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The Futures and Options Association
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March 1, 2013

Dear Sirs,

Netting Analyser Library

You have asked us to give an opinion in respect of the laws of India ("this jurisdiction") as to the effect of certain collateral arrangements in relation to National Commodities Clearing Limited ("NCCL" or the "Clearing House") and its clearing members (each a "Member").

We understand that your requirement is for the enforceability and validity of collateral arrangements to be substantiated by a written and reasoned opinion letter.

There are no separate rules, regulations and bye-laws specifically enacted in relation to NCCL and the rules, regulations and bye-laws prescribed in relation to the National Commodity and Derivative Exchange of India ("NCDEX") also govern, *inter alia*, collateral arrangements in relation to NCCL.

The NCDEX Byelaws (as defined hereinafter) include the following provisions (these are instructive in appreciating the role played by the Clearing House in transactions involving Members):

When funds and commodities or documents of title to commodities are routed through the Clearing House, the responsibility for settlement of these transactions would rest solely and wholly upon the Members of the Clearing House and that the Clearing House would basically act as a common agent of the Members/constituents/trading members for receiving or giving delivery of commodities and for receiving and paying funds, without incurring any liability or obligation as principal.

Members giving and receiving delivery would be deemed to have made a contract with each other as sellers and buyers.

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A Clearing House may specify (either generally or specifically) that Members giving and receiving delivery and paying and receiving funds would be deemed to have made a contract with the Clearing House as sellers and buyers and between themselves as receiving and delivering members. However, we have not come across any general or specific notification pursuant to which NCCL has declared that it would act on a principal basis for clearing Contracts. Based on our verbal discussions with representatives of NCDEX, we understand that NCCL only acts as an agent between Members for clearing Contracts and does not perform the clearing functions on a principal basis.

In relation to guaranteeing transactions, the NCDEX Byelaws provide that the Clearing House would undertake to guarantee the financial settlement of all deals arising out of trades in commodities executed on the trading system of NCDEX irrespective of default, insolvency or failure on the part of the corresponding Member, provided that the settlement guarantee of the Clearing House will only extend to cover:

- i. its own Members;
- ii. those transactions that have been executed, registered and accepted for clearing and settlement by the Clearing House after having been matched by the Exchange; and
- iii. those members who are not in default in their financial obligations to the Clearing House or the Exchange.

This is further subject to the following conditions:

- i. the Clearing House would not be deemed to guarantee the title, ownership, genuineness, regularity or validity of any goods or any document passing through the Clearing House (the object of maintaining the Clearing House being to facilitate the delivery and payment in respect of the goods or documents between Members);
- ii. the nature of guarantee by the Clearing House will be strictly financial, that is:
 - a) The seller will be assured the payment of the settlement price fixed by the Relevant Authority on the delivery / expiry date after the Clearing House is satisfied that the delivery has been completed; and
 - b) The buyer will be assured either a delivery order, or upon failure of the seller to give delivery, the monetary value of the short delivery based on the settlement price fixed by the Relevant Authority as on the delivery / expiry



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date and the monetary value based on the ready market price on the expected delivery day as may be specified by the Relevant Authority.

In view of the aforesaid provisions, it would appear that although NCCL has the ability to do so, NCCL does not, as a matter of course, act as a typical Central Counterparty (CCP) to all the Contracts settled on NCDEX.

References herein to "**this opinion**" are to the opinion given in Section 3.

1. TERMS OF REFERENCE

- 1.1 Except where otherwise defined herein, terms defined in the Rules of the Clearing House have the same meaning in this opinion letter.
- 1.2 The opinions given in Section 3 are in respect of a Member's powers under the Rules as at the date of this opinion. We express no opinion as any provisions of the Rules of the Clearing House other than those on which we expressly opine.
- 1.3 The opinions given in Section 3.6 are given only in relation to Non-cash Collateral comprising securities credited to an account.

