Roll No……..……..

Membership No……

The Institute of Chartered Accountants of India
Certificate Course Forex & Treasury Management
Evaluation Test Booklet

Test II

22nd January, 2017

Duration- 3 Hours **Total Marks- 100**

INSTRUCTIONS:

1. Please read the instructions carefully given in the question paper and solve it in the space provided.
2. The candidates are not allowed to carry the evaluation test booklet with them. This should be tied up with sheets provided to answer the question Paper.
3. Use Blue/Black pen only.
4. Do not write your Roll No. or Name or other identification other than in the space (perforated) provided on this sheet.
5. Please show Identity Card to the invigilator for verification of your identity, when asked.
6. The candidates may use the simple calculator.
7. In order to get full credit on the problems, the candidates must show all their rough work/ other workings.

_____ _____

(Participant Signature) (Invigilator Signature)

PLEASE RETURN THIS BOOKLET BEFORE LEAVING THE EXAMINATION HALL

Date : 22nd January, 2017

Centre : Noida/ Mumbai/Vadodara/Bangalore/Hyderabad/Chennai/Kanpur/Pune & Sivakasi.

(Do not write your Roll No. and Membership number anywhere in the answer sheet except as mentioned above)

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CERTIFICATION COURSE ON FOREX AND TREASURY MANAGEMENT

Paper -2

SUGGESTED ANSWERS–JANUARY, 2017 EXAM

S. No.	Total Number of Questions	Questions to be answered	Total Marks	Marks Obtained
Multiple Choice - Section A	65	65	65	
Short Notes – Section B	7	5	25	
Case Study – Section C	2	1	10	
Total	**74**	**71**	**100**	

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Disclaimer

The suggested answers contained in this publication constitute ideal answers for various questions. They do not constitute the basis for the evaluation of the candidate's answers in FXTM examinations. These suggested answers are arranged by the Banking, Financial Services and Insurance Committee with a view to assist the candidates pursuing the FXTM Course for their preparation for the Technical Examinations. While due care has been taken in preparation of the answers, if any errors & omission is noticed, the same may be brought to the notice of the Secretary, Banking, Financial Services and Insurance Committee . The Council and Banking, Financial Services and Insurance Committee of the Institute are not responsible in any way for correctness or otherwise of the answers published hereinunder.

Section A

Number of questions: 65

Marks: 65

Multiple choices: Please [✓] mark for the correct answer.

Part A: Answer all questions. **1 mark each**

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1. Hedging exchange rate risk in respect of the market value of overseas direct investments (in equity and loan)

   a. Is not allowed ☐
   b. Allowed but if the contract becomes naked due to shrinking of investment value, it should be immediately cancelled ☐
   c. Allowed but if the contract becomes naked due to shrinking of investment value, it may be allowed to continue at customer's request ☐
   d. Allowed subject to RBI permission ☐

2. While booking a forward contract to a customer,

   a. The currency of the contract has to be the same as that of the underlying ☐
   b. The maturity of the contract has to be the same as that of the underlying ☐
   c. The currency of the contract can be different from that of the underlying if the risk management policy of the corporate customer permits it ☐
   d. Contract in a different currency can be booked subject to RBI permission ☐

3. Where an exporter is bidding for a project export contract, bank can offer FC-INR option contract subject to:

   a. The customer can be resident in India or nonresident ☐
   b. Customer can buy only call option ☐
   c. Customer can buy only put option ☐
   d. Banks can offer only plain vanilla European option ☐

4. Companies can buy cost reduction structures such as simultaneous buy and sell of European options subject to

   a. There is no net receipt of premium ☐
   b. There is no net outflow of premium ☐
   c. Only if they are listed companies ☐
   d. Not being availed to hedge exchange risk arising out of domestically availed FC loans [FCNR B loans] ☐

5. When a customer desires to convert EEFC balance into rupee,

   a. He cannot book a forward contract for such conversion at a future date ☐
   b. He can book a forward sale contract with the bank for such conversion at future date ☐
   c. He can book a forward purchase contract with the bank for such conversion at future date ☐
   d. If such contract is booked, it can be cancelled ☐

