29 July 2022

BY E-MAIL and HAND

The Chief General Manager
Reserve Bank of India Financial Markets Regulation
Department 9th Floor,
Central Office Building Shahid Bhagat Singh Marg, Fort
Mumbai – 400 001

Email: fmrdfeedback@rbi.org.in

Dear Smt. Dimple Bhandia,

ISDA's response to RBI consultation on draft Initial Margin directions for non-centrally cleared derivatives

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] welcomes the opportunity given by the Reserve Bank of India ("**RBI**") to comment on the regulations relating to Initial Margin of the Draft RBI (Margining for Non-Centrally Cleared OTC Derivatives) Directions, 2022[2] ("**Draft Directions**") which includes consolidated provisions for both variation margin ("**VM**") and initial margin ("**IM**").

ISDA strongly supports the development of derivatives markets in India and the implementation of close-out netting, which is important to facilitate the growth of India's derivatives market. ISDA also welcomes and appreciates RBI's continued efforts to finalize the margin requirements for non-centrally cleared derivatives ("**NCCD**") thereafter.

The effective implementation of a non-cleared margin framework in India, especially IM, could serve as an opportunity to improve efficiencies of India's OTC derivatives markets and further strengthen the engagement of international financial market participants and the development of hedging activities. As such, ISDA is keen to continue an open and constructive dialogue with RBI and to propose practical solutions.

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 990 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org

[2] https://rbidocs.rbi.org.in/rdocs/Content/PDFs/NCCD16062022A3A46AB3058142BCB6D957DD060573F2.PDF , Master Direction – Reserve Bank of India (Margining for Non-Centrally Cleared OTC Derivatives) Directions, 2022 – Draft

International Swaps and Derivatives Association, Inc.
Suite 1602, 16th Floor, China Building,
29 Queen's Road, Central
Central, Hong Kong
P 852 2200 5900 F 852 2840 0105
www.isda.org

NEW YORK WASHINGTON
LONDON BRUSSELS
HONG KONG SINGAPORE
TOKYO

We welcome the following proposals made by RBI in its Draft Directions on IM that are consistent with international standards and practices in other jurisdictions:

- Use of either standardised approach or quantitative portfolio margin model for the calculation of IM without subjecting the IM amount to a floor of 80% of the amount computed under the standardised approach that was in consideration in 2016.
- Exemption from IM of physically settled foreign exchange transactions associated with the exchange of principal of cross-currency swaps.
- Confirmation of segregation of IM by either using a third-party custodian or other legally effective arrangements.
- Allowing substituted compliance for cross-border derivatives transactions between Domestic Covered Entity ("**DCE**") and Foreign Covered Entity ("**FCE**").

In the past ten years, ISDA has developed a fruitful dialogue with policy makers, central banks and financial markets regulators in jurisdictions that have implemented the final policy framework[3] first issued by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions ("**BCBS-IOSCO Framework**") on margin requirements for NCCD. In this respect, ISDA has played a key role in the advocacy and implementation efforts for margin requirements in APAC jurisdictions (such as Australia, Hong Kong, Japan, Singapore, South Korea), and we are happy to share our experience and perspective on the issues faced by these jurisdictions in the implementation of IM requirements.

ISDA has also developed the ISDA Standard Initial Margin Model (ISDA SIMM® or SIMM)[4], which is widely used across jurisdictions and recognised by regulators. The ISDA SIMM is a common industry-wide methodology, delivering key benefits to the market, such as permitting timely and transparent dispute resolution and allowing consistent regulatory governance and oversight.

From our perspective, the following pillars would be considered essential to the successful implementation of the IM framework for NCCD :

- Consistent implementation of internationally agreed standards across jurisdictions in accordance with BCBS-IOSCO Framework
- Mutual recognition between jurisdictions and therefore substituted compliance
- Permission of exchange of collateral offshore (outside of India) for transactions executed between (i) two DCEs and (ii) DCEs and FCEs.
- Adoption of common global practices such as the use of third-party custodians and segregation of collateral.

