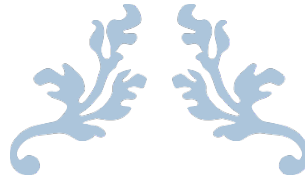


INDIA INTERNATIONAL BULLION EXCHANGE IFSC LIMITED



RISK MANAGEMENT POLICY

2022



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Overview

The India International Bullion Exchange IFSC Limited (IIBX) is India's first International Bullion Exchange set up at the GIFT City and inaugurated by Honourable Prime Minister, Shri Narendra Modi, on July 29, 2022.

IFSCA vide letter dated July 26, 2021, had permitted to perform functions of both Exchange & Clearing Corporation by a single unified entity i.e., the India International Bullion Exchange IFSC Limited, for a period of three (3) years. The Clearing Corporation functions as a Clearing Department within the Exchange.

The Exchange performs the functions of the Clearing Corporation and Post Trade activities through a dedicated "Clearing & Settlement Department" and "Risk Management Department" that is ring fenced and maintains an integrated and comprehensive view of risk and ensures that its risk management tools can manage and report on all relevant risks. The risk management policies, procedures, systems, and controls form a part of a coherent and consistent governance framework which is reviewed and updated regularly.

Participant Exposure and Settlement Default Risk, Credit Risk, Liquidity Risk, Legal Risk, Operational Risk, Investment Risk, Technology Risk, Clearing Bank Risk etc. are some of the risks that IIBX deals with on a continuous basis. IIBX's risk management policy is in accordance with the Principles for Financial Market Infrastructures ("PFMI") published by the Committee on Payments and Market Infrastructures ("CPMI") and the Technical Committee of the International Organization of Securities Commissions ("IOSCO").

Currently, all the trades are executed with 100 % advance payment of funds and Securities (in the form of bullion depository receipts BDRs). However, the Exchange has the mechanism in place whereby the obligations can be netted at CM level. The CM would settle all obligations including margins arising out of trades made by them as TM and also of those TM for whom they have undertaken to settle as clearing members. This mechanism shall be applicable once the margin based trading is introduced.

Objective and purpose :

The Risk Management Policy is prepared with the main objective to identify the key events and risks impacting the business of the Company and attempts to develop a comprehensive risk policies and strategies wherever required to ensure timely evaluation, reporting and monitoring of key business risks. The following are the key objectives :-

- Develop an appropriate risk appetite.
- Adopt good practice in the anticipation, timely identification, evaluation and cost-effective control of risk in carrying out both normal and extraordinary business activities.
- Ensure that adverse risks are either avoided, reduced to an acceptable level, or managed and contained; and to do so in good time and on a continuous basis.
- Ensure that individual members of staff and teams take appropriate risk-based decisions informed by an understanding of risk.
- Ensure business continuity
- Focus risk assessment and management on the highest level of threats to our ability to achieve our strategic objectives; and opportunities to promote them.

- Assure Regulators / Stakeholders / investors that there is a robust approach and mechanism in place to assess and manage risk.

IIBX's risk control mechanisms include:

- Periodical Audits viz. System Audits, Cyber Security Audit, Collateral Audit, Accounts Audit, Statutory Audit etc.
- The availability and the system software to conduct daily stress tests to assess the adequacy of the Settlement Guarantee Fund. On-line/off-line surveillance is done to monitor risks associated with member's trading exposure.
- Clearing bank's net-worth monitored on a periodic basis
- Clearing member's ("CM") net-worth monitored on a periodic basis
- Eligible collateral, as prescribed by the regulator, in the form of cash or cash equivalent and non-cash equivalent, is subject to concentration limits and appropriate haircuts.
- Business Continuity Plan (BCP) plan for systems as well as required manpower
- Different categories of admissible Members and admission criteria

IIBX undertakes to act as the central counterparty to all the trades executed on the Stock Exchange for which IIBX clears trades and provides full novation, unless specified otherwise. In essence, IIBX splits the original contract between the initiating counterparties into two new contracts: one each between IIBX and the initiating counterparties. The initiating parties are only exposed to IIBX and no longer face the other initiating party's credit risk. Elimination of counterparty risk is achieved through the process of novation and the interposition of IIBX as the common counterparty. Novation enables IIBX to be the universal counterparty to all contracts and allows greater flexibility and discretion in its clearing and settlement practices. IIBX remains the counterparty to trades from the time of the execution of the trade until settlement/expiry/delivery.

