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## **Collateral Policy**

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**FMDQ CLEAR LIMITED**

**Version 1.0 - September 2022**

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**Table of Contents**

1. Definition of Key Terms ..... 2

2. Introduction ..... 4

3. Principles: Policy Statement..... 4

4. Acceptable Collateral ..... 4

5. Haircut Determination ..... 5

6. Collateral Valuation..... 5

7. Maintenance Threshold ..... 5

8. Collateral Concentration Limits ..... 6

9. Collateral Substitution and Release ..... 6

10. Policy Review ..... 6

## 1. Definition of Key Terms

The following terms and expressions shall, unless the context otherwise requires, have the following meanings in this Collateral Policy.

Term	Definition
<b>“Business Day”</b>	means a day (other than a Saturday, Sunday or Federal Government of Nigeria declared public holiday) on which banks are open for business in Nigeria;
<b>“Central Counterparty” or “CCP”</b>	means an entity that interposes itself between counterparties to contracts/transactions traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the performance of open contracts/transactions;
<b>“Clearing Member”</b>	means a means a Trading Member that is either a General Clearing Member or a Direct Clearing Member of FMDQ Clear authorised to clear and settle transactions under the conditions set forth in the FMDQ Clear Clearing Member Rules;
<b>“Client”</b>	means a Non-Trading Member or Trading Member whose transactions are cleared and settled by a Clearing Member of FMDQ Clear;
<b>“Collateral”</b>	means the securities or cash pledged by Clearing Members to secure the performance of their obligations with FMDQ Clear;
<b>“Default”</b>	means a failure by a Clearing Member to meets its obligations (financial and non-financial) as contemplated in the Default Events of the Default Management Policy or as may be prescribed by FMDQ Clear from time to time;
<b>“Default Fund”</b>	means a fund, comprising pre-funded financial resources provided by FMDQ Clear and its Clearing Members, to allocate any losses arising in the event that one or more Clearing Member Defaults on their obligations to FMDQ Clear and resources provided by the Defaulting Clearing Member(s) are not sufficient to cover such losses;
<b>“Eligible Security”</b>	means a security that is acceptable by FMDQ Clear to satisfy its Collateral requirements for Initial Margin and Default Fund contribution;
<b>“Exchange”</b>	means any regulated market, multilateral trading facility, or other trading venues duly authorised, regulated, recognised, or licensed (to the extent necessary) under applicable laws in any jurisdiction for which FMDQ Clear provides CCP services;
<b>“FMDQ Clear”</b>	means FMDQ Clear Limited or the Central Counterparty;
<b>“Initial Margin”</b>	means Collateral deposited by Clearing Members to ensure performance of potential obligations arising from future price movement on open Positions;
<b>“Maintenance Threshold”</b>	means a rate or threshold which determines the minimum market value of a Clearing Member’s Collateral required by the CCP to cover

Term	Definition
	the Clearing Member's obligations from Initial Margin and Default Fund;
<b>"Position"</b>	means the amount of a particular derivative contract, security, commodity or currency held or owned by a Clearing Member on behalf of its Clients;
<b>"The Securities and Exchange Commission" or "SEC"</b>	means a Nigerian government agency mandated to regulate the Nigerian capital markets;
<b>"Trading Member"</b>	means a member of an Exchange authorised to execute transactions on the Exchange's trading system;

## **2. Introduction**

FMDQ Clear defines its Collateral Policy in accordance with Section 21 of the Securities and Exchange Commission's rules on Central Counterparty and Principle 5 [Collateral] of the CPMI-IOSCO<sup>1</sup> Principles for Financial Market Infrastructures ("PFMIs").

FMDQ Clear accepts only highly liquid securities with minimal credit and market risks to cover risk exposures to its Clearing Members and has taken a conservative approach to the admission and assessment of certain assets as Collateral. This document describes the procedure for determining Eligible Securities, valuation guidelines, Collateral administration as well as established concentration limits for each Clearing Member's stock of Collateral pledged to FMDQ Clear.

It is a fundamental requirement that the cash and eligible securities that will serve as Collateral must be validly and lawfully transferred to FMDQ Clear or a custodian acting on behalf of FMDQ Clear in accordance with the FMDQ Clear Clearing Member rules and agreements. Whilst the Collateral provided by Clearing Members remains the property of the Clearing Members, the custody of same shall wholly be with FMDQ Clear.

FMDQ Clear's Collateral Policy shall be read in conjunction with other FMDQ Clear policies, agreements, rules and any other documents as may be published by FMDQ Clear from time to time.

## **3. Principles: Policy Statement**

There are key principles that are critical to Collateral management. The application of these principles will ensure that FMDQ Clear and its Clearing Members are adequately protected against potential losses from a Clearing Member's Default.

