to be repealed. However, in the transition this Act will be amended to allow the PDMA to transition and integrate the systems with securities market infrastructure.[77]

Once the PDMA is fully operational, the GSA will be repealed and would be governed by the provisions of the PDMA law.[78]

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under Section 21(2) of this Act, entrusting the Bank with the function of managing public debt and issuing and managing bonds and debentures of the Central Government."

74 §21(2) of the Reserve Bank of India Act shall be substituted as under:

"(2) The Central Government shall, by notification in the Official Gazette, entrust the Bank or the Public Debt Management Agency, on such conditions as may be agreed upon, with the management of the public debt, issue and management of bonds and debentures of the Central Government and issue of any new loans."

75 §§17(11)(e), 17(11)(f) and 21(2) of RBI Act shall stand deleted.

76 §4, Government Securities Act, 2006. It states:

"A subsidiary general ledger account including a constituents' subsidiary general ledger account and a bond ledger account may be opened and maintained by the Bank subject to such conditions and restrictions as may be specified and in such form and on payment of such fee as may be prescribed."

§2(c), Government Securities Act, 2006 defines Bond ledger account as "an account with the Bank or an agent in which the Government securities are held in a dematerialised form at the credit of the holder."

77 The following section shall be inserted as §34A in the Government Securities Act:

"34A. Power of the Bank transitioned to the Public Debt Management Agency- All references to the Bank in this Act shall be construed as references to the Public Debt Management Agency.

Provided that -(a) all directions issued by the Bank under this Act, before the date on which this amendment is notified, shall stand repealed;

(b) all actions taken by any person under any direction issued by the Bank under this Act, before the date on which this amendment is notified, shall be valid and legal."

78 After §35 of the Government Securities Act, the following section shall be inserted, namely, "35A. The Government Securities Act, 2006 is hereby repealed."

There is no statutory backing for the exchange and clearing house that RBI has established (the Negotiated Dealing System-Order Matching System ('NDS-OM')[79] and the CCIL[80]). Therefore, no legislative changes are required in order to address them.

C. REGULATION OF THE BOND MARKET

As discussed in the preceding sections there are gains to be achieved through harmonisation of securities market regulation. All securities are fundamentally alike. There is some traded security. There are orders to buy and sell. There is some mechanism through which buy and sell orders are matched. These go into a clearing house and are settled at a depository. In India, for historical reasons,[81] a carve-out was created for regulation of government securities market, distinct from the mainstream financial regulation. This led to fragmentation of financial markets. As discussed in the preceding section, a number of expert committees have also argued in favour of unification of financial market regulation.

Unification of financial market regulation is critical for an efficient conduct of PDMA. The Planning Commission, Report of the Committee on Financial Sector Reforms, September, 2008, Ministry of Finance, Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre, February, 2007 and Ministry of Finance, Report of the Financial Sector Legislative Reforms Commission, March, 2013 focused on financial sector reform and have all supported PDMA using the securities market infrastructure on the grounds that wider participation in the bond market would enable the development of deep and liquid bond markets in India.[82] From

[79] As mentioned earlier, NDS-OM is a screen based electronic anonymous order matching system for secondary market trading in Government securities. The membership of the system is open to entities like Banks, Primary Dealers, Insurance Companies, Mutual Funds etc. i.e. entities who maintain SGL accounts with RBI. This system was set up by RBI in 2002 to automate the process of trading and settlement in government securities. For operational details on NDS-OM, *see* Reserve Bank of India, *Negotiated Dealing System (NDS)* (April 29, 2010) available at https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/NDSOM290410.pdf (Last visited on August 2, 2017); Securities Contracts (Regulation) Act, 1956, §§3, 4 (confers powers on the government of India to regulate and supervise all stock exchanges. However NDS-OM is not set up under the Securities Contracts (Regulation) Act).

[80] CCIL is a Central Counterparty (CCP) which was set up in April 2001 to provide clearing and settlement for transactions in Government securities, foreign exchange and money markets in the country. This was set up by RBI and does not derive its origin from any statute.

