

Interoperability among Clearing Corporations

Draft Operating Guidelines

**Jointly issued by Indian Clearing
Corporation Ltd., Metropolitan Clearing
Corporation Ltd., NSE Clearing Ltd.**

April 15, 2019

1 Background

SEBI issued the broad framework for interoperability among clearing corporations vide circular ref. no. CIR/MRD/DRMNP/CIR/P/2018/145 dated November 27, 2018, to allow market participants to consolidate their clearing and settlement functions at a single CCP, irrespective of the stock exchange on which the trade is executed

While introduction of interoperability may be beneficial for the intermediaries and market participants, its implementation will also involve system/process changes for members. These draft guidelines are strictly to help members assess possible changes in the existing processes before the issuance of the final guidelines and to facilitate questions/comments from the members if any.

The draft operating guidelines in this note is a draft for informational purposes only and must NOT be considered as final guidelines. The operational guidelines/circulars will be issued later by respective CCs.

1.1 Structure of Clearing Corporation (CC) Interoperability

A simplified structure of CC Interoperability is depicted in the schematic below:

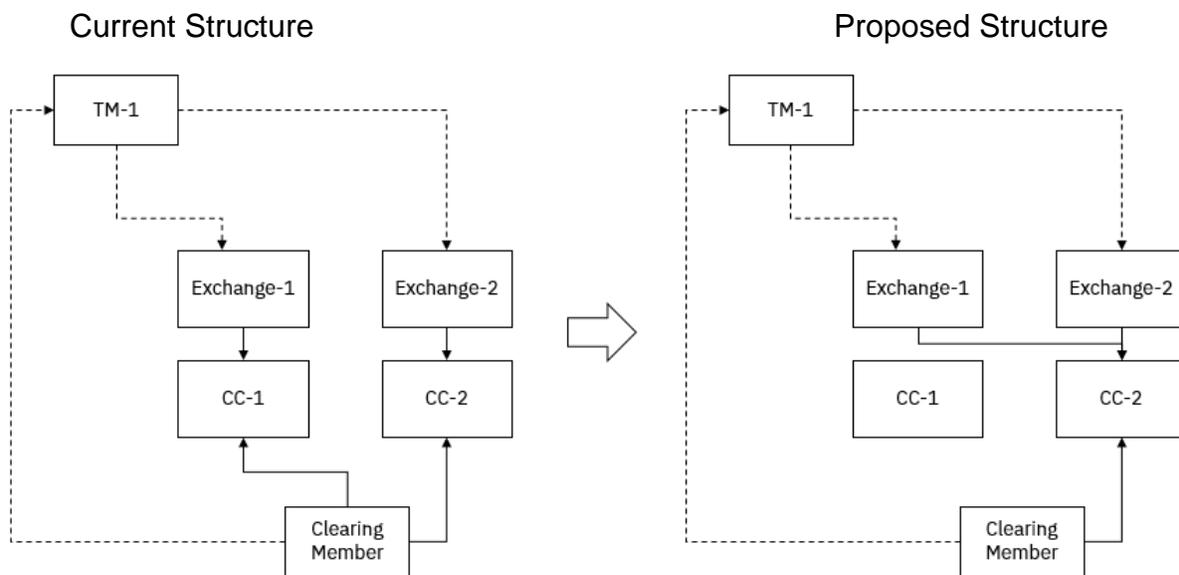


Figure 1: CC Interoperability: Simplified Structure

Under the current framework, the exchanges and clearing corporations operate under a vertically integrated model wherein the clearing and settlement of trades executed on an exchange is done by a dedicated and single clearing corporation. Trading members trading on multiple exchanges need to make arrangements for clearing with clearing

corporations of respective exchanges, who need to clear and settle deals with the clearing corporations of respective exchanges separately.

Under CC Interoperability, a Clearing Member may maintain association with a single clearing corporation. The trades executed on multiple exchanges can be consolidated into a single Clearing Corporation for the clearing member and there will not be a strict one-to-one association of exchanges and clearing corporations.

