Forward Rate Agreement

This Product Disclosure Statement is in reference to RBI Circular dated 16.09.2021, Master Direction – Reserve Bank of India (Market-makers in OTC Derivatives) Directions, 2021.

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 forward Rate Agreement (FRA) is an over-the-counter contract between parties that determines the fixed rate of interest to be paid or received beforehand, based on a specified principal amount. The purpose of the FRA is to hedge risk of lower yields of the reference obligations in the future. The FRA locks in the yields of the Reference obligations and thereby hedges the risk of lower yields in the future.

Sample features of a FRA 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.

By entering into Forward Rate Agreements ("FRA") transactions it 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 Insurance Companies to lock in yields and thereby eliminating interest rate risks.

<u>Building Blocks:</u>

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 rate agreement

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 remaining 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 FRA cost consists of market cost which is determined through Bid/Offer spread of building blocks, tenure of the FRA, notional, administrative costs, Capital charge and transaction handling charges.

An Illustration how product works

Coupon in (%)	Maturity	Notional Amount (in Cr)	Termination Date	Forward Yield (%)	Forward Purchase Dirty Pri
7.5	10-08-2034	10.0	08-09-20XX	7.969%	96.8535
7.5	10-08-2034	45.0	08-09-20XX	8.4742%	93.3724
7.5	10-08-2034	72.0	08-09-20XX	9.0277%	90.1674
7.5	10-08-2034	80.0	08-09-20XX	9.6318%	87.1647
7.5	10-08-2034	40.0	08-09-20XX	10.3771%	84.1116

On FRA maturity date, the Bank and client net settle the amount equivalent to difference between Reference Security Price and Forward Purchase Price. If Reference Security Price is more than Forward Purchase price then Bank pays the client the difference between two and vice versa. The amount is calculated as below:

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

Pay-off Profile

Scenarios at Various Referen Yields	Forward Purchase Price	Reference Securi Price	Gain/Loss in INR for client
-20 bps	99.9918	111.9069	11.9151
-10 bps	99.9918	110.9248	10.933
10 bps	99.9918	108.9951	9.0032
20 bps	99.9918	108.0471	8.0553

Risks

(1) Interest rate not moving as anticipated by the Insurance Company

(2) Cash flows via Premium received by Insurance Companies if substantially lower than their expected calculations.

(3) Liquidity risk: Low volumes or illiquidity in the market

(4) Bid-offer spreads in case of unwind.

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