ISDA® Safe, Efficient Markets

14 May 2018

BY E-MAIL and HAND

Shri. Sunil Nair
Department of Banking Regulation
Reserve Bank of India

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Financial Markets Regulation Department
Reserve Bank of India

Dear all

Presentation for RBI – Global developments in Initial Margin and the ISDA SIMM

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] is grateful to the Reserve Bank of India ("**RBI**") for the opportunity to conduct a presentation on *Global developments in Initial Margin and the ISDA SIMM* for the Department of Banking Regulation ("**Presentation**") on 12 March, 2018 at the RBI office in Mumbai. This was followed by a meeting on the same day with the Financial Markets Regulation Department ("**Meeting**"), where we discussed the contents of the presentation, amongst other related topics.

As you know, we are in constant dialogue with our members, including global, regional and national financial institutions, end-users and many other financial market participants. The points discussed during the presentation and meeting are derived from this experience and our active involvement with regulators in Asian jurisdictions such as Hong Kong, Singapore, and Australia as well as other jurisdictions across the globe such as the United States and the European Union, with the implementation of margin requirements for non-centrally cleared derivatives ("**Margin Requirements**") in these jurisdictions. As you may also know, ISDA has played a key role in the re-documentation efforts in Asian as well as global jurisdictions, and we feel that we can provide the RBI with a unique perspective on the issues faced by these jurisdictions in the implementation of margin requirements.

We appreciate the opportunity provided to us by the RBI to highlight the concerns of the derivatives market participants with some of the margin requirements proposed by the RBI in the *Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives* issued in May 2016[2] ("**2016 Margin Consultation**"). These concerns are discussed in detail in the ISDA response to the 2016 Margin Consultation submitted on 8 June, 2016[3] ("**2016 Margin Response**"). We have highlighted these concerns in order to better align

[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 68 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://rbidocs.rbi.org.in/rdocs/Content/PDFs/DPMR02052016ACC458CF292D4F5C876057C8BD2835D5.PDF, RBI, Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives.
[3] https://www.isda.org/a/BmiDE/india-submission-080616.pdf, ISDA, Response to RBI Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives.

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the RBI's margin requirements with that of other Asian and global jurisdictions, keeping in mind the overall goal of strengthening resilience in the non-centrally cleared derivatives market.

We also appreciate the continuous engagement that the RBI has had with ISDA and industry participants since the 2016 Margin Consultation, as well as the decision taken by the RBI to postpone implementation of the Margin Requirements[4] until the issues identified by the 2016 Margin Response and the industry are addressed. We wish to reiterate the request that the RBI continue to postpone implementation until these issues are resolved, while also decoupling implementation of variation margin ("**VM**") requirements with that of initial margin requirements ("**IM**"). We would also like to reiterate the request that the RBI provide the industry sufficient implementation time once the final Margin Requirements are issued, including sufficient time to allow the industry to repaper all agreements to regulatory-compliant documentation.

The main issues that we raised in the Presentation and Meeting, and which were set out in detail in the 2016 Margin Response, are discussed below, taking into account certain local and global developments since then.

1. **Resolving and achieving consistency of netting application**

   We refer to the 2016 Margin Consultation, in particular to paragraph 14, where the RBI referred to a "lack of legal unambiguity" as the reason for applying margin on a "contract by contract" basis and not on a net basis[5]. We also attach a table prepared by Juris Corp, ISDA's netting counsel, highlighting previous statements made by the RBI with respect to bilateral netting of counterparty credit exposures in **Annex 1** of this letter. ISDA had previously sent a letter dated 12 October, 2012[6] ("**2012 Netting Letter**") to the RBI to set out our view of the netting position in India. A primary concern highlighted in the 2012 Netting Letter is the inconsistent netting treatment under the insolvency proceedings to which nationalized banks (such as the State Bank of India) are subject, and those insolvency proceedings to which entities incorporated under the Indian Companies Act, 2013 (or previous laws relating to companies) are subject.

