

July 20, 2009

To all members of Securities Segment of CCIL

Securities Segment

Implementation of changes in Valuation methodology, computation of margin factors and imposition of volatility margin

As you are aware, a note on proposed changes in valuation methodology, use of multipliers in computation of margin factors and imposition of volatility margin in securities segment was circulated amongst the members on 31st July'08. Subsequently we conducted a meeting with the user group on 14th Oct'08. Other members who had suggestions to offer were also invited. The user group discussed these issues in detail and a sub-committee with six members of the user group was formed to examine the results closely and provide CCIL with feedback on the proposed processes. Minutes of the meeting were circulated to all members (copy of the minutes of the meeting attached as Annexure 'A').

2. In terms of the decisions taken during the meeting held on 14th October'08, comparative results, i.e. Model Prices, MTM Prices and Margin factors based on NSS yield curve and Prices of SDLs and GOI securities adjusted for illiquidity using LAF/yield spreads etc. for the period from 08th Dec'08 to 03rd Jan'09 and data regarding applicability of volatility margin from 01st to 31st Dec'08 were forwarded to the members on 24th, 26th and 30th Dec'08 and on 01st & 7th Jan'09. These results were also placed on our website for the information of all members.

3. Subsequently, a meeting with the sub-committee of user group was held on 19th Jan'09 to discuss the issues associated with implementation of the proposed processes. In terms of decision taken in the meeting held on 19th Jan'09, results of the security-wise back testing analysis carried out for the period from 2nd Feb '09 to 16th Feb '09 using model prices adjusted for illiquidity adjustment factor were forwarded to the members on 28th Feb'09 for their feed back. Minutes of the meeting were circulated to all the members (Copy of the minutes attached as Annexure 'B')

4. As the proposed changes were agreed upon by the members, as per the decisions taken during the meeting, we propose to change the yield curve to NSS based yield curve, use yield spreads for valuations and use multipliers for arriving at margin factors for illiquid securities etc. These processes are proposed to be implemented w.e.f. **01st Sep'09**. We also propose to introduce the processes for identifying volatility in the securities market for imposition of volatility margin and collection of intra-day MTM margin (at times of unusual volatility).

5. A note detailing the changes being effected is enclosed for your reference (Annexure 'C'). The gist of proposed changes in the processes is as under:

- a) NSS yield curve to be used for valuation and computation of margin factors and hair-cut rates.
- b) Liquidity adjustment factor(LAF)and tenor wise illiquidity spreads to be used in valuation of semi-liquid and illiquid securities (GOI Bonds & SDLs)
- c) YTM based yield spreads polled by FIMMDA to be used in valuation of Floating Rate Bonds(FRBs)
- d) Margin factors to be stepped up by the illiquidity multiplicants
- e) Collection of intra-day MTM margin at times of unusual volatility(new process)
- f) Volatility margin to be imposed based on the volatility in the three highest traded securities (new process).

6. Please revert back in case you require any clarification or have any suggestions on or before **14th August'09**

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Sd/-
Chief Risk Officer

[ANNEX_A_MINUTES OF 14.10.08.pdf](#)

[ANNEX_B_MINUTES OF 19.01.09.pdf](#)

[Annex_C_Change in Risk Management Processes of Sec Segment.pdf](#)