Month	Chronology of Decisions / Changes given effect to Valuation Methodology for the year 2011
For the month of **December** -meeting held on 31-Dec-11	<u>G Sec:</u> **Price Bands of State Development Loan and Special Securities (Oil, Fertilizer Bonds):** As noticed after the implementation of Price Bands for trading on NDS-OM and applicable to OTC trades reported on PDO-NDS, a number of SDLs and Special securities have breached the prescribed bands. General consensus in the market says that these securities trade at levels quite different from the ones at which these are valued by FIMMDA and are in turn used to derive the price bands. A request was thus raised by market participants to re-consider the method which is being used to calculate the price bands for these securities. Currently, FIMMDA does the valuation at G Sec +25 bps and then uses a band of 1.25% (above and below) over last FIMMDA closing (across all tenors) for SDLs and Special securities. Market participants concurred on using a 75 bps band on the FIMMDA closing yields (both sides) for SDLs and Special securities and requested if the same can be put in use. The matter will be taken up with RBI for approval. **Valuation of Callable Bonds:**A query was raised by HDFC Bank in relation to Valuation of Bonds with Call/Put options. FIMMDA Valuation guidelines say that bonds with Call options need to be valued on Yield to Worst basis. As per the Bank's query, highest yield may not lead to the lowest price. They wanted to confirm whether, in such a situation, the price given by the highest yield be considered or should the bond be valued at the yield that gives the worst (lowest price). FIMMDA clarified that the idea behind using Yield to Worst basis is to follow a conservative valuation methodology and thus, a yield that gives the worst (lowest) price (call option date or maturity date), should be used.
	<u>Corporate Bond:</u> **Valuation of Compulsorily Convertible Debentures:** Another query raised by HDFC Bank was regarding the maturity date to be used in the valuation of Compulsorily Convertible Debentures. FIMMDA confirmed that the conversion date of Compulsorily Convertible Debentures is to be taken as the maturity date for calculations. HDFC bank also came forth with a query on valuation of SDLs on the month end. They stated that month end valuation of SDLs at their end is being done with month end date as the valuation date, whereas FIMMDA valuation is being done on a T+1 basis and thus needed clarification on the same. FIMMDA clarified saying that all SDL valuations being done using FIMMDA published curves need to be done on a T+1 basis. **Valuation of Compulsorily Convertible Debentures:** Another query raised by HDFC Bank was regarding the maturity date to be used in the valuation of Compulsorily Convertible Debentures. FIMMDA confirmed that the conversion date of Compulsorily Convertible Debentures is to be taken as the maturity date for calculations. HDFC bank also came forth with a query on valuation of SDLs on the month end. They stated that month end valuation of SDLs at their end is being done with month end date as the valuation date, whereas FIMMDA valuation is being done on a T+1 basis and thus needed clarification on the same. FIMMDA clarified saying that all SDL valuations being done using FIMMDA published curves need to be done on a T+1 basis.
For the month of **November** -meeting held on 1-Dec-11	<u>G Sec:</u> **Valuation of State Development Loan and Special Securities (Oil, Fertilizer Bonds) 25 basis points above G-Sec Valuation:** It was observed that the State Development Loan and Special Securities (Oil, Fertilizer Bonds) are traded above the prescribed price band. The committee discussed and reviewed the need for valuing the State Development Loan and Special Securities (Oil, Fertilizer Bonds) around 5 to 10 basis point higher than the corresponding G-sec yields instead of the regular practice of valuing it at 25 bps above the G-sec curve. As the cases of breach of bonds were only for 1 or 2 Oil & Fertilizer Bonds, it was not felt necessary to pursue the matter with RBI at this stage. **Treatment of Open Short Positions for SLR computation:** Open short sell position is to be adjusted in such a way that there is no negative SLR position for Banks. To cover the short position one needs to borrow through market Repo, thus it will be included in the computation for the SLR holding of the bank.
For the month of **October** -meeting held on 1-Nov-11	<u>G Sec:</u> **Valuation of State Development Loan and Special Securities (Oil, Fertilizer Bonds) based on last traded prices – Minimum Volume / Minimum Trades:** The criteria to recognize the last traded price/yield of SDL/Special Securities is revised to at least one trade for 5 crores or higher volume. The rationale for this change is because these securities do not trade daily. **Valuation of Securities auctioned, but not traded after auction (E.g.: 8.30-2040 on 28th Oct):** If a security is auctioned, but no trade happens after the auction, then the cut-off price/yield will be considered for the day – end valuation, on the auction date only. From the next day onwards, the "Model Price" will prevail, if no trade takes place.
	<u>Corporate Bond:</u> **Method to be used for Amortization of CPs:** It was clarified that the market participants can use any of the amortization methods, i.e. straight line method or discounted price method as FIMMDA does not prescribe any particular method. The method used should be uniform and mentioned in the individual Bank's Principal Accounting Policy.
For the month of **September** -meeting held on 30-Sep-11	<u>G Sec:</u> **Discussion on the Code of Conduct for using RBI's "Negotiated Dealing System – Order Matching (NDS-OM)" – Dated October 1st, 2011:** A brief on the "Code of Conduct for NDS-OM" was discussed, and market participants were cautioned to be extra careful not to violate the Code, as the current system did not have facilities for preventing big figure and other mistakes.