We have shared this perspective with RBI in the past few years. Some of our comments were already included in the ISDA response to the 2016 Margin Consultation submitted on 8 June 2016[5] ("**2016 Margin Response**"), and further discussed in the ISDA letter submitted to the RBI on 14 May 2018[6] ("2018 May Margin Letter") as well as the joint ISDA and Fixed Income and Money Market Derivatives Association of India ("**FIMMDA**") follow-up letter submitted on 31 August 2018[7] ("**2018 August Margin Letter**").

[3] https://www.bis.org/bcbs/publ/d499.pdf BCBS-IOSCO, April 2020 version, margin requirements for non-centrally cleared derivatives

[4] ISDA has published the ISDA SIMM® Methodology, version 2.4, with an effective date of December 4, 2021. https://www.isda.org/a/CeggE/ISDA-SIMM-v2.4-PUBLIC.pdf.

[5] https://www.isda.org/a/BmiDE/india-submission-080616.pdf, ISDA, Response to RBI Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives.

[6] https://www.isda.org/a/FTAEE/India-Submission-14-May-18.pdf, ISDA, Submission to RBI on netting & margin requirements.

[7] https://www.isda.org/a/sTAEE/India-Submission-31-Aug-18.pdf, ISDA & FIMMDA, Follow-up submission to RBI on netting and margin requirements.

ISDA

We wish to emphasize in this response that unlike the exchange of VM, which is mostly in cash, IM mostly consists of exchange of sovereign debt and other securities according to our annual survey[8]. Therefore, it is critical to ensure the full effectiveness of netting sets between counterparties and of custodial arrangements because the operational and legal preparation would be more challenging, and resource- and time-consuming.

In light of the abovementioned objectives and to support a robust IM framework in India, ISDA and its members consider that certain clarifications would be required to avoid uncertainties that would be detrimental to the development of derivatives markets in India. ISDA would particularly welcome the following amendments to the Draft Directions:

- Allow offshore exchange of collateral and substituted compliance for Indian branches of foreign banks when dealing with other DCEs
- Align the implementation of substituted compliance with global regulators and deem the Working Group on Margin Requirements ("**WGMR**") jurisdictions as comparable
- Expand the list of eligible collateral to be in line with BCBS-IOSCO Framework and global regulations
- Incentivise the use of third-party custodial arrangements to assure ring-fencing and safety
- Allow separate Minimum Transfer Amount ("**MTA**") for IM and VM

In addition to these amendments to the Draft Directions, ISDA members would strongly recommend that RBI approaches other concerned Indian authorities to seek exemption from stamp duty, registration, filing or other perfection requirements for the purpose of exchanging IM.

Lastly, ISDA would call for RBI to put in place a sufficient timeframe for the implementation of the IM requirements. Given the current absence of custodial arrangements in India and the operational and documentation challenges, the industry would need at least 18 months to implement the IM requirements, counting from the later of (i) the date when the final IM rules are published or (ii) when onshore custodial infrastructures are operational.

[8] See: https://www.isda.org/a/TwVgE/ISDA-Margin-Survey-Year-End-2021.pdf. Regulatory IM collected by phase-one firms included 5.5% of cash, 73.6% of government securities and 20.9% of other securities at year-end 2021.

General comments

In this section of the response, ISDA is raising issues that are considered top priorities by our members.

- **Allow the offshore exchange of collateral and recognize global Credit Support Annex ("CSA") construct**

ISDA members note that the definition of DCE (Clause 4.2(1) of the Draft Directions) includes '*branches of foreign banks operating in India*'. As such, ISDA members have carefully looked at the legal and operational consequences with this inclusion.

We understand from proposed Clause 6(6) of the Draft Directions that the offshore exchange of collaterals will not be applicable to the NCCD transactions between two DCEs (including the scenario where one party to the NDDC transaction is an Indian branch of a foreign bank). collateral has to be INR denominated, therefore collateral can only be kept in India, which forces the branch of a foreign bank to have two Credit Support Annex ("CSA"). In addition, Clause 9(2) states that between two DCEs – IM shall be exchanged using (a) Indian Currency (referred to as "**INR**"); and (b) Debt securities issued by Government of India and State Governments ("**Indian G-Secs**"), which would need to be kept onshore given currency controls and restrictions.

