



Default Management Policy

FMDQ CLEAR LIMITED

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1. Definition of key Terms

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

Term	Definition
“Business Day”	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;
“Central Counterparty” or “CCP”	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;
“Clearing Member”	means a member 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;
“Clearing System”	means FMDQ Clear’s system deployed for data exchange, clearing and settlement of executed contracts/transactions;
“Client”	means a Non-Trading Member or Trading Member whose transactions are cleared and settled by a Clearing Member of FMDQ Clear;
“Closeout”	means the process of offsetting an open Position to prevent further losses on defaulted Positions;
“Collateral”	means the securities or cash pledged by Clearing Members to secure the performance of their obligations with FMDQ Clear;
“Default”	means a failure by a Clearing Member to meet 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;
“Default Fund”	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;
“Default Management Process”	means FMDQ Clear's documented procedures that outlines the Default resolution procedures that a CCP would take in the event of a Default;
“Defaulter-Pays”	means an arrangement whereby each Clearing Member of FMDQ Clear is required to cover exposures it has vis-à-vis other Clearing Members in the arrangement. As a result, losses from a Clearing Member's Default are borne by the Defaulting Clearing Member through the liquidation of the collateral posted by the Defaulting Clearing Member;
“Defaulting Clearing Member”	means a Clearing Member who is considered to be in Default;
“Exchange”	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;

Term	Definition
“FMDQ Clear”	means FMDQ Clear Limited or the Central Counterparty;
“FMDQ”	means FMDQ Group PLC;
“Initial Margin”	means Collateral deposited by Clearing Members to ensure performance of potential obligations arising from future price movement on open Positions;
“Non-Defaulting Clearing Member”	means a Clearing Member who is not considered to be in Default;
“Porting”	means the transfer of Client’s Positions and Collateral from a Clearing Member to another pre-approved Clearing Member;
“Position”	means the amount of a particular derivative contract, security, commodity or currency held or owned by a Clearing Member on behalf of its Clients;
“Regulatory Authority”	means the Securities and Exchange Commission, the Central Bank of Nigeria, or any other authority established by an Act within the Federal Republic of Nigeria or overseas with the responsibility of regulating the activities in the financial market;
“Repurchase Agreement”	means the generic term for Classic Repos and Sell/Buy-Backs which involves a loan/sale of securities with a simultaneous agreement to return/repurchase the securities at a specified price on a predetermined future date;
“Skin-in-the-Game”	means the CCP’s contribution to the Default Fund;
“Trading Member”	means a member of Exchange authorised to execute transactions on the Exchange’s trading system;
“Variation Margin”	means funds that are collected and paid out to reflect Clearing Members' current exposures resulting from actual changes in market prices of open Positions;

2. Introduction

FMDQ Clear's Default Management 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.

FMDQ Clear's role is to reduce the impact of a Clearing Member's default on Non-Defaulting Clearing Members ("non-defaulters") to the greatest extent possible thereby ensuring the stability and efficiency of the market. Together, FMDQ Clear and its Clearing Members work to establish and operate a market that simultaneously reduces risk and cost.

Clearing Members are incentivised to actively participate early in the Default Management Process during the auction towards efficiently closing out the defaulter's portfolio in order to reduce the likelihood and size of losses that may trigger additional contribution to the Default Fund by Non-Defaulting Clearing Members

3. Principles: Policy Statement

There are key principles that are critical to the management of a Clearing Member's Default, the application of which is independent of one another and may be applied based on the nature of the Default and market conditions at the time.

