21 June 2024

HOD-Derivatives, CCIL
The Clearing Corporation of India Ltd.

By email: drvtrading@ccilindia.co.in

Dear Sirs,

Consultation Paper: Electronic Trading Platform (ETP) and Clearing and Settlement services for USD INR FX Options

Executive summary

The International Swaps and Derivatives Association (ISDA) appreciates CCIL's efforts in deepening the over-the-counter (OTC) derivatives market in India with a proposal to introduce ETP and Clearing and Settlement services for USD INR FX Options. We are supportive of this initiative as FX options is one of the derivatives products which ISDA recommended for the expansion of scope of products centrally cleared and settled via CCIL in our March 2024 whitepaper on India's derivatives markets which is based on a comprehensive consultation with market participants in India[1].

Our feedback mainly focuses on Section B.1 CCP Risk Management of the consultation paper which sets out the risk management framework for clearing USD INR FX Options and is based on the valuable views of our members which would be instrumental in the development of the proposed services.

As the consultation paper only sets out the risk management framework broadly, our comments are similarly high level. ISDA assumes that CCIL will provide a more detailed consultation in due course, to which we are looking forward to respond. Details of our feedback are set out below.

Detailed comments

Margin models

On initial margin, we welcome that CCIL plans to use a Margin Period of Risk (MPOR) of 5 days and is exploring different margin models. We would like to highlight that while OCC uses a type of Monte Carlo simulation, ForexClear uses a Filtered Historical Simulation with expected shortfall. Members look forward to understanding CCIL's eventual choice of IM margin model, including why the model was selected and how other models would performed against the selected model.

Concentration of positions played a role in the two recent issues at CCPs (Nasdaq Clearing and LME). Members therefore support the implementation of concentration margin and welcome

[1] See page 88 of ISDA's whitepaper on Charting the Next Phase of India's OTC Derivatives Market

details on this margin component as well as how it is determined. We would also like to clarify if and how the proposed concentration limits are linked to concentration margin.

Members highlight that data underlying pricing models should be robust, filtered by an automated validation process and manually adjusted for outliers. CCP derived daily settlement prices should be published and the use of stale prices during periods of illiquidity should be avoided. Members would also welcome the publication of detailed documentation on the construction of the volatility surface, which is shared with clearing members.

For intraday variation margin (VM) calls, as mentioned in our response to the CPMI-IOSCO discussion paper on VM practices[2], members would prefer scheduled (rather than unscheduled) intraday VM calls. CCIL could discuss the approach to scheduling intraday VM calls with clearing members through consultation with its risk management committee.

Members encourage CCIL to implement stress based anti-procyclicality measures that take into account historical and forward looking stress events. The lookback period for option prices and implied volatility in the base margin model should be appropriately calibrated under prevailing market conditions at a specific point in time while the concentration charge should be calibrated to the cost of hedging or disposing of a portfolio taking into account delta liquidation cost and vega liquidation cost under stressed market conditions.

Default Management

We welcome a separate default fund for the FX Options segment and the use of the Cover-2 standard. When modelling stress scenarios, CCIL should seek to cover all possible movements of different risk factors and their co-movements with underlying hedges. For example, CCIL's stress testing suite should include historical, theoretical and forward looking scenarios. When deriving historical scenarios, CCIL should examine all historical data that could give any indication of extreme movements that are sufficiently outside of normal market conditions while hypothetical scenarios should incorporate breakdowns in the expected correlations between risk factors prevalent in FX Options. Alternatively, forward looking stress scenarios could be calibrated with reference to a historical parallel of observed dependencies between risk factors in another market. Theoretical scenarios should utilize a model that relies on the empirically observed probability distribution of risk factors individually and/or collectively (e.g. Principal Component Analysis).

We note that CCIL intends to also allow forward transactions in this segment and would like to clarify how the choice in which segment forward transactions are booked would work.

The consultation paper states that "f*or the purpose of Default Management, CCIL may conduct a default management auction, allocation or tear up of trades.*" We assume that the first step in CCIL's default management process is an auction, as only an auction can provide a good valuation of the defaulter's portfolio, and that allocation or tear-up of trades will be recovery measures. In this context, ISDA would like to emphasize that members see allocations as problematic.

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[2] ISDA-IIR response to the CPMI-IOSCO discussion paper "Streamlining variation margin in centrally cleared markets – examples of effective practices"

We also refer CCIL to previous comments[3] made around the clearing members' capped liability framework used in existing segments, should a similar set of rules be adopted for this new business. To reiterate, the liability cap related multiples, maximum further assessment amounts and thresholds to exit are very high. We constantly expect CCIL to modify this framework with a view to substantially reduce clearing members concerns over their exposure during the default of one or more other clearing members.

Treatment of rejected trades for clearing

Members welcome further details on the treatment of rejected trades for clearing. For trades that are passed through for clearing from the execution platform but are rejected due to reasons such as insufficient margin, members would like to clarify if such trades will be treated as voided or as bilateral trades. For the latter, members would like to clarify if, as users of the platform, they would be required to execute agreements with their counterparties that describe the course of action if such a trade is not accepted to be cleared (akin to Cleared Derivatives Execution Agreements in the Dodd-Frank context).

Comments on feedback questionnaire

For Q3, we suggest using broker quotes to capture the forward premium as the data source to correctly capture the correct mid-rate. As an alternative, we suggest allowing clearing members to override the forward premium if mutually agreed.

For Q5, we suggest a 10 minutes window near expiry for trades very close to the cut-off, i.e., within 1-2bps of the cut-off.

For Q6, we prefer using synthetic forwards. Further, we wish to confirm that the synthetic forwards will have an offset impact on margining and default fund requirements for the options contracts.

For Q7, we suggest including a spread window for Vega Neutral (VN) contract such as 1month vs 3 month, 3 month vs 6 month, 6 month vs 1 year etc. as additional product offerings as these products are actively traded in the market and should be included in the ETP.

Other comments

On settlement/exercise, members would like to clarify if CCIL also intend to allow for cash settled FX Options.

Conclusion

ISDA greatly appreciates CCIL's kind consideration of our feedback and is available to discuss should CCIL have any questions on any of the points raised. Please do not hesitate to contact ISDA via Shule Peh, Assistant Director, Public Policy (speh@isda.org), or Ulrich Karl, Head of Clearing Services (ukarl@isda.org).

[3] i) ISDA's response to CCIL's consultation paper on CCP Recovery and Resolution Mechanism. See comments made under paragraph 6 Allocation of losses for cash calls (page 7).
ii) ISDA's response to CCIL's consultation paper on Recovery tools at the end of the prefunded default waterfall. See comments made under ii. Cash call in proportion to default fund contribution (page 8).

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About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 77 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. Follow us on Twitter, LinkedIn, Facebook and YouTube.