ISDA® Safe, Efficient Markets

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BY E-MAIL and HAND

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Dear Smt. Dimple Bhandia,

Draft Variation Margin (Reserve Bank) Directions, 2020

1. Introduction

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] is grateful to the Reserve Bank of India ("**RBI**") for our continuous and ongoing engagement in various key regulatory and market initiatives, including discussions around the implementation of margin requirements for non-centrally cleared derivatives ("**Margin Requirements**").

We are grateful to the RBI for the opportunity to provide comments on the *Draft Variation Margin (Reserve Bank) Directions, 2020*[2] ("**VM Consultation**"). Individual members may have their own views on the VM Consultation, and may therefore provide their comments to the RBI directly.

We support RBI's decision to decouple the implementation of variation margin ("**VM**") and initial margin ("**IM**"), and welcome the opportunity to comment on the draft IM regulations in due course.

We also appreciate the opportunity provided to us by the RBI to highlight the concerns of the derivatives market participants with certain aspects of the margin requirements proposed by the RBI in its *Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives* issued in May 2016[3] ("**2016 Margin Consultation**"). These concerns are discussed in detail in the ISDA response to the 2016 Margin Consultation submitted on 8 June 2016[4] ("**2016 Margin Response**"), and further discussed in the ISDA

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 925 member institutions from 75 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.

[2] https://rbidocs.rbi.org.in/rdocs/Content/PDFs/VARIATIONMARGINFD324E5885184A69B28C61583816EA28.PDF, RBI, Draft Variation Margin (Reserve Bank) Directions, 2020

[3] https://rbidocs.rbi.org.in/rdocs/Content/PDFs/DPMR02052016ACC458CF292D4F5C876057C8BD2835D5.PDF, RBI, Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives.

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

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letter submitted to the RBI on 14 May 2018[5] ("**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[6] ("**2018 August Margin Letter**"), and most recently the ISDA letter submitted to the RBI on 5 March 2020[7] ("**2020 Margin Letter**") (collectively, the "**Industry Margin Submissions**"). For ease of reference, the Industry Margin Submissions are available in **Annex 1** of this submission.

The points raised in this response to the VM Consultation take into account our experience and active involvement regarding the Margin Requirements with regulators and ISDA members in Asian jurisdictions such as Hong Kong, Singapore, and Australia as well as other jurisdictions across the globe such as the United States and the European Union. As you may also know, ISDA has played a key role in the advocacy and implementation efforts for Margin Requirements in Asia as well as global jurisdictions, and we believe that we are able to provide the RBI with a unique perspective on the issues faced by these jurisdictions in the implementation of Margin Requirements in India.

We have highlighted the feedback in this response to the VM Consultation in order to better align the RBI's Margin Requirements with those of the final policy framework issued by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions in March 2015[8] ("**BCBS-IOSCO Framework**"), as well as that of other Asian and global jurisdictions, keeping in mind the overall goal of strengthening resilience in the non-centrally cleared derivatives market.

2. General comments

a. Netting Act passed in Parliament and the impact on Margin Requirements

We note that the Bilateral Netting of Qualified Financial Contracts Bill, 2020[9] ("**Netting Bill**") was passed in the *Lok Sabha* (Lower House of Parliament) on 20 September, 2020[10] and *Rajya Sabha* (Upper House of Parliament) on 23 September, 2020[11]. Subsequently, the Netting Bill received assent from the President and was published in the Gazette of India as the Bilateral Netting of Qualified Financial Contracts Act, 2020 ("**Netting Act**") on 28 September, 2020[12], with the provisions of the Netting Act coming into force on 1 October, 2020[13].

We are grateful for the RBI's constant engagement with ISDA, the Ministry of Finance ("**MoF**"), and other stakeholders in considering and proposing solutions to resolving the netting position in India as well as the formulation of the Netting Act. In particular, we commend RBI for providing constructive feedback and input on the draft Netting Act during the MoF's closed consultation sessions in 2019. ISDA is also grateful for the opportunity to present its views on netting to

[5] https://www.isda.org/a/FTAEE/India-Submission-14-May-18.pdf, ISDA, Submission to RBI on netting & margin requirements.
[6] https://www.isda.org/a/sTAEE/India-Submission-31-Aug-18.pdf, ISDA & FIMMDA, Follow-up submission to RBI on netting and margin requirements.
[7] https://www.isda.org/a/1u9TE/RBI_Margin-Netting-letter.pdf, ISDA, Submission to RBI on Margin Requirements and the Bilateral Netting of Financial Contracts Bill, 2020
[8] https://www.bis.org/bcbs/publ/d317.pdf, BCBS-IOSCO, Margin requirements for non-centrally cleared derivatives
[9] http://164.100.47.219/BillsTexts/LSBillTexts/Asintroduced/98_2020_LS_Eng.pdf, Parliament of India, Bilateral Netting of Qualified Financial Contracts Bill, 2020.
[10] http://164.100.47.193/bull1/17/IV/20.09.2020.pdf, Parliament of India, Lok Sabha Bulletin Part 2, Page 24, Paragraph 15.
[11] http://164.100.47.5/newsite/bulletin2/Bull_No.aspx?number=60251, Parliament of India, Rajya Sabha Bulletin, Paragraph 9.
[12] http://egazette.nic.in/WriteReadData/2020/222064.pdf, Government of India, The Gazette of India.
[13] http://egazette.nic.in/WriteReadData/2020/222198.pdf, Government of India, The Gazette of India.

policymakers and regulators such as the RBI and MoF, and to work together on this important initiative.

As we have highlighted in the Industry Margin Submissions, resolving the netting position in India is key to advancing the work in various other initiatives, including the implementation of Margin Requirements in India.

The Netting Act will resolve the existing inconsistency of netting application to different types of entities incorporated in India, and will also resolve the inconsistencies noted by the RBI in previous statements, summarized in **Annex 2** of this submission.

