Report of the Internal Working Group on Debt Management

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Department of Economic Affairs
Ministry of Finance
New Delhi India

Establishing a National Treasury Management Agency

Internal Working Group on Debt Management

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The Secretary
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Dear Sir,

We submit herewith a report on establishing a National Treasury Management Agency.

Yours sincerely,

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CHAPTER 1

Executive Summary

In the 2007 Budget speech, the Honourable Minister of Finance announced a proposal to establish a debt management office to manage India's public debt.

A similar recommendation was made by the Report on Ministry of Finance for the 21st Century, and more recently, the HPEC Report on Mumbai: An International Financial Centre. In light of these developments, the Ministry of Finance formed an Internal Working Group to analyse how best to move forward on establishing a DMO. This report details our analysis and proposes a draft Bill to establish a National Treasury Management Agency.

Chapters 2 and 3 examine the rationale for creating a debt management body, and review existing legal and institutional arrangements of managing public debt.

Establishing a debt management office would consolidate all debt management functions in a single agency, and be the catalyst for wider institutional reform and transparency about public debt. It is internationally accepted best practice that debt management should be disaggregated from monetary policy, and taken out of the realm of the central bank. Most advanced economies have dedicated debt management offices. Several emerging economies, including Brazil, Argentina, Colombia, and South Africa, have restructured debt management in recent years and created a DMO. The Central Government's proposal to create a DMO is the crucial first step in reviewing and improving public debt management and building a government securities market.

There is a variety of institutional arrangements for debt management. After examining such arrangements in a number of countries, the Working Group recommends establishing a statutory body to perform debt and cash management in India. A draft Bill to create a National Treasury Management Agency is included in Appendix A. Chapter 4 discusses different aspects of the Bill, including proposed ownership, management and funding of the NTMA. The Working Group envisions an agency that will manage debt for the Centre and States, with the overarching objectives of meeting their financing needs, while minimising borrowing costs within acceptable levels of risk.

Chapter 5 discusses in detail the functions that the NTMA would perform. It lays out what the NTMA is likely to do in the short to medium-term, and how it might evolve over the longer-term. Chapter 5 also describes the powers that this agency would have to achieve its objectives. Arrangements for accountability and auditing are discussed in Chapter 6. The proposed NTMA would act at all times as the agent of the Central and of State Governments. Therefore, the draft Bill tries to ensure that the NTMA is adequately accountable to its principals. At the same time, it aims to ensure that the NTMA does not face counter productive constraints, so that the Central and State Governments can benefit from focussed debt management expertise.

Chapter 7 looks at the legislative ripple effects of creating the NTMA. It outlines amendments to existing legislation that should accompany the creation of the NTMA. It also examines policy questions that affect the government securities market and financial markets more widely and suggests ways to make progress on these questions. Finally, Chapter 8 examines how to transition from the current system of managing public debt to a fully functional NTMA.

This report aims to lay out the rationale for restructuring debt management arrangements in India, the Working Group's vision for these new arrangements and practical steps for transitioning to these new arrangements.

CHAPTER 2

Why India needs a National Treasury Management Agency

2.1. Introduction

This chapter discusses the motivation for establishing a debt management agency in India, which can consolidate and improve upon the present systems for debt and cash management. It outlines the conflicts that result when the same institution is tasked with being the Central Bank, the banking regulator and the debt manager. It also traces thinking on how to resolve these conflicts by officials, policy-makers and academics.

2.2. Economic rationale

The three key issues that influence the design of debt management in India are : *consolidation*, *conflicts of interest* and *financial repression*.

Consolidation A well structured debt management office is one where all information about onshore and offshore liabilities, and contingent liabilities, is centralised into a single database. This enables better information transmission to the bond market, which yields increased confidence and thus lowered interest rates. Unification of information also makes possible a variety of strategies for reducing the cost of borrowing.

In many emerging markets, as in India, debt management is dispersed over several departments, and lines of action and accountability can be unclear. A consolidated debt manager that deals with all government borrowing, and understands the entire portfolio, is better at coordinating borrowing and managing risk. The international experience shows that there are important gains from consolidation (Wheeler, 2004).

Conflicts of interest The Internal Working Group surveyed arrangements for managing public debt in a range of emerging and mature market economies, as well as guidelines, programmes and literature on public debt by international financial institutions (IMF and World Bank, 2002; OECD, 2002b; Balino and Sundararajan, 2008; Kappagoda, 2004). This analysis reveals a widespread, and growing, consensus that the Central Bank should not be tasked with managing public debt.

Having the Central Bank manage public debt generates a series of conflicts, which have negative effects on economic and financial policy.

- There is a severe conflict of interest between setting the short term interest rate (i.e. the task of monetary policy) and selling bonds for the government. If the Central Bank tries to be an effective debt manager, it would lean towards selling bonds at high prices, i.e. keeping interest rates low. This leads to an inflationary bias in monetary policy.
- Where the Central Bank also regulates banks, as in India, there is a further conflict of interest. If the Central Bank tries to do a good job of discharging its responsibility of selling bonds, it has an incentive to mandate that banks hold a large amount of government paper. This bias leads to flawed banking regulation and supervision, so as to induce banks to buy government bonds, particularly long-dated government bonds. Having a pool of captive buyers undermines the growth of a deep, liquid market in government securities, with vibrant trading and speculative price discovery. This, in turn, hampers the development of the corporate bond market - the absence of a benchmark sovereign yield curve makes it difficult to price corporate bonds.
- If the Central Bank administers the operating systems for the government securities markets, as the RBI currently does, this creates another conflict, where the owner/ administrator of these systems is also a participant in the market.

Separating debt management from the Central Bank addresses these conflicts. In this framework, the Central Bank focuses on monetary policy, on modifying the short-term interest rate so as to stabilise the domestic business cycle. The debt management office works as the 'investment banker' for the government, selling bonds and engaging in other portfolio management tasks in close coordination with its client, the budget division. Each of these agencies then has a clear focus, specialised professional skills are built up (in monetary policy at the central bank and in investment banking at the debt management office), and conflicts of interest are avoided.

Financial repression Debt management is relatively simple when financial firms are forced to purchase government bonds through financial repression. The process of institution building in financial regulation leads to a reduction in the extent of financial repression. The effectiveness of financial repression also declines as households tend to utilise less constrained components of the financial system. In the medium term, India will evolve towards reduced financial repression. In this context, the task of funding public debt will become more complex. It is hence important to undertake institutional reform that strengthens debt management alongside the process of financial sector reforms that eases financial repression.

The separation of debt management from monetary policy does help reduce one kind of conflict of interest. At the same time, another conflict of interest – the ownership by government of financial firms – remains. Yet, reforms of debt management are desirable, for several reasons. A substantial fraction of government bonds are now purchased by players who are not public sector financial firms. The benefits above (consolidation, freeing monetary policy of the conflict of interest, and dovetailing with easing financial repression) are obtained by reforms to debt management even if the conflict of interest of government owning financial firms is unchanged. Finally, it is possible, at an operational level, to clearly distance the functioning of a debt management office from the ownership function of government.

2.3. International experience

Moving public debt management from the Central Bank to a DMO is internationally accepted best practice (IMF and World Bank, 2002).

Most OECD countries established dedicated debt management units in the late 1980s and early 1990s, in the face of fiscal problems and high debt-to-GDP ratios. More recently, several emerging economies, including Brazil, Argentina, Colombia, and South Africa, have also restructured and consolidated debt management. Naturally, the particular debt management arrangements in any country are influenced by its broader institutional environment and precedents. However, there are certain common features across countries that have restructured and modernized public debt management:

- The Central Bank no longer manages public debt; there is a clear separation between monetary policy and public debt management.
- Debt management is integrated in one entity rather than dispersed over several departments and authorities.
- The split between external and domestic debt management gives way to integrated debt management, with a front-middle-back office structure.
- The DMO focuses on making debt management more transparent.
- The DMO focuses on communicating regularly and clearly with financial markets.

To illustrate some of these features, we highlight three examples of countries that have re-structured debt management in recent years (See Box 1, 2 and 3).

The Working Group has tried to learn from precedents such as these in thinking about how India's public debt can be managed more efficiently. Throughout the report, we have highlighted examples of good practice that seem relevant to establishing an Indian DMO.

2.4. The evolution of institutional arrangements in India

However, the Working Group also emphasizes that restructuring debt management in India must be tailored to the Indian context. This work falls in the context of a twenty-year effort on reforming the institutional framework for fiscal, financial and monetary policy in India. This report builds upon several years of analysis and recommendations from the RBI, the government, financial experts and academics, ultimately culminating in the announcement by the Minister of Finance in the 2007 Budget speech.

2.4.1. *Narasimham I committee*

The **Narasimham I Committee on Financial Sector Reform** (1991) identified and critiqued the distortions that result from using the Statutory Liquidity Ratio (SLR) and the Cash Reserve Ratio (CRR) as instruments of public financing. It recommended restricting the use of SLR to prudential requirements for banks and CRR for monetary policy. The Committee's analysis clearly identifies the conflicts that result when the same institution manages debt and regulates banks.

> "The Committee is of the view that the SLR instrument should be depoloyed in conformity with the original intention of regarding it as a

Box 2.1: Case Study: Portugal's autonomous DMO

Between 1995 and 1998, debt managers in Portugal were concerned with managing convergence to join the Economic and Monetary Union, and with preparations to join the single currency. The management of convergence attempted to reconcile several objectives: positioning the debt portfolio to take advantage of the expected reduction of interest rates; protecting the portfolio and the Budget from domestic money market turbulence linked to the exchange rate stabilisation process; and promoting the domestic capital market and ensure a more active and flexible management of the debt portfolio.

European monetary unification was the catalyst for a thorough restructuring of public debt management. In 1996, Portugal created the Portuguese Government Debt Agency (IGCP), a separate agency structured according to the model of a private financial institution. All the functions connected with public debt management and State financing which had formerly been split between two different public authorities were transferred to the IGCP.

The IGCP is a distinct legal entity. It is created by a law on management of public debt also lays down fiscal responsibility measures. This law is a model of clarity, and reflects the thoughtful systemic restructuring that accompanied legislation to create the IGCP. The IGCP's structure, functions, powers and accountability are detailed in delegated legislation.

The transition to the IGCP unfolded over three years in order to avoid disturbances in debt management or in the operation of the relevant markets.

In the first year, 1997, the agency took physical shape, procedures and management framework were defined, and functions formerly split between two different public authorities were gradually transferred to the IGCP. The government also promoted the new institution to market participants.

The second year, 1998, saw the reorganization of the internal structure of the Agency, taking the different operational pieces inherited from the former structures and attempting to fuse them into a streamlined institution.

The last year, 1999, coincided with joining the competitive environment brought about by the introduction of the Euro. Since the IGCP was up and running, it concentrated on becoming more efficient. It adopted a sophisticated information system, created a benchmark to evaluate debt management, clarified the terms of its "management contract" with the Government, and crystallised Guidelines which set boundaries on the autonomy of debt management by the IGCP.

Source: Extract from Bento (2000), in Togo, Dethier, and Currie (2003); IGCP website; Law No. 7/98 of 3 February 1998 and Decree Law n. 160/96 of 4 September.

> prudential requirement and not be viewed as a major instrument for financing the public sector. . . As regards the Cash Reserve Ratio, the Reserve Bank should have the flexibility to operate this instrument to serve its monetary policy objectives. The Committee also believes that given the Government's resolve to reduce the fiscal deficit, the occasion for the use of cash reserve ratio to control the secondary expansion of credit should also be less."

2.4.2. *Working Group on Separation of Debt Management from Monetary Management*

The **Working Group on Separation of Debt Management from Monetary Management**, which submitted its report to the Reserve Bank in December 1997, recommended, *inter alia*, the separation of the two functions and establishment of a company under the Indian Companies Act to take over the debt management function (RBI, 2001).

Box 2.2: Case Study: New Zealand DMO - Modernisation within the Treasury

During the 1980s in New Zealand, three different groups within the Treasury dealt with different debt and cash management functions, in addition to their other responsibilities. Lines of reporting were unclear and there were gaps in accountability. Personnel managing public debt did not know what was expected of them, and often took *ad hoc* decisions rather than being guided by an overarching debt management strategy. In an attempt to tackle ballooning public debt, debt and cash management were consolidated in a single unit within the New Zealand Treasury in 1988.

By design, the structure of NZDMO resembles that of a private-sector financial-markets institution, with separate front, middle, and back offices. That structure leads to clearly defined responsibilities and accountabilities, procedural controls, and the segregation of duties, which is consistent with best practice. The NZDMO focuses on balancing portfolio management with clearly defined public policy objectives, and tries to combine a private sector model with public sector goals.

The Portfolio Management Group is responsible for portfolio analysis, developing and negotiating transactions, managing the government's liquidity and cash-disbursement system, and managing relationships with international investors and rating agencies. The Risk Policy and Technology Group is responsible for measuring NZDMO's performance in adding value, measuring risk, monitoring compliance with the approved policies for managing the government's net debt portfolio, maintaining NZDMO's portfolio and risk management framework consistent with international best practice, and maintaining NZDMO's information technology systems. Accounting and Transactional Services Group is responsible for NZDMO's accounting and forecasting functions and ensuring that transactions are settled in a timely, efficient, and secure manner.

Source: New Zealand DMO web site; Zohrab (1993) extracted in Togo et al. (2003).

2.4.3. *The Ways and Means Agreement*

The Central Government and the Reserve Bank signed an **agreement on Ways and Means in March 1997**, which discontinued the practice of issuing ad hoc Treasury Bills to replenish the Centres cash balance with effect from April 1, 1997. Under the agreement, the Central Government would meet temporary mismatches between receipts and expenditure through Ways and Means Advances (WMA) provided by the RBI. The size and cost of WMA would be mutually agreed, WMAs were to be fully repaid within three months from the date of the advance, and amounts drawn beyond the WMA limit would be treated as overdraft.[1]

The transition from ad hoc Treasury Bills to the WMAs was a major milestone in fiscal, financial and monetary policy reform. It ended automatic monetisation of the fiscal deficit, improving fiscal discipline and ensuring greater independence for monetary policy. It paved the way for designing institutional machinery which allows debt management to be separate from monetary policy.

2.4.4. *RBI Annual Report, 2000-01*

The **RBI Annual Report for 2000-01** unequivocally recommended the separation of the functions of debt and monetary management in the medium-term, and the explicit removal of the debt management function from the RBI. It said:

> "The separation of the functions of debt management and monetary management is regarded as a desirable medium-term objective, conditional

[1] The function of WMAs is discussed in more detail in Chapter 5.

Box 2.3: Case Study: Brazil restructures debt management

Brazil's Public Debt Office (PDO) was set up within the National Treasury Secretariat in 2000. Its mandate is "cost minimization over the long term, taking into consideration the maintenance of judicious levels of risks". Its secondary objective is the development of the domestic government securities market. The PDO was the culmination of fiscal and monetary reform in Brazil since the late 1980s.

Brazil's Central Bank used to manage public debt until 1987. However, the Brazilian debt crisis of the early 1980s forced several reforms of public finance institutions. The National Treasury Secretariat (NTS) was created in 1986. In 1987 domestic debt management was transferred from the Central Bank to the Treasury's debt unit (CODIP). In 1988, the Federal Constitution forbade the Central Bank from buying treasury bills in primary auctions.

In the early 1990s, Brazil took steps to further segregate the operation of fiscal and monetary policies. In 1991, the External Debt Office was established in NTS. However, external debt management was still divided between the Central Bank and NTS.

Over the next few years, the Treasury improved its performance by focussing on internal research, data collection, staff-replacement and training, and building relationships with investors and rating agencies. The Treasury and the Central Bank coordinated more closely with each other, including regular joint meetings with investors, dealers and banks.

In 2000, the Public Debt Office was established in the NTS. External debt management was transferred to the PDO. However, the PDO dissolved the division between domestic and external debt management, and adopted a front, middle and back office structure.

- The front office focuses on the development of short term strategies related to securities issuances in the domestic and external markets. It also conducts primary market auctions and external issuances.
- The middle office is responsible for medium and long term strategies, risk management, monitoring macroeconomic aspects and domestic and external investor relations.
- The back office performs the functions of registering and controlling issuance, payment and monitoring the domestic and external debt budget.

The restructured PDO aims to consolidate custody and settlement of securities. It is focussing on building state-of-the-art risk management models and adopting the ALM framework into its work.

The PDO emphasises staff training and retention. It revised the Treasury salary scale so that it could recruit highly skilled professionals in the financial sector, and also defined the specialised skills it required from potential employees, i.e. if offered better compensation, but also demanded high standards from PDO personnel.

Source: (Barbosa, 2000); (IMF and World Bank, 2002), National Treasury Secretariat website.

upon development of the government securities market, durable fiscal correction and an enabling legislative framework. The separation of the two functions is expected to have significant effects on the functioning of the government securities market . . . The Union Budget, 2000-01 expressed the need to accord greater operational flexibility to the Reserve Bank for the conduct of monetary policy and regulation of the financial system. The existing Public Debt Act is sought to be repealed and replaced by a new Government Securities Act. The new Act will simplify the procedures for transactions in Government securities, allow lien marking/pledging of securities as also electronic transfer in a dematerialised form. The new Act has been passed by the Legislatures of most of the States. Attendant

> legislative changes are envisaged under the Fiscal Responsibility Bill and the Reserve Bank of India Act to enable greater flexibility and operational effectiveness in the conduct of monetary policy in the new environment. **The Reserve Bank has proposed amendments to the Reserve Bank of India Act, 1934 which would take away the mandatory nature of management of public debt by the Reserve Bank and vest the discretion with the Central Government to undertake the management of the public debt either by itself or to assign it to some other independent body, if it so desires**. The amendments to various legal acts are also expected to bring about greater compatibility with innovations taking place in banking operations. (emphasis added)"

2.4.5. *Internal Expert Group on the Need for a Middle Office for Public Debt Management*

The Ministry of Finance **Report of the Internal Expert Group on the Need for a Middle Office for Public Debt Management**, 2001 chaired by Arvind Virmani, discussed the need for a comprehensive strategy for public debt management, with an integrated approach towards domestic and external public debt management. 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. It further recommended establishing an autonomous Public Debt Office as the second stage. It said:

> "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."

2.4.6. *RBI Annual Report, 2005-06*

The **RBI Annual Report for 2005-06** emphasized functional separation of debt management and monetary functions in the post-FRBM Act era (RBI, 2006a):

> "In order to address the issues arising from these provisions of the FRBM Act, and to equip the Reserve Bank as well as market participants accordingly. . . the Reserve Bank constituted a new department named as Financial Markets Department (FMD) in July 2005 with a view to moving towards functional separation between debt management and monetary objectives."

2.4.7. *Ministry of Finance for the 21st Century*

The report on **Ministry of Finance for the 21st Century**, (the "Kelkar Report") emphasised the need for fiscal consolidation and recommended setting up a *National Treasury Management Agency* (MoF, 2004). The Kelkar Report said:

> "In the present situation, it is imperative to seek every institutional innovation which can yield even the slightest improvements in the implemention of public borrowing, or slight improvements in risk management."
>
> "The placement of domestic debt issuance in RBI causes difficulties for RBI, given the conflicts of interest that arise between the multiple roles at RBI of debt issuance, monetary policy, bank regulation, and securities market infrastructure."
>
> "The committee proposes the creation of a new agency, which may be named National Treasury Management Agency (NATMA). It would be an independent body, which interacts with MoF... Distancing the treasury function from the central bank is related to the need to avoid the three-way conflicts of interest, at the Central Bank, between the goals of (a) monetary policy, (b) banking regulation, (c) the fiscal goals of government bond issuance and (d) the goals of RBI as a systems operator for securities infrastructure. The effectiveness and independence of RBI is being adversely affected by the need to make compromises between these frequently conflicting goals... In terms of the relationship with MoF, and questions of autonomy and accountability, NATMA should be placed on the identical footing as other external agencies, such as SEBI, RBI or CBDT."

2.4.8. *Percy Mistry Committee*

The **Mistry Report** recommended the setting up of an autonomous DMO, either under the Ministry of Finance, or as an arm's-length agency (HPEC, 2007). It said:

> "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."

2.4.9. *Raghuram Rajan Committee*

The **Rajan Report** also argued for a change in the structure of public debt management in India (CFSR, 2008):

> "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. The Ministry of Finance has announced that an independent Debt Management Office (DMO) will be set up. This provides an opportunity to think about and incorporate best practices in this field. The structure of public debt management should also be designed while keeping in mind the broader implications for financial market development...
>
> "At present, the 'investment banking' function for the government is performed by the RBI. In the past decade, a series of expert committees have commented on the undesirability of burdening RBI with the task of selling bonds for the government. This involves a conflict of interest, since the government would benefit from lower interest rates, which the RBI has some control over. Investors in the bond market may also perceive the

> sale of bonds by RBI to be informed by a sense of how interest rates will evolve in the future. Finally, the RBI is the regulator of banks. Banking supervision could be distorted by the desire to sell bonds at an attractive price.
>
> "Internationally, there has been a strong movement towards establishing independent debt management offices (DMOs) which sell bonds for the government. This is now considered best practice. Moreover, as rules that force financial firms to buy government bonds are relaxed, greater demands will be placed on the DMO, hence the need to move in an expedited fashion. The February 2007 Budget Speech had announced the creation of a DMO, and this now needs to be implemented."

2.4.10. *Other policy analyses*

The policy recommendations detailed above show a growing consensus amongst expert committees that India needs a debt management agency. Senior policy-makers have also said that asking the RBI to manage public debt forces it to grapple with a series of conflicts. For instance, Mohan (2003) argues: "In India, fiscal imbalances arise from the government's inability to raise adequate revenues to meet growing expenditure. Being the banker to the government, the RBI is often required to provide temporary financial support in the form of WMAs. Such accommodation on a continuous basis would be a potential threat to monetary management by the central bank. Moreover, being the debt manager for both the central and state governments, the RBI needs to strike a balance between short-run liquidity management and cost-effective public debt management."

Singh (2006) has also argued at length for the separation of debt and monetary management in India:

> "In view of the developments in the markets and the commitment on the part of the central government to contain the fiscal deficit, it would be appropriate to consider the separation of monetary and debt management. The separation would provide the central bank necessary independence in monetary management with neither the need to provide credit to the government nor the responsibility to ensure that government borrowings are incurred at low cost."

2.4.11. *Other concerns*

In addition to these basic conflicts of interest, Indian debt management is quite fragmented at present. Debt management is divided between the RBI and different divisions within the Ministry of Finance.[2] Thus, we do not have an integrated view of the full portfolio in any one location, and this dilutes the quality of portfolio management. While there is considerable data on government liabilities, integrating this data would make it easier to use it effectively for analysing costs and risks associated with borrowing, thus optimising the government's financial burden and managing the risk it faces.

Moreover, Indian banks are required to hold 25% of their deposits in government securities; the high statutory liquidity ratio is arguably influenced by the need to sell long-dated government bonds, rather than being driven purely by the demands of prudential supervision. The Mistry Report notes that when the banking regulator's actions are influenced by the aim of financing deficits, this conflict makes the global financial community sceptical about whether banking regulation is sound and unbiased (HPEC, 2007).

[2] Detailed in Chapter 3.

2.4.12. *Budget announcement of 2006-07*

This process of policy analysis and public debate led up to the decision announced by Finance Minister Shri. P. Chidambaram, in his **Budget Speech** 2006-07, where he said:

> "World over, debt management is distinct from monetary management. The establishment of a Debt Management Office (DMO) in the Government has been advocated for quite some time. The fiscal consolidation achieved so far has encouraged us to take the first step. Accordingly, I propose to set up an autonomous DMO and, in the first phase, a Middle Office will be set up to facilitate the transition to a full-fledged DMO."

This debt management office, that we term the *National Treasury Management Agency*, is a key pillar of fiscal, financial and monetary institution building in India. It follows on the Ways and Means Agreement of 1997 and the FRBM Act of 2003 in laying the foundations for a sound **fiscal** architecture. It sets the stage for modernisation of the bond market, and establishing the Bond-Currency-Derivatives Nexus; through this it complements the strategy for **financial** sector reforms. It frees monetary policy from the conflict of interest that it is presently burdened with, thus paving the way towards a sound institutional framework for **monetary** policy that can stabilise the domestic business cycle.

Before getting on with a treatment of how debt management should be organised in India, the next chapter describes the current debt management framework, so that any further analysis is grounded in a thorough understanding of the present arrangements.

CHAPTER 3

The status quo: How is public debt currently managed?

3.1. Introduction

This chapter lays out the current operational and legal framework for managing public debt. It describes the various categories of public debt and explains how the RBI and Ministry of Finance manage debt and coordinate with one another. It then details how the primary and secondary markets in government securities operate. Finally, it traces the legal underpinnings of public debt management, as well as of primary and secondary market operations.

3.2. Categories of debt

Under current budgetary practice, there are three categories of Union government liability that constitute public debt - internal, external and “other” liabilities.

Internal debt is classified into (1) market loans, (2) other long and medium-term borrowing and (3) short-term borrowing and is shown in the receipt budget of the Union government. It includes market loans, special securities issued to the Reserve Bank of India (RBI), compensation and other bonds, treasury bills (including 14-day treasury bills issued to States only), commercial banks and other parties, as well as non-negotiable and non-interest bearing rupee securities issued to international financial institutions.

External debt represents loans received from foreign governments and multilateral institutions. The Union Government does not borrow directly from international capital markets. Its foreign currency borrowing takes place from multilateral agencies and bilateral sources, and is a part of official development assistance (ODA). At present, the Government of India does not borrow in the international capital markets. However, as noted by the Report on Ministry of Finance for the 21st Century (Kelkar Report), this is a partial picture and does not account for “proxy” foreign exchange borrowing, in the form of contingent liabilities. Foreign exchange borrowing by para-statal agencies is substantially influenced by the Union Government. For example, the State Bank of India (SBI), which is majority owned by the Union Government and the RBI, borrows in foreign currency through instruments such as Resurgent India Bonds, India Millenium Deposits and Millenium India Bonds (MIB). The

Table 3.1: Debt Management Functions of the Central Government

	Front Office	Middle Office	Back Office
Function	Implementation of debt strategy	Strategy formulation	Record keeping etc.
Domestic debt	PDO, RBI, Banks, Post Offices	IDMD, RBI, Budget Division	DGBA and CAS, RBI, CCA(F), MoF
External debt	BC and FB Division of MoF	External Debt Management Unit	CAAA

Union Government and RBI restrict how SBI can use these funds, and the Union Government provides exchange rate guarantees for this borrowing. Government-owned banks have raised substantial funds through this route for many years now; 1.6 billion USD was raised using the "India Development Bond" in 1991, 4.2 billion USD using the "Resurgent India Bond" in 1998 and 5.3 billion USD using the "Millennium India Deposit" in 2000, (MoF, 2004).

The **"other" liabilities** category, not a part of public debt, includes other interest-bearing obligations of the government, such as post office savings deposits, deposits under small savings schemes, loans raised through post office cash certificates, provident funds and certain other deposits.

Table 3.1 shows the dispersion of the debt management functions of the Central Government over various agencies.

3.3. Operational framework

In thinking about the operational framework, it is useful to use the vocabulary of the 'Front Office', 'Middle Office' and 'Back Office'. The Front Office negotiates all new loans. The Middle Office measures and monitors all loans and conducts policy formulation. The Back Office looks after auditing, accounting and data consolidation (EDMU, 2006).

3.3.0.1. *Domestic Debt*

Within the RBI, the Internal Debt Management Department formulates, in consultation with the Ministry of Finance, a core calendar for primary issuance of dated securities and treasury bills, and suggests the size and timing of issuance and conducts auctions, keeping in account the government's needs, market conditions, and preferences of various segments. The RBI charges the Central and State Governments fees for issuing and managing securities. Primary and secondary market mechanisms are discussed in more detail later in this chapter.

Any person including firms, companies, corporate bodies, institutions, State Governments, provident funds and Trusts, can invest in government securities. NRIs, Overseas Corporate Bodies predominantly owned by NRIs and Foreign Institutional Investors registered with SEBI and approved by the RBI are also eligible to invest in government securities, subject to the Foreign Exchange Management Act, 1999.[1]

3.3.0.2. *External Debt*

As regards external debt, the Fund-Bank Division, the External Commercial Borrowing (ECB) Division, ADB Division, EEC Division, Japan Division in the Ministry of

[1] GoI, General Notification No. F.No 4(9)-WM/2000 on Issue of Government Securities, dated 6 May 2002.

Finance and RBI (IMF Loans) perform front office functions. The External Debt Management Unit performs the role of the Middle Office, and the Office of the Controller of Aid Accounts and Audit acts as the Back Office.