- I. Clearing Members shall pledge acceptable Collateral for its Initial Margin and Default Fund contribution to FMDQ Clear.
- II. Clearing Members shall be required to transfer all Collateral pledged by its Clients as Initial Margin to FMDQ Clear.
- III. FMDQ Clear shall conduct liquidity test for all non-cash collateral to determine Eligible Securities in line with principle 5 of the CPMI-IOSCO PFMI.
- IV. The liquidity test shall be based on the outstanding value and trading intensity of Eligible Securities.
- V. Only liquid securities shall be classified as Eligible Securities.
- VI. The list of Eligible Securities shall be updated on a quarterly basis or more frequently in line with market realities and published regularly on FMDQ Clear's website.

## **4. Acceptable Collateral**

- I. The following shall qualify as Collateral for use as Initial Margin and contributions to FMDQ Clear Default Fund:
  - a. Cash; and

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<sup>1</sup> Committee on Payment and Market Infrastructure – International Organisation of Securities Commissions

- b. Non-cash Collateral which includes Federal Government of Nigeria (“FGN”) issued debt securities, Central Bank of Nigeria (“CBN”) issued debt securities, and any such other securities as may be determined by FMDQ Clear.
- II. FMDQ Clear shall accept Collateral denominated in Nigerian Naira, US Dollars, and any other such currencies as may be stipulated by FMDQ Clear from time to time.
- III. Cash and non-cash Collateral shall be pledged by Clearing Members in the acceptable ratio advised by FMDQ Clear.
- IV. The acceptable ratio of cash to non-cash Collateral pledged by Clearing Members shall be published via communique on FMDQ Clear’s website.

**5. Haircut Determination**

FMDQ Clear shall develop suitable haircut profiles for all Eligible Securities taking into account periods of stressed market conditions. The haircut profiles shall be determined by the market volatility and liquidity of the respective securities. The profiles would reflect the potential for asset values to decline over the interval between their last revaluation and the time by which they can reasonably be assumed to be liquidated. Haircut profiles will be reviewed at least quarterly and published on FMDQ Clear’s website.

**6. Collateral Valuation**

In determining the sufficiency of the Collateral posted by a Clearing Member to cover its obligations, FMDQ Clear shall determine the current market value of pledged Collateral availed by a Clearing Member for this purpose. The following principles shall guide the Collateral valuation process of FMDQ Clear.

- I. The closing prices for valuing the securities held as non-cash Collateral shall be as obtained from the Exchange.
- II. Valuation of Collateral shall be carried out at least once every Business Day (end of day) by FMDQ Clear.
- III. The applicable haircut profiles for the respective securities shall be applied in determining the current market value of Clearing Member’s Collateral.
- IV. Where the current market value of a Clearing Member’s Collateral is below the required Maintenance Threshold a collateral call notice shall be transmitted to the respective Clearing Member same day and;
- V. Clearing Members shall be required to pledge additional Collateral to provide sufficient cover on or before 12:00 Noon of the next Business Day or any other time specified by FMDQ Clear.

**7. Maintenance Threshold**

FMDQ Clear shall apply a Maintenance Threshold to ascertain the CCP’s minimum Collateral requirement for Initial Margin and Default Fund obligations of a Clearing Member. Once the market value of a Clearing Member’s pledged Collateral is below the required minimum for Initial Margin and Default Fund obligations, the Clearing Member will be required to provide additional Collateral.

The applicable Maintenance Threshold for Initial Margin and Default Fund shall be set and communicated by FMDQ Clear.

## **8. Collateral Concentration Limits**

FMDQ Clear shall stipulate concentration limits on Eligible Securities used as Collateral where it is reasonable that high concentrations could affect the ability to liquidate such securities or affect the market value of such securities in the event of a liquidation.

To disincentivise Clearing Members from maintaining high concentrations of a particular security with the CCP, the portion of any Eligible Security that has been availed to FMDQ Clear above the stipulated limit shall be valued at zero. These concentration limits shall be reviewed by FMDQ Clear quarterly or more frequently, in the event of extreme volatility to determine their adequacy and any change to the concentration limit shall be communicated to Clearing Members.

## **9. Collateral Substitution and Release**

Collateral deposited as Initial Margin by Clearing Members on behalf of its Clients and contributions to the Default Fund can be substituted or released following request from the Clearing Member's authorised representatives. The following shall be applicable to Collateral substitution and release:

- I. Clearing Members shall be required to substitute pledged non-cash Collateral within eight (8) days prior to maturity.
- II. Clearing Member may request for substitution of pledged Collateral subject to FMDQ Clear's confirmation of the substitute Collateral eligibility and adequacy of the consequent Collateral coverage.
- III. Clearing Member may request for the release of pledged Collateral subject to FMDQ Clear's confirmation of Collateral coverage sufficiency.
- IV. All request for substitution or release of pledged Collateral shall be communicated by authorised representatives of the Clearing Member.
- V. Clearing Members shall give a notice of two (2) Business Days for the release or substitution of pledged Collateral.
- VI. FMDQ Clear shall transfer coupon payments on pledged non-cash Collateral to Clearing Members upon receipt of same.

## **10. Policy Review**

A review of this policy shall be done by FMDQ Clear at least annually, or more frequently if there are material market developments or significant changes to the policies captured here-in.