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SEBI/DNPD/Cir- 32/2007
September 11, 2007

To

- 1. The Managing Director of NSE, BSE and their Clearing House/Corporation**
- 2. All Registered FIs and Custodians**

Dear Sirs,

Sub.: Circular on acceptance of Foreign Sovereign Securities as collateral from Foreign Institutional Investors (FIIs) for Exchange Traded Derivative Transactions

1. Presently, in Exchange Traded Derivative transactions, FIIs are depositing the collateral with the clearing members, in the form of cash. Under the existing guidelines for clearing members, as per SEBI Circular Ref. No. IES/DC/CIR-4/99 dated July 28, 1999, for collateral purposes, at least 50% of the liquid assets, shall be in the form of cash or cash equivalents, and the rest can be in the form of non-cash components.
2. Reserve Bank of India (RBI) vide A. P. (DIR Series) Circular no. 2 dated July 19, 2007 has permitted clearing corporations and clearing members –
 - i) to open and maintain demat accounts with foreign depositories and to acquire, hold, pledge and transfer the foreign sovereign securities, offered as collateral by FIIs;
 - ii) to remit the proceeds arising from corporate action, if any, on such foreign sovereign securities; and
 - iii) to liquidate such foreign sovereign securities if the need arises.
3. Accordingly, clearing members are now permitted to accept foreign sovereign securities with 'AAA' rating, (hereinafter referred to as "sovereign securities") as collateral from FII client with the following necessary safeguards:
 - i. Before accepting sovereign securities as collateral from FII, the clearing member shall enter into a written agreement with the FII and also with the clearing corporation, containing, *inter alia*, the following terms-

- a. In the event of any dispute regarding liquidation or return of the sovereign securities tendered as collateral, or any other incidental matter, the courts in India will have jurisdiction to decide such disputes. Alternatively, the agreement may contain an arbitration clause.
 - b. The agreement shall also contain the right of the clearing corporation as well as the clearing member to liquidate the sovereign securities tendered as collateral, in the event of default by clearing member or FII, as the case may be.
 - ii. The clearing member shall take due care to ensure that the sovereign securities tendered as collateral are available for liquidation in the event of insolvency of the FII or any intermediary or any other person located overseas through whom the securities are held.
 - iii. The clearing corporation shall also take due care to ensure that sovereign securities tendered as collateral are available for liquidation in the event of insolvency of the clearing member or any intermediary or other person located overseas through whom the securities are held.
 - iv. The clearing corporation shall take adequate care to ensure that the sovereign securities accepted by it as margin are tendered under a mechanism which does not unduly hinder timely liquidation in the event of default by the clearing member.
4. The clearing corporation shall value the collateral tendered by applying due haircuts. The haircut may either be a fixed percentage or VaR based. A higher haircut may be considered to cover the expected time frame for liquidation. A market determined price as obtained from an internationally recognized data vendor shall be considered for valuation. The prices shall be converted into rupee terms on a daily basis. The rupee value so used for conversion shall be the "RBI Reference rate". The RBI reference rate shall be disclosed by the clearing corporation to the clearing members, so as to enable them to report the value of the margins collected from FIIs.
 5. The sovereign securities tendered as collateral shall be treated as part of the cash component of the liquid assets of the clearing member, and shall be subject to the condition that the value of the sovereign securities shall not be more than 10% of the total value of the cash component of the liquid assets of the clearing member.

6. The existing procedure for acceptance and release of collateral tendered by domestic investors in the case of domestic securities shall be adopted *mutatis mutandis* for the sovereign securities tendered by FII, except to the extent specifically provided otherwise.
7. This circular is being issued in exercise of powers conferred by sub-section (1) of Section 11 of the Securities and Exchange Board of India Act, 1992, to promote the development of the securities market.
8. This circular is available on SEBI website at www.sebi.gov.in, under the category “Derivatives – Circulars”. The Circular shall come into force from the date of the circular.

Yours faithfully,

Dr. Sanjeevan Kapshe

Encl.: Annexure I – List of Foreign Sovereign Securities, with ‘AAA’ rating, eligible to be tendered as collateral by Foreign Institutional Investors (FIIs) for Exchange Traded Derivative Transactions.

Annexure I

List of Foreign Sovereign Securities, with 'AAA' rating, eligible to be tendered as collateral by Foreign Institutional Investors (FIIs) for Exchange Traded Derivative Transactions

To begin with, US Government securities, with 'AAA' rating, are eligible to be tendered as collateral by Foreign Institutional Investors (FIIs) for Exchange Traded Derivative Transactions.