Similarly, the trades for custodial participants trading through multiple trading members but clearing through a single clearing member may also be cleared by the clearing member with a single clearing corporation.

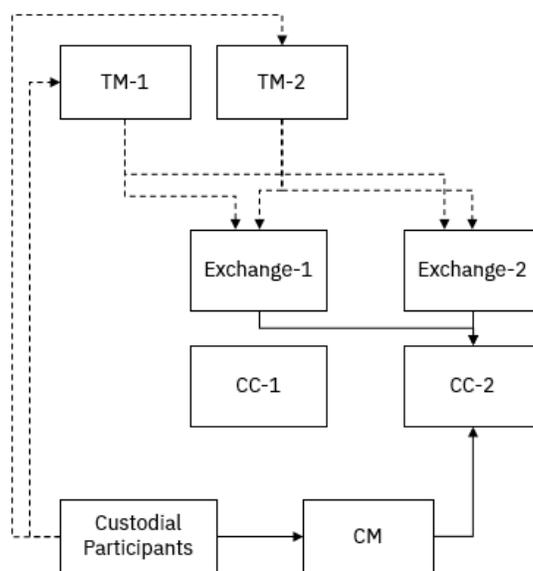


Figure 2: Clearing of Custodial Participant Trades

1.2 Products

All products under the Cash Market Segment, F&O Segment, Currency Derivatives Segment (including Interest Rate derivatives), and Debt Segment (except Tri-party Repo and Trade Reporting Platform) will be covered under CC Interoperability. The interoperability arrangement will be applicable for exchange traded products only. The Order collection mechanisms/schemes such as Offer for Sale, Mutual Funds Service Scheme, Buy-back/Tender Offer schemes, Non-competitive bidding, Primary bidding of SGB etc. are not covered under interoperability. Securities Lending and Borrowing Scheme is not included under interoperability since the scheme is operated by Clearing Corporation as an Approved Intermediary.

2 Degree of choice for interoperability

The choice of interoperability will be at a Clearing Member – segment level. In other words, each clearing member will be required to designate a clearing corporation for every segment for clearing and settlement of trades executed in any of the stock exchanges under interoperability. Clearing members may continue to maintain clearing membership of multiple clearing corporations at their choice and will be permitted to change the designated clearing corporation following the process set out in the subsequent sections.

The Custodians in the cash market segment will have a facility to specify the designated clearing corporation separately for each of their clients.

3 Registration process

The registration process for various intermediaries is provided below.

3.1 Clearing Members

1. Clearing member registration process will be same as the process currently followed for admitting clearing members.
2. Depending upon the degree of choice for interoperability, the new/existing clearing members will need to indicate their choice of clearing corporation. The custodians in the cash market segment will have a facility to specify the designated clearing corporation separately for their clients.
3. Clearing members will have a choice to change their designated clearing corporation.
 - a. In cash market, the trades done on and after the effective date of such change will be cleared through the new clearing corporation.
 - b. In derivatives, the positions of the clearing member will be transferred from the old clearing corporation to the new clearing corporation. The settlement obligations determined prior to the effective date will be settled with the old CC.

The clearing corporations shall define the process for change in association of clearing members.

3.2 Trading Members

1. Exchanges will admit trading members as per their existing process.
2. The choice of clearing corporation made by the clearing members will be applicable to the trading members availing services of such clearing members.
3. Trading members shall be permitted to change their association of clearing member. The change of clearing member may result in the change in the associated clearing corporation. The clearing corporations shall put in place a mechanism for change of

such association after due confirmation from old CM/CC and new CM/CC. In case of cash market, the trades beginning from the effective date of change of association will be cleared by the new CM/CC. In case of derivatives, the positions of the trading member and its constituents will be transferred to the new CM/CC from the effective date of transfer.

3.3 Custodial Participants

1. Clearing corporations shall issue custodial participant (CP) codes to their clearing members clearing through them.
2. Clearing corporations shall coordinate and ensure that the existing and future CP codes are unique, and the clearing member and clearing corporation through which the trades of the CP are to be cleared can be uniquely identified based on the CP code.
3. A process for change of CM/CC association of a CP code will be put in place. The process will be similar to the process for change of association of TM, except that it will be initiated by the new CM with the new CC, rather than by the TM with exchange(s).