We note that Paragraph 4 (Powers of Authority) of the Netting Act gives the RBI and other regulators the power to *"designate any bilateral agreement or contract or transaction, or type of contract regulated by it, as qualified financial contract"* [14].

We would urge that the RBI, in conjunction with the other regulators, continue to actively engage with the MoF and market participants to consider and put in place any further measures, by way of follow-up regulations and guidance that would be necessary in order to designate the list of qualified financial contracts ("**QFC**"). We would also encourage the RBI to ensure that the list of QFCs aligns with those in the 2018 ISDA Model Netting Act[15], which has been reproduced in **Annex 3** of this submission for ease of reference.

We would urge the RBI to only implement the proposals in the VM Consultation after the relevant list of QFCs has been notified under the Netting Act.

As discussed during our meetings with the RBI as well as the MoF closed consultation sessions, it is imperative that the Netting Act confirms, among others, the enforceability of netting in India with respect to the different counterparty types as well as transaction types. Therefore, it is essential that the RBI and other regulators notify the list of QFCs in order for the netting provisions to have full effect, and for the market to fully benefit from the provisions of the Netting Act, prior to the proposals in the VM Consultation being implemented.

b. *Offshore posting of collateral should be allowed*

We welcome the RBI's explicit confirmation in the VM Consultation that, as part of their global exposure management, Domestic Covered Entities ("**DCE**") and Foreign Covered Entities ("**FCE**") will be able to exchange collateral offshore for the purposes of complying with such Margin Requirements. This request has been highlighted in the Industry Margin Submissions and through extensive discussions in bilateral meetings with the RBI over the years, and we thank the RBI for considering our feedback in this regard.

We understand that a foreign bank branch in India is considered to be a DCE and accordingly, paragraph 4(5) of the VM Consultation regarding offshore posting of collateral will not be applicable to the non-centrally cleared derivatives ("**NCCD**") transactions entered into by a foreign bank via its onshore branch with an Indian bank, or another foreign bank branch in India. This means that when a foreign bank collateralizes its NCCD transactions with its counterparty in India, it will need to split its collateral portfolios and credit agreement (for example, ISDA Credit Support Annex ("**CSA**"))

[14] http://164.100.47.219/BillsTexts/LSBillTexts/Asintroduced/98_2020_LS_Eng.pdf, Parliament of India, Bilateral Netting of Qualified Financial Contracts Bill, 2020, Page 4, Paragraph 4.
[15] https://www.isda.org/a/X2dEE/FINAL_2018-ISDA-Model-Netting-Act-and-Guide_Oct15.pdf, ISDA, 2018 ISDA Model Netting Act and Guide, Page 36-37.

with the same counterparty into two: one for transactions booked at the onshore branch level, and the other for transactions booked at the head office and offshore branches of the foreign bank. This would significantly increase documentation and operational complexity for both parties.

It is common practice globally that inter-bank NCCD transactions are documented under a multi-branch ISDA Master Agreement, and VM is exchanged and centrally managed under a single CSA which collateralizes the net mark-to-market exposure under all the transactions entered into between two banks. Requesting a foreign bank's onshore branch to keep VM exchanged in India will entail the use of two CSAs with the same counterparty and represents a major departure from international best practice. We are not aware of any other jurisdictions where a similar requirement has been included in the margin rules. A global CSA construct as described above is also relevant in the case of cross-border trades, and we request that the RBI recognize such a construct in allowing offshore posting of collateral.

Therefore, we request that the RBI expand the application scope of paragraph 4(5) to cover NCCD transactions entered into between a foreign bank via its onshore branch and another DCE. We further note that some changes will need to be made to paragraph 5(1) to allow 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 such collateral to be held and managed offshore.

We would also request that the RBI circular to be issued allow offshore posting of collateral on a permanent basis and allows any related capital relief, and that in making such a determination, the RBI also considers all the relevant fact patterns in reviewing such cross-border collateral exchanges as highlighted in the Industry Margin Submissions and reiterated in **Annex 4** of this letter, and updated to incorporate our members' request regarding exchange of margin between an onshore foreign bank branch and an Indian bank as discussed above. We would also welcome the opportunity to provide feedback on this RBI circular prior to implementation, in addition to clarity on the timeline for the publication of this circular.

c. *Allowing full substituted compliance*

ISDA commends the RBI for allowing substituted compliance for cross-border NCCD transactions between a DCE and a FCE in the VM Consultation. However, the VM Consultation does not seem to allow substituted compliance for NCCD transactions between a DCE which is a foreign bank branch and another DCE. We reiterate the request that the RBI allow full substituted compliance in line with other global regulators, including those in Asia such as Hong Kong, Singapore, and Australia, who have provided a full substituted compliance framework under which:

i. Branches of regulated foreign financial institutions are allowed 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, or other branches of regulated foreign financial institutions; and
ii. Local regulated entities are allowed to comply with foreign margin rules to which their counterparties, including local branches of regulated foreign financial institutions, are subject to if such rules are deemed or assessed to be comparable.

Excluding transactions between foreign entities (including Indian branches of foreign entities) and Indian entities from such a substituted compliance framework would be contrary to the intent of principle 7 of the BCBS-IOSCO Framework[16], which was formulated to address the application of duplicative rule sets in a cross-border context where a foreign entity (or its local branch) trades with a local entity.

It is also worth noting that global banks have already been exchanging VM for onshore transactions under foreign margin rules for a number of years. Not allowing substituted compliance for these transactions now could disrupt established trading relationships and severely limit hedging & financial flows. Therefore, we request that the RBI harmonises its approach with respect to substituted compliance so as to be in line with the BCBS-IOSCO Framework and other global regulators.

