

Review of stress testing framework for equity derivatives segment

October 2024

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Background

SEBI has introduced new guidelines¹ to enhance **stress testing framework** for equity derivatives segments for determining the corpus of Core Settlement Guarantee Fund (SGF).

The circular introduces new stress testing methodologies to have broad understanding of the **prevalent tail risks** in the equity derivatives segment, ensuring better preparedness for evolving market dynamics.

The additional stress tests will lead to increase in the initial Minimum Required Corpus (MRC) requirement of equity derivatives segment after adoption and regulator provides guidance for inter-segment transfer of funds and staggered contributions to the Core SGF.



Applicable to:

- Recognised Stock Exchanges (SE)
- Recognised Clearing Corporations (CCs)



Timelines:

- Joint SOP – 30 days from issue of circular
- Additional contribution to core SGF – on or before 01 February 2024

Key areas for immediate action



Stressed VAR

Using variance-covariance matrix for price movements, 2X volatility of stressed period and Monte Carlo simulations for daily returns



Filtered historical simulation

Adjust past data to capture prevailing volatility and adjusting historical returns to incorporate latest estimates of volatility



Factor model

Highest 3-day Nifty movements adjusted by the stock's beta during stress period for determining price movement



Choice of stress period

CCs to collectively design policy to update and review stress periods with Stress Period of Risk (SPOR) of 3 days



Staggered SGF contribution

CCs to design framework for bringing in additional contribution for the Core SGF in a staggered manner for monthly MRC



Joint Standard Operating Procedures (SOP)

SEs and CCs to formulate SOPs for new stress testing models, staggered contributions to SGF and other operational aspects

¹01 October 2024 | Circular No.: SEBI/HO/MRD/MRD-PoD-2/P/CIR/2024/131

How can we help?

KPMG in India with financial risk management (FRM) practice has a strong team of 400+ professionals assisting financial institutions and corporates in identifying, assessing and managing various aspects of financial and non-financial risks. We have extensive experience in executing complex risk and regulatory transformation programs for financial institutions and regulators globally.

KPMG in India will assist you in identifying changes and manage through implementation of the revised guidelines mandated by the SEBI circular dated 01 October 2024.



Review of existing processes and methodologies

Perform thorough review of existing process, Standard operation procedures, stress testing methodologies and systems used for stress testing and related activities



Gap and impact assessment

Identify gaps in current processes and methodologies and offer recommendations assisting compliance with new stress testing requirements. Furthermore, evaluate the impact of these changes on the SGF contribution



Implementation of changes

Assist in wide ranging implementation of the changes i.e., drafting of updated SOPs, finalising methodologies and frameworks for incorporation of new stress testing scenarios and other operational aspects of the circular



Automation

Assist in automation of calculation intensive and manually run processes like scenario expansions by using stochastic and machine learning frameworks for rapidly changing regulations

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