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BY E-MAIL and HAND

Chief Risk Officer,
Clearing Corporation of India Limited,
CCIL Bhavan, College Lane, off S K Bole Road,
Dadar (West),
Mumbai 400 028

E-mail: rmd@ccilindia.co.in

Dear Sirs

Revised Rupee Derivatives and Forex Forward Segment Regulations

Introduction

The International Swaps and Derivatives Association, Inc. (“ISDA”)¹ welcomes the revised Rupee derivatives (“**IRS Regulations**”)² and forex forward (“**FX Regulations**”)³ segment regulations, as well as the revised Rupee derivatives segment default handling circulars (“**IRS Circular**”)⁴ and forex forward default handling circular (“**FX Circular**”)⁵ (collectively, “**Revised Regulations**”) published by The Clearing Corporation of India Limited (“**CCIL**”) in September 2019. While we understand that there is no formal consultation on these Revised Regulations, ISDA would like to take this opportunity to provide CCIL with feedback on the changes proposed under these Revised Regulations.

As you know, ISDA is in constant dialogue with our members, including global, regional and national financial institutions, end-users and many other financial market participants. On behalf of our members, ISDA has also been in constant dialogue with CCIL and provided responses on past consultations (summarized in *Appendix 1* below), and our comments are derived from this experience and our active involvement with regulators and clearinghouses in Asian jurisdictions such as Hong Kong, Singapore, Australia as well as other jurisdictions across the globe such as the United States and the European Union. ISDA hopes to continue the constructive ongoing dialogue between CCIL and derivatives market participants to assist CCIL in formulating a central counterparty (“**CCP**”) recovery framework that is at the

¹ Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 72 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.

² https://www.ccilindia.com/Membership/ByLawsDocs/3_Rupee%20Derivatives%20and%20Rupee%20Derivatives%20GS%20Segment.pdf, CCIL, Rupee Derivatives Segment and Rupee Derivatives (Guaranteed Settlement) Segment Regulations.

³ https://www.ccilindia.com/Membership/ByLawsDocs/FFS%20REGULATIONS_28Aug2019.pdf, CCIL, Forex Forward Segment Regulations

⁴ https://www.ccilindia.com/Lists/IstRMD_SpecificNotification/Attachments/196/Default%20Handling%20MIBOR%20MIOIS%20IRS%20048.pdf, CCIL, Rupee Derivatives Segment Default Handling for trades referenced to MIBOR and MIOIS Benchmarks

⁵ https://www.ccilindia.com/Lists/IstRMD_SpecificNotification/Attachments/200/Default%20Handling%20FFS%20044.pdf, CCIL, Forex Forward Segment Default Handling

same time robust as well as in line with international best practices. We note that our members may have feedback which they may wish to provide separately to CCIL.

General Comments

In principle, we welcome the initiative taken by CCIL to develop a set of recovery tools as well as a well defined recovery plan, which is consistent with the guidelines for the characteristics of recovery tools under the *Recovery of Financial Markets Infrastructures - Revised Report* (“**Recovery Report**”)⁶ published by the Committee on Payments and Market Infrastructures (“**CPMI**”) and the International Organisation of Securities Commissions (“**IOSCO**”) (collectively known as “**CPMI-IOSCO**”) in July 2017.

We also encourage CCIL to align with section 3.23.2 of the *Principles for Financial Markets Infrastructures* (“**PFMI**”)⁷ published by CPMI-IOSCO, which states that “*an FMI should adopt clear and comprehensive rules and procedures that are fully disclosed to participants*”⁸.

We have provided more details on specific areas of the Revised Regulations that we feel need to be reconsidered in the *Specific Comments* section below.

Specific Comments

For ease of reference, the headings and paragraph numbers used below correspond to those used in the IRS and FX Regulations.

1. Assessment Calls

We note that chapter VII(II)(E1)(5)(d) of IRS Regulations⁹ and chapter VI(D)(5)(d) of FX Regulations¹⁰ indicates:

“Inability of a Member to meet the Assessment Calls shall be deemed to be an action preventing the Clearing Corporation from returning to the Matched Book and shall result in the Clearing Corporation initiating appropriate actions against such Member which could include allocation of portions of defaulter’s portfolio, or tearing up its portfolio, partly or completely, and appropriating its margin resources.”

