

MONOGRAPH ON INTERNAL AUDIT OF TREASURY FUNCTIONS OF COMMERCIAL BANK



July, 2016

PROFESSIONAL DEVELOPMENT COMMITTEE

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
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Any mistake, error or discrepancy noticed may be informed to Director (Professional Development), The Institute of Cost Accountants of India, CMA Bhawan, 3, Institutional Area, Lodhi Road, New Delhi-110003, which will be taken care of in the next edition.

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FROM PRESIDENT

The evaluation of processes and operations associated with treasury required a deep understanding of the treasury function. The focus of treasury internal audit has traditionally been pivoted on the evaluation of operational controls and financial reporting risks. However, the other aspects of treasury management have also surfaced with the evolution of treasury function.

In order to help the internal auditors for a better understanding of Treasury functions before actually taking up the assignment of its Internal Audit, a birds' eye view on different aspects of treasury functions was found to be necessary.

I am happy to note that the Professional Development Committee has brought out the Monograph on Internal Audit of Treasury Functions of Commercial Bank. This Monograph has been an endeavour of the Institute to reach to the various regulators about the Institute prowess in developing such publications to aid both members and bank Officials at large on matters pertaining to Internal Audit of treasury.

I am thankful to CMA Vijender Sharma, Chairman- Professional Development (PD) Committee, other members of the PD Committee and also the PD Department for their contributions in bringing out "Monograph on Internal Audit of Treasury Functions of Commercial Bank" in the present form.

(CMA PRAMOD KUMAR BHATTAD)

15 July, 2016
New Delhi

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PREFACE

Treasury function of the Bank was traditionally limited in managing funds optimally and profitably as well as maintenance of Cash Reserve Ratio and Statutory Liquidity Ratio. The ambit of Treasury activities has since been extended due to deregulation of market inter alia. Now, Treasury has been evolved as a profit centre with its trading and investment activities and scope of treasury function of a bank is centered round the management of certain assets and liabilities in the bank balance sheet.

This Monograph is an honest attempt to provide the regulators and other stakeholders about the ambit of Internal Audit of treasury. It also guides extensively on Organisation Chart and Structure of Treasury, Treasury Dealing Room specially Internal control Guidelines regarding Dealers and Dealing Room Organisation by RBI, Domestic Treasury - Maintenance of Investment Portfolios, Treasury Risks & Mid Office and Risk Based Internal Audit on Treasury.

I would like to acknowledge the sincere efforts of technical team of Professional Development Department of the Institute for preparing this Monograph. My sincere thanks to all members of the Professional Development Committee for their highly valuable contribution in finalization of this Guidance Note.

I would like to convey my special thanks to CMA P. V. Bhattad, President and CMA Manas Kumar Thakur, Vice President of the Institute for providing guidance and able leadership in the affairs connected with the PD Committee.

I am quite hopeful that this Monograph will be of great use to all the Members of CMA profession, be in practice or in employment, and also to the industry in internal audit of treasury functions.

15 July, 2016
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Chapter 1: Treasury – an Introduction

1. Treasury - an Introduction

The role of the internal audit function has evolved from being a value preserver to a value enhancer in the business context. The landscape of treasury operations and expectations from an internal audit function is changing. Hence, the manner in which treasury processes and operations are evaluated requires a deep understanding of the treasury function.

The focus of treasury internal audit has traditionally been pivoted on the evaluation of operational controls and financial reporting risks. However, the evolution of the treasury function has brought other aspects of treasury management on the surface.

In order to help the budding internal auditors for a better understanding of Treasury functions before actually taking up the assignment of its Internal Audit, a birds' eye view on different aspects of treasury functions is found to be necessary.

1.1 Treasury - its meaning

The word 'Treasury' is closely associated with 'Treasure' and broadly used to mean a place where treasure is kept. More analytically, it was used to mean a place where private or public funds are received, kept, managed and disbursed.

The term 'Treasury' with its basic underlying sense remaining intact has been used differently in different organizations. The 'Treasury' in government parlance is meant as a department of a government in charge of the collection, management and expenditure of public revenue. In case of a manufacturing company treasury function is equated with management of working capital or short term funds. However, now-a-days, goals of treasury management departments of big companies have far been widened. It is required to optimize the liquidity of the companies, make sound financial investment for the future with excess cash and reduce or enter into hedges against its financial risk.

1.2 Treasury in Banks:

Traditionally, Treasury function was limited in managing funds of the Bank optimally and profitably as well as maintenance of CRR and SLR. The periphery of Treasury activities has since been extended due to deregulation of market and host of other factors. Now, Treasury has been evolved as a profit centre with its trading and investment activities. Now, scope of treasury function of a bank is centered round the management of certain assets and liabilities in the bank balance sheet as depicted below.

Asset Side:

- Management of cash and currencies



- Management of cash in demand and term deposits with other banks
- Management of cash in current account with the RBI
- Lending of money in call/notice/repo/CBLO/term and other segments of the money market
- Management of Investment portfolio

Liability Side:

- Management of borrowings in call/notice/Repo/term and other segments of the money market
- Management of Refinance from SIDBI, NABARD, NHB etc.

Besides the above, treasury plays a very important role in implementation of asset liability system in the bank. Head of Treasury Department is a very important member of Asset Liability Committee. In many cases Treasury also offers portfolio management services, risk management services to the corporate clients in managing their interest, foreign exchange and liquidity risk. Thus dimension of treasury function of a bank has been extended to a great extent from its traditional function of managing reserve requirement to complete balance sheet management including complete off balance sheet products like derivatives.

1.3 Objectives of Treasury Management :

- **Cash Management:**

Treasury is required to plan and organize cash and fund management in such a way that there remains no idle cash as also any deficit of funds. In other words it is expected to deploy Bank's scarce resources optimally as well as profitably.

- **Investment Portfolio Management:**

Now-a-days, Investment portfolio of Banks has increased proportionately with the growth of Business. One of the important objectives of Treasury is to maintain this Investment portfolio in a sound, liquid and healthy manner.

- **Profit Maximization:**

- To ensure that a trading culture is developed with regard to interest rate, foreign exchange, money market, debt market and capital market operations.
- To develop expertise in trading of exchange traded and OTC derivative instruments across domestic and foreign exchange markets and other treasury products as and when introduced.
- To develop the treasury as an important "Profit Centre".



- **Risk Management:**
 - The document aims at evolving a clearly defined risk management system across all the parameters of Treasury operations.
 - To ensure that the decision taken by and large meet Asset Liability Managements requirements.
- **Compliance:**
 - Compliance of all regulatory requirements including Reserve requirements and prudential Norms for classification, valuation and operation of Investment Portfolio by Banks.

1.4 Understanding of the market

Treasury operations are closely connected with the following markets. So a first- hand knowledge regarding modus operandi of these markets are essential.

- Money market and different money market instruments
- Primary and Secondary market of Government securities as well as corporate debt securities
- Repo Market
- Capital Market including Equity market
- Forex Market
- Derivative Market

1.5 Main functions of Treasury Department/Branch

- Fund Management through borrowing and lending of funds in Repo, CBLO, Call, Notice, and Forex markets.
- Trading in securities market.
- Management of Investment Portfolio containing fixed income and variable income securities
- Use of derivatives or hedging in managing different risks emanated from treasury operations.
- Maintenance of CRR and SLR.

1.6 Infrastructure/Supports normally required for Treasury operations:

- Technology (Suitable software Package used in treasury operation)



- Equipments (required hardware for IT support, NDS terminal for recording voices of dealers in dealing room, other trading terminals)
- Communication Lines (hotlines with selected brokers, internet facility, mobile phone to dealers and other provisions for any other means of communications.)
- Information Source: Data Bank, Reuters Screen or Bloomberg or Dow Jones, or other reliable platforms for market information.
- Disaster management and Data Recovery System.

1.7 Integrated Treasury

In earlier times domestic treasury was independent of forex treasury. This concept underwent a complete change due to a number of factors as stated below.

- There has been a voluminous growth in international trade and finance in recent years.
- Reforms in Indian economy have helped it to be connected with the global economy more closely and there has been integration of domestic and international markets.
- Various financial markets in Indian economy like forex, money and securities market have been deregulated; have acquired depthness and liquidity due to advancement in systems, introduction of varied instruments and participation of new entities. Emergence of this new set up has caused them to be integrated with each other.
- Since Treasury basically deals with these markets --their interdependence and reciprocity forced Treasury to be integrated to reap more benefits.

1.8 Features of Integrated Treasury:

- Under Integrated Treasury, there remains a combined dealing room. Forex treasury dealing room is merged with domestic treasury dealing room.
- This combined dealing room is guided by the uniform policy and same technology and accounting platform.
- All existing and diverse trading and arbitrage activities are brought under single supervision and common pool of funding.
- Opened up opportunities for maximization of profit.
- Increased the ambit and intensity of risks substantially.
- Helps the bank to structure their multi-currency balance sheets to manage all market risk associated with bank liabilities and assets and to take advantage of strategic positioning in the markets.
- Integrated Treasury is considered to be one of the main profit centres of the bank.



1.9 Benefits of Integrated Treasury

- **Optimisation of cost of funding:** In earlier days banks were required to raise funds from domestic market irrespective of prevailing cost. With the deregulation of interest rates in domestic market and also due to globalization, banks, now, have an access to low cost of funds both in domestic as well as in overseas markets. Integrated treasury helps banks garner lower cost funds from either of the market and helps in earning profit. Further to meet short term liquidity crunch, banks can now have access to both overseas market and local market to raise financial resources in different combination of currencies and maturities so that an optimal liquidity management can be ensured and overall funding cost may also be substantially lowered.
- **Optimisation on return on investments:** Treasury is now treated as profit centre. Treasury maintains its investment securities in trading and banking book. The banking book for securities is held for interest income and statutory obligations and is held till maturity. On the other hand trading assets are held for trading profit on short term differences in yield. Integrated treasury helps bank to grab arbitrage opportunities and to deploy that fund in the market to optimize return on investment.
- **Augmentation of fee based income:** Integrated Treasury helps to augment fee-based income of the bank by offering risk management products i.e., derivatives and services to large corporate clients.
- **Combating onslaught of expanding risk:** Globalisation and deregulation in different financial markets have unfurled a wide vista of risks for the banks who participate in these markets and to combat the onslaught of these expanding risks, banks are required to put up an integrated risk management system. Integrated Treasury plays a vital role in facilitating this integrated risk management.

1.10 Policy Documents

- Investment Policy of Treasury that sets out objectives, selection of securities, trading strategies, methods and systems, laid down limits, discretionary powers of investment in different levels of management and other parameters regarding domestic as well as forex operations.
- Manuals of dealers in domestic as well as in foreign exchange markets
- Work flow manuals detailing description of the operations in integrated treasury
- Other documents that Treasury may prepare in conformity with RBI guidelines, FIMMDA's guideline

1.11 System and Procedures

- Reconciliation



- Risk limit sanctions monitoring, control and review
- Trade discipline monitoring (to comply with the guidelines of RBI, FIMMDA & FEDAI etc.)
- System of Investment in Primary market including the required processing note regarding thereto.
- Different approval notes that are placed to the appropriate authorities for their respective approval where laid down limit in investment of different securities as mentioned in Investment Policy have exceeded.
- Weekly and monthly Transaction notes, quarterly broker notes, quarterly non-SLR securities statements, Half yearly review statements and other notes that Treasury are required to regularly submit to the top management/Board that depict different aspects of Treasury.
- Concurrent audit of transactions in securities, review process and the monthly Board Note in this respect.
- System of Broker empanelment and relevant Board Note.
- Note to the top management regarding shifting of securities as per guidelines in Investment Policy.
- The process of valuation of securities and system of making marked to market and provisioning for depreciation in case of AFS and HFT portfolio.
- The system of Investment in Mutual Fund and policy norms set out in Investment Policy regarding thereof.
- System of trading in unquoted shares.

1.12 Performance Measurement

- Profit Budgets
- Expected return (yield) on investment portfolio
- Expected dividend on invested shares
- Expected trading profits
- System of transfer pricing
- Reduction of loss in case of adverse market condition
- NPI-its management.

Chapter 2: Treasury - Different Financial Market and Financial Instruments

A. MONEY MARKET

2.1 A lot of activities that Treasury of a bank performs are associated with money market. Money market is essentially short term market ranging between overnight to one year. Treasury participation in money market may be as follows:

- Daily fund management through CALL/ CBLO/Notice/Term/Repo/Reverse Repo
- Maintenance of SLR and CRR
- Trading on Treasury bills
- Issuing and trading on Certificate of Deposits
- Availing Arbitrage opportunities
- Subscribing to the commercial papers.

2.2 Money Market Instruments:

a) Treasury Bill :

- Treasury Bills are short term debt instrument issued by the Government of India and are presently issued in three tenors, namely- 91 day, 182 day and 364 day.
- Treasury Bills are issued at a discount and redeemed at the face value at maturity.
- The RBI conducts Auctions usually every Wednesday to issue T-Bills. Payments for the T-Bills purchased are on the following Friday.
- RBI releases an Annual calendar of T-Bills issuances for a financial year in the last week of March of the previous financial year. It announces issue details of T-Bill through a press release every week.
- Bank Treasury actively participates in Treasury market – both primary and secondary. T-Bills have an active secondary market.

b) Certificate of Deposits :

- Certificate of Deposits are money market instruments in the nature of usance promissory notes.
- Banks issue this Certificate of Deposit for specified period against funds deposited with it. C.D. is unsecured, negotiable and are to be rated.



- Banks can issue CDs as per its requirement of funds.
- All scheduled banks (except RRBs and Co-operative banks) are eligible to issue CDs.
- CDs can be issued to individuals, corporations, trusts, funds and associations.
- The maturity period of CDs issued by Banks should not be less than 7 days and not more than one year from the date of issue.
- CDs can be used in D-mat form or in physical form.
- CDs issued in physical form are freely transferable by endorsement and delivery. Procedure of transfer of dematted CDS is similar to that of any other demat securities.
- Banks/FIs should issue CDs only in dematerialized form. However as per Depositories Act, 1996 investors have the option to seek certificate in physical form. Accordingly, if an investor insists on physical certificate, the Bank/FIs may inform the Chief General Manager, Financial Markets Regulation Department, Reserve Bank of India, Central Office, Mumbai about such instances separately.
- Issuance of CDs will attract stamp duty.
- CDs can be issued in denomination of Rs. one lakh or in multiple thereof.

c) Commercial Paper:

- It is an unsecured money market instrument issued in the form of a promissory note.
- Corporate, Primary dealers and all India financial institutions are eligible to issue C.P.
- C.Ps should be credit rated by CRISIL, ICRA, CARE or the FITCH ratings. The minimum credit rating shall be A2.
- It is issued at a discount to face value.
- It is issued as per RBI guidelines.
- Banks are prohibited to issue or underwrite C.Ps but can subscribe to C.Ps through its Treasury.
- C.Ps should be issued minimum 7 days and maximum up to one year from the date of issue. Maturity date of C.P should not, however, go beyond the date up to which the credit rating of the issuer is valid.
- C.P. can be issued in denominations of Rs. 5 lakh or multiples.

d) Liquidity Adjustment Facility :

Liquidity adjustment facility (LAF) is a monetary policy tool which enables banks to borrow money under repurchase agreements to smoothen short term liquidity



distortions. LAF is used to aid banks in adjusting the day to day mismatches in liquidity. LAF consists of repo and reverse repo operations.

As per recommendations of the Internal Group on Liquidity Adjustment Facility and suggestions from the market participants and experts, RBI revised the LAF Scheme which came into effect from March 29, 2004.

All Scheduled Commercial Banks (excluding Regional Rural Banks) and Primary Dealers (PDs) having Current Account and SGL Account with Reserve Bank, Mumbai will be eligible to participate in the Repo and Reverse Repo auctions.

Under the scheme, (i) Repo auctions (for absorption of liquidity) and (ii) Reverse Repo auctions (for injection of liquidity) will be conducted on a daily basis (Monday to Friday, excepting holidays).

Repos and Reverse Repos are undertaken in all SLR-eligible transferable Government of India dated Securities/Treasury Bills.

Under the revised Scheme, Reserve Bank will continue to have the discretion to conduct overnight repo or longer term repo auctions at fixed rate or at variable rates depending on market conditions and other relevant factors.

Since it issued as a monetary tool, RBI considering the economic conditions of the country tighten or loosen the norms of borrowing/lending from Repo and Reverse Repo. Since Treasury of a Bank is in charge of optimal cash management of a Bank, availing the facility of LAF is one of the vital activities of Treasury.

e) Repo in Corporate Bond:

The RBI vide its direction dated 8th January, 2010 introduced with effect from 1st March, 2010 Repo in Corporate Bond securities. Only listed corporate debt securities which are rated 'AA' or above by the rating agencies, that are held in the security account of the repo seller, in demat form, shall be eligible provided that commercial papers, certificate of deposits and other instruments including Non-convertible debentures of less than one year of original maturity, shall be eligible securities for undertaking repo.

Any scheduled commercial bank excluding RRBs and LABs, Any Primary Dealer authorized by the RBI, Any NBFC registered with RBI (other than Govt. company as defined in Sec. 617 of the Companies Act, 1956); All-India Financial Institutions, namely, Exim Bank, NABARD, NHB and SIDBI; other regulated entities like mutual fund, housing finance companies, insurance companies subject to the approval of the regulators concerned, any other entity specifically permitted by the RBI are permitted to participate in this market. Repos in corporate debt securities shall be for a minimum period of one day and a maximum period of one year.



Participants shall enter into repo transactions in corporate debt securities in the OTC market. All repo trades shall be reported within 15 minutes of the trade on the FIMMDA reporting platform and also to any of the clearing houses of the exchanges for clearing and settlement.

All repo trade in corporate debt securities shall settle either on a T+1 or T+2 basis under DVP (gross basis) framework.

Repo transactions in corporate bond securities shall settle in the same manner as outright OTC trades in corporate debt securities.

On the date of reversal of repo trades, the clearing houses shall compute the obligation of the parties and facilitate settlement on DVP basis.

A haircut of prescribed percentage (rating haircut matrix published by FIMMDA may be followed) shall be applicable on the market value of the corporate debt security prevailing on the date of trade of 1st leg.

The security acquired under repo shall not be sold by the repo buyer (lender of the funds) during the period of repo.

f) Collateralized Borrowing and Lending Obligations (CBLO):

It is another RBI approved money market instrument backed by Gilts as collaterals to even out short term fluctuations in money. The lender of money having short term surplus funds can lend it out through CBLO to insurance companies, mutual funds, financial institutions, banks and primary dealers.

CBLO involves collaterals. Interested parties are required to open Constituent SGL (CSGL) Account with Clearing Corporation of India Limited (CCIL) for depositing securities as collateral. CBLO is traded on screen and anonymity of both borrowers and lenders are maintained.

CCIL is the counterparty of all transactions in CBLO. It creates an obligation to repay the borrowed money along with interest on a fixed date. Also it provides a right to the lender to receive money lent with interest on a fixed future date.

g) Call/Notice Money:

The call/notice money market forms an important segment of the Indian Money Market. Under call money market, funds are transacted on an overnight basis and under notice money market; funds are transacted for a period between 2 days and 14 days.

Participants in call/notice money market currently include scheduled commercial banks (excluding RRBs), co-operative banks (other than Land Development Banks) and Primary Dealers (PDs), both as borrowers and lenders.



The prudential limits in respect of both outstanding borrowing and lending transactions in call/notice money market for scheduled commercial banks, co-operative banks and PDs are as follows:-

On a fortnightly average basis, borrowing outstanding should not exceed 100 per cent of capital funds (i.e., sum of Tier I and Tier II capital) of latest audited balance sheet. However, banks are allowed to borrow a maximum of 125 per cent of their capital funds on any day, during a fortnight. On a fortnightly average basis, lending outstanding should not exceed 25 per cent of their capital funds. However, banks are allowed to lend a maximum of 50 per cent of their capital funds on any day, during a fortnight.

Eligible participants are free to decide on interest rates in call/notice money market. Calculation of interest payable would be based on the methodology given in the Handbook of Market Practices brought out by the Fixed Income Money Market and Derivatives Association of India (FIMMDA). Deals in the Call/Notice/Term money market can be done from 9:00 am to 5:00 pm on weekdays and from 9:00 am to 2:00 pm on Saturdays or as specified by RBI from time to time.

h) Inter Bank Participation Certificate:

Inter-Bank Participations is an additional instrument in money market for evening out short term liquidity within the banking system. A bank in need of short term funds can issue participation certificate and can allow another bank to participate in its credit portfolio either with risk or without risk.

There will be two types of Participations:

- i) Inter-Bank Participations with Risk Sharing; and**
- ii) Inter-Bank Participations without Risk Sharing.**

The Participations would be strictly interbank confined to scheduled commercial banks and RRBs.

i) Inter Bank Participation with Risk Sharing:

The IBP with risk sharing can be issued for 91-180 days and only in respect of advances classified under Health Code No. 1 Status. Under the uniform grading system introduced by Reserve Bank for application by banks to measure the health of bank advances portfolio, a borrower account considered satisfactory or assigned Health Code No. 1 is the one in which the conduct of account is satisfactory, the safety of advance is not in doubt, all the terms and conditions are complied with, and all the accounts of the borrower are in order. The IBP risk sharing provides flexibility in the credit portfolio of banks. The aggregate amount of such IBPs under any loan account at the time of issue is not to exceed 40 per cent of the outstanding in the account.



In the case of the issuing bank, the aggregate amount of Participations would be reduced from the aggregate advances outstanding. Such transactions will not be reflected in the individual borrower's accounts but will be only netted out in the General Ledger. The participating bank would show the aggregate amount of such Participations as part of its advances. The issuing bank will maintain a register to record full particulars of such Participations.

ii) Inter Bank Participation without Risk sharing:

The IBP without risk sharing is a money market instrument with a tenure not exceeding 90 days and the interest rate on such IBPs is left to be determined by the two concerned banks without any ceiling on interest rate.

The issuing bank will show the amount of Participations as borrowing while the participating bank will show the same under Advances to bank i.e. due from banks. The Participations would be treated as part of the net Demand and Time Liabilities and net bank balances for purposes of statutory reserve requirements.

i) Money market Mutual Fund:

The detailed scheme was announced in April 1992. The purpose of this scheme is to provide additional short term avenues to investors and to reach money market instruments within the reach of individual investors. It is regulated by SEBI but RBI clearance is required before registration by SEBI. The fund is permitted to invest in rated corporate bonds and debentures with residual maturity up to one year.

B. CAPITAL MARKET

2.3 A bank can invest in capital market where for long term purpose, usually for more than a year. It can invest in equity shares, debentures, bonds and mutual funds where it would fetch a return on investments. The risk factors involved are credit and market risk. Treasury of Banks deal in the following components of capital market.

Components of Capital Market:

- **Indian Debt Market: deals in bonds, debentures etc.**
- **Indian Share Market: deals in shares and stocks.**

2.4 Indian Debt Market

Indian debt market is comprised of Government debt securities market and corporate debt securities market. The Government debt securities market is the most dominant segment of the Indian debt market. So far as primary debt market is concerned, the corporate debt market is almost 31 percent of the combined debt market in India. However, the secondary



market for non-government debt securities is less than 1 percent indicating the market is almost illiquid.

2.4.1 Government Debt Securities Market

There have been significant changes in the Government securities market during the past decade. Introduction of an electronic screen based trading system, dematerialized holding, straight through processing, establishment of the Clearing Corporation of India (CCIL) as the central counterparty for guaranteed settlement, new instruments and changes in the legal environment are some of the major aspects that have contributed to the rapid development of the market.

Government Securities:

A government security is a tradable instrument issued by the Central Government or the State Government which acknowledges the Government debt obligation.

Such securities may be short term (original maturities of less than one year) like Treasury Bills or long term (original maturity is one year or more) like Government bonds or dated securities.

In India, Central Government issues Treasury Bills and dated securities whereas State Government issues only dated securities known as State Development Loan (SDL).

Dated Government Securities:

Dated government securities are long term securities and carry a fixed or floating coupon which is paid on the face value payable at fixed time periods usually half yearly. The tenor of dated securities can be up to 30 years.

The Public Debt Office of the Reserve Bank of India acts as the registry/depository of Government securities and deals with the issue.

Just like T-bills, dated securities of Central Government and State Government are issued by RBI through auctions.

Bonds / Securities that are issued may be of various types- a) Fixed Rate Bonds b) Floating Rate Bonds c) Zero coupon Bonds d) Capital Indexed Bond e) Bonds with call/put options f) Special securities

STRIPS:

Strips are instruments where each cash flow of the fixed coupon security is converted into a separate tradable zero coupon bond and traded. Each cash flow of coupon will become coupon Strip and the principal payment will become a principal strip. These cash flows are traded separately as independent securities in the secondary market. Minimum amount of securities that needs to be submitted for stripping /reconstitution will be Rs. 1 crore and multiple thereof.



SDL:

These are dated securities issued by State Governments through auction similar with that of Central Government dated securities. Interest is serviced at half yearly intervals and the principal is repaid at maturity debts.

2.4.1 Secondary Markets- Govt. securities

2.4.1.1 NDS-OM for trading in securities:

Trading in secondary market of Government securities take place between markets participants like banks, PDs, MFs having SGL accounts with the RBI. Deals in trading may be negotiated directly by participants themselves or negotiated through brokers. The RBI has introduced Negotiated Dealing System (NDS) and accordingly the members of NDS have been provided connectivity. NDS is an electronic platform for facilitating deals in Government securities and other money market instruments. If the members of NDS executes a deal outside NDS system i.e., through a broker or over telephone, they are required to report that deal on NDS within 15 minutes of concluding such deals. Thus NDS is also used as a reporting platform for the transactions in Government securities in the secondary market.

NDS-OM (Negotiated Dealing System-Order Matching) was introduced in August, 2005 with an idea of providing NDS members with a more efficient trading platform.

The system of NDS – OM has helped to bring efficient price discovery, reduce bid-ask spread and intraday price volatility. Once a trade is done or reported on NDS, it gets settled through Clearing Corporation of India (CCIL) and subsequently through NDS gets reflected in SGL and current account with the RBI. The settlement of trade is done as per Delivery Versus Payment mechanism.

As per the RBI's guidelines, banks are required to keep their additional investment in government securities over and above their prescribed SLR requirement in the form of Held for Trading (HFT) and /or Available for Sale (AF) category. Such securities are identified for sale in the secondary market. As such, by and large all the commercial banks have been active participants in the secondary market. Their objective is to earn sizeable trading profit in Government securities in the secondary market. Trading in government securities is supposed to be the most predominant activity of the domestic treasury of a commercial bank.

2.5 Corporate Debt Market

2.5.1 Issuers of Corporate Debt Securities:

a) Bonds issued by public sector undertakings (PSUs)

Since 1985-86 several central as well as state level private sector undertakings have



issued in the market a number of taxable as well as tax-free bonds to raise funds. These bonds are subscribed by banks, insurance companies, mutual funds and other institutions as well as retail investors.

b) Bonds issued by financial institutions (FIs)

Financial institutions that cannot accept deposits from the public like banks raise fund from the market through issuance of bonds. Institutions like SIDBI, NABARD, IFCI etc. issue in the market various types of bonds like capital gain bonds, deep discount bonds, floating rate bonds etc. Apart from financial institutions, banks also raise funds through issue of subordinated debt to maintain Capital Risk Asset Ratio (CRAR) as per prudential norm prescribed by the RBI.

c) Corporate Debentures

Private corporate enterprises issue debentures to raise long term funds. These debentures may be of various types such as convertible debentures, debentures with put and call options, floating rate debentures etc. A large portion of such debt instruments are issued through private placement to institutional investors such as banks, mutual funds etc. These debt instruments are also issued through public offer to retail investors.

2.5.2 Primary Market of Corporate Debt Securities: Private Placement and public Issue.

Corporate can issue debt instruments through private placement or through public issue. Over the last few years, companies have shown distinct preferences for private placements over public issue because of a number of factors like cost of issue, disclosure norms etc.

The companies are, also, permitted by the SEBI to issue debt securities through public issue. In this case, issuer is required to undergo and comply the relevant rules, regulations and norms prescribed by SEBI.

As an investment opportunity, Bank treasury can purchase these non-governmental debt securities in the primary market though detailed processing note under the prescribed guidelines of its investment policy which should be duly sanctioned by the appropriate prescribed authority.

2.5.3 Secondary Market of Corporate debt securities:

Transactions regarding purchase/sale of any type of non-SLR bonds in the secondary market by banks are settled through C-BRICS. C-BRICS is a web-based browser controlled by NSE. After concluding the trade, seller is needed to report the deal in the system and the buyer has to accept the deal. After accepting the trade, the deal is ready for settlement. The buyer is required to send the settlement value to the designated account in NSE whereas the seller needs to transfer the stock to NSE. If settlement value and stocks are received



by NSE in DVP mode, stocks are transferred to buyer's DP account and amount credited to seller's account.

2.5.4 Dealing in Equity Shares in secondary market:

Listed Shares:

On the basis of market feedback and recommendation given by the dealers, the trading committee analyses the market trend and take investment decisions which are communicated to the equity dealers. Equity Desk of every Bank is having Market Viewing Screen to watch the movement of price of stock prices. Dealers of Equity Desk then undertake to execute 'Buy' and 'Sell' transaction in accordance with the decision taken by the trading committee.

Equity Dealers are required to execute the deals through those empanelled brokers over recorded telephone lines. Dealers have also to monitor that no broker should get more than 5% of business in a financial year.

Once the deal has been executed on the exchange (i.e. BSE and NSE etc. as per policy of the respective bank) the dealers should obtain confirmation from the brokers as well as the confirmation note. Then the deal has to be recorded in the Software used by the respective bank to generate the deal tickets. Broker also sends the confirmation to the custodian of the Bank.

- Once the deal ticket generated the deal ticket along with the confirmation note should be sent to the Back office for checking all the details of the deals and sending online confirmation to the Custodian of the bank. The said officer should also settle the deal through the software.
- After receiving the confirmation from Bank, custodian match the deal with the confirmation received from the brokers and settle the deals as per settlement date and obtain the 'pay in' and 'pay out' obligation.
- Equity Dealers then obtain the approval of the executed deals from the appropriate authority as per delegated discretionary power prescribed In the Investment Policy.
- Equity dealers then update the portfolio position as maintained by them to observe the daily price movement of listed shares.
- On the settlement date, the back office reconcile the 'pay in' and 'pay out' obligation as sent by the custodian.

Unlisted shares

- Banks usually invest in unlisted shares as a part of its strategic investment for which proper processing note and required due diligence keeping in view the prescribed guidelines of Investment Policy are required to be made.



- This note is normally initiated by the Equity Research analyst in Back Office for taking due approval from the appropriate authority as prescribed in Investment policy.

2.5.5 Dealing in Equity Shares in Primary Market:

Banks also invest Initial Public Offering (IPO) and Follow on Public Offering (FPO) of the company. Equity Research analysts of the Bank undertake the required due diligence and prepare and process the note in the light of the relevant provisions of Investment Policy to take approval from the appropriate authority prescribed by the Investment Policy.

Once the note gets approved and investment decision is made, bank will invest the money as per the relevant method of payment /subscribing to the shares. Thereafter, proper deal has to be put into the system to record the investment after allotment.

- For IPO, the shares must be listed in the exchange after a stipulated time. The valuations of these shares are to be done as they are quoted in the bourses.
- For FPO, the shares are already listed in the bourses. Once allotment of the shares has been done valuation of these shares are to be made as per their quotation in the bourses.
- The company also announces the corporate action like bonus issue, issue of right shares, dividend payment, demerger of company, split of face value etc.
- The dealers have to keep a keen watch on the corporate actions of the company and put the deals into the system to keep record and update the equity portfolio accordingly to record the changes.

C. FOREX MARKET

2.6 The forex market is a market in which individuals, business firms and banks purchase and sell foreign currency. Here, market does not refer to any centralized meeting place but to a communication system through which participants remain in continuous contact with one another.

Banks are the most active players in the forex market. They are the conduits for all other market participants and deal in the market on behalf of their retail clients and also on their own account. Banks also trade in forex markets. As commercial banks play actively in forex market, they are able to offer competitive rates to customers, better manage the risks arising from exchange rate fluctuations, generate profits and achieve efficient management of integrated treasury.

Other Participants in Forex Market: Apart from Bank, the other participants in forex market are:

Retail clients: Individuals and organizations related with export or import of goods and services and other foreign trade transactions require conversion of currencies for meeting



their international obligations. Retail Market also includes the market wherein travellers and tourists exchange one currency to another in the form of currency notes or travellers' Cheques.

Central Bank : Central Bank, often take part in buying or selling of foreign currency in order to maintain the price of a given currency, usually the domestic currency, against another currency.

Brokers: The role of foreign currency broker is to act as middleman between two market makers. They may provide information about prices at which there are firm buyers and sellers in a pair of currencies. A bank may advise a broker to buy or sell a specific amount of currency X against currency Y at a specific price or within a price limit. The broker usually searches for an appropriate counterparty, another bank, and collects a commission on the conclusion of the deal. Brokers cannot buy or sell on their own account. But by specializing in certain pairs of currencies and keeping a constant liaison with market makers, brokers are in a position to garner more information about the market than those of the dealers.

Price makers and Price takers: Professional dealers or primary price makers make a two way market to their clients and to each other. They, on request, may quote two way price and be prepared to either buy or sell .Mainly commercial banks, some large investment dealers and a few large corporate play the role of price taker and price maker. Primary makers take positions off the hands of another dealer or corporate customer and then offset them by doing an opposite deal with another entity with a matching requirement.

2.6.1 Forex Activities of Treasury in Bank :

Treasury of a bank, normally, performs the following activities relating to Forex.

- a) Sale and Purchase of Currency on behalf of customers.
 - b) Inter Bank placements/borrowings
 - c) Forward Cover bookings
 - d) Cross currency swaps
 - e) Interest Rate Swaps
 - f) Forward Rate Arrangements
- a) Sale and Purchase of Currency on behalf of customers:** This is a major and very vital activity of Integrated Treasury. Customers of the Bank require foreign currency for meeting various commitments. Similarly they want to convert foreign currency at their disposal to Indian currency. All transactions with public or customers are called Merchant Business and the rates quoted for such transactions are called Merchant Rates.



For undertaking Sales and Purchase of foreign exchange, the Authorised Dealer usually looks into two important aspects namely i)Rate of Conversion and ii)Date of Delivery

Date of delivery under foreign exchange contract refers to the date on which the transaction is to be completed. Delivery, other than under forward exchange contract can be settled in any one of the ways.

- i) Ready or Cash: Transaction has to be settled on the same day.
- ii) TOM: Delivery of foreign exchange/currencies shall be made on the next day of transaction.
- iii) SPOT: Delivery of foreign exchange/currencies shall take place on 2nd working day from the date of contract.

The standard exchange rate quoted is for spot value, that is, for settlement on the second working day after the date on which the deal is concluded.

Value Today (Cash), Value Tomorrow (TOM) transactions are not common as value spot transaction.

Although the bulk of the transactions between banks in the foreign exchange markets are concluded on spot basis, it has distinct limitations when it comes to hedging international transactions by banks and corporate. Although cash market facilitates cash flows in foreign currencies to be converted into the currencies required, it cannot cope with cash flows that although known, will not materialize until sometime in future. The forward exchange market grew precisely to meet this need.

Forward Deals are those, where the transaction takes place today with delivery beyond spot date. It can be at a premium or at a discount. If foreign currency will be available at a higher price (i.e. for more rupees), it carries premium. If available at a lower price (for lesser rupees), it is at a discount.

Selling Rate- Buying Rate=Spread/Margin/Profit.

The buying price is also called Bid Price and Selling Price is called Offer Price.

- b) Inter Bank Transaction/Placements/borrowings:** The dealing (sale/purchase) of an Authorized Dealers with another Authorized Dealer are called Inter-Bank transaction and this segment of the market is known as Inter Bank Market. An Authorized Dealer enters into sale transactions with another Authorized Dealer for disposing off the foreign exchange it purchases from the merchant market. It enters into a purchase transaction with another Authorized Dealer to collect foreign exchange it sells in merchant market. Such deals in the Inter Bank Market are for relatively bigger amount and are wholesale in nature. Here the rates quoted are known to be Inter Bank rates and are relatively better than merchant rates. These rates often form the Base Rate for Authorised Dealers to quote their merchant rates.



Interbank placements/borrowings is a very common activity of Treasury similar to the Money Market Call lending / borrowing transaction; the only difference is that it is denominated in Foreign Currency. Mark-up calculations depend upon the day count of the currency of placement/borrowing.

- c) Forward Cover Bookings:** 'Forward cover bookings' is a common activity of banks in forex market in order to hedge any adverse fluctuations in exchange rate due to a lot of unseen factors.

Forward cover or Forward Exchange Contract, is a contract between a bank and its customer, whereby a rate of exchange is fixed immediately, for the buying and selling of one currency for another, for delivery at an agreed future date. A lot of (Economic, technical and political) factors can cause upheaval in the foreign exchange markets, resulting in volatile exchange rates that can hamper international trade. The forward cover or Forward exchange contract (FEC) is used as an effective hedging tool tantamount to an insurance policy, in that it protects traders and clients from unfavourable exchange rate fluctuations which might occur between the contract date and the payment date. The exact value of the import and export order can be calculated on the day it is processed and thus, budgeting and costing are accurate.

- d) Cross currency swaps:** Currency swaps are an essential financial instrument utilized by banks, Multinational corporations and institutional investors. A currency swap involves two parties that exchange a notional principal with one another in order to gain exposure to a desired currency. Following the initial notional exchange, periodic cash flows are exchanged in the appropriate currency. A typical cross currency swap has three cash flows: the initial exchange of cash flows at the beginning, the exchange of interest payments during the contract period, and the re-exchange of principals at the end.

- e) Interest Rate Swaps:** Interest Rate Swaps are agreements between two parties where one stream of future interest payments is exchanged for another based on a specified principal amount. Interest rate swaps often exchange a fixed payment for a floating payment that is linked to an interest rate (like LIBOR) over an agreed period of time.

Interest-rate swaps are separate products that are not directly linked to the original loans in respect of which the company wants to hedge the interest rate risk. That said, their purpose is to ensure stability of the interest paid on those loans.

When agreeing on an interest-rate swap, the bank and the company trade variable and fixed rates. Under the interest rate swap the company receives from the banks the variable rate of interest it owns under its loan(s) excluding any variable mark-ups, and subsequently pays a fixed rate as agreed under the interest rate swap to the banks. This set-up protects companies from increases in interest rates.



Note that companies still have to pay any variable mark-ups and that these are not covered by interest-rate swaps.

- f) Forward Rate Agreements (FRAs):** An FRA is an agreement between the Bank and a Customer to pay or receive the difference (called settlement money) between an agreed fixed rate (FRA rate) and the interest rate prevailing on stipulated future date (the fixing date) based on a notional amount for an agreed period (the contract period).

In short, this is a contract whereby interest rate is fixed now for a future period. The basic purpose of the FRA is to hedge the interest rate risk.

For example, if a borrower is going to borrow FC loan for 6 months at LIBOR rate after 3 months, he can buy an FRA whereby he can fix interest rate for the loan.



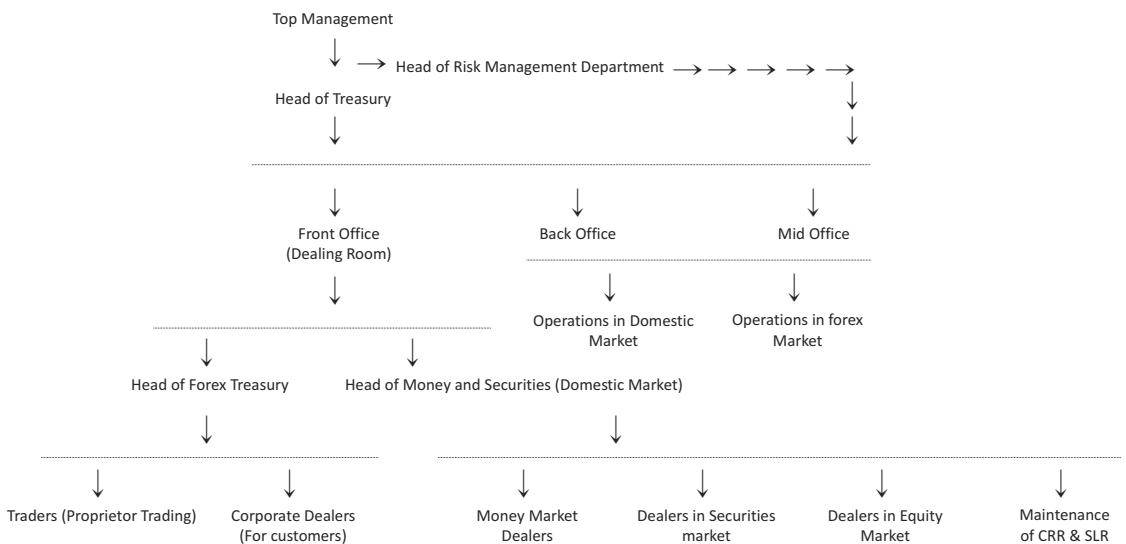
Chapter 3: Organisation Chart and Structure of Treasury

3.1 Organisation Chart and Structure of Treasury

Treasury of a Bank may work either as a department or as a specialized branch under the direct control of Head Office of the bank. Treasury working as a specialised branch is preferred as it can have its own independent books of accounts with its own P&L account and GL accounts. As a specialised branch Treasury may also enjoy an additional advantage as the branch can act as an authorized dealer for foreign exchange business and can participate in clearing and settlement system directly. A treasury is normally headed by a General Manager or Vice President or some other like post. Depending on the size of Treasury there may be one or more deputies under him. Treasury being a key activity of the bank, the head of treasury directly reports to chief executive of the Bank, The hierarchy of management of Treasury and delegation of authority at different levels, of course, depends upon the size of Treasury of individual bank.

As depicted in the organization chart of Treasury given below, Treasury has got three divisions a) Front Office b) Mid Office c) Back Office

3.2 Organisation Chart of Treasury



3.3 Front Office Functions:

- Fund Management and maintenance of CRR and SLR
- Execution of deals in money, securities (Buy, Sale, Switch). Repo and forex markets.



- Submission of bids in the auction of dated government securities and T-Bills in the primary market.
- Maintenance of deal records including the tapping of telephonic conversation of dealers with counter parties and preservation of Reuter's hard copies if any.

3.4 Mid Office Functions:

- Risk measurement
- Risk monitoring
- Risk Management and reporting for the Bank's ALCO.
- Management Information System
- Support functions vis-à-vis the front office
- Submission of reports to the top executives and board
- Maintenance of data base and updating front office with relevant information
- Formulation and review of investment policy and guidelines for transactions in securities
- Undertaking the work of market analysis and submission of reports.

3.5 Back Office Functions:

- Inter bank settlement of funds borrowed or lent
- G-Sec accounting and Settlement
- Non-SLR accounting and Settlement
- Accounting and Settlement of foreign exchange transactions
- Maintenance of CSGL accounts, Its reconciliation, RIDF accounts, CD issuance
- Monitoring Brokers Turnover
- Reconciliation of RBI current account and maintenance of SGL investment portfolio
- Interest collection on dated securities, NCDs and Bonds
- Dividend collection on shares or units of mutual funds
- Follow-up of certificates for Tax Deducted at source
- Maintenance of investment in Venture Capital Funds, Security Receipts
- Valuation of securities(G-Sec, Non-SLR ,Equity) including unquoted shares



- Equity Research Desk
- Preparation of various Treasury related notes to higher authorities like shifting of securities, brokers empanelment etc.; Management Information System
- Follow-up of concurrent as well as statutory auditors reports and RBI Inspection
- Calculation of Reserve requirements and communication to Front office.
- Monitoring of risk limits and usage
- Control over payments system
- Submission of different Board Notes related to Treasury like Quarterly non-SLR securities, Half-yearly review of Investment, Monthly Transaction Note, Quarterly Broker Note etc.

Chapter 4: Front Office

A. TREASURY DEALING ROOM

4.1 Dealing room acts as the Bank's interface to the domestic and international financial markets. It has the responsibility to manage the market risks of the banks emanated for all its operations, on behalf of the customers and on behalf of the bank within the prescribed limits and policies framed by the Board or Risk Management Committee of the Bank.