   Subsequent to the 2016 Margin Consultation, on 29 September, 2016 the Ministry of Finance ("**MoF**") issued a consultation on the draft Financial Resolution and Deposit Insurance Bill[7] ("**2016 FRDI Consultation**"). ISDA responded to the 2016 FRDI Consultation on 14 October, 2016[8] ("**2016 FRDI Preliminary Response**") and 4 November, 2016[9] ("**2016 FRDI Final Response**"). ISDA, along with industry representatives, also met with the MoF on 28 October, 2016 to discuss the draft provisions of the 2016 FRDI Consultation, including the proposed amendments to the Reserve Bank of India Act, 1934 ("**RBI Act**") in relation to the netting of mutual transactions in resolution, insolvency, winding up, or liquidation. ISDA and the industry are supportive of these amendments to the RBI Act, which was reflected in the 2016 FRDI Preliminary Response and 2016 FRDI Final Response.

[4] https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=37940, RBI, Implementation of margin requirements for non-centrally cleared derivatives.
[5] https://rbidocs.rbi.org.in/rdocs/Content/PDFs/DPMR02052016ACC458CF292D4F5C876057C8BD2835D5.PDF, RBI, Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives, Page 7.
[6] https://www.isda.org/a/6QiDE/india-submission-oct-12.pdf, ISDA, Consistency of netting application to spur financial market growth.
[7] https://dea.gov.in/sites/default/files/FRDI%20Bill-27092016_1.pdf, Ministry of Finance, Committee Draft on the Financial Resolution and Deposit Insurance Bill, 2016.
[8] https://www.isda.org/a/vmiDE/india-submission-101416.pdf, ISDA, Preliminary submission to Ministry of Finance on Consultation on the draft Financial Resolution and Deposit Insurance Bill.
[9] https://www.isda.org/a/dmiDE/india-submission-110416.pdf, ISDA, Final submission to Ministry of Finance on Consultation on the draft Financial Resolution and Deposit Insurance Bill.

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Subsequently, the *Financial Resolution and Deposit Insurance Bill, 2017*[10] ("**FRDI Bill 2017**") was introduced into the Lok Sabha, and referred to a Joint Parliamentary Committee on 10 August, 2017[11]. As of the date of this letter, the Joint Parliamentary Committee has requested an extension until the last day of the Monsoon Session of Parliament to submit their report[12]. Given this extension, the earliest we can expect the FRDI Bill 2017 to be passed is in the Winter Session of Parliament, i.e., around December 2018.

As discussed on multiple occasions with the RBI, we would like to reiterate here that requiring margin on a gross (and not net) basis would result in significantly higher costs, and would be out of step with global moves towards incentivizing bilateral margining of non-centrally cleared derivatives. It is therefore absolutely essential for the RBI to ensure greater consistency in the application of netting in India and aligning the Margin Requirements with global standards in fulfilment of its G20 commitments. We would also like to highlight here that collateralization of transactions on a gross basis in light of an assessment that netting is not "unambiguously clear", would only compound counterparty credit exposure. An illustrative example outlining such scenarios is provided in **Annex 2** of this letter.

In this regard, while we consider the progress of the FRDI Bill through the legislative process, we welcome the RBI's suggestion of exploring various interim measures to ensure greater consistency in the application of netting in India. As discussed in our Presentation and Meeting, we have summarized the main sections of the RBI Act that we believe will need to be amended to ensure consistency in achieving close-out netting of transactions in resolution, insolvency, winding up, or liquidation in **Annex 3** of this letter. Please note that the language proposed in Annex 3 is indicative, and has been drafted along the lines of what is presently contained in the FRDI Bill on netting. While the proposed language set out in Annex 3 amends the RBI Act specifically, we note that for the for the purpose of netting related amendments, amendments to the RBI Act and/or any other relevant legislation may be considered. The language in Annex 3 may be adapted accordingly in the relevant legislation which is proposed to be amended. We would be happy to provide further assistance in this regard. We also welcome further engagement and discussion with the RBI on how best to enact these amendments.