We understand this to mean that a clearing member (“**CM**”) unable to meet a cash call or assessment will be allocated a part of the auction portfolio, instead of being declared a defaulter. From our discussions with CCIL, we understand that the intention with this proposal may be to avoid multiple defaults of liquidity strapped CMs. However, this is a very unique proposal that is not aligned with the PFMI or any other global CCPs, and may not properly incentivise CMs from meeting cash calls or assessments. Instead, participants might be incentivized to weigh up the cost of a cash call against the additional risk that could be allocated to them. We would also like to highlight that there is the possibility that the netting sets of the winning bidder could be broken up in such a situation, if a portion of their portfolio is allocated to the CM that has defaulted on the cash call or assessment.

Also, given the fact that a CM is not able to meet cash calls or assessments, such members will not be best placed to manage the additional risk allocated to it and it is likely that such non-compliant CMs will eventually default on further obligations eventually, such as the margin on positions allotted to it.

⁶ <https://www.bis.org/cpmi/publ/d162.pdf>, CPMI-IOSCO, Recovery of Financial Markets Infrastructures - Revised report.

⁷ <http://www.bis.org/cpmi/publ/d101a.pdf>, CPSS-IOSCO, Principles for Financial Market Infrastructures.

⁸ <http://www.bis.org/cpmi/publ/d101a.pdf>, CPSS-IOSCO, Principles for Financial Market Infrastructures, Paragraph 3.23.2, Page 122.

⁹ https://www.ccilindia.com/Membership/ByLawsDocs/3_Rupee%20Derivatives%20and%20Rupee%20Derivatives%20GS%20Segme nt.pdf, CCIL, Rupee Derivatives Segment and Rupee Derivatives (Guaranteed Settlement) Segment Regulations, page 41.

¹⁰ http://www.ccilindia.com/Membership/ByLawsDocs/FFS%20REGULATIONS_28Aug2019.pdf, CCIL, Forex Forward Segment Regulations, page 20.

Furthermore, CCIL proposes that such CMs who fail to meet additional margin requirements on these allocated positions will be subject to tear-up of its trades (and not be subject to another auction), which is also problematic.

Therefore, we suggest CMs not able to meet cash calls or assessments should also be declared as defaulters, and their portfolio should also be closed through a full-fledged default management process including auction (instead of direct resort to a tear-up). This ensures that CMs are incentivized to meet replenishment calls, and the auction process ensures the other CMs facing the defaulting CM also get full payment through the default waterfall and not be unfairly limited to just the defaulter's resources. The shortfall generated by the CM not meeting cash calls or assessments should be covered as part of the next cash call or assessment, and in this way will be mutualized across all the remaining CMs (and not just to a limited subset of CMs, as in case of tear-up).

As also highlighted in our previous responses to CCIL, this provision continues to be highly problematic, and is a significant departure from global best practices. We reiterate that if a CM does not respond to a cash call or assessments, this should constitute a member default in itself and should trigger the default management process. We would also like to note that this provision is unnecessary, as CMs will always attempt to meet their obligations to the CCP or face reputational damage.

As provided in the Revised Regulations, CCIL is creating an incentive where CMs will intentionally default on cash calls if the commercial or economic considerations of forced allocations are not very negative, and we request that CCIL review this requirement.

2. Restoration of a matched book - forced allocation and partial tear-up

We note that chapter VII(II)(E1)(4)(e) of IRS Regulations¹¹ and chapter VI(D)(4)(e) of FX Regulations¹² indicates:

"In case, the Clearing Corporation is not able to restore a Matched Book by the above process, it may then, in consultation with the DMC, use one or both of the following measures for matched book restoration:

- *Allocation of positions to any non-defaulting Member(s) regardless of whether such Member(s) has (have) positions opposite or related to those in the Auction Pool(s).*
- *Tear-Up of trades of non-defaulting Members who hold positions opposite to those in the Auction Pool(s).*

The price at which positions are torn up or allocated will be determined by CCIL in consultation with the DMC. The allocation of defaulter's position to non-defaulting Members or/ and tear up of non-defaulters' portfolio shall be carried out in accordance with the procedures as notified by the Clearing Corporation from time to time."

