RESERVE BANK OF INDIA
FINANCIAL MARKETS REGULATION DEPARTMENT
9^{TH} FLOOR, CENTRAL OFFICE BUILDING, FORT
MUMBAI 400 001

Variation Margin (Reserve Bank) Directions, 2020 - Draft

In exercise of the powers conferred under section 45W of the Reserve Bank of India Act, 1934 (hereinafter called the Act) read with section 45U of the Act, the Reserve Bank of India (hereinafter called the Reserve Bank) hereby issues the following Directions.

A reference is also invited to the Foreign Exchange Management Act, 1999 (42 of 1999), Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (Notification no. FEMA.25/RB-2000 dated May 3, 2000), Foreign Exchange Management (Margin for Derivative Contracts) Regulations, 2020 (Notification no. FEMA.XXX/RB-2020 dated XXX, 2020)] and A.P. (DIR Series) Circular No. XXX dated XXX, 2020.

1. Short title, commencement and applicability of the directions

(1) These Directions shall be called as the Variation Margin (Reserve Bank) Directions, 2020 and shall come into force with effect from < a specified date>.

(2) These Directions shall be applicable to non-centrally cleared derivative (NCCD) contracts, which are entered into, on or after the date on which these Directions come into force.

2. Definitions

(1) In these Directions, unless the context otherwise requires:

- (a) **Average aggregate notional amount (AANA)** means the average of the aggregate month-end gross notional amount of outstanding NCCDs, for the previous 12 months.
- (b) **Consolidated group** means a group within the meaning of Indian Accounting Standard (Ind AS) 110: Consolidated Financial Statements.
- (c) **Collateralise to Market** (CTM) refers to an approach to transfer Variation Margin wherein the transferred margin is characterised as collateral to secure

the current mark-to-market exposure between the parties to a derivative contract.

(d) **Domestic Covered Entities** means:

(i) Financial entities regulated by Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority of India and Pension Fund Regulatory and Development Authority of India;

(ii) International Financial Services Centre (IFSC) Banking Units (IBUs); and

(iii) Other entities, including Foreign Portfolio Investors (FPIs), having an AANA of outstanding NCCDs of ₹50,000 crore and above, on a consolidated group wide basis.

(e) **Foreign Covered Entity** means an entity operating outside India and includes:

(i) Regulated financial entities; and

(ii) Other entities having an AANA of outstanding NCCDs of USD 8 billion and above, on a consolidated group wide basis.

(f) **Netting agreement** means an arrangement where, upon a default or early termination by a party to the arrangement, the parties to the arrangement are contractually obligated to net the mark-to-market values of all NCCDs that are the subject of the arrangement, into a single net payable or receivable.

(g) **Non-centrally cleared derivatives (NCCDs)** means permitted derivatives which are not cleared by a central counter party.

(h) **Permitted derivative contract means**:

(i) Foreign exchange derivative contract undertaken in terms of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 and Master Direction – Risk Management and Inter-bank Dealings, as amended from time to time.

(ii) Interest rate derivative contract undertaken in terms of the Rupee Interest Rate Derivatives (Reserve Bank) Directions, 2019 (Notification no. FMRD.DIRD.20/2019 dated June 26, 2019), as amended from time to time, issued under section 45W of the Reserve Bank of India Act, 1934.

(iii) Credit derivative contract undertaken in terms of Notification no., IDMD.PCD.No.10/14.03.04/2012-13 January 7, 2013, as amended from time to time.

(iv) Any other derivative contract as may be specified by the Reserve Bank.

(i) **Related entities** means entities as defined under Para-9 of Indian Accounting Standard (Ind AS) 24: Related Party Disclosures.

(j) **Settle to Market** refers to an approach to the transfer of Variation Margin wherein the transferred margin is deemed to settle the current mark-to-market exposure between the parties to a derivative contract, with no right to reclaim and no obligation to return the Variation Margin. After the settlement, the mark-to-market exposure between the parties is reset to zero.

(k) **Variation Margin** means the collateral that is collected or paid to reflect the current mark-to-market exposure resulting from changes in the market value of a derivative contract.

(l) Words and expressions used but not defined in these Directions shall have the meaning assigned to them in the Reserve Bank of India Act, 1934.

3. Entity Scope

(1) These directions shall be applicable to Domestic Covered Entities.

(2) A Domestic Covered Entity shall exchange Variation Margin with a counterparty to an NCCD transaction if the counterparty is a Domestic Covered Entity or a Foreign Covered Entity. Where a counterparty to an NCCD transaction is not a Domestic Covered Entity or a Foreign Covered Entity, the market maker shall obtain a declaration from the counterparty to the effect that it is not a covered entity under these Directions.

(3) These Directions shall not be applicable to an NCCD transaction in which one of the counterparties is any of the following entities:

(a) Government of India and State Governments;

(b) Foreign Sovereign;

(c) A Central Bank;

(d) A Multilateral Development Bank; and

(e) Bank for International Settlements.

(4) These Directions shall not be applicable to an NCCD transaction between entities belonging to the same consolidated group.

(5) For the purpose of ascertaining whether an entity is a Domestic Covered Entity or a Foreign Covered Entity in terms of paragraph 2 (1) (d) (iii) or 2 (1) (e) (ii) of these Directions respectively, the computation of AANA shall include NCCD

transactions with entities referred to under paragraph 3(3) above, but exclude intra-group transactions.