[81] *See* Part 3(C) of the paper.

[82] *See* Reserve Bank of India, *supra* note 6; Ministry of Finance, *supra* note 51; Ministry of Finance, *supra* note 55. At present, the bond market is characterised by restricted membership of the SGL account. Each entity eligible for dealing in Government securities is required to open a SGL account and a current account with the back office of RBI. In exercise of powers under §4 of the Government Securities Act, the RBI specifies the conditions for opening and maintaining the SGL account. The RBI lays down a list of entities who are eligible to open and maintain SGL accounts (for more details *see* Reserve Bank of India, Subsidiary General Ledger Account: Eligibility Criteria and Operational Guidelines, (December 4, 2009)) The list primarily includes banks, Primary Dealers, Financial Institutions, Insurance companies,

the point of view of the PDMA, it will need a bond market to sell government securities as the present arrangement of RBI as the banking regulator requiring banks to hold government securities under their SLR, is also being slowly phased out.[83]

The work-process leading up towards the harmonised framework of securities market trading requires the following legal changes:

1. Deletion of Chapter IIID of RBI Act

Chapter IIID of RBI Act comprises of §§45U, 45V, 45W and 45X. These sections are proposed to be deleted, for the following reasons:

"(a) §45V provides that notwithstanding the Securities Contracts (Regulation) Act, transactions in derivatives are valid only if one of the parties to such transactions is the RBI, a scheduled bank or an agency under the regulatory purview of RBI. In the proposed framework, all derivative transactions will be governed under Securities Contracts (Regulation) Act.

(b) §45W empowers the RBI to issue directions to all agencies dealing in government securities, money market instruments, foreign exchange, derivatives, or other instruments of like nature. To harmonise the regulation of securities trading, the RBI will no longer have the power to issue directions in respect of these instruments, except as set out below:

Mutual Funds, Provident and Pension Funds, NSDL and CDSL. Entities other than these cannot directly deal in Government securities. This explains the concentrated ownership of Government securities. In addition, the membership of NDS-OM is also restricted. The RBI prescribes the routes to access the order-matching segment of NDS for trading in government securities. Direct access is provided only to SGL account holders including banks, primary dealers, mutual funds, insurance companies, financial institutions etc.

83 Statutory Liquidity Ratio is the proportion of net demand and time liabilities which the RBI requires banks to keep aside for investment in government securities; *See* Reserve Bank of India, Maintenance of Statutory Liquidity Ratio (SLR), RBI/2015-16/262 (notified on December 10, 2015) in which the RBI announced a phased reduction in SLR. With this arrangement in place, banks would be mandated to hold a progressively smaller proportion of their net demand and time liabilities in government securities. As a result, the captive base of investors will progressively decline and voluntary investors would be needed to finance the government borrowing programme. The proposed amendments to the RBI Act to implement the above changes are as under:

"Sections 45U, 45V, 45W and 45X of Chapter IIID of the Reserve Bank of India Act, shall stand deleted.

Provided that –

(a) any direction issued by the Reserve Bank before the date on which this amendment is notified, under Chapter IIID of the Reserve Bank of India Act, shall stand repealed;

(b) any action taken by any person, before the date on which this amendment is notified, in pursuance of any direction issued by the Reserve Bank under Chapter IIID of the Reserve Bank of India Act, shall be valid and legal."

(i) RBI can continue issuing directions in respect of foreign exchange and currency spot, under FEMA.

(ii) RBI can continue undertaking its monetary policy functions, by regulating repo and reverse repo transactions that it enters into with other entities. Similarly, RBI can continue to regulate the inter-bank call and notice money market.

(c) §45X obligates the agencies, referred to in §45W, to comply with the directions issued under §45W and to furnish information in this regard. This section will need to be consequentially deleted.

