NATIONAL COMMODITY CLEARING LIMITED

Circular to all Members of the Clearing Corporation
Circular No. : NCCL/RISK-025/2024
Date : May 30, 2024
Subject : Norms for acceptable collaterals and exposure of Clearing Corporations

The Securities and Exchange Board of India (SEBI) has issued a circular no. SEBI/HO/MRD/MRD-PoD-3/P/CIR/2024/65 dated May 29, 2024 on "Norms for acceptable collaterals and exposure of Clearing Corporations".

A copy of the referred SEBI circular is enclosed as Annexure.

Members and participants are requested to note the same.

For and on behalf of

National Commodity Clearing Limited

Abhishek Soni
Chief Risk Officer

For further information / clarifications, please contact

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भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

CIRCULAR

SEBI/HO/MRD/MRD-PoD-3/P/CIR/2024/65 **May 29, 2024**

To

All Recognized Clearing Corporations

Sir/Madam,

Subject: Norms for acceptable collaterals and exposure of Clearing Corporations

I. SEBI through various circulars issued from time to time has prescribed norms for risk management of Clearing Corporations (CCs), including acceptable liquid assets by CCs with applicable haircuts to meet the requirements for initial margins, mark to market losses, value at risk margins, extreme loss margins, base minimum capital, etc.

II. In order to further strengthen the risk management framework of CCs, it has been felt to review the existing collaterals accepted by CCs and also to have prudential norms for exposure of CCs. The details are given as under:

A. Collaterals accepted by CCs

1. Paragraphs 1.1.1 and 1.1.2 of Chapter 4, of SEBI Master Circular No. SEBI/HO/MRD2/PoD-2/CIR/P/2023/171 dated October 16, 2023 for Stock Exchanges and Clearing Corporation, states that the core of the risk management system is the liquid assets deposited by members with the CCs as collateral with applicable haircuts therein. Similar provisions have also been prescribed under

paragraphs 9.1.1 and 9.1.2 of Chapter 9 of SEBI Master Circular No. SEBI/HO/MRD/MRD-PoD-1/P/CIR/2023/136 dated August 04, 2023 for Commodity Derivatives Segment.

2. The acceptable liquid assets for Cash Market includes -

a. Cash Equivalents such as cash, bank fixed deposits, bank guarantees, securities of the Central Government, units of liquid mutual funds (including units of overnight mutual funds) or government securities mutual funds;
b. Other Liquid Assets such as Group I equity shares, units of other mutual fund schemes and corporate bonds. In addition, for Commodity Derivatives Segment, the Other Liquid Assets includes Bullion, units of Gold ETF, Agricultural Commodities, Base Metals & Alloys, and Diamond.

3. Currently, units of overnight mutual funds are considered as part of liquid mutual funds under Cash Equivalent with a haircut of 10%. Overnight mutual funds invest only in overnight securities having maturity of 1 day, making it less risky and more liquid than liquid mutual fund schemes. Further, amongst Other Liquid Assets, Liquid (Group I) Equity Securities are also accepted as collaterals by CCs. was noted that the number of equity securities featuring in Group I have become quite large.

4. Accordingly, the issues highlighted at paragraph 3 above were reviewed by the Working Group (WG), consisting of CCs and Depositories and the recommendation of the WG were further deliberated by Risk Management Review Committee of SEBI (RMRC). Based on the recommendations of RMRC and subsequent deliberations, the following have been decided:

a) Units of growth plan of overnight mutual fund schemes shall be accepted as Cash Equivalent by CCs with a haircut of 5% and for other plans of overnight mutual fund schemes the hair cut of 10% shall continue to be applicable.

b) Equity shares with impact cost of up to 0.1% for an order value of INR 1 lakh and traded for 99% of days over the period of previous 6 months shall be accepted as part of other liquid assets.

5. Accordingly, paragraph 1.1.2 of Chapter 4 of Master Circular dated October 16, 2023 for Stock Exchanges and Clearing Corporation shall be modified as under:

"1.1.2 The acceptable liquid assets and the applicable haircuts are listed below:

