ISDA Safe, Efficient Markets

20 March 2013

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Dear Sirs

CCIL's Forex Forward Guaranteed Settlement Segment

1. **Introduction:** The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] is writing to you with regard to FEDAI's Rule 8.11 which requires all eligible dealers to become members of CCIL's Forex Forward Guaranteed Settlement segment (the "**Segment**") and submit all eligible interbank Forex Forward contracts to the Segment by 31 March 2013 at the latest.

2. Whilst we greatly appreciate the efforts that The Clearing Corporation of India Ltd ("**CCIL**") has made to change the regulations of the Segment (with approval from the Reserve Bank of India ("**RBI**")) to address some of the issues raised by our members in the past, such changes have not addressed all of our members' key concerns. Thus, the deadline specified in FEDAI's Rule 8.11

[1] ISDA's mission is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products. ISDA has more than 800 members from 58 countries on six continents. These members include a broad range of OTC derivative market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. For more information, visit www.isda.org.

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remains problematic for our members that are subject to the requirement. We have set out below an explanation of the key issues that have not yet been addressed for your further consideration.

3. **Close-Out netting on CCIL's default/insolvency:** Notwithstanding the recent changes made on 28 February 2013 by CCIL to its regulations governing the Segment, CCIL's rules and regulations still do not contemplate the possibility of a default by, or the insolvency of, CCIL. Thus, they do not contain express rights granted to clearing members that will allow clearing members to terminate their transactions with CCIL in the event of CCIL's default or insolvency, value the transactions so terminated and crystallize a net sum payable by or to CCIL as a result of such termination ("**Close-Out Netting Rights**").

4. As we have previously raised in our letter dated 12 October 2012 regarding *"Consistency of netting application to spur financial market growth"* (the "**Netting Letter**"), this is not in line with and currently lags behind international developments on the key features of OTC derivatives central counterparties ("**CCPs**"). All major CCPs including LCH, ICE, CME and SGX now have express rules granting their members Close-Out Netting Rights in the event of the CCP's default or insolvency. Under the Basel III framework, banks will need to treat their exposures to a CCP as gross if, amongst other things, the rules of such CCP or the contractual arrangements with such CCP do not provide for express Close-Out Netting Rights, the enforceability of which has been confirmed (both pre and post-insolvency) by independent legal opinion. The higher capital charges that will result from the implementation of Basel III will also mean that the cost of carrying gross exposures like this will increase significantly. We understand that CCIL has submitted to RBI for approval proposed changes and amendments to its regulations which would allow clearing members to terminate their transactions with CCIL upon the default or insolvency of CCIL. The industry views this as a constructive step and ISDA and its members urge RBI to approve these amendments before the imminent FEDAI deadline for on-boarding the Segment.

5. **Exposure norms:** RBI's Master Circular on Exposure Norms currently prohibits the netting of exposures for exposure norms purposes and subjects CCIL to the single borrower exposure ("**SBL**") limit of 15% of capital funds. We note that RBI's proposed Guidelines for *"Capital requirements for bank exposures to central counterparties"* will allow the netting of exposures to CCIL. ISDA and its members support this proposal. ISDA and its members would also urge RBI to consider exempting CCIL from the SBL limit in respect of banks' exposures to CCIL in their capacity as a CCP. Transactions cleared by CCIL carry less counterparty risk than an equivalent uncollateralized derivative transaction due to CCIL's margining and loss mutualization mechanisms. There is therefore a strong case for treating these exposures differently. In addition, granting such an exemption is not unprecedented as SGX for example is not subject to the analogous single borrower limit in Singapore.

6. **EMIR Article 25:** Under Article 25 of the European Regulation on OTC Derivatives, Central Counterparties and Trade Repositories[2] (known as "**EMIR**" – EMIR Financial Infrastructure Regulation) which came into effect on 15 March 2013, a central counterparty such as CCIL established in a non-EU country must be recognized by the European Securities and Markets Authority ("**ESMA**") before it can provide clearing services to clearing members established in the EU (including the non-EU branches of EU-established clearing members). For non-EU, "third country" CCPs ("**TC-CCP**"), recognition will require an assessment of compliance with regulations and laws that are "equivalent" to EMIR. Article 25 applies not only to non-EU CCPs clearing OTC derivatives but also applies to non-EU CCPs clearing cash securities and exchange-traded derivatives.

7. According to Article 25(2) of EMIR, ESMA may only recognize a TC-CCP where certain conditions have been satisfied as follows (in summary):

[2] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ 27/7/2012, L201/1.