Alternatively, as highlighted in the 2016 Margin Response, the RBI can consider allowing transactions entered into by foreign bank branches in India to a framework of automatic deference. Under such a framework, where a foreign-incorporated DCE is directly subject to foreign margin requirements that are substantially similar to the BCBS-IOSCO Framework, it may comply with the margin requirements of its home regulator. This approach will assist in achieving a workable cross-border framework

d. Exemption of stamp duty and filing charges for VM and IM

As previously highlighted in the Industry Margin Submissions, the execution of credit support documents and transfer of collateral may attract stamp duty (with the latter attracting ad valorem stamp duty in certain States in India) at both the federal level and at the state level in India. In the case of transfer of collateral, 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.

In addition, we understand that Paragraph 77 (Duty to register charges, etc.) of the Companies Act, 2013[17] requires all charges to be registered, which could also be interpreted to include the posting of VM. If the charge is not registered, then the said charge will not be taken into account by a liquidator in case of insolvency or winding up of the company. This would defeat the very purpose that the Margin Requirements are intended to serve.

Given the frequency of margin exchange for VM and IM, large amounts of IM to be posted, and the serious consequences of non-payment or inadequate payment of stamp duty and failure of registering a charge, we request that the RBI works with the relevant authorities to introduce exemptions relating to transfer of margin in the relevant laws for stamp duty and exempt documents in relation to exchange of margin from the ambit of filing of charges.

e. Treatment of non-netting jurisdictions

Where in-scope transactions are executed with an FCE that is located in a jurisdiction where either close-out netting is not enforceable upon insolvency of the counterparty or collateral arrangements are not legally enforceable upon default of the counterparty, there are additional enforcement risks associated with posting of margin as previously highlighted in the Industry Margin Submissions. We request that the RBI consider putting in place exemptions on the exchange of VM in such situations, and any legal review on determining whether a counterparties and jurisdictions are

[16] https://www.bis.org/bcbs/publ/d317.pdf, BCBS-IOSCO, Margin requirements for non-centrally cleared derivatives, Page 23, Paragraph 7.1.
[17] https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf, Ministry of Corporate Affairs, The Companies Act, 2013, Page 60, Paragraph 77.

netting friendly or not should be permitted to be undertaken by each entity. In this respect, we note that the margin rules in the EU, Australia, Hong Kong, and Singapore have included an exemption for transactions entered into with counterparties incorporated in non-netting jurisdictions.

f. Implementation timeline

As highlighted in the Industry Margin Submissions, we would like to reiterate the request that the RBI provide the industry sufficient implementation time prior to the implementation of VM requirements, including sufficient time to allow the industry to repaper all agreements to regulatory-compliant documentation. We would also request more clarity on the timeline for implementation of IM requirements.

3. Specific Comments

For ease of reference, the headings and paragraph numbers used below correspond to those used in the VM Consultation.

a. Definition of AANA, paragraph 2(1)(a)

The definition of average aggregate notional amount ("**AANA**") in paragraph 2(1)(a) deviates substantially from the one used in the BCBS-IOSCO Framework and other BCBS-IOSCO jurisdictions, which use observations of March, April and May month-end gross notional amounts for the relevant year. We should note that most jurisdictions use AANA to decide initial margin phase-in dates and do not apply AANA to VM requirements. Nonetheless, if RBI intends to define the VM threshold by reference to AANA, we would recommend RBI align the AANA calculation with the one used in the BCBS-IOSCO Framework, as monitoring AANA for a 12-month period will be very burdensome for all entities. Please refer to paragraph 3(b) and 3(c) below for our comment on the definitions of DCE and FCE, and how AANA should be defined for those entities.

Furthermore, subject to the clarification of the definition of 'permitted derivative contracts' (as discussed in paragraph 3(e) below), we understand that only 'permitted derivative contracts' should be taken into consideration for the AANA calculation, and request explicit confirmation from the RBI that this is the intent.

b. Definition of DCE, paragraph 2(1)(d)

The scope of DCEs as currently defined in paragraph 2(1)(d) is unclear when considering DCEs that may have headquarters overseas. Based on the current definition, our interpretation is that 'financial entities' would include foreign bank branches in India. We would like to seek clarification that only trades booked within Indian branches of such foreign entities are subject to VM requirements. Therefore, we request that the RBI explicitly clarify that the proposals in the VM Consultation only apply to trades booked at the onshore branch of entities headquartered offshore, to the extent that such entities are regulated by the relevant regulators in paragraph 2(1)(d)(i). This clarification would be in line with requirements of other global regulators, including those in Asia such as Hong Kong, Singapore and Australia.

In addition, the definition of DCE also includes Foreign Portfolio Investors ("**FPIs**") in paragraph 2(1)(d)(iii). We request that the RBI consider FPIs as FCEs as opposed to DCEs, and seek clarification that only activities of an FPI entity which relate to investments in NCCDs using the FPI license are in-scope. It is also worth noting that paragraph 5(3) allows FPIs the same flexibility as FCEs for eligible collateral, therefore treating them at par with FCEs in some aspects.

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Similarly, the definition of DCE also includes International Financial Services Centre ("**IFSC**") Banking Units ("**IBUs**") in paragraph 2(1)(d)(ii). The existing RBI Operational Guidelines on IFSC issued on 31 March, 2015[18] indicate that *"a financial institution or a branch of a financial institution set up in the IFSC and permitted / recognised as such by the Government or a Regulatory Authority shall be treated as person resident outside India"*[19]. In addition, the RBI circular on Setting up of IFSC IBUs published on 1 April, 2015[20] indicates that *"all transactions of IBUs shall be in currency other than INR"*[21]. It is also worth noting that, similar to FPIs, paragraph 5(3) allows IBUs the same flexibility as FCEs for eligible collateral. Therefore, we request that the RBI consider IBUs as FCEs as opposed to DCEs.

