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1. Limit for members/Participants

Member/Client limits is fixed to manage settlement risk related to borrower and lender default. For the borrower, limits are set to ensure daily settlements, reduce concentration, credit, and liquidity risk, and manage the availability of the Core SGF Fund.

Limit fixing methodology for setting up member limits is given below:

- Entities are categorized into different categories based on financial, non-financial (Credit rating) parameters, regulatory support & regulatory overview, specific to the sector the entity belongs to. Stronger entities should be categorized into the top category.
- Maximum lending limits is fixed for entities belonging to the top category, having strong regulatory support, liquidity resources, regulatory overview, and financial strength.
- Maximum borrowing limits is fixed based on the expected Core SGF availability.
- Clearing Member / Clients will be categorised into Category-A (top category) and Category-B based on financial criteria and non-financial criteria to assign maximum permissible borrowing limit and maximum permissible lending limit. Such assignment of limits to members is necessary for managing liquidity risk and default risk of its members. While fixing limits, various criteria viz. liquidity resources available at ARCL's disposal, Core Settlement Guarantee Fund (Core SGF) and the risk profile of members are considered. Category A entities are strong entities and will be allotted the maximum limits for lending and borrowing. For assigning limits to Category-B entities (other than Category-A entities), ARCL will follow methodology based on various financial and non-financial parameters.

2. Issuer and ISIN Selection Criteria

The following selection criteria is used while considering the issuer whose bonds would be accepted as eligible collateral for tri-party repo.

- Positive Net Worth as per the latest audited financial statement.
- Profit making as per the latest audited financial statement.
- Issuers equity listed on stock exchanges.
- Unlisted PSUs meeting the first two criteria as above.
- Long term credit rating from AAA to AA- (outlook stable).

The listed bonds (NCDs) issued by the issuers meeting the above criteria and having the ratings from AAA to AA- (up to stable outlook) will be accepted as eligible collateral. Bonds with following characteristics will not be accepted as eligible collateral:

- Tier I & Tier II bonds issued by Banks, NBFC & other institutions
- Perpetual Debt
- Floating rate bonds
- Market linked bonds
- Convertible bonds (Optional or Compulsorily)
- Subordinate bonds
- Securities with below AA- (stable) rating

3. Issuer Limit

ARCL specifies the following cumulative limit for an issuer across all members/participants.

| Sr. No | Type of Issuers | Limit |
|--------|---------------------------------------|--|
| 1 | Banks - Public & Private Sector Banks | Lower of 10% of Net Worth or Rs.10,000 crs |
| 2 | Financial Institutions | Lower of 10% of Net Worth or Rs.10,000 crs |
| 3 | Public Sector Undertakings | Lower of 10% of Net Worth or Rs.10,000 crs |
| 4 | Private Corporates | Lower of 10% of Net Worth or Rs.5,000 crs |

To address the concentration risk of issuer at a member/participant level, ARCL has implemented:

- The member/participant wise Issuer limit is currently 20% of total limit or Rs.25 Crs whichever is higher.

- AA or AA- rated instruments can be maximum of 50% of base borrowing limit.

4. Haircut

ARCL has prescribed the following haircut for securities based on rating and residual maturity of the security for repo tenor up to 7 days.

| Security Rating | <= 5 year Maturity | >5 year Maturity |
|-----------------|--------------------|------------------|
| AAA & AA+ | 7.50% | 15.00% |
| AA | 10.00% | 15.00% |
| AA- | 15.00% | 15.00% |

5. Margin from Lender

ARCL levies an Initial Margin of 0.5% of the transaction value on the Lender. The Initial Margin shall be collected on an upfront basis in cash.

6. Mark-to-market

ARCL carries out mark-to-market valuation of the securities to ensure that the value of the collateral after adjusting for haircut is sufficient to support the outstanding borrowing positions.

7. Order Level Risk Management

There is order level risk management. Only those lending orders that satisfy the margin requirement vis-a-vis cash collateral deposited by the Clearing Member/Client will be accepted, subject to it is within the overall lending limits of the specific entities. Only those borrow orders that satisfy collateral requirement will be accepted subject to it is within the overall borrowing limits of the specific entities.

8. Liquidity Risk

ARCL manages the liquidity risk (i.e., fund settlement shortage) by means of the following resources.

- Credit lines with clearing banks
- Own Funds
- Core Settlement Guarantee Fund

9. Core SGF

ARCL has established a Core SGF based on stress events to meet any loss arising on account of default of members. The contribution to Core SGF is as per SEBI Circular dated December 21, 2020:

- Issuers (at the rate equivalent to 0.5 basis points of the issuance value of debt securities)
- Clearing Member primary contribution based on the risk the CM brings to the system.
- ARCL from its profit

The contribution from clearing members will be considered at later date based upon stabilization of volume.

10. Back testing

ARCL is conducting back testing at regular intervals to ensure adequacy of haircut and adequacy of initial margin requirement.

11. Investment Risk

Investment is done within the framework prescribed by SEBI. In terms of SEBI circular dated May 04, 2016, and Nov 28, 2019, a recognized clearing corporation can invest only in the following types of investments:

- Fixed Deposit with Banks [only those banks which have a net worth of more than INR 500 crores and are rated A1 (or A1+) or equivalent as mentioned at para 12 of SEBI circular dated August 27, 2014.
- Central government securities / treasury bills; and
- Liquid schemes of debt mutual funds and overnight debt mutual funds (shall not exceed 10% of investible resources)

12. Default Handling

In case of a default by a borrower, the collateral placed by it will be liquidated through the sale or auction as stated above and any loss from such sale or auction will be met through haircut kept. Similarly, in case a lender defaults the initial margin collected should normally be adequate to meet the shortfall.

In case of any residual loss i.e. the realization of collateral value is less than the outstanding obligation of borrower etc. as stated above, such loss would be absorbed by the Core SGF as per the default waterfall structure defined by SEBI as under:

- a) monies of defaulting member/participant (including defaulting member's primary contribution to Core SGF)
- b) Insurance, if any.
- c) Issuers contribution to Core SGF.
- d) ARCL resources (equal to 5% of MRC).
- e) Core SGF in the following order:
 - i) Penalties.
 - ii) Previous financial years profit of ARCL transferred to Core SGF.
 - iii) Remaining Core SGF: ARCL contribution and non-defaulting members' primary contribution to Core SGF on pro-rata basis.
 - iv) Remaining profit of ARCL transferred to Core SGF.
 - v) Remaining ARCL resources (excluding higher of INR 100 Crore or capital requirement towards orderly Winding Down of Critical Operations and Services).*
- f) Remaining ARCL resources to the extent as approved by SEBI.
- g) Capped additional contribution by non-defaulting members/participant. **
- h) Any remaining loss to be covered by way of pro-rata haircut to payouts. ***

* INR higher of INR 100 Crore or capital requirement towards orderly Winding Down of Critical Operations and Services to be excluded only when remaining Clearing Corporation resources are more than INR 100 Crores.

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

- (i) ARCL shall have relevant regulations/provisions for non-defaulting members to resign un-conditionally within the abovementioned period of thirty 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.
- (ii) 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.
- (iii) 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 ARCL post using this layer shall be as per the terms decided by SEBI in public interest.