Taken together, this would mean that operationally, an Indian branch of a foreign bank would need to split its collateral portfolios and credit arrangements (for example, ISDA CSA) for IM covering (i) onshore-onshore transactions; and (ii) all other transactions respectively. Global dealers would have to enter into a separate IM CSA for onshore booked transactions will require new collateral management set-up which is operationally cumbersome and would lead to increased transaction costs without bringing significant benefits given the global dealers have implemented IM arrangements pursuant to their home jurisdiction rules since 2016. This would significantly increase documentation and operational complexities for both parties.

ISDA members note that the Draft Directions would in effect not recognize the global CSA construct that is in place between global banks. This arrangement involving multiple IM CSAs covering different transactions under a single ISDA Master Agreement has not been tried and tested globally. We are not aware of any other jurisdictions that have requirements that would lead to multiple CSAs as branches of foreign banks are not treated as covered entities and collateral need not be kept onshore. It is common practice globally that inter-bank derivative transactions are documented under a single multi-branch ISDA Master Agreement. This holds good for all the branches of the bank including where an Indian branch of a foreign bank is transacting with an Indian bank or another foreign bank's branches located in and outside India.

Additionally, these will ultimately lead to increased cost and unfavourable pricing of derivative contracts in India because of currency mismatch haircut. Clause 9(7) of the Draft Directions allows parties to specify one termination currency and imposes a currency mismatch haircut of 8% to all cash and non-cash collateral received in a currency other than the termination currency. The list of eligible collateral under Clause 9(2) for onshore transactions is denominated in INR and for cross-border transactions under Clause 9(4) both INR and foreign currency denominated collateral is permitted. Where parties are posting collateral onshore (for onshore transactions) and offshore (for cross-border transactions), there will be a currency mismatch haircut that will apply to collateral in at least one of the CSAs because substituted compliance and offshore posting of collateral are not permitted for transactions between two DCEs. This will make the collateral management more expensive and eventually leads to increased cost and unfavourable pricing of derivative contracts in India.

Therefore, we request RBI to first expressly permit offshore exchange of collaterals with respect to onshore transactions between two DCEs under Clause 6(6) that are Indian branches of foreign banks as part of their global exposure management to ensure that they continue participating in the Indian derivatives market.

This is in accordance with the BCBS-IOSCO Framework and RBI can still be assured that there will not be impact on the rights of Indian entities in the event of the insolvency of the foreign bank counterparty. According to the BCBS-IOSCO Framework, IM should be held in such a way as to ensure that (i) the margin collected is immediately available to the collecting party in the event of the counterparty's default; and (ii) the collected margin must be subject to arrangements that fully protect the posting party to the extent possible under applicable law in the event that the collecting party enters bankruptcy. We would like to highlight that these two requirements should be the focus of the Indian IM rules instead of the location of the custodian. As IM is held by a custodian and subject to the segregation requirement, the fact that it is not held in India will not have any impact on the rights of Indian entities in the event of the insolvency of the foreign bank counterparty.

We further note that to address any concerns RBI may have, RBI may require covered entities conduct legal review to verify that the segregation arrangements for IM meet the standards in the Directions, such that the IM posted can be returned in a timely manner in the event of the insolvency of a counterparty. The verification may take the form of a legal opinion obtained on an industry-wide basis by market participant (e.g., the ISDA collateral provider and taker opinions and opinions provided by relevant custodians).

- **Allow full substituted compliance for NCCD transactions executed by branches of foreign banks operating in India with other DCEs to avoid regulatory conflicts and market disruption associated with the potential application of two contradicting sets of rules to these branches**

ISDA commends the RBI for allowing substituted compliance for cross-border NCCD transactions <u>between DCE and</u> <u>FCE</u> in the Draft Directions. However, the Draft Directions does not seem to allow substituted compliance for NCCD transactions <u>between two DCEs</u>. Certain regulatory and operational difficulties will arise when an Indian branch of a foreign bank has to exchange collateral with another DCE:

- Under the proposed Draft Directions Clause 9(2), as a DCE, the Indian branch of a foreign bank shall exchange collateral with another DCE in INR or Indian G-Secs only.
- On the other hand, under the rules of the home jurisdiction of the foreign bank, the Indian branch, which is treated as part of the consolidated group and not a separate legal entity, will have to also comply with the home jurisdiction margin requirements.