As currently drafted, the definition of DCE could also include non-banking financial institutions ("**NBFIs**") and corporates. Many corporates in India are subsidiaries of multi-national corporations, and therefore could exceed the AANA threshold of INR 50,000 crore proposed in paragraph 2(1)(d)(iii). The BCBS-IOSCO Framework is applicable only to financial institutions and systemically important non-financial institutions. In this respect, we note that the application scope of the margin rules in each jurisdiction vary from one to another, in particular when it comes to corporates. For example, the margin rules in the US, Singapore and Australia are not applicable to corporates whereas the margin rules in the EU and Hong Kong cover corporates which are considered to be systemically important and the minimum notional amount of NCCDs applicable to corporates under the EU and Hong Kong rules are much higher than INR 50,000 crore.

NBFIs with an AANA as low as INR 50,000 crore are unlikely to cause any systemic risk to the financial markets in India. We would therefore request RBI to consider raising the AANA threshold for NBFIs to USD 8 billion - this will align the applicable AANA with that of FCEs as defined in paragraph 2(e)(ii) and create a level playing field for domestic and foreign NBFIs.

In addition, corporates in India are unlikely to have the operational capacity or infrastructure for the exchange of VM, nor do they currently have access to clearing. Applying the Margin Requirements to corporates would severely limit such entities' access to the derivatives markets and their ability to hedge risk, and therefore we request RBI to consider excluding corporates from the definition of DCE.

We also request that the RBI consider exempting transactions undertaken by corporates and NBFIs to hedge underlying business risks from VM requirements, in line with other global jurisdictions. Such end-user exemptions will ensure that corporates that undertake derivative trades to hedge business risks are not burdened with VM requirements. Requiring non-financial end users who transact in derivatives to hedge underlying business risk to exchange VM may discourage such entities from entering into derivative trades for genuine business purposes if the cost of hedging is substantially increased for them, which could lead to the unintended consequence of disincentivization of hedging activities.

We request that the RBI also provide a comprehensive list of in-scope entity types for the avoidance of doubt.

[18] https://rbidocs.rbi.org.in/rdocs/notification/PDFs/92APDIRIFSC0104.pdf, RBI, Operational guidelines on International Financial Services Centre
[19] https://rbidocs.rbi.org.in/rdocs/notification/PDFs/92APDIRIFSC0104.pdf, RBI, Operational guidelines on International Financial Services Centre, Page 1, Paragraph 2.
[20] https://rbidocs.rbi.org.in/rdocs/notification/PDFs/FNIBU010415CIRN.PDF, RBI, Setting up of IFSC Banking Units (IBUs)
[21] https://rbidocs.rbi.org.in/rdocs/notification/PDFs/FNIBU010415CIRN.PDF, RBI, Setting up of IFSC Banking Units (IBUs), Page 3, Paragraph 2.6(ii).

c. Definition of FCE, paragraph 2(1)(e)

The definition of FCE in paragraph 2(1)(e)(i) includes the term "regulated financial entities". However, this term is not defined in the VM consultation. We request that the RBI clarify the definition of "regulated financial entities" that would be in scope for VM requirements as FCEs.

d. Definition of NCCDs, paragraph 2(1)(g) and exemption for genuine amendments to legacy NCCD transactions

We would welcome a clear definition of NCCDs, as the current definition provided in paragraph 2(1)(g) refers to 'permitted derivatives' which is by reference to what is permitted under paragraph 2(1)(h) of the VM Consultation, and the 'permitted derivatives' under the relevant RBI regulation mentioned in this paragraph is not entirely clear to our members. We therefore request that the RBI provide a clear list of permitted derivative products for the avoidance of doubt, and to eliminate uncertainty as to which contracts will be subject to VM requirements.

Paragraph 1 of the VM Consultation provides that the VM requirements only apply to new NCCD contracts entered into on or after the effective date of the requirements and accordingly, NCCD transactions entered into prior to such date ("**Legacy Derivative**") are excluded. However, we note that the VM Consultation does not provide an exemption for genuine amendments to a Legacy Derivative made after the effective date of the VM requirements. We would request that RBI include a paragraph to confirm that genuine amendments to Legacy Derivatives do not qualify as a new NCCD contract and therefore will not bring the transaction into the scope, in line with the BCBS-IOSCO Framework and other jurisdictions[22]. We would also seek the RBI's specific confirmation that Legacy Derivatives with the following amendments will not be subject to the margin requirements:

i. trades amended in a non-material manner (or arising from life-cycle events): so long as an amendment does not create any new significant exposure under the Legacy Derivatives, the act of amending the derivative (or the occurrence of a life-cycle event) should not bring it within the scope of the VM requirements;
ii. new derivatives that result from multilateral portfolio compression: portfolio compression is designed to reduce complexity in the derivatives market and has been generally encouraged by regulators. However, if the result of multilateral portfolio compression of Legacy Derivatives would cause the resulting trades to be subject to margin requirements, it would severely reduce the incentives of market participants to conduct multilateral portfolio compression;
iii. Wholesale novations completed for the sake of a group restructuring: wholesale novation in the case of a group restructuring should not be considered as 'new' trades; and
iv. Genuine amendments to Legacy Derivatives to include all benchmark reforms: ISDA has identified concerns around Legacy Derivatives being brought into scope of clearing and margining obligations as a critical issue on the path to ensuring successful transition away from the London Interbank Offered Rate ("**LIBOR**") and adoption of the contractual fallbacks for derivatives referencing benchmarks. These include fallbacks for not only interbank rates such as LIBOR, but also the generic fallbacks contained in the ISDA Benchmarks Supplement[23]. The ISDA Benchmarks Supplement was published in

[22] Footnote 20 of the BCBS-IOSCO Framework provides that *"genuine amendments to existing derivatives contracts do not qualify as a new derivatives contract. Any amendment that is intended to extend an existing derivatives contract for the purpose of avoiding margin requirements will be considered a new derivatives contract."*
[23] https://www.isda.org/book/isda-benchmarks-supplement, ISDA, ISDA Benchmarks Supplement.