One other possibility that may be considered is to enact the amendments through the Payment and Settlement Systems Act, 2007[13] ("**PSS Act 2007**"), which explicitly provides for multilateral netting which will be enforceable in the resolution, insolvency, winding up or liquidation of any participant[14]. This would help to cover netting in relation to financial entities other than those covered by the RBI Act, and which do not fall within the purview of the Insolvency and Bankruptcy Code, 2016 such as insurance companies and mutual funds, among others.

However, we would like to highlight here that, regardless of the ultimate legislative tool that the RBI chooses to enact these amendments, these amendments should (a) be included as part of the primary legislation, and (b) be structured as an interim measure until the FRDI Bill 2017 is ultimately passed. We state this with a view to ensure legal certainly and clarity.

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[10] http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/165_2017_LS_Eng.pdf, Parliament of India, The Financial Resolution and Deposit Insurance Bill, 2017.
[11] http://164.100.47.194/Loksabha/Committee/CommitteeInformation.aspx?comm_code=72&tab=1, Parliament of India, Joint Committee on the Financial Resolution and Deposit Insurance Bill, 2017.
[12] http://164.100.47.193/bull1/16/XIV/16.03.2018.pdf, Parliament of India, Lok Sabha Bulletin Part 1, Page 15.
[13] http://164.100.47.193/BillsPDFFiles/Notification/2006-50-gaz.pdf, Parliament of India, Payment and Settlement Systems Act 2007
[14] See Section 2(e) in relation to multilateral netting to be read with Section 23(3) in relation to netting and settlement finality. Please also see Section 23(4) in relation to settlement (including netting) finality in case of insolvency or winding up of a system participant.

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2. Proposed 80% floor on Initial Margin model

As we have highlighted in the 2016 Margin Response, we strongly disagree with the proposal of subjecting the IM amount calculated under a model to a floor of 80% of the amount computed under the standardised approach. This proposal is inconsistent with the BCBS-IOSCO Framework and the margin regimes in all other jurisdictions.

The use of the standardised approach would yield IM amounts that are excessively conservative and disproportionate to the risks involved. Based on internal assessments done by ISDA and the industry, the IM amount computed using the standardised approach could be up to 15 times higher than that computed under the ISDA Standard Initial Margin Model ("**ISDA SIMM**"), a model developed by ISDA and the industry for use by market participants, which has been approved for use for the calculation of IM by market participants by global regulators since September 2016.

We would also like to highlight that the ISDA SIMM has been designed to meet certain prescribed criteria and is based on first order sensitivities. The ISDA SIMM is available to all market participants, and has also been licensed for use by vendors[15]. It is a simple model derived from the Sensitivity Based Approach under the Basel framework. It is easy to use, and is designed to produce conservative results. The IM calculated under such model would still provide a prudent buffer against the risks incurred without subjecting parties to inordinately high level of margin. Based on backtesting results, the margin calculated under the ISDA SIMM is around 2 times greater than the sum of all historical Value at Risk measures, and is 1.4 times to 7.7 times greater than the margin required by central counterparty clearing houses and exchanges for similar products with corresponding risk profiles. The ISDA SIMM also has a governance framework that ensures consistent oversight, and the SIMM Governance Forum regularly engages with regulators to provide them with updates on the ISDA SIMM. Use of the ISDA SIMM thus provides a conservative yet good approximation of the risks incurred, without the disadvantage of reducing liquidity, while at the same time ensuring consistent governance and oversight.

Therefore, setting a floor for the IM amount at 80% of the amount computed under the standardised approach would entail a significant increase in the funding requirements of covered entities, and would exacerbate changes in bank trading behaviours and market liquidity fragmentation, disincentivize hedging activities, and have the unintended consequence of impeding economic growth.

