Guidelines on Exchange Traded Interest Rate Derivatives

June 11, 2003

IDMD.PDRS. 4802(A)/03.64.00/2002-03

To
All Primary Dealers

Dear Sir,

Guidelines on Exchange Traded Interest Rate Derivatives

Please refer to our circular IDMC.PDRS. 4802 /03.64.00/2002-03 dated June 3, 2003 on the captioned subject in terms of which Primary Dealers are allowed to transact in Exchange Traded Interest Rate futures for the purpose of hedging the interest rate risk of their underlying government securities portfolio.

2. Based on the feedback from Primary Dealers requesting for permitting them to hold trading positions in Interest Rate futures subject to the prudential regulations , the issue has been revisited and it has now been decided to allow Primary Dealers to hold trading positions in Interest Rate Futures subject to the following prudential regulations:

i) *Construction of trading portfolio*:The trading portfolio of the participants comprising IRS, FRAs , exchange traded IRDs etc. should be clearly demarcated from that of the hedging portfolio .

ii) *Interest rate sensitivity of trading portfolio* : The interest rate derivatives should be split into basic building blocks and PV01 / VaR limits on the trading portfolio of interest rate derivatives (comprising OTC as well as exchange traded) be approved by the ALCO. For the purpose, the floating rate leg of MIFOR linked swaps should be adjusted against the gap limits and the fixed leg included in the rupee trading positions. ALCO should also consider placing similar limits on the composition of trading positions comprising balance sheet and off balance sheet products.

iii) *Accounting for trading positions*: The following should be used as general principles for accounting of trading transactions:
   a) Trading positions in interest rate derivatives(OTC and Exchange traded) should be marked to market on a daily basis .
   b) Profits and Losses arising out of trading positions should be taken to the Profit & Loss Account.

3. Capital Adequacy :

The charges for credit risk for trading positions in Interest Rate Futures should be in terms of our previous circular IDMC.PDRS. 4802 /03.64.00/2002-03 dated June 3, 2003. Guidelines for charges on market risk in respect of derivatives (OTC and Exchange traded) in line with international norms is being issued separately.

4. *ALM Classification*: Trading positions in Interest Rate futures should be classified as a risk sensitive asset or liability under 0-30 day maturity bucket.

5. *Disclosures:* The PDs undertaking interest rate derivatives on exchanges may disclose as a part of the notes on accounts to balance sheets the following details:

(Rs. Crores)

Sr.No.	Particulars	Amount
1	Notional principal amount of exchange traded interest rate futures undertaken during the year (product-wise) a) b) c)	
2	Notional principal amount of exchange traded interest rate futures outstanding as on 31st March ____ (product -wise) a) b) c)	
3	Notional principal amount of exchange traded interest rate futures outstanding and not "highly effective" (product -wise) a) b) c)	
4	Mark-to-market value of exchange traded interest rate futures outstanding and not "highly effective" (product -wise) a) b) c)	
5.	Notional Principal Amount of trading positions in Interest Rate futures outstanding as on 31st March ____ (product -wise) a) b) c)	

6. *Reporting:* Primary dealers should submit a monthly statement to IDM Department as per the revised enclosed format.

7. These guidelines may be placed before the respective Board of Directors for formulating the policy, framework and appropriate risk control measures before the regulated entities undertake trades in interest rate futures on the stock exchanges.

8. Please acknowledge receipt.

Yours faithfully,

sd/-
(G Padmanabhan)
Chief General Manager

MONTHLY RETURN ON EXCHANGE TRADED INTEREST RATE FUTURES

Name of the PD:

As on last working day of the month:

I. Activity during the month :

NPA* of the futures contract outstanding at the beginning of the month (settlement date / underlying interest rate exposure wise break up)	NPA * entered into during the month (settlement date / underlying interest rate exposure wise break up)	NPA* of the futures contract reversed during the month (settlement date / underlying interest rate exposure wise break up)	NPA* outstanding at the end of the month (settlement date / underlying interest rate exposure wise break up)

II. Analysis of "highly effective" hedges: A certificate from the concurrent auditor stating the size of the hedge portfolio and that the hedge is highly effective as per the definition of the RBI circular.

III. Analysis of Trading positions:

NPA* of the trading futures position	MTM value of the trading futures position

* NPA- Notional principal amount