response to Article 28(2) of the EU Benchmarks Regulation ("**EU BMR**")[24] and covers interest rates, equity indices, commodity indices and FX rates. The wide-ranging scope of this Regulation means that many NCCD transactions between an Indian entity and an EU regulated entity are subject to its requirements. Greater certainty would be provided if the RBI clarifies that amendments to Legacy Derivatives to (a) insert fallback provisions for all benchmarks, rather than being restricted to benchmarks for interest rates; or (b) voluntary transition[25] away from IBORs, in either case, would not constitute new contracts. This will remove any impediment market participants may otherwise perceive to ensuring that fallback provisions in their existing transactions (regardless of when these transactions were executed or the benchmarks they reference) are consistent with fallback provisions in their new transactions and as such, help to reduce basis risk across their portfolio of transactions to the fullest extent. Furthermore, such clarity would be helpful in facilitating efficient and cost-effective adoption of the IOSCO statement on the use of financial benchmarks as well as compliance with the EU BMR. Clarity on the treatment of voluntary transition away from LIBOR and other LIBOR related rates (e.g., MIFOR) in relation to RBI margin requirements would ensure an orderly market-wide transition consistent with public sector expectations to transition away from LIBOR[26].

e. *Definition of permitted derivative contracts, paragraph 2(1)(h)*

As highlighted in the 2016 Margin Response, we request that the RBI exempt physically-settled foreign exchange forwards and swaps from VM requirements. Physically-settled foreign exchange forwards and swaps are exempted from VM requirements under the BCBS-IOSCO Framework, and we request that the RBI take an approach which is consistent with other jurisdictions and exempt physically-settled foreign exchange forwards and swaps from VM requirements.

We also request the RBI to ensure that there are clear definitions of 'physically settled foreign exchange forwards and swaps' and a clear indication of the distinction between spot and forward transactions, and that the RBI expressly exclude foreign exchange spot transactions from VM requirements which would align the RBI's approach for VM requirements with the BCBS-IOSCO Framework for all types of deliverable foreign exchange contracts (i.e., FX Forwards, FX Spot, and security conversion transactions).

We understand that the Global Foreign Exchange Division ("**GFXD**") of the Global Financial Markets Association has requested similar exemptions in the GFXD response to the 2016 Margin Consultation[27] and the GFXD response to the VM Consultation[28], and we are supportive of the GFXD comments on this request.

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[24] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.171.01.0001.01.ENG&toc=OJ:L:2016:171:TOC, EU Parliament and the Council of the EU, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds.

[25] As itemized in Annex 2 of the ARRC's letter to the US regulators, voluntary transition can take various forms including a portfolio compression. The ARRC's letter is available at: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC_Letter_CFTC_Regulatory_Derivatives_Treatment_05132019.pdf.

[26] The US Commodity Futures Trading Commission ("**CFTC**") issued several no-action letters providing relief to swap dealers and other market participants related to the industry-wide initiative to transition from swaps that reference the LIBOR and other interbank offered rates to swaps that reference alternative benchmarks: https://www.cftc.gov/PressRoom/PressReleases/8228-20

[27] https://www.gfma.org/wp-content/uploads/0/83/91/207/f6f02eef-59e9-47e4-873e-c5fb9739ff40.pdf, GFXD, Response to RBI Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives, Paragraph 4, Page 3.

[28] Not publicly available as of date.

The definition of 'permitted derivative contracts' also appears to exclude equity derivatives and commodity contracts, and we would welcome explicit clarification from the RBI that such contracts are excluded.

We reiterate our request for a clear list of permitted derivative products from the RBI to eliminate uncertainty as to which contracts will be subject to VM requirements.

In addition, to the extent that other derivative contracts that are currently not within scope of VM requirements are proposed to be added to the list of permitted derivative contracts, we request that the RBI provide a public consultation before finalizing such additions.

f. Entity scope, paragraph 3

We would like to seek clarification from the RBI that VM requirements will only apply to trades booked within an Indian branch of a foreign financial entity, and VM requirements will not be applied at a legal entity level. In addition, we would like to seek clarity that trades executed by an FPI should only be in-scope to the extent that they relate to FPI investments in NCCDs.

We request that the RBI remove the need for market makers to obtain a declaration from counterparties to confirm they are not a covered entity as outlined in paragraph 3(2). This requirement will be a burdensome exercise for impacted firms, and is best to be dealt with under each regulated entity's existing KYC procedures.

We also request that the RBI provide definitions of the exempted entity types in paragraph 3(3), and clarification that government-owned entities (such as Public Sector Enterprises) are not included within the list of excluded entities.

Furthermore, we note that the VM Consultation exempts VM requirements for NCCDs executed between entities belonging to the same consolidated group. 'Consolidated group' has been defined in paragraph 2(1)(b) as the meaning given to 'group' under Indian Accounting Standard ("**IAS**") 110. As IAS 110 does not currently apply to many foreign banks (including Indian branches of foreign banks), these entities will be unable to take benefit of the inter-group transaction exemption permitted by RBI under the VM Consultation. The RBI may consider allowing global banks with Indian branches to rely on a 'consolidated group' definition as set out in equivalent foreign accounting standards that apply to the consolidated financial statements of such global banks.

Therefore, we request the RBI provide a comprehensive definition of 'consolidated group' that will apply to all DCEs and FCEs and will also accommodate global accounting standards, and also clarify at what level consolidation will be permitted (i.e. at an entity level or at a local branch level).