(d) §45U which defines terms used in Chapter IIID will need to be consequentially deleted."[84]

2. Repeal of Government Securities Act

Currently, the Government Securities Act allows the RBI to regulate all aspects of government securities, including maintaining records of holders of government securities, transfer of title, nomination, etc. The Government Securities Act will require to be repealed to enable the PDMA to issue and manage government securities under the legal framework governing PDMA. To harmonise the regulatory framework governing government securities with all other securities, the provisions relating to transfer, nomination, evidence of title, etc. will be the same as are applicable to the securities of any other issuer. Accordingly, the corresponding provisions of the Companies Act, 2013 are replicated in the PDMA law as drafted by FSLRC.[85]

3. Amendments to Securities Contracts (Regulation) Act

To allow Securities Exchange Board of India ('SEBI') to regulate derivatives and repo and reverse repo transactions entered into by market participants, which are currently regulated by RBI, the definition of 'derivatives' in Securities Contracts (Regulation) Act will need to be expanded to include the following transactions:

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[84] The proposed amendments to the RBI Act to implement the above changes are as under:

"Sections 45U, 45V, 45W and 45X of Chapter IIID of the Reserve Bank of India Act, shall stand deleted." Provided that -

(a) any direction issued by the Reserve Bank before the date on which this amendment is notified, under Chapter IIID of the Reserve Bank of India Act, shall stand repealed;

(b) any action taken by any person, before the date on which this amendment is notified, in pursuance of any direction issued by the Reserve Bank under Chapter IIID of the Reserve Bank of India Act, shall be valid and legal."

[85] *See* §§357, 358, 359, Revised Indian Financial Code, FSLRC.

"(a) repo and reverse repo transactions entered into by market participants (RBI will continue to control repo and reverse repo transactions that it enters into with others); and

(b) foreign exchange currency derivatives."[86]

§29A of the Securities Contracts (Regulation) Act allows the central government to delegate its powers under the Securities Contracts (Regulation) Act to SEBI and RBI.[87]

This section will need to be appropriately amended to restrict the power of delegation to SEBI only.[88]

4. Consequential Amendments to Subordinate Legislations

All notifications including notifications issued by RBI under Chapter IIID of RBI Act, the GSA and Securities Contracts (Regulation) Act, in respect of government securities, OTC Derivatives ('OTCD') and Exchange

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[86] The proposed amendment to widen the definition of derivatives is as under:

"The following amendments shall be made in section 2 of the Securities Contracts (Regulation) Act–

after sub-clause (C) of clause (ac), the following sub-clauses shall be inserted – "(D) repo and reverse repo; (E) a contract which derives its value from change in interest rate, foreign exchange rate or credit index or a combination of more than one of them and includes interest rate swaps, forward rate agreements, foreign currency swaps, foreign currency-rupee swaps, foreign currency options, foreign currency-rupee options"; and

after clause (f), the following clauses shall be inserted–

"(fa) "repo" means an instrument for borrowing funds by selling securities with an agreement to repurchase the securities on a mutually agreed future date at an agreed price which includes interest for the funds borrowed; (fb) "reverse repo" means an instrument for lending funds by purchasing securities with an agreement to resell the securities on a mutually agreed future date at an agreed price which includes interest for the funds lent.""

[87] §29A, Securities Contracts (Regulation) Act, 1956. It states:

"The Central Government may, by order published in the Official Gazette, direct that the powers (except the power under section 30) exercisable by it under any provision of this Act shall, in relation to such matters and subject to such conditions, if any, as may be specified in the order, be exercisable also by the Securities and Exchange Board of India or the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934 (2 of 1934)"

[88] The proposed amendment to said section is as under:

"The following words shall stand deleted in Section 29A of the Securities Contracts (Regulation) Act 'or the Reserve Bank of India constituted under Section 3 of the Reserve Bank of India Act, 1934 (2 of 1934)'

Provided that -

(a) any notification issued by the Reserve Bank, before the date on which this amendment is notified, in exercise of any power delegated to it by the Central Government under Section 29A of the Securities Contracts (Regulation) Act, shall stand repealed;

(b) any action taken by any person, before the date on which this amendment is notified, in pursuance of any notification issued by the Reserve Bank under the said Section 29A of the Securities Contracts (Regulation) Act, shall be valid and legal."

