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RBI Issues Master Direction on Credit Derivatives, 2026

28 June 2026 · ECONOMY · GS3

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28 June 2026 · 3 min read ·

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WHY IN NEWS

The Reserve Bank of India (RBI) (Credit Derivatives) Directions, 2026, came into force on June 25, 2026, finalising a harmonised credit-derivatives framework intended to deepen India's corporate bond market.

WHAT ARE CREDIT DERIVATIVES

A credit derivative is a financial contract that allows the **credit risk** of a borrower to be transferred from one party to another without transferring the underlying loan or bond.

- A **Credit Default Swap (CDS)** transfers the default risk of a borrower from the **protection buyer** to the **protection seller**. The buyer pays a periodic premium; if the borrower defaults, the seller compensates the buyer. It works like insurance against default.
- A **Total Return Swap (TRS)**, newly introduced, transfers **both credit risk and market risk** of an underlying asset, allowing one party to receive the total return (income plus price change) of the asset in exchange for a fixed or floating payment.

Until this framework, **CDS was the only credit derivative permitted** in the Indian over-the-counter market. The 2026 Directions add TRS and credit-index products.

KEY FEATURES OF THE 2026 DIRECTIONS

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FEATURE	PROVISION
New instruments	Total Return Swaps (TRS) and credit-index products added alongside CDS
Resident non-retail users	May freely buy and sell credit protection via CDS and TRS
Retail residents (non-individuals)	May use CDS or TRS only for hedging
Non-residents	May use credit derivatives only for hedging
Market-makers	Scheduled commercial banks, standalone primary dealers, NBFCs and HFCs meeting prescribed conditions
Exchange-traded products	Standardised single-name CDS and CDS-on-index with guaranteed settlement
Foreign Portfolio Investors (FPIs)	Newly allowed into credit-index futures, with anti-speculation safeguards

A notable shift is that the framework **removes the link between participation and an underlying credit exposure** for resident non-retail users, giving eligible entities greater flexibility to manage credit risk.

WHO REGULATES CREDIT DERIVATIVES

In India, credit derivatives are regulated by the **RBI**, not by SEBI. This reflects their close connection to credit and money markets rather than to pure capital-market instruments.

ANALYSIS AND WAY FORWARD

India's corporate bond market remains shallow compared with its bank-credit and equity markets. Investors hesitate to hold lower-rated corporate bonds because they cannot easily hedge default risk. By widening CDS use and adding TRS and credit-index products, the RBI gives investors tools to **separate and trade credit risk**, which should improve liquidity, price discovery and depth in the bond market.

The framework is deliberately cautious. The **2008 global financial crisis** showed how unregulated and opaque CDS markets can amplify contagion when default risk is layered and hidden. Hence the RBI's safeguards: hedging-only access for retail and non-resident users, guaranteed settlement on exchanges, and anti-speculation limits for FPIs.

The way forward lies in balancing **market deepening with systemic-risk management**: building robust central clearing, transparent reporting of positions, **prudent** (<https://ujjiyari.com/vocab/prudent/>) exposure limits, and investor education, so that credit-risk transfer strengthens rather than destabilises the financial system.

UPSC RELEVANCE

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GS Paper 3 (Economy): Financial markets, corporate bond market, financial instruments, RBI's regulatory role, credit-risk management.

Prelims pointers:

- Credit derivatives in India are regulated by the RBI, not SEBI.
- CDS transfers default risk from protection buyer to protection seller.
- TRS transfers both credit and market risk; newly introduced in 2026.
- RBI (Credit Derivatives) Directions, 2026, in force from June 25, 2026.
- FPIs newly allowed into credit-index futures with anti-speculation safeguards.

Mains question: “Deepening the corporate bond market requires effective credit-risk transfer, but the lessons of 2008 demand strong safeguards.” Examine in the context of India’s credit-derivatives framework. (15 marks, 250 words)

FACTS CORNER

★ FACTS CORNER, KNOWLEDGEPEDIA

RBI (Credit Derivatives) Directions, 2026: In force from June 25, 2026; harmonised framework to deepen the corporate bond market.

CDS (Credit Default Swap): Transfers a borrower’s default risk from the protection buyer to the protection seller; functions like default insurance.

TRS (Total Return Swap): Newly introduced; transfers both credit and market risk of an underlying asset.

Regulator: Credit derivatives in India are regulated by the RBI, not SEBI.

Access: Resident non-retail users may use CDS or TRS freely; retail residents (non-individuals) and non-residents only for hedging.

FPIs: Newly permitted in credit-index futures, with anti-speculation safeguards.

Lesson of 2008: Unregulated CDS amplified the global financial crisis, hence the built-in safeguards.

Sources: *Reserve Bank of India* (<https://www.rbi.org.in>), *Business Standard* (<https://www.business-standard.com>), *ANI News* (<https://www.aninews.in>)

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