We also request that the RBI explicitly clarifies that inter-branch transactions or transactions executed between a bank branch with its own head office are not subject to VM requirements. We note that such transactions are not documented under a single, legally enforceable netting and collateral agreement, given that bank branches (including the head office) are not separate legal entities. We would like to clarify that this is different from inter-affiliate trades, which are trades executed between two separate legal entities of the same group that can be documented under a legally enforceable netting and collateral arrangement.

g. Calculation and exchange of variation margin, paragraph 4

Given the cross-border nature of derivative markets and the fact that many market participants have collateral operations outside of India, we request that the RBI allow for the exchange of VM on at least a T+3 basis as an outer limit, and not the proposed T+1 basis provided for in paragraph 4(1). This amendment is to ensure that VM exchange deadline will not cause significant operational issues, and this also aligns with the requirements of other jurisdictions in Asia such as Hong Kong and Singapore. For example, the VM exchange deadline of other jurisdictions are provided in Table 1 below.

South Korea	Hong Kong	Singapore	Australia
Calculation, call, and settlement of VM cannot exceed three local business days from the trade date (T+3).	VM must be called within T+1 and collected within 2 business days from when VM is called.	VM should be exchanged no later than three local business days from the MTA of transaction date (T+3).	VM settlement must be conducted promptly.

Table 1: Comparison of VM exchange deadlines for Asian jurisdictions

Paragraph 4(2) also mentions that "in the event that the exposures cannot be marked-to-market, a pre-agreed alternative process or fallback mechanism should be used". Currently, all trades permitted by the relevant regulators in India can be marked-to-market, and hence we request clarity on what trades the RBI considers may require such an alternative process be put in place.

The concept of "threshold" referred to in paragraph 4(4) appears to refer to a minimum transfer amount ("**MTA**") which is intended to reduce operational burden, not a threshold for the application of the VM requirements. For the avoidance of doubt, we ask that the RBI define this as an MTA. We would also like to point out that an MTA of INR 500,000 (approximately USD 6,800) is far too low, and is inconsistent with global standards. Such a low MTA will require frequent exchange of collateral and will be operationally challenging, and defeats the purpose of having an MTA. We request that the RBI increase the MTA to a level which is close to the one used in other jurisdictions and the BCBS-IOSCO Framework. For example, the MTAs of other Asian jurisdictions are provided in Table 2 below.

South Korea	Hong Kong	Singapore	Australia
MTA cannot exceed KRW 1 billion.	MTA of no more than HK$3.75 million.	MTA of no more than SGD 800,000.	MTA of no more than AUD 750,000.

Table 2: Comparison of MTA for Asian jurisdictions

We also request clarity from the RBI that any eligible collateral posted as VM can be re-hypothecated, re-pledged or re-used by the collateral receiver without any limitation.

h. Eligible collateral and haircuts, paragraph 5 & Annex 1

For our comment on paragraph 5(1), please refer to section 2(b) of this response regarding expansion of the list of eligible collateral to cover non-INR denominated collateral for NCCD transactions entered into by a foreign bank's onshore branch.

Paragraph 5(2) sets out restrictions on the use of foreign central government bonds, and does not allow the use of foreign corporate bonds and equities. This is inconsistent with the eligible collateral allowed by other jurisdictions, and we would request the RBI align the eligible collateral with the

BCBS-IOSCO Framework and other jurisdictions to allow high-quality, liquid assets that are expected to remain liquid and retain their value, with appropriate haircuts in place. For more information on this point, please refer to the ISDA table comparing the eligible collateral across jurisdictions, along with associated haircuts[29].

We also request that the RBI allow more types of collateral as reflected in the BCBS-IOSCO Framework, such as gold, equities and units of collective investment schemes.

We would also like to note that the eligible collateral allowed is different depending on whether the exchange of VM is between two DCEs (paragraph 5(1)), or a DCE and an FCE (paragraph 5(2)). Global jurisdictions have the same set of eligible collateral between domestic and offshore counterparties, and we would request that the RBI consider harmonizing the eligible collateral to be the same for DCEs and FCEs.

Annex 1 prescribes a haircut of 8% where the 'currency of derivatives obligation differs from that of the collateral asset'. Given the fact that the under paragraph 4(3) VM is to be calculated on a net aggregate basis across all NCCD contracts, it will be impossible for counterparties to distinguish the collateral being sought vs. the currency of the derivatives obligation. We request that the RBI explicitly clarify that 'the currency of derivative obligation' could also refer to either the termination currency of the master agreement, or the base currency or eligible currencies of the CSA. Similarly, the 0% haircut for 'cash in the currency of settlement of the derivative transaction' should also apply to the termination currency of the master agreement or the base currency or eligible currencies of the CSA.

i. Treatment of cash collateral as VM, paragraph 6

Paragraph 6(2) seems to suggest that cash collateral received as VM is treated purely as a liability for the purpose of the computation of demand and time liabilities and net demand and time liabilities ("**DTL/NDTL**"). Ideally, in cases where the VM is transferred on a title transfer basis, the bank's books will have an asset (positive MTM on the NCCDs) on one hand, and a liability (VM collateral) on the other. The NDTL should take into account the net of the asset and the liability to reflect the bank's true liabilities. For avoidance of doubt, we would request that the RBI explicitly recognize such netting for the purposes of NDTL in paragraph 6 of the VM consultation, and in the related RBI master circular on cash reserve ratio and statutory liquidity ratio[30].

Furthermore, we request the RBI also confirm that any cash collateral received in a foreign currency as VM will not be treated as a loan or overdraft, and such foreign currency cash VM will be exempted from the overseas foreign currency borrowing limits and other limits as prescribed under the related master direction on risk management and inter-bank dealings[31].

We also request RBI to clarify that the treatment of cash collateral received as VM will also apply for VM exchanged on a discretionary basis, and that the treatment of all VM (irrespective of whether it is exchanged based on RBI rules, the rules of any other regulator, or on a discretionary basis) will be consistent for regulatory capital purposes as well.

