THE CLEARING CORPORATION OF INDIA LTD

Risk Management Department

This has been Superseded by Notification No. RMD/ SS/21/27 dated 01-Sept-2021 on Default Fund (revised and updated)

No. RMD/SS/19/27 **25th Jul, 2019**

FOR INFORMATION OF ALL MEMBERS

Securities Segment

Default Fund (revised and updated)

Introduction

In terms of the provisions of Chapter XVI, "Default Fund" of the Regulations of the Securities Segment, the Clearing Corporation shall maintain two separate Default Funds, viz. *the Securities Default Fund (SEC-DF),* referenced to outright and repo trades and, *the Tri-party repo Default Fund (TPR-DF),* referenced to Tri-party repo trades in Securities segment, with a view to meeting losses arising out of default by Member(s) of this segment. Members seeking to avail guaranteed settlement services in this segment shall be required to deposit their contribution to the appropriate Default Fund/s.

In this regard, we invite your attention to our Notification No. RMD/SS/18/127 dated 21st December 2018 which details the processes in place with regard to the Default Fund for Securities Segment. Members are advised to take note of the enhancements / modifications to these processes. Accordingly, the afore-mentioned notification stands revised as below. The changes implemented have been **underlined.**

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2. Default Fund Corpus

2.1. Default Fund corpus, refers to the contribution required to be made by all members of the segment towards each fund viz. SEC-DF and TPR-DF. The corpus for both the funds shall be determined at the end of each month, and shall be applicable for the following month.

2.2. Corpus of each Default Fund shall be determined by the Clearing Corporation on the basis of daily Credit Stress Test results as follows:

a. The Default fund shall be equal to the sum of the highest stress loss on account of a Member & its affiliates in the preceding six months period *and* the highest stress losses on account of five weak entities (on same day and same scenario as the highest stress loss).

b. In case such revision results in a reduction in the corpus of the Default Fund to an amount which is less than 85% of the corpus prevailing at the time of the revision, then the revised corpus shall be restricted to 85% of the prevailing default fund corpus.

2.3. Additionally, during the month, in the event, the highest stress loss on account of a Member and its affiliates exceeds 95% of prefunded default handling resources, the respective Default Fund shall be revised and, additional contributions towards that Default Fund shall be called, to the extent by which the stress loss exceeds 95% of pre-funded default handling resources. This call for additional contributions will be made on the day stress test results indicate a breach of resources.

3. Stress Test methodology

3.1. Settlement obligations, outstanding trades and outstanding TPR borrowings and lending of the members and, securities deposited by members towards margin requirements and TPR borrowings shall be assessed over a range of historical and hypothetical stress scenarios.

3.2. Historical stress scenarios shall be based on historically observed extreme movements in risk factors over a short duration which is equal to the Margin Period of Risk (MPOR[1]) applicable for the segment. Risk factors include standard tenor interest rates, swap rates and USD/INR spot and forward exchange rates.

[1] MPOR or 'Margin period of risk' is the holding period assumed in margin model. In Securities Segment, MPOR is 3 days for initial margin on trades and for the haircuts on securities deposited towards SGF. For securities deposited as collateral towards Borrowing Limit for Triparty repo trades, MPOR is 5 days.

3.3. Hypothetical scenarios shall be based on extreme value distributions, such as Generalised Pareto distribution, which are used to determine extreme movements in risk factors at a very high confidence level. The confidence level shall be 99.9%.

3.4. Loss on Member's portfolio in excess of stressed value of securities deposited as margins, on any given stress scenario shall be considered as stress loss on account of the Member for the given stress scenario.

3.5. Stress losses (ignoring profits) on account of members and their affiliates are then aggregated for each group of members and for each stress scenario.

4. Member contribution to Default Fund

4.1. The contribution required to be made by a Member towards Default Fund shall be notified by means of a report published on the report browser that can be downloaded by the Member. The information can also be availed by logging in to Integrated Risk Information System (IRIS).

4.2. Members will be required to deposit the requisite amount of collateral towards their respective Default Fund requirements latest by 11 AM on subsequent working day (including working Saturday) post receipt of such notice for revision in Default Fund requirement.

4.3. Members' Default Fund requirements shall be based on the following three components:

a. Average outstanding gross trade volume in the previous six months with a weightage of 50%.

b. Average Initial Margin requirement in the previous six months with a weightage of 25%.

c. Highest Stress Loss on account of the member in the previous six months with a weightage of 25%.

4.4. The minimum contribution required to be made by a Member shall be as under:

- SEC-DF: Rs. 10 lacs and,
- TPR-DF: Rs. 10 lacs.

4.5. Members shall be required to maintain a minimum of 5% of their default fund requirements in the form of cash. The remaining contribution may be in the form of eligible Government Securities.

4.6. All Central Government Securities *(except Special Securities*) including STRIPS created out of these securities and Treasury Bills (including Cash Management Bills) shall be eligible for deposit towards Default Fund. Any new security becoming eligible for deposit towards Default Fund shall be notified to the members.