Item	***Haircut (see Note i)***	***Limits***
	Cash Equivalents	
Cash	*0%*	*No limit*
Bank Fixed Deposits (FDs)	*0%*	*No limit*
Bank Guarantees (BGs)	*0%*	*Limit on exposure to a single bank (See Note ii)*
Securities of the Central Government (T-bills and G-Secs).	*See Note iii*	*No limit*
Units of growth plans of overnight mutual fund schemes.	*5%*	*No Limit*
Units of overnight mutual fund schemes (other than growth plans), liquid mutual fund schemes or	*10%*	*No limit*

government securities mutual fund schemes (by whatever name called which invest in government securities).		
Other Liquid Assets ***1. Cannot be used for mark to market losses (see Note iv)*** ***2. Total of Other Liquid Assets cannot exceed total of Cash Equivalents (see Note v)***		
Equity shares with impact cost of upto 0.1% for an order value of Rupees 1 lakh and traded for at least 99% of days over the period of previous 6 months.	*VaR Margin based on 6σ, subject to minimum of 9%.* *(VaR Margin applicable to liquid securities (Group I) as mentioned at paragraph 1.1.8.1 of Chapter 4 of abovementioned Master Circular)*	*Limit on exposure to a single issuer (see Note vi)*
Units of mutual fund schemes other than those listed under cash equivalents.	*VaR Margin based on 6σ, subject to minimum of 9%.* *(VaR Margin for the units computed using the traded price on stock exchange, if*	*No limit*

	available, or else, using the NAV of the unit treating it as liquid securities (Group I) as mentioned at paragraph 1.1.8.1 of Chapter 4 of abovementioned Master Circular)	
Corporate Bonds	*Fixed percentage based or VaR based haircut. A higher haircut may be considered to cover the expected time frame for liquidation. However, the haircut shall not be less than 10%.*	*Not to exceed 10% of the total liquid assets of the CM.*

Notes:

i. *The valuation of the liquid assets shall be done on a daily basis after applying applicable haircuts.*

ii. *Please refer paragraph 3.3 of Part B of this circular.*

iii. *Haircut on securities of the Central Government:*

Type and Tenor of Securities	***Haircut***
Treasury Bills, and Liquid Government of India Dated Securities having residual maturity of less than 3 years.*	*2%*
Liquid Government of India Dated Securities having residual maturity of more than 3 years.*	*5%*
For all other Semi-liquid and Illiquid* Government of India Dated Securities.*	*10%*

**As jointly decided by clearing corporations. The classification of the Government of India Dated Securities, as above, shall be reviewed on 15th of every month. The revision in classification, if any, shall be implemented with effect from 1st of the next month.*

iv. *For Cash Markets, mark to market losses shall be paid by the member only in the form of cash or cash equivalents.*

v. *Cash equivalents shall be at least 50% of liquid assets. This would imply that Other Liquid Assets in excess of the total Cash Equivalents would not be regarded as part of Total Liquid Assets.*

vi. *Please refer paragraph 3.4 of Part B of this circular."*

6. In view of paragraphs 4 and 5 above, the provisions for "liquid assets" such as cash, bank guarantee, FDs, central govt. securities, units of overnight mutual funds, liquid mutual funds, money market mutual funds, govt. securities mutual funds and securities as specified under Chapter 5 of Master Circular dated October 16, 2023 for Stock Exchanges and Clearing Corporations, for risk management of various derivatives segment, shall stand modified.

7. Further, in view of paragraphs 4 and 5 above, paragraph 9.1.2 of Chapter 9 of SEBI Master Circular dated August 04, 2023 for Commodity Derivatives Segment shall stand modified. Provisions with regard to Bullion, Gold ETF, Agriculture Commodities, Base Metals & Alloys and Diamond as part of Other Liquid Assets, for Commodities Derivatives Segment, shall remain unchanged.

B. <u>Prudential Norms for Exposure of CCs</u>

1. SEBI at paragraph 2.5.1 of Chapter 6 and paragraph 6.6 of Chapter 3 of abovementioned Master Circular dated October 16, 2023 for Stock Exchanges and Clearing Corporations has specified the principles to be followed by the CCs while

framing the investment policy for deployment of their own funds and Core Settlement Guarantee Fund (SGF) respectively. Further, paragraph 1.1.2 of Chapter 4 of the abovementioned Master Circular as revised above, specified the list of acceptable liquid assets with applicable haircuts and single issuer limits, by CCs, for the purpose of risk management.

2. In order to further enhance the risk management of the CCs and ensure their operational resilience, it is essential that any type of exposure of CC is appropriately monitored and managed. A diversification of exposure of the CCs in the instruments issued by various entities is essential towards stability and sustainability of a CC. Based on recommendations of the RMRC and subsequent discussions, it has been decided to introduce prudential norms for exposure of CCs:

3. The prudential norms for exposure of CCs are given as under:

3.1 <u>For the purpose of monitoring of exposure, CCs shall, inter-alia, consider the following types of exposures:</u>

a) CCs' own funds invested or deployed in FDs, units of overnight and liquid mutual funds, T-bills and G-secs;
b) Core SGF corpus invested or deployed in FDs, units of overnight and liquid mutual funds, T-bills and G-secs;
c) CCs' exposure through their members, warehouse service providers or other entities -
    i. CCs' balances with the bank in its capacity as a clearing bank;
    ii. FDs and BGs lien marked to CCs;
    iii. Equity shares, debt instruments, mutual fund units pledged or re-pledged with CCs;
d) CCs' exposure through their subsidiaries.

