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TO:

The Chief General Manager  
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Via email: [fmrdfedback@rbi.org.in](mailto:fmrdfedback@rbi.org.in)

29 July, 2022

**Re: Feedback on Draft Reserve Bank of India (Margining for Non-Centrally Cleared OTC Derivatives) Directions, 2022**

Dear Smt. Dimple Bhandia,

The Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) welcomes the opportunity to comment on behalf of its members on the *Draft Reserve Bank of India (Margining for Non-Centrally Cleared OTC Derivatives) Directions, 2022* (the Draft IM Directions) issued by the Reserve Bank of India (RBI) on June 16, 2020.

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 24 global foreign exchange (FX) market participants,<sup>1</sup> collectively representing a significant portion of the foreign exchange inter-dealer market. Both the GFXD and its members are

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<sup>1</sup> Bank of America Merrill Lynch, Bank of New York Mellon, Bank of Tokyo Mitsubishi, Barclays Capital, BNP Paribas, Citi, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, ING, JP Morgan, Lloyds, Mizuho, Morgan Stanley, Nomura, Northern Trust, RBC, RBS, Standard Chartered Bank, State Street, UBS and Wells Fargo.

committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

The FX market is the world's largest financial market. Effective and efficient exchange of currencies underpins the world's entire financial system. Many of the current legislative and regulatory reforms have had, and will continue to have, a significant impact upon the operation of the global FX market, and the GFXD wishes to emphasize the desire of our members for globally coordinated regulation which we believe will be of benefit to both regulators and market participants alike.

The FX market is also the basis of the global payments system. The volume of transactions is very high, and these transactions are often executed by market participants across geographical borders. As reported by the Bank for International Settlements (BIS) in their 'Triennial Central Bank Survey: Foreign Exchange Turnover' in April 2019, sales desks in five countries – the United Kingdom, the United States, Hong Kong SAR, Singapore and Japan – facilitated 79% of all foreign exchange trading,<sup>2</sup> hence the view from the GFXD that regulations should be harmonised at the global level. Cross border markets cannot operate in conflicting regulatory landscapes and the natural outcome, should this be the case, is unwanted fragmentation of what is an already highly automated and transparent FX market.

## **EXECUTIVE SUMMARY**

Whilst we support the RBI taking initiatives to implement the G20 commitments to reform the OTC derivative market, we highlight below some key points of particular importance to our members from an FX perspective. We respectfully ask these points are taken into account by the RBI in finalising the relevant rules, in order to preserve market liquidity and avoid causing any bifurcation of the FX market.

To summarise our comments:

- 1. Definition of Non-Centrally Cleared Derivative (NCCD):** We fully support the RBI's decision to exclude physically-settled FX forwards and swaps from the exchange of margin. However, we request the RBI maintain a clear distinction between FX spot, which are not derivatives and not subject to swaps regulation, including margin, and FX forward transactions, and to expressly exclude FX spot transactions from the requirement to exchange margin.
- 2. Allow posting of collateral offshore:** The definition of a branch of a foreign bank operating in India as a DCE means that when a foreign bank collateralises its NCCD transactions with a DCE in India, it will need to split its collateral portfolios and CSA with the same DCE into two: one for NCCD transactions booked by the onshore

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<sup>2</sup> BIS 2019 Triennial Survey, available at [https://www.bis.org/statistics/rpfx19\\_fx.pdf](https://www.bis.org/statistics/rpfx19_fx.pdf)

branch, and the other for transactions booked by the head office and offshore branches of the foreign bank. This significantly increases documentation and operational complexity for both parties and will require system development.

International market practice is that interbank NCCD transactions are documented under a multi-branch ISDA Master Agreement and margin is exchanged and centrally managed under a single CSA which collateralises the exposure of all transactions entered into between two counterparties. Therefore, we request that the RBI expand the application scope of paragraph 6(6) to cover NCCD transactions entered into between a foreign bank via its onshore branch and another DCE.

3. **Allow full substituted compliance/margin for cross-border transactions:** the GFXD recommends that the RBI either (i) confirms all WGMR jurisdictions are comparable, or (ii) provides a list of comparable jurisdictions prior to the implementation of the requirements rather than place responsibility on a DCE to determine whether the framework in the foreign jurisdiction is comparable to the Directions.

We respectfully repeat our previous request in the FX Letters that the RBI allow full substituted compliance in line with other global regulators who allow:

- a. Branches of regulated foreign financial institutions to comply with the foreign margin rules that are deemed or assessed to be comparable instead of the local margin rules when trading with local entities; and
  - b. Local regulated entities are allowed to comply with foreign margin rules to which their counterparties are subject if such rules are deemed or assessed to be comparable.
4. **Treatment of Margin:** in order to satisfy the initial margin (IM) segregation requirements under global standards, counterparties have to enter into a tripartite or other appropriate arrangements with a third-party custodian. However, we understand that the current custodial infrastructure is underdeveloped, especially for the purpose of meeting the IM segregation requirements.

