17th Apr’ 18

THE CLEARING CORPORATION OF INDIA LTD

Risk Management Department

Consultation Paper: Introduction of Concentration Margin in Forex Forwards and Rupee Derivatives Segment

1. Need for Concentration Margin

1.1. CCIL collects mark-to-market (MTM) margin to cover its current exposure (CE) and Initial Margin (IM) to cover its potential future exposures (PFE).

1.2. In the event of a default, any loss in excess of defaulter’s margins is covered using CCIL’s contributions from Settlement Reserve Fund and member contributed Default Fund as per Default Waterfall for the segment.

1.3. Stress Testing results suggest that the probability of large losses (on default) is generally high for entities who have large positions in the respective segments.

1.4. Such participants if subjected to higher margin requirements are likely to cushion the CCP and other participants against the losses arising from liquidation of such concentrated portfolios. CCP will be in a position to liquidate such participants’ portfolio with a greater confidence even if such liquidation leads to significant price impact.

1.5. Since, margins are posted to cover losses arising from one’s own positions whereas default fund contributions form part of a loss mutualisation arrangement, members have a preference to pay higher margins vis a vis higher default fund requirements.

1.6. Default Fund requirements from members are directly linked to the highest stress loss of an entity and affiliates in the respective segments. Increasing margin requirements of such dominant market participants will help in containing stress losses to reasonable levels, thereby limiting the required contributions towards Default Fund.

1.7. Owing to the above stated benefits, many global CCPs are now collecting additional margins from dominant market participants either by stepping up their initial margin requirements or by collecting margins separately in the form of "*Concentration Margin*".

1.8. Implementation Monitoring Standing Group (IMSG) of CPMI-IOSCO in Level 3 assessment of implementation of PFMIs also made a similar observation[1].

2. Concentration Margin in Forex Forward and Rupee Derivatives Segments

2.1. Positions in Forex Forwards and Rupee Derivatives are accumulated over a period of several months.

2.2. In the event of a default, a sizeable portfolio may have to be liquidated over a short duration of 2 – 3 days.

2.3. To account for price impact arising from liquidation of such concentrated portfolios, Concentration margins are being proposed in these segments.

3. Approach for Concentration Margin in Forex Forward and Rupee Derivatives Segments

3.1. Participants with large positions are subject to high Initial Margin (IM) requirements. Hence a member's IM relative to total IM is a fair indicator of the extent of concentration in a member's portfolio.

3.2. Concentration Margin will be levied on participants having Initial Margin requirements greater than a pre-determined threshold.

3.3. <u>Threshold level will be set equal to 10%</u> (which will be reviewed by CCIL on a semiannual basis). At the end of each month, this threshold percentage will be

[1] *"By far the most common add-ons applied for both exchange-traded and OTC derivatives are add-ons to account for <u>concentration in a participant's portfolio</u> (as measured, for instance, by the participant's share of total exposure across participants) or underlying liquidity in the relevant product. Most CCPs apply some form of concentration or liquidity add-ons in respect of OTC derivatives products." Source: Implementation monitoring of PFMI: Level 3 assessment, BIS, Aug 2016*

applied on the average (averaged over days in the month) daily total (market-wide) initial margin requirement of all members in the segment in the month, to arrive at absolute (Rupee) threshold level applicable for the next month.

3.4. Concentration Margin will be charged as a percentage of Initial Margin. Initially, this is proposed to be <u>15% of extant Initial margin on the breach of threshold level.</u> This rate will be reviewed by CCIL on a semi-annual basis.

3.5. Concentration Margin will be levied in the event Initial Margin requirement for a participant exceeds the threshold level. As currently being done in case of other margin requirements, Concentration Margin requirements will be blocked from Securities segment Settlement Guarantee Fund (SGF).

3.6. Shortfall in SGF on account of levy of Concentration Margin will need to be replenished within one hour from the time of shortfall.

3.7. Concentration Margin will be released when Initial Margin requirement for the participant falls below the <u>second threshold level which is proposed to be 8%</u> (which will be reviewed by CCIL on a semiannual basis) of average daily total of market wide Initial Margin.

4. All Members and other interested entities are requested to send their comments and feedback on the suggested approach for introduction of Concentration Margin in Forex Forwards and Rupee Derivatives segments. The feedback may be sent to us latest by 31st May 2018 at rmd@ccilindia.co.in for attention of Chief Risk Officer, CCIL with subject as "*Consultation Paper : Introduction of Concentration Margin in Forex Forwards and Rupee Derivatives Segment*".

5. If any clarification is required on any aspect of this paper, please feel free to contact Mr. Kausick Saha, Chief Risk Officer, at 61546441 or Mr. Nandan Pradhan, AVP, Risk Management Dept. at 61546422.

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