- I. FMDQ Clear operates a "Defaulter-Pays" approach to managing Default.
- II. Where the Defaulting Clearing Member's Initial Margin is insufficient to cover the Default loss, financial resources of the CCP will be consumed in the following order:
 - a. The Defaulting Clearing Member's Default Fund contribution,
 - b. The CCP's Skin-in-the-Game,
 - c. The Non-Defaulting Clearing Members' Default Fund contribution.
- III. The preservation of the financial resources of Clients will be prioritised in the resolution of a Default resulting from a Clearing Member's Position, the CCP shall endeavour to port Clients' Position from the Defaulting Clearing Member to another Clearing Member in an efficient and timely manner.
- IV. FMDQ Clear's outstanding Positions and risk are to be neutralised as soon as possible – FMDQ Clear will restore a matched book.
- V. FMDQ Clear may choose to temporarily use its liquidity facilities to ensure the smooth running of the market and any cost thereof will be recoverable from the Defaulting Clearing Member for whom the facilities are used. The use of liquidity facilities will as much as possible be collateralised by the Clearing Member for whom they are being used.
- VI. Where the Default Fund contribution of a Non-Defaulting Clearing Member has been utilised in the resolution of a Clearing Member's default, same must be replaced by the Non-Defaulting Clearing Member within three (3) Business Days, or within any other period specified by FMDQ Clear:
 - a. Where the Non-Defaulting Clearing Member is unwilling to restore its Default Fund contribution to the minimum required level within the prescribed timeframe, FMDQ Clear shall consider such Clearing Member as being in Default, and commence termination of its membership;
 - b. Following from 3.VI(a) above, the Non-Defaulting Clearing Member shall remain liable for any Event of Default that may occur until the commencement of its membership termination on a pro-rata basis;
 - c. The liabilities of the Non-Defaulting Clearing Member resulting from 3.VI(b) above, and

any losses that may arise from the close out of its position, shall be collected from the Non-Defaulting Clearing Member directly, or offset against its Default Fund contribution (where applicable) and the Collateral remaining returned upon completion of its membership termination process;

- VII. Should a Defaulting Clearing Member provide the resources it owes fully or in part after FMDQ Clear has used the contributions of Non-Defaulting Clearing Members to the Default Fund, FMDQ Clear shall refund these to the Non-Defaulting Clearing Members in proportion to how the contributions have been used.

4. Default Readiness

FMDQ Clear will conduct fire-drills that simulate a Clearing Member default twice annually to ensure that adequate and sufficient liquid and prefunded resources are readily maintained and available in the case of a Clearing Member Default. The Default fire-drill will seek to demonstrate that FMDQ Clear and Clearing Members' systems can deal with Position closeout and Client Porting.

4.1 Default Fire-Drill

- I. FMDQ Clear will determine clear scope and success criteria of each Default fire-drill.
- II. Clearing Members are required to participate in fire drills that simulates a Default event.
- III. FMDQ Clear will be required to provide sufficient notice to participating Clearing Members.
- IV. FMDQ Clear will be expected to perform actions required when a Clearing Member Defaults and these include suspension of Clearing Member and the Close Out procedures as stipulated in section 7.
- V. Clearing Members will be required to demonstrate that their systems can deal with supporting auctions and accepting Clients that are scheduled for Porting.

4.2 Default Fire-Drill Requirement

FMDQ Clear will maintain facilities with all the hardware, software, telecommunications and network capabilities required to ensure that the key decision makers and key personnel of the Default Management Committee (the "DMC" or the "Committee") are able to give swift effect to the Default Management Proceedings ("DMP").

FMDQ Clear will open and maintain the necessary accounts (cash and securities) for the management of the Defaulting Clearing Member's Collateral and payments.

5. Default Events

The causes of a Default may be due to one (1) or more reasons as outlined in **Table 1** of the **Appendix**. FMDQ Clear will consider the Default in the context of the clearing business and take action that is appropriate with the severity and nature of the event.

In deciding the specific actions and the order thereof, the causes and circumstances surrounding the Default will be taken into consideration by FMDQ Clear. An important goal of FMDQ Clear is to ensure the smooth running and integrity of the market(s) it clears. An event of Default will be established under any of the four scenarios below:

5.1 Default on Settlement

Default on Settlement will occur if a Clearing Member defaults on cash or security obligations on settlement date. This will occur if a Clearing Member's cash settlement account or security settlement account does not have sufficient funds or security for the fulfilment of its settlement obligations

resulting from its cleared transactions. Default on Settlement is only applicable to a market where there is physical delivery of products cleared.

5.2 Default on Payment

Default on Payment will occur if a Clearing Member defaults on payment obligations arising from a Variation Margin call. A Default is deemed if a Clearing Member's cash settlement account does not have sufficient funds for the fulfilment of its payment obligations resulting from Mark-to-Market activities on transactions cleared by the CCP.