We understand that this chapter should be read in conjunction with paragraph 2.5.3 of the IRS Circular¹³ and FX Circular¹⁴, which provides further details on the forced allocation procedure, and states:

¹¹

https://www.ccilindia.com/Membership/ByLawsDocs/3_Rupee%20Derivatives%20and%20Rupee%20Derivatives%20GS%20Segment.pdf, CCIL, Rupee Derivatives Segment and Rupee Derivatives (Guaranteed Settlement) Segment Regulations, page 40.

¹² https://www.ccilindia.com/Membership/ByLawsDocs/FFS%20REGULATIONS_28Aug2019.pdf, CCIL, Forex Forward Segment Regulations, page 19.

¹³

https://www.ccilindia.com/Lists/IstRMD_SpecificNotification/Attachments/196/Default%20Handling%20MIBOR%20MIOIS%20IRS%20048.pdf, CCIL, Rupee Derivatives Segment Default Handling for trades referenced to MIBOR and MIOIS Benchmarks, page 12.

¹⁴ https://www.ccilindia.com/Lists/IstRMD_SpecificNotification/Attachments/200/Default%20Handling%20FFS%20044.pdf, CCIL, Forex Forward Segment Default Handling, page 12.

“Allocation may be carried out on two categories of members, viz.

- Members who did not meet their respective expectations¹⁵ after one or two rounds of auction (category 1), and/or,*
- Members, who did not meet their default fund replenishment calls (category 2).*

Allocation of units of defaulter’s portfolio will be made to category 2 members, commensurate to their shortfall in meeting default fund replenishment.

The remaining unsold units of defaulter’s portfolio will be allocated to category 1 members pro-rata based on their shortfall in meeting expectations. Maximum allocation made to category 1 member will be to the extent of its expectation. The units shall be allocated to these members at a price determined by Clearing Corporation in consultation with DMC.”

While we appreciate the level of detail on this process provided by CCIL in the IRS Circular and FX Circular, we would like to highlight that this language suggests forced allocation of the defaulted portfolio to a CM who may have neither the ability nor the appetite to take on additional positions. CCILs ability to allocate additional positions to CMs who did not meet their respective expectations after one or two rounds of auction, and/or did not meet their default fund replenishment calls, is also viewed as forced allocation. Forced allocation of the defaulted portfolio to a CM who may have neither the ability nor the appetite to take on additional positions may further exacerbate the volatility in the market instead of minimizing it. Forced allocation may also lead to unquantifiable liabilities for CMs, as they would not be able to determine what positions may be allocated back to them and at what price. Such allocation could materially increase the exposure and risk of these CMs vis-à-vis similarly situated CMs that are not allocated positions.

The failure of the auction process would have established that CMs are unable or unwilling to clear the problematic positions, for risk management or other reasons. Forcing CMs to clear these positions regardless could have adverse consequences on individual CMs, and would almost certainly have adverse systemic consequences. For the above reasons we believe that a CCP should in no event be able to apply forced allocation of positions to non-defaulting clearing members.

With reference to partial tear ups (“PTU”), we believe that PTUs should be a last resort position allocation tool to re-establish a matched book upon failure of the CCP’s auction or similar mechanism to rebalance its book. We believe that PTUs should apply to the smallest portion of illiquid contracts possible to offset the positions/contracts of the defaulting CM that could not be sold to other clearing participants.

One difficulty that has been highlighted with PTUs in OTC derivatives is that, unlike exchange-traded derivatives, it is not always clear how to define the opposite positions/contracts to be torn up, especially if trade compression is deployed. Further analysis is required from CCIL on how to operationalize PTUs and ensure that it is equitable, especially in the context of products that are subject to compression. We advise that any decisions regarding the scope of contracts to be torn up should be subject to strict governance procedures that are established and disclosed to clearing participants on an *ex-ante* basis, and should account for the views of clearing participants whose positions could be torn up.