3.3.0.3. *Cash Management*

Cash management in India is a collaborative effort of the Reserve Bank of India (RBI) and the Budget Division, Ministry of Finance. The RBI acts as the banker to the Government and in this process maintains the Consolidated Fund of India. It also participates actively in the cash forecasting process, which is carried out via negotiations between the Budget Division and the RBI. The Monitoring Group on Cash and Debt Management coordinates this process in its meetings. The RBI uses the Ways and Means Advances, which are short-term (three month) loans to States to smooth temporary mis-matches in revenues and expenditures.

3.3.0.4. *Contingent Liabilities*

Government guarantees are approved by the Ministry of Finance, Department of Economic Affairs (Budget Division). Once a guarantee is approved by Ministry of Finance, it is executed and monitored by the Administrative Ministry concerned. The concerned Ministry is also required to annually report the status of the guarantee in this regard, until the guarantee falls due or expires.

3.3.0.5. *Gaps in the present arrangement*

A unified database about all onshore and offshore liabilities of the government (including contingent liabilities) is absent in the present system. Further, no single arm of government is charged with the function of analysing such an integrated database and working towards identifying mechanisms through which the long-term cost of borrowing of the government is minimised.

3.4. Coordination between RBI and MoF

The Monitoring Group on Cash and Debt Management of the Government of India, generally meets twice a year or as necessary to make decisions regarding the borrowing programme of the Government of India. This formal mechanism is accompanied by regular discussions between the Budget Division and the RBI.

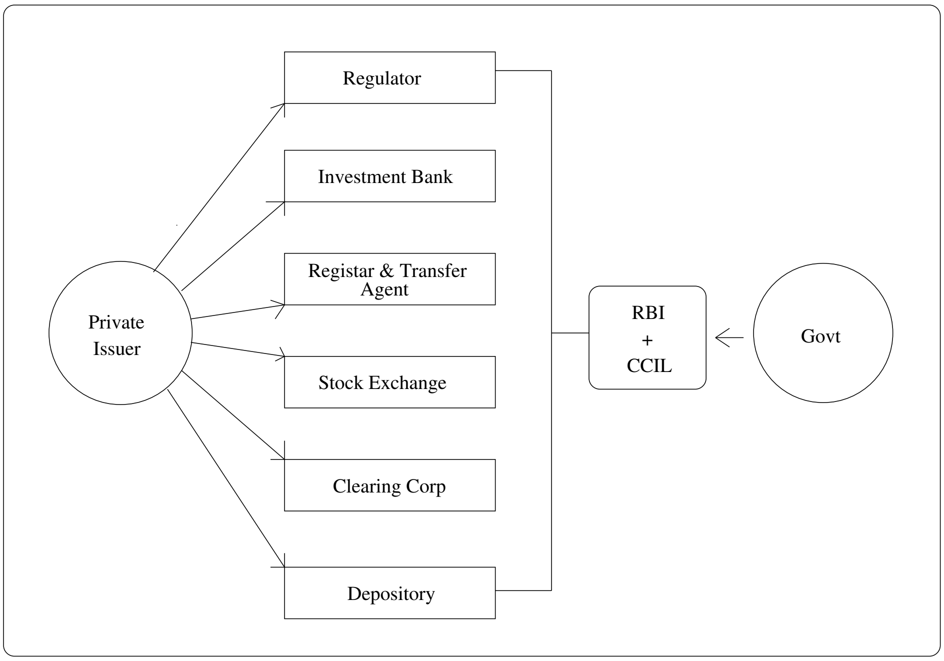
The Technical Advisory Committee on Money and Government Securities Market advises the RBI on development and regulation of the government securities market. This committee comprises financial sector professionals, representatives of market associations such as the Primary Dealers Association of India, the Fixed Income Money Markets and Derivatives Association of India, as well as representatives from mutual funds, academia, and the Government.

3.5. Issuance and trading of securities

This section discusses the functioning of the primary and secondary markets in government securities. If a private entity issued bonds, the various agencies involved in issuing and trading would, broadly speaking, be the regulator, the investment bank, the registrar and transfer agent, the stock exchange, the clearing corporation and the depository. Figure 3.1 shows the agencies typically involved in issuing and trading securities.

When the Central Government or a State Government issues securities, the RBI performs almost the entire range of these functions. The Clearing Corporation of

Figure 3.1: Agencies involved in the issuance and trading of securities.



India acts as a central counter-party in government securities transactions. The RBI and CCIL's roles in primary and secondary markets are detailed below.

3.5.1. *Primary issuance of dated securities*

The Reserve Bank of India issues Central and State Government securities through an auction mechanism.[2] The auctions of government securities are open to individuals, institutions, pension funds, provident funds, NRIs, Overseas Corporate Bodies (OCBs) and foreign institutional investors. Individuals and small investors such as provident and pension funds and corporations can also participate in auctions on a non-competitive basis in certain specific issues of dated government securities and in Treasury bill auctions. Non-competitive bidding has been allowed since January 2002 and, in the case of dated securities, a small percentage of up to 5 percent is allocated for allotment to non-competitive bidders at weighted average cut-off rates. Bids are received through banks and primary dealers. Figure 3.2 describes the process.

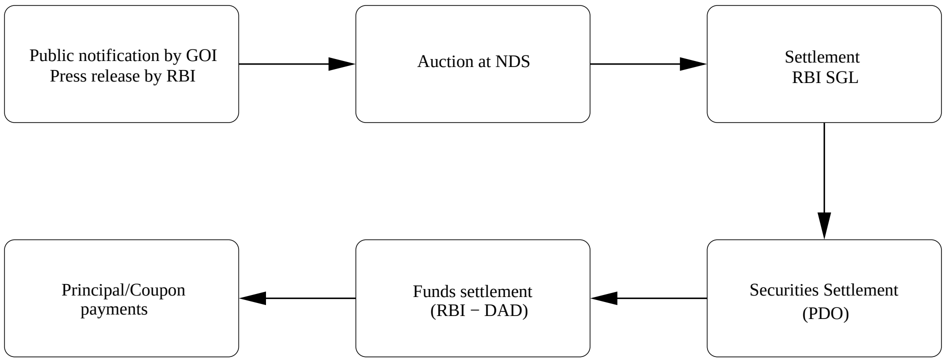
Calendar: The RBI formulates an issuance calendar in consultation with the Budget Divison of MoF, which is announced before the auctions. The calendar does not cover issuance of Treasury Bills or dated securities under the MSS scheme.

Loan notification: As per the borrowing requirement in the calendar, the government issues a Public Notification that specifies the amount it wishes to borrow in dated securities. In the case of money market or MSS auctions, the RBI directly issues the press release.

Auction press release: The RBI issues a press release that gives the details of the auction - the amount involved and the maturity and tenor of the notes. This is cir-

[2]The sources for this information are: RBI website (section on NDS) at http://www.rbi.org.in/scripts/FAQView.aspx?Id=15; CCIL website at http://www.ccilindia.com/; the report of the RBI Technical Group on Central Government Securities.

Figure 3.2: Primary Issuance of Dated Securities.



Box 3.1: The Negotiated Dealing System

The Negotiated Dealing System (NDS) is an electronic trading platform within the RBI, exclusively for the trading of government securities and treasury bills. The NDS facilitates electronic bidding in auctions, and offers straight through settlement, since it connects with the Public Debt Offices and the accounts of the banks with the RBI. Banks, primary dealers and other financial institutions including mutual funds can negotiate deals in government securities through this electronic mode on a real-time basis and report all trades to the system for settlement. NDS Participation is restricted to members of INFINet, a closed user group network. Members of INFINet hold a Subsidiary General Ledger and/or a current account with the RBI. Subsidiary General Ledger or SGL is a facility that the RBI provides for large banks and financial institutions. This allows the holding of government securities in electronic or book form with the RBI.

Source: Reserve Bank of India website, http://www.rbi.gov.in

culated to all commercial banks and primary dealers, and also posted on the RBI website.

Bidding: As per the schedule in the press release, the bidding process is carried out both on the Negotiated Dealing System (NDS) and via sealed bid tenders dropped in the auction box at the Mumbai office of the RBI (See Box 4). This takes place for both competitive and non-competitive bids. Primary dealers underwrite auctions of dated securities (See Box 5).

Auction results: The RBI announces the allottees of the auctions at the date and time indicated in the press release.

Clearance and Settlement: Transactions are settled at the RBI.

Monitoring: The CAS then monitors the interest payments and maturity dates for issued securities/Treasury Bills.

3.5.2. *Secondary market in government securities*

The secondary market for government securities is split across a variety of trading platforms - the RBI's internal NDS, NSE and BSE. However, the majority of trading is concentrated in the NDS. The RBI also encourages members of the NDS to inform

NDS of any secondary trades they undertake on other platforms. Settlement is carried out through the RBI. The CCIL provides settlement guarantee for these trades.

Once trades are received by CCIL, it validates counterparties and their exposure limits for the particular trade. Valid trades are then settled under a DVP (III) system. The net funds statement is sent to the RBI Public Debt Office along with the record of settlement. Based on the information sent by CCIL, the PDO debits the requisite counter-party's SGL account and credits the CCIL's SGL account. The funds settlement is carried out by the RBI-DAD, a cell under the Central Accounts Section (CAS) in Nagpur.

The RBI disseminates information via its website regarding the nature and volume of secondary trades in securities, in order to encourage better pricing.

There is also a retail debt market for government securities, traded on the Retail Debt Market (RDM) segments of the NSE, BSE and OTCEI. However, market transactions in this segment are an extremely small proportion of total trading volume.

3.6. Legal framework

3.6.1. *Constitutional Provisions*

3.6.1.1. *Power to legislate on public debt*

Under the Constitution, Union Government debt is a "Union subject", while State Government debt is a "State subject", i.e. the Centre cannot legislate how State Governments should manage State borrowing. Article 246(1) of the Constitution read with Entries 35 and 37 of List I provides that Parliament has exclusive power to make laws regarding the public debt of India and foreign loans. Article 246(3) of the Constitution read with Entry 43 of List II provides that State legislatures have exclusive power to make laws regarding the public debt of the States.

3.6.1.2. *Executive powers to borrow and give guarantees*

However, the Constitution limits the *sources* from which State Governments can borrow, and gives the Centre power under certain circumstances to influence whether the State Government can borrow from sources other than the Centre. Therefore, the Constitution implicitly empowers the Centre to place limits on the amount and sources of State Government borrowing.

Article 292 and 293 define the executive borrowing powers of the Centre and the States.

Article 292 provides that the Central Government can borrow upon the security of the Consolidated Fund of India within such limits as Parliament may fix.

Under Article 293, State Governments can borrow money on the security of the Consolidated Fund of the State within such limits, if any, as the State legislature may fix. States can only borrow domestically, whether from the Centre or from other sources. However, if a State has any loans outstanding from the Centre, or for which the Centre is a guarantor, it must obtain the Centre's consent before borrowing from any other source. As a consequence, in effect, almost all States today need Union consent before they can borrowing funds.

No separate law has been enacted under Article 292 to regulate Central Government borrowing. However, the Fiscal Responsibility and Budget Management ("FRBM") Act, 2003 and FRBM Rules, 2004 lay down a framework for fiscal management. The FRBM Act aims to ensure inter-generational equity in fiscal management and long-term macro-economic stability. This requires a sufficient revenue surpluses, reducing the fiscal deficit, removing fiscal impediments in the effective conduct of

Box 3.2: The Primary Dealer system

The RBI introduced the Primary Dealer ("PD") system in the government securities market in 1995, and 19 PDs now exist.

Primary Dealers are expected to play an active role in the government securities market, both in its primary and secondary segments. The primary obligations of a PD include, *inter alia*:

- Supporting auctions of government bonds by giving annual bidding commitments to the RBI, to underwrite the primary issuance and to offer two-way quotes in select Government securities. The annual bidding commitments are determined through negotiations between the RBI and the primary dealers. Serious bidding is ensured through a stipulation of a success ratio (40 percent).
- Offering two-way prices in Government securities, through the Negotiated Dealing System-Order Matching (NDS-OM), over-the-counter market and recognised Stock Exchanges in India and taking principal positions in the secondary market.
- PDs' investment in government bonds on a daily basis should be at least equal to the net call/notice/repo (including CBLO) borrowing plus net RBI borrowing (through LAF/ Intra-Day Liquidity/ Liquidity Support) plus the minimum prescribed NOF.
- PDs should annually achieve a minimum turnover ratio of 5 times for Government dated securities and 10 times for Treasury Bills of the average month-end stocks. The turnover ratio in respect of outright transactions should not be less than 3 times in government dated securities and 6 times in Treasury Bills (Turnover ratio is computed as the ratio of total purchase and sales during the year in the secondary market to average month-end stocks)

The Reserve Bank currently extends the following facilities to PDs to enable them to effectively fulfil their obligations:

- Access to Current Account facility with RBI.
- Access to Subsidiary General Ledger (SGL) Account facility
- Permission to borrow and lend in the money market including call money market and to trade in all money market instruments.
- Memberships of electronic dealing, trading and settlement systems (NDS platforms/INFINET/RTGS/CCIL).
- Access to the Liquidity Adjustment Facility whereby the RBI operates in the market through repos and reverse repos
- Access to liquidity support from RBI under a scheme separately notified for standalone PDs.
- Favoured access to open market operations

Source: Reserve Bank of India website http://www.rbi.gov.in; (RBI, 2008e).

monetary policy and prudential debt management consistent with fiscal sustainability through limits on Central Government borrowings, debt and deficits, and greater transparency in fiscal operations.

Simultaneously, 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. The Act also attempts to check contingent liabilities by restricting guarantees to 0.5 percent of GDP during any financial year.

The FRBM Act, 2003 prohibits participation of RBI in the primary Government securities market with effect from April 1, 2006, except under special circumstances.

The FRBM Rules, 2004 specify the annual targets for reduction of fiscal and revenue deficits, annual targets for assuming contingent liabilities in the form of guarantees and the assumption of additional liabilities as a percentage of GDP.

The Rules do the following[3]:

- Restrict assumption of additional liabilities (including external debt at current exchange rate) in excess of 9% of GDP for 2004-05 and require that this limit be progressively reduced by at least one percentage point of GDP in each subsequent year.
- Require a reduction of the revenue deficit by an amount equivalent to 0.5 per cent or more of the GDP in each financial year, beginning with 2004-05.
- Require a reduction of the fiscal deficit by an amount equivalent of 0.3 per cent or more of the GDP in each financial year, beginning with 2004-05.
- Restrict issuance of guarantees in excess of 0.5 per cent of GDP in any financial year, beginning with 2004-05.

3.6.1.3. *Borrowing secured against the Consolidated Fund*

Central and State government borrowing is constitutionally secured against the Consolidated Funds of India (CFI) and of State Governments respectively. Article 112(3)(c) provides that the expenditure in respect of "debt charges for which the Government of India is liable, including interest, sinking fund charges and redemption charges and other expenditure relating to the raising of loans and the service and redemption of debt" shall be charged on the Consolidated Fund of India. Article 202(3)(c) makes the parallel provision for States, and provides that a State's cost of borrowing is charged on the Consolidated Fund of the State.

3.6.1.4. *Annual financial statement and appropriations process*

Under Article 112, the Central Government is required to submit an annual financial statement before both Houses of Parliament each year, showing estimated receipts and expenditures for that year. The estimates of expenditure in the annual financial statement fall into two categories: (1) sums required to meet expenditure that the Constitution provides is to be charged upon the CFI and (2) sums required to meet other expenditure proposed by the Central Government.

Under Article 113(1), estimated expenditure charged on the Consolidated Fund of India under the first category is not submitted to the vote of the Parliament, but nothing in Article 113 prevents either house of Parliament from discussing those estimates. Under Article 113(2), the Lok Sabha shall have the power to vote on "other expenditure", i.e. the second category of proposed expenditure in the annual financial statement.

Once Parliament sanctions grants based on the annual financial statement, an Appropriations Bill is introduced to provide for the appropriation out of the CFI of all monies required to meet these grants and any expenditure charged on the CFI.

3.6.2. *Legislation on debt management*

The Reserve Bank of India is legally *obliged* to manage Central Government debt. It *agrees* to manage State Government debt through a formal agreement.

Under Section 20 of the Reserve Bank of India ("RBI") Act 1934, the Reserve Bank is obliged to manage the Central Government's public debt. Section 21 of the RBI Act 1934, provides that the Central Government shall entrust debt management to the

[3]Discussed in Economic Survey 2004-05, p.39, available at http://indiabudget.nic.in/es2004-05/chapt2005/chap27.pdf

RBI. Section 21A of the RBI Act 1934 provides that a State Government may agree to let the RBI manage that State's debt. Thus, 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.

Under Section 17(11) of the RBI Act, the RBI is empowered to act as an agent of, *inter alia*, the Central Government and State Governments, in managing public debt and issuing and managing bonds and debentures.

3.6.3. *Legal underpinnings of securities issuance*

Investment banking function: As discussed above, the RBI Act 1934 vests the RBI with the investment banking function for the Central and State governments; it obligates and empowers the Bank to manage the Centre's public debt and empowers it to manage States' public debt.

While this broad power and obligation to manage public debt is embedded in primary legislation, detailed functions and operations connected with issuance and trading are, in general, not spelled out in the RBI Act 1934. Such functions are largely regulated by the Government Securities Act, 2006 and rules and regulations framed thereunder, and through other notifications and circulars issued by the Government or the RBI.

RTA Function: The RBI acts as the Registrar and Transfer Agent (RTA) for government securities. This function is not covered directly by the RBI Act 1934. The GSA 2006 defines a bond ledger account[4], subsidiary general ledger account[5], and a constituents' subsidiary ledger account[6]. However the GSA 2006 does not explicitly lay down the structure of the primary dealer system, or require primary dealers to hold a bond ledger account or an SGL account.

Under section 2(c) of the GSA 2006, a bond ledger account is an account with the RBI or with an agent - a scheduled bank or any other person specified as an agent - in which government securities are held in a dematerialised form at the credit of the holder. Under section 2(d), a constituents' subsidiary general ledger account is defined as a general ledger account opened and maintained with the RBI by an agent on behalf of the constituents of the agent. Section 4(1) of the GSA 2006 provides:

> "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" [emphasis added].

This provision allows, but does not require, the creation of an SGL; thus the GSA 2006 does not lock the RBI or any other public authority into the present arrangement.

The RBI has the power to prescribe the manner and form in which government securities can be transferred under the GSA 2006, by regulations and with prior approval of the Central Government.[7]

Primary and secondary market trading: The RBI Act 1934 and the GSA 2006 do not prescribe how to conduct primary and secondary trading in government securities.

[4] Section 2(c) of the GSA 2006
[5] Section 4 of the GSA 2006
[6] Section 2(d) of the GSA 2006
[7] Section 5(2) of the GSA 2006.

Instructions to primary dealers are laid down in the RBI guidelines and circulars, the most recent of which are Master Circular on Operational Guidelines to Primary Dealers in Government Securities Market dated 1 July 2008, and the Master Circular on Capital Adequacy Standards and Risk Management for standalone Primary Dealers dated 1 July 2008.

Terms and conditions for issue of government securities are laid down in a General Notification by the Central Government dated 6 May 2002.[8] The General Notification prescribes, *inter alia*, who is eligible to invest in government securities, types of securities, types of auctions, mode of payment, and form in which securities may be held. The General Notification may be supplemented by Specific Notifications issued from time to time which address specific features of a particular security issue.

Clearance and Settlement: The clearance and settlement mechanism discussed earlier is not prescribed by primary legislation.

Under the Payment and Settlement Systems Act, 2007, the RBI regulates payment systems in India. However, the Act does not apply to stock exchanges or clearing corporations of the stock exchanges.[9] Thus, when government securities are traded on the NSE or the BSE, the payment and settlement systems of these stock exchanges are not covered by the Act.

Depository function: The depository function is covered in primary legislation. Section 17(9) of the RBI Act 1934 authorises the RBI to have “the custody of monies, securities and other articles of value, and the collection of the proceeds, whether principal, interest or dividends, of any such securities”. However, section 17(9) is somewhat ambiguous because it does not specify whether the RBI has this authority as a principal, as an agent of the Centre and States, or as both principal and agent. In addition, nothing in section 17(9) prohibits the RBI from contracting with an external depository, nor does section 17(9) positively require that the depository for government securities must be internal to the RBI.

The RBI’s depository arrangements for government securities are not regulated by the Depositories Act 1996. The NSE’s and BSE’s depository arrangements for government securities are regulated by the Depositories Act, 1996. However, section 31 of the GSA 2006 provides that nothing in the Depositories Act 1996 shall apply to government securities covered by the GSA 2006, unless an agreement to the contrary is executed between a depository under the Depositories Act 1996, and the Government or the RBI.

Regulatory functions: The RBI regulates trading in government securities, under section 45W of the RBI Act 1934, with the caveat that RBI cannot issue directions on the procedure for execution or settlement of the trades on stock exchanges recognised by the Central Government under the SCRA 1956.

3.7. Summing up

The operational and legal framework described above is the Working Group’s base material and point of departure in suggesting new arrangements for public debt management. Therefore, the following chapters should be read against the background of Chapter 3.

[8] General Notification F.No 4(9)-WM/2000, available at http://rbidocs.rbi.org.in/rdocs/notification/PDFs/28347.pdf

[9] Section 34 of the PSS Act 2007

CHAPTER 4

Structure of the NTMA

4.1. Introduction

There is strong international consensus that: (1) a well-run economy should have a dedicated, consolidated public debt manager and (2) the Central Bank should not, in general, perform this role. However, once debt management is disaggregated from the Central Bank, there is no "one size fit all" structure for a debt management office. Debt management arrangements vary from country to country.

In this chapter, the Working Group proposes that the Indian DMO should be an autonomous statutory body. We also present several alternatives that we analysed, and our reasons for preferring an autonomous arrangement. We then discuss the contours of draft Bill included in Appendix A, focussing on provisions that establish the Agency, and define arrangements for management, accountability, relationship with States and funding.

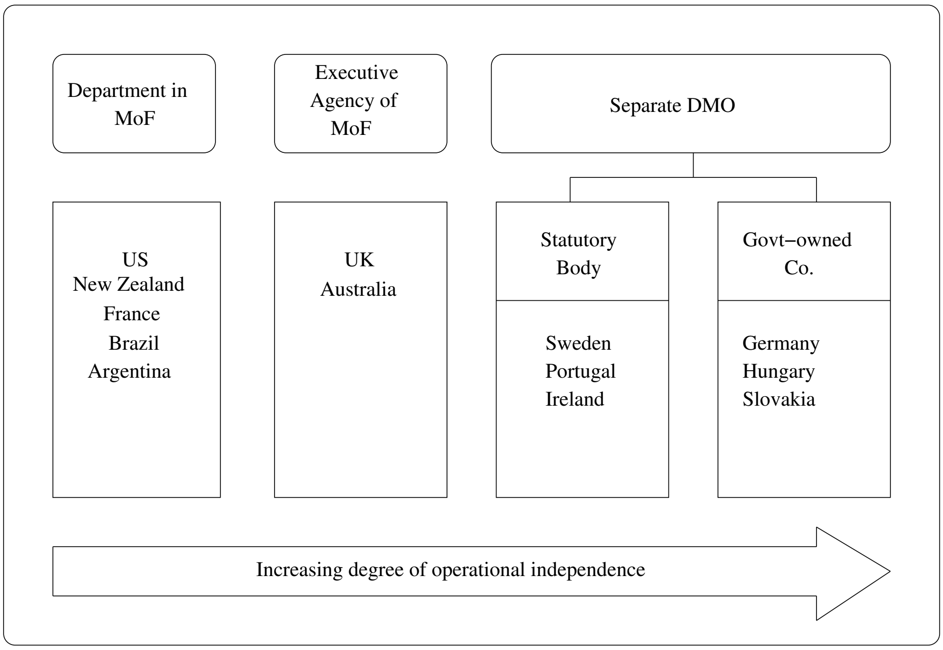
4.2. Location of the NTMA

Location and functions are influenced by existing institutional arrangements as well as a finely grained understanding of institutional culture. Factors that influence location and function include whether there is a strong culture of accountability and service delivery, whether the Ministry of Finance has the capacity to manage a financial portfolio, whether it has the capacity to monitor an arm's length agency, whether it has salary flexibility within the mainstream government framework, whether financial markets are well developed, and whether financial regulation is effective and robust.

Broadly speaking, there are four models for debt management offices: (1) a division or unit within the Ministry of Finance, (2) an executive agency which is not a creature of statute, and operates at arm's length from the Government (3) a statutory body which functions at arm's length from the Ministry of Finance, (4) a state-owned company that manages public debt.

After studying existing models, the Working Group took the view that an Indian DMO should be a statutory body corporate with considerable operational autonomy, which functions as an agent of the Central and State Governments.

Figure 4.1: Possible Locations of the DMO.



4.2.1. *Why an arm's-length body?*

There was strong consensus amongst the Working Group that the debt management office should be at arm's length from the Ministry of Finance. Before reaching this consensus, the Working Group considered arguments in favour of consolidating debt management within the Ministry of Finance.

External debt is substantially handled by MoF, through various divisions of the DEA, External Debt Management Unit and the Office of the Controller of Aid Accounts and Audit. Arguably, integrating internal and external debt management would not require new legislation and might require less institutional restructuring.

Some of the comparative literature also suggests that, in an emerging economy, the NTMA should be located within Ministry of Finance. For e.g., the public debt department within the National Treasury in Brazil, widely regarded as an emerging market DMO that is performing well, is located in the Ministry of Finance. Colombia and South Africa have re-structured debt management in recent years, but retained DMOs in the Ministry of Finance. Many high income countries, including the US, Canada, Italy and New Zealand, also follow this model.

These countries cite several advantages for their choice. As a unit within MoF, the government's debt manager is tightly woven into wider fiscal planning and annual budgeting. An internal DMO might build portfolio management expertise within MoF, and this expertise can feed into other MoF programmes. An internal DMO can mean greater accountability and reporting to the Minister.

However, retention within MoF does not imply lack of reform. Several OECD countries and emerging market countries that chose this model extensively restructured and professionalised debt management, and created the space to do this within the Ministry of Finance. India can learn from the reforms of countries like New Zealand and Brazil, but needs to ask itself whether it can effectively implement such reforms within the Ministry of Finance. Considering this, the Working Group felt that a DMO within MoF would be not be the best option for several reasons, which are discussed below.

4.2.1.1. *Federal Balance*

A debt management body in India has to serve both the Centre and the States, and should not have primary allegiance to the Central Government or any individual State Government. It must, in fact, be a responsive and accountable agent to both national and sub-national governments, and it must be perceived as such. For this reason, it is necessary in the Indian context to have a debt management agency at arm's length from MoF that is genuinely national in scope, rather than a debt management office within MoF.

4.2.1.2. *Political Process*

The Working Group also feels that a well-functioning DMO should be able to deploy its financial expertise to implement the government's decisions, without having to negotiate competing strategic priorities and agendas on a daily basis. Locating the DMO at arm's length from the thick of policy and political processes would be conducive to this goal. In addition, some distance helps the DMO to resist any pressure to borrow in ways that exposes the tax payer to excessive risk. While this scenario is unlikely given India's record of risk-averse debt management, a DMO should nevertheless be designed to withstand extreme situations.

4.2.1.3. *Resource Constraints*

Like the Kelkar Report, the Working Group envisions an NTMA staffed by financial experts. To do this, the NTMA would need to offer salaries and terms that compete with the private sector. A DMO within MoF would be unable to do this within the civil service structure. A DMO also needs specialised IT systems that support front office and back office activities, and might require specialised internal audit, accounting and legal services, particularly as it expands. It would be a challenge to provide these specialist services and skills within the constraints of a departmental budget with competing priorities. It is worth noting that in some countries such as New Zealand, it is possible to offer differential salaries within the Treasury, which makes it easier to house a high-quality DMO inside the government. Our context is different, and points us towards a different arrangement.

4.2.1.4. *Dedicated Attention*

International experience shows that when Ministry of Finance officials have to manage public debt, this can dilute attention to public debt as the Ministry is also managing a host of other policies and programmes that compete for attention and resources (Togo et al., 2003). In an autonomous NTMA, senior financial experts can concentrate on debt management, while being sensitive to wider fiscal and monetary considerations. As the NTMA grows, Central and State governments can draw on this financial expertise across a wider range of areas, such as managing contingent liabilities or advising on infrastructure financing.

4.2.1.5. *Wider Restructuring*

Creating a dedicated NTMA can catalyse wider, deeper reform of public debt management. The Working Group believes that setting up the NTMA would also be an opportunity to rationalise debt management strategy, lay down clear lines of reporting and accountability, inject greater transparency into debt management, identify and fill gaps in public debt data, and build relationships with financial markets. It would also be the catalyst to hone capacity within national audit and transparency institutions to monitor debt management. The Working Group recognises that these institutional reforms require time and serious effort, but believes that the NTMA is an important step in the right direction.

