Financial RegTech Newsletter

June 2019

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FX-Retail – the new FX trading platform

Transparency and fair pricing in the foreign exchange (FX) market have always been concerns for global regulators as well as the RBI. In May 2017, the Global Foreign Exchange Committee (GFXC) published the FX Global Code (FXGC) with guiding principles to promote the effective functioning and integrity of the FX market. Principle 14 of the code requires the markup on client transactions to be fair and reasonable.

With a view to have greater transparency and better price discovery for retail customers, the RBI has announced the roll-out of an FX trading platform, FX–Retail,[1] for retail customers by the Clearing Corporation of India Ltd (CCIL). To start with, the platform will provide an anonymous and order-driven mechanism for dealing in the USD/INR currency pair.

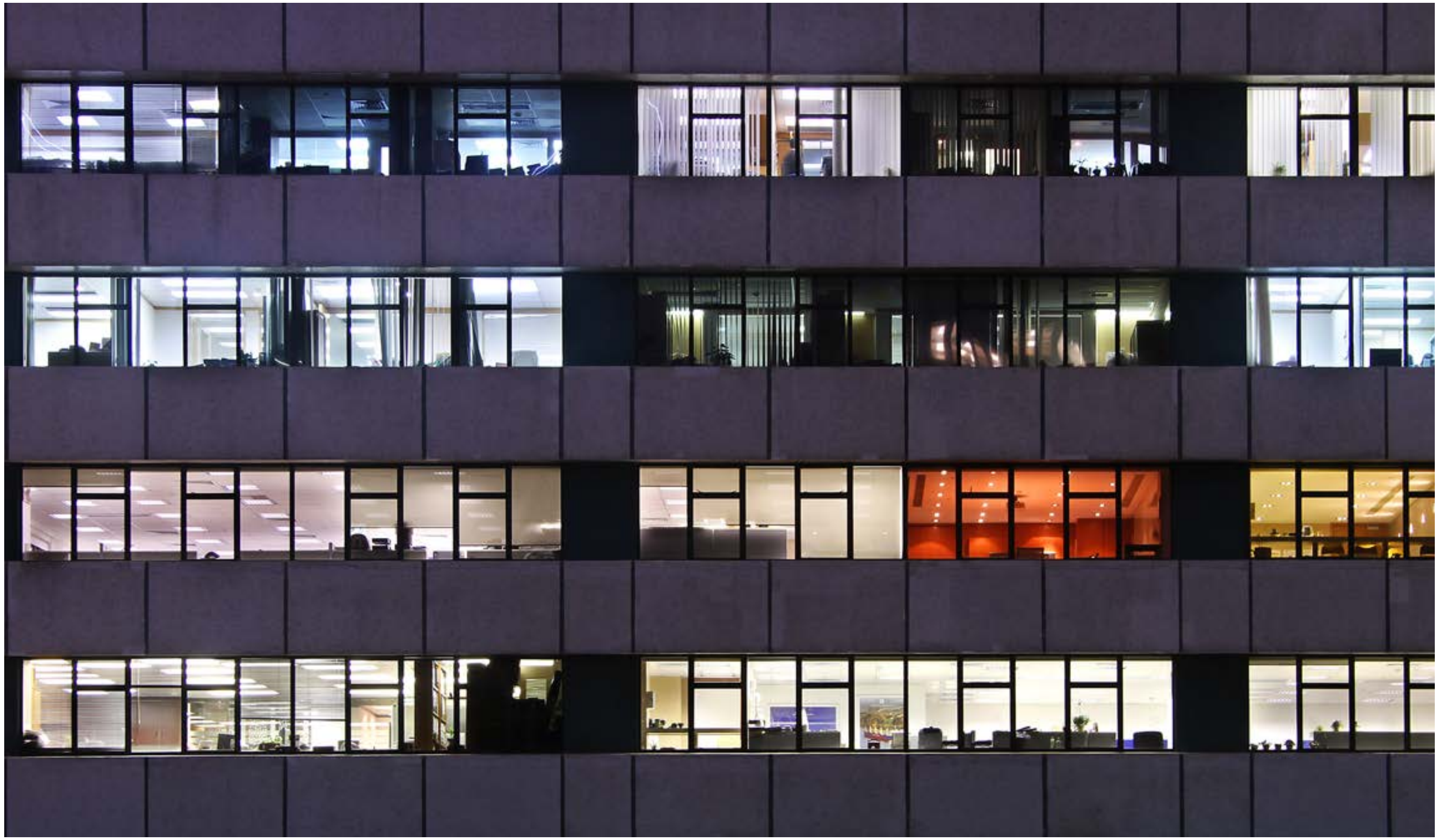
Customers can register on the portal *https://www.fxretail.co.in* from 1 July 2019 and transactions can be performed from 5 August 2019.

