

JSE CLEAR DEFAULT MANAGEMENT POLICY

April 2020

TABLE OF CONTENTS

1. Version Control 3

2. Version History..... 3

3. Introduction 4

4. Objective of the default management Policy 4

5. Roles and responsibilities 4

6. Pre-default activities..... 5

 6.1. Fire Drills..... 5

 6.2. General risk management activities & reporting readiness 5

 6.3. Consultation with the authorities 6

7. Default activities activation..... 6

8. Default Management..... 6

 8.1. Trading ability and referenced collateral 6

 8.2. Un-allocated positions..... 7

 8.3. Position termination..... 7

 8.4. Liquidity 7

9. Communication 7

10. Post default Activities..... 8

 APPENDIX 1 - JSE CLEAR RISK COMMITTEE AND BOARD ACTIONS 9

1. VERSION CONTROL

Created By:	Post Trade Services Division
Creation Date:	13 April 2018
To be approved by:	JSE Clear Risk Committee JSE Clear Board
Version:	2.0
Last update:	April 2020

2. VERSION HISTORY

Version	Date	Summary of changes	Author
1.0	April 2018	Initial Draft of Policy	Post-trade Risk
2.0	April 2020	Regular review, minor updates	Post-trade Risk

3. INTRODUCTION

JSE Clear is a central counterparty (CCP) which clears exchange traded derivative products in the South African financial market. Through novation, JSE Clear becomes the seller to every buyer and the buyer to every seller. Clearing members are admitted to guarantee, process and clear payments of their trading members, and the clients of those trading members, to the CCP. JSE Clear has designed its risk management framework to ensure that in the unlikely event of a clearing member default, JSE Clear will have sufficient pre-funded resources to ensure that the defaulter's obligations are still fulfilled.

This policy covers how JSE Clear will manage the default of a clearing member in accordance with the JSE Derivative Rules¹.

4. OBJECTIVE OF THE DEFAULT MANAGEMENT POLICY

The objective of the default management policy is to ensure that the actions required to resolve a default event are executed in an orderly and timely fashion, and that disruption to the markets operated by JSE Clear is minimised to the greatest extent possible. The desired outcome of successfully managing a default event is the maintenance of business-as-usual clearing activities for the market throughout the resolution of the defaulting Clearing Member and its portfolio.

The default management policy should make the resolution process of a default transparent while ensuring that there is sufficient flexibility for the CCP and decision makers to manage the default process effectively while still maintaining the market. The policy assigns clear responsibilities and accountabilities for actions required for the resolution of the default.

5. ROLES AND RESPONSIBILITIES

The JSE Clear Board is responsible for approving this policy, upon recommendation by the JSE Clear Risk Committee.

The Default Management Group Committee (DMGC) of JSE Clear is responsible for carrying out the activities required for the management of a clearing member default. The members of the DMGC are:

- JSE Clear Responsible Officer (chairman);
- JSE Head of Market Regulation;
- JSE Clear Head of Risk; and
- JSE Clear Head of Operations

¹ References to the Rules or JSE Derivatives Rules include the JSE Interest Rate and Currency Rules

6. PRE-DEFAULT ACTIVITIES

6.1. Fire Drills

JSE Clear should perform a clearing member default simulation, or fire-drill, at least annually and should involve all clearing members. The primary purpose of the fire-drill is to ensure market readiness, including testing of processes and tools, should a default event actually occur.

The JSE Clear Risk Committee should agree on the scenario to be tested prior to the fire-drill date, and JSE Clear will advise all market participants of the scenario, along with the expectation of their involvement prior to the fire-drill date. In general, sufficient time will be afforded for all market participants to prepare adequately for the fire-drill. Different aspects of the default process may be tested, but generally the test will include testing of:

- Lines of communication between JSE Clear, Clearing Members and the Regulators, amongst others;
- Closeout of positions, including the prices at which closeout occurs;
- Porting of non-defaulting clients to alternative clearing members; and
- Usage and availability of dedicated lines of liquidity.

Enhancements to the default management processes and tools are to be identified and implemented appropriately. The JSE Clear Risk Committee should be briefed on the outcome of the fire-drills shortly after their completion.

