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A Study on OTC Derivatives Market Reforms in India

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A B S T R A C T

Financial derivatives markets look up the stretching of the financial system by allowing market participants to effectively manage risks. However, fast growth in over-the-counter (OTC) derivatives markets over the past decade has been accompanied by an increasing understanding of the systemic importance of these markets, and prospective risks involved in market mechanisms. In reaction to the financial crisis, the G20 initiated a series of reforms planned to build up the regulation and oversight of the financial system and tasked the Financial Stability Board with coordinating the reforms and assessing their implementation. The purpose of this study is to highlight the significance of OTC Derivatives Market Reforms in India. Regulatory reform of OTC derivatives is very significant from financial strength viewpoint. Therefore, all the stakeholders need to attempt for execution of the reforms as per the recommended timelines to ensure an energetic OTC derivatives market.

Introduction

Derivatives are financial contracts whose value is derived from the price of an underlying commodity, asset, rate, index or the happening or magnitude of an event. Derivatives are traded in two kinds of markets: exchanges and OTC markets. OTC derivatives or Privately Negotiated Derivatives are considerable part of the world of global finance. They grew rapidly from 1980 through 2000. The expansion has been driven by interest rate products, foreign exchange instruments and credit default swaps. In response to the financial crisis, the G20 initiated a series of reforms intended to strengthen the regulation and oversight of the financial system and tasked the Financial Stability Board (FSB) with coordinating the reforms and assessing their implementation. Financial derivatives markets improve the stretching of the financial system by allowing market participants to effectively manage risks. However, rapid growth in over-the-counter (OTC) derivatives markets over the past decade has been accompanied by an increasing awareness of the systemic importance of these markets, and potential risks involved in market practices.

The extent of implementation of detailed regulations varies across jurisdictions and across policy reform areas. The greatest progress to date has been in adopting regulations implementing higher capital requirements for unofficially cleared derivatives and trade reporting requirements, which are each now at least partially effective in more than three-quarters of FSB member jurisdictions. Implementation in other reform areas is also proceeding, though timetables draw out well into 2015 and beyond. Measures to promote trading on exchanges or electronic trading platforms continue to take longer than those in other reform areas.

The financial derivative markets in India have evolved through a reform process over the last two decades, witnessed in its growth in terms of size, product profile, nature of participants and the development of market infrastructure.

The OTC derivative markets in India, unlike the developed financial markets where these markets epitomized complex, unregulated financial innovations, have evolved within a regulated space. The process of evolution needs to be seen in the point of view of the boundary conditions imposed by the broader macro-economic framework for the development of the financial sector.

The importance of OTC derivative markets

The wholesale OTC markets offer a deep and liquid trading venue for professional market participants, such as major banks and financial institutions, to execute transactions, the key terms of which are normally individually negotiated. After more than three decades of virtually continuous growth the wholesale OTC markets are, to say the least, very substantial in both volumes and numbers of transactions. Factors that have significantly impacted the continuing evolution of the OTC markets over the past decade, and in particular the post-trade environment, are:

The growth of derivatives trading

The lower capital 115 utilisation of derivatives makes these products a more efficient and attractive medium for trading than cash markets for many market participants. For this reason, trading volumes in derivatives are normally a multiple of volumes in the equivalent underlying cash markets. The unstable growth of OTC derivatives has marked not only the dynamics of how all assets classes are transacted but all these issues have also increased the complexity of the operational tasks facing all OTC market participants and have created significant capacity challenges for their middle and back offices.

The growth of electronic trading

Electronic trading has developed in many liquid, mature OTC markets as commoditisation, competition and narrowing bid-ask spreads oblige market participants to find cheaper and more efficient execution channels for benchmark products for both themselves and their clients. Electronic trading also greatly increases the transparency of price formation and the resulting market activity. When electronic trading is introduced more advanced trading techniques become possible, such as model-based or low latency algorithmic execution. These enterprising tools boost trading velocity which in turn drives both steep volume growth and the increasing ticket numbers which have been the target of regulatory reforms.

