CCIL Response: 'Resilience and recovery of central counterparties (CCPs): Further guidance on the PFMI- Consultative Report'.

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Submitted Electronically

Re: ***Resilience and recovery of central counterparties (CCPs): Further guidance on the PFMI- Consultative Report***

CCIL appreciates the opportunity made available to comment on the *'Resilience and recovery of central counterparties (CCPs): Further guidance on the PFMI- Consultative Report'*.

The Clearing Corporation of India Ltd. (CCIL), set up in April 2001, is a payment system authorized under the Payment and Settlement Systems Act, 2007 and Regulations there under by Reserve Bank of India (RBI). It provides clearing & settlement in OTC financial market products, mainly to the wholesale market players which are also regulated entities. As a CCP and clearing service provider, it has always managed the incidental risks in a proactive manner. Reserve Bank of India, as regulator, has declared CCIL as a qualified CCP (QCCP) in January '14.

While, CCIL as an organisation is pleased with the guidance provided, there are certain areas on which we have provided our comments as below:

<u>Governance: Design and Objectives of margin systems and stress testing framework (Section 2.2.1-2.2.5)</u>

- CCIL is of the opinion that the board should take overall responsibility for the risk management framework while directing material risk management decisions, either directly or through one of its sub-committees dedicated to oversee risk management functions, but the responsibility for day-to-day risk management should continue to be with the internal risk management set up of the CCP.

- Also, respective jurisdictions have stringent legislations (For example Companies Act in India) that regulate governance related issues and the regulators of the jurisdictions come out with very detailed regulatory framework governing this space and hence it is best left to the regulators of the respective jurisdiction to regulate this space. The granularity of implementation should be decided by the respective jurisdictions based on the broad guidelines of PFMI.

- While a CCP's Board or one of the sub-committees dedicated to oversee risk management functions should be responsible for putting in place an appropriate framework for margining and stress testing and any changes/ modifications thereto, the implementation of the framework should be left to the risk management set up of the CCP.

<u>Governance: Disclosure and Feedback mechanism (Section 2.2.15- 2.2.20)</u>

- On the point that a CCP should publish their proposed rules for clearing member comments may create further problems to the system as there may be tendencies to drive the individual member's agenda through this process.

- Clearing members should not be a part of the discussions to decide the appropriate amount of the CCPs skin in the game (SIG) as this would create perverse incentives that could lead to a CCP loss absorbing resource that is unnecessarily large. CCP SIG is not meant to subsidize the risk of the clearing members. In fact the amount of CCPs skin in the game should be appropriate so as to create sufficient incentive to mitigate any imprudent risk management practices on its part as well as the free rider effects of over relying on contributions made by member participants. The ultimate objective is to align incentives of the CCP with those of its clearing members and soliciting views of clearing members on CCP's skin in the game could lead to commercially driven feedback.

<u>Stress Testing: Use of end-of-day, intra-day and intra-period price and intraday position movements (Section 3.2.34- 3.2.35)</u>

- CCPs already have a robust exposure management and margining system (initial margin, variation margin, etc.) in place to manage intraday exposures. This ensures that it is able to detect any kind of surge in the risk parameters or outliers (through floors/triggers set into the system) and deal with them, well in time. Besides intra-day fluctuations are generally transitory in nature and generally get captured through the end of day data.

Coverage: Ignoring Voluntary, Excess Contributions (Section 4.2.4)

- A CCP should be allowed to consider excess contributions made by clearing participants, if the CCP has sufficient rules and procedures in place to control or delay the withdrawal of such excess contributions at the time of a default. However, such excess resources should not be counted upon to assess the adequacy of a CCP's resources. This is because participants tend to reduce their excess collateral when their perception on CCP risk and/or systemic risk deteriorate (even in the absence of defaults), a coverage weakness may be identified exactly in moments in which it should be no doubt on the CCP ability to deal with defaults.

CCP contribution to losses: Custody and Investment losses (Section 6.2.3)

- In addition, a CCP that is charged with physical settlement may be compelled to use a commercial bank for such settlement, either because the central bank does not maintain accounts for such entities or because the settlement is in a foreign currency. Typically, a CCP appoints settlement bank(s) for the purpose after a careful process of evaluation and selection, ensuring that the account balances are monitored and are not allowed to exceed predefined limits. Despite these risk controls, participants could be exposed to potential losses because of a failure of the settlement bank at a time when money that has been received into the account has not yet been paid out. While a CCP should identify some amount of its own resources to be used to meet such a default, the participants may also be expected to bear a portion of such loss if prudent practices as set out above have been followed, if the participants have been given due notice of their exposure to the settlement bank and the circumstances under which a share of the loss is likely to devolve upon them.