

March 25, 2010

To

All Market Participants

Dear Sir,

**Guidelines on Stripping/Reconstitution of Government Securities**

Please refer to [paragraph No.101](#) of the Annual Policy Statement for the year 2009-10. As indicated therein, it has been decided to introduce Separate Trading of Registered Interest and Principal of Securities (STRIPS) in Government Securities as part of the efforts to develop the Government Securities market.

2. STRIPS in Government Securities will ensure availability of sovereign zero coupon bonds, which will lead to the development of a market determined zero coupon yield curve (ZCYC). STRIPS will also provide institutional investors with an additional instrument for their asset-liability management. Further, as STRIPS have zero reinvestment risk (discounted instruments with no periodic interest payment thereby obviating the need for reinvestment of intermediate cash flows arising out of the investment), they can be attractive to retail/non-institutional investors.

3. The terms and conditions governing the stripping/reconstitution of Government of India securities are set out in the RBI Notification IDMD.1762/2009-10 dated October 16, 2009.

4. Detailed guidelines outlining the process of stripping/reconstitution and other operational procedures regarding transactions in STRIPS are enclosed. These guidelines shall come into effect from **April 01, 2010**.

Yours faithfully,

(K.V. Rajan)  
Chief General Manager

## **Guidelines on Stripping/Reconstitution of Government Securities**

(Enclosure to circular IDMD.DOD.07/11.01.09 dated March 25, 2010)

### **Stripping/Reconstitution**

Stripping is a process of converting periodic coupon payments of an existing Government security into tradable zero-coupon securities, which will usually trade in the market at a discount and are redeemed at face value. Thus, stripping a five-year security would yield 10 coupon securities (representing the coupons), maturing on the respective coupon dates and one principal security representing the principal amount, maturing on the redemption date of the five-year security. Reconstitution is the reverse of stripping, where, the Coupon STRIPS and Principal STRIPS are reassembled into the original Government security.

2. In terms of Explanation to section 11(2) of the Government Securities Act 2006, “A *Government security may be stripped separately for interest and principal or reconstituted on the application of the holder subject to such terms and conditions as may be specified*”. Accordingly, the terms and conditions for stripping and/or reconstitution of Securities issued by the Government of India have been notified by Reserve Bank of India vide Notification IDMD.1762/2009-10 dated October 16, 2009 (***Annex 1***)

### **Process of Stripping/Reconstitution**

3. Stripping/Reconstitution will be carried out at RBI as an automated process within the Negotiated Dealing System (NDS). The process of stripping/reconstitution will be a straight-through process without any manual intervention. Requests for stripping/reconstitution will be generated and approved by market participants on the NDS and the same will, thereafter, flow to a Primary Dealer (PD) of their choice for authorization. After authorization by the PD, such requests would be received and processed by the system (PDO-NDS) and necessary accounting entries posted in the accounts of the requesting participant for the STRIPS created/securities reconstituted. The NDS will do necessary validation check like eligibility of securities, balances available, etc., on the requests for stripping/reconstitution made by participants. However, participants are required to ensure that sufficient balances are available in their accounts before putting through requests for stripping/reconstitution.

4. Normally, ISIN for Government securities are assigned at the time of auction of the securities. However, in the case of STRIPS, as these securities are created at the request of the participant,

ISIN as well as nomenclature for STRIPS are created automatically based on a predefined algorithm (see **Annex 2**).

5. Individual STRIPS (Coupon as well as Principal) will have a face value of Rs.100.

### **Eligibility**

6. Any entity, including individuals, holding balances of Government securities that are eligible for stripping/reconstitution (as notified by RBI from time to time) can strip/reconstitute these securities. However, a participant (non-PD) desirous of stripping/reconstituting his balance of eligible Government securities/STRIPS should generate a request on the NDS for stripping/reconstitution by choosing any one of the Primary Dealers. Such requests for stripping/reconstitution by non-PD members shall be authorized by the PD and thereafter flow to the NDS for appropriate action (stripping/reconstitution). Requests for stripping/reconstitution by gilt account holders (GAH) shall be placed by the GAH with their respective custodians, who, in turn, will place the requests, on behalf of its constituents, in the NDS. Since stripping/reconstitution is permitted only in respect of securities held in electronic form, any participant desirous of stripping/reconstituting Government securities should have a SGL Account with the RBI or a Gilt Account with a custodian maintaining a CSGL Account with the RBI. In the case of Primary Dealers, they can place requests directly in the NDS for stripping/reconstitution and need not route the same through another PD.