Increasingly sophisticated investors

In recent decades, demographic change in the form of 116 globalisation as an educational tool and spur to higher expectations, the availability of a wider range of financial products, the search for yield and the growing focus on absolute returns rather than meeting index performance has led to a seismic shift in the asset management industry generally and rapid expansion in the hedge fund industry in particular. This in turn fostered rapid growth in prime broking where the consolidation of borrowing, clearing, netting and settlement allowed more smart investors to widen their scope. Now, however, the Infrastructure that supported the prime brokerage industry has been called into question due to apparent concentration and counterparty risks. However, the spirit escaping from the bottle to expose end users to a range of derivative products will be a permanent match of the derivative markets going forward and, indeed, the requirement from these investors for modified products and hedges will ensure that derivatives remain a predominantly OTC market for the near future.

The relationship between the OTC markets and the exchanges

The relationship between the OTC markets and the exchanges is often portrayed as competitive, but is in reality more often symbiotic. Certainly the peaks in either great OTC volumes or global exchanges open interest would not have been within reach without the other. OTC and exchange markets each have separate, unique and rational reasons to exist, each of which has been durable by the recent market chaos. One aspect of the professional OTC market which has contributed to its growth relative to the exchange world is the existence of "information symmetry" where the multiple information channels, hybrid execution venues and widely 116exposed trading prices renders access relatively equal for wholesale market participants. In the exchange arena, the mass arms race led by the most experienced "member" participants to control access to best prices renders competition more uneven. This sense of openness has been an important factor in the creation of the OTC sphere in our generation and will continue to hold influence going forward.

Regulation and Supervision in OTC Markets

All participants in wholesale OTC markets are professional in nature and are closely regulated as such. This allows the supervision and regulation of OTC markets to focus upon the market participants themselves rather than upon the products traded. It is critical to emphasize that both regulators and national supervisors can and do investigate trades conducted at IDBs to the same extent as at exchanges. The Basel II Accord sets out the framework for the supervision and regulation of these participants by setting up precise risk and capital management requirements designed to ensure that a bank holds capital reserves appropriate to the risk to which the bank exposes itself. Generally speaking, these rules mean that the greater risk to which the bank is exposed, the greater the amount of capital the bank needs to hold to maintain its solvency and overall economic stability.

Assessment of the position of compliance of the regulatory framework in the country in comparison with the FSB policy guidelines

The OTC derivatives permitted to be traded in India are Interest Rate Swaps (IRS), Forward Rate Agreements (FRA), FOREX forwards, currency options and swaps and

Credit Default Swaps (CDS). The Reserve Bank of India Act, 1934 empowers RBI to regulate OTC products such as interest rate derivatives, foreign currency derivatives and credit derivatives. Therefore necessary legal and regulatory mechanism is in place in India to carry out the OTC derivatives reform.

The main objective of this study is to highlight the significance of OTC Derivatives Market Reforms in India.

Methodology

The study is based on secondary data, which is obtained from available published sources.

OTC Derivatives Market Reforms in India

Implementation of the OTC derivatives market reforms that were started following the global financial crisis is not yet complete, but progress has continued to be made in reform areas across jurisdictions and further progress was anticipated for 2015. The adoption of legislation, where this has been a necessary first stage of the reform process, is nearing completion.

The extent of implementation of detailed regulations varies across jurisdictions and across policy reform areas. The greatest progress to date has been in adopting regulations implementing higher capital requirements for non-centrally cleared derivatives and trade reporting requirements, which are each now at least partially effective in more than three-quarters of FSB member jurisdictions. Implementation in other reform areas is also proceeding, though timetables stretch well into 2015 and beyond. Measures to promote trading on exchanges or electronic trading platforms continue to take longer than those in other reform areas.

The financial crisis established that poor transparency, skewed incentives and poor liquidity hold back financial markets. The financial crisis in 2008 uncovered weaknesses in the structure of the over-the-counter (OTC) derivatives markets that had contributed to the increase of systemic risk and potential for corruption arising from the interconnectedness of OTC derivatives market participants and the limited transparency of the markets.