Setting up an autonomous NTMA necessitates sound mechanisms for monitoring the agency's performance and holding it accountable. In addition, the NTMA would need to understand debt as part of the government's balance sheet, intimately linked to fiscal and budget policies (Togo et al., 2003). It would have to guard against becoming overly focussed on cost minimisation at the expense of core policy priorities.

4.2.2. *The NTMA as an executive agency*

Another basic question was whether an NTMA should be a creature of statute or a product of executive authority. The DMO is an executive agency in some OECD countries, such as UK and Australia, which means the legal requirements for establishing the body were relatively small. In the UK, a formal agreement rather than a statute, anchors the relationship between the DMO and HM Treasury, which lays down the respective responsibilities, rights and obligations of each party.[1]

As an executive body, the NTMA would be within the legal framework of MoF. This might make it easier to monitor its performance. On the other hand, an executive agency might be vulnerable to excessive control over day-to-day decision-making. Comparators such as the UK have outsourced specialised functions to executive agencies for several years, and have considerable experience balancing flexibility and appropriate Ministerial control. A framework for establishing executive agencies already existed in the UK when the DMO was created. In the Indian context, we have more experience balancing independence with checks and balances vis-a-vis statutory bodies, such as the RBI and independent regulators such as SEBI. The NTMA would be performing a core government function, and Parliament and the Executive would need to tailor checks and balances to its particular role. It is arguably more appropriate to choose a legal shell with which we have considerable experience, and disaggregate debt management more fully from MoF.

Moreover, an executive agency of MoF would face resource constraints and would risk being perceived as closer to the Centre rather than a neutral agent of both Central and State Governments. Given the structural changes involved in re-organising debt management, some form of legislation would be required divesting the RBI of debt management powers and investing another entity with powers of domestic and external public debt management. So, establishing the NTMA as an agency would not have the advantage of speed. In any event, the Working Group believes that Parliament should have every opportunity to scrutinise an important structural change such as this one, which also points us towards a statutory NTMA.

Having laid out the caveats above, the Working Group feels that establishing the NTMA as an executive agency will be a sound interim step, before we transition to a full-fledged, statutory NTMA. This is discussed in more detail in Chapter 8.

4.2.3. *The NTMA as a company*

The Working Group also examined the model adopted by Germany and Hungary, where the DMOs are government owned companies. Like a statutory body, a company has the advantages and disadvantages of autonomy. On the one hand, it would require strong monitoring and accountability mechanisms. On the other hand, it would have more operational flexibility.

At a minimum, establishing the NTMA as a government owned company would mean the following:

[1] United Kingdom: Debt Management Office, Executive Agency Framework Document.

- The Companies Act 1956 and related legislation would apply to a government company, though under Section 620 of the Act, the Central Government has the power to exempt a government company from any of the provisions of the Companies Act by notification in the Official Gazette, subject to Parliamentary approval of such exemption.
- The NTMA would be obligated to register a Memorandum and Articles of Association with the Registrar of Companies. The implications of a company structure with regard to, *inter alia*, taxation, insolvency, and the personal liability and responsibilities of the directors would have to be carefully worked out.
- The Central and State governments would have to devise suitable formal arrangements to ensure that they have sufficient information about and control over the company's activities. Potential methods might include agreement on the terms of the Memorandum and Articles of Association, conditions attached to funding, representation in company membership, and appointments to the Board of Directors.
- The NTMA would be affected by the large and constantly evolving jurisprudence on company law.

This last factor in particular suggests that the government company model might be more suited to a civil law system, as in Germany and Hungary, rather than a common law system such as ours. The NTMA must, of course, be subject to the rule of law at all times. But, in a common law system, the NTMA would be bound by judicial decisions on company law that, while not connected in any way to public debt, may affect the NTMA's structure, functions or accountability framework. Regulatory certainty and predictability is crucial when an agency implements the government's decisions on a core sovereign function such as debt management. Creating a statutory body allows Parliament to lay down the appropriate regulatory framework.

OECD experience shows that the government's debt manager should focus on "government balance sheet risk management" rather than purely on marginal cost efficiencies. Creating a statutory body is arguably a better means of ensuring this attention to public sector responsibilities while building a culture of private sector efficiency. That said, the Working Group feels that the NTMA should learn from and adopt methods of corporate governance, particularly on conflicts of interest, auditing and accounting standards.

4.2.4. *The NTMA as a Society or Trust*

The Working Group looked into establishing the NTMA as a society or a trust, but rejected both alternatives as impractical. Neither arrangement would be optimal for the complex financial transacting that the NTMA would do. For example, as a trust, the NTMA would be limited in the range of financial instruments it could deploy. Both legal arrangements would be unconventional, comparing against DMOs in OECD countries as well as emerging markets, and might not build investor confidence.

4.2.5. *The NTMA as a statutory body*

Regardless of location, an effective debt management body should have the following features:

- Operational flexibility
- Accountability to Central and State governments and to Parliament
- Financial expertise

- Ability to prioritise public policy objectives rather than tactical trading objectives

In the Indian context, a statutory body would best be able to synthesise these features. Within India, the RBI, SEBI and NHAI, amongst several others agencies, are precedents we can draw upon in designing the NTMA. The Working Group has also studied international comparators which have statutory debt management agencies, such as Ireland, Portugal and Sweden, and adapted good practices that they have tried and tested. We discuss the NTMA's statutory framework in more detail in the sections that follow.

4.3. Law establishing the NTMA

The proposed Bill is framed under the aegis of Article 53(3) of the Constitution and within the Constitutional framework for borrowing outlined in Chapter 3.6.1.1. The Working Group aimed to design a Bill which lays down the basic framework of the NTMA, including its powers and functions, but delegates enough rule-making power to ensure that that the law does not ossify as the NTMA's scope and functions expand.

See Clause **31** on page 106 and Clause **32** on page 106

Therefore, the proposed Bill allows the Central Government to make rules and the NTMA to make regulzations in relation to its functions. These rules and regulations are to be placed before both Houses of Parliament, which can accept, reject or modify them.

The Working Group also considered DMO legislation in other countries and examined international best practice regarding DMO legislation (See Box 6).[2] The Working Group aimed to include references to all the provisions dealing with issues covered in Box 6 in either primary or delegated legislation for the NTMA.

4.3.1. *Preamble*

The Preamble emphasises the NTMA's role as debt manager and its status as an agent, subject to the general superintendence and control of the government.

4.3.2. *Commencement*

See Clause **1** on page 97

Clause 1 of the Bill empowers the Central Government to bring different provisions into force at different times. This enables the NTMA to take on additional functions as it develops the capacity to perform them.

4.3.3. *Legal form and Ownership*

See Clause **3** on page 98 and Clause **4** on page 98

Clauses 3 and 4 of the Bill establish the NTMA as a body corporate and declare that its head office will be in Delhi.

See Clause **5** on page 98

The Working Group envisions that the Central and State Governments will share ownership of the NTMA, while emphasising that the Bill does not mandate how States should manage public debt. Therefore, Clause 5 provides that the Central Government shall own at least 51% of the NTMA, but provides the option for States to own shares in the Agency should they so choose. There shall be a ceiling on the proportion of ownership by any individual State, which will be set by the Centre and shall apply to all States. This ceiling is not specified in the Bill to ensure flexibility.

[2] These included legislation from Sweden, Ireland, Portugal and Slovakia, in addition to agency agreements for a number of non-statutory DMOs.

Box 4.1: Usual provisions of legislation establishing an autonomous debt management agency

Where debt management agencies have been established under specific legislation, such legislation usually:

- Describes the name, location, and purpose of the agency.
- Outlines the functions and responsibilities of the agency.
- Empowers the minister of finance to delegate responsibilities to the chief executive of the agency.
- Specifies the role and composition of any governing board (e.g., board of advisers) and the procedures relating to compensation and appointments.
- Outlines the responsibilities of the chief executive or the head of the organization, including responsibilities regarding personnel issues.
- Specifies the reporting requirements in relation to the Minister of Finance and the Parliament.
- Indicates the need for transparent and independent auditing arrangements.
- Addresses code of conduct related issues such as obligations with respect to secrecy, disclosure requirements, and avoidance of conflict of interest.

Source: Extract from (Wheeler, 2004), pp 52.

4.3.4. *Structure and Management of the NTMA*

The NTMA is likely to move away from the current division between managing foreign and domestic debt and towards a front, middle and back office structure. However, the draft Bill does not specify operational arrangements, and concentrates instead on defining the NTMA's management structure.

4.3.4.1. *Management Committee*

See Clause 7 on page 99 and Clause 8 on page 99

It is proposed that the NTMA will have a Management Committee, headed by a Chief Executive. The Chief Executive will be directly accountable to the Ministry of Finance. The draft Bill gives the Central Government the power to detail selection procedures, terms of office and terms and conditions for the Management Committee.

The Working Group suggests that the committee should have State government representatives and members should also be drawn from the private sector to ensure that the Management Committee has the necessary expertise and mix of skills. However, these details are best addressed in rules rather than in primary legislation.

See Clause 8 on page 99 and Clause 9 on page 99

The draft Bill defines the circumstances in which a member of the Management Committee may resign, or the Central Government may remove a member from his or her position. It restricts post-resignation employment for members of the Management Committee for two years, specifying that members need the approval of the Central Government before accepting jobs under the Central or State Governments or any regulated entity in the financial sector.

See Clause 30 on page 105

Under the proposed Bill, the Central Government has the power to entirely supersede the Management Committee under certain extreme circumstances. The Central Government has to report its actions to Parliament as soon as possible and appoint a new Committee. This provision mirrors similar provision in the SEBI Act, 1992 and the PFRDA Bill 2005 - the law needs to provide a last resort in the unlikely event that a need for it arises.

4.3.4.2. *Advisory Board*

See Clause 13 on page 100

The draft Bill provides for an Advisory Board. The Advisory Board would not play a direct role in the NTMA's management or operations. The Working Group visualises a Board which, as its name suggests, will advise the NTMA and the Central and State Governments on the NTMA's operations. These governments should have the benefit of the Advisory Board's opinions on the NTMA's annual financing plan and the annual financing remit. Similarly, the Advisory Board should give its opinion on the NTMA's performance in any given year, in light of the fiscal situation and the state of the market.

DMOs in several countries, including Ireland, New Zealand, Portugal, Sweden, and the UK, have Boards, which provide external input on specific areas of expertise.

The proposed Bill does not specify a selection procedure or terms for the Advisory Board, so that these can be tailored to the NTMA's needs. However, the Working Group recommends that the Advisory Board should include a Deputy Governor of the RBI, a senior official of the Ministry of Finance and the Chief Executive of the NTMA (in an *ex-officio* capacity), so that the Board can also aid regular communication with the RBI.

4.3.5. *Officers and Employees*

See Clause 12 on page 100

The draft Bill delegates to the Management Committee the power to hire the staff it needs and to set terms and conditions that it considers appropriate.

The Working Group sees the NTMA as having a small staff, with a focus on expertise rather than staff strength. This has also been recommended by the Kelkar report (MoF, 2004).

> "There will need to be a special effort in dealing with problems of compensation and recruitment procedures, in order to reach to the top-end finance skills that are required. This requires new "rules of the game" but it emphatically does not require a large number of staffpersons. As an example, in Hungary, where the Government Debt Management Agency performs these exact functions, the staff strength is 43".

As an example, the Swedish DMO (SNDO) has 140 employees, including administrative and support staff.[3] The Irish NTMA has 151 employees, including administrative staff, support staff and contract (rather than permanent) staff.[4] All DMOs place a high level of importance on recruiting and retaining quality staff (See Box 7).

4.3.6. *Objective of the NTMA*

The NTMA will function with the objective of meeting the financing needs of the government, while minimising borrowing costs in the long run and functioning within an acceptable level of risk. It will, therefore, perform its functions and exercise its powers in a way that meets this objective.

The Working Group considered whether to include promotion of the domestic debt market as an an explicit, overarching objective of the NTMA. There are different models on this point. Some countries, such as Canada, Brazil, Colombia and South Korea, include promoting the development of the domestic debt market as one of the DMO's objectives (Wheeler, 2004). Some countries, such as Sweden, Ireland and

[3] Source: Communication from SNDO dated 18.7.08.
[4] Source: Communication from NTMA, dated 13.8.08.

Box 4.2: Case Study: Building human resource capacity for government debt management - New Zealand's approach

The New Zealand Debt Management Office (NZDMO) has a development program designed to build the professional and personal skills of staff members. The program is reviewed and monitored regularly. Training programs, conducted by external suppliers or provided through on-the-job mentoring, are used extensively to build skills in all aspects of debt management, including governance practices and portfolio and risk management. There are extensive opportunities for part-time study or for enrolling in chartered financial analyst (CFA) courses, with the NZDMO paying the fees and providing time off for study. When experts have been hired, their contracts place considerable emphasis on training other staff.

New staff generally require the most development and typically receive a greater proportion of the training opportunities. This has become an important factor in attracting applicants to the NZDMO. Although staff are not formally bonded as a result of the training, the organization has had low staff turnover. Other recruitment practices, particularly the ability to offer close to market rates, allow experienced people to be recruited to add depth to the team.

The quality of the work programs and training are key factors in attracting and retaining staff. The work program includes opportunities to advise on the design and implementation of debt management strategy, the development of the domestic debt market, the management of contingent liabilities, and the interplay between debt management policy and monetary and fiscal policy. Valuable learning opportunities arise from networking with investors, other financial institutions, and rating agencies, and participating in conferences and publishing research papers. The technical expertise gained can also assist career development in that it is valued by state-owned enterprises and the private sector.

Source: Extract from (Wheeler, 2004), pp 167.

the UK, have not included this objective in primary legislation or their agency agreement. Sweden decided not to include this objective in its Act on Central Government Borrowing and Debt Management (1988) on the grounds that this could, in some circumstances, be in conflict with the cost/risk objective.[5]

In a long term sense, the only path to low-cost borrowing is through obtaining a liquid and efficient market. It is only in the short term that conflicts can arise. As an example, stretching out the yield curve might require issuing long term bonds, which might be an expensive form of borrowing in the short term. Yet, once the long term bond becomes liquid, this would yield a reduced cost of borrowing in the long term.

The formulation adopted by the Working Group involves including market development as a *function* of the NTMA rather than an *objective*. NTMA will undertake every effort possible to build a liquid and efficient Bond-Currency-Derivatives Nexus, as an instrumentality towards low-cost financing in the long run. Such a formulation avoids any potential of conflicting *objectives*.

4.3.7. *Provisions on determining debt management strategy*

Once the long-term debt management objectives are defined, Chapter IV of the draft Bill lays down a mechanism for determining debt management strategy for the year.

The NTMA will annually submit to the Central Government and each State Gov-

[5]In the Bill on Central Government Borrowing and Debt Management (1988), the Swedish Government wrote that if the DMO would like to undertake a transaction sole for the purpose of market-development, outside the cost/risk framework, it would have to require budget means to cover the extra cost.

ernment for which it manages borrowing, a financing plan, proposing borrowing strategy for the year, anchored by its long term objectives and taking financial conditions and borrowing needs into account. As Magnusson (2005) notes, the strategy should be to ensure that the government has access to a number of different sources of funding to reduce the risk of relying on a narrow funding base, i.e. to develop a broad funding and investor base. The annual plan will also address cost-risk tradeoffs. Preparing the annual plan is one of the most important functions of the NTMA.

While the government - Central or State as the case may be - makes decisions about the plan, it is advised on this by the Advisory Board. Since the Advisory Board as proposed would include senior officials from the RBI and Ministry of Finance, the Advisory Board input would also serve to highlight any strong conflicts with monetary policy,

Based on the plan proposed by the NTMA, and the Advisory Board's input, the government will decide on an annual remit, which lays down debt management strategy for the year. The NTMA will then operationalise this remit. The remit lays down the parameters within which the NTMA will function.

The Working Group has chosen this mechanism, similar to that adopted by several DMOs across the world, because it ensures that major decisions as to the overall volume of indebtedness and the acceptable risks in the debt portfolio - in terms of their impact on the budget, taxes, government spending programs, or other such fiscal indicators - with political decision-makers, while allowing finance professionals in the NTMA to seek the best cost-risk balance within the remit. As Magnusson (2005) points out, having the government and ultimately the concerned Ministers deciding on strategy ensures democratic accountability on the one hand; on the other hand, it also reduces the NTMA's vulnerability to *ad hoc* pressure through the year.

The NTMA's annual report evaluates how the Agency performed in meeting the remit for the year. This is placed before Parliament, and any comments by Parliament are addressed in the following year's annual report.

See Clause 17 on page 101

This arrangement has been written into the draft Bill in broad terms. The Bill seeks to combine flexibility with adequate accountability, and so it outlines the NTMA's role as an agent, while leaving timing, manner and form of the plan and remit to the realm of delegated legislation.

4.3.8. *Principal-Agent relationship*

As discussed above, the NTMA will not control debt management policy. It will advise Central and State Governments on borrowing, in the form of a financing plan. The government in question will consider this plan, consult the advisory board, and formulate a financing remit, which lays down the borrowing strategy for the year. The NTMA will then implement this remit, operating within the scope of the remit.

The Bill includes several additional provisions to ensure the NTMA's accountability. These include:

See Clause 29 on page 105

See Clause 8 on page 99 and Clause 30 on page 105

- Empowering the Central Government to direct the NTMA on policy questions.
- Empowering the Central Government to remove members of the Management Committee in specified circumstances and to entirely supersede the Management Committee as a last resort, if necessary.
- The Bill also provides for government and Parliamentary scrutiny of audits, accounts and reports, which are discussed in more detail in Chapter 6 below.

4.3.9. *Functions and Powers*

The functions and powers of the NTMA are laid down in Chapter IV of the Bill and discussed in Chapter 5.

4.3.10. *Federalism*

A State's public debt is a State subject. Therefore Parliament cannot mandate how a State should manage public debt.

Article 252 of the Constitution allows Parliament to legislate on a matter in the State List if the legislatures of two or more States pass resolutions to the effect that it is desirable for Parliament to regulate that matter. The resulting law can be extended to any other State as and when the legislature of that State passes a resolution to that effect. Experience shows that legislation under Article 252 can face long delays, and is not suited to the present endeavour.

See Clause 16 on page 101

Any new law establishing the NTMA must respect the legislative division of labour. The proposed bill adopts the mechanism within the RBI Act 1934 for managing State Government debt. Section 21A of the RBI Act 1934 gives State Governments the option to formally agree with the RBI that it will manage public debt for them. Section 21A strikes a delicate balance: it empowers the RBI to enter into a formal agreement with any State, but does not bind State Governments in any way. The NTMA would replicate this arrangement, which is captured in Clause 16 of the draft Bill.

See Clause 18 on page 101

Clause 18 of the proposed Bill lays down the same accountability mechanism for the NTMA vis–vis any State government as for the Centre.

As a result of Clauses 16 and 18, States would have the option to ask the NTMA to provide debt management services, but would be free to choose any other alternative they consider appropriate. If they choose to have the NTMA as a debt manager, the NTMA is accountable to them in the same way that it is to the Centre.

4.3.11. *Liability*

The law must make absolutely clear that the government raising debt or giving a guarantee is liable for that debt or the guarantee. If counterparties in the credit and derivative markets are hesitant about whether the NTMA has the mandate to bind the State, they will be reluctant to transact with the NTMA or will seek a risk premium to cover their legal risk. Emphasising the Government's liability is particularly important for an emerging market.

See Clause 27 on page 104

The draft Bill deals with this concern through two provisions. Clause 20 provides that the NTMA shall have the power to borrow funds as an agent of the Central Government and of such State Governments as may have entered into formal agreements with the NTMA. Clause 27 provides that the Central Government and State Governments are liable for funds raised and transactions undertaken for them by the NTMA.

4.3.12. *Funding*

Chapter V of the draft Bill deals, *inter alia*, with funding for the NTMA.

See Clause 21 on page 103

Clause 21 allows the Central Government to make grants or loans to the NTMA. This provision enables rather than mandates financial assistance from the Centre.

See Clause 22 on page 103

Clause 22 enables the NTMA to charge fees for its services, and requires it to consult the Centre on deciding the fee structure. Note that the RBI currently charges the Centre and the States fees for its services, and the NTMA might want to draw upon the existing fee structure.

See Clause 23 on page 103

Clause 23 establishes a General Fund for the NTMA. The General Fund will hold all the fees, grants, and funding received from any other source. It will be used to meet the Agency's expenses, including salaries and benefits.

See Clause 23 on page 103

Clause 23 empowers the Central Government to set a ceiling on the maximum amount to be held in the General Fund, in consultation with the Management Committee. When the corpus of money in the Fund exceeds the ceiling, the excess shall be credited to the Consolidated Fund of India, and and Consolidated Funds of States, in proportion to the share that the Centre and any State holds in the NTMA. The Centre can choose not to set a ceiling.

This clause attempts to address the concern that the NTMA should not amass resources greatly in excess of its needs, while ensuring that it has the wherewithal to hire qualified personnel and maintain state-of-the-art systems. Clause 23 tries to temper any potential rigidity by provided that the Central Government shall review the ceiling on a two-yearly basis, and in any event, on such occasion as the Management Committee might request.

4.4. Summing up

The Working Group has endeavoured to design a legal foundation for the NTMA that will secure the Agency's operational autonomy, allow it to provide operational expertise, but within an annual remit defined by the government. The next chapter discusses in depth the functions and powers of the NTMA.

CHAPTER 5

Functions of the NTMA

5.1. Introduction

This chapter discusses the functions and powers of the NTMA, as defined by Clause 19 and 20 of the draft Bill.

See Clause 19 on page 101

Clause 19 enumerates the functions of the Agency, and provides room to add new responsibilities by specifying that the Agency shall perform any additional functions that the Central Government assigns to it. The draft Bill tries not to define the NTMA's functions too narrowly; it lays down what the NTMA should do, rather than how it should perform its tasks. Our discussion below is more detailed: we think through how certain functions might evolve over time, against the background of current performance and international standards.

See Clause 20 on page 102

Clause 20 enumerates the NTMA's powers. Chapters 4 and 6 highlight the mechanisms by which the NTMA will be held accountable to the Centre and States. It is equally important to ensure that the NTMA is empowered to deliver on the tasks assigned to it. It should have enough operational autonomy to tangibly enhance debt management and lower the cost of financing for Union and State Governments. As the Kelkar report emphasised, "it is imperative to seek every institutional innovation which can yield even the slightest improvements in... public borrowing, or slight improvements in risk management" (MoF, 2004).

5.2. Functions

Functions of the proposed NTMA may broadly be classified and analysed under debt management, cash management, management of contingent and other liabilities, risk assessment, and advisory functions.

The key mandate for the NTMA would be cash and debt management for the Central Government and those State Governments which seek to entrust such functions with this agency. The NTMA would also advise the Central Government and State Governments, or manage, as mandated, their guarantees and other contingent liabilities and financial assets.

The objective of the NTMA would be to minimize the medium-long term cost of the debt with due regard to the risks in the debt portfolio, besides promoting development of the domestic debt market.

In the light of the above key mandate and long-term debt management objective, the functions of the NTMA would broadly be as follows:

5.2.1. *Debt management*

See Clause 19 on page 101

The debt management functions of the NTMA may include:

1. Meet the funding needs of the Central/State governments.
2. Implement annual borrowing plans consistent with approved budget.
3. Build up an arbitrage-free and liquid yield curve in the domestic market.
4. Issue benchmark gilts that achieve a benchmark premium.
5. Issue index-linked/inflation-linked securities.
6. Issue foreign currency denominated debt.
7. Introduce new products and instruments or new debt management techniques including debt swaps and other portfolio operations.
8. Adjust the government debt portfolio through suitable changes in composition of debt issuance, while taking into account the investor's appetite for gilts, and the government's own needs and risk appetite.
9. Advise the government on medium term and long term debt strategy.
10. Monitor developments in the government securities market and the wider economy.

It may be appropriate for the Budget Division/Macroeconomic Unit in the Central/State Government to continue with the following aspects of the debt management function: Composition of debt instruments including proportion of domestic to foreign debt instruments and the Debt sustainability analysis (DSA).

5.2.2. *Cash management*

See Clause 19 on page 101

The cash management functions of the NTMA may include:

1. Cash flow forecasting.[1]
2. Cash surplus management.

5.2.3. *Management of contingent and other liabilities*

See Clause 19 on page 101

Contingent liabilities management may include:

1. Assess and price credit risk.
2. Implement policies and guidelines for the issue of Government guarantees and on-lending of borrowed funds.
3. Advise on recapitalization of public sector enterprises given a risk management policy framework.
4. Record and report government guarantees and other contingent liabilities.

5.2.4. *Risk management*

See Clause 19 on page 101

The risk management functions of the NTMA may include:

1. Review the debt portfolio to assess risk characteristics.
2. Establish limits for financial risks and initiate measures to reduce operational risks.
3. Monitoring, evaluation and reporting of strategy implementation.

[1] Some DMOs (e.g. UK) are responsible only for cash balance management.

5.2.5. *MIS and information dissemination*

Managing information systems and data dissemination may include:

1. Development of MIS for debt recording and portfolio management systems.
2. Preparation of manual on government securities.
3. Public communication of debt and cash management strategy.
4. Liaison with credit rating agencies to identify and address emerging concerns.
5. Maintain channels of communication with market participants both formally and informally to solicit their views on gilt issuance and other issues.
6. Annual debt management report to Parliament.
7. Internal reports for senior policy makers.
8. Regular reporting to international institutions, including the IMF and the World Bank.

5.2.6. *Coordination between NTMA and the Monetary Authority*

Currently, the coordination between RBI and Government takes effect at a macro level through the Monitoring Group on Cash and Debt Management (CDM). At an operational level this coordination takes place through regular interactions between IDMD in the RBI and the Budget Division in DEA. However, this is more in the nature of an interaction between the agent and principal. The coordination required between RBI as a monetary authority and RBI as a debt manager takes place internally within the RBI although the consequential debt management decisions are generally taken under instruction of the Government, e.g., adjustment of normal Treasury Bill auction amounts to meet lumpy cash requirements.

The need for coordination between the debt manager and monetary authority arises in different contexts:

1. Since the instruments of both debt management and monetary policy operate within the same market space, there is a need to ensure coordination and avoid conflicting actions.
2. Both the Central Bank and the debt manager have the common goal of developing bond markets. Since they both are arms/agents of the Government, they need to be seen to be acting cohesively.
3. If the debt manager actively manages Governments cash position, it needs to closely coordinate with the liquidity operations of the monetary authority.
4. Under situations where the monetary authority issues its own debt for liquidity management, arrangements need to be in place to ensure that there is no conflict between these operations and debt management.
5. A debt manager, as a manager of foreign currency liabilities of the Government, needs a clear understanding of the reserve management policy. While a large part of the coordination requirements can be met through a modified form of the current CDM (to include senior officials drawn from the debt manger, Central Bank and the MOF) there should be formal channels for regular information sharing and interactions at the operational level. Care needs to be exercised to ensure that such coordination or information sharing does not compromise the operational independence of either the monetary authority or the debt manager. Similarly, it is important to avoid any arrangement that leads to a situation where the market starts to read monetary signals in debt management actions.

5.2.7. *Other functions*

Other functions of the NTMA may include:

1. Investment advisory services for government departments and government entities.
2. Advice on management of NSSF and other government funds and their on-lending to States or other government entities.
3. Managing foreign-currency assets related to government transactions required to meet net foreign-currency obligations.
4. Maintaining hedges of foreign-currency debt that cannot be bought back from investors.
5. Monitoring performance of central bank and other agents under the agency "contract for service."

Core NTMA functions are analysed in more detail in the following sections.

5.3. Debt management

Debt management refers to the effective management of the government portfolio, with the broad objective of minimising the cost of debt in the medium-long term while maintaining a judicious level of risk (IMF and World Bank, 2002). This includes an active management of the debt portfolio, focusing on reducing interest rate, exchange rate and credit risk and continuous monitoring and evaluation of the portfolio.

5.3.1. *The relationship between the NTMA and the MoF*

See Clause 17 on page 101

As discussed earlier, the NTMA will advise the Ministry of Finance, and implement its instructions. Interaction with the UK DMO revealed a delicate "institutional dance" designed to achieve this balance between accountability and independence. Once the Treasury puts forth its borrowing requirements for the year, the DMO arrives at an optimum maturity structure, tenor, type and number of securities to issue. It then *proposes* this portfolio to the Treasury, and there is a three-member staff within the Treasury that who *accept* the proposal of the DMO and then *instruct* the DMO to issue such a portfolio of borrowing. Having received these *instructions*, the DMO proceeds to *implement* the remit. The DMO is also part of the budget process as it provides analysis and indicative ideas regarding the projected fiscal deficit.

5.3.2. *The NTMA's role*

Currently, all bond issuance is in domestic markets. Dollar denominated and inflation-indexed bonds are not currently issued, and sovereign INR bond issuance does not take place in foreign markets.