The price for torn-up contracts should be as close to the fair market value of the contracts as possible so that tear-up is fair, transparent and will not lead to loss allocation. It is critical that PTUs are only used for the purpose of returning the CCP to a matched book, not to allocate losses. Allocation of losses through the re-establishment of a matched book should be avoided. The best way to execute a PTU is to use prevailing market prices and an appropriate time may be after a variation margin (“VM”) settlement run, as at this time all changes in mark-to-market value are settled via VM and contracts have zero mark-to-market value. If positions have been allocated based on stale settlement prices, or if the allocation does not happen

¹⁵ Defined by CCIL as “the number of units a member is expected to win for each Auction Pool”.

directly after a VM settlement run, the position allocation will lead to a loss once market prices become observable again. We note that appropriate pricing may differ across product classes and we have urged policymakers to work with CCPs and their clearing participants to establish appropriately consistent procedures and methodologies for pricing torn-up positions¹⁶.

In addition to occurring at fair market value, PTUs should not negate the ability to apply netting (for accounting or capital purposes) or otherwise increase capital, as risks of additional capital charges would dissuade banks from providing clearing services. In general, for netting not to be negated by a PTU, the process and methodology for PTUs must be clear and documented in the CCP rulebook so that market participants have certainty regarding how their portfolios could be impacted, and how the value at which trades will be terminated will be determined. More information on accounting requirements that have to be met to not endanger netting can be found in a whitepaper on *Consideration of Accounting Analysis for CCP Recovery and Continuity Tools*¹⁷.

We note that such clarity is lacking in the Revised Regulations, and request that CCIL provide more clarity on how forced allocations and PTUs will be implemented.

3. Restoration of a matched book - reserve price

We note that chapter VII(II)(E1)(4)(c) of IRS Regulations¹⁸ and chapter VI(D)(4)(c) of FX Regulations¹⁹ indicates:

“The Clearing Corporation in consultation with the DMC shall determine the Reserve Price, acceptable to it for the entire portfolio of the Defaulter or Reserve Price in respect of each Auction Pool.”

We appreciate that CCIL considered our feedback in previous responses, and removed the requirement for a declaration of a reserve price based on the MTM price of the defaulted portfolio. Determining a reserve price in consultation with the Default Management Committee (“**DMC**”) is a step in the right direction.

However, we would like to highlight recent discussions on auction design elements, specifically the reserve price, as discussed in section 4.2.2 of the *Discussion paper on central counterparty default management auctions* published by CPMI-IOSCO in June 2019, which states that *“although this tool may limit auction losses, it could potentially present certain disadvantages. First, the reserve price could be far from the market price. For example, it may be based on the statistical models used to calibrate the default fund, which may be less reactive to changes in the market. Second, if the reserve price is applied to an auction with mandatory participation, it can (if participants are required to bid the reserve price) have similarities to a forced allocation tool”*²⁰.

¹⁶ <http://www2.isda.org/attachment/ODgwMw==/FIA-GFMA-IIF-ISDA-TCH-Response-to-FSB-Discussion-Note-CCP-Resolution.pdf>, ISDA Response to FSB Discussion Note: Essential Aspects of CCP Resolution Planning, Page 4, 9-10.

¹⁷ <https://www.isda.org/a/LEiDE/isda%E2%80%90accounting%E2%80%90committee%E2%80%90ccp%E2%80%90recovery%E2%80%90tools%E2%80%90white%E2%80%90paper%E2%80%90oct%E2%80%9013%E2%80%902015%E2%80%90final.pdf>, ISDA Accounting Committee White Paper: Consideration of Accounting Analysis for CCP Recovery and Continuity Tools

¹⁸ https://www.ccilindia.com/Membership/ByLawsDocs/3_Rupee%20Derivatives%20and%20Rupee%20Derivatives%20GS%20Segment.pdf, CCIL, Rupee Derivatives Segment and Rupee Derivatives (Guaranteed Settlement) Segment Regulations, page 39.

¹⁹ https://www.ccilindia.com/Membership/ByLawsDocs/FFS%20REGULATIONS_28Aug2019.pdf, CCIL, Forex Forward Segment Regulations, page 19.

²⁰ <https://www.bis.org/cpmi/publ/d185.pdf>, CPMI-IOSCO, Discussion paper on central counterparty default management auctions, page 8.

