TO ALL THE MEMBERS

REVIEW OF METHODOLOGY FOR IMPOSITION OF VOLATILITY MARGIN IN FOREX SEGMENT.

We have circulated a note on 04th December'07 detailing the proposed process for imposition of volatility margin in Forex Segment, amongst the members for their feed back. This note was recirculated on 14th February'08.

2. We have received some responses and after considering the suggestions and the recent market movements, it has been decided that the under-mentioned methodology would be followed for impostion and withdrawal of volatility Margin.

Imposition:

Volatality Margin will be imposed when impact of one day exchange rate fluctuation for the day reaches a level equal to market risk component of margin factor for one settlement date (i.e., 1.25% at present) *or* impact of 3 day exchange rate fluctuation, on cumulative positions in the spot window reaches a level equal to market risk component of margin factor for all three days in the spot window (i.e. 3.75% at present)

Withdrawal:

Volatility Margin would be withdrawn after impact of 3 day exchange Rate fluctuation on cumulative positions in spot window falls below 3% and impact of one day exchange rate fluctuation is also at lower than 1%.

3. a) For assessing the impact of 1 day exchange rate fluctuation:

- Intra-day price fluctuation as a difference between High and Low Exchange Rate [Estimator –I]
- Price fluctuation based on the higher of the difference between

  i) FEDAI closing Exchange rate of the previous day and lowest exchange rate of the current day, and

  ii) FEDAI closing Exchange Rate of the previous day and highest Exchange Rate of the current day, [Estimator-II]

- Impact of one day exchange rate fluctuation will be taken as higher of the Estimators I and II.

b) For assessing impact of 3 day exchange rate fluctuation on the positions within the spot window :

- Maximum possible loss for spot positions of USD 1 million each created on the day of assessment and on two previous working days(i.e., on all possible days within the spot window) will be computed by taking the maximum possible loss based on the difference between:

    - Highest exchange rate on the respective date and the lowest Exchange Rate of the current day(maximum possible loss for buy positions), and

    - Lowest exchange rate on the respective date and highest Exchange Rate of the current day (possible maximum loss for sale positions),

  And summing up the total possible maximum loss on each such position [Estimator – III]

4. Moreover, it has been felt that Market Risk Component of margin factor be set at 3 day Value at Risk [at 99% confidence level for observation period of 500 days for each settlement date in the spot window and in multiples of 0.25%]. Further, there should also be a rule based approach in place for increasing or decreasing Market Risk Component of Margin Factor in case of sudden increase in volatility. We propose the under mentioned methodology to be followed while increasing or decreasing Margin Factors as per the situation:

a) If end of the day (over previous day's FEDAI closing rate) or intra-day rate fluctuation is observed to be greater than Market Risk Factor for each settlement date (1.25% at present) for any 3 days in a month, Margin Factor will be increased (by 0.25% or more, as the case may be) and ;

b) After an increase in margin factor, if end of the day (over previous day's FEDAI closing rate) or intra-day rate fluctuation is observed to be lesser than the previous level (i.e. rate applicable before increase) for a month, Margin Factor will be decreased (by 0.25% or more as the case may be).

5. Any suggestions or observations may please be forwarded to CCIL latest by 30th September'08.

Chief Risk Officer