



# Default of a client, Trading Member or Clearing Member in the Derivatives Market

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## 1. References

Document	Author	Version	Issue Date
Derivatives Rules	JSE		
Securities Services Act			
Insolvency Act			

## 2. Version Control

Version	Author	Date	Reason for Changes
0.01 Draft	Brett Kotze	31/07/2012	Document creation.
1.00 Final	Brett Kotze	01/10/2012	Update with comments and move to final

### 3. Introduction

Currently the JSEs Rules for the Derivatives Market (Equities and Commodities) and IRC Market (Interest Rates (including cash bonds) and Currencies) cover the default of a client, Trading Member or Clearing Member but there is no procedural document.

The purpose of this document is to define the processes of default and thereby the functionality required for when there is a default of a client, Trading Member or Clearing Member.

Once agreement has been reached internally, the processes of default, as detailed in the final version of this document, will have to be discussed and agreed with the Trading Members and Clearing Members for their comment and agreement. This will also assist with the potential changing of the Derivatives and IRC Rules to cater for default as detailed in this document.

This document has been created in line with the recommendations put forth by principle 13 ("Participant-default rules and procedures") of the *"Principles for Financial Market Infrastructures"*, as published by the Committee on Payment and Settlement Systems (CPSS) at the Bank for International Settlements and the Technical committee of the International Organization of Securities Commissions (IOSCO).

## 4. Insolvency Act

The Insolvency Act, 1936 (Act 24 Of 1936) amended for the Securities Service Act promulgated in February 2005 states the following;

### 35A Transactions on an exchange

(1) In this section-

'exchange' means an exchange as defined in section 1 and licensed under section 10 of the Securities Services Act, 2004, and for the purpose of this section includes a central securities depository as defined in section 1 of that Act and which is also licensed as a clearing house under section 66 of that Act, or a clearing house as defined in section 1 of that Act”;

'market participant' means an authorised user, a participant, a client or a settling party as defined in section 1 of the Securities Services Act, 2004, or any other party to a transaction”;

'exchange rules' means the exchange rules and depository rules as defined in section 1 of the Securities Services Act, 2004.

'transaction' means any transaction to which the rules of an exchange apply.

(2) If upon the sequestration of the estate of a market participant the obligations of such market participant in respect of any transaction entered into prior to sequestration have not been fulfilled, the exchange in question in respect of any obligation owed to it, or any other market participant in respect of obligations owed to such market participant, shall in accordance with the rules of that exchange applicable to any such transaction be entitled to terminate all such transactions and the trustee of the insolvent estate of the market participant shall be bound by such termination.

(3) No claim as a result of the termination of any transaction as contemplated in subsection (2) shall exceed the amount due upon termination in terms of the rules of the exchange in question.

(4) Any rules of an exchange and the practices thereunder which provide for the netting of a market participant's position or for set-off in respect of transactions concluded by the market participant or for the opening or closing of a market participant's position shall upon sequestration of the estate of the market participant be binding on the trustee in respect of any transaction or contract concluded by the market participant prior to such sequestration, but which is, in terms of such rules and practices, to be settled on a date occurring after the sequestration, or settlement of which was overdue on the date of sequestration.

(5) Section 341 (2) of the Companies Act, 1973 (Act 61 of 1973), and sections 26, 29 and 30 of this Act shall not apply to property disposed of in accordance with the rules of an exchange.

## 5. Current Rules

Section 12 of the Derivatives Rules provides for the following for Default;-

### 5.1 Default of Client

#### 12.10A Default by a client

A client shall default if –

- 12.10A.1 he fails to fulfil any of his obligations in terms of a trade or a position; or
- 12.10A.2 the JSE, in its sole discretion, considers that he has defaulted; or
- 12.10A.3 he is in default with respect to one particular member and the JSE in its discretion decides that he is in default with respect to any other member.

