

Institutional Framework &
Regulatory Aspects of
Capital Market Development

Bhutan: Nascent financial markets

- No active secondary market for government debt securities.
- Rare secured interbank transactions. No secured transactions.
- A shallow and fragmented interbank market:
 - Lack of incentives to develop interbank links due to structural excess liquidity
 - Lack of financial sophistication & lack of a prudent, forward-looking, approach to liquidity management
 - Hegemonic liquidity position

Regulatory Framework

- RMA requires all Financial Institutions to be listed
- Short-term securities- included in computation of Statutory Liquidity Ratio requirement
- Collateral framework by the RMA?
 - **Addressing Regulatory constraint**
- Securities needs to be registered with Stock Exchange
- Interest rate capping by the Government.

Addressing interbank market fragmentation

Main challenges

Absence of a secured interbank market

Absence of interest rate references for interbank transactions

Possible solutions

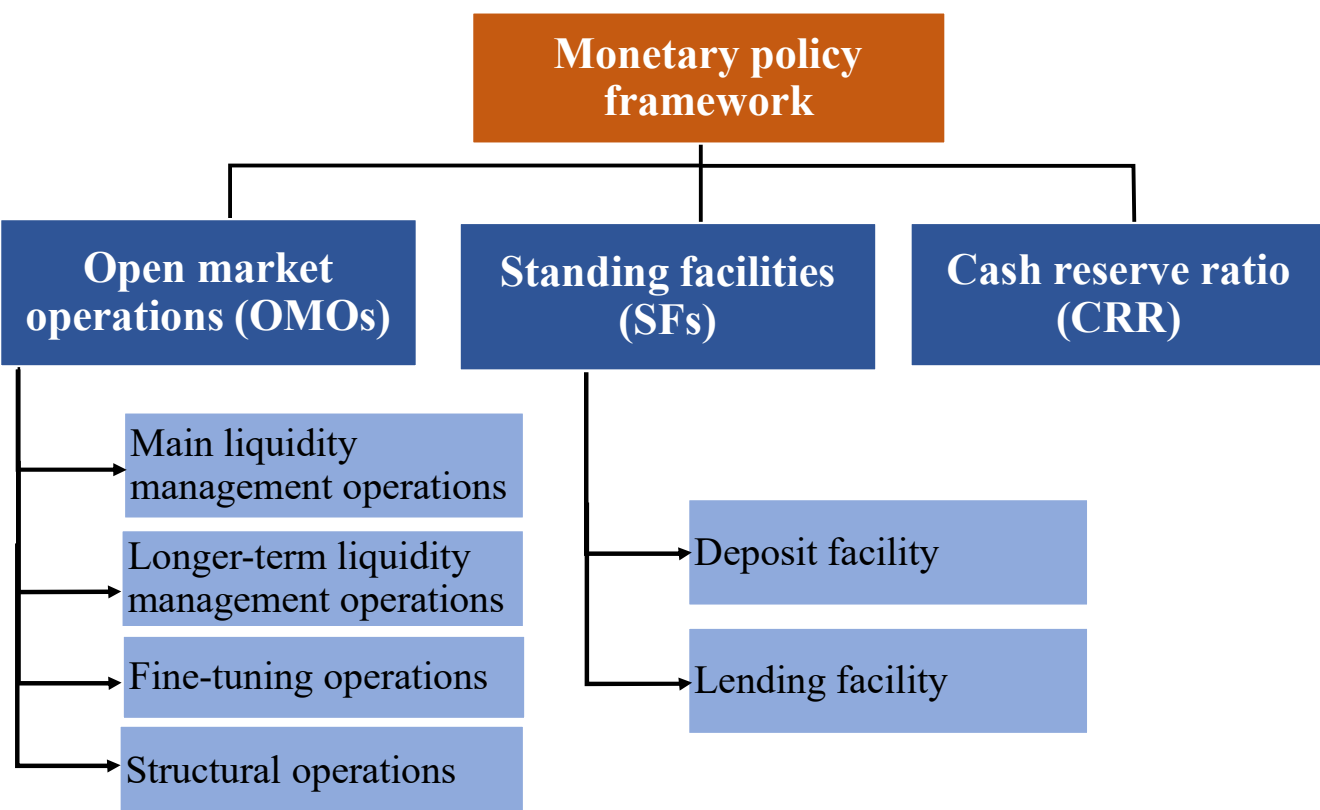
Need for high-quality instruments for secured transactions (T-bills, T-bonds, RMA bills), with an active secondary market

Need for appropriate legal framework, e.g. treatment of repos under bank bankruptcy law

Need for infrastructure: role of the RMA in the confirmation and verification of the mobilization of collateral

Central bank's possible role as independent calculator of interest rate secured and unsecured benchmarks

Way Forward – Monetary Policy and secondary market



Conventional approach of monetary policy (CRR) will be supplemented by market based approach.

- **Open Market Operation and**
- **Standing Facilities**

Monetary Policy- Market based approach

- Align RMA's Monetary Policy with RBI's liquidity management
- Support peg exchange rate through domestic liquidity management
- Signal monetary policy transmission
- Help development of secondary market

Merits of RMA's monetary policy framework

- Covers all elements of monetary policy framework, including tools, operations, procedures, collateral requirements and sanctions.

- Covers broad range of instruments including instruments which may not be required on a regular basis.

- Adaptable in dealing both liquidity surplus and liquidity deficit conditions in the market.

Section 6: Eligible Assets as collateral

Category of Debt Securities	Maturity Less than 1 Year	Maturity More than 1 year
Government	Not applicable	Not applicable
State owned companies	5 percent	10 percent
Private sector entities	10 percent	20 percent

Note: Proposed haircut is, subject to review