



# CONTENTS

	PAGE
<i>Foreword</i>	<i>I-3</i>
<i>Recommended Reading</i>	<i>I-5</i>
<i>Syllabus</i>	<i>I-7</i>
<i>Chapter-heads</i>	<i>I-11</i>

## PAPER I

### **TREASURY & INVESTMENT MANAGEMENT**

#### **CHAPTER 1 :**

#### **FINANCIAL MARKETS**

<b>1.1</b>	<b>An Overview of Markets and Functions</b>	<b>3</b>
<b>1.2</b>	<b>Classification of Financial Markets</b>	<b>5</b>
<b>1.2.1</b>	<b>Capital Market</b>	<b>5</b>
<b>1.2.2</b>	<b>The Money Market</b>	<b>6</b>
<b>1.2.3</b>	<b>The Foreign Exchange Markets</b>	<b>6</b>
<b>1.2.4</b>	<b>Insurance Markets</b>	<b>7</b>
<b>1.2.5</b>	<b>Mutual Funds</b>	<b>7</b>
<b>1.2.6</b>	<b>Commodity Markets</b>	<b>8</b>
<b>1.3</b>	<b>Role of the Emerging Markets : (BRICS)</b>	<b>11</b>
<b>1.4</b>	<b>Roles and Functions of Participants in the Financial Market</b>	<b>13</b>
<b>1.4.1</b>	<b>Banks</b>	<b>13</b>
<b>1.4.2</b>	<b>Primary Dealers (PDs)</b>	<b>14</b>
<b>1.4.3</b>	<b>Financial Institutions (FIs)</b>	<b>14</b>
<b>1.4.4</b>	<b>Stock Exchanges</b>	<b>14</b>
<b>1.4.5</b>	<b>Brokers</b>	<b>14</b>



## CONTENTS

	PAGE
1.4.6 Investment Bankers (Merchant Bankers)	15
1.4.7 Foreign Institutional Investors (FIIs)	15
1.4.8 Custodians	15
1.4.9 Depositories	16

## CHAPTER 2 :

### MONEY MARKET

2.1	Introduction	17
2.2	Need for the Market	18
2.3	Participants in the Money Market	19
2.3.1	Central Government	19
2.3.2	State Government	19
2.3.3	Public Sector Undertakings	20
2.3.4	Scheduled Commercial Banks	20
2.3.5	Private Sector Companies	21
2.3.6	Provident/Pension Funds	22
2.3.7	General Insurance Companies	23
2.3.8	Life Insurance Companies	23
2.3.9	Mutual Funds	23
2.3.10	Non-banking Finance Companies	23
2.3.11	Primary Dealers (PDs)	23
2.4	Money Market-Instruments	24
2.4.1	Call Money/Notice Money	24
2.4.2	Term Money	26
2.4.3	Bank Fixed Deposits (FDs)	26
2.4.4	Certificate of Deposits (CDs)	27
2.4.5	Commercial Paper (CP)	29
2.4.6	Bill Rediscounting Scheme (BRDS)	32
2.4.7	Inter-bank Participation Certificates (IBPCs)	34
2.4.8	Collateralised Borrowing and Lending Obligation (CBLO)	36

<b>2.4.9</b>	Treasury Bills (T-Bills)	37
<b>2.4.10</b>	Repurchase Agreements (Repos)	37