Overall, the shape of the regulatory background across jurisdictions has become clearer since the previous progress report in April 2014. In particular, there is more certainty around the implementation and functioning of regulation in some of the largest jurisdictions. International standards and guidance in key areas have been 117 finalised. In addition, bilateral and multilateral discussions addressing outstanding cross-border issues have intensified over the course of 2014.

The availability of market infrastructure, and market participants' use of that infrastructure, continues to gradually broaden. The adoption of regulatory frameworks and the development of infrastructure are mutually supportive. In particular, the availability of market infrastructure may, in many instances, be a factor in shaping jurisdictions' decisions regarding detailed regulatory requirements. It is important that jurisdictions take remaining implementation steps to ensure the G20 reform commitments are achieved, and to help resolve the various implementation issues that are being identified as authorities move forward with their reforms. Full implementation of the reforms can help ensure that the objectives of the reforms set out by the G20 Leaders –

improved transparency, systemic risk mitigation and protection against market exploitation – are 118 maximised.

In November 2011, the G20 further directed that internationally consistent minimum standards be developed for the margining of non centrally cleared OTC derivatives and called upon the Basel Committee on Banking Supervision (BCBS) and

International Organization of Securities Commissions (IOSCO) to develop for consultation, consistent global standards for these margin requirements. These commitments for reforming OTC derivatives markets aimed at achieving the overarching goals of the G20 to increase transparency, mitigate systemic risk and protect against market abuse. The reforms include:

(a) Reporting transaction details to trade data repositories (TRs) which improve transparency both for the official sector and for market participants. This supports the management of systemic risk by allowing the official sector to monitor and react to the aggregate build-up of risk and permitting market participants to better understand and price risk.

(b) Standardization contributes to market transparency and liquidity. Sufficient standardization, both in terms of contractual details and operational processes, is necessary for OTC derivatives transactions to be centrally cleared and traded on exchanges or electronic trading platforms.

(c) In turn, clearing through Central Counterparties (CCPs) reduces systemic risk by improving counterparty risk management, reducing interconnectedness and enhancing the netting of financial exposures. This reduces the probability that the default of a market participant will destabilize other participants.

(d) Exchanges and electronic trading platforms also improve transparency and help to reduce market abuse by standardizing trading rules and processes and bringing them into the open.

(e) Higher capital and margin requirements reduce systemic risk by creating a buffer that can absorb losses and by creating incentives to properly manage risk. Incentives provided by capital and margin requirements for non-118standardized derivatives will motivate increased use of 118 standardised products and discourage spurious 118 customisation.

As G20 has tasked FSB to study the progress in OTC derivatives reforms, the FSB made 21 recommendations in the October 2010 report on *Implementing OTC Derivatives Market Reforms*, addressing practical issues that the authorities may meet in implementing these commitments relating to standardization, central clearing, exchange or electronic platform trading and reporting of OTC derivatives transactions to trade repositories which were endorsed by G20 Leaders at the Seoul Summit in October 2010.

Present status in India

In India, the small size of the OTC derivatives market, low level of complexity in products and regulatory structure which mandates that validity of any OTC derivative contract is dependent on one of the parties to the transaction being a regulated entity, resulted in orderly derivatives market development and lessened the concerns with regard to total risk. The OTC derivative products were introduced in a phased manner keeping in view the hedging needs of the real sector. Reserve Bank has focused on improving transparency and reducing counterparty risk in the OTC derivatives markets and fostered development of strong market infrastructure for trading, settlement and reporting of transactions. As India is committed to implementation of the G20 / FSB reforms, reasonable progress has been made in implementing the OTC derivative reform measures in India. The status of reforms is as under:

Standardization

The process of standardization is designed to be undertaken gradually. CDS transactions are standardized in terms of documentation, coupon, coupon payment date etc. Following the recommendations of the Working Group on Enhancing Liquidity in the Government Securities and Interest Rate Derivatives Markets [Gandhi Committee], it has been decided to standardise IRS contracts to facilitate centralized clearing and settlement of these contracts. IRS on Overnight Index Swap for interbank trades has been standardized from April 1, 2013. Other benchmarks in IRS would be standardized in a phased manner. Foreign exchange derivatives are generally ‘plain vanilla’ and majority of interbank trades are driven by customized client trades.

