Nurturing Markets,
Widening Horizons

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FIMCIR/2011-12/40

January 13, 2012

To,

All FIMMDA Members
Users of NDS-OM,
Participants in the G-Sec OTC markets

Dear All,

FIMMDA's Code of Conduct for Usage of NDS-OM, and OTC trades in G.Secs
Breach of price-bands set for individual scrips

We attach the following documents for your perusal :

i) Minutes of the meeting dated January 4, 2012 , conducted by PDAI and FIMMDA to discuss the breach of price-bands on January 2, 2012 in specific G.Secs.
ii) RBI's communication FMD. MSRG.No.1340/02.13.005/2011-2012 dated January 10, 2012.
iii) Copy of circular FIMCIR/2011-12/36 dated December 08. 2011 .

As advised in the meeting on January 04, 2012, and again further stated by RBI in its enclosed letter, at the cost of repetition, we once again convey the strong displeasure expressed by the regulator for the manner in which the market participants have thrown all caution to the winds and "blatantly" violated the price-bands accepted, while putting the Code of Conduct in place . Needless to add the embarrassing position in which the office bearers of FIMMDA and PDAI were placed while facing the regulator to seek their condoning of breaches, which would normally have resulted in reversal of the trades .

While we have taken up the matter with RBI, for widening the trading bands as proposed in the enclosed minutes of the meeting, we once again reiterate that until the relaxed bands are approved, the market participants should ensure meticulous adherence to the stipulated price bands .

We request the Supervisors of the Dealing Rooms to once again examine the systems and controls put in place internally, the reasons why the breaches took place without their knowledge, and how such incidents are not allowed to occur in future .

With regards,

Yours truly,

C.E.S.Azariah
Chief Executive Officer

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Minutes of the Meeting of FIMMDA and PDAI members (on January 4th, 2012) to discuss the "FIMMDA's Code of Conduct for Usage of NDS-OM, and OTC transactions in G. Secs reported on PDO-NDS"

The following members attended the meeting physically:

- Mr. Madhukar — United Bank
- Mr. Manish Luharuka — ICICI Securities PD
- Mr. Manish Wadhwan — HSBC
- Mr. Pradeep Madhav — STCI PD
- Mr. M.A.K. Prabhu — Canara Bank
- Mr. Arun G. — J & K Bank
- Mr. Ashok B. Sharma — PNB Gilts
- Mr. Sankar Chebiyyam — Deutsche Bank
- Mr. Mohd. Alumuddin — SBH
- Mr. Gaurav Mehta — HDFC Bank
- Mr. Aniket Jain — HDFC Bank
- Mr. D. Sood — Barclays Bank
- Mr. Phani Srinivas — SBH
- Mr. S.V. Dhotre — LIC
- Mr. Soumyadip Sarkar — DBS Bank
- Mr. Rajkumar Singhal — Bank of America
- Mr. Anand Bagri — Ratnakar Bank
- Mr. Vivek Prabhu — Bank of India
- Mr. Gopal Tripathi — RBS

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The following members were present over Conference Call:

• Mr. Vivek Mhatre	Union Bank
• Mr. Ashok Gautam	Axis Bank
• Mr. Ashutosh Khajuria	Federal Bank
• Mr. Mohan Shenoi	Kotak Mahindra Bank
• Mr. Sanjeev Nariyani	SBI
• Mr. Soumyo Dutta	Citi Bank

BACKGROUND: The Chairman PDAI, requested the CEO FIMMDA, to brief the gathering on the events of January 2nd, 2012, which formed the background for this meeting of market participants.

Mr. Azariah then outlined the price movements in the following G. Secs on January 2, 2012:

8.79 % - 2021

9.15 % - 2024

8.28 % - 2027

It was observed that there was steady trading in the above G. Secs continuously, from 9.00 am and the prices crept up (respective yields declined) gradually in steps of 0.01 paise. By 13.30, the prices had reached the upper price band of 1% and 1.25% set for the above securities by the FIMMDA Code dated October 1st 2011.