A dealing room consists of a series of customized desks or positions, where dealers with specialized tasks operate under a chief dealer.

There is no standard model for a dealing room. Each bank designs its dealing room that it feels best for its dealers to operate. Dealers have certain basic requirements for execution of his work. These are communication equipment, information retrieval equipment, telephone and teletype. Besides, normal dialling, dealers may keep a linkage with the brokers, clients and other branches by direct wires, which are connected by simply depressing a button.

Dealers must keep updated information about political, financial and economic development of the country that may have a bearing on the market. They should have access to new releases on tele-printers or screens. They also follow on a continuous basis the market rates that all major organizations provide on screens. Internal computer terminals also give the information regarding current positions, available credit lines etc.

The chief dealer has the most significant role in the dealing room. He with his leadership quality, behaviour pattern and psychological ability keeps a bonding with the junior dealers so that an amicable ambience prevails in the dealing room that is congenial to draw maximum productivity from his team members.

Management provides the Chief Dealer the necessary guidelines and limits-(as prescribed in Integrated Treasury Policy) for the operation of the dealing room. However, he is expected to assist management in updating and fine-tuning them in tune with the market developments.

Preparation and monitoring of the budget of the dealing room is one of the important functions of chief dealer. This can help the management in getting a better insight of the profitability of the operations of the dealing room.

4.2 Internal control guidelines regarding Dealers and Dealing room organisation by RBI:

Profound responsibility rests upon the dealers as the manner of handling the foreign exchange business of the bank can make all the difference to the bank and its customers. Adequate care therefore needs to be exercised while selecting and grooming the dealers.



Management should provide opportunities to the dealing room staff to get continuously updated on global market trends in forex and derivatives trading and risk control.

The dealer has to operate according to the guidelines laid down by the management. Ideally dealers may confer before work starts on the trend in the overnight markets in the light of the news bag and the bank's own business and arrive at a tentative view of the market. It is essential that efficient communication channels be provided for dealers to facilitate consultations with designated authorities.

The dealers should not be entrusted with accounting work. Deals struck should be recorded on printed deal slips. The deal slips should indicate the name of the broker (if any), and the counterparty bank, currencies, amounts, time, deal rate due dates and other necessary particulars depending on the type of product traded, under authentication of the dealer. The deal slips should be passed on without delay to the Back Office for further processing. Banks are free to devise the format of the slips. In an automated system, hard copies of deal slips may not be required.

It is desirable to introduce voice recorders in the dealing rooms. This will be helpful in resolution of future differences and disputes. The tapes may be preserved for at least two months and where a dispute has been raised, until the issue is resolved. Access to the equipment and tapes should be subject to strict control.

The tenure and rotation of duties of dealers may be decided by the individual bank management which may, however, be documented in the bank's internal control policies. Further, a system of an annual compulsory two-week (or longer) continuous break should be maintained so that no dealer remains at the job continuously.

Electronic Data Processing (EDP)

The data processing systems used must be appropriate to the nature and volume of activities and programmed to ensure functional separation. Access rules for performing distinct functions should be defined in detail and drawn up by persons unconnected with the dealing activity. Confidentiality of the data in the systems may be ensured in the case of outsourcing of IT services to external agencies.

Where data is recorded direct in an EDP system, it must be ensured that dealers are enabled to enter transactions solely through identification. The trading date, time and transaction serial number must be entered automatically by the system, which must be made impossible for the dealer to alter without proper authorisation. If the dealer deviates from the specified norms while entering transaction data, this must be approved in each case by an official not connected with the dealing office. Deals concluded after the Back Office has closed recording for the day (late deals) are to be marked as such and included in that day's position. A late deal slip must be passed immediately to an official unconnected with the dealer.



Code of conduct:

Authorized Dealers should conduct their activities with utmost prudence and integrity. Authorised Dealers must ensure that the staff concerned in the dealing room understand and abide by the Code of Conduct prescribed by FEDAI and FIMMDA. Dealers should be required to acknowledge in writing that they have read, understood and would observe the Code. It must be made clear to them that disciplinary actions could be taken against those who breach the Code. All dealers should furnish an undertaking to conform to the Codes of Conduct.

Code of conduct for Electronic Order Matching System (EOMS)

In the Indian forex broking service space, voice brokers are accredited by the FEDAI. With the advent and wide spread usage of technology, electronic forex broking and order matching systems have arrived in the forex market. As service providers were not subject to any regulation, FEDAI in 2009, evolved a Code of Conduct and Rules for self-regulation by EOMS. This has been communicated to the service providers to whom the Code is applicable with effect from January 1, 2010.

B. DEALINGS THROUGH EXCHANGE BROKERS

Since brokers play an important part in forex dealing in a bank, dealers should aware of the relevant guidelines and should undertake to operate within these guidelines. RBI has charted out detailed Instructions in this respect.

- Exchange brokers cannot maintain positions and act as principals. Bank should be careful while dealing with brokers to ensure that they do not take over the function of dealers.
- Banks should ensure to collect Brokers' notes promptly normally before the close of business on the day on which the deals are concluded and exceptionally before the opening hours of the succeeding day so that the Back Office can check and reconcile them on the same day.
- Banks should normally prepare a panel of brokers which should be reviewed annually. The number of brokers to be empanelled depends on the volume of the business executed through brokers, credit worthiness of the brokers, their market reputation, their net worth etc. This is done to make an equitable treatment to the brokers for business offered at competitive terms.
- Dealers should not accept any gifts, gratification or other favours from brokers. Any complaints in this regard against the dealers should be reported to the appropriate authorities for necessary action.
- Dealing room should be precluded from maintaining any record of broker wise deal



made by the dealers. The accounting department/back office should maintain it. Dealing room staff should not have any role regarding the scrutiny and passing of payments or brokerage claims.

- A monthly statement specifying broker wise payment along with a statement of payment for the preceding twelve months should be placed to the management. This statement should also mention any changes in the panel of brokers. Complaints relating to the malpractices of brokers should promptly be reported to FEDAI, Mumbai

C. PROCESS OF RECORD OF DEALING TRANSACTIONS IN GOVERNMENT SECURITIES BY THE DEALING DESK

For every transaction entered into by the trading desk, a deal slip should be generated which should contain data relating to nature of the deal, name of the counter-party, whether it is a direct deal or through a broker (if it is through a broker, name of the broker), details of security, amount, price, contract date and time and settlement date. The deal slips should be serially numbered and verified separately to ensure that each deal slip has been properly accounted for. Once the deal is concluded, the deal slip should be immediately passed on to the back office (it should be separate and distinct from the front office) for recording and processing. For each deal, there must be a system of issue of confirmation to the counter-party. The timely receipt of requisite written confirmation from the counter-party, which must include all essential details of the contract, should be monitored by the back office. The need for counterparty confirmation of deals matched on NDS-OM will not arise, as NDS-OM is an anonymous automated order matching system. However, in case of trades finalized in the OTC market and reported on NDS, confirmations have to be submitted by the counterparties in the system i.e., NDS.

Once a deal has been concluded through a broker, there should not be any substitution of the counter-party by the broker. Similarly, the security sold / purchased in a deal should not be substituted by another security under any circumstances. A maker-checker framework should be implemented to prevent any individual misdemeanour. It should be ensured that the same person is not carrying out the functions of maker (one who inputs the data) and checker (one who verifies and authorizes the data) on the system.

On the basis of vouchers passed by the back office (which should be done after verification of actual contract notes received from the broker / counter party and confirmation of the deal by the counter party), the books of account should be independently prepared.

Chapter 5: Domestic Treasury – Maintenance of Investment Portfolios

5.1 Investment activities of a bank have gained substantial importance over the years. Earlier, banks' investment operations were mainly concentrated on maintenance of SLR requirement. But in course of time, there have been a lot of developments in different market segments. They have become much more investor friendly. Money and securities market has been deregulated, Trading and settlement system has been rationalized and facilitator for investment. The recruitment of skilled, knowledgeable, and expert personnel in the treasury has prompted banks to undertake more trading in SLR and Non-SLR securities of various kinds to reap the benefits of favourable market and Investment has been turned into a profit centre. In a situation when due to depressed market condition, demand for fresh advance become slow and bank suffers from threats of burgeoning NPAs, Investment provides a secondary avenue for profitable deployment of bank funds.

5.2 Investment Policy:

Every bank should frame an Investment policy which should be approved by the Board of the concerned bank. This policy should be reviewed every year keeping in view the guidelines in master circular of RBI on 'Prudential norms for classification, valuation and operation of investment portfolio by banks' to accommodate any changes that are deemed to be necessary for better operation and management of investment portfolio. The guidelines of Investment policies should be followed in true spirit to ensure that operations in securities conducted in accordance with sound and acceptable business practices.

5.3 Broad Contents of the Policy:

- 5.3.1 Investment objectives
- 5.3.2 Portfolio composition
- 5.3.3 Procedure for Investment
- 5.3.4 Various prudential exposure limits
- 5.3.5 Delegation of powers for investment
- 5.3.6 Internal control system
- 5.3.7 Audit, Review and Reporting system

5.3.1 Investment Objectives:

- Discussed against Point no.1.3



5.3.2 Portfolio composition:

The securities held under investment portfolio are broadly classified into two groups. They are SLR Securities and Non SLR Securities.

The bank usually invests in the following instruments:

SLR Securities: Govt. Securities issued by both Central and State Governments, approved securities issued by Central and State Bodies and other Gilt securities like Treasury Bills etc.;

Non-SLR Securities

- i) Bonds and Debentures of PSU and Corporates.
- ii) Tier II (both upper and lower) Bonds of Banks and FIs.
- iii) Innovative Perpetual Debt instrument.
- iv) Hybrid instrument like Partly Convertible Debentures.
- v) Commercial Papers.
- vi) Certificate of deposits.
- vii) Units of various Mutual Funds.
- viii) Equity Shares.
- ix) Preference Shares.
- x) Floating Rate Bonds/Notes.
- xi) MIBOR linked instruments.
- xii) Units of Venture Capital Funds.
- xiii) RIDF.
- xiv) Pass through Certificates and other asset backed Securities.
- xv) Securities Receipts.
- xvi) Derivative instruments.
- xvii) Private Equity.
- xviii) Such other types of Securities as may be approved by RBI.

For Balance sheet purposes classification of securities will be made into six groups in terms of RBI guidelines, viz. (i) Government Securities, (ii) Other Approved Securities, (iii) Bonds / Debentures, (iv) Shares, (v) Subsidiaries / Joint ventures, & (vi) Others i.e. CP, Mutual Fund, etc).



5.3.3 Procedure for Investment:

5.3.3.1 SLR Securities:

a) Investment in SLR securities by the Bank is subject to RBI guidelines.

Gist of RBI guidelines:

- Banks cannot sell any security which it does not purchase or hold.
- However, the Scheduled Commercial Banks (SCBs) (other than RRBs and LABs) and PDs have been permitted to short sell Government securities in accordance with the requirements specified.
- Further, the NDS-OM members have been permitted to transact on 'When Issued' basis in Central Government dated securities, subject to the guidelines specified.
- Banks successful in the auction of primary issue of Government Securities may enter into contracts for sale of the allotted securities in accordance with the prescribed terms and conditions
- The settlement of all outright secondary market transactions in Government Securities is being done on a standardised T+1 basis effective May 24, 2005.
- All the transactions put through by a bank, either on outright basis or ready forward basis and whether through the mechanism of Subsidiary General Ledger (SGL) Account or Bank Receipt (BR), should be reflected on the same day in its investment account and, accordingly, for SLR purpose wherever applicable. With a view to bringing in uniformity in the methodology of accounting for investments in Government securities, banks should follow 'Settlement Date' accounting for recording purchase and sale of transactions in Government Securities.
- The brokerage on the deal payable to the broker, if any, (if the deal was put through with the help of a broker) should be clearly indicated on the notes/ memoranda put up to the top management seeking approval for putting through the transaction and a separate account of brokerage paid, broker-wise, should be maintained.
- For issue of BRs, the banks should adopt the format prescribed by the Indian Banks' Association (IBA) and strictly follow the guidelines prescribed by them in this regard. The banks, subject to the above, could issue BRs covering their own sale transactions only and should not issue BRs on behalf of their constituents, including brokers.
- Any instance of return of SGL from the Public Debt Office (PDO) of the Reserve Bank for want of sufficient balance in the account should be immediately brought to the Reserve Bank's notice with the details of the transactions.



b) Ready forward transactions in Government Securities

- Ready forward contracts including Reverse Ready Forward Contract may be undertaken only in (i) Dated securities and Treasury Bills issued by Govt. of India and (ii) Dated Securities issued by State Govt.
- Ready forward contracts on above securities may be entered by
 - i) Persons or entities having SGL account with RBI, Mumbai.
 - ii) Gilt account holders (maintaining gilt accounts with a bank) or other entity permitted by the RBI to maintain CSGL (Constituent Subsidiary General Ledger) with Public Debt Office, Mumbai.

Exceptions:

- a) An SGL account holder may not enter into a ready forward contract with its own constituent.
- b) Any two gilt account holders maintaining their gilt accounts with the same custodian may not enter into ready forward contracts with each other.
- c) Co-operative banks may not enter into ready forward contracts with the NBFCs
 - All ready forward contracts shall be reported on Negotiated Dealing System. In case of CSGL account holder, responsibility of reporting such transaction to NDS devolves on the custodian with whom the constituent maintains his gilt account.

c) Transactions through SGL Accounts:

- In case of transaction of securities through SGL account under Delivery versus Payment Basis wherein transfer of securities and payment thereof takes place simultaneously, both the selling bank and the buying bank must maintain current account with the RBI. Since no overdraft is allowed in the current account maintained with the RBI, a buying bank must maintain an adequate balance in its current account to accommodate its purchase and to avoid devolvement.
- All transactions in government securities for which SGL facility is available should be put through SGL account only.
- As already said, all transactions in government securities is done through NDS-OM where CCIL is the counterparty through which the transaction is settled and subsequently through NDS got reflected in SGL and current account with the RBI.

5.3.3.2 Non-SLR Securities:

A bank while investing in privately placed/public issue of Non-SLR securities and also



in secondary market, should take into consideration the followings in pursuance of the respective guidelines of the RBI.

i) Appraisal and Internal Assessment:

- While investing in privately placed unrated bonds and bonds issued by corporate non-borrowers, bank in order to appraise the proposals with proper due-diligence, should prescribe minimum disclosure standards as a policy with Board approval. In order to ensure that investments through the route of private placements do not engender any systematic risk, the Board approved Investment Policy of the Bank should take care in the following aspects:
 - (a) The Board of banks should lay down policy and prescribe prudential limit of investments in bonds and debentures including cap and on private placement basis, sub-limits for PSU bonds, corporate bonds, guaranteed bonds, issuer ceiling etc.
 - (b) Bank appraisal standard and process regarding investment in non-SLR securities in the primary market will be the same as it follows in case of loan proposal. Bank should make internal credit analysis rating in case of rated securities also. The appraisal process should be more stringent in case of investments in the instruments issued by the non-corporate borrowers.
 - (c) Strengthening the internal rating system that should include a system of regular tracking of the financial position of the issuer (quarterly or half-yearly) with a view to continuous monitoring of the rating migration of the issuers.
 - (d) As a matter of prudence, banks should stipulate entry-level minimum ratings/ quality standards and industry-wise, maturity-wise, duration-wise, issuer-wise etc. limits to mitigate the adverse effects of concentration and the risk of illiquidity.
 - (e) Bank should have a system of analyzing the risks of these investments and taking timely measures to manage the risks.
 - (f) Before investing to such bonds, debentures, shares etc. Bank should refer to the 'Defaulter List' to avoid investing to the securities issued by defaulters.

ii) Regulatory Requirement:

- a) Banks should not invest in Non-SLR securities of original maturity of less than one year except Commercial Paper, Certificate of Deposits and NCDs with original or initial maturity up to one year issued by corporate (including NBFCs) which are covered under RBI guidelines.
- b) RBI regulations prohibit banks from extending credit facilities for some purpose.



Bank should be cautious to see that such activities are not financed by way of funds raised through the non-SLR securities.

c) Listing and Rating Requirement:

- Banks must not invest in unrated non-SLR securities with the exception of unrated bonds of companies engaged in infrastructure activities within the ceiling of 10% of unlisted non-SLR securities.
- SEBI vide their circular dated September 30, 2003 (amended vide circular dated May 11, 2009) have stipulated requirements that listed companies are required to comply with for making issue of debt securities on a private placement basis and listed on a stock exchange.
- Banks while making investment in non-SLR securities should ensure that such investment is made to the issues of listed debt securities of the companies that comply with SEBI's above requirement.
- Bank's total investment in unlisted non-SLR securities should not exceed 10% of total investment in non-SLR securities as on March 31 of the previous year and such investment should comply with the disclosure requirement of SEBI as mentioned above.
- Bank's investment in non-SLR securities may exceed the 10% limit, by an additional 10% if this investment is made in securitisation papers issued for infrastructure projects, and bonds/debentures issued by Securitisation companies and Reconstruction companies set up under the SARFEASI ACT and registered with RBI.
- The following securities will not be counted as non-SLR securities for computing 10% cap of investment in unlisted non-SLR securities.
 - a) Security receipts issued by SCs/RCs registered with RBI
 - b) Investment in Asset Backed Securities and Mortgage Backed Securities which are rated at or above the Investment grade.
 - c) Investment in unlisted convertible debentures.
 - Investment in RIDF/SIDBI/RHDF deposits may not be reckoned in numerator as well as in denominator while calculating this peg limit of 10%.
 - While calculating this prudential limit of 10%, mutual fund schemes, Treasury Bills, CBLO, Repo/Reverse Repo and Bank fixed deposits should be excluded from numerator.
 - For compliance of above prudential limit of 10%, denominator should



include four categories of investment e.g., 'shares', 'bonds and debentures', 'subsidiaries/joint ventures' and 'others' that are mentioned in Schedule-8 to the balance sheet.

- The total investment by banks in liquid/short term debt schemes of mutual funds with weighted average maturity of portfolio of not more than 1 year will be subject to a prudential cap of 10 per cent of their net worth as on March 31 of the previous year. The weighted average maturity would be calculated as average of the remaining period of maturity of securities weighted by the sums invested.
- Banks having investment in unlisted non-SLR securities less than its prudential limit of 10% can make further investment up to prudential limit.

The guidelines on listing and rating pertaining to non-SLR securities vide above paragraphs are not applicable to banks' investments in:

- a. Securities directly issued by the Central and State Governments, which are not reckoned for SLR purposes.
- b. Equity shares
- c. Units of equity oriented mutual fund schemes, viz. those schemes where any part of the corpus can be invested in equity
- d. Equity/debt instruments/Units issued by Venture capital funds
- e. Commercial Paper
- f. Certificates of Deposit
- g. Non Convertible Debentures (NCDs) with original or initial maturity up to one year issued by corporates (including NBFCs)
- h. Securities acquired by way of conversion of debt, subject to periodic reporting to the Reserve Bank in the DSB return on Asset Quality.

5.3.3.3 Role of Board of Bank:

Bank's Investment Policy as approved by the Board must take into account the above guidelines while formulating norms of investment in non-SLR securities.

A note on non-SLR investment position of the Bank should be put before Board at least quarterly, that, inter alia, should provide-

- Total Investment (Investment and Divestment) during the reporting period
- Compliance with the prudential limits prescribed by the Board for non-SLR investment.



- Compliance with the prudential guidelines issued by RBI on non-SLR securities.
- Rating migration of the issuers/issues held in the bank's books and consequent diminution in the portfolio quality
- Extent of non-performing investments in the non-SLR category.

5.3.3.4 Limits of Bank's Exposure to Capital Market:

The aggregate exposure of a bank to the capital market in all form (both fund based and non-fund based) should not exceed 40% of its net worth as on March 31 of the previous year.

Within this overall ceiling, the bank's direct investment in shares, convertible bonds / debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered] should not exceed 20 per cent of its net worth.

This is peg limit and taking into consideration the risk appetite and overall risk profile of the bank and its corporate strategy, the Board of the bank may adopt a lower ceiling for the bank.

5.3.3.5 Classifications

The entire Investment portfolio of a bank consisting of SLR and non-SLR securities should be classified into three categories:

a) Held to Maturity b) Available for Sale c) Held for Trading.

a) Held to Maturity:

- The securities that are meant to be held by the bank till their maturities are classified in 'Held to Maturity' category.
- Banks total investment in this category is restricted to 25% of their DTL as on last Friday of the second preceding fortnight.
- Non-SLR securities that the banks hold as on September 2, 2004 may remain in that category. No fresh investment in non-SLR securities made after the above date will not find its room in HTM category except the following
 - i) Fresh re-capitalization bonds received from the Government of India towards their recapitalization requirement and held in Investment portfolio.
 - ii) Fresh investment in the equity of subsidiaries and joint ventures.
 - iii) RIDF/SIDBI/RHDF deposits.
 - iv) Investment in long term bonds (with a minimum residual period of seven

years) issued by companies engaged in infrastructure activities).

Profit on sale of securities from this category should be first taken to profit and loss account and thereafter be appropriated to capital reserve account after net of taxes. Loss of sale, if any, will be recognized in the profit and loss account.

b) Held for Trading:

The securities that are meant for trading by taking advantage of short term price/ interest rate movements in the market are classified in this category. Securities held in this category must be sold within 90 days. Profit and Loss on sale of investments in this category will be taken to Profit and Loss account.

c) Available for Sale:

The securities that do not fall within the above two categories will be classified in this category. Profit and loss on investment in this category will be taken to Profit and Loss account.

The extent of holdings in 'Available for Sale' and 'Held for Trading' category will be decided by the bank by taking into consideration its trading strategy, market scenario, its intent, risk management capabilities, tax planning, manpower skills and capital position.

5.3.3.6 Shifting Among Categories

- i) Banks are allowed to shift securities to/ from HTM category once in a year with the approval of the Board of Directors. Shifting is normally allowed at the beginning of the accounting year. No further shifting will be allowed during the remaining part of the accounting year.
- ii) If the value of sales and transfers of securities from HTM Category exceeds 5% of the book value of the investments held in the HTM category at the beginning of the year, banks should disclose in the 'Note to Accounts' in banks' audited financial statements the market value of the investments held in HTM category and indicate the excess of book value over market value for which provision has not been made. However, this one time shifting to/from HTM category with the approval of Board of Directors at the beginning of financial year and sales to the RBI under preannounced OMO auctions will be excluded from the 5 percent limit.
- iii) Shifting of investments from AFS to HFT may be done with the approval of Board of Directors, Alco/Investment Committee. In case of exigency, however, such shifting may be done with the approval of chief executive of the bank /head of the ALCO, but subsequently should be ratified by the Board of Directors/ALCO.



- iv) Shifting of investments from HFT to AFS is normally not allowed. It may, however, be permitted in case of 'exceptional circumstances like when securities in HFT category could not be sold within prescribed maximum 90 days due to tight liquidity conditions or extreme volatility or market becoming unidirectional. Such transfer requires approval of Board of Directors/ALCO/Investment committee.
- v) Transfer of scrips from AFS/HFT category to HTM category should be made at lower of cost price and market price. If the market value of the scrips to be transferred is higher than book value, the scrips will be transferred at book value. On the contrary, if market value of the scrips is lower than book value then the book value will be reduced by the required amount by setting off the provision against depreciation held against the security(including additional provision required based on valuation done on the date of transfer) to make it equal with market value
- vi) In the case of securities to be transferred from HTM category to AFS/HFT category, where the securities were originally placed at HTM category at a discount, the securities should be transferred at the acquisition price/book value. Where the securities are originally placed in the HTM category at a premium, the securities will be transferred to AFS/HFT category at the amortized cost. In either of the case, the securities so transferred should immediately be revalued after transfer and resultant depreciation, if any, may be provided.
- vii) In case of transfer of securities from AFS to HFT category or vice versa, the securities need not be revalued on the date of transfer. Here only the accumulated depreciation against these securities may be transferred to the provisions for depreciation against the HFT securities and vice versa.

5.3.3.7 Valuation

A. Classification-wise norms of valuation

1. Held to Maturity:

- i) The securities held under 'Held to Maturity' category are not required to make marked to market for providing depreciation. They will be carried at acquisition cost unless it is more than the face value, in which case it should be amortised over the period remaining to the maturity. The Book value of the securities should continue to be reduced to the extent of the amount amortised during the relevant accounting period.
- ii) Banks should recognize any diminution, other than temporary, in the value of their investments in Subsidiaries/Joint Ventures, which are included under HTM and provide therefore. Such diminution should be determined and provided for each investment individually.



2. Available for Sales:

- i) The individual scrip in the 'Available for Sales' category should be marked to market and depreciation to be provided at quarterly or more frequent intervals. For Equity Shares portfolio, it should be valued daily or at least weekly. Domestic securities under this category should be valued scrip-wise and depreciation/appreciation should be aggregated for each classification as follows:
 - a) Government securities
 - b) Other Approve Securities
 - c) Shares
 - d) Debentures and Bonds
 - e) Subsidiaries/Joint Ventures
 - f) Others (CP, Mutual Fund Units etc.)
- ii) Valuation of foreign scrips under this category should, similarly be made scrip- wise and then depreciation/appreciation should be aggregated for five classifications as follows'
 - a) Government Securities (including local bodies)
 - b) Shares,
 - c) Debentures and Bonds
 - d) Subsidiaries and/or Joint Ventures abroad
 - e) Other Investments (to be specified)
- iii) Further, investment in a particular classification, both in domestic and foreign securities, may be aggregated to find out net depreciation/appreciation of investments under that category. Net depreciation, if any, should be provided and net appreciation, if any, should be ignored. Net depreciation required to be provided against any classification should not be reduced on account of net appreciation in any other classification. The Book value of individual securities would not undergo any change after making mark to market.

3. Held for Trading

The individual scrips in 'Held for Trading' category should individually be marked to market at monthly or at more frequent intervals (for equity shares—it should be marked to market daily or at least weekly) and provided to, as is done in the 'Available for Sales' category. The book value of the securities, of course, will not undergo any change for this exercise of 'Marked to market'.



B. Market Value for Valuation

1. Market value

The 'market value' for the purpose of periodical valuation of investments included in the AFS and HFT categories would be the market price of the scrip as available from the trades/ quotes on the stock exchanges, SGL account transactions, price list of RBI, prices declared by Primary Dealers Association of India (PDAI) jointly with the Fixed Income Money Market and Derivatives Association of India (FIMMDA) periodically. In respect of unquoted securities, the procedure as detailed below should be adopted.

2. Unquoted SLR securities

- i) Central Government Securities: Banks should value the unquoted Central Government securities on the basis of the prices/ YTM rates put out by the PDAI/ FIMMDA at periodical intervals.
- ii) Treasury Bills should be valued at carrying cost.

3. State Government Securities

State Government securities will be valued applying the Yield to Maturity (YTM) method by marking it up by 25 basis points above the yields of the Central Government Securities of equivalent maturity put out by PDAI/ FIMMDA periodically.

4. Other 'approved' Securities

Other approved securities will be valued applying the YTM method by marking it up by 25 basis points above the yields of the Central Government Securities of equivalent maturity put out by PDAI/ FIMMDA periodically.

5. Unquoted Non-SLR securities

i) Debentures/ Bonds

a) All debentures/ bonds should be valued on the YTM basis. Such debentures/ bonds may be of different companies having different ratings. These will be valued with appropriate mark-up over the YTM rates for Central Government Securities as put out by PDAI/ FIMMDA periodically. The mark-up will be graded according to the ratings assigned to the debentures/ bonds by the rating agencies subject to the following:-

- The rate used for the YTM for rated debentures/ bonds should be at least 50 basis points above the rate applicable to a Government of India loan of equivalent maturity.



However, the special securities, which are directly issued by Government of India to the beneficiary entities, which do not carry SLR status, may be valued at a spread of 25 basis points above the corresponding yield on Government of India Securities, with effect from the financial year 2008-09. At present, such special securities comprise Oil Bonds, Fertilizer Bonds, bonds issued to the State Bank of India (during the recent rights issue), Unit Trust of India, Industrial Finance Corporation of India Ltd., Food Corporation of India, Industrial Investment Bank of India Ltd., the erstwhile Industrial Development Bank of India and the erstwhile Shipping Development Finance Corporation.

- The rate used for the YTM for unrated debentures/ bonds should not be less than the rate applicable to rated debentures/ bonds of equivalent maturity. The mark-up for the unrated debentures/ bonds should appropriately reflect the credit risk borne by the bank.
- Where the debentures/ bonds are quoted and there have been transactions within 15 days prior to the valuation date, the value adopted should not be higher than the rate at which the transaction is recorded on the stock exchange.

b) Bonds issued by State Distribution Companies (Discoms) under Financial Restructuring Plan

- i) If these bonds are traded and quoted, they will be valued at their current 'Market Value' as defined in paragraph 3.5 of Master Circular on 'Prudential norms for classifications, valuation and operation of investment portfolio by banks'.
- ii) In case the bonds are not traded and quoted, they will be valued on YTM basis. The relevant YTM will be YTM rates for Central Government Securities of equivalent maturities as put out by FIMMDA on the valuation day with the following mark-ups:
 - iii) During the period when bonds' liabilities are with the State Discoms and
 - If guaranteed by respective State Governments – 75 basis points
 - If not guaranteed by respective State Governments – 100 basis points
 - iv) During the period when bonds' liabilities are with the respective State Governments – 50 basis points.

c) Zero coupon bonds (ZCBs)

ZCBs should be shown in the books at carrying cost, i.e., acquisition cost plus discount accrued at the rate prevailing at the time of acquisition, which may be marked to market with reference to the market value. In the absence of market



value, the ZCBs may be marked to market with reference to the present value of the ZCB. The present value of the ZCBs may be calculated by discounting the face value using the 'Zero Coupon Yield Curve', with appropriate mark up as per the zero coupon spreads put out by FIMMDA periodically. In case the bank is still carrying the ZCBs at acquisition cost, the discount accrued on the instrument should be notionally added to the book value of the scrip, before marking it to market.

d) Preference Shares

The valuation of preference shares should be on YTM basis. The preference shares will be issued by companies with different ratings. These will be valued with appropriate mark-up over the YTM rates for Central Government Securities put out by the PDAI/FIMMDA periodically. The mark-up will be graded according to the ratings assigned to the preference shares by the rating agencies subject to the following:

- i) The YTM rate should not be lower than the coupon rate/ YTM for a Govt loan of equivalent maturity. The rate used for the YTM for unrated preference shares should not be less than the rate applicable to rated preference shares of equivalent maturity. The mark-up for the unrated preference shares should appropriately reflect the credit risk borne by the bank.
- ii) Investments in preference shares as part of the project finance may be valued at par for a period of two years after commencement of production or five years after subscription whichever is earlier.
- iii) Where investment in preference shares is as part of rehabilitation, the YTM rate should not be lower than 1.5% above the coupon rate/ YTM for Govt loan of equivalent maturity.
- iv) Where preference dividends are in arrears, no credit should be taken for accrued dividends and the value determined on YTM should be discounted by at least 15 per cent if arrears are for one year, and more if arrears are for more than one year. The depreciation/provision requirement arrived at in the above manner in respect of nonperforming shares where dividends are in arrears shall not be allowed to be set-off against appreciation on other performing preference shares.
- v) The preference share should not be valued above its redemption value.
- vi) When a preference share has been traded on stock exchange within 15 days prior to the valuation date, the value should not be higher than the price at which the share was traded.



e) Equity Shares

The equity shares in the bank's portfolio should be marked to market preferably on a daily basis, but at least on a weekly basis. Equity shares for which current quotations are not available or where the shares are not quoted on the stock exchanges, should be valued at break-up value (without considering 'revaluation reserves', if any) which is to be ascertained from the company's latest balance sheet (which should not be more than one year prior to the date of valuation). In case the latest balance sheet is not available the shares are to be valued at Re.1 per company.

f) Valuation norms on conversion of outstanding:

Banks sometime get shares from the companies as a consequence of corporate debt restructuring. These shares acquired by way of conversion of outstanding principal and / or interest should be classified in the AFS category, and valued in accordance with the extant instructions on valuation of banks' investment portfolio. Equity classified as standard asset should be valued either at market value, if quoted, or at break-up value, if not quoted (without considering the revaluation reserve, if any) which is to be ascertained from the company's latest balance sheet. In case the latest balance sheet is not available, the shares are to be valued at Re.1. Equity instrument classified as NPA should be valued at market value, if quoted, and in case where equity is not quoted, it should be valued at Re.1. Depreciation on the instruments acquired by way of conversion, whether classified as standard or NPA, should not be offset against the appreciation in any other securities held under the AFS category may be listed or unlisted.

g) Mutual Funds Units (MF Units)

Investment in quoted MF Units should be valued as per Stock Exchange quotations. Investment in un-quoted MF Units is to be valued on the basis of the latest re-purchase price declared by the MF in respect of each particular Scheme. In case of funds with a lock-in period, where repurchase price/ market quote is not available, Units could be valued at Net Asset Value (NAV). If NAV is not available, then these could be valued at cost, till the end of the lock- in period. Wherever the re-purchase price is not available, the Units could be valued at the NAV of the respective scheme.

h) Commercial Paper: Commercial paper should be valued at the carrying cost.

i) Investments in Regional Rural Banks (RRBs)

Investment in RRBs is to be valued at carrying cost (i.e. book value) on a consistent basis.

Besides, the above, valuation of other securities likes Security Receipt, Venture Capital Funds etc. as per guidelines prescribed by the RBI in 'Master Circular



–Prudential Norms for classification, valuation and operation of Investment Portfolio by Banks.’

5.3.3.8 Investment Fluctuation Reserve & Investment Reserve Account

a) Investment Fluctuation Reserve:

- i) In order to maintain adequate reserve to guard against any possible reversal of interest rate environment due to some unexpected developments in future, banks were advised by the RBI to build up Investment Fluctuation Reserve (IFR) of a minimum 5 per cent of the Investment Portfolio within a period of 5 years.
- ii) Banks were advised in October 2005 that, if they have maintained capital of at least 9 per cent of the risk weighted assets for both credit risk and market risks for both HFT and AFS category as on March 31, 2006, they would be permitted to treat the entire balance in the IFR as Tier I capital. For this purpose, banks may transfer the balance in the IFR ‘below the line’ in the Profit and Loss Appropriation Account to Statutory Reserve, General Reserve or balance of Profit & Loss (P&L) Account.

b) Investment Reserve Account (IRA):

- i) In the event, provisions created on account of depreciation in the ‘AFS’ or ‘HFT’ categories are found to be in excess of the required amount in any year, the excess should be credited to the P&L Account and an equivalent amount (net of taxes, if any and net of transfer to Statutory Reserves as applicable to such excess provision) should be appropriated to an IRA Account in Schedule 2 – “Reserves & Surplus” under the head “Revenue and Other Reserves”, and would be eligible for inclusion under Tier-II within the overall ceiling of 1.25 per cent of total Risk Weighted Assets prescribed for General Provisions/ Loss Reserves.

- ii) Banks may utilise IRA as follows:

The provisions required to be created on account of depreciation in the AFS and HFT categories should be debited to the P&L Account and an equivalent amount (net of tax benefit, if any, and net of consequent reduction in the transfer to Statutory Reserve), may be transferred from the IRA to the P&L Account. The amounts debited to the P&L Account for provision should be debited under the head ‘Expenditure- Provisions & Contingencies’. The amount transferred from the IRA to the P&L Account, should be shown as ‘below the line’ item in the Profit and Loss Appropriation Account, after determining the profit for the year.

5.3.3.9 Non-Performing Investments (NPI)

- a) In respect of securities included in any of the three categories where interest/ principal is in arrears, banks should not reckon income on the securities and should also make



appropriate provisions for the depreciation in the value of the investment. The banks should not set-off the depreciation requirement in respect of these non-performing securities against the appreciation in respect of other performing securities.

An NPI, similar to a non performing advance (NPA), is one where:

- i) Interest/ instalment (including maturity proceeds) is due and remains unpaid for more than 90 days.
- ii) The above would apply mutatis-mutandis to preference shares where the fixed dividend is not paid. If the dividend on preference shares (cumulative or non-cumulative) is not declared/paid in any year it would be treated as due/unpaid in arrears and the date of balance sheet of the issuer for that particular year would be reckoned as due date for the purpose of asset classification.
- iii) In the case of equity shares, in the event the investment in the shares of any company is valued at Re.1 per company on account of the non-availability of the latest balance sheet in accordance with the instructions contained in paragraph 28 of the Annex to the circular DBOD.BP.BC.32/ 21.04.048/ 2000-01 dated October 16, 2000, those equity shares would also be reckoned as NPI.
- iv) If any credit facility availed by the issuer is NPA in the books of the bank, investment in any of the securities, including preference shares issued by the same issuer would also be treated as NPI and vice versa. However, if only the preference shares are classified as NPI, the investment in any of the other performing securities issued by the same issuer may not be classified as NPI and any performing credit facilities granted to that borrower need not be treated as NPA.
- v) The investments in debentures/bonds, which are deemed to be in the nature of advance, would also be subjected to NPI norms as applicable to investments.
- vi) In case of conversion of principal and/or interest of loan into equity, debentures, bonds, etc., such instruments should be treated as NPA ab-initio in the same asset classification category as the loan if the loan's classification is substandard or doubtful on implementation of the restructuring package and provision should be made as per the norms.

5.3.3.10 Engagement of Brokers

We have already discussed role of brokers in dealing of different securities. However, to prevent the possible malpractices relating to dealing with brokers as well as giving an equitable and fair treatment to all the empanelled brokers, RBI has given comprehensive guidelines in regard to engagement of brokers. A gist of these guidelines is enumerated below.

- i) Interbank transactions should not be put through brokers.



- ii) For a deal put through the broker, role of a broker should be restricted to that of bringing the two parties in the deal together.
- iii) A broker should not disclose the identity of the counterparty while negotiating the deal. It is only after conclusion of the deal, he should disclose the counterparty and his contract note should clearly indicate the name of the counterparty. Bank should also ensure that the Broker note clearly mentions the exact time of the deal. The back office should ensure that the deal time mentioned in the broker note and deal ticket remains the same which should also be checked by the concurrent auditor.
- iv) After the counterparty is known from the contract note, fund transfer and security transfer will be settled between banks directly and the broker should have no role to play with in the process.
- v) An empanelment of brokers on the basis prescribed criteria like creditworthiness, market reputation, volume of transactions; experience etc. should be prepared by the bank with the approval of top management which should be reviewed annually and more often if so warranted. A record of broker-wise details of deals put through and brokerage paid should be maintained.
- vi) Bank should fix aggregate contract limit for each of the approved broker. A limit of 5% of the total transactions (both purchase and sales) entered into by a bank during a year should be treated as the aggregate upper contract limit of each of the approved brokers. Bank should ensure that the transactions with individual broker during a year do not exceed the limit. However, for any reason if it is required to exceed this limit for any broker, the specific reasons for that should be recorded by the person putting through the deal. It requires post facto confirmation of the Board.

5.3.3.11 General

Income Recognition:

- i) Bank may book interest on accrual basis on securities issued by corporate bodies/ public sector undertakings in respect of which payment of interest and repayment of principal is guaranteed either by the Central or State Government provided interest is not in arrears and is serviced regularly.
- ii) Bank may book income from Government securities and from corporate bonds and debentures on accrual basis where interest on these instruments are predetermined provided the interest is not in arrear and is serviced regularly.
- iii) Bank may book income from dividend from corporate bodies on accrual basis provided dividend on the shares has been declared by the corporate body in its Annual General Meeting and the owner right to receive payment is established.



- iv) Bank may book income from units of mutual fund on cash basis.

5.3.4 Various Prudential Exposure Limit:

Within the overall exposure limit as specified in the RBI master circular- 'Prudential norms for classification, valuation and operation of Investment portfolio by banks', individual bank as per its trading objective, trading strategy, market scenario, risk appetite, risk management system may specify various exposure limits for trading and taking positions on different kinds of securities. The policy may also specify the methods and authority to approve, if any, the deviations from this prescribed limits. As there is no uniformity of these laid down limits, we may specify below some of the areas where these limits can be fixed.

- i) Investment in SLR securities (overall limit), Overall limit in exposure in HTM category.
- ii) Investment in Non-SLR securities (overall limit)
 - a) Limits for investment in bonds and debentures – separate limit and minimum credit rating may be set for investment in PSU bond, corporate bond, public and private sector bank bond. Limit for unrated and unlisted bond and debentures, rating-wise exposure limit, deal limit. Limits set out regarding net worth, profit earning tenure etc. of the counterparty while assessing investment proposal in the primary market.
- iii) Investment in certificate of deposit, commercial paper- minimum credit rating and maximum exposure per deal, counterparty and overall exposure, dealer-wise deal limit per deal.
- iv) Overall exposure limit in share portfolio. Limit of exposure in the secondary market. Limit in type of shares to be invested e.g., BSE, NSE, BSE 100, NIFTY JUNIOR etc. Primary market investment limit per organization for corporate and public sector separately, deal limit, Benchmark Beta for equity investment.
- v) Exposure limit for investment in mutual fund.
- vi) Investment limit per venture capital fund, overall venture fund exposure limit. Investment policy within the overall guidelines of Master Circular usually prescribes detailed paraphernalia for investment in Venture Capital Funds.
- vii) Counterparty-wise exposure limits for IRS and FRI. Limits in respect of size and tenor of the transaction.
- viii) Broker-wise limit for dealing through the brokers.
- ix) Stop loss (cut-loss) limit in aggregate, scrip-wise cut loss limit e.g., shares, mutual fund etc. Short sell limits, different paraphernalia regarding short sell, dealer-wise and deal-wise limit, Accumulated short position limit in HFT category for different type of securities.



- x) VAR tolerance limit.
- xi) Counter-party wise limit in call transactions. Separate limit in call money borrowing and lending operations.
- xii) Portfolio duration limit, Limit of modified duration in AFS portfolio.
- xiii) Net Open position limit, Aggregate gap limit, Dealer-wise Deal limit.

5.3.5 Delegation of Power for Investment

The Investment Policy as approved by the Board should specify discretionary power of different functionaries in the Treasury Department. There should be an Internal Committee for Investment. Composition of committee should be specified in the Investment policy. After Board of Directors, the committee holds maximum power in decision making regarding Investment. In short, the following may be activities of ICI.

- a) The Committee should take decision based on the notes / information to be submitted by the department.
- b) Discretionary Power of ICI will be as set out in the Investment Policy.
- c) Committee will meet at prescribed intervals.
- d) Decision of the Committee will be recorded immediately after the meeting on the notes submitted for discussion.

Besides, committee for investments, there may be a departmental trading committee who meet regularly to take decision on day to day trading activities. The composition of this committee may be specified also in the Investment Policy. This committee may discharge the following functions.

Departmental Trading Committee's Function

- i) All types of trading related to Secondary Market operation i.e. Govt. Security / other approved Security / Non-SLR Bonds / Equity / Debt Equity within the discretionary power of Chief Manager (Treasury), Asstt. General Manager/ Dy. General Manager (Treasury), and General Manager (Treasury) will be placed in the Committee daily for arriving at a decision taking into account market scenario.
- ii) All decision taken should be recorded in a Registrar on daily basis duly signed by all the members and decision should be unanimous.
- iii) As per decision taken above, the Dealers should put through deals on line or through Broker and record all deals in the Deal Register.
- iv) Investment policy should specify monetary limit of discretionary power of different functionaries e.g., ICI, MD, ED, GM, DGM, AGM, CM for sanctioning amount of different



deals settled under different segments of Treasury operations. The above powers are the maximum permissible in a day subject to reporting to the next higher authority of persons exercising discretionary power for ratification.

- v) Discretionary power so specified should meticulously be followed to validate a transaction.

