Indian Clearing Corporation Limited

January 08, 2021

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Issuer Rating*	-	**CARE AAA (Is); Stable [Triple A; Outlook: Stable]**	**Reaffirmed**

Details of instruments/facilities in Annexure-1
**The rating is subject to the company maintaining overall gearing not exceeding 2 times*

Detailed Rationale & Key Rating Drivers

The rating remains underpinned by the strong linkage of Indian Clearing Corporation Limited [ICCL] with BSE Ltd. [BSE]; ICCL being BSE's wholly-owned subsidiary and as a central counterparty for clearing and settlement of almost half of BSE's trades post inter-operability, implemented in July 2019. The linkage is strengthened by SEBI requirements on minimum ownership by BSE and BSE's minimum contribution to Core Settlement Guarantee Fund (Core SGF). The rating factors in the strong regulatory oversight of the sector by SEBI which has outlined various risk management guidelines – Core SGF, Default Waterfall and Stress Test to be adhered to by the Clearing Corporations (CCPs) underlining ICCL's systemic importance as a Financial Market Infrastructure (FMI). The rating also considers ICCL's solid liquidity buffer supported by the counterparty default insurance of Rs.450 crore. While revenues remain vulnerable to the inherent fluctuations in trading volumes, post-interoperability, the uniform fee structure across exchanges has lent an element of stability to the income profile.

Continued strong inter-connectedness with BSE, maintenance of liquidity buffers to cover default risk, fall in profitability levels led by decline in market share, regulatory changes and change in BSE's competitive position are the key rating sensitivities.

Rating Sensitivities

Negative Factors - Factors that could lead to negative rating action/downgrade:

- Shortfall in Actual SGF from regulatory requirements
- Significant impact on profitability as a result of loss in market share on account of interoperability among clearing corporations
- Weakening of linkages due to reduction in shareholding or significant decline in the amount of settlement of trades executed on BSE
- Moderation in credit profile of BSE

Detailed description of the key rating drivers

Key Rating Strengths

Systemic importance; benefits from linkages with parent company: ICCL is one of the three CCPs that clear exchange listed products and has been designated as a FMI by SEBI. Being a CCP, the entity is systemically important in the financial sector as it bears the counterparty credit risk of both the trading parties. The recognition of its growing importance is exhibited by the increasing regulatory scrutiny by SEBI and the continuing regulatory developments led by SEBI.

ICCL is a wholly owned subsidiary of BSE and continues to remain integrated with the parent in terms of technology and other infrastructure. The parent-subsidiary linkage is further strengthened by SEBI regulatory guidelines, wherein BSE is required to have a minimum 51% ownership in ICCL and contribute at least 25% to Core SGF. BSE Ltd. had a standalone tangible net worth of Rs.2,092 crore as on March 31, 2020 with a PAT of Rs.173 crore as compared to ICCL's tangible equity of Rs.583 crore with a PAT of Rs.26 crore. During an adverse scenario, the parent company's ability to provide capital support is likely to be supported by its willingness to provide support considering high reputational risk.

Strong capitalization levels and nil gearing: Capitalisation levels continued to remain solid with ICCL reporting a tangible net worth of Rs.583 crore as at March 31, 2020 and Rs.605 crore as at September 30, 2020. ICCL had nil borrowings as on September 30, 2020 (Nil borrowings as on March 31, 2020) and therefore is low on balance sheet leverage. As on September 30, 2020 ICCL had bank lines in place of Rs.698 crore which had negligible utilization levels of 0.3% from April, 2020 to September, 2020. Further, ICCL had Rs.500 crore bank guarantee in place to manage its inter-CCP risk. Assuming, full utilization of the bank facilities in place, the overall on-balance sheet gearing levels would have been 1.2 times as on September 2020.