Therefore, we would request CCIL to reconsider the need for a reserve price entirely. As we have also highlighted in previous responses to CCIL, as well as in the industry response to the above CPMI-IOSCO discussion paper²¹, in a stress situation any bid should be encouraged, and therefore any bids should be accepted. The function of an auction is to set a market driven price for the defaulted portfolio, and we believe CCIL should not mandate a price floor by imposing a reserve price.

If a mechanistic application of the reserve price would force the CCP to hold a second auction, there is a possibility that the market will move in the meantime even further and that the results of the next auction are worse than accepting the result of the first auction. It should be in the power of the CCP and the DMC to determine whether the bids resulting from an auction are market prices or not.

If the CCP management and the DMC believe that the achieved auction price is too far away from fair value and have good reason to believe it could be improved at a subsequent auction, or the pattern of bids is not commensurate with a successful auction, they could consider running another auction. If not, the CCP needs to accept the price. The flexibility required for such decisions requires effective governance. We turn your attention to the abovementioned CPMI-IOSCO discussion paper and industry response for further considerations on the governance of auctions.

As highlighted by the above CPMI-IOSCO discussion paper, we note that work is ongoing at the global level in the area of CCPs' default management auctions. We urge CCIL to monitor the discussions closely, and align with international best practice.

4. Settlement of obligations arising out of auction(s) or allocation(s)

We note that chapter VII(II)(E1)(7)(c) of IRS Regulations²² and chapter VI(D)(5)(d) of FX Regulations²³ indicates:

“Where the funds payable to a Member is less than the margin shortfall and the Member is unable to meet the margin shortfall within such time as may be notified by the Clearing Corporation, the Clearing Corporation shall withhold the entire amount payable to such Member. In addition the Clearing Corporation shall also have the right to tear up such member’s portfolio along with the allocated portion of Defaulter’s Portfolio”

As we have highlighted in point 1 above (*Assessment Calls*), if a CM does not respond to a cash call or assessments, this should constitute a member default in itself and should trigger the default management process instead of a tear-up, which will affect other CMs. We request that CCIL review this requirement in the Revised Regulations.

²¹ <https://www.isda.org/a/CNhME/FIA-ISDA-Response-to-IOSCO-Auction-DP-final.pdf>, ISDA-FIA Response to the CPMI-IOSCO Discussion Paper on CCP Default Management Auctions

²²

https://www.ccilindia.com/Membership/ByLawsDocs/3_Rupee%20Derivatives%20and%20Rupee%20Derivatives%20GS%20Segment.pdf, CCIL, Rupee Derivatives Segment and Rupee Derivatives (Guaranteed Settlement) Segment Regulations, page 41.

²³ https://www.ccilindia.com/Membership/ByLawsDocs/FFS%20REGULATIONS_28Aug2019.pdf, CCIL, Forex Forward Segment Regulations, page 21.

5. Establishing a matched book - Sale of defaulter's portfolio

We note that chapter 2.5.1 of IRS Circular²⁴ and chapter 2.5.1 of FX Circular²⁵ indicates:

“Clearing Corporation in consultation with the DMC may seek to sell the defaulter's portfolio to non-defaulting members at a price acceptable to Clearing Corporation (agreed to in consultation with DMC) otherwise than by way of an Auction.”

We understand that CCIL's intention may be to close out positions in a manner which is less tedious, both for the CCP and members, and that CCIL may use this tool in consultation with the DMC. In order to eliminate any uncertainty around the use of this provision and protect the sanctity of CCIL's default management process, we would urge CCIL to provide further clarity and transparency with respect to such a sale. Areas where we would appreciate more clarity include:

- How such CMs will be chosen;
- The length of time during which CCIL will try for such a sale before it decides to conduct a full fledged auction;
- Whether such positions can be sold to one of the DMC members; and
- If so, how the conflict of interest with the DMC member will be managed.

Clarity on these areas is essential to ensure that the default management process is conducted in an efficient, effective, and impartial manner.

6. Default Management Committee

We note that chapter XVI of IRS Regulations²⁶ and chapter XII of FX Regulations²⁷ provide an overview of the general provisions, roles & responsibilities, constitution, and other details relating to the DMC. We appreciate the work that CCIL has done in providing such detail.