6. Hedging based on probable exposure based on past performance is allowed

   a. For importers and exporters of goods and services ☐
   b. Only in the form of forward contracts ☐
   c. If such forward contract is cancelled, the gain or loss is to be shared with the customer ☐
   d. Roll over is allowed of such contracts ☐

7. Who is a market marker for Cross Currency Options (not involving Rupee):

   a. Any AD category 1 bank ☐
   b. AD category 1 bank approved by RBI for this purpose ☐
   c. Any foreign bank ☐
   d. The customer desiring this product ☐

8. Currency futures contracts can be traded on SEBI recognized stock exchanges subject to

   a. The maturity of the contract not exceeding six months ☐
   b. They being USD-INR, EUR-INR, GBP-INR or JPY-INR contracts ☐
   c. The contract shall be quoted and settled in respective FC ☐
   d. The size of the contract is prescribed by the exchange ☐

9. Facility for Hedging Trade Exposures, invoiced in Indian Rupees in India

   a. Is not available ☐
   b. Is needed by nonresident exporter or importer ☐
   c. Is needed by the Indian exporter or importer ☐
   d. Is available subject to RBI permission ☐

10. For a bank, the net open position is arrived at for each currency separately and while aggregating it for each currency, the following is not included

    a. Net spot position
    b. Net forward position
    c. Net options position
    d. Net open position in gold

11. Overall net foreign exchange position of a bank is

    a. The sum of all net short positions
    b. The sum of all net long positions
    c. The sum of all net short positions & net long positions, whichever is higher
    d. The sum of all net short positions & net long positions, whichever is lower

12. The gap limit for a treasurer refers to

    a. Ceiling on the outstanding position at the end of the day
    b. Ceiling on the outstanding position in each time bucket
    c. Ceiling on the outstanding position any time of the day
    d. The exposure limit per each currency

13. The aggregate gap limit [AGL] of a bank is

    a. Fixed by the bank's board
    b. Fixed by RBI
    c. Should not exceed 12 times the total capital of the bank
    d. Decided depending on the trading activity of the bank

14. Swaption is

    a. An option to buy or sell a swap that will become operative at the expiry of the option
    b. Buying or selling of an option that will become operative at the expiry of the swap
    c. An option on a forward contract
    d. An option on a forward sale

15. A call option at a strike of Rs80 is selling at a premium of Rs26 At what price will it break even for the buyer of the option?

a. Rs 94
b. Rs 85
c. Rs 102
d. Rs 106

16. Delta is a measure of:

a. change in the premium with respect to the change in the price of underlying
b. return on the instrument
c. safety of an instrument
d. change in an option value for a unit change in the volatility of the underlying

17. Which of the following options will yield a profit to the purchaser?

a. A call option when the price of the underlying share increases above the option's strike price by an amount greater than the premium paid for the option
b. A call option when the price of the underlying share increases above the option's strike price
c. A put option when the price of the underlying share increases above the option's strike price by an amount greater than the premium paid for the option
d. In all the above cases

18. In a covered call,

a. The writer is long on the underlying asset
b. The writer does not own the underlying asset
c. The investor generally is short on asset but long via option
d. The investor is long on the asset and also long via option

19. Financial Market Infrastructure refers to

a. The infrastructure facilities made available to financial market
b. The financial system including banking system
c. A multilateral system used for the purposes of clearing, settling, or recording financial transactions
d. The clearing system prevailing in the market

20. Under the Basic Indicator Approach, banks must hold capital for operational risk equal to
    a. The average over the previous five years of a fixed percentage of positive annual gross income ☐
    b. The average over the previous three years of a fixed percentage of positive annual gross income ☐
    c. The previous year's positive annual gross income ☐
    d. The average over the previous three years annual gross income ☐

21. In case of an interbank contract if the fixed date delivery is contracted is a holiday, the contract shall be delivered

    a. On the immediate preceding working day ☐
    b. On the immediate succeeding working day ☐
    c. On that day itself since electronic funds movement can take place on holidays ☐
    d. As mutually agreed ☐

22. Negotiated Dealing System is

    a. An electronic platform for facilitating dealing in Government Securities and Money Market Instruments ☐
    b. A system where sale takes place after negotiation ☐
    c. The same as Reuters dealing screen ☐
    d. An electronic system for putting through deals by dealers ☐