5.3 Default on Collateral

A Default on Collateral will occur if a Clearing Member fails to deposit sufficient clearing Collateral to cover the minimum Initial Margin on its cleared transaction or fails to meet its obligation to contribute to the Default Fund of FMDQ Clear as required within the stipulated time.

5.4 Technical Default

FMDQ Clear may place a Clearing Member in Technical Default if:

- I. FMDQ Clear has reason to believe that a Default is not due to insolvency or the inability to pay or perform is temporary, and that the Clearing Member will fulfil its obligations without delay.
- II. A Clearing Member fails to meet any of its requirements / obligations as stated in the FMDQ Clear's Clearing Member Rule / Agreement
 - a. Clearing Members are obliged to inform FMDQ Clear immediately, if the requirements for admission and participation in clearing are no longer met or the compliance with the FMDQ Clear Clearing Member Rule is at risk. This shall apply in case of imminent insolvency.

5.4.1 Events of a Technical Default

In the event of a Technical Default, FMDQ Clear may explore the following options:

- I. Grant an extension period to the Defaulting Clearing Member to enable resolution of Default.
- II. Use of Repurchase Agreements or any other means available to it to facilitate the resolution of Default.
- III. Refrain from notifying the Exchange in its function as the operator of the trading system.
- IV. Revoke a Technical Default at its discretion.

The Clearing Member affected by the Technical Default is obliged to submit a written and reasoned statement to FMDQ Clear immediately after the Technical Default has occurred and to promptly remedy its causes.

6. Determination of Default

FMDQ Clear will consider all relevant facts when determining whether a Clearing Member is in Default. The FMDQ Clear Default Management Committee ("DMC"), as detailed in Section 10, is responsible for investigating the conditions that led to the event requiring consideration of a Default. The DMC will determine whether the Clearing Member is in Default as well as the category of Default. When it has been determined that a Clearing Member is in Default, FMDQ Clear will establish the appropriate timing

and order of DMP.

7. Default Management Proceedings

Once the DMC has established that a Clearing Member has defaulted, FMDQ Clear will determine the course of action to take depending on the nature and severity of the Default. FMDQ Clear will determine at what time and stage to implement each of the procedures as discussed in subsequent sub-sections and captured in **Table 1** of the Appendix in line with the principles stated in Section 3.

FMDQ Clear will ensure that transparency regarding procedures is provided to all Clearing Members while no information is shared regarding the direction of the defaulting portfolio. The timing of closeout of Positions and Collateral is at the discretion of FMDQ Clear.

7.1 Default Notification

Upon confirmation of Default by the DMC, FMDQ Clear will notify all Clearing Members, FMDQ Exchange and Regulatory Authorities via a formal correspondence of a Clearing Member's default within twenty-four (24) hours of establishing Default. FMDQ Clear shall also notify other Financial Market Infrastructures such as CCPs, Exchanges, Depositories etc. of a Clearing Member's Default.

7.2 Suspension

Upon Default, the Defaulting Clearing Member and its Clients are immediately suspended from all market activities. This is to prevent the defaulted Clearing Member's exposure from increasing. The suspension will include access restriction to the trading platform, pledged Collateral and any actions relating to the Clearing Member's exposures. All open and unfilled orders of the Defaulting Clearing Member on the trading platform prior to suspension shall be automatically cancelled. The suspension of a Clearing Member or the termination of its membership agreement shall not release the concerned Clearing Member from the rights and obligations arising from existing open and cleared Positions.

Clearing Members suspended due to other category of Default other than Technical Default are obliged to notify their Clients via an official correspondence. This is to enable their Clients take appropriate measures to either contract another Clearing Member for the transfer of their open Positions and Collateral or become a Clearing Member itself where the Client is a Trading Member.

7.3 Position Transfers

Performing Trading Members of a Defaulting Clearing Member shall be under the obligation to immediately furnish a letter of commitment of another General Clearing Member or to become a Clearing Member. Until this time, the right to take part in trading activities of the Trading Member shall be suspended.