## **CHAPTER 3 :**

### **CAPITAL MARKET**

<b>3.1</b>	Introduction	48
<b>3.2</b>	Equity Shares	48
<b>3.3</b>	Preference Shares	50
<b>3.4</b>	External Commercial Borrowings (ECB)	51
<b>3.4.1</b>	Forms of ECB	52
<b>3.4.2</b>	Available Routes for Raising ECB	52
<b>3.4.3</b>	Parameters for ECBs	53
<b>3.4.4</b>	Individual Limits	58
<b>3.4.5</b>	Currency of Borrowing	59
<b>3.4.6</b>	Hedging Requirements	60
<b>3.4.7</b>	Security for Raising ECB	60
<b>3.4.8</b>	Additional Conditions	60
<b>3.4.9</b>	Issuance of Guarantee	62
<b>3.4.10</b>	Debt Equity Ratio	62
<b>3.4.11</b>	Parking of ECB Proceeds	63
<b>3.4.12</b>	Parking of ECB Proceeds Abroad	63
<b>3.4.13</b>	Parking of ECB Proceeds Domestically	63
<b>3.4.14</b>	Conversion of ECB into Equity	63
<b>3.4.15</b>	Exchange rate for conversion of ECB dues into equity	64
<b>3.4.16</b>	Procedure of Raising ECB	64
<b>3.4.17</b>	Reporting Requirements	64
<b>3.4.18</b>	Loan Registration Number (LRN)	64
<b>3.4.19</b>	Changes in Terms and Conditions of ECB	65
<b>3.4.20</b>	Reporting of actual Transactions	65
<b>3.4.21</b>	Reporting on account of conversion of ECB into equity	65

	PAGE
3.4.22 Foreign Currency Convertible Bonds (FCCB)	66
3.4.23 Foreign Currency Exchangeable Bonds (FCEB)	66
3.4.24 Refinancing of ECB	66
3.4.25 Powers Delegated to AD category I Banks to deal with ECB cases	67
3.4.26 Compliance with the Guidelines	67
3.5 Framework for Issuance of rupee denominated bonds overseas	68
3.5.1 Form of borrowing	68
3.5.2 Available routes and limits of borrowing	68
3.5.3 Parameters of Borrowing by issuance of rupee denominated bonds	68
3.5.4 Minimum Maturity	68
3.5.5 Eligible Borrowers	68
3.5.6 Recognised Investors	69
3.5.7 All-in-cost	69
3.5.8 End-use Prescriptions	69
3.5.9 Exchange Rate for Conversion	69
3.5.10 Hedging	69
3.5.11 Leverage Ratio	70
3.5.12 Other Provisions	70
3.6 Borrowing and lending in foreign currency by an authorised dealer	70
3.6.1 Borrowing in foreign currency by an authorised dealer	70
3.6.2 Lending in foreign currency by an authorised dealer	71
3.7 Global Depository Receipts (GDRs)	72
3.8 American Depository Receipts (ADRs)	76
3.9 Indian Depository Receipts (IDRs)	76
3.9.1 Legislations governing issue of IDRs	77
3.9.2 Eligibility criteria under IDR Rules and Guidelines	77
3.9.3 Intermediaries involved in issuance of IDRs	77
3.9.4 Requirements for investing in IDRs	78
3.10 When issued securities	80

	PAGE
3.10.1 Mechanics of operation	80
3.10.2 Internal control	81
3.11 Credit linked notes	82

## CHAPTER 4 :

### FOREIGN EXCHANGE (FX) MARKETS

4.1	Introduction	84
4.2	Definitions and exchange rate quotations	85
4.3	Factors Influencing Exchange Rates	97
4.4	Role of banks in the Indian forex market	99
4.5	Relationship with money market operations	101
4.6	International financial Institutions - An overview	103
4.6.1	The World bank group	103
4.6.2	Multilateral development bank	104
4.6.3	Regional development banks	106
4.6.4	Bilateral development banks and Agencies	106
4.6.5	Other Regional financial institutions	106
4.7	Correspondent Banking and NRI accounts	107
4.7.1	Correspondent Banking	107
4.7.2	Non-resident Indians (NRIs) and Persons of Indian Origin (PIOs)	107
4.8	Risks in Foreign trade	116
4.9	Role of Exim Bank, RBI and FEDAI	118
4.9.1	Role of Export-Import Bank of India	118
4.9.2	Role of Reserve Bank of India	119
4.9.3	Role of FEDAI	121
4.10	FEDAI Guidelines and forex valuation	121
4.10.1	FEDAI Guidelines and valuation	121
4.10.2	Revaluation of Mirror account balances	123
4.10.3	Forwards valuation	123



## CONTENTS

	PAGE
4.11 Effects of revaluation	123
4.12 Registered foreign portfolio investors	124

