

Ref. IDMC.No.4376 /03.75.00/2000-01

May 3, 2001

To,

All Primary Dealers and Scheduled Commercial Banks (excluding RRBs)

Dear Sirs,

**Sub: Scheme of Liquidity Adjustment Facility: 2001-2002**

As announced in the Statement on Monetary and Credit Policy for the year 2001-02, the existing Liquidity Adjustment Facility has been reviewed and certain amendments have been made. The revised Scheme will be made effective from May 8, 2001. Please find enclosed a copy of the revised Scheme.

Yours faithfully,

(T. C. Nair)  
Chief General Manager

Encl: As above

## **Scheme of Liquidity Adjustment Facility: 2001-2002**

As indicated in April 2000 Policy Statement, the scheme of Liquidity Adjustment Facility (LAF) is being introduced progressively in three convenient stages in order to ensure smooth transition. In the first stage, with effect from June 5, 2000, variable rate Repo auctions with the same day settlement were introduced replacing the Additional Collateralised Lending Facility (ACLF) to banks and Level II support to Primary Dealers (PDs). The second stage of LAF envisages replacement of Collateralised Lending Facility (CLF) to banks and Level I support to PDs by variable rate Repo auctions. It was indicated that the effective date for the second stage would be decided in consultation with banks and PDs. Taking the above factors into consideration and on the basis of experience gained in operating LAF coupled with wide ranging consultations with the market participants, it has been decided to revise the earlier LAF Scheme, circulated vide our letter No. 3968/03.75.00/99-2000 dated May 29, 2000. The main features of the revised Scheme, known as LAF Scheme 2001-2002, are as under:

### **1. The Scheme**

Under the scheme, (i) Repo auctions (for absorption of liquidity) and (ii) Reverse Repo auctions (for injection of liquidity) will be conducted on a daily basis (except Saturdays). But for the intervening holidays and Fridays, the Repo tenor will be one day. On Fridays, the auctions will be held for three days maturity to cover the following Saturday and Sunday. The funds under LAF are expected to be used by the banks for their day-to-day mismatches in liquidity.

### **2. Fixed rate Repo auction**

RBI will henceforth have an additional option to switchover to fixed rate Repos on overnight basis; but this option is expected to be sparingly used. For the purpose of such Repos, the rates of interest intended to be offered would be announced as part of auction announcement on the previous evening or before 10.00 a.m. on the day of auction, if necessary.

### **3. Long term Repo**

In addition to overnight Repos, RBI will also have the discretion to introduce longer-term Repos up to 14 day period as and when required.

### **4. Rate of Interest**

At present, auctions under LAF are conducted on "uniform price" basis. It has been decided to introduce "**multiple price**" auction, in place of existing uniform price auction on an experimental basis for one month period during May 2001. Interest rates in respect of both Repos and Reverse Repos will be, accordingly, based on the bids quoted by participants and subject to the cut-off rates as decided by the Reserve Bank of India, at Mumbai. The Repo/Reverse Repo rate in per cent per annum expected by the tenderer

will be expressed up to two decimal points rounded off to the nearest 5 basis points. As there will be no adjustment for accrued coupon, the cash flow will depend upon the Repo rate emerging on day-to-day basis.

## **5. Mechanics of operations:**

i) The LAF auction timing is being advanced by 30 minutes. Bids will be received in tender forms (Annexures I and II) at IDM Cell **before 10.30 a.m.**, as against 11.00 a.m. at present. A separate box for the purpose will be kept at the reception on the Ground floor of the Central Office Building, RBI, Mumbai. Processing of the bids will be done at IDMC. The auction results will be displayed by Mumbai Office by **12.00 noon** as against 12.30 p.m. at present.

ii) The Repo will be conducted as “Hold in Custody” type, wherein the Reserve Bank of India will act as a custodian for the participants and hold the securities on their behalf in the Repo/Reverse Repo Constituents’ Accounts. In pursuant to this, the participants will have to give an undertaking as given in the respective tender forms authorizing RBI to act on behalf of them. Reserve Bank of India shall not, however be responsible for any loss, damage or liability on account of acting as the Custodian on behalf of the participants. A Repo Constituents’ SGL Account (RC SGL Account) and Reverse Repo Constituents’ SGL Account (RRC SGL Account) will be opened and held in the Securities Department in Mumbai Office for this purpose which will have institution-wise subsidiary records of the securities sold under Repo and securities bought under Reverse Repo. RBI will have Subsidiary Accounts in the case of both of these Accounts.