The state of the market will influence the NTMA's short term activity, which would include buying back illiquid securities, consolidating existing liabilities and issuing instruments across the yield curve. The NTMA would also have to engage actively with credit rating agencies and the private sector, to build relationships with market participants.

Even as the NTMA concentrates on developing the market, it must be sensitive to its position as one of the largest players in the domestic securities markets. Its behaviour can send very powerful signals to market participants, and so its actions must be carefully calibrated. In light of this, the Working Group envisions the following role of the NTMA in its market behaviour:

1. Since the objective of the NTMA is low-cost funding in the medium-long term, with an emphasis on risk management, it should not be opportunistic in domestic bond markets. It should focus on predictability and consistency in its market signals, and avoid deviating from the announced calendar. Information dissemination is crucial: the NTMA should pre-announce all participation in markets. Even though some trading or issuance opportunities might appear to yield profits in the short term, the goal of the NTMA is to nurture trust in the market thus yielding low-cost financing in the long run.
2. NTMA needs to win the trust of both domestic and foreign market participants, and be perceived as reliable and consistent. Trust-building is particularly important in emerging markets such as India where foreign institutional investment in GoI securities is regulated and fiscal imbalances and exchange rate risk is high.
3. NTMA can trade opportunistically in international financial markets as it is just one market participant among many.

Over the medium term, the NTMA's focus is likely to shift towards building voluntary demand for government paper. It may consider options such as issuing inflation-indexed bonds, dollar-denominated debt or short-term nominal debt. These instruments will help to address market concerns regarding inflation, exchange rate and credit risk, respectively. Deploying these instruments in appropriate combinations would help to develop different segments of the market. Over the longer term, as statutory holding requirements decrease and capital controls lift, demand for sovereign INR bonds is likely to increase in both domestic and foreign markets. This would allow the government to move towards issuing long-duration, INR denominated, fixed-rate bonds.

5.4. Cash management

Cash management has been defined as the strategy and associated processes for managing cost-effectively the government's short-term cash flows and cash balances, both within government, and between government and other sectors (Williams, 2006). The main objectives of cash management are matching short-term flows and balances efficiently, reducing operational, credit and market risk, managing and minimising idle balances and ensuring flexibility in matching cash inflows and outflows.

5.4.1. *Main Functions of a Cash Manager*

The scope of cash management activity varies across countries. The two main components are cash forecasting and cash balancing. Cash forecasting involves:

1. Participating actively in the forecasting of expenditure and revenue, including longer-term forecasts (in our case, the half-yearly calendar) and the shorter fortnightly or monthly internal forecasts. This is achieved via close coordination with the Budget Division in the Ministry of Finance.
2. Integrating forecasts of receipts and payments with other information on cash flows, notably those generated by financing decisions - bond issuance and servicing - and by the cash manager's own transactions.

Cash balancing involves:

1. Coordinating the matching of day-to-day expenses and revenues. This includes maintaining a regular channel of communication with the government's banker to estimate end-of-day balances.
2. Targeting an appropriate end-of-day balance in the Treasury account, implementing a remit from the MoF regarding managing idle balances.

5.4.2. *Cash Management Models*

International experience suggests three main models of cash management. In the first two models, the DMO is involved in cash management to a greater or lesser degree. The third is where the Central Bank performs both the functions of a debt and cash manager.[2]

Model One: The DMO plays a dominant role in cash forecasting and cash balancing. It seeks to cover short-term mismatches in revenue and expenditure on an active day-to-day basis by issuing money market instruments, and auctions these instruments. However, clearing and payment of these securities continue to take place in the Central Bank. These DMOs usually target an end-of-day balance in their treasury accounts, and follow MoF remits regarding the management of surplus funds, if any. Examples: UK, Sweden.

Model Two: This is usually adopted by emerging markets as a prelude towards more active management of cash. The DMO plays a dominant role in cash forecasting, but less so in cash balancing. It is not able to actively manage cash on a day-to-day basis, but varies its T-bill issuance in rough tune with the expected balance. Under this model, the cash manager does not actively invest the cash balance in the financial market, but will generally deposit the balance at the central bank or at commercial banks when there is a surplus, or fund a cash shortage by short-term borrowing programs such as the T-bill program or a line of credit with commercial banks. Examples of this strategy include Brazil and Australia.

Model Three: The Central Bank is directly responsible for cash balancing and plays a dominant role in cash forecasting. Example: Canada.

Model One and Two support the conceptual case for relieving the central bank of cash management, apart from the actual account maintenance. Cash management is closely intertwined with monetary policy, as large inflows and outflows of cash can have an substantive impact on money markets. Treasury bills are the usual means for managing cash, and this can generate additional volatility in short-term interest rates, or influence market perceptions of impending changes in rates. It is therefore important to coordinate but separate cash and monetary management. A weak cash management system can prove expensive due to increased exposure to credit and market risks or additional debt interest costs, and dilute the system's ability to respond flexibly to economic shocks (Williams, 2006).

It is important that a cash manager be seen as completely independent from information regarding monetary policy changes. It is useful to take the example of the UK in this regard, where the DMO explicitly states that its cash management does not distort markets or trading patterns (See Box 8).

Although arrangements vary, international comparisons reveal certain best practices in cash management. Practices particularly relevant to the Indian context are given below.

1. Single Treasury Account (STA): This is one of the key institutional pre-requisites for active cash management. A consolidated treasury account structure allows for the netting and aggregation of balances and consolidated cash flow forecasting.

[2] There is also a fourth, unique, model of cash management currently adopted in the United States but not particularly applicable to the Indian context. In the US, tax inflows are held in the banking system, until the DMO requests a transfer to its treasury account at the Federal Reserve. This is a good way to manage idle balances and maintain a minimum balance, but relies on payment and clearing systems, which are sophisticated enough that the cash flows to the Federal Reserve instantaneously upon request, and that money markets are both deep and liquid.

> **Box 5.1: Case Study: Separating cash management and monetary policy in the UK**
>
> In its bilateral dealings with the market, the DMO calls itself a "price-taker" and its remit is to balance the Exchequer cash flow cost-effectively. It emphasises its lack of contact with the Monetary Policy Committee, and does not hold weekly bill auctions or ad hoc auctions at times when the Bank of England (BOE) is conducting its money market operations. Moreover, it does not hold reverse repo auctions of a maturity that could be perceived as competing with the BOE's structured daily repo operations.
>
> The UK DMO also maintains a clear separation between its cash and debt management operations. Hence, it does not create gilts purely for the purpose of meeting its needs for general collateral or DBV repo. It does not receive from the Treasury, the Office for National Statistics or other parts of the Government, advance notice of policy statements or data releases that will affect the market's short-term interest rate expectations. The only exceptions are data and forecasts relating to the government's financing needs, or any policy announcement that could involve significant short-term cash flow implications.
>
> Source: UK DMO Website http://www.dmo.uk.gov

2. Using pre-authorisation: The use of pre-authorization rather than pre-funding can further reduce the need for a cash balance. When a new project is approved, the government usually does not need to spend the money immediately, nor does it need to fund the project in cash. The actual cash does not need to be transferred to the relevant account immediately, as it translates into idle balances until paid out.
3. A clear definition of the role of the cash manager with regard to bi-lateral aid, IDA, sub-national government cash and the cash of state-owned enterprises.
4. Ability to make accurate forecasts of short-term inflows and outflows.
5. Adequate transactions processing and accounting systems
6. Timely information sharing between DMO, Budget Office, the Central Bank and commercial banks.
7. Using short-term financial instruments for cash management

The Working Group has kept these in mind while considering the NTMA's role in cash management.

5.4.3. *The Indian System: Passive Cash Management*

Cash management in India is a collaborative effort of the Reserve Bank of India (RBI) and the Budget Division, Ministry of Finance. The cash account of the Central Government is maintained with RBI. There is a two tier arrangement with agency banks as the first tier and RBI as the second tier. There are no specific targets prescribed by the Government for cash balances. The temporary mismatches in cash flows are met through a Ways and Means arrangement and if necessary, overdraft facility, between RBI and the Government of India. The WMA ceilings are fixed on the basis of mutual agreement between the RBI and the Government. Treasury bills are usually notified for a fixed amount and are not generally used for meeting short term cash requirements. Chapter 3 briefly outlined measures the RBI uses to manage short-term flows. These are described in more detail below.

5.4.3.1. *Ways and Means Advances*

Ways and Means Advances (WMA) are temporary loans given by the RBI to the government, to bridge the interval between expenditures and revenues. There are two

Table 5.1: Ways and Means Advances 2005-8.

	Special WMA			Normal WMA			Overdraft			Total		
Month	2005-6	2006-7	2007-8	2005-6	2006-7	2007-8	2005-6	2006-7	2007-8	2005-6	2006-7	2007-8
April	458	25	235	1984	723	114	1084	37	15	3526	785	364
May	254	6	437	920	162	654	118	0	461	1292	169	1552
June	5	1	204	61	3	222	0	0	10	66	4	436
July	67	5	389	282	56	310	38	0	3	387	61	702
August	79	10		244	145		31	10		354	164	
September	27	10		244	145		31	10		354	164	
October	8	9		102	189		0	22		110	220	
November	13	10		148	268		0	48		161	327	
December	8	22		175	246		24	122		207	390	
January	3	43		15	297		0	75		19	415	
February	1	39		2	121		0	5		4	165	
March	0	35		3	4		0	2		3	41	
Average	77	18	316	337	203	325	108	27	122	522	248	763

*Figures are average of daily outstandings

*Amounts are in Rs. Crore

*Source: Reserve Bank of India, Annual Report 2006-7

types of WMA - normal or clean advances, which were introduced in 1937 and special or secured advances, instituted in 1953, collateralised by Government of India securities.

WMA for the Union: WMA for the Union: The process of issuing ad hoc treasury bills to maintain the cash balance of the government was discontinued in April 1997. Since then, the RBI provides Ways and Means Advances under Section 17(5) of the RBI Act to the Central Government. The size and cost of WMA is decided by mutual agreement. The WMA interest rate is currently the repo rate. For overdrafts, the rate is 2% above the repo rate at present (RBI, 2005c). As per section 17(5), WMA has to be repaid in 3 months.. Since then, the limits have been set bi-annually. The Internal Debt Management Division monitors the overdraft process daily on receiving the position from the Central Accounts Section in RBI Nagpur (RBI, 2005c).

WMA for the States: Under Section 21A of the RBI Act, States voluntarily entrust their banking business to the RBI. Under Section 17(5) of the RBI Act, the RBI has been making Ways and Means Advances (WMA) to States since 1937. State-wise limits in respect of Normal and Special WMA are fixed as per the Bezbaruah Committee (2006-7) on the basis of average revenue receipts of the past three years and specific multipliers based on Special Category (SC) and non-Special Category states. The State goes into overdraft (OD) occurs whenever these limits are exceeded. Maximum time-period (days) and/or financial limits for which State Governments can remain in OD have also been revised periodically. The OD limit is 100% of the WMA limit. Payments are suspended on behalf of the State Governments if OD limits are breached for more than 14 consecutive working days (RBI, 2005c). The table below describes the issuances under WMA between 2005-6. It can be seen that demand for WMA is concentrated around the beginning of the fiscal year (RBI, 2005c).

5.4.4. *Overall assessment*

Despite these measures, cash management in India is largely passive in nature. This is due to a lack of end-day balance management, presence of surplus funds in the form of idle balances, and delay in the remit of cash balance information to the Budget Division.

5.4.5. *The NTMA's role*

Given the passive nature of cash management in India currently, and the potential conflicts of an active cash management system with monetary policy, there is a case for moving cash management to the NTMA over the medium term. Since the NTMA will advise the Budget Division on annual borrowing and expenditure forecasts, it will have the institutions in place for active management of cash including MIS, technical staff and good coordination channels with the Budget Division and the RBI. However, cash management by the NTMA may be difficult in the short-term because it is operationally intensive, requires more staff and close co-ordination between different agencies and systems.

International experience shows that cash management typically migrates to the DMO at a later stage than debt management. This is because of the day-to-day and dynamic nature of this function. In the UK, for example, the DMO began actively managing cash only in 2000, two years after it was instituted.

See Clause **19** on page 101

We propose to include an enabling clause in the legislation for the NTMA to undertake cash management. However, the Working Group also feels that the Government should maintain the present arrangements in the short term and transition gradually to cash management by the NTMA. We suggest the following legal arrangement to enable a measured, practical transition:

1. Legally, the NTMA would have formal responsibility for cash management as per the draft Bill.
2. The draft Bill empowers the NTMA to contract with third parties to perform its functions.
3. The NTMA may formally outsource its cash management function to the RBI in the short term. In practice, the present arrangments may remain intact over this horizon.
4. Over the medium term, the NTMA can incrementally take on this function and reduce the RBI's cash management duties, until the transition is complete. This transition would be supervised by the Central Government under its general supervisory powers over the NTMA.

5.5. Contingent liabilities

Contingent liabilities (CL) are implicit or explicit obligations whose timing and amount depend on the occurrence of some uncertain future event.[3] Since they do not involve explicit cash flows, they are usually treated as off-budget items for accounting purposes, which belies the fact that they are liabilities that may be called in at a later stage. There are two types of contingent liabilities - explicit and implicit. Explicit guarantees are usually in the form of credit guarantees for private sector provision of public goods, state insurance schemes and legal claims against the State. Implicit liabilities are a result of *inter alia*, the State's role as a lender of last resort, a commitment to the de facto pegging of the exchange rate, bailing out state or local governments under financial stress, provision of disaster relief measures, privatisation of previously state-provided goods/services.

Explicit contingent liabilities are a cost-effective manner for states to incentivise the private provision of public goods. However, proper pricing and valuation of these guarantees is very important for efficient risk management by the State. There could be significant negative fiscal repercussions for the State if contingent liabilities mature in large numbers at the same point in time.

[3] OECD: Glossary of financial terms, 2007

By their very nature, contingent liabilities are most likely to be called in during an economic downturn. Given the counter-cyclicity of fiscal payments, this is also the time when the state is least able to afford to fulfil such obligations. Risk management of these liabilities would allow states to lessen the risk of default on these liabilities. Making the nature and volume of these liabilities public will increase both transparency and accountability. And finally, guarantee-risk is conceptually the same as the risk taken in borrowing and on-lending funds, which is a risk that the NTMA will deal with on a day-to-day basis.

5.5.1. *International Comparisons*

The literature shows that an ideal contingent liability management framework must have three components - (1) guidelines for issuance, (2) budgeting and transparency and (3) financial risk management (Currie, 2002).

Guidelines for Issuance include co-ordination with the government budget office in order to prescribe a set of general rules and standards to guide the issuance of explicit guarantees. These aim to manage counter-party credit risk, exchange rate risk, risk of moral hazard and operational risk. They would include specify *inter alia*, credit ratings of counter-parties, minimum collateral issuance, counter-party stake in consortiums, and transparency standards.

Budgeting and Transparency includes specifying the expected and unexpected costs of the contingent liability, and imputing Cost-at-Risk or Value-at-Risk estimates. This involves identification, registration and disclosure of all CL, and financial statements of CL provided not only by the central government, but also by sub-national governments. Costing methods take into account both expected and unexpected costs of the guarantee. The methodology of pricing of liabilities varies. The Asset-Liability Management (ALM) framework is useful, as it matches financial characteristics across assets and liabilities, thereby minimising risk.

Financial risk management of the contingent liabilities includes the decision of whether they must be explicitly incorporated into the risk-management function of the DMO. It is usually challenging for emerging markets since risk assesment can be resource-intensive. Often, the uncertainties in contingent liability management are far greater than those in traditional liabilities, and it is extremely difficult to try and map these onto the debt portfolio. There are also DMOs that keep the CL in a separate profit-loss account, tracking them closely but not specifically incorporating them into their portfolio.

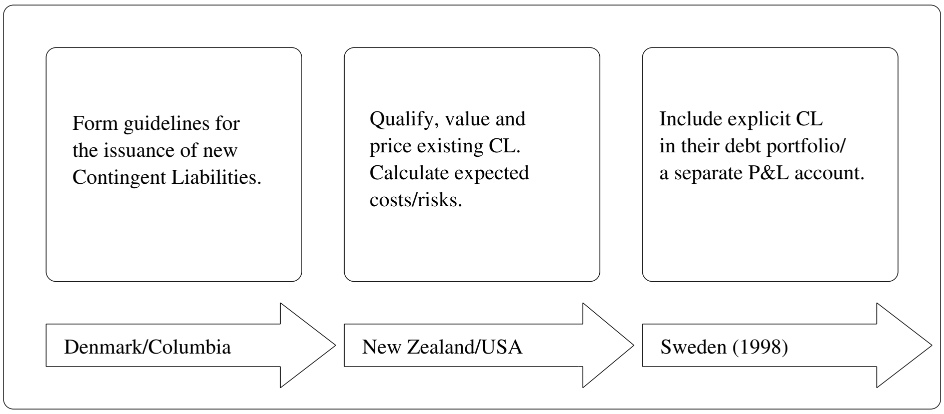
International comparisons in managing contingent liabilities show a spectrum of involvement. Sweden is at one end of this spectrum, where the DMO manages and prices all contingent liabilities. These are included in a separate profit-loss account, and the DMO coordinates drawing up the initial guarantee agreement, implements continuous risk analysis of the guarantee, and charges the beneficiary for the credit risk of the guarantee. The New Zealand DMO plays a more modest role: it manages and prices all contingent liabilities, but does not include these in the balance sheet. There are also cases where the DMO coordinates with the Central Bank in drawing up guarantees (Denmark), or where it works with the Ministry of Finance in approving the methodology of pricing cost/risk(Colombia).

In all the cases outlined above, the DMO actively coordinates with the Budget Office or the Central Bank in drawing up guidelines for issuing guarantees. These guidelines act as a pre-emptive risk management measure.

5.5.2. *Present System of Managing Contingent Liabilities*

Limits on guarantees: Constitutionally, the Union and the States are empowered to issue guarantees under the aegis of Article 292 and 293(1) (RBI, 2002). The Fiscal

Figure 5.1: Different models of managing contingent liabilities.



Responsibility and Budget Management Act, 2003 and the FRBM Rules prescribe a limit of 0.5% of GDP for guarantees given in any financial year beginning with the financial year 2004-05. Chapter 11 of the General Financial Rules (GFR), 2005 detail the current administrative guidelines for grant, review, accounting and monitoring of sovereign guarantees.

Composition of guarantees in India: The most important component of contingent liabilities in India is loan guarantees, both by the Centre and the States, with a major chunk of the guarantees being to institutions such as LIC, NABARD, HUDCO, NCDC and REC (RBI, 2002). The nature of guarantees vary - from Union guarantees on State and sub-national liabilities, guarantees in respect of loans to public sector enterprises including co-operative enterprises engaged in commercial activity, guarantees in respect of advances to State enterprises for specific projects of a non commercial nature, guarantees in respect of loans, guarantees in respect of state and sub-national bonds, guarantees in respect of multi-lateral agency loans and guarantees with respect to public-private partnerships in India.

Guarantee Fees: Guarantee fee is charged on a per annum basis, without any uniformity across States. As regards Central Government, all Government guarantees are also subject to a consideration in the form of a fee which, in general, is levied as per GFR provisions at 1% p.a. in respect of domestic borrowing and 1.2% p.a. in respect of external borrowings. The fee is levied initially at the time of issue of guarantee and thereafter on outstanding amount at the beginning of each financial year.

Risk Management: The RBI Monetary and Credit Information Review specifies the risk weights to be applied for guarantees in India, following capital adequacy norms, though this does not apply for sovereign liabilities.

Management of guarantees: The RBI has strongly emphasised the nature and importance of contingent liabilities to risk management. The RBI appointed a technical committee to look into the fiscal risk imposed by guarantees on state budgets in 1998. This committee made many important recommendations regarding the management of contingent liabilities, including setting ceilings on guarantees, adequate risk sharing between the two parties and honouring of called guarantees.[4] The RBI Group to

[4]Some of these recommendations were implemented, and now many states have administrative or legislative caps on guarantees. These include West Bengal (2001), Assam/Sikkim (2000), Rajasthan/Karnataka (1999). Some States like Gujarat and Goa had these arrangements in place even before the committee recommended them.

Assess Fiscal Risk of State Government Guarantees (2002) also analysed fiscal exposure of States to guarantees and made similar recommendations regarding monitoring and pricing of guarantees. Despite these steps, the number and value of guarantees issued have been increasing over the years.

Central Government guarantees are approved by the Ministry of Finance, Department of Economic Affairs (Budget Division). Once the guarantee is approved by Ministry of Finance, the guarantees are executed and monitored by the Administrative Ministries concerned, who are also required to report the status in this regard on an annual basis till they fall due or expire. However, as noted earlier, there is no comprehensive and consolidated source of information regarding contingent liabilities in India, either at the Centre or at the State level.

5.5.3. *The NTMA's role*

See Clause 19 on page 101

The Working Group feels that the NTMA is the logical place to begin managing contingent liabilities. Due to its debt management functions, the NTMA will already be equipped with the technical and operational skills and equipment needed to carry out the management of contingent liabilities. It will also have the MIS in place to facilitate monitoring and evaluation of these guarantees.

It recommends that the NTMA begins by assimilating a database on outstanding liabilities of the Centre and the States. Over the longer term, the NTMA can work with MoF in laying down guidelines for the issuance of government guarantees. It can also move towards pricing and managing risk. Since this process is very resource intensive, it can consider options such as contracting out to other agencies of the government government to carry out this task.

5.6. Data dissemination

Currently, data on the securities markets and on debt management as a whole is published by the RBI. These releases, which conform to the IMF's Data Dissemination Standards include the Weekly Statistical Supplement, the monthly RBI Bulletin and the annual publications of the Hand Book of Statistics on the Indian Economy and the Annual Report. These include data regarding the outstanding stock of debt, composition, volume and tenor of securities issued, secondary market dealings and the half-yearly calendar. The RBI also publishes data on macroeconomic variables such as inflation, growth, output and employment. Aggregated data regarding outstanding guarantees is published in the Receipts Budget. However, data regarding contingent liabilities as a whole is not available.

See Clause 19 on page 101

The Working Group believes that the NTMA should supplement and enhance current data collection and dissemination. The NTMA will need to analyse data for its own purposes. It should also make this data accessible to the market. The NTMA must undertake the following steps:

1. Establish information flows from all existing sources of data;
2. Identify gaps, and work with public and private institutions to fill them, including funding some initiatives that strengthen the statistical system;
3. Synthesise data for market participants where relevant.
4. Collect and disseminate data on its own performance and operations.

Under the Draft Bill, the NTMA has the power to call for information relevant to its functions.

5.7. Developing a Government Securities market

See Clause 19 on page 101

The NTMA will need to perform within the possibilities and constraints of the government securities market and, more widely, financial markets as a whole. Effective debt management and a deep and liquid market for government securities reinforce each other; by the same token, a market hampered by financial repression limits what a DMO can achieve. Developing a securities market is a primary objective of several DMOs across the world including Japan, Brazil, Morocco and South Africa. The Working Group believes that this is an important function of the NTMA, since the market for government securities is not yet substantially developed in India, despite significant progress since the 1990s.[5]

5.7.1. *The Indian government securities market*

Active monetisation of the fiscal deficits pre-1997 forced government securities markets in India to be weak and ineffectual. Since interest rates were kept low in order to ensure low cost of government borrowing, the real rates of return remained negative for several years (RBI, 2006b). The RBI has worked actively to promote market development since the 1990s, but many issues of concern remain. High levels of financial repression and the existence of captive buyers of government securities have led to a fragmented yield curve and mis-pricing of securities (CFSR, 2008). The Rajan Report argues that while the market in "on the run" government bonds has depth and immediacy, it lacks resilience; the market in other government bonds lack all three features that contribute to liquidity.[6]

5.7.1.1. *Participants*

At present, the Indian securities market is dominated by captive buyers. The largest of these buyers are banks, including scheduled urban co-operative banks, scheduled co-operative banks and regional rural banks. The requirement for non-scheduled urban cooperative banks varies as per the nominal size of their net demand and time liabilities (NDTL). All insurance companies are also mandated by the provisions of the IRDA Act 1999 to hold a minimum stipulated percentage of their assets in government securities. Non-Government provident funds, superannuation funds and gratuity funds are also subjected to similar requirements since 2005. And finally, non-banking financial companies (NBFCs) accepting public deposits are required to maintain 15 per cent of such outstanding deposits in liquid assets, of which not less than 10 per cent should be maintained in approved securities.[7] As noted earlier, this situation reflects the conflicts that arise when the same institution has to reconcile debt management, monetary policy and banking regulation.

5.7.1.2. *Instruments*

Securities issuance is fragmented across a range of instruments, but only a fraction of them are actively traded (HPEC, 2007). Over the past few years, the RBI has issued many different types of instruments, hoping to tap into specific pockets of demand in the markets. However, the market still lacks width and depth.

[5] Developments since the 1990s include the banning of issuance of *ad hoc* treasury bills, passing of the FRBM Act, emergence of market driven interest rates, reduction of SLR, setting up of a primary dealer system and focusing on the development of the secondary markets

[6] The report defines these terms as follows. "Immediacy refers to the ability to execute trades of small size immediately without moving the price adversely. Depth refers to the impact cost suffered when doing large trade. Resilience refers to the speed with which prices and liquidity of the market revert back to normal conditions after a large trade has taken place" (CFSR, 2008).

[7] RBI website: http://www.rbi.gov.in

Table 5.2: Ownership of Central and State Government securities: 2006-7.

Owner	Amount in Rs. Crore	Percentage of Total
Reserve Bank of India	62452.2	4.95
Commercial banks	585913.7	46.46
Life Insurance Corporation	280423.1	22.23
Unit Trust of India	4575.2	0.36
NABARD	2229.2	0.18
Employees Provident Fund Scheme	46530.6	3.69
Coal Mines Provident Fund Scheme	7625.6	0.6
Primary dealers	8495	0.67
Others	262949.5	20.85
Total	1261194.1	100

1. Source: Reserve Bank of India, Handbook of Statistics on the Indian Economy 2007.

2. Central and State Government securities represent the face value of interest-bearing outstanding rupee securities excluding Treasury Bills, Saving Deposit Certificates, other postal obligations, Prize Bonds, expired loans and interest-free non-negotiable securities of Government of India.

3. "Others" category includes subscription made by the rest of the economy.

5.7.1.3. *Yield Curve*

A benchmark yield curve has not, as yet, emerged. Liquidity of the bond market is poor, which impedes the calculation of a yield curve that can be reliably used to price all cashflows off the curve. Price data for illiquid bonds is strongly influenced by liquidity premia and microstructure noise; this data hampers yield curve estimation. Restrictions against short selling, and infirmities of repos, have prevented the emergence of an arbitrage-free yield curve.

A handful of securities accounts for the bulk of trading. Isolated pockets of liquidity are found, generally with very short term and very long term securities. Medium-term instruments are often the most difficult part of the yield curve to build. This is because the medium-term carries the impact, but not the transitivity of short-term events.

Interest rates on small-savings, which fall into the "other liabilities" category of government debt, continue to be administered. This impedes with the goal of a yield curve that is used by the entire economy.

5.7.1.4. *Primary Market*

As per the recommendations of the Technical Group on Central Government Securities Market (2006), the RBI permitted banks to undertake primary dealership and also revised guidelines for PDs to ensure that there is no under- subscription. Stand alone PDs have been permitted to diversify their activities in addition to their core business of government securities, subject to limits, so as to enable them to manage risk efficiently. So, the RBI has broadened access to the primary dealer system (RBI, 2006).

It has also tried to reach out to retail investors. A scheme of non-competitive bidding was introduced in 2002 to enable small and medium investors to participate in primary auctions without having to quote the yield or price in the bid . Eligible investors have to come through a bank or PD. These efforts are similar to those of DMOs in high-income countries such as Sweden, UK and Germany.

5.7.1.5. *Secondary Markets*

Volume and turn-over in secondary markets has been growing. The RBI has been consolidating securities, attempting to buy back illiquid securities and encouraging active trading. However, the market still lacks liquidity and fungibility across instruments. Since buyers in primary markets are holding securities by mandate, they are often reluctant to liquidate. The absence of an integrated sovereign yield curve also makes it difficult to correctly price securities in the secondary market.

There are still limits on FII investment in government securities, which are periodically reviewed. These ceilings limit voluntary demand for INR securities from abroad, which increases the pressure on local commercial banks to finance government debt.

5.7.2. *Links with other markets*

Government bond markets significantly impact the development of other equity, debt and derivatives markets (HPEC, 2007), (CFSR, 2008). This is because sovereign bond rates are "risk-free" and market-determined interest rates on these bonds can then be used to price liquidity and risk premia on all other financial instruments. This reduces price uncertainty, and transaction costs, and supports the development of longer-term contractual arrangements throughout the economy. Over time, the development of corporate bond markets reduces corporations' dependence on commercial banks, increasing competitive pressures on banks and other lending institutions to reduce their lending margins and develop more innovative products.