In other words, an Indian branch of a foreign bank will be subject to the terms of the Draft Directions <u>and</u> NCCD margin rules applicable in its home jurisdiction, which may be conflicting to each other in the absence of full substituted compliance.

For instance, under the US CFTC Margin Rules[9], the posting party is required to direct the custodian to re-invest the collateral received in the form of cash into eligible non-cash collateral of some type, or the posting party is required to deliver eligible non-cash collateral to substitute for the posted cash collateral. An Indian branch of a US bank – being a DCE – while dealing with another DCE will be required to comply with US margin rules as well as the Draft Directions. Therefore, even if Indian branches of US banks accept INR cash as collateral for their transactions with other DCEs, they will be required to convert the INR cash collateral in a timely manner into eligible non-cash collateral. Under clause 9(2) of the Draft Directions, the eligible non-cash collateral for transactions between two DCEs can only be in the form of Indian G-Secs.

[9] The US margin rules refer, collectively, to the Prudential Regulators (consisting of the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC)), *Margin and Capital Requirements for Covered Swap Entities*, available at https://www.govinfo.gov/content/pkg/FR-2015-11-30/pdf/2015-28671.pdf ("**PR Margin Rule**"), the Commodity Futures Trading Commission ("**CFTC**") *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, available at https://www.cftc.gov/LawRegulation/FederalRegister/finalrules/2020-27736.html ("**CFTC Margin Rules**") and the Securities and Exchange Commission ("**SEC**") *Security-Based Swaps Capital, Margin and Segregation Rules*, availabel at https://www.sec.gov/rules/final/2019/34-86175.pdf,("**SEC Margin Rules**"). PR Margin Rules, CFTC Margin Rules and SEC Margin Rules all contain a USD 50 million IM threshold.

Presently, because the CFTC Margin Rules[10] deem India as a category 3[11] country in the Country Risk Classification[12] ("**CRC**") and therefore the risk weight is 50%[13].

As CFTC rules accept securities that are issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to swap dealers subject to regulation by a prudential regulator, Indian G-SECs would not qualify as eligible collateral under §23.156(iv) of the CFTC rules.

We note, however, that §23.156(vii) CFTC rules provides that collateral deemed eligible under the US prudential rules is acceptable[14]. Although subject to a higher haircut, under USPR rules other publicly traded debt may be considered eligible collateral provided the swap dealer can substantiate the debt meets the definition of Investment Grade. This determination is subjective, and might vary, leaving uncertainty as to whether it will be possible for firms to use Indian G-Secs widely in cross-border transactions with the US.

In the case of branches of European banks operating in India as well, there is a potential gap between the requirements under the Draft Directions and European Market Infrastructure Regulation[15] ("**EMIR**") requirements – if parties post IM collateral in INR cash, under the Draft Directions, the cash could be kept with a third-party custodian or through a legally effective method. However, under EMIR, eligible cash collateral is required to be kept with third-party custodians which could be central banks or authorised credit institutions (in accordance with Directive 2013/23/EU). If INR cash collateral is placed with a third-party custodian, the non-defaulting party may be subject to the credit risk of the custodian in the event of the insolvency of the custodian. This gap will remain unless there is a specific regime for ensuring solvency of a third-party custodian and segregation of the cash held with a third-party custodian (from its own assets).

This issue is more acute in the context of IM than VM because there are no segregation requirements for VM which is mainly in the form of cash, and hence does not pose significant challenges. In the context of IM, the collateral would have to be kept segregated in a bankruptcy remote arrangement, hence, it is more difficult to accept IM in the form of cash in practice.

Inadvertently, this could lead to reduced trading activities by Indian branches of foreign banks with other DCEs to avoid regulatory violations, and ultimately impact liquidity in the Indian derivatives market and ability for Indian market participants to hedge off their risk with global players.

