RBI Establishes Comprehensive Regulatory Framework for Credit Derivatives: Master Direction on CDS, TRS, and Credit Index Futures

The Reserve Bank of India ("RBI"), through its Master Direction dated June 25, 2026, has introduced a formal regulatory framework for credit derivatives, including Credit Default Swaps (CDS), Total Return Swaps (TRS), and Futures on credit indices. Issued under Section 45W of the RBI Act, 1934, the directions aim to facilitate risk management and credit risk transfer while ensuring market stability through strict participant classification, reporting mandates, and a centralized dispute-resolution mechanism.

Analysis

- The framework applies to both Over-the-Counter (OTC) markets and recognised stock exchanges, bringing standardization to previously fragmented credit risk transfer mechanisms.
- Market-makers are strictly defined and limited to regulated entities such as Scheduled Commercial Banks (with specific exclusions), Standalone Primary Dealers, and certain NBFCs within the Upper and Middle layers.
- A User Classification Framework bifurcates participants into Retail and Non-retail. Resident retail users are legally restricted to buying protection solely for hedging purposes, whereas non-retail users have broader participation rights.
- From a consumer protection and regulatory risk standpoint, the RBI has explicitly prohibited market-makers from offering CDS or TRS contracts to individuals, effectively ring-fencing the complex derivative market to institutional and corporate entities.
- Eligible reference obligations are limited to dematerialized money market debt instruments, rated INR corporate bonds, and unrated bonds issued by infrastructure SPVs. Notably, Asset-backed securities (ABS) and Mortgage-backed securities (MBS) are strictly excluded from the scope of permitted reference assets.

- The Directions impose a Related Party Prohibition, preventing participants from entering into contracts if the reference entity is a related party to either counterparty, though an exemption is provided for transactions between government-related entities.
- For hedging transactions, the RBI mandates strict discipline: users must match the notional amount and tenor to the underlying exposure and are required to exit their credit derivative position within one month if the underlying exposure is liquidated.
- A significant governance feature is the establishment of the Credit Derivatives Determinations Committee by FIMMDA. This committee will make binding factual determinations on credit events, substitution events, and settlement procedures, providing a quasi-adjudicatory layer to minimize contractual disputes.
- Compliance and transparency are enforced through a 30-minute reporting window for all OTC trades to the Clearing Corporation of India Ltd. (CCIL).
- Non-compliance with these Directions may result in the RBI disallowing a participant from dealing in the credit derivatives market for up to one month at a time, with such enforcement actions being made public.
- **Key Takeaways**

  - RBI has issued a comprehensive regulatory code for credit derivatives under Section 45W of the RBI Act, effective June 25, 2026.
  - The framework enforces a hedging-only mandate for retail users and a total prohibition on individual participation.
  - Infrastructure SPV bonds (unrated) are included as eligible reference assets, supporting sector-specific risk management.
  - The FIMMDA Determinations Committee will issue binding rulings on credit events, ensuring market-wide uniformity in contract settlement.
  - Strict reporting timelines (30 minutes) and FPI investment caps (5%) serve as primary macro-prudential safeguards.

- Enforcement powers include public debarment from the market for up to one month for violations.

➢ The notification is attached herein.

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