4. Calculation and exchange of Variation Margin

(1) Variation Margin shall be calculated on a daily basis and exchanged at the earliest possible after the transaction date (“T”) or margin recalculation date (“R”), but no later than the end of the next local business day (“T+1” or “R+1”).

(2) Variation Margin shall be exchanged to fully collateralise to market or settle to market, the mark-to-market exposure of an NCCD contract. In the event that the exposures cannot be marked-to-market, a pre-agreed alternative process or fallback mechanism shall be used.

(3) Variation Margin shall be calculated and collected on an aggregate net basis, across all NCCD contracts that are executed under a single, legally enforceable netting agreement.

(4) A minimum threshold of ₹ 5 lakh will be applicable for the exchange of Variation Margin. The participants may agree to not exchange margin if the Variation Margin amount due, since the last exchange of margin, is lower than the minimum threshold. The entire margin amount will need to be mandatorily exchanged if the Variation Margin amount is equal to or more than ₹ 5 lakh.

(5) In case of an NCCD transaction between a Domestic Covered Entity and a Foreign Covered Entity, the Variation Margin may be posted/collected either in India or in an overseas jurisdiction, in terms of the Credit Support Annex (CSA) and subject to the provisions of A.P. (DIR Series) Circular No. _ dated xxxx xx, 2020 (*to be issued*).

5. Eligible collateral and haircuts

(1) The collateral eligible for exchange of Variation Margin between two Domestic Covered Entities shall include:

   (a) Cash (INR);

   (b) Debt securities issued by Indian Central Government and State Governments; and

   (c) Listed INR bonds with a credit rating of AAA, and issued by an Indian corporate.

(2) The collateral eligible for exchange of Variation Margin between a Domestic Covered Entity and a Foreign Covered Entity shall include:
   (a) Cash (INR or any freely convertible currency);
   (b) Debt securities issued by Indian Central Government and State Governments;
   (c) Debt securities issued by a foreign central government with a credit rating of AA and above; and
   (d) Listed INR bonds with a credit rating of AAA, and issued by an Indian corporate.

(3) Foreign Portfolio Investors (FPIs) and IFSC Banking Units (IBUs) shall be allowed to use eligible collateral mentioned under para 5(2) above, for exchange of Variation Margin.

(4) A schedule of minimum haircuts, to be applied on the collateral exchanged as Variation Margin, is set out in Annex 1. Entities may apply additional haircut based on tenor and liquidity of the security.

(5) Securities issued by both the counterparties to an NCCD transaction, or their related entities, shall not be accepted as collateral.

(6) The value of the collateral shall not exhibit significant correlation with the creditworthiness of the counterparty or the value of the underlying NCCD portfolio in a way that could undermine the effectiveness of the protection offered by the margin collected.

(7) The collateral collected in the form of listed INR bonds shall not be overly concentrated in terms of an individual issuer or issuer type.

6. Treatment of cash collateral as Variation Margin

(1) Cash collateral received as Variation Margin by banks shall not be treated as deposit, and the provisions under Master Direction - Reserve Bank of India (Interest Rate on Deposits) Directions, 2016, as amended from time to time, shall not be applicable to it.

(2) Cash collateral received as Variation Margin by banks shall be included in the bank's DTL/NDTL for the purpose of reserve requirements.

7. Margin requirements for cross-border NCCD transactions

(1) An NCCD transaction between a Domestic Covered Entity (including its foreign branches) and a Foreign Covered Entity may be subject to margin requirements in a foreign jurisdiction. A Domestic Covered Entity (including its foreign branches) and its counterparty in the foreign jurisdiction may decide to comply with these Directions, or the margin requirements implemented by the foreign jurisdiction provided the margin requirements in the foreign jurisdiction are assessed to be comparable to the requirements in these Directions.

(2) In considering whether the margin requirements in a foreign jurisdiction are comparable, the Reserve Bank of India would have regard to whether the framework in the foreign jurisdiction is implemented in line with the policy framework on Margin Requirements for Non-Centrally Cleared Derivatives issued by the Basel Committee for Banking Supervision (BCBS) and International Organization of Securities Commissions (IOSCO). The Reserve Bank may impose additional conditions to be met by a Domestic Covered Entity intending to comply with the margin requirements of specific foreign jurisdictions.

8. Dispute Resolution

(1) A Domestic Covered Entity shall ensure that rigorous and robust dispute resolution procedures are in place with the counterparty before undertaking an NCCD transaction.

(2) In the event that a margin dispute arises, the non-disputed amount shall be exchanged first. A Domestic Covered Entity shall make all necessary and appropriate efforts, including timely initiation of dispute resolution protocols, to resolve the dispute and exchange the remaining Variation Margin amount in a timely fashion.

(Dimple Bhandia)
General Manager-in-charge

Annex 1

Standardised Haircut Schedule

Asset Class		Haircut (% of market value)
Cash in the currency of settlement of the derivative transaction		0
Debt securities issued by Indian central and state governments / foreign central governments	Residual maturity ≤ 1 year	0.5
	Residual maturity > 1 year, ≤ 5 years	2
	Residual maturity > 5 years	4
Listed INR bonds issued by an Indian corporate and with a credit rating of AAA	Residual maturity ≤ 1 year	4
	Residual maturity > 1 year, ≤ 5 years	6
	Residual maturity > 5 years	8
Additional (additive) haircut on INR listed bonds issued by financial institutions (to address possible wrong way risk)		5
Additional (additive) haircut on asset in which the currency of the derivatives obligation differs from that of the collateral asset		8