#### 12.20 Consequences of a client's default

Without limiting or detracting from any other remedies and rights which a member may have against a client, in the event of default by a client -

- 12.20.1 the client shall, save as provided in this rule, be suspended from trading through the member;
- 12.20.2 the member shall close out the positions of the client by trading to transfer those positions to himself and for his own account at a price approved by the JSE within two business days or such other period as may be determined by the JSE from the date of default;
- 12.20.3 any amount payable by the member to the client as a result of such close out or arising from any suretyship, cession, pledge or other security or from any other cause shall be set off against any amount payable by the client in terms of rule 8.90.7;
- 12.20.4 any shortfall remaining after the application of these derivatives rules shall be recovered from and any balance paid to the client.

### 5.2 Default of Trading Member

#### 12.10 Default by a member

A member shall default if -

- 12.10.1 he fails to fulfil any of his obligations in terms of a trade or a position; or
- 12.10.2 his membership is terminated; or
- 12.10.3 the JSE, in its sole discretion, considers that he has defaulted.

#### 12.30 Consequences of default by a trading member

Without limiting or detracting from any other remedies and rights which a member or client or the clearing house may have against a trading member, in the event of default by a trading member –

- 12.30.1 the trading member shall, save as provided in this rule, be suspended from trading;
- 12.30.2 the clearing member shall close out the proprietary positions of the trading member by trading to transfer those positions to himself and for his own account at a price approved by the JSE within two business days or such other period as may be determined by the JSE from the date of default;
- 12.30.3 any amount payable to the trading member as a result of such close out or arising from any suretyship, cession, pledge or other security or from any other cause shall be set off against any amount payable by the trading member in terms of rule 8.90.4;
- 12.30.4 if after all the above rules have been exhausted a shortfall remains, any JSE shares held by the trading member may be sold by the JSE and the proceeds utilised towards settlement of any remaining shortfall, and any surplus paid to the trading member;
- 12.30.5 any shortfall remaining after the application of these derivatives rules shall be recovered from and any balance paid to the trading member;
- 12.30.6 the clients of the trading member shall, without notice to such clients, become the clients of the clearing member , and-
  - 12.30.6.1 the clearing member shall assume the obligations of the trading member in terms of rule 8.90.7 that accrued on the date of default or on the previous business day;
  - 12.30.6.2 all clients who did not previously have client agreements with the clearing member shall conclude client agreements with the clearing member to cover the positions and obligations assumed by the clearing member ; and
  - 12.30.6.3 where the clearing member previously had a client agreement with the client of the trading member , such positions and obligations and subsequent trades shall be subject to that agreement;
  - 12.30.6.4 the JSE shall on request provide the clearing member with the registration and contact details of the clients of a defaulting member as supplied to the JSE; and
  - 12.30.6.5 on the default of a trading member, the clearing member shall contact the clients of such defaulting member immediately, to inform them of the default and to make arrangements for the transfer of existing client positions to the trading division of the clearing member or to another trading member.

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12.30.4 amended with effect from 1 July 2005.

12.30.6.4 introduced with effect from 31 October 2002.

### 5.3 Default of Clearing Member

#### 12.10 Default by a member

A member shall default if -

- 12.10.1 he fails to fulfil any of his obligations in terms of a trade or a position; or
- 12.10.2 his membership is terminated; or
- 12.10.3 the JSE, in its sole discretion, considers that he has defaulted.

#### 12.40 Consequences of default by a clearing member

Without limiting or detracting from any other remedies and rights which a member or client or the clearing house may have against a clearing member, in the event of default by a clearing member

