



CIRCULAR

SEBI/HO/MRD2/DCAP/CIR/P/2020/245

December 21, 2020

To

All recognized Clearing Corporations

Dear Sir / Madam,

Core Settlement Guarantee Fund, Default Waterfall and Stress Test for Limited Purpose Clearing Corporation (LPCC)

- 1) In order to enhance robustness of the risk management system in the clearing corporations, granular norms relating to core settlement guarantee fund, stress testing and default waterfall procedures have been prescribed by SEBI vide Circular no. [CIR/MRD/DRMNP/25/2014](#) dated August 27, 2014. Further, vide Circular no. [CIR/MRD/DRMNP/33/2017](#) dated April 26, 2017, clearing members were permitted to bring their contribution towards Core Settlement Guarantee Fund, in the form of Central Government Securities, in addition to Cash and Bank Fixed Deposits. Also, norms relating to contribution by a non-defaulting member in the Default waterfall of Clearing Corporations were modified vide Circular No. [SEBI/HO/MRD2/DCAP/CIR/P/2020/01](#) dated January 03, 2020.
- 2) Further, vide Circular no. [SEBI/HO/MRD/DRMNP/CIR/P/2019/55](#) dated April 10, 2019, granular norms related to computation of risk-based capital and net worth requirements for Clearing Corporations were prescribed.
- 3) Based on consultation with various stakeholders, SEBI notified the [Securities Contracts \(Regulation\) \(Stock Exchanges and Clearing Corporations\) \(Amendment\) Regulations, 2020, \(SECC Amendment Regulations, 2020\)](#) on October 08, 2020, to permit setting up of a Limited Purpose Clearing Corporation for clearing and settlement of repo transactions in debt securities.
- 4) Regulation 22D of the SECC Amendment Regulations, 2020, provides that

“(1). The contribution to the Fund as specified in regulation 37 shall be made by the recognized limited purpose clearing corporation, the clearing members and issuers of the debt securities, in the manner as may be specified by the Board from time to time.

(2) Any shortfall in the Fund, shall be replenished by the recognized limited purpose clearing corporation to the threshold level as may be specified by the Board from time to time.”

5) Regulation 22E (1) of the SECC Amendment Regulations, 2020, provides that

“(1) The utilization of profits and investments by recognized limited purpose clearing corporations shall be in accordance with the norms specified by the Board:

Provided that for the first five years from the date of grant of recognition by the board, there shall be no distribution of dividend to the shareholders and the profits of recognized limited purpose clearing corporation shall be transferred to the Fund specified in regulation 37.”

6) In view of the above, the abovementioned Circulars dated August 27, 2014 and January 03, 2020 stand modified as under:

(i) After Clause 8 of the said Circular dated August 27, 2014, following Clause 8A shall be inserted:

“Contribution to Core SGF of LPCC

8A) At any point of time, the contributions of various contributors to Core SGF shall be as follows:

a. Issuer contribution: Contribution of Issuers of Debt securities to Core SGF shall be equivalent to 0.5 basis points of the issuance value of debt securities per annum based on the maturity of debt securities, to be collected upfront, in the manner specified by the Board.

b. Clearing Member (CM) primary contribution: CMs contribution to Core SGF shall be risk based and equivalent to deficit in MRC post contribution by Issuers. The said contribution by CMs shall be subject to the following conditions:

- that no exposure shall be available on Core SGF contribution of any CM (exposure-free collateral of CM available with CC can be considered towards Core SGF contribution of CM), and*
- that required contributions of individual CMs shall be pro-rata based on the risk they bring to the system.*

LPCC shall have the flexibility to collect CM primary contribution, including flexibility to either collect the CM primary contribution upfront or staggered over a period of time. In case LPCC does not seek contribution from CM or seeks staggered contribution, the remaining balance shall be met by LPCC to ensure adequacy of total Core SGF corpus at all times. Such LPCC contribution shall be available to LPCC for withdrawal as and when further contributions from CMs are collected / received.

c. Clearing Corporation contribution: LPCC shall transfer profit to the Core SGF in terms of Regulation 22E(1) above, within 30 days of adoption of financial statements by the shareholders in the Annual General Meeting. LPCC may make additional contribution to Core SGF from its own funds. LPCC's contribution to core SGF shall be considered as part of its net worth.

The above prescribed limits of contribution may be reviewed by SEBI from time to time (latest by end of 5 years from the date of grant of recognition to a LPCC), considering the prevailing market conditions.

(ii) After Clause 14 of the said Circular dated August 27, 2014 read with Circular dated January 03, 2020, following Clause 14A shall be inserted:

“Further contribution to / Recoupment of Core SGF of LPCC

14A) Requisite contributions to Core SGF by various contributors (as per clauses 7 and 8A), except upfront contribution by Issuers (as per clause 8A.a) and annual contribution of profits by LPCC (as per clause 8A.c), for any month shall be made by the contributors before start of the month.