Therefore, we request that RBI extend Clause 10(1) to allow substituted compliance for all NCCD transactions executed by branches of foreign banks operating in India with other DCEs, in line with other global and regional regulators. This will be in addition to allowing full substituted compliance for all NCCD transactions executed between a DCE and FCE.

---

[10] See, for instance, § 23.156 of the *Capital and Margin Requirements for Swap Dealers and Major Swap Participants* issued by the Commodity Futures Trading Commission.
[11] see https://www.oecd.org/trade/topics/export-credits/documents/cre-crc-current-english.pdf
[12] https://www.oecd.org/trade/topics/export-credits/arrangement-and-sector-understandings/financing-terms-and-conditions/country-risk-classification/
[13] The US CFTC rules only accept securities that are issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to swap dealers subject to regulation by the Prudential Regulators.
[14] CFTC 23.156:
(iv) A security that is issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to swap dealers subject to regulation by a prudential regulator;
(vii) Other publicly-traded debt that has been deemed acceptable as initial margin by a prudential regulator;
USPR §_.6:
Investment grade means the issuer of a security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected.
[15] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32012R0648

- **Align the implementation of substituted compliance with global regulators**

We appreciate that substituted compliance for NCCD transactions between a DCE and FCE is allowed in the Draft Directions under the condition that the margin requirements implemented by the foreign jurisdiction are assessed to be comparable. However, members expressed that the Draft Directions would require DCEs to put in place a Board-approved policy for the comparability assessment appears out of step with other jurisdictions as the comparability assessment is set top-down by other regulatory authorities. Further, this assessment of the margining framework of each foreign jurisdiction would need to be placed before the Risk Management Committee of the Board/ equivalent body and would be subject to periodic review.

We wish to share two common practices adopted in other jurisdictions:

(i) Authorities provide a list of jurisdictions assessed by the authorities to be comparable and substituted compliance with the margin requirements or provisions issued or administered by any of the following listed foreign regimes is permitted. In this regard, authorities such as CFTC and APRA provide such a list in their regulations. We note that the International Financial Services Centres Authority ("**IFSCA**") provides a list of such comparable jurisdictions in its handbook too.

(ii) Authorities deem the WGMR member jurisdictions non-cleared margin requirements to be comparable since they are based on the BCBS-IOSCO Framework. Authorities such as MAS and HKMA deem comparable jurisdictions this way, which is easier and avoids the need to do country by country comparison. The WGMR member jurisdictions include Australia, Brazil, Canada, the European Union, Hong Kong, India, Japan, Republic of Korea, Russia, Singapore, Switzerland, the United Kingdom and the United States. In this regard, HKMA's rules state that the deemed comparable status is applicable to the margin rules issued by all relevant authorities in a WGMR jurisdiction.

Therefore, we request that RBI harmonise its approach with respect to substituted compliance to be in line with global regulators. We would suggest RBI consider the latter practice adopted by MAS and HKMA to deem WGMR member jurisdictions comparable. DCEs would then be able to rely on the Draft Directions on substituted compliance with these jurisdictions. This would eradicate the need for each DCE to compare and assess multiple jurisdictions' margin rules on a regular basis and avoid any jurisdiction's margin rules to be assessed differently by different entities in India.

In the same vein, we would also recommend that RBI take the same approach in relation to substituted compliance of onshore transactions executed between an Indian branch of a foreign bank and another DCE, which ISDA members have requested RBI to consider in the previous submissions.

- **Expand the list of eligible collaterals to be in line with BCBS-IOSCO Framework and global regulators**

Members note that in the context of transactions between a DCE and FCE, the list of eligible collaterals for IM is limited to a) Indian Currency, b) Indian G-Secs, and freely convertible foreign currency and debt securities issued by foreign sovereigns with minimum credit rating. Such limitations are not aligned with the BCBS-IOSCO Framework and margin requirements of other jurisdictions. To illustrate, BCBS-IOSCO Framework suggests the following collateral would satisfy the key principle:

- Cash;
- High-quality government and central bank securities;
- High-quality corporate bonds (not included in Draft Directions except Rupee bonds);
- High-quality covered bonds (not included in Draft Directions);

- Equities included in major stock indices (not included in Draft Directions); and
- Gold (not included in Draft Directions).