Strong regulatory supervision by SEBI ensures adherence to global financial standards: ICCL's business operations are closely monitored by SEBI in line with the strong regulatory framework stipulated by SEBI over the last few years with

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

guidelines on stress testing, Core Settlement Guarantee Fund (Core SGF) and Default Waterfall, to ensure that its operations are compliant with International benchmarks and regulations, including the Principles for Financial Market Infrastructures (PFMI) issued by CPMI-IOSCO. The FMI principles include standards regarding participant default rules and procedures, minimum financial resources to cover credit and liquidity exposure of central counterparties and testing (stress testing, reverse stress testing, back testing). ICCl has also been recognized as a Qualifying CCP (QCCP) with its operational systems subject to regular scrutiny by SEBI. ICCL needs to seek approval of SEBI before extending its services to any segment of a recognized stock exchange and before admitting any securities for clearing and settlement. SEBI also prescribes margins to be collected from the members for the positions taken by them.

Adequate counterparty and operational risk management: ICCL also has strong risk management systems in place which helps to manage the risk of default by clearing members wherein ICCL regularly collects prescribed margins from its clearing members in each segment. The members get margin usage alerts on pre-defined levels on real-time basis. ICCL has prescribed various margins like Initial Margin (VaR) and SPAN, Spread Margin, Extreme Loss Margin, Additional Margin and Special Margin which are monitored on a real time basis. Stress tests are performed daily with model testing frequency increased on identification of risks led by volatility in the price of the underlying securities, increase in the position of the clearing member etc. ICCL has a comprehensive margin and collateral risk management system with 50% of the margins and collateral required in the form of cash and cash equivalents to manage its liquidity risk in a stress environment. Initial margins are calculated with a 99.99% confidence interval and haircuts to collateral (10% or VaR) are applied on a real-time basis.

In case of shortfall of margin, risk management system generates various alerts at different collateral utilization levels (70%, 80% and 90%), puts the member in risk reduction mode at 90% and disables the trading terminal of a member when the collateral utilization exceeds 100%. On 100% collateral utilization, member’s terminal is put under suspension. In case of default by clearing members, ICCL follows a defined waterfall mechanism to recover money and mitigate the counterparty risk. ICCL has also set aside Rs.100 crore as a part of its recovery and resolution for covering operational cost for 1 year, legal cost, regulatory cost, and other labilities. The entity has a transparent governance structure with a Board of Directors independent of BSE.

Solid headroom led by a well-funded default waterfall: ICCL has a well-developed structure with strong liquidity buffers providing the required cushion to its risk exposures. While the highest Minimum Required Corpus (MRC) in the last one year was Rs.109 crore, ICCL had maintained an average Core SGF of Rs.437 crore translating into a headroom of about 75%. This is in line with the 2014 SEBI mandate to form a core SGF to provide liquidity buffer in order to provide a hedge against default risk of clearing members. ICCL also has additional buffer in the form of counterparty default insurance in the amount of Rs.457 crore.

The collaterals and margin being the first line of defense mechanism in the waterfall structure, the adequacy of margins are computed and monitored on a real-time basis. Further, as required by SEBI, core SGF adequacy is reviewed on a monthly basis through various stress scenarios. Under the extreme stress scenario of default by two of the top two clearing members, the highest stress loss was about 60% of core SGF providing a 40% cushion on its core SGF. Going forward, clearing and settling of trades of other exchanges by ICCL will likely lead to additional contribution to the default fund resources from the other exchanges as well.

Key Rating Weaknesses

Earnings vulnerability to volatile trading volumes partly offset by wider market access through inter-operability: Profit After Tax (PAT) rose 27.6% to Rs.26 crore during FY20 against PAT of Rs.20 crore during FY19. Post inter-operability, ICCL settles and clears trades for about 40%-45% of BSE’s trade volumes; ICCL also gained about 5% market share in NSE resulting in an increase in its overall turnover. Moreover, the standardisation of pricing across exchanges has provided further boost to its fee income. Subsequently, fee income has reported increases over the past few quarters with clearing and settlement fees now contributing 30% to the total income in FY20 as against 8% in FY19. In view of the inherent earnings susceptibility to the volatile trading volumes, the increasing composition of fee income in overall revenue eliminates the risk of uncertainty to some extent.