As a matter of principle, there is also no rationale to justify the imposition of a floor on an IM model. IM models and capital models are very distinct in this regard. While a firm charges a capital model to itself, the IM model is charged to a counterparty. Therefore, the counterparty has an interest in understanding how the IM model is calculated, and if they do not agree with the IM model calculation, they will not trade. The result, as we have highlighted above, will be a fragmentation of market liquidity, disincentivization of hedging activities, and the unintended consequence of impeding economic growth.

Therefore, we strongly request the RBI to remove the proposed 80% floor on IM models to minimize any regulatory conflicts. ISDA would be happy to provide the RBI with a more in-depth and technical overview of the ISDA SIMM if needed.

[15] https://www.isda.org/2016/09/15/isda-simm-licensed-vendors/, ISDA, ISDA SIMM Licensed Vendors.

3. Lack of custodial service provider(s)

As also highlighted in the 2016 Margin Response, there is a very clear need for one or more third party custodial service provider(s) in India, prior to the IM rules being implemented. There should be at least one third party custodial service provider for each type of eligible collateral in the Margin Requirements. Any third party custodial infrastructure established in India will also need to enable Indian branches of foreign financial entities to comply with the IM segregation and other requirements under the margin rules of their home jurisdictions (e.g., requirements in relation to credit quality of the custodian and account structures).

Based on our understanding, collateral exchange with respect to OTC derivatives transactions is not a common practice in India. The current custodial infrastructure is restricted to exchange-traded products and does not extend to OTC derivatives, especially for the purpose of meeting the IM segregation requirements. There is a very real need to ensure that existing or new custodial infrastructures can be developed in time for collateral exchange and management, and provide support to the market, by the implementation date.

We would also like to note that even if third party custodial infrastructures that are compliant with the Margin Requirements were developed in time, there is also the need to ensure that there is sufficient time for market participants to negotiate and enter into new custodial agreements by the implementation date. It's important to note that few onshore entities have collateral management systems or are familiar with the documentation required, and hence it will be important to educate the market on these requirements.

4. Offshore posting of collateral should be allowed

We understand that according to a circular issued by the Foreign Exchange Derivatives Association of India ("**FEDAI**") on 24 September, 2012 ("**FEDAI Circular**"), the RBI provided a clarification to certain specific questions posed by FEDAI members that "providing collaterals/margins for onshore transactions at an offshore centre is not permissible under the Foreign Exchange Management Act, 1999". In an ISDA-commissioned collateral opinion, Juris Corp opined that the FEDAI Circular would only apply if an onshore branch of a foreign bank or an Indian bank were involved in the actual posting or collection of the collateral. The FEDAI Circular would not apply if offshore entities exchange collateral offshore and their Indian branches were not involved or did not participate in the collateral exchange in any manner.

We would welcome the RBI's confirmation that a foreign covered entity would be able to exchange collateral offshore as part of its global exposure management. This is only if its Indian branch were not involved or did not participate in the collateral exchange in any manner for domestic trades entered into with an Indian branch of another foreign covered entity. We would also welcome the RBI's confirmation that commodity derivatives transactions booked with market makers located offshore will not be treated as onshore transactions[16].

Requiring foreign covered entities to post collateral onshore only for domestic transactions means they may have to "ring-fence" the trades entered into by their Indian branches, negotiate new credit support documents with their Indian counterparts to provide for onshore collateral arrangements for such Indian exposures. They will also have to set up new or expand existing onshore collateral

[16] The RBI has explicitly stated that cross border commodity hedging is permissible, as per Regulation 6 of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 and a person resident in India is permitted to remit funds which are incidental to a commodity derivative transaction under Regulation 8 of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000.

management departments to handle settlement and other operational issues for a great number of OTC derivatives transactions. All of the above entail increased costs and risks to foreign financial entities, which would likely pass the costs to their Indian counterparties or end users. Such a requirement would also be inconsistent with BCBS-IOSCO requirements, and the way foreign covered entities operate in other jurisdictions.