23. Which does not fit into the description of Primary Dealer

    a. Merchant bankers to the Government of India ☐
    b. First tier of the government securities market ☐
    c. Second tier of the government securities market ☐
    d. Works in tandem with satellite dealers ☐

24. A member of the Institute of Chartered Accountants of India, carrying out an internal audit activity of a treasury, would apart from other requirements, additionally be governed by [mark the incorrect one]

    a. the requirements of the Chartered Accountants Act, 1949 ☐
    b. the Code of Ethics issued by the Institute of Chartered Accountants of India ☐
    c. other relevant pronouncements of the Institute of Chartered ☐
    d. the code of conduct for dealers ☐

25. Which of the following statement is untrue in the context of guidelines on internal audit of treasury functions of a bank?

a. After completing the preliminary review, the internal auditor performs the procedures outlined in the audit program
b. After completing the procedures outlined in the audit program, the internal auditor performs the preliminary review
c. The internal audit procedures usually test the internal controls and the accuracy of the transactions
d. The audit procedure includes observation

26. In connection with internal audit of treasury functions of banks, the following is true

a. The internal auditor should be independent from the internal control process
b. The internal audit head should not report to any authority below the level of the Board of Directors/Audit Committee
c. The internal auditor should not be assigned the responsibility of performing other accounting or operational functions
d. **All the above**

27. The scope of risk-based internal audit does not include

a. review of the systems in place for ensuring compliance with money laundering controls
b. the guidelines for appraising large credit proposals
c. identifying potential inherent business risks and control risks, if any
d. suggesting various corrective measures and undertaking follow up reviews to monitor the action taken thereon

28. Which is not one of the pillars on which the ALM process rests as per RBI Guidelines

a. ALM risk management system
b. ALM information system
c. ALM organization
d. ALM process

29. Successful implementation of the risk management process require strong commitment on the part of the senior management in the bank

    a. To have risk policies
    b. To adhere to defined tolerance limits
    c. To integrate basic operations and strategic decision making with risk management
    d. All the above

30. Responsibility of ALCO of the bank does not include

    a. According clearance for large value credit proposals
    b. Ensuring adherence to limits set by the board
    c. Deciding business strategy of the bank on the assets & liabilities
    d. Aligning the business with the decided risk management objectives

31. The basic analytical models for ALM analysis and scientific decision making does not include

    a. GAP Analysis Model
    b. Black Scholes Model
    c. Scenario Analysis Model
    d. Value at Risk Model

32. Repricing gaps are calculated

    a. for assets and liabilities of differing maturities
    b. for assets and liabilities with differing interest rates
    c. which will show that a negative gap means assets get repriced before liabilities
    d. which will show that a positive gap means assets get repriced after liabilities

33. Duration used in bond mathematics has the following characteristic

    a. The larger the value of the duration, the more sensitive is the price of that asset or liability to changes in interest rates
    b. The larger the value of the duration, the less sensitive is the price of that asset or liability to changes in interest rates
    c. The larger the value of the duration, the more sensitive is the price of that asset or liability to changes in period
    d. The larger the value of the duration, the less sensitive is the price of that asset or liability to changes in period

34. The liquidity shortfall of one bank can

a. Affect that bank only ☐
b. Affect the entire banking system ☐
c. Affect neighboring banks ☐
d. Affect the Central Banking system ☐

35. For the purpose of ALM, the investments in SLR Securities are considered as

a. Liquid as they are in Government securities ☐
b. Illiquid due to lack of depth in secondary market ☐
c. Excluded category ☐
d. Liquid to the extent of defined percentage ☐

36. In case of Government securities, Defeasance period is

a. The time taken to liquidate the position ☐
b. The shut period ☐
c. The period for which it is held ☐
d. The maturity period ☐

37. The Statement of Structural Liquidity for purpose of ALM shows

a. all cash inflows in the maturity ladder according to the expected timing of cash flows ☐
b. all cash outflows in the maturity ladder according to the expected timing of cash flows ☐
c. all cash inflows & outflows in the maturity ladder according to the expected timing of cash flows ☐
d. the Bank's liquidity position on any given date ☐