5.3.6 Internal Control System

RBI Master circular on 'Prudential norms for classification, valuation and operation of Investment Portfolio of banks' specifies the following guidelines regarding internal control system of investment transactions

- (a) There should be a clear functional separation of (i) trading, (ii) settlement, monitoring and control and (iii) accounting. Similarly, there should be a functional separation of trading and back office functions relating to banks' own Investment Accounts, Portfolio Management Scheme (PMS) Clients' Accounts and other Constituents (including brokers') accounts. The Portfolio Management service may be provided to clients, subject to strictly following the guidelines regarding thereto (covered in Master Circular – Para-Banking Activities). Further, PMS Clients Accounts should be subjected to a separate audit by external auditors.
- (b) In the interest of maintaining integrity and orderly conditions in the government securities market, all SGL/CSGL account holders should adhere to the FIMMDA code of conduct while executing trades on NDS-OM and in the OTC market.
- (c) For every transaction entered into, the trading desk should prepare a deal slip which should contain data relating to nature of the deal, name of the counter-party, whether it is a direct deal or through a broker, and if through a broker, name of the broker, details of security, amount, price, contract date and time. The deal slips should be serially numbered and controlled separately to ensure that each deal slip has been properly accounted for. Once the deal is concluded, the dealer should immediately pass on the deal slip to the back office for recording and processing.
- (d) For each deal there must be a system of issue of confirmation to the counterparty. The timely receipt of requisite written confirmation from the counterparty, which must include all essential details of the contract, should be monitored by the back office.
- (e) With respect to transactions matched on the NDS-OM module, since CCIL is the central counterparty to all deals, exposure of any counterparty for a trade is only to CCIL and not to the entity with whom a deal matches. Besides, details of all deals on NDS-OM are available to the counterparties as and when required by way of reports on NDS-OM itself. In view of the above, the need for counterparty confirmation of deals matched on NDS-OM does not arise. The deals in Government Security transactions in OTC



market that are mandated to be settled through CCIL by reporting on the NDS, are not required to be confirmed physically as OTC deals depend on electronic confirmation by the back offices of both the counterparties on NDS system like the NDS-OM deals.

However, all Government Securities transactions, other than those mentioned above, will continue to be physically confirmed by the back offices of the counterparties, as hitherto.

(f) Banks are required to report OTC trades in Commercial Papers (CPs) and Certificate of Deposits (CDs) and OTC repo trades in corporate debt securities, CPs, CDs and non-convertible debentures (NCDs) of original maturity less than one year on F-TRAC- the reporting platform of Clearcorp Dealing Systems (India) Ltd. (CDSIL). These trades have to be physically confirmed by the back offices of the counterparties. In F-TRAC, both the counterparties individually report their respective sides of the trades and the trades are validated for trade details before matching by F-TRAC. This ensures implicit confirmation by both counterparties. Further, the details of the transactions are available on the F-TRAC system. The requirement of exchange of physical confirmation of trades matched on F- TRAC is waived subject to the following conditions:

- (i) Participants entering into one time bilateral agreement for eliminating the exchange of confirmation;
- (ii) Participants adhering to the extant laws such as stamp duty as may be applicable; and
- (iii) Participants ensuring adherence to a sound risk management framework and complying with all the regulatory and legal requirements and practices, in this regard.

The dispensation with respect to waiver of physical confirmation will be subject to review in case of any change in ownership of the F-TRAC platform or reporting arrangements thereof.

- (g) Once a deal has been concluded, there should not be any substitution of the counter party bank by another bank or by the broker, through whom the deal has been entered into; likewise, the security sold/purchased in the deal should not be substituted by another security.
- (h) On the basis of vouchers passed by the back office (which should be done after verification of actual contract notes received from the broker/ counterparty and confirmation of the deal by the counterparty), the Accounts Section should independently write the books of account.
- (i) In the case of transaction relating to PMS Clients' Accounts (including brokers), all the relative records should give a clear indication that the transaction belongs to PMS

Clients/ other constituents and does not belong to bank's own Investment Account and the bank is acting only in its fiduciary/ agency capacity.

- (j) Balances as per bank's books should be reconciled at quarterly intervals with the balances in the books of PDOs. If the number of transactions so warrant, the reconciliation should be undertaken more frequently, say on a monthly basis. This reconciliation should be periodically checked by the internal audit department.
- (k) A system for verification of the authenticity of the BRs and SGL transfer forms received from the other banks and confirmation of authorised signatories should be put in place.
- (l) Banks should put in place a reporting system to report to their top management, on a weekly basis, the details of transactions in securities, details of bouncing of SGL transfer forms issued by other banks and BRs outstanding for more than one month and a review of investment transactions undertaken during the period.
- (m) Banks should not draw cheques on their account with the Reserve Bank for third party transactions, including inter-bank transactions. For such transactions, bankers' cheques/ pay orders should be issued.
- (n) In case of investment in shares, the surveillance and monitoring of investment should be done by the Audit Committee of the Board, which shall review in each of its meetings, the total exposure of the bank to capital market, both fund based and non-fund based, in different forms as stated above and ensure that the guidelines issued by the Reserve Bank are complied with and adequate risk management and internal control systems are in place.
- (o) The Audit Committee should keep the Board informed about the overall exposure to capital market, the compliance with the Reserve Bank and Board guidelines, adequacy of risk management and internal control systems.
- (p) In order to avoid any possible conflict of interest, it should be ensured that the stockbrokers as directors on the Boards of banks or in any other capacity, do not involve themselves in any manner with the Investment Committee or in the decisions in regard to making investments in shares, etc., or advances against shares.
- (q) The internal audit department should audit the transactions in securities on an ongoing basis, monitor the compliance with the laid down management policies and prescribed procedures and report the deficiencies directly to the management of the bank.
- (r) The banks' managements should ensure that there are adequate internal control and audit procedures for ensuring proper compliance of the instructions in regard to the conduct of the investment portfolio. The banks should institute a regular system of monitoring compliance with the prudential and other guidelines issued by the Reserve



Bank. The banks should get compliance in key areas certified by their statutory auditors and furnish such audit certificate to the Regional Office of DBS, RBI under whose jurisdiction the HO of the bank falls.

As an internal control measure, all the transactions in Treasury should be reported to the General Manager (Treasury) on daily basis, to ICI on weekly basis and to the Board on monthly basis.

5.3.7 Audit, Review and Reporting System

RBI Master circular relating to investment specifies the following regarding Audit, Review and Reporting System which banks should follow meticulously.

- (a) FIs should undertake a half-yearly review (as of September 30 and March 31) of their investment portfolio, which should, apart from other operational aspects of investment portfolio, clearly indicate and certify adherence to laid down internal investment policy and procedures and Reserve Bank guidelines, and put up the same before their respective Boards within a month, i.e., by end-April and end-October.
- (b) A copy of the review report put up to the FI's Board should be forwarded to the Reserve Bank (concerned Regional Office of DBS) by November 15 and May 15 respectively. With effect from the half-year ended March 31, 2003 the half-yearly reviews of the investment portfolio of the FIs should be submitted to the Regional Offices of the Department of Banking Supervision (DBS), within whose jurisdiction the Head Office of the FI concerned is located, instead of being submitted to the Department of Banking Regulation, Financial Institutions Division as hitherto.
- (c) In view of the possibility of abuse, treasury transactions should be separately subjected to concurrent audit by internal auditors and the results of their audit should be placed before the CMD of the FI once every month. The major irregularities observed in the concurrent audit report of the treasury transactions as also the position of compliance therewith should be incorporated in the half-yearly reviews of the investment portfolio to be submitted to the Regional Offices of the DBS.

Chapter 6: Treasury Risk and Mid Office

Bank managements are highly sensitive to Treasury risks, as they arise out of the high leverage of the Treasury business. The risk of losing capital is much higher than, say, in the credit business. The second reason for managements' concern is the large size of the transaction done, at the sole discretion of the treasurers.

Treasury operations generally give rise to three kinds of risks: market risk (comprises liquidity risk, interest rate risk, exchange rate and equity price), credit risk and operational risk.

6.1 Market Risk

Market risk is the possibility of loss due to adverse movement of market variables. The RBI defines market risk as the risk of losses in on balance sheet and off balance sheet positions arising from movements in market prices. Thus, Market Risk is the risk to the bank's earnings and capital due to changes in the market level of interest rates or prices of securities, foreign exchange and equities, as well as the volatilities of those changes. Besides, it is equally concerned about the bank's ability to meet its obligations as and when they fall due. In other words, it should be ensured that the bank is not exposed to Liquidity Risk.

Treasury investments of a bank comprise securities like, government bonds, other approved securities, bonds and debentures, shares, mutual fund, commercial paper etc. In tune with the international best practices, the investments of a bank are classified into three categories namely i) Held for Trading (HFT) ii) Available for Sales (AFS) iii) Held to maturity (HMT). As per RBI, trading book refers to securities held under HFT and AFS while banking book refers to securities held under HTM. The securities held in trading book are basically aimed at deriving profit out of trading taking advantage of short term price movement. The securities held in HTM are basically meant earning steady income, meeting statutory obligation. The securities in trading book are to be marked to market periodically as per RBI guidelines.

6.1.1 Interest Rate Risk:

Interest rate risk is the exposure of a bank's financial condition to adverse movements in interest rates. Accepting this risk as a normal part of banking, it can be used as an important source of profitability and shareholder value. However, excessive interest rate risk can pose a significant threat to a bank's earnings and capital base. Changes in interest rates affect a bank's earnings by changing its net interest income and the level of other interest-sensitive income and operating expenses. Changes in interest rates also affect the underlying value of the bank's assets, liabilities and off-balance sheet instruments because the present value of future cash flows (and in some cases, the cash flows themselves) change when interest rates change.



Management of Interest Rate Risk aims at capturing the risks arising from maturity and re-pricing mismatches of various risk sensitive assets and liabilities. Interest rate risks are measured both from the earnings and economic value perspective.

Earnings perspective involves analysing the impact of changes in interest rates on accrual or reported earnings in the near term. This is measured by measuring the changes in the Net Interest Income (NII) or Net Interest Margin (NIM) i.e. the difference between the total interest income and the total interest expense.

Economic Value perspective involves analysing the changes of impact of interest on the expected cash flows on assets minus the expected cash flows on liabilities plus the net cash flows on off-balance sheet items. It focuses on the risk to net worth arising from all re-pricing mismatches and other interest rate sensitive positions. The economic value perspective identifies risk arising from long-term interest rate gaps.

The level of interest rate changes is a crucial factor to decide fixed or floating rate sensitive assets and liabilities, their maturities and hedging decisions.

6.1.1.1 Interest Rate Risk in Trading and Banking Book

- Generally, the approach towards measurement and hedging of IRR varies with the segmentation of the balance sheet. In a well functioning risk management system, banks broadly position their balance sheet into Trading and Investment or Banking Books. While the assets in the trading book are held primarily for generating profit on short-term differences in prices/yields, the banking book comprises assets and liabilities, which are contracted basically on account of relationship or for steady income and statutory obligations and are generally held till maturity. Thus, while the price risk is the prime concern of banks in trading book, the earnings or economic value changes are the main focus of banking book.

- **Measuring and Managing Interest Rate Risk:**

Before interest rate risk could be managed, they should be identified and quantified. Unless the quantum of IRR inherent in the balance sheet is identified, it is impossible to measure the degree of risks to which banks are exposed. It is also equally impossible to develop effective risk management strategies/hedging techniques without being able to understand the correct risk position of banks.

a) Trading Book

The interest rate risk in Trading Book arises due to:

- i) volatility in interest rate – this might have an impact in exercising different embedded options
- ii) movement in different benchmark interest rate in either direction is not by the same basis point.



- iii) movement of different currency interest rates in either direction not by the same basis point
- iv) the impact on interest cost/yield of debt instruments not be equal due to non-parallel shift in yield curve.
- v) economy being highly inflationary-managing interest rate in this situation is a challenging option
- vi) due to business compulsions and market competition, the bank may force to change interest rate opposite to the general market movement of interest
 - The top management of banks should lay down policies with regard to volume, maximum maturity, holding period, duration, stop loss, defeasance period, rating standards, etc. for classifying securities in the trading book. While the securities held in the trading book should ideally be marked to market on a daily basis, the potential price risk to changes in market risk factors should be estimated through internally developed Value at Risk (VaR) models. The VaR method is employed to assess potential loss that could crystallise on trading position or portfolio due to variations in market interest rates and prices, using a given confidence level, usually 95% to 99%, within a defined period of time. The VaR method should incorporate the market factors against which the market value of the trading position is exposed. The top management should put in place bank-wide VaR exposure limits to the trading portfolio (including forex and gold positions, derivative products, etc.) which is then disaggregated across different desks and departments. The loss making tolerance level should also be stipulated to ensure that potential impact on earnings is managed within acceptable limits. The potential loss in Present Value Basis Points should be matched by the Middle Office on a daily basis vis-à-vis the prudential limits set by the Board. The advantage of using VaR is that it is comparable across products, desks and Departments and it can be validated through back testing. However, VaR models require the use of extensive historical data to estimate future volatility.

b) Banking Book:

The changes in market interest rates have earnings and economic value impacts on the bank's banking book. Thus, given the complexity and range of balance sheet products, banks should have IRR measurement systems that assess the effects of the rate changes on both earnings and economic value. The variety of techniques ranges from simple maturity (fixed rate) and re-pricing (floating rate) gaps and duration gaps to static simulation, based on current on-and-off-balance sheet positions, to highly sophisticated dynamic modelling techniques that incorporate assumptions on behavioural pattern of



assets, liabilities and off-balance sheet items and can easily capture the full range of exposures against basis risk, embedded option risk, yield curve risk, etc. are used for this purpose.

Different Interest Risk Management Techniques:

i) Maturity Gap Analysis: It is the simplest analytical technique for calculating IRR exposure in trading book. Maturity Gap Analysis distributes interest rate sensitive assets, liabilities and off-balance sheet positions into a certain number of pre-defined time-bands according to their maturity (fixed rate) or time remaining for their next re-pricing (floating rate). Those assets and liabilities lacking definite re-pricing intervals (savings bank, cash credit, overdraft, loans, export finance, refinance from RBI etc.) or actual maturities vary from contractual maturities (embedded option in bonds with put/call options, loans, cash credit/overdraft, time deposits, etc.) are assigned time-bands according to the judgement, empirical studies and past experiences of banks.

While using time bands, most banks focus their attention on near-term periods, viz. monthly, quarterly, half-yearly or one year. It is very difficult to take a view on interest rate movements beyond a year. Banks with large exposures in the short-term should test the sensitivity of their assets and liabilities even at shorter intervals like overnight, 1-7 days, 8-14 days, etc.

In order to evaluate the earnings exposure, interest Rate Sensitive Assets (RSAs) in each time band are netted with the interest Rate Sensitive Liabilities (RSLs) to produce a re-pricing Gap for that time band. The positive Gap indicates that banks have more RSAs than RSLs. A positive or asset sensitive Gap means that an increase in market interest rates could cause an increase in NII. Conversely, a negative or liability sensitive Gap implies that the banks' NII could decline as a result of increase in market interest rates. The negative gap indicates that banks have more RSLs than RSAs. The Gap is used as a measure of interest rate sensitivity. The Positive or Negative Gap is multiplied by the assumed interest rate changes to derive the Earnings at Risk (EaR). The EaR method facilitates to estimate how much the earnings might be impacted by an adverse movement in interest rates. The changes in interest rate could be estimated on the basis of past trends, forecasting of interest rates, etc. The banks should fix EaR which could be based on last/current year's income and a trigger point at which the line management should adopt on- or off-balance sheet hedging strategies may be clearly defined.

ii) Duration gap analysis: Duration is a time and value weighted measure of maturity that takes into consideration the timing of future cash flows from the assets and the timing of all future cash outflow from the liabilities. In its simplest form, duration measures changes in economic value resulting from a percentage change of interest



rates under the simplifying assumptions that changes in value are proportional to changes in the level of interest rates and that the timing of payments is fixed.

- iii) **Convexity:** Convexity is the rate of change in duration. Compared to duration, it is a better measure of price sensitivity when change in interest rate is large.
- iv) **Simulations:** Simulations are computer generated scenarios about the future that permits bank to analyse interest rate risk and form business strategies in a dynamic framework. Given different scenarios of probable market condition, banks may assess the desirability of different courses of actions. These scenarios are based on assumptions on probable changes of interest rate, shape of yield curve, pricing strategies, growth volume and mix of assets and liabilities and their categorization and hedging strategies. The main advantage of the simulation methods is that they are dynamic and forward-oriented. Banks can change their interest rate scenarios depending on many factors such as pricing and structure of assets and liabilities. The models also take into account the fact that interest rates do not change similarly in the various maturity groups, so risk caused by unparallel changes in the yield curve can be identified through using a simulation method. The accuracy of those models depends on the validity of the used output.
- v) **VaR based methodology:** VaR is a measure of potential loss in a position or assets/liabilities or a portfolio of assets/liabilities over a given holding period at a given level of certainty. The Bank for International Settlement has accepted VaR as a measurement of market risks and provision for capital adequacy for market risks. VaR is used as an MIS tool in the trading portfolio to 'slice and dice' risk by levels/products/geographic/level of organization etc. It is also used to set risk limits. In its strategic perspective, VaR is used to decisions as to what business to do and what not to do. However VaR as a useful MIS tool has to be "back tested" by comparing each day's VaR with actual and necessary re-examination of assumptions needs to be made so as to be close to reality. VaR, therefore, cannot substitute sound management judgment, internal control and other complementary methods. It is used to measure and manage market risks in trading portfolio and investment portfolio.

However, in case of extreme volatile condition, VaR may not give good results where stress testing should be used as a compliment.

- vi) **Stress Testing:** 'Stress testing' has been adopted as a generic term describing various techniques used by banks to gauge their potential vulnerability to exceptional, but plausible, events. Stress testing addresses the large moves in key market variables of that kind that lie beyond day to day risk monitoring but that could potentially occur. The process of stress testing, therefore, involves first identifying these potential movements, including which market variables to stress,



how much to stress them by, and what time frame to run the stress analysis over. Once these market movements and underlying assumptions are decided upon, shocks are applied to the portfolio.

The application of various techniques depends to a large extent on the quality of data and the degree of automated system of operations. Thus, banks may start with the gap or duration gap or simulation techniques on the basis of availability of data, information technology and technical expertise. In any case, as suggested by RBI in the guidelines on ALM System, banks should start estimating the interest rate risk exposure with the help of Maturity Gap approach. Once banks are comfortable with the Gap model, they can progressively graduate into the sophisticated approaches

6.1.2 Foreign Exchange Risk

Foreign Exchange Risk maybe defined as the risk that a bank may suffer losses as a result of adverse exchange rate movements during a period in which it has an open position, either spot or forward, or a combination of the two, in an individual foreign currency. The banks are also exposed to interest rate risk, which arises from the maturity mismatching of foreign currency positions. Even in cases where spot and forward positions in individual currencies are balanced, the maturity pattern of forward transactions may produce mismatches. Consequently, banks may suffer losses as a result of changes in premium/discounts of the currencies concerned.

In the forex business, banks also face the risk of default of the counterparties or settlement risk. While such type of risk crystallization does not cause principal loss, banks may have to undertake fresh transactions in the cash/spot market for replacing the failed transactions. Thus, banks may incur replacement cost, which depends upon the currency rate movements. Banks also face another risk called time-zone risk or Herstatt risk which arises out of time-lags in settlement of one currency in one centre and the settlement of another currency in another time-zone. The forex transactions with counterparties from another country also trigger sovereign or country risk.

The three important issues that need to be addressed in this regard are:

- Nature and magnitude of exchange risk
- The strategy to be adopted for hedging or managing exchange risk.
- The tools of managing exchange risk.

Forex Risk and Treasury Operations

The primary treasury operation of a bank is that of catering to customer needs, both in the spot as well as forward market. This lands the bank with net foreign exchange positions

which it needs to manage on a real time basis. If the bank needs to sell Dollars forward to an importer, the bank has a short Dollar position. It can offset the position by buying matching forward Dollars in the market in which case all risks apart from the profit element are covered for the bank. However, it may be easier for the bank to immediately cover the forex risk with a purchase of Dollars in the spot market. Here again the exchange risk is fully covered except for the profit element. However the bank now has a swap position. This is called a gap. The bank has a gap risk which affects it if interest rates change affecting the forward premia for Dollar. In the case of our domestic markets, in addition, premium could also change due to forward demand/supply factors. However, gap risks are easier to manage than exchange risks. So the bank can build up gaps, subject to the management mandated gap limits, and do offsetting swaps to reduce gap risks if it so desires periodically. The bank's treasury might also do transactions to take advantage of disequilibrium situations, subject to such transactions being permissible. For instance if the forward premium for 6 months is say 5% while the 6-month interest differential between Rupee and Dollar is say 4%, the bank can receive in the forex market (buy spot, sell 6-month swap to earn 5% annualised for 6 months) and finance the transaction by borrowing in the money market (money market cost being 4% annualised for 6 months). The bank can also do transactions to take advantage of expected interest rate changes. It can then use either the money market route (mismatched cash-flow maturities) or the forex market route (by running a gap risk). The bank of course also trades on currency movements with a view to make profits. Here the management must keep in place systems of stop loss discipline, proper monitoring and evaluation of open positions, etc.

6.2 Liquidity Risk

Liquidity risk is the potential inability to meet the bank's liabilities as they become due. It arises when the banks are unable to generate cash to cope with a decline in deposits or increase in assets. It originates from the mismatches in the maturity pattern of assets and liabilities. Measuring and managing liquidity needs are vital for effective operation of commercial banks. By assuring a bank's ability to meet its liabilities as they become due, liquidity management can reduce the probability of an adverse situation developing.

Analysis of liquidity risk involves the measurement of not only the liquidity position of the bank on an ongoing basis but also examining how funding requirements are likely to be affected under crisis scenarios. Net funding requirements are determined by analysing the bank's future cash flows based on assumptions of the future behaviour of assets and liabilities that are classified into specified time buckets and then calculating the cumulative net flows over the time frame for liquidity assessment.

Future cash flows are to be analysed under "what if" scenarios so as to assess any significant positive / negative liquidity swings that could occur on a day-to-day basis and under bank specific and general market crisis scenarios. Factors to be taken into consideration



while determining liquidity of the bank's future stock of assets and liabilities include their potential marketability, the extent to which maturing assets /liability will be renewed, the acquisition of new assets / liability and the normal growth in asset / liability accounts.

Factors affecting the liquidity of assets and liabilities of the bank cannot always be forecast with precision. Hence they need to be reviewed frequently to determine their continuing validity, especially given the rapidity of change in financial markets.

The liquidity risk in banks manifest in different dimensions:

- i. Funding Risk** – need to replace net outflows due to unanticipated withdrawal/non-renewal of deposits (wholesale and retail);
- ii. Time Risk** – need to compensate for non-receipt of expected inflows of funds, i.e. performing assets turning into non-performing assets; and
- iii. Call Risk** – due to crystallisation of contingent liabilities and unable to undertake profitable business opportunities when desirable.

The first step towards liquidity management is to put in place an effective liquidity management policy, which, *inter alia*, should spell out the funding strategies, liquidity planning under alternative scenarios, prudential limits, liquidity reporting / reviewing, etc. Liquidity measurement is quite a difficult task and can be measured through stock or cash flow approaches. The key ratios, adopted across the banking system are Loans to Total Assets, Loans to Core Deposits, Large Liabilities (minus) Temporary Investments to Earning Assets (minus) Temporary Investments, Purchased Funds to Total Assets, Loan Losses/Net Loans, etc.

While the liquidity ratios are the ideal indicator of liquidity of banks operating in developed financial markets, the ratios do not reveal the intrinsic liquidity profile of Indian banks which are operating generally in an illiquid market. Experiences show that assets commonly considered as liquid like Government securities, other money market instruments, etc. have limited liquidity as the market and players are unidirectional. Thus, analysis of liquidity involves tracking of cash flow mismatches. For measuring and managing net funding requirements, the use of maturity ladder and calculation of cumulative surplus or deficit of funds at selected maturity dates is recommended as a standard tool. The format prescribed by RBI in this regard under ALM System should be adopted for measuring cash flow mismatches at different time bands. The cash flows should be placed in different time bands based on projected future behaviour of assets, liabilities and off-balance sheet items. In other words, banks should have to analyse the behavioural maturity profile of various components of on / off-balance sheet items on the basis of assumptions and trend analysis supported by time series analysis. Banks should also undertake variance analysis, at least, once in six months to validate the assumptions. The assumptions should be fine-tuned over a period which facilitate near reality predictions about future behaviour of on



/ off-balance sheet items. Apart from the above cash flows, banks should also track the impact of prepayments of loans, premature closure of deposits and exercise of options built in certain instruments which offer put/call options after specified times. Thus, cash outflows can be ranked by the date on which liabilities fall due, the earliest date a liability holder could exercise an early repayment option or the earliest date contingencies could be crystallised.

The difference between cash inflows and outflows in each time period, the excess or deficit of funds becomes a starting point for a measure of a bank's future liquidity surplus or deficit, at a series of points of time. The banks should also consider putting in place certain prudential limits as detailed below to avoid liquidity crisis:

- I Cap on inter-bank borrowings, especially call borrowings;
- ii Purchased funds vis-à-vis liquid assets;
- iii. Core deposits vis-à-vis Core Assets i.e. Cash Reserve Ratio, Statutory Liquidity Ratio and Loans;
- iv. Duration of liabilities and investment portfolio;
- v. Maximum Cumulative Outflows across all time bands;
- vi. Commitment Ratio – track the total commitments given to corporate/banks and other financial institutions to limit the off-balance sheet exposure;
- vii. Swapped Funds Ratio, i.e. extent of Indian Rupees raised out of foreign currency sources.

Banks should also evolve a system for monitoring high value deposits (other than inter-bank deposits) say Rs.1 crore or more to track the volatile liabilities. Further, the cash flows arising out of contingent liabilities in normal situation and the scope for an increase in cash flows during periods of stress should also be estimated. It is quite possible that market crisis can trigger substantial increase in the amount of draw downs from cash credit/overdraft accounts, contingent liabilities like letters of credit, etc.

The liquidity profile of the banks could be analysed on a static basis, wherein the assets and liabilities and off-balance sheet items are pegged on a particular day and the behavioural pattern and the sensitivity of these items to changes in market interest rates and environment are duly accounted for. The banks can also estimate the liquidity profile on a dynamic way by giving due importance to:

- 1) Seasonal pattern of deposits/loans;
- 2) Potential liquidity needs for meeting new loan demands, unavailed credit limits, potential deposit losses, investment obligations, statutory obligations, etc.



Contingency Funding Plan

- All banks are required to produce a Contingency Funding Plan. These plans are to be approved by ALCO, submitted annually as part of the Liquidity and Capital Plan, and reviewed quarterly. The preparation and the implementation of the plan may be entrusted to the treasury.
- Contingency Funding Plans are liquidity stress tests designed to quantify the likely impact of an event on the balance sheet and the net potential cumulative gap over a 3-month period. The plan also evaluates the ability of the bank to withstand a prolonged adverse liquidity environment. At least two scenarios require testing: Scenario A, a local liquidity crisis, and Scenario B, where there is a nationwide name problem or a downgrade in the credit rating if the bank is publicly rated.
- The bank's contingency funding plans should reflect the funding needs of any bank managed mutual fund whose own Contingency Funding Plan indicates a need for funding from the bank.
- Reports of Contingency Funding plans should be performed at least quarterly and reported to ALCO.

Foreign Currency Liquidity Management

For banks with an international presence, the treatment of assets and liabilities in multiple currencies adds a layer of complexity to liquidity management for two reasons. First, banks are often less well known to liability holders in foreign currency markets. Therefore, in the event of market concerns, especially if they relate to a bank's domestic operating environment, these liability holders may not be able to distinguish rumour from fact as well or as quickly as domestic currency customers. Second, in the event of a disturbance, a bank may not always be able to mobilise domestic liquidity and the necessary foreign exchange transactions in sufficient time to meet foreign currency funding requirements. These issues are particularly important for banks with positions in currencies for which the foreign exchange market is not highly liquid in all conditions.

Banks should, therefore, have a measurement, monitoring and control system for liquidity positions in the major currencies in which it is active. In addition to assessing its aggregate foreign currency liquidity needs and the acceptable mismatch in combination with its domestic currency commitments, a bank should also undertake separate analysis of its strategy for each currency individually.

6.3 Credit Risk

Credit risk is the chance that a bond issuer will not make the coupon payments or principal repayment to its bondholders. In other words, it is the chance the issuer will default.



Credit Risk in treasury operations arises when an investor enters into a transaction with some form of payment obligation from another party, be it with a bank, a company or a government institution. This is because there is a risk that the bank, government institution may not be able to meet its repayment obligation. For example, if an investor buys a debt security from a corporate issuer that gets into financial difficulties, there is a risk that the issuer may fail to repay the principal on the loan, or meet its interest payments. If this happens, then the issuer is said to be in default. Credit risk simply refers to the risk that the issuer will default. The greater the potential for default, the higher the level of credit risk.

However, day to day concern for treasurers is not simply that a company or government will default, but whether there is a perceived risk that it might. A downgrade or just the possibility of a downgrade to the credit quality of a debt security can have a negative impact on price and liquidity and lead to losses or breach of investment policy guidelines.

The negative impacts that credit downgrades can have for investors have been highlighted recently in Greece, where liquidity in the Greek government bonds market dried up and short term yield surged after Standard & Poor's cut Greece's sovereign credit rating to sub-investment grade status. The situation in Greece has also shown how counterparty risk can spread, as the threat of contagion has led to sovereign downgrades in other highly indebted Euro zone countries (Portugal and Spain).

It is therefore imperative that Treasury should ensure that the credit quality of all the securities that it invests is always fully assessed and that counterparty risk is managed carefully. The treasury must also ensure that it knows its full exposure to any particular counterparty. For example, a company may have counterparty exposures to a particular bank through investments such as deposits, short-term securities, and bond. It may also use the same bank for lending, transactional services and foreign exchange and interest rate risks. Furthermore, if the company invests in money market funds, it may also have indirect counterparty exposure. Thus the total counter party exposure for the company may exceed desirable limit.

Credit risk also includes country/political/sovereign risk. This risk covers governments' legislative change and is usually beyond the control of either party.

Some pertinent questions for Auditor on Credit Risk on treasury:

- Whether Investment Policy lays down adequate provisions to determine credit limits relating to investment in different kind of securities?
- Whether adequate capacity is there to measure credit exposure.
- Whether the organization has some system in place for handling and valuing collateral received or paid.
- Whether the organization has settlement limits.



- Whether the organization has its own system of risk rating which is duly approved by the Board/Investment Committee.
- If the exposure is credit rated by credit rated agency, what reliance is placed on it by the top management.
- Whether credit risk is appropriately managed.
- Whether any instance of breaches of credit or settlement limits are immediately brought to the notice of the appropriate authority.

6.4 Operational Risk

Under Basel II developed by the Bank for International Settlements (BIS) 2, operational risk is defined as “the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.” The definition explicitly includes legal risk, but excludes strategic and reputation risk. While this definition and sound practices established by the Basel Committee on Banking Supervision has been primarily designed for the banking and financial sector, the governing principles can appropriately be applied to treasury operations. What is necessary is an ORM framework that is appropriate to the range and nature of treasury operations and the operating environment.

For treasury, the categories of risks, such as market risk (exchange rate and interest rate risk), liquidity risk, and credit risk are relatively well known; however operational risk is not. Government treasurers are now beginning to understand operational risk management and the importance to their treasury. A summary of operational risks faced by the treasury is set out in Box 1. Business continuity planning should be an integral part of the ORM framework for treasury

ORM

The treasurer should be aware of the major aspects of operational risks as a distinct risk category that should be managed, and should approve and periodically review the operational risk management framework applicable to treasury. The framework should provide a definition of operational risk and lay down the principles of how operational risks are to be identified, assessed, monitored, and controlled or mitigated. A risk committee may be in place to oversee this process. Senior management in treasury should have responsibility for implementing the ORM framework. The framework should be consistently implemented throughout all treasury operations, and all levels of staff should understand their responsibilities with respect to ORM. Senior management should also have responsibility for developing policies, processes and procedures for managing operational risk across all treasury activities, processes and systems. Senior management should also ensure that before new activities, processes, and systems are introduced or undertaken, the operational risks inherent in them is subject to adequate assessment and managed appropriately.



Treasury should implement a process to regularly monitor incidents that may cause a business disruption and/or have a serious impact on treasury operations. There should be regular reporting of pertinent information to the treasurer and senior executives in the ministry of finance. Treasury should have policies, processes, and procedures to control and/or mitigate the potentially more serious operational risks. Treasury should periodically review the ORM framework and should adjust their risk limitation and control strategies in the context of the regulator's overall risk management strategy and objectives. Treasury should have in place business continuity and disaster recovery plan to ensure its ability to operate on an ongoing basis and limit losses in the event of any business disruption.

Typical Treasury operational Risk

- Infrastructure and technology failure covering computer systems, power, telecommunications, data and physical records.
- Incidents where access to premises denied either through inaccessibility or building damage.
- Dependency on third party key service providers such as the central and/or commercial banks, telecom and internet providers and other outsourced operations, or resource failures from such incidents as a pandemic.
- Human errors or failures through lack of resources, skill, training, policies, procedures, delegation, code of conduct and poor management.
- Failure to meet statutory, legal or contractual human resources and other obligations including management objectives and reporting obligations.
- Natural and regional disasters covering incidents such as earthquake, tsunami, severe flooding, hurricane/typhoon, volcanic eruptions, severe fires, landslides and civil disturbances or terrorism.

MID OFFICE ROLE OF TREASURY

RBI guidance note on 'Market Risk Management' has charted out the role of Mid office of Treasury as follows:

The **Middle Office** is responsible for the critical functions of independent market risk monitoring, measurement, analysis and reporting for the bank's ALCO. Ideally this is a full time function reporting to, or encompassing the responsibility for, acting as ALCO's secretariat. An effective Middle Office provides the independent risk assessment which is critical to ALCO's key-function of controlling and managing market risks in accordance with the mandate established by the Board/Risk Management Committee. It is a highly specialised function and must include trained and competent staff, expert in market risk concepts. The methodology of analysis and reporting will vary from bank to bank



depending on their degree of sophistication and exposure to market risks. These same criteria will govern the reporting requirements demanded of the Middle Office, which may vary from simple gap analysis to computerised VaR modelling. Middle Office staff may prepare forecasts (simulations) showing the effects of various possible changes in market conditions related to risk exposures. Banks using VaR or modelling methodologies should ensure that its ALCO are aware of and understand the nature of the output, how it is derived, assumptions and variables used in generating the outcome and any shortcomings of the methodology employed. Segregation of duties should be evident in the middle office which must report to ALCO independently of the treasury function. In respect of banks without a formal Middle Office, it should be ensured that risk control and analysis should rest with a department with clear reporting independence from Treasury or risk taking units, until formal Middle Office frameworks are established.



Chapter 7: Risk-Based Internal Audit of Treasury

Internal audit is an independent, objective assurance and consulting activity designed to provide assurance services, add value and improves an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes

7.1. Goals and Objectives:

Audit objectives are goals to be accomplished from audit activities. In a treasury environment the objectives should include:

- To undertake allocation of audit resources in accordance with the risk profile to minimise the impact of crisis situations i.e. to draw audit plans based on risk assessment
- To ensure that the risks faced by the branch in its efforts to meet its goals –short term as well as long term are identified, assessed and the procedure followed for monitoring the risk is correct and fool proof.
- To evaluate the process, by which the risks are identified, analysed, measured, monitored and managed by reviewing and reporting on the line of control over key processes i.e. control environment as a whole instead of identifying and testing controls.
- To test 'how well all the risks perceived by the bank are managed' rather than finding out 'whether the control over risks are adequate and effective'
- To ensure that the entity frames policies and procedures relating to all treasury activities and review them for adequacy and coverage.
- To determine whether management has planned for liquidity needs for both normal operating conditions and emergency situations
- To ensure adequate physical and access control procedures are in place in the department.
- To verify existence of satisfactory controls exist in the processing of deals
- To ascertain that the entity receives favourable rates for all its deals.
- To check that there is accurate recording and accounting of positions
- To ensure that their there is proper documentation procedures and filing systems in place.
- To ensure that limits are set for different procedures and they are adhered to in a consistent manner.
- To verify that any violations are promptly reported and properly dealt with.



- To ensure that reconciliation is being made timely and accurately.

The audit objectives must be accomplished for the audit to be useful and have value.

7.2 Scope of RBIA in Treasury:

Within the broad objectives of RBIA in Treasury mentioned hereinabove, scope of RBIA for treasury segment is attuned to the dimension of risks in various segments of Treasury operations. The extremely high risk areas and very high risk areas identified in Treasury must be intervened with more intensity and more intermittently compared to the medium and low risk areas. But basically, internal audit provides an independent and objective review and advisory service to:

- Provide reasonable assurance to the Board and top management, that Treasury's financial and operational controls, designed to identify and manage the organisation's risks and achieve the entity's objectives, are operating in an efficient, effective and ethical manner,
- Evaluate the reliability, effectiveness and integrity of management information systems and processes (including relevance, accuracy, completeness, availability, confidentiality and comprehensiveness of data);
- Monitoring of compliance with laws and regulations, including any requirements from supervisors;
- Safeguarding of assets;
- And assist management in improving Treasury's business performance.
- The internal auditor, apart from above, is expected to review/report at the minimum on:-
 - Process by which risk are identified and managed to various areas
 - The control environment in various areas
 - Gaps, if any, in control mechanism which might lead to frauds, identification of fraud prone areas;
 - Internal regulatory and statutory compliance
 - Budgetary control and performance reviews
 - Transaction testing /verification of assets to the extent considered necessary
 - Monitoring compliance with the risk-based internal audit report
 - Variation, if any, in the assessment of risks under the audit plan vis-à-vis the risk-based internal audit



7.3 Audit Universe:

7.3.1 Areas in Treasury Audit

i) Audit Activities:

- a) The treasury organization:
 - Review of the effectiveness of the current organization.
 - Adequacy of Treasury policy and procedures documentation,
 - Evaluation of procedures, and practices for effectiveness, appropriateness, and security.
 - Review and assess that adequate segregation of duties in the Treasury function exists;
 - Review and assess reporting of Treasury positions in terms of detail and frequency;
 - Review and assess reconciliation, recording, monitoring processes;
 - Review and assess authorisation levels within the Treasury function; and
 - Review and assess the systems utilized to undertake the Treasury function.
- b) Cash flow forecasting activities:
 - Review the effectiveness of the organization's cash flow forecasting activities is measured against plan over a period of time.
 - Evaluation of its impact on investing and/or borrowing activities.
- c) Investment activities:
 - Review of investment strategies and activities.
 - Review of organization's investment policy and guidelines for reasonability and effectiveness.
 - Comparison of yields on investments with appropriate standard benchmarks to measure performance.
 - Whether the organization has established procedures for
 - o Reviewing and assessing the performance benchmarks
 - o Reviewing and assessing product management
 - o Reviewing and assessing liquidity management



d) Financial risk management activities:

- Evaluation of the steps and strategies of the organization's financial risk management activities
- Comparison of risk management activities with appropriate standard benchmark
- Evaluate the effectiveness of, and contribute to the improvement in, risk management processes.
- Provide assurance that risk exposures relating to the organisation's strategy, governance, operations, and information systems are correctly evaluated, including:
 - reliability and integrity of financial and operational information
 - effectiveness, efficiency and economy of operations, and safeguarding of assets
 - evaluate the design, implementation, and effectiveness of the organisation's ethics-related objectives, programs, and activities.
 - assess whether the information technology governance of the organisation sustains and supports the organisation's strategies and objectives

e) Foreign exchange risk management activities:

Assessment of the foreign exchange policies in relation to the effectiveness in reducing the impact of exchange rate variances on the reported annual earnings and operating cash flow;

f) Compliance

Compliance with applicable laws, regulations, policies, procedures and contracts.

g) Performance improvement

- the efficiency, effectiveness, and economy of Treasury's business systems, processes and programs.
- Advisory services: The Internal Audit function can advise Treasury's management on a range of matters including:

New programs, systems and processes

- providing advice on the development of new programs and processes and/or significant changes to existing programs and processes including the design of appropriate controls



Risk management

- assisting management to identify risks and develop risk mitigation and monitoring strategies as part of the risk management framework

Fraud control

- evaluating the potential for the occurrence of fraud and how the organisation manages fraud risk
- assisting management to investigate fraud, identify the risks of fraud and develop fraud prevention and monitoring strategies.

7.4 Independence:

Independence is essential to the effectiveness of the Internal Audit function. “Independence” is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. Internal audit activity must be independent, and internal auditors must be objective in performing their work. Internal auditors must have an impartial, unbiased attitude and avoid any conflicts of interest. The Internal Audit function has no direct authority or responsibility for the activities it reviews. The Internal Audit function has no responsibility for developing or implementing procedures or systems, except for those related to governance and internal audit. It does not prepare records or engage in original line processing functions or activities excepting certain exceptions. It should be independent from internal control process and should not be assigned the responsibility to perform any other operational or accounting functions. An Internal Auditor should be free from any conflict of interest arising from professional or personal relationships or other interests which he/she may be subjected to audit. The Internal Audit function is responsible on a day to day basis to the Chief Audit Executive. The Internal Audit function, through the Chief Audit Executive, reports functionally to the Audit and Risk Committee on the results of completed audits and for strategic direction and accountability purpose.

7.5 Authority and Confidentiality

Internal auditors are authorised to have full, free and unrestricted access to all functions, premises, assets, personnel, records, and other documentation and information that the Chief Audit Executive considers necessary to enable the Internal Audit function to meet its responsibilities.

All records, documentation and information accessed in the course of undertaking internal audit activities are to be used solely for the conduct of these activities. The Chief Audit Executive and individual internal audit staff are responsible and accountable for maintaining the confidentiality of the information they receive during the course of their work.



7.6 Roles and Responsibilities

The Internal Audit function must evaluate and contribute to the improvement of governance, risk management and control processes using a systematic and disciplined approach based on established Audit Standards.

In the conduct of its activities, the Internal Audit function will play an active role in:

- developing and maintaining a culture of accountability and integrity
- facilitating the integration of risk management into day-to-day business activities and processes, and
- Promoting a culture of cost-consciousness, self-assessment and adherence to high ethical standards.

7.7 Standard

Internal audit activities will be conducted in accordance with relevant professional standards including:

- International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors
- Standards for audit and for risk management issued by the International Standards Organization.

In the conduct of internal audit work, internal audit staff will:

- comply with relevant professional standards of conduct
- possess the knowledge, skills and technical proficiency relevant to the performance of their duties
- be skilled in dealing with people and communicating audit, risk management and related issues effectively
- exercise due professional care.

7.8 Stages of Internal Audit:

- 7.8.1 Preparation Stage
- 7.8.2 Information gathering Stage
- 7.8.3 Audit Plan Preparation Stage
- 7.8.4 Audit Documentation Stage
- 7.8.5 Conduct of Audit Procedure
- 7.8.6 Internal Audit Report



7.8.1 Preparation Stage

1. At the preparation stage, the auditor, with his due professional care, is required to critically analyse his engagement, which may, inter alia, include the followings.

Detailed Terms of Engagement (Detailed Scope)

The Detailed Terms of Engagement will normally include:

- A title/subtitle for the audit which clearly indicates the topic of the audit, the areas of the Treasury Cluster to which it will apply, the type of assurance the audit will offer (e.g. reasonable assurance) and the Standard with which it will comply (if applicable)
- An overview of the area to be audited
- Background on why the audit is taking place
- The objectives of the audit
- A preliminary risk assessment
- A list of stakeholders and stakeholders' expectations for the audit
- The audit criteria
- The scope of the audit i.e. the processes the audit will include and exclude
- The audit standards that will be followed including the type of engagement
- The audit approach to be taken
- The key deliverables of the project
- The resources that will be used on the audit and the cost, and
- The timetable for delivery of audit report.

The Detailed Terms of Engagement must be approved and signed by both the Treasury Chief Audit Executive and the audit provider's Engagement Partner before the commencement of field work.

2. Analysis of the terms of engagement in the following perspective may be helpful to take a decision regarding acceptance of the engagement.
 - Extent of work needed to achieve the engagement's objectives.
 - Relative complexity, materiality, or significance of matters to which assurance procedures are applied.



