

# The Clearing Corporation of India Limited

## Consultation Paper

5<sup>th</sup> Sept'19

### Introduction of Clearing Member structure in the Forex Forward Segment

#### A. Introduction

The Clearing Corporation of India Ltd. (CCIL) was set up in April, 2001 for providing Central Counterparty (CCP) clearing services for transactions in Money, Government Securities, Foreign Exchange and Rupee Derivatives. CCIL is a Qualified Central Counterparty (QCCP) which is authorized and supervised by the RBI under the Payment and Settlement Systems Act, 2007 and is subject to the Principles for Financial Market Infrastructures (PFMIs) issued by the Committee on Payment and Market Infrastructure (CPMI) and International Organization of Securities Commissions (IOSCO).

2. As per PFMI requirements, a QCCP is required to adhere to the under-noted requirements:

#### Principle 14: Segregation and portability

*A CCP should have rules and procedures that enable the segregation and portability of positions of a participant's customers and the collateral provided to the CCP with respect to those positions.*

Key considerations in this respect are as under:

*i. A CCP should, at a minimum, have segregation and portability arrangements that effectively protect a participant's customers' positions and related collateral from the default or insolvency of that participant. If the CCP additionally offers protection of such customer positions and collateral against the concurrent default of the participant and a fellow customer, the CCP should take steps to ensure that such protection is effective.*

*ii. A CCP should employ an account structure that enables it readily to identify positions of a participant's customers and to segregate related collateral. A CCP should maintain customer positions and collateral in individual customer accounts or in omnibus customer accounts.*

*iii. A CCP should structure its portability arrangements in a way that makes it highly likely that the positions and collateral of a defaulting participant's customers will be transferred to one or more other participants.*

*iv. A CCP should disclose its rules, policies, and procedures relating to the segregation and portability of a participant's customers' positions and related collateral. In particular, the CCP should disclose whether customer collateral is protected on an individual or omnibus basis. In addition, a CCP should disclose any constraints, such as legal or operational constraints, that may impair its ability to segregate or port a participant's customers' positions and related collateral.*

3. CCIL deals directly with all its members and there is no indirect participation except in Securities Segment where the indirect participation is through a constituent mode as stipulated by the Reserve Bank of India.

CCIL had issued a consultation paper in Feb 2014 proposing client clearing with segregation of collaterals to be introduced in Securities and CBLO<sup>1</sup> segments. A Member meeting was held on 23<sup>rd</sup> May 2014 to discuss the proposal and the feedback received on the Consultation paper. The minutes of the Member meeting were then circulated to all members. Subsequently, the proposal was submitted to RBI along with Member feedback and CCIL's response to the feedback.

4. RBI advised CCIL to make some revisions in the proposed model highlighting the need to have "*fellow customer protection*" for the margin made available by a client. The original model was then slightly modified to incorporate the Regulator's suggestions and the same is now scheduled for implementation in the Securities Segment (including for Triparty repo clearing) soon.

---

<sup>1</sup> Since 5<sup>th</sup> Nov 2018, CBLO segment has been decommissioned and the same has been aligned to Triparty Repo (within Securities segment) as per RBI's Directions on Triparty repo (2018).

5. With the implementation of the Clearing Member structure already underway in the Securities Segment, it is felt that a similar structure can be put in place in other segments as well. Segregation of margins deposited by the Clearing Member on its own account and on behalf of each of its clients forms an integral part of Clearing Member structure. This is going to be achieved by way of new account structures for SGF in the Securities Segment. However, since the margin made available by a member in the form of SGF in the Securities Segment is also used to meet the member's margin obligation in Forex Forward and Rupee Derivatives segments, once the new account structures are in place in the Securities Segment, they would thus automatically apply to Forex Forward and Rupee Derivatives clearing as well. Implementation of the Clearing Member structure in the Securities thus paves the way for extending this structure to these two segments cited above.