As highlighted earlier, ISDA's annual surveys show[16] that securities other than government securities made up 20.9% of IM collected by phase-one firms. In addition, global jurisdictions that have implemented margin requirements allow these other instruments as eligible collateral too, subject to appropriate haircuts accordingly. We append the list of eligible collateral by MAS and HKMA below for ease of reference.

MAS allows the following to qualify as eligible collateral for both VM and IM:
(a) Cash
(b) Gold
(c) Any debt securities[17]
(d) Any equity security (including convertible bonds) included in a main stock index of a regulated exchange
(e) Any unit in a collective investment scheme where –
(i) a price for the units is publicly quoted daily; and
(ii) the collective investment scheme is limited to investing in the instruments listed in this paragraph.

HKMA lists the following as eligible collateral for VM and IM:
a) Cash funds (money credited to an account or similar claims for the repayment of money) in any currency
b) Marketable debt securities issued or fully guaranteed by a sovereign
c) Marketable debt securities issued or fully guaranteed by a multilateral development bank
d) Marketable debt securities issued or fully guaranteed by a public sector entity
e) Other marketable debt securities
f) Gold
g) Publicly traded equities included in the Hang Seng Index or any other main index as specified in Section 51 of the Bank Capital Rules.

As such, we would like to request RBI to consider expanding and aligning the list of eligible collateral for transactions between a DCE and FCE with the BCBS-IOSCO Framework and global jurisdictions.

We would also like to request that RBI extend the same expanded list of eligible collateral for NCCDs executed between two DCEs, particularly between an Indian branch of a foreign bank and another DCE. This is related to our earlier request for posting and exchange of collateral offshore. This is because the current list of eligible collateral under the Draft Directions for onshore transactions between two DCEs is very restrictive under Clause 9(2) and for Indian branches of foreign banks, these collateral under Clause 9(2) may not qualify as eligible collateral under their home country regulations nor be operationally feasible to be used as IM collateral as described above.

- **Strongly incentivise the provision of custodial services and the use of third-party custodial arrangements**

ISDA wishes to reiterate[18] the need for one or more third-party custodial service provider(s) to be operational in India, prior to the IM rules being implemented. Ideally, there should be at least one third-party custodial service provider for each type of eligible collateral in the margin requirements.

[16] See: https://www.isda.org/a/TwVgE/ISDA-Margin-Survey-Year-End-2021.pdf.
[17] (i) with an original maturity of one year or less that has a credit quality grade of "III" or better as set out in Table 4 in Annex 3 (of MAS' Guidelines); or (ii) with an original maturity of more than one year that has a credit quality grade of "4" or better as set out in Table 3 in Annex 3 if it is issued by a central government or central bank, or a credit quality grade of "3" or better as set out in Table 3 in Annex 3 (of MAS' Guidelines) if it is issued by any other entity;

[18] See our letter from 5 March 2020: : https://www.isda.org/a/1u9TE/RBI_Margin-Netting-letter.pdf.

We would encourage RBI to develop clear guidelines on licensing frameworks for international custodians to provide services in India. Any third-party custodial infrastructure established in India would also need to enable Indian branches of foreign banks comply with the IM segregation and other requirements under the margin rules of their home jurisdictions (e.g., requirements in relation to credit quality of the custodian and account structures). ISDA members highlight that any other legally effective arrangement (as mentioned under Clause 8(2) of the Draft Directions) may not comply with the margin rules of the home country jurisdiction of foreign banks operating in India. ISDA and its members therefore would like to underline the importance and the urgency to set-up at least one custodial infrastructure, preferably before or simultaneously to the finalisation of the IM rules. ISDA members suggest that RBI supports counterparties, in order to satisfy the IM segregation requirements under global standards, enter into a third-party agreement.