- Adequacy and effectiveness of risk management, control, and governance processes.
 - Resources available with him in terms of knowledge adequacy, infrastructure, timeliness.
 - Probability of significant errors, irregularities, or noncompliance.
 - Cost of assurance in relation to potential benefits.
3. Acknowledgement of terms of the audit — The auditor is required to provide the engagement agreement to the audit committee and the audit committee has to acknowledge and agree to the terms. While the standard says this acknowledgement can be either oral or in writing, it is better that audit committee considers including a discussion of the engagement agreement on its meeting agenda and get the agreement documented in the meeting minutes.
 4. Obtaining information relevant to the audit — In addition to current inquiries regarding fraud risks, the auditor needs to inquire to audit committee members whether they are aware of other matters relevant to the audit.
 5. The internal auditor should not be engaged in a consulting engagement in the same area within the bank unless a reasonably long “cooling-off” period has elapsed. Subsequently, those experts who participated in an internal audit engagement should not provide consulting services to a function of the bank they recently audited. He should not be the statutory auditor for the same bank in the same financial year.

7.8.2 Information Gathering Stage

In this stage, the internal auditor will strive to garner as much information as possible regarding the subject of the business entity to be audited and will gather the required momentum for final take-off. He should acquire the detailed knowledge about the operating, regulatory and supervisory environment of the entity so that he can design his audit programme smoothly and meaningfully to deliver as per his engagement terms and expectation. We may chart out below a few indicators in this process.

1. Project Brief

For each planned audit, Treasury should provide a Project Brief which sets out issues and risks of which it is already aware in relation to the area to be audited and its preliminary views about what should be in and out of scope. The Brief will usually give the service provider guidance on the amount of resourcing envisaged for the audit. This may be subject to negotiation during the scoping phase.



2. Planning Meeting

The purpose of the planning meeting is to give the internal audit provider the opportunity to meet relevant managers, gain an overview and understanding of the audited area and agree timing.

The internal audit provider must establish an understanding with senior management within the area to be audited regarding objectives, scope, audit criteria, respective responsibilities and other client expectations. These points should be discussed at a planning meeting between the audit provider and Treasury CAE (client).

These points will then be documented in the Detailed Scope.

3. Audit Criteria

The audit provider should clarify the specific explicit and implicit criteria against which evidence collected will be evaluated.

Criteria are explicit when they are clearly set out in policies, manuals, standard operating procedures, standards, laws and/or regulations.

4. Information Repertoire:

Some of the key documents and information that the audit manager can use to gain a good understanding of the auditee include:

- Acts and related legislation or regulations
- Policy, procedures and standards manuals and directives
- Internal circulars relevant to the purpose of audit, Management directives
- Results of previous audits and evaluations by the AFI by RBI, System audit
- Organization charts
- Job descriptions and delegation instruments
- Listings of key personnel
- Process and system maps or flowcharts
- Operational and financial data and reports
- Management meeting reports or minutes
- Management control frameworks, e.g. results-based management and accountability frameworks (RMAFs), risk-based audit frameworks (RBAFs)
- Risk assessments
- Management studies or reports



- Accounting Policies
- Statutory and Regulatory Returns
- Board Notes, Internal Notes
- Best practice guidance and industry benchmark

In addition to reviewing documentation and analyzing financial and non-financial performance information, the audit manager may also want to consider visiting sites and observing operations, interviewing management, field staff, subject matter experts, and reviewing any available internal controls documentation.

To consolidate and confirm the understanding acquired, the audit manager should prepare a summary of the program, activity, organization or initiative in the form of an auditable unit or auditee profile. Such a profile should be reviewed with the auditee in order to confirm the audit manager's understanding of the auditee's business.

7.8.3 Audit Plan Preparation Stage

1. Planning the Internal Audit Program

Planning out the Audit Program on an at-least annual basis is essential to ensure that internal audit effort is directed to areas that will provide the most benefit and value to Treasury.

It also helps ensure that internal audits will not overburden the areas under review by clashing with external audits or with peak business periods.

The total audit planning process should involve the establishment of:

- A **Strategic Audit Plan** which is the identification and documentation of auditable areas within the Treasury Branch/department, and the prioritization of these areas for review based on a predetermined risk assessment methodology over a period of ,say, three years;
- An **Annual Audit Plan** which sets out the planning of individual audit assignments over one financial year; and
- A **Field Audit Plan**, which determines the scope and parameters for each individual audit.

a) Strategic Audit Planning

The Chief Audit Executive should establish long-term, strategic, risk-based plans to determine the priorities of the internal audit function and how they are linked to Treasury's objectives which should be approved by the Audit Committee of the Board of the bank



The Chief Audit Executive should be responsible for providing to the Audit Committee a three-year Strategic Audit Plan, the purpose of which is to ensure that there is reasonable internal audit coverage of all relevant risk areas and key internal control systems over time.

The Plan should prioritise the areas within Treasury for review, based on the risk assessment methodology. This strategic audit plan is desirable to demonstrate, in conjunction with the annual audit plan, sufficient internal audit coverage of all significant auditable units.

Developing a strategic audit plan follows a logical process as described below.

Understanding the Environment (Step 1): In order to understand the environment within which each organization operates, a top-down view of the organization depicting and detailing its business, operational risks and control for managing those risks may be taken.

Strategic Overview (Step 2): An understanding of the strategic plan and objectives for the organisation must be established that should aim at identifying the risks to which the organization is presently exposed and those to which it is likely to be exposed in future.

The strategic plan overview covers the following areas:

- Mission;
- Vision;
- Values; and
- Objectives.

In order to identify and analyse the risks that threaten the attainment of organisation's strategic objectives, strategic risk workshop and /or interviews may be conducted on the basis of above information.

Using the above information, a strategic risk workshop and/or interviews should be conducted where risks that threaten the attainment of the organisation's strategic objectives are identified and analysed. The controls put in place to manage the risks should be identified.

Detailed Analysis (Step 3): The understanding of the strategic objective and functioning of the organization provides the necessary ground to the management to devise how these strategic objectives can be translated and broken down into operational objectives .Conducting of a detailed risk analysis of the organisation is helpful in identifying those risks that impact on the achievement of organization objectives.

The analysis:

- helps in assessment of the effect of each risk on the objectives
- helps in considering the relevant risk management activities applied to the risk;
- helps in evaluating the effectiveness of such activities; and
- helps in identifying any further measures/actions needed to improve the risk management activities considering the risk appetite levels set by the management for the different activities or parts



of the organization. helps in identifying a risk that has not yet been included in risk management framework but seems to be pertinent.

In considering the effectiveness of risk management activities' actual or perceived control, measures are identified and their effectiveness assessed with regard to the identified risk.

Consolidated Risk Reporting (Step 4): It provides detailed reports of the processes reviewed that allow for risk rating, evaluation of control effectiveness, detailed action plans and audit strategy determination. The reports set out the risk and risk management response per business process.

The data can be used to plan, direct a risk management approach and provide the basis for risk management activities.

Risk Management Activities (Step 5): Establishment of an effective risk management system in the organisation is the responsibility of the management. In its bid to do that effectively, a mechanism is put in a place that formalizes the responsibility and establishes the accountability for management activities. This is often achieved through the establishment of a "Risk Committee" function. Its efforts should identify further actions that may be needed to reduce risk to an acceptable level.

The three-year Strategic Audit Plan should be reviewed by the Executive team and provided to the Audit Committee annually.

b) Annual Audit Plan:

The Annual Audit Plan, which sets out the Audit Program for the coming year, should be based on documented risk assessment and revised at least annually. The annual audit plan, approved by the Board, should include the schedule and rationale for audit work planned. It should also include all risk areas and their prioritization based on the level and direction of risk. Illustratively, the areas or activities identified as high, very high or extremely high risk (based on risk matrix) may be audited at shorter intervals as compared to medium or low risk areas, which may be audited at longer intervals subject to regulatory guidelines, as applicable.

i) Risk Assessment Methodology:

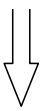
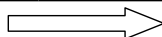
Risk assessment methodology, in order to determine incidence of risk in the auditable area and also to fix prioritization of auditable area based on the level and direction of risks, is mentioned below.

- The risk assessment would, as an independent activity, cover risk at various levels as also process in place to identify measure, monitor and control the risk. The internal audit department should devise the risk assessment methodology, with

the approval of the Board of Directors, keeping in view the size and complexity of the business undertaken by the bank.

- In the overall risk assessment both the inherent business risks and control risks should be factored in. Inherent business risks indicate the intrinsic risk in a particular area/activity of the bank and could be grouped into low, medium and high categories depending on the severity of risk .Control risks arise out of inadequate control systems, deficiencies /gaps and /or likely failures in the existing control processes. The control risks could also be classified into low, medium and high categories.
- After identification of business risk and evaluation of the effectiveness of the control system for monitoring business risks i.e. control risk, a risk-matrix is drawn up for taking into account both the factors viz., inherent business risks and control risks. An illustrative risk matrix is given below.

Risk Matrix

Inherent Business Risk 	High	A High Risk	B Very High Risk	C Extremely High Risk
	Medium	D Medium Risk	E High Risk	F Very High Risk
	Low	G Low Risk	H Medium Risk	I High Risk
		Low	Medium	High
	Control Risk 			

Risk Matrix

The basis for determination of the level (high, medium, low) and trend (increasing, stable and decreasing) of inherent business risks and control risks should be clearly spelt out. The risk assessment may make use of both quantitative and qualitative approaches. While the quantum of credit, market, and operational risks could largely be determined by quantitative assessment, the qualitative approach may be adopted for assessing the quality of controls in various business activities.

- The risk assessment methodology should include, inter alia, the following parameters
 - Previous internal audit reports and compliance
 - Proposed changes in business lines or change in focus
 - Significant change in management /key personnel



- Results of latest regulatory examination report
 - Report of external auditors Industry trend and other environmental factors
 - Time elapsed since last audit
 - Volume of business and complexity of activities
 - Substantial performance variations from the budget
- The Plan should be in draft form by the end of March for the forward financial year. There should be consultation with the Inspection and Audit Department to ensure the proposed internal and external audit plans are not duplicated, that the same area of Treasury is not subjected to internal and external audit at the same time, and that any efficiency can be realised.
- The input of senior management and the other CEOs is vital in the development of an Annual Audit Plan for the cluster.
- Also vital is a newly revised Risk Register. This should incorporate the legislative and regulatory compliance framework and identified fraud and corruption risks and controls. If it does not, these should also be taken into account in developing the Annual Audit Plan, as the findings of any audit helps post-dating revision of the Risk Register.
- The Audit Committee of the Board should review and approve the Annual Audit Plan each year after they have considered the Strategic Audit Plan.
- Once the Annual Audit Plan has been approved, the Chief Audit Executive (CAE) and the internal audit provider's senior management must meet with the Treasury senior managers who will be impacted by the Annual Program to agree the timing of each audit. This should be consulted with the Audit Office to ensure internal and external audit timing is synchronized. It is important that both managers and service providers comply with the timetable once it is set, and provide proactive notice of delays or problems.
- The Chief Audit Executive must communicate to the Audit Committee of the Board and the CEO the impact any resource limitations are projected to have on the effectiveness of the internal audit program.
- It is important to note that:
- The Strategic and Annual Internal Audit Plans will be weighted towards areas of higher risk to Treasury. All areas and all risk types should be covered over a 3-5 year period, but higher risk areas will be considered more frequently and have more time allocated to them.



- The extent of the strategic and annual internal audit programs should be limited by the available resources and by the scope of external audit work.

The Chief Audit Executive should report periodically on the status of the Internal Audit Program to the Audit a Committee of the Board, which may be submitted to the other CEOs where relevant. .

ii) Annual Audit Plan Preparation Checklist

Desired Qualities

- The annual audit plan is prepared and available for approval prior to the start of the fiscal year in which it will be implemented.
- An updated audit universe/multi-year plan is desirable to demonstrate, in conjunction with the annual plan, sufficient internal audit coverage of all significant auditable units.
- The annual plan demonstrates that the planned work is consistent with department goals and priorities and is based upon an assessment of risk.
- The plan clearly describes how the basic requirement of the Policy on Internal Audit is to be met (i.e. sufficient and timely assurance services provided on risk management, control and governance).
- The annual plan describes the planning process undertaken and the extent of consultation with senior management.
- The annual plan identifies and schedules (an indication of the activity by quarter of the fiscal year is usually sufficient) the engagements to be undertaken by the internal audit group during the period of the plan.
- The expected outcomes for assurance engagements are clearly identified and, where possible, the criteria to be employed in reaching conclusions or opinions should be referenced.
- The annual plan notionally allocates resources to engagements.
- The annual plan allocates resources to ensure that there is a systematic monitoring and effective implementation of management action plans arising from earlier audit activities.
- The annual plan includes summaries of the resources required to implement the plan and demonstrates how shortfalls in resources may affect the implementation of the plan.



C) Field Audit Plan

The Field Audit Plan determines the terms of engagement and parameters for each individual audit. In Treasury this is included in the Detailed Terms of Engagement

Before the commencement of any work by an internal audit service provider, a plan should be developed which identifies the project activities, deliverables and milestones. This will ensure that the resources allocated are within the agreed budgets. It is particularly important that the audit provider, in determining the scope, objectives and timing of work to be done on a planned audit, takes into consideration any previous audits, or relevant information gathering, in the target area.

The Detailed Terms of Engagement should include the Standards in accordance with which the project will be performed and the level of assurance the audit or review will offer.

The Detailed Terms of Engagement must be completed and submitted to the Chief Audit Executive for approval prior to commencement of fieldwork.

If a contract has not been signed before receipt of the Detailed Terms of Engagement, it must be signed by both parties before fieldwork proceeds.

7.8.4 Audit Documentation Stage

Internal auditors must document relevant information to support the conclusions and engagement results. Information can be documented in any form determined by Internal Audit and Inspection Department (A&ID). Proper working papers document the work that was done from the preliminary scoping stages through to the final report.

The design and content of the working papers will depend on the nature of the engagement and the policies and methodology adopted by the Audit and Inspection Department.

The Chief Audit Executive (CAE) should establish working paper policies for different engagements.

Working papers are the property of the organisation and must be under control of Audit and Inspection Department. Access to and retention of A&ID's records should be addressed in the IA Charter.

Access to working papers should be restricted to authorized personnel only.

A policy should be in place to address access requirements to working papers and procedures for granting access. The policy should also address retention of records in line with policies of the organisations.

The following audit procedures are normally performed in gathering audit evidence:



- Inspection: Among all the audit procedures, Inspection is most persuasive audit test. The inspection of documents and physical items are conducted to gather audit evidence.
- Re-performance: Re-performance is treated to be an important audit procedure through which auditor tends to check auditee's control processes and/or processes. An example of this is the re-calculating of the items on the invoice for accuracy, etc.
- Confirmation: It is also a very important audit procedure. By confirmation, the auditor seeks to independently validate the information provided by the auditee or to validate the control processes of the auditee.
- Enquiry The internal auditor should carefully design appropriate questions to verify management information and processes.
- Observation: Observation is an useful audit procedure whereby the auditor strives to be present in person and observe the process being performed by the auditee.

Methods of Documenting Audit Evidence – Working Papers

Working papers are the supporting documentation for the entire audit – they are the repository for the accumulated audit evidence. Working papers provide a complete audit trail and demonstrate, in detail, how the engagement was performed. They contain the evidence to support the report and any related products, such as management letters that are frequently used to report matters outside of the scope of the audit of less significance. More specifically, working papers provide a demonstrable link between reports issued and the work performed, and support the findings, conclusions and recommendations. Working papers can also be used to:

- Justify and provide proof of work carried out
- Help auditors respond to questions about coverage or results
- Facilitate supervisory quality assurance reviews and
- Provide supporting evidence when external auditors or other reviewers want to rely on the results.

A completed set of working papers is normally prepared in the form of either paper or computer files, however, the set may be later stored in the form of tapes, diskettes, films or other media. The organization, design and content of a set of internal audit working papers will depend on the nature of the audit; however, the set should document all aspects of the audit process, including all meetings and discussions with the auditee, notes of meetings, correspondence (including emails), planning memos, testing documentation, and draft reports and final report and should be consistently and efficiently prepared to facilitate review and control.



A completed set of working papers should be neat and uniform in size and appearance and include:

- An index to contents
- A legend of symbols and abbreviations used
- A statement of the purpose of the working papers
- Evidence of the application of the audit program
- The results of the audit, e.g. debriefings, reports, action plans

Within the set of working papers, each page should include a descriptive heading (e.g. Interview Summary, Test Result, Document Examined), the auditor's name or initials and dates of preparation, appropriate cross-references and evidence of supervisory review and comments.

- Each audit working paper file should have an indexing system to assist future users to easily consult the information it contains. Although there is no set format for the indexing system, common practice is an alphanumeric system whereby alpha identifies the section within the working paper file and numeric identifies the items within a section.
- As previously noted, working papers should be properly cross-referenced. Cross-references should stand out clearly and provide direct and prompt access to information so that a reviewer can trace conclusions back to the original audit tests and the evidence gathered and vice versa. Cross-referencing of documents should follow the system established for the working paper file index. The extent of cross-referencing required may vary depending on the engagement; good practice indicates, however, that, at a minimum, the following items should be cross-referenced:
 - i) Specific items in the audit report to the pertinent audit observation worksheet
 - ii) Audit observation worksheets to the supporting evidence
 - iii) Evidence that relates to other evidence and
 - iv) Audit program steps to the supporting evidence.

General requirements for the preparation of working papers are:

- Completeness and Accuracy – working papers should be complete, accurate, and support observations, testing, conclusions, and recommendations. Nature and scope of the work performed should also be demonstrated in the working papers.
- Clarity and Understanding - working papers should be clear and understandable without supplementary oral explanations. It should be sufficiently informative so that



any reviewer without facing any sort of problem, whatsoever, can easily grasp what this working paper is all about- the purpose, the nature and scope of the work done and the preparer's conclusions;

- Pertinence- Information contained in working papers should be limited to matters that are important and necessary to support the objectives and scope established for the audit;
- Logical Arrangement- working papers should follow a logical order;
- Legibility and Neatness- working papers should be legible and as neat as practicable. Sloppy working papers may lose their worth as evidence. For handwritten papers, crowding and writing between lines should be avoided by anticipating space needs before writing.

All audit working papers should be reviewed to ensure that all information contained is relevant and supports the report and that all necessary auditing procedures have been performed. Evidence of supervisory review (i.e. review of the working papers by at least one more senior member of Audit Service Provider) should consist of the reviewer's initialling and dating each working paper after it has been reviewed).

7.8.5 Conduct of Audit Procedure

a) Undertaking the Audit

i) Opening ('Kick-off') Meeting

The purposes of the 'kick off' meeting are:

- to ensure all relevant staff of the audited area are aware that the audit is taking place and know who the auditors are;
- to confirm the project timetable; and
- signal the commencement of fieldwork.

The 'kick-off' meeting will be attended by the Chief Audit Executive, senior management (and often all staff) from the area to be audited. It will be chaired by the audit service provider.

ii) Risk Assessment (Risk and Control Matrix)

As part of scoping an audit, a risk assessment is conducted at the activity level to identify and evaluate risk exposures and determine audit objectives. It involves considering business process risks, quality of management and individual performance in different situations. As part of the planning activities, the risks that threaten the objectives of each process to be audited should be identified and classified.



The risk assessment process provides a structured means of evaluating information and applying professional judgment as to the most important areas for audit examination.

A detailed risk assessment is undertaken during the planning phase of the engagement to confirm that the lines of enquiry and the initial objectives have indeed focused on the most important risks associated with the program or activity being audited.

The objective statements for the audit, as outlined in the Risk-based Audit Plan, may need to be amended if the more detailed risk assessment reveals additional risks or assigns higher or lower risk scores to those risks already identified.

The steps involved in performing a detailed risk assessment are:

- Identify the risks associated with the achievement of the auditee's objectives and expected results
- Assess the relative significance of the risks in terms of the likelihood of each risk occurring and the impact should it occur
- Determine on a preliminary basis whether management's assertions on controls are likely to prevent or mitigate the occurrence of the risks of greatest concern and

Plan to focus audit objectives and scope on testing the existence or adequacy and effectiveness of key controls over areas of greatest risk. The audit will concentrate on those processes which are assessed as very high or high risk. The risk categories of these processes indicate the types of objectives that should be included in the audit project plan. For example where residual compliance risks are rated as moderate or high, the audit objectives should include a review of *compliance with* the procedures/policies related to the activity. If residual operational risks are high, the objectives should include a review of the *efficiency and effectiveness of* the procedures and policies.

- The audit service provider must be sensitive to situations where management may have undertaken a risk assessment and made decisions with which the audit service provider may not be comfortable. Since management can choose to accept, transfer, eliminate, reduce or mitigate risks, the audit service provider may encounter situations where the auditee does not view a given risk with the same degree of concern that the audit service provider might. In some situations, the audit service provider may need to proceed with testing to demonstrate that a chosen course of action to address a risk may be insufficient or unnecessary. In the event that serious disagreements arise with the auditee, the audit service producer may need to seek assistance from his seniors in pursuing discussions with the auditee and their more senior management.

The processes identified should also be a determinant of the type of audit to be conducted (performance, financial, IT, etc).



iii) Control Analysis (Risk and Control Matrix)

All audits, regardless of their nature, involve providing assurance on the design and effectiveness of a system of internal control.

An audit provider will be in a position to make preliminary assessment of the internal control system to determine whether identified controls are designed to meet the control objectives and mitigate risk when he gains a complete understanding of the internal control system by way of interviews, documents and records, questionnaires, systems documentation and/or performing some initial analytical procedures or data analysis.

Assessing Internal Control

Simply stated, control is making sure that what happens is what is supposed to happen and that, to the extent practical, undesirable results do not occur. A control is any action taken by Treasury management or staff to enhance the likelihood that established goals and objectives will be achieved while eliminating or mitigating the impacts of risks and protecting assets, including money, reputation, physical property, and human resources.

Controls are commonly thought of as of two types, either preventive or detective. As implied by the name, preventive controls are intended to prevent unintended consequences occurring, i.e. they are intended to function during an activity or transaction, e.g. setting minimum rating and financial cap in investment in CP and CD; setting financial limit in investment in quoted shares and its type like say only in NIFTY or SENSEX share. Preventive controls are intended to trigger an obstacle that prevents the routine processing of a particular transaction. Some examples of preventive controls are providing (and reinforcing) training of employees on how to do the job correctly, segregating duties to reduce the opportunity for intentional wrongdoing, creating physical deterrents such as locks, passwords, alarms and building passes to deter theft, and convening peer review committees or expert panels to review project proposals and recommend funding. Preventive controls may also be thought of as application controls in the sense that they are embedded in the intended transaction, process, or activity.

Detective controls are intended to detect unintended consequences after they have occurred. Some examples of detective controls are reports which detail the information accessed by an employee from a department system, reconciliation of an inventory listing to the actual physical material, reconciliation of RBI account with the Bank records, Reconciliation of the dividend account as per the dividend declared by the issuing companies etc. Detective controls may also be thought of as monitoring controls in the sense that they operate above of or outside of routine processes or activities and their preventive controls.



iv) Audit Programs (Field Audit Program)

The audit program establishes the procedures necessary to complete an efficient and effective audit. It includes a detailed plan of the work to be performed as well as the steps required to achieve the audit objectives.

The structure of the audit program should be made up of the following sections:

- Audit Objective – the primary (and perhaps secondary) objective for the audit as a whole. Any summary assessment of the audit will be based on the achievement of this objective.
- Audit Scope – the scope of activities to be included or excluded.
- Risk and Control Analysis/Matrix (RACA or RACM) – This is the outcome of the analysis explained under.
- Audit Criteria – The audit provider should clarify the specific explicit and implicit criteria against which evidence collected will be evaluated.

Criteria are explicit when they are clearly set out in policies, manuals, standard operating procedures, standards, laws and/or regulations.

Where management has not yet established goals and objectives or determined the controls needed in a particular area, it may be necessary to develop implicit criteria based on industry best practice or what management considers to be satisfactory performance standards. The accuracy of implicit criteria should always be confirmed with the audited area.

Some examples might include:

- Treasury's internal policies, procedures and management directives;
- better practice guidance or industry benchmarks;
- legislation or regulation; or
- accounting or ISO Standards.

If no specific criteria can be identified, the audit opinion should describe the benefits of implementing the recommendations.

Conducting an audit without agreeing the criteria may result in wasted audit effort and fruitless argument, when conclusions and recommendations are not accepted by management.

The audit criteria should be referred to in the audit opinion and in the Independent Auditor's Report.



Previous Audit Recommendations – in cases where previous audits are relevant, this section requires the audit provider to list the relevant recommendations relating to significant (or higher) rated findings from both previous internal audits and Audit Office management letters. The audit provider will then verify that the matters have been addressed or are being addressed

v) Audit Evidence

Audit evidence is obtained through procedures such as observing conditions, interviewing people, examining records and analysing data. Provided the methodology is documented, sampling approaches and other means of selecting information may be used if useful conclusions can be drawn by those means. Audit evidence is cumulative in nature and is usually persuasive rather than conclusive. Audit inferences are drawn from the body of evidence collected.

Audit evidence refers to all the information used by the audit provider in arriving at the recommendations. It should be sufficient, competent, relevant and useful.

- a. Sufficient information is factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions as the audit provider. There should be enough of it to support the audit provider's findings. In determining the sufficiency of evidence it may be helpful to ask such questions as: Is there enough evidence to persuade a reasonable person of the validity of the findings?
- b. Competent information is reliable and is the best attainable through the use of appropriate engagement techniques such as statistical sampling and analytical audit procedures. Information is more competent if it is (i) obtained from an independent source, (ii) corroborated by other information, (iii) obtained directly by the audit provider, such as through personal observation, (iv) documented, and (v) an original document rather than a copy.
- c. Relevant information supports engagement observations and recommendations and is consistent with the objectives for the engagement. It should have a logical relationship with the key risk/s and the associated audit finding.
- d. Useful information will help Treasury meet its goals

Evidence collected by audit providers should possess all of these qualities. For example, it is not enough merely to interview staff members without using other sources to corroborate any important information obtained. Sample sizes should be representative i.e. sufficient that conclusions reached may be validly extrapolated from the data.

Evidence may be categorised as physical, documentary, testimonial or analytical and is obtained by using various procedures:



a. Physical Evidence

Physical evidence is obtained by direct inspection or observation of people, property or events. Inspection of tangible assets provides reliable audit evidence about their existence, but not necessarily about their ownership or value. Observation consists of watching a process or procedure being performed by others, for example, physically counting inventory and making observations.

b. Documentary Evidence

Documentary evidence entails information that exists in some permanent form such as letters, contracts, accounting records, invoices and management information on performance. It is the most common form of evidence; it may be internal, external or a combination of both. The source of documentary evidence affects its reliability, as may its context.

c. Testimonial Evidence

Testimonial evidence is obtained through inquiries, interviews, or questionnaires. Inquiry and confirmation consist of seeking information from knowledgeable persons inside or outside Treasury. Responses to inquiries may provide audit providers with new information or with corroborative audit evidence. Testimonial evidence should be supported by other forms of information where possible and not regarded as conclusive by itself.

d. Analytical Evidence

Analytical evidence arises from the application of analytical procedures, which produce information in the form of inferences or conclusions based on examining data for inconsistencies, anomalies, cause-effect relationships and so on.

Working Papers

Working papers that document the engagement should be prepared by the internal audit provider and reviewed by management within the internal audit provider and by the Treasury internal audit function.

Audit working papers show whether due professional care was exercised and illustrate compliance with professional auditing standards. Careful documentation of work performed is necessary to support the findings, recommendations and opinions contained in the final audit report. Generally working papers should provide:

- documentation of information obtained about the area being audited;
- support for findings and recommendations contained in the audit report;
- a summary of documents reviewed;



- details of persons interviewed;
- detail of any control failures or exceptions noted;
- a means of evaluation- both in performance reviews and quality assurance reviews;
- evidence of consistency to the audit process;
- a guide for subsequent audits; and
- communication with the audited area – during the course of field work, the auditor will query all exceptions that have been noted and other matters of significance to the audited area. Where satisfactory responses are provided by management these should be recorded in the working papers with justification as to why the matter can be closed. Supporting evidence should be retained.

A detailed discussion of working paper has been made in the ‘Documentary Stage’.

vi) Audit Sampling

Audit Sampling is one of the important components of Audit Procedure. In Audit Sampling, sample size should take into account the audit objectives, the attributes to be tested, materiality, population size and complexity and system reliability.

Sample items should be selected with the expectation that all sampling units in the population have a chance of selection.

Once a decision has been made to use audit sampling, the audit provider must choose between statistical (e.g. interval selection) and non-statistical (e.g. random selection) or judgment sampling. Judgment sampling is sampling without particular regard to the parameters of a statistical sample. Once again, this decision should be based on the objectives of the procedure and audit sample to be taken.

A procedure calling for an audit sample with the objective of making a judgment on the whole population would require a statistical sample rather than a judgment sample. However, statistical sampling would not be feasible when sampling a relatively small population. Ultimately, the audit provider should rely on sound audit judgment in determining which method to use.

vii) Conclusion and Evaluation

Evaluation is a means of arriving at a professional judgment. As audit providers compare circumstances observed against relevant audit criteria, they evaluate the significance of any variance and determine whether corrective action is necessary. The analysis and evaluation of evidence obtained should give rise to issues (positive and negative), which internal audit may report to management.



Internal audit providers should draw conclusions – i.e. logical inferences from the findings- for each audit objective. Conclusions should be specified and not left to be inferred by readers.

The strength of a conclusion depends on the persuasiveness of the evidence supporting the findings, and how convincing the logic is which was used to formulate the conclusions. It should be free from personal biases or prejudices, and be objective. The conclusion reached by an internal audit provider should be the same as would have been reached by a similar experienced professional reviewing the same evidence.

viii) Exit Interviews (End of Fieldwork Meetings)

The purpose of exit interviews is to confirm the facts and to allow the management and (usually) staff of the audited area to hear and comment on the auditor’s interpretation. The exit interview may also provide the auditor with input on proposed (or new) options for corrective action.

During the course of audit work, the auditor will communicate matters of significance with the audited area to minimise the possibility of “surprises” at the end of the audit. This may be done informally (e.g. emails, discussions) or via formal meetings.

7.8.6 Internal Audit Report

1. Audit Reports

The purpose of the audit report is to communicate. The messages must be clear and precise to ensure that the reader will understand what the report is trying to achieve. The report should be fair and balanced and presented in an unbiased tone, noting where management has taken actions to correct deficiencies and pointing out exemplary performance.

Only matters of significance should be included in the report – thus not all observations and recommendations recorded during the conduct of the audit will be brought forward to the report. Reports are normally more effective when related observations can be aggregated and addressed with higher-level recommendations, e.g. to improve controls.

- This section sets out the basic components of a report and report writing, as well the consultation processes to be followed in completing reports. Reports should:
 - meet the purpose and objectives set out in the Terms of Engagement (Detailed Scope)
 - comply with appropriate Professional Standards and with the standards of accuracy, clarity and ethics reflected in this Manual



- clearly communicate their findings to management and the Audit Committee
 - add value by alerting management to matters requiring attention, including advice on best practice in such matters, and by giving assurance regarding those controls which are functioning well.
- Basic Components of an Internal Audit Report

The basic components of a Treasury internal audit report are:

- a. Executive Summary, including Summary Statement;
- b. Statement of Assurance;
- c. Introduction;
- d. Scope and Objectives;
- e. Risk Assessment;
- f. Summary of Recommendations;
- g. Audit Opinion/Conclusion;
- h. Observations / Issues (optional);
- i. Detailed Findings, with a risk rating for each;
- j. Recommendations; and
- k. Management responses.

a. Executive Summary

The Executive Summary is intended to provide an overview of the report to the Chief Audit Executive, Audit & Risk Committee, senior management and Audit Committee of the Board.

Executive Summary will help a reader to gain a general understanding of the audited area as well as the objectives, key issues, risk implications and recommendations of the audit. The Executive Summary should draw attention to positive findings as well as improvement opportunities (e.g. examples of better practice, controls in place and actions in progress).

Individual findings more relevant to operational management should be explained in detail in the body of the report.

The Summary Statement should be of no more than two sentences and is used to describe the overall risk landscape of the area reviewed by an internal audit.



b. Statement of Assurance

The Statement of Assurance Section is a fundamentally new component of audit reports that came into force by the change in the definition of internal audit as an “assurance” service.

The Statement of Assurance provides a conclusion, relative to the audit objective(s), that conveys to management a clear understanding of what was assessed, the criteria against which the assessment was made, and the level of assurance supporting the conclusion. The conclusion must be put in context in the Statement of Assurance by including the following:

- the professional auditing standards in accordance with which the audit was conducted
- the objectives of the audit
- a description of what the audit did and did not examine (scope)
- the time periods during which the audit was conducted and represented by any transactions examined or tests conducted
- the criteria on which the conclusion is based
- a statement that sufficient and appropriate audit procedures were followed and evidence gathered.

c. Introduction

The introduction provides any background information and acknowledgments the audit provider considers relevant. It may include contextual information about the audited area and/or the type of audit undertaken.

The introduction also states the reason for the audit, for example making reference to the risk register or the audit plan.

d. Scope and Objectives

Components normally include:

- Objectives;
- Scope;
- Exclusions;
- Approach- methodology and procedures followed; and
- Details of testing.

For the most part, this section should align with the Terms of Engagement (Detailed Scope) agreed and signed prior to commencement of the audit. Any



variations to the Scope should have been made and signed off by the CAE (Chief Audit Executive) during the audit, and should be outlined in the Final Report.

The Detailed Scope will normally be appended to the Final Report.

e. Risk Assessment

The risk section describes how the risks have been assessed and usually includes a copy of the Treasury risk matrix. The key risks identified during scoping and then during fieldwork will be outlined and given inherent and residual risk ratings. Where possible these risks will refer back to the Treasury risk registers. If there is a recommendation made in the report relating to a risk the link will be clear.

The risk assessment will show how each risk rating was calculated i.e. the value assigned to “consequence” and “likelihood”.

f. Summary of Recommendations

This section provides a table summarising each issue identified in the detailed findings section and its associated risk.

g. Audit Opinion/Conclusion

The audit opinion should make clear the criteria against which the subject was evaluated or assessed. The key criteria should have been agreed in the Detailed Scope.

h. (Other) Observations/Issues

This section presents the audit provider’s key observations, identified during the course of their fieldwork. This section is different from the Detailed Findings section, which presents findings and recommendations based on the audit criteria agreed at scoping stage.

Observations may represent key themes that the audit provider has identified and believes important to bring to senior management’s attention, particularly where the observation was not explicit in the scope of the audit.

This section may be omitted if the service provider considers that the findings speak for themselves.

i. Detailed findings, with risk rating for each

Findings are specific observations which relate to each recommendation. Ideally, the format would be:



- Risk Rating
- Observation
- Root Cause
- Implication/Impact
- Recommendation
- Management Response

Risk Rating: The risk rating should include the scoring used to ascertain the rating i.e. the likelihood and consequence rating. The following is an example of the expected layout:

Risk Rating: Significant Risk: Senior management attention needed

➤ *Consequence: Moderate (3)*

➤ *Likelihood: Likely (4)*

Observation:

Each finding should make clear the type of risk exposure perceived, and should be assigned a risk rating as per the chart below:

<p>Extreme risk: Immediate action required; for MD's attention.;</p> <p>High risk: Executive management attention needed</p> <p>Significant risk: Senior management attention needed</p> <p>Moderate to Low: Manage by Standard Procedures</p>
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Recommendations

These cover corrective actions to rectify an issue and/or identified improvement opportunities.

Recommendations should be based on the issues raised in the finding, implementable within a foreseeable period, and practicable taking into account the size of the risk and the size of the auditee budget.

Since it will be used by the Audit Committee for monitoring the progress subsequently, the Recommendations table should be standalone, i.e. it should not refer to findings in a way which requires the rest of the report to be consulted.

Management Response

Management responses which question the facts presented, or how audit



findings were drawn from them, should be percolated at the exit meeting so that factual errors can be corrected while the report is still in draft. They should never appear in the draft report unless there is an insuperable disagreement.

All management responses which appear in the Report must commence with: ACCEPTED; REJECTED or PARTIALLY ACCEPTED. The response should then concisely detail the action management intends to take in response to the recommendation, stating who will take action and when it will be completed. If the recommendation is wholly or partially rejected the response must say why.

The recommendation should include the person responsible for implementing the agreed action as well as the date by which the action is expected to be completed by. When considering the date by which the action will be completed by, management should weigh the risk against the resources available for action, to arrive at a realistic date for completion.

Management responses should be written in such a way that allows for the recommendation to be marked complete once an outcome has been reached. Actions which are “ongoing” should be avoided where possible.

➤ **Report Writing Style**

Treasury internal audit reports should be written using the following basic principles:

- All reports must be “spell checked” and proofed
- Use plain language, short sentences and avoid technical jargon as much as possible
- Use of graphs, tables or flow charts is encouraged if they convey the findings more clearly than words.

➤ **Draft Reports and Exit Meeting**

As soon as the draft report is ready, the internal audit provider should contact the Audit Branch to schedule an Exit Meeting.

The purpose of an Exit Meeting is to discuss the draft report and formally end the fieldwork phase.

The exit meeting will be attended by the audit provider, Chief Audit Executive, project sponsor, project manager and senior management from the audited area. The draft audit report will be circulated to the Chief Audit Executive and the meeting invitees long enough beforehand to allow them to read and



consider it (minimum of two days prior). This version of draft audit report is to be marked “draft for discussion purposes only”.

If the report is not circulated prior to the exit meeting the meeting will be postponed.

The exit meeting should be documented by the audit provider. Its purpose is to:

- discuss the draft audit report and ensure there is a common understanding of its findings and recommendations
- resolve any misunderstandings or misinterpretations of facts on either side
- ensure that any recommendations that the senior management wishes to challenge or reject are discussed, to minimise the risk of conflict between senior management and the service provider when the service provider is asked to finalise the report, incorporating the management responses.
- agree on the wording of observations and recommendations.

Subsequent to the exit meeting a new, formal draft report (marked “draft”) will be issued for management responses. Under normal circumstances management will be given a reasonable time say ten working days to provide responses to recommendations outlined in the draft report.

The formal draft report may be addressed to the Chief Audit Executive or General Manager (Inspection).

➤ **Close-out Meeting**

The General Manager (Inspection) should ensure management responses are prepared, including responsibility and a realistic timeframe for completion, ensure they are approved by the Audit Committee of the Board of Director and forward them to the audit provider with a copy to the General Manager (Treasury).

Once management responses have been provided a close-out meeting should be held between the audit provider, the Chief Audit Executive and representatives from the audited area. The purpose of the close-out meeting is to discuss and agree on the management responses. This is particularly important where the audit provider believes that the responses provided do not sufficiently address the recommendations made.

If there is full agreement and understanding on the recommendations and the management responses, both parties may agree to waive the need for the close-out meeting.

➤ **Final Report**

Following the close-out meeting and on receiving any further amendments to the management responses, the internal audit provider should issue the final report within one week, or as stipulated in the signed project scope. The final report should be addressed to the Chief Audit Executive or General Manager (Inspection).

The finalised report will be tabled at the next available Audit Committee meeting. The service provider (Audit firm) and a representative from the audited area will usually be requested to attend the meeting to answer any questions the Committee may have.

On the Committee's recommendation the report will be submitted to the General Manager (Inspection and Audit) for endorsement and sign-off.

Should the Committee request further changes, this will be made known to the audited area. The report will be returned to the service provider to make the amendments, as once a final report has been submitted to Treasury, only the internal audit provider is entitled to edit it.

➤ **Close the Audit**

Once the final report has been issued, the following steps are taken to close the audit:

- Finalize and archive working papers.
- Complete project performance discussion



Annexure - I

Specimen Checklist for RBIA on Treasury

Sl. No.	Description	Remarks
A.	GENERAL	
i)	See whether the Bank does have an integrated treasury policy covering all treasury operations	
ii)	See whether different provisions enacted in this policy are in tune with those of RBI master circular on 'Prudential norms for classification, valuation and operation of investment portfolio of banks.'	
iii)	See whether this policy is approved by the board including date of approval and is updated and reviewed periodically. Should see the evidence of actual board approval. Any intervening board note amending the policy should also to be checked. See that a copy of the policy is duly sent to RBI.	
iv)	See whether the policy frames detailed guidelines regarding all back office, mid office and front office operations and whether they are adequate	
v)	See whether the coverage of the policy is in conformity with the nature of operations undertaken by the treasury.	
vi)	See whether the responsible persons are associated with the policy	
vii)	See whether the policy specifies types and purposes of the financial instruments	
viii)	See whether the policy specifies frequency of reporting and reporting authority	
ix)	See whether cash reserve ratio and statutory reserve ratio have been correctly and properly calculated and maintained	
x)	See whether the policy specifies the role of individuals, committees and the Board in regard to treasury operations	
xi)	See whether the policy outlines the organisational structure for the management of financial risks, including the authority and role of each body or individual	
xii)	See whether the policy includes a table of specific delegations. For example, power of initiating a deal, discretionary power for sanction of different functionaries.	
xiii)	Verify whether the policy specifies which financial instruments can be used and for what purpose. For example, if options are permitted, can they be bought or sold and in what circumstances?	
xiv)	See whether the policy should state formal escalation procedures for policy breaches	
xv)	Interview selected treasury personnel and accounting personnel	
xvi)	Review internal control reports and prior reports	

xvii)	Verify whether follow-up activities have been undertaken and issues in past reports have been satisfactorily resolved	
xviii)	Review management reports, board notes, internal notes, statutory and regulatory returns etc.	
xix)	Verify statement of treasury objectives in policy document and risk appetite.	
B.	ORGANISATION STRUCTURE	
i)	Verify whether treasury operations are supervised by an officer who is independent of day to day activities.	
ii)	Get an organisation chart mapping the organization network of treasury activities to have a bird's eye view of the organisational flow of treasury activities	
iii)	Verify whether there is an effective segregation of key activities –among trading, settlement accounting. And reconciliation. This segregation should be reinforced through procedures documentation and position descriptions.	
iv)	Verify that segregation of duties is enforced through organisational structures, user access in the treasury/payment systems and procedural documents.	
v)	Verify whether all policies and procedures are documented and accessible easily to all staff	
vi)	Verify whether all jobs in treasury are properly defined and there is proper delegation for key treasury positions.	
vii)	Verify whether the level of staffing and type of staff (in terms of their qualifications and experience) should be commensurate with the workload and complexity of transactions undertaken by the treasury staff.	
viii)	Verify whether the sufficient resources are available to operate the treasury effectively.	
ix)	Verify whether there should be a formal and independent compliance function which monitors compliance with policy, procedures and limits.	
x)	Verify whether there is segregation between functions of authorization, execution and recording of transactions	
C.	PERSONNEL: TRAINING, COMPLIANCE AND PERFORMANCE	
i)	Verify that all personnel should be appropriately trained above the minimum required.	
ii)	Verify that Dealers have appropriate qualifications and current relevant training experience.	
iii)	Verify to ensure that all employees' references have been duly checked.	
iv)	Verify whether all employees sign an ethics policy, if any, at the time of joining.	
D.	DEAL EXECUTION PROCESS	
i)	Verify whether all transactions concluded by the dealing room get confirmed with the back office manager.	



ii)	Verify whether dealers check position/exposure limits and credit limits prior to dealing; Process to check limits including counterparty limits and exposure limits in treasury systems.	
iii)	Verify whether the dealers execute deals clearly and concisely and there is no possibility of confusion;	
iv)	Verify the Process in vogue to check registers/ spreadsheets of exposures and counterparty limits.	
v)	Verify whether the Dealers are trained in correct dealing methods and entry of deal information into treasury systems.	
vi)	Verify the agreement with counterparties to be able to review phone conversations.	
vii)	Verify whether dealers enter their own deals into the treasury system as soon as practicable after the deal is executed	
viii)	Verify whether the electronics data processing systems used is appropriate to the nature and volume of activities and programmed to ensure functional separation. Access rules for performing distinct functions should be defined in detail and drawn up by persons unconnected with the dealing activity. Confidentiality of the data in the systems may be ensured in the case of outsourcing of IT services to external agencies.	
ix)	Verify whether the dealer maintains the position blotter, spread sheet or scratch pad	
x)	Verify the dealing process, recording the dealing in treasury system and spreadsheet. See whether outward confirmations are recorded in a register.	
xi)	Verify whether the audit trail of new deals as well as deal amendments and cancellations, is reviewed daily by a party independent of the dealing function	
xii)	Verify whether amended and cancelled deals are reported on an end of day report and reviewed by the person in charge of the treasury.	
xiii)	Verify whether management sign-of on deal ticket is obtained and confirmation from the counterparty is received for any amendment or cancellation of deal and whether cancelled deal is recorded in register or spreadsheet.	
xiv)	Examine third party payment and verify that a letter of instruction to that effect is filed.	
E.	LIMITS	
i)	Verify the counterparty exposure limit of all brokers, lenders	
ii)	Verify dealing limits (maximum amount, a person can transact without seeking higher level approval).	
iii)	Verify Product limits (maximum exposure in a particular instrument or product)	
iv)	Verify Sector limits (maximum investment in a particular sector)	
v)	Verify whether limits are reviewed annually and approved by the board. To the extent possible, limits are loaded in the treasury system. Verify whether Credit limits are usually based on information from an external ratings agency.	