For the month of **August** -meeting held on 2-Sep-11	**<u>G Sec:</u> Criteria to recognize LTP of FRB for Day-End Valuations w.r.t. no. of Trades and volume :** As some of the members had represented the fact that FRBs when traded, are at prices which are about Rs. 2.47 lower than the "Model Price" there is a wide fluctuation in Daily MTM of the Traded FRB in the books of the Banks and PDs. This is because the "Model Price" is used for Valuation on days when the FRB is not traded. To smoothen the day to day fluctuations in valuation of traded FRB's, it was decided as follows: i. A minimum number of 3 trades and minimum volume of Rs. 25 Crores on any single day would be the criteria for using the last traded price for daily valuation. ii. Once a traded price is used for valuation as per (i) above, the "Desired Spread" over the Floating Benchmark would be calculated using the LTP. iii. In case the FRB is not traded subsequently the "Desired Spread" obtained from (ii) above would be used for valuing the specific FRB for the next 14 days, instead of the "polled" Desired Spread. iv. While the floating Benchmark would change every alternate Wednesday and usual polling would be done for revised "Desired Spread", the spread used for arriving at the Model Price of the traded FRB would be the one as indicated in (ii) above instead of the "polled" Spread as long as the trade is not more than 14 days old. v. If there is no trade for an FRB for the last 14 days, then the "polled" Desired Spread would be used for the Daily Valuation.

For the month of **July** -meeting held on 1-Aug-11	**<u>G Sec:</u> Criteria to identify Last Traded Price and Yield on NDS:** It was discussed that we may recognize traded price of "Benchmark Securities" reported on NDS where there are a minimum of 5 Trades and 25 Crores. **Discussion regarding RBI's letter requesting FIMMDA's feedback on SBI's request to waive FRB's from Marking to Market** The Committee discussed the issue and concluded as follows: 1. SBI's letter consisted of two parts: a) Reliability of current methodology (A.V. Rajwade – Model) for ascertaining Fair Value of FRB's for marking to market. b) Reasons for discontinuing marking FRB's to market. 2. The Committee felt that the current methodology was in order, as the FRB's showed a maximum depreciation of 87 paise for the period 31-03-2011 to 31-07-2011 while "Benchmark" coupon bonds showed a maximum depreciation of Rs. 3.75 during the same period, when interest rates were rising. 3. Regarding (1) (b) above, and answering RBI's letter to FIMMDA, it was decided that FIMMDA would confirm that there was no problem regarding methodology of valuation. The Director nominee of SBI would draft the portion giving reasons for waiving MTM process for FRBs. The consolidated reply would be vetted by the Valuation Committee members, then submitted to the FIMMDA Board and thereafter forwarded to RBI for their consideration. **Valuation of Securities as on Month - End:** It was clarified that the last trading day of the month would be the date for which the closing prices and model price would be used for Valuation for month-end, quarter-end and year-end. If the month-end date happens to be a holiday, the last trading day's prices would be used but the valuation sheet would be dated with the month-end date. Thus, if 31st July is a Sunday, 30th July is a Saturday, both being non-trading days, the prices as on 29th July 2011 would be the valuation prices applicable for 31st July 2011, and the valuation sheet for month-end would be dated 31st July 2011 although it is a Sunday/holiday.

For the month of **June** -meeting held on 1-Jul-11	**<u>G Sec:</u> Criteria to recognize LTP of SDL and Special Securities for Day-End Valuations:** It was suggested that the criteria for recognizing the LTP of SDL and Special Securities would be a minimum of 5 Trades and 5 Crores. **Discussion on "Code of Conduct – NDS OM":** The draft of the Code of conduct for the usage of Negotiated Dealing System – Order Matching was discussed with the committee. The members were requested to acquaint themselves with the discipline sought to be introduced in the G-sec market by the code and be ready for its implementation from August 01, 2011 or earlier. **PUBLISHING DAILY VALUATION PRICES FOR SDL AND SPECIAL SECURITIES:** At the request of RBI, w. e. f. 30-06-2011 FIMMDA has started uploading the Day-End Valuations of State Development Loans and Special Securities (Oil Bonds, Fertilizer Bonds, SBI Bonds, etc.) based on the methodology detailed in paragraph 3.6.2, 3.6.3, and the "Note" under paragraph 3.7.1 of RBI's Master Circular "Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks" dated July 1, 2011. These valuations would have to be used while calculating the "Price - Bands" mentioned in the Code of Conduct for usage of NDS-OM.