### CHAPTER 5 :

#### DEBT MARKETS AND FIXED INCOME SECURITIES

5.1	Introduction	127
5.2	Terminologies	128
5.3	Types of Bonds	130
5.4	Government of India securities	130
5.5	State Development Loans (SDLs)	132
5.6	Other approved securities	133
5.7	Non-SLR Securities	133
5.8	Public Sector Undertakings (PSU) bonds	133
5.9	Corporate Debentures	135
5.10	Bonds and debentures	137
5.11	Some other aspects of fixed Income Instruments	139
5.12	Bond Dynamics	141
	5.12.1 Factors influencing interest rates	141
	5.12.2 Dynamics	142
	5.12.3 Discounted cash flow and time value of money	143
5.13	Accounting	147
5.14	Valuation	149

### CHAPTER 6 :

#### INTEREST RATE QUOTATIONS AND MARKET TERMINOLOGY

6.1	Introduction	155
6.2	Fixed and Floating Rate of Interest	155
6.3	Simple and compound rate of interest	156
6.4	Yield	157
6.5	Premium & discount	158



	PAGE
6.6 Front end and rear end	159
6.7 Day count conventions	160

## CHAPTER 7 :

### DERIVATIVES - AN OVERVIEW

7.1 Introduction	162
7.1.1 Characteristics of derivatives	162
7.1.2 Functions of derivatives	163
7.1.3 Users of derivatives	163
7.1.4 Salient points	164
7.2 Futures	165
7.2.1 Futures Contract	165
7.2.2 Currency Futures	167
7.2.3 Bond Futures	168
7.2.4 Stock Index Futures	170
7.2.5 Pricing Financial Futures	171
7.2.6 Forward Contract	172
7.3 Forward Rate Agreement (FRA)	172
7.3.1 Market Conventions of FRAs	174
7.3.2 Pricing a forward rate agreement	175
7.3.3 Salient points	177
7.4 Swaps	177
7.4.1 Pricing an Interest Rate Swap (IRS)	179
7.4.2 Types of Interest Rate Swaps	181
7.4.3 Salient Features of RBI Guidelines on IRS	182
7.4.4 Salient Points	183
7.5 Options	183
7.5.1 European & American Style of Options	185
7.5.2 Call options	185
7.5.3 Put options	185



## CONTENTS

	PAGE
7.5.4 'In the money', 'at the money' & 'out of the money' options	187
7.5.5 Covered & Naked calls	188
7.5.6 Intrinsic value of an option	188
7.5.7 Factors that affect the value of an option (Premium)	189
7.5.8 Different pricing models for options	189
7.5.9 Option Greeks	190
7.5.10 Stock Index Options	191
7.5.11 Options on individual Stocks	191
7.5.12 Exotic Options	192
7.5.13 The buyer and seller of an option	192
7.5.14 Value of an Option	193
7.5.15 Interest rate options	194
7.5.16 Option Strategies	197

## CHAPTER 8 :

### TREASURY MANAGEMENT

8.1	Introduction	198
8.2	Sources of profit for Treasury	200
8.3	Treasury Operations : The Global Scenario	201
8.4	RBI Measures	202
8.5	Scope and Functions of Treasury Management	205
8.5.1	Nature of Treasury Assets and Liabilities	205
8.5.2	Objectives of the Treasury	208
8.5.3	Organisational Structure	209
8.6	Integrated Treasury : Cost center and profit center	217
8.6.1	Functions of Integrated Treasury	218
8.6.2	Nature of Integration	219
8.6.3	Benefits of Integration	220
8.6.4	Structure of Integrated Treasury	221



