RBI/2005-06/ 267

DBOD. No. BP.BC. 53 / 21.04.157 / 2005-06

December 28, 2005

All Scheduled Commercial Banks

Dear Sir

Rupee Interest rate derivatives (including rupee – foreign currency derivatives) – Setting of limits for non-option derivative contracts

Please refer to letter DBOD No. BP.BC. 91/ 21.04.157/ 2004-05 dated May 20, 2005 regarding interest rate derivatives in terms of which while market participants were advised to henceforth use only domestic rupee benchmarks for interest rate derivatives, they had been given a transition period of 6 months for using MIFOR as a benchmark subject to review. Subsequently, it was clarified that eligible market makers could continue to use MIFOR swaps for market making subject to appropriate limits as approved by RBI.

2. On a review and in consultation with market participants it has now been decided as under :

(i) The gross PV 01 of all non-option rupee derivative contracts (including rupee – foreign currency contracts) should be within 0.25 per cent of the net worth of the bank as on the last balance sheet date. The limit would, however, exclude the PV 01 of derivatives which are hedges for balance sheet exposures provided these hedges meet the criteria of hedge effectiveness as laid down in our circular IDMC.MSRD.4801 /06.01.03/2002-03 dated June 3, 2003. In this connection, attention of the banks is invited to RBI letter No.DBS.CO.PPD.47/ 11.01.021/ 2005-06 dated August 19, 2005 regarding computation of net worth.

(ii) The capital charge for market risk for the non-option derivative contracts would be 3 times the PV 01 calculated as at (i) above or the capital charge for market risk calculated as per the methodology given in the Master Circular on capital adequacy

DBOD No.BP.BC.13/21.01.002 /2005-06 dated 4th July 2005, whichever is higher.

(iii) Banks should not exceed their AGL limits.

3. It is clarified that market participants can use MIFOR swaps in respect of transactions having underlying permissible forex exposure.

4. Banks, currently having exposure above the specified PV 01 limit for non-option derivative portfolio should report to RBI their current position and the time frame within which they expect to bring down the exposure within the specified limit. The period for bringing down the position should not be more than six months from the date of this circular.

Please acknowledge receipt.

Yours faithfully

Sd/-

Prashant Saran
Chief General Manager-in-Charge