(a) The EU Commission has adopted an implementing act determining that the legal and supervisory arrangements in the TC-CCP's country ensure that CCPs authorized in that country comply with legally binding requirements which are equivalent to the requirements set out under Title IV of EMIR, that such CCP is subject to effective supervision and enforcement in that country on an on-going basis and that the legal framework of that country provides for an effective equivalent system for the recognition of CCPs authorized under other countries' legal regimes;

(b) The TC-CCP is authorized in the relevant country and is subject to effective supervision and enforcement ensuring compliance with the prudential requirements applicable to that third country;

(c) Cooperation arrangements have been established with competent authorities in that third country which specify amongst other things the mechanism for the exchange of information between ESMA and such competent authorities (including access to all information regarding the relevant CCP requested by ESMA) and procedures concerning the coordination of supervisory activities (including on-site inspections); and

(d) The jurisdiction in which the TC-CCP is established needs to have equivalent systems for anti-money laundering and combating the financing of terrorism to those established in the EU.

8. It is our members' understanding that CCIL will benefit from transitional relief under Article 89(2) of EMIR[3], and will therefore have until 15 September 2013 to apply to ESMA for recognition if they wish to retain any EU members for the Segment after that date. However, if the above listed pre-conditions have not been satisfied by the time that CCIL makes its application to ESMA, our members' understanding is that such application may be immediately rejected by ESMA. Therefore, although EU banks may be permitted under transitional relief provisions to join the Segment, if CCIL's application is subsequently rejected (due to a failure to satisfy the above pre-conditions) or if CCIL elects not to make an application to ESMA by 15 September 2013, all EU members of the Segment (including their non-EU branches) would be required to stop using the Segment. Given that CCIL's rules on resignation of clearing members require a clearing member to have at least two clear months with no outstanding transactions in the Segment before they can give notice of resignation, this would mean that EU members of the Segment would need to consider resigning their Segment memberships (and potentially exiting their on-shore Indian FX businesses) if the above pre-conditions have not been satisfied and CCIL has not clearly demonstrated its intention to apply for recognition by July 2013.

9. We understand that the European Commission has requested ESMA to assist them with making the necessary equivalence assessment referred to in paragraph (a) above by 15 July 2013. This assessment process will require active cooperation on the part of the RBI and CCIL and we would urge RBI, together with the Ministry of Finance, to actively seek engagement with ESMA on this issue as soon as possible so as to avoid the potentially serious market disruption that may occur if multiple members of the Segment were required to stop using its services at the same time.

10. **Dodd-Frank Act:** We also highlight the US concerns below for your consideration. We would however state at the outset that these concerns would only become relevant when CCIL begins clearing interest rate swaps since it is our members' understanding that the US Treasury

[3] Please note that this merely reflects the views of ISDA's members and should not be relied upon. CCIL should seek such legal and other advice as it considers appropriate.

Secretary's exemption of FX forwards and swaps from being treated as "swaps" extends to registration as a derivatives clearing organization ("**DCO**")[4].

11. Issues similar to the concerns raised in the preceding paragraphs in relation to EMIR arise under Section 5b(a) of the Commodity Exchange Act ("**CEA**") as modified by the Dodd-Frank Act ("**DFA**"). Any CCP that clears a "swap" for a US person or where there is a sufficient US nexus will have to be registered as a DCO with the Commodity Futures Trading Commission ("**CFTC**") unless it is exempted by the CFTC or a no-action relief has been granted by the CFTC. Similar to EMIR, the CFTC may exempt a CCP from registration if the CFTC determines that the CCP is subject to comparable, comprehensive supervision and regulation by the appropriate government authorities in the CCP's home country. A "US person" would include the non-US branches of a US person. As a result, Indian branches of a US bank (or even Indian branches of a European bank that is registered as a Swap Dealer with the CFTC as Swap Dealer registration may be deemed to constitute a sufficient US nexus) may face a similar issue to EU clearing members of CCIL, i.e., they may be prohibited from clearing transactions through CCIL if CCIL does not register as a DCO with the CFTC.

12. **Further engagement with CCIL:** For completeness, we note that our members have concerns relating to certain gaps in CCIL's rules insofar as these relate to default management, loss allocation, margin and collateral which our members will continue to discuss with CCIL.

We would be most pleased to assist in any way. Please contact Jacqueline Low (jlow@isda.org, +65 6538 3879) or Keith Noyes (knoyes@isda.org, +852 2200 5909) at your convenience.

Yours faithfully,
For the International Swaps and Derivatives Association, Inc.

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