Similar concerns also apply to cross-border trades when Indian financial entities face foreign covered entities. Currently, derivatives transactions between Indian banks and foreign covered entities that have no presence in India are not collateralised due to the prohibition under the FEDAI Circular. We believe that the FEDAI Circular is incorrectly applied, as it could not have been the intent that cross-border transactions should not be collateralized by posting collateral in the jurisdiction of the non-Indian counterparties. This is all the more so as the collateral will be in foreign currency.

If the Margin Requirements were to require onshore collateralisation, such foreign covered entities would not have established local collateral management system in time to receive collateral posted by Indian banks in India. Further, due to the prohibition under the FEDAI Circular, Indian banks currently have less choice in counterparties and are not able to benefit from a more competitive pricing that would otherwise be available for collateralised trades, including with offshore central counterparty clearing houses ("**CCPs**").

In order to avoid disruption of established trading relationships and severe limitation in hedging and financial flows, we strongly suggest that the RBI expressly confirms that (a) offshore collateral posting for cross-border trades is permitted, and (b) offshore branches of foreign financial entities can post collateral offshore for trades in India between themselves without the involvement of Indian banks or foreign covered entities in India.

We have provided various fact patterns which the RBI may consider in reviewing such cross-border collateral exchanges in **Annex 4** of this letter.

5. Exemption of stamp duty for VM and IM, and exemptions relating to perfection requirements of IM arrangements

Currently, the execution of credit support documents and transfer of collateral may attract stamp duty (with ad valorem stamp duty being charged in certain States in India) at both the federal level and at the state level in India. In the case of transfer of collateral, stamp duty may be payable if (a) a written notice calling for collateral is issued; and (b) an acknowledgement of, or an agreement with, such notice is required by the collateral provider.

Given the frequency of margin exchange for both VM and IM, large amounts of IM to be posted, and the serious consequences of non-payment or inadequate payment of stamp duty, we request that the RBI work with the relevant authorities to introduce an exemption relating to transfer of margin in relevant stamp duty legislations. Any additional costs incurred in connection with complying with the Margin Requirements would have a serious impact on how businesses conduct their trades.

In addition, collateral segregation requirements relating to IM may be subject to certain registration, filing or other perfection requirements. For example, posting of Indian Government Securities as IM may be subject to the prior approval of the RBI. Furthermore, the posting of collateral by a company may also require filings with the Registrar of Companies ("**RoC**") under the Companies Act, 2013. In this connection, we would also like to point out that the Companies (Amendment) Act, 2017, has provided the leeway for the Central Government (in consultation with the RBI) to identify

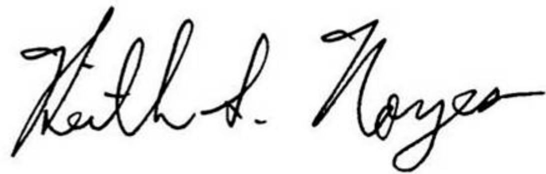
certain charges that are not mandatorily required by a Company to register with the RoC. Accordingly, we request the RBI to work with the relevant authorities to waive any perfection requirements to ensure the IM settlement timeframe could be met.

We would urge RBI to continue an open and constructive dialogue with market participants on addressing the concerns we have highlighted here, as well as aligning the Margin Requirements with global margin rules to ensure that there is no unintended consequence of market liquidity fragmentation, disincentivization of hedging activities, or negative impact on economic growth. We would also like to reiterate here that we would like the RBI to continue to postpone implementation of the Margin Requirements until these issues are resolved, and to ensure that the RBI provides the industry with sufficient implementation time once the final Margin Requirements are issued to allow the industry to repaper all agreements to regulatory-compliant documentation.