We would also like to underscore that there is a need to allow a sufficient transition period of at least 18 months from the later of (i) the date the final IM rules are published or (ii) the point from which custodial infrastructures are developed and operational in India for market participants to negotiate and enter into new custodial agreements. This is because we note that only a few onshore entities have collateral management systems or are familiar with the documentation required. Hence it will be important to educate the market on these requirements and allow for sufficient implementation time. Collateral exchange with respect to OTC derivatives transactions is not yet a common practice in India. The current custodial infrastructure is restricted to exchange-traded products and does not extend to OTC derivatives, especially for the purpose of meeting the IM segregation requirements. There is a need to ensure that existing or new custodial infrastructures can be developed in time for collateral exchange and management, and provide support to the market, by the implementation date.

The final IM rules should be harmonized with the legal, operational, and custodial framework which support compliance with margin requirements for dealers, banks, and buy-side firms around the globe today. It should allow DCEs, particularly Indian branches of foreign banks, to leverage existing global custodial frameworks to comply with the IM rules, to improve efficiencies of India's OTC derivatives markets and to further strengthen the engagement of international financial market participants and the development of hedging activities. In addition to developing local custodial capability in India, we encourage RBI to recognize the significant role that international custodians, which are highly regulated institutions, are playing in risk mitigation of the market under the IM rules of NCCDs across the globe and to attract international custodians to provide services in India. We request again for RBI to consider allowing exchange of IM offshore as not allowing offshore exchange of IM may disincentivise the interest of international custodian (who are presently operating in offshore locations) from entering the Indian market.

Lastly, we note that there could be a possibility that an existing entity in India that is presently offering payment services or clearing service could add custodian services to its offerings for IM. If such an entity were to step in to perform the custodian role, it would be critical to get the assurance under the Indian law that the IM in relation to NCCDs would be completely ring-fenced and cannot be affected in cases where such entity is in distress in the course of the provision of non-custodian related services.

- **Allow separate MTA for IM and VM**

Clause 6(4) of the Draft Directions states that "*A minimum transfer amount, not exceeding ₹4.5 crore, may be applied for the exchange of Variation Margin and Initial Margin combined*". We request that RBI clarify in the preceding text that entities may maintain separate MTAs for IM and VM, provided that on a combined basis, the IM MTA and VM MTA do not exceed ₹4.5 crore. This separate IM and VM MTA approach has been agreed to globally by market participants in their CSAs and is employed consistently across foreign jurisdictions as necessitated by the distinct settlement flows for IM and VM resulting from the requirement to segregate IM with an unaffiliated third party. This amendment would better reflect the operational requirements and the legal structure of Indian margin rules. A requirement which contradicts established industry flows may be impractical or impossible to implement and would negate the benefit of the MTA, which is intended to reduce operational burden by eliminating frequent exchanges of small amounts of collateral.

We recognize that in some cases separate IM and VM MTAs may result in the exchange of a lower amount of total margin than the amount that would be exchanged if the IM and VM MTA were computed on an aggregate basis. However, we believe that such differences in total margin exchanged would not be material and would not result in an unacceptable level of credit risk as the total amount of combined IM and VM that is not exchanged at any point in time will never be more than the ₹4.5 crore MTA. In other cases, the separate MTAs may result in a requirement to exchange either a VM or IM amount which exceeds the relevant MTA even when the combined amounts would not exceed ₹4.5 crore.

To illustrate how the separate MTAs will work, for example, a covered entity and a counterparty can agree to a ₹3 crore IM MTA and a ₹1.5 crore VM MTA. If the margin calculations set forth require the covered entity to post ₹4 crore of IM with the counterparty and ₹1 crore of VM with the counterparty, the covered entity will be required to post ₹4 crore of IM with the counterparty (assuming that the minimum IM threshold amount for this counterparty has been exceeded). The covered entity, however, will not be obligated to post any VM with the counterparty as the ₹1 crore requirement is less than the ₹1.5 crore MTA.

In practice, most global regulations do not explicitly state that parties can agree to maintain separate MTA amounts for IM and VM (provided the combined amount does not exceed the total allowance) but regulators have allowed this as the standard and only operationally feasible approach. However, South Korea has clarified that MTA can be specified separately for IM and VM in their Guidelines on Margin Requirements for Non-Centrally Cleared OTC Derivatives Transactions and the US Commodity Futures Trading Commission issued a letter[19] recognizing the ability to maintain separate MTAs for IM and VM. We appreciate if RBI could clarify that covered entities in India could adopt this global approach too.