4.7. The securities contributed by members towards Default Fund shall be valued at end of the day using the latest MTM prices and will be subjected to haircut. The hair cut rate shall be at 5 day VaR at 99% confidence level adjusted by a volatility component of 50%. The values so adjusted shall be further subjected to a minimum/ maximum value for securities[2] falling in a particular tenor bucket and then stepped up using illiquidity multiplicands as indicated below (and rounded up to the next higher integer):

a. For Liquid-Securities having average of more than ten trades (face value>= Rs.5 Cr) per day during previous calendar month – no adjustment to the VaR as above.

b. For Semi-liquid securities having average of 1-10 trades(of face value >=Rs.5 crores) per day during previous calendar month - 1.5 times the adjusted VaR as above.

c. For illiquid securities having average of less than 1 trade (of face value>=Rs.5 crores) per day during previous calendar month - 2 times the adjusted VaR as above.

[2] Refer notification no. RMD/SS/18/75 dated 21st Aug 2018.

Further, in the event of imposition of Volatility Margin in Securities segment, the securities deposited towards the Default Fund will be re-valued using the latest traded prices or MTM prices, as the case may be, and the hair cut rates will be scaled up by the applicable Volatility Margin percentage. In case such revaluation of securities results in increase in value of collateral even after applying the increased haircut rate, such increase in value will be ignored.

4.8. If the value of the securities deposited towards default fund, net of haircuts (adjusted for Volatility Margin if any in the Securities Segment), falls below a threshold level of 95% of required Default Fund contribution, then such members shall be required to contribute additional collateral towards Default Fund as may be necessary to meet their respective Default Fund requirements.

4.9. Additional contributions towards Default Fund may also be required in the event of default by a Member and the resultant usage of non-defaulters' Default Fund contribution.

4.10. In case at end of the day, a shortfall is recorded in the requisite Default Fund contribution by a Member, the same shall be automatically adjusted by the Clearing Corporation in the following order:

A. Shortfall in Sec-DF

4.10.a.1. First from the surplus balance in any of the Default Funds contributed by the Member in this or in any other segment(s).

4.10.a.2. In case the surplus as in (1) above is not adequate to cover the shortfall in the default fund then, the shortfall shall be sought to be covered by drawing from the unutilized margin (excluding MTM credits, if any) made available in the Securities Segment SGF.

B. Shortfall in TPR-DF

1. First from the surplus balance in any of the Default Funds contributed by the Member in this or in any other segment(s).
2. In case the surplus as in (1) above is not adequate to cover the shortfall in the default fund then, the shortfall shall be sought to be covered by

drawing from the unutilized initial margin / collateral towards TPR Borrowing Limit (BL).

4.11 Excess collateral and/or margins blocked in terms of para 4.10 above shall be released as soon as the shortfall in the Default Fund account is replenished by the Member by depositing additional collateral.

4.12 Failure to replenish the residual shortfall in default fund (after the adjustments as per para 4.10 above) by 11-00 AM on the next business day shall attract penalty as per the following structure:

Penalty for shortfall in default fund (based on number of days in a calendar quarter)*	**Penal charges applicable (exclusive of applicable taxes)**
For first three days	5 basis points per day on the amount of Shortfall*
From 4th to 13th days (or till the day of replenishment whichever is earlier)	10 basis points per day on the amount of shortfall*
From 14th day onwards till the day of replenishment	20 basis points per day on the amount of shortfall*

*Subject to minimum applicable of Rs. 100/- + taxes

5. CCIL's contribution towards prefunded default handling resources

5.1. Member contributed Default Fund and, CCIL's contributions from Settlement Reserve Fund referred to as 'Skin In the Game (SIG)', together constitute prefunded default handling resources.

5.2. CCIL's contributions shall be higher of 25% of the respective default fund or highest amount contributed by any Member towards the respective Default Fund.

5.3. CCIL's contributions as per para 5.2 above shall be subject to availability of resources in Settlement Reserve Fund. In the event, aggregate SIG requirement across all segments exceeds the available balance in Settlement Reserve Fund, then CCIL's SIG contribution for all segments shall be reduced on pro-rata basis to the level of resources available in Settlement Reserve Fund.

5.4. Once defaulter's margin and default fund contributions have been used to meet losses, 60% of CCIL's contribution determined as per para 5.2 and 5.3 above shall be made available as first tranche of CCIL's contribution, which shall be utilised before non-defaulters' contribution towards Default Fund are utilised.

5.5. The remaining 40% of CCIL's contribution, which is the second tranche, shall be utilized after non-defaulters' contribution towards Default Fund are utilized.

6. This Notification supersedes all earlier Notifications issued in this regard for the segment.

7. This notification shall be effective from **1st September 2019.**

Yours faithfully,

For The Clearing Corporation of India Ltd

Sd/-

Managing Director