For the month of **May** -meeting held on 1-Jun-11	**<u>G Sec:</u> Valuation of Floating Rate Bonds:** The letter submitted by a member bank requesting approaching RBI to waive marking FRB's to market was discussed. As FRB's had actually appreciated from April 1st 2011 to 31st May 2011 and no other bank had any problems regarding marking FRB's to market, it was decided to have one to one discussions with RBI in this matter. **Incorporating traded prices in valuation of STRIPS:** It was discussed and decided that for the traded prices to be recognized for valuation purpose, a minimum of 5 trades is required otherwise the model generated prices would be considered. **Valuation methodology for CDS:** The revised valuation methodology for CDS as discussed by the Core product development committee for CDS was presented to the valuation committee, for information.

<table>
<tr><td rowspan="3">For the month of April -meeting held on 2-May-11</td><td><u>G Sec:</u>Criteria to define Semi-liquid Securities: On being requested by a member bank, FIMMDA defined Liquid, Semi-Liquid & Illiquid Securities in the End-of-day (EOD) FIMMDA, PDAI GOI Prices sheet. These definitions were as follows:
Benchmark Securities- 100 trades and Rs.1000 crores turnover per month in each tenor
(***) Liquid Securities- 50 trades and 500 Crs turnover per month in any tenor
(**) Semi - Liquid Securities- Total turnover of Rs.5 crores or above in last 3 months
(*) Illiquid Securities- Total turnover of less than Rs.5 crores in last 3 months
From May 2011 onwards, these definitions stand withdrawn. Instead, FIMMDA has the following categories now:
Benchmark Securities with 100 Trades and Rs.1000 crores Turnover per month in each tenor
(P Benchmark) Pseudo Benchmark: Highest Turnover and Trades in maturity tenors 1-7 yrs (regardless of volumes & trades)
(***) Securities with 100 Trades & 1000 Crores Turnover per month
(**) Securities with more than 25 Crores but less than 1000 Crores turnover and less than 100 Trades in a month
(*) Securities with less than 25 Crores Turnover in a month
(#) Securities with no Trades in the past three months
There will be only one Benchmark per tenor
While a Benchmark has to be (***) security, all (***) securities are not Benchmarks</td></tr>
<tr><td><u>Corporate Bond:</u> Valuation and Accounting norms for LAF with RBI: A query raised by HDFC Bank was regarding valuation of securities under Repo with the RBI. RBI’s Prudential norms on Investment say that:
“In order to ensure uniform accounting treatment for accounting Repo/Reverse Repo transactions and to impart an element of transparency, uniform accounting principles, have been laid down for Repo/Reverse Repo transactions undertaken by all the regulated entities. However, for the present, these norms would not apply to Repo/Reverse Repo transactions under the Liquidity Adjustment Facility (LAF) with RBI.”
Similarly, RBI’s guidelines for Accounting of Repo/Reverse Repo Transactions state that:
“The revised accounting guidelines will apply to market repo transactions in government securities and corporate debt securities. These accounting norms, however, not apply to Repo/Reverse Repo transactions conducted under the Liquidity Adjustment Facility (LAF) with RBI”
Both the above mentioned documents do not mention Valuation/Accounting norms for Securities held under LAF with RBI. On being asked for suggestions, members present during the meeting concurred on the rules being followed by their respective organizations with respect to this particular issue. Members reported the following:
For Repo in RBI LAF, securities which are:
• Repo’ed out of Available-for-sale (AFS) portfolio are Marked to Market.
• Repo’ed out of Held to Maturity are not Marked to Market.</td></tr>
<tr><td><u>Corporate Bond:</u> Valuation of preference shares: A query was raised by yes bank for the valuation treatment of premium received on redemption of preference shares. The committee has requested Yes bank to provide a detailed working of the process suggested, to enable FIMMDA to seek approval from RBI.
Valuation methodology for CDS: The proposed valuation methodology for CDS as discussed by the Core product development committee for CDS was presented to the valuation committee, and explained.</td></tr>
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<tr><td rowspan="2">For the month of March -meeting held on 1-Apr-11</td><td><u>G Sec:</u> Putting FRBs separately in the EOD FIMMDA, PDAI GOI Prices file
End-of-Day(EOD) FIMMDA, PDAI GOI Prices file has coupon bonds arranged according to their maturity. This sheet also includes FRBs between coupon bonds, arranged according to their maturity. Once the Cubic-Spline Yield Curve is generated and prices are calculated for coupon bonds, prices calculated for FRBs as per A. V. Rajwade’s calculator need to be put in manually. As this process involves changes to be made at places between the fixed coupon model generated prices it may lead to errors at times.
In order to minimize errors due to manual intervention while preparing the EOD Valuation File the idea of removing FRBs from respective tenors and adding them at the end of the file was put up in front of the committee. This is also in line with RBI’s intention to keep manual intervention at its minimum. The response of the committee was affirmative and thus the change will apply to EOD prices starting 5th April, 2011.</td></tr>
<tr><td><u>Corporate Bond:</u> Valuation of less-than-1 yr NCDs
A query was raised by a member bank about the valuation methodology to be adopted for valuation of less than one year NCDs. The ratings assigned by the rating agencies for these instruments are similar to that of CDs and CPs i.e., the rating scale for these instruments will be like P1+ or PR1 or P1 etc instead of AAA, AA, BBB etc which are issued for medium term to long term instruments.
The committee decided to circulate the query to the rest of the market participants to source their opinions on the same.</td></tr>
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For the month of **February** -meeting held on 1-Mar-11	**Computation of second leg price on Repo in <u>Corporate Bonds</u>:** A query was raised by Nomura on the applicability of haircut on the second leg price of a corporate bond repo transaction. It was clarified that a corporate bond repo transaction is treated as a borrowing and lending transaction, hence the computation of second leg price on a Repo in Corporate Bond does not arise.

