

Risk Management Department

**This has been Superseded by Notification No. RMD/FX/
USD-INR/21/28 dated 01-Sep-2021 on Default Fund
(revised and updated)**

No. RMD/FX/USD-INR/18/102**28-Sep-2018****FOR INFORMATION OF ALL MEMBERS**

**Forex Settlement Segment
Default Fund (revised and updated)**

Introduction

- 1.1. In terms of the provisions of Chapter VIII, “Default Fund” of the Regulations¹ of the Forex Settlement Segment, the Clearing Corporation maintains Default Fund with a view to meet losses arising out of default by Member(s) of this segment. Members seeking to avail guaranteed settlement services in this segment shall be required to deposit their contribution to the Default Fund upfront at the time of joining the segment.
- 1.2. The extant processes in place with regard to the Default Fund have been revised in the light of the amendments to Chapter VIII-Default Fund. The updated provisions applicable to the Default Fund in this segment are described below. The changes implemented have been underlined.

2. Default Fund Corpus

- 2.1. Default Fund corpus, refers to the contribution required to be made by all members of the segment towards the Default Fund. The corpus of Default Fund is determined at the end of each month, and is applicable for the following month.
- 2.2. Corpus of Default Fund, which is revised at the end of each month, is based on the highest stress loss on account of a member and its affiliates in the

¹ Revised with effect from 29th Oct 2018.

preceding six months, along with the stress losses on account of five weak entities on the same day and the same scenario that had the highest stress loss.

2.3. Additionally, in the event, highest stress loss on account of a member and its affiliates exceeds 95% of CCIL's pre-funded default handling resources (i.e. 95% of amount earmarked for the segment from SRF and member contributed default fund) under any stress test scenario, additional default fund contributions will be called from all members of the segment, to the extent by which the stress loss exceeds 95% of pre-funded default handling resources. This call for additional contributions will be made on the day stress test results indicate a breach of resources.

3. Stress Test methodology

3.1. Obligations of members for settlement on Cash, Tom and Spot basis and, securities/USD deposited by members towards margin requirements/exposure limits are assessed over a range of historical and hypothetical stress scenarios.

3.2. Historical stress scenarios are based on historically observed extreme movements in risk factors over a short duration which is equal to the MPOR² applicable for the segment. Risk factors include USD/INR spot and forward exchange rates, standard tenor interest rates and swap rates.

3.3. Hypothetical scenarios are based on extreme value distributions, such as Generalised Pareto distribution, which are used to determine extreme movements in risk factors at a very high confidence level. Presently, confidence level of 99.9% is being considered.

3.4. Loss on Member's portfolio in excess of stressed value of collateral deposited towards margins/exposure limit, on any given stress scenario is considered as stress loss on account of the Member for the given stress scenario.

² MPOR or 'Margin period of risk' is the holding period assumed in margin model. MPOR is 3 days for Forex settlement segment.

3.5. Stress losses (ignoring profits) on account of members and their affiliates are then aggregated for each group of members and for each stress scenario.

4. Member contribution to Default Fund

4.1. The contribution required to be made by a Member towards Default Fund is notified by the means of a report published on the report browser that can be downloaded by the Member. The information can also be availed by logging in to Integrated Risk Information System (IRIS).

4.2. Members are required to deposit the requisite amount of collateral towards Default Fund requirements latest by 11 AM on subsequent working day (including working Saturday) post receipt of such notice for revision in Default Fund requirement.

4.3. Members' Default Fund requirements are based on their average outstanding trade volume (aggregate of settlement date wise net USD positions in absolute terms) in the previous month.

4.4. The minimum contribution required to be made by a Member towards Default Fund in this segment is Rs. 10 lacs.

4.5. Members shall be required to maintain a minimum of 5% of their default fund requirements in the form of cash. The remaining contribution may be in the form of eligible Government Securities.

4.6. All Central Government Securities (*except Special Securities*) including STRIPS created out of these securities and Treasury Bills (including Cash Management Bills) are eligible for deposit towards Default Fund. Any new security becoming eligible for deposit towards Default Fund will be notified to the members.