38. The interest rate risk to a bank has two perspectives viz:

a. earnings perspective which is immediate impact of changes in interest rates on reported profits ☐
b. earnings perspective which is immediate impact of changes in bank's Market Value of Equity ☐
c. economic value perspective which is immediate impact of changes in interest rates on reported profits ☐
d. economic value perspective which is long range impact of changes in interest rates on reported profits ☐

39. The risk from the earnings perspective can be measured as changes in

a. Net Interest Income
b. Net Interest Margin
c. Net interest revenue
d. a or b above

40. The foreign exchange policy of a corporate does not address

a. Names of authorized traders
b. The marketing strategy involving usage of currency
c. The levels of authority
d. Electronic platform and usage

41. In CDR mechanism, the method of reorganization of the outstanding obligations does not include

a. Increasing the tenure of the loan
b. reducing the rate of interest
c. conversion of equity into debt
d. one time settlement

42. If portable disk players made in China are imported into the United States, the Chinese manufacturer is paid with

a. International monetary credits
b. Dollars
c. yuan, The Chinese currency
d. Euros, or any other third currency

43. In the foreign exchange market, the _____ of one country is traded for the _____Of another country

a. Currency - currency
b. Currency financial instruments
c. Currency goods
d. Goods - goods

44. Which of the following examples definitely illustrates a depreciation of the US dollar?

a. The dollar exchanges for 1 pound and then exchanges for 12 pounds
b. The dollar exchanges for 250 yen and then exchanges for 275 francs
c. The dollar exchanges for 100 francs and then exchanges for 120 yen
d. The dollar exchanges for 120 francs and then exchanges for 100 francs

45. By definition, currency appreciation occurs when

a. The value of all currencies fall relative to gold
b. The value of all currencies rise relative to gold
c. The value of one currency rises relative to another currency
d. The value of one currency falls relative to another currency

46. Given a home country and a foreign country, purchasing power parity suggests that:

a. The home currency will appreciate if the current home inflation rate exceeds the current foreign inflation rate
b. The home currency will depreciate if the current home interest rate exceeds the current foreign interest rate
c. The home currency will depreciate if the current home inflation rate exceeds the current foreign inflation rate
d. The home currency will depreciate if the current home inflation rate exceeds the current foreign interest rate

47. If purchasing power parity were to hold even in the short run, then:

a. Real exchange rates should tend to decrease over time
b. Quoted nominal exchange rates should be stable over time
c. Real exchange rates should tend to increase over time
d. Real exchange rates should be stable over time

48. Interest Rate Parity (IRP) implies that:

a. Interest rates should change by an equal amount but in the opposite direction to the difference in inflation rates between two countries ☐
b. The difference in interest rates in different currencies for securities of similar risk and maturity should be consistent with the forward rate discount or premium for the foreign currency ☐
c. The interest rates between two countries start in equilibrium, any change in the differential rate of inflation between the two countries tends to be offset over the long-term by an equal but opposite change in the spot exchange rate ☐
d. in the long run real interest rate between two countries will be equal e) Nominal interest rates in each country are equal to the required real rate plus compensation for expected inflation ☐

49. A forward currency transaction:

a. Is always at a premium over the spot rate ☐
b. Means that delivery and payment must be made within one business day (USA/Canada) or two business days after the transaction date ☐
c. Calls for exchange in the future of currencies at an agreed rate of exchange ☐
d. Sets the future date when delivery of a currency must be made at an unknown spot exchange rate ☐
e. None of the above is correct ☐

50. If inflation is expected to be 5 per cent higher in the United Kingdom than in Switzerland:

a. Purchasing power parity would predict that the UK spot rate should decline by about 5 per cent ☐
b. The theory of purchasing power parity would predict a drop in nominal interest rates in the United Kingdom of approximately 5 per cent ☐
c. Expectations theory would suggest that the spot exchange rates between the two countries should remain unchanged over the long run ☐
d. The efficient market hypothesis suggests that no predictions can be made under a system of freely floating rates ☐

51. The date of settlement for a foreign exchange transaction is referred to as:

a. Clearing date
b. Swap date
c. Maturity date
d. Value date
e. Transaction date

52. Hedging is used by companies to:

a. Decrease the variability of tax paid
b. Decrease the spread between spot and forward market quotes
c. Increase the variability of expected cash flows
d. Decrease the variability of expected cash flows
e. Increase the variability of tax paid