Central clearing

Calibrated steps towards central clearing of OTC derivative transactions are being taken. More than 90% of IRS trades are currently being centrally cleared on a nonguaranteed basis without regulatory mandate. CCIL carries out regular portfolio compression exercise on IRS to reduce the overall systemic risk. Further, CCIL has also introduced a facility wherein trades matched between two interbank counterparties at CCIL may act as final confirmation and eliminate the paper confirmation, which eliminates operational risk. There is a guaranteed centralized clearing arrangement for settlement of USD-INR forwards though central clearing is not mandated by regulation. CDS market is still developing and it may take more time to achieve the necessary market activity to support central clearing of CDS transactions.

Exchange or electronic platform trading

Electronic platforms are available for transactions involving forward rate agreements and foreign exchange swaps. Forex forwards can be traded on FX-SWAP trading platform. Gandhi Committee has also recommended introduction of an electronic swap execution facility (electronic trading platform) for the IRS market, and introduction of a CCP which may provide guaranteed settlement of trades executed through the electronic platform. The issue of modalities of introduction is under examination. Further market consultation is needed in order to finalize regulations for a mandatory trading requirement on electronic platforms.

Reporting to trade repositories

RBI had already put in place a reporting arrangement for interbank/PD transactions in Rupee Interest Rate Swap (IRS)/ Forward Rate Agreement (FRA) in August 2007 itself. The CCIL’s reporting platform for OTC foreign exchange derivatives was introduced on July 9, 2012 and was expanded thereafter in three phases to cater to the reporting of interbank and client transactions in various actively used derivative instruments. The last phase was rolled out on December 30, 2013, in which reporting of client transactions in Rupee IRS/FRA was also covered. The reporting platform for Credit Default Swaps (CDS) was put in place from the date of introduction of the instrument itself, i.e., 1st December 2011. Thus, the current trade reporting arrangement covers Rupee IRS/FRA, Foreign Exchange Forwards, Foreign Exchange Options, FX Swaps, Currency Swaps, and IRS/FRA in foreign currencies and CDS.

Progress in cross-border coordination and meeting G20 goals

Satisfactory and timely resolution of cross-border regulatory issues is needed to ensure that reform implementation meets underlying G20 goals. There remain issues of conflicts, inconsistencies, gaps and duplications in regulatory requirements applying in cross-border contexts. The G20 Leaders, in their September 2013 St. Petersburg declaration, highlighted that, as a tool for addressing these issues, jurisdictions should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a unbiased way, paying due respect to home country regulatory regimes. To provide more information about existing deference processes and arrangements, the FSB published a report in September 2014 summarising the status of member jurisdictions' capabilities and processes to defer to one another's OTC derivatives market regulatory regimes. The G20 Finance Ministers and Central Bank Governors in September 2014 encouraged jurisdictions to defer to each other when it is justified, in line with the St. Petersburg G20 Leaders' Declaration in September 2013. Most jurisdictions have established or are establishing frameworks and processes for applying deference where justified. This information, together with the forthcoming IOSCO report on cross-border regulatory tools, can help to inform any further work done to better understand the circumstances under which deference and other regulatory tools could be used effectively. The Regulators Group, in the context of its work to implement understandings in the area of equivalence and substituted compliance, is continuing to consider how deference to foreign regimes will work in practice and is well positioned to take such work forward. The FSB encourages jurisdictions and regulators to defer to each other when it is justified, in line with the St. Petersburg G20 Leaders' Declaration in September 2013.