Thus, well-functioning government securities markets make the domestic capital markets more efficient - they help to generate market interest rates that reflect the true opportunity cost of financing across a range of maturities. This facilitates efficient allocation of capital, because financing and investment decisions can rest upon the true cost of capital. This benefits the government as well as the private sector.

As Wheeler (2004) notes, liquid government bond markets also facilitate the development of a range of fixed-income derivatives products - such as swaps, repurchase agreements, futures, and options - that can be used to hedge financial risk on individual transactions or at the portfolio level. The price of these hedging contracts is based on the price of the underlying bond market instrument. The hedging contracts, in turn, help to develop the domestic bond market, as the underlying bonds can be used, along with derivatives, to help structure suitable hedges.

Thus, the absence of a robust government securities market undermines the emergence and growth of other markets. The Rajan and Mistry Reports both highlight the absence of deep, liquid markets in a number of financial instruments, including corporate bonds, money market instruments and the currency markets (CFSR, 2008), (HPEC, 2007).

These missing or weak markets may seem tangential to public debt management; however, they warrant serious consideration because they reflect the limits of the financial system within which the NTMA will have to function, and have a direct impact on the costs and methods of financing government borrowing. A full set of financial markets would allow the NTMA to tap into a wider range of financing sources and at a lower cost; this in turn would strengthen the government's ability to respond to budgetary shocks without sharp cuts in expenditure or hikes in taxes. Missing financial markets or illiquid and inefficient financial markets also result in higher transaction costs, making it harder for prices to reflect fundamentals, and thereby increase the risks faced by all participants, including the NTMA.

Missing markets also undermine the emergence of the "Bond-Currency-Derivatives" (BCD) Nexus. The Rajan Report defines the Bond-Currency-Derivatives Nexus as "the interlinked set of markets on government bonds, corporate bonds and currencies" and argues that it is crucial to fully link these markets, and for these markets to be linked to other financial markets in order to function in an efficient and effective manner (CFSR, 2008). All these building blocks need to be liquid, driven by speculative price discovery, and all of them need to be tightly integrated by arbitrage. The Mistry Report emphasises the importance of conceptualising the BCD markets as an integral package whose individual components cannot be delinked, and argues that all three markets need to develop rapidly in order to attract local and foreign participation, have vibrant trading in spot and derivatives and have vibrant speculation and arbitrage to guarantee liquidity (HPEC, 2007).

The absence of a well-functioning BCD nexus has serious implications. For one, it has rendered equity financing disproportionately important for financial and non-financial firms. The equity market also disproportionately absorbs the impact of developments in the wider political economy. As the other markets needed to absorb adjustments do not exist or are illiquid and inefficient, the equity market bears the brunt of adjustments and is thus more volatile than it should be (HPEC, 2007).

A weak BCD nexus also weakens "monetary policy transmission", the process through which an increase in the short-term interest rate by the central bank propagates into changes in interest rates across the economy, thus pulling back demand and slowing inflation. If monetary policy transmission is efficient, the central bank can control inflation through small changes in the interest rate. In India, the lack of robust, tightly linked markets means that interest rates for corporate bonds, interest rates charged by banks, etc do not smoothly reflect a change in the policy rate. Weak monetary policy transmission thus necessitates large changes in the policy rate if a reduction in inflation is required (Patnaik, 2008), (Prasad, 2008).

5.7.3. *The NTMA's role*

Developing the government securities market and achieving a well-functioning BCD nexus requires a range of reforms, including regulatory reform, lowering capital controls, and upgrading existing systems. What role should the NTMA play in these systemic reforms, and what role can it play without straying too far from its core mandate?

As mentioned earlier, the NTMA's ability to achieve its objectives will be constrained by the limited secondary market in government securities, missing financial markets and the absence of a BCD nexus. Therefore, the Agency needs to understand the barriers to efficient and liquid markets, and take steps that help to dismantle these barriers.

The Rajan Report identifies the following reasons for stunted or missing financial markets (CFSR, 2008):

- Banning of products and markets.
- Rules that impede participation of firms and individuals in certain markets for reasons other than sophistication.
- Inadequacies of financial firms arising out of their ownership, size, and other reasons.
- A silo model of regulation and the structure, incentives, and staffing, of regulatory institutions that results in barriers to innovation and competition.
- Frictions caused by taxes.

While the NTMA cannot directly change policy, it can devise operational systems that make the primary and secondary market in government securities more accessible. It can engage closely with market participants, understand their needs, and foster demand for government securities. DMOs in countries such as Slovakia and Portugal reached out aggressively to foreign and domestic investors. The Working Group recommends that NTMA should learn from their experience. As a public sector entity that understands the markets, the NTMA can also be an important voice on legal and institutional reform. These are endeavours which require considerable effort, and are unlikely to yield instantaneous results. Nevertheless, promoting the development of the government securities market is an important part of the NTMA's role, and will eventually enable it to perform more effectively.

5.8. The NTMA's powers

See Clause 20 on page 102

The draft Bill gives the NTMA all such powers as are necessary or expedient for the effective performance of its functions. This broad, general power should not be understood in isolation - it is anchored and bounded by the NTMA's accountability to its principals at all times. Clause **20** also spells out certain specific powers - while these powers are housed within the general power under Clause **20**, the Working Group feels that these should be discretely enumerated. They do not detract from the enabling, general power under Clause **20**.

5.8.1. *Power to transact as an agent*

See Clause 20 on page 102

Clause **20** gives the NTMA the power to act as the agent of the Central Government, State Governments, local authorities, statutory corporations, or any other person or authority as the Central Government permits, in transacting on financial markets. The NTMA should have explicit authority to transact for the Centre and States, to reassure market participants of its *bona fides*, particularly foreign investors who may be unfamiliar with Indian institutions and markets.

The Working Group believes that the NTMA should also be empowered to act for a range of other public entities, so that it is able to advise, consult or offer services to them as it develops expertise and capacity. However, it should be *required* to act only for the Central Government and such State Governments as enter into agreements with it, for that is its primary role.

In relation to the Centre and States, the NTMA will operate the specified accountability mechanism: it will submit an annual financing plan, the principal government will set an annual financing remit based on the plan, and the NTMA will be obliged to implement the remit. However, the NTMA should be able to develop more attenuated arrangements with any other clients it might have, such as local authorities or PSUs.

5.8.2. *Power to contract with service providers*

See Clause 20 on page 102

Chapter 3 showed that very little of the current operational architecture of primary and secondary markets is embedded in primary legislation. This is as it should be. The RBI Act, 1934 did not enshrine particular issuance and trading mechanisms so that these could adapt to changing circumstances. Similarly, the draft Bill does not get into the operational details.

That said, the draft Bill specifically empowers the NTMA to choose and contract with service providers related to transacting in financial instruments. The NTMA should have the ability to restructure existing arrangements for debt management, including primary market auctions, secondary market trading, registrar and transfer functions, clearance and settlement and depository functions.

The mechanisms of the primary and secondary market for government securities are critically important. These mechanisms have to adapt to the needs of market participants, and should encourage rather than limit participation. The NTMA has the mandate of delivering low-cost funding in the long term. In order to do this, it must be able to design market mechanisms and choose service providers. Consider the following hypothetical example: as capital account convertibility increases in the future, international participation in the government securities market is also likely to increase; international participants may well have a strong preference for dealing with a depository or clearing corporation in a foreign financial centre. In these circumstances, assuming it were legally permissible, the NTMA should be able to contract with state-of-the-art service providers, and enable the Central and State Governments to benefit from increased activity in the market. The NTMA should not be locked into legacy systems that have outlived their usefulness simply because that is how things have been done in the past. This would undercut the Agency's ability to achieve its objectives, and Clause **20** attempts to guard against this specific possibility.

5.8.3. *Power to call for information*

See Clause **20** on page 102

Under the draft Bill, the NTMA has the power to call for information relevant to its functions. The Working Group expects that governments and public authorities will pro-actively share information with the NTMA, as the Agency will be a conduit through which to communicate effectively with the market. However, it is also necessary to allow the NTMA to request specific information that it considers necessary or relevant from public authorities when the need arises.

5.9. Summing up

The Working Group has attempted to ensure that the NTMA has the powers to competently perform the functions that a debt manager needs to in the Indian context, both in the short term and in the longer term as the economy grows and financing options become more complex. Of course, if the NTMA is invested with these powers and functions, this affects existing arrangements for cash and debt management. These effects are discussed in the Chapter 7.

CHAPTER 6

Transparency and accountability

6.1. Introduction

In the earlier chapters, the Working Group has considered in detail the ways in which the NTMA will be accountable to the government. Our analysis and proposals are guided by the assumption that transparency and accountability should be bedrock principles for the Agency, built into the law that creates it, the rules that bind it, the internal policies it formulates, and the debt management architecture it designs.

This chapter suggests concrete ways to ensure transparency and highlights international examples. It also reflects on how the NTMA can engage productively with anti-corruption and transparency laws and institutions.

6.2. Taking Transparency Seriously

The Fiscal Responsibility and Budget Management (FRBM) Act 2003 obligates the government to pursue "greater transparency in fiscal operations... and conducting fiscal policy".[1] There is a utilitarian reason for transparency: as the government securities market develops, investors, particularly foreign investors, will want transparent, consistent strategies and comprehensive disclosure about the government's financial position. An arm's length agency in particular should comply with a high threshold of accountability, and communicate regularly and reliably with Central and State governments.

The NTMA must also be sensitive to the fundamental shift in the public sector towards transparency and pro-active disclosure, anchored by the Right to Information Act 2005. Transparency is also emphasised by the IMF-World Bank Guidelines for Public Debt Management (IMF and World Bank, 2002). The Guidelines suggest that the State should:

- Define and disclose the objectives of public debt management.
- Formulate and report on debt management policies as openly as practicable.
- Disclose the important aspects of debt management operations.
- Clarify the roles, responsibilities and objectives of financial agencies managing public debt, and disclose information about who is responsible for debt management policy advice, primary debt issues, secondary market arrangements,

[1] Preamble and section 6, FRBM Act 2003

depository facilities, and clearing and settlement arrangements for trade in government securities.

- Explain the measures of cost and risk that have been adopted.
- Publicise information on past, current, and projected budgetary activity, including its financing, and the consolidated financial position of the government.
- Regularly publish information on the stock and composition of its debt and financial assets, including their currency, maturity, and interest rate structure.

The Central government has taken several steps to become more transparent about public debt. The Ministry of Finance published its first auction calendar in April 2002. The RBI began disseminating data on trades in government securities on a real-time basis through its web site in October 2002. The NTMA should build on these foundations and share information pro-actively, pre-emptively, wherever possible.

6.3. The Right to Information Act 2005

The Right to Information Act 2005 places a strong obligation on public bodies to disclose information pro-actively. Much of the information discussed in the next section would fall within the NTMA's disclosure obligations under section 4 of the RTI Act 2005.

6.3.0.1. *Safe harbour for sensitive information*

However, the NTMA will also be dealing with some information that cannot be disclosed pre-emptively. Sections 8(1)(a) and 8(1)(d) of the RTI Act 2005 provide the exemptions necessary for the NTMA to withhold sensitive information from the public. Section 8(1)(a) provides that a public authority is not obliged to disclose the following:

> 'Information, disclosure of which would prejudicially affect the sovereignty and integrity of India, the security, strategic, scientific or economic interests of the State, relations with foreign States or lead to incitement of an offence'.

Section 8(1)(d) provides that a public authority is not obliged to disclose the following:

> 'Information including commercial confidence, trade secrets or intellectual property, the disclosure of which would harm the competitive position of a third party, unless the competent authority is satisfied that the larger public interest warrants the disclosure of such information.'

The Act also exempts information held in a fiduciary capacity[2] and information that would infringe a private party's copyright if disclosed.[3]

The RTI Act 2005 encourages public authorities to provide information through the Internet[4], which would, of course, be necessary for an agency dealing with financial markets. A number of DMOs put serious thought into website design, to harness the site as a tool for advocacy, as well as for accountability. The UK website is an excellent example of this (See Box 9).

[2] Section 8(1)(e) of the RTI Act 2005.
[3] Section 9 of the RTI Act 2005.
[4] Section 4(2) of the RTI Act 2005

Box 6.1: Case study: The UK DMO website

The UK DMO's website is particularly clear and user-friendly. Conversations with officials at the DMO reveal that they have put a lot of thought into designing the website, making it central to communicating with the market and leaving a public information trail not only of their actions, but the deliberation that precedes the action.

Institutional information and analysis The website is a vehicle to explain the DMO's purpose, functions, vision and mission. It links to all relevant legislation, archives of press releases, annual reports and publications, audits and accounts, prior debt management strategies, primary dealer details and rating histories.

Current operational issues The website provides information regarding upcoming money and bond market auctions, daily data for prices and yields of bonds/notes, auction results, tender results, secondary market operations, sub-national debt management, coordination with fiscal and monetary authorities and management of contingent liabilities. This fulfils all operational information requirements for market participants.

Expectations management and market-smoothing The website publishes quarterly auction calendars for bond and money markets, the annual financing remit, progress against the remit, and in-house analyses of the macroeconomic outlook for debt management. It also provides comprehensive time-series data on all variables related to debt management. The website also has a series of Investor Guides, tailored to different types of investors.

While this might seem like a standard list of information, there few DMO websites are quite as comprehensive or detailed. For example:

- Not only does the site publish DMO gilt market formulae, amongst other technical documents, it also intends to publish information such as the Yield Curve Model, and methods of calculating cash flows on index-linked securities.
- Market consultation documents are available, as are reports by the National Audit Office. So, external evaluation and feedback, even that which is critical, is made public.
- The annual report has extensive information on corporate governance, including details such as important management decisions taken that year, and salaries paid to senior staff.

With this level of disclosure, the website becomes a highly persuasive way for the DMO to explain its rationale and demonstrate its commitment to market participants. It is more than just an administrative communication mechanism, and plays an important role in market signalling. As DMO staff themselves indicated, knowing that information and processes will be on the website adds rigor to the way the office works, because pro-active transparency is ultimately the most effective regulator.

6.4. Reporting requirements

Debt management bodies in different countries use a mixture of formal reports and regular media announcements to report on their performance, how far they met their annual objectives and their plans and priorities for the year ahead.

6.4.1. *Core Reporting Requirements*

The NTMA should be required, from the outset, to publicise a core of information, including:

- Its proposed debt management strategy for the year
- Annual remits prescribed by the Ministry of Finance or state governments.
- Auction calendars and results.
- Operational documents, including:
  - Regulations and procedures for the primary distribution of government securities, including the auction format and rules for participation, bidding,

and allocation.
   - Rules covering the licensing of primary dealers and other officially designated intermediaries in government securities, including the criteria for their choice and their rights and obligations.
   - Regulations and procedures covering secondary market operations.

See Clause 28 on page 104

- An annual report and accounts, which measures its performance against the annual remit, and which it formally presents to the Minister of Finance at an appropriate time in the budgetary process. The Ministry of Finance, in turn, should present the annual report to Parliament. Should Parliament comment on any aspect of the NTMA's annual performance, the NTMA should disclose and address these comments and concerns, as appropriate, in the following year's annual report.

See Clause 31 on page 106

  Under the draft Bill, the Central Government has the power to prescribe the manner and form of the Annual Report through Rules. Besides analysing the NTMA's performance, the annual report should also include information about corporate governance, and the rationale behind key management decisions.

6.4.2. *Information on an 'as-needed' basis*

In addition, the NTMA would be explicitly obliged to provide the Central or State governments with information regarding its activities when asked specific questions.

See Clause 19 on page 101

6.4.3. *Further requirements*

The core reporting obligations outlined earlier would be a sound starting point for the NTMA. As the NTMA develops capacity, the Management Committee can lay down further reporting / publicity obligations, such as:

- More frequent performance updates, on a quarterly or monthly basis depending upon the NTMA's capacity.
- Regular updates on primary and secondary market activity.
- Quarterly internal audit.
- Information for investors.
- Publication of consultation papers and committee reports.
- Links to external research.

6.5. Auditing and Accounting Standards

The NTMA should have robust auditing and accounting standards. The proposed Bill therefore provides for an internal and an external audit.

See Clause 26 on page 104

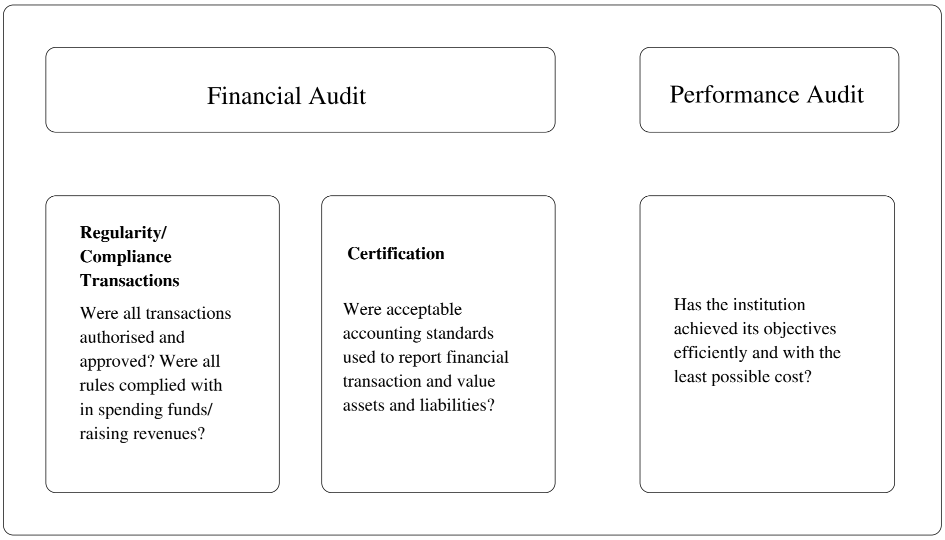
6.5.1. *The status quo*

The RBI Act 1934 empowers the central government to appoint auditors on an annual basis.[5] Section 51 of the Act also gives the Central Government a residuary power to "at any time appoint the Comptroller and Auditor-General to examine and report upon the accounts of the bank".

At present, the RBI is not audited by the CAG, although the Central Government has the power to appoint the CAG as Special Auditor of the RBI under Section 51 of

[5] Section 50 and 52 of the RBI Act 1934.

Figure 6.1: Financial and Performance Audits.



the RBI Act 1934. CAG scrutiny is restricted to transactions involving the RBI and MoF, such as the transfer of reserves. The RBI is audited by external auditors appointed by GoI under section 50 of the RBI Act 1934. However, this is a general audit, and as the RBI does not prepare discrete financial accounts of its debt management operations, these operations are not separately audited. The RBI also conducts an internal audit. Internal debt management functions are covered in the RBI's statutory Annual Report, which is placed before Parliament. External debt management functions are reported in the Annual Status Report on External Debt presented to the Parliament by the Finance minister.

6.5.2. *Auditing the NTMA*

Creating an NTMA provides an opportunity to audit debt management more thoroughly. The World Bank-IMF Guidelines recommend that external auditors should rigorously scrutinise debt management activity every year (IMF and World Bank, 2002). Audits should cover a DMO's performance, systems and procedures and should be made public.

6.5.3. *External Audit*

See Clause **26** on page 104

The Office of the Comptroller and Auditor General (CAG) is the appropriate external auditor for the NTMA. This is considered best practice. For example, the Ireland NTMA's annual accounts are audited by the state auditor (Comptroller and Auditor General). The Australian National Audit Office audits the AOFM as part of a larger audit of public sector entities, and the report is tabled before Parliament.

The CAG audits the full array of government activities and programmes. Broadly speaking, it conducts two types of audits (See Fig 6.1)

The Working Group considered various auditing arrangements before concluding the most appropriate arrangement was for the CAG to have unrestricted powers of audit.

- The purview of the CAG's audit can be restricted for a statutory body corporate under Section 19(2) of the CAG (DPC) Act 1971. However, such restriction or exclusion would be extremely unusual and may be perceived as a lack of candour. In addition, given that the Executive is accountable to Parliament for public debt management, it is arguable that section 19(2) does not apply to an agency such as the NTMA. Conversations with the CAG indicate that the CAG tends to exercise its powers over statutory corporations with deference towards their intended autonomy. For e.g., the CAG does not audit the Orders of regulatory bodies such as SEBI. Moreover, the CAG invests time with the audited entity at the beginning of a performance audit identifying suitable benchmarks for performance, and undergoing this exercise could potentially be valuable for the NTMA in developing its own internal performance metrics.

- When auditing government companies, private auditors (acting under the aegis of the CAG) usually certify the accounts. These "commercial" audit reports are prepared by empanelled private auditors, and the CAG follows this with a superimposed or supplementary audit.[6] The Working Group considered whether to adopt this formulation for the NTMA, and decided against it.

The NTMA will be a specialist agency that transacts in financial markets. There are concerns that the CAG would need to develop expertise in NTMA activities. The experience of other emerging markets shows that effective debt management is undermined when the debt manager feels that every financial decision will be second-guessed. It is important that audits are nuanced and tailored to the NTMA's work. The CAG's Office is willing to work closely with the Ministry of Finance by liaising with their counterparts in other jurisdictions to understand debt management audits as well as how to train staff and build capacity. The Working Group suggests that the NTMA should develop an Auditing Manual, in conjunction with the CAG, that explains its mandate and lays down metrics or methods to measure performance.

The UK's National Audit Office has been creative in the way it audits the UK DMO, and its methods are described in Box 10.

6.5.4. *Internal Audit*

In addition to an external audit, the NTMA should maintain high internal auditing standards. Rules and Regulations should define the manner and form of the internal audit. The Irish debt management agency hires a major international accounting firm to audit all data, systems and controls, as does the Australian AOFM. The Working Group recommends that the NTMA follow the Irish and Australian model. A credible high quality internal audits is particularly important for an emerging market DMO.

In addition, international experience suggests that the Constitutional auditor may take some time to build the expertise to audit the debt manager's performance. This makes a thorough internal audit even more important. As mentioned before, the NTMA's specialised functions should not insulate it from evaluation. The Australian AOFM's internal audit is an example of a thoroughgoing review, which can be a catalyst for improving core functions and risk management. It covers the agency's basic systems, but also tests particular aspects of its functioning.

6.5.5. *Audit Committee*

Some DMOs form audit committees, distinct from the internal auditor, which report to the DMO's Board or Management Committee and ensure that the DMO is complying with its various legal obligations and operational and risk management policies. The Working Group recommends that the NTMA have an audit committee in place, particularly as its role becomes larger and more complex.

[6] Section 619(2) of the Companies Act 1936.

6.6. Relationship with the Central Vigilance Commission

The Central Vigilance Commission ("CVC") is a statutory watchdog, created to investigate allegations that the Prevention of Corruption Act ("PoCA") 1988 has been violated[7]. Employees of a statutory corporation fall under the purview of the CVC Act 2003.[8] The CVC has wide-ranging powers and the courts have adopted a purposive, expansive approach to interpreting PoCA 1988 and the CVC Act 2003. There is some concern that good faith decisions by NTMA staff might invite suspicion because the nature of financial markets is not adequately understood. The next section highlights salient aspects of PoCA 1988 and then examines how to manage the NTMA's relationship with the CVC.

6.6.1. *Understanding PoCA 1988*

Under PoCA 1988, the NTMA would be considered a part of the "State" and all NTMA officials would be considered "public servants". The "State" is defined as encompassing a statutory corporation by section 2(b) of PoCA 1988.[9] Under Section 2(c) of PoCA 1988, any person in the service or pay of a statutory corporation is explicitly included under the definition of "public servant". Note that this is congruent with how the Indian Penal Code defines "public servant", which includes "Every person in the service or pay of a . . . corporation established by or under a Central, Provincial or State Act.[10]"

It is an offence under PoCA 1988 to do any of the following:

- Accepting "any gratification whatever, other than legal remuneration" in respect of an official act.[11]
- Accepting any gratification as a motive or reward for improperly influencing a public servant.[12]
- Accepting a valuable thing for inadequate or no consideration from a person who has any connection with the public servant's official function.[13]

Important concepts under PoCA 1988:

- *Gratification*: is not restricted to obtaining goods, services, favours or advantages that are purely pecuniary or estimable in money.[14] So, as an example, the promise of a job for one's child would arguably fall under the definition of gratification.
- *Legal remuneration*: is not restricted to remuneration which the public servant can lawfully demand, but includes all remuneration that he or she is permitted to accept.
- *Reverse burden of proof*: Section 20 of PoCA, 1988 partially reverses the burden of proof. The prosecution only has to prove that the accused has received the gratification or valuable object in question. It is then for the accused to establish that he has acted lawfully.

[7] Preamble of the CVC Act 2003
[8] Preamble and Section 8(2)(b) of the CVC Act 2003.
[9] Section 2(b) of PoCA 1988.
[10] Section 21(12)(b) of the Indian Penal Code 1860.
[11] Section 7 of PoCA 1988.
[12] Sections 8 and 9 of PoCA, 1988.
[13] Section 11 of PoCA 1988.
[14] Section 7, Explanation (b) of PoCA 1988.

Box 6.2: Case study: The UK DMO's external audit

In the UK, the National Audit Office ("NAO") conducts a performance audit of the DMO. This is one strand of a wider effort to make fiscal policy more transparent. Since the July 1997 Budget, the UK government invited the NAO to audit key assumptions and conventions underpinning fiscal projections. The NAO was given a formal role as auditor under the Code for Fiscal Stability, a fiscal policy framework introduced in 1998, which is the policy equivalent of fiscal responsibility legislation in many jurisdictions.

The Code requires the Treasury to invite the NAO to audit any changes to the key assumptions and conventions underlying projections of the public finances and to ensure that any advice received is published . All reports produced under the Fiscal Stability Code, including DMO reports, are placed before the Treasury Committee of the House of Commons.

The UK NAO took the following steps in its most recent audit of the DMO:

- It surveyed debt managers in a range of countries, sending out detailed questionnaires.
- It surveyed 16 market makers and 20 representatives of End Investors, seeking their views on the impact on borrowing costs of the long term debt management strategy and the effectiveness of contact with the DMO.
- It met key staff at the DMO and the Treasury.
- It shadowed DMO staff to gain a first-hand insight into operational activities, including observing management meetings on future issuance, attending a gilt auction and a T-bill tender.
- It attended key debt management events at the Treasury, the DMO and internationally.

Thus, the NAO develops a comparative perspective by surveying foreign DMOs. It has sought input from the financial sector and learned about public debt management and fiscal policy more broadly. It has also endeavoured to understand the content, constraints and pressures faced by DMO and Treasury officials. This makes the NAO a credible and rigorous auditor of public debt management. DMO staff, in turn, uses the NAO audit as a way to reflect upon and improve their systems and performance.

Source: UK DMO website at http://www.dmo.gov.uk; NAO website at http://www.nao.org.uk/

6.6.2. *Legal safeguards to meet vigilance standards*

- *Clarify staff terms and conditions*: It is absolutely essential for the NTMA to clearly spell out remuneration for every level of staff, including, *inter alia*, any bonus or incentive structures, allowances, rules about extending and receiving hospitality. This is particularly important if the NTMA departs from conventional salary structures for statutory bodies.
- *Protect action taken in good faith*: The proposed draft NTMA Bill includes a provision protecting action taken in good faith by any employee of the NTMA. The Working Group feels that the NTMA can make this protection more effective by ensuring a paper trail when the Chief Executive or the Management Committee makes important decisions. In particular, the NTMA should meticulously document research, recommendations and decisions on annual debt strategy and steps to implement the annual remit.
- *Power to limit suo motu enquiries*: The CVC has the power to make *suo motu* enquiries into allegations of violation of PoCA 1988 or offences under the Code

Box 6.3: Case Study: Australia's Internal Audit

The AOFM engages a major international auditor for its annual internal audit. Each year, in addition to conducting a basic audit, the auditor examines particular functions, systems or policies within the AOFM. For example, in 2006-07, in addition to the regular annual audit review of internal operational controls and IT specific controls, PricewaterhouseCoopers reviewed the following areas:

Regulatory risk:
Examined framework for identification, monitoring and sign off of legal and regulatory requirements.
Business continuity and disaster recovery (IT):
Assessed the AOFM's Business Continuity and Disaster Recovery Plans.
Contract management:
Examined the framework for managing contracts within the AOFM and tested a sample of contracts for compliance with the framework.
The year before that, the internal auditor examined the following:
Collateralisation:
Governance framework in relation to collateralisation including the AOFM's Credit Risk policy.
Securities lending:
Control framework around the AOFM's recently introduced securities lending arrangements.
Quantum application security:
Security environment supporting the Quantum Treasury Management System.
This type of internal audit allows the AOFM to "stress test" particular systems and departments, and identify weaknesses at an early stage.