53. Which of the following is not a type of foreign exchange exposure?

a. Tax exposure
b. Translation exposure
c. Transaction exposure
d. Balance sheet exposure
e. Economic exposure

54. Which of the methods below may be viewed as most effective in protecting against economic exposure?

a. Futures market hedging
b. Forward contract hedges
c. Geographical diversification
d. Money market hedges
e. None of the above

55. When an enterprise has an unhedged receivable or payable denominated in a foreign currency and settlement of the obligation has not yet taken place that firm is said to have:

a. Tax exposure
b. Operating exposure
c. Infinite exposure
d. Accounting exposure
e. Transaction exposure

56. The potential for an increase or decrease in the parent's net worth and reported net income caused by a change in exchange rates since the last consolidation of international operations is a reflection of:

a. Translation exposure
b. Exchange rate exposure
c. Strategic exposure
d. Economic exposure
e. Operating exposure

57. If one anticipates that the pound sterling is going to appreciate against the US dollar, one might speculate by _____ pound call options or _____ pound put options

a. Buying - buying
b. Selling - buying
c. Selling - selling
d. Buying - selling

58. Which of the following is true of foreign exchange markets?

a. The futures market is mainly used by hedgers while the forward market is mainly used for speculating
b. The futures market and the forward market are mainly used for hedging
c. The futures market is mainly used by speculators while the forward market is mainly used for hedging
d. The futures market and the forward market are mainly used for speculating

59. The difference between the value of a call option and a put option with the same exercise price is due primarily to:

a. The greater liquidity of call options
b. The use of continuous as opposed to discrete discounting
c. The differential between the current stock price and the exercise price in present value terms
d. The effect of dividends on the two securities
e. The volatility of the price of the underlying stock

60. Counterparty risk is:

a. The risk of loss when exchange rates change during the period of a financial contract
b. Based on the notional amount of the contract
c. The risk of loss if the other party to a financial contract fails to honor its obligation
d. Present only with exchange-traded options
e. Eliminated by the use of compulsory insurance

61. The impact of Foreign exchange rate on firm is called as

a. Operating Exposure
b. Transaction exposure
c. Translation exposure
d. Business risk

62. Foreign currency forward market is

a. An over the counter unorganized market
b. Organized market without trading
c. Organized listed market
d. Unorganized listed market

63. Forward premium / differential depends upon

a. Currencies fluctuation
b. Interest rate differential between two countries
c. Demand & supply of two currencies
d. Stock market returns

64. If transaction exposure are in same dates, then it can be hedged

a. By purchasing single forward contract
b. By purchasing multiple forward contract
c. Cannot be hedged by forward contracts
d. None of the above

65. Interest rate swaps are usually possible because international financial markets in different countries are

a. Efficient
b. Perfect
c. Imperfect
d. Both a & b

Answer (objective type 1-65)

1. C	**2.C**	**3.D**	**4.A**	**5.C**	**6.A**	**7.B**	**8.B**	**9.B**	**10.D**
11. C	**12.B**	**13.A**	**14.A**	**15.D**	**16.A**	**17.A**	**18.A**	**19.C**	**20.B**
21. A	**22.A**	**23.C**	**24.D**	**25.B**	**26.D**	**27.B**	**28.A**	**29.D**	**30.A**
31. B	**32.A**	**33.A**	**34.B**	**35.B**	**36.A**	**37.C**	**38.A**	**39.D**	**40.B**
41. C	**42.C**	**43.A**	**44.D**	**45.C**	**46.C**	**47.D**	**48.B**	**49.C**	**50.A**
51. D	**52.D**	**43.A**	**54.C**	**55.E**	**56.A**	**57.D**	**58.C**	**59.C**	**60.C**
61. A	**62.A**	**63.B**	**64.A**	**65.C**					

Section B
Number of questions: 7
Marks: 25

Note: Answer any five questions. Each answer will carries 5 marks
[Unrelated answers & answers exceeding the brief will attract negative marks]

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1. Reserve Bank of India would like to cut Repo Rate by 50 Bps. As a Corporate Treasurer of State Bank of India (SBI) what would be the impact in your Books.