7. Initially, all PDs would be eligible to authorize stripping/reconstitution requests. However, Reserve Bank, at its discretion, can exclude any PD from authorizing such requests. Market participants will have the flexibility to choose a PD of their choice while submitting requests for stripping/reconstitution. PDs will act as market makers in STRIPS and provide two-way quote in the market.

### **Timings**

8. Requests for stripping can be submitted by participants between 9.00 am and 2.00 pm only. All requests for stripping, received by the system (PDO-NDS), will be processed at 2.00 pm and necessary book entries will be passed in the SGL account of the participants to credit the due amount of STRIPS (coupon as well as principal) on account of stripping. All requests that have

not been authorized by 2.00 pm will be rejected by the system. Stripping requests cannot be approved/authorized after 2.00 pm on any business/working day.

9. Similarly, requests for reconstitution can be submitted between 9.00 am and 2.00 pm only. However, the requests for reconstitution would be processed online i.e., as and when such requests are authorized by the PD, and the necessary accounting entries would be passed in the SGL account of the requesting participant immediately subject to availability of sufficient and necessary balances. However, as indicated at paragraph 8 above, requests for reconstitution that are not authorized by 2.00 pm will be rejected by the system. No reconstitution request can be approved/authorized after 2.00 pm on any business/working day. Since reconstitution requests are processed online, such requests, whenever routed through a PD, must be authorized by the PD within 15 minutes of the receipt of the system notification (authorization request).

### **Eligible Securities**

10. RBI will notify, from time to time, the securities that are eligible for stripping/reconstitution. To begin with, securities issued by Government of India, other than floating rate bonds, with coupon dates as 2<sup>nd</sup> January and 2<sup>nd</sup> July, will be eligible for stripping/reconstitution. Thus, all outstanding securities issued by Government of India, except floating rate bonds, with coupon dates/maturity date as 2<sup>nd</sup> January and 2<sup>nd</sup> July, irrespective of the year of maturity, will be eligible for stripping/reconstitution.

### **Minimum amount for stripping/reconstitution**

11. The minimum amount of securities that needs to be submitted for Stripping/Reconstitution will be Rs.1 crore (face value) and multiples thereof.

### **Accounting and Valuation**

12. STRIPS, being zero coupon securities, trade at a discount and are redeemed at face value. Thus, STRIPS will have to be valued and accounted for as zero coupon bonds and in the manner prescribed vide para 3.7.2 in the DBOD Master Circular dated July 1, 2009 on prudential norms for classification, valuation and operation of investment portfolio by banks.

13. The discount rates used for valuation of STRIPS at inception should be market-based. However, in case traded zero-coupon rates are not available, the zero coupon yields published by FIMMDA should be used instead.

14. Accounting entries in the SGL accounts as a consequence of stripping/reconstitution, will be passed at the face value. Thus, when a participant places a request for stripping, his SGL account will be debited by the face value of the Government security submitted for this purpose, and will be simultaneously credited with the aggregate face value of Coupon STRIPS (equal to the aggregate coupon amounts) as well as the face value of Principal STRIPS (equal to the face value of the government security). An illustration is given in **Annex 3**.

15.1 However, on the day of stripping, the STRIPS should be recognised in the books of account of the participant at their discounted value and at the same time, the Government security in question should be derecognised. The accounting treatment for reconstitution should be exactly the opposite of stripping. The detailed procedure for accounting of STRIPS is given below.

