

## Chapter 3

### Organizational Framework

#### 3.1 Introduction

Organisational framework for debt management should establish clear roles and responsibilities to ensure the effective execution of debt management activities, provide well defined coordinating mechanism and establish a transparent and accountable system of checks and balances. It should also enable debt managers to have the operational independence to execute their objectives and strategies.

In order to increase efficiency, create adequate segregation of duties and achieve a basic level of internal control, a Debt Management Office (DMO) is normally organized with front, middle and back offices discharging distinct functions.

- The front office is typically responsible for executing transactions in financial markets, including the management of auctions and other forms of borrowing, and all other funding operations.
- The back office handles the settlement of transactions and the maintenance of the financial records.
- The middle office usually undertakes risk analysis, monitors and reports on portfolio-related risks and assesses the performance of debt managers against any strategic targets/benchmarks.

In India, a number of entities are involved in public debt management operations with their functions ranging from advisory to actual implementation to recording operations. Internal debt is managed by the Budget Division of DEA, MOF along with the Internal Debt Management Department (IDMD) of RBI while external debt is managed by various divisions of DEA like Multilateral Relations (MR), Bilateral Cooperation (BC) and Multilateral Institutions (MI) and Controller of Aid, Accounts and Audit (CAAA). Chief Controller of Accounts (CCA), MOF maintains accounts for both internal and external debt.

Debt Management functions in respect of Public Debt Management of Union Government are presented in **Table 3.1** as below:

**Table 3.1: Debt Management Functions of the Union Government**

	Front Office	Middle Office	Back Office
<b>Internal Debt</b>	IDMD (RBI)	IDMD (RBI), Middle Office (DEA), Budget Division (DEA)	IDMD (RBI), CCA (MOF)
<b>External Debt</b>	MI, MR and BC Divisions (DEA)	-	CAAA (DEA), CCA (MOF)

### 3.2 Functioning of Middle Office

In India, though a DMO was not set up, as a first step the Middle Office (MO) was established in September 2008. The responsibilities of MO, *inter alia*, included:

- formulation of comprehensive risk management framework;
- formulation of a long term debt management strategy; and
- developing and maintaining a centralized database on Government liabilities.

However, it was observed that these activities were not performed by the MO. Detailed observations in this regard have been brought out in Chapter 4 and Chapter 6 of this Report.

In the Exit Conference, DEA stated that the MO could not function as a full-fledged MO unless the statutory framework was appropriately amended to assign these functions to the MO. It was added that apart from the creation of a centralized database, the other functions were being performed by other agencies.

From the submission of DEA, it can be seen that the MO was not fully discharging the functions assigned to it.

### 3.3 Middle Office Functions in respect of External Debt

Audit observed that in respect of external debt, the functions of MO were not being performed by any entity.

DEA replied (September 2015) that performance evaluation and back testing against portfolio-related benchmarks might not be meaningful as India's external debt was largely multilateral and on concessional terms. In the Exit Conference, it was stated that RBI were conducting a cost-benefit analysis to ascertain the benefit or otherwise of contracting external loans as far as

market loans were concerned. It was also added that a strategic cap on the quantum of external debt which could be contracted had been fixed.

Reply of DEA may be seen in the light of the fact that:

- Borrowings from IBRD and ADB which accounted for nearly 31 *per cent* of the total external borrowing as on 31 March 2015 were not on concessional terms.
- The cost-benefit analysis conducted by RBI was to decide between market borrowing within India or from abroad and was not in respect of bilateral and multilateral loans which form the entirety of the external debt.
- The functions of the Middle Office also include risk analysis, essential for effective debt management but the same were not being performed in respect of external debt. It is to be noted that external debt is prone to exchange rate variations which pose a serious risk and therefore, effective management of the same is of utmost importance.

### **3.4 Public Debt Management Agency (PDMA)**

The issue of establishment of a separate PDMA in India has been considered by a number of Committees like the Committee on Capital Account Convertibility (1997), the Working Group on Separation of Debt Management from Monetary Management (1997), the Internal Expert Group on the Need for a Middle Office for Public Debt Management (2001), the Committee on Fuller Capital Account Convertibility (2006), High Level Committee on Financial Sector Reforms (2008) and the Internal Working Group on Debt Management (2008) among others. All the above Committees had suggested that there should be an independently functioning office of public debt outside of RBI to enable more efficient debt management as well as monetary management. Further, it was stated that internationally, there had been a strong movement towards establishing separate debt management offices for selling bonds for the government which was considered a best practice. Moreover, a separate debt management agency would consolidate all debt management functions and be the catalyst for wider institutional reform and transparency in public debt management.

The Finance Minister in his Budget Speech (2007-08) had proposed to set up an autonomous DMO and, in the first phase a MO to facilitate the transition to a full-fledged DMO. Accordingly, a MO was established in September 2008 in the MOF. The Financial Sector Legislative Reforms Commission (FSLRC) in its Report (March 2013) recommended fast-tracking of setting up of an independent PDMA.

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It is pertinent to mention here that announcements on the establishment of a separate debt management agency were made in the budget speeches of 2011-12, 2012-13 and 2014-15 also. Taking forward the process for establishment of a separate DMO, the MOF set up a task force (September 2014) with the objective of supporting the Ministry in preparatory work for PDMA.

The Finance Minister in his budget speech (2015-16) observed that *“one vital factor in promoting investment in India, including in the infrastructure sector, is the deepening of the Indian bond market, which we will have to bring at the same level as our world class equity market. I intend to begin this process by setting up a Public Debt Management Agency (PDMA) which will bring both India’s external borrowings and domestic debt under one roof.”*

The proposal for the setting up a separate public debt management agency had, however, been shelved from the finance bill for the year with the following remarks of the Finance Minister made in the Parliament (30 April 2015), *“since, RBI has been handling Public Debt Management, the Government in consultation with the RBI will prepare a detailed roadmap separating the debt management and market infrastructure from RBI and having a unified financial market.....it is being decided to delete the PDMA provisions from the finance bill for the financial year”*. He further added, *“this Government is committed to unifying the financial market both by making Government securities part of this market as well as creating a proper bond currency market.”*

From the above, it could be seen that even though a number of expert committees had recommended the establishment of a separate public debt management agency over the past two decades and the first step in the direction was taken seven years ago with the setting up of a Middle Office, no further progress was made on the setting up of a separate public debt management agency, except for setting up of a task force in September 2014.

RBI in their reply (September 2015), stated that DMO was only an agent of the treasury and could not be independent while adding that multiplicity of arrangements existed around the world regarding location of sovereign debt management functions. RBI further added that they had been discharging their functions efficiently and effectively.

Referring to the statements made by the successive Finance Ministers in their budget speeches, DEA replied (September 2015) that it was clear that the Government was ready with the draft bill on PDMA with inputs from all stakeholders. DEA enumerated some measures taken for

setting up the PDMA like capacity building at MO, publications by MO for information dissemination, setting up of task force for PDMA with a time schedule for implementation, etc.

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