Proposed Margining and Collateral Solution for Non-Centrally Cleared Derivative (NCCD) Trades

Consultation Paper

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THE CLEARING CORPORATION OF INDIA LIMITED

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Introduction:

1. Clearing Corporation of India Limited (CCIL) has created a robust market infrastructure for servicing the OTC market space in the Indian jurisdiction for over two decades and has demonstrated its capabilities in successfully running various Payment Systems for Government Securities, Forex, Money market and Derivatives catering to the requirements of the Market Players and other stakeholders. As a critical Financial Market Infrastructure (FMI) closely regulated by RBI, it has created systems and processes in line with the growing requirements of Central Clearing and Settlement functions in the Indian OTC market.

2. CCIL acts as a Central Counterparty (CCP) for secondary market transactions (outright, market repo and triparty repo) in Government Securities, Foreign exchange and Derivatives markets. As a central counterparty, it mitigates the counterparty risk in the system through robust margining processes. Reserve Bank of India granted CCIL the status of a Qualified Central Counterparty (QCCP) in January 2014.

3. As a Financial Market Infrastructure (FMI), CCIL adheres to the Principles for Financial Market Infrastructures (PFMIs) issued by the Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO). CCIL is also assessed by RBI based on compliance with the PFMI for Central counterparty.

4. Currently, CCIL is offering CCP services for USD INR Forex Forwards and Rupee Derivatives (IRS trades for MIBOR-OIS and MIFOR) to the market participants. It has necessary technical and functional expertise in ‘Valuation’ and ‘Margining’ of OTC derivative trades. Collateral management, incidental to Clearing and Settlement functions, is also being handled by CCIL.

5. CCIL also operates a Trade Repository (TR), where the market participants report all their Inter Bank and Client OTC derivative transactions. CCIL has provided necessary infrastructure for reporting/monitoring and the same has now become an integral part of this market.

6. In addition to providing the TR services, CCIL also provides value added services to its Members by way of multilateral settlement of Rupee IRS trades (on a non-

guaranteed basis), portfolio compression of Fx Forward and Rupee IRS trades and life cycle management on other non-cleared OTC derivative trades.

7. The market infrastructure provided by CCIL has helped the Indian OTC market in achieving multi fold increase in volume over a period of time.

PROPOSAL

Globally, the infrastructure for the Uncleared Margin Regulations (UMR) covering Variation and Initial Margin requirements for non- Centrally Cleared Derivative (NCCD) trades have been created in many jurisdictions.

1. Recently, the Reserve Bank of India has issued the undernoted directions relating to Margining for Non Centrally Cleared Derivatives (NCCDs) namely:

i. Master Direction – Reserve Bank of India (Variation Margin) Directions, 2022 dated June 1, 2022

ii. Master Direction – Reserve Bank of India (Margining for Non-Centrally Cleared OTC Derivatives) Directions, 2022 – Draft dated June 16, 2022

iii. (“I and ii are collectively referred as Directions in this Consultation Paper”)

2. In terms of the directions, RBI has provided thresholds for Aggregate Average Notional Amount (AANA) of NCCDs beyond which the market participants, known as Covered Entities, would be required to calculate Variation Margin (VM) / Initial Margin (IM) and exchange collaterals on account of such trades.

3. The RBI directions require market participants to put in place a robust dispute resolution mechanism.

4. CCIL has a well-established and regulated Centralised Clearing Infrastructure and is ideally positioned to extend its expertise to the bilateral market as well for creation of a secure, centralised and seamless Market Infrastructure for NCCDs in India. This could include activities such as Valuation, Margin computation, Collateral Management and custody functions. The centralised neutral infrastructure would benefit the market participants, reduce the operational risk and aid dispute elimination to a large extent. The market participants have also evinced a keen interest in creation of a third party neutral infrastructure. Incidentally, most of the entities covered under the proposed Directions are existing members of CCIL.

5. Accordingly, CCIL proposes to offer a resilient, standardised and efficient centralised service in the bilateral NCCD market, enabling the market participants to seamlessly implement the VM and IM requirements as stipulated in the RBI Direction.