Source: AOFM Annual Reports 2005-06 and 2006-07, Management and Accountability
http://www.aofm.gov.au/content/publications/reports.asp?NavID=20

of Criminal Procedure (CrPC) 1973.[15] However, section 8(2)(b) of the CVC Act 2003 provides that the Central Government can specify what level of officers in a statutory corporation are subject to this power. As an example, the Central Government has brought public sector bank officials of Scale V and above under the CVC's section 8(1)(d) *suo motu* powers.[16] Where the Central Government does not notify to whom these powers are applicable, they are deemed to apply to all the officers of a statutory corporation.[17] The Central Government can consider whether it wants to limit *suo motu* investigative / enquiry powers to NTMA officials at and above a certain level of seniority.

6.6.3. *Policy measures to meet vigilance standards*

6.6.3.1. *The Central Vigilance Officer's role*

Under CVC guidelines, the NTMA should have a Vigilance Division headed by a Chief Vigilance Officer ("CVO").[18] The CVO advises the chief executive on vigilance and anti-corruption measures. He or she also provides a link between the public authority, the Central Vigilance Commission and the Central Bureau of Investigation.[19]

The CVO collects intelligence about corrupt practices, investigates allegations reported to him; refers matters to the CVC and takes steps to prevent corruption.[20] The

[15] Section 8(1)(d) of the CVC Act 2003.
[16] See S.O. 371(E), dated 18 March 2004, published in the Gazette of India, Extra., Pt. II, Sec.3(ii)
[17] Proviso to Section 2(b) of the CVC Act 2003
[18] CVC Vigilance Manual 2006, 13-20, available at http://cvc.nic.in/man04.pdf.
[19] CVC Vigilance Manual 2006, p.1, available at http://cvc.nic.in/man04.pdf
[20] Vigilance Manual, p. 8-11

Box 6.4: Case Study: AOFM's Audit Committee

In Australia, Section 46 of the Financial Management and Accountability Act 1997 requires that the Chief Executive Officer of the AOFM establish and maintain an Audit Committee. The AOFM Audit Committee meets four to five times a year and is a forum for reviewing audit and accounting policies. It does the following:

- Approves the AOFM's internal audit plans;
- Reviews all audit reports and provides advice to the Chief Executive Officer on action to be taken on matters raised in them;
- Provides advice to the Chief Executive Officer on the preparation and review of the AOFM's financial statements; and
- Reviews operational risks and oversees development of the Fraud Control Plan.

The Audit Committee membership for 2007 comprised:

- An independent member of the AOFM Advisory Board (Chair);
- The former Group Auditor, Financial Controller of Institutional Banking and Executive General Manager of the Commonwealth Bank of Australia;
- The Manager of the Asset and Liability Analysis Unit of the Treasury; and
- The Head of Compliance and Reporting, AOFM.

Invited attendees included the Australian National Audit Office (ANAO), the AOFM internal auditor (PricewaterhouseCoopers) and the AOFM Chief Finance Officer. This structure ensured that the AOFM had expert advice, and that the Treasury and the NAO were woven into the internal audit.

Source: AOFM Annual Report 2006-07, Management and Accountability
http://www.aofm.gov.au/content/publications/reports.asp?NavID=20

CVO's remit is wider than offences under PoCA 1988. It also includes looking into instances of gross or wilful negligence, reckless decision-making, blatant violations of systems and procedures, and "exercise of excessive discretion with no apparent public interest consideration".

Clearly, the CVO has wide powers, and would play an important role as internal watchdog and interlocutor between the NTMA and the broader public vigilance system. The NTMA should ensure it appoints a proficient CVO from the outset, so that the agency is in a steady dialogue with the CVC about its functions and the inherently contingent nature of its decisions.

CVOs are appointed in consultation with the Central Vigilance Commission.[21] The CVC Vigilance Manual provides that 'big departments/organisations should have a full-time CVO, i.e. he should not be burdened with other responsibility'. The Manual also advises that the CVO should normally be an outsider on deputation to avoid conflicts of interest.[22]

6.6.3.2. *Consultations with the CVC*

Under Section 8(1)(g) of the CVC Act 2003, the CVC shall tender advice to the Central Government or statutory corporation established by a Central Act on such matters referred to it by those bodies.

[21] Vigilance Manual, p. 13-20
[22] Vigilance Manual, p. 13

Under Section 8(1)(h) of the CVC Act 2003, the CVC can 'exercise superintendence over the vigilance administration of . . . corporations established by any Central Act' provided that such supervision is compatible with Government directions on vigilance.

The Working Group recommends that the Ministry of Finance consult the CVC at an early stage about how to ensure that the legal framework is compatible with PoCA 1988 and the CRPC 1973. Further, the NTMA should strongly consider inviting CVC representation if it forms an audit committee. Working closely with anti-corruption bodies will be an important part of educating them about the NTMA's work and the type of decisions it has to make, as well as ensuring that the NTMA has implemented robust governance measures.

6.7. Summing up

Some of the issues raised above have been incorporated in the draft Bill in Appendix A. However, much of the practice and policy needed to ensure good governance cannot be prescribed in primary legislation. These will be shaped by the NTMA Management Committee, in consultation with the Centre and States, once the Agency is established and as it evolves. This chapter aimed to discuss some important aspects of governance, and proffer suggestions and examples that the NTMA can draw upon. In addition to the case studies in this chapter, Appendix B includes a list of corporate governance measures that various other DMOs have adopted, which might provide ideas and benchmarks. This is also an opportunity to underscore that good governance measures should be embedded in every aspect of the NTMA's design, from primary legislation, to staffing practices, to communicating with the market.

CHAPTER 7

Legal Effects of creating an NTMA

7.1. Introduction

This chapter considers how creating the NTMA affects existing laws and policies on financial markets:

1. It begins by outlining amendments to existing laws that would be a necessary by-product of establishing the NTMA, which are included in Schedule I of the draft Bill.
2. An important reform such as this also motivates wider systemic analysis, which throws light on other aspects of the financial system that can be improved. Therefore, the Working Group also uses this chapter to raise some broader questions on legal, institutional, operational and policy reform.

The Working Group has examined the effects of the proposed Bill on existing laws, with particular focus on the following:

1. The Reserve Bank of India Act, 1934
2. The Government Securities Act, 2006
3. The Public Debt Act, 1944
4. The Securities Contract (Regulation) Act, 1956
5. The Depositories Act, 1996
6. The Payments and Settlements Act, 2007
7. The Securities and Exchange Board of India Act, 1992
8. The Fiscal Responsibility and Budget Management Act, 2003

We approached this analysis from two perspectives:

1. *Statute-based analysis:* If the NTMA is created and the RBI Act 1934 amended as a result, what ripple effects would this legislation and amendment have on other laws?
2. *Functional analysis:* If we examine the functions that various agencies perform in issuing and trading securities, how might each function be affected by creating the NTMA, and how should this be reflected in law? As discussed in Chapter 3, the various agencies involved in issuing and trading would, broadly speaking, be the regulator, the investment bank, the registrar and transfer agent, the

stock exchange, the clearing corporation and the depository. When the Central Government issues securities, the RBI performs almost the entire range of these functions. The Clearing Corporation of India acts as central counter-party in government securities transactions

7.2. Amendments to existing laws

See Schedule I and Clause 38 on page 107

Our analysis reveals the need for specific legal amendments which are discussed below and included in Schedule I of the draft Bill.

7.2.1. *Reserve Bank of India Act, 1934*

The RBI Act, 1934 would be the main piece of legislation affected by the proposed Bill. The Working Group emphasizes that only the RBI's powers and obligations relating to debt and cash management as an agent for the government should be affected. Any amendments must be very careful not to impinge upon the RBI's role in relation to monetary policy, banking regulation and financial stability. The RBI's input on the suggested amendments will be actively sought, in addition to inputs on the report in general.

7.2.1.1. *Debt management*

The RBI's power and functions related to public debt management need to be removed from the RBI Act, 1934.

The Working Group recommends the following amendments, which are folded into Schedule 1 of the draft Bill:

- Section 17(11), dealing with the RBI's power to purchase assets, make investments and manage debt as an agent of, *inter alia*, the Centre, States, local authorities, statutory body corporates and foreign governments should be revoked.
- Similarly, Section 17(11A)(a), dealing with the RBI's power to act as agent for the Central Government in guaranteeing the performance of debt obligations by small scale industries, should be revoked.
- In Section 20, dealing with RBI's obligation to transact government business, the phrase "including the management of the public debt of the Union" should be removed.
- Section 21(2), dealing with the Central Government's obligation to entrust debt management to the RBI, should be omitted.
- Similarly, in Section 21A which deals with the RBI's power to transact government business of States on agreement, subsection (1), clause (b) which states "the management of the public debt of, and issue of new loans by, that State." should be omitted.

7.2.1.2. *Cash management*

If the NTMA is to act as a cash manager for the Central or State Governments, hindrances to this function must be removed. Therefore, the Working Group recommends the following amendments, which are folded into Schedule 1 of the draft Bill:

- Section 21(1), dealing with the RBI's cash management functions for the Central Government, should be removed.
- Section 21A(1)(a), dealing with the RBI's cash management functions for State Governments, should be removed.

The Working Group recognizes that cash management should be transitioned to the NTMA at a slower pace than debt management, as the former is arguably more operationally intensive and requires more staff. Therefore, the Working Group proposes that the NTMA should have formal responsibility for cash management, but to aid a carefully calibrated transition, the RBI be assigned to act as agent of the NTMA to perform such cash management functions as required, provided that the Central Government authorizes the terms of any such agency agreement between the NTMA and the RBI.

Creating the NTMA should not affect provisions that empower the RBI to transact as a principal in government securities, foreign exchange, gold and silver. Therefore there is no change to the following:

- Section 17(6A), which empowers the RBI to deal in derivatives or in any other financial instrument.
- Section 17(8), which empowers the RBI to buy and sell Central Government securities, State Government securities or specified securities of a local authority.
- Section 17(12AA), which empowers the RBI to lend and borrow Central Government securities, State Government securities or specified securities of a local authority.
- Section 17(12), which empowers the RBI to buy and sell gold and silver coins and bullion, buy and sell forex, and open a gold account with the principal currency authority of any foreign country, with BIS, or with any international or regional financial institution.
- Section 17(12A), which empowers the RBI to buy and sell foreign securities, whether issued by a foreign government, institution or body corporate.

7.2.1.3. *Depository function*

Section 17(9) authorises the RBI to keep 'custody of monies, securities and other articles of value, and the collection of the proceeds, whether principal, interest or dividends, of any such securities'. It does not specify whether the RBI acts for itself as a principal or as an agent for the Centre or State governments. As this provision is ambiguous, it should not be amended. It does not affect the NTMA's power to dismantle present depository arrangements for government securities and design an arrangement with alternative service providers.

7.3. Policy Questions

In this section, we lay out a series of policy and legal policy issues related to government securities, and propose ways to make progress on them. As mentioned earlier, these are recommendations, which are not necessary to create the NTMA and are not included in the proposed Bill. However, the Working Group feels these reforms are extremely important for the development of the securities market, and it is important for policy-makers to think constructively about them. We cover the following issues:

- Regulation of the government securities market
- Registrar and Transfer (RTA) functions
- Trading system
- Clearance & Settlement
- Depository functions
- Other policy issues relevant to the NTMA, including WMA, MSS scheme, coordination with FRBM requirements, and small-savings schemes.

We proceed on the basis that transaction costs in financial markets are deeply influenced by regulatory architecture, the design of market mechanisms and the quality of market infrastructure (Rajan and Shah, 2005). High transaction costs, in turn, impact the size and growth of the financial sector. Our analysis and recommendations below are focused on how to lower transaction costs in the government securities market, but would impact financial markets more broadly. Some of our policy recommendations require legal change, but many do not. For example, the trading system and settlement functions of the bond market, which are presently placed inside RBI are not embedded in primary legislation.

We have used the Indian equity market as an analytical benchmark in our deliberations. While the government securities market has developed considerably over the past decade, it has yet to flourish in a way comparable to the equity market. As Rajan and Shah (2005) note, the post-trade systems of the debt market do not match those seen on the equity market. The SGL does not offer the functionality offered by NSDL and CDSL. The equity market has millions of participants, and routinely processes over a million trades a day. The fixed income market does not offer transaction processing of the same quality, while facing a tiny fraction of this throughput (Rajan and Shah, 2005).

In the equity market, SEBI has positioned itself as a regulator and policy-maker, and is not involved in day-to-day market operations. So, NSDL runs the depository, NSE and other exchanges run the order-matching computer facilities and NSCC runs the clearing corporation. In contrast, RBI is involved in operations through the NDS, SGL and DVP systems. This is not optimal, for two reasons. First, entities like NSDL or the CCIL are likely to have a greater professional focus on operational tasks, with the attendant IT capabilities. Second, there is a conflict of interest when the market regulator is also involved in operations and is a participant in the securities market.

As discussed in Chapters 3 and 5, the RBI has made commendable improvements in securities markets infrastructure over the years, and ably shepherded innovations such as the CCIL. It has also maintained high standards of systemic integrity. While fully recognizing the importance of these infrastructural upgrades and reforms, the Working Group believes that there is room for significant improvement to bring debt market systems on par with systems in the equity market and with international standards. It is increasingly clear that securities infrastructure is best placed outside of government. The clearing function for the OTC bond market is already outside RBI, at CCIL. The trading system (NDS) and the settlement system (SGL) can also benefit from a similar movement. Specific proposals on these lines are detailed below.

7.3.1. *Regulation of the government securities market*

At present, India has a “silo model” of regulation, where specialist agencies have separate responsibilities for regulating the banking, securities and insurance sectors. Regulation of organised financial trading in India is divided amongst three agencies:

- The RBI: government bonds and currencies
- SEBI: equities and corporate bonds
- FMC: commodities, futures

The Mistry and Rajan Reports have both analysed and critiqued the status quo, and strongly recommended that regulatory and supervisory functions for all organised financial trading be merged within SEBI (HPEC, 2007) (CFSR, 2008). The Working Group endorses the analysis and recommendation of these reports.

Dispersed regulation of financial trading across three agencies has several negative effects.

- Participants in one silo are constrained from operating in other silos.
- An exchange or clearing corporation or depository working in one silo is prohibited from competing with entities in other silos.
- Regulated entities that offer financial services and products that traverse different silos find themselves complying with three distinct sets of regulations and regimes.

This can also create gaming opportunities for market players, to the detriment of the market at large and also of consumers.

As the Rajan Report notes, these constraints reduce competition, hamper economies of scale and stop financial markets from efficiently adapting innovations in one part of the market to another (CFSR, 2008). When multiple regulatory authorities supervise different aspects of the market, this increases transaction costs, creates frictions and reduces liquidity in all markets. Having multiple regulators can make it more difficult to find skilled staff for each authority. As markets and products become more complex, there is a risk that new products that do not fall squarely within an existing silo are unregulated or under-regulated (HPEC, 2007) (CFSR, 2008).

Individual regulatory agencies may be performing their respective roles prudently and efficiently. However, the negative effects of regulatory silos detract from what a regulatory framework is supposed to do: protect investors and consumers, build investor confidence, promote transparent, efficient markets and reduce systemic risk.

The Rajan Report argues that unifying financial trading regulation under SEBI would promote robust competition between the pool of exchanges, clearing corporations and depositories.[1] Low entry barriers would enable new players to enter each of these areas, including professional exchanges and foreign exchanges. Government, exchanges and financial firms would be better able to harness economies of scale and scope if all financial trading was consolidated in a single regulator CFSR (2008).

If all organised financial trading, spanning currencies, fixed income, equities, commodity futures, exotics (such as weather and decision markets) and including all trading venues and forms of trading is to come under SEBI, this will require legal reform. Consolidation of financial trading regulation under SEBI would require thorough amendment or repeal and replacement of the Securities Contracts (Regulation) Act, 1956; the RBI (Amendment) Act, 2006; and the Forward Contracts (Regulation) Act, 1952.

As the Working Group is focussing on the government securities market, we highlight in particular the need to repeal section 45W of the RBI Act, 1934, inserted by the RBI (Amendment) Act, 2006. Section 45W confers power on the RBI to regulate the market in interest rate products, including government securities, money market instruments, foreign exchange, derivatives, or other instruments that the RBI may specify. Under section 45W, the RBI may lay down policy and issue directions to the agencies operating in these contracts, securities and derivatives, but these directions cannot relate to the procedure for execution or settlement of trades in these products on recognised stock exchanges. Section 45W creates a regulatory silo, separating regulation of government securities and other interest rate products from corporate securities. This provision also generates legal ambiguity about who regulates secondary market activity in government securities on the NSE or BSE.

The Working Group recognises that this regulatory reform cannot happen overnight, and would need concerted institutional reform and strengthening of regulatory capacity. However, it shares the view of the Mistry and Rajan Reports that regulatory architecture is absolutely crucial to developing the Indian financial sector, and recommends that the various stakeholders begin working towards the goal of consolidating financial trading regulation under SEBI.

[1] For a discussion of the advantages of regulatory consolidation, see (Taylor and Fleming, 1999) (Mwenda, 2006) (Martinez and Rose, 2003).

7.3.2. *RTA functions*

7.3.2.1. *Government Securities Act, 2006*

The Government Securities Act, 2006 empowers the RBI to perform certain record-keeping and administrative functions related to government securities. The Act prescribes, *inter alia*, the form for transfer of government securities, the procedure for recognising title to government securities in various situations, summary procedure for resolving disputes as to title, procedure for pledge, hypothecation and lien of government securities, how government securities can be nominated, and how duplicate securities may be issued in certain circumstances.

It empowers the RBI to prescribe the manner and form of transferring government securities.[2]

As discussed in Chapter 3, the GSA, 2006 defines what constitutes an SGL Account, a Constituents SGL Account and bond ledger account, but does not require that these accounts be used by participants in the primary or secondary market. This suggests that the proposed NTMA Bill and the existing Government Securities Act 2006 can co-exist in the short term without the latter being amended.

Beyond the short term, the Working Group recommends that the power to prescribe manner and form of government securities transfer as well as the administrative, record-keeping and dispute resolution functions in the GSA, 2006 should be performed by the NTMA for the sake of cohesion.

For this, the Government Securities Act, 2006 would require extensive amendment, transferring powers and functions currently with the RBI to the NTMA. The Government Securities Act, 2006 was passed via the procedure laid down in Article 252 of the Constitution, i.e. State legislatures passed resolutions stating that the matters in the Act[3] should be regulated by Parliamentary legislation. Amendment would also require at least two State legislatures to pass resolutions stating that Parliament should amend the Act, and other State legislatures to pass resolutions accepting the amendments.[4]

As Article 252 does not affect the proposed NTMA Bill, amendments to the Government Securities Act, 2006 are not included in the draft Bill. However, amendments to the Government Securities Act, 2006 should be pursued separate from, but alongside, establishing the NTMA.

7.3.2.2. *The Public Debt Act, 1944*

The Public Debt Act, 1944 was the precursor to the GSA, 2006. Section 31 of the GSA, 2006 states that the Public Debt Act shall not apply to government securities covered by the GSA, 2006. While the GSA, 2006 does not overrule the Public Debt Act, the latter no longer regulates administrative, record-keeping and transfer in relation to government securities, except in Jammu and Kashmir. Therefore, amending the GSA, 2006 would suffice and separate amendment of the PDA, 1944 is not required.

7.3.3. *Primary and Secondary Trading*

7.3.3.1. *Future direction for the NDS*

As noted in Chapter 3, the RBI Act, 1934 and the GSA, 2006 do not prescribe how primary or secondary market activity should be conducted. Delegated legislation prescribes these operational details. Therefore, no legal amendments are required

[2] Section 5 of the GSA, 2006

[3] The State of Jammu and Kashmir has yet to pass such a resolution, which is why the Public Debt Act, 1944 inapplicable in every other State, continues to apply there.

[4] Article 252(2) of the Constitution

to change the operational mechanisms for trading in government securities. The Working Group recommends that present trading arrangements should be changed.

The Working Group believes that the central bank should not continue running a securities exchange such as the NDS. Firstly, the NDS, in effect, has a monopoly on trading, and very little government securities activity takes place on competing platforms such as the NSE or BSE. A closed system can limit greater, more diverse participation in the market. It also dilutes the impact of other, very positive, reforms. For example, establishing the CCIL offers an opportunity to widen market access by reducing credit risk premiums and thus allowing smaller players into the market. This opportunity for greatly expanding market access is not harnessed if CCIL is largely limited, as it presently is, to members of NDS.

Secondly, having the NDS within RBI creates the anomalous situation of the regulator of the government securities market also being the provider of basic infrastructure. The conflict of interest is even greater on the secondary market, where the RBI is simultaneously the regulator, the infrastructure provider, and a participant. Clearly, this anomaly should be resolved, and since it requires no legislative amendments, it should be tackled sooner rather than later.

Therefore, the Working Group agrees with the Rajan Report's recommendation that the NDS should be corporatised, and should then compete with other stock exchanges.

7.3.3.2. *RBI immunity from SCRA, 1956*

The NTMA may continue to use the NDS as a secondary market platform in the very short term, in the longer term, secondary market activity will migrate substantially to recognized stock exchanges, which may include a corporatized NDS.

In light of this, it may be appropriate to revisit Section 28(1) of the SCRA, 1956, which provides that the SCRA, 1956 will not apply to "the Government, the Reserve Bank of India, any local authority or any corporation set up by a special law or any person who has effected any transaction with or through the agency of" any of these authorities. The original object and purpose of the SCRA, 1956 was, as stated in the Preamble, "to prevent undesirable transactions in securities by regulating the business of dealing therein…". Given this focused object, it is understandable that the Government, the RBI and certain other public authorities were excluded from the ambit of the Act.

Given that the scope of the SCRA, 1956 has since expanded, and that the RBI will transact on the secondary market, it would be appropriate to bring the RBI, *in its capacity as a secondary market participant*, under the purview of the SCRA, 1956. This would also be consistent with bringing all government securities market regulation under SEBI.

7.3.4. *Clearance and Settlement*

7.3.4.1. *CCIL's monopoly status*

As Chapter 3 discussed, transactions on the primary market, and all transactions on the NDS, are settled through CCIL or through the SGL at RBI. CCIL, by functioning as a central counterparty for trades on the OTC market, increased transparency and risk management to in the OTC market. It has translated an innovative idea - "Novation" for the OTC market - into practical success, that has helped to make the financial markets more stable.

However, CCIL also has a monopoly over clearing services for bond and currency markets - it is the only clearing corporation with access to clearing in central bank funds and connectivity into RBI settlement systems. The other clearing corporation in India - the National Securities Clearing Corporation Ltd (NSSCL) is not allowed to perform these functions. As the Mistry Report notes, forcing service providers to operate only in one market segment prevents competition, and market participants lose out on cost efficiency and innovation as a result (HPEC, 2007). The Working Group recommends that this particular instance of segmentation, and segmented financial service provision in general, should be dismantled. Every player on the OTC market for currencies or securities should be free to choose between multiple clearing corporations, and this principle should apply across agencies.

7.3.4.2. *Silos within payment systems regulation*

The Payment & Settlement Systems ("PSS") Act, 2007 brings existing retail payment systems, such as MICR cheque clearing systems, Electronic Clearing Systems card payment system, ATM and large payment systems such as Negotiated Dealing system for government securities, inter-bank foreign exchange transactions and RTGS under a single regulatory framework, with the RBI as the regulator. Previously, these systems were regulated by the RBI, but functioned only under a contractual framework. The Act does not regulate stock exchanges and their clearing corporations.[5]

The Act provides for finality of settlement, stating that settlement effected under the rules and procedure of the system provider shall be final and irrevocable.[6] Settlement is final and irrevocable "as soon as the money, securities, foreign exchange or derivatives or other transactions payable as a result of such settlement is determined, whether or not such money, securities, foreign exchange or derivatives or other transactions is actually paid.[7]

The Act also protects transactions that have become final from the effects of insolvency laws.[8] It provides that if a system participant has become insolvent, insolvency will not affect any settlement that has become final and irrevocable. Insolvency will also not affect the system provider's right over any collateral previously deposited by the system participant as a part of its obligations within the payment system. Thus, final settlements and collateral are protected from the liquidator, which makes the payment system as a whole more stable.

Clearly, the PSS Act, 2007 is an important step in developing robust financial payment systems that meet international standards. However, stock exchanges and their clearing corporations do not benefit from PSS Act's protection against the effects of insolvency laws. For this reason, the Working Group recommends that stock exchanges and their clearing corporations be brought under the ambit of the PSS Act, 2007.[9]

7.3.5. *Depository function*

7.3.5.1. *Applicability of the Depositories Act, 1996 to government securities*

The Working Group endorses the Rajan Report's recommendation that the bond market depository within RBI (SGL) will need to be corporatized (CFSR, 2008). It could then compete with NSDL and CDSL as a third depository. The Rajan Report argues that neither a Central Bank, nor a regulator should be providing services such as depository or clearing services. This type of service provision has nothing to do with the core purposes of a Central Bank, but consumes intellectual and practical resources. It is anomalous for a regulator to be providing these services to the entities that it

[5] Section 34 of the PSS Act, 2007.
[6] Section 23 of the PSS Act, 2007.
[7] Section 23(4) of the PSS Act, 2007.
[8] Section 23(4) of the PSS Act, 2007
[9] Notified and in force since August 14, 2008.

regulates. Thus, the present situation burdens the RBI with duties that are extraneous to its primary role, is not sound from the perspective of regulatory propriety, and prevents market participants from accessing the quality of infrastructure that would be available if there was open competition amongst several providers.

The Depositories Act has a pro-competitive framework where an environment with multiple depositories is envisaged. Users of NSE or BSE or the OTC market are able to use NSDL or CDSL without constraint. A corporatised SGL will be able to easily inject itself as a third depository within this framework.

Using private depositories in the government securities market would involve an amendment to section 31 of the GSA, 2006. Section 31(3) provides as follows:

> "Nothing contained in the Depositories Act, 1996 or the regulations made thereunder shall apply to Government securities covered by this Act unless an agreement is executed to the contrary by any depository under the Depositories Act, 1996 with the Government or the Bank, as the case may be."

This provision does not hamper the NTMA's power under the proposed Bill to contract with any depository of its choice. It also does not prevent existing depositories from providing depository services for government securities. However, Section 31 does ask them to jump through an extra hoop to provide these services, and this should be amended as a part of rationalizing financial market architecture.

In addition, if government securities are to be brought under the Depositories Act, 1996 regime, this has the following implications: Section 18 and 19 of Depositories Act, 1996 gives power to SEBI to call for information and give directions to issuers. If government securities are held in depository and governed by the Depositories Act, 1996, it would give powers to SEBI over central government and state government in their role as issuers.

7.3.6. *Other policy issues*

7.3.6.1. *Ways and Means Advances*

Section 17(5) of the RBI Act, 1934 empowers the RBI to make Ways and Means Advances (WMA) to Central and State Governments. As detailed in Chapter 5, WMA are temporary loans given by the RBI to the government, to bridge the interval between expenditures and revenues. At present, India does not use money market operations to manage short term cash flows in any substantial way, in contrast to mature market economies, who use money market operations as the predominant form of cash management, including as a bridge for temporary revenue short-falls. Managing cash through money market operations would allow better investment of short-term surpluses as well as more efficient sourcing of short-term needs (Williams, 2006).

In Chapter 5, the Working Group recommended that the NTMA take on the cash management function only in the medium term, given its operational intensity. However, in the short-term, it could act as an advisor to the Central and State governments regarding the WMA process, alerting them when they approach their overdraft limits and monitoring re-payments. Over this same horizon, it may be advisable to broaden the sourcing of liquidity to money market instruments, which would also help realign the balance of cash management functions between the NTMA and the RBI.

Many countries retain the WMA mechanism as one source of short-term liquidity, while predominantly drawing from money market operations to manage cash. Reforms to existing WMA arrangements on these lines would be a policy decision with input from stakeholders such as the RBI, the Ministry of Finance and State Governments. However, as the NTMA moves towards building an integrated yield curve, the short end of the curve can be dominantly used towards cash management, in line with international best practice.

7.3.6.2. *Market Stabilisation Scheme*

The Market Stabilisation Scheme (MSS) is a sterilisation instrument used by the RBI in the context of currency trading. Operationally, MSS is a mechanism whereby the GOI issues securities, including Treasury Bills, and the proceeds of such issues are held in a separate account with the RBI. MSS issuance reduces reserve money, but induces transparent fiscal costs upon the exchequer.

Policymakers and academics have a range of views on MSS, and exchange rate policy more broadly. This report is not the appropriate forum for a detailed discussion on MSS and exchange rate management in the long run.[10]

More immediately, the Working Group envisions an agreement between the RBI, NTMA and the Ministry of Finance, which would allow the present arrangement for issuing government securities for the purpose of MSS to continue for the time being. At present, the RBI and the Central Government liaise with one another to issue securities for MSS. Once the NTMA is established, it will operationalise the decision to issue government securities for MSS when the Central Government and RBI decide that issuance is required. There are no legal barriers to this arrangement in the draft Bill or in existing legislation.