F.	DEALING FRONT OFFICE OF DOMESTIC TREASURY	
	a) NEGOTIATED DEALING SYSTEM	
i)	Verify whether all SLR deals are settled in NDS platform	
ii)	Verify the deals that are concluded over OTC (Voice deal), have been subsequently put into reporting platform in NDS. Verify their subsequent deal settlement.	
iii)	Verify all transactions to see that delivery takes place on settlement day which is done on DVP mode. The funds account and investment account should be reconciled on the same day before close of business.	
iv)	Verify whether any deal fell through for non-maintenance of securities in SGL account and CCIL charged penalty for that.	
v)	Verify whether reconciliation of books is done at the end of the day with the report on settlement received from CCIL.	
vi)	Verify the deal slip of every deal to get the details of securities traded and they should be serially numbered and individually verified to see their proper accounting	
	b) DEALING IN CP/CD/REPO/CORPORATE BOND	
i)	Verify whether all OTC deals in CP/CD in the secondary market are reported in F-TRAC platform now controlled by CCIL within scheduled time.	
ii)	Verify whether all OTC deals in respect of corporate bonds have been reported in C-BRICS platform of NSE within scheduled time.	
iii)	Verify whether the deal slip has been generated for each deal and for direct deal whether it specifies details of security, amount, price, contract date and time and settlement date. If the deal is through broker, the deal slip should contain the name of the broker also. The slip should be serially numbered and individually verified to see that they are properly accounted for.	
iv)	Verify whether requisite written confirmation from the counter-party has been received and whether the confirmation includes all essential details of the contract.	
	c) MONEY MARKET OPERATIONS	
i)	All Inter-bank deals and Repo deals are with authorised players.	
ii)	Correct application of rates in money market credit lines.	
iii)	Entering into Rupee/USD Swaps deals only when swap yields are at least on par with call money rates.	
iv)	Profitable squaring off position taken in the intra-day dealings	
v)	Justification of net borrowing position.	
	• Inter Bank Participation Certificates (IBPCs)	
i)	Obtention of approval for issue of IBPC.	



ii)	Strict adherence of norms in the case of IBPC with risk sharing	
iii)	Strict adherence of norms in the case of IBPC without risk sharing	
	• Money Market Credit Lines to Indian and Foreign Banks :	
i)	Sanction / review of credit line at appropriate level	
ii)	Recovery of commitment fees	
iii)	Repayment in accordance with the relative agreement	
iv)	Timely renewal of period of validity of the credit line	
v)	Segregation of credit limits	
	• Call Money Operations	
i)	Verify there is adherence of ceiling in Money market transactions	
ii)	Verify there is a system of maintenance of levels of liquidity mismatches in the short term	
iii)	Verify whether all call/notice money market deals, other than those done on NDS-Call, are reported on NDS.	
iv)	Verify whether overall borrowing and lending limits in call money market as prescribed in the investment policy subject to those of prudential limit have been breached.	
v)	Verify whether the counterparty wise borrowing and lending limits as prescribed in investment policy have not been breached. Verify whether these limits are reviewed periodically as per market perception of the counterparty and risk appetite of the bank.	
	d) READY FORWARD DEAL OF GOVT. SECURITIES	
i)	Verify that ready forward deals are executed only on permitted securities (dated central govt. securities, treasury bills, state government securities)	
ii)	Verify that the entity maintains an SGL account with RBI, Mumbai or a Gilt account with any Bank or with any custodian permitted to maintain CSGL account with PDO Mumbai.	
iii)	Verify these ready forward deals are not executed with its constituent if the entity is an SGL accountholder; if it is a gilt account holder verify the deal is not made with another gilt account holder.	
iv)	Verify (i) ready forward transactions are undertaken only against the clear balance of securities in the gilt account, (ii) all such transactions are promptly reported on the CBS, and (iii) other terms and conditions referred to above have been complied with.	
v)	Verify whether these transactions are held only on excess SLR securities over and above the entity's prescribed SLR requirement.	
vi)	Verify the entity does not sell any security under Ready Forward Deal which it does not hold in its portfolio.	
vii)	Verify that the securities purchased under the ready forward contracts are not sold during the period of the contract.	

viii)	Verify that all transactions in Govt. Securities for which SGL facility is available have been put through SGL A/Cs only.	
ix)	Verify the deals executed under Delivery versus Payment mode get settled simultaneously by debiting/crediting SGL Account and crediting/debiting Current account simultaneously.	
x)	Verify that all ready forward contracts are reported on the Negotiated Dealing System (NDS). If the entity is a custodian In respect of ready forward contracts involving gilt account holders, verify the entity being custodian (i.e., the CSGL account holder) reports the deals on the NDS on behalf of the constituents (i.e. the gilt account holders)	
xi)	Verify whether Ready Forward Deals have been entered with any non-eligible (as per RBI guideline) counterparty.	
xii)	Verify whether all existing Ready Forward Deals have been completed on due dates without any extension and roll over.	
xiii)	Verify whether all existing guidelines of RBI regarding Ready Forward Deals have been complied with.	
G.	FOREX OPERATIONS	
	FRONT OFFICE FUNCTION	
	a) INTER BANK DEAL	
i)	Verify the dealing hours specified by the bank for FOREX market. Bank can conduct dealing during the working hours though bank if it thinks so can require dealers to work longer hours. Verify whether there is a shift system of working for the dealers.	
ii)	Verify whether deals done off-premises and after office hours are permitted. If such transactions are permitted, whether adequate controls are put in place to ensure that transactions are executed by authorised personnel and within the approved limits. Check that the particulars of these transactions must be entered into the bank's account at the earliest.	
iii)	Verify that the bank lays down clear guidelines regarding use of other communication equipments, if permitted, such as mobiles, chat facility on internet, etc., for dealing after office hours, and regarding primary record of the transaction.	
iv)	Verify whether the dealers operate within the various limits and guidelines specified in the Treasury Policy.	
v)	Verify whether a dealer is kept in the dealing room for more than say 7 years. Also verify there is a rotational break of a fortnight at the minimum (in a year) for every dealer. This is applicable in case of domestic dealers also.	
vi)	Verify whether a rotational system of duties prevail among the dealers.	
vii)	Verify whether the dealers strictly adhere to overnight, daylight, gap, counterparty etc. limits and stop losses for various currencies approved by the Management.	



viii)	Verify that the dealer follows the dealing procedure of noting in the deal slip immediately after execution of a deal, the broker/direct deal, bank name, currency, amount, rate, time, date and initial of the dealer. In a fully automated system, system itself generates this deal slip containing the above information. Also verify dealers pass on the deal slips for data processing without delay.	
ix)	Verify that all dealers undertake to abide by the Code of Conduct prescribed by FEDAI.	
x)	Verify whether voice recording equipment is installed which tape conversations to avoid disputes with brokers/branches /counterparties etc.	
xi)	Verify whether the dealers have the required knowledge and quick understanding of market forces and trends. They should have the capability to derive their own view from the inputs sourced from constant currency movements and diverse viewpoints and expectations from various players in the market. A real time access to the key information in the market is to be ensured for the dealers.	
xii)	Verify, in case of any fully automated system oriented dealing, the system is designed to enforce all the operating parameters in respect of transactions undertaken by the dealing room. It maintains a complete track of all transactions to enable continual and concurrent audit of the operations.	
xiii)	Verify, whether the computer system is designed to provide the dealer the current position vis-à-vis the operating limits and cumulative position for each currency so as to make deal decisions within the norms.	
xiv)	Verify whether deviations from the prescribed limits are immediately recorded and a list of all such deviations referred as exceptions is put up to head of the department at the end of the day for his information and ratification.	
xv)	Verify whether the dealers are provided online information access through internet and television through the cable network. These channels can provide the latest status continuously and provide access to the contracting banks and brokers and enable the dealers to maintain contact with branches, other banks, brokers etc. Verify also the transactions put through by the dealers using these facilities are later confirmed.	
xvi)	Verify whether the dealers are provided with Online Analytical Processing and Chart services provided by Reuters, Bridge (Dow Jones). Telerate and others on their network to facilitate their decision making and the policies of the management in this regard.	
xvii)	Verify whether the dealers are provided with many supporting gadgets, real-time financial data providers such as Reuters monitor services/Bridge/Bloomberg which provide real-time bid and offer quotations of contributing banks, other market information that has a bearing on currency movements.	
xviii)	Verify whether dealer wise profit target is fixed.	
	b) MERCHANT	
i)	Verify whether profit or loss on cancellation of merchant deals are calculated correctly and duly accounted for.	

ii)	Verify all the foreign exchange transactions that are put through by the authorized branches at different centres and sent to the dealing room for cover must be covered on the same day	
iii)	Verify whether the merchant rates calculated and offered to the branches are in accordance with the policy laid down by the management.	
H	FOREX OPERATIONS	
	a) BACK OFFICE	
i)	Verify whether deals done by the dealers are timely processed so that receipt and delivery of funds at various centres have taken place at the right time.	
ii)	Verify the role of back office as an ultimate centre to hold on to the gains made by the dealing room. Verify there is no delayed settlements, interest claims, loss of image and hence loss of dealing lines.	
iii)	Verify whether merchant desk in the back office pass proper entries to ensure all forex transactions reported from branches get due cover without delay,	
iv)	Verify whether the Merchant Desk makes proper analysis of the pattern of foreign exchange business of the bank(Export: Import ratio) and use this analysis to structure the merchant rates that are quoted to the customers.	
v)	Verify whether Contracts Desk in the Back Office goes through all the interbank contracts concluded by the dealers and confirms that every contract has a counterparty bank confirmation and a broker confirmation if the contract is booked through a broker.	
vi)	Verify that Independent confirmation of contracts is obtained for deals other than those put through the Clearing Corporation of India Ltd (CCIL), which are matched by CCIL from the counterparty banks and subject to exchange of one time bilateral agreement between them and duly verified for correctness	
vii)	Verify that In respect of computer generated deal confirmation slips, which are not signed, banks issuing such confirmation execute a stamped agreement in favour of the counterparty banks assuming responsibilities for errors/ omissions	
viii)	Verify whether the Contracts Desk has got the ratifications from the counterparty bank/broker if there is any discrepancy or variation between deal slip and counterparty confirmation after bringing the points of discrepancies in the notice of the counterparty bank/broker	
ix)	Verify whether monthly outstanding contracts are exchanged between banks and confirmations obtained.	
x)	Verify to ensure that no contract can remain in the bank's books which are not backed by a counterparty confirmation.	
xi)	Verify that the Position and Funds Registers. if any, are continuously updated on the basis of deal slips and the reports of business flowing in from the branches, to assist the efficient transmission of information to the dealing room and the management.	



xii)	Verify that the claims regarding overdue interest are lodged and followed up by the Fund Settlement Desk in Back Office.	
x)	Verify whether the Fund Desk in the Back Office monitors the balances available in the nostro accounts of the bank and ensures that optimum balances are maintained. Verify this desk informs the dealer whether the funding is to be done or surplus utilized and also puts up his daily report of approximate balances to the management.	
xi)	Verify whether Cabling section of the Back Office ensures that funds are transferred out of the accounts maintained with the correspondents of the bank to the correspondents of the various counterparties as per the deals concluded by the dealing room. The methods used may be SWIFT or tested telex.	
xii)	Verify whether Reconciliation Section of the Back Office reconciles the nostro accounts, identify outstanding items and follow-up and eliminate the same. Verify also this section puts up monthly reports to management according to the value of the entries as well as age-wise grouping.	
xiii)	Verify whether a forex policy (this should be a part of Integrated Treasury Policy) has been formulated by the management conforming to RBI regulations and guidelines wherein it has clearly set the objectives of the back-office and the dealing room..	
xiv)	Verify whether this policy includes (a) exchange exposure limits (b) gap limits (c) stop loss levels (d) optimum balances in nostro accounts (e) selection of dealers (f) rotation of dealers (g) payment of brokerage. See whether the guidelines are communicated to the concerned desk.	
xv)	Verify where the system does not provide the facility, Rate-Scan reports are prepared at least thrice a day (viz. at opening hours, afternoon and closing hours) and deals at wide variance with the ongoing market rates are enquired into.	
b) COMPUTERISED BACK-OFFICE ACCOUNTING SYSTEM		
i)	Verify whether the computer system provided in the Back Office of the foreign department supports the full range of activities required for efficient processing of transactions, control and monitoring of accounts and in extending customer support through branches.	
ii)	Verify whether the system automatically captures in the case of a deal various key or basic data as input like a) Currency b) Currency Amount c) Currency Rate d) Delivery Period (i.e., Spot, Tom or Forward), Type of Deal (Outright/Swap), Counter party bank's name, Place of settlement of funds, Name of bank correspondents, Name of Counterparty correspondents etc.)	
iii)	Verify whether the system being fed with the above inputs completes automatically various tasks like a) Updating currency positions b) Generate day wise Funds position) List maturity position for the month d) Prepare bank-wise exposure position e) Prepare broker wise business reports.	

iv)	Verify whether the database gets updated dynamically after every deal is put through the system to enable the dealer to get various information like average rate, updated currency wise position , funds availability etc. on his terminal at any interval he desires viz, after each deal, at the end of the day etc.	
v)	Where system generates a deal ticket inputs from the Reuters interface verify whether it is authenticated by the dealer with his signature. Verify also whether other data required for completing the deal would be entered and authorized by a back-up official.	
vi)	Verify whether all guidelines issued by the RBI requiring checkpoints and system control in the computer are followed to ensure that proper procedures are followed at all stages.	
vii)	Verify different controls and monitoring reports generated by the system are gone through properly by the management. Verify also the system of tracking the Exception Reports for any deviation of the standard procedure and exceptional transactions.	
viii)	Verify whether the computer system generates different reports and registers automatically. like-a) Summary report of Funds settled b) Funds settlement Register c) Delivery Confirmations d) Delivery vouchers in respect of all contracts actually settled e) Inter Bank contracts register f) Bank wise list of outstanding contracts g) Summary statement of Interbank contracts h)Contract Confirmations for deals booked on that day i) A list of all fixed date and option contracts that could be settled on that day j) After actual daily settlements, a Funds Settlement Register k)Contract Register, Maturity-wise Diary and the Brokerage Register l) Inter branch transaction statements.	
ix)	Verify that the computer records all the transactions properly and the necessary related books are updated.	
x)	Verify whether all settled contracts are automatically reversed by the computer and information regarding outstanding contracts are available at any point of time.	
xi)	Verify whether system facilitates rates calculation with pre definable margins, funding of accounts , settlement of deals and transactions with branches , generation of advice, downloading of Nostro account details for reconciliation of accounts etc.	
xii)	Verify also the computer gives a correspondent-wise fund position every day to facilitate inter-correspondent transfer.	
xiii)	Verify whether the computer, in Return Section, compile all the required returns out of the information available with it.	
xiv)	Verify the various functions of the back office rendered by the computer in fund management and cash flow, in the arena of data communication, in the Reconciliation section especially the Nostro account.	
xv)	Verify the computerised accounting system for merchant transactions., See whether the system posts the transaction registers and diarises the due dates for crystallization and last dates for delivery under forward contracts etc.	



xvi)	Verify the role of computer system in regard to generating reminders to branches well ahead of due date, calculation of charges for extension/cancellation of contracts and production of a list of outstanding contracts, instruments, export bills, import bills etc.	
xvii)	Verify the reports of system audit which should be held at least once in a year to verify the system adequacy and reliability.	
xviii)	The following audit areas should be subjected to a risk- based audit once a year a) limit system b) determination and reconciliation of positions and results c) changes in the EDP systems d) completeness, correctness and timeliness of the internal reporting system e) functional separation f) degree to which transactions are in line with market conditions g) confirmations and counter-confirmations	
I	FOREX OPERATIONS MANAGEMENT INFORMATION SYSTEM	
i)	Verify whether chief dealer submits daily a report to the management regarding- a) the dealers view of the market, preferably currency wise, at the start of the business and their strategy for the day b) the high value transactions report to the dealing room for cover and the margins on the same c) profits/losses on spot transactions in INR and crosses, swaps, arbitrage d) Reasons for exceeding any limits-exchange exposure or counter party or gap. e) Reasons for large losses only.	
ii)	Verify whether the back office submits any periodical reports (may be weekly) on work done and discrepancies/variances noted by them during the period and the proposed actions for their elimination.	
iii)	Verify different control and monitoring reports generated by the systems that are of immense help for the proper management of the forex operations in this bank. Review the adequacy and timeliness of key management reports such as those relating to limit excesses and maturity periods and see that appropriate action is initiated in response to the information,	
iv)	Statutory and regulatory compliance reviews, data processing control reviews, and back-office efficiency reviews-are some of the important tasks the internal auditor should perform.	
J	FOREIGN EXCHANGE OPERATIONS DEALING THROUGH BROKERS	
i)	Verify whether there is an approved panel of brokers of sufficient numbers and see whether they are periodically revised as per Investment Policy taking into account the efficiency, market reputation, credit worthiness, experience etc. of the brokers.	
ii)	Verify there is no discrimination between brokers where rates offered by them are competitive.	



iii)	Verify whether the brokers are allowed to take positions. Check whether banks treat the brokers as intermediaries only and never put itself in a position where forex brokers behave as principals,	
iv)	Verify that all broker notes for all deals through brokers are received and that gets reconciled on the same day and only in exceptional circumstances be received before working hours of the next day.	
v)	Verify there is no nomination of brokers where the deal is not done through that medium.	
vi)	Verify whether substitution of one bank by another in inter-bank contract by brokers is noticed and see whether brokers go by instructions from dealer.	
vii)	Verify whether brokers have any role in verification and payment of brokerage claims.	
viii)	Verify whether there is any instance of malpractices by brokers and see whether the same has been promptly reported to FEDAI and Exchange Control Department RBI, Central Office.	
ix)	Verify whether a monthly statement showing broker-wise payments together with a statement for the preceding twelve months is put up to the management. Changes in the panel of brokers may also be indicated in the report.	
x)	Check whether all claims of brokerage are verified from the broker register if it is not provided by the system.	
K	FOREX OPERATIONS INTERNAL CONTROL- FOREX OPERATIONS a) organization of dealing department	
i)	Verify that the operational procedures in the area of trading activities ensure functional segregation of Dealing, Mid-Office, Back-Office. a) Front Office - Dealing Room b) Mid - Office - Risk Management; Accounting Policies and Management Information System c) Back Office - Settlement, Reconciliation, Accounting	
ii)	Verify that adequate is exercised while selecting and grooming the dealers. Management should provide opportunities to the dealing room staff to get continuously updated on global market trends in forex and derivatives trading and risk control. Verify whether the antecedents have been carefully verified from the standpoint of integrity in case of drafting personnel from other banks or organisations as dealers.	
iii)	In case of electronics data processing verify the data processing systems used is appropriate to the nature and volume of activities and programmed to ensure functional separation. Access rules for performing distinct functions should be defined in detail and drawn up by persons unconnected with the dealing activity. Confidentiality of the data in the systems may be ensured in the case of outsourcing of IT services to external agencies.	



iv)	Verify that the dealer operates according to the guidelines laid down by the management. Ideally dealers may confer before works starts on the trend in the overnight markets in the light of the news bag and the bank's own business and arrive at a tentative view of the market. It is essential that efficient communication channels be provided for dealers to facilitate consultations with designated authorities.	
v)	Verify also the aspects regarding dealing procedure, voice recording, code of conduct as mentioned in the Inter Bank Deal against point no. G (a).	
	b) Back office	
i)	Internal control procedure for Back-Office operations in forex that the internal auditor should verify has been extensively covered under point H (a) and (b) above.	
	c) Dealings in Exchange Traded Currency Products	
i)	Verify where exchange traded products like currency future are traded on behalf of customers, bank recovers margin amounts required by the exchanges from customers as also the negative MTM, based on the daily settlement price.	
ii)	Verify whether for proprietary trading portfolios in exchange traded products, banks ensure revaluation of their portfolios on a daily basis, and apply stop loss norms as deemed fit, to these positions. All guidelines of the RBI, SEBI as well as extant regulatory guidelines, must be adhered to.	
	d) Dealing through exchange brokers	
i)	The internal control points that the internal auditor should verify regarding dealing through exchange brokers have been covered against point 'J' above.	
	e) RISK CONTROL AND RISK MANAGEMENT	
	1. Requirements of the system	
i)	The auditor should verify that the risk control and risk management systems is designed in accordance with the scale, complexity and risk content of the trading activities being conducted or envisaged.	
	2. Responsibilities of the Senior management	
i)	Check whether transactions in different hedging products (forwards and derivatives) are closely overseen by the senior management.	
ii)	Verify whether dealing in any new product or any change in the existing product design has prior approval from the competent authority. Also verify that Banks have policies approved by the Board or a Committee so authorised in this regard by the Board, encompassing control processes guiding the activities	
iii)	Verify whether the policies detail the type and nature of the activity authorised, articulate the risk tolerance of the bank through comprehensive risk limits and require regular risk position and performance reporting.	

iv)	Verify whether this approved policy includes the business strategies on which trading in the individual product groups is based, the markets in which trading is allowed, the nature, scope, legal framework and documentation of trading activities, the list of counterparties with whom trade may be conducted, the procedures for measuring, analyzing, monitoring and managing the risks, ceilings for risk positions according to the type of business or risk organizational unit or portfolio, the procedure for reacting to (i) any overshooting of the limits and (ii) to extreme market developments, the functions and responsibilities of individual members of staff and work units, internal accounting and external/internal reporting, staffing and technical equipment, the internal control and monitoring system, the maintenance of confidentiality in respect of trades, 'Suitability and Appropriateness' guidelines, electronic trading platforms, access control to dealing room, with audit trails, access control management and review.	
v)	Verify whether there is a written acknowledgement of these guidelines from the members of the staff confirming that they have noted the relevant instructions applicable to them.	
vi)	Verify whether the bank has an effective process of evaluation and review of the risks involved in various trading activities undertaken by the dealers, in respect of all hedging products.	
	<p>a) Credit Risk:</p> <p>i) Pre settlement Risk: Verify whether exposure limits on counterparties have been fixed for managing this risk.</p> <p>ii) Settlement Risk: Settlement risk arises due to failure to perform as per contractual obligation on the settlement date. This risk arises due to operational breakdown, counterparty default or legal impediments. Internal audit should verify whether there remains an effective system to monitor and control settlement risk.</p>	



	<p>b) Liquidity Risk: The auditor should verify bank has a sound system in place to manage liquidity risk so that it can execute a transaction at a reasonable price and is able to exit or offset positions quickly at a reasonable price. Market liquidity risk is the risk of a bank not being able to exit or offset positions quickly at a reasonable price.</p> <p>c) Gap Risk/Interest Rate Risk: Verify whether there is adequate system in place to manage this risks owing to adverse movements in implied interest rates or actual interest rates differentials that arise through transactions involving foreign currency deposits, forward contracts, currency swaps, forward rate agreements, forward delta equivalent of currency options trades, and through numerous other currency and interest rate derivative.</p> <p>d) Legal Risk: Verify whether bank has taken enabling steps like insisting on exchange of internationally accepted Master Agreements such as ISDA, IFEMA, and ICOM between the parties to be supported by other relevant documentation to manage this risk which exists in all kinds of financial markets and more so in foreign exchange and interest rates given their inherent volatility</p> <p>e) Operational Risk: Verify whether the data processing system used must be appropriate to the nature and volume of trading activities. Also verify whether a written contingency plan is there to ensure, among other things that in the event of a breakdown of the equipment back up facilities can be deployed at a short notice.</p>	
	<p>3. The Risk Management Process: Verify whether the bank has a comprehensive and adequate risk management procedure covering both trading and non-trading activities that will enable the management to assess exposures on a consolidated basis. Also verify whether this procedure which is very helpful for limiting and monitoring the risk, is easily understood by the dealers, back-office, mid-office, senior management and the Board of Directors.</p>	
	<p>4. Limiting risks:</p>	
<p>i)</p>	<p>Verify whether global limits have been set up for the bank's local interbank business as well as its transactions in the overseas markets. The 'limits' system should be consistent with the banks.</p>	
<p>ii)</p>	<p>Verify overall risk management process, expertise and the adequacy of its capital to undertake such activities.</p>	
<p>iii)</p>	<p>Verify whether the bank has taken required approval from the RBI for its net open exchange position limit and the Gap limits.</p>	
<p>iv)</p>	<p>Verify whether an upper limit for losses keeping in view the bank's capital and earnings performance.</p>	
<p>v)</p>	<p>Verify whether a system of risk containing limits has been set up which is related both to credit risks and market price risks. Verify also whether overall limits are set and approved by the management for each category of risks.</p>	

vi)	Verify whether appropriate Value-at-Risk (VAR) models are in operation for quantifying the extent of market risk for a given level of confidence. Also see that periodic review of existing models like VaR including assumptions used are done to test the robustness.	
vii)	Verify as already said, bank maintain appropriate internal control systems for managing pre-settlement credit risk. For settlement risk, see when a central counter party is recognized, risk weight applied is subject to RBI norms and in all other cases nominal exposure may be equal to actual credit risk.	
viii)	<p>Verify whether the following risk containment measures have been adopted by the bank:</p> <ul style="list-style-type: none"> i) The bank should ensure that every dealer is advised promptly of the limit allocated to him. ii) All deals done should be accounted for against the corresponding limits. All the individual positions are to be aggregated into overall risk position at the close of business each day with a view of ensuring that the same does not exceed the overnight limit authorised by the management and NOPL and AGL approved by the Reserve Bank. iii) The limits when exceeded should be promptly reported to appropriate senior management and got approved. Banks should therefore have an adequate control system in this regard. iv) Any breach of regulatory limits should be promptly reported to Reserve Bank of India, Foreign Exchange Department, C.O; Mumbai. 	
ix)	<p>Verify whether the following important matters relating to risk management are contained in Integrated Treasury Policy:</p> <ul style="list-style-type: none"> i) Each risk is covered in the policy document. The policy document may state which issues are applicable and which are not. ii) For each financial risk, state the amount of discretion delegated to management. For example, management may hedge 60 to 80 per cent of an exposure iii) The policy should outline the organisational structure for the management of financial risks, including the authority and role of each body or individual. iv) The policy should include credit limits for each individual counterparty or rating bands. Additional consideration may be given to settlement limits, limitations on concentration or diversification and tenor of transactions. Review of counterparties and their credit rating regularly. Monitor compliance with limits daily. v) The policy should clearly state the rules relating to historic rate rollovers (HRRs) and pre-deliveries of foreign exchange contracts 	
	<p>5. Reporting System-MIS: An effective MIS is helpful in monitoring internal control and regulatory requirements. The internal audit points regarding MIS have been discussed against point no. I above.</p>	



	<p>6. Documentation and Record Keeping</p> <p>For forward exchange contract where the tenor does not exceed 13 months</p> <p>a) Contracts between banks and customers</p> <ul style="list-style-type: none">• Verify whether the bank has obtained specific individual contract note (duly stamped), for each transaction containing the detailed terms of the contract such as amount, rate, value ii/ delivery date, etc. <p>b) Interbank deals</p> <ul style="list-style-type: none">• Verify whether unsigned computer generated confirmations have been exchange backed by 'one time' stamped letter of indemnity executed in favour of the counterparty banks as per FEDAI guidelines in case of forward exchange contracts. <p>Forward exchange contracts where the tenor exceeds 13 months</p> <p>a) Contract between banks and retail/individual customers</p> <ul style="list-style-type: none">• As given in a (i) above <p>b) Inter -bank deals and contracts with other customers</p> <ul style="list-style-type: none">• Verify whether Banks have entered into International Swaps and Derivative Association (ISDA) Master Agreement. <p>All other derivative transactions</p> <p>a) Contracts between bank and retail/individual customer</p> <ul style="list-style-type: none">• As given in a (i) above <p>b) Inter-bank deal and contract with other customers</p> <ul style="list-style-type: none">• Verify that Banks enter into International Swaps and Derivative Association (ISDA) Master Agreement <p>Verify whether Banks obtain Board Resolution from their corporate clients specifically authorising their officials to deal and execute contracts (including derivatives).</p> <p>Verify whether Banks establish processes (checklists, tickler files, etc.) to ensure proper documentation to support these transactions and to monitor and control receipt of the documents</p> <p>7. Preservation of Records</p> <p>Verify whether all business, control and monitoring records have been preserved up to the existing statutory retention periods. Wherever statutory retention periods are not stipulated whether they have been preserved as per the internal guidelines of the bank management. Also verify whether Back up of crucial information and data have been done and preserved according to the IT policy of the bank.</p>	
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	<p>f) RECONCILIATION OF NOSTRO BALANCES</p>	
	<ul style="list-style-type: none"> • Verify whether Nostro mirror account is reconciled on a regular basis with the foreign bank account statement to ensure that every transaction undertaken of the bank in Nostro account has been correctly executed. Verify whether action on unreconciled items has been taken on an on-going basis as any delay in this regard renders reconciliation more difficult, particularly, because the correspondent banks/ branches abroad employ computerised accounting systems and micro filming procedure. • Verify to ensure that no set-off of debit or credit items has been made/any unreconciled item written off or appropriated to profit & loss except as permitted under the Reserve Bank guidelines. • Verify whether Reconciliation Department submits a monthly report to the management indicating the progress made in reconciliation of Nostro account balances highlighting special features such as large unreconciled items, age-wise grouping of items, etc. 	
	<p>g) MANAGEMENT OF RISK ARISING IN RUPEE (VOSTRO) ACCOUNTS</p>	
	<ul style="list-style-type: none"> • Verify whether proper Control over vostro accounts covers various aspects, viz. funds flow into the accounts, observance of discipline in credit lines extended to the correspondent bank, concealed overdrafts (and recovery of interest there against), apart from periodical evaluation of credit risks. • Verify that banks assess their credit risks periodically say, at least once in twelve months vis-à-vis their correspondent banks whether or not they maintain Rupee accounts. • Verify whether the bank exercises proper control over the flow of the paid drafts, etc. to the account maintaining office from the drawee branches to mitigate credit risk arising from drawings on branches. The control points are: <ul style="list-style-type: none"> A) Reduction in the number of branches on whom drafts, etc. can be drawn. B) Imposition of suitable limits for drawing or for aggregate drawings during a day. C) Securing draft, etc. issued advices from the correspondent. D) Decentralisation of Vostro accounts by opening subsidiary or independent accounts at other important offices. E) Arrangements for advice over expeditious mode of communication of large payments by paying branches. F) Prompt value-dating. G) As far as possible, bringing all the drawee branches under Core Banking Solution. H) Where on-line monitoring of funds position is ensured to avoid concealed overdrafts in vostro accounts. 	



	<p>Verify whether close monitoring of funds flow in Vostro account is exercised to avert hot money flows on the one hand and speculative dealing in the Rupee on the other. Verify also, the accounts are monitored for quickly identifying sudden changes in volume of operations, changes in nature of operations, etc. so that discreet enquiries can be made about the cause for the changes. See any unusually large operations (whether credits or debits) in inactive or the less active Vostro accounts are promptly looked into to ensure that they are genuine operations.</p> <p>Verify whether overseas banks maintaining Vostro accounts send out certificates of balance and obtain confirmation thereof periodically. It should be ensured that the confirmations duly signed by the authorised signatory of the bank are received in time and are kept on record. Authenticated SWIFT confirmation may also be acceptable.</p>	
	<p>h) AUDITING</p> <p>As a part of internal control the internal auditor should see there is concurrent audit, system audit and internal audit on a regular basis with the broad objectives as specified by the RBI. The internal auditor should consult the report of respective audit and study the observations made in these audits carefully to make his audit more purposeful.</p>	
	DOMESTIC OPERATIONS	
	a) INVESTMENTS	
i)	<i>Review the investment strategy .Is the strategy followed in letter and spirit?</i>	
ii)	<i>Verify whether authority level set for investments in different instruments in terms of monetary limits.</i>	
iii)	<i>Obtain a list of investment</i>	
iv)	<i>Analyse investment portfolio statements</i>	
v)	<i>Verify whether all investments are made in the name of the entity; if not, is there any valid reasons for that.</i>	
vi)	<i>Verify whether the entity possesses the valid documents for ownership of investments.</i>	
vii)	<p>Verify the control system of investment manager’s activities</p> <p>Verify the compliance of investment policy by investment manager</p>	
	b) INTERNAL CONTROL-DOMESTIC OPERATION	
i)	<p>Verify that there is a clear functional separation of (i) trading, (ii) settlement, monitoring and control and (iii) accounting. Also verify that there is a functional separation of trading and back office functions relating to banks’ own Investment Accounts, Portfolio Management Scheme (PMS) Clients’ Accounts and other Constituents (including brokers’) accounts.</p>	
ii)	<p>Verify whether the Portfolio Management service is provided to clients. If so, whether it is subject to strictly following the guidelines in regard thereto (covered in Master Circular – Para-Banking Activities). Further, see that PMS Clients Accounts are subjected to a separate audit by external auditors.</p>	
iii)	<p>Verify whether all SGL/CSGL account holders adhere to the FIMMDA code of conduct while executing trades on NDS-OM and in the OTC market.</p>	

iv)	Verify for every transaction entered into, the trading desk prepares a deal slip which should contain data relating to nature of the deal, name of the counter-party, whether it is a direct deal or through a broker, and if through a broker, name of the broker, details of security, amount, price, contract date and time. The deal slips should be serially numbered and controlled separately to ensure that each deal slip has been properly accounted for. Once the deal is concluded, the dealer should immediately pass on the deal slip to the back office for recording and processing.	
v)	Verify that for each deal there is a system of issue of confirmation to the counterparty. The timely receipt of requisite written confirmation from the counterparty, which must include all essential details of the contract, should be monitored by the back office.	
vi)	The auditor should note that with respect to transactions matched on the NDS-OM module, since CCIL is the central counterparty to all deals, exposure of any counterparty for a trade is only to CCIL and not to the entity with whom a deal matches. Besides, details of all deals on NDS-OM are available to the counterparties as and when required by way of reports on NDS-OM itself. In view of the above, the need for counterparty confirmation of deals matched on NDS-OM does not arise. The deals in Government Security transactions in OTC market that are mandated to be settled through CCIL by reporting on the NDS, are not required to be confirmed physically as OTC deals depend on electronic confirmation by the back offices of both the counterparties on NDS system like the NDS-OM deals.	
vii)	However, verification should be made whether all Government Securities transactions, other than those mentioned above, are physically confirmed by the back offices of the counterparties, as hitherto.	
viii)	Verify whether Banks report OTC trades in Commercial Papers (CPs) and Certificate of Deposits (CDs) and OTC repo trades in corporate debt securities, CPs, CDs and non-convertible debentures (NCDs) of original maturity less than one year on F-TRAC - the reporting platform of Clearcorp Dealing Systems (India) Ltd. (CDSIL).	
ix)	<p>Also verify whether these trades are physically confirmed by the back offices of the counterparties. In F-TRAC, both the counterparties individually report their respective sides of the trades and the trades are validated for trade details before matching by F-TRAC. This ensures implicit confirmation by both counterparties. Further, the details of the transactions are available on the F-TRAC system. The requirement of exchange of physical confirmation of trades matched on F- TRAC is waived subject to the following conditions:</p> <ul style="list-style-type: none"> (i) Participants entering into one time bilateral agreement for eliminating the exchange of confirmation; (ii) Participants adhering to the extant laws such as stamp duty as may be applicable; and (iii) Participants ensuring adherence to a sound risk management framework and complying with all the regulatory and legal requirements and practices, in this regard. 	



x)	The dispensation with respect to waiver of physical confirmation will be subject to review in case of any change in ownership of the F-TRAC platform or reporting arrangements thereof.	
xi)	Verify that after conclusion of a deal, there is not any substitution of the counter party bank by another bank by the broker, through whom the deal has been entered into; likewise, also verify whether the security sold/purchased in the deal is not substituted by another security.	
xii)	Check whether on the basis of vouchers passed by the back office (which should be done after verification of actual contract notes received from the broker/ counterparty and confirmation of the deal by the counterparty), the Accounts Section independently write the books of account.	
xiii)	Verify whether In the case of transaction relating to PMS Clients' Accounts (including brokers), all the relative records give a clear indication that the transaction belongs to PMS Clients/ other constituents and does not belong to bank's own Investment Account and the bank is acting only in its fiduciary/ agency capacity.	
xiv)	Verify that balances as per bank's books are reconciled at quarterly intervals or more frequently if the number of transactions so warrant with the balances in the books of PDOs. Also verify that this reconciliation is periodically checked by the internal audit department.	
xv)	Verify whether a system for verification of the authenticity of the BRs and SGL transfer forms received from the other banks and confirmation of authorised signatories is in place.	
xvi)	Verify whether Banks put in place a reporting system to report to their top management, on a weekly basis, the details of transactions in securities, details of bouncing of SGL transfer forms issued by other banks and BRs outstanding for more than one month and a review of investment transactions undertaken during the period.	
xvii)	Verify that Banks do not draw cheques on their account with the Reserve Bank for third party transactions, including inter-bank transactions. For such transactions, bankers' cheques/ pay orders are issued.	
xviii)	Verify that In case of investment in shares, the surveillance and monitoring of investment is done by the Audit Committee of the Board. Also verify the Board reviews in each of its meetings, the total exposure of the bank to capital market, both fund based and non-fund based and ensure that the guidelines issued by the Reserve Bank are complied with and adequate risk management and internal control systems are in place.	
xix)	Verify that the Audit Committee keeps the Board informed about the overall exposure to capital market, the compliance with the Reserve Bank and Board guidelines, adequacy of risk management and internal control systems.	

xx)	Verify that the stockbrokers as directors on the Boards of banks or in any other capacity, do not involve themselves in any manner with the Investment Committee or in the decisions in regard to making investments in shares, etc., or advances against shares.	
xxi)	Verify whether the transactions in securities are audited on an ongoing basis, whether their compliance is monitored with the laid down management policies and prescribed procedures and whether the deficiencies are directly reported to the management of the bank.	
xxii)	Verify whether the banks' management ensures that there are adequate internal control and audit procedures for ensuring proper compliance of the instructions in regard to the conduct of the investment portfolio. Verify that the banks institute a regular system of monitoring compliance with the prudential and other guidelines issued by the Reserve Bank. Also verify that the banks get compliance in key areas certified by their statutory auditors and furnish such audit certificate to the Regional Office of DBS, RBI under whose jurisdiction the HO of the bank falls.	
xxiii)	<p>Apart from what has been discussed above, the auditor should verify the following areas:</p> <p>1. Physical Controls</p> <p>a. Observe that entry into the dealing room (in case there is one) is restricted to authorised personnel only</p> <p>b. Examine in case of physical securities</p>	
xxiv)	<p>Verify whether there are procedures for safekeeping of valuables and they are working effectively.</p> <p>Movement of securities is recorded and updated</p> <p>There is physical/password security over key systems and equipment, including routing inward confirmations to render them secure from interception</p> <p>Access to spreadsheets or treasury drives and electronic banking systems is restricted by password</p> <p>The treasury management system has a system of permissions that prevents dealing staff and settlement staff from performing each other's tasks in the systems</p> <p>Monitoring of money market back up / investment back up section for CRR, SLR, Refinance, CLGFB, IBPC, Reconciliation</p>	
	<p>2. Authorisation</p> <p>i. Verify that all a. For entities having dealing rooms and dealing for others:</p> <p>ii. Check that all sampled deals are authorised at the proper levels of authority against the deal slip (Chief Dealer or Treasury Manager)</p> <p>iii. Ensure that alterations and cancellations on deal slips are authorised</p> <p>iv. Ensure that acknowledged copy is taken from the client</p>	



	<p>3. Recording Control</p> <ul style="list-style-type: none"> i. Control over documents money market deals are timely and accurately recorded at the correct monetary value. ii. Inspect and ensure that filed copies are pre-numbered and continuous for ease of reference and continuity in document filing. iii. Verify that all the documents and statements have been received from concerned parties (brokers, bankers, lenders etc.) and properly filed in a logical sequence. <p>Control over Accounting Procedures</p> <ul style="list-style-type: none"> i. Verify that adequate systems are in place to track all matured investments. ii. Check for accurate recording and accounting of positions. iii. Verify that an independent person checks the recording of postings iv. Trace all deals to the General Ledger and re-compute interest calculations. v. Check that account reconciliation is done and time frame is set for clearing all outstanding items. vi. Inspect source documents for accuracy of information on source documents and ascertain that they are initialled as evidence of checking. 	
	<p>4. Segregation of Duties</p> <p>Check and ascertain that segregation of duties is in place. Under no circumstances staff involved in initiating deals staff be involved in checking or receiving the related documents.</p> <p>Check that there is segregation between functions of authorisation, execution and recording of transactions.</p> <p>Do an overall assessment and ensure that management supervision is practiced where segregation of duty is not possible</p> <p>In cases where management override has taken place, ensure that satisfactory reasons for doing so were recorded.</p>	
	<p>5. Limits</p> <p>Discussed against point no. E (i),(ii) , (iii) and iv)above.</p>	
	<p>6. Reconciliations</p> <p>Check that all printed reconciliations are filed in sequential order.</p> <p>Select a sample for verification</p> <ul style="list-style-type: none"> i. Trace each individual item to the reconciliation ii. Follow up each item and note when it is cleared off the reconciliation. Establish that proper procedures on clearing the outstanding item are set and followed iii. Establish that only outstanding items are carried on reconciliation. iv. Trace items from the recon to the General Ledger and get an assertion that they are included in the accounts. <p>Check opening balances in General Ledger and establish continuity of balances at close periods.</p>	