Ring-fencing

To ensure that there is no contagion effect to / from IIBX, the Clearing Settlement Department and the Risk Management Department of IIBX is ring fenced down to the lowest level and would limit its functions to the core activities to be performed in its capacity as a Clearing House, which includes, as prescribed by the regulatory guidelines, clearing & settlement and risk management policies.

Legal & Regulatory

IIBX is regulated by the International Financial Services Centres Authority (IFSCA)

IIBX is also subjected, on an ongoing basis, to rules and regulations that are consistent with the PFMI, issued by the CPMI-IOSCO.

Assessment and Management of Risks

Some of the risks managed within IIBX's domain are:

Legal Risk

The risk of the unexpected and/or uncertain application of a law or regulation, usually resulting in a loss.

IIBX ensures that its Rules, Byelaws, Regulations, policies and procedures are consistent with the laws prevalent in India and other relevant jurisdictions.

IIBX is regulated by the IFSCA under International Financial Services Centres Authority (Bullion Exchange) Regulations, 2020 and subsequent amendments thereto, the International Financial Services Centres Authority (Market Infrastructure Institutions) Regulations, 2021 Rules and Regulations made there under and other regulations as may be applicable.

Credit Risk

At present, all the transactions are on T+0 settlement cycle with 100% advance on both buy and sell side. In view of this, the risk of default by any clearing member does not exist.

Going forward, IIBX shall introduce the T + 2 settlement cycle and establish a Settlement Guarantee Fund (SGF) to provide for and cover risks that may arise due to a clearing member defaulting in payment of requisite funds to IIBX and the necessity to honor such trades out of the Settlement Guarantee Fund arises.

IIBX has policies requiring members to be approved before they can participate; ensuring that they have pre-paid collateral into their accounts.

IIBX provides full novation and has the responsibility of guaranteeing contractual performance by playing the role of a central counterparty for all trades executed on the stock exchange for which it clears trades, thereby eliminating counterparty risk for the members. IIBX has put in place stringent eligibility criteria for banks which can be empanelled as clearing banks. IIBX has put in place a risk management framework to mitigate the risk it undertakes in its capacity as a Clearing Corporation.

Settlement Guarantee Fund

IIBX shall have a dedicated “Settlement Guarantee Fund”, which shall be readily and unconditionally available to meet settlement obligations of IIBX in case of Clearing / Custodian member(s) (“CMs”) failing to honor settlement obligation.

Corpus of the Fund

The corpus of the fund shall be utilized to meet out, inter-alia, the contingencies arising on account of failure of any member(s). The risk or liability to the fund would depend on various factors such as trade volume, open positions, maximum settlement liability of the members, the history of defaults, capital adequacy of the members, the degree of safety measures employed by the clearing corporation etc. In order to assess the fair quantum of the corpus of Settlement Guarantee Fund, IIBX would consider the following factors:

- Risk management system in force
- Track record of defaults of members (number of defaults, amount in default)

The corpus of the fund shall be in accordance and as provided by IFSCA vide their circular no. F.No.415/IFSCA/Consolidated Operating Guidelines/2021-22 dated August 25, 2021.

The fund shall have a corpus as may be decided by IFSCA and the Exchange

The minimum required corpus (MRC) shall be arrived at from the monthly stress test value or the corpus as may be decided by IFSCA, whichever is higher.

The Exchange shall develop a framework for devising a stress test for assessing the size of the Settlement Guarantee Fund (SGF).

The contribution to the SGF shall be made by the Exchange / CC and clearing members in the following manner:

a) The Exchange shall contribute to the Settlement Guarantee Fund at least 25% of the Minimum Required Corpus (MRC) from its own funds.

b) The Bullion Clearing Corporation can seek risk-based contribution towards Settlement Guarantee Fund from Clearing Members subject to the following conditions:

i) The total contribution from Clearing Members shall be at least 50 per cent of the minimum required corpus.

ii) No exposure shall be available to any Clearing Member on settlement guarantee fund contribution made by it.

iii) The required contributions of individual Clearing Members shall be on pro rata basis depending on the risk undertaken by them.

iv) The Bullion Clearing Corporation shall develop a framework for utilization of the settlement guarantee fund and submit the same for the approval of the Authority.

Calculation of Minimum Required Corpus (MRC)

(i) The MRC shall be fixed for a month.

(ii) By 15th of every month, IIBX shall review and determine the MRC for next month based on the results of daily stress tests of the preceding month. (For example, by 15th February, IIBX shall determine MRC for March based on results of various stress tests conducted in January). IIBX shall also review and determine by 15th of every month, the adequacy of contributions made by various contributors and any further contributions to the Fund required to be made by various contributors for the next month.

