

November 26, 2004

**STATE BANK ALLOWS BANKS / DFIs TO  
UNDERTAKE FINANCIAL DERIVATIVES BUSINESS**

The State Bank of Pakistan has decided to allow banks / DFIs, that meet the requisite eligibility criteria, to undertake the financial derivatives business under the Financial Derivatives Business Regulations (FDBR) formulated by it (SBP).

The proposed regulatory framework stipulates necessary operational and risk management standards for derivatives business, keeping in view the higher level of inherent risk. From now on, banks / DFIs that want to undertake derivatives transactions will be required to get approval from the SBP for an Authorized Derivative Dealer (ADD) or Non-Market Maker Financial Institution (NMI) status and will then be allowed to undertake derivatives business within the framework envisaged in the FDBR.

The State Bank had recently allowed Over the Counter (OTC) financial derivatives in Pakistan, under which banks were permitted to undertake Interest Rate Swap (IRS), Foreign Currency (FX) Option and Forward Rate Agreement (FRA) on the basis of transactional approval from SBP. Such prior approvals will no longer be needed for the vanilla IRS, FX Options and FRAs, once a bank or DFI is granted an ADD or NMI status by the SBP.

It may be pointed out that the OTC financial derivatives has undergone tremendous growth throughout the world during the last decade as the derivatives have become extremely popular for hedging risks as well as for profit making. The State Bank's decision to allow banks / DFIs to undertake the financial derivatives business is to concurrently develop the FX market in Pakistan and to provide a risk hedging mechanism to the market participants.

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