	<p>7. Processing</p> <p>Examine deals from the front office and establish that they are confirmed by the Back Office Manager</p> <p>Trace the selected deals to the filing system and establish that a systematic filing is in place.</p> <p>Examine third party payment and establish that a letter of instruction to that effect is filed.</p> <p>Establish that outward confirmations are recorded in a Register.</p>	
	<p>ENGAGEMENT OF BROKERS</p>	
	<p>(a) Verify that transactions between one bank and another bank are not put through the brokers' accounts. Also verify that the brokerage on the deal payable to the broker, if any (if the deal was put through with the help of a broker), is clearly indicated on the notes/ memorandum put up to the top management seeking approval for putting through the transaction.</p>	
	<p>(b) Verify that in case of a deal put through with the help of a broker, the role of the broker is restricted to that of bringing the two parties to the deal together.</p>	
	<p>(c) Verify that while negotiating the deal, the broker does not disclose the identity of the counterparty to the deal. On conclusion of the deal, he discloses the counterparty and his contract note clearly indicates the name of the counterparty. Verify that the broker note contains the exact time of the deal. Check whether the deal time on the broker note and the deal ticket is the same. See that it is checked by the concurrent auditor.</p>	
	<p>(d) Verify that, settlement of deals between banks, viz. both fund settlement and delivery of security happens directly between the banks and the broker does have no role to play in the process.</p>	
	<p>(e) Verify whether there is, a panel of approved brokers which is reviewed annually or more often if so warranted. Clear-cut criteria is laid down for empanelment of brokers, including verification of their creditworthiness, market reputation, etc. Verify whether a record of broker-wise details of deals put through and brokerage paid, is maintained.</p>	
	<p>(f) Verify that a disproportionate part of the business is not transacted through only one or a few brokers. Banks have fixed aggregate contract limits for each of the approved brokers. Whether a limit of 5% of total transactions through brokers (both purchase and sales) entered into by a bank during a year is treated as the aggregate upper contract limit for each of the approved brokers. This limit should cover both the business initiated by a bank and the business offered/ brought to the bank by a broker. Verify whether Banks have ensured that the transactions entered into through individual brokers during a year normally do not exceed this limit.</p>	



	g) Check if the bank has exceeded ever the aggregate limit for any broker, whether the specific reasons for the same has been recorded, in writing, by the authority empowered to put through the deals. Further, whether the board has been informed of this, post facto.	
	(h) Verify whether the concurrent auditors has scrutinized the business done through brokers also and included it in their monthly report to the Chief Executive Officer of the bank. Besides, see that the business put through any individual broker or brokers in excess of the limit, with the reasons for the same, has been covered in the half-yearly review to the Board of Directors/Local Advisory Board.	
	(i) Verify that Inter-bank securities transactions have been undertaken directly between banks and no bank has engaged the services of any broker in such transactions.	
	d) SGL Forms	
i)	Verify there is a control system in place to account for each SGL form.	
ii)	Verify that SGL form is in the standard format prescribed by the RBI and printed on semi-security paper of uniform size. See SGL forms are serially numbered.	
iii)	Verify SGL forms are signed by the two authorized officials of the bank whose signatures are recorded with the RBI and other banks.	
iv)	Verify that no SGL transfer form issued by a bank in favour of another bank gets bounced for want of sufficient balance of securities in the SGL A/c of seller or for want of sufficient balance of funds in the current a/c of the buyer.	
v)	Verify that the SGL transfer form received by purchasing banks is deposited in their SGL account immediately, i.e., the date of lodgement of the SGL Form with the Reserve Bank happens within one working day after the date of signing of the Transfer Form. Verify that in cases of OTC trades, the settlement takes place only on 'spot' delivery basis. See that in cases of deals on the recognised Stock Exchanges, settlement occurs within the delivery period as per their rules, bye laws and regulations.	
vi)	Verify that the deal/trade/contract date in Part C of the SGL Form under 'Sale date' is indicated by the participants in all cases.	
vii)	Verify that no sale is affected by way of return of SGL form held by the bank.	
viii)	Verify that record of SGL transfer forms issued/received should be maintained. Also verify that balances as per the bank's books in respect of SGL accounts are reconciled with the balances in the books of PDOs	
ix)	Verify that a system for verification of the authenticity of the SGL transfer forms received from other banks and confirmation of authorised signatories are put in place.	
	e) BANKER'S RECEIPT	
i)	Verify that no BR is issued under any circumstances in respect of transactions in Government Securities for which SGL facility is available.	

ii)	Verify that no BR is issued on the basis of a BR (of another bank) held by the bank and no transaction takes place on the basis of a mere exchange of BRs held by the bank.	
iii)	Verify that in case of other than Government securities, BR is issued for ready transactions only, under the following circumstances: (i) The scrips are yet to be issued by the issuer and the bank is holding the allotment advice. (ii) The security is physically held at a different centre and the bank is in a position to physically transfer the security and give delivery thereof within a short period. (iii) The security has been lodged for transfer / interest payment and the bank is holding necessary records of such lodgements and will be in a position to give physical delivery of the security within a short period.	
iv)	Verify that BRs are issued covering transactions relating to banks' own Investments Accounts only, and no BR are issued by banks covering transactions relating to either the Accounts of Portfolio Management Scheme (PMS) Clients or Other Constituents' Accounts, including brokers	
v)	Verify that no BR remains outstanding for more than 15 days.	
vi)	Verify that a BR gets redeemed only by actual delivery of scrips and not by cancellation of the transaction/ set off against another transaction.	
vii)	Verify that BRs are issued on semi-security paper, in the standard format (prescribed by IBA), serially numbered and signed by two authorised officials of the bank, whose signatures are recorded with other banks.	
viii)	Verify that a control system remains in place to account for each BR.	
ix)	Verify that separate registers of BRs issued and BRs received are maintained and arrangements are put in place to ensure that these are systematically followed up and liquidated within the stipulated time limit.	
x)	Verify that the banks do have a proper system for the custody of unused BR Forms and their utilisation.	
	f) Non-SLR Securities General	
i)	Verify that in the case of investment in non-SLR securities through private placement basis, the bank has, while appraising the proposal, takes into consideration the guidelines in 'Master Circular-Prudential Norms for classification, valuation and operation of investment portfolio by banks. Also verify that the bank has put in place appropriate systems to ensure that investment in private policy investments is made in accordance with the systems and procedures prescribed under Investment Policy of the Bank.	
ii)	Verify that while investing in non-SLR securities, banks follows the prudential restrictions and make necessary due diligence.	



iii)	Verify that Board of the bank lays down policy and prudential limits on investments in bonds and debentures including those on private placement basis, sub limits for PSU bonds, corporate bonds, guaranteed bonds, issuer ceiling, etc. Verify that investment policy of the bank takes care of all prudential guidelines specified in the related Master circular regarding investment in non-SLR securities.	
iv)	Verify that bank follows the prudential guidelines on 'Rating and Listing' of non-SLR securities.	
v)	Verify whether Bank has put in proper risk management systems for capturing and analyzing the risk in respect of non-SLR investment and taking remedial measures in time.	
vi)	Verify that a note on non-SLR investment containing, inter alia, the following points is placed before the Board at least at quarterly intervals. a) Total Business (Investment and Divestment) during the reporting period b) Compliances with the prudential limits prescribed by the Board for non-SLR investment. c) Compliance with the prudential guidelines issued by RBI on non-SLR securities. d) Rating migration of the issuers /issues held in the bank's books and consequent diminution in the portfolio quality. e) Extent of non-performing investments in the non-SLR category.	
vii)	Verify that in case of primary investment through private placement of debt, the bank submits a copy of all offer documents to CIBIL. Also verify that all instances of defaults relating to interest/instalment in respect of any privately placed debt have been reported to CIBIL.	
viii)	Verify that bank discloses the details of the issuer composition of non-SLR investments in the 'Notes on Accounts' of the balance sheet.	
ix)	Verify that all trades barring spot transactions in a listed debt security is executed on the trading platform of a stock exchange. Also verify that all spot transactions in listed and unlisted debt securities are reported on the NDS and settled through the CCIL from a date to be notified by RBI.	
x)	Verify that all OTC trades in corporate bonds are cleared and settled through the NSCCL or ICCL as per the norms specified by the NSCCL and the ICCL from time to time.	
xi)	Verify that the bank while undertaking repo in corporate debt securities follows prudential guidelines as specified in the Master Circular on 'Prudential Norms For Classification, Valuation and Operation of Investment Portfolio by Banks'.	
xii)	Verify that the bank while making an investment in non-SLR securities must keep in view the prudential ceiling on Banks' exposure to capital markets on 'solo' and 'consolidated basis or the lower ceiling that the board of a bank may specify keeping in view its overall risk profile and corporate strategy.	
	Bonds and Debentures, Shares, CP, CD, Venture Capital Funds	

i)	The auditor should verify that the relative provisions specified in the Investment Policy have been followed while investing in each of the above scrips. The Investment policy, in pursuance of the prudential guidelines enacted in the related Master Circular, usually formulate different parameters/conditions for investing in these securities including monetary limits for individual scrip, total exposure limit, minimum ratings standard, maturity period, duration, beta etc. Verification should be made to see these conditions have been duly complied with.	
	g) HTM/AFS/HFT	
i)	Verify that the investment policy specifies the level of authority for classification of securities in HTM/AFS/HFT category and see that the same authority who takes the decision of purchasing the securities are not the authority to take the decision for classification of securities.	
	h) STOP LOSS/CUT LOSS	
i)	The investment policy should specify detailed parameters regarding cut loss/stop loss exercise. The discretionary power of sanctioning cut loss at different tiers of management is also specified. It also specifies the role of the concerned dealer in this respect and the circumstances when the cut loss decision should be exercised. Separate limit may be provided for Govt. securities, shares, bonds and debentures etc. The auditor should verify whether there are instances of cut-loss and if so the situations leading to this cut-loss and whether they are within the specified limits and whether they are duly reported and sanctioned.	
	i) SHORT SALE OF SECURITIES	
i)	Detailed parameters and limit of short sale of different kinds of securities are specified in the investment policy. The limits as specified in the investment policy for liquid and illiquid securities are certainly subject to the guidelines issued by the RBI in this respect. It should be verified that the bank does not accumulate short position exceeding the limit.	
ii)	Verify that any short sale position executed in OTC market is reported in NDS platform within 15 minutes of this execution.	
iii)	Verify that all regulatory requirements regarding short sale and cover transactions are strictly followed. Verify if there is any violation that has been reported to the RBI promptly.	
iv)	Verify whether there is any instance of default in payment of cash and delivery of security and whether the bank has been penalized for that.	
v)	Verify whether banks submit a report of the daily security-wise short sale position, as per the specified format of the RBI , to the Principal Chief General Manager, Financial Market Department, Reserve Bank of India, Mumbai on a monthly basis, on the first working day of the succeeding month	



	j) PRIVATE EQUITY FUND	
i)	Verify whether investment in private equity fund has been made as per RBI guidelines and the Private Equity Fund is registered with SEBI. Verify that investment in single private equity fund and total exposure in all the private equity funds are within the maximum limit specified by the Investment policy. Also verify the operational guidelines followed in respect to these funds are as per RBI guidelines.	
	k) DERIVATIVES FORWARD RATE AGREEMENTS (FRA) AND INTEREST RATE SWAPS(IRS)	
	1. Appropriate infrastructure and risk management systems are in place;	
	2. Functions relating to hedging and market making are clearly separated between the Front and Back Offices;	
	3. Proper Internal Control System for trading, settlement, monitoring, control and accounting activities;	
	4. Individual deal is confirmed by Back Office in normal course;	
	5. Exposure on account of FRA/IRS is within the prescribed limit;	
	6. Obtention of declaration from Corporates/Mutual Funds for FRA/IRS;	
	7. Adherence of prudential limits on Swap positions;	
	8. Adherence of risk management norms prescribed by ALCO in respect of FRA/IRS for hedging ;	
	9. Submission of Policy Document to MPD/RBI;	
	10. Separate recording of transactions for hedging and market making purposes;	
	11. Proper revaluation of FRA/IRS for trading purposes;	
	12. Obtention of Confirmation Note and ISDA agreement;	
	13. Net Open Position within the prescribed ceiling;	
	14. Meticulous follow-up of prudential limits for various currencies and counter-parties;	
	15. Credit exposure to banks are within the approved limits;	
	16. Appropriate sanction of credit exposure to Corporates;	
	17. Reporting of FRA/IRS to MPD/RBI;	
	18. Monthly reporting of details of transactions to Senior Management;	
	19. Quarterly reporting of details of transactions to Board.	



k) CLASSIFICATION, ACCOUNTING AND VALUATION		
i)	Verify whether entire investment portfolio of the bank is classified into a) HTM b) AFS c) HFT according to RBI guidelines. Also verify that the decision of this classification is taken at the time of acquisition of the concerned security and recorded in the investment proposal.	
ii)	Verify the total investment in HTM category does not exceed the maximum prescribed limit by the RBI.	
iii)	Verify the HTM category contains only the kind of securities permitted by the RBI.	
iv)	Verify the securities sold and transferred to/from HTM category strictly as per RBI guidelines under circumstances specified in this guidelines and within the limit specified. Also verify in case the bank exceeds the limit, it mentions the same under 'Notes to Accounts 'in bank's audited financial statement	
v)	Verify that the securities classified in HFT category are meant for trading purpose and are sold within a period of 90 days.	
vi)	Verify that shifting of securities to/from HTM is held once at the beginning of the accounting year with the approval of the Board of Directors following the guidelines of the RBI.	
vii)	Verify that in Transfer of scripts from AFS / HFT category to HTM category has been made at the lower of book value or market value..	
ix)	<p>Verify that In the case of transfer of securities from HTM to AFS / HFT category, If the security was originally placed under the HTM category at a discount, it gets transferred to AFS / HFT category at the acquisition price / book value. Also verify that. After transfer, these securities are immediately re-valued and resultant depreciation, if any, are provided.</p> <p>(b) If the security was originally placed in the HTM category at a premium, verify that it is transferred to the AFS / HFT category at the amortized cost. Also verify that after transfer, these securities are immediately re-valued and resultant depreciation, if any, are provided.</p> <p>In the case of transfer of securities from AFS to HFT category or vice-versa, verify that the provisions for the accumulated depreciation, if any, held is transferred to the provisions for depreciation against the HFT securities and vice-versa.</p>	
	Valuation	
i)	Verify that Investments classified under HTM are not marked to market and are carried at acquisition cost, Verify when acquisition cost is more than the face value, the premium has been amortised over the period remaining to maturity.	



ii)	Verify that the individual scrips in the Available for Sale category are marked to market at quarterly or at more frequent intervals. Verify that Domestic Securities under this category are valued scrip-wise and depreciation/ appreciation is aggregated for each classification like. Government securities) Other approved securities, Shares, Debentures & Bonds, Subsidiaries/ joint ventures and f) Others (CP, Mutual Fund Units, etc.).Verify further, the investment in a particular classification, both in domestic and foreign securities, are aggregated for the purpose of arriving at net depreciation/appreciation of investments under that category. Net depreciation, if any, is provided for. Net appreciation, if any, is ignored. Check that net depreciation required to be provided for in any one classification is not reduced on account of net appreciation in any other classification and book value of individual securities does not undergo any change after marking to market.	
iii)	Verify that the individual scrip in the Held for Trading category is marked to market at monthly or at more frequent intervals and provided for. Consequently, the book value of the individual securities in this category would also not undergo any change after marking to market.	
iv)	Verify the valuation method applied for all quoted and unquoted securities. See that the process applied are in accordance with the RBI guidelines as mentioned in the Master Circular-Prudential norms for classification, valuation and operation of investment portfolio by banks.	
	Accounting	
i)	Verify that Uniform Accounting guidelines issued by the RBI which has been effective from April 1, 2010 are followed by the Bank in accounting Repo/Reverse Repo transactions in government securities and corporate debt securities. These guidelines, of course, are not applicable in Repo/Reverse Repo with the RBI under Negotiated Dealing System.	
ii)	Verify that bank book interest from government securities, bonds and debentures of corporate bodies on accrual basis where interest rate on these securities are predetermined and serviced regularly.	
iii)	Verify that bank book income from dividend on shares on accrual basis provided dividend on the shares has been declared by the companies in Annual general meeting and bank's right to receive this dividend has been established.	
iv)	Verify that the bank has a system to check whether the interest are received on due dates and maintains a follow-up system for those entities who have defaulted.	
v)	Verify that bank maintains a system to ensure that the dividends declared by the investee companies have actually been received	
vi)	Verify that on maturity all payments due on different securities are received actually.	
vii)	Verify that banks has not capitalised the Broken Period Interest paid to seller as part of cost, but treated it as an item of expenditure under P&L Account in respect of investments in Government and other approved securities.	

viii)	Verify that banks settle all transactions in securities as notified by SEBI only through depositories. Check whether Banks make fresh investments in and hold bonds and debentures, privately placed or otherwise, and equity instruments only in dematerialised form.	
ix)	Verify that banks do not invest in long term zero coupon bond, issued by corporates and NBFCs unless the issuer builds up sinking fund for all accrued interest and keep it invested in liquid investments and securities. Verify also that bank do not invest in securities with very low coupon of interest which are not market related unless the issuer builds up a sinking fund to the extent of the difference in the accrued interest calculated on the basis of YTM applicable to the bond and the actual coupon payable on the bond and keeps it invested in liquid investments/ securities (Government bonds).	
x)	Verify that bank put in place a conservative limit on investment in above mentioned bonds.	
xi)	Verify that deals are reflected in General Ledger.	
xii)	Verify that reconciliation of bank accounts and treasury records with the General Ledger is done on a regular basis.	
	I) CASH MANAGEMENT	
i)	Verify that there is an effective procedure of monitoring daily cash position.	
ii)	Verify that there is a system of planning of the liquidity needs for normal operating conditions and emergency situations by management	
iii)	Verify that the system that bank adopts in cash forecasting. Usually it captures all forecasted cash flow statement all known cash inflows and outflows from deposits, advances, investments and borrowings; bank may have an in-built system of getting information from the branches of all possible inflows and outflows above a prescribed limit, it must take into account the reserve requirement and can make a trend analysis while forecasting.	
iv)	Verify that the daily cash position is maintained in the treasury system or spreadsheet	



	<p>m) Audit, review and reporting of investment transactions The banks should adhere to the following instructions in regard to audit, review and reporting of investment transactions:</p> <p>(a) Verify Banks undertake a half-yearly review (as of March 31 and September 30) of their investment portfolio, which should, apart from other operational aspects of investment portfolio, clearly indicate amendments made to the Investment Policy and certify adherence to laid down internal investment policy and procedures and the Reserve Bank guidelines, and put up the same before their respective Boards within a month, i.e. by end-April and end-October.</p> <p>(b) Verify whether a copy of the review report put up to the Bank's Board has been forwarded to the Reserve Bank (concerned Regional Office of DBS, RBI) by May 15 and November 15 respectively.</p> <p>(c) Verify whether treasury transactions are separately subjected to concurrent audit by internal auditors and the results of their audit has been placed before the CMD of the bank once every month.</p>	
	<p>n) RISK MANAGEMENT- GENERAL</p>	
<p>i)</p>	<p>Treasury staff and systems must recognise all new risks when they are accepted by the company</p>	
<p>ii)</p>	<p>Staff and business unit staff must be trained to recognise key risks.</p>	
<p>iii)</p>	<p>All new financial investment products must be examined for risks and approved by the board.</p>	
<p>iv)</p>	<p>Bank accounts must be reconciled in a timely manner to detect incidents and failed settlements or unauthorized transactions.</p>	
<p>v)</p>	<p>There must be a system that enables risk management measures to be reported in an adequate and timely manner.</p>	
<p>vi)</p>	<p>There should be daily marking to market all positions with the reporting of the profit and loss effect.</p>	
<p>vii)</p>	<p>The magnitude of complexities and associated risks within the treasury must be commensurate with the entity's activities.</p>	
<p>viii)</p>	<p><i>There must be an annual review of valuation methods.</i></p>	
<p>ix)</p>	<p>Ensure the data for revaluations is valid, independent and current.</p>	
<p>x)</p>	<p>Revaluation rates downloaded from information systems (e.g, Reuters), directly into a TMS. All treasury software and systems have been subject to rigorous internal and external testing</p>	
<p>xi)</p>	<p>There should be daily marking to market all positions with the reporting of the profit and loss effect</p>	



Annexure - II

Master Circular – Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks - 2015

RBI/2015-16/97

DBR No BP.BC.6/21.04.141/2015-16

July 1, 2015

All Commercial Banks
(excluding Regional Rural Banks)

Dear Sir,

Master Circular – Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks

Please refer to the [Master Circular No. DBOD.BP.BC.20/21.04.141/2014-15 dated July 1, 2014](#), containing consolidated instructions/guidelines issued to banks till June 30, 2014, on matters relating to prudential norms for classification, valuation and operation of investment portfolio by banks. This [Master Circular](#) consolidates instructions on the above matters issued up to June 30, 2015.

Yours faithfully,

(Sudha Damodar)
Chief General Manager – in – Charge

Encl: As above



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Appendix



1. Introduction

The Reserve Bank of India issues guidelines for the investment portfolio of the banks, keeping in view the developments in the financial markets and taking into consideration the evolving international practices. This Master Circular consolidates the guidelines/circulars issued by the Reserve Bank of India on prudential norms for classification, valuation and operation of investment portfolio by banks.

1.1 Investment Policy

(i) Banks should frame Internal Investment Policy Guidelines and obtain the Board's approval. The investment policy may be suitably framed/ amended to include Primary Dealer (PD) activities also. Within the overall framework of the investment policy, the PD business undertaken by the bank will be limited to dealing, underwriting and market-making in Government Securities. Investments in Corporate/PSU/FI bonds, Commercial Papers, Certificate of Deposits, debt mutual funds and other fixed income securities will not be deemed to be part of PD business. The investment policy guidelines should be implemented to ensure that operations in securities are conducted in accordance with sound and acceptable business practices. While framing the investment policy, the following guidelines are to be kept in view by the banks:

(a) Banks may sell a government security already contracted for purchase, provided:

- (i) The purchase contract is confirmed prior to the sale,
- (ii) The purchase contract is guaranteed by Clearing Corporation of India Ltd. (CCIL) or the security is contracted for purchase from the Reserve Bank and,
- (iii) The sale transaction will settle either in the same settlement cycle as the preceding purchase contract, or in a subsequent settlement cycle so that the delivery obligation under the sale contract is met by the securities acquired under the purchase contract (e.g., when a security is purchased on T+0 basis, it can be sold on either T+0 or T+1 basis on the day of the purchase; if however it is purchased on T+1 basis, it can be sold on T+1 basis on the day of purchase or on T+0 or T+1 basis on the next day).

For purchase of securities from the Reserve Bank through Open Market Operations (OMO), no sale transactions should be contracted prior to receiving the confirmation of the deal/advice of allotment from the Reserve Bank.

- In addition to the above, the Scheduled Commercial Banks (SCBs) (other than RRBs and LABs) and PDs have been permitted to short sell Government securities in accordance with the requirements specified in Annex I-A.
- Further, the NDS-OM members have been permitted to transact on 'When Issued'



basis in Central Government dated securities, subject to the guidelines specified in Annex I-B.

- (b) Banks successful in the auction of primary issue of Government Securities may enter into contracts for sale of the allotted securities in accordance with the terms and conditions as per Annex I-C.
- (c) The settlement of all outright secondary market transactions in Government Securities is being done on a standardised T+1 basis effective May 24, 2005. Settlements on T+2 basis is permitted for outright secondary market transactions in Government Securities undertaken by FPIs and reported on NDS-OM, subject to following conditions:
 - (i) All sale and purchase transactions in Government securities, where at least one of the parties is an FPI, will be settled only on T+2 basis. These will include deals between a domestic entity and an FPI, deals between two FPIs of different custodians, deals between a custodian and its FPI Gilt Account Holder, and deals between two FPI Gilt account Holders of the same custodian.
 - (ii) All other trades not involving an FPI will continue to settle on T+1 basis.
 - (iii) Custodian bank of the FPI selling the security or the counterparty entity selling the security to the FPI will have to report the deal on trade date itself within the prescribed reporting time.
 - (iv) Custodian bank of the FPI buying the security can report the deal till next business day upto prescribed reporting time.

Guidelines on DVP III settlement issued vide [circular IDMD.PDRS.05/10.02.01/2003-04 dated March 29, 2004](#) and as updated from time to time shall continue to apply for such transactions settled on T+2 basis.

- (d) All the transactions put through by a bank, either on outright basis or ready forward basis and whether through the mechanism of Subsidiary General Ledger (SGL) Account or Bank Receipt (BR), should be reflected on the same day in its investment account and, accordingly, for SLR purpose wherever applicable. With a view to bringing in uniformity in the methodology of accounting for investments in Government securities, banks should follow 'Settlement Date' accounting for recording purchase and sale of transactions in Government Securities.
- (e) The banks should be circumspect while acting as agents of their broker clients for carrying out transactions in securities on behalf of brokers.
- (f) Any instance of return of SGL from the Public Debt Office (PDO) of the Reserve Bank for want of sufficient balance in the account should be immediately brought to the Reserve Bank's notice with the details of the transactions.



- (g) Banks desirous of making investment in equity shares/ debentures should observe the following guidelines:
- (i) Build up adequate expertise in equity research by establishing a dedicated equity research department, as warranted by their scale of operations;
 - (ii) Formulate a transparent policy and procedure for investment in shares, etc., with the approval of the Board; and
 - (iii) The decision in regard to direct investment in shares, convertible bonds and debentures should be taken by the Investment Committee set up by the bank's Board. The Investment Committee should be held accountable for the investments made by the bank.
 - (iv) Banks should clearly lay down the broad investment objectives to be followed while undertaking transactions in securities on their own investment account and on behalf of clients, clearly define the authority to put through deals, procedure to be followed for obtaining the sanction of the appropriate authority, procedure to be followed while putting through deals, various prudential exposure limits and the reporting system. While laying down such investment policy guidelines, banks should obtain the approval of respective Boards and strictly observe Reserve Bank's detailed instructions on the following aspects:
 - a. STRIPS (Paragraph 1.1.1)
 - b. Ready Forward (buy back) deals in G-Sec (Paragraph 1.1.2)
 - c. Transactions through Subsidiary General Ledger A/c (Paragraph 1.1.3)
 - d. Use of Bank Receipts (Paragraph 1.1.4)
 - e. Retailing of Government Securities (Paragraph 1.1.5)
 - f. Internal Control System (Paragraph 1.1.6)
 - g. Dealings through Brokers (Paragraph 1.1.7)
 - h. Audit, Review and Reporting (Paragraph 1.1.8)
 - (v) The aforesaid instructions will be applicable mutatis mutandis, to the subsidiaries and mutual funds established by banks, except where they are contrary to or inconsistent with specific regulations of Securities and Exchange Board of India (SEBI) and the Reserve Bank, governing their operations.

1.1.1 STRIPS

STRIPS stands for Separate Trading of Registered Interest and Principal Securities. Stripping is a process of converting periodic coupon payments of an existing Government Security



into tradable zero-coupon securities, which will usually trade in the market at a discount and are redeemed at face value. For instance, stripping a five-year Government Security would yield 10 coupon securities (representing the coupons), maturing on the respective coupon dates and one principal security representing the principal amount, maturing on the redemption date of the five-year security. Reconstitution is the reverse process of stripping, where, the Coupon STRIPS and Principal STRIPS are reassembled into the original Government Security. Detailed guidelines outlining the process of stripping/reconstitution and other operational procedures regarding transactions in STRIPS are given in Annex I-D.

1.1.2 Ready Forward Contracts in Government Securities.

The terms and conditions subject to which ready forward contracts (including reverse ready forward contracts) may be entered into are as under:

- (a) Ready forward contracts may be undertaken only in (i) Dated Securities and Treasury Bills issued by Government of India and (ii) Dated Securities issued by State Governments.
- (b) Ready forward contracts in the above-mentioned securities may be entered into by:
 - (i) persons or entities maintaining a Subsidiary General Ledger (SGL) account with RBI, Mumbai and
 - (ii) the following categories of entities who do not maintain SGL accounts with the Reserve Bank but maintain gilt accounts (i.e gilt account holders) with a bank or any other entity (i.e. the custodian) permitted by the Reserve Bank to maintain Constituent Subsidiary General Ledger (CSGL) account with its PDO, Mumbai:
 - a. Any scheduled bank,
 - b. Any PD authorised by the Reserve Bank,
 - c. Any Non-Banking Financial Company (NBFC) registered with the Reserve Bank, other than Government Companies as defined in Section 617 of the Companies Act, 1956,
 - d. Any mutual fund registered with the SEBI,
 - e. Any housing finance company registered with the National Housing Bank (NHB),
 - f. Any insurance company registered with the Insurance Regulatory and Development Authority (IRDA),
 - g. Any non-scheduled Urban Co-operative bank,
 - h. Any listed company, having a gilt account with a SCB, subject to the following conditions:
 - 1. The minimum period for Reverse Repo (lending of funds) by listed companies



- is seven days. However, listed companies can borrow funds through repo for shorter periods including overnight;
2. Where the listed company is a 'buyer' of securities in the first leg of the repo contract (i.e. lender of funds), the custodian through which the repo transaction is settled should block these securities in the gilt account and ensure that these securities are not further sold during the repo period but are held for delivery under the second leg; and
 3. The counterparty to the listed companies for repo / reverse repo transactions should be either a bank or a PD maintaining SGL Account with the Reserve Bank.
- i. Any unlisted company which has been issued special securities by the Government of India and having gilt account with a SCB; subject to the following conditions in addition to the conditions stipulated for listed company:
 1. The eligible unlisted companies can enter into ready forward transactions as the borrower of funds in the first leg of the repo contract only against the collateral of the special securities issued to them by the Government of India; and
 2. The counterparty to the eligible unlisted companies for repo transactions should be either a bank or a PD maintaining SGL account with the Reserve Bank.
- (c) All persons or entities specified at b ii) above can enter into ready forward transactions among themselves subject to the following restrictions:
- i. An SGL account holder may not enter into a ready forward contract with its own constituent. That is, ready forward contracts should not be undertaken between a custodian and its gilt account holder,
 - ii. Any two gilt account holders maintaining their gilt accounts with the same custodian (i.e., the CSGL account holder) may not enter into ready forward contracts with each other, and
 - iii. Cooperative banks may not enter into ready forward contracts with NBFCs. This restriction would not apply to repo transactions between Urban Co-operative banks and authorised PDs in Government Securities.
- (d) All ready forward contracts shall be reported on the Negotiated Dealing System (NDS). In respect of ready forward contracts involving gilt account holders, the custodian (i.e., the CSGL account holder) with whom the gilt accounts are maintained will be responsible for reporting the deals on the NDS on behalf of the constituents (i.e. the gilt account holders).



- (e) All ready forward contracts shall be settled through the SGL Account/CSGL Account maintained with the RBI, Mumbai, with the Clearing Corporation of India Ltd. (CCIL) acting as the central counter party for all such ready forward transactions.
- (f) The custodians should put in place an effective system of internal control and concurrent audit to ensure that:
 - i. ready forward transactions are undertaken only against the clear balance of securities in the gilt account,
 - ii. all such transactions are promptly reported on the NDS, and
 - iii. other terms and conditions referred to above have been complied with.
- (g) The RBI regulated entities can undertake ready forward transactions only in securities held in excess of the prescribed Statutory Liquidity Ratio (SLR) requirements.
- (h) No sale transaction shall be put through, in the first leg of a ready forward transaction by CSGL constituent entities without actually holding the securities in the portfolio.
- (i) Re-repo is permitted in government securities, including state development loans and Treasury Bills, acquired under reverse repo, subject to following conditions:
 - i. Scheduled commercial banks and Primary Dealers (PDs) maintaining subsidiary general ledger (SGL) account with the Reserve Bank of India will be permitted to re-repo the securities acquired under reverse repo;
 - ii. Mutual Funds and Insurance Companies maintaining SGL account with the Reserve Bank will also be permitted to re-repo the securities acquired under reverse repo, subject to the approval of the regulators concerned;
 - iii. Re-repo of securities can be undertaken only after receipt of confirmation / matching of first leg of repo transaction;
 - iv. Re-repo period should not exceed the residual period of the initial repo;
 - v. Eligible entities undertaking re-repo transactions should 'flag' the transactions as a re-repo on the authorised reporting platform. Participants may review their systems and controls to ensure strict compliance with the requirement of reporting of re-repo transactions.
 - vi. All repo / re-repo transactions should be subject to internal audit and concurrent audit. Violation of the regulatory guidelines, if any, may be brought to the notice of Chief General Manager, Financial Markets Regulation Department, Reserve Bank of India, Mumbai.
 - vii. Default in payment of cash or delivery of security shall be viewed seriously and subject to penal measures as prescribed in RBI [circular IDMD.DOD.17/11.01.01\(B\)/2010-11](#)



dated July 14, 2010, as amended from time to time. Reserve Bank may also take any action including temporary or permanent debarment of the SGL account holder from the repo market as it may deem fit, for violation / circumvention of the regulatory guidelines or if Reserve Bank is of the view that the entity has attempted to manipulate the market, involved in market abuse, or provided information that was incorrect, inaccurate, or incomplete.

- viii. These guidelines are not applicable to repo transactions executed with the Reserve Bank as counterparty.
- ix. All eligible entities are also required to adhere to the prudential guidelines prescribed by their respective regulators from time to time for undertaking repo transactions.
- (j) Securities purchased under the ready forward contracts shall not be sold during the period of the contract except by entities permitted to undertake short selling.
- (k) Double ready forward deals in any security are strictly prohibited.
- (l) The guidelines for uniform accounting for Repo / Reverse Repo transactions are furnished in paragraph 4.

1.1.3 Transactions through SGL account

The following instructions should be followed by banks for purchase / sale of securities through SGL A/c, under the Delivery Versus Payment System wherein the transfer of securities takes place simultaneously with the transfer of funds. It is, therefore, necessary for both the selling bank and the buying bank to maintain current account with the Reserve Bank. As no 'Overdraft facility' in the current account would be extended, adequate balance in current account should be maintained by banks for effecting any purchase transaction.

- (i) All transactions in Government Securities for which SGL facility is available should be put through SGL account only.
- (ii) Under no circumstances, a SGL transfer form issued by a bank in favour of another bank should bounce for want of sufficient balance of securities in the SGL A/c of seller or for want of sufficient balance of funds in the current a/c of the buyer.
- (iii) The SGL transfer form received by purchasing banks should be deposited in their SGL account immediately, i.e., the date of lodgement of the SGL Form with the Reserve Bank shall be within one working day after the date of signing of the Transfer Form. While in cases of OTC trades, the settlement has to be only on 'spot' delivery basis as per Section 2(i) of the Securities Contracts (Regulations) Act, 1956, in cases of deals on the recognised Stock Exchanges, settlement should be within the delivery period as per their rules, bye laws and regulations. In all the cases, participants must indicate the



deal/trade/contract date in Part C of the SGL Form under 'Sale date'. Where this is not completed, the SGL Form will not be accepted by the Reserve Bank.

- (iv) No sale should be effected by way of return of SGL form held by the bank.
- (v) SGL transfer forms should be signed by two authorised officials of the bank whose signatures should be recorded with the respective PDOs of the Reserve Bank and other banks.
- (vi) The SGL transfer forms should be in the standard format prescribed by the Reserve Bank and printed on semi-security paper of uniform size. They should be serially numbered and there should be a control system in place to account for each SGL form.
- (vii) Records of SGL transfer forms issued/ received should be maintained.
- (viii) If a SGL transfer form bounces for want of sufficient balance in the SGL A/c, the (selling) bank which has issued the form will be liable to the following penal action against it :
 - (a) The amount of the SGL form (cost of purchase paid by the purchaser of the security) would be debited immediately to the current account of the selling bank with the Reserve Bank.
 - (b) In the event of an overdraft arising in the current account following such a debit, penal interest would be charged by the Reserve Bank, on the amount of the overdraft, at a rate of 3 percentage points above the SBI Discount and Finance House of India's (SBIDFHI) call money lending rate on the day in question. However, if the SBIDFHI's closing call money rate is lower than the prime lending rate of banks, as stipulated in the Reserve Bank's interest rate directive in force, the applicable penal rate to be charged will be 3 percentage points, above the prime lending rate of the bank concerned, and
 - (c) SGL bouncing shall mean failure of settlement of a Government Securities transaction on account of insufficiency of funds in the current account of the buyer or insufficiency of securities in the SGL / CSGL account of the seller, maintained with the Reserve Bank. In the event of bouncing of SGL transfer forms and the failure of the account holder concerned to offer satisfactory explanation for such bouncing, the account holder shall be liable to pay penalties as under:



- (i) Graded monetary penalties subject to a maximum penalty of Rs.5 lakhs per instance;

Sl. No	Applicable to	Monetary penalty	Illustration [Penal amount on Rs.5 crore default]
1	First three defaults in a financial year (April to March)	0.10% (10 paise per Rs.100 FV)	Rs.50,000/-
2	Next three defaults in the same financial year	0.25% (25 paise per Rs.100 FV)	Rs.1,25,000/-
3	Next three defaults in the same financial year	0.50% (50 paise per Rs.100 FV)	Rs.2,50,000/-

- (ii) On the tenth default in a financial year, the eligible entities will be debarred from using the SGL A/c for undertaking short sales in Government Securities even to the extent permissible under circular IDMD.No/ 11.01.01(B)/2006-07 dated January 31, 2007 as amended from time to time, during the remaining portion of the financial year. In the next financial year, upon being satisfied that the a/c holder in question has effected improvements in its internal control systems, the Reserve Bank may grant specific approval for undertaking short sales by using the SGL A/c facility.
- (iii) The monetary penalty may be paid by the account holder concerned by way of a cheque or through electronic mode for the amount favouring the Reserve Bank, within five working days of receipt of intimation of order imposing penalty from the Reserve Bank.
- (d) Any bouncing of SGL transfer forms issued by selling banks in favour of the buying bank should immediately be brought to the notice of the Regional Office of DBS of the Reserve Bank by the buying bank.
- (ix) The defaulting member shall make appropriate disclosure, on the number of instances of default as well as the quantum of penalty paid to the Reserve Bank during the financial year, under the “Notes to Account” in its balance sheet.
- (x) The Reserve Bank reserves the right to take any action including temporary or permanent debarment of the SGL account holder, in accordance with the powers conferred under the Government Securities Act, 2006 as it may deem fit, for violation of the terms and conditions of the opening and maintenance of SGL/ CSGL accounts or breach of the operational guidelines issued from time to time.



1.1.4 Use of Bank Receipt (BR)

The banks should follow the following instructions for issue of BRs:

- (a) No BR should be issued under any circumstances in respect of transactions in Government Securities for which SGL facility is available.
- (b) Even in the case of other securities, BR may be issued for ready transactions only, under the following circumstances:
 - (i) The scrips are yet to be issued by the issuer and the bank is holding the allotment advice.
 - (ii) The security is physically held at a different centre and the bank is in a position to physically transfer the security and give delivery thereof within a short period.
 - (iii) The security has been lodged for transfer / interest payment and the bank is holding necessary records of such lodgements and will be in a position to give physical delivery of the security within a short period.
- (c) No BR should be issued on the basis of a BR (of another bank) held by the bank and no transaction should take place on the basis of a mere exchange of BRs held by the bank.
- (d) BRs could be issued covering transactions relating to banks' own Investments Accounts only, and no BR should be issued by banks covering transactions relating to either the Accounts of Portfolio Management Scheme (PMS) Clients or Other Constituents' Accounts, including brokers.
- (e) No BR should remain outstanding for more than 15 days.
- (f) A BR should be redeemed only by actual delivery of scrips and not by cancellation of the transaction/ set off against another transaction. If a BR is not redeemed by delivery of scrips within the validity period of 15 days, the BR should be deemed as dishonoured and the bank which has issued the BR should refer the case to the Reserve Bank, explaining the reasons for which the scrips could not be delivered within the stipulated period and the proposed manner of settlement of the transaction.
- (g) BRs should be issued on semi-security paper, in the standard format (prescribed by IBA), serially numbered and signed by two authorised officials of the bank, whose signatures are recorded with other banks. As in the case of SGL forms, there should be a control system in place to account for each BR form.
- (h) Separate registers of BRs issued and BRs received should be maintained and arrangements should be put in place to ensure that these are systematically followed up and liquidated within the stipulated time limit.
- (i) The banks should also have a proper system for the custody of unused BR Forms and their utilisation. The existence and operations of these controls at the concerned



offices/ departments of the bank should be reviewed, among others, by the statutory auditors and a certificate to this effect may be forwarded every year to the Regional Office of Department of Banking Supervision (DBS), RBI, under whose jurisdiction the Head Office of the bank is located.

- (j) Any violation of the instructions relating to BRs would invite penal action, which could include raising of reserve requirements, withdrawals of refinance facility from the Reserve Bank and denial of access to money markets. The Reserve Bank may also levy such other penalty as it may deem fit in accordance with the provisions of the Banking Regulation Act, 1949.

1.1.5 Retailing of Government Securities

The banks may undertake retailing of Government Securities with non-bank clients subject to the following conditions:

- (i) Such retailing should be on outright basis and there is no restriction on the period between sale and purchase.
- (ii) The retailing of Government Securities should be on the basis of ongoing market rates/ yield curve emerging out of secondary market transactions.

1.1.6 Internal Control System

The banks should observe the following guidelines for internal control system in respect of investment transactions:

- (a) There should be a clear functional separation of (i) trading, (ii) settlement, monitoring and control and (iii) accounting. Similarly, there should be a functional separation of trading and back office functions relating to banks' own Investment Accounts, Portfolio Management Scheme (PMS) Clients' Accounts and other Constituents (including brokers') accounts. The Portfolio Management service may be provided to clients, subject to strictly following the guidelines in regard thereto (covered in Master Circular – Para-Banking Activities). Further, PMS Clients Accounts should be subjected to a separate audit by external auditors.
- (b) In the interest of maintaining integrity and orderly conditions in the government securities market, all SGL/CSGL account holders should adhere to the FIMMDA code of conduct while executing trades on NDS-OM and in the OTC market.
- (c) For every transaction entered into, the trading desk should prepare a deal slip which should contain data relating to nature of the deal, name of the counter-party, whether it is a direct deal or through a broker, and if through a broker, name of the broker, details of security, amount, price, contract date and time. The deal slips should be serially numbered and controlled separately to ensure that each deal slip has been



properly accounted for. Once the deal is concluded, the dealer should immediately pass on the deal slip to the back office for recording and processing.

- (d) For each deal there must be a system of issue of confirmation to the counterparty. The timely receipt of requisite written confirmation from the counterparty, which must include all essential details of the contract, should be monitored by the back office.
- (e) With respect to transactions matched on the NDS-OM module, since CCIL is the central counterparty to all deals, exposure of any counterparty for a trade is only to CCIL and not to the entity with whom a deal matches. Besides, details of all deals on NDS-OM are available to the counterparties as and when required by way of reports on NDS-OM itself. In view of the above, the need for counterparty confirmation of deals matched on NDS-OM does not arise. The deals in Government Security transactions in OTC market that are mandated to be settled through CCIL by reporting on the NDS, are not required to be confirmed physically as OTC deals depend on electronic confirmation by the back offices of both the counterparties on NDS system like the NDS-OM deals.

However, all Government Securities transactions, other than those mentioned above, will continue to be physically confirmed by the back offices of the counterparties, as hitherto.

- (f) Banks are required to report OTC trades in Commercial Papers (CPs) and Certificate of Deposits (CDs) and OTC repo trades in corporate debt securities, CPs, CDs and non-convertible debentures (NCDs) of original maturity less than one year on F-TRAC- the reporting platform of Clearcorp Dealing Systems (India) Ltd. (CDSIL). These trades have to be physically confirmed by the back offices of the counterparties. In F-TRAC, both the counterparties individually report their respective sides of the trades and the trades are validated for trade details before matching by F-TRAC. This ensures implicit confirmation by both counterparties. Further, the details of the transactions are available on the F-TRAC system. The requirement of exchange of physical confirmation of trades matched on F- TRAC is waived subject to the following conditions:
 - (i) Participants entering into one time bilateral agreement for eliminating the exchange of confirmation;
 - (ii) Participants adhering to the extant laws such as stamp duty as may be applicable; and
 - (iii) Participants ensuring adherence to a sound risk management framework and complying with all the regulatory and legal requirements and practices, in this regard.

The dispensation with respect to waiver of physical confirmation will be subject to review in case of any change in ownership of the F-TRAC platform or reporting arrangements thereof.



- (g) Once a deal has been concluded, there should not be any substitution of the counter party bank by another bank by the broker, through whom the deal has been entered into; likewise, the security sold/purchased in the deal should not be substituted by another security.
- (h) On the basis of vouchers passed by the back office (which should be done after verification of actual contract notes received from the broker/ counterparty and confirmation of the deal by the counterparty), the Accounts Section should independently write the books of account.
- (i) In the case of transaction relating to PMS Clients' Accounts (including brokers), all the relative records should give a clear indication that the transaction belongs to PMS Clients/ other constituents and does not belong to bank's own Investment Account and the bank is acting only in its fiduciary/ agency capacity.
- (j) Balances as per bank's books should be reconciled at quarterly intervals with the balances in the books of PDOs. If the number of transactions so warrant, the reconciliation should be undertaken more frequently, say on a monthly basis. This reconciliation should be periodically checked by the internal audit department.
- (k) A system for verification of the authenticity of the BRs and SGL transfer forms received from the other banks and confirmation of authorised signatories should be put in place.
- (l) Banks should put in place a reporting system to report to their top management, on a weekly basis, the details of transactions in securities, details of bouncing of SGL transfer forms issued by other banks and BRs outstanding for more than one month and a review of investment transactions undertaken during the period.
- (m) Banks should not draw cheques on their account with the Reserve Bank for third party transactions, including inter-bank transactions. For such transactions, bankers' cheques/ pay orders should be issued.
- (n) In case of investment in shares, the surveillance and monitoring of investment should be done by the Audit Committee of the Board, which shall review in each of its meetings, the total exposure of the bank to capital market, both fund based and non-fund based, in different forms as stated above and ensure that the guidelines issued by the Reserve Bank are complied with and adequate risk management and internal control systems are in place.
- (o) The Audit Committee should keep the Board informed about the overall exposure to capital market, the compliance with the Reserve Bank and Board guidelines, adequacy of risk management and internal control systems.
- (p) In order to avoid any possible conflict of interest, it should be ensured that the



stockbrokers as directors on the Boards of banks or in any other capacity, do not involve themselves in any manner with the Investment Committee or in the decisions in regard to making investments in shares, etc., or advances against shares.