iii) On success in auction in respect of Repos, the tenderer’s RC SGL Account will be credited with the required quantum of securities debiting Bank’s subsidiary account/Investment Account. Likewise, the tenderer’s Current Account will be debited for the resultant cash flows and credited to the Bank’s Account. The transaction will be reversed in the second leg.

iv) In the case of Reverse Repos, on acceptance of bid, the tenderer's SGL account/ RRC SGL Account will be debited with the required quantum of securities and credited to Bank’s Investment Account/Subsidiary RRC SGL Account. Accordingly, the tenderer’s Current Account will be credited with the Reverse Repo amount, debiting the Bank's account. The transactions will be reversed in the second leg.

v) Transactions between RBI and counter parties including operation of the RC SGL Account and RRC SGL Account would not require separate SGL forms as provision will be made in the application form for the purpose. Likewise, transfer of securities from/to RBI’s Investment Account and Subsidiary Accounts in the Repo and Reverse Repo SGL account will not require signing of SGL transfer forms. However, transfer from tenderer’s SGL Account to the RRC SGL Account will require completion of SGL form. In the case of Reverse Repos, tenderers will

have the option to either use the RRC SGL Account route or getting their SGL Accounts debited for the purpose of transferring securities to RBI.

vi) Pricing of all securities including Treasury Bills will be at face value for Repo/Reverse Repo operations by RBI. Accrued interest as on the date of transaction will be ignored for the purpose of pricing of securities. Coupon, if any, will be transferred to RBI in the case of Repos, and RBI will collect the coupon, if any, on the due date and credit the same to the party's Current Account in the case of Reverse Repos.

## **6. Eligibility**

All Scheduled Commercial Banks (excluding Regional Rural Banks) and Primary Dealers (PDs) having Current Account and SGL Account with RBI, Mumbai will be eligible to participate in the Repo and Reverse Repo auctions.

## **7. Minimum bid size**

To enable participation of small level operators in LAF and also to add further operational flexibility to the scheme, the minimum bid size for LAF is being reduced from the existing Rs.10 crore to **Rs.5 crore** and in multiples of Rs.5 crore thereafter.

## **8. Eligible Securities**

Repos and Reverse Repos will be undertaken in all transferable Government of India dated Securities/Treasury Bills (except 14 days Treasury Bills).

## **9. Margin Requirement**

A margin will be uniformly applied in respect of the above collateral securities comprising the Government of India dated securities/ Treasury bills. The amount of securities offered or tendered on acceptance of a bid for Rs.100 will be Rs.105 in terms of face value.

## **10. Settlement of Transactions**

The settlement of transactions in the auction will take place on the same day.

## **11. SLR and Securities held in Repo SGL Account**

Securities held by RBI on behalf of banks' Repo Constituents' SGL account and credit balance in the RRC SGL Account will be counted for SLR purpose and a certificate will be issued to banks by RBI on a fortnightly basis. As far as valuation etc. for SLR purpose is concerned, extant DBOD instructions will apply.

## **12. Terms and Conditions**

Tender Forms for “Repo Auction” and “Reverse Repo Auction” along with terms and conditions are enclosed at Annexures I and II.

### **13. Information Dissemination**

For a smooth transition to full-fledged operation of LAF, banks and PDs are being provided a back-stop facility at variable rate of interest, as a cushion over the normal liquidity facility at Bank Rate. Along with the auction results, the rate of interest applicable for the back-stop facility for the concerned day will also be announced for the benefit of the participants who wish to avail of such facility. Further, to facilitate better bidding by the participants, additional information on the aggregate cash balances of scheduled commercial banks maintained with RBI, during the fortnight, on a cumulative basis with a lag of two days as also weighted average cut-off yield will also be released as a part of the Press Release on money market operations.