NCDEX
Pragati ka Solid Exchange

NATIONAL COMMODITY & DERIVATIVES EXCHANGE LIMITED

Circular to all trading and clearing members of the Exchange
Circular No. : NCDEX/RISK-033/2016/207
Date : September 02, 2016
Subject : Additional risk management norms for National Commodity Derivatives Exchanges

The Securities and Exchange Board of India (SEBI) has issued a circular on "Additional risk management norms for National Commodity Derivatives Exchanges" in order to further strengthen the risk management framework of commodity derivatives markets.

A copy of the circular No. SEBI/HO/CDMRD/DRMP/CIR/P/2016/77 dated September 01, 2016 issued by SEBI is attached as Annexure for information.

Members and their respective clients are requested to note the above.

For and on behalf of
National Commodity & Derivatives Exchange Limited

Rahul Ghosh
Vice President – Risk Management

For further information / clarifications, please contact
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CIRCULAR

SEBI/HO/CDMRD/DRMP/CIR/P/2016/77 September 01, 2016

To,

The Managing Directors / Chief Executive Officers
National Commodity Derivatives Exchanges

Sir / Madam,

Sub: Additional risk management norms for National Commodity Derivatives Exchanges

1. With an objective of streamlining and strengthening the risk management framework across national commodity derivatives exchanges SEBI vide circular CIR/CDMRD/DRMP/01/2015 dated October 01, 2015, had prescribed comprehensive risk management framework for National Commodity Derivatives Exchanges.

2. In order to further strengthen the risk management framework of commodity derivatives markets and avoid any systemic risk, it has been decided to prescribe additional norms/modify (to the extent specified hereunder) certain existing norms on risk management at National Commodity Derivatives Exchanges. The additional/modified norms are placed at Annexure-I.

3. The norms prescribed in this circular shall be implemented by national commodity derivatives exchanges latest by December 1, 2016, except for the norm prescribed for base minimum capital at paragraph 7 of Annexure-I, which shall be complied with latest by April 01, 2017.

4. It is emphasized that risk management is primarily the responsibility of exchanges. In cases of excessive market volatility or circumstances where risk element is higher, exchanges are expected to impose higher margins and/or additional margins in the form of special/ ad-hoc or other margins as considered appropriate by the exchanges.

5. The exchanges are also advised to:
    i. ensure that their risk management framework is in line with the provisions contained in the annexure and take steps to make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the same.
    ii. bring the provisions of this circular to the notice of their members and also to disseminate the same on their website.
    iii. communicate to SEBI, the status of implementation of the provisions of this circular.

6. This circular is issued in exercise of the 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.

7. This circular is available on SEBI website at www.sebi.gov.in.

Yours faithfully,

Shashi Kumar
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Division of Risk Management and Products
Commodity Derivatives Market Regulation Department
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Encl: as above

Annexure - I

Additional/modified risk management norms for National Commodity Derivatives Exchanges

1. **Initial Margins (IM):**
   Exchanges shall impose initial margins sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default. Exchanges shall therefore estimate the appropriate Margin Period of Risk (MPOR) for each product based on liquidity in the product and scale up the initial margins, if required. However, the MPOR for all commodity derivatives contracts shall be at least 2 days.

2. **Delivery Period Margins:**
   Delivery period margins shall be higher of:

   a. 3% + 5 day 99% VaR of spot price volatility
      Or
   b. 20%

   Exchanges may impose higher margins if deemed fit. If extant delivery period margins on certain commodities are higher than that specified above, the extant delivery period margins shall continue.

3. **Measures in case of repeated shortfall in margin/pay-in:**
   In case of repeated margin/pay-in shortfalls beyond a threshold amount by any member in a month, following risk mitigation measures shall be initiated by commodity derivatives exchanges:
   a. The member be put in square off mode and required to reduce positions.
   b. The member be charged initial margins at a higher rate for the next one month,
      Or
      The member be subjected to a penal exposure free deposit equal to the cumulative funds/margin shortage over previous one month which could be kept with the exchange for the next month.
   c. Exchange shall keep a close watch on such member.

4. **Concentration margins:**
   Exchanges shall impose adequate concentration margins (only on concentrated positions) to cover the risk of longer period required for liquidation of concentrated positions in any commodity. The threshold value for imposing concentration margin may be determined taking into account factors including open interest, concentration and estimated time to liquidation based on prevailing liquidity and possible reduction in

liquidity in times of market stress etc. The quantum of concentration margins imposed may vary based on the level of concentration.

5. **Regaining matched book:**
In the event of a member/client failing to honour pay-in/margin obligations, exchanges may employ the below given alternative tools to liquidate the positions and regain a matched book based on the conditions of market liquidity, volatility, size of position to be liquidated etc. Any tool lower in the list prescribed hereunder may be resorted to only in extremely rare occasions when the exchange reasonably expects that it may not be able to restore a matched book by choosing the alternatives above it and also records the reasons for the same in writing:
    a. Alternative 1: Liquidation in normal market in orderly manner (with relaxed price limits, if required);
    b. Alternative 2: Auction of the positions within a specified price band;
    c. Alternative 3: Voluntary tear-up at last mark-to-market price along with compensation (%age of last mark-to-market price equal to twice the daily price limit) and penalty (5%, to be credited to SGF);
    d. Alternative 4: Partial tear-up (pro-rata against members/clients having opposite positions) at last mark-to-market price along with compensation (%age of last mark-to-market price equal to thrice the daily price limit) and penalty (5%, to be credited to SGF).

6. **Spread margin benefit:**
Margin benefit on spread positions shall be entirely withdrawn latest by the start of tender period or Expiry-6th day, whichever is earlier.

7. **Base Minimum Capital (BMC) for clearing members:**
Clearing members who clear and settle only non-algo trades for other trading members shall have BMC requirement of INR 25 lakhs. Clearing members who clear and settle algo trades shall continue to have BMC requirement of INR 50 lakhs.

8. **Exchange contribution to SGF:**
Currently exchanges make risk assessment on SGF on quarterly basis and are required to make fresh contribution to SGF in case of any shortfall. This contribution requirement by exchange in any year is currently capped to 5% of the gross revenue (net of Income Tax). The said cap to the contribution requirement is hereby removed and exchanges shall be required to meet the shortfall in full as indicated in quarterly assessments.

9. Default waterfall:

Till clearing and settlement of trades in commodity derivatives are transferred to clearing corporations, the default waterfall of exchanges shall follow the following order:

1. Defaulting member's monies (including contribution to SGF)
2. Insurance, if any
3. Exchange resources equal to 5% of SGF
4. SGF resources in the following order:
    a. Penalties and investment income on SGF
    b. 25% of Exchange contribution to SGF
    c. Remaining (non-defaulting members' and exchange) contribution to SGF on pro-rata basis.
5. Remaining exchange resources (excluding INR 100 Crore*)
6. Capped additional contribution by non-defaulting members (equal to their required contribution to SGF)
7. Any remaining loss to be covered by way of pro-rata haircut to payouts.

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