1.4 Definitions

In this opinion, unless otherwise indicated:

- (a) "**Assessment Liability**" means a liability of a Member to pay an amount to the Clearing House (including a contribution to the assets or capital of the Clearing House, or to any default or similar fund maintained by the Clearing House); but excluding:
 - (i) any obligations to provide margin or collateral to the Clearing House, where calculated at any time by reference to Contracts open at that time;
 - (ii) membership fees, fines and charges;
 - (iii) reimbursement of costs incurred directly or indirectly on behalf of or for the Member or its own clients;
 - (iv) indemnification for any taxation liabilities;
 - (v) payment or delivery obligations under Contracts; or



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- (vi) any payment of damages awarded by a court or regulator for breach of contract, in respect of any tortious liability or for breach of statutory duty.
- (b) "**Clearing House Documentation**" means the Rules and the agreements entered into between the Member and the Clearing House in relation to the Contracts;
- (c) "**Contract**" means a ready delivery contract, forward contract, futures contract or any derivatives contract relating to buying and selling commodities admitted to dealing by NCDEX;
- (d) "**NCDEX**" means National Commodity and Derivatives Exchange Limited;
- (e) "**Non-cash Collateral**" means the non-cash collateral provided to the Clearing House as margin under the Rules;
- (f) "**Party**" means the Clearing House or the relevant Member;
- (g) "**Relevant Authority**" means the board of directors of NCDEX or such other authority as may be specified by the board of directors of NCDEX from time to time for a specific purpose;
- (h) references to the word "**enforceable**" and cognate terms are used to refer to the ability of a Party to exercise its contractual rights in accordance with their terms and without risk of successful challenge. We do not opine on the availability of any judicial remedy;
- (i) "**Rules**" means the rules (including the bye-laws and regulations) of the Clearing House in force as at the date of this opinion;
- (j) references to a "**section**" or to a "**paragraph**" are (except where the context otherwise requires) to a section or paragraph of this opinion (as the case may be).

2. ASSUMPTIONS

We assume the following:

2.1 That, except with regards to the provisions discussed and opined on in this opinion



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letter, the Clearing House Documentation and Contracts are legally binding and enforceable against both Parties under their governing laws.

- 2.2 That each Party has the capacity, power and authority under all applicable law(s) to enter into the Clearing House Documentation and Contracts; to perform its obligations under the Clearing House Documentation and Contracts; and that each Party has taken all necessary steps to execute and deliver and perform the Clearing House Documentation and Contracts.
- 2.3 That each Party has obtained, complied with the terms of and maintained all authorisations, approvals, licences and consents required to enable it lawfully to enter into and perform its obligations under the Clearing House Documentation and Contracts and to ensure the legality, validity, enforceability or admissibility in evidence of the Clearing House Documentation in this jurisdiction.
- 2.4 That, in the case of the opinion given at paragraph 3.6 only, both Parties have properly executed the documents.
- 2.5 That the Clearing House Documentation has been entered into / have become effective and applicable prior to the commencement of any insolvency procedure under the laws of any jurisdiction in respect of either Party.
- 2.6 That each Party acts in accordance with the powers conferred by the Clearing House Documentation and Contracts; and that each Party performs its obligations under the Clearing House Documentation and each Contract in accordance with their respective terms.
- 2.7 That, apart from any circulars, notifications and equivalent measures published by the Clearing House in accordance with the Clearing House Documentation, there are not any other agreements, instruments or arrangements between the Parties which modify or supersede the terms applicable to the Parties in relation to the clearing and settlement arrangements.
- 2.8 That the Member is at all relevant times solvent and not subject to insolvency proceedings under the laws of any jurisdiction.



2.9 That the obligations assumed under the Clearing House Documentation and Contracts are mutual between the Parties, in the sense that the Parties are each personally and solely liable as regards obligations owing by it and is solely entitled to the benefit of obligations owed to it.

3. **OPINION**

On the basis of the foregoing terms of reference and assumptions and subject to the qualifications set out in Section 4 below, we are of the following opinions.