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- 12.40.1 the clearing member shall, save as provided in this rule, be suspended from trading;
- 12.40.2 the clearing house shall open a separate trust account with a bank (hereinafter referred to as the "trust account"), into which shall be paid all margin due and payable, the proceeds from the sale of any JSE shares held by the clearing member, the proceeds from the suretyship referred to in rule 4.20.6 and any other moneys or securities held by the clearing house in favour of or on behalf of or for the account of the clearing member;
- 12.40.3 the clearing house shall manage the trust account and all the affairs of the clearing member arising from and relating to his membership of the JSE and -
  - 12.40.3.1 shall assume control of all assets held or administered by the clearing member on behalf of or for the account or benefit of any member or client, and, when requested by the JSE, render such reports to the JSE as the JSE may require;
  - 12.40.3.2 shall, without prior notice to the clearing member, close out all the proprietary positions of the clearing member at the best price it can obtain when, in its sole discretion, it so decides;
  - 12.40.3.3 any amount payable to the clearing member as a result of such close out or arising from any suretyship, cession, pledge or other security or from any other cause, shall be set off against any amount payable by the clearing member in terms of rule 8.90.1;
  - 12.40.3.4 if after all the above rules have been exhausted a shortfall remains, any JSE shares held by the clearing member may be sold by the JSE and the proceeds utilised towards settlement of any remaining shortfall, and any surplus paid to the clearing member;
  - 12.40.3.5 any shortfall remaining after the application of these derivatives rules shall be recovered from and any balance paid to the clearing member;
  - 12.40.3.6 transfer all positions of clients and trading members cleared through the clearing member to another clearing member until

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12.40.2 amended with effect from 1 July 2005.

12.40.2 amended with effect from 1 August 2005.

12.40.3.4 amended with effect from 1 July 2005.

such time as the provisions of rule 12.40.5 have been complied with: Provided that the clearing house shall be entitled to appoint a trustee to exercise all its powers in terms of this rule subject to the trustee being entitled to the same indemnity as the clearing house.

- 12.40.4 within a period decided by the JSE each trading member with whom the defaulting clearing member had a clearing agreement shall conclude a clearing agreement with another clearing member, failing which the trading member shall be deemed to be in default and his membership shall terminate;
- 12.40.5 the clients of the clearing member shall within a period determined by the JSE -
  - 12.40.5.1 enter into client agreements with other members and trade with the clearing house and such other members to transfer their positions to them, or
  - 12.40.5.2 trade with the clearing house to close out their positions;
- 12.40.6 after all liabilities of the defaulting clearing member have been settled, the amounts paid by any surety in terms of the derivatives rules shall be refunded from any balance remaining in the trust account and any further balance remaining shall be paid to the defaulting clearing member: Provided that if there are insufficient funds to cover such liabilities, the clearing house shall call on all clearing members for an equitable contribution on a voluntary basis to make good any shortfall and, in the event of such contributions being insufficient, the funds of the Fidelity Fund shall be applied.

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12.40.6 amended with effect from 2 November 2004.

12.40.6 amended with effect from 1 August 2005.

## **6. Current Market Practices**

Although the past Rules and the current Rules updated in terms of the Securities Services Act have stipulated the requirements for default and are therefore covered by the Securities Services Act and the Insolvency Act other market practices have been developed (and currently prevail) in the market over time due to either system limitations or what was believed as better risk management by various participants. The obvious concern is that if the market practices are not covered by the Rules then the participants have non protection under the Securities Services Act not the Insolvency Act.

### **6.1 Default of client**

The Trading Members themselves coordinate this and currently the business practice is that the Trading Member will trade out of the positions on the defaulted client code as soon as possible. Very seldom do they transfer the positions onto their own account, as it is far easier for the member to manage the exposure with the positions separated from their own trading accounts. The exchange at all times has a full audit trail of the positions closed at the relevant price levels.

### **6.2 Default of a Trading Member**

This is coordinated by the Clearing Member and Exchange and involves the Trading Member and any clients that may be registered. The exchange also has the right to declare a default. All trading rights of the defaulted member are removed. However to ensure the process is managed efficiently, the trading arm of the Clearing Member is given access to execute on the defaulted members code. This then allows the Clearing Member to manage all client positions with the same client codes and also ensures that the defaulted Trading Members' positions are ring fenced and clearly identified. In most instances the client's positions are transferred to other Trading Members once they have opened up new accounts. This ensures minimum impact to the client.