8.6.5	Arbitrage benefit to Treasury	221
8.6.6	Initiatives of Integrated Treasury	221

## **CHAPTER 9 :**

### **LIQUIDITY MANAGEMENT**

9.1.	Objective, Sources and Deployment	222
9.2.	Cash Reserve Ratio (CRR)	224
9.2-1	Computation of DTL	225
9.3	Statutory Liquidity Reserve (SLR)	230
9.3.1	Procedure for computation of SLR	233
9.3.2	Classification and valuation of approved securities for SLR	233
9.3.3	Penalties	233
9.3.4	Return in Form VIII (SLR)	234
9.3.5	Correctness of computation of DTL to be certified by statutory auditors	234
9.3.6	Cost of SLR Maintenance	234
9.4.	Clearing Corporation of India Limited (CCIL) - Netting/Elimination of Exposures	237
9.4.1	Products handled by CCIL are	238
9.4.2	FX-clear	238
9.4.3	FX-swap	239
9.4.4	Network	239
9.4.5	Novation and multilateral netting	240
9.4.6	Margins	240
9.4.7	G-secs	240
9.4.8	Forex	241
9.4.9	Delivery versus Payment III (DVP-III) Settlement for Securities	241
9.4.10	Settlement Guarantee Fund (SGF)	242
9.4.11	Risk Management	242



## CONTENTS

	PAGE
9.4.12 Collateralized Borrowing and Lending Obligation (CBLO)	242
9.5 Real Time Gross Settlement (RTGS)	243
9.5.1 IDRBT as Certifying Authority (CA)	244
9.5.2 Essential Components of RTGS	244
9.5.3 Types of transactions covered under RTGS	245
9.5.4 Functioning of RTGS	245
9.5.5 Indian financial network	245
9.5.6 Structured Financial Messaging System (SFMS)	246
9.5.7 Public Key Infrastructure (PKI)	246

## CHAPTER 10 :

### RISK ANALYSIS AND CONTROL

10.1 Risk analysis and control	248
10.2 Operational risk	250
10.2.1 Mitigation	250
10.3 Financial Risks	251
10.3.1 Credit Risk	251
10.3.2 Liquidity Risk	252
10.4 Market Risk	253
10.4.1 Event Risk	253
10.4.2 Interest Rate Risk (Balance Sheet)	253
10.5 Risk Management : RBI Guidelines/norms	255
10.5.1 Risk Management in Banks	256
10.5.2 Asset-liability Pricing	257
10.5.3 Adding new Products	257
10.6. Forex (market) Risk	258
10.6.1 Open positions and gaps	259
10.6.2 Gap (interest rate/swap) Risk	261
10.6.3 Customer Credit Risk	262
10.6.4 Settlement Risk	262



	PAGE
10.6.5 Country Risk	262
10.6.6 Legal Risk	264
10.7 Operational Risk and Concurrent audit	264

## **CHAPTER 11 :**

### **FRONT OFFICE/MID OFFICE/BACK OFFICE**

11.1 Front-office	265
11.2 Dealing Functions	266
11.3 Mid-office	267
11.4 Back-office operations	267
11.5 Operational clarity	273
11.6 Documentation	273
11.7 Monitoring	275
11.8 Settlement of Transactions	278
11.9 Investment Accounting & Internal Controls	281

## **CHAPTER 12 :**

### **REGULATIONS, SUPERVISION AND COMPLIANCE OF TREASURY OPERATIONS**

12.1 Reserve Bank Guidelines	287
12.1.1 Organizational set up	287
12.1.2 The Dealing Room	289
12.2 Extracts From FIMMDA : Handbook of Market Practices	291
12.2.1 Management Controls	292
12.2.2 Organization of the Dealing Department	292
12.2.3 Know Your Counterparty	293
12.2.4 Recording of Conversations	293
12.2.5 Off-Premise Dealing	293
12.2.6 Dealing Hours	294
12.2.7 Rate Scan	294



## CONTENTS

	PAGE
12.2.8 Conflicts of Interest	294
12.2.9 Rotation of Dealers	295
12.2.10 Confirmations	295
12.3 Dealing procedures and principles	295
12.3.1 Scope	295
12.3.2 Preliminary Negotiation of Terms	296
12.3.3 Firmness of Quotation	296
12.3.4 Delivery of the Securities/Funds	297
12.3.5 Concluding a Deal	298
12.3.6 Passing of Names by Brokers	298
12.3.7 Reporting of Deals on the NDS	299
12.3.8 Oral Confirmations	299
12.3.9 Written Confirmations	300
12.3.10 Settlement of Differences	301
12.3.11 Bank Holidays/Market Disruption	301

### CHAPTER 13 :

#### ROLE OF INFORMATION TECHNOLOGY IN TREASURY MANAGEMENT

13.1 Negotiated Dealing System	302
13.2 Other Trading Platforms/Systems	303
13.3 Straight-Through-Processing (STP)	303
13.4A Settlement	303
13.4B Custody	304