4.7. The securities contributed by members towards Default Fund shall be valued at end of the day using the latest MTM prices and will be subjected to haircut. The hair cut rate shall be at 5 day VaR at 99% confidence level adjusted by a volatility component of 50%. The values so adjusted shall be further subjected to a minimum/ maximum value for securities³ falling in a particular tenor bucket and then stepped up using illiquidity multiplicands as indicated below (and rounded up to the next higher integer):

- a. For Liquid-Securities having average of more than ten trades (face value \geq Rs.5 Cr) per day during previous calendar month – no adjustment to the VaR as above.
- b. For Semi-liquid securities having average of 1-10 trades (of face value \geq Rs.5 crores) per day during previous calendar month - 1.5 times the adjusted VaR as above.
- c. For illiquid securities having average of less than 1 trade (of face value \geq Rs.5 crores) per day during previous calendar month - 2 times the adjusted VaR as above.

Further, in the event of imposition of Volatility Margin in Securities segment, the securities deposited towards the Default Fund will be re-valued using the latest traded prices or MTM prices, as the case may be, and the hair cut rates will be scaled up by the applicable Volatility Margin percentage. In case such revaluation of securities results in increase in value of collateral even after applying the increased haircut rate, such increase in value will be ignored.

4.8. If the value of the securities deposited towards default fund, net of haircuts, falls below a threshold level of 95% of required Default Fund contribution, then such members shall be required to contribute additional collateral towards Default Fund as may be necessary to meet their respective Default Fund requirements.

4.9. Additional contributions towards Default Fund may also be required in the event of default by a Member and the resultant usage of non-defaulters' Default Fund contribution.

³ Refer notification no. RMD/SS/18/75 dated 21st Aug 2018.

4.10. In case at end of the day, a shortfall is recorded in the requisite Default Fund contribution by a Member, the same shall be automatically adjusted by the Clearing Corporation in the following order:

- 1) First from the surplus balance in any of the Default Funds contributed by the Member in any other segment(s).
- 2) In case the surplus as in (1) above is not adequate to cover the shortfall in the default fund then, the shortfall will be sought to be covered by drawing from the unutilized margin (excluding MTM credits, if any) made available in the Securities Segment SGF.

4.11. Excess collateral and/or margins blocked in terms of para 4.10 above will be released as soon as the shortfall in the Default Fund account is replenished by the Member by depositing additional collateral.

4.12. Failure to replenish the residual shortfall in default fund (after making adjustments as per para 4.10 above) by 11-00 AM on the next business day will attract penalty as per the following structure:

Penalty for shortfall in default fund (based on number of days in a calendar quarter)*	Penal charges applicable (exclusive of applicable taxes)
For first three days	5 basis points per day on the amount of Shortfall*
From 4th to 13th days (or till the day of replenishment whichever is earlier)	10 basis points per day on the amount of shortfall*
From 14th day onwards till the day of replenishment	20 basis points per day on the amount of shortfall*

*Subject to minimum applicable of Rs. 100/- + taxes

5. CCIL's contribution towards prefunded default handling resources

5.1. Member contributed Default Fund and CCIL's contributions from Settlement Reserve Fund referred to as 'Skin In the Game (SIG)', together constitute prefunded default handling resources.

- 5.2. CCIL's contributions will be higher of 25% of the default fund or highest amount contributed by any Member towards the Default Fund.
- 5.3. CCIL's contributions as per para 5.2 above is subject to availability of resources in Settlement Reserve Fund. In the event, aggregate SIG requirement across all segments exceeds the available balance in Settlement Reserve Fund, then CCIL's SIG contribution for all segments will be reduced on pro-rata basis to the level of resources available in Settlement Reserve Fund.
- 5.4. Once defaulter's margin and default fund contributions have been used to meet losses, 60% of CCIL's contribution determined as per para 5.2 and 5.3 above will be made available as first tranche of CCIL's contribution, which will be utilised before non-defaulters' contribution towards Default Fund are utilised.
- 5.5. The remaining 40% of CCIL's contribution, which is the second tranche, will be utilized after non-defaulters' contribution towards Default Fund are utilized.
6. This Notification supersedes all earlier Notifications issued in this regard for the segment.
7. This notification shall be effective from **29th Oct 2018**.

Yours faithfully,

For The Clearing Corporation of India Ltd.

Managing Director