15.2 The stripping/reconstitution, per se, should not result in any profit or loss. As the present value of the STRIPS (coupon as well as principal) discounted using the ZCYC will not be equal to the book value/market value of the security, the value of STRIPS shall be normalized using a factor that will be the ratio of the book value or market value of the security (whichever is lower) to the sum total of the market value of all STRIPS created out of the security (illustration given in **Annex 4**). This will ensure that the sum total of the market value of STRIPS equals the book value/market value of the security, whichever is lower.

15.3 Banks can strip eligible Government securities held under the AFS/HFT category of their investment portfolio. However, if strips are to be created out of securities held in the HTM category, then the security first needs to be transferred to AFS/HFT category. The shifting of securities from HTM category for the purpose of stripping, will be as per the relevant guidelines prescribed vide DBOD Master Circular dated July 1, 2009 on prudential norms for classification, valuation and operation of investment portfolio by banks.

15.4 In case STRIPS are created from securities held in the HTM portfolio, the securities should be transferred from the HTM category to the AFS/HFT category (as per the shifting discipline from HTM, i.e., once a year at the beginning of the year as per the above-mentioned master circular dated July 01, 2009) and the shifted security shall be carried at the least of the book

value/market value. Depreciation, if any, shall be provided for and appreciation, if any, ignored as hitherto. Thereafter, the lower of the book value/market value will be used for normalizing the market value of individual STRIPS to the book value/market value. Post-stripping, the book value/market value of the existing securities will be derecognized and replaced by the normalized value of STRIPS whose sum total shall exactly equal the book value/market value of the extinguished security (thereby ensuring that there is no profit or loss on account of stripping). Any appreciation, arising due to the shifting of the security from HTM shall be ignored. The same methodology would follow for securities that are stripped from the AFS/HFT portfolio.

### **SLR Status of STRIPS**

16. STRIPS will be reckoned as eligible Government securities for SLR purposes and retain all the characteristics of Government security. They will be eligible securities for market repo as well as repo under LAF of RBI but with appropriate haircut.

### **Trading in STRIPS**

17. To begin with, STRIPS will be tradable only in the OTC market. Hence, trades in STRIPS will have to be undertaken in the OTC market and reported on NDS for clearing and settlement through CCIL.

18. Short sale of STRIPS shall not be permitted.

19. Participants shall not sell STRIPS/securities upfront based on the requests placed by them for stripping/reconstitution. Accordingly, sale transaction in STRIPS/securities shall be undertaken by participants only after the securities are stripped/reconstituted and the same is reflected in the SGL account of the participant.

### **Fees & Charges**

20. Reserve Bank will not charge any fees for stripping/reconstitution of Government Securities. Further, to begin with, PDs, who are the “authorized entities” for authorizing requests for stripping/reconstitution in the PDO-NDS may also not charge the participants for carrying out this activity.

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**NOTIFICATION**

Mumbai, October 16, 2009

Government Securities –  
Separate Trading of Registered Interest and Principal of Securities (STRIPS)

IDMD.1762/2009-10

In exercise of the powers conferred vide explanation to section 11(2) of the Government Securities Act, 2006 read with section 2(i) of the Act, *ibid*, the Reserve Bank of India hereby notifies that stripping/reconstitution of Government securities shall be subject to the terms and conditions specified herein:

I. Definitions

- a) "STRIPS" (Separate Trading of Registered Interest and Principal of Securities) are distinct, separate securities that are created from the cash flows of a Government security and shall consist of –
- (i) Coupon STRIPS, where the single cash flow of the STRIP represents a coupon flow of the original security
  - (ii) Principal STRIP, where the single cash flow of the STRIP represents the principal cash flow of the original security.
- Explanation:* Stripping of a security shall result in Coupon STRIPS for all outstanding coupon payments and one Principal STRIP for the redemption payment. Each STRIP accordingly becomes a zero coupon bond since it has only one cash flow at maturity. Each STRIP shall be a distinct Government security and shall have a separate and distinct International Securities Identification Number (ISIN).
- b) "Stripping" means the process of separating the cash flows associated with a regular Government security i.e., each outstanding semi-annual coupon payment and the final principal payment into separate securities.
- c) "Reconstitution" means the reverse process of stripping, where the individual STRIPS i.e., both coupon STRIPS and Principal STRIPS are reassembled to get back the original security.
- d) "Authorized entity" means a Primary Dealer or any other entity recognized by the RBI to accept requests from the holders of Government securities for stripping/reconstitution of the securities and submission to the RBI.

