

RBI introduces a special funds facility scheme to avoid gridlocks in security settlement

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The Reserve Bank of India(RBI) will, from October 3, 2000 introduce a special fund facility for securities settlement. Meant for banks and primary dealers, the objective of the scheme is to provide intra-day funds to facilitate settlement of securities transactions in case of gridlock.

The delivery versus payment system introduced by the Reserve Bank in July 1995 has generally been working satisfactorily. There have, however, been a few instances of gridlock in the system. This mainly occurred on account of shortage of funds on a gross basis in the current account of one or more SGL account holders. To take care of such unusual and exceptional occurrences, the scheme of special fund facility for security settlement has been envisaged. Introduction of the scheme was announced in the Monetary and Credit Policy for 2000-2001 in April 2000.

The delivery versus payment system involves simultaneous transfer of securities and funds in government securities transactions to alleviate counter party risk. Under this system trades are settled on gross basis with irrevocable final settlement taking place simultaneously for securities and funds. This necessitates adequate funds in the buyer's account and sufficient balance of securities in the seller's account. With the increase in government securities transactions, it is likely that the transactions may fail to settle due to shortfall of funds on a gross basis in the current accounts of one or more SGL account holders, especially when the transactions are linked. Such situations are called gridlocks.

Under the Special Funds Facility Scheme, the Reserve Bank would provide collateralised intra-day credit to banks and primary dealers to facilitate settlement of securities transactions in case of such gridlocks. Funds provided for this purpose will not be overnight credit. It will be available for settlement relating to their transactions in Government of India dated securities, treasury bills and state government securities through their own SGL accounts as well as in constituent SGL accounts.

Banks and Primary Dealers who are eligible for Collateralised Lending Facility (CLF)/Liquidity Support Facility (LSF) from the Reserve Bank at the Bank Rate will be eligible for this facility. Credit will be available on a collateralised basis and will be given against undrawn CLF/ Primary Dealers Liquidity Support (PDLS). The drawal would be restricted to 95 per cent of the face value of outstanding securities in reverse repo constituent SGL account of a participant after providing for successful bids in reverse repo auctions. The funds will be provided at Bank Rate and the interest cost will be shared equally among all beneficiary participants involved in the settlement of linked securities transactions. In addition, a flat fee of Rs. 25 per transaction would be charged from each beneficiary

participants. The Reserve Bank will also apply a uniform margin on the transaction. The transaction for this purpose will be reversed on the same day.

The Reserve Bank will constantly review the scheme and modify it as and when necessary. If deemed necessary, it could also suspend the scheme.

Full details of the scheme are available on the RBI website (www.rbi.org.in)

Alpana Killawala
General Manager

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