

India Ratings Affirms Indian Clearing Corporation at 'IND AAA'/Stable

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By [Harshal Patkar](#)

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India Ratings and Research (Ind-Ra) has affirmed Indian Clearing Corporation Limited's (ICCL) Long-Term Issuer Rating at 'IND AAA' with a Stable outlook. The rating, which indicates ICCL's credit risk profile on Ind-Ra's credit rating scale, is for the benefit of clearing members that are ICCL's counterparties.

KEY RATING DRIVERS

The rating reflects ICCL's strong risk management track record (earlier as the internal clearinghouse of BSE Limited) in managing risks in post-trade clearing and settlement. The rating also considers the collateral-backed nature of ICCL's business model and BSE group's governance framework. A proactive regulatory regime along with BSE's high capitalisation relative to ICCL's settlement volumes also provides comfort.

ICCL's risk profile benefits from the Securities and Exchange Board of India's (SEBI) strong regulatory oversight over the clearing corporation's risk management, governance practices and capital requirements. This entails having an independent board, defined guidelines of executive compensation, regulatory screening of key executives and the prevention of trading or clearing members from being on the board. Ind-Ra draws comfort from SEBI's highest ratings (level 4: June 2015) by International Organization of Securities Commissions (IOSCO) on the implementation status of Principles of Financial Market Infrastructure (PFMI) in various countries and the Qualified Central Counterparty status granted to ICCL by SEBI for its compliance with the Committee on Payments and Market Infrastructures (CPMI)-IOSCO Principles.

SEBI mandates maintaining of Core -Settlement Guarantee Fund (C-SGF) for clearing corporations (ICCL had INR 1.9bn in C-SGF as of April 2016) which should be readily and unconditionally available to meet settlement obligations. SEBI also prescribes daily stress test reporting (across all segments effective 1 December 2014) aligned with FMI principles which bolsters the safety net. SEBI prescribes a monthly review of stress testing model and a daily review of C-SGF. ICCL also has INR4.11bn in counterparty default insurance (which comes above the C-SGF in the default waterfall) which adds a further cushion.

ICCL's operational risks remain high. Direct risks could emanate from a possible systems failure leading to inadequate margins while indirect risks could come from an operational failure at BSE where it has a strong reputational linkage. ICCL manages operational risk through its disaster management systems and has reported a zero loss record due to operational failures so far. Further its operations are subject to regular audit and inspections from SEBI. ICCL maintains a far disaster recovery site in a different seismic zone which is reviewed and tested periodically to ensure seamless clearing and settlement. ICCL also maintains SEBI mandated INR1bn as part of its recovery and resolution process for covering the operational cost for one year, legal cost, regulatory cost, and other liabilities.

ICCL manages credit risk by imposing regulator-prescribed value at risk (VaR) and extreme loss margins on clearing

members and their clients for each open position and monitors collateral adequacy on a real time basis. Ind-Ra's tests (increasing VaR confidence levels to 99.99% and measuring margin adequacy for the worst one-day decline in the last 10 years for 30 actively traded stocks) on cash segment practices indicate that prescribed margins continue to cover most extreme stock scenarios in volatile periods and large shortfalls were largely on account of idiosyncratic factors. However, the stress tests for two-day VaR indicate that the current margins appear insufficient for seven instances out of 30. That being said, the circuit filters allow markets to process new information during sudden market-wide shocks.

Ind-Ra views ICCL's equity position of INR 4.6bn as adequate for current business volumes, which provides coverage (net worth to value of shares delivered daily) of over 35% for its equity cash segment. The agency opines ICCL may also receive equity or liquidity support from BSE (1HFY16 equity: INR23.0bn) in case of a crisis, due to the high reputational risk involved. ICCL maintains sufficient liquid buffers in the form of over INR7bn lines of credit (both collateralised and non-collateralised) with multiple banks covering four to five days of any given payouts requirement and or stress scenario covering defaults of two participants to meet obligations in a liquidity crunch scenario.

The business profile of ICCL remains modest despite improved latency (6 micro seconds) of BSE. With BSE's implementation of the new technology, the volumes were likely to pick up in the medium term. However, the technology competitiveness has not resulted in business traction at least in FY16. ICCL has revised its terms with BSE and now it neither receives the clearing and settlement income nor pays any investment income to BSE. Thus, the volatility in the trading volume of BSE has a limited impact on ICCL's income.

RATING SENSITIVITIES

A decline in BSE's competitiveness, leading to a sustained erosion of ICCL's operating profitability, could lead to a revision in the rating Outlook to Negative. The rating could face multiple-notch downgrades if ICCL's capitalisation is affected due to defaults by clearing members or if capital levels appear inadequate to protect any enhanced legal or operational risk arising out of evolving business models.

COMPANY PROFILE

ICCL was incorporated in 2007 as a wholly owned subsidiary of BSE and is regulated by SEBI as an FMI entity and Reserve Bank of India for select products. It carries out the functions of clearing, settlement, collateral management and risk management for various segments of BSE. ICCL acts as a central counterparty through the process of novation; it becomes a buyer for all sellers and seller for all buyers. ICCL settles trades reported on the debt and mutual fund segments of BSE and clears and settles trades executed on all the other segments of BSE, including equity cash, equity derivatives, currency derivatives, interest rate futures, debt, BSE SME, offer for sale, securities lending & borrowing, etc.

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Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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Rating Outstanding

(As on 31/Aug/2016)

Long Term Issuer Rating

IND AAA / Stable

Applicable Criteria

[Financial Institutions Rating Criteria](#)

[Non-Bank Finance Companies Criteria](#)

[Rating FI Subsidiaries and Holding Companies](#)

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