Initial Margin 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 Initial Margin Policy:

Terms	Definitions
"Base Initial Margin" or "BIM"	means a standardised component of the margin deposit required of each Clearing Member to cover the potential losses and market risks;
"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 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;
"Client"	means a Non-Trading Member or Trading Member whose transactions are cleared and settled by a Clearing Member of FMDQ Clear;
"Close Out"	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;
"Direct Clearing Member" or "DCM"	means a Clearing Member authorised to clear and settle transactions dealt for its own account or its Non-Trading Members;
"Default"	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;
"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;
"FMDQ Clear"	means FMDQ Clear Limited or the Central Counterparty;
"General Clearing Member" or "GCM"	means a Clearing Member authorised to clear transactions which have been dealt for its own account or the account of its Non-Trading Members and/or other Clients;
"Initial Margin Add-ons"	means an incremental Initial Margin used to account for additional close-out costs for concentrated Positions compared to the market capacity;
"Initial Margin Methodology"	means a framework prescribing the method used in calculating Initial Margin;
"Initial Margin"	means Collateral deposited by Clearing Members to ensure performance of potential obligations arising from future price movement on open Positions;

Terms	Definitions
“Margin Period of Risk” or “MPOR”	means the assumed length of time that it would take to close out or hedge a defaulting participant’s portfolio, during which the CCP is exposed to adverse price movements;
“Non-Defaulting Clearing Member”	means a Clearing Member who is not considered to be in Default;
“Non-Trading Member”	means any person or legal entity that has no direct access to trading and uses the services of a Clearing Member or a Trading Member to execute transactions cleared by the CCP;
“Position”	means the amount of a particular derivative contract, security, commodity or currency owned or held by a Clearing Member on behalf of its Clients;
“Trading Member”	means a member of an Exchange authorised to execute transactions on the Exchange’s trading system;

2. Introduction

Initial Margin represents the first prefunded line of defense and protection against a Default. Initial Margin is required from Clearing Members to ensure there are resources available to meet potential losses in the event that a Clearing Member can no longer meet its obligations in the market.

This document describes FMDQ Clear's philosophy regarding Initial Margin, sets out the governance and articulates the controls FMDQ Clear has in place to ensure the integrity of the Initial Margin calculation.

3. Principles: Policy Statement

There are key principles that are critical to FMDQ Clear's approach in determining, collecting and ensuring the adequacy of Initial Margin at every point in time. These principles are:

I. FMDQ Clear shall determine a BIM per contract based on the volatility in prices/rates, the degree of confidence level, lookback period, and the Margin Period of Risk.

II. Initial Margin shall be calculated by FMDQ Clear at Client level, aggregated at the Trading Member level and collected from the respective Clearing Members. However, for each Client, margin offsets for correlated Positions between contracts may be applied.

III. Initial Margin shall be prefunded, i.e., collected upfront in the acceptable form of Collateral, in line with FMDQ Clear's Collateral Policy. The split between cash and non-cash Collateral shall be advised by FMDQ Clear from time to time.

IV. Collateral posted by a Clearing Member as Initial Margin shall remain the property of the Clearing Member, however the custody of the Collateral shall solely remain with FMDQ Clear, and FMDQ Clear shall have the right to the use of same to satisfy losses in the event of a default by the Clearing Member.

4. Initial Margin Determination

The computation of the Initial Margin due from each Clearing Member shall be made up of the following:

I. Base Initial Margin

II. Margin Add-Ons – Liquidation Period Margin and Concentration Margin

III. Margin Offset

4.1 Base Initial Margin

The Base Initial Margin requirement covers the potential losses and market risk that may occur as a result of future adverse price movements across the portfolio of each Clearing Member. In determining the BIM:

I. FMDQ Clear shall adopt the "Value at Risk" approach using an established lookback period, MPOR, and degree of confidence.

II. The MPOR shall be set as required, based on the risks and particular attributes of each product cleared by FMDQ Clear, taking into account the impact of a Clearing Member's default on prevailing market conditions. The MPOR as recommended by IOSCO[1] for centrally cleared

[1] International Organisation of Securities Commission

products is between 1 and 5 days.