The movements in the above G. Secs after market opening apparently occurred due to the following fundamentals and news items at the start of the day and also appearing on the electronic media during the day:

i. The cash inflows of around Rs 10,000 to Rs 15,000 on account of interest payment by the Government of India for funds kept in Special Deposit Scheme.

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ii. Comments by Dr. C. Rangarajan, Chairman of the Prime Minister's Economic Advisory Council, that "*RBI may not necessarily wait until the end of March to take action to reverse its present stance*".

iii. News of Government announcement of extra borrowings of Rs. 40,000 Cr. between January to March 2012, exceeding budget estimates by 25%.

Based on the above publically available information, "views" of individual participants in the market, the positions "short" and "long" created earlier and taken during the day, the overall market sentiment was "bullish " on G. Sec prices of the above highly traded securities.

By 13.30, the prices breached the 1% band, and calls were being made to FIMMDA and RBI, for action regarding relaxation of the price band, to enable markets continuity without necessitating reversal of deals beyond the price band. However, the traders who were putting the bids and offer above the FIMMDA band appeared to have ignored the dictat enshrined in the "Code" which states:

i. **Under normal circumstances, market participants should not breach the price band/range during the course of the day, either on the NDS-OM or on the PDONDS.**

ii. **In case of extra-ordinary circumstances warranting a wider price band/range, the "price band" may be relaxed in consultation with RBI.**

By the time FIMMDA office could analyze the news available and the fundamentals as perceived by the market players which were moving the markets and request RBI to relax the bands as per (ii) above, the prices of the scrips under reference has already crossed 1.40% (9.15% GS 2024), 1.26% (8.79% GS 2021), and 1.35% (8.28% GS 2027). After consulting one of the member bank and member PD, FIMMDA office could send an e-mail request to RBI only by 4.30 pm requesting relaxation of the band for the above securities to 1.50% from the existing 1%, quoting the above enumerated reasons and our interpretation that this was an "***extra-ordinary circumstance***" warranting a relaxation of the band.

The RBI responded to the mail, expressing extreme displeasure that FIMMDA has not come to RBI well in time to request review of the 1% band, and the dealers had breached the band without any intimation about any relaxation of the band in utter disregard of the "Code". RBI felt that the reasons attributed for the upward movement in prices and lower movement in yields on the specific securities did not constitute an "*Extra–ordinary Circumstance*" warranting relaxation of the band. Moreover RBI did not take kindly to the approach by FIMMDA, of approaching RBI 'post-facto' for the relaxation of the Band.

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At this stage of the meeting, Mr. Azariah advised the members on earlier occasions when specific trades had breached the band, in adherence to the "Code", RBI had disclosed the names of the counterparties to the NDS-OM and PDO-NDS trades to FIMMDA which in turn had instructed the concerned buyer and seller to reverse the trades .

As the number of trades which had breached the band were around 400 and amount exceeding Rs 3500 crore per scrip and RBI had not approved the relaxation of the band, an urgent Conference Call meeting was called by the FIMMDA and PDAI Boards members for discussing the market movements on the evening of January 2, 2012 (after receipt of RBI's oral and written communication declining our request).

This was followed by request for an appointment with FMD, RBI, for an urgent meeting at 9.00 am on January 03, 2012, and also request for delay in opening of NDS-OM, till the fate of the deals which had crossed the set band were decided.

On January 3rd, 2012, at the meeting with RBI, officials, it was once again conveyed by RBI in clear terms that;

i. RBI Governor, Dy. Governor, CGMs , DGMs, were thoroughly displeased with the working of FIMMDA and its members in following and enforcing the rules framed by it under its "Code of Conduct" .
ii. Such en-masse flouting of the trading bands without approaching RBI through FIMMDA sufficiently early, before the traders breached the band, was proof of inefficiency of FIMMDA's dictats and its member's utter disregard for adhering to, and ensuring compliance with the rules laid down.
iii. While appreciating the fact that a "Hard-Filter" could have prevented the en-masse breach of the trading band, RBI repeated its earlier instructions (while finalizing the Code) that until such time the "Hard Filters" were in place, the members were expected to lay down internal systems and controls to prevent the extra-ordinary enthusiasm and exuberance of the dealers .
iv. The breach of the band on January 2, 2012 spoke very poorly about the controllers and supervisors in the Dealing Rooms of the market participants.