Any customer, including individuals, corporates and small and medium enterprises (SMEs), can access this portal.

1. RBI circular on roll-out of the FX-Retail platform: *https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11597&Mode=0*

Current scenario

Currently, retail customers in India do not have any direct access to the FX market. They can sell or purchase FX from banks holding Authorised Dealer (AD) licences under the Foreign Exchange Management Act (FEMA), 1999, or RBI approved money changers/FX dealers. Both charge a markup of 1–3% on currency rates apart from the on-boarding and transaction fees. Although multiple proprietary platform exists, there is a minimum order restriction for retail customers. Customers with a large order size enjoy better rates compared to those with a small order size.



Current scenario

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What is FX-Retail bringing to the table?

The platform[2] is an extension of CCIL's FX-Clear, which is used for interbank trading for large volumes. The FX-Retail platform can act as not only a price matching platform wherein bids/offers from different customers and AD banks are matched automatically but also a direct buy/sell platform for counterparties. The retail market will be separate from the interbank market but will have the same market hours, i.e. 9:00–17:00. Currently, 27 customer categories who can access this portal are listed on the CCIL website. Customers can register by paying one-time registration fees and providing the required Know Your Customer (KYC) and bank details.

The RBI has not defined any limit for the number of transactions per customer in a day; however, representative banks can impose a limit on the total transaction amount. The maximum limit for a single transaction is USD 5 million. Customers have the following options on the portal for settlement of forex transactions: on cash basis (same day), tom basis (next day) or spot basis (two days after date of transaction). The FX-Retail portal will also display the FX-CLEAR interbank spot rates for reference.

One-time registration fees	• INR 300 for individuals • INR 1,000 for non-individuals
Transaction charges by CCIL	• No charges for transactions up to USD 50,000 per day • A nominal fee of 0.0004% on transactions exceeding USD 50,000
Other charges	• Banks can charge a pre-agreed flat fee towards administrative expenses • The charges would be declared on the portal

Currently, the portal will be available only for the USD-INR currency pair. More currencies are expected to be added in the future.

2. RBI discussion paper on FX trading platform: *https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=879*

The big picture

The FX market is the largest financial market in the world, ahead of both the securities and derivatives market, with trades averaging USD 5.1 trillion per day in April 2016.[3] According to the RBI, the Indian FX trading turnover grew 9% from USD 600.9 billion in June 2017 to USD 665.4 billion in June 2018.[4] The introduction of this electronic trading platform is expected to be a contributing factor to the growth of the Indian FX market.

The new FX-Retail platform is expected to bring the following advantages to the market:

- The new platform allows retail customers to directly trade on the platform. An increase in customer order volumes over time is expected to improve the overall liquidity in the system.
- There is no minimum order size for transacting on FX-Retail compared to the existing proprietary electronic platforms of individual banks and multi-bank portals (MBPs), which have a minimum order size defined for retail customers. However, a single transaction size cannot exceed USD 5 million.
- Currently, customers largely buy/sell currencies over the phone with an AD bank. With access to current rates and automatic price discovery, the new platform is expected to bring in a transformation from phone-based trading to electronic trading. This will also benefit customers with small order sizes as they can avoid negotiation with banks and enjoy fair market rates through an online platform.
- Banks also follow the practice of fixing 'rate cards' for the various forex pairs at the beginning of the day. Irrespective of the intraday movement in the currency value, the currencies are purchased/sold at the initial card rates. This portal will help customers to take advantage of intraday price movement.