III. The degree of confidence shall be set on a product-by-product basis within a range of 99% to 99.9%

IV. The data that is used to calculate the BIM shall be historical data over a look-back period of one thousand (1,000) days, where available. This shall include the most recent seven hundred and fifty (750) trading days and is supplemented by stress period data of two hundred and fifty (250) trading days, or as shall be determined by FMDQ Clear. The stress period data are included to ensure stability and limit the likelihood of procyclical changes in margin requirements, without undermining the resilience of the CCP

V. The preference for historical data follows the hierarchy listed below:

   a. Observed prices in the actual cleared contracts.

   b. Observed prices in the underlying asset.

   c. Observed price moves in a proxy asset. The proxy shall be reviewed on an annual basis, plus a stress for the mismatch between the asset under consideration and its proxy.

   d. Where no proxy asset or variable is deemed appropriate, FMDQ Clear shall approve proposed scenarios based on conservative assumptions.

4.2 Initial Margin Add-Ons

The Margin Add-Ons are required to cover risks beyond the contract-specific risk factors.

4.2.1 Liquidation Period Margin

I. The ability to liquidate a Defaulting Clearing Members' Position timeously, with minimal impact on market prices, is paramount to protect Non-Defaulting Clearing Members. Consequently, FMDQ Clear shall account for a plausible situation where Clients hold unusually large Positions relative to the contract turnover, that may be liquidated during a period beyond an assumed MPOR.

II. Where this is identified, a Liquidation Period Margin shall be added onto the Base Initial Margin collectible by FMDQ Clear on a net contract basis at the Client level.

4.2.2 Concentration Margin

I. Where a Clearing Member clears a significant portion of the contracts in the market, FMDQ Clear may require an additional margin from such a Clearing Member to protect against large market moves and market liquidity shortages in the case of that Clearing Member's Default.

II. Furthermore, FMDQ Clear may require an additional margin to cover Clearing Member-specific risks where there is a noticeable or perceived change in the credit quality of the Clearing Member.

4.3 Margin Offset

I. FMDQ Clear may from time to time, identify significant and reliable correlations in the observed prices of different contracts, or their underlying assets. To this end, in calculating the Initial Margin at the Client level, FMDQ Clear may allow offsets in required margin amounts between correlated contracts.

II. Offsets across contracts with different tenors, underlying assets, and product classes shall be considered and introduced as the market develops.

5. Clearing Member Exposure Limit

I. A maximum exposure limit shall be availed to each Clearing Member, subject to an upfront Initial Margin amount provided by the Clearing Member to cover the aggregate potential exposure on the nominal value of trades to be executed for its own account or by its Clients.

II. Access to the trading system may be restricted by the Exchange where the exposure limit has been breached. Such trading system restriction will affect the account of the Clearing Member and its Clients.

6. Maintenance of Initial Margin

Collateral provided as Initial Margin shall be valued regularly, in line with FMDQ Clear's Collateral Policy. Clearing Members whose Collateral value fall below the required minimum for Initial Margin obligations as determined by the maintenance threshold shall be restricted from the trading system pending the pledge of additional Collateral.

7. Data and Calibration

The parameters used to determine Initial Margin shall, where necessary, be re-calibrated annually or more frequently as the need arises. The BIM per contract shall be revised and updated as market conditions may dictate and by way of communique, the results of this revision shall be published in advance on FMDQ Clear's website.

FMDQ Clear shall ensure that the data used to calibrate the model is consistent with market transactions and the calculation models used are robust. Data shall be obtained from the Exchange or other independent data sources and tested for normality and outliers. If outliers exist, the data shall be winsorised to limit the impact of such outliers, hence ensuring statistically valid inference.

The degree of confidence, the MPOR or time horizon for the liquidation of open Positions and the selection of the historical look-back period may be revised, as part of the annual review of this document or as the need arises, commensurate to the observed risks in the macroeconomic, financial markets and regulatory landscape.

8. Back-Testing

Back-testing shall be used to provide assurance on the implementation of the Initial Margin model in its entirety. The Initial Margin parameters shall be back-tested daily, and the results reviewed over a 250-day-a-year horizon.

9. Model Validation

Independent validation shall be conducted on an annual basis to validate the Initial Margin model and to certify the assumptions used to determine the parameters. In addition, the Initial Margin Methodology and its implementation are validated whenever any significant change to the model is made. The independent validation shall be carried out by a body external to FMDQ Clear.