## II. Terms and Conditions for STRIPS

1. The process of stripping/reconstitution of Government securities shall be carried out at RBI, Public Debt Office in the PDO-NDS (Negotiated Dealing System).
2. All dated Government securities other than floating rate bonds having coupon payment dates on 2<sup>nd</sup> January and 2<sup>nd</sup> July, irrespective of the year of maturity shall be eligible for Stripping/Reconstitution.
3. All Coupon STRIPS with the same maturity date shall have the same ISIN, regardless of the underlying security from which the interest payments were stripped, and coupon STRIPS of the same cash flow shall be fungible (interchangeable). The ISIN of Coupon STRIPS shall be different from the ISIN of Principal STRIPS, even if they have the same maturity date, and shall not be fungible.
4. Stripping/reconstitution may be done at the option of the holder at any time from the date of issuance of a Government security till its maturity.
5. Stripping/reconstitution shall be permitted only in the eligible Government securities held in the Subsidiary General Leger (SGL)/Constituent Subsidiary General Ledger (CSGL) accounts maintained at the Public Debt Office, RBI, Mumbai. Physical securities shall not be eligible for stripping/reconstitution.
6. Holders of Government securities shall place their requests for stripping/reconstitution only with an "Authorized entity".
7. Reserve Bank will not charge any fees on stripping/reconstitution.
8. The amount of securities that could be tendered for stripping/reconstitution shall be a minimum of Rs.1 crore and multiples thereof.
9. These terms and conditions shall come into effect from the date of this Notification.

Sd/-

**(H R Khan)**  
Executive Director  
Reserve Bank of India



**ISIN for STRIPS**

Structure:

<b>I</b>	<b>N</b>			<b>M</b>	<b>M</b>	<b>Y</b>	<b>Y</b>				
Country code	Issuer type/state code	Month and year of maturity of the STRIP				Security type	Subsequent strips/series serial number		Checksum digit		

Example of a CG Principal STRIP maturing in March 2011:

<b>I</b>	<b>N</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>3</b>	<b>1</b>	<b>1</b>	<b>P</b>	<b>0</b>	<b>1</b>	
Country code	Issuer type/state code	Month and year of maturity of the STRIP				Security type	Subsequent strips/series serial number		Checksum digit		

Example of a CG Coupon STRIP maturing in March 2011:

<b>I</b>	<b>N</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>3</b>	<b>1</b>	<b>1</b>	<b>C</b>	<b>0</b>	<b>1</b>	
Country code	Issuer type/state code	Month and year of maturity of the STRIP				Security type	Subsequent strips/series serial number		Checksum digit		

**Nomenclature for Coupon STRIPS**

GSDDMONYYYYC; where GS=Government Security, DDMONYYYY=date of maturity of the STRIPS and C=Coupon STRIP. (Ex. A coupon STRIP maturing on March 25, 2011 would be written as **GS25MAR2011C**)

**Nomenclature for Principal STRIPS**

x.xx%GSDDMONYYYYP; where x.xx is the coupon of the parent security from which the principal STRIP has been generated, GS=Government Security, DDMONYYYY=date of maturity of the STRIPS and P=Principal STRIPS. (Ex. A principal STRIP generated from, say, 7.99%2019 maturing on 02 July 2019 will be written as **7.99%GS02JUL2019P**)

## Stripping of securities – An illustration

### Strippable Securities

Security	Date of Maturity
9.39% 2011	02-Jul-11
12.30 % 2016	02-Jul-16

### Investor "A"

Portfolio as on October 16, 2009 (in the books of PDO, Mumbai)

Security	Rs. (Cr) {Face Value}
9.39% 2011	100.00
12.30 % 2016	250.00

On March 17, 2010, investor "A" strips Rs.5 Cr worth of 9.39%2011 & Rs.10 Cr worth of 12.30%2016