6. CCIL proposes to offer the undernoted services:

i. **Trade Reporting and portfolio creation for calculating margining:**

   a. Existing members of TR already report all their OTC Derivative Trades to CCIL. Trades, which require bilateral margining, can be easily identified from these trades. Thus, there is no separate requirement for reporting and reconciliation of such trades.

   b. Non TR members, opting to avail such services shall have the option to report through front end or through bulk uploads

ii. **Valuation and Pricing systems for OTC derivative trades**

   a. CCIL shall provide functionalities to perform valuation of all the NCCD OTC Derivatives trades currently traded in the market. CCIL shall add more products as and when traded in the market.

   b. For avoidance of disputes and have a uniformity in the margin amounts in the market for similar products, CCIL shall implement a commonly used market standard model for VM/IM calculations.

iii. **Margining (both Variation Margin (VM) and Initial Margin (IM) computation**

   a. Counterparty wise Variation Margin calculation for entire portfolio

   b. Margin call workflows for Variation Margin/Initial Margin

   c. Counterparty-wise IM Calculations, either through:

      - **Standardized Approach** based Initial Margin calculation
      - ISDA **Standard Initial Margin Model (SIMM)** based Initial Margin calculation. Output can be provided in CRIF file format or facility to import external CRIF file for reconciliation

   d. Dispute Management for Initial Margin/Variation Margin

iv. **Collateral Management for Non-centrally Cleared Derivative trades**

   a. Margin call workflow management

   b. Facility to deposit/withdraw Cash and Government Securities

   c. Corporate Action handling such as interest/ Coupon and redemption

iv Margin Maintenance Service

a. CSA Management

b. Collateral Valuations

c. Margin Call Workflow management

d. Variation Margin call management –

i. VM collateral directly transferred to the receiving member's account. Interest payments/ corporate actions etc. has to be handled by Members bilaterally

ii. VM collateral remains in CCIL's books but credited to receiving Member's account (like TREPS).Interest payments/ corporate actions etc. can be handled by CCIL reducing overhead to members

e. Initial Margin – Deposit, segregation and maintenance of collaterals as per Regulatory requirements

v. Risk and Analytic tools for OTC derivative trades

a. Analytics Infrastructure

b. Scenario-based risk views

c. Greeks and sensitivities

d. Drill-down on Scenario, PL Results and Risk Factors

e. Customisable reports/views

7. In addition to the above as a centralised neutral agency rendering these services, it infuses trust and confidence in the system ensuring free flow of information amongst the stakeholders.

8. Way back in 2016 when RBI published its draft directions for NCCD, market participants had shown a keen interest in CCIL acting as a central agent for such trades. The same sustained interest in CCIL acting as centralised agency for NCCD as evidenced by the constant flow of feedback and suggestions for creation of such infrastructure from Member community has encouraged CCIL in taking forward this proposal.

9. In the absence of a centralised infrastructure, to implement the VM and IM requirements, all the members may be individually required to build/subscribe to various infrastructure necessary for valuation, exchange of information, posting of collateral, etc. Additionally, as observed globally, due to various factors and variables involved in computation of VM and IM, disputes often arise in bilateral arrangements.

These issues are equally relevant to the Indian markets, considering that the domestic markets have diverse degrees of sophistication in IT and Risk infrastructure. The proposed solution of CCIL can be offered to the market in an efficient and cost effective manner.

10. The proposed structure for NCCD solution shall take effect upon approval from the regulator, viz. RBI and shall be carried out under a separate infrastructure, which will operate within the purview of the Bilateral Netting of Qualified Financial Contracts Act, 2020.

11. Members are requested to kindly peruse the proposed solution. Comments and feedback, if any, on the proposed solution may be sent to us latest by 14th October 2022 at akpandey@ccilindia.co.in and bjaiswal@ccilindia.co.in with subject "CCIL Margining Solution for NCCDs".

12. If any clarification is required on any aspect of this paper, please feel free to contact us on 022- 6154 6470/ 6472
