

Microstructure to Control Counterparty and Systemic Risks on Exchange

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Concept Presentation

- **Types of Settlement in Commodity Derivatives**
 - **Daily MTM Settlement**
Funds to be paid / received on a daily basis through the banking channels through the Clearing Member
 - **Delivery Settlement (for open position at expiry)**
 - **Compulsory Delivery Contracts (Bullion and Agri)**
 - **Seller's Option Contracts (Agri)**
 - **Both Option Contracts (Energy and Metal contracts)**

- Failure by counter party Clearing Member to carry out Funds settlement for Daily MTM
- Failure to Delivery Obligations at expiry
 - Funds Settlement
 - Delivery Settlement

- **Margins**

- Initial Margin (considering Margin Period of Risk)
- Extreme Loss Margin
- Concentration Margin
- Additional and Special Margin
- Tender Period and Delivery Period Margin

- ❖ *Margin alerts to Clearing Member (CM)*

- ❖ *Member transferred to square off mode at 100% margin utilisation*

- Margins collected in the form of Cash, FDR, BG, Securities, G-Secs, Warehouse Receipts (with applicable haircuts)

- Risk Reduction Mode
 - Pre trade margin validation @90% of Margin Utilisation
- Mark to Market (MTM) Loss Monitoring
 - MTM Loss is monitored on real-time basis
 - 75% of collateral limit is considered as MTM Loss Limit
 - Alerts sent to CM at 60%, 75% and 90% of MTM Limits
 - At 100% CM transferred to square off mode
- For members repetitively over utilising margins, additional deposits blocked

Mitigation Measures

- Settlement Guarantee Fund

- Stress test carried out based on Regulatory guidelines
- Contribution currently by Exchange and members in the form of Base Capital
- Settlement related penalties and interest credit to SGF
- Proposed in Clearing Corporation as 50:25:25

- Utilisation of SGF

- Default Water Fall Mechanism
- Capped additional contribution (if required) restricted at 1:1 based on contribution to SGF

Mitigation Measures – Systemic Risk

- Members admitted only on sufficiency of net worth requirements (Self Clearing Member – Rs 1 crore, Clearing Member – Rs 3 crores)
- Deposit requirement – Rs 50 lacs
- Base Capital Requirement
- Position limits at client and member level
- Client Margin Reporting requirement to ensure compliance of margin payment by clients

Way Forward

- SEBI has stipulated formation of Clearing Corporation by existing Commodity Derivative Exchanges carrying out in-house Clearing & Settlement by September 2018
- Networth requirement of CC to be Rs 100 crores (to be increased to Rs 300 Crores within a period of 3 years)

Practitioner Presentation

Events affecting Commodity Prices

- Prices of contracts are affected by international events - Volatility seen before/after events like US elections, Brexit, FED meet, OPEC meet
- Agri commodity prices are affected by bumper crop / crop failures
- Periodic Data on stock of Commodities like Crude/ Natural Gas

Risk Mitigation

- Exchanges impose additional margins / special margins

Settlement Statistics

- Of the open positions at the end of contract expiry in Compulsory Delivery contracts, more than 99% of the open positions are settled through delivery
- Of the volumes traded, in case of Compulsory Delivery contracts, approx. 0.5% to 5% commodities are settled through delivery

THANK YOU