2. If you are acting as a Governor of Reserve Bank of India define Sterilization Process and how Sterilization helps RBI both the ways.

3. Define the complete cycle of Aggregate Gap Limits (AGL) assuming you are on the board of JP Morgan Chase Risk Management Committee.

4. You are acting as a Foreign Exchange Trader for Citi Bank, India. Define NOP (Net Overnight Position) with respect to your FX Positions.
5. Define various methods adopted under Assets & Liability Management (ALM)?

6. Define the complete Steps of Strategic Debt Restructuring (SDR) performed by RBI to mitigate NPA in books.

7. Define various types of Swaps a Corporate Treasurer can take to mitigate the impact of Interest Rate in the books?

Answer:-

Short Answer 1:- As a Corporate Treasurer of State Bank of India the biggest impact would be on the lending Cost from Reserve Bank of India as they are cutting Repo Rates. SBI would also reduce the funding rate for its borrowers so Net Interest Margin would intact. At the same time I would try and sold out all the Bonds who are already identified as Available for Sale and Held for Trading and try and pass MTM Gains in by books. Rest all Bonds who are identified as Held till maturity would continue to be in the Balance Sheet.

Short Answer 2:- Sterilization is a process by Central Banks whereby they would manage two things at the same time which is Liquidity, FX Rates. In case of high depreciation in local currency Central Banks would sell $ from its FX Reserves and use that liquidity to buy back funds henceforth they would be able to manage both FX volatility as well as Liquidity Management.

In case of sudden appreciation in local currency Central Banks would issue Bonds and use the same liquidity to buy $ in that sense they would be able to manage high currency as well as Liquidation process.

Short Answer 3:- Aggregate Gap Limit is nothing but the aggregate of all Individual limits. An Individual Gap limit refers to net overbought or oversold position in $ terms by an individual bank. Take an example: Today is a working date and JPM Chase India left with GBP X Mn, CHF X Mn, USD X Mn, and INR X1 Mn in their books as overbought position. Conversion of everything in $ terms at the end of the day is known as IGL. While the sum of all of IGL of respective days is known as AGL. Pls note that both IGL, AGL is decided by both Central Bank as well as ALCO Committee of the Bank. Both IGL, AGL keeps changing as per the volatility in FX markets.

Short Answer 4:- The number of currency positions a trader can carry over from one trading day until the next. The central bank that regulates the bank or financial institution where the positions are held sets the overnight limit. These limits are reviewed on an ongoing basis. Overnight limits are preventative measures enacted by central banks to keep financial institutions from accumulating more currency exposure than can be hedged by the close of the trading day. This also has the effect of making financial institutions keep a closer eye on exposure to exchange rate movements throughout the day. Central banks can also set intraday limits to mitigate risk in the foreign exchange market.

Short Answer 5:- Asset Liability Management (ALM) can be defined as a mechanism to address the risk faced by a bank due to a mismatch between assets and liabilities either due to liquidity or changes in interest rates. Liquidity is an institution's ability to meet its liabilities either by borrowing or converting assets. Apart from liquidity, a bank may also have a mismatch due to changes in interest rates as banks typically tend to borrow short term (fixed or floating) and lend long term (fixed or floating).

A comprehensive ALM policy framework focuses on bank profitability and long-term viability by targeting the net interest margin (NIM) ratio and Net Economic Value (NEV), subject to balance sheet constraints. Significant among these constraints are maintaining credit quality, meeting liquidity needs and obtaining sufficient capital.

An insightful view of ALM is that it simply combines portfolio management techniques (that is, asset, liability and spread management) into a coordinated process. Thus, the central theme of ALM is the coordinated – and not piecemeal – management of a bank's entire balance sheet.

Although ALM is not a relatively new planning tool, it has evolved from the simple idea of maturity-matching of assets and liabilities across various time horizons into a framework that

includes sophisticated concepts such as duration matching, variable rate pricing, and the use of static and dynamic simulation.

Various methods are GAP like Cumulative Gap Model, Duration GAP Model Immunization

Short Answer 6:- Strategic debt restructuring is a new mechanism introduced by the RBI in order to deal with NPAs by helping banks t0 recover their loans by taking control of the distressed listed companies.