### STRIPS generated

9.39% 2011		
	02 July 10	2,347,500
	02 Jan 11	2,347,500
	02 July 11	2,347,500
<b>Principal STRIP (PS)</b>	02 July 11	50,000,000

# Each coupon strip = {9.39%/2} x 5 Cr.

12.30 % 2016		
	02 July 10	6,150,000
	02 Jan 11	6,150,000
	02 July 11	6,150,000
	02 Jan 12	6,150,000
	02 July 12	6,150,000
	02 Jan 13	6,150,000
	02 July 13	6,150,000
	02 Jan 14	6,150,000
	02 July 14	6,150,000
	02 Jan 15	6,150,000
	02 July 15	6,150,000
	02 Jan 16	6,150,000
	02 July 16	6,150,000
<b>Principal STRIP (PS)</b>	02 July 16	100,000,000

# Each coupon strip = {12.30%/2} x 10 Cr.

### Portfolio as on March 17, 2010 after stripping (in the books of PDO, Mumbai)

Security	Amount (Rs.) {Face Value}
9.39% 2011	950,000,000
12.30 % 2016	2,400,000,000
CS 02 July 10	8,497,500
CS 02 Jan 11	8,497,500
CS 02 July 11	8,497,500
CS 02 Jan 12	6,150,000
CS 02 July 12	6,150,000
CS 02 Jan 13	6,150,000
CS 02 July 13	6,150,000
CS 02 Jan 14	6,150,000
CS 02 July 14	6,150,000
CS 02 Jan 15	6,150,000
CS 02 July 15	6,150,000
CS 02 Jan 16	6,150,000
CS 02 July 16	6,150,000
PS 02 July 11	50,000,000
PS 02 July 16	100,000,000

# CS=Coupon STRIPS; PS=Principal STRIP

### Procedure for normalization of STRIPS (at stripping/reconstitution) to ensure no profit/loss

(For illustration only)

Security	12.30% 2016
Date of maturity	02-Jul-16
Coupon	12.30%
Date of Stripping	03-Mar-10

(1) Market value of 12.30% on 03-Mar-10	129.96
(2) Book Value	120.00
(3) Sum total of PV of STRIPS	127.87
(4) Normalization Factor [(2) ÷ (3)]	0.9385

	Maturity Date	Maturity amount	ZCYC	PV of STRIPS (Market Value)	Normalized value of STRIPS
	(a)	(b)	(c)	(d)	[0.9385 x (d)]
1	2/Jul/10	6.15	4.0683	6.0274	5.6564
2	2/Jan/11	6.15	4.6948	5.8711	5.5098
3	2/Jul/11	6.15	5.3212	5.6841	5.3343
4	2/Jan/12	6.15	5.6128	5.5055	5.1666
5	2/Jul/12	6.15	5.9044	5.3174	4.9901
6	2/Jan/13	6.15	6.1339	5.1305	4.8147
7	2/Jul/13	6.15	6.3633	4.9392	4.6352
8	2/Jan/14	6.15	6.4744	4.7663	4.4730
9	2/Jul/14	6.15	6.5855	4.5946	4.3118
10	2/Jan/15	6.15	6.7227	4.4187	4.1467
11	2/Jul/15	6.15	6.8599	4.2439	3.9827
12	2/Jan/16	6.15	6.9971	4.0707	3.8201
13	2/Jul/16	106.15	7.1343	67.3029	63.1606
<b>TOTAL</b>				127.87	120.00

**Note:**

1. The security is presumed to be held in HTM category and hence is to be shifted to AFS/HFT before stripping, marked-to-market and the lower of the book value or market value will be used to arrive at the normalization factor.
2. In case the market value of 12.30% 2016 is less than the book value then the market value, instead of the book value, will be used to normalize the STRIPS, i.e., the normalization factor would be **market value ÷ sum total of PV of STRIPS**; where the PV of STRIPS are arrived at by discounting the cash flow using the ZCYC.
3. Securities in AFS/HFT will be normalized using the same principle (i.e., lower of market value/book value).