ISDA thanks the RBI for the opportunity to present the industry's concerns, and we welcome dialogue with the RBI on any of the points raised in the presentation and this letter, as well as the previous related submissions. Please do not hesitate to contact me at knoyes@isda.org or at +852 2200 5909 should you wish to discuss any of these issues.

Yours sincerely,

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



Keith Noyes
Regional Director, Asia-Pacific

ANNEX 1

Extracts and references in relation to netting in India (prepared by Juris Corp)

Sr. No.	Topic	Extract	Date	Link
1.	Notification : Prudential Norms for Off-Balance Sheet Exposures of Banks – Bilateral netting of counterparty credit exposures	*"Since the legal position regarding bilateral netting is not unambiguously clear, it has been decided that bilateral netting of mark-to-market (MTM) values arising on account of such derivative contracts cannot be permitted. Accordingly, banks should count their gross positive MTM value of such contracts for the purposes of capital adequacy as well as for exposure norms."*	1/10/2010	Link
2.	Bulletin : Regulatory and Other Measures	*"Since the legal position regarding bilateral netting is not unambiguously clear, it has been decided that bilateral netting of mark-to-market (MTM) values arising on account of such derivative contracts cannot be permitted. Accordingly, banks should count their gross positive MTM value of such contracts for the purposes of capital adequacy as well as for exposure norms."*	12/11/2010	Link
3.	Circular : Prudential Norms for Off-balance Sheet Exposures of Banks	*"Since the legal position regarding bilateral netting is not unambiguously clear, receivables and payables from/to the same counterparty including that relating to a single derivative contract should not be netted."*	11/08/2011	Link
4.	Bulletin : Regulatory and Other Measures	*"Since the legal position regarding bilateral netting is not unambiguously clear, receivables and payables from/to the same counterparty including that relating to a single derivative contract should not be netted."*	13/09/2011	Link
5.	Speech : Legislative Reforms- Strengthening Banking Sector – Anand Sinha	*"Similarly, while bilateral netting in the event of liquidation is admissible for private sector banks governed by the Companies Act and the normal bankruptcy laws, the position in this regard for public sector banks, SBI and its subsidiaries is not clear in law, as liquidation, if at all, of such banks would be as per the Notification to be issued by the Government in this regard."* *"The legal position regarding bilateral netting is not unambiguously clear in case of banks established by special statutes [like SBI Act, Banking Companies (Acquisition and Transfer of Undertakings) Act, etc.]."*	12/01/2012	Link
6.	Master Circular : Prudential norms on Income Recognition,	*"Since the legal position regarding bilateral netting is not unambiguously clear, receivables and payables from/to*	01/07/2014	Link

Sr. No.	Topic	Extract	Date	Link
	Asset Classification and Provisioning pertaining to Advances	*the same counterparty including that relating to a single derivative contract should not be netted."*		
7.	Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives	*"The methodology applied to compute margin requirements should be able to capture any loss caused by default of a counterparty with a high degree of confidence. Due to lack of legal unambiguity on reckoning exposures based on net basis, the requirement of variation and initial margins have to be applied on a contract by contract basis. Portfolio margining models can be used only when RBI specifically permits computation of margins on a portfolio basis."*	02/05/2016	Link
8.	Interview: Corporate Debt Market - Mr. H. R. Khan	*"So, what we are trying to do is in terms of CDS, the main issue which has been a stumbling block as per the market is this netting issue involving public sector because of that capital charge increases. So, we were in dialogue with the government whether we have that amendment to the RBI act, netting and if that is not possible, pending that whether based on legal opinion we got second tracked whether the netting can be allowed. So, that will be a big boost."*	01/08/2016	Link
9.	Speech: Strengthening Our Debt Markets - Dr. Raghuram G. Rajan	*"We are conscious of the limitations placed on netting of derivative contracts, and thus the higher associated capital requirements on banks. The issue has been taken up with the Government, and we hope to amend the RBI Act to make such netting possible."*	26/08/2016	Link
10.	Notification: Guidelines for Computing Exposure for Counterparty Credit Risk arising from Derivative Transaction	*"At present, due to lack of unambiguity of legal enforceability of bilateral netting agreements, each non-centrally cleared OTC derivative trade will be considered a netting set of its own and therefore, computation of RC and PFE will not recognise any offset among different derivative transactions."*	10/11/2016	Link