In addition, it is highly likely that very few, if any, onshore covered entities will have collateral management systems in place or be familiar with the documentation required.

We recommend that sufficient time be permitted before these Directions come into force to enable the custodial infrastructure to become more developed, and for market participants to put the necessary legal arrangements in place.

5. **Implementation Timeline:** the implementation of the RBI (Variation Margin) Directions, 2022 (VM Directions) and these Draft IM Directions will be a significant

policy change for most market participants that will require significant operational enhancements and additional amounts of collateral. In addition to which there will be a dependency on third-party custodians to put the necessary infrastructure in place to support the segregation of IM.

Given the requirements for covered entities to put in place the necessary VM and IM CSAs and implement a robust process and control environment to support the exchange of margin, and for custodians to put in place the necessary infrastructure to support the exchange of IM and sign agreements, we recommend that the RBI delay the implementation date for the VM Directions by 6 months to 1 May 2023, and for IM we recommend an implementation date of no earlier than 12 months after the finalisation of the Draft IM Directions.

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We set out below our detailed comments. In several places we refer to the comments made in the letters submitted to the RBI in 2016 in response to the May 2016 *Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives* (2016 FX Letter<sup>3</sup>) and in 2020 in response to the *Variation Margin (Reserve Bank) Directions, 2020 – Draft* (2020 FX Letter<sup>4</sup>) (collectively, the ‘FX letters’).

## **1. Definition of Non-Centrally Cleared Derivative (NCCD)**

Paragraph 4.4(3) states that “Covered Entities may not exchange Variation Margin and/or Initial Margin for physically-settled foreign exchange forward and physically-settled foreign exchange swap contracts”. We fully support the RBI’s decision to exclude physically-settled FX forwards and swaps from the exchange of margin.

However, in our FX Letters we requested the RBI to ensure there are clear definitions of “physically settled foreign exchange forward” and “physically-settled foreign exchange swap” under the RBI’s margin Directions and maintain a clear distinction between FX spot, which are not derivatives and not subject to swaps regulation, including margin, and FX forward transactions. We request that the RBI expressly exclude FX spot transactions from the requirement to exchange margin.

## **2. Allow Offshore Posting of Collateral**

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<sup>3</sup> <https://www.gfma.org/correspondence/gfma-fx-division-submits-comments-to-the-reserve-bank-of-india-on-its-discussion-paper-on-margin-requirements-for-non-centrally-cleared-derivatives/>

<sup>4</sup> <https://www.gfma.org/wp-content/uploads/2021/04/gfxd-response-to-rbi-consultation-on-vm-oct-14-2020.pdf>

The GFXD supports that margin on a NCCD transaction between a Domestic Covered Entities (DCE) and a Foreign Covered Entity (FCE) may be exchanged either in India or in an overseas jurisdiction, subject to the provisions of the A.P. (DIR Series) Circular No. 10 dated February 15, 2021 and, therefore covered under a multi-branch ISDA Master Agreement and centrally managed single Credit Support Annex (CSA).

However, the definition of a foreign bank branch operating in India as a DCE (paragraph 4.2(1)) means that the ability to post/collect IM either in India or in an overseas jurisdiction (paragraph 6(6)) is not applicable to NCCD transactions entered into between a foreign bank branch and a DCE or another foreign bank branch operating in India. Consequently, when a foreign bank collateralises its NCCD transactions with a DCE in India, it will need to split its collateral portfolios and CSA with the same DCE into two: one for NCCD transactions booked by the onshore branch, and the other for transactions booked by the head office and offshore branches of the foreign bank. This significantly increases documentation and technological and operational complexity for both parties.

International market practice is that interbank NCCD transactions are documented under a multi-branch ISDA Master Agreement and margin is exchanged and centrally managed under a single CSA which collateralises the exposure under all the transactions entered into between two counterparties. Requesting a foreign bank's onshore branch to separately exchange margin in India will entail use of two CSAs with the same counterparty in India and represents a major departure from this best practice. We are not aware of any other jurisdictions where a similar requirement has been included in the margin rules.

Therefore, we request that the RBI expand the application scope of paragraph 6(6) to cover NCCD transactions entered into between a foreign bank via its onshore branch and another DCE. In addition, a change would need to be made to paragraph 9(2) to enable two DCEs, one or both of which is/are a foreign bank branch, to exchange cash collateral denominated in a freely convertible foreign currency or foreign securities to enable those collateral to be held and managed offshore.