Mechanism: A consortium of lenders (Joint Lenders Forum) converts a part of their loan in an ailing company into equity, with the consortium owning at least 51% stake. This will help banks and financial institutions to more easily recover NPAs

It has been observed that in many cases of restructuring of accounts, borrower companies are not able to come out of stress due to operational/ managerial inefficiencies despite substantial sacrifices made by the lending banks. In such cases, change of ownership will be a preferred option. Henceforth, the Joint Lenders' Forum (JLF) should actively consider such change in ownership under the above Framework issued vide the circular dated February 26, 2014.

RBI circular states that both under JLF and CDR mechanism, the restructuring package should also stipulate the timeline during which certain viability milestones (e.g. improvement in certain financial ratios after a period of time, say, 6 months or 1 year and so on) would be achieved. The JLF must periodically review the account for achievement/non-achievement of milestones and should consider initiating suitable measures including recovery measures as deemed appropriate. With a view to ensuring more stake of promoters in reviving stressed accounts and provide banks with enhanced capabilities to initiate change of ownership in accounts which fail to achieve the projected viability milestones, banks may, at their discretion, undertake a 'Strategic Debt Restructuring (SDR)' by converting loan dues to equity shares, which will have the following features:

At the time of initial restructuring, the JLF must incorporate, in the terms and conditions attached to the restructured loan/s agreed with the borrower, an option to convert the entire loan (including unpaid interest), or part thereof, into shares in the company in the event the borrower is not able to achieve the viability milestones and/or adhere to 'critical conditions' as stipulated in the restructuring package. This should be supported by necessary approvals/authorizations (including special resolution by the shareholders) from the borrower company, as required under extant laws/regulations, to enable the lenders to exercise the said option effectively. Restructuring of loans without the said approvals/authorizations for SDR is not permitted. If the borrower is not able to achieve the viability milestones and/or adhere to the 'critical conditions' referred to above, the JLF must immediately review the account and examine whether the account will be viable by effecting a change in ownership. If found viable under such examination, the JLF may decide on whether to invoke the SDR, i.e. convert the whole or part of the loan and interest outstanding into equity shares in the borrower company, so as to acquire majority shareholding in the company;

Provisions of the SDR would also be applicable to the accounts which have been restructured before the date of this circular provided that the necessary enabling clauses, as indicated in the above paragraph, are included in the agreement between the banks and borrower;

The decision on invoking the SDR by converting the whole or part of the loan into equity shares should be taken by the JLF as early as possible but within 30 days from the above review of the account. Such decision should be well documented and approved by the majority of the JLF members (minimum of 75% of creditors by value and 60% of creditors by number);

In order to achieve the change in ownership, the lenders under the JLF should collectively become the majority shareholder by conversion of their dues from the borrower into equity. However the conversion by JLF lenders of their outstanding debt (principal as well as unpaid interest) into equity instruments shall be subject to the member banks' respective total holdings in shares of the company conforming to the statutory limit in terms of Section 19(2) of Banking Regulation Act, 1949;

Post the conversion, all lenders under the JLF must collectively hold 51% or more of the equity shares issued by the company;

The share price for such conversion of debt into equity will be determined as per the method given in paragraph 4 of this circular;

Henceforth, banks should include necessary covenants in all loan agreements, including restructuring, supported by necessary approvals/authorizations (including special resolution by the shareholders) from the borrower company, as required under extant laws/regulations, to enable invocation of SDR in applicable cases;

The JLF must approve the SDR conversion package within 90 days from the date of deciding to undertake SDR;

The invocation of SDR will not be treated as restructuring for the purpose of asset classification and provisioning norms;

On completion of conversion of debt to equity as approved under SDR, the existing asset classification of the account, as on the reference date indicated at para 4(ii) below, will continue for a period of 18 months from the reference date. Thereafter, the asset classification will be as per the extant IRAC norms, assuming the aforesaid 'stand-still' in asset classification had not been given. However, when banks' holding are divested to a new promoter, the asset classification will be as per the para 3(xiii) of this circular;