- **Exempt stamp duty, registration, filing or other perfection requirements**

Stamp duty exists in many jurisdictions (e.g., UK, France) and is based on the transfer of ownership of securities resulting from a transaction. ISDA members note a fundamental difference with the application of the stamp duty in India. Currently, the execution of credit support documents and notice issued calling for collateral may attract stamp duty (with the latter attracting *ad valorem* stamp duty in certain States in India) at both the federal and state level in India. As such, stamp duty may be payable if (a) a written notice calling for collateral is issued; and (b) an acknowledgement of, or an agreement with, such notice is required by the collateral provider.

Given the serious consequences of non-payment or inadequate payment of stamp duty, ISDA members strongly call for a specific exemption in stamp duty requirements. Any additional costs incurred in connection with complying with the margin requirements would have a serious impact on how businesses conduct their trades. Application of the stamp duty would be a barrier to the development of vibrant derivatives markets in India compared to other jurisdictions where stamp duty does not apply to exchange of margin.

In addition, ISDA members note that collateral segregation requirements relating to IM may be subject to certain registration, filing or other perfection requirements. The posting of collateral by a company may also require filings with the Registrar of Companies ("**RoC**") under Section 77 of the Companies Act, 2013. However, the Companies (Amendment) Act, 2017, has provided leeway for the Central Government (in consultation with the RBI) to identify and waive certain charges that are not mandatorily required by a company to register with the RoC.

[19] See CFTC Staff Letter 19-25: https://www.cftc.gov/csl/19-25/download

ISDA members would therefore strongly support that RBI approaches the Central Government and other relevant authorities to waive registration or any perfection requirements under any legislation to ensure that the IM settlement timeframe can be met.

Specific comments

In this section of the response, ISDA is raising requests for clarification on specific clauses in the Draft Directions.

(i) Definition of 'foreign sovereign' (Clause 4.4(6)(b) of the Draft Directions)

ISDA members note that there should be a clear definition of 'foreign sovereign' under Clause 4.4(6)(b). In particular, we appreciate if RBI could clarify if any foreign state-owned entities would be considered a foreign sovereign for the purpose of the Draft Directions.

(ii) Standardised approach or Margin Model (Clause 5(2) of the Draft Directions)

ISDA members note the requirement in paragraph 5.2(1) of the Draft Directions which states that IM shall be calculated *"… thereafter on a regular and consistent basis upon changes in the potential future exposure including, but not limited to, when trades …"*.

Members would welcome further clarification because the text, as it currently states, does not provide a certain approach to the frequency, whereas other frameworks do, such as the EMIR in the EU or the IM rules in Singapore or South-Korea.

Members would also welcome the Draft Directions to confirm the ISDA SIMM model as an example of model capable of meeting the requirements of calculation "on a regular and consistent basis upon changes in potential future exposure".

If RBI does not wish to refer to a specific model, we would support that the Draft Directions provide guidance on what would be considered sufficient to meet these requirements.

Regarding paragraph 5.2 (2) of the Draft Directions, ISDA members would support a clarification that financial counterparties can use the Standardised Approach or the Model approach depending on their clients' preferences, i.e., Standardised approach for some clients and Model approach for other clients.

In other words, ISDA members strongly support that paragraph 5.2(2) does not imply that financial counterparties must choose to either use the Standardised Approach or the Model approach for all clients as each client's choice may differ and it is important to recognise flexibility in the approach.

(iii) FX haircut (Annex III of the Draft Directions)

ISDA members understand that the last line item in Annex III "Additional (additive) haircut for currency mismatch" is not meant to be an additional 8% haircut on top of the currency mismatch haircuts in para 9(6) and (7). ISDA members however feel that it should be clarified that the Draft Directions do not apply two layers of haircut to the same exchange of collateral.

Should you have any questions or desire further clarification on the matters discussed in this letter, please do not hesitate to contact the undersigned.

Yours faithfully,

ISDA

For the **International Swaps and Derivatives Association, Inc.**

Benoît Gourisse

Head of Public Policy, Asia Pacific