For the month of **February** -meeting held on 1-Mar-11	**Day Count Convention for <u>GOI Securities</u> of residual maturity of less than 6 months:** The committee agreed for the need to use money market convention i.e Actual/365 for valuation of bonds of maturity less than 6 months. **GOI FRB Polling:** It has been decided that the practice of sending prices based on different Spreads will be discontinued. A single sheet containing Average Rate/Current Benchmark will be sent for the members to poll the “Desired Spread”. The committee also concurred on FIMMDA’s decision whereby a minimum of 5 polls will be needed to calculate the Desired Spread. Less than 5 polls on a particular polling day will not be taken into consideration and the spreads being used for the last fortnight will be repeated. All members were once again requested to poll an unbiased “Fair Value Desired Spread”. **Feedback on reducing the standard lot size on NDS-OM from Rs. 5 cr. To Rs. 1 cr:** The consensus view was that the “Regular Market” as displayed on the NDS-OM should continue to be a minimum market lot of Rs 5 crore, because it is meant for large ticket Interbank Deals. For lot sizes of Rs 1 crore, it was suggested that the “Odd-Lot” segment of the NDS-OM should be used, and the Primary Dealers be mandated to quote narrow spreads in lots of Rs 1 crore, at least for the FIMMDA Benchmark securities. This feedback was forwarded to RBI.

For the month of **January** -meeting held on 1-Feb-11	**Further refining the definitions of Liquid, Semi-Liquid and Illiquid <u>GOI Securities</u>:** In the last valuation committee meeting (1st Jan 2011) the committee defined “liquid”, “semi-liquid” and “illiquid” GOI securities. The above definition does not take into consideration the status of securities which may have been Benchmarks, but get overtaken by other securities in the same tenor, or securities which may be becoming more popular but not yet a benchmark. In brief, while a “Benchmark” security has to be invariably a “liquid” security; all “liquid” securities may not be benchmarks. To overcome the above anomaly, the committee decided that benchmarks should remain as per the criteria they are selected which itself defines a benchmark and its purpose for a tenor. A “liquid” security should be the one which has at least 50 trades and Rs.500 Crs of volume in aggregate for the month (should satisfy both trade and volume criteria). Definitions of “semi-liquid” and “illiquid” securities remains the same as it was decided i.e. any security having an aggregate of at least Rs.5 Crs in volume for the last 3 months will be termed as “semi-liquid” and rest will be treated as “illiquid”. The committee also made it clear that these are definitions and have nothing to do with the FIMMDA G-Sec Valuation process.
	Development, hosting and maintenance of <u>Corporate Bond</u> Reporting Platform with Clearcorp – Business Requirement Solution: The committee members were circulated with a draft regarding business/functionality requirements for the FIMMDA platform for reporting secondary market outright trades in corporate bonds. The committee decided to let the members send their feedback if any by 4th of February 2011.

For the month of **December** -meeting held on 1-Jan-11	**Defining Liquid, Semi-liquid and Illiquid <u>GOI Securities</u>:** A member bank requested FIMMDA to put up proper definition/criteria for defining “liquid”, “semi-liquid” and “illiquid” GOI securities. The valuation committee reviewed each security’s aggregate trades and volumes for the last 3 months. The committee decided that all “benchmarks” will be termed as “liquid” securities, any security having an aggregate of at least 5 Crs in volume for the last 3 months will be termed as “semi-liquid” and rest will be treated as “illiquid”. The committee will identify such securities every month at the valuation committee meeting.