The defaulted Trading Member's positions are closed, hedged or transferred to the Clearing Member's account. However these positions are often closed as soon as possible in the market place on the Clearing Members account. Once again full audit trails exist which ensure that the exchange has the ability to confirm the full costs applicable for closing the positions. Should positions be transferred to the member this is again only done once the defaulted member is totally wound down with all clients' positions moved to other parties.

The CDM market has facilitated a number of these with the surveillance department and relevant Clearing Member and in all instances the above process has proved most beneficial to the clients. The fact that the defaulted members positions are isolated allows the Clearing Member to manage the default far more efficiently as this does not have a direct impact on the positions held at the firms trading arm.

Once all positions has been transferred or closed the defaulted members code is deactivated.

### **6.3 Default of a Clearing Member**

The exchange also has the mandate to declare a Clearing Member default. The same functionality used when a Trading Member defaults can potentially also assist with transferring remaining members and clients to other Clearing Members.

In all instances where positions have to be transferred, the exchange is the only party who will have access to this functionality, this ensures complete control over all default proceedings.

## 7. Default Procedures

It is believed that that the Derivatives Rules relating to default are outdated in places, and that the market practices, where appropriate, should prevail.

The procedures as agreed by the market are as follows:

### 7.1 Default of Client

- 7.1.1 The Client must have a Client Agreement with their Trading Member which must contain the requirements as set out in the JSE's Rules and Directives which covers the below;
- 7.1.2 The client is suspended from trading by the Trading Member;
- 7.1.3 Trading Member notifies the Surveillance Division of the default of their client and supplies the necessary documentary proof. At the same time the Trading Member notifies the Clearing Member;
- 7.1.4 Surveillance Division after due consideration and at their discretion, if the client is with another Trading Member as well, may place the client into default with the other Trading Member.i.e. The client could be a client of several Trading Members. Therefore the client may be defaulted with each Trading Member;
- 7.1.5 Market Notice sent to the market advising the details of the client that has defaulted. Other Trading Members that have accounts for the same client will contact Surveillance to confirm if the account in their books must also be defaulted;
- 7.1.6 The client's account is updated to a suspended status on the Trading System (including Deal Management) and the Clearing System but the Trading System allows for the Trading Member to trade out any open positions out on the clients account. NOTE - The system should limit the Trading Member to trade out any open positions but not to open any new positions for the clients account;
- 7.1.7 The Trading Member will also have the right to transfer the client's open positions to a proprietary sub-account to trade the open positions out. The member shall close out the positions of the client by trading to transfer those positions to himself and for his own account at a price approved by the JSE within two business days or such other period as may be determined by the JSE from the date of default
- 7.1.8 Once all open positions have been closed or transferred the client's account will be updated to a terminated status;
- 7.1.9 On receipt of the notification a Proprietary sub-Account is opened under the Trading Member automatically by the systems dealing with default;
- 7.1.10 The clients positions will be transferred to the Proprietary sub-Account at the closing price for that day or a price entered into the systems by the Trading Member;
- 7.1.11 The open positions will be transferred as trades between the clients account and the Proprietary sub-Account.
- 7.1.12 The trades created for transferring the positions for default will be done at "zero fees";
- 7.1.13 In the case where the Trading Member trades out any open positions on the defaulting clients account, normal initial margin, variation margin and booking fees will be generated for any transactions entered into by the Trading Member by the Clearing System which will be processed through the Clearing Member through the normal sequence of events. The Trading Member must account for the trading out of the open positions and any profits and/or losses will be retained by the Trading Member until all the open positions across all market (if the client is trading across markets) have been traded out and where the Trading Member will return any residual profit to the client or claim any residual losses against the estate with the assumption that the client is put into liquidation;