3.1 **Insolvency Proceedings**

The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which the Clearing House could be subject under the laws of this jurisdiction, and which are relevant for the purposes of this opinion are liquidation (including provisional liquidation), administration, receivership, voluntary arrangements and schemes of arrangement.

These procedures are together called "**Insolvency Proceedings**".

NCCL is a public limited company. The only legislation applicable to Insolvency Proceedings of such a public limited company is the Companies Act, 1956 ("Companies Act").

3.2 **Special provisions of law**

The following special provisions of law apply to Contracts by virtue of the fact that the Contracts are, or relate to, exchange-traded derivative products and are cleared through a central counterparty:

- 3.2.1 Forward Contract (Regulation) Act, 1952, and rules and regulations thereunder ("FCRA");
- 3.2.2 Byelaws of NCDEX ("NCDEX Byelaws");
- 3.2.3 Regulations of the National Commodity & Derivatives Exchange Limited ("NCDEX Regulations"); and
- 3.2.4 Rules of the National Commodity & Derivatives Exchange Limited ("NCDEX Rules").



3.3 **Recognition of choice of law**

The choice of Indian law as being applicable to the Clearing House Documentation would be recognised under the laws of this jurisdiction, even if the Member is not incorporated, domiciled or established in this jurisdiction.

3.4 **Cash Collateral**

Payments made by a Member to the Clearing House as cash margin do not constitute an absolute transfer of cash, so that, in the event of Insolvency Proceedings relating to the Clearing House, such cash would not be treated as the property of the Clearing House available to its creditors generally.

However, the amount of cash so provided would not constitute a debt owed by the Clearing House to the Member as principal.

This is because of the following reasons:

- i. Paragraph 5.2 of the NCDEX Byelaws (Part B) states that the margins to be provided by a Member under the Byelaws, Rules and Regulations of NCDEX would be in such form as may be prescribed by the Relevant Authority from time to time and would be deemed to have been pledged and/or hypothecated, as the case may be, in favour of the Clearing House. This implies that the intent of the Clearing House Documentation is to provide the Clearing House a security interest (or rights akin to a security interest) over the deposits and margins, as opposed to any ownership interest.
- ii. Paragraph 5.6 of the NCDEX Byelaws (Part B) states that the monies paid by way of margin or bank deposit receipts pledged or hypothecated by a Member in lieu of margin under the provisions of the NCDEX Byelaws, Rules and Regulations shall be subject to a first and paramount lien for all sums due to the Clearing House.

3.5 **Non-cash Collateral**

Any securities provided to the Clearing House as cover for margin and constituting Non-cash Collateral would not be treated as the property of the Clearing House and would be returnable to the Member, even in the event of Insolvency Proceedings relating to the Clearing House, subject to the Member satisfying its obligations to the Clearing House.



However, the value of the Non-cash Collateral provided would not constitute a debt owed by the Clearing House to the Member as principal.

This is because of the following reasons:

- i. Paragraph 5.2 of the NCDEX Byelaws ws (Part B) states that the margins to be provided by a Member in the forms of securities under the Byelaws, Rules and Regulations of NCDEX would be deemed to have been pledged and/or hypothecated, as the case may be, in favour of the Clearing House. This implies that the intent of the Clearing House Documentation is to provide the Clearing House a security interest (or rights akin to a security interest) over the deposits and margins, as opposed to any ownership interest.
- ii. Paragraph 5.6 of the NCDEX Byelaws (Part B) states that the margin paid by way of securities or other assets pledged or hypothecated by a Member in lieu of margin under the provisions of the Byelaws, Rules and Regulations would be subject to a first and paramount lien for all sums due to the Clearing House.
- iii. Paragraph 8.4 of the NCDEX Byelaws (Part B) permits replacement of margin deposited. By giving a suitable notice to the Clearing House and subject to such conditions as may be specified by the Relevant Authority from time to time, a Member may withdraw qualifying securities from pledge, or may cause the Clearing House to revoke an acceptable letter of credit or bank guarantee, provided that the Member has, effective simultaneously with such withdrawal or revocation, deposited cash with, or pledged qualifying securities to the Clearing House or through such other mode as may be approved the Clearing House from time to time to satisfy his required contribution or deposit. Such possible replacement of deposited margin indicates that there is no absolute transfer of collateral involved.

