भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

CIR/MRD/DP/ 27 /2013 September 12, 2013

To

All Stock Exchanges and Clearing Corporations

Dear Sir / Madam,

Sub: Risk Management Framework for Dedicated Debt Segment on Stock Exchanges.

1. With an objective to develop debt markets and encourage transition of trading in debt instruments from OTC markets to stock exchanges, SEBI issued Guidelines for providing dedicated Debt Segment on Stock Exchanges vide circular no CIR/MRD/DP/03/2013 dated January 24, 2013. Pursuant to these Guidelines, the stock exchanges have been given approval to launch the Debt Segment.

2. Subsequent to introduction of Debt Segment on stock exchanges, market feedback has been received on various issues including need for DVP-3 settlement in corporate bond trades. For enabling settlement on DVP-3 basis in corporate bonds trades, implementation of appropriate risk management framework is necessary. Stock exchanges have submitted proposals for risk management framework and these were discussed in Secondary Market Advisory Committee. Based on discussions, it has been decided that the risk management framework for corporate bond trades shall be as specified herein.

3. Feedback from market participants and stock exchanges also pointed towards need for further clarity/ amendments to certain provisions of SEBI circular dated January 24, 2013. Hence, such provisions are being amended as specified hereunder.

4. The term "corporate bonds" in this circular refers to debt securities as defined in the SEBI (Issue and Listing of Debt Securities) Regulations, 2008.

5. **Institutional Market**: In the circular dated January 24, 2013, it was specified that institutional market of debt segment shall be the market for non-publicly-issued debt instruments with a market lot size of minimum Rs 1 crore. It is clarified that institutional market shall provide for trading in both publicly issued and non-publicly (privately) issued debt instruments with a market lot size of minimum Rupees one crore. For trading in smaller lot sizes of minimum rupees ten lakhs in respect of privately issued debt instruments in the institutional market, a separate odd lot window may be provided.

6. **Clearing and Settlement**

6.1 **Settlement Cycle**: The trades settled on DVP-3 basis in debt segment shall have settlement cycle of T+1 . In case of trades settled on DVP-1 basis, Stock exchanges shall have flexibility to settle trades on T+0 or T+1.

6.2 **Settlement Basis:**

6.2.1 Retail Market: The Stock Exchanges shall continue to settle trades on DVP-3 basis in retail market of debt segment for publically issued corporate bonds.

6.2.2 Institutional market: The Stock exchanges may provide settlement on DVP-3 basis for publicly issued corporate bonds and for such privately placed corporate bonds which meet certain selection/eligibility criteria to be specified by the exchanges.

6.2.2.1 The minimum selection/eligibility criteria for privately issued corporate bonds to be eligible for DVP-3 settlement shall include the following:

(a) The corporate bonds shall have a minimum rating of AA+ (or similar nomenclature).

(b) The yield spread of corporate bonds over similar residual tenure government securities shall not exceed 150 basis points.

(c) New corporate bonds listed during the month shall also be eligible for DVP-3 settlement if they meet the rating and yield spread criteria stated at (a) and (b) above.

(d) In case of existing corporate bonds, only liquid bonds shall be permitted. The stock exchanges may consider one or more following factors while defining liquid bonds-

(i) Bonds to have traded for at least 5 trading days in every month (including both exchange trades and reported trades) ;
(ii) Bonds to have minimum trading volumes of Rs 25 crores in every month (including both exchange trades and reported trades)

6.2.2.2 The list of eligible bonds may be reviewed on monthly basis and made applicable from 15th of subsequent month.

6.2.2.3 In all other cases, privately issued corporate bonds shall continue to settle on DVP-1 basis.

7. **Risk Management:**

7.1 The Clearing Corporation shall provide settlement guarantee for trades settled on DVP-3 basis. For this purpose, the Clearing Corporation shall create a Settlement Guarantee Fund on similar lines as in other segments.

7.2 For the purpose of risk management in respect of trades settled on DVP-3 basis, the Clearing Corporation shall impose the following margins:

7.2.1 **Initial Margin (IM)**: Initial margin shall be based on a worst case loss of a portfolio of an individual client across various scenarios of price changes so as to cover a 99% VaR over one day horizon.

7.2.1.1. The minimum initial margin shall be 2% for residual maturity up to three years, 2.5% for residual maturity above three years and up to five years; and 3% for maturity above five years. The margin shall be calculated as percentage of traded price of the bond expressed in terms of clean price i.e. without taking accrued interest into account.

7.2.1.2. Stock Exchanges may follow a VaR estimation model similar to Interest Rate Futures as prescribed in SEBI circular SEBI/DNPD/Cir-46/2009 dated August 28, 2009.

7.2.1.3. The Initial Margin shall be deducted upfront from the liquid assets of the member taking into account gross open positions.

7.2.2 **Extreme Loss Margin (ELM):** The ELM shall cover the expected loss in situations that go beyond those envisaged in risk estimates used in the initial margins. The ELM for any bond shall be 2% of the traded price expressed in terms of clean price. It would be deducted upfront from the total liquid assets of the member.

7.3 **Liquid Assets**: The liquid assets for meeting margin requirements may be deposited in the following form:

(a) At least 50% in cash or cash equivalents i.e. government securities, bank guarantee, fixed deposits or units of liquid mutual funds or government securities mutual funds;

(b) Not more than 50% in the form of corporate bonds / liquid equity shares/ mutual fund units other than units of liquid mutual funds or government securities mutual funds;

as specified in SEBI circular No. MRD/DoP/SE/Cir-07/2005 dated February 23, 2005.

8. **Auction/financial close-out**: In case of shortages, stock exchanges may conduct auction and/or financial close-out with a mark up of 4% on traded price of such corporate bonds.

9. **Reporting**: The reporting platform made available by stock exchanges under the earlier SEBI circulars shall be merged with the negotiated window or facility for RFQ or other such similar facility provided by debt segment of exchanges for enabling reporting of OTC trades or facilitating OTC trades. This platform shall be available for reporting of trades by both members and non-members.

10. This circular is in partial modification of earlier circular no CIR/MRD/DP/03/2013 dated January 24, 2013 on debt segment.

11. The stock exchanges and clearing corporations are directed to:
    (i) take necessary steps and put in place necessary systems for implementation of the above.

    (ii) make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision.

    (iii) bring the provisions of this circular to the notice of the stock brokers/ trading members and clearing members and also disseminate the same on their website.

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.

Yours faithfully,

Maninder Cheema
Deputy General Manager
Email: maninderc@sebi.gov.in