3.4 Clients

The exchanges shall require every trading member to:

1. Use the same client code (UCC) at all exchanges
2. Not use the same client code (UCC) for different clients in different exchanges.

The point #1 above ensures that there is netting of transactions, wherever applicable, executed by clients in different exchanges through the same Trading Member. The point #2 above ensures that there is no inappropriate netting across different clients.

For clarity, trading member “TM-1” must use the client code “CL-1” for the same client across exchanges. “TM-1” may not use “CL-1” for different clients for different exchanges. Other TMs may use the code “CL-1” for their clients following the same principle.

4 Life cycle for cash market transactions

This section provides a life cycle for transactions in the cash market.

4.1 Trade

1. Trading members may enter orders as per the current practice. No change in order structure is envisaged. The clearing corporations shall put in place appropriate mechanisms to handle the order structure differences between exchanges.
2. The facility for modification of client codes will be provided by the exchanges to the trading members. This facility will not be available at the clearing corporations.
3. The facility for modification of CP codes will be provided by the Clearing Corporations to trading members. This facility will not be available at the exchanges.
4. All clearing corporations will clear all existing products (which are in scope) for all exchanges. This will mean that even if certain securities/contracts are listed on only one exchange, such securities/contracts will be cleared by all clearing corporations.

4.2 Allocation and confirmation

4.2.1 Interim Model

The following interim model for allocation and confirmation shall be adopted for the initial period as mutually agreed by the clearing corporations (currently envisaged to be one year from the date of implementation of interoperability). After such period is elapsed, the clearing corporations shall adopt the “Steady state model” as outlined in the subsequent section.

The interim model shall be applicable for all custodial participant trades in cash market.

In the context of allocation and confirmation process in cash market;

1. “Local CC” of an exchange will mean the CC undertaking clearing and settlement for a given exchange in the existing framework prior to implementation of CC interoperability.
2. “Designated CC of trading member” will mean the CC designated by the clearing member of a given trading member under interoperability.
3. “Designated CC of custodial participant” will mean the CC designated by the custodian of a given custodial participant under interoperability.

Under the interim model:

1. Regardless of the designated CCs of trading member or custodial participant, the allocation and confirmation process for trades executed on an exchange will take place at the Local CC of the exchange in accordance with its existing practices.
2. However, the levy of margin (as applicable in case of upfront marginable and non-upfront marginable custodial participants) and settlement will be performed by the members at their designated CCs.
3. The role of the Local CC will be restricted to provide the facility of allocation and confirmation only; and the local CC will not be responsible for any other functions.

Consider the following example:

