

FIMCIR/2023-24/40

Date: 29<sup>th</sup> February 2024

TO ALL MEMBERS AND STAKEHOLDERS

**Subject: Bond Forward Rate Agreement (Bond-FRA)  
Operational Guidelines**

Rupee Interest Rate Derivatives (Reserve Bank) Directions 2019 dated 26<sup>th</sup> June, 2019 (RBI/2018-19/222 FMRD/DIRD/19/14.03.046/2018-2019) provide that Forward Rate Agreement (FRA), among other specified products, can be offered by Market Makers to retail and non-retail users.

RBI directions also provide that, settlement basis and other market conventions for IRD transactions may be specified by FIMMDA, where possible, in consultation with market participants.

Accordingly, FIMMDA in consultation with Market Participants, has put in place settlement basis and other market conventions applicable for **Bond Forward Rate Agreement (Bond-FRA)**

The conventions are placed at **Annexure**.

Banks to ensure that all RBI relevant guidelines and Banks' internal policies are strictly adhered to for client transactions.

**Members are to note that, in case of any conflict of the provisions in the product convention with the Rupee Interest Rate Derivatives (Reserve Bank) Directions, 2019 dated June 26, 2019('the Directions'), as updated from time to time, the Directions shall prevail.**

Members /Stakeholders are advised to note the contents as above.

Sd/-

G. Ravindranath  
Chief Executive Officer

## Bond Forward Rate Agreement (Bond-FRA)

### Background

Reserve Bank of India had issued Rupee Interest Rate Derivatives (Reserve Bank) Directions, 2019 vide notification RBI/2018-19/222 FMRD.DIRD.19/14.03.046/2018-19 dated 26<sup>th</sup> June 2019 updated as on 8<sup>th</sup> August 2022.

These directions provide that:

#### *Para 6*

*(b) Market-makers may offer the following products to retail users*

- i. Forward Rate Agreement (FRA),*
- ii. Interest Rate Swap (IRS), and*
- iii. European Interest Rate Options (IRO) including caps, floors, collars and reverse collars*

*(c) In addition to the products listed in (b) above, market-makers may offer swaptions and structured derivative products, excluding leveraged derivatives, only to non-retail users.*

*(j): "Settlement basis and other market conventions for IRD transactions may be specified by FIMMDA, where possible, in consultation with market participants."*

### **Product Brief:**

Bond Forward Rate Agreement (Bond-FRA) is a derivative product, wherein the two parties enter into an agreement to exchange the difference between the price of a specified debt security (Bond) for a specified future date as determined today (the FRA price) and the price of the said specified security on the said specified future date as per the contractual agreement entered into.

This product has been popular with Insurance Companies, for managing the interest rate risks. Banks have predominantly been the market makers for these transactions with insurance companies. The underlying security has predominantly been dated securities issued by the Government of India.

As FBIL publishes the prices of G-Secs, SDLs and STRIPS daily, these can be used as underlying for Bond FRA.

Accordingly, FIMMDA New Product Committee comprising of key players in the Market have met and deliberated on the subject and proposed the following Settlement basis and other Market conventions to be followed by the *interbank market* in respect of Bond Forward Rate Agreement (Bond-FRA) as below:

## **Bond FRA Conventions**

### **1. Product Offering:**

FRA definition is as per RBI circular RBI/2018-19/222 FMRD.DIRD.19/14.03.046/2018-19 dated June 26, 2019 (IRD guidelines) or as amended from time to time. (Link given below)

### **2. Underlying for hedge requirement:**

As per RBI IRD guidelines, amended from time to time (Extant RBI IRD guidelines can be accessed at <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI2224CBE27435E9F48F89E23BA7ED7A44371.PDF> )

### **3. FRA Security / Reference Rates:**

FBIL publishes daily various securities such as prices of G-Secs, SDLs and STRIPs etc. These can be used as underlying / references for Bond- FRA.

### **4. Notional Amount:**

As per mutual agreement

### **5. FRA Maturity Date:**

As per mutual agreement

### **6. Trading Hours:**

09:00 to 17:00 (Monday to Friday) on Mumbai working days or as decided by the regulator.

### **7. Settlement Basis:**

Net settlement

### **8. Settlement Fixing Price:**

Price of the published Benchmark security price published by FBIL on S-2 date.

- i. The same may be adjusted for any price movement of the agreed benchmark security between S-2 and S-1 as mutually agreed on S-1 date.
- ii. Any price adjustment by mutual agreement as above must keep the FBIL Benchmark published on S-2 as the base.

### **9. Holiday Convention:**

MFBD -Mumbai Following Business Day

### **10. Holiday Calendar:**

Mumbai

### **11. Valuation:**

As per Bank's Internal Valuation Methodology as approved by appropriate internal Committee.

## 12. Reporting:

All Bond FRAs are to be reported to CCIL TR as per timelines applicable.

## 13. Compliance:

*In case of any conflict of the provisions in the product convention with the Rupee Interest Rate Derivatives (Reserve Bank) Directions, 2019 dated June 26, 2019 ('the Directions'), as updated from time to time, the Directions shall prevail.*

## 14. Others:

The conventions are intended to bring in uniformity and standardization in the market. The above conventions may be customised to suit the requirements of the counterparties of the agreement/ease of operations subject to such terms being not in contravention of any statutory/regulatory guidelines as applicable.

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## Product Mechanics (in detail)

Party A is the receiver of fixed rate (future yield of underlying security)

Party B is the payer of fixed rate (future yield of underlying security).

The two parties to the transaction agree on the transaction date (Trade Date, T), the yield and hence the price [Px (FRA)] of a specified security (ISIN XXXX) for a future date (Settlement Date S) for a specified notional amount ( F).

The price Px (FRA) is determined from spot yield (price) of underlying bond at the initiation of the deal (Px (Ini)) and funding cost for holding the security (funding cost) till the settlement date. The cashflows considered for valuation involve outflow related to purchase the bond as a hedge, inflow of coupons from the bond and inflow from the Bond FRA price. These are discounted at funding curve and Px(FRA) is computed which makes NPV equal to zero.

Typically, funding costs are determined as a spread over OIS for the period (S-T).

On the settlement date, the difference between Px(FRA) and the price ISIN XXXX, viz. the Settlement Price Px (Fin) is exchanged.

Party A gets Px (Fin)- Px (FRA) multiplied by the face value of the trade from the seller.

## Transaction Example:

Counterparty A: Fixed Rate Receiver

Counterparty B: Fixed Rate Payer

Trade Date- T

Security: ISIN XXXX

Notional Amount/ Nominal Amount/ Face Value of the Bond: F

Initial Price of Bond: Px (Ini)

FRA Price: Px (FRA)

Settlement Date: S

Settlement Price: Px (Fin)

Settlement Amount on Settlement Date: Party A gets  $F * (Px (Fin) - Px (FRA)) / 100$

Determining Px (Fin)

Px (Fin) is determined on S-1, known as price determination date. (As Security settlement is usually +1 day).

Typically, on S-1, parties look at the ISIN XXXX price published by FBIL on S-2 end of day and duly adjusted for any price movement of an agreed benchmark security between S-2 and S-1.

**It should be ensured that the settlement price (keeping FBIL Benchmark price published on S-2 as a base) is representative of the market and is determined in a fair, transparent and objective manner agreed by the both parties.**

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