Banks should ensure compliance with the provisions of Section 6 of Banking Regulation Act and JLF should closely monitor the performance of the company and consider appointing suitable professional management to run the affairs of the company;

JLF and lenders should divest their holdings in the equity of the company as soon as possible. On divestment of banks' holding in favor of a 'new promoter', the asset classification of the account may be upgraded to 'Standard'. However, the quantum of provision held by the bank against the said account as on the date of divestment, which shall not be less than what was held as at the 'reference date', shall not be reversed. At the time of divestment of their holdings to a 'new promoter', banks may refinance the existing debt of the company considering the changed risk profile of the company without treating the exercise as 'restructuring' subject to banks making provision for any diminution in fair value of the existing debt on account of the refinance. Banks may reverse the provision held against the said account only when all the outstanding loan/facilities in the account perform satisfactorily during the 'specified period' (as defined in the extant norms on restructuring of advances), i.e. principal and interest on all facilities in the account are serviced as per terms of payment during that period. In case, however, satisfactory performance during the specified period is not evidenced, the asset classification of the restructured account would be governed by the extant IRAC norms as per the repayment schedule that existed as on the reference date indicated at para 4 (ii) below, assuming that 'stand-still' / above upgrade in asset classification had not been given. However, in cases where the bank exits the account completely, i.e. no longer has any exposure to the borrower, the provision may be reversed/absorbed as on the date of exit;

Short Answer 7:- The following are the types of Swaps Corporate Treasurer can be used to hedge Interest Rate Exposures in the books.

- $ Swaps
- Reverse $ Swaps
- Overnight Index Swaps (OIS)
- Constant Maturity Treasury Swaps (CMS)
- Principal Only Swaps (POS)
- Coupon Only Swaps (COS)
- Cross Currency Interest Rate Swaps (CCIRS)
- Libor Swaps
- Libor Fiat Swaps

Section C

Number of questions: 2

Marks: 10

Note: Case Studies. Answer any one. Max 10 marks

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1. You are acting as a VP Finance of Indigo Airlines who is planning to take $ 100 Mn of long term funds in your books. You would like to go with Citi Bank for ECB (External Commercial Borrowings) for 2 Years but 2 months from now. Define the role of Forward Rate Agreement (FRA) and how you would go with FRA. Assuming Credit Spread is 0 for Indigo.

2. As a Portfolio Manager what all are the options available with you in Indian Fixed Income Markets to invest your funds covering short term to long tenor period. Define also the role of Carry Trades you as a Portfolio Manager can perform in India.

Answers:-

Case Study Answer 1:- As we understand that Indigo would be taking the loan after 2 months however. We understand that Credit Spread is Zero for Indigo henceforth there is a probability that Libor rates would inch up henceforth they would go with an Interest Rate Derivatives which is Forward Rate Agreement (FRA).

As we understand that the maximum tenor of Forward Rate Agreement is 12X24 which 12 months from now for 12 months. In this case Indigo would buy FRA which would be 1X13 which is 1 month from now for 12 months. Using the same they would be able to save themselves from the cost in case Libor would inch up after 1 month when Indigo would take the loan.

Take an example: - Assuming at the onset 1X13 is trading at 3% and Indigo is expecting Libor would move up so they would be taking FRA at 3%. After 1 month Libor inched up and 1X13 traded at 4%. In that sense Indigo would get compensated by (4%- 3%)* $ 100 Mn. FRA would able to help Indigo saving cost when they would actually take up the loan.

Case Study Answer 2:- As a Portfolio Manager the following are the options:-

- Treasury Bills – 91,182,365 Days
- Cash Management Bills
- Treasury Notes – 10 Years
- Medium Term Notes
- Treasury Bonds
- Principal Protected Securities
- Term Deposits
- Money Market Mutual Funds
- Debt Mutual Funds
- Duration Mutual Funds
- Income Mutual Funds

As a Portfolio Manager you are having right to invest either in Discounted instruments or Long term Instruments as stated above. In case of discounted instruments the tenor of the investments would be till 1 Year while in the case of long tenor you can invest up to 30 years.

In terms of Carry Trades you would act as a Sub Account of FII whereby you would invest INR receipts in India using aforesaid instruments. Post maturity INR receipts would convert into $ terms and repatriate $ to United States.