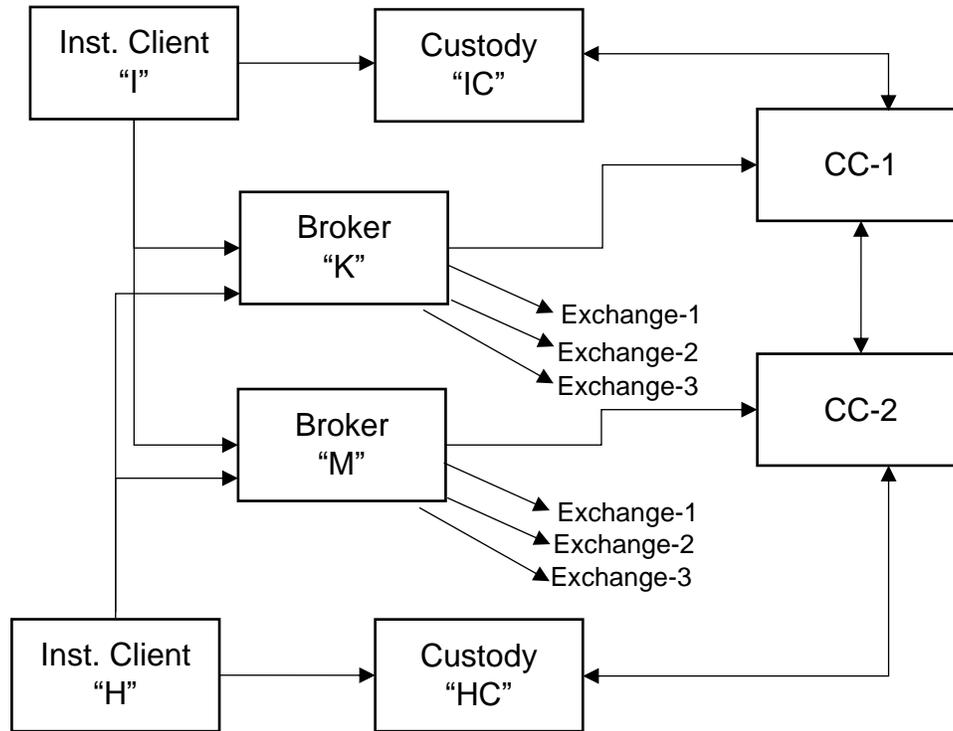


Figure 4B: Detailed example of Allocation/Confirmation in Cash Market

1. Institutional client "I" is associated with custody "IC" who has designated CC-1.
2. The client "I" trades through brokers "K" and "M", who are SCMs and have designated CC-1 and CC-2 respectively. The client "I" may trade on all exchanges through each of the brokers.
3. Institutional client "H" is associated with custody "HC" who has designated CC-2.
4. Client "H" also trades through brokers "K" and "M"

Allocation Process

1. Allocation CC will be as per the CC mapped to the executing broker. In this example "K" will perform allocation at CC-1 and "M" will perform allocation at CC-2; regardless of the exchange on which the trades are executed.
2. The allocation will be done by "K" and "M" using the allocation facility provided by each CC, the manner, file structures etc. will be as per the facility of the CC, regardless of the exchange where the trade is executed.

Confirmation and rejection

1. Confirmation will be done by the custodian using the facility provided by confirmation CC. In this example, "IC" will confirm trades of "I" executed by both "K" and "M" in all the exchanges, using the confirmation facility provided by CC-1.

2. Trades once confirmed cannot be rejected or vice-versa.

4.3 Collateral and Risk Management

1. The clearing members shall maintain the collateral at clearing corporation(s) based on the model for choice of interoperability. The collateral deposited at a CC for a given segment will be used for the margin requirements based on the transactions cleared through the CC in the respective segment as per current process; regardless of the exchange on which the trades are executed.
2. When the clearing corporations decide to place a trading/clearing member in Risk Reduction (RR)/Closeout mode, the clearing corporations will notify all exchanges and all exchanges will act on such instructions (subject to the model for choice of interoperability.)

4.4 Settlement

There shall be no change in the settlement process of the clearing corporations.

5 Life cycle for derivatives transactions

5.1 Confirmation process

The confirmation process in derivatives shall be as under:

1. All clearing corporations shall coordinate for issuance of unique CP codes.
2. The custodial participant code shall be entered at the time of order entry.
3. The exchange where the trade is executed shall route the trade to the allocation CC.
4. Allocation CC will levy margins on the CM of the executing trading member as per the current practice.
5. Allocation CC will provide the trade information to the confirmation CC for confirmation on the real-time interface between the CCs. The confirmation CC will provide the trade for confirmation to the clearing member as per existing practice.
6. Confirmation CC will intimate the confirmation/rejection to the allocation CC. There after allocation CC will intimate the confirmation/rejection to the Exchange where the trade was executed.
7. Upon confirmation, the inter-CC positions and margins shall be suitably adjusted to reflect the confirmation.

5.2 Other processes

The other provisions applicable to cash market shall be applicable mutatis mutandis to derivatives also.

6 Questions/Comments

In case of any questions/comments regarding the draft operating guidelines contained in the document, the members may email such questions/comments to the each of the addresses mentioned below.

Indian Clearing Corporation Ltd.	iccl.interop@icclindia.com
Metropolitan Clearing Corporation Ltd.	mccil_interoperability@mclear.in
NSE Clearing Ltd.	support@nscl.co.in