

Bond Forwards

This Product Disclosure Statement is in reference to RBI Circular Master Direction – Reserve Bank of India (Market-makers in OTC Derivatives) Directions, 2021 (as updated from time to time).

This document contains standard information about the product which may enable the user to determine if the product will meet its hedging needs and to facilitate comparison with other products.

Features

A bond forward is a rupee interest rate derivative contract in which one counterparty (buyer) agrees to buy a specific government security from another counterparty (seller) on a specified future date and at a price determined at the time of the contract. In summary, it is a forward contract in government securities undertaken in the OTC markets. Bond Forwards may be cash-settled or physically-settled on the settlement date. In cash settlement, the amount based on the difference between the contracted Price and Settlement Price multiplied by the amount of bond notional for the specific settlement date is settled. In physical settlement, the seller transfers the underlying government security to the buyer, against the receipt of the contracted price from the buyer.

Sample features of a Bond Forward contract for a counterparty in Insurance Industry:

Life insurance companies offer a wide range of insurance products including term plans, income protection plans, pension plans, saving and investment plans. Certain insurance products offered by them allow for guaranteed returns to customers, some offer market linked returns and while others only offer an insurance cover. As part of its regular course of business, they collect premiums from customers and invest these premiums in accordance with the IRDAI guidelines. Given the nature of products offered to customers and the investment strategy adopted, they are exposed to interest rate risk.

Bond Forward transactions enable life insurance companies to lock-in the yield on the government security and thereby mitigate the guarantee and re-investment risk of their business.

Benefits

This product allows counterparties to lock in yields on the government security and thereby eliminating interest rate risks.

Building Blocks:

The building blocks of the transaction are:

- (1) Spot Price of the underlying exposure; and
- (2) INR Overnight Index Swap curve for the tenor of the forward contract

The mark-to-market value of the product is determined by the value of different parameters reflecting the market condition at that time, as well as the terms and tenor of the product (which may have been impacted by the market movements since the inception of the purchase of the product).

Costs and fees, including break-up and details:

The Bond Forward consists of market cost which is determined through Bid/Offer spread of building blocks, tenure of the forward contract, notional, administrative costs, Capital charge and transaction handling charges

An Illustration how product works

Coupon in (%)	Bond Forward Maturity	Notional Amount (in Cr)	Termination Date	Forward Yield (%)	Forward Purchase Dirty Price
6.64%	29-09-2027	100.0	08-09-20XX	7.0795%	99.3074

On the maturity date, as per agreed terms, the Bank and client either gross settle by physical delivery of the underlying specific government security or net settle the amount equivalent to difference between Reference Security Price and Forward Reference Price. In case of net settlement, If Reference Security Price is less than Forward Reference price then Bank pays the client the difference between two and vice versa. The amount is calculated as below:

Net Settlement Amount: Principal Amount * (Forward Reference Price -Reference Security Price) / 100

Gross Settlement: Physical delivery of the underlying government security against the receipt of Forward Reference Price

Pay-off Profile

Scenarios at Various Reference Yields	Forward Purchase Price	Reference Security Price on maturity	Gain/(Loss) in INR for client
-20 bps	99.3074	103.3465	4.0391
-10 bps	99.3074	102.6293	3.3219
10 bps	99.3074	101.9184	2.6110
20 bps	99.3074	101.2138	1.9064

Risks

1. Price Risk
 - a) Bond price: Fluctuations in MTM due to changes in interest rates, spreads & liquidity may impact bond forward valuation
 - b) OIS curve: Shift in discounting rates may affect present values and margin requirements
2. Cash Outflow Risk
 - a) Daily Variation Margin settlements: Margin calls may be triggered by sudden market movements
 - b) On unwinds: Early termination may require significant cash outflow
 - c) On settlement: In case of net settlement, final cash settlement may be sizeable if market moves against the client
3. Liquidity Risk
 - a) Liquidity of underlying bond: Wide bid-ask spreads/ low volumes/ illiquidity in the market

Terms and conditions: The terms and conditions applicable for booking/termination will be guided by deal term sheet/sanction letter/ISDA document.