- 7.1.14** In the case where the Trading Member transfers the defaulting client's open positions to a proprietary sub-account, initial margin and variation margin for the closing of the open positions and opening the positions under the Trading Member's proprietary sub-account will be generated by the Clearing System which will be processed through the Clearing Member through the normal sequence of events. The Trading Member must account for the trading out of the open positions and any profits and/or losses will be retained by the Trading Member until all the open positions across all market (if the client is trading across markets) have been traded out and where the Trading Member will return any residual profit to the client or claim any residual losses against the estate with the assumption that the client is put into liquidation; and
- 7.1.15** Interest will be calculated and paid by the Clearing System to the applicable Clearing Member, who in turn will process the interest to the Trading Member, for the initial margin held under the defaulting client's account until the positions are traded out, by either the Trading Member trading the open positions out on the client's account or the Trading Member transferring the open positions to the Trading Member's proprietary sub-account. In the case where the Trading Member transfers the open positions to the Trading Members proprietary sub-account interest will only be accrued to the defaulting clients account until such time as the open position was transferred to the Trading Members proprietary sub-account, following which the interest will be calculated on the initial margin held for the Trading Member as a proprietary position. This will be paid at the end of the current calendar month. The Trading Member must account for the interest and the interest will be retained by the Trading Member until all the open positions across all market (if the client is trading across markets) have been traded out and where the Trading Member will return any residual profit to the client or claim any residual losses against the estate with the assumption that the client is put into liquidation.

## **7.2 Default of Trading Member**

- 7.2.1** The Trading Member must have a Clearing Agreement with their Clearing Member which must contain the requirements as set out in the JSE's Rules and Directives which covers the below;
- 7.2.2** Clearing Member suspends the Trading Member from trading;
- 7.2.3** Clearing Member notifies the Surveillance Division of the default of their Trading Member and supplies the necessary documentary proof;
- 7.2.4** Surveillance Division after due consideration and at their discretion puts the Trading Member into default;
- 7.2.5** Market Notice sent to the market advising the details of the Trading Member that has defaulted
- 7.2.5** The Trading Member must be updated to a suspended status on the Trading System (including Deal Management) and the Clearing System but the Trading System must allow for the Clearing Member to trade out any open proprietary positions on the Trading Member accounts and to continue to trade for the defaulting Trading Members clients. The Trading System should limit the Clearing Member to only trade out any open proprietary positions on the defaulting Trading Member's accounts but not to open any new positions for the defaulting Trading Members;
- 7.2.6** The Clearing Member will also have the right to transfer the defaulting Trading Members open positions to a proprietary sub-account under their Trading Member leg to trade the open positions out. The Clearing Member shall close out the proprietary positions of the Trading Member by trading to transfer those positions to himself and for his own account at a price approved by the JSE within two business days or such other period as may be determined by the JSE from the date of default. This also includes the transferring of the clients of the defaulting Trading Member – covered under portability;
- 7.2.7** On receipt of the notification, a Proprietary sub-Account in the name of the defaulting Trading Member is opened under the Trading Member leg of the Clearing Member automatically by the systems dealing with default;
- 7.2.8** Also on receipt of the notification, the client's accounts under the defaulting Trading Member will be automatically opened under the Trading Member leg of the Clearing Member by the systems dealing with default. All reference and static data associated to the client's account, including banking details, will also be transferred across to the new accounts opened;
- 7.2.9** The defaulting Trading Member's proprietary positions will be transferred to the Proprietary sub-Account of the Trading Member leg of the Clearing Member at the closing price for that day or a price entered into the systems by the Clearing Member;
- 7.2.10** The positions will be transferred as trades between the Defaulting Trading Members account and the Proprietary sub-Account of the Trading Member leg of the Clearing Member;
- 7.2.11** The trades created for transferring the positions will be done at "zero fees";
- 7.2.12** The clients positions of the defaulting Trading Member will be transferred to the accounts opened under the Trading Member leg of the Clearing Member at the closing price for that day or a price entered into the systems by the Clearing Member;
- 7.2.13** The client's positions will be transferred as trades between the Defaulting Trading Member and the Trading Member leg of the Clearing Member;
- 7.2.14** The trades created for transferring the positions for the clients will be done at "zero fees";
- 7.2.15** In the case where the Trading Member leg of the Clearing Member continues to trades for the defaulting Trading Members clients, under the defaulting Trading Member, initial margin, variation margin and booking fees will be generated under the defaulting Trading Member for any transactions entered into by the by their Trading Member leg, by the Clearing System, which will be processed through the Clearing Member through the normal sequence of events;