The FIMMDA and PDAI representatives who attended the above meeting accepted the fact that there had been a lack of adequate supervision and control by the supervisors of the FIMMDA and PDAI member dealers who breached the trading bands. The point was also taken that FIMMDA should have approached RBI sufficiently early, seeing the market activity pushing the prices steadily higher and yields lower.

Having expressed our regrets and assuring RBI that such breaches would not occur in future and that the members and users of the G. Sec markets would be suitably warned and instructed in the

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matter, RBI, after consultations with the Dy. Governor, accepted relaxation of bands for individual scrips to just about cover the breaches which had occurred, **as a onetime concession**.

RBI further advised us that FIMMDA and PDAI to instruct the members to put in suitable internal controls until such time as "Hard Filters" are put in place ; put in place a system for approaching RBI for seeking relaxation of bands well before the market reaches the trading band itself ; hold con-calls or discussions well ahead of time for deciding to approach RBI for specific relaxation of the band with complete reasons and rationale.

After the above briefing by Mr. Azariah, the meeting was thrown open for discussions.

The suggestions for a "Duration" based band, recommended by Kotak Mahindra Bank and some other members was examined and it was felt that a yield based band would be more effective as compared to a price band as it would address the issue of duration adequately.

After detailed discussions it was agreed that:

i. A uniform band of (+) / (-) 25 basis be put in place throughout the previous day's closing. Sec YTM curve as determined by the closing valuation yields of the G. Secs in the market.
ii. To take care of the volatility in the shorter–end of the yield curve, the band was suggested at 50 basis points for maturity of scrips with residual tenor of 2 years, and 25 basis for scrips of tenors higher than 2 years.
iii. The "Trigger – Points" (TPs) for approaching RBI for relaxation of the band so set would be a 40 basis point movement either up or down for residual maturities upto two years and 20 basis points up or down for higher residual maturities.
iv. A "Market –Watch Committee" be constituted for keeping a watch on the markets and approaching RBI as soon as the TPs are touched.
v. The volunteers for the "Market-Watch" committee were:
   a. IDBI Bank – Primary Contact Mr. N.S. Venkatesh, CGM (Director, FIMMDA)
   b. Axis Bank – Primary Contact Mr. Ashok Gautam, Senior Vice President and Head Global Markets (Director, FIMMDA)
   b. HSBC – Primary Contact Mr. Manish Wadhawan, Director and Head Interest Rates, Global Markets (Director, PDAI)
   c. Bank of America (PD) – Primary Contact Mr. Rajkumar Singhal, MD Head Trading, Global Markets (Director PDAI)

vi. In addition to the above the Chairman and CEO, FIMMDA, and Chairman PDAI would be a part of the "Market –Watch"Committee.
vii. The detailed working of the MWC would be discussed and documented, so that the procedures are known for action by the MWC in times of market turbulence, exuberance,

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or panic, pushing the yields toward the upper or lower yield bands. This would form a part of the "Code of Conduct" document .

viii. While any of the named officials in (v) or (vi) above can approach RBI officials (to be identified), the route would be preferably be through CEO FIMMDA, or Chairman ,PDAI, and in the absence of their ready availability , any of the MWC could approach RBI . Other market players should alert the MWC suitably as soon as the trigger –points are touched.

ix. As soon as the "Trigger Points" are touched, a standard mail would be sent to RBI by either FIMMDA, PDAI, or in their absence a member of MWC, to RBI, the wordings of which would be drafted by FIMMDA and PDAI and circulated to the MWC. The 'standard mail' would save time for approaching RBI.

x. As soon as the TPs are touched, the request to RBI in the standard mail would be for a relaxation of 10 basis points in the band. After the band is re-set, the MWC wuld prefereably have discussions regarding the market exuberance or panic causing the brand to be breached, and thereafter approach RBI once again with specific recommendations regarding continuance of the market with a further relaxed band, or for trading to be suspended on the NDS-OM and OTC , for "Cooling" and re-commencement the same day, or the next day . If there is another re-set, the next TP would then be 5 basis below/above each reset band depending on the direction of the market movement.