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[29] https://www.isda.org/a/Z9uTE/Eligible-Collateral-Comparison-3.21.20.pdf, ISDA, Eligible Collateral Comparison by Jurisdiction (as on 21 March, 2020).
[30] https://rbidocs.rbi.org.in/rdocs/notification/PDFs/98MNDADA89616D1B44C1B8106ED375AE0E57.PDF, RBI, Master Circular - Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR).
[31] https://rbidocs.rbi.org.in/rdocs/notification/PDFs/MD3191FD1C01B7704FB9B24E7073F651AB51.PDF, RBI, Master Direction - Risk Management and Inter-Bank Dealings.

In addition, paragraph 6 does not recognize the treatment of other forms of eligible collateral referred to in paragraph 5 (such as debt securities), and we request that the RBI allow for such non-cash collateral as well.

j. *Margin requirements for cross-border NCCD transactions, paragraph 7*

As highlighted in the Industry Margin Submissions and reiterated in the *General Comments* section (paragraph 2(c)) of this response, we request that the RBI allow for a full substituted compliance framework.

For substituted compliance for cross-border transactions, we request that the RBI confirm all BCBS-IOSCO jurisdictions are comparable under paragraph 7(2), similar to what Hong Kong and Singapore have done, or to provide a list of comparable jurisdictions prior to VM requirements being implemented. In addition, we would like clarification on whether the RBI has specified any other foreign jurisdictions where additional considerations would be imposed in order to apply substituted compliance, as indicated under paragraph 7(2).

As highlighted in the *General Comments* (paragraph 2(c)) section of this response, we would like to reiterate the request to consider a framework of automatic deference for transactions entered into by foreign bank branches in India, in order to assist in achieving a workable cross-border framework.

4. Conclusion

We thank the RBI for the continued engagement on this topic. We would urge the RBI to continue an open and constructive dialogue with market participants to address the concerns we have highlighted in this response to ensure the VM requirements in India are aligned with the BCBS-IOSCO Framework and with global margin rules, and to ensure that there is no unintended consequence of market liquidity fragmentation, disincentivization of hedging activities, or negative impact on economic growth.

We would also like to reiterate here that we would like the RBI to continue to postpone implementation of the VM requirements until these concerns are addressed, and to ensure that the RBI provides the industry with sufficient implementation time once the final VM requirements are issued to allow the industry to put in place the necessary implementation measures as well as repaper all existing agreements with their counterparties.

ISDA thanks the RBI for the opportunity to respond to the VM Consultation, and we welcome continued dialogue with the RBI on any of the points raised this response, as well as the previous related submissions.

Please do not hesitate to contact ISDA via Rahul Advani, Interim Head of Public Policy, Asia Pacific (radvani@isda.org or at +65 6653 4171), or Jing Gu, Head of Legal, Asia Pacific (jgu@isda.org or at +65 6653 4173).

Yours sincerely,

For the International Swaps and Derivatives Association, Inc.

ANNEX 1

Previous Industry Margin Submissions to RBI on Margin Requirements

Date	Subject	Link
June 8, 2016	ISDA response to RBI Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives.	https://www.isda.org/a/BmiDE/india-submission-080616.pdf
May 14, 2018	ISDA submission to RBI on netting & margin requirements	https://www.isda.org/a/FTAEE/India-Submission-14-May-18.pdf
August 31, 2018	ISDA & FIMMDA follow-up submission to RBI on netting & margin requirements	https://www.isda.org/a/sTAEE/India-Submission-31-Aug-18.pdf
March 5, 2020	ISDA submission to RBI on Margin Requirements and the Bilateral Netting of Financial Contracts Bill, 2020	https://www.isda.org/a/1u9TE/RBI_Margin-Netting-letter.pdf

ANNEX 2

Extracts and references in relation to netting in India (prepared by Juris Corp)

Sr. No.	Topic	Extract	Date	Link
1.	Notification : Prudential Norms for Off-Balance Sheet Exposures of Banks – Bilateral netting of counterparty credit exposures	*"Since the legal position regarding bilateral netting is not unambiguously clear, it has been decided that bilateral netting of mark-to-market (MTM) values arising on account of such derivative contracts cannot be permitted. Accordingly, banks should count their gross positive MTM value of such contracts for the purposes of capital adequacy as well as for exposure norms."*	1/10/2010	Link
2.	Bulletin : Regulatory and Other Measures	*"Since the legal position regarding bilateral netting is not unambiguously clear, it has been decided that bilateral netting of mark-to-market (MTM) values arising on account of such derivative contracts cannot be permitted. Accordingly, banks should count their gross positive MTM value of such contracts for the purposes of capital adequacy as well as for exposure norms."*	12/11/2010	Link
3.	Circular : Prudential Norms for Off-balance Sheet Exposures of Banks	*"Since the legal position regarding bilateral netting is not unambiguously clear, receivables and payables from/to the same counterparty including that relating to a single derivative contract should not be netted."*	11/08/2011	Link
4.	Bulletin : Regulatory and Other Measures	*"Since the legal position regarding bilateral netting is not unambiguously clear, receivables and payables from/to the same counterparty including that relating to a single derivative contract should not be netted."*	13/09/2011	Link
5.	Speech : Legislative Reforms-Strengthening Banking Sector – Anand Sinha	*"Similarly, while bilateral netting in the event of liquidation is admissible for private sector banks governed by the Companies Act and the normal bankruptcy laws, the position in this regard for public sector banks, SBI and its subsidiaries is not clear in law, as liquidation, if at all, of such banks would be as per the Notification to be issued by the Government in this regard."* *"The legal position regarding bilateral netting is not unambiguously clear in case of banks established by special statutes [like SBI Act, Banking Companies (Acquisition and Transfer of Undertakings) Act, etc.]."*	12/01/2012	Link
6.	Master Circular : Prudential norms on Income Recognition,	*"Since the legal position regarding bilateral netting is not unambiguously clear, receivables and payables from/to*	01/07/2014	Link

