RBI/ 2004-05/ 383
DBOD.No.BP.BC. 72/21.04.018/2004-05 **March 3, 2005**

To Chairmen / CEOs of all
Scheduled Commercial Banks
(excluding RRBs)

Dear Sir,

<u>Disclosures on risk exposures in derivatives</u>

The Reserve Bank has been periodically reviewing the prudential disclosures made by banks as a part of the Notes on Accounts to the Balance Sheets. Best international practices require meaningful and appropriate disclosures of banks' exposures to risk and their strategy towards managing the risk. In this direction, it has been decided that banks should be required to make meaningful disclosures of their derivatives portfolio.

2. A minimum framework for disclosures by banks on their risk exposures in derivatives is furnished in the Annex. The disclosure format includes both qualitative and quantitative aspects and has been devised to provide a clear picture of the exposure to risks in derivatives, risk management systems, objectives and policies. Banks should make these disclosures as a part of the 'Notes on Accounts' to the Balance Sheet with effect from March 31, 2005.

3. Please acknowledge receipt.

Yours faithfully,

Sd/-

(C.R.Muralidharan)
Chief General Manager-in-Charge

Encls: as above

Annex

Disclosures on risk exposure in derivatives

Qualitative Disclosure

Banks shall discuss their risk management policies pertaining to derivatives with particular reference to the extent to which derivatives are used, the associated risks and business purposes served. The discussion shall also include:

- the structure and organization for management of risk in derivatives trading,
- the scope and nature of risk measurement , risk reporting and risk monitoring systems,
- policies for hedging and / or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges / mitigants, and
- accounting policy for recording hedge and non-hedge transactions; recognition of income, premiums and discounts; valuation of outstanding contracts; provisioning, collateral and credit risk mitigation.

Quantitative Disclsoures

(Rupees in Crore)

Sl. No	**Particular**	**Currency Derivatives**	**Interest rate derivatives**
1	**Derivatives (Notional Principal Amount)**		
	a) For hedging		
	b) For trading		
2	**Marked to Market Positions[1]**		
	a) Asset (+)		
	b) Liability (-)		
3	**Credit Exposure [2]**		
4	**Likely impact of one percentage change in interest rate (100*PV01)**		
	a) on hedging derivatives		
	b) on trading derivatives		
5	**Maximum and Minimum of 100*PV01 observed during the year**		
	a) on hedging		
	b) on trading		

Note:

1. The net position may be shown either under asset or liability, as the case may be, for each type of derivatives.

2. Banks may adopt the Current Exposure Method prescribed vide Circular DBOD.No.BP.BC.48/21.03.054/02-03 dated December 13, 2002 on Measurement of Credit Exposure of Derivative Products. In brief the method to be adopted is as follows:

In order to calculate the credit exposure equivalent of off-balance sheet interest rate and exchange rate instruments under Current Exposure Method, a bank would sum:

- the total replacement cost (obtained by "marking to market") of all its contracts with positive value (i.e. when the bank has to receive money from the counterparty), and
- an amount for potential future changes in credit exposure calculated on the basis of the total notional principal amount of the contract multiplied by the following credit conversion factors according to the residual maturity :

Residual Maturity	**Conversion Factor to be applied on Notional Principal Amount**	
	Interest Rate Contract	**Exchange Rate Contract**
Less than one year	Nil	1.0 %
One year and over	0.5%	5.0 %