6. Currently, the pre-requisites for seeking Forex Forward Segment (FFS) membership are:

- i. The applicant has to be a member of the CCIL's Forex Settlement Segment
- ii. The applicant has to be a member of CCIL's Securities Settlement Segment

Further, the eligibility criteria for membership of the Forex segment of Clearing Corporation are as under:

- i. Has to be an Authorized Foreign Exchange Dealer;
- ii. Have a current account with the Reserve Bank of India for settlement of transactions in Indian Rupees;
- iii. Have INFINET connectivity;
- iv. Have a Nostro Accounts(s) with its Correspondent(s);
- v. Be a member of Securities segment;
- vi. Have adequate Risk Management capabilities.

CCIL is proposing a change in the membership structure of the Forex Forward segment with a view to extending access to entities that may not satisfy the afore-mentioned membership eligibility criteria. The structure has been designed to provide for a higher level of protection to the clients' collateral placed by them as margin with the Clearing Members.

7. One of the key recommendations of the Task Force set up by RBI<sup>2</sup> is to “*establish a central clearing and settlement mechanism for non-resident transactions in the onshore market to facilitate non-residents to hedge their foreign exchange exposure onshore*”. CCIL’s proposed Clearing Member structure will be a significant step towards meeting this recommendation.

8. We present below the following:

- a) A description of the account structures being implemented in the Securities Segment to achieve segregation of the margins deposited by the Clearing Member on its own account and on account of each of its clients.
- b) An approach to implementation of the Clearing Member structure in the Forex Forward Segment (**which is the subject matter of this consultation paper**)

---

<sup>2</sup> The Task Force on Offshore Rupee Markets set up by the Reserve Bank of India in February 2019 and chaired by Smt. Usha Thorat, former Deputy Governor, RBI, submitted its report on 30th July, 2019. The Task Force was set up to examine the issues relating to the offshore Rupee markets in depth and recommend appropriate policy measures while factoring in the requirement of ensuring stability of the external value of the Rupee including measures for incentivising non-residents to access the onshore foreign exchange market. The report is in the link: [https://www.rbi.org.in/Scripts/BS\\_PressReleaseDisplay.aspx?prid=47839](https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=47839)

## **B. Account Structures being implemented in the Securities Segment**

CCIL will be offering two different account structures with regard to the SGF maintained in the Securities Segment, viz.:

- a. Legally Separated, Operationally commingled (LSOC) omnibus account (*in line with PFMI recommendation, 3.14.12*)
- b. Individual client segregated account (*in line with PFMI recommendation, 3.14.9*)

### **I. Legally Separated, Operationally commingled (LSOC) omnibus account**

#### **a) Margin**

- i. The clearing member shall be required to report to the Clearing Corporation the value of margin collected by it from each constituent. In the case of Legally Separated, Operationally Comingled (LSOC) model, the cumulative “Margin Posted by the CM for all the clients” in the group should be equal to or greater than the “Cumulative Margin reported by CM for all the clients” in the group. The margin posted by the clearing member will be in the form of eligible securities and cash (as specified by CCIL for other direct members).
- ii. In the case of LSOC accounts, the Cumulative Margin blocked by CCIL on all clients’ portfolios in the group will be higher of (cumulative Margin computed on all clients’ portfolios, Cumulative Margin reported by CM for all the clients in the group) and the same will be blocked from the Margin Posted by CM for the client group. This would ensure that if the CM has reported higher cumulative margin for the client group than the cumulative actual margin requirement for the client group, the reported higher cumulative margin will be blocked from the margin made available for the group.
- iii. Clearing members will continue to be responsible to CCIL for any margin deficit or any settlement shortfall in the account of any of the clients which access clearing services through them.

- b) LSOC requires that customer collateral be segregated on the books and records of the clearing member and CCP, but allows customer collateral to be commingled in an omnibus account. All margins deposited on behalf of the constituents will be in the CSGL account of CCIL but the same will be segregated in the books and records of clearing members and CCIL.