7.3.6.3. *NTMA's role vis-a-vis FRBMA reporting requirements*

The FRBM Act, 2003 imposes an obligation on the Central Government to lay three types of statements of fiscal policy before both Houses of Parliament.

In the future, the Central Government might consider specifying how the NTMA should contribute to these statements when prescribing rules on the NTMA's reporting requirements.

7.3.6.4. *Retail non-market debt*

As detailed in Chapter 1, non-market borrowings of the Central and State governments in India includes small savings schemes under NSSF, employee provident funds, post-office savings schemes and RBI relief funds. These fall under the category of "retail debt", although retail debt as a whole is wider and also includes retail market borrowing on the RDM of the NSE/BSE or through primary auctions.

Various small savings schemes are framed by the Central Government under the following Central Acts:

- The Government Savings Banks Act, 1873
- The Government Savings Certificates Act, 1959
- The Public Provident Fund Act, 1968

The Post Office Savings Bank is included in the Union List, as Item No. 39 of the Seventh Schedule of the Constitution of India. In addition, there are non-statutory schemes introduced by executive orders.

Currently, all NSSF surpluses are invested in Central Government securities. The interest rates on national small savings are administered by the Central Government (MoF, 2000).

Nothing in the proposed Bill restricts the NTMA from managing retail debt as a category. However, as far as the sub-category of small savings schemes are concerned, there might, in practice, be a conflict between the social objective of subsidised interest rates on small savings and low-cost financing of government debt (MoF, 2000).

[10]For a recent discussion on capital flows and exchange rate management, see Chapter 2 of the Rajan Report which argues that it is neither possible nor advisable to resist the long-run appreciation of the rupee through nominal exchange rate intervention.

In the short-term, the Working Group considers it most appropriate if the NTMA does not manage small savings scheme, in light of the potential conflict between its objectives and those of the NSS schemes. The medium to long-term direction of the NSS schemes is a complex policy question, and this report is not the appropriate forum for the detailed discussion this warrants. However, if the potential conflict of objectives is resolved in the future, it may be appropriate to ask the NTMA to manage all retail debt in the interest of consolidation. There are no legal barriers in the proposed Bill or in any of the Acts above to the management of any form of retail debt by the NTMA.

7.4. Summing up

This chapter explained the amendments to the RBI Act, 1934 that are included in the draft NTMA Bill. It also discussed more wide-ranging legal and policy reforms. The Working Group focussed on reforms which it feels are important to build the regulatory and operational architecture that will encourage financial markets to grow. In the next chapter, we turn back to the NTMA, and outline the contours of transitioning from the present system to a robust, functioning NTMA.

CHAPTER 8

Managing the transition

8.1. Introduction

This chapter lays out the road-map for the transition of public debt management from the RBI to the NTMA. The first section focuses on the initial building of research and analytical capabilities of the NTMA, and on building MIS systems and data-bases that would assist the NTMA's functioning once it is fully set up. The second section discusses transition of core debt management functions from the RBI to the NTMA.

8.2. Setting up the NTMA: Initial Steps

The NTMA would commence operation as a non-statutory office of the Ministry of Finance, as was done in the early days of SEBI, IRDA and PFRDA. A mechanism will need to be arranged for MOF to give the NTMA a budget in this phase. The key tasks that need to be put into place at the outset are:

1. Office premises
2. Setting up a organisation chart
3. Establishing an HR process; Recruiting key individuals into this organisation chart
4. Establishing the advisory board
5. Setting up a series of outsourcing relationships.

The best DMOs seen internationally are highly lean organisations. A wide variety of tasks performed by the DMO are outsourced to external agencies. These outsourced tasks range from canteen and security, to financial services, to database development and management, to research.

A desirable strategy at this phase would be to establish a close relationship with three DMOs in OECD countries. One element of this should be an internship program through which a substantial subset of the staff recruited into the NTMA at all levels go spend six to twelve months working in an overseas DMO. Conversely, individuals who are staff at these DMOs should spend an extended stay in India, advising in the establishment of the NTMA.

8.2.1. *Establishing databases and website*

The first task that the NTMA needs to turn its attention to is designing a series of databases about the central government's debt and contingent liabilities. Outsourcing relationships need to be setup for the software development and database management through which over a very short period of time, these databases get up and running. Simultaneously, these databases should be utilised to create a database-backed website, through which these databases become a focal point for the bond market.

A focus group of bond market practitioners, international bond investors, international country credit rating agencies and public finance economists must be created, and their requirements must drive the constant development of the transparency regime as expressed in the website.

The database design and the website design needs to be done in a forward looking way, anticipating and incorporating the day when the NTMA would be doing actual transactions, where these databases and the website will be integrally a part of these transactions.

All these things need to be done using enterprise IT systems. At no time must data reside only in a spreadsheet.

8.2.2. *Establishing a research and analytical capability*

The second area where a focus is required in the earliest weeks of setting up the NTMA is the creation of the research and analytical capability that is required in the operations of the NTMA in the very first months of actual functioning. This would also involve a blend of insourcing and outsourcing.

8.2.3. *Planning out bond market processes*

The NTMA needs to plan the desired set of financial market mechanisms required for bond issuance and trading. This includes auction mechanisms, bond characteristics, supporting infrastructure such as auction software, depository, secondary market, methods to bring in a very wide range of investors including foreign investors so as to bring down the cost of financing, etc. A planning effort needs to be undertaken, leading to a full fledged document that sketches the full picture that the NTMA will set about putting into place.

8.2.4. *Strategic planning for bond placement*

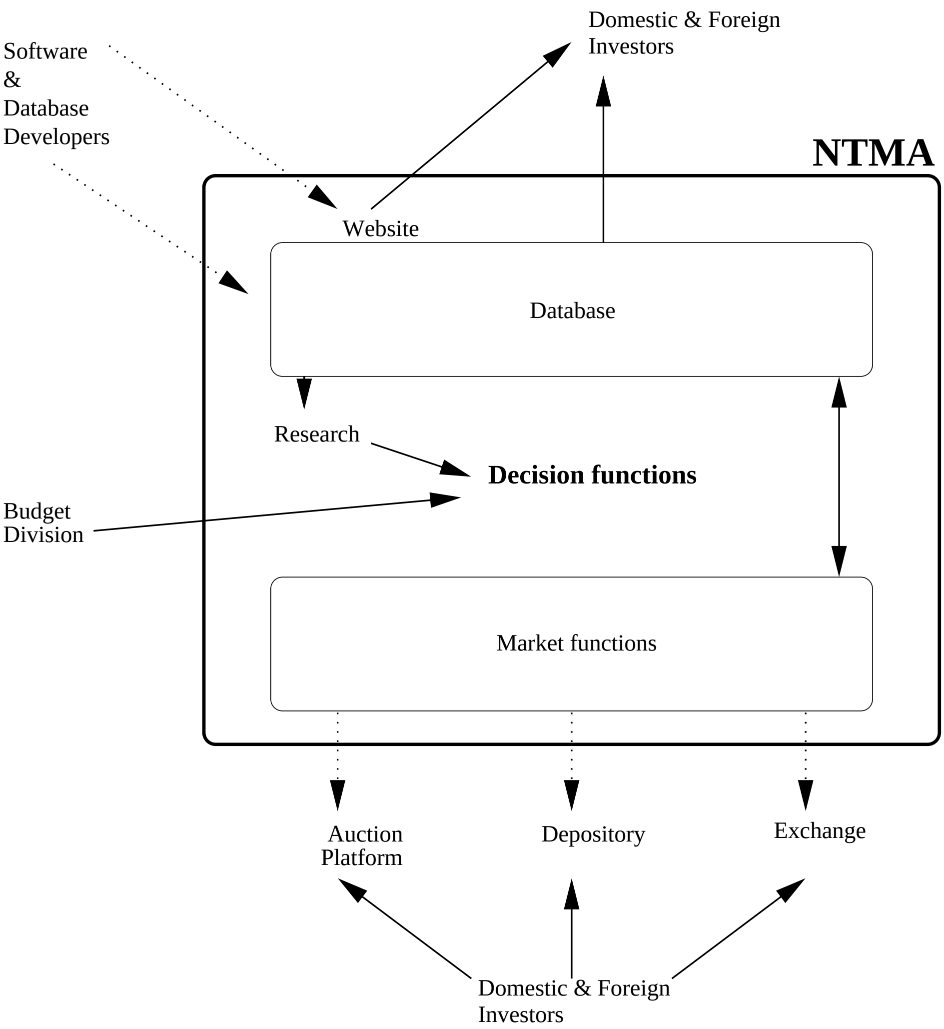
The Working Group anticipates that as the NTMA is setting up systems and building capacity, in parallel, a gradual process of easing financial repression is likely to be underway in India. Increasingly, institutional investors and their regulators will be *choosing* to hold government bonds voluntarily. The NTMA needs to make a plan for how bond issuance will respond to the phasing out of financial repression. This requires reaching out to bond buyers who are absent today, so as to fill the gap created by the involuntary buyers of today.

8.2.5. *Activities and interactions*

Figure 8.1 shows the key internal and external interactions of the NTMA. Dotted lines depict outsourcing relationships that are established by the DMO.

One pillar of NTMA is a database about government finances, bond issues, and the activities of the DMO. The website should be a view to this database with an emphasis on transactions and the actual activities of NTMA. It is crucial to establish

Figure 8.1: Internal and external interactions of NTMA.



the website as a view to this database, that is tightly wired to this database in realtime, rather than establishing the website as a separate function. The website would drive interactions with the external world, including domestic and foreign investors. In addition, NTMA would also have a direct engagement with domestic and foreign investors. The database and the website, put together, constitute the public face of NTMA.

A series of outsourcing arrangements would be setup with software and database developers, for building the database and the tightly integrated website.

The research function of NTMA would utilise the database to help provide analytical inputs into the core decisions of NTMA. The budget division of DEA would, of course, be the main client of the NTMA and would have direct interactions.

The database would be tightly linked to the market facing functions. Here, outsourcing contracts would be setup through which external auction platforms, depositories, exchanges, and other securities market infrastructure would perform functions for the NTMA. Domestic and foreign investors would participate in the markets created in this fashion by directly accessing this securities infrastructure. NTMA would play a crucial in designing this infrastructure, but it would preserve an arms length relationship with the service providers who would perform these functions.

8.3. Building functionality: The early years

Once the intial steps are undertaken, the NTMA needs to get engaged from December onwards with the budget process for the first time in what we term 'Year 1'. If work on establishing the NTMA commences in late 2008, then the Agency can treat December 2009 as the beginning of Year 1 and aspire to play a role in the preparation of budget documents of February 2010, and in the auction calendar for 2010-2011.

In Year 1, the NTMA would get involved with the Budget Division on the following tasks:

- Preparing a medium-term debt management strategy that is consistent with the budget.
- Participate in the budget process, contributing feedback from the debt management perspective into budget decisions.
- Prepare a financing plan for the budget, which is sent to MOF as a proposal.
- As an integral part of the budget process, one of the documents which would come in the budget packet would be the financing remit, which is the instruction to the NTMA from MOF. This would include the bond issuance calendar for the coming 12 months.

The key element of this is the establishment of institutional mechanisms, staff-level coordination and the paper trail through which the NTMA will work closely with Budget Division in planning and executing the bond issuance program for the year.

8.3.1. *Operationalisation of bond issuance for Year 1*

If little progress is made on the legal foundations, and if the NTMA has a relatively weak staff capability, then in the early weeks, the NTMA can outsource functions of bond issuance to the existing bond auction mechanisms that are taking place through the NDS, leading to issuance of bonds into the SGL depository. In this scenario, bond issuance in Year 1 would commence using mechanisms which are largely unchanged when compared with the existing arrangements.

When the legal foundations are adequate, and if the NTMA has an adequate staff capability, it will set about implementing the plan described in Section 8.2.3.

8.3.2. *Broadening out the portfolio of bonds*

Initially, the NTMA will carry forward the existing strategy of issuing purely rupee-denominated securities. As financial repression is eased, buyers of bonds will increasingly face choices about the extent to which they buy government bonds. This could, in the short run, lead to an increased cost of borrowing for the government. Hence, once the minimum level of functionality is in place, the NTMA needs to work on three fronts:

1. Broaden the base of buyers of bonds - both domestic and foreign - so as to create an offsetting buying interest to make up for the reduction in demand that is caused by easing financial repression. On the domestic side, this involves removing barriers faced by various financial firms and households in direct participation in the primary and secondary market. In addition, a key area for progress is placing FII investments into government bonds on par with FII investments into equities.

2. The NTMA needs to establish a program of issuing foreign currency bonds. At the outset, this would involve US dollar denominated bonds. This would constitute one more lever for fund-raising for GoI.
3. The NTMA needs to establish a program of issuing inflation indexed bonds. This involves many technical difficulties. In particular, inflation measurement in India is widely mistrusted. The NTMA needs to actively get engaged with these questions and play either an enabling role or a leadership role in solving these problems.

The destination that is envisaged involves a very wide range of investors directly participating in the GoI bond market, with three broad strands of bond issuance by the NTMA – rupee denominated, foreign-currency denominated and inflation indexed. Atleast 10% of the bond issuance of any year should be in each of these three classes of bonds, so as to keep all three markets alive and viable. Once these three markets are viable and well functioning, the NTMA can continually choose where issuance is the most cost effective for GoI on an ongoing basis. The choice of which of the three to emphasise would be made in a pragmatic fashion by the government based on the advice of NTMA, aiming to reduce the long-term cost of borrowing while bearing acceptable levels of risk. By having three choices instead of one, in the long run, this would yield a reduction of the cost of borrowing for GoI.

8.3.3. *Cash management*

As detailed in Chapter 5, the NTMA should undertake cash management only gradually, since it is an operationally intricate function. It can begin by participating in the WMA process, moving from an observer to an advisor to State governments about the nature and timing of WMA borrowing. It can also gradually use money market operations to manage short-term borrowings of Central and State governments. This will help realign the cash management functions from the RBI to the NTMA, leading to an ultimate active management of cash by the NTMA through money market operations. The legal foundations of the WMA can be retained, as per international best practice.

The Working Group proposes that the NTMA should have formal responsibility for cash management, but to aid a carefully calibrated transition, the RBI be assigned to act as agent of the NTMA to perform such cash management functions as required, provided that the Central Government authorizes the terms of any such agency agreement between the NTMA and the RBI.

8.3.4. *Contingent liabilities*

As explained in Chapter 5, the very first task of the NTMA regarding contingent liabilities is assembling a comprehensive database of outstanding liabilities/guarantees. Since this process is very resource intensive, it can consider options such as contracting out to other agencies to carry out this task.

Once this database is complete, the NTMA can move towards pricing and managing these liabilities, in order to better manage risk. Over the longer term, it can work with the Budget Division at MoF in laying down guidelines for the issuance of guarantees.

8.4. Summing up

This chapter set forward a road-map for the NTMA to begin its operations. The NTMA's focus should be on capacity-building, and on a gradual transition of core debt management functions from the RBI. Simultaneously, it should emphasise promoting the development of the government securities markets and building relationships with market participants.

APPENDIX A

Draft legislation

NATIONAL TREASURY MANAGEMENT AGENCY BILL, 2008

ARRANGEMENT OF CLAUSES

CLAUSES

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2. Definitions.

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3. Establishment and incorporation of the Agency.
4. Head Office.
5. Ownership of the Agency.

CHAPTER III

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7. Terms of office and conditions of service of members of the Management Committee.
8. Removal of member from office.
9. Restriction on future employment of members.
10. Meetings and procedures.
11. Vacancies etc. not to invalidate proceedings of the Agency.
12. Officers and employees of the Agency.
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16. Agency to perform functions for States on agreement.
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DRAFT

National Treasury Management Agency Bill 2008

A

BILL

to provide, in the public interest, for the establishment of a body to be known as the National Treasury Management Agency to manage the public debt on behalf of and subject to the control and general superintendence of the Central Government and to perform certain related functions and to provide for connected matters and to amend the law relating to management of public debt

Be it enacted by Parliament in the Fifty-ninth Year of the Republic of India as follows:-

Chapter I
Preliminary

1. Short title, application and commencement.

(1) This Act may be called the National Treasury Management Agency Act, 2008.
(2) It extends to the whole of India except the State of Jammu and Kashmir.
(3) It 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 Act, and any reference to the commencement in any such provision of this Act shall be construed as a reference to the commencement of that provision.

See Section 4.3.2 on page 40

2. Definitions.

In this Act, unless the context otherwise requires,

(a) "Agency" means the National Treasury Management Agency established under section 3;
(b) "agreement" means a formal agreement between the Agency and a State Government under section 16;
(c) "Chief Executive" means Chief Executive of the Agency;
(d) "member" means a member of the Management Committee and includes the Chief Executive;
(e) "notification" means a notification published in the Official Gazette;
(f) "other public authority" means any authority or body or institution established or constituted,

(i) by or under the Constitution

(ii) by any other law made by Parliament;

(iii) by any other law made by State Legislature;

(iv) by notification issued or order made by the Central Government or any State Government, and includes any body owned, controlled or substantially financed, directly or indirectly by funds provided by the appropriate Government;

(g) "prescribed" means prescribed by rules made under this Act;
(h) "public debt" means the financial liabilities of a government;

(i) "regulations" means the regulations made by the Agency under this Act.

Chapter II
Establishment of the Agency

3. Establishment and incorporation of the Agency.

(1) With effect from such date as the Central Government may, by notification in the Official Gazette, appoint, there shall be established a body known as the National Treasury Management Agency.

See Section 4.3.3 on page 40

(2) The Agency shall be a body corporate, having perpetual succession and a common seal and power to sue and be sued in its corporate name and to enter into contracts in its own name and to acquire, hold and dispose of property, both movable and immovable.

4. Head Office.

See Section 4.3.3 on page 40

(1) The head office of the National Treasury Management Agency shall be in Delhi.
(2) The Agency may establish branches in any other place in India, or, with the permission of the Central Government, elsewhere.

5. Ownership of the Agency.

See Section 4.3.3 on page 40

(1) The Central Government shall own at least 51% of the shares of the Agency, and such shares over and above 51% as may not be owned by State Governments under sub-section (2) of this section.
(2) Any State Government shall have the option of subscribing to shares in the Agency, on such terms as may be prescribed by the Central Government.

Chapter III
Structure and Management of the Agency

6. Management Committee of the Agency.

See Section 4.3.4.1 on page 41

(1) The Agency shall have a Management Committee which shall comprise such number of members as may be prescribed.
(2) The Management Committee shall be headed by a Chief Executive who shall exercise general superintendence over, and manage the administration and business of, the Agency and shall perform such other functions, if any, in relation to the Agency as may be prescribed by the Central Government.
(3) The Chief Executive shall be directly responsible to the Central Government for the performance of the functions of the Agency.
(4) The Chief Executive and the other members of the Management Committee shall be appointed by the Central Government in such manner as may be prescribed.
(5) The Chief Executive and the other members of the Management Committee shall be persons of ability, integrity and standing who have shown capacity in dealing with public debt, public finance or financial markets, or have special knowledge or experience of accountancy, administration, economics, finance, law or any other discipline which, in the opinion of the Central Government, shall be useful to the Agency.

7. Term of office and conditions of service of members of the Management Committee.

See Section 4.3.4.1 on page 41

(1) The term of office and other conditions of service of the Chief Executive and the other members of the Management Committee shall be such as may be prescribed by the Central Government.

(2) Notwithstanding anything contained in subsection (1), the Central Government may:–

(a) terminate the services of the Chief Executive or other member of the Management Committee at any time before the expiry of the period prescribed under subsection (1), by giving him or her notice of not less than three months in writing or three months' salary and allowances in lieu thereof ;

(b) remove the Chief Executive or other member of the Management Committee from his or her office in accordance with the provisions of section 8.

(3) Notwithstanding anything contained in subsection (1), the Chief Executive or other member of the Management Committee, as the case may be, shall also have the right to relinquish his or her office at any time before the expiry of the period prescribed under sub-section (1) by giving the Central Government notice of not less than three months in writing.

8. Removal of member from office.

(1) The Central Government may remove the Chief Executive or other member of the Management Committee from office if he or she:-

(a) is, or at any time has been, adjudicated as insolvent; or

(b) is of unsound mind and stands so declared by a competent court; or

(c) has been convicted of an offence which, in the opinion of the Central Government, involves a gross disregard for moral standards; or

(d) has acquired such financial or other interest as is likely to prejudicially affect his functions as a member; or

(e) has, in the opinion of the Central Government, so abused his position as to render his continuation in office detrimental to the public interest.

(2) No Chief Executive or other member shall be removed under sub-section (1) unless he or she has been given a reasonable opportunity of being heard in the matter.

9. Restriction on future employment of members.

See Section 4.3.4.1 on page 41

The Chief Executive and other members of the Management Committee shall not, for a period of two years from the date on which they cease to hold office as such, except with the previous approval of the Central Government, accept:-

(a) any employment either under the Central Government or under any State Government; or

(b) any appointment in any regulated entity in the financial sector.

10. Meetings and procedures.

The Management Committee shall meet at such times and places and shall observe such rules of procedure in respect of the meetings as may be provided by regulations.

11. Vacancies etc. not to invalidate proceedings of the Agency.

No act or proceeding of the Agency shall be invalid merely by reason of any vacancy in, or any defect in the constitution of the Agency, or any defect in the appointment of a member of the Management Committee, or any irregularity in the procedure of the Agency that does not affect the substantive performance of its functions.

12. Officers and employees of the Agency.

See Section 4.3.5 on page 42

(1) The Management Committee may appoint such officers and employees as it considers necessary for the efficient discharge of its functions under this Act.
(2) The term and other conditions of service of persons appointed under sub-section (1) shall be such as may be determined by regulations.

13. Composition of the Advisory Board.

See Section 4.3.4.2 on page 42

(1) The Agency shall have an Advisory Board which shall comprise such number of members as may be prescribed.
(2) The members of the Advisory Board shall be appointed by the Central Government from amongst persons of ability and integrity, who have expertise in economic and financial matters.
(3) A Deputy Governor of the Reserve Bank of India shall be included amongst the members of the Advisory Board.
(4) The Chief Executive of the Agency shall be an *ex-officio* member of the Advisory Board.
(5) A senior official from the Ministry of Finance shall be an *ex-officio* member of the Advisory Board.
(6) The members of the Advisory Board shall be appointed in such manner and on such terms and conditions as may be prescribed.
(7) The rules of operation of the Advisory Board shall be such as may be prescribed.

14. Powers and Duties of the Advisory Board.

(1) The Advisory Board shall advise and issue opinions on any matter related to the purpose and functions of the Agency, that is referred to the Advisory Board by the Agency, the Central Government and, where relevant, any State Government.
(2) The Advisory Board shall issue its opinion on financing plans proposed under section 17 and section 18 by the Agency and on the annual report prepared by the Agency under section 28.
(3) The Advisory Board shall not have a direct role in the management or operations of the Agency.

Chapter IV
Objective, Functions and Powers of the Agency

15. Objective of the Agency.
The main objective of the Agency will be to meet the funding needs of the Central Government while minimising borrowing costs over the long term within an acceptable level of risk, under the general superintendence and control of the Central Government, as provided by this Act.

16. Agency to perform functions for State on agreement.

See Section 4.3.10 on page 45

(1) The Agency may by agreement with the government of any State undertake to perform for it any of the functions specified in Section 19.
(2) While an agreement under sub-section (1) subsists between the Agency and a State Government, the Agency shall implement the agreement with the objective of minimising borrowing costs over the long term within an acceptable level of risk, under the general superintendence and control of that Government, as provided by this Act.
(3) Any agreement made under this section shall be laid, as soon as may be after it is made, before Parliament.

17. Annual Financing Remit for the Centre.

See Section 4.3.7 on page 44

(1) The Agency shall propose to the Central Government, on an annual basis and in such manner and form as may be prescribed, the annual financing plan to be followed in Central Government financing, taking into account that Government's borrowing requirements, market conditions, and such other factors as it considers appropriate.
(2) The Central Government will set the terms of the annual financing remit, including the amount, structure and timing of Central Government debt to be issued, and make such in-year revisions to it as may be necessary, following consultation with the Management Committee, the Advisory Board, and such other public authorities as it considers appropriate.
(3) In setting the annual financing remit for the year, the Central Government shall consider the annual financing plan proposed to it by the Agency under sub-section (1) for that year.
(4) The Agency shall implement, to the best of its abilities, the Central Government's annual financing remit and any in-year revisions thereof.

18. Annual Financing Remit for States.

See Section 4.3.10 on page 45

(1) The Agency shall propose to any State Government with which it has an agreement, on an annual basis and in such manner and form as may be prescribed, the annual financing plan to be followed in that Government's financing, taking into account that Government's borrowing requirements, market conditions, and such other factors as the Agency considers appropriate.
(2) On receipt of the financing plan under sub-section(1) by a State Government, that State Government may set the terms of the annual financing remit, including the amount, structure and timing of the debt of that Government to be issued, and make such in-year revisions to it as may be necessary, following consultation with the Management Committee, the Advisory Board, and such other public authorities as it considers appropriate.
(3) In setting the annual financing remit for the year, the State Government may consider the annual financing plan proposed to it by the Agency under sub-section(1) for that year.
(4) The Agency shall implement, to the best of its abilities, that State Government's annual financing remit and any in-year revisions thereof.

19. Functions of the Agency.

See Section 5.3 on page 50

(1) The Agency shall undertake issuance and management of public debt for the Central Government and for any State Government with which it has an agreement.

See Section 5.4.5 on page 55

(2) The Agency shall undertake cash management for the Central Government and for any State Government with which it has an agreement.

(3) The Agency shall advise the Central Government, and any State Government with which it has an agreement, on all matters related to the Agency's purpose and functions.

See Section 5.6 on page 58

(4) The Agency shall collate and disseminate information in relation to its functions, in such manner and form as may be prescribed by rules and regulations made under this Act.

See Section 5.7 on page 59

(5) The Agency shall take steps to promote the development of the government securities market.

See Section 6.4.2 on page 68

(6) The Agency shall maintain such information systems as may be required for the effective performance of its functions and effective exercise of its powers under this Act and rules and regulations made under this Act.

See Section 5.2.4 on page 48

(7) The Agency shall manage the risks associated with its functions and maintain such administrative and technical systems as it may require so to do.

See Section 5.5.3 on page 58

(8) The Agency may manage the contingent liabilities of the Central Government and for any State Government, on such terms as may be prescribed.

(9) The Agency shall perform such other functions as may be assigned to it by the Central Government.

20. Powers of the Agency.

See Section 5.8 on page 63

(1) The Agency shall have all such powers as are necessary or expedient for the effective performance of its functions.

(2) Without prejudice to the generality of the power in sub-section (1), the Agency shall have the power to provide such public authority as may be permitted by the Central Government, including but not limited to any local authority or any statutory body corporate, with advisory, consultancy and debt management services, provided that this is not incompatible with its obligations under section 15, section 16, section 17, section 18 and section 19 of this Act.

(3) Without prejudice to the generality of the power in sub-section (1), the Agency shall have the power to act as the agent of the Central Government, or any State Government, or such other public authority as may be permitted by the Central Government, in relation to the following:-

   (a) purchase or sale of financial instruments, including but not limited to cash, bonds, equities and derivatives;
   (b) issuance and management of securities;
   (c) borrowing from or lending funds to banks and other financial institutions:

   Provided that the Agency shall ensure that any activity under this sub-section shall be in compliance with existing laws regulating such activity and such rules as may be prescribed.

(4) Without prejudice to the generality of the power in sub-section (1), the Agency shall have the power to choose and contract with providers of functions and services related to transacting and trading in securities.

(5) Without prejudice to the generality of the power in sub-section (1), the Agency shall have the power to call for such information as it deems necessary in relation to its objectives, functions and duties under this Act and any rules and regulations thereof from the Central Government or any State Government or any public authority.

(6) Notwithstanding the generality of the power in sub-section (1), the Agency shall not have the power to raise funds or undertake transactions in financial markets on its own behalf.

Chapter V
Finance, Accounts and Audit

21. Grants and loans by the Central Government.

See Section 4.3.12 on page 45

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to the Agency grants or loans of such sums of money as that Government may think fit for being utilised for the purposes of this Act.

22. Fees.

See Section 4.3.12 on page 45

(1) The Agency may charge such fees for performing its functions under this Act as may be provided by regulations.
(2) In deciding upon a fee structure, the Agency shall consult the Central Government and be mindful of its duty to act in the public interest.