However, as we have noted in point 2 (*Restoration of a matched book - forced allocation and partial tear-up*), point 3 (*Restoration of a matched book - reserve price*), and point 5 (*Establishing a matched book - Sale of defaulter's portfolio*), there is still a lack of clarity on how CCIL, in conjunction with the DMC, will arrive at the pricing of PTU's, the setting of a reserve price for auctions, and the process used to determine the sale of a defaulter's portfolio, including any potential conflicts of interest that may arise during these processes. We urge CCIL to provide more details on how CCIL and the DMC will advise on these and other key areas of the default management process, as such clarity is essential for effective risk management.

Conclusion

We understand that the effective date for the implementation of the Revised Regulations will be notified in due course, and that CCIL will be conducting a “fire drill” with CMs prior to implementation. We request that CCIL make the results and any findings of the “fire drill” publicly available, and request the opportunity to provide further comments at such point as well.

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https://www.ccilindia.com/Lists/IsRMD_SpecificNotification/Attachments/196/Default%20Handling%20MIBOR%20MIOIS%20IRS%2048.pdf, CCIL, Rupee Derivatives Segment Default Handling for trades referenced to MIBOR and MIOIS Benchmarks, page 3.

²⁵ https://www.ccilindia.com/Lists/IsRMD_SpecificNotification/Attachments/200/Default%20Handling%20FFS%2044.pdf, CCIL, Forex Forward Segment Default Handling, page 3.

²⁶

https://www.ccilindia.com/Membership/ByLawsDocs/3_Rupee%20Derivatives%20and%20Rupee%20Derivatives%20GS%20Segment.pdf, CCIL, Rupee Derivatives Segment and Rupee Derivatives (Guaranteed Settlement) Segment Regulations, page 74-81.

²⁷ https://www.ccilindia.com/Membership/ByLawsDocs/FFS%20REGULATIONS_28Aug2019.pdf, CCIL, Forex Forward Segment Regulations, page 42-49.

We welcome further dialogue with CCIL on the points raised above, as well as any points raised in the previous ISDA submissions highlighted in *Appendix 1*. We would be grateful for the opportunity to engage with CCIL on any specific clarification that may be required during implementation of the Revised Regulations.

ISDA thanks CCIL for the opportunity to provide feedback on the Revised Regulations and we welcome dialogue with CCIL on any of the points raised, as well as any other areas. Please do not hesitate to contact ISDA via Rahul Advani, Director, Public Policy (radvani@isda.org or at +65 6653 4171), Hyelin Han, Director, Public Policy (hhan@isda.org or at +852 2200 5903), or Erryan Abdul Samad, Assistant General Counsel (eabdulsamad@isda.org or at +65 6653 4172).

Yours sincerely,

For the **International Swaps and Derivatives Association, Inc.**

APPENDIX 1
Previous ISDA submissions to CCIL

Date	Subject	Link
January 19, 2015	ISDA response to CCIL consultation on Default Handling-Auction of Trades & Positions of defaulters	https://www.isda.org/a/mEEDE/submission-ccil-deafault-handling-final.pdf
September 25, 2015	ISDA response to CCIL consultation on CCP Recovery and Resolution Mechanism	https://www.isda.org/a/yFDDE/india-250915.pdf
December 15, 2016	ISDA response to CCIL consultation Proposal to Resize CCIL's 'Skin in the Game' and Restructure Default Waterfall	https://www.isda.org/a/zmiDE/india-submission-121516.pdf
January 31, 2017	ISDA response to CCIL consultation on Optimizing Segmental Default Fund Contributions	https://www.isda.org/a/i9iDE/india-submission-310117.pdf
January 31, 2017	ISDA response to CCIL consultation on Forex Segment- Loss Mutualisation on Settlement Bank Default (USD-INR Segment)	https://www.isda.org/a/g9iDE/india-submission-usd-inr-segment-310117.pdf
March 15, 2017	ISDA & FIA response to CCIL consultation on Recovery tools at the end of the prefunded default waterfall	https://www.isda.org/a/K9iDE/india-submission-031517.pdf