The Regulators Group is continuing its work to address cross-border implementation issues. The Regulators Group recently published its second report of this year, which provides an update to the G20 on further progress in resolving identified cross-border implementation issues. For the November 2014 G20 Leaders' Summit, the Regulators Group will report how it has addressed or intends to address identified cross-border issues, with timelines where appropriate.

Progress in implementation of recommendations

FSB member jurisdictions are fully committed to completing the agreed reforms and are making some progress. The progress can be 120summarized as follows:

(a) The European Union, Japan and the United States – having the largest volumes of OTC derivatives activity – are among the most advanced in implementing legislative and regulatory reform, with several key regulatory measures in force (or becoming so) by mid2013. Even so, the timeline for applying the full spectrum of reforms to implement the G20 commitments still stretches well beyond 2013.

(b) Several jurisdictions are in the process of implementing regulatory measures related to trade reporting and these measures are expected to come into force over the course of this year. A few jurisdictions expect clearing requirements to come into force in 2013–2014.

(c) At present only three jurisdictions have requirements adopted and in force for OTC derivatives to be traded on 121organized platforms.

Future road maps

While it is desirable to achieve consistency in implementation across jurisdictions and within jurisdictions, while promoting greater use of OTC derivatives products in standardized form and minimizing the potential for regulatory arbitrage, there exist several country specific implementation issues which impact the pace and direction of the reform initiatives. Size and depth of the market, complexity of the products, characteristics of the market participants and their motivation to enter into derivatives trades etc. impact the reforms. While India is fully committed to reforms, the pace and nature of reforms, depends on the domestic market conditions. The future roadmap of reform product wise is discussed below:

Trade reporting/trade repository

A trade repository is a 121 tandardiza registry that maintains an electronic database of records of transactions. Use of trade repositories would improve operational efficiencies in post-trade processing, either by the trade repository or by other service providers that use the data maintained by the trade repository. Data from a trade repository can be used to facilitate electronic trade matching and confirmation, settlement of payment obligations, trade novation and affirmation, portfolio compression and reconciliation, and collateral management thereby resulting in risk reduction and improved operational efficiencies for individual market participants. This full and timely information can be used to identify the buildup of systemic risks, help detect market abuse and facilitate greater market efficiency. The Reserve Bank had even required mandated transaction level reporting much before the importance of transparency for financial safety was widely accepted. In pursuit of derivatives reform, significant progress has been achieved with regard to establishment of trade repositories and mandating disclosures.

- *IRS:* Trade reporting platform is available for both interbank and client trades.
- *Forex Forward, Forex Swaps & Options:* Reporting platform is available for both interbank and client trades. Trade reporting is mandatory.
- *Currency Swaps, IRS in Foreign Currency, Interest Rate Options in Foreign Currency*: Reporting platform for interbank and client trades in currency swaps and IRS in foreign currency has been developed by CCIL and reporting has been made effective from December 30, 2013. As the trading volumes in FCY interest rate options are negligible, the instrument will be brought under the ambit of reporting later when the transaction volume picks up. It is recommended to take a review in this regard by March 2015.
- *CDS:* Reporting platform is available for both interbank and client trades. Reporting of all trades is mandatory.

- *Extraterritorial Legislation and Trade Repositories*: An important aspect that needs attention with regard to trade repositories is the impact of extraterritorial legislation. The DoddFrank Wall Street Reform and Consumer Protection Act (the DoddFrank Act) and European Market Infrastructure Regulation (EMIR) create a new regulatory regime for OTC derivative transactions mandating comprehensive reporting obligations for market participants wherein transaction and/or position data, including the identities of the counterparties ("Trade Data") of swap transactions must be reported to regulators or to data repositories, which collect and maintain Trade Data. These reporting requirements may potentially lead to conflicts of law in a number of other jurisdictions including India. Financial Stability Board in its document on "implementing OTC derivatives market reforms" (October 2010) has stated that an analysis of G20 jurisdictions has revealed that client confidentiality laws apply in a large number of jurisdictions.
- In order to avoid breaching such laws, potential solutions have been identified, viz. obtaining client consent by having an industry standard protocol that fulfills the requirement for client consent and which effectively waives the right to confidentiality of the customers; Changing the local law, such that, it has an overriding effect on the local client confidentiality laws. In this regard, dealing with several jurisdictions would present problems due to privacy legislation. Penalties for violating privacy laws can be severe—including damages, fines, loss of license to operate and even criminal sanctions. Resolution of the issue calls for global coordination. In this regard Commodity Futures Trading Commission (CFTC) and European Commission (EC) have reached an understanding on June 11, 2013 on the cross-border issues and agreed to take a common path forward in G20 reform agenda, which is a welcome development. Reserve Bank is actively engaging with international regulators and agencies for satisfactory resolution of the issue.

