



बीमा विनियामक और विकास प्राधिकरण  
**INSURANCE REGULATORY AND  
DEVELOPMENT AUTHORITY**

Ref: IRDA/F&I/INV/CIR/ <sup>247/11</sup> /2012

27<sup>th</sup> November, 2012

The CEOs of all Insurers

**Sub: Investments in Credit Default Swaps (CDS)**

1. The Reserve Bank of India, vide notification no.IDMD.PCD.No.5053/14.03.04/2010-11 dated May 23, 2011, has issued the 'Guidelines on Credit Default Swaps (CDS) on Corporate Bonds' effective from October 24, 2011. The said guidelines inter alia, provide for participation as "Market maker" and "Users" by the Insurers subject to the approval of the IRDA.
2. IRDA prepared draft exposure draft and invited public comments by placing the draft on its website [www.irda.gov.in](http://www.irda.gov.in) on 3<sup>rd</sup> August, 2012. The comments were received from various stake holders including Insurance Companies, Regulators, market participants etc. After examining these comments in detail, the draft guidelines are suitably modified as follows:
  - A. Insurers are allowed only as "Users" (protection buyers) of CDS subject to the following:
    - i. The CDS are permitted as a "hedge" to manage the Credit Risk covering the credit event. The category of the investment will not change pursuant to buying CDS on such underlying.
    - ii. CDS will be allowed only on listed corporate bonds as reference obligations. CDS can also be bought on unlisted but rated bonds of Infrastructure companies. Besides, unlisted/unrated bonds issued by the SPVs set up by the infrastructure companies are also eligible as reference obligation as permitted in the circular dated 23<sup>rd</sup> May, 2011.
    - iii. On purchase of protection, the exposure on reference entity shall shift to the protection seller to the extent of protection purchased and Regulation 3,4 and 5 of the IRDA (Investment) Regulations, 2000 shall apply. However, such shift of exposure to protection seller happens only in the


case of credit event in case of reference entity/underlying of CDS is an investment in Infrastructure sector.

- iv. CDS shall not be purchased
    - a. On Reference Asset belonging to the promoter group and no CDS transaction shall be made between entities belonging to Promoter Group.
    - b. On short term instruments with original maturity up to one year such as Commercial Papers, Certificate of Deposit, Non-Convertible debentures with original maturity of less than a year etc.
    - c. On The obligations such as asset-backed securities/mortgage-backed securities, convertible bonds and bonds with call/put options, CLOs, CDOs or any other pool of assets/loans.
  - v. All other norms pertaining to the eligibility norms for the counter party to the User (Market-maker), Reference Obligation, requirement of underlying, conditions while exiting the CDS transactions by Users, Credit events, settlement methodologies, documentation, pricing/valuation methodologies, other requirements and Accounting norms etc. are as prescribed by RBI vide the aforesaid circular dated 23<sup>rd</sup> May, 2011.
- B. Insurers shall enter into Master Agreement for CDS with counterparties as issued by FIMMDA. Such agreements may have additional clauses to suit the specific requirements of the Insurer provided such clauses are more stringent than the clauses prescribed by FIMMDA. The Investment Committee should review such additional clauses on continuous basis.
- C. The Board of the Insurer shall amend its Investment Policy and put in place necessary Risk Management Frame work covering, *interalia*, the following:
- a) Types of Assets on which Protection can be bought
  - b) Counterparties from whom CDS can be bought and limits on the counter parties
  - c) Valuation norms
  - d) Reporting and monitoring norms
  - e) Stress testing on the capability of the counterparty to meet the obligation at periodic intervals
  - f) Margins applicable (Margins should be in cash or Govt. securities). Such margins collected should be not part of Investment Assets and Insurer should act as 'trustee' of such margins.
  - g) Settlement of MTM obligations

- h) MIS, exception reporting
- i) Necessary systems and controls prescribed for User in line with risk management architecture provided in the aforesaid RBI circular
- j) Review of the policy at periodic intervals in line with the Investment policy

The concurrent Auditor should confirm that the above requirements have been incorporated in the investment policy before the Insurer undertaking transaction in CDS. The certificate issued by the Concurrent Auditor, shall be filed with the Authority.

- D. All CDS transactions shall be reported to the Investment Committee, Audit Committee on a quarterly periodicity.
- E. The Concurrent Auditor shall issue a certificate to the effect that all CDS transactions for the Quarter complies with the norms prescribed by RBI and the Authority and such certificate shall be filed on quarterly basis.
- F. CDS as per the valuation for the unexpired protection period are shown as part of respective category of underlying in the pattern of investments. If the same is part of Approved Investments, the CDS are to be reported under Approved Investments under category code ECDS and as OCDS, if the underlying is part of Other Investments.
- G. Insurer shall file quarterly report on the CDS in the format as per the *Annexure A*.

  
(R. K. Nair)  
Member (F&I)

## CDS transactions

|                     |  |
|---------------------|--|
| Name of the Insurer |  |
| Quarter- Year       |  |

## i. Details of CDS, counter party wise

| S.No. | Name of the Counter Party | Tenor of CDS | FV of the underlying | Tenor of the underlying | Notional Amount | Spread (bps) | Net Position | Margin Held |
|-------|---------------------------|--------------|----------------------|-------------------------|-----------------|--------------|--------------|-------------|
|       |                           |              |                      |                         |                 |              |              |             |
|       |                           |              |                      |                         |                 |              |              |             |
|       |                           |              |                      |                         |                 |              |              |             |
|       |                           |              |                      |                         |                 |              |              |             |
|       |                           |              |                      |                         |                 |              |              |             |
|       |                           |              |                      |                         |                 |              |              |             |

## ii. Details of CDS, reference entity wise

| S.No. | Name of the reference entity | Tenor of CDS | FV of the underlying | Tenor of the underlying | Notional Amount | Spread (bps) | Net Position | Margin Held | Approved/Other Inv. |
|-------|------------------------------|--------------|----------------------|-------------------------|-----------------|--------------|--------------|-------------|---------------------|
|       |                              |              |                      |                         |                 |              |              |             |                     |
|       |                              |              |                      |                         |                 |              |              |             |                     |
|       |                              |              |                      |                         |                 |              |              |             |                     |
|       |                              |              |                      |                         |                 |              |              |             |                     |
|       |                              |              |                      |                         |                 |              |              |             |                     |
|       |                              |              |                      |                         |                 |              |              |             |                     |

## iii. Details of reference assets wherein credit event occurred and status of fulfillment of commitment by the Market Maker.