- I. If the Positions and Collateral of a Clearing Member and its Clients are segregated, in the event of Default of a Clearing Member, FMDQ Clear may initiate the procedure for transferring the Positions and Collateral held by the Defaulting Clearing Member for its Clients, upon request and without the consent of the Defaulting Clearing Member, to a Non-Defaulting Clearing Member named by these Clients.
- II. However, for omnibus Clients' account, FMDQ Clear may trigger the procedures for the transfer of Positions and Collateral value held by the Defaulting Clearing Member on behalf of the Clients to a Non-Defaulting Clearing Member upon request of all the Clients and without consent of the Defaulting Clearing Member.

- III. Where the Collateral of a Client does not sufficiently cover their respective Positions, Positions and Collateral of the concerned Client shall be excluded from the transfer procedure and FMDQ Clear may commence the Close Out and realisation procedure.
- IV. The Non-Defaulting Clearing Member shall consent to the transfer of Positions and Collateral of the Client via an official correspondence.
- V. The Non-Defaulting Clearing Member shall maintain a contractual agreement, presentable to FMDQ Clear, prior to the transfer of Positions and Collateral.

7.4 Liquidation / Position Closeout

FMDQ Clear shall commence the liquidation and closeout of all outstanding Positions of a Defaulting Clearing Member including that of its Clients that were not successfully transferred.

- I. FMDQ Clear shall determine the net open Positions of the Defaulting Clearing Member as well as those of its Clients
- II. FMDQ Clear may hedge outstanding Positions of the Defaulting Clearing Member against market movements prior to auction process
- III. FMDQ Clear will auction net outstanding Positions of the Defaulting Clearing Members to Non-Defaulting Clearing Members via various auction mechanism as may be determined by FMDQ Clear
- IV. All Non-Defaulting Clearing Members must participate in the auction process as determined by FMDQ Clear
- V. All Positions not successfully auctioned will be closed-out at the prevailing market price
- VI. Profits/losses realised from the auction/closeout activities. Where there are profits, same will be paid out to the Defaulting Clearing Member upon offsetting all other attendant liabilities/expenses
- VII. FMDQ Clear shall keep accurate account of all expenses incurred during the DMP. These shall include Variation Margins paid out, Initial Margin obligations, losses (profits) incurred in the auction process/closeout activities and any other expense as may be deemed by FMDQ Clear

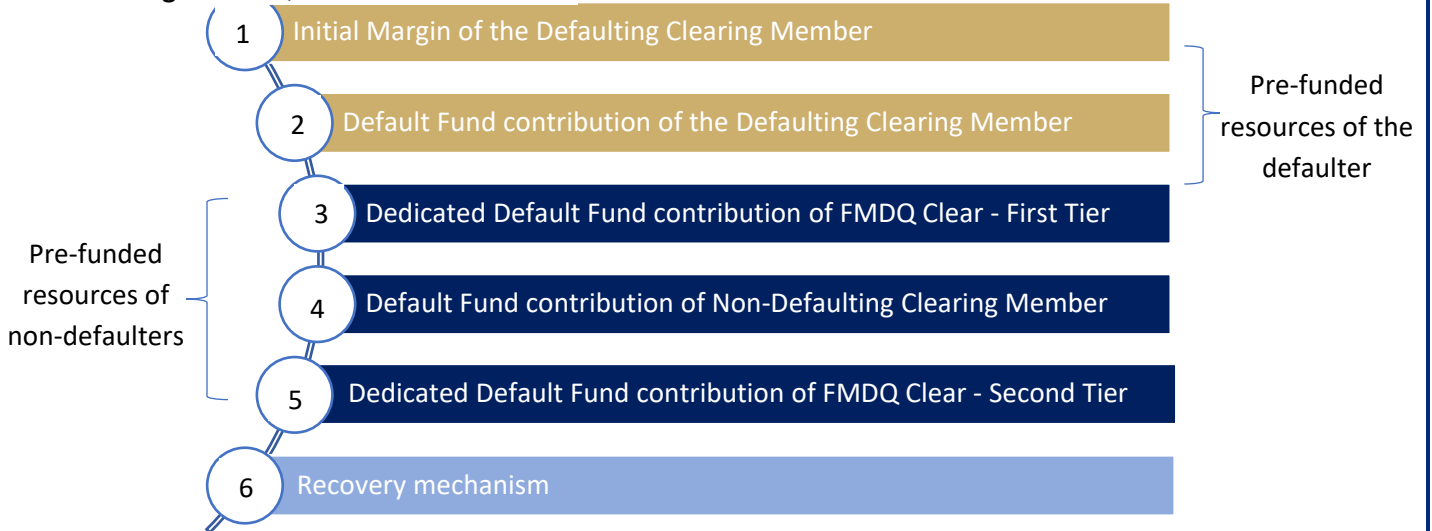
7.5 Realisation of Initial Margin and Default Fund