(iii) For every day of the preceding month (i.e., January as per example in (ii) above), uncovered loss numbers shall be estimated by the various stress test scenarios (with or without weightages) for credit risk conducted by the IIBX to arrive at the worst case loss number for the day.

(iv) Average of all the daily worst case loss numbers determined in (iii) above shall be calculated.

(v) The MRC for next month (i.e., March as per example in (ii) above) shall be highest of MRC for preceding months.

(vi) Contribution towards the Fund in excess of MRC may be released by IIBX to the contributors on a pro-rata basis.

Investment Policy for Settlement Guarantee Fund

IIBX shall follow prudential norms for investment of the Fund's corpus to ensure that the corpus is invested in financial instruments with minimal market and credit risk and is capable of being liquidated with minimal adverse price effect.

Further contribution to / recouplement of the Settlement Guarantee Fund

Requisite contributions to the Fund by various contributors for any month shall be made by the contributors before start of the month.

In the event of usage of the Fund during a calendar month, IIBX may call for additional funds to replenish the Settlement Guarantee Fund at least to the extent of MRC.

In case there is failure on part of some contributor(s) to replenish its (their) contribution, same shall be immediately met, on a temporary basis during the month, by IIBX (for settlement of trades of which the Fund has been constituted)

Review of Settlement Guarantee Fund

The Quarterly results shall be communicated to the Governing Board of IIBX. The exception reporting shall be made to IFSCA detailing the outcome of the review by IIBX Governing Board, including steps taken to enhance the Fund.

Default Waterfall

As provided by IFSCA vide their circular no. F.No.415/IFSCA/Consolidated Operating Guidelines/2021-22 dated August 25, 2021, IIBX shall settle the obligations under default by utilization of funds in the following order :-

- i. Funds of defaulting member, including defaulting member's primary contribution to SGF(s).
- ii. Insurance, if any.
- iii. Bullion Clearing Corporation resources (equal to 5% of the MRC).
- iv. In case the funds from above point (i) to (iii) are not sufficient, the contributions to Settlement Guarantee Fund may be utilized in the following order:
 1. Penalties
 2. Bullion Clearing Corporation contribution to the extent of at least 12.5% of the MRC.
 3. Remaining portion of SGF: Bullion Clearing Corporation contribution, Bullion Exchange contribution and non-defaulting members' primary contribution to SGF on pro-rata basis.
 4. Any remaining loss to be covered by way of pro-rata haircut to pay outs. Bullion Clearing Corporation shall limit the liability of non-defaulting members towards additional contribution to a multiple of their required primary contribution to

SGF and the framework regarding the same should be disclosed. Post default if the member fails to maintain the minimum funds in the SGF, the Bullion Clearing Corporation shall be empowered to:

- a) Suspend / Cancel the membership.
- b) Restrain the member from taking new positions.
- c) Liquidate the existing positions of the member and apply the margins if any.
- d) Liquidate the collaterals marked as Lien/Pledge towards Margins/settlement guarantee.
- e) Immediately take sufficient measures with respect to Risk Management to prevent ripple effects on the default on the other members.

Collateral Risk

At present all the transaction are on T+0 settlement cycles. The buyers and sellers have to bring in 100% cash and 100% securities (BDR) respectively. No collaterals in any form are accepted as on date.

With the introduction of T+2 settlement cycle, depending upon the collateral that may be permitted to be accepted, the assessment shall be done.

Market Risk

At present, all the transactions are on T+0 settlement cycle which are mandatorily pre-funded with 100% advance on both buy and sell side. In view of this there is no market risk. However, with the introduction of T+2 settlement cycle and derivative products, if any, IIBX has the necessary systems and mechanism for computing the gross and net exposure and the value of clearing and settling of different kinds of contracts permitted in the Exchange.

Liquidity Risk

Presently, 100% advance payment of funds is mandatory for the buyers, therefore, there is no liquidity risk.

With the introduction of T+2 settlement cycles, the Exchange shall have the necessary systems and mechanism in place to identify measure and monitor its settlement and funding flows, including its use of intraday liquidity. Liquidity requirements, adequacy of liquidity arrangements and resources shall be measured, monitored and managed through liquidity stress tests that would ensure to effect payment and settlement obligations as they fall due, in a timely manner, even under stress scenarios.

Settlement Risk

Settlement risk is the risk due to the failure of clearing / settlement banks and / or depositories for funds and securities settlement, the risk that a counterparty will lose the full value involved in a transaction.

