

Asset Liability Management (ALM) System – amendments to ALM Guidelines

Ref.DBS.FID No. C.5 /01.02.00/ 2001-02

August 29, 2001

To

The CEOs of the All-India term Lending and Refinancing Institutions

Dear Sir,

Asset Liability Management (ALM) System – amendments to ALM Guidelines

Please refer to our Circular DBS.FID. No.C-11/01.02.00/1999-2000 dated 31 December 1999 prescribing the Guidelines for ALM System in the FIs. The Guidelines have been in operation for more than a year now and in the process of operationalising the Guidelines, certain issues have arisen which need to be addressed. With a view, therefore, to addressing these issues as also to refine the ALM Guidelines, it has been decided to amend the Guidelines, with immediate effect, to the extent indicated below.

2. Time-buckets for slotting of the off-balance sheet items

In order to clarify the treatment of the contingent cash flows emanating from the off-balance sheet items and to ensure their time-bucketing as per the timing of the underlying cash flows, it has been decided to amplify the treatment of some of these items for the purpose of compiling the liquidity and interest rate gap reports. Accordingly, the item C(f) of Appendix I and items A.7 and B.12(a) of Appendix II to the aforesaid Circular may please be substituted by the items as indicated in the **Annexure**.

3. Treatment of securities in the trading book for Interest Rate Sensitivity statement

Para 6.3 of the ALM Guidelines, *inter alia*, stipulates the criteria to be applied for keeping the securities in the 'trading book'. In this context, it has been represented to us that since the securities in the 'trading book' are already subject to a system of marking-to-market on weekly / daily basis, and the resultant revaluation gains / losses are reflected in the profit and loss account, the interest rate risk of the trading book stands adequately addressed. Hence, the inclusion of the trading book securities in various time-buckets for the purpose of preparing Interest Rate Sensitivity statement could lead to distortions. It has also been brought out that a ceiling on maximum maturity / duration of the trading portfolio could restrict the development of an active market in longer-duration securities which could adversely impact their liquidity. Moreover, subsequent to the issuance of the ALM Guidelines in December 1999, we have also issued the Guidelines for Classification and Valuation of Investment vide Circular DBS.FID. No. C-9 /01.02.00/2000-01 dated 9 November 2000 which, *inter alia*, also require classification of the investment portfolio of the FIs into three categories including the "Held for Trading" category.

Hence, there is also a need to harmonise the definitions of the “Trading Book” of ALM guidelines and the “Held for Trading” category of the investment portfolio.

4. However, reckoning that the FIs are still in a nascent stage of developing risk management systems and with a view to keeping the ALM system simple at the initial stages, it has been decided that the “trading book” may continue to be covered under the ALM system, till the ALM system stabilises and the FIs are able to migrate to more sophisticated techniques for management of interest rate risk, separately for the banking and the trading book. Meanwhile, however, the securities in the Trading Book may be slotted as per their residual maturity or repricing maturity for floating rate securities, as against the defeasance period prescribed at present. Accordingly, the item B.4(a) of Appendix II to the ALM Guidelines dated 31 December 1999 may please be substituted as indicated at serial number 3 of the **Annexure**.

5. Please acknowledge receipt.

Yours faithfully,

(K. C. Bandyopadhyay)
Chief General Manager

Encls.: As above

ANNEXURE

**Amendments to the Appendix I and II to the Circular
DBS.FID.No. C-11 dated 31 December 1999**

<u>S. No.</u>	<u>Existing Item</u>	<u>To be substituted by</u>	
		<u>Heads of Account</u>	<u>Time-bucket category</u>
1.	Appendix I : C. <u>Contingent cash flows</u> : Item no. (f) [Forward exchange contracts / rupee-foreign currency swaps, bills rediscounted, repos, FRAs, Interest Rate Swaps (inflows/ outflows)]	(f) Forward exchange contract (inflow / outflow)	As per the residual maturity of the contract
		(g) rupee-foreign currency swaps (forex swaps) (inflow / outflow)	
		(h) bills rediscounted (inflow)	As per the residual maturity of the underlying bills
		(i) Repos/ reverse repos (inflow / outflow)	As per the residual maturity of the underlying ready forward deal
		(j) Interest rate swaps (inflows/ outflows)	As per the residual period till each of the contractual cash flows under the IRS / FRAs / currency swaps. The cash flows relating to currency swaps may be shown in the liquidity statement of the respective currencies.
		(k) Forward rate agreements (inflows/ outflows)	
		(l) Currency swaps (financial swaps)	
	<u>Existing Item</u>	<u>Heads of Account</u>	<u>Time-bucket for rate sensitivity</u>
2.	Appendix II : A. <u>LIABILITIES</u> Item no. 7 [Repos / bills rediscounted / forex-rupee swaps (sell/buy) / interest rate swaps / FRAs]	7(a) Repos / Bills rediscounted / Forex-rupee swaps (sell / buy)	Sensitive; reprice on maturity. To be placed as per the residual maturity of the underlying ready forward deal / bills / forex contract, in the respective time-buckets.
		7(b) Interest rate swaps / Forward Rate Agreements / Currency swaps (financial swaps)	Sensitive on payment. The contractual cash outflows under the IRS / FRAs / currency swaps should be placed as per the residual period till each of the contractual cash flows. The cash flows relating to currency swaps may be shown in the IRS statement of the respective currencies.

3.	Appendix II: B. <u>Assets</u>: Item 4: <u>Investments</u> [(a) Securities in the Trading Book]	(a) Securities in the Trading Book	Sensitive on maturity / repricing or roll-over date. The Fis which maintain separate 'Trading Book' consisting of securities which comply with the stipulations of para 6.3 of the Guidelines and duly approved as such by the Board / ALCO, should be slotted as per their residual maturity (or repricing maturity in case of floating rate instruments).
4.	Appendix II: B. <u>Assets</u> : Item no. 12 (a) [Interest rate swaps / FRAs]	12(a) Interest rate swaps / Forward Rate Agreements / Currency swaps (financial swaps)	Sensitive on payment. The contractual cash inflows under the IRS / FRAs / currency swaps should be placed as per the residual period till each of the contractual cash flows. The cash flows relating to currency swaps may be shown in the IRS statement of the respective currencies.