## II Individual client segregated (ICS) account

PFMI Principle 3.14.9 states that:

*“The individual account structure provides a high degree of protection to the clearing level collateral of customers of participants in a CCP, even in the case where the losses associated with another customer’s default exceed the resources of the participant. Under this approach, each customer’s collateral is held in a separate, individual account at the CCP, and depending on the legal framework applicable to the CCP, a customer’s collateral may only be used to cover losses associated with the default of that customer (that is, customer collateral is protected on an individual basis).....Maintaining individual accounts, however can be operationally and resource intensive for the CCP in settling transactions and ensuring book keeping”.*

### a. Margins

- i. In the case of Individual Client Segregated (ICS) Accounts, the margin posted should at all times be equal to or greater than the margin reported by the clearing member as collected from the constituent.
- ii. In the case of ICS accounts, the margin blocked by CCIL on account of the Client’s portfolio will be higher of (Margin computed on a client’s portfolio, Margins reported as collected from client by CM) and the same will be blocked from the Margin Posted by CM for the client. This would ensure that if the CM has reported higher margin for the client than the client’s actual margin requirement, the reported higher margin will be blocked from the margin provided by CM.

- b. As mentioned in PFMI, this account structure facilitates the clear and reliable identification of a customer's collateral which supports full portability of an individual client's positions and collateral or alternatively, can expedite the return of collateral to the customer.

## **C. Proposal for implementation in the Forex Forward Segment**

### **1. Account Structures**

1.1 In the proposed clearing member structure, CCIL will have no contractual relationship with the constituents. The existing membership structure will be modified as under:

i. Trading cum Self Clearing Members (SCM)

These are direct members of the segment who can only clear their proprietary trades.

ii. Trading Cum Clearing Members (CM)

In addition to clearing their own trades, such members can also clear trades of their constituents. The criteria for selection of a Clearing Member (CM) in the segment shall be notified. Only Clearing Members with a good financial standing shall be permitted to offer clearing member services in the segment.

1.2 Since the margin made available by an entity in the Securities Segment is used to meet its margin obligation in this segment, the two types of account structures for segregation of client collateral placed as margin will be as specified in the Securities Segment i.e.:

i. Legally separated, operationally comingled (LSOC) model

ii. Individual Client Segregated Account (ICS)

1.3 A direct member in another segment of CCIL may be allowed to avail CCP clearing through a Clearing Member in this segment. Each constituent shall be required to be set up under a Clearing Member.

1.4 A constituent can avail the services of multiple clearing members within the Forex Forward segment.

1.5 It will be possible for a constituent to trade with multiple Clearing members, but settlement for these trades will be the responsibility of Clearing Member (s) selected by him. CCIL shall have no contractual relationship with any constituent.

## **2. Trade Reporting and Status**

2.1 Trades concluded by the Constituent bilaterally, either with his own CM or with any other market maker can be CCP cleared. The trades done by constituents will be reported by the constituents/ clearing member to CCIL.

2.2 Trades done by constituents will be accepted by debiting the margin requirements from their respective margin account.

2.3 Trades will continue to remain with Status as “*pending acceptance for CCP clearing*” if the margin made available in the account is not sufficient to support the trades.

2.4 The constituent will be provided information of the status of their trades.

## **3. Settlement**

3.1 CMs will be responsible for the settlement of client trades which will be cleared through CCIL. All obligations arising between the Clearing Member and its constituents will be settled between them bilaterally. On the settlement (S) day, the net obligation with each of its CMs will be arrived at separately and these obligations will need to be bilaterally settled between the constituents and their CMs.

## **4. Margins**

4.1 The outstanding trades’ portfolio of the Clearing Member and the portfolios of each of its constituents shall be considered separately for the purpose of margining. The exposure check will be performed on an online basis for the constituent as well. Each constituent’s portfolio shall be treated independently. No offset shall be provided between clients or between a client and the CM in either the LSOC or the ICS model across constituents. Moreover, a constituent availing clearing service through multiple

clearing members will not be allowed any margin offset for offsetting positions across the clearing members.