While there are visible benefits, some potential issues can be expected:

- By giving AD banks the freedom to charge 'pre-agreed flat fees', there is a possibility of there not being a significant reduction in the final cost borne by customers per transaction, which contrasts with RBI's prime objective.
- Banks, a major source of liquidity, may form cartels in the forex market to restrict competition and set the spot rates at a higher price, ultimately defeating the purpose of this portal. Recently five multinational banks were fined by the European Commission (EC) for taking part in trading cartels.[5]

3. Triennial Central Bank Survey of foreign exchange and OTC derivatives markets in 2016: *https://www.bis.org/publ/rpfx16.htm*
4. Sell side turnover as per handbook of statistics on Indian economy 2018: *https://rbi.org.in/scripts/AnnualPublications.aspx?head=Handbook%20of%20Statistics%20on%20Indian%20Economy*
5. European commission press release on FX spot trading cartels: *http://europa.eu/rapid/press-release_IP-19-2568_en.htm*

The way forward

There will always be challenges with the introduction of a new platform. It might take some time to improve and become popular with the masses. It is expected that the currency basket, which is now restricted to the USD-INR pair, will be expanded soon. By making possible direct trading by the customer and removing the dependency on AD banks for the determination of currency rates, FX-Retail is likely to bring down the cost of transactions for retail customers in the long term.

A clear picture will emerge only once the banks declare the fees for their services as permitted by the RBI. Based on the experience with FX-Retail, other market players may be allowed to start similar retail platforms in the future. With a few issues to be addressed, this platform is more likely to achieve the RBI's objective of bringing in more transparency in pricing and promoting competition among market players by unifying the existing fragmented forex market.

Regulatory news

Prudential Framework for Resolution of Stressed Assets

As per the new framework released by the RBI, lenders have 30 days to review the borrower account before declaring it as a non-performing asset (NPA) and to finalise the 'resolution plan' (RP) along with the timeline and approach for implementation.

The framework asks lenders to enter into an inter-creditor agreement (ICA) in case a borrower has credit facilities with multiple lenders, to jointly agree on the RP. For accounts with aggregate exposure above a threshold with the lenders, the RBI states that the RP is to be implemented within 180 days from the end of the review period.

The detailed notification can be accessed here.

RBI permits asset reconstruction companies to acquire assets from peers

The banking regulator has permitted asset reconstruction companies (ARCs) to purchase financial assets from other ARCs, provided the settlement is done on cash basis only. The circular is an amendment to the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, 2002.

The RBI further states that price discovery for these transactions "shall not be prejudicial to the interest of Security Receipt holders". Also, the ARC selling the assets is required to make sure that the proceeds from the transaction are used for the redemption of underlying security receipts. Most importantly, the redemption date of the underlying security receipts and total period of realisation should not be more than eight years from the acquisition date of the financial asset by the first ARC.

The detailed notification can be accessed here.

Regulatory news

RBI issues fresh guidelines on rupee interest rate derivatives

With a view to consolidate, simplify and rationalise all previous directions released on interest rate derivatives, the apex banking regulator has released new directions on rupee interest rate derivatives (IRD) on 26 June 2019, which will come into force with immediate effect. It permits stock exchanges to design and offer new standardised products, or make modifications to existing products after obtaining prior approval of the RBI. Additionally, over-the-counter (OTC) market participants such as banks have been provided with the flexibility to design tailored products for corporates and non-retail entities.

By ensuring that customised products are only offered to large, sophisticated and non-retail users, the RBI aims to protect the interest of small and retail participants with low risk appetite. Various products offered will be periodically reviewed by the RBI. These regulations are expected to achieve consistency and ease of access and eventually create an environment for better management of interest rate risk in the Indian economy.

The detailed notification can be accessed here.

Large Exposures Framework

The RBI has made amendments to the Large Exposures Framework (LEF) with the objective of recording the concentration risk and exposures accurately and aligning them with international regulations. As per the modified norms, entities related to the sovereign are excluded from the definition of the connected counterparties group. The definition now includes economic interdependence criteria. In the case of collective investment undertakings, securitisation vehicles and other structures, the RBI has incorporated the mandatory application of the look-through approach (LTA) while determining the relevant counterparties.