However, inter-CC collateral will be exempt from the exposure limit to individual banks.

3.2 Criteria for selection of Banks

a) CCs shall devise well-defined criteria for selection of banks for the purpose of exposure through Cash, FDs and BGs, which shall be based on parameters such as financials (including net-worth), capital adequacy, credit worthiness considering long term credit rating, etc. of the bank as part of their internal policy.

b) CCs shall closely and continuously monitor such parameters and other material events or news surrounding such banks in order to take appropriate steps for mitigating the risks that may arise on account of any significant event.

c) CCs shall have exposure (through Cash, FDs and BGs) to only such banks which fulfil the following criteria:

   i. Minimum net worth of the bank shall be INR 5,000 Cr.

   ii. Banks with unsupported long-term rating of AA and above or banks issuing unsupported long-term instrument with rating of AA and above (excluding rating of bonds issued by the Bank for the purpose of capital requirements under the Basel III). Banks issuing unsupported long-term instrument with rating below AA, shall not be eligible for this purpose. In case of foreign banks, an equivalent credit rating on the global credit rating scale (equivalent to AA and above rating by domestic Credit Rating Agencies (CRAs)) may be considered by the CCs for assessment of the credit worthiness of the bank;

   iii. In case, credit rating is obtained from multiple CRAs, the most conservative rating shall be considered for this purpose.

   iv. Meet the capital adequacy requirements prescribed by Reserve Bank of India (RBI) from time to time; and

v. Banks which are not under Prompt Corrective Action (PCA) Framework of RBI.

d) In case of exposure to banks which subsequently fails to meet any of the above eligibility conditions, CCs shall rebalance its exposure through own funds and Core SGF to such banks as soon as possible but not later than three months from such non-compliance. However, exposure of CC to such banks through CMs shall be removed at the earliest.

3.3 <u>Single Bank exposure limits</u>

a) The exposure of CCs and its subsidiaries towards banks through Cash, FDs and BGs must be adequately diversified, and daily exposure to a single bank shall not exceed:

i. 15% of the average daily exposure of previous three months considering all liquid assets of CCs, for banks with AAA rating; and

ii. 10% of the average daily exposure of previous three months considering all liquid assets of CCs, for banks with AA (include both AA and AA+) and above rating but below AAA.

b) At the end of every month, the average daily exposure of CC in liquid assets shall be calculated based on the exposure of previous three months. The single bank exposure limit for the next month would be based on this average daily exposure. The same shall be monitored on daily basis.

c) In order to allow the CCs to have operational flexibility, the daily exposure may be extended by 5%. In those cases, the CCs shall record the reasons for such increase in exposure and ensure to bring down the daily exposure to a single bank to 15% (or 10% as the case may be) on monthly average basis on priority.

d) The above limits shall be applicable separately for the following heads:

i. CCs’ own funds.

ii. Core SGF corpus.

iii. CCs' exposure through their members, warehouse service providers or other entities.

e) CCs' own funds and core SGF corpus can only be deployed in FDs, T-bills, G-secs and units of Liquid and Overnight mutual fund scheme.

f) The exposure to FDs shall be through premature withdrawable FDs, which can be terminated at any time before maturity, at the discretion of the CM/CC, without any loss of principal.

g) Margin monies or cash collateral received after closing of RTGS window and/or market hours leading to breach of the exposure limit shall not be treated as non-compliance on that day and shall be rebalanced on the next day.