- (q) The internal audit department should audit the transactions in securities on an ongoing basis, monitor the compliance with the laid down management policies and prescribed procedures and report the deficiencies directly to the management of the bank.
- (r) The banks' managements should ensure that there are adequate internal control and audit procedures for ensuring proper compliance of the instructions in regard to the conduct of the investment portfolio. The banks should institute a regular system of monitoring compliance with the prudential and other guidelines issued by the Reserve Bank. The banks should get compliance in key areas certified by their statutory auditors and furnish such audit certificate to the Regional Office of DBS, RBI under whose jurisdiction the HO of the bank falls.

1.1.7 Engagement of brokers

- (i) For engagement of brokers to deal in investment transactions, the banks should observe the following guidelines:
 - (a) Transactions between one bank and another bank should not be put through the brokers' accounts. The brokerage on the deal payable to the broker, if any (if the deal was put through with the help of a broker), should be clearly indicated on the notes/ memorandum put up to the top management seeking approval for putting through the transaction.
 - (b) If a deal is put through with the help of a broker, the role of the broker should be restricted to that of bringing the two parties to the deal together.
 - (c) While negotiating the deal, the broker is not obliged to disclose the identity of the counterparty to the deal. On conclusion of the deal, he should disclose the counterparty and his contract note should clearly indicate the name of the counterparty. It should also be ensured by the bank that the broker note contains the exact time of the deal. Their back offices may ensure that the deal time on the broker note and the deal ticket is the same. The bank should also ensure that their concurrent auditors audit this aspect.
 - (d) On the basis of the contract note disclosing the name of the counterparty, settlement of deals between banks, viz. both fund settlement and delivery of security should be directly between the banks and the broker should have no role to play in the process.
 - (e) With the approval of their top managements, banks should prepare a panel of approved brokers which should be reviewed annually or more often if so warranted.



Clear-cut criteria should be laid down for empanelment of brokers, including verification of their creditworthiness, market reputation, etc. A record of broker-wise details of deals put through and brokerage paid, should be maintained.

- (f) A disproportionate part of the business should not be transacted through only one or a few brokers. Banks should fix aggregate contract limits for each of the approved brokers. A limit of 5% of total transactions through brokers (both purchase and sales) entered into by a bank during a year should be treated as the aggregate upper contract limit for each of the approved brokers. This limit should cover both the business initiated by a bank and the business offered/brought to the bank by a broker. Banks should ensure that the transactions entered into through individual brokers during a year normally do not exceed this limit. However, if for any reason it becomes necessary to exceed the aggregate limit for any broker, the specific reasons for the same should be recorded, in writing, by the authority empowered to put through the deals. Further, the board should be informed of this, post facto. However, the norm of 5% would not be applicable to banks' dealings through PDs.
- (g) The concurrent auditors who audit the treasury operations should scrutinise the business done through brokers also and include it in their monthly report to the Chief Executive Officer of the bank. Besides, the business put through any individual broker or brokers in excess of the limit, with the reasons for the same, should be covered in the half-yearly review to the Board of Directors/Local Advisory Board. These instructions also apply to subsidiaries and mutual funds of the banks.

[Certain clarifications on the instructions are furnished in the Annex II.]

- (ii) Inter-bank securities transactions should be undertaken directly between banks and no bank should engage the services of any broker in such transactions.

Exceptions:

Note (i) Banks may undertake securities transactions among themselves or with non-bank clients through members of the National Stock Exchange (NSE), OTC Exchange of India (OTCEI), the Stock Exchange, Mumbai (BSE) and MCX Stock Exchange (MCX-SX). If such transactions are not undertaken on the NSE, OTCEI, BSE or MCX-SX, the same should be undertaken by banks directly, without engaging brokers.

Note (ii) Although the Securities Contracts (Regulation) Act, 1956 defines the term 'securities' to mean corporate shares, debentures, Government Securities and rights or interest in securities, the term 'securities' here would exclude corporate shares. The Provident / Pension Funds and Trusts registered under the Indian Trusts Act, 1882, will be outside the purview of the expression 'non-bank clients' for the purpose of note (i) above.



1.1.8 Audit, review and reporting of investment transactions

The banks should adhere to the following instructions in regard to audit, review and reporting of investment transactions:

- (a) Banks should undertake a half-yearly review (as of March 31 and September 30) of their investment portfolio, which should, apart from other operational aspects of investment portfolio, clearly indicate amendments made to the Investment Policy and certify adherence to laid down internal investment policy and procedures and the Reserve Bank guidelines, and put up the same before their respective Boards within a month, i.e. by end-April and end-October.
- (b) A copy of the review report put up to the Bank's Board should be forwarded to the Reserve Bank (concerned Regional Office of DBS, RBI) by May 15 and November 15 respectively.
- (c) In view of the possibility of abuse, treasury transactions should be separately subjected to concurrent audit by internal auditors and the results of their audit should be placed before the CMD of the bank once every month. Banks need not forward copies of the above mentioned concurrent audit reports to the Reserve Bank. However, the major irregularities observed in these reports and the position of compliance thereto may be incorporated in the half yearly review of the investment portfolio.

1.2 Non- SLR investments

1.2.1 (i) Appraisal

Banks have made significant investment in privately placed unrated bonds and, in certain cases, in bonds issued by corporates who are not their borrowers. While assessing such investment proposals on private placement basis, in the absence of standardised and mandated disclosures, including credit rating, banks may not be in a position to conduct proper due diligence to take an investment decision. Thus, there could be deficiencies in the appraisal of privately placed issues.

(ii) Disclosure requirements in offer documents

The risk arising from inadequate disclosure in offer documents should be recognized. In this connection, Securities Exchange Board of India (SEBI) has notified the Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008 and also simplified listing agreement for Debt Securities vide their circular dated May 11, 2009 and subsequent amendments, both for issuers whose equity shares are listed or not listed on the Exchange. Banks may henceforth make investments only in those securities which adhere to the SEBI regulations with respect to the disclosure norms for issue of debt securities. Even in case of investment in non-SLR debt securities which are not listed, banks may ensure that the disclosure standards prescribed by SEBI are



adhered to. All other guidelines issued by RBI with respect to investment in Non-SLR securities remain unchanged.

(iii) Internal assessment

With a view to ensuring that the investments by banks in issues through private placement, both of the borrower customers and non-borrower customers, do not give rise to systemic concerns, it is necessary that banks should ensure that their investment policies duly approved by the Board of Directors are formulated after taking into account the following aspects:

- a. The Boards of banks should lay down policy and prudential limits on investments in bonds and debentures including those on private placement basis, sub limits for PSU bonds, corporate bonds, guaranteed bonds, issuer ceiling, etc.
- b. Investment proposals should be subjected to the same degree of credit risk analysis as any loan proposal. Banks should make their own internal credit analysis and rating even in respect of rated issues and should not entirely rely on the ratings of external agencies. The appraisal should be more stringent in respect of investments in instruments issued by non-borrower customers.
- c. Strengthen their internal rating systems which should also include building up of a system of regular (quarterly or half-yearly) tracking of the financial position of the issuer with a view to ensuring continuous monitoring of the rating migration of the issuers/issues.
- d. As a matter of prudence, banks should stipulate entry-level minimum ratings/quality standards and industry-wise, maturity-wise, duration-wise, issuer-wise etc. limits to mitigate the adverse impacts of concentration and the risk of illiquidity.
- e. The banks should put in place proper risk management systems for capturing and analysing the risk in respect of these investments and taking remedial measures in time.

(iv) Banks may exercise due caution, while taking any investment decision to subscribe to bonds, debentures, shares etc., and refer to the 'list of defaulters/wilful defaulters disseminated by the Reserve Bank /obtained from the Credit Information Companies to ensure that investments are not made in companies/entities who are defaulters/wilful defaulters to banks/FIs. Some of the companies may be undergoing adverse financial position, turning their accounts to sub-standard category due to recession in their industry segment. Despite restructuring facility provided under the Reserve Bank guidelines, the banks have been reported to be reluctant to extend further finance, though considered warranted on merits of the case. Banks may not refuse proposals for such investments in companies whose director's name(s) find place in the list of defaulters/wilful defaulters disseminated by the Reserve Bank/obtained from



the Credit Information Companies and particularly in respect of those loan accounts, which have been restructured under extant RBI guidelines (after the respective bank's board approval in case of wilful defaulters), provided the proposal is viable and satisfies all parameters for such credit extension.

Prudential guidelines on investment in Non-SLR securities

1.2.2 Coverage

These guidelines cover banks' investments in non-SLR securities issued by corporates, banks, FIs and State and Central Government sponsored institutions, Special Purpose Vehicles (SPVs) etc., including capital gains bonds, bonds eligible for priority sector status. The guidelines will apply to investments both in the primary market as well as the secondary market.

Regulatory requirements

1.2.3 Banks should not invest in Non-SLR securities of original maturity of less than one-year, other than Commercial Paper and Certificates of Deposits and NCDs with original or initial maturity up to one year issued by corporates (including NBFCs), which are covered under RBI guidelines. However, while investing in such NCDs banks should be guided by the extant prudential guidelines in force, ensure that the issuer has disclosed the purpose for which the NCDs are being issued in the disclosure document and such purposes are eligible for bank finance to Non-Banking Financial Companies under extant RBI guidelines.

1.2.4 Banks should undertake usual due diligence in respect of investments in non-SLR securities. Present RBI regulations preclude banks from extending credit facilities for certain purposes. Banks should ensure that such activities are not financed by way of funds raised through the non-SLR securities.

Listing and rating requirements

1.2.5 The guidelines on listing and rating pertaining to non-SLR securities vide paragraphs 1.2.7 to 1.2.16 are not applicable to banks' investments in:

- a. Securities directly issued by the Central and State Governments, which are not reckoned for SLR purposes.
- b. Equity shares
- c. Units of equity oriented mutual fund schemes, viz. those schemes where any part of the corpus can be invested in equity
- d. Equity/debt instruments/Units issued by Venture capital funds
- e. Commercial Paper



- f. Certificates of Deposit
- g. Non Convertible Debentures (NCDs) with original or initial maturity up to one year issued by corporates (including NBFCs)
- h. Securities acquired by way of conversion of debt, subject to periodic reporting to the Reserve Bank in the DSB return on Asset Quality.

1.2.6 Definitions of a few terms used in these guidelines have been furnished in Annex III with a view to ensure uniformity in approach while implementing the guidelines.

1.2.7 Banks must not invest in unrated non-SLR securities. However, the banks may invest in unrated bonds of companies engaged in infrastructure activities, within the ceiling of 10 per cent for unlisted non-SLR securities as prescribed vide paragraph 1.2.10 below.

1.2.8 While making investments in non-SLR debt securities, banks should ensure that such investments are made only in listed debt securities of companies which comply with the requirements of the SEBI, except to the extent indicated in paragraphs 1.2.9 and 1.2.10 below.

Fixing of prudential limits

1.2.9 Bank's investment in unlisted non-SLR securities should not exceed 10 per cent of its total investment in non-SLR securities as on March 31, of the previous year, and such investment should comply with the disclosure requirements as prescribed by SEBI for listed companies. As there is a time lag between issuance and listing of securities, investment in non-SLR debt securities (both primary and secondary market) by banks where the security is proposed to be listed on the Exchange(s) may be considered as investment in listed security at the time of making investment. However, if such security is not listed within the period specified, the same will be reckoned for the 10 per cent limit specified for unlisted non-SLR securities. In case such investments included under unlisted non-SLR securities lead to a breach of the 10 per cent limit, the bank would not be allowed to make further investment in non-SLR securities (both primary and secondary market) as also in unrated bonds issued by companies engaged in infrastructure activities till such time bank's investment in unlisted non-SLR securities comes within the limit of 10 per cent.

1.2.10 Bank's investment in unlisted non-SLR securities may exceed the limit of 10 per cent, by an additional 10 per cent, provided the investment is on account of investment in Securitisation papers issued for infrastructure projects, and bonds/debentures issued by Securitisation Companies (SCs) and Reconstruction Companies (RCs) set up under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and registered with the Reserve Bank. In other words, investments



exclusively in securities specified in this paragraph could be up to the maximum permitted limit of 20 per cent of non-SLR investment.

- 1.2.11** The total investment by banks in liquid/short term debt schemes (by whatever name called) of mutual funds with weighted average maturity of portfolio of not more than 1 year, will be subject to a prudential cap of 10 per cent of their net worth as on March 31 of the previous year. The weighted average maturity would be calculated as average of the remaining period of maturity of securities weighted by the sums invested.
- 1.2.12** Investment in the following will not be reckoned as ‘unlisted non-SLR securities’ for computing compliance with the prudential limits prescribed in the above guidelines:
- i. Security Receipts issued by SCs / RCs registered with the Reserve Bank.
 - ii. Investment in Asset Backed Securities (ABS) and Mortgage Backed Securities (MBS), which are rated at or above the minimum investment grade. However, there will be close monitoring of exposures to ABS on a bank specific basis based on monthly reports submitted to the Department of Banking Supervision, Reserve Bank of India, under the Supervisory Reporting System.
 - iii. Investments in unlisted convertible debentures. However, investments in these instruments would be treated as “Capital Market Exposure”.
- 1.2.13** The investments in RIDF/SIDBI/RHDF deposits may not be reckoned as part of the numerator as well as denominator for computing compliance with the prudential limit of 10 per cent of its total non-SLR securities as on March 31 of the previous year.
- 1.2.14** With effect from January 1, 2005, only investment in units of such mutual fund schemes, which have an exposure to unlisted securities of less than 10 per cent of the corpus of the fund, will be treated on par with listed securities for the purpose of compliance with the prudential limits prescribed in the above guidelines. While computing the exposure to the unlisted securities for compliance with the norm of less than 10 percent of the corpus of the mutual fund scheme, Treasury Bills, Collateralised Borrowing and Lending Obligations (CBLO), Repo/ Reverse Repo and Bank Fixed Deposits may not be included in the numerator.
- 1.2.15** For the purpose of the prudential limits prescribed in the guidelines, the denominator, viz., ‘non-SLR investments’, would include investment under the following four categories in Schedule 8 to the balance sheet viz., ‘shares’, ‘bonds & debentures’, ‘subsidiaries/joint ventures’ and ‘others’.
- 1.2.16** Banks whose investment in unlisted non-SLR securities are within the prudential limit of 10 per cent of its total non-SLR securities as on March 31, of the previous year may make fresh investment in such securities and up to the prudential limits.



Role of Boards

1.2.17 Banks should ensure that their investment policies, duly approved by the Board of Directors, are formulated after taking into account all the relevant issues specified in these guidelines on investment in non-SLR securities. Banks should put in place proper risk management systems for capturing and analysing the risk in respect of non-SLR investment and taking remedial measures in time. Banks should also put in place appropriate systems to ensure that investment in privately placed instruments is made in accordance with the systems and procedures prescribed under respective bank's investment policy.

1.2.18 Boards of banks should review the following aspects of non-SLR investment at least at quarterly intervals:

- a. Total business (investment and divestment) during the reporting period.
- b. Compliance with the prudential limits prescribed by the Board for non-SLR investment.
- c. Compliance with the prudential guidelines issued by the Reserve Bank on non-SLR securities.
- d. Rating migration of the issuers/ issues held in the bank's books and consequent diminution in the portfolio quality.
- e. Extent of non-performing investments in the non-SLR category.

Disclosures

1.2.19 In order to help in the creation of a central database on private placement of debt, a copy of all offer documents should be filed with one of the credit information companies, which has obtained Certificate of Registration from the Reserve Bank, by the investing banks. Further, any default relating to interest/ instalment in respect of any privately placed debt should also be reported to all the four credit information companies, by the investing banks along with a copy of the offer document.

1.2.20 Banks should disclose the details of the issuer composition of non-SLR investments and the non-performing non-SLR investments in the 'Notes on Accounts' of the balance sheet, as indicated in Annex IV.

1.2.21 Trading and Settlement in Corporate Debt Securities

As per the SEBI guidelines, all trades with the exception of spot transactions in a listed debt security shall be executed only on the trading platform of a stock exchange. In addition to complying with the SEBI guidelines, banks should report their secondary market OTC trades in Corporate Bonds within 15 minutes of the trade on any of the stock exchanges (NSE, BSE and MCX-SX).

1.2.22 All OTC trades in corporate bonds shall necessarily be cleared and settled through the National Securities Clearing Corporation Ltd. (NSCCL) or Indian Clearing Corporation Ltd. (ICCL) or MCX-SX Clearing Corporation Ltd. (MCX-SX CCL) as per the norms specified by the NSCCL, ICCL and MCX-SX CCL from time to time.

1.2.23 Repo in Corporate Debt Securities

Eligible entities can undertake repo in corporate debt securities as per detailed guidelines given in Annex I-E.

1.2.24 OTC transactions in Securitized Debt Instruments

Banks should report their secondary market OTC trades in securitized debt instruments within 15 minutes of the trade on any of the stock exchanges (NSE, BSE and MCX-SX).

These trades may be cleared and settled through any of the clearing corporations (NSCCL, ICCL and MCX-SX CCL).

1.2.25 Settlement of OTC Transactions - in Certificates of Deposit (CDs) and Commercial Papers (CPs)

Banks shall report their OTC transactions in CDs and CPs on F-TRAC platform managed by Clearcorp Dealing System (India) Ltd. (CDSIL) within 15 minutes of the trade for online dissemination of market information.

Further, all OTC trades in CDs and CPs shall necessarily be cleared and settled through the National Securities Clearing Corporation Limited (NSCCL) or Indian Clearing Corporation Limited (ICCL) or MCX-SX Clearing Corporation Limited (MCX-SX CCL) as per the norms specified by NSCCL, ICCL and CCL from time to time.

1.2.26 Limits on Banks' Exposure to Capital Markets

A. Solo Basis

The aggregate exposure of a bank to the capital markets in all forms (both fund based and non-fund based) should not exceed 40 per cent of its net worth as on March 31 of the previous year. Within this overall ceiling, the bank's direct investment in shares, convertible bonds/debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered] should not exceed 20 per cent of its net worth.

B. Consolidated Basis

The aggregate exposure of a consolidated bank to capital markets (both fund based and non-fund based) should not exceed 40 per cent of its consolidated net worth as on March 31 of the previous year. Within this overall ceiling, the aggregate direct



exposure by way of the consolidated bank's investment in shares, convertible bonds / debentures, units of equity- oriented mutual funds and all exposures to VCFs ([both registered and unregistered]) should not exceed 20 per cent of its consolidated net worth.

The above-mentioned ceilings are the maximum permissible and a bank's Board of Directors is free to adopt a lower ceiling for the bank, keeping in view its overall risk profile and corporate strategy. Banks are required to adhere to the ceilings on an ongoing basis.

1.2.27 Investments in Long Term Bonds issued by banks for Financing of Infrastructure and Affordable Housing

Banks can invest in the long term bonds issued by other banks for financing of infrastructure and affordable housing, subject to conditions as follows:

- i. An investing bank's investment in a specific issue of such bonds will be capped at 2% of the investing bank's Tier 1 Capital or 5% of the issue size, whichever is lower.
- ii. An investing bank's aggregate holding in such bonds will be capped at 10% of its total Non-SLR investments.
- iii. Not more than 20% of the primary issue size of such bond issuance can be allotted to banks.
- iv. Banks cannot hold their own bonds.

1.3 General

1.3.1 Reconciliation of holdings of Government Securities – Audit Certificate

Banks should furnish a 'Statement of the Reconciliation of Bank's Investments (held in own Investment account, as also under PMS)', as at the end of every accounting year duly certified by the bank's auditors. The statement should reach the Regional Office of the DBS, RBI, under whose jurisdiction the bank's head office is located within one month from the close of the accounting year. Banks, in the letters of appointment issued to their external auditors, may suitably include the aforementioned requirement of reconciliation. The format for the statement and the instructions for compiling the same are given in Annex V.

1.3.2 Transactions in securities- Custodial functions

While exercising the custodial functions on behalf of their merchant banking subsidiaries, these functions should be subject to the same procedures and safeguards as would be applicable to other constituents. Accordingly, full particulars should be available with the subsidiaries of banks of the manner in which the transactions have been executed. Banks



should also issue suitable instructions in this regard to the department/office undertaking the custodial functions on behalf of their subsidiaries.

1.3.3 Investment Portfolio of banks- transactions in Government Securities

In the light of fraudulent transactions in the guise of Government Securities transactions in physical format RBI has been taking measures for further reducing the scope of trading in physical forms. These measures are as under:

- i. For banks, which do not have SGL account with the Reserve Bank, only one gilt account can be opened.
- ii. In case the gilt accounts are opened with a SCB, the account holder has to open a designated funds account (for all gilt account related transactions) with the same bank.
- iii. The entities maintaining the gilt / designated funds accounts will be required to ensure availability of clear funds in the designated funds accounts for purchases and of sufficient securities in the gilt account for sales before putting through the transactions.
- iv. No transactions by the bank should be undertaken in physical form with any broker.
- v. Banks should ensure that brokers approved for transacting in Government Securities are registered with the debt market segment of NSE/BSE/OTCEI.

2. Classification

- (i) The entire investment portfolio of the banks (including SLR securities and non-SLR securities) should be classified under three categories viz. 'Held to Maturity, 'Available for Sale' and 'Held for Trading'.

However, in the balance sheet, the investments will be disclosed as per the existing six classifications:

- a) Government securities,
 - b) Other approved securities,
 - c) Shares,
 - d) Debentures & Bonds,
 - e) Subsidiaries/ joint ventures and
 - f) Others (CP, Mutual Fund Units, etc.).
- (ii) Banks should decide the category of the investment at the time of acquisition and the decision should be recorded on the investment proposals.



2.1 Held to Maturity

- (i) The securities acquired by the banks with the intention to hold them up to maturity will be classified under 'Held to Maturity (HTM)'.
- (ii) Banks are allowed to include investments included under HTM category upto 25 per cent of their total investments.
- (iii) Banks are permitted to exceed the limit of 25 per cent of total investment under HTM category provided:
 - a. the excess comprises only of SLR securities, and
 - b. the total SLR securities held in the HTM category is not more than 22.5 per cent with effect from July 11, 2015 and 22.0 per cent with effect from September 19, 2015, of their Demand and Time Liabilities (DTL) as on the last Friday of the second preceding fortnight.
- (iv) Banks may hold the following securities under HTM:
 - a. SLR Securities upto the extent permitted.
 - b. Non-SLR securities included under HTM as on September 2, 2004.
 - c. Re-capitalisation bonds received from the Government of India towards their re-capitalisation requirement and held in Investment portfolio.
 - d. Investment in the equity of subsidiaries and joint ventures (a Joint Venture would be one in which the bank, along with its subsidiaries, holds more than 25 percent of the equity).
 - e. RIDF/SIDBI/RHDF deposits.
 - f. Investment in long-term bonds (with a minimum residual maturity of seven years) issued by companies engaged in infrastructure activities. The minimum residual maturity of seven years should be at the time of investment in these bonds. Once invested, banks may continue to classify these investments under HTM category even if the residual maturity falls below seven years subsequently. However banks' investments in long term bonds issued by other banks for their financing of infrastructure and affordable housing loans are not to be held in HTM category.
- (v) No fresh non-SLR securities, are permitted to be included in HTM, with effect from September 2, 2004 except the following:
 - a. Fresh re-capitalisation bonds received from the Government of India, towards their re-capitalisation requirement and held in their investment portfolio. This will not include re-capitalisation bonds of other banks acquired for investment purposes.



- b. Fresh investment in the equity of subsidiaries and joint ventures.
 - c. RIDF / SIDBI/RHDF deposits.
 - d. Investment in long-term bonds (with a minimum residual maturity of seven years) issued by companies engaged in infrastructure activities.
- (vi) The investments as specified at para 2.1 ii) c), d) and f) above may, at the discretion of the banks, be classified under HTM but are not accounted for the purpose of ceiling of 25 per cent specified for this category.
- (vii) Profit on sale of investments in this category should be first taken to the Profit & Loss Account, and thereafter be appropriated to the 'Capital Reserve Account'. It is clarified that the amount so appropriated would be net of taxes and the amount required to be transferred to Statutory Reserves. Loss on sale will be recognised in the Profit & Loss Account.

2.2 Available for Sale & Held for Trading

- (i) The securities acquired by the banks with the intention to trade by taking advantage of the short-term price/interest rate movements will be classified under 'Held for Trading (HFT)'.
(ii) The securities which do not fall within the above two categories will be classified under 'Available for Sale (AFS)'.
- (iii) The banks will have the freedom to decide on the extent of holdings under HFT and AFS. This will be decided by them after considering various aspects such as basis of intent, trading strategies, risk management capabilities, tax planning, manpower skills, capital position.
- (iv) The investments classified under HFT would be those from which the bank expects to make a gain by the movement in interest rates/market rates. These securities are to be sold within 90 days.
- (v) Profit or loss on sale of investments in both the categories will be taken to the Profit & Loss Account.

2.3 Shifting among categories

- (i) Banks may shift investments to/from HTM with the approval of the Board of Directors once a year. Such shifting will normally be allowed at the beginning of the accounting year. No further shifting to/from HTM will be allowed during the remaining part of that accounting year, except when explicitly permitted by RBI.
- (ii) If the value of sales and transfers of securities to/from HTM category exceeds 5 per cent



of the book value of investments held in HTM category at the beginning of the year, banks should disclose the market value of the investments held in the HTM category and indicate the excess of book value over market value for which provision is not made. This disclosure is required to be made in 'Notes to Accounts' in banks' audited Annual Financial Statements. However, the one-time transfer of securities to/from HTM category with the approval of Board of Directors permitted to be undertaken by banks at the beginning of the accounting year. Further, additional shifting of securities explicitly permitted by the Reserve Bank from time to time, direct sales from HTM for bringing down SLR holdings in HTM category, sales to the Reserve Bank of India under pre-announced OMO auctions and repurchase of Government securities by Government of India from banks will be excluded from the 5 per cent cap.

- (iii) Banks may shift investments from AFS to HFT with the approval of their Board of Directors/ ALCO/ Investment Committee. In case of exigencies, such shifting may be done with the approval of the Chief Executive of the bank/Head of the ALCO, but should be ratified by the Board of Directors/ ALCO.
- (iv) Shifting of investments from HFT to AFS is generally not allowed. However, it will be permitted only under exceptional circumstances like not being able to sell the security within 90 days due to tight liquidity conditions, or extreme volatility, or market becoming unidirectional. Such transfer is permitted only with the approval of the Board of Directors/ ALCO/ Investment Committee.
- (v) Transfer of scrips from AFS / HFT category to HTM category should be made at the lower of book value or market value. In other words, in cases where the market value is higher than the book value at the time of transfer, the appreciation should be ignored and the security should be transferred at the book value. In cases where the market value is less than the book value, the provision against depreciation held against this security (including the additional provision, if any, required based on valuation done on the date of transfer) should be adjusted to reduce the book value to the market value and the security should be transferred at the market value.

In the case of transfer of securities from HTM to AFS / HFT category:

- (a) If the security was originally placed under the HTM category at a discount, it may be transferred to AFS / HFT category at the acquisition price / book value. (It may be noted that as per existing instructions banks are not allowed to accrue the discount on the securities held under HTM category and, therefore, such securities would continue to be held at the acquisition cost till maturity). After transfer, these securities should be immediately re-valued and resultant depreciation, if any, may be provided.
- (b) If the security was originally placed in the HTM category at a premium, it may be



transferred to the AFS / HFT category at the amortised cost. After transfer, these securities should be immediately re-valued and resultant depreciation, if any, may be provided.

In the case of transfer of securities from AFS to HFT category or vice-versa, the securities need not be re-valued on the date of transfer and the provisions for the accumulated depreciation, if any, held may be transferred to the provisions for depreciation against the HFT securities and vice-versa.

3. Valuation

3.1 Held to Maturity

- (i) Investments classified under HTM need not be marked to market and will be carried at acquisition cost, unless it is more than the face value, in which case the premium should be amortised over the period remaining to maturity. The banks should reflect the amortised amount in 'Schedule 13 – Interest Earned: Item II – Income on Investments', as a deduction. However, the deduction need not be disclosed separately. The book value of the security should continue to be reduced to the extent of the amount amortised during the relevant accounting period.
- (ii) Banks should recognise any diminution, other than temporary, in the value of their investments in subsidiaries/ joint ventures, which are included under HTM and provide therefor. Such diminution should be determined and provided for each investment individually.
- (iii) The need to determine whether impairment has occurred is a continuous process and the need for such determination will arise in the following circumstances:
 - (a) On the happening of an event which suggests that impairment has occurred. This would include:
 - (i) the company has defaulted in repayment of its debt obligations.
 - (ii) the loan amount of the company with any bank has been restructured.
 - (iii) the credit rating of the company has been downgraded to below investment grade.
 - (b) When the company has incurred losses for a continuous period of three years and the net worth has consequently been reduced by 25% or more.
 - (c) In the case of new company or a new project when the originally projected date of achieving the breakeven point has been extended i.e., the company or the project has not achieved break-even within the gestation period as originally envisaged.



When the need to determine whether impairment has occurred arises in respect of a subsidiary, joint venture or a material investment, the bank should obtain a valuation of the investment by a reputed/qualified valuer and make provision for the impairment, if any.

3.2 Available for Sale

The individual scrips in the Available for Sale category will be marked to market at quarterly or at more frequent intervals. Domestic Securities under this category shall be valued scrip-wise and depreciation/ appreciation shall be aggregated for each classification referred to in item 2(i) above. Foreign investments under this category shall be valued scrip-wise and depreciation/ appreciation shall be aggregated for five classifications (viz. Government securities (including local authorities), Shares, Debentures & Bonds, Subsidiaries and/or joint ventures abroad and Other investments (to be specified)). Further, the investment in a particular classification, both in domestic and foreign securities, may be aggregated for the purpose of arriving at net depreciation/appreciation of investments under that category. Net depreciation, if any, shall be provided for. Net appreciation, if any, should be ignored. Net depreciation required to be provided for in any one classification should not be reduced on account of net appreciation in any other classification. The banks may continue to report the foreign securities under three categories (Government securities (including local authorities), Subsidiaries and/or joint ventures abroad and other investments (to be specified)) in the balance sheet. The book value of the individual securities would not undergo any change after the marking of market.

3.3 Held for Trading

The individual scrips in the Held for Trading category will be marked to market at monthly or at more frequent intervals and provided for as in the case of those in the Available for Sale category. Consequently, the book value of the individual securities in this category would also not undergo any change after marking to market.

3.4 Investment Fluctuation Reserve & Investment Reserve Account

Investment Fluctuation Reserve

- (i) With a view to building up of adequate reserves to guard against any possible reversal of interest rate environment in future due to unexpected developments, banks were advised to build up Investment Fluctuation Reserve (IFR) of a minimum 5 per cent of the investment portfolio within a period of 5 years.
- (ii) To ensure smooth transition to Basel II norms, banks were advised in June 24, 2004 to maintain capital charge for market risk in a phased manner over a two year period, as under:



- (a) In respect of securities included in the HFT category, open gold position limit, open foreign exchange position limit, trading positions in derivatives and derivatives entered into for hedging trading book exposures by March 31, 2005, and
 - (b) In respect of securities included in the AFS category by March 31, 2006.
- (iii) With a view to encourage banks for early compliance with the guidelines for maintenance of capital charge for market risks, it was advised in April 2005 that banks which have maintained capital of at least 9 per cent of the risk weighted assets for both credit risk and market risk for both HFT (items as indicated at (a) above) and AFS categories may treat the balance in excess of 5 per cent of securities included under HFT and AFS categories, in the IFR, as Tier I capital. Banks satisfying the above were allowed to transfer the amount in excess of the said 5 per cent in the IFR to Statutory Reserve.
- (iv) Banks were advised in October 2005 that, if they have maintained capital of at least 9 per cent of the risk weighted assets for both credit risk and market risks for both HFT (items as indicated at 3.4 ii(a) above) and AFS category as on March 31, 2006, they would be permitted to treat the entire balance in the IFR as Tier I capital. For this purpose, banks may transfer the balance in the IFR 'below the line' in the Profit and Loss Appropriation Account to Statutory Reserve, General Reserve or balance of Profit & Loss (P&L) Account.

Investment Reserve Account (IRA)

- (v) In the event, provisions created on account of depreciation in the 'AFS' or 'HFT' categories are found to be in excess of the required amount in any year, the excess should be credited to the P&L Account and an equivalent amount (net of taxes, if any and net of transfer to Statutory Reserves as applicable to such excess provision) should be appropriated to an IRA Account in Schedule 2 – "Reserves & Surplus" under the head "Revenue and Other Reserves", and would be eligible for inclusion under Tier-II within the overall ceiling of 1.25 per cent of total Risk Weighted Assets prescribed for General Provisions/ Loss Reserves.
- (vi) Banks may utilise IRA as follows:

The provisions required to be created on account of depreciation in the AFS and HFT categories should be debited to the P&L Account and an equivalent amount (net of tax benefit, if any, and net of consequent reduction in the transfer to Statutory Reserve), may be transferred from the IRA to the P&L Account.

Illustratively, banks may draw down from the IRA to the extent of provision made during the year towards depreciation in investment in AFS and HFT categories (net of taxes, if any, and net of transfer to Statutory Reserves as applicable to such excess provision). In other words, a bank which pays a tax of 30 per cent and should appropriate 25 per cent



of the net profits to Statutory Reserves, can draw down Rs.52.50 from the IRA, if the provision made for depreciation in investments included in the AFS and HFT categories is Rs.100.

(vii) The amounts debited to the P&L Account for provision should be debited under the head 'Expenditure – Provisions & Contingencies'. The amount transferred from the IRA to the P&L Account, should be shown as 'below the line' item in the Profit and Loss Appropriation Account, after determining the profit for the year. Provision towards any erosion in the value of an asset is an item of charge on the profit and loss account, and hence should appear in that account before arriving at the profit for the accounting period. Adoption of the following would not only be adoption of a wrong accounting principle but would, also result in a wrong statement of the profit for the accounting period:

- (a) the provision is allowed to be adjusted directly against an item of Reserve without being shown in the profit and loss account, OR
- (b) a bank is allowed to draw down from the IRA before arriving at the profit for the accounting period (i.e., above the line), OR
- (c) a bank is allowed to make provisions for depreciation on investment as a below the line item, after arriving at the profit for the period,

Hence none of the above options are permissible.

viii) In terms of our guidelines on payment of dividend by banks, dividends should be payable only out of current year's profit. The amount drawn down from the IRA will, therefore, not be available to a bank for payment of dividend among the shareholders. However, the balance in the IRA transferred 'below the line' in the Profit and Loss Appropriation Account to Statutory Reserve, General Reserve or balance of P&L Account would be eligible to be reckoned as Tier I capital.

3.5 Market value

The 'market value' for the purpose of periodical valuation of investments included in the AFS and HFT categories would be the market price of the scrip as available from the trades/quotes on the stock exchanges, SGL account transactions, price list of RBI, prices declared by Primary Dealers Association of India (PDAI) jointly with the Fixed Income Money Market and Derivatives Association of India (FIMMDA) periodically. In respect of unquoted securities, the procedure as detailed below should be adopted.

3.6 Unquoted SLR securities

3.6.1 Central Government Securities



- (i) Banks should value the unquoted Central Government securities on the basis of the prices/ YTM rates put out by the PDAI/ FIMMDA at periodical intervals.
- (ii) Treasury Bills should be valued at carrying cost.

3.6.2 State Government Securities

State Government securities will be valued applying the Yield to Maturity (YTM) method by marking it up by 25 basis points above the yields of the Central Government Securities of equivalent maturity put out by PDAI/ FIMMDA periodically.

3.6.3 Other 'approved' Securities

Other approved securities will be valued applying the YTM method by marking it up by 25 basis points above the yields of the Central Government Securities of equivalent maturity put out by PDAI/ FIMMDA periodically.

3.7 Unquoted Non-SLR securities

3.7.1 Debentures/ Bonds

All debentures/ bonds should be valued on the YTM basis. Such debentures/ bonds may be of different companies having different ratings. These will be valued with appropriate mark-up over the YTM rates for Central Government Securities as put out by PDAI/ FIMMDA periodically. The mark-up will be graded according to the ratings assigned to the debentures/ bonds by the rating agencies subject to the following:-

- (a) The rate used for the YTM for rated debentures/ bonds should be at least 50 basis points above the rate applicable to a Government of India loan of equivalent maturity.

NOTE:

The special securities, which are directly issued by Government of India to the beneficiary entities, which do not carry SLR status, may be valued at a spread of 25 basis points above the corresponding yield on Government of India Securities, with effect from the financial year 2008- 09. At present, such special securities comprise Oil Bonds, Fertilizer Bonds, bonds issued to the State Bank of India (during the recent rights issue), Unit Trust of India, Industrial Finance Corporation of India Ltd., Food Corporation of India, Industrial Investment Bank of India Ltd., the erstwhile Industrial Development Bank of India and the erstwhile Shipping Development Finance Corporation.

- (b) The rate used for the YTM for unrated debentures/ bonds should not be less than the rate applicable to rated debentures/ bonds of equivalent maturity. The mark-up for the unrated debentures/ bonds should appropriately reflect the credit risk borne by the bank.



- (c) Where the debentures/ bonds are quoted and there have been transactions within 15 days prior to the valuation date, the value adopted should not be higher than the rate at which the transaction is recorded on the stock exchange.

3.7.2 Bonds issued by State Distribution Companies (Discoms) under Financial Restructuring Plan

- (i) If these bonds are traded and quoted, they will be valued at their current 'Market Value' as defined in paragraph 3.5 of this Master Circular.
- (ii) In case the bonds are not traded and quoted, they will be valued on YTM basis. The relevant YTM will be YTM rates for Central Government Securities of equivalent maturities as put out by FIMMDA on the valuation day with the following mark-ups:
- (a) During the period when bonds' liabilities are with the State Discoms and
- If guaranteed by respective State Governments – 75 basis points
 - If not guaranteed by respective State Governments – 100 basis points
- (b) During the period when bonds' liabilities are with the respective State Governments – 50 basis points.

3.7.3 Zero coupon bonds (ZCBs)

ZCBs should be shown in the books at carrying cost, i.e., acquisition cost plus discount accrued at the rate prevailing at the time of acquisition, which may be marked to market with reference to the market value. In the absence of market value, the ZCBs may be marked to market with reference to the present value of the ZCB. The present value of the ZCBs may be calculated by discounting the face value using the 'Zero Coupon Yield Curve', with appropriate mark up as per the zero coupon spreads put out by FIMMDA periodically. In case the bank is still carrying the ZCBs at acquisition cost, the discount accrued on the instrument should be notionally added to the book value of the scrip, before marking it to market.

3.7.4 Preference Shares

The valuation of preference shares should be on YTM basis. The preference shares will be issued by companies with different ratings. These will be valued with appropriate mark-up over the YTM rates for Central Government Securities put out by the PDAI/FIMMDA periodically. The mark-up will be graded according to the ratings assigned to the preference shares by the rating agencies subject to the following:

- (a) The YTM rate should not be lower than the coupon rate/ YTM for a GoI loan of equivalent maturity.



- (b) The rate used for the YTM for unrated preference shares should not be less than the rate applicable to rated preference shares of equivalent maturity. The mark-up for the unrated preference shares should appropriately reflect the credit risk borne by the bank.
- (c) Investments in preference shares as part of the project finance may be valued at par for a period of two years after commencement of production or five years after subscription whichever is earlier.
- (d) Where investment in preference shares is as part of rehabilitation, the YTM rate should not be lower than 1.5% above the coupon rate/ YTM for GoI loan of equivalent maturity.
- (e) Where preference dividends are in arrears, no credit should be taken for accrued dividends and the value determined on YTM should be discounted by at least 15 per cent if arrears are for one year, and more if arrears are for more than one year. The depreciation/provision requirement arrived at in the above manner in respect of nonperforming shares where dividends are in arrears shall not be allowed to be set-off against appreciation on other performing preference shares.
- (f) The preference share should not be valued above its redemption value.
- (g) When a preference share has been traded on stock exchange within 15 days prior to the valuation date, the value should not be higher than the price at which the share was traded.

3.7.5 Equity Shares

The equity shares in the bank's portfolio should be marked to market preferably on a daily basis, but at least on a weekly basis. Equity shares for which current quotations are not available or where the shares are not quoted on the stock exchanges, should be valued at break-up value (without considering 'revaluation reserves', if any) which is to be ascertained from the company's latest balance sheet (which should not be more than one year prior to the date of valuation). In case the latest balance sheet is not available the shares are to be valued at Re.1 per company.

3.7.6 Mutual Funds Units (MF Units)

Investment in quoted MF Units should be valued as per Stock Exchange quotations. Investment in un-quoted MF Units is to be valued on the basis of the latest re-purchase price declared by the MF in respect of each particular Scheme. In case of funds with a lock-in period, where repurchase price/ market quote is not available, Units could be valued at Net Asset Value (NAV). If NAV is not available, then these could be valued at cost, till the end of the lock- in period. Wherever the re-purchase price is not available, the Units could be valued at the NAV of the respective scheme.



3.7.7 Commercial Paper

Commercial paper should be valued at the carrying cost.

3.7.8 Investments in Regional Rural Banks (RRBs)

Investment in RRBs is to be valued at carrying cost (i.e. book value) on a consistent basis.

3.8 Investment in securities issued by Securitisation Company (SC) / Reconstruction Company (RC)

When banks / FIs invest in the SRs / Pass-Through Certificates (PTCs) issued by SCs / RCs, in respect of the financial assets sold by them to the SCs / RCs, the sale shall be recognised in books of the banks / FIs at the lower of:

- the redemption value of the SRs /PTCs, and
- the Net Book Value (NBV) (i.e. Book value less provisions held), of the financial asset.

The above investment should be carried in the books of the bank / FI at the price as determined above until its sale or realisation, and on such sale or realisation, the loss or gain must be dealt with as under:

- (i) If the sale to SC/ RC is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year. Banks can also use countercyclical / floating provisions for meeting any shortfall on sale of NPAs i.e., when the sale is at a price below the net book value (NBV).

However, for assets sold on or after February 26, 2014 and upto March 31, 2016, as an incentive for early sale of NPAs, banks can spread over any shortfall, if the sale value is lower than the NBV, over a period of two years. This facility of spreading over the shortfall will be subject to necessary disclosures in the Notes to Account in Annual Financial Statements of the banks.

- (ii) Banks may reverse the excess provision on sale of NPAs, if the sale value is for a value higher than the NBV, to its profit and loss account in the year the amounts are received. However, banks can reverse excess provision arising out of sale of NPAs only when the cash received (by way of initial consideration and / or redemption of SRs / PTCs) is higher than the net book value (NBV) of the asset. Further, reversal of excess provision will be limited to the extent to which cash received exceeds the NBV of the asset.

With regard to assets sold before February 26, 2014, the quantum of excess provision reversed to the profit and loss account on account of sale of NPAs shall be disclosed in the financial statements of the bank under 'Notes to Accounts'.



All instruments received by banks / FIs from SC / RC as sale consideration for financial assets sold to them and also other instruments issued by SC / RC in which banks / FIs invest will be in the nature of non-SLR securities. Accordingly, the valuation, classification and other norms applicable to investment in non-SLR instruments prescribed by the Reserve Bank from time to time would be applicable to bank's / FI's investment in debentures / bonds / security receipts / PTCs issued by SC / RC. However, if any of the above instruments issued by SC / RC is limited to the actual realisation of the financial assets assigned to the instruments in the concerned scheme the bank / FI shall reckon the Net Asset Value (NAV), obtained from SC / RC from time to time, for valuation of such investments.