Traded Currency Derivatives ('ETCD'), need to be reviewed and streamlined to give effect to the above- mentioned amendments.

One such notification which will require to be repealed is the 2000 SCRA Notification issued by the Ministry of Finance delegating the powers of the Central Government under Securities Contracts (Regulation) Act to RBI in relation to (a) government securities, gold related securities and securities derived from these securities and (b) ready forward contracts in bonds, debentures, securitised debt and other debt securities.[89]

D. SEQUENCING

The global best practices on transition path show that that transition towards a full-fledged debt management agency is achieved over a period of three years. This includes physical installation of agency to gradual transfer of functions to finally, introduction of integrated and autonomous information systems. The various stages of transition are outlined as under:

1. Stage 0

(a) The PDMA Bill would need to be passed by the Parliament. The law needs to have an enabling provision that the law shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint and different dates may be appointed for different provisions of this law.[90]

2. Stage 1

(a) In this stage, the provisions of the PDMA law dealing with establishment, governance and funding of the PDMA, would need to be notified. At this stage, the PDMA wound not undertake the functions mandated

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[89] *See* Ministry of Finance, *supra* note 39. The text of the said notification is as under:

"In exercise of powers conferred by section 29A of the Securities Contracts (Regulation) Act, 1956 (42 of 1956), the Central Government hereby amends the notification of the Government of India, Ministry of Finance (Department of Economic Affairs), number S.O. 573 (E), dated the 30th July,

1992, as follows, namely:

"Provided the powers exercisable by the Central Government under the said section 16 of the said Act, in relation to any contracts in Government securities, money market securities, gold related securities and in securities derived from these securities and in relation to ready forward contracts in bonds, debentures, debenture stock, securitised debt and other debt securities shall also be exercisable by the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act. 1934 (2 of 1934)."

[90] This is needed to facilitate seamless transition. The text of such provision could be: "This law shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint and different dates may be appointed for different provisions of this law."

under the PDMA law. The PDMA should be able to enter into contracts, recruit employees, evaluate and replicate the IT systems used by the RBI for public debt management or build new systems and infrastructure, and build capacity for discharging its functions. RBI and the PDMA would need to coordinate with each other for transitioning – (i) the existing systems and software used by RBI for public debt management, and (ii) records (such as the securities general ledger) maintained by RBI.

To allow this, the provision of the PDMA law imposing an obligation upon RBI to co-operate with the PDMA for the transition, will need to be notified.

(b) In the transition, the Central Government should have the ability to delegate its public debt management function to the RBI or PDMA, through an executive notification. Currently, the RBI Act obligates the Central Government to delegate its public debt management function to the RBI only. To allow the Central Government to delegate the debt management function to PDMA, the provisions of the RBI Act which impose this obligation on the Central Government, will need to be amended.

(c) The Central Government will need to issue a notification under the amended provision (referred to in item 2) entrusting the public debt management function to RBI. This will ensure that RBI continues to manage the public debt and issue government securities, until Stage 2.[91]

3. Between Stage 1 and Stage 2

(a) PDMA will acquire office space, recruit employees, do procurement for infrastructure, build capacity (for example, prepare operations manuals and internal process manuals, build record keeping and IT capacity), take over or replicate the software and systems used and records maintained, by the RBI in connection with its debt management function.

(b) SEBI will prepare and keep ready substitutes for circulars, notifications and directions issued by RBI in respect of government securities.[92]

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[91] §21(2) of RBI Act will need to be amended. The text of the proposed amendment is discussed in the preceding sections of the paper.

