The wait is over: Mandatory Variation Margining for Derivatives in India

Read on if you have also been waiting for the Variation Margin (**"VM"**) norms in India to be released and want a snapshot of it…

The Reserve Bank of India (**"RBI"**) has published the Master Direction – Reserve Bank of India (Variation Margin) Directions, 2022, on 1st June 2022 (**"VM Norms"**) for non-centrally cleared derivatives (**"Transactions"**). The VM Norms will be effective from 1st December 2022.

Key features

- **Applicability**:
  - Appliable -
    - (i) Transactions entered into on or after 1st December 2022.
    - (ii) Where both parties are 'Covered Entities' under VM Norms.
  - Not applicable -
    - (i) Transactions entered before 1st December 2022 and any genuine amendments made to the existing contracts.
    - (ii) To certain types of entities such as the RBI (being the Central Bank) and other sovereign entities. It also excludes intra group Transactions.

- **Eligible Collateral**:

<table>
<tr><th>Domestic Covered Entities</th><th>Foreign Covered Entities</th></tr>
<tr><td colspan="2">Indian currency ("INR")</td></tr>
<tr><td colspan="2">Government debt securities</td></tr>
<tr><td colspan="2">Listed rupee bonds issued by Indian corporates having a credit rating of at least AAA
* Securities issued by counterparty, or its related entity will not be eligible collateral</td></tr>
<tr><td></td><td>Freely convertible foreign currency</td></tr>
<tr><td></td><td>Debt securities issued by a foreign central government with a credit rating of at least AA-</td></tr>
</table>

- **Minimum transfer amount:**
  The minimum amount of VM to be exchanged should not exceed INR 35 million (3.5 crore).

- **Treatment:**
  Cash collected will not to be treated as deposit/ borrowing.

➢ **<u>Miscellaneous</u>:**

- Margin is allowed to be posted or collected overseas when dealing with 'Foreign Covered Entities'.
- In case of Transactions between a Domestic Covered Entity and a Foreign Covered Entity may be subject to margin requirements in a foreign jurisdiction. If parties decide to comply with margin requirements implemented by the foreign jurisdiction, the margining framework of the foreign jurisdiction is to be assessed by the Domestic Covered Entity to be comparable to the requirements under the VM Norms.

Background

With the passing of the Bilateral Netting of Qualified Financial Contracts Act, 2020 (**"Netting Act"**), netting finally received statutory certainty prompting RBI to also recognize netting for capital adequacy purposes thereby, freeing up a significant amount of usable capital for banks. This has created an even favorable environment for derivative transactions market. The next step in this market reform was that of introducing the margining requirements.

Existing norms governing VM

➢ RBI had in 2020 issued the Foreign Exchange Management (Margin for Derivative Contracts) Regulations, 2020 (**"FEMA Regulations"**). Subsequently, in 2021, RBI issued the circular dated 15th February 2021 on Margin for Derivative Contracts (**"Margin Circular"**).

➢ The FEMA Regulations are applicable for cross border transactions and prohibit any persons from exchanging margin without RBI's prior permission. A general permission is given to AD Banks to exchange margin, either on their own account or on behalf of their customers, under permitted derivative contracts entered into with a person resident outside India.

➢ Margin Circular provides further operational details including the types of margins that may be exchanged in India and the types of margins that may be exchanged for cross border transactions.

With the foundation laid by the FEMA Regulations and the Margin Circular, the VM Norms now provides a comprehensive framework for exchange of collateral to reflect the current mark-to-market exposure.

What's next?

➢ Soon after, draft directions in relation to initial margin requirements for Transactions may be issued by RBI.

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Contact us:

MUMBAI OFFICES

Corporate Office
302, Century Bhavan, 3rd Floor
Dr Annie Besant Road, Worli,
Mumbai - 400 030, India
Tel: +91 22 6720 5555 / +91 22 4057 5555
Fax: +91 22 2421 2547

Dispute Resolution Office
148, Jolly Maker Chamber II,
14th Floor, Nariman Point,
Mumbai - 400 021, India
Tel.: +91 22 4920 5555
Fax: +91 22 2204 3579

DELHI OFFICE

502, 504 & 506, 5th Floor,
Antriksh Bhawan, Kasturba Gandhi Marg,
New Delhi - 110 001, India
Tel: +91 11 4175 1889
Fax: +91 11 4014 4122

BENGALURU OFFICE

Kheny Chambers, Upper Ground Floor,
4/2 Cunningham Road,
Bengaluru - 560 052, India
Tel: +91 80 4669 8200
Fax: +91 80 2226 6990

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