3.9 Valuation and classification of banks' investment in VCFs

- 3.9.1** The quoted equity shares / bonds/ units of VCFs in the bank's portfolio should be held under AFS and marked to market preferably on a daily basis, but at least on a weekly basis, in line with valuation norms for other equity shares as per existing instructions.
- 3.9.2** Banks' investments in unquoted shares/bonds/units of VCFs may, at the discretion of the bank, be classified under HTM for initial period of three years and valued at cost during this period.
- 3.9.3** For this purpose, the period of three years will be reckoned separately for each disbursement made by the bank to VCF as and when the committed capital is called up. However, to ensure conformity with the existing norms for transferring securities from HTM, transfer of all securities which have completed three years as mentioned above will be affected at the beginning of the next accounting year in one lot to coincide with the annual transfer of investments from HTM category.
- 3.9.4** After three years, the unquoted units/shares/bonds should be transferred to AFS category and valued as under:
- (i) Units: In the case of investments in the form of units, the valuation will be done at the NAV shown by the VCF in its financial statements. Depreciation, if any, on the units based on NAV has to be provided at the time of shifting the investments to AFS category from HTM category as also on subsequent valuations which should be done at quarterly or more frequent intervals based on the financial statements received from the VCF. At least once in a year, the units should be valued based on the audited results. However, if the audited balance sheet/ financial statements showing NAV figures are not available continuously for more than 18 months as on the date of valuation, the investments are to be valued at Rupee 1 per VCF.
 - (ii) Equity: In the case of investments in the form of shares, the valuation can be done at the required frequency based on the break-up value (without considering 'revaluation



reserves', if any) which is to be ascertained from the company's (VCF's) latest balance sheet (which should not be more than 18 months prior to the date of valuation). Depreciation, if any on the shares has to be provided at the time of shifting the investments to AFS category as also on subsequent valuations which should be done at quarterly or more frequent intervals. If the latest balance sheet available is more than 18 months old, the shares are to be valued at Rupee 1 per company.

- (iii) Bonds: The investment in the bonds of VCFs, if any, should be valued as per prudential norms for classification, valuation and operation of investment portfolio by banks issued by the Reserve Bank from time to time.

3.9.5 Valuation norms on conversion of outstanding

Equity, debentures and other financial instruments acquired by way of conversion of outstanding principal and / or interest should be classified in the AFS category, and valued in accordance with the extant instructions on valuation of banks' investment portfolio. Equity classified as standard asset should be valued either at market value, if quoted, or at break-up value, if not quoted (without considering the revaluation reserve, if any) which is to be ascertained from the company's latest balance sheet. In case the latest balance sheet is not available, the shares are to be valued at Re.1. Equity instrument classified as NPA should be valued at market value, if quoted, and in case where equity is not quoted, it should be valued at Re.1. Depreciation on the instruments acquired by way of conversion, whether classified as standard or NPA, should not be offset against the appreciation in any other securities held under the AFS category.

3.10 Non-Performing Investments (NPI)

3.10.1 In respect of securities included in any of the three categories where interest/ principal is in arrears, banks should not reckon income on the securities and should also make appropriate provisions for the depreciation in the value of the investment. The banks should not set-off the depreciation requirement in respect of these non-performing securities against the appreciation in respect of other performing securities.

3.10.2 An NPI, similar to a non performing advance (NPA), is one where:

- (i) Interest/ instalment (including maturity proceeds) are due and remain unpaid for more than 90 days.
- (ii) The above would apply mutatis-mutandis to preference shares where the fixed dividend is not paid. If the dividend on preference shares (cumulative or non-cumulative) is not declared/paid in any year it would be treated as due/unpaid in arrears and the date of balance sheet of the issuer for that particular year would be reckoned as due date for the purpose of asset classification.
- (iii) In the case of equity shares, in the event the investment in the shares of any company

is valued at Re.1 per company on account of the non-availability of the latest balance sheet in accordance with the instructions contained in paragraph 28 of the Annex to the circular DBOD.BP.BC.32/ 21.04.048/ 2000-01 dated October 16, 2000, those equity shares would also be reckoned as NPI.

- (iv) If any credit facility availed by the issuer is NPA in the books of the bank, investment in any of the securities, including preference shares issued by the same issuer would also be treated as NPI and vice versa. However, if only the preference shares are classified as NPI, the investment in any of the other performing securities issued by the same issuer may not be classified as NPI and any performing credit facilities granted to that borrower need not be treated as NPA.
- (v) The investments in debentures/bonds, which are deemed to be in the nature of advance, would also be subjected to NPI norms as applicable to investments.
- (vi) In case of conversion of principal and/or interest into equity, debentures, bonds, etc., such instruments should be treated as NPA ab-initio in the same asset classification category as the loan if the loan's classification is substandard or doubtful on implementation of the restructuring package and provision should be made as per the norms.

3.10.3 Government guaranteed investments

- (i) With effect from the year ending March 31, 2006, investment in State Government guaranteed securities, including those in the nature of 'deemed advance', will attract prudential norms for identification of NPI and provisioning, when interest/ instalment of principal (including maturity proceeds) or any other amount due to the bank remains unpaid for more than 90 days.
- (ii) The prudential treatment for Central Government Guaranteed bonds has to be identical to Central Government guaranteed advances. Hence, bank's investments in bonds guaranteed by Central Government need not be classified as NPI until the Central Government has repudiated the guarantee when invoked. However, this exemption from classification as NPI is not for the purpose of recognition of income.

4. Uniform accounting for Repo / Reverse Repo transactions

- 4.1** The revised accounting guidelines effective from April 1, 2010 are applicable to market repo transactions in Government Securities and corporate debt securities. These accounting norms will, however, not apply to repo / reverse repo transactions conducted under the Liquidity Adjustment Facility (LAF) with the Reserve Bank.
- 4.2** Market participants may undertake repos from any of the three categories of investments, viz., Held For Trading, Available For Sale and Held To Maturity.



- 4.3** The economic essence of a repo transaction, viz., borrowing (lending) of funds by selling (purchasing) securities shall be reflected in the books of the repo participants, by accounting the same as collateralized lending and borrowing transaction, with an agreement to repurchase, on the agreed terms. Accordingly, the repo seller, i.e., borrower of funds in the first leg, shall not exclude the securities sold under repo but continue to carry the same in his investment account (please see the illustration given in the Annex) reflecting his continued economic interest in the securities during the repo period. On the other hand, the repo buyer, i.e., lender of funds in the first leg, shall not include the securities purchased under repo in his investment account but show it in a separate sub-head (please see the Annex). The securities would, however, be transferred from the repo seller to repo buyer as in the case of normal outright sale/purchase transactions and such movement of securities shall be reflected using the Repo/Reverse Repo Accounts and contra entries. In the case of repo seller, the Repo Account is credited in the first leg for the securities sold (funds received), while the same is reversed when the securities are repurchased in the second leg. Similarly, in the case of repo buyer, the Reverse Repo Account is debited for the amount of securities purchased (funds lent) and the same is reversed in the second leg when the securities are sold back.
- 4.4** The first leg of the repo transaction should be contracted at the prevailing market rates. The reversal (second leg) of the transaction shall be such that the difference between the consideration amounts of first and second legs should reflect the repo interest.
- 4.5** The accounting principles to be followed while accounting for repo / reverse repo transactions are as under:
- (i) Coupon /Discount
- The repo seller shall continue to accrue the coupon/discount on the securities sold under repo even during the repo period while the repo buyer shall not accrue the same.
- In case the interest payment date of the security offered under repo falls within the repo period, the coupons received by the buyer of the security should be passed on to the seller of the security on the date of receipt as the cash consideration payable by the seller in the second leg does not include any intervening cash flows.
- (ii) Repo Interest Income / Expenditure
- After the second leg of the repo / reverse repo transaction is over, the difference between consideration amounts of the first leg and second leg of the repo shall be reckoned as Repo Interest Income / Expenditure in the books of the repo buyer / seller respectively; and the balance outstanding in the Repo Interest Income / Expenditure account should be transferred to the P&L Account as an income or an expenditure. As



regards repo / reverse repo transactions outstanding on the balance sheet date, only the accrued income / expenditure till the balance sheet date should be taken to the P&L account. Any repo income / expenditure for the remaining period should be reckoned for the next accounting period.

(iii) Marking to Market

The repo seller shall continue to mark to market the securities sold under repo transactions as per the investment classification of the security. To illustrate, in case the securities sold by banks under repo transactions are out of the Available for Sale category, then the mark to market valuation for such securities should be done at least once a quarter. For entities which do not follow any investment classification norms, the valuation for securities sold under repo transactions may be in accordance with the valuation norms followed by them in respect of securities of similar nature.

4.6 Accounting Methodology

The accounting methodology to be followed along with the illustrations is given in Annexes VII-A and VII-B. Participants using more stringent accounting principles may continue using the same principles. Further, to obviate the disputes arising out of repo transactions, the participants should enter into bilateral Master Repo Agreement as per the documentation finalized by FIMMDA. The Master Repo Agreement finalised by FIMMDA is not mandatory for repo transactions in Government Securities settling through a Central Counter Party (CCP) [e.g. (CCIL), having various safeguards like haircut, MTM price, margin, Multilateral netting, closing out, right to set off, settlement guarantee fund/ collaterals, defaults, risk management and dispute resolution/ arbitration etc. However, Master Repo Agreement is mandatory for repo transactions in Corporate Debt Securities, which are settled bilaterally without involving a CCP.

4.7 Classification of Accounts

Banks shall classify the balances in Repo A/c under Schedule 4 under item I (ii) or I (iii) as appropriate. Similarly, the balances in Reverse Repo A/c shall be classified under Schedule 7 under item I (ii) a or I (ii) b as appropriate. The balances in Repo interest expenditure A/c and Reverse Repo interest income A/c shall be classified under Schedule 15 (under item II or III as appropriate) and under Schedule 13 (under item III or IV as appropriate) respectively. The balance sheet classification for other participants shall be governed by the guidelines issued by the respective regulators.

4.8 Disclosure

The disclosures as prescribed in Annex VI should be made by banks in the “Notes on Accounts’ to the Balance Sheet.



4.9 Treatment for Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)

(i) Government securities:

The regulatory treatment of market repo transactions in Government securities will continue as hitherto, i.e., the funds borrowed under repo will continue to be exempt from CRR/SLR computation and the security acquired under reverse repo shall continue to be eligible for SLR.

(ii) Corporate debt securities:

In respect of repo transactions in corporate debt securities, as advised vide IDMD. DOD.05/11.08.38/2009-10 dated January 8, 2010,

- (a) The amount borrowed by a bank through repo shall be reckoned as part of its Demand and Time Liabilities (DTL) and the same shall attract CRR/SLR.
- (b) The borrowings of a bank through repo in corporate bonds shall be reckoned as its liabilities for reserve requirement and, to the extent these liabilities are to the banking system, they shall be netted as per clause (d) of the explanation under section 42(1) of the RBI Act, 1934. Such borrowings shall, however, be subject to the prudential limits for inter-bank liabilities.

5. General

5.1 Income recognition

- (i) Banks may book income on accrual basis on securities of corporate bodies/ public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the Central Government or a State Government, provided interest is serviced regularly and as such is not in arrears.
- (ii) Banks may book income from dividend on shares of corporate bodies on accrual basis provided dividend on the shares has been declared by the corporate body in its Annual General Meeting and the owner's right to receive payment is established.
- (iii) Banks may book income from Government Securities and bonds and debentures of corporate bodies on accrual basis, where interest rates on these instruments are predetermined and provided interest is serviced regularly and is not in arrears.
- (iv) Banks may book income from units of mutual funds on cash basis.

5.2 Broken Period Interest

Banks should not capitalise the Broken Period Interest paid to seller as part of cost, but treat it as an item of expenditure under P&L Account in respect of investments in Government and other approved securities. It is to be noted that the above accounting treatment does



not take into account the tax implications and, hence, the banks should comply with the requirements of Income Tax Authorities in the manner prescribed by them.

5.3 Dematerialised Holding

Banks should settle the transactions in securities as notified by SEBI only through depositories. Banks are permitted to make fresh investments in and hold bonds and debentures, privately placed or otherwise, and equity instruments only in dematerialised form.

5.4 Investment in Zero Coupon Bonds and Low Coupon Bonds issued by corporates

In view of high credit risk involved in long term Zero Coupon Bonds (ZCBs) issued by corporates (including those issued by NBFCs) banks should not invest in such ZCBs unless the issuer builds up sinking fund for all accrued interest and keeps it invested in liquid investments/ securities (Government bonds). It had come to our notice that banks are investing in bonds which carry very low coupons that are not market related and therefore are redeemed at maturity with substantial premium. These bonds, therefore, carry credit risk similar to ZCBs. Banks should not invest in such Low Coupon Bonds unless the issuer builds up a sinking fund to the extent of the difference in the accrued interest calculated on the basis of YTM applicable to the bond and the actual coupon payable on the bond and keeps it invested in liquid investments/ securities (Government bonds). Further, banks should also put in place conservative limits for their investments in such bonds.



Appendix

List of Circulars consolidated by the Master Circular

No.	Circular No.	Date	Subject
1	DO.DBOD.No.FSC. 46/C.469-91/92	July 26, 1991	Investment portfolio of banks - Transaction in securities
2	DBOD.No.FSC. BC.143A/24.48.001/91-92	June 20, 1992	Investment portfolio of banks - Transaction in securities
3	DBOD.No.FMC/BC/ 17/24.48.001.92/93	Aug. 19, 1992	Investment portfolio of banks - Transaction in securities
4	DBOD.FMC.BC.62/ 27.02.001/92-93	Dec. 31, 1992	Investment portfolio of banks - Transaction in securities
5	DBOD. No.FMC.1095/27.01.002/93	April 15, 1993	Investment portfolio of banks - Reconciliation of holdings
6	DBOD.No.FMC.BC. 141/27.02.006/93/94	July 19, 1993	Investment Portfolio of Banks - Transaction in Securities Aggregate contract limit for individual brokers – Clarifications
7	DBOD.No.FMC.BC. 1/27.02.001/93-94	Jan. 10, 1994	Investment Portfolio of Banks - Transaction in Securities - Bouncing of SGL transfer forms - Penalties to be imposed.
8	DBOD.No.FSC.BC.130/24.76.002/ 94-95	Nov. 15, 1994	Investment Portfolio of Banks - Transaction in Securities – Bank Receipts (BRs)
9	DBOD.No.FSC.BC.129/24.76.002/ 94-95	Nov. 16, 1994	Investment Portfolio of Banks - Transaction in Securities – Role of brokers
10	DBOD.No.FSC.BC.142/24.76.002/ 94-95	Dec. 9, 1994	-Do-
11	DBOD.No.BP.BC.37/ 21.04.048/95	April 3, 1995	Investment Portfolio of Banks - Transaction in Securities
12	DBOD.No.FSC.BC. 70/24.76.002/95-96	June 8, 1996	Retailing of Government Securities
13	DBOD.No.FSC.BC. 71/24.76.001/96	June 11, 1996	Investment portfolio of banks - Transaction in securities
14	DBOD.No.BC.153/ 24.76.002/96	Nov. 29, 1996	-Do-
15	DBOD.BP.BC.9/21.04.048/98	Jan. 29, 1997	Prudential norms - capital adequacy, income recognition, asset classification and provisioning.



No.	Circular No.	Date	Subject
16	DBOD.BP.BC.32/ 21.04.048/97	April 12, 1997	-Do-
17	DBOD.FSC.BC.129/ 24.76.002-97	Oct. 22, 1997	Retailing of Government Securities
18	DBOD.No.BC.112/24.76.002/1997	Oct. 14, 1997	Investment portfolio of banks - Transaction in securities – Role of brokers
19	DBOD.BP.BC.75/ 21.04.048/98	Aug. 4, 1998	Acquisition of Government and other approved securities – Broken Period Interest- Accounting Procedure
20	DBS.CO.FMC.BC.1/ 22.53.014/98-99	July 7, 1999	Investment portfolio of banks – Transactions in securities
21	DBS.CO.FMC. BC.18/22.53.014/99-2000	Oct. 28, 1999	-Do-
22	DBOD.No.FSC.BC. 26/24.76.002/2000	Oct. 6, 2000	Sale of Government securities allotted in the auctions for Primary issues
23	DBOD.BP.BC.32/ 21.04.048/2000-01	Oct. 16, 2000	Guidelines on classification and valuation of investments.
24	DBOD.FSC.BC.No. 39/24.76.002/2000	Oct. 25, 2000	Investment portfolio of banks - Transaction in securities – Role of brokers
25	Dir.BC.107/13.03.00/2000-01	April 19, 2001	Monetary and Credit Policy for the year 2000 - 2002 - Interest Rate Policy
26	DBOD. BP.BC.119/21.04.137/2000-2001	May 11, 2001	Bank financing of equities and investments in shares - Revised guidelines
27	DBOD.BP.BC.127/ 21.04.048/2000-01	June 7, 2001	Non-SLR Investments of Banks
28	DBOD. BP.BC.61/21.04.048/2001-02	Jan. 25, 2002	Guidelines for investments by banks/FIs and Guidelines for financing of restructured accounts by banks/FIs
29	DBOD.No.DL(W).BC/ 110/20.16.003(1)/2001-02	May 30, 2002	Wilful Defaulters and Action there against
30	DBOD.No.FSC. BC.113/24.76.002/2001-02	June 7, 2002	On Investment Portfolio of Banks Transaction in Govt. Securities
31	DBS.CO.FMC.BC.7/ 22.53.014/2002-03	Nov. 7, 2002	Operation of investment portfolio by banks -submission of concurrent audit reports by banks
32	DBOD.No.FSC.BC. 90/24.76.002/2002-03	Mar. 31, 2003	Ready Forward Contracts



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No.	Circular No.	Date	Subject
33	IDMC.3810/11.08.10/2002-03	March 24, 2003	Guidelines for uniform accounting for Repo/ Reverse Repo transactions
34	DBOD.BP.BC.44/ 21.04.141/03-04	Nov. 12, 2003	Prudential guidelines on banks' investment in non-SLR securities
35	DBOD.BP.BC.53/ 21.04.141/03-04	Dec. 10, 2003	-Do-
36	DBOD.FSC.BC.59/ 24.76.002 /03-04	Dec. 26, 2003	Sale of Government securities allotted in the auctions for primary issues on the same day
37	IDMD.PDRS.05/10.02.01/ 2003-04	Mar. 29, 2004	Transactions in Government Securities
38	DBOD.FSC.BC.28/ 24.76.002/2004-05	Aug. 12, 2004	Transactions in Government securities
39	DBOD.BP.BC. 29/21.04.141/2004-05	Aug. 13, 2004	Prudential norms-State Government guaranteed exposures
40	DBOD.Dir.BC.32/ 13.07.05/2004-05	Aug. 17, 2004	Dematerialisation of banks' investment in equity
41	DBOD. BP.BC.37/21.04.141/2004-05	Sep. 2, 2004	Prudential norms on classification of investment portfolio of banks
42	IDMD.PDRS/4777/ 10.02.01/2004-05	May 11, 2005	Sale of securities allotted in primary issues
43	IDMD.PDRS/4779/ 10.02.01/2004-05	May 11, 2005	Ready forward contracts
44	IDMD.PDRS/4783/ 10.02.01/2004-05	May 11, 2005	Government securities transactions - T+1 settlement
45	DBOD.FSD. BC.No.31/24.76.002/2005-06	Sep. 1, 2005	NDS-OM - Counterparty Confirmation
46	DBOD.BP.BC.38/ 21.04.141/2005-06	Oct. 10, 2005	Capital Adequacy – Investment Fluctuation Reserve
47	IDMD.No.03/11.01.01 (B)/2005-06	Feb. 28, 2006	Secondary Market transactions in Government Securities - Intraday short selling
48	IDMD.No.3426/11.01.01 (D)/ 2005-06	May 3, 2006	'When Issued' transactions in Central Government Securities'
49	Mailbox Clarification	June 2, 2006	Computation of the Percentage of Unlisted Securities in Mutual Fund Schemes



No.	Circular No.	Date	Subject
50	DBOD.No.BP. BC.27/21.01.002/2006-07	Aug. 23, 2006	Prudential guidelines – Bank’s Investments in VCF
51	IDMD. No.2130/11.01.01(D)/2006-07	Nov. 16, 2006	When Issued Transactions in Central Government Securities
52	DBOD.No.FSD. BC.46/24.01.028/2006-07	Dec. 12, 2006	Financial Regulation of Systemically Important NBFCs And Bank’s Relationship with them
53	IDMD.No./11.01.01 (B)/2006-07	Jan. 31, 2007	Secondary Market transactions in Government Securities - Short selling
54	Mailbox Clarification	July 11, 2007	HTM Securities
55	DBOD.No.BP. BC.56/21.04.141/2007-08	Dec. 6, 2007	Limits on Investment in Unrated Non-SLR securities - infrastructure bonds
56	DBOD.No.BP. BC.86/21.04.141/2007-08	May 22, 2008	Valuation of securities
57	DBOD.No.BP. BC.No.37/21.04.132/2008-09	Aug. 27, 2008	Prudential Guidelines on Restructuring of Advances by Banks
58	Mailbox Clarification	Oct. 10, 2008	Transfer of Securities from One Category to Another
59	Mailbox Clarification	Feb. 5, 2009	Unlisted Non- SLR Securities
60	Mailbox Clarification	March 16, 2009	Investment in Unlisted Non-SLR Securities
61	Mailbox Clarification	Sept. 19, 2008	Classification of Securities
62	Mailbox Clarification	July 21, 2008	Investment Portfolio of Banks
63	IDMD.DOD.No. 334/11.08.36/2009-10	July 20, 2009	Ready Forward contracts in G-Sec
64	Mailbox Clarification	Sept. 3, 2009	Waiver of trade confirmation in Government Securities Transactions in OTC market
65	IDMD No. 1764/ 11.08.38/2009-10	Oct. 16, 2009	OTC trades in Corporate debt securities
66	Mailbox Clarification	Nov. 6, 2009	Clarification on Capital Reserve Account and Special Reserves Created under Income Tax Act, 1961
67	Mailbox Clarification	Dec. 23, 2009	Treatment for Investment in Rural Housing Development Fund (RHDF) of National Housing Bank



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No.	Circular No.	Date	Subject
68	IDMD.DOD.05/11.08. 38/ 2009-10	Jan. 8, 2010	Repo in Corporate Debt Securities
69	IDMD/4135/11.08.043/ 2009-10	March 23, 2010	Uniform accounting for repo/reverse repo transactions in G-Sec
70	IDMD.DOD.07/11.01.09/ 2009-10	March 25, 2010	Guidelines on Stripping/ reconstitution of G-Sec
71	Mailbox Clarification	March 30, 2010	Clarification on investment in debentures in the nature of advances
72	IDMD.DOD.08/11.08. 38/2009-10	April 16, 2010	Ready Forward Contract in Corporate Debt Securities
73	DBOD.No.BP. BC.98/21.04.141/2009-10	April 23, 2010	Investment in Unlisted Non- SLR Securities
74	DBOD.No.BP. BC.97/21.04.141/2009-10	April 23, 2010	Classification of Investments by banks in Bonds issued by Companies engaged in Infrastructure activities
75	IDMD.DOD.11/ 11.08.36/2009-10	June 30, 2010	Reporting of OTC Transactions in Certificates of Deposit (CDs) and Commercial Papers (CPs)
76	IDMD.DOD.17/ 11.01.01(B)/ 2010-11	July 14, 2010	Government Securities Act, 2006, Sections 27 & 30 - Imposition of penalty for bouncing of SGL forms
77	Mailbox Clarification	July 20. 2010	Clarification on classification of investments by banks in bonds issued by companies engaged in infrastructure activities.
78	Mailbox Clarification	Aug. 3, 2010	Bank's investments in Central Government guaranteed bonds – asset classification
79	DBOD. No. BP.BC. 34/21. 04.141/2010-11	Aug. 6, 2010	Sale of Investments held under Held to Maturity (HTM) category
80	DBOD. No.BP.BC.56/ 21. 04.141/2010-11	Nov. 1, 2010	-Do -
81	DBOD No. BP.BC. 44 / 21.04.141/ 2010-11	Sept. 29, 2010	Prudential norms on Investment in Zero Coupon Bonds
82	DBOD No. BP.BC. 58/21.04.141/2010-11	Nov. 4, 2010	Accounting Procedure for Investments – Settlement Date Accounting



No.	Circular No.	Date	Subject
83	DBOD.BP.BC.No.72/21.04.141/2010-11	Dec. 31, 2010	Investment in Non-SLR Securities - Non-Convertible Debentures (NCDs) of maturity up to one year
84	DBOD. No. BP.BC. 79/21.04.141/2010-11	Jan. 31, 2011	Recognition of permanent diminution in the value of investments in banks' subsidiaries/joint ventures
85	IDMD No./29/ 11.08.043/2010-11	May 30, 2011	Guidelines for Accounting of Repo / Reverse Repo Transactions-Clarification
86	DBOD.No.BP.BC. 23/21.04.141/2011-12	July 5, 2011	Investment by banks in liquid/short term debt schemes of mutual funds
87	IDMD.PCD 14/ 14.03.07/2011-12	Dec. 28, 2011	Secondary market transactions in Government securities – short selling
88	IDMD.PCD 19/ 14.03.07/2011-12	Feb. 6, 2012	Transaction in Government securities
89	IDMD.PCD.20/ 14.01.02/2011-12	March 5, 2012	Settlement of OTC Transactions in Certificates of Deposit (CDs) and Commercial Papers (CPs)
90	IDMD.PCD.21/ 14.03.07/2011-12	June 21, 2012	Secondary market transactions in Government Securities - Short Selling
91	IDMD. PDRD.188/03.64.00/2012-13	July 16, 2012	Sale of securities allotted in Primary issues on the same day
92	IDMD.PCD.1423/14.03.02/2012-13	Oct. 30, 2012	Ready Forward Contracts in Corporate Debt Securities - Permitting Scheduled Urban Cooperative Banks
93	IDMD.DOD.No.06/10.25.66/2012-13	Dec. 06, 2012	FIMMDA Code of Conduct for usage of Negotiated Dealing System-Order Matching (NDS-OM) and Over-The-Counter (OTC) Market
94	IDMD.PCD.09/14.03.02/2012-13	Jan. 7, 2013	Revised Guidelines on Ready Forward Contracts in Corporate Debt Securities
95	Mail Box Clarification	Jan. 30, 2013	Prudential Norms on Investment in Low Coupon Bonds
96	DBOD.No.BP. BC.92/21.04.141/2012-13	May 15, 2013	Monetary Policy Statement 2013-14 SLR Holdings under Held to Maturity Category
97	IDMD.PCD.11/14.03.06/2012-13	June 26, 2013	Settlement of OTC transactions in Corporate Bonds on DvP-I basis



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No.	Circular No.	Date	Subject
98	IDMD.PCD.12/14.03.02/2012-13	June 26, 2013	Settlement of OTC Transactions in Certificates of Deposit (CDs) and Commercial Papers (CPs)
99	IDMD.PCD.13/14.03.07/2012-13	June 26, 2013	Guidelines on Securities Transactions to be followed by Primary Dealers
100	DBOD.BP.BC. No.105/21.04.132/2012-13	June 27, 2013	Bonds issued by State Distribution Companies (Discoms) – Guidelines on Valuation
101	DBOD.BP.BC. No.41/21.04.141/2013-14	Aug. 23, 2013	Investment portfolio of banks – Classification, Valuation and Provisioning
102	IDMD.PCD. 06 / 14.03.06/ 2013-14	Aug. 26, 2013	Reporting of OTC transactions in Securitised Debt Instruments
103	Mailbox clarification	March 21, 2014	Sale of Investments held under Held to Maturity (HTM) Category
104	IDMD.PCD. 10 / 14.03.06/ 2013-14	Feb. 24, 2014	FIMMDA's Trade Reporting and Confirmation platform for OTC transactions in Corporate Bonds and Securitised Debt Instruments
105	DBOD.BP.BC. No.97/21.04.132/2013-14	Feb. 26, 2014	Framework Revitalising Distressed Assets in the Economy - Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP)
106	DBOD.No.BP.BC.98/21.04.132/2013-14	Feb. 26, 2014	Framework for Revitalising Distressed Assets in the Economy – Refinancing of Project Loans, Sale of NPAs and Other Regulatory Measures
107	IDMD.PCD.13/ 14.01.02/ 2013-14	June 25, 2014	Reporting of OTC transactions on F-TRAC-Hiving off to CDSIL
108	Mailbox clarification	June 27, 2014	Disclosure requirements for non-SLR investments
109	DBOD.No.BP.BC.30/ 21.04.141/2014-15	Aug. 5, 2014	Monetary Policy Statement 2014-15 - SLR Holdings under Held to Maturity Category
110	IDMD.PCD.06/ 14.03.07/2014-15	Sept. 30, 2014	Secondary market transactions in Government Securities - Short Selling
111	DBOD.No.BP.BC.42/ 21.04.141/2014-15	Oct. 7, 2014	Fourth Bi-monthly Monetary Policy Statement, 2014-15 - SLR Holdings under Held to Maturity Category



No.	Circular No.	Date	Subject
112	Mailbox clarification	Dec. 15, 2014	SLR Holdings under Held to Maturity Category
113	FMRD.FMID.01/14.01.02/2014-15	Dec. 19, 2014	F-TRAC - Counterparty Confirmation
114	FMRD.DIRD.02/ 14.03.007/2014-15	Dec. 24, 2014	Secondary market transactions in Government Securities - Short Selling
115	DBR.No.CID.BC.60/20.16.056/2014-15	Jan. 15, 2015	Membership of Credit Information Companies (CICs)
116	FMRD.DIRD.04/14.03.002/2014-15	Feb. 3, 2015	Ready Forward Contracts in Corporate Debt Securities
117	FMRD.DIRD.5/14.03.002/2014-15	Feb. 5, 2015	Re-repo in Government Securities Market
118	DBR.No.BP.BC.75/21.04.048/2014-15	March 11, 2015	Guidelines on Sale of Financial Assets to Securitisation Company (SC)/Reconstruction Company (RC) and Related Issues
119	FMRD.DIRD.5/14.03.002/2014-15	March 20, 2015	T+2 Settlements for Outright Secondary Market Transactions in Government Securities Undertaken by Foreign Portfolio Investors and Reported on NDS-OM
120	FMRD.DIRD.08/14.03.002/2014-15	May 14, 2015	Ready Forward Contracts in Corporate Debt Securities
121	DBR.No.BP.BC.94/21.04.048/2014-15	May 21, 2015	Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances - Spread over of Shortfall
122	DBR.BP.BC.No.98/08.12.014/2014-15	June 01, 2015	Issue of Long Term Bonds by banks for Financing of Infrastructure and Affordable Housing – Cross Holding



Annexure-III

Glossary

SIDBI: Small Industries Development Bank of India, set up on April 2, 1990 under an Act of Indian Parliament, is the Principal Financial Institution for the Promotion, Financing and Development of the Micro, Small and Medium Enterprise (MSME) sector and for Co-ordination of the functions of the institutions engaged in similar activities.

NABARD: National Bank for Agriculture and Rural Development came into being on 12th July 1982 by an Act of Parliament. Its mission is to promote sustainable and equitable agriculture and rural prosperity through effective credit support, related services, institution development and other innovative initiatives.

NHB: Established under an Act of the Parliament to function as a principal agency to promote Housing Finance Institutions and to provide support to such institutions.

FIMMADA: Fixed Income Money Market and Derivatives Association of India is an association of Scheduled Commercial Banks, Public Financial Institutions, Primary Dealers and Insurance Companies. FIMMADA is a voluntary market body for the bond, money and derivatives markets.

Primary Dealers: Primary dealers are registered entities with the RBI who have the license to purchase and sell government securities. They are entities who buy government securities directly from the RBI (the RBI issues government securities on behalf of the government), aiming to resell them to other buyers. In this way, the Primary Dealers create a market for government securities.

The Primary Dealers system in the government securities market was introduced by the RBI in 1995.

FEDAI: Foreign Exchange Dealer's Association of India was set up in 1958 as an Association of banks dealing in foreign exchange in India (typically called Authorized Dealers - ADs) as a self-regulatory body and is incorporated under Section 25 of The Companies Act, 1956. Its major activities include framing of rules governing the conduct of inter-bank foreign exchange business among banks vis-à-vis public and liaison with RBI for reforms and development of forex market.

NPI: Non-performing investment is an investment which does not generate any income or not performing. An investment will be treated as NPI where interest/instalment (including maturity proceeds) is due and remains unpaid for more than 90 days. In NPI banks should not reckon its interest on these securities as income and also should make appropriate provisions for the depreciation in the value of investments.

CRISIL: Credit Rating and Information Services of India Limited is a global analytical company providing ratings, research, and risk and policy advisory services. It is India's leading rating agency.



It empowers its customers, and the markets at large, with independent analysis, benchmarks and tools. These help lenders and borrowers, issuers and investors, regulators, and market intermediaries make better-informed investment and business decisions.

ICRA: ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

CARE: Credit Analysis Research Limited is the second largest credit rating agency in India which commenced operation in April, 1993. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations.

FITCH: FITCH is an international credit rating agency like Standard and Poor's and Moody's based on New York City and London. The company's ratings are used as a guide to investors as to which investments are most likely going to yield a return.

CCIL: The Clearing Corporation of India Ltd. was set up in April, 2001 for providing exclusive clearing and settlement for transactions in Money, G-Secs and Foreign Exchange. The prime objective has been to improve efficiency in the transaction settlement process, insulate the financial system from shocks emanating from operations related issues, and to undertake other related activities that would help to broaden and deepen the money, debt and forex markets in the country.

RRB: Regional Rural Banks came into existence on Gandhi Jayanti in 1975 with the formation of a Prathama Grameen Bank. The rural banks had the legislative backing of the Regional Rural Banks Act 1976. This act allowed the government to set up banks from time to time wherever it considered necessary. The RRBs were owned by three entities with their respective shares as follows: Central Government → 50% State government → 15% Sponsor bank → 35% Regional Rural Banks were conceived as low cost institutions having a rural ethos, local feel and pro poor focus.

TIER-1 CAPITAL: Tier 1 capital is the core measure of a bank's financial strength from a regulator's point of view. It is composed of core capital, which consists primarily of common stock and disclosed reserves (or retained earnings), but may also include non-redeemable non-cumulative preferred stock.

TIER-II CAPITAL: Tier 2 capital is supplementary bank capital that includes items such as revaluation reserves, undisclosed reserves, hybrid instruments and subordinated term debt. A bank's reserve



requirements include its Tier 2 capital in its calculation, but it is considered less reliable than its Tier 1 capital.

CRR: Cash reserve Ratio is the amount of funds that the banks have to keep with the RBI. If the central bank decides to increase the CRR, the available amount with the banks comes down. The RBI uses the CRR to drain out excessive money from the system. Scheduled banks are required to maintain with the RBI an average cash balance, the amount of which shall not be less than 4% of the total of the Net Demand and Time Liabilities (NDTL) adjusted for the exemptions noted by the RBI, on a fortnightly basis. It is dealt with under Sec-42 (1) of the Reserve Bank of India Act, 1934

SLR: Statutory liquidity ratio is the Indian government term for reserve requirement that the commercial banks in India require to maintain in the form of gold, government approved securities before providing credit to the customers on their total demand and time liabilities in India as on the last Friday of the second preceding fortnight as the RBI by notifying in the Official Gazette may specify from time to time. It is dealt with under Sec-24 of Banking Regulation Act. 1949.

OTC market: A decentralized market, without a central physical location, where market participants trade with one another through various communication modes such as the telephone, email and proprietary electronic trading systems. An over-the-counter (OTC) market and an exchange market are the two basic ways of organizing financial markets. In an OTC market, dealers act as market makers by quoting prices at which they will buy and sell a security or currency. A trade can be executed between two participants in an OTC market without others being aware of the price at which the transaction was effected. In general, OTC markets are therefore less transparent than exchanges and are also subject to fewer regulation

SEBI: The Securities and Exchange Board of India was enacted on April 12, 1992 in accordance with the provisions of the Securities and Exchange Board of India Act, 1992. to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto”.

NSE: The National Stock Exchange (NSE) is India’s leading stock exchange covering various cities and towns across the country. NSE was set up by leading institutions to provide a modern, fully automated screen-based trading system with nation. NSE has played a catalytic role in reforming the Indian securities market in terms of microstructure, market practices and trading volumes.al reach.

BSE: The Bombay Stock Exchange (BSE) is an Indian stock exchange located at Dalal Street, Mumbai Established in 1875, the BSE is Asia’s first stock exchange and the world’s fastest stock exchange with a median trade speed of 6 microseconds.



IPO: An initial public offering, or IPO, is the first sale of stock by a company to the public. A company can raise money by issuing either debt or equity. If the company has never issued equity to the public, it's known as an IPO. Companies fall into two broad categories: private and public.

FPO: Follow on Public Offer is a process by which a company, which is already listed on an exchange, issues new shares to the investors or the existing shareholders.

LIBOR: The London Interbank Offered Rate is the average of interest rates estimated by each of the leading banks in London that it would be charged were it to borrow from other banks. It serves as a benchmark reference rate to determine floating interest rate. It is also used as a measure of trust in the financial system and reflects the confidence banks have in each other's financial health.

RIDF: Rural Infrastructure Development Fund (RIDF) was instituted in NABARD with an announcement in the Union Budget 1995-96 with the sole objective of giving low cost fund support to State Govts. and State Owned Corporations for quick completion of ongoing projects relating to medium and minor irrigation, soil conservation...

RIDF/SIDBI/RHDF deposits: It is the deposits placed with NABARD, SIDBI and NHB for meeting shortfall in priority sector lending by banks.

SARFAESI ACT: The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (also known as the Sarfaesi Act) is an Indian law. It also provides for the manner for enforcement of security interests by a secured creditor without the intervention of a court or tribunal. It allows banks and other financial institution to auction residential or commercial properties to recover loan.

PDAI: Primary Dealers' Association of India ("the Association") was incorporated on December 22, 1997 under the provisions of Section 25 of the Companies Act, 1956 and having no share capital but it is a Company limited by guarantee. Its main object is to encourage and promote a friendly feeling among primary dealers to serve their common interest and further the interests and regulate the dealings of and between the Dealers in Government securities i.e. any person/institution authorized by Reserve Bank of India (RBI) to function as a Primary dealer or as a satellite dealer in government securities both inter-se, and with the public, brokers, the Reserve Bank of India and other bodies and to promote protect and represent the interests of members

YTM: Yield to maturity is the discount rate at which the sum of all future cash flows from the bond (coupons and principal) is equal to the price of the bond. The YTM is often given in terms of Annual Percentage Rate (A.P.R.), but more usually market convention is followed.

RISK WEIGHTED ASSETS: Risk-weighted asset (also referred to as RWA) is a bank's assets or off-balance-sheet exposures, weighted according to risk. This sort of asset calculation is used in determining the capital requirement or Capital Adequacy Ratio (CAR) for a financial institution. Risk



weighting adjusts the value of a asset for risk, simply by multiplying it be a factor that reflects its risk. Low risk assets are multiplied by a low number, high risk assets by 100% (i.e. 1).

SENSEX and NIFTY: The Sensex and Nifty are both Indices. The Sensex, also called the BSE 30, is a stock market index of 30 well-established and financially sound companies listed on Bombay Stock Exchange (BSE). The Nifty, similarly, is an indicator of the 50 top major companies on the National Stock Exchange.

PDO: A public debt office or a debt management office is an autonomous government agency which acts as the investment banker to the government and raises capital from the markets for the government. It formulates the borrowing calendar for the government and decides upon the maturities of the securities to be issued on behalf of the government. A public debt office works separately from the central bank and has nothing to do with the formulation of the monetary policy or setting interest rates.

RISK SENSITIVE ASSETS: Assets held by a bank that is vulnerable to changes in interest rates. This change can occur either when the asset matures or when it is re-priced according to an index rate. The value of these assets is adjusted according to the rise or fall of a published rate or index.

RISK SENSITIVE LIABILITIES: Short-term deposit instruments paying floating, as opposed to fixed, rates of interest. Interest sensitive liabilities make up a significant amount of the assets of most banks.

ALCO: Asset Liability Committee is a risk-management committee in a bank or other lending institution that generally comprises the senior-management levels of the institution. The ALCO's primary goal is to evaluate, monitor and approve practices relating to risk due to imbalances in the capital structure.

CBLO: "Collateralized Borrowing and Lending Obligation", as the name implies facilitates in a collateralized environment, borrowing and lending of funds to market participants who are admitted as members in CBLO Segment. It is a money market segment.

CBLO is conceived and developed by CCIL CBLO Dealing system, an anonymous order matching platform, is hosted and maintained by Clearcorp Dealing Systems (India) Ltd, a fully owned subsidiary of CCIL. CCIL becomes Central Counterparty to all CBLO trades and guarantees settlement of CBLO trades.

REPO: Repo is a contractual arrangement between two parties whereby one party agrees to sell the securities to another party at some specified price with the condition of buying the securities back at a later date for some other specified price.

REVERSE REPO: It is just the opposite of Repo. It is a purchase of securities with an agreement to resell them at a higher price at specific future date.

USUANCE PROMISSORY NOTES: As per Sec. 4 of Negotiable Instrument Act ‘promissory note is an instrument in writing (not being a bank-note or a currency-note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.’” When this promise of payment is made on demand – it is a demand promissory note and when it is made to pay at a future date after a certain time period it becomes a usance promissory note.

SGL A/c: The Central Bank makes it mandatory on all commercial banks to invest a certain percentage of their liabilities [(only demand) or (demand and time both)] in government securities viz. T-Bills, Bonds etc which is called Statutory Liquidity Requirement. These securities are parked in an account maintained with the Central Bank which is called Subsidiary General Ledger. The main purpose of this account is the holding and trading of government securities.

CSGL A/c: CSGL, i.e. Constituents’ Subsidiary General Ledger account, means an SGL account opened and maintained with RBI by an agent on behalf of the constituents of such agent, i.e. a second SGL account opened by an agent with the RBI to hold the securities on behalf of their constituents. The constituents are known as the Gilt Account Holders (GAHs). Additional CSGL and / or Gilt Account can be opened only with the prior / specific permission of the Bank.

MIBOR: MIBOR is the interest rate at which banks can borrow funds, in marketable size, from other banks in the Indian interbank market. It is an overnight lending rate calculated daily by the National Stock Exchange of India. This rate is given to first class borrowers and lending institutions and is based on an average of lending rates offered by major banks throughout India.

DVP: Delivery versus payment is a settlement system that stipulates that cash payment must be made prior to or simultaneously with the delivery of the security.

AFS, HFT, HTM: Investments of banks is classified into three categories.

- Held to Maturity (HTM)
- Available for Sale (AFS)
- Held for Trading(HFT)

While investing banks have to take a decision to put the securities purchased in either of the above three categories. Securities acquired with the intention to hold them till maturity will be classified under Held to Maturity. The securities acquired by the banks with the intention to trade within 90 days of their purchase by taking advantage of the short term price/interest rate movements



etc. will be classified under Held for Trading. The securities which do not fall within the above two categories will be classified under Available for Sale.

NDS (OM): NDS-OM is a screen based electronic anonymous order matching system for secondary market trading in Government securities owned by RBI. Presently the membership of the system is open to entities like Banks, Primary Dealers, Insurance Companies, Mutual Funds etc. i.e. entities who maintain SGL accounts with RBI.

F-TRAC: “F-TRAC” stands for FIMMDA Trade Reporting and Confirmation System which is used for capturing/ reporting of trades in (i) certificate(s) of deposit and/or commercial paper(s) transactions in secondary market; (ii) outright corporate bonds trades in secondary market; and (iii) repo transactions in corporate bonds. Only OTC trades in Corporate Bond, CP’s & CD’s are to be reported.

C-BRICS: Corporate Bond Reporting and Integrated Clearing System is a platform intended to enable members to report their transactions in corporate bonds in accordance with the requirements of SEBI. This platform shall also provide information on reported trading volumes, yields, prices, information about bonds and its attributes. It is controlled by NSE.

HERSTATT RISK: Cross-currency settlement risk that arises where the working hours of inter-bank fund transfer systems do not overlap due to time zone differences. In this situation, failure by one counter party to settle its side of the deal starts a chain reaction of cross-defaults. It is named after a small German bank (Bankhaus Herstatt) which failed in June 1974 during the period it was supposed to settle a contract after having received the payment from the counterparty.



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