[92] The RBI derives its regulatory powers over government securities through Chapter III-D of the RBI Act, Government Securities Act and through notifications issued under §29A of the Securities Contracts (Regulation) Act. As a regulator, a number of circulars, notifications and directions are issued by the RBI. To ensure a seamless transfer of regulatory powers to SEBI, it needs to keep ready appropriate substitutes for circulars, notifications and directions issued by RBI. One example of such a circular is Subsidiary General Ledger Account: Eligibility Criteria and Operational Guidelines.

4. Stage 2

(a) PDMA will begin the public debt issuance and management functions, namely, using existing RBI systems, and under the current regulatory framework. To allow this, the following two steps will be required to be taken:

(i) The Central Government will issue a notification entrusting the public debt management function to PDMA (under the amended provision of the RBI Act referred to in item 2 of Stage 1).

(ii) All references to RBI in the GSA will be replaced with references to PDMA. Currently, GSA allows the RBI to issue directions and generally control the government securities markets. To allow PDMA to issue government securities and manage public debt under the current regulatory framework, the PDMA will step into the shoes of RBI in the GSA.

(b) Chapter IIID of the RBI Act will require to be deleted. Currently, Chapter IIID of the RBI Act empowers the RBI to (i) regulate OTCD; and (ii) issue directions to all agencies dealing in government securities, money market instruments, foreign exchange, derivatives and other instruments as the RBI may specify. As a result of the deletion of this chapter, government securities and other instruments, will, like all other securities, be regulated under the Securities Contracts (Regulation) Act.

(c) The Central Government will need to issue a notification delegating its powers under the Securities Contracts (Regulation) Act to SEBI, in respect of (i) government securities; and (ii) derivatives, both exchange traded and OTC.

The steps enumerated in items 2 and 3, will ensure that there is a consolidated statutory and regulatory framework for all securities.

(d) SEBI will need to issue its own set of notifications prepared and kept ready before Stage 2. These notifications will replace the directions issued by RBI in respect of government securities and derivatives.[93]

[93] As discussed in the preceding sections, the definition of Derivatives in Securities Contracts (Regulation) Act needs to be widened to enable the regulation of these instruments by SEBI. Once the regulatory power shifts to SEBI, it needs to issue notification governing the said instruments. One example of such a notification issued by RBI is the RBI notification on ready forward contracts.

5. Between Stage 2 and Stage 3

(a) PDMA will need to replace all circulars, notifications and directions issued by RBI under the GSA, and issue its own directions transitioning market participants to the PDMA framework and systems. For example, (i) government securities held in the constituents' SGL account will need to be transferred to the demat accounts of the holders, maintained with depositories;[94] (ii) the issuance and trading of government securities will need to be integrated with existing issuance and trading platforms available for other securities.[95]

(b) PDMA will develop capacity for undertaking the cash management and contingent liability management and other functions, as envisaged in the PDMA law.

6. Stage 3

(a) The GSA will be repealed, and the entire public debt management function will move to the new PDMA framework and systems. All securities issued under the GSA will now be covered under the PDMA law.

(b) All provisions of the law on Public Debt Management, other than the provisions which are notified in Stage 1, will be notified.

(c) §§17(11)(e), 17(11)(f) and 21(2) of the RBI Act will need to be deleted.

VI. STATE DEBT

The preceding sections present an overview of the legislative arrangements and transition path to move the debt management function of the Central Government from the RBI to an independent PDMA. The RBI Act respects the Constitutional allocation of state debt to the State List. It does not mandate how state governments should manage their debt but gives them the option of letting RBI manage their debt.[96] However, once the PDMA is fully op-

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[94] At present, there is a carve-out created for Government securities under the Government Securities Act. The depository arrangement for government securities is not governed by the Depositories Act. To ensure a unification of financial market regulation, the records of government securities under SGL and Constituents Subsidiary General Ledger (CSGL) need to be transferred to the depositories registered under the Depositories Act. The register recording the ownership of government securities maintained by the PDMA will be linked to the register and an index of beneficial owners maintained under §11 of the Depositories Act.