6.2. General risk management activities & reporting readiness

JSE Clear should ensure that at all times it maintains, in a readily accessible manner, all information required to manage a clearing member default in a prudent manner. Such information includes:

- Derivative positions for each account (trading member house account and client account) cleared through each clearing member;
- Variation margin obligations for each account (trading member house account and client account) cleared through each clearing member;
- Initial margin balances (including cash and securities) for each account (trading member house account and client account) cleared through each clearing member;
- Reports indicating the potential variation margin obligations, under stressed market conditions, for each account (trading member house account and client account) cleared through each clearing member;
- Contact lists for representatives and alternate representatives of clearing members, including after-hours and cellular telephone numbers.

6.3. Consultation with the authorities

A single communication protocol has been established with the Prudential Authority and the Financial Sector Conduct Authority ('the authorities') to be used during clearing member default management. All clearing members are regulated by both authorities under the Financial Sector Regulation Act and hence both should be consulted in the process of default resolution.

7. DEFAULT ACTIVITIES ACTIVATION

The DMGC will take the decision to commence default management activities, as per the DMGC terms of reference. When considering this decision, the DMGC will consult the authorities. The DMGC will also engage with the SARB in accordance with the memorandum of understanding between the JSE and the SARB which governs the process that must be followed by the JSE in order to seek the SARB's concurrence on the default of a clearing member in terms of section 31 of the FSR Act.

A default of a clearing member occurs when a clearing member fails to make full payment of its obligation due to JSE Clear by the time that payment is due; or the clearing member or regulatory authorities, informs JSE Clear that it will be unable to make a payment that will become due; or their membership is involuntarily terminated.

It is the clearing member's responsibility to ensure that payment obligations are met regardless of any operational impediment they may be experiencing to the processes or systems. The clearing member remains responsible to find an alternative means of making the payment to JSE Clear within the expected timeframes.

Involuntary membership termination may occur if a clearing member is placed under business rescue or curatorship.

Once default has been established by the DMGC, the JSE Clear default management activities will be invoked, and the defaulting trading members and/or clients of the defaulting clearing member will be identified and dealt with according to the JSE Rules.

8. DEFAULT MANAGEMENT

The actions of the DMGC will be to protect non-defaulting market participants and to ensure that the obligations of the defaulting clearing member are fulfilled, to the extent reasonably possible.

8.1. Trading ability and referenced collateral

The DMGC will ensure that permission to trade for the defaulting clearing member and the parties for whom it clears is revoked and they will be suspended from trading and performing deal management. The affected entities will no longer be allowed to register accounts in their name, and movement of collateral out of their accounts will be blocked.

8.2. Un-allocated positions

In instances where there are unallocated positions for the defaulting clearing member's own trading member, or any other defaulting trading member of the defaulting clearing member, the DMGC will attempt to identify the underlying clients for whom the trades were executed. Should there remain unallocated positions after a reasonable time, the unallocated positions will be moved to defaulting trading member's house account and netted against the other positions within this account.

8.3. Position termination

The DMGC will re-establish a matched book as soon as is practical. The DMGC will request JSE Clear to facilitate auctions, per asset class, for the entire set of derivative positions, within the particular asset class, and belonging to all defaulting entities. All trades resulting from the auction will be booked by JSE Clear on behalf of the defaulting entities. The DMGC will repeat this exercise until all positions are sold. If auction bids received are such that a reasonable price, as determined by JSE Clear, is not obtained for a position or positions through the auction, JSE Clear may close out the position/s at a price that it determines.

8.4. Liquidity

JSE Clear will use the defaulters' cash initial margin to pay variation margin which is immediately due as a result of market moves and as a result of the sale of the portfolio. Upon the sale of collateral, JSE Clear will call on the liquidity facilities it has arranged to fund any variation margin requirements - in line with the Rules and liquidity policy. JSE Clear will re-pay the liquidity facilities upon receipt of the proceeds from the sale of collateral.

9. COMMUNICATION

The DMGC will, immediately upon the decision to activate default management activities, communicate such information to the authorities, in accordance with paragraph 5.3 of this policy. Throughout the default management process, the DMGC will communicate key activities to the authorities. Events and activities that will be communicated will include the decision to institute default management activities, the initiation of the sale of the defaulter's portfolio, the completion thereof, the accessing of any liquidity lines, and the finalization of default activities.

The DMGC will also immediately communicate the decision to institute default management activities to the JSE Clear Board and JSE Clear Risk Committee, and will keep members of both committees abreast of actions being taken throughout the default management process.

The DMGC will also be responsible for communication with the JSE, JSE Clear's clearing members and the wider market. The DMGC will consider the nature and extent of its communication in line with relevant law, the rules and the objectives of this policy.

10. POST DEFAULT ACTIVITIES

After the resolution of the default, when all profit and