The detailed notification can be accessed here.

Other regulatory news

Implementation of Phase II of the UPI process for retail investors

According to the circular released by SEBI on 28 June 2019, the implementation of Phase II of the Unified Process Interface (UPI) mechanism as a way to invest in the public issue of shares for retail customers will be effective from 1 July 2019. The circular released by SEBI in November 2018 stated that implementation in a phased manner would ensure a smooth transition to UPI with Application Supported by Blocked Account (ASBA).

In Phase II, the current process of bid-cum-application form submission with an intermediary and the movement of a submitted application form to self-certified syndicate banks for blocking of funds will be discontinued. Such applications will be permitted to be routed only via the UPI mechanism.

The detailed notification can be accessed here.

Stricter guidelines for disclosures by credit rating agencies

With a view to further enhance the disclosures made by credit rating agencies (CRAs) and improve the rating standards, SEBI has come up with tightened norms. For timely identification of defaults and enhanced tracking, SEBI has advised CRAs to formulate a standard operating procedure (SOP) in consultation with SEBI and disclose the same on their respective websites. The circular also introduces probability of default (PD) benchmarks for CRAs, in addition to various other norms. Each CRA is required to consolidate and disclose the standardised PD benchmarks on its website for short-term and long-term instrument ratings for all financial instruments it rates by 31 December 2019.

The detailed notification can be accessed here.

Other regulatory news

Handling of Clients' Securities by Trading Members/Clearing Members (TM/CM)

SEBI has released circulars from time to time, regulating the operational process behind handling a client's securities and funds with a view to protecting the client's funds and securities. In the recent notification released, SEBI has stated that clients' securities with the TM/CM in the following accounts – client collateral account, client margin trading securities account and client unpaid securities account – will not be permitted to be pledged to banks or NBFCs for raising funds, even with client authorisation. This will be effective from 1 September 2019. In addition, TM/CM will have to open a separate client unpaid securities account for securities which have not been paid in full. Stock exchanges, CCs and depositories will also be required to put a monitoring mechanism in place for handling of client securities.

The detailed notification can be accessed here.

Credit of penalty for margin money shortfall in commodity derivatives segments to the Core SGF

SEBI had initially prescribed the deposit of penalties levied by stock exchanges and clearing corporations (CCs) to the Investor Protection Fund (IPF). However, it was noted that a few CCs/exchanges were crediting the penalties to the Core Settlement Guarantee Fund (SGF), while a few were crediting them to the IPF. In order to bring uniformity, SEBI declared that all the penalties levied in case of short-collection or non-collection of margins will have to be credited to the Core SGF only.

This will come into force with immediate effect.

The detailed notification can be accessed here.

Global regulatory news

ESMA Annual Report 2018

The European Securities and Market Authority (ESMA) has published its 2018 annual report. The objective of the report is to review the priorities and objectives defined for 2018 and assess achievements. The key objectives for 2018 revolved around supervisory convergence, risk assessment, a single rulebook for EU financial markets and direct supervision of financial entities.

The detailed notification can be accessed here.

ESMA updates list of derivative contracts subject to trading under the MiFIR

As per the notification, ESMA has added multiple UK venues to the public register. It has also updated the derivatives contracts that can be traded under these venues as per the Markets in Financial Instruments Regulation (MiFIR).

The detailed notification can be accessed here.

Bank for International Settlements – Annual Economic Report 2019

The Bank for International Settlements has released its annual report for the year 2019. The report reviews global economic and financial developments. According to BIS report 2019, there should be a balance between monetary policy, structural reforms, fiscal policy and macroprudential measures.

The detailed report can be accessed here.

EBA – draft guidelines on loan origination and monitoring

With the aim of developing a robust standard for high-quality credit and prudent risk monitoring, the European Banking Authority (EBA) has launched consultation on its draft guidelines on loan origination and monitoring. The draft guidelines present requirements in terms of internal governance, borrowers' creditworthiness assessment and credit-granting policies. The new guidelines are also expected to replace the existing EBA guidelines on creditworthiness assessments.

The consultation will run till 30 September 2019, with the guidelines expected to come into effect from January 2020.

The detailed notification can be accessed here.

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