- 7.2.16** In the case where the Clearing Member through their Trading Member leg trades out any open positions on the defaulting Trading Member accounts, normal initial margin, variation margin and booking fees will be generated under the defaulting Trading Member for any transactions entered into by the Clearing Member through their Trading Member leg, by the Clearing System, which will be processed through the Clearing Member through the normal sequence of events. The Clearing Member must account for the trading out of the open positions and any profits and/or losses will be retained by the Clearing Member until all the open positions across markets (if Trading Member is trading across markets) have been traded out and where the Trading Member will return any residual profit to the client or claim any residual losses against the estate with the assumption that the defaulting Trading Member is put into liquidation;
- 7.2.17** In the case where the Clearing Member transfers the defaulting Trading Members open positions and their clients to their Trading Member leg, initial margin and variation margin for the closing of the open positions and opening the positions under the Clearing Members Trading Member leg will be generated by the Clearing System which will be processed through the Clearing Member through the normal sequence of events. With regard to the defaulting Trading member the Clearing Member must account for the trading out of the open positions and any profits and/or losses will be retained by the Clearing Member until all the open positions across markets (if Trading Member is trading across markets) have been traded out and where the Clearing Member will return any residual profit to the client or claim any residual losses against the estate with the assumption that the defaulting Trading Member is put into liquidation;
- 7.2.18** Interest will be calculated and paid by the Clearing System to the applicable Clearing Member for the initial margin held for the defaulting Trading Member until the open positions are traded out, by either the Trading Member trading the open positions out on the defaulting Trading Member or the Clearing Member transferring the open position to their Trading Member leg. In the case where the Clearing Member transfers the open position to their Trading Member leg interest will only be accrued to the defaulting Trading Member account until such time as the open positions are transferred to their Trading Member leg, following which the interest will be calculated on the initial margin held for the Trading Member leg as a proprietary position. This will be paid at the end of the current calendar month. The Clearing Member must account for the interest and the interest will be retained by the Clearing Member until all the open positions across markets (if the Trading Member is trading across markets) have been traded out and where the Clearing Member will return any residual profit to the client or claim any residual losses against the estate with the assumption that the Trading Member is put into liquidation; and
- 7.2.19** Interest will be calculated and paid by the Clearing System to the applicable Clearing Member for the defaulting Trading Member's clients until such time as the clients are transferred to another Trading Member or their Trading Member leg. Until such time as the Trading Member's clients are transferred as noted, it will fall upon the Clearing Member to account to the defaulting Trading Member's clients and to pay the interest to them.