In the event of usage of Core SGF during a calendar month, contributors shall, as per usage of their individual contribution, immediately replenish the Core SGF to MRC. However, such contribution towards replenishment of Core SGF by the members would be restricted to only once during a period of 30 calendar days regardless of the number of defaults during the period. The period of 30 calendar days shall commence from the date of notice of default by Clearing Corporation to market participants.

In case there is failure on part of some contributor(s) to replenish its (their) contribution, same shall be immediately met, on a temporary basis during the month, by LPCC.

(iii) After Clause 16 of the said Circular dated August 27, 2014 read with Circular dated January 03, 2020, following Clause 16A shall be inserted:

Default waterfall of LPCC

16A) The default waterfall of CC shall generally follow the following order –

- I. monies of defaulting member (including defaulting member's primary contribution to Core SGF.
- II. Insurance, if any.
- III. Issuers contribution to Core SGF.
- IV. LPCC resources (equal to 5% of MRC).
- V. Core SGF in the following order:
 - i. Penalties
 - ii. Previous financial years profit of LPCC transferred to Core SGF
 - iii. Remaining Core SGF: LPCC contribution and non-defaulting members' primary contribution to Core SGF on pro-rata basis.
 - iv. Remaining profit of LPCC transferred to Core SGF
- VI. Remaining LPCC resources (excluding INR 100 Crore).*
- VII. Remaining LPCC resources to the extent as approved by SEBI
- VIII. Capped additional contribution by non-defaulting members.**
- IX. Any remaining loss to be covered by way of pro-rata haircut to payouts.***

* INR 100 Crore to be excluded only when remaining LPCC resources are more than INR 100 Crore.

*** (i) LPCC shall call for the capped additional contribution only once during a period of 30 calendar days regardless of the number of defaults during the period. The period of 30 calendar days shall commence from the date of notice of default by LPCC to market participants.*

(ii) LPCC shall have relevant regulations/provisions for non-defaulting members to resign un-conditionally within the abovementioned period of 30 calendar days, subject to member closing out/settling any outstanding positions, paying the capped additional contribution and any outstanding dues to SEBI. No further contribution shall be called from such resigned members.

(iii) The maximum capped additional contribution by non-defaulting members shall be lower of 2 times of their primary contribution to Core SGF or 10% of the Core SGF on the date of default.

(iv) In case of shortfall in recovery of assessed amounts from non-defaulting members, further loss can be allocated to layer 'VII' with approval of SEBI."

****In case loss allocation is effected through haircut to payouts, any subsequent usage of funds shall be with prior SEBI approval. Further, any exit by CC post using this layer shall be as per the terms decided by SEBI in public interest.*

- 7) Accordingly, Clauses 8, 14 and 16 of the said Circular dated August 27, 2014 read with Circular dated January 03, 2020 shall not be applicable to LPCC. All other provisions of the Circulars dated August 27, 2014, April 26, 2017 and January 03, 2020, including the aforesaid newly inserted clauses 8A, 14A and 16A, shall be applicable to LPCC.
- 8) In view of the above, the abovementioned Circular dated April 10, 2019 stand modified as under:
 - (i) Considering the contribution by issuer towards Core SGF of LPCC, after Clause 3.1.1 and 3.1.2 of the said Circular dated April 10, 2019, following Clause 3.1.1A and 3.1.2A shall be inserted:

"3.1.1A The credit risk from default of clearing members is being captured through the Core SGF framework as prescribed vide SEBI circular CIR/MRD/DRMNP/25/2014 dated August 27, 2014 on "Core Settlement Guarantee Fund, Default Waterfall and Stress Test.

"3.1.2A The contribution made by LPCC towards Core SGF, shall be considered for the purpose of computing capital requirements towards credit risk.
- 9) Accordingly, Clauses 3.1.1 and 3.1.2 of the said Circular dated April 10, 2019 shall not be applicable to LPCC. All other provisions of the said Circular dated April 10, 2019, including the aforesaid newly inserted clauses 3.1.1A and 3.1.2A shall be applicable to LPCC.
- 10) The provisions of this Circular shall be effective from the date of grant of recognition to LPCC by SEBI.
- 11) LPCC shall:
 - a) take necessary steps to put in place systems for implementation of the circular, including necessary amendments to the relevant bye-laws, rules and regulations;

- b) bring the provisions of this circular to the notice of their members and also disseminate the same on its website;
 - c) make the following details available on its website:
 - i. Policy on composition and contributions to be made to the Core SGF of LPCC;
 - ii. Investment policy for Core SGF of LPCC;
 - iii. Default waterfall for segment along with the quantum of resources available in each layer of default waterfall;
 - d) implement the provisions of this circular within three months from the date of grant of recognition to LPCC by SEBI and communicate to SEBI the status of implementation.
- 12) This circular is being issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market.
- 13) This circular is available on SEBI website at www.sebi.gov.in, under the category "Circulars".

Yours faithfully,

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