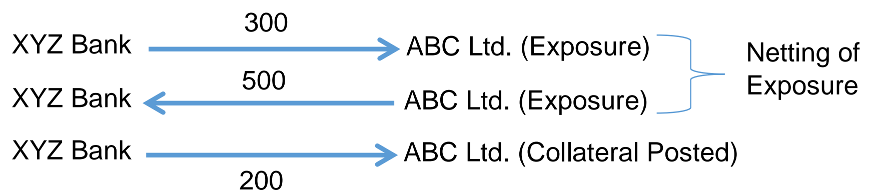
ANNEX 2

Illustrative example of collateralization on a net vs. gross basis

XYZ Bank has an MTM exposure of INR 300 to ABC Limited. ABC Limited has an MTM exposure of INR 500 to XYZ Bank. If netting is recognized (scenario 1), XYZ Bank has to post collateral of INR 200 to ABC Limited. If netting is not recognized and margin is on gross basis (scenario 2), XYZ Bank will post a collateral of INR 500 to ABC Limited and ABC Limited will post collateral of INR 300 to XYZ Bank. In this case, if ABC Limited were to go insolvent, XYZ Bank's exposure to it would be INR 800 due to collateral without netting. XYZ Bank would have been better off without collateral (scenario 3), as its exposure to ABC Limited would have been restricted to INR 500.

Scenario 1:

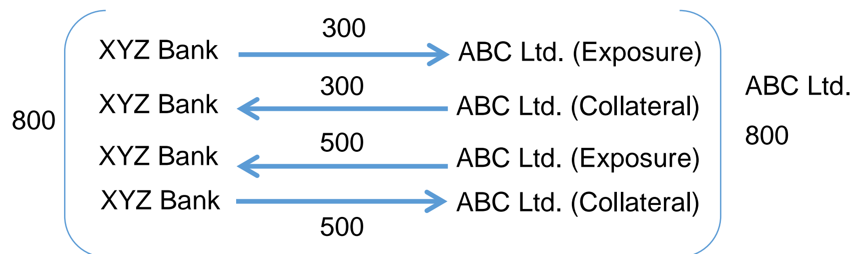
Netting of exposures:



Insolvency of ABC Ltd:

Scenario 2:

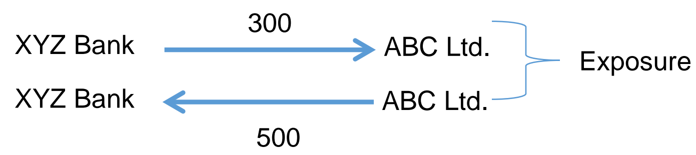
Collateral on gross basis:



Insolvency of ABC Ltd:

Scenario 3:

No netting, no collateralisation:



Insolvency of ABC Ltd:

ANNEX 3

Proposed amendments to the Reserve Bank of India Act, 1934[17]

Netting of mutual transactions in resolution, insolvency, winding up or liquidation
Amendment to Reserve Bank of India Act, 1934 (2 of 1934)