xi. As there are numerous categories of users of NDS-OM, all of whom are not FIMMDA and PDAI members, RBI would be requested to broad-cast the re-set of the FIMMDA band (if approved), on the NDS-OM system . FIMMDA would also update the re-set band on FIMMDA website, after approval by RBI.

xii. **Unless the market participants see the above relaxations, prices should not breach the set bands for the day**.

xiii. FIMMDA would calculate the bands for the following day, at the end of each day's valuation and display on the FIMMDA website, as it is doing currently, and market participants should avail of this facility for guiding individual traders in their Dealing Rooms and setting internal filters.

xiv. In the case of State Development Loans (SDLs), since the auction cut-offs are normally 50 basis points above G. Sec par yields, and investors (buyers) look for this mark-up while trading, it was suggested that an upper yield band of 75 bps and lower yield band of 25 bps above/below the closing G. Sec par yield be set for individual SDLs.

xv. In the case of Oil Bonds and other Special Securities (SSs), since such securities tend to trade closer to a G. Sec yield, a yield band of (+)/(-) 50 basis points may be recommended.

xvi. In a fast moving market, as it would be difficult to have an "error –free" and 'totally disciplined' traders from all class of users (MFs, NBFCs, Banks, PDs, Insurance Companies, PFs, CSGL account holders etc) , we should press for "Hard Filters" on the NDS-OM.

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xvii. Having noted (xv), above it was again re-iterated that **FIMMDA and PDAI expect its members to abide the "Code" and any breach of the existing bands, or above proposals (if approved by RBI), would open the individual buyer and seller to regulatory action as deemed fit, without any recourse to FIMMDA or PDAI.**

xviii. A "Wider Band " of 35 bps , for tenors 2 years and above, and 60 basis for tenors upto 2 years be made applicable for "Special Occasions" such as :

a. RBI's Policy announcement dates
b. GOI's budget announcement dates

In the same light, the bands for SDLs and Special Securities be widened to
SDLs : an upper band of 85 basis and lower band of 35 basis and
Special Securities : a band of (+)/(-) 60 basis
on the above "Special Occasions"

After approval of the above minutes by the Chairman and the Directors of PDAI and FIMMDA present at the meeting, a suitable communication would be sent to RBI regarding our proposal for revised Bands as suggested in the minutes above.

In the meanwhile the members are advised **not to take the proposals as approved** and urgently put in place necessary internal systems for supervision and control of the dealers so that the existing Bands as laid down in the "Code" are not violated and use is made of the MWC in case there are movements necessitating approach to RBI for relaxation of Band on a Case-to-case basis.

The meeting ended with the vote of thanks.

C.E.S.Azariah
Chief Executive Officer

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FIMCIR/2011-12/36

December 08, 2011

To,

All FIMMDA Members

Dear All,

G-Sec Trading on NDS-OM and OTC trades reported on PDO-NDS
Code of Conduct for usage of NDS-OM (equally applicable to OTC trades)
Price Bands for Daily trades

We invite your attention to the captioned Code of Conduct, and recent circulars drawing the attention of the members to the breaches occurring in the Price –Bands applicable for the day. Recently we had to get 6 trades in 8.30 %-2040, reversed by both counterparties, as they breached the price-band for the day.

To aid our members, FIMMDA is now publishing the Daily Price Bands for individual securities on the Home Page of our website www.fimmda.org, with the symbol showing a warning not to breach (overtake) the price band set. While all care is being taken by FIMMDA to set the band as per the Code, members may please calculate the band individually and alert us in case our calculations are incorrect.

If the Market-Makers feel that the price band set needs to be relaxed on account of unforeseen market events, they are requested to be immediately in touch with RBI IDMD or FMD through FIMMDA or PDAI or directly, to enable RBI to announce the relaxation of the band.

All members and users are requested to please take note.

With regards

Yours truly,

C.E.S.Azariah
Chief Executive Officer