Standardization

- *IRS:* As mentioned elsewhere in this report, interbank IRS on Overnight Index Swap –MIBOR (Mumbai Inter Bank Offer Rate) has been standardized since April 2013 by regulatory mandate. It was decided to follow a gradual approach and consider examining 122standardization of other benchmarks [Mumbai Interbank Forward Offer Rate (MIFOR) and Indian Bench Mark (INBMK)] in a phased manner due to low liquidity. It is recommended that standardization in IRS may be made mandatory for all interbank trades in due course.
- *Forex Forward and Forex Swaps*: As majority of interbank trades executed are to cover the nonstandard client trades, it is recommended that standardization of forex forward/swap contracts may not be mandated for the present. The matter may be reviewed by March 2015.
- *Forex Option:* Currently, option traded volumes are fairly low (about $ 100 million turnover in plain vanilla and about $200 million turnover in strategies per day). The instruments are not very standardized in terms of notional, tenors or terms of settlement. Interbank trades in Forex options are essentially entered to cover nonstandard client trades, which are highly customized. Hence it may be difficult for the market to standardize

forex option trades and to comply with mandatory standardization of the same. As interbank trades in forex option are primarily to cover nonstandard client trades, which are highly customized, it is recommended that standardization may not be made mandatory by the regulator for the present. However, it is recommended that the issue may be reviewed in March 2015.

- *Currency Swaps, IRS in FCY, Interest Rate Option in FCY*: Market liquidity is very low to consider mandating 123standardization of currency swaps, IRS in FCY and Interest rate options. It is recommended that the issue of standardization may be reexamined by end2015.
- *CDS:* Contracts have been standardized by FIMMDA upon regulatory mandate by RBI.

CCP Clearing

- A highly effective way to manage many of the counterparty and operational risks in financial markets, while also introducing 123standardization and other efficiencies into the market, is for transactions to be centrally cleared. Through central clearing numerous bilateral exposures of a market participant can be substituted for a single net exposure to a CCP. The resulting multilateral netting has the potential to substantially reduce the size of individual counterparties' outstanding obligations relative to bilateral arrangements, while also reducing market-wide collateral needs. By acting as a central hub for market participants, CCPs can improve the effectiveness of default management arrangements, as well as coordinate operational improvements and efficiencies.
- However, in order for a CCP to clear a certain class of products safely and reliably, a number of preconditions must be satisfied such as product that is under clearing must have a robust valuation methodology for that product so that the CCP can confidently determine margin and default fund requirements; must have sufficient liquidity in the market and there must be sufficient transaction activity and participation so that the fixed and variable costs of clearing the transaction are covered. These issues were considered while mandating CCP based clearing in India.
- *IRS:* Nonguaranteed central clearing is being provided by CCIL. Though it is not mandatory for banks to clear interbank trades through CCIL's central clearing, more than 90% of trades are being centrally cleared. The proposal to provide CCP based clearing is already under consideration. It is recommended to make operational CCP based clearing by March 2014.

In the matter of mandating CCP based clearing for interbank trades, it is recommended that a decision may be taken by March 2015. One issue that merits examination in this context is exposure norms / limits for exposures to CCP which is being examined by RBI.