ISDA

Sr. No.	Topic	Extract	Date	Link
	Asset Classification and Provisioning pertaining to Advances	*the same counterparty including that relating to a single derivative contract should not be netted."*		
7.	Discussion Paper on Margin Requirements for non-Centrally Cleared Derivatives	*"The methodology applied to compute margin requirements should be able to capture any loss caused by default of a counterparty with a high degree of confidence. Due to lack of legal unambiguity on reckoning exposures based on net basis, the requirement of variation and initial margins have to be applied on a contract by contract basis. Portfolio margining models can be used only when RBI specifically permits computation of margins on a portfolio basis."*	02/05/2016	Link
8.	Interview: Corporate Debt Market - Mr. H. R. Khan	*"So, what we are trying to do is in terms of CDS, the main issue which has been a stumbling block as per the market is this netting issue involving public sector because of that capital charge increases. So, we were in dialogue with the government whether we have that amendment to the RBI act, netting and if that is not possible, pending that whether based on legal opinion we got second tracked whether the netting can be allowed. So, that will be a big boost."*	01/08/2016	Link
9.	Speech: Strengthening Our Debt Markets - Dr. Raghuram G. Rajan	*"We are conscious of the limitations placed on netting of derivative contracts, and thus the higher associated capital requirements on banks. The issue has been taken up with the Government, and we hope to amend the RBI Act to make such netting possible."*	26/08/2016	Link
10.	Notification: Guidelines for Computing Exposure for Counterparty Credit Risk arising from Derivative Transaction	*"At present, due to lack of unambiguity of legal enforceability of bilateral netting agreements, each non-centrally cleared OTC derivative trade will be considered a netting set of its own and therefore, computation of RC and PFE will not recognise any offset among different derivative transactions."*	10/11/2016	Link

ANNEX 3

Proposed list of QFC based on the 2018 ISDA Model Netting Act

(a) a currency, cross-currency or interest rate swap or profit rate swap;

(b) a basis swap;

(c) a spot, future, forward or other foreign exchange transaction;

(d) a cap, collar or floor transaction;

(e) a commodity swap;

(f) a forward rate agreement;

(g) a currency or interest rate future;

(h) a currency or interest rate option;

(i) an equity derivative, such as an equity or equity index swap, equity forward, equity option or equity index option;

(j) a derivative relating to bonds or other debt securities or to a bond or debt security index, such as a total return swap, index swap, forward, option or index option;

(k) a credit derivative, such as a credit default swap, credit default basket swap, total return swap or credit default option;

(l) an energy derivative, such as an electricity derivative, oil derivative, coal derivative or gas derivative, including a derivative on physical transmission rights, financial transmission rights or transmission capacity;

(m) a weather derivative, such as a weather swap or weather option;

(n) a bandwidth derivative;

(o) a freight derivative;

(p) an emissions derivative, such as an emissions allowance or emissions reduction transaction;

(q) an economic statistics derivative, such as an inflation derivative;

(r) a property index derivative;

(s) a spot, future, forward or other securities or commodities transaction;

(t) a securities contract, including a margin loan and an agreement to buy, sell, borrow or lend securities, such as a securities repurchase or reverse repurchase agreement, a securities lending agreement or a securities buy/sell-back agreement, including any such contract or agreement relating to mortgage loans, interests in mortgage loans or mortgage-related securities;

(u) a commodities contract, including an agreement to buy, sell, borrow or lend commodities, such as a commodities repurchase or reverse repurchase agreement, a commodities lending agreement or a commodities buy/sell-back agreement;

(v) a collateral arrangement;

(w) an agreement to clear or settle securities transactions or to act as a depository for securities;

(x) any other agreement, contract or transaction similar to any agreement, contract or transaction referred to in paragraphs (a) to (w) with respect to one or more reference items or indices relating to, without limitation, interest rates, currencies, commodities, energy products, electricity, equities, fund interest, weather, bonds and other debt instruments, sukuk, precious metals, quantitative measures associated with an occurrence, extent of an occurrence, or contingency associated with a financial, commercial or economic consequence, or economic or financial indices or measures of economic or financial risk or value ;

(y) any swap, forward, option, contract for differences or other derivative in respect of, or combination of, one or more agreements or contracts referred to in paragraphs (a) to (x);

(z) an instrument, agreement or transaction that is or effects the economic equivalent of one of the instruments, agreements or transactions referred to in paragraphs (a) to (y) through use of a murabaha, musawama or wa'ad or any other structure commonly used for the purpose of effecting Shari'a compliant instruments, agreements or transactions; and

(aa) any agreement, contract or transaction designated as a qualified financial contract by the Authority under this Act;

ANNEX 4

Fact patterns to be considered for the offshore posting of collateral

Counterparty A	Counterparty B	Collateral should be allowed
Onshore branch of Indian bank	Onshore branch of Indian bank	Onshore
Onshore branch of global bank	Onshore branch of Indian bank	Onshore OR Offshore
Onshore branch of global bank	Onshore branch of global bank	Onshore OR Offshore
Onshore branch of global or Indian bank	Offshore hedge counterparty[32]	Offshore
Onshore company	Offshore hedge provider (for commodity derivatives)	Offshore
Offshore branch of global bank or CCP	Onshore branch of Indian bank	Offshore
Offshore branch[33] of global bank or CCP	Onshore branch of global bank	Offshore
Offshore branch of global bank or CCP	Offshore branch of Indian bank	Offshore

Explanation: For the purposes of this table,

(i) "Onshore" means a collateral transfer that is made onshore in India

(ii) "Offshore" means a collateral transfer that is made offshore outside of India

[32] An offshore hedge counterparty could include Foreign Portfolio Investors (FPIs), Foreign Direct Investment (FDI) investors, Non-Resident Indian (NRI) investors, Non-Resident importers or exporters (having INR exposure), External Commercial Borrowings (ECB) lenders (having INR exposure), or such other hedge counterparty having INR exposures as permitted by the regulator from time to time.

[33] Including entities that are not multi-branch.