### **7.3 Default of Clearing Member**

- 7.3.1** The exchange also has the mandate to declare a Clearing Member default. This may also include discussions or agreement with other regulators such as the FSB/SARB/National Treasury;
- 7.3.2** The Clearing Member must have a Clearing House Agreement with SAFCOM which must contain the requirements as set out in the JSE's Rules and Directives which covers the below;
- 7.3.3** All cash movements through the SAFCOM PCH will be suspended immediately and the positions – clients versus Trading Member – movements will be unwound and applied down to client level;
- 7.3.4** Where clients or Trading Members are due to pay Initial or Variation Margin they will be contacted to transfer funds to the Trust Account. Where they do not fund the Trust Account this may lead to their default – see above procedures;
- 7.3.5** The Trading Member leg of the defaulting Clearing Member is suspended from trading;
- 7.3.4** A trust account is opened by the clearing house. The system is updated with the trust account to the systems for the flow of initial and variation margin for clients and Trading Members i.e. the clearing house takes on the role of the Clearing Member and all margin flows need to go through the trust account;
- 7.3.5** All proprietary positions will be traded out or hedged for the Trading Member leg of the defaulting Clearing Member by the Clearing House. Therefore the Clearing House will require a trading front end and trading access to the Trading Member leg of the defaulting Clearing Member;
- 7.3.6** The trading out of the positions could include the selling of the book to another Trading Member or Clearing Member at agreed prices. This will involve a Proprietary sub-Account being automatically opened at another Trading Member by the systems;
- 7.3.7** In the case where the book is sold at agreed prices, the positions will be transferred as trades to the Proprietary sub-Account of the Trading Member at the agreed prices. A trade type specific to the clearing system for default will have to be introduced to cater for this;
- 7.3.8** The trades created for transferring the positions will be done at “zero fees”;
- 7.3.9** Interest will be calculated and paid by the clearing system to the trust account for the initial margin held for the defaulting Clearing Members Trading Member leg until the positions are closed out as per the above, at the end of the calendar month;
- 7.3.10** All initial and variation margin, booking fees and interest dealing with the closed out positions will be processed through the trust account and managed by the clearing house;
- 7.3.11** The Trading Members and their clients that the Clearing Member clears for have to be transferred to another Clearing Member – refer portability. All reference and static data associated with the Trading Members and their clients account, including banking details, will also be transferred across to the new accounts opened;
- 7.3.12** The Trading Members and their clients positions will be transferred to the to the new Clearing Member at the closing price for that day;
- 7.3.13** The positions will be transferred as trades between the Defaulting Clearing Member and the new Clearing Member;
- 7.3.14** The trades created for transferring the positions will be done at “zero fees”;

- 7.3.15** The initial and variation margin for the transfers in the Trading Members and their clients positions to the new Clearing Member will be processed through the trust account. These funds will be passed to the new Clearing Member who will process through their books. In the case of initial margin this will be a straight refund and call which should net off to zero unless further positions have been opened. In the case of variation margin, as this is done as an end of day process, it is the same as the current m-t-m process. Therefore any profits will be processed to the new Clearing Member and any losses will be called for. The Clearing Member will then process the variation margin to the Trading Member who in turn will process to the client as per normal processes catered for by the Clearing Members;
- 7.3.16** Interest will be calculated and paid by the clearing system to the trust account for the initial margin held under the old Clearing Member for the Trading Members and clients they were clearing for. This must be accounted for in the old Clearing Member's systems and statements generated but the margin will be paid to the new Clearing Member who in turn will pay same to the Trading Member and the Trading Member to their clients where applicable.

## **8. Testing of Default Procedures**

The contents of this document require the ratification of both the SAFCOM Advisory Committee, as well as the SAFCOM Board. Once this approval has been secured, the document will form the basis for an annual test of these procedures – also known as a “fire-drill” – which will involve all market participants, and assessment of their abilities to fulfill all obligations (from both an operations and system capabilities perspective) in a default instance.

The outcomes of these annual tests should be used to identify and resolve operational issues that may prohibit all parties from complying with the Default Procedures. It should also serve as an ongoing education tool, reinforcing the expectations placed on all participants in a default situation. The results of the tests should be shared with the members of the SAFCOM Board and Risk Committee, and well as with the operational heads of the respective market participants involved in each test.

## 9. Way forward

The Derivatives Rules relating to default are outdated in places, and that the market practices, where appropriate, should prevail and the Derivatives Rules should be changed in due course. In terms of this the recommended way forward is as follows;

- Agreement by business of the processes detailed in this document;
- Agreement by Trading Members and Clearing Members of the processes detailed in this document;
- Definition of an approach and schedule for the execution of the testing of these processes; and
- Updating of the Derivatives Rules.