3.6 Members' Assessment Liabilities

A Member's Assessment Liability is as follows:

- i. A settlement fund is maintained by the Clearing House in which every Member is required to provide initial deposits as specified hereunder, or to provide additional deposits, in any form or manner as may be determined by the Relevant Authority from time to time.



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- ii. The Relevant Authority in its discretion, may permit a Member to contribute or provide the deposit either in the form of cash, securities, bank guarantee or by such other method and subject to such terms and conditions as may be specified from time to time by the Relevant Authority.
- iii. In the event a Member is declared a defaulter and the Member fails to meet the clearing and settlement obligations to the Clearing House under the Rules, the Relevant Authority may utilise the Settlement Fund and other monies to the extent necessary to eliminate the obligation in the following order:
 - a) any amount that may be paid in the form of margin or any other payment of the defaulting member retained by the Clearing House for the purpose of the clearing and settlement; and if this amount is not sufficient to settle the obligation,
 - b) any contribution or deposit made by or bank guarantee arranged by the defaulting member to the Settlement fund, whether in the form of cash or securities or bank guarantee; and if this amount is not sufficient to settle the obligation,
 - c) the amount of security deposit, if any, made by the defaulting member to NCDEX to the extent not appropriated by NCDEX towards the obligations of the defaulting member to it; and if this amount is not sufficient to settle the obligation,
 - d) the proceeds, if any, recovered from auctioning or transferring the membership of the defaulting member in the NCDEX, subject to deduction of the expenses relating or incidental to the auction; and if this amount is not sufficient to settle the obligation,
 - e) the profits available for appropriation in the respective year in which the default took place, if this amount is not sufficient to settle the obligation; and if this amount is not sufficient to settle the obligation,
 - f) the retained earnings of the Clearing House including any reserves created for this purpose to the extent available, if this amount is not sufficient to settle the obligation; and if this amount is not sufficient to settle the obligation.



- g) the amount of contribution and deposit made by all categories of Clearing Members to the Settlement Fund in proportion to the total contribution and deposit made by each Clearing Member; and if this amount is not sufficient to settle the obligation,
- h) If the above amount is not sufficient, the balance obligation remaining after application of the above funds shall be assessed against the Clearing Members in the same proportion as their total contribution and deposit and Clearing Members shall be required to contribute or deposit in the Settlement Fund, within such time as the Relevant Authority shall require, the deficient amount.

iv. If the Member fails to make the due contribution towards the Settlement Fund within the stipulated time, the Relevant Authority may charge such interest, impose penalties and fines and take such disciplinary action against the Member as it may determine from time to time. Any disciplinary action taken by the Relevant Authority or involuntary cessation of membership by the Member would not affect the obligations of the Member to the Clearing House or any remedy to which the Clearing House may be entitled under applicable law.

v. The allocation of each Member's contribution and deposit towards Settlement Fund to meet the losses or liabilities of the Clearing House incidental to the operation of that clearing member can be decided at the sole discretion of the Clearing House.

vi. Paragraph 6.7 of the NCDEX Rules further states that the Relevant Authority can require a Member to suspend its business when it fails to provide the margin deposits, deposits and contribution to Settlement Fund and/or meet capital adequacy norms as provided in the Rules and the suspension of business would continue until it furnishes the necessary margin deposits, deposits and contribution to Settlement Fund or meet capital adequacy requirements. The Relevant Authority may also expel such a defaulting Clearing Member.

4. QUALIFICATIONS

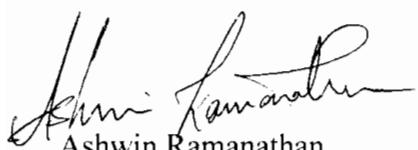
There are no other material issues relevant to the issues addressed in this opinion which we wish to draw to your attention.



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Yours faithfully,



Ashwin Ramanathan

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