[95] The existing market infrastructure for Government securities such as NDS-OM and SGL should follow due process of law and be governed and recognised under Securities Contracts (Regulation) Act and Depositories Act, respectively, as is the case with other exchanges and depositories.

[96] *See* Ministry of Finance, *supra* note 4.

erational states could be given the option to delegate the issue and management of State Government securities to PDMA. This section lays down the mechanism through which the states could assign the debt management role to PDMA.

The RBI Act provides that the states may enter into an agreement with RBI to manage public debt of states.[97] Public debt of states is part of the State List. However, under Article 252(1) of the Constitution, if two or more States (say, State A and State B) find it desirable that any of the matters under the State list should be regulated in State A and State B, by the Parliament, then State A and State B may authorise the Parliament to pass a law on such subject. Such a resolution must be passed by the legislatures of State A and State B and the Parliament may pass a law regulating such subject in State A and State B.

All the states except the state of Jammu and Kashmir have passed the GSA in pursuance of clause (1) of Article 252.[98]

Once an independent debt management agency is set up, states must be given the option to delegate the issue and management of State Government securities to PDMA. If a State Government opts to delegate the issue and management of State Government securities to PDMA, then the following steps are required to be followed. First, it will be required to opt itself out of the GSA framework, i.e. the GSA will be repealed to the extent of the securities issued by that State Government. Second, for the repeal of GSA with respect to the securities of any State Government, in pursuance to Article 252(2) of the Constitution of India, at least two States must pass a resolution authorising the Parliament to repeal the GSA. Third, the repealing legislation may, then, be adopted by other States desiring to opt out of the GSA and consequently the provisions of the PDMA law would apply to state government debt.

Thereafter, §§17(11)(e) and 17(11)(f) of the RBI Act will cease to apply to state debt. §21(A)(1)(b) of the RBI Act will also then have to be deleted.

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[97] Reserve Bank of India Act, 1934, §17(11)(e) & (f).

[98] The *Statement of Objects & Reasons* of the Government Securities Act, 2006 states as under:

"And whereas in pursuance of clause (1) of Article 252 of the Constitution, resolutions have been passed by the Houses of the Legislatures of all the Sates, except the State of Jammu and Kashmir, to the effect that the matters aforesaid should be regulated in those States by Parliament by law;"

Pursuant to the aforesaid statement, §1(4) of the Government Securities Act, 2006 provides that the provisions of GSA will apply to all the States, except the State of Jammu and Kashmir, unless this State also adopts the provisions of the Government Securities Act, 2006 by similarly passing a resolution under the Constitution of India, Art. 252(1).

VII. CONCLUSION

The Indian macroeconomic and financial system has undergone enormous changes from the 1930s. RBI has transformed from an agency that was a 'temporary provision' to one having clarity of purpose in the form of an inflation target. The mainstream financial system has achieved high capabilities with legal foundations for the securities markets, regulation by SEBI, and securities infrastructure in the form of exchanges, clearinghouses and depositories.

From 1997 onwards, there have been calls for the establishment of an independent PDMA. This would yield numerous gains. It would free RBI of the conflict of interest of performing debt management work for the Central and State governments. It would also improve debt management services obtained by the Central and State governments. Moreover it would ignite bond market development by harnessing the capabilities of the mainstream financial markets of India. Furthermore it would yield improvements in government borrowing by selling bonds to voluntary buyers in a deep and liquid government bond market.

FSLRC has a comprehensive solution in the form of a draft law which builds on a clean slate. A new agency, the PDMA, has been created, and there is a unified treatment of financial markets. The contribution of this paper lies in working out the legislative strategy for the PDMA reform in isolation. This involves using the FSLRC draft for the PDMA as an agency, with small changes, amendments to existing law that merge the bond market into the mainstream financial market system, and a careful construction of a steps through which the changes are put into place without causing any disruption. This analysis would be useful when, at a future date, the PDMA reform is executed.