1. In section 45MC,
(i) in sub-section (1), for the words "the Companies Act, 1956 (1 of 1956)", the words "the Financial Resolution and Deposit Insurance Act, 2016 (of 2016) or the Insolvency and Bankruptcy Code, 2016 (of 2016), as the case may be" shall be substituted.
(ii) in sub-section (4), for the words "the Companies Act, 1956 (1 of 1956) relating to winding up of a company", the words 'the Financial Resolution and Deposit Insurance Act, 2016 (of 2016) or the Insolvency and Bankruptcy Code, 2016 (of 2016), as the case may be, relating to winding up' shall be substituted.
2. After section 45X, the following section shall be inserted, namely: -
" 45XA (1) Notwithstanding anything to the contrary contained in any other law for the time being in force or any rule, regulation, scheme, direction or order that may be issued under any law or any order of a court, tribunal or other authority, where one of the parties to the specified transaction is a party referred to in section 45V, netting shall be applicable in the event of resolution, insolvency, winding up or liquidation of a party to such transaction, including a bank or a financial institution.

Explanation: For the purposes of this sub-section, -
(i) "netting" means determination of any payment or other obligation arising out of any exposure, including an exposure from specified transactions between the parties, whether or not due or payable, by set off or adjustment between the parties and whereby a net obligation is arrived at;
(ii) "specified transaction" means a transaction in securities, money market instruments, foreign exchange, derivatives or such other instruments or transactions.
(2) For the purpose of netting under sub-section (1), the following shall be taken into account –
(a) the value of cash or security or collateral provided by either party or other person and which is not a security interest and the proceeds of sale of securities available with either of the parties to the transaction; and
(b) the current value of payment or other obligations due at a future date arrived at by prematurely terminating the transactions.
(3) The amount payable or other claims that may be made, determined under sub-section (1) and subsection (2), shall be final and irrevocable and shall be binding on the liquidator, receiver or trustee, by whatever name called, of the party in resolution, insolvency, winding up or liquidation.
(4) Notwithstanding anything to the contrary contained in any agreement or contract between the parties, for the realization, appropriation and/or liquidation of any collateral (referred to in 2)(a) above) to determine the amount payable or other claims that may be made under sub-section (1) and sub-section (2), no prior notice to or consent of the party in resolution, insolvency, winding up or liquidation or its liquidator or receiver or trustee, by whatever name called shall be required."

[17] The language proposed in Annex 3 is indicative, and has been drafted along the lines of what is presently contained under the FRDI Bill on netting. While the proposed language set out here amends the RBI Act, we note that for the purpose of netting related amendments, the RBI Act, the Payment and Settlement Systems Act and/or any other relevant legislation may be considered. The language in Annex 3 may be accordingly adapted in the relevant legislation which is proposed to be amended. We would be happy to provide our assistance in this regard.

ANNEX 4

Fact patterns to be considered for the offshore posting of collateral

Counterparty A	Counterparty B	Collateral should be allowed
Onshore branch of Indian bank	Onshore branch of Indian bank	Onshore
Onshore branch of global bank	Onshore branch of Indian bank	Onshore
Onshore branch of global bank	Onshore branch of global bank	Onshore OR Offshore
Onshore branch of global or Indian bank	Offshore hedge counterparty[18]	Cross border
Onshore company	Offshore hedge provider (for commodity derivatives)	Cross border
Offshore branch of global bank or CCP	Onshore branch of Indian bank	Offshore
Offshore branch of global bank or CCP	Onshore branch of global bank	Offshore
Offshore branch of global bank or CCP	Offshore branch of Indian bank	Offshore

Explanation: For the purposes of this table,

(i) "Onshore" means a collateral transfer that is made onshore in India

(ii) "Offshore" means a collateral transfer that is made offshore outside of India

(iii) "Cross border" means a collateral transfer that may be made both onshore and offshore

[18] An offshore hedge counterparty could include Foreign Portfolio Investors (FPIs), Foreign Direct Investment (FDI) investors, Non-Resident Indian (NRI) investors, Non-Resident importers or exporters (having INR exposure), External Commercial Borrowings (ECB) lenders (having INR exposure), or such other hedge counterparty having INR exposures as permitted by the regulator from time to time.