### ANNEXURE 1

PRICE CALCULATIONS : TREASURY BILLS	305
-------------------------------------	-----

### ANNEXURE 2

PRICE CALCULATIONS : FOREX TREASURY	317
-------------------------------------	-----

### ANNEXURE 3

MARKET PRACTICES	350
------------------	-----

## **ANNEXURE 4**

### **TREASURY TERMINOLOGY**

393

## **PAPER II**

### **RISK MANAGEMENT**

## **CHAPTER 1 :**

### **INTRODUCTION TO RISK MANAGEMENT**

- ◆ Background 413
- ◆ The Concept of Risk 418
- ◆ The Changing Forms of Risk 419
- ◆ Characteristics of Risk 420
- ◆ Types of Risk 420
- ◆ Non-Financial Risks 426

## **CHAPTER 2 :**

### **RISK MANAGEMENT PROCESS**

- ◆ Introduction 430
- ◆ Sources of Risk 432
- ◆ Risk Indicators 434
- ◆ The Process 435
- ◆ Measures for Identifying and Controlling Risks 437

## **CHAPTER 3 :**

### **SETTING UP A RISK ORGANIZATION**

- ◆ The Process 447
- ◆ Pre-Requisites 448
- ◆ Fundamentals 450
- ◆ Some Misconceptions 452
- ◆ Comprehensive View on Risk 454

## CHAPTER 4 :

### ASSETS/LIABILITIES MANAGEMENT (ALM)

◆ The Concept	464
◆ Definition From Risk Perspective	464
◆ Banking and Trading Book For Risk Management	465
◆ Interest Rate Risk in the Banking Book (IRRBB)	466
◆ Rate Sensitivity of Assets (RSA) & Liabilities (RSL)	467
◆ Liquidity Risk & Liquidity Gaps	468
◆ Interest Rate Gaps	470
◆ Interest Rate Gap and Variations of the Interest Margin	472
◆ Limitations of Interest Rate Gaps	474
◆ Cumulative Gap	474
◆ Duration Gap	474
◆ Duration Gap Analysis	474
◆ Immunisation	475
◆ Relationship Between MDG And Sensitivity of MVE to Interest Rate Changes	476
◆ Simulation Analysis	477
◆ Managing Interest Rate Risk	477
◆ How ALM Process Differs from Market and Credit Risk Techniques	477
◆ ALM Governance Framework	478
◆ Pre-Requisites for ALM	478
◆ Framework of Policy	480
◆ Asset and Liabilities Committee (ALCO)	491
◆ Activities of ALCO	492
◆ Indian Context	496



## CHAPTER 5 :

### SOME IMPORTANT CONCEPTS

◆ Risk Exposure Analysis	498
◆ Stress Testing	503
◆ The Exposure Document	505
◆ Role of the Board	505
◆ Role of the Risk Manager	506
◆ Role of Internal Audit	506
◆ Risk Based Supervision/Audit (RBS)	507
◆ Open Position	507
◆ Currency Pairs	508
◆ The Players	508
◆ Trading Transactions	509
◆ Types of Prudential Risks	510
◆ Closing out a Position	511
◆ Stop-Loss Limit	512
◆ The Concept	512
◆ Setting Stop-Loss Limits	514
◆ Limitations	515
◆ Duration	516
◆ Modified Duration	517
◆ Convexity	519
◆ Using Convexity (C) and DMOD.	519
◆ RAROC (Risk Adjusted Return on Capital)	520
◆ Auditing Risk Management	526



## CONTENTS

PAGE

### **CHAPTER 6 :**

#### **UNDERSTANDING BASEL ACCORD AND ITS IMPLICATIONS**

◆ Introduction	530
◆ In Retrospect	531
◆ Comparing two Accords	533
◆ Supervisory Review (Pillar 2)	541
◆ Market Discipline (Pillar 3)	543
◆ Decision Areas for Banks	545
◆ Basel II and Role of Information Technology	546
◆ Basel III & its Implications	548
◆ Introduction	548