IIBX empanels commercial banks as Clearing Banks / Settlement Bank(s), as per IIBX's eligibility criteria which includes its networth, regulatory structure, adequacy of infrastructure, agreement with IIBX etc. The Clearing Banks / Settlement Bank(s) shall enter into an Agreement with IIBX. To mitigate the risk of securities settlement failure due to any kind of failure at the depository, IIBX may tie up with reputed International Central Securities Depositories or Central Securities Depositories with sound risk

management practices and compliant with PFMI. The norms regarding finality of transfer of funds and financial instruments are laid down in Byelaws, Rules, Regulations and circulars of IIBX as well as various laws governing transfer of funds/securities, risk management, defaults procedures and other aspects of the settlement system laid down by the regulators.

General Business Risk

The risks related to the administration and operation of IIBX as a business enterprise, excluding those related to the default of a participant or another entity, such as a settlement bank, FMIs etc., not separately covered by financial resources under the credit or liquidity risk principles.

IIBX has a strong risk governance structure to identify, monitor and mitigate its general business risks. The management and Board of Directors have defined responsibilities and accountability. Measures like security checks and restricted access to employees, ring fencing of critical operations, periodical audits of systems and processes to prevent occurrences of breach or fraud shall be in place.

Custody & Investment Risk

Investment risk refers to the risk of loss faced when the Exchange invests its own or its participants' assets.

All liquid funds collected in the form of deposits from trading and clearing members and liquid funds available with the company are invested in fixed deposits maintained with IBUs

IIBX shall conduct a thorough due diligence to ensure that the commercial bank with which IIBX places deposits meets the criteria of minimum networth requirements, capital adequacy ratios and low ratio of non-performing assets to their total assets.

Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. IIBX has identified various sources of operational risks namely risks associated with IIBX activities, processes and systems and include deal entry errors, breakdown in trading processes, documentation failures, physical production and delivery of commodities.

IIBX shall conduct periodical audits of its systems and processes to identify the operational risk on an ongoing basis to take timely measures to manage such risks. IIBX analyses any change in the business environment on account of changes in rules and regulations, business competition etc. and responds accordingly to mitigate such risks. IIBX shall put in place various checks and balances in the systems that include audits to address the risk of fraud.

Systemic Risk

Systemic risk is broadly defined as the probability that the financial system is unable to support economic activity linked to or dependent upon one another, having common participants and serving interconnected institutions and markets.

IIBX as FMI is subject to heightened standards for boards of directors, comprehensive risk management framework expectations, minimum capital requirements, robust default handling process, rules and procedures, requirements for liquidity shortfalls, broader risk management requirements and enhanced disclosure requirements.

Interdependency Risk

The risk that a CCP bears from other entities as a result of interdependencies or links to other FMIs.

Clearing Banks: Please refer Clearing Banks criteria in Settlement Risk.

Stock Exchanges: Risk management and Surveillance measures implemented by IIBX include price bands, circuit filters, circuit breakers (market halts in case of extreme volatility). The stock exchanges also have a trade annulment process provided in its Byelaws to protect the market against erroneous trades.

Reputation and Image Risk

IIBX has a policy of openness, transparency and fairness to all stakeholders to ensure that its reputation or standing in the community is not diminished. IIBX has a well deigned website as an external interface to enhance communication and for effective brand building. The selection of an appropriate risk management strategy to address each domain of risk is based on sound understanding of the underlying risk after a comprehensive assessment of the risk and a good sense of IIBX appetite for risk.

Margining Framework

At present, all the transactions are on T+0 settlement cycle with 100% advance on both buy and sell side. In view of this, the risk of default by any clearing member does not exist.

Going forward, IIBX shall introduce the T + 2 settlement cycle and other products including Derivatives products. Accordingly, a Settlement Guarantee Fund (SGF) shall be constituted to provide for and cover risks that may arise due to a clearing member defaulting in payment of requisite funds to IIBX and the necessity to honor such trades out of the Settlement Guarantee Fund arises.

Accordingly, a margining framework shall be designed keeping in mind best practices prevalent globally and is in accordance with the PFMI principles. This shall be enclosed as a separate annexure to the Risk Management Policy.

IIBX shall develop a margining framework based on the best practices prevalent globally. IIBX shall conduct stress tests, reverse stress tests, back testing, liquidity stress testing etc. to ensure the robustness of the risk management framework. The margining framework shall be compliant with CPMI – IOSCO Principles for Financial Market Infrastructures at all times. Margins shall include Initial margin, Value-at-



risk (VAR) margin, Extreme Loss margins (ELM), mark-to-market margin (MTM), any other additional margins that may be prescribed by the Exchange shall be collected from the Members.
