

Date: 15th September 2021

All Members/Users/Market Participants

Risk Management Tools- Swaptions

On 17th August 2021, the first day of the launch of "Interest Rate Swaption" product, there have been 6 trades with volume of Rs.700 crores as per data disseminated by CCIL on their website. This is a milestone event for the development on options market for the India Fixed income market. The success of this product rollout goes to all member banks, CCIL and FBIL and the continued guidance and support of the regulator.

Risk management for users both corporates and investors had largely been confined to just linear interest rate instruments like swap and forward rate agreement since 1999. However, the capital market had progressed significantly with bonds being raised by corporates in India with calls and put options. Many of the banks have also moved to price customer loans linked to external benchmarks to enable better interest rate transmission. The evolution of these products necessitated development of the risk management tools that can be used by users to better manage interest volatility.

A swaption contract gives the buyer the right, but not the obligation, to enter into an interest-rate swap deal. Apart from the direct usage of the product to protect against change in interest rates this will also enable development of other interest products like caps and floors. Corporates who are borrowing at a floating rate can use these products to protect themselves from adverse movements in interest rates while retaining flexibility to participate in lower rates. Similarly, the enablement of the product will help issuers and investors to hedge the risk of callable and puttable bonds eg if a borrower issues a bond with a put option, in a rising interest rate scenario they runs the risk of the put option being exercised. Issuers can offset the same by entering into a swaption contract to benefit from rise in yields. The reverse is also true for an investor investing in a callable bond and feels the need to protect himself from a falling interest rate scenario. The products would also allow insurance companies and asset managers to manage their investments more efficiently once their regulator approves the usage of these products.

Pls find attached link to the swaption circular

https://www.fimmda.org/Uploads/general/Operational_Guidelines_for_Swaptions_26062021.pdf

Regards,

G. Ravindranath
CEO, FIMMDA