Guidelines on Counter party limits and Inter-Corporate Deposits.

IDMC.No.PDRS./ 3369 /03.64.00/2001-02

January 17, 2002

To All Primary Dealers in Government Securities Market
Dear Sirs,

Guidelines on Counter party limits and Inter-Corporate Deposits.

In the "Guidelines on Securities Transactions to be followed by Primary Dealers" issued by Reserve Bank of India (IDMC. No. PDRS. 2049A/03.64.00/99-2000 dated December 31,1999) it was advised that Primary Dealers (PDs) should clearly establish sound Internal Control System and Risk Management System to take care of the various risks inherent in the business. It is presumed that as part of the Credit Risk Management system, with the approval of their Board of Directors, PDs have in place appropriate exposure limits / dealing limits, for each of their counter parties which cover all dealings with such counter parties including Money market, Repos and outright Securities transactions. We also presume that these limits are reviewed periodically on the basis of financial statements, market reports, ratings etc and exposures taken only on a fully collateralized basis where there is slippage in the rating/assessment of any counterparty. The importance of timely review of exposures and limits can not be over emphasized especially in the light of recent events in the market. We shall be glad if you will confirm that such a policy is in place and is monitored in an integrated manner to cover all exposures to the same counterparty.

2. In the context of Primary dealers sourcing their funds through Inter-Corporate Deposits (ICD) and deploying in "non-SLR bonds", it is felt necessary to have guidelines on account of the liquidity and credit risk associated with such transactions. PDs are exposed to "funding-liquidity risk" arising from any inability to rollover such deposits as also "market-liquidity risk" arising from the relative illiquidity of the non-SLR bond portfolios. For these reasons, ICDs should be raised sparingly and not used as a continuous source of funds. After proper and due consideration of the risks involved, the Board of Directors of the PD should lay down the policy in this regard, which among others should include the following guidelines:

i) An appropriate aggregate limit on ICD borrowings should be fixed. While the ceiling should in no case exceed 50% of the Net Owned Funds (NOF) of the PD, it is expected that actual dependence on ICDs would be much below this ceiling.

ii) ICDs accepted by PDs should be for a minimum period of one week.

iii) ICDs accepted from parent/promoter/group companies or any other related party should be on "arms length basis" and disclosed in financial statements as "related party transactions".

iv) Funds raised through ICDs would be subject to ALM discipline.

v) PDs are prohibited from placing ICDs with other counter parties.

3. PDs who have accepted ICDs in excess of 50% of the NOF should bring down the same by end of February 2002. The guidelines will come into effect immediately.

4. Please acknowledge receipt and send us a copy of the policy approved by your Board in this regard at the earliest.

Yours faithfully

(Usha Thorat)
Chief General Manager-In-Charge