THE CLEARING CORPORATION OF INDIA LTD

Risk Management Department

This has been Superseded by Notification No. RMD/SS/ 11/01 dated 01-Mar-2011 on Computation of Margin Factors

No. RMD/SS/ 10/02 **14th January, 2010**

FOR INFORMATION OF ALL MEMBERS

Securities Segment
Changes in Valuation Methodology, Computation of Margin Factors

Further to our notification No.RMS/SS/09/13 dated 28th August'09, it has been decided to modify the processes followed for valuation, computation of margin factors for Floating Rate Bonds (FRBs) and multiplicants for margin factors etc. to bring about further improvements in the quality of valuation and also to improve upon risk containment measures.

2. The changes being brought into effect will be as under:

I. Illiquidity based multiplicants for margin factors:

(a) multiplicants for margin factors of newly issued SDLs will henceforth be arrived at after excluding the trades on the date of auction of the security and for seven days after the date of issue.

(b) review of multiplicants for margin factors will henceforth be carried out on monthly basis instead of on quarterly basis.

II. Margin factors of Floating Rate Bonds (FRBs) will be computed by treating the FRBs as fixed coupon bonds with the coupon equal to current coupon in the lines of approach being followed in the case of valuation of FRBs.

III. Criteria for arriving at security-wise illiquidity adjustment factors for Government of India Securities:

a) minimum number of trades required for a security to be considered for security-wise illiquidity adjustment factor being raised from 5 to 10.

b) trades of securities during the period of When Issued trading will henceforth be excluded while arriving at the security-wise illiquidity adjustment factors.

The detailed changes have been listed in the Annexure

3. The changes related to margin factors will come into effect from 15th Jan'10.

4. In case of illiquidity adjustment factors and yield spreads, the changes will come into effect on or after 01st February'10.

****

Encls.

Annexure to Notification No. RMD/SS/10/02
dated 14th Jan'10

The Clearing Corporation of India Ltd.
Risk Management Dept

Securities Segment
Changes in Valuation Methodology, Computation of Margin Factors

S.No.	Process	Change in Process
1.	Illiquidity multiplicants for margin factors of newly issued SDLs	Illiquidity based multiplicants for margin factors of newly issued SDLs will be arrived at after excluding the trades on the date of auction of the security and for seven days after the date of issue. This change is being effected to make the process aligned to that of computation of yield spread for SDLs.
2.	Review of illiquidity multiplicants for margin factors.	Review of illiquidity based multiplicants for margin factors will be carried out on monthly basis instead of on quarterly basis to make the process aligned to processes used for valuation. This change is expected to help in fine tuning of the margin factors to reflect the risks in dealing with various types of securities in a better manner. Margin factors of all securities are revised only on reporting Fridays. If a change is required in the already notified margin factor for any security, due to monthly review of multiplicants, margin factor for such security would only be modified by using the revised multiplicants. This approach would help in keeping the changes in margin factors at minimum level.
3	Margin factors of Floating Rate Bonds (FRBs)	Margin factors of Floating Rate Bonds (FRBs) will be computed by treating the FRBs as fixed coupon bonds with the coupon equal to current coupon. This change is being brought in as the margin factor arrived at by the existing process of taking next interest reset date as maturity date is inadequate to cover the intra-day movement as revealed by back testing results. The new approach is similar to that used now for valuation of FRBs.

4	Valuation of Govt.of India Securities – criteria for arriving at security wise illiquidity adjustment factors and tenor wise yield spreads	Back testing results of effectiveness of spread for the previous four months indicated that 5 trades per month appear to be small in number for arriving at security-wise Illiquidity Adjustment Factor. It is expected that the position would be better if the number of trades is increased to 10 per month. The changed crieteria for arriving at illiquidity adjustment factor/ illiquidity spread is as under: **a) For Securities maturing with a year and T-Bills** No yield spread(spread over zero coupon will be applied) **b) For securities having 10 and above trades of face value of Rs.5 crore during the previous month** – Security wise illiquidity adjustment factor in rupee terms based on average of daily difference between the model price and the weighted average price of the security during the previous month will be arrived at the end of the month. **c) For securities having less than 10 trades of face value of Rs.5 crore during previous month** Tenor-wise spreads in yield terms (spread over zero coupon yields for tenors) 1-3 years, 3-5 years, 5-7 years, 7-10 years, 10-15 years, 15-20 years, 20-25 years and above 25 years, will be arrived at by grouping the securities in different buckets based on residual maturity. **II. Securities in When Issued Market**: Trades in securities during the period of When Issued trading are to be excluded while arriving at the security wise illiquidity adjustment factor .This change is being brought in as inclusion of these trades in computation of security wise illiquidity adjustment factors leads to inaccurate estimation.

*****