- 4.2 All types of margins applicable in the segment would apply to the constituents. These margins will continue to be blocked as part of CCIL's Forex Forward segment. In case the margins of the CM are eligible to be stepped up, then such step up shall apply to all its clients as well. While computing the Initial Margin for constituents, the Margin Period of Risk (MPOR) shall be set equal to the MPOR for the Clearing Members' portfolio.
- 4.3 Concentration margin will be imposed at an entity level (on the Clearing Member or/and its constituents) if the Initial Margin and Position of the entity breaches the thresholds specified for applicability of concentration margin.
- 4.4 Any margin shortfall of the constituent on account of increase in margin requirements on already accepted trades shall be met by the Clearing Member and margins to the extent of the shortfall will be blocked from the margin made available by the Clearing Member on its own account.
- 4.5 Margins for both the constituent and the Clearing Member will be released by CCIL on the day of settlement.

## **5. Default Fund**

Stress testing shall be carried out on the portfolio of the Clearing Member and on the portfolios of its clients independently. The stress gains of clients will not be netted with stress loss of other constituents of the clearing member or the stress loss of the clearing member. However, stress gain from the clearing member's proprietary position could be set off with the stress loss of its clients. The default fund shall be contributed by the clearing member. The default fund requirement for a Clearing Member will be based on the positions and initial margin of the clearing member and its constituents.

## **6. MTM Margin / Gain**

- 6.1 The existing practice of marking-to-market the positions daily will be extended to the constituents positions as well. In case of the constituent portfolio having a MTM loss, MTM margin will be debited from the margin pool posted. In case of the constituent portfolio having a MTM gain, a notional credit (subject to a haircut) will be given to the individual constituent's margin account.
- 6.2 The MTM margin / gain of each constituent and Clearing Member shall be released at a pre-determined time on the day of settlement as notified by CCIL. If release of such notional credit for any constituent or the Clearing Member results in a margin shortfall, such shortfall shall be met by the Clearing Member from the margin made available by the Clearing Member on its own account.

## **7. Cash Margin Composition, Interest Payments and Corporate Action**

- 7.1 Composition monitoring of the cash utilization in the Forex Forwards Segment shall continue at 5% of the total margin requirement.
- 7.2 Interest payments on the eligible cash balances shall be paid to the clearing member, irrespective of whether such payment is towards the proprietary position of the clearing member or the constituent. Corporate Action i.e. Coupon Payments in respect of Securities deposited with CCIL shall be to the clearing member.

## **8. Penalty on account of margin shortfall**

- 8.1 In case of margin shortfall (where the Margin provided by the Clearing member for his own account and for his clients falls short of total Margin required) a penalty will be charged to the Clearing Member as per the extant process.

## **9. Default Handling**

- 9.1 The existing default handling process for the segment shall remain unchanged. In the event of a default of the clearing member, the portfolio of outstanding proprietary

trades of the Clearing Member shall be closed out with its bilateral counterparties at the latest MTM rates.

- 9.2 In the future, when CCIL implements the auction based default handling process in this segment, the portfolio of outstanding proprietary trades of the defaulting Clearing Member shall be auctioned. Constituent's portfolio could be ported to another Clearing Member. Constituents of defaulted CM may be taken as direct members (where possible) till their positions are ported to another (non defaulter) CM. In case the client trades are not ported successfully, CCIL will auction the client portfolio as well.
- 9.3 In the event of a client default, the client's positions will be transferred to its CM account by the CCP and shall form part of the CM's portfolio of outstanding trades. The responsibility of informing the Clearing Corporation about the default of a client will lie with its Clearing Member.

## 10. Trading System Risk Management

If constituents become members of the trading platform operated by Clearcorp Dealing Systems Ltd., the trades concluded by them on the trading platform will be accepted for CCP clearing after subjecting these trades to checks for adequacy of margin for both counterparties.

-----

In case any clarification is required, you may get in touch with Mr Kamal Singhania on 022-6154 6311 (for Trade processing, settlements etc.) or Mr. Nandan Pradhan on 022-61546422 (for Risk Management related queries).

The feedback may be emailed to [frx@ccilindia.co.in](mailto:frx@ccilindia.co.in) or/and [rmd@ccilindia.co.in](mailto:rmd@ccilindia.co.in) for attention of Chief Forex Officer/ Chief Risk Officer with the Subject reading as *'Introduction of Clearing Member structure in the Forex Forward Segment'* on or before 5th Oct 2019.

\*\*\*\*\*