Treasury & Risk Management - Guidelines

-Vinay Advani

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Treasury in Banks– Basics & Functions

- Balancing & managing daily cash flows and Liquidity of funds within the bank
- Maintaining risk limits within the accepted level
- Maximizing returns for the organization
- Monitoring the asset liability gaps
- Ensuring good relationship with internal / external stakeholders
- Ensuring funding at minimum rates (from the best alternatives)

Segregation of Treasury in Banks

- Front Office (FO) – Dealing & Investment – Risk Taking
- Middle Office (MO) – Risk Management and Management Information
- Back Office (BO) – Deals with Confirmations, Settlements, Accounting & Reconciliations

Internal Control Guidelines (ICG)

- Organization of Department –Segregation of Duties (SOD), Selection & Training of Dealers, Separate Access rights to dealers, Duties of the dealers, Voice recording, Code of Conduct, Rate Scan
- Dealings through Brokers
- Risk Control & Risk Management
- Evaluation of Foreign Exchange Profit & Loss
- Nostro Reconciliation
- Off – Premises Dealing
- Auditing

Hedging for Corporate Counter-parties

- Forwards
- Options – Plain Vanilla & Structured Derivative
- Swaps – Interest rate and currency swaps

Currency Options

- A derivative contract where the buyer of the option has the right but not the obligation to either purchase (call option) or sell (put option) an agreed amount of specified currency at price agreed in advance and denominated in another currency (strike price) on a specified date (European Option)

Call Spread – Option Structure (For Importer)

- Buying a call option and simultaneously selling a comparatively deep out of the money put option

- Example - If the current spot price for USD / INR is 65, then buying a USD call option at 66 and selling a call at 68

Import Seagull – Option Structure

- It involves selling an OTM put option in a call spread
- Example – If the current spot price for USD / INR is 65, then buying a USD call option at 66 and selling a all at 68 **and also selling a put at 64**
- Other strategies may include Straddle, Strangles, etc.

Operational Guidelines for Contracted Exposures

- Valid underlying to be submitted with AD-I banks within 15 days
- If valid underlying is not submitted within time, loss (if any) should be recovered from the user
- Maturity of the hedge should not exceed the maturity of underlying
- Risk Management Policy (RMP) declaration from the Company should be obtained (covering all the parameters required for dealing in structured products, if applicable)
- If it is a natural hedge then same should be allowed as per RMP
- Board Resolution (for derivative contracts apart from forwards but including Long term forward contracts) as required by Comprehensive Guidelines and Risk Management & inter–bank dealings

Continued…

- Earlier, users were not allowed to write options on standalone basis. However, with effect from June 23, 2016 users are permitted to write options and that should be considered as structured derivative and accordingly guidelines shall be made applicable
- Deferment of option premium
- Cost Reductions Structures

Process for offering product

- Client approaching the bank
- Multiple discussion with the senior officials
- Signing of the ISDA (if applicable)
- Conducting pre-checks
- Concluding derivative deal
- Sending confirmation/term sheet
- Receiving the premium
- Continuous limit monitoring and making MTM calls
- At expiry, option gets settled by gross/net basis

Risks in a Bank

- Credit Risk – Settlement and pre-settlement risk
- Market Risk – Exchange Risk, interest rate risk, liquidity risk, asset liability mismatch
- Operational Risk – Legal risk, fraud risk

Mitigating Risks

- Counter Party Limit – Fund and non-fund based exposures
- Country Limit
- Net Open Position limit
- Deal size limit
- Day Light limit
- Night Desk Limit
- Stop Loss Limit
- Value at Risk (VAR)

Continued…

- Stress Testing
- Back Testing
- Gap Limit (AGL & IGL)
- Providing regular training to employees
- Maker checker concept
- Automated systems
- Voice recording
- Exchange of confirmation
- Dealing Authority

Capital Adequacy Requirements

- To improve banking sector’s ability to absorb shocks
- Capital to Risk Weighted Assets Ratio (CRAR) = Eligible total capital / Credit risk RWA + Market risk RWA + Operational risk RWA
- Minimum requirement of 9%

Money Market – Call, Notice and Term Money

- Market for short term financial assets that are close substitutes of money
- Maximum borrowing limit is capped at 125% of Tier I and Tier II capital
- Maximum lending limit should not exceed 50% of the capital funds
- Timings for Call / Notice / Term money is 9:00 am to 5:00 pm
- Products can be traded on NDS-Call
- OTC trade to be reported on NSD - Call

Commercial Paper

- Unsecured money market instrument issued in a form of promissory note
- Can be issued by the company / PDs / FIs subject to fulfilment of certain conditions with respect to tangible net worth, classification of asset
- Issued in denomination of INR 5 lakhs
- It is issued at a discounted face value
- Minimum tenure to be 7 days
- Must appoint IPA (Issue & Paying Agent)
- Settlement shall either be on T+0 or T+1

Certificate of Deposits

- Unsecured instrument
- Issued by the banks or select FIs as permitted by RBI
- Minimum amount shall not be less than one lakh
- Maturity of the CD ranges between 7 days to one year
- To be reported on FTRAC

Questions please…

Thank You ☺