For 6MFY21, net profit reported decline to the extent of Rs.6 crore (6MFY20: Rs.14.9 crore) primarily due to Rs.6 crore contribution to Core SGF in the June quarter led by increased fund requirement in line with increased trading volumes. Regular SEBI review of core SGF leads to increased requirement of core SGF in line with increased trading volumes which adds an element of volatility to the profitability metrics. As a result, operating expenses rose to Rs.27 crore from Rs.14.5 crore during 6MFY20. Earnings are likely to remain moderate in the near term with Return on Tangible Assets (ROTA) likely to remain around 1%.

Liquidity: Strong
ICCL has substantial liquidity to manage both its clearing member defaults and to support its business operations. In addition to Core SGF, ICCL also has access to liquidity in the form of cash and bank balances and liquid investments from own funds in the amount of Rs.863 crore vis-à-vis no external borrowings as on November 30, 2020. ICCL also has sanctions from eight banks of Rs.698 crore with no drawdowns as on November 2020 and negligible utilisation over the last one year. In an adverse stress scenario of clearing member default, ICCL has a robust liquidity framework and an adequate default waterfall to manage the consequent liquidity risk. Moreover, with regards to operational liquidity, net liquid assets' coverage of the operational costs for six months remains strong at 9x and is likely to remain in the 9x-10x range in the near term.

Analytical approach:
CARE has analyzed the standalone profile of ICCL along with its strong operational and financial linkages with parent, BSE.

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE Policy on Default Recognition
Rating Methodology: Factoring Linkages in Ratings
Criteria for Issuer Rating
Financial ratios - Financial Sector

About the Company
ICCL was incorporated in April 2007 as a wholly owned subsidiary of BSE. ICCL carries out the functions of clearing, settlement, collateral management and risk management for various segments such as equity cash market (including BSE SME, offer for sale, securities lending & borrowing, corporate bonds and government securities), equity derivatives segment (stock & index futures and options), currency derivatives (currency (including cross-currency) futures and options, interest rate futures and options), commodity derivatives and debt products, including tri-party repo products. Post-interoperability, ICCL settles trades reported on the debt and mutual fund segments of BSE as well as other exchanges.
ICCL operates under the primary regulation of the SEBI and the Reserve Bank of India (RBI) for select products. ICCL received recognition as a Third Country Central Counterparty (TC-CCP) by European Securities and Market Authority (ESMA) in accordance with the European Market Infrastructure Regulation (EMIR). A TC-CCP recognized under the EMIR process also receives the Qualified Central Counterparty (QCCP) status across the European Union, and so is subject to lower capital requirements/charges under the Basel III Framework introduced by the Basel Committee on Banking Supervision.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total Income	54.08	59.61
PAT	20.40	26.03
Total Assets	1,291.44	1,675.89
PAT Margin (%)	37.72	43.67
ROTA (%)	1.44	1.80

A: Audited

Status of non-cooperation with previous CRA:
Not applicable

Any other information:
Not applicable

Rating History for last three years: Please refer Annexure-2
Covenants of rated instrument / facility: Not applicable
Complexity level of various instruments rated for this company: Annexure 3

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Issuer Rating	**-**	**-**	**-**	**-**	**0.00**	**CARE AAA (Is); Stable**

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Issuer Rating-Issuer Ratings	Issuer Rating	0.00	CARE AAA (Is); Stable	1) CARE AAA (Is); Stable (04-Jan-21)	1) CARE AAA (Is); Stable (11-Feb-20) 2)CARE AAA (Is); Stable (04-Apr-19)	1)CARE AAA (Is); Stable (03-Apr-18)	-

Annexure 3: Complexity level of various instruments rated for this company

Sr No	Name of instrument	Complexity level
1	Issuer Rating	Simple

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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