23. Fund.

See Section 4.3.12 on page 45

(1) There shall be constituted a Fund to be called the National Treasury Management Agency General Fund and the following shall be credited thereof:-
   (a) all grants, loans, fees and charges received by the Agency under this Act;
   (b) all sums received by the Agency from such other sources as may be decided upon by the Central Government.
(2) The Fund shall be applied for meeting:-
   (a) the salaries, allowances and other remuneration of its members, officers and other employees of the Agency;
   (b) the expenses of the Agency in the discharge of its functions;
   (c) the expenses on objects and for purposes authorised by the Act.
(3) When the corpus of money in the Fund exceeds a ceiling to be prescribed by the Central Government in consultation with the Management Committee, any sum in excess of the prescribed ceiling shall be credited to the Central Government and such State governments as have shares in the Agency, in proportion to the share of the total owned by each Government:
   Provided that the Central Government shall review the ceiling prescribed, if any, on a two-yearly basis, and in any event, on such occasion as the Management Committee might request.

See Section 4.3.12 on page 45

(4) Any sums received by the Central Government under sub-section(3) shall be credited to the Consolidated Fund of India.
(5) Any sums received by a State Government under sub-section(3) shall be credited to the Consolidated Fund of that State.

24. Exemption from taxes.

Notwithstanding anything contained in the Wealth Tax Act, 1957 (27 of 1957), the Income Tax Act, 1961 (43 of 1961), the Finance (No.2) Act, 2004 (23 of 2004), the Indian Stamp Act, 1899 (2 of 1899), the Finance Act, 1994 (32 of 1994) or any other enactment for the time being in force relating to tax or duty on wealth, income, profits, gains, securities transactions, stamp duty or services, the Agency shall not be liable to pay wealth tax, income tax, securities transaction tax, stamp duty, service tax or any other tax in respect of its wealth, income, profits, gains, transactions undertaken or services rendered.

25. Accounts of the Agency.

The Agency shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.

26. Audit.

See Section 6.5 on page 68

(1) The Agency shall conduct an internal audit on an annual basis.
(2) The accounts of the Agency shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Agency to the Comptroller and Auditor-General.
(3) The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the accounts of the Agency shall have the same rights, privileges and authority in connection with such audit as the Comptroller and Auditor-General generally has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the Agency.
(4) The accounts of the Agency as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf, together with the audit-report thereon, shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

Chapter VI
Miscellaneous

27. Liability for transactions undertaken or funds raised.

See Section 4.3.11 on page 45

(1) The Central Government shall be liable for any financial transaction undertaken or funds raised on its behalf by the Agency.
(2) Where the Agency has undertaken financial transactions or raised funds for any State Government, that State Government shall be liable for any financial transactions undertaken or funds raised on its behalf by the Agency.
(3) Where the Agency has undertaken financial transactions or raised funds for any other public authority, that public authority shall be liable for any financial transactions undertaken or funds raised on its behalf by the Agency.

28. Returns and reports.

See Section 6.4.1 on page 67

(1) The Agency shall furnish to the Central Government at such time and in such form and manner as may be prescribed or as the Central Government may direct, such returns and statements and such particulars in regard to any proposed or existing operations of the Agency as the Central Government may, from time to time, require.

See Section 6.4.1 on page 68

(2) Without prejudice to the provisions of sub-section (1), the Management Committee shall, within a prescribed time limit at the end of each financial year, submit to the Central Government and to any State Governments with which it has agreements, an annual report in such form as may be prescribed, giving a true and full account of its activities, policies and programmes during the previous financial year.

(3) A copy of the report received under sub-section (2) shall be laid as soon as may be after it is received, before each House of Parliament.

(4) If either House of Parliament makes any comments or raises any concerns about the contents of the report laid before each House of Parliament under sub-section (3), the Agency shall record and respond to any such comments or concerns in its annual report for the following year, or as soon as possible thereafter.

29. Power of Central Government to issue directions.

See Section 4.3.7 on page 44

(1) Without prejudice to the foregoing provisions of this Act, the Agency shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy as the Central Government may give in writing to it from time to time:
Provided that the Management Committee shall, as far as practicable, be given an opportunity to express its views before any direction is given under this subsection.

(2) The decision of the Central Government as to whether a question is one of policy or not shall be final.

30. Power of Central Government to supersede the Agency.

(1) If at any time the Central Government is of the opinion:-
   (a) that on account of a grave emergency, the Agency is unable to discharge the functions and duties imposed on it by or under the provisions of this Act; or
   (b) that the Agency has persistently defaulted in complying with any direction issued by the Central Government under this Act or in the discharge of the functions and duties imposed on it by the provisions of this Act and as a result of such default the financial position of the Agency or the administration of the Agency has deteriorated to an unacceptable degree; or
   (c) that circumstances exist which render it necessary in the public interest so to do, the Central Government may, by notification, supersede the Management Committee for such period, not exceeding six months, as may be specified in the notification:

See Section 4.3.4.1 on page 41

Provided that before issuing any such notification, the Central Government shall give a reasonable opportunity to the Agency to make representations against the proposed supersession and shall consider the representations, if any, of the Agency.

(2) Upon the publication of a notification under sub-section (1) superseding the Agency,
   (a) all the members of the Management Committee shall, as from the date of supersession, vacate their offices;
   (b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Agency, shall, until the Agency is reconstituted under sub-section (3), be exercised and discharged by such person or persons as the Central Government may direct; and

(c) all property owned or controlled by the Agency shall, until the Agency is reconstituted under sub-section (3), vest in the Central Government.

(3) When the period of supersession specified in the notification issued under sub-section (1) expires, the Central Government may reconstitute the Management Committee by fresh appointments and in such case any person or persons who vacated their offices under clause (a) of sub-section (2) shall not be deemed disqualified for appointment: Provided that the Central Government may take action towards reconstituting a Agency at any time before the period of supersession expires, and that the Central Government should take such action as soon as practicable.

(4) The Central Government shall cause a notification issued under sub-section (1) and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

31. Power to make rules.

See Section 4.3.3 on page 40

The Central Government may, by notification, make rules for carrying out the purposes of this Act.

32. Power to make regulations.

See Section 4.3.3 on page 40

The Management Committee may, by notification, make regulations consistent with this Act and with any rules made under this Act by the Central Government, to carry out the purposes of this Act.

33. Rules and regulations to be laid before Parliament.

Every rule and every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament while it is in session for a total period of thirty days which may be comprised in one session or two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses of Parliament agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter, have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

34. Delegation.

The Management Committee may, by order in writing, delegate to any member, officer or any other person subject to such conditions as may be specified in the order, such of its powers and functions under this Act, except the power under section 32, as it may deem necessary:

Provided that it obtains the approval of the Central Government for such delegation.

35. Members, officers and employees of the Agency to be public servants.

The Chief Executive, other members of the Management Committee, officers and employees of the Agency shall be deemed, when acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of Section 21 of the Indian Penal Code (45 of 1860).

36. Protection of action taken in good faith.
No suit, prosecution or other legal proceedings shall lie against the Central Government or the Agency or any State Governments or any other person in respect of anything which is done in good faith or intended to be done in good faith under this Act or under any Rule, Regulation, Order or Direction made or given under this Act.

37. Application of other laws not barred.

The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

38. Amendment of certain enactments.

The enactments specified in Schedule I to this Act shall be amended in the manner specified therein and such amendments shall take effect on such date as the Central Government may notify.

39. Power to remove difficulties.

(1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order published in the Official Gazette, make such provisions consistent with the provisions and the intent and purpose of this Act as may appear necessary for removing the difficulty:
Provided that the Central Government shall not make any order under this section after five years have expired from the commencement of this Act.

(2) Every order made under this section shall be laid before each House of Parliament as soon as possible after it is made.

SCHEDULE I
(See Section 38)
AMENDMENT OF CERTAIN ENACTMENTS
PART I
AMENDMENTS TO THE RESERVE BANK OF INDIA ACT, 1934
(2 OF 1934)

1. In section 17, sub-section (11) shall be omitted.
2. In section 17, clause (a) of sub-section (11A) shall be omitted.
3. In section 20, the words “including the management of the public debt of the Union” shall be omitted.
4. In section 21, sub-section (1) shall be omitted.
5. In section 21, sub-section (2) shall be omitted.
6. In section 21A, clause (a) of sub-section (1) shall be omitted.
7. In section 21A, clause (b) of sub-section (1) shall be omitted.

APPENDIX B

International best practice in DMO governance

The table below summarizes the governance structures of the DMOs, and discusses corporate governance arrangements for public debt management by describing how boards and committees function in selected countries.

Corporate governance for public debt management: Examples of Boards and Committees

In *Australia* an **Advisory Board** was established in December 2000. The accountability of the Board is to the Secretary to the Treasury, the Chair of the Board. Its role is to provide advice to the Secretary to the Treasury. Although the Board does not possess executive powers or decision making authority in its own right, the Board advises the Secretary on matters relating to corporate governance, strategic planning, financial risk management strategy, business and planning. The Board also provides advice to the Secretary with respect to monitoring the performance of the AOFM generally. The Board meets on a monthly basis. The six member Board comprises the Secretary to the Treasury, the Executive Director of the Economics Group in the Department of the Treasury, a Senior Executive from the Department of Finance and Administration (representing the Secretary of the Department), the CEO of the AOFM and two representatives from the private sector. Three committees have been established for AOFM internal governance. A **Liability Management Committee** has primary

Table B.1: Debt management and ALM committees in selected countries

Country	Board of directors	Advisory board	Committee(s)
Sweden (indep. agency)	Yes		
Portugal (indep. agency)	Yes	Yes	
Ireland (indep. agency)		Yes	
New Zealand (agency in MoF)		Yes	
Belgium (agency in MoF)			Yes
South Africa (agency in MoF)			Yes
Colombia (dept. in MoF)			Yes

1. Note: Committees and Boards reporting to the Ministry of Finance

responsibility for establishing policy and programs governing debt management operations and reviewing liability performance; an **Audit Committee** has responsibility for statutory financial reporting and for monitoring internal financial controls; and a **Management Committee** has responsibility for oversight and reviewing the overall strategic management of the organisation. Source: AOFM Annual Report 2001. http://www.aofm.gov.au/

Sweden's DMO **Board of Commissioners** is made up of eight members, all appointed by the Government, including the Director General of the DMO as chairman, four members of Parliament, and the remaining members including academics and heads of think tanks. The Board normally meets six times a year and decides on the proposal to the Government for debt management guidelines, the principles guiding the implementation of the Government guidelines, the data to be presented to the Government for its evaluation of the Debt Office's activities, and the limits and guidelines for the management of the risks associated with the DMO's activities. In addition, the Board takes decisions with respect to the DMO's annual reports to the Government, budget data, audit reports and internal audit plans. Source: http://www.rgk.se/aboutthesndo.htm

Portugal's DMO **Board of Directors** meets once a week and includes the head of the DMO and two other members, all appointed by the Council of Ministers for a 3-year mandate. Its responsibilities include all organizational and operational matters of the DMO such as defining its internal management policy, as well as the structure and functions of the departments, preparing the annual budget for the Minister, managing the human resources and assets of the DMO, etc. The **Advisory Board**, on the other hand, is made up of the head of the DMO, one member of the central banks Board of Directors, and four persons having recognized expertise in economic and financial matters, also appointed by the Council of Ministers. The AB meets at least once every quarter, and must express its opinion on the annual financing plan of the State, on the annual report on financing and the public debt and any other matters solicited. Source: http://www.igcp.pt/

New Zealand's DMO has a three member **Advisory Board**, comprising private sector representatives, which assists the Secretary to the State in providing quality assurance on the management of the NZDMO. It meets a minimum of four times a year, and provides oversight and advice across a broad range of operational and strategic risk management issues and procedural controls. Source: http://www.nzdmo.govt.nz/aboutnzdmo/

Ireland's DMO has an **Advisory Board**, composed mostly of private sector executives from the banking and corporate sector, and the Secretary of the MoF. Source: http://www.ntma.ie/

France's DMOs **Strategic Committee** is made up of leading experts from different backgrounds providing Agency France Trsor with advice on government issuing policy. The purpose of the SC is primarily to offer its own interpretation of the principles underlying government issuing policy and treasury management and to state its views on existing practices and contemplated developments. The SC meets twice a year. The **Market Committee** is chaired by the Treasury Director, and is made up of top bond managers from the most active French and foreign primary dealers. This committee discusses developments on bond markets in Europe and the rest of the world from the viewpoint of investors, issuers and intermediaries, to make sure that Agency France Trsor's issuing policy and the organization of the French government securities market continue to reflect strict application of public finance management rules and to meet the expectations of all market players. The Market Committee meets two or three times a year. Source: http://www.francetresor.gouv.fr

In the *United Kingdom*, the Chief Executive and the heads of two business areas and main functional teams constitute the **Managing Committee** which is the senior decision making body for the DMO. All strategic operational and management issues must be considered by the MC. The MC is guided by an **Advisory Board** which comprises the Chief Executive, the Deputy Chief Executive (and head of policy and markets) and the head of operations and resources, together with non-executive members from outside the DMO. The MC is supported by a **Credit and Risk Committee** and **Strategy Groups** for each key business area (debt, cash and investments). Source: http://www.dmo.gov.uk/

Source: **Extract from (Togo et al., 2003), Annex, pp 49-50**

Appendix C: **International Experience: Debt Management Offices.**

Features	Australia	Brazil	New Zealand	Portugal	Sweden	UK	Colombia
Structure	Executive agency of the Treasury	National Treasury, under the Ministry of Finance	Unit within the Treasury	Autonomous agency	Autonomous agency	Executive Agency of the Treasury	General Directorate of Public Credit within the Ministry of Finance
Year founded	1999	1986. The current structure was formally introduced in 2001	1988	1997	Agency of the Swedish Parliament since 1789. Agency of the Executive since 1989	1998	Created before 1985, transformed into a more modern DMO style unit in 1996 and merged in 2004 with Treasury (cash management)
Independent from Central Bank?	Yes	Yes	Yes	Yes	Yes By law. Required to consult with the Central Bank on certain matters	Yes	Yes
Sub-national Debt							
Management of subnational debt?	No	No	No	No	No	No	DMO has to approve loan operations of sub-nationals and SOEs
If yes, is this an obligation or an option?	NA	NA	NA	NA	NA	NA	These responsibilities are established in primary/ secondary legislation.
Management of debt for other public authorities?	No	No	No, but does on-lending to some public authorities	No, although it is required to appraise the financial terms of guaranteed debt/debt issued by public sector services and funds	No	No, but does on-lending through the Public Works Loan Board	No
Legal framework							

Contd. . .

Appendix C Contd. . .

Features	Australia	Brazil	New Zealand	Portugal	Sweden	UK	Colombia
Does the Constitution give the Executive explicit authority to borrow?	No, only implicit	Yes	No written constitution. The Public Finance Act (amended 2004) limits the power to borrow to the Minister of Finance	No written constitution. The Public Debt Law states that the State financing has to be authorized by the Parliament	No. It is stated that the executive branch cannot borrow without authorization of the Parliament	No. However, the National Loans Act 1968 under Section 12, titled "Power of Treasury to Borrow", limits the power of borrowing to the Treasury	Yes
Annual borrowing authorisation?	No	Yes. The amount borrowed per year is limited to 60% of NCR for federal government and 16% of NCR for states and municipalities, above the refinancing of the principal outstanding during that year	No, the Ministry of Finance may borrow if it appears to be necessary or expedient in the public interest	Yes. The annual Budget Law establishes limits for the amounts that the Government is authorized to borrow during the year and may also define maximum terms for the debt issued and limits to the currency exposure and to the floating rate debt	Yes, annually the Parliament authorizes the executive to borrow on behalf of the central government	No	Yes, in the Budget
Does the Consitution provide for the State's liability for borrowing	No, only implicitly	No. All branches are limited by a senate resolution, as a percentage of their NCR	No, but the Public Finance Act provides a permanent authority for the repayment of debt and the payment of interest	Yes		No, but the Public Finance Act provides a permanent authority for the repayment of debt and the payment of interest under Section 13 headed "Existing National debt"	The Constitution establishes that the yearly budget must include debt servicing

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Appendix C Contd. . .

Features	Australia	Brazil	New Zealand	Portugal	Sweden	UK	Colombia
Legislation on public debt management?	1. Commonwealth Inscribed Stock Act 1911 2. Loans Redemption and Conversion Act 1921 3. Loans Securities Act 1919 4. Loan (Temporary Revenue Deficits) Act 1953	1. Specific law gives the authorization to borrow to the MoF and defines the objectives of new issuances, among other subjects. A presidential decree describes the specific characteristics of each bond to be issued and its objectives	Public Finance Act (amended 2004)	1. Public Debt Law 2. Annual Budget Law 3. Decree-Law that regulates the activity of the IGCP	Act on Central Government Borrowing and Debt Management 1988	National Loans Act 1968	Multiple laws and decrees. The most relevant is Presidential Decree 2681 of 1993. No general Law of Public Debt Management
Relevant delegated legislation	Commonwealth Inscribed Stock Regulations	MoF can transfer borrowing authorization, by an administrative regulation, to the National Treasury Secretary who can again transfer this to the Deputy Secretary responsible for debt management (the head of the DMO)	The MoF may appoint "loan agents"	No	Ordinance containing Instructions for the National Debt Office (2007)	Finance Act 1998	Only in the case of debt management operations e.g. derivatives for risk management, or debt buy-backs, is there a Resolution 2650/1996, where the Finance Minister delegates the responsibility to the Director General of Public Credit
Clear ToR or a MoU with the MoF?	Directions issued by Treasurer (Minister)	NA	NA	The Decree-Law regulates the activity of the IGCP	Yes, as described in the Ordinance containing Instructions for the National Debt Office (2007)	Executive Agency Framework Document, April 2005	NA

Contd. . .

Appendix C Contd. . .

Features	Australia	Brazil	New Zealand	Portugal	Sweden	UK	Colombia
Accountability							
Accountability Structure	DMO is accountable to the Treasurer and the Secretary to the Treasury	The Deputy Secretary is accountable to the Secretary of the Treasury, who is directly accountable to the MoF	The Treasurer/Assistant Secretary has line accountantability to the Deputy Secretary, who in turn reports to the Secretary of the Treasury, who is directly accountable to the MoF	The Board of Directors reports to the MoF	The Board members and the CEO (the Director General) are appointed by and accountable to the Government	The Chief Executive of the DMO is accountable to Treasury Ministers and to Parliament	Director General accountable to Minister of Finance
Compulsory Reports/ Submissions	Annual Report and Financial Statements provided to Treasurer and tabled in Parliament	Quarterly and annual release to the Congress of a report confirming if legal limits were achieved	The DMO contributes to Government financial statements and the Budget Policy Statement	Quarterly Report submitted to the MoF, and Annual Activities Reports	By law, the Government shall every second year evaluate the management of central government debt in a written communication to the Parliament. According to the Ordinance, the DMO is annually required to submit information for the evaluation of its debt management	The DMO prepares and publishes an Annual Report and Accounts	Minister of Finance produce an annual report for Congress with a chapter on debt management. By law, the government must produce financial statements by the Accounting Office. Also debt servicing projections for the budget.
Advisory Board?	Yes	Public Debt Committee	Yes	Yes	No	There is a Managing Board that considers all strategic operational and management issues relating to the DMO.	No. But in the past, an advisory committee has functioned on a sporadic basis.
Does the Board advise MoF or only the DMO?	Secretary of the Treasury who advises the Treasurer	The Treasury	Advises the Secretary/Deputy Secretary to the Treasury	Only DMO		NA	NA

Contd. . .

Appendix C Contd. . .

Features	Australia	Brazil	New Zealand	Portugal	Sweden	UK	Colombia
Other relevant corporate governance measures	Audit Committee within AOMF, Internal Auditor, Australian National Audit Office		The PF Act requires the audit office to audit the financial statements, including the processes in the DMO. "Portfolio management policy" - Compliance is managed internally and by the Advisory Board	The Audit Committee is responsible for monitoring and controlling the financial management of IGCP and the Public Debt Stabilization Fund, as well as supervising the respective accounting procedures		The accounts relating to the DMO's administrative expenditure and income and the Debt Management Account are subject to external audit by the National Audit Office's Comptroller and Auditor General	
Formal mechanism for coordination with the CB	Reserve Bank of Australia (RBA) provides services to AOFM under commercial contracts	Meets informally, but regularly, with the Central Bank to exchange information about the money market, the public debt and the secondary market (including the joint dealer system)	No formal mechanism	No formal mechanism	Apart from the general requirement to consult with the Central Bank, the Government is required by law to seek an opinion from the Central Bank on the proposed debt management strategy, which the DMO is required to annually submit to the Government for decision.		None
Staffing							
Number of Staff	30	Approximately 90 people	20	110	Around 120	80	Around 87
Hiring/salaries autonomy?	Yes	No. The DMO hires people based in public contest done every 2 years for the National Treasury. The salaries are the same in all the Treasury and also in a number of categories of public servants	Yes	No. The guidelines for personal compensation approved by the MoF are based on the need to maintain competitiveness when compared with the banking sector	Yes. Within its budget means, the Debt Office is free to set the salaries	Yes. The DMO has delegated authority for resourcing, pay, pay bargaining and setting terms and conditions	No autonomy, salaries determined by civil service rules.

Contd. . .

Appendix C Contd. . .

Features	Australia	Brazil	New Zealand	Portugal	Sweden	UK	Colombia
Civil Service terms and conditions?	Yes (Public Service Act 1999)	Yes	Yes, staff are public servants	Staff is hired under the general labour law	No	Yes, staff are civil servants	Yes, staff are civil servants
Accountability mechanisms	Code of Conduct	There is a code of ethics for all the National Treasury staff	The State Sector Act specifies the standards and general obligations of the public service. In addition, the DMO has additional guidelines to avoid conflict of interest	IGCP's staff is ruled by the individual employee's contract and by the Portuguese banking sector's collective agreement	Yes, both code of conduct and conflict-of-interest guidelines	Yes. There is a general Civil Service Management Code and a specific Employee Handbook	In process of drawing up Staff Code of Ethics
Strategy & Operations							
Objectives	Manage the net debt portfolio for which it is responsible at least cost over the medium-term, subject to an acceptable level of risk. Contribute to the operation of financial markets by supporting efficient Treasury Bond and Treasury Bond futures markets.	Minimize long-term financing costs, ensuring the maintenance of prudent risk levels and contributing to the well functioning of the public bond market.	Maximize the long-term economic return on the government's financial assets and debt in the context of the government's fiscal strategy, particularly its aversion to risk.	Minimize the direct and indirect cost of public debt on a long term perspective; Guarantee a balanced distribution of debt costs through the several annual budgets; Prevent an excessive temporal concentration of redemptions; Avoid excessive risks; Promote an efficient and balanced functioning of financial markets	Minimize the long-term costs of the debt, while taking account of the risks.	Carry out the Government's debt management policy of minimising its financing cost over the long-term taking account of risk.	
Functions							
Cash management	Yes	No	Yes	Yes	Yes	Yes	Yes

Contd. . .

Appendix C Contd. . .

Features	Australia	Brazil	New Zealand	Portugal	Sweden	UK	Colombia
Contingent liabilities	No	No	No	No	Yes	No	Yes
Conduct of primary auctions?	AOFM	The National Treasury - front office.	NZDMO (as from April 2008)	IGCP	The Debt Office	DMO	DMO
Eligibility for primary auction participation	Registered Bidders. To register, must be members of Austraclear	Commercial banks, investment banks, broker houses, mutual funds, pension funds and other institutional investors. There are no restrictions for foreigners aside from the legal bureaucracy defined by the regulator	Any registered bidder	- Fixed-rate on-the-run government bonds (OT) Auctions - Open to the Primary Dealers (OEVT) and Other Auction Participants (OMP) - Treasury Bills (BT) Auctions - Open to Treasury Bill Specialists (EBT) - OT reverse Auctions - Only open to Primary Dealers	Primary Dealers	Members of the public that belong to DMO's Approved Group of Investors or, otherwise, through a Gilt-edged Market Maker (GEMM)	Primary Dealers
Is there a primary dealer system?	No	Yes	No	Yes	Yes	Yes - GEMMs	Yes
How is secondary trading carried out?	Over the counter trading	Mostly OTC. However, usage of electronic platforms such as Bloomberg, Reuters and Brazilian stock exchange - BMF (called SISBEX) is increasing	OTC, primarily	The wholesale segment for specialists, the Special Market for Public Debt (MEDIP) and the retail segment	Internal system	There is a DMO's Purchase and Sales Service. Also investors can resort to stock exchange or OTC market	Two trading systems, one run by the SE and the other by the CB. There is also OTC

Contd. . .

Appendix C Contd. . .

Features	Australia	Brazil	New Zealand	Portugal	Sweden	UK	Colombia
Clearing & Settlement system	Austraclear provides these services to its members	Selic (Special System for Settlement and Custody), administered by the Central Bank is the settlement system for around 96% of central government's domestic securities	Contracted out (Austraclear)	Contracted out (Euroclear and Clearstream)	Contracted out	In-house with external use of clearing & settlement agents	Contracted out
Depository function	Austraclear provides these services to its members	Also done by the Selic system	Contracted out, owned by the RBNZ	Contracted out to Central de Valores Mobilirios (CVM)	Contracted out	Euroclear UK and Ireland (EUI), is the Central Securities Depository (CSD) in the UK and Ireland and operates the CREST system which is used to settle gilt transactions. EUI is part of the Euroclear Group	Contracted out
RTA functions, if any	Registry operated by Reserve Bank of Australia for AOFM under contract	No. It is done by the Selic system	No	Yes	No	The DMO managed the contract with CIS on behalf of HM Treasury	No
Funding							
Separate balance sheet?	Yes	No	No	Yes	No	Yes for the Debt Management Account	No
Annual appropriations	Combination of separate annual appropriations and standing appropriations	Annual appropriations through the MoF for the entire National Treasury	Annual	Through MoF	Through MoF	Through MoF	Budget

Contd. . .

Appendix C Contd. . .

Features	Australia	Brazil	New Zealand	Portugal	Sweden	UK	Colombia
Fee Structure	No (debt management activities). Yes (investment activities and securities lending)	No	No	Yes	No	No	No
MoF involvment in setting fees?	None			None			
Other sources of funding	Assistance to other sovereign debt managers funded from government's aid program	No	No	Consulting fees	No	Fees from adminstration of loans to local authorities via the Public Works Loan Board	No

*Compiled from websites of and communication with various DMO's.

APPENDIX D

Abbreviations

ADB	Asian Development Bank
ALM	Asset Liability Management
AOFM	Australian Office of Financial Management
BOE	Bank of England
BRA	Banking Regulations Act
CAAC	Controller of Aid Accounts and Audit
CAG	Comptroller Audit-General
CAR	Cost-at-Risk
CAS	Central Accounts Section
CBI	Central Bureau of Investigation
CCIL	Clearing Corporation of India Ltd
CFI	Consolidated Fund of India
CFMA	Centralised Funds Management System
CGA	Controller General of Accounts
CrPC	Code of Criminal Procedure
CVC	Central Vigilance Commission
DEA	Department of Economic Affairs
DMO	Debt Management Office
ECB	External Commercial Borrowing
EDMU	External Debt Management Unit
EEC	European Economic Commission
EFT	Electronic Funds Transfer
FII	Foreign Institutional Investors
FRBM	Fiscal Responsibility and Budget Management
GDP	Gross Domestic Product
GOI	Government of India
GSA	Government Securities Act
HPEC	High Powered Executive Committee
HUDCO	Housing and Urban Development Corporation
IDA	International Developmental Assistance
IDMU	Internal Debt Management Unit
IGCP	Instituto de Gestao da Tesouraria e do Credito Publico I.P
IMF	International Monetary Fund
INR	Indian Rupees

IPC	Indian Penal Code
IT	Information Technology
LAF	Liquidity Adjustment Facility
LIC	Life Insurance Corporation
MIB	Millenium India Bonds
MSS	Market Stabilisation Scheme
MOF	Ministry of Finance
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-Bank Financial Companies
NCDC	National Co-operative Development Corporation
NDS	Negotiated Dealing System
NDTL	Net Demand and Time Liabilities
NHAI	National Highways Authority of India
NIPFP	National Institute of Public Finance and Policy
NSSF	National Small Savings Fund
NTMA	National Treasury Management Agency
NZDMO	New Zealand Debt Management Office
OD	Overdraft
ODA	Overseas Development Assistance
OECD	Organisation for Economic Co-operation and Development
PD	Primary Dealers
PDO	Public Debt Office
PFRDA	Pension Fund Regulatory and Developmental Agency
PoCA	Prevention of Corruption Act
RBI	Reserve Bank of India
REC	Rural Electrification Corporation Ltd.
RTGS	Real Time Gross Settlement
RTI	Right to Information
SBI	State Bank of India
SCRA	Securities Contract Regulation Act
SEBI	Securities and Exchange Board of India
STA	Single Treasury Account
STC	Standing Technical Committee
UK	United Kingdom
USA	United States of America
USD	United States Dollars
VAR	Value-at-Risk
WMA	Ways and Means Advances
WSS	Weekly Statistical Supplement

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