CDS MARGINING POLICY

OVERVIEW

As part of the guidelines on CDS on corporate bonds, RBI has asked the market participants to maintain margins on CDS transactions. Few salient points are:

1. Market participants to have individual margining policy with prescribed **minimum level of margin.**
2. Margins can be maintained on **net exposure** to each counterparty on account of CDS transactions.
3. INR margined at least on **weekly basis.**

FIMMDA has been entrusted with the task of publishing a standard margining policy for market participants based on the above.

AFTER SEVERAL ROUNDS OF DISCUSSIONS WITH MARKET PARTICIPANTS THE FOLLOWING MARGINING POLICY FOR CDS IS NOW EFFECTIVE.

MARGINING

- Margin to be maintained by both the buyer and seller of protection unless specified otherwise.
- Margin can be maintained as both cash / government securities unless specified otherwise.
- The entire MTM of the trade is to be maintained as margin subject to minimum threshold limits.
- The frequency of the margining is weekly.
- MTM will be calculated as per FIMMDA methodology (curve and model).
- There is an initial / additional margin in Market-Maker-User trades which is at the mutual discretion of the counterparties.

UNDER CURRENT GUIDELINES:

Trades between Market-Makers

Buyer of Protection (MM)	Seller of Protection (MM)	Margin Amount	Margining	Allowable Collateral	Threshold Limit Floor	Minimum Transfer Amount
Bank / PD	Bank / PD	MTM	Both ways	Cash/G sec	Zero	Rs. 2,00,000/-

Trades between Market-Maker / User

Buyer of Protection (User)	Seller of Protection (MM)	Margin Amount	Margining	Allowable Collateral	Threshold Limit Floor	Minimum Transfer Amount
Bank/NBFC/PD/MF/Insurance co	Bank / PD	MTM	Both ways	Cash/G sec	Zero	Rs. 2,00,000/-
HFC/PF/ Corporate	Bank/ PD	MTM	Both ways	Cash/G sec	Zero	Rs. 2,00,000/-
FII	Bank / PD	MTM	Buyer	Cash	Zero	Rs. 2,00,000/-

Threshold limit = Minimum MTM amount above which counterparty is liable for posting margin

EXPLANATION:

If the MTM crosses the threshold level, then margin amount would be equal to the whole MTM and not the excess of MTM over the threshold level.

For example:

a) If threshold level for margining is fixed at say, 10 lakhs and MTM is 15 lakhs, then the entire 15 lakhs would be posted as margin and not 5 lakhs.
b) Subsequently, if the MTM goes down by more than 2 lakhs (minimum margin), then margin would be refunded to that extent. If MTM now reduces to say 11.5 lakhs, then 3.5 lakhs would be refunded to the party who posted the collateral.
c) However, if the MTM decreases below the threshold level, then the entire margin would be refunded. If MTM now reduces to say 9 lakhs, then the entire margin would be refunded to the party who posted the collateral.

PROCESS

- The MTM to be used for margining to be calculated based on Monday EOD prices (preceding working day if a holiday).
- The MTM calculation to be communicated on Tuesday to counterparty.
- The collateral should be exchanged by Wednesday.
- In case of cash collateral, the rate of interest would be the **1Week O/N MIBOR Compounded Daily and Settled weekly.**

The above Margining Policy has been discussed at FIMMDA Product Development Committee Meeting dated 22nd May 2012 and approved.

The policy will be reviewed after 6 months or earlier, if so required.

C.E.S. Azariah
Chief Executive Officer
22.05.2012

FAQs (Not forming a Part of the Policy)

1. **G- Sec as collateral?**

    a. In the ISDA margin Survey 2011:
    81% / 80% of collateral was received / delivered as Cash collateral
    10% / 17% of collateral was received / delivered as G-Sec collateral
    So globally the preferred mode is cash collateral. Although the decision would be bilateral, the ideal preference would be to have both ways cash collateral across all counterparties to avoid any mismatch (Example: One buy protection deal was margin settled using cash collateral and its counter hedge done after two weeks i.e. a protection sell deal was margin settled using G-sec).
    RBI has issued a notification regarding value free transfer of G-sec; (copy attached)

2. **Would there be service tax treatment of CDS premium?**

    a. As per RBI's circular no. IDMD.PCD.11/14.03.04/2011-12 dated October 19, 2011; Credit Default Swaps are defined as a derivative under Reserve Bank of India Act, 1934. Thus, it was clarified that the premium is not to be treated as a guarantee fee and would not attract service tax.

3. **Would Cash collaterals be considered under CRR?**

    a. As per Master Circular – Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR): " Cash collaterals received under collateralized derivative transactions should be included in the bank's DTL / NDTL for the purpose of reserve requirements as these are in the nature of outside liabilities".

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भारतीय रिज़र्व बैंक

RESERVE BANK OF INDIA

www.rbi.org.in

PDO.NDS /08.02.001/2349 /2011-12 **PUBLIC DEBT OFFICE**

12/12

December 28, 2011

To
The General Manager
«Member_Name»
«Member_Address_1»
«Member_Address_2»
«Member_Address_3»

[As per attach List 208 letters.]

Dear Sir,

Allowing Value Free Transfer of Securities for Margin requirements in Credit Default Swaps (CDS)

Please refer to our circular IDMD.PCD. NO.5053/14.03.04/2010-2011 dated May 23, 2011 ~~on the guidelines~~ on Credit Default Swaps guidelines.

2. In this regard, it has been decided to allow SGL/CSGL account holders to undertake Value Free Transfers of securities for maintaining margin requirements in CDS. Accordingly, entities undertaking CDS transactions may approach PDO, Mumbai with the following documents with their request for VFT of the securities.

a) Joint Declaration stating that the transfer is for meeting the margin requirement for CDS and is not for any other purpose.

b) SGL Transfer Form (Form IV of Government Securities Regulations 2007) duly signed by the authorized signatories of both the parties.

c) List of Securities.

3. Details of the circular is available in our website at www.rbi.org.in/pressreleases.

Please acknowledge receipt.

Yours faithfully,

(S. Ravi)
Deputy General Manager

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