Upon Default, FMDQ Clear has the right to realise the Initial Margin deposited to cover all obligations on open Positions including any open interest on arrears, fees of the CCP and the Exchange and to cover any liability arising from the Default event. Liquidation of Defaulting Clearing Member's Collateral shall include the Initial Margin pledged for the defaulted Positions and contributions to the Default Fund.

8. Loss Attribution

Following the Default of a Clearing Member and liquidation of its portfolio, losses incurred by FMDQ Clear from the liquidation process will be recovered in line with FMDQ Clear's Default waterfall (**Figure 1**).

Fig 1: FMDQ Clear Default Waterfall



9. Reconciliation and Replenishment of the Default Fund

- FMDQ Clear will perform a full reconciliation on the events of the Default. This reconciliation will account for the Variation Margins, Initial Margins and any liquidity facilities utilised for the resolution of a Default.
- After all obligations are satisfied including all fees and costs incurred as a result of the Default, any surplus Collateral of the Defaulting Clearing Member will be used to replenish the Default Fund in line with the Default Fund policy. The remaining Collateral will be returned to the Defaulting Clearing Member at which time FMDQ Clear shall commence the process for the termination of the Clearing Member's membership from all cleared markets.

10. Default Management Committee

The DMC is responsible for providing oversight on the DMP upon the establishment of an event of Default and is involved in the periodic fire-drills towards assessing the preparedness of the CCP prior to a Default. The DMC shall evaluate the Positions of a Defaulting Clearing Member and make recommendations on the optimal approach to closing out its Positions in line with the approved DMP. A DMC may be established for each product or asset class market as the need arises.

The structure of FMDQ Clear's DMC takes into consideration the need for the CCP to take actions quickly and efficiently closeout and/or hedge the Positions of a Defaulting Clearing Member in a way that protects the Positions and resources of Non-Defaulting Clearing Members, and FMDQ Clear.

FMDQ Clear's DMC will be comprised of:

- Representatives of FMDQ Clear
 - MD, FMDQ Clear (Chair)
 - Divisional Head, Clearing Risk Management
 - Divisional Head, Clearing Operations
- Representatives of FMDQ Group

I. MD, FMDQ Exchange (Alternate Chair)

II. GCOO, FMDQ Group

c. Representatives of Clearing Members (subject to the FMDQ Clear DMC Charter)

The DMC proceedings shall be recorded and reported to the Management of FMDQ Group PLC and the Board of FMDQ Clear.

11. Governance

This Policy shall be reviewed annually or as necessitated by prevailing market conditions.

Appendix

Table 1: FMDQ Clear Event of Default Grid

Event of Default	Triggers	Actions / Activities					Resolution Steps
		Market Notification	Suspension	Position Transfer	Liquidation of Position	Realisation of Initial Margin and Default Fund	
Default on Settlement	Securities Settlement Failure	Applicable	Applicable	Applicable	Applicable	Applicable	
	Cash Settlement Failure	Applicable	Applicable	Applicable	Applicable	Applicable	
Default on Payment	Variation Margin Payment Failure	Applicable	Applicable	Applicable	Applicable	Applicable	
Default on Collateral	Insufficient Initial Margin	Applicable	Applicable	Applicable	Applicable	Not Applicable	
	Insufficient Default Fund Contribution	Applicable	Applicable	Applicable	Applicable	Not Applicable	
Technical Default	Temporary Default on Settlement	Not Applicable	Applicable	Not Applicable	Not Applicable	Not Applicable	
	Temporary Default on Payment	Not Applicable	Applicable	Not Applicable	Not Applicable	Not Applicable	
	Default on Membership Requirement	Not Applicable	Applicable	Not Applicable	Not Applicable	Not Applicable	

Legends

	Applicable		Likely Applicable		Not Applicable		Captured in the Default Management Process
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