3.4 <u>Exposure of CCs to equity, corporate debt instruments and units of overnight & liquid mutual fund schemes:</u>

Exposure of CCs to equity and debt instruments (both bank and non-bank entities) through CMs may be subject to the following:

a) CCs shall devise well-defined criteria for exposure to equity and debt instruments through CMs (i.e. acceptance of collateral) in order to ensure adequate diversification, liquidity, etc.

b) The total exposure of the CC to equity and debt instruments of an issuer, received as collateral from CM in both cash and F&O segment (including commodity and currency derivatives segment) put together, shall not exceed 15% of total liquid assets of the CC received from CMs; and shall be treated as part of non-cash component of the total liquid assets of the CC.

c) CCs shall ensure that the corporate bonds provided by a CM shall not exceed;

i. 10% of the total liquid assets of the CM placed with CC, in case the unsupported long-term issuer rating or unsupported rating of long-term instruments of that issuer is AAA.

ii. 8% of the total liquid assets of the CM placed with CC, in case the unsupported long-term issuer rating or unsupported rating of long-term instruments of that issuer is AA and above but below AAA.

iii. Exposure for this purpose through equity and debt instruments shall be based on mark to market value of the securities less the applicable haircuts.

iv. In case of exposure to entities whose own rating or rating of any of its instruments has been downgraded subsequently from the rating criteria specified in paragraphs above, the CCs shall remove the exposure to such issuers at the earliest.

d) In case the equity security does not meet the liquid security criteria (as specified in the table contained in paragraph 5 of Part A of this circular), the same needs to be replaced by the CM at the earliest. In case of passive breach in exposure limit for equity securities due to mark to market valuation, the CCs shall rebalance the excess exposure to the issuer within three months from such deviation.

e) CCs shall not accept the collaterals from CMs, which are acquired through bespoke transactions (i.e. the CM is the sole subscriber of such corporate debt issuances).

f) The aforesaid exposure limits to debt instruments shall not be applicable to securities which are underlying the repo on corporate debt securities.

g) Investments made by CCs in units of Overnight and Liquid Mutual Fund Schemes shall not exceed a limit of 10% of the total investible resources held in CCs’ own funds. and Core SGF corpus separately, at any point in time.

3.5 Overall Bank Exposure:

The overall daily exposure of a CC to a single bank (including cash, FD, BG, equity and debt) through CM collateral shall not exceed 20% of the total liquid assets.

3.6 Restriction on Exposure to instruments of TM/CMs' Own Group:

CCs shall not accept collateral including FDs, BGs, equity, or debt securities issued by CMs/TMs themselves or their group or associate entities. A Declaration to that effect will be given by CMs/TMs mentioning all their group/associate entities to CCs.

3.7 Exemption from these norms for trading based on UPI Blocking:

In case of trading based on UPI Blocking, amount received through UPI blocks shall be exempted from computation of exposure limits to the banks providing such services to CC.

3.8 Implementation and Monitoring of the norms by the CC:

i. CCs shall incorporate periodic targets in their internal policy so as to achieve the above mentioned exposure limits in a timely manner. Further, CCs shall have a mechanism in place for monitoring their exposure through CMs/TMs on End of day (EoD) basis and keep a cushion of limits so that the exposures can be maintained within the limit without any operational difficulties.

ii. In order to ensure smooth implementation of the above measures, it has been decided to implement the same in a phased manner as given below:

Sl. No.	Exposure Type	Proposed Timeline
1	CCs' own funds and Core SGF funds invested or deployed with banks in the form of Cash and BG	3 months

2	CCs' own funds and Core SGF funds invested or deployed with banks in the form of FDs.	1 Year
3	Exposure of CCs' to banks in the form of Cash, FDs, BGs received from their members or warehouse service providers or other entities.	1 year
4	Phasing out of collaterals with CCs, which are issued by CMs or their TMs; or group or associate companies of such CMs/TMs; in the form of FDs, BGs, Equity or Debt securities.	6 months
5	Overall exposure limit of 20% to a single bank.	1 year

4. The prudential norms prescribed at paragraph 3 above, represents the minimum standards to be adopted by the CCs. However, CCs based on their own risk assessment, may stipulate more conservative prudential norms.

5. In view of the provisions at paragraph 3 above, paragraph 2.5.1 of Chapter 6 and paragraph 6.6 of Chapter 3 of Master Circular dated October 16, 2023 for Stock Exchanges and Clearing Corporations shall stand modified suitably.

III. **Applicability:** The provisions of this circular shall come into force with effect from August 01, 2024.

IV. All clearing corporations are advised to:

1. take necessary steps and put in place necessary systems for implementation of the above.
2. make necessary amendments to the relevant bye-laws, rules and regulations, wherever required, for the implementation of the above; and
3. bring the provisions of this circular to the notice of the market participants (including investors) and disseminate the same on their website.

V. This circular is issued in exercise of the powers conferred under Section 11(1) of the Securities and Exchange Board of India Act 1992 read with Regulation 51 of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

VI. This circular is available on SEBI website at www.sebi.gov.in at “Legal Framework - Circulars.”

Yours faithfully,

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