### **3. Allow Full Substituted Compliance/Margin Requirements for Cross-Border NCCD Transactions**

The GFXD supports the availability of substituted compliance for cross-border NCCD transactions between a DCE and an FCE. However, the GFXD recommends that the RBI either confirms (i) all WGMR jurisdictions are comparable, or (ii) provides a list of comparable jurisdictions prior to the implementation of the requirements rather than place responsibility on a DCE to determine whether the framework in the foreign jurisdiction is comparable to the Directions.

At present, the Draft Directions do not appear to permit the substitute compliance for NCCD transactions between a DCE that is a foreign bank branch and another DCE. We respectfully

repeat our previous request in the FX Letters that the RBI allow full substituted compliance in line with other global regulators who allow:

- a. Branches of regulated foreign financial institutions to comply with the foreign margin rules that are deemed or assessed to be comparable instead of the local margin rules when trading with local entities; and
- b. Local regulated entities are allowed to comply with foreign margin rules to which their counterparties are subject if such rules are deemed or assessed to be comparable.

For a number of years, international banks have already been exchanging margin for onshore transactions under foreign margin rules. By not permitting substituted compliance for these transactions could disrupt established trading relationships and severely limit hedging and financial activity. Therefore, we urge the RBI to harmonise its approach with respect to substituted compliance so as to be in line with the BCBS-IOSCO Framework and other global regulators.

#### **4. Treatment of Margin**

The GFXD supports the requirement that legally enforceable collateral arrangements should protect the IM collected from the posting party in the event of bankruptcy of the collecting party. These arrangements require that the IM is segregated from the proprietary assets of the collecting party by either placing the IM with a third-party custodian or through other legally effective agreements.

In order to satisfy the IM segregation requirements under global standards, counterparties also have to enter into a tripartite or other appropriate arrangements with a third-party custodian to establish the conditions under which a collateral giver or taker could access the collateral.

Given this requirement, there will be a need for an established third-party custodial service provider in India prior to the effective date of the finalised Draft IM Directions. However, we understand that the current custodial infrastructure is underdeveloped, especially for the purpose of meeting the IM segregation requirements. Consequently, there is a concern as to whether existing or new custodial infrastructure could be developed by the implementation date to support the exchange and management of collateral.

There will also be significant pressure on domestic custodians to ‘sign-up’ covered entities to support the exchange of IM.

In addition, it is highly likely that very few, if any, onshore covered entities will have collateral management systems in place or be familiar with the documentation required, and that for branches of foreign banks operating in India onshore it is likely that collateral arrangements will not be compliant with the standards of IM segregation and custodian under their home jurisdictions.

Therefore, we recommend that sufficient time be permitted before the Draft Directions come into force to enable the custodial infrastructure to become more developed in order to be able to support IM segregation requirements, and for market participants to put the necessary legal arrangements in place.

## **5. Implementation Timeline**

Both the VM Directions and these Draft IM Directions will be a significant policy change for most market participants in respect of NCCD transactions that are in scope. The new requirements will call for operational enhancements and additional amounts of collateral for which liquidity planning will have to be undertaken by entities within scope.

The Draft IM Directions will also need to be finalised before firms will be able to begin necessary work, including legal, documentary, technology systems, operational and risk management work, all of which will take some time. There will also be a requirement for third-party custodians to put the necessary infrastructure in place to support the segregation of IM before covered entities will be able to sign agreements.

Furthermore, resources will be required to implement the VM Directions prior to the proposed implementation date of 1st December 2022. There will also be a need to negotiate separate CSAs for foreign banks and their branches operating in India because of the inability for these branches to rely on substituted compliance.

Consequently, we urge the RBI to consider an implementation period that provides sufficient lead time to put in place the necessary VM and IM CSAs, for covered entities to implement a robust process and control environment to support the exchange of margin, and for custodians to put in place the necessary infrastructure to support the exchange of IM and sign agreements. Therefore, we would recommend the RBI delay the implementation date for the VM Directions by 6 months to 1 May 2023, and for IM we recommend an implementation date of no earlier than 12 months after the finalisation of the Draft IM Directions.

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We appreciate the opportunity to share our views on the Draft IM Directions.

Please do not hesitate to contact John Ball on +852 2531 6512, email [jball@ap.gfma.org](mailto:jball@ap.gfma.org) or Janet Dawson on +1 212 313 1176, email [jdawson@us.gfma.org](mailto:jdawson@us.gfma.org) should you have questions about our comments or wish to discuss any of the above.

Yours sincerely,

A handwritten signature in black ink, appearing to read "James Kemp". The signature is fluid and cursive, with a large initial "J" and a long, sweeping underline.

James Kemp  
Managing Director  
Global Foreign Exchange Division, GFMA