- *Forex Forward and Forex Swaps:* Guaranteed central clearing facility is being provided by CCIL in forex forward. Though RBI has not mandated banks to clear their trades through the CCIL's CCP based clearing, currently around 30% of trades are being cleared under guaranteed settlement mechanism. As regards swaps, guaranteed central clearing facility is being provided by CCIL separately for the two legs of the swap. Keeping in view the benefits of CCP based clearing, it is recommended that CCP based clearing would be made mandatory for all interbank trades by March 2014.

- *Forex Options*: There is no guaranteed central clearing facility for options due to limited market liquidity. It is recommended that the introduction of CCP clearing for forex options may be reviewed by March 2015 subject to improvement in liquidity.
- *Currency Swaps, IRS in FCY, Interest Rate Option in FCY*: Market liquidity is not sufficient to consider CCP clearing. Hence, it is recommended that a review may be done by end2015 to examine the possibility of introducing CCP based clearing.
- *CDS:* Currently volumes in CDS are very low. As CCP based clearing which require reasonable volume to reliably calculate margin requirements has not been introduced. However, it is recommended that CCP based clearing for CDS contracts may be put in place by March 2015 subject to adequate liquidity in the instrument by that time.
- *Extraterritorial Legislation and CCP Clearing:* The US and European laws dealing with OTC derivatives reform have raised concerns over possibilities of extra territorial regulatory jurisdiction leading to regulatory conflict and disruptions for market activity. For instance, European Market Infrastructure Regulation (EMIR) and the Commodity Exchange Act (CEA) as modified by the DoddFrank Act contain prescriptive rules that may prevent European/US banks from participating in third-country clearing houses that have not applied for recognition by the European Securities and Markets Authority (ESMA) or that are not registered as a derivatives clearing organization (DCO) as per CFTC regulations. While the discussions are still on, the uncertainty over the inconsistencies between EU and US rules, the process and timeline for equivalence assessments may affect the trust in the functioning of international financial markets and may have impact on progress of implementation of G20 reform agenda.

Electronic trading platform

- *IRS:* It was suggested to introduce an electronic trading platform for IRS and trades executed through the trading platform would be settled through CCP based clearing. Hence, development of the platform could be taken after introduction of CCP based clearing in IRS. It is estimated that CCIL would take 69 months' time from receipt of approval of RBI for developing platform for IRS. In view of this it is recommended that the electronic trading platform may to be put in place by September 2014 subject to approval from RBI.
- *Forex Forward:* Currently, there is no exclusive trading platform available. However, forward trades can be traded in CCIL's FXSWAP trading platform for certain maturities. Trading is not taking place as certain market participants are not part of forward clearing, non-standardised nature of most of the trades executed, etc. As such, it is recommended that the possibility of introducing an exclusive trading platform for forex forwards may be examined by March 2015 subject to standardization of the instrument and trades attaining a critical mass.
- *Forex Swaps:* Presently trading platform developed by CCIL and Reuters are available for trading in forex swaps. However, there is no regulatory requirement to mandatorily execute trades on any of these trading platforms. It is recommended that review regarding

mandatory execution of trades in 125standardized forex swaps on the 125recognized trading platforms would be made by March 2015.

- *Forex Option:* The product is not very 125standardized to be traded on an electronic trading platform. As forex options are highly customized, move to trading platform could be considered after the experience of mandatory trading platform for forex swaps and forwards. However, members agreed in principle to put in place a trading platform. It is recommended that the issue may be reviewed by March 2015.
- *Currency Swaps, IRS in FCY, Interest Rate Option in FCY*: Market liquidity is not sufficient to consider setting up trading platforms. As market develops, possibility of introducing a trading platform would be examined at a later date.
- *CDS:* Since there is no trading activity, trading platform has not been introduced. As market develops, possibility of introducing a trading platform would be examined.

Margin requirements

- *IRS:* IRS trades are presently not margined as per market practice. Therefore it is recommended that non-centrally cleared IRS trades (including client trades) should be subject to margin requirements. It is recommended that detailed modalities may be worked out in accordance with the recommendations of report of WGMR.
- *Forex Forward:* International consensus is emerging that physically settled forex forwards and swaps may be exempted from initial margin requirement. It is recommended that the detailed modalities may be worked out as per recommendation of the report of WGMR.
- *Forex Swap:* It was decided that the issue requires wider consultation before taking a call on prescribing variation margin requirement. Since the international commitment is to implement margin requirement by the year 2015, it is recommended that a wider market consultation may be held through Fixed Income Money Markets & Derivatives Association of India (FIMMDA) and Foreign Exchange Dealers' Association of India (FEDAI) and their views may be communicated to RBI.
- *CDS*: Margin requirements have already been prescribed by RBI.

Conclusion

OTC derivatives reforms have been committed to be implemented in India. However, the rate and scope of reform implementation depends up on the domestic market conditions and features. As issues like market liquidity, valuation norms, participants' style in trading strategies, use of product as hedge etc. force scope for 125standardization and the implementation of central clearing, the roadmap for level of reforms and their implementation must factor in these nuances. This is especially the case with markets like India, where in the OTC derivatives are simple products with low volumes. The Working Group is aware of these factors and hence recommended the roadmap with milestones. As some of the milestones are dependent on exogenous variables like improvement in liquidity, there is a chance that the timelines may be revised based on developments in the OTC derivatives market. Nevertheless, to clearly clear our commitment to G20 reform agenda and spell out trail for implementation, it is suggested that the Working Group report which contains timelines may be placed in public domain. Regulatory reform of OTC derivatives is very significant from financial strength viewpoint. Therefore, all the stakeholders need to attempt for execution of the reforms as per the recommended timelines to ensure an energetic OTC derivatives market.

Present Status on OTC Derivative Products

Product/G-20 requirements		Trade Repository (for both interbank and client trades)	Standardisation	Central Clearing (CCP)	Electronic trading platform	Higher capital /Margin requirements for non-centrally clearing OTC derivative trades
Interest Rate Derivatives	IRS	Available for both interbank and client trade	Partial- MIBOR standardised	Non-guaranteed central clearing in place CCP based clearing under consideration	Not Available. Electronic trading platform under consideration	No margin requirement
Credit Derivatives	CDS	Available for both interbank and client trade	Standardised	Not available	Not available	Margin requirement in place
Forex OTC Derivatives	Forex forward	Available for both interbank and client trade(FCY –INR & FCY-FCY)	Not available as majority of interbank trades driven by customized client trades.	Guaranteed central clearing available. RBI has not mandated it.	No exclusive platform available. Can be traded on FX-SWAP	No regulatory requirement
	Forex Swap	Available for both interbank and client trade(FCY –INR & FCY-FCY)	Not available as majority of interbank trades driven by customized client trades.	Guaranteed central clearing available. RBI has not mandated it.	Can be traded on CCIL and Reuters'Trading platform. Majority of trades done Through brokers.	No regulatory requirement.
	Forex Option	Available for both interbank and client trade(FCY –INR & FCY-FCY)	Not available as majority of interbank trades driven by customized client trades.	Central clearing not available	Not available	No regulatory requirement
	Currency Swap	Available for both interbank and client trade(FCY –INR & FCY-FCY)	Not available	Not available	Not available	No regulatory requirement
	IRS in FCY	Available for both interbank and client trades	Not available	Not available	Not available	No regulatory requirement
	IRS option in RCY	Not available due to negligible trading volume	Not available	Not available	Not available	No regulatory requirement

Abbreviations

BCBS : Basel Committee on Banking Supervision
CCIL : Clearing Corporation of India Limited
CCP : Central Counterparty
CFTC : Commodity Futures Trading Committee
EMIR : European Market Infrastructure Regulation
FCY : Foreign Currency
FRA : Forward Rate Agreement
FSB : Financial Stability Board
INBMK: Indian Benchmark
INR : Indian Rupee
IRS : Interest Rate Swaps
IOSCO: International Organisation of Securities Commissions
MIBOR: Mumbai Inter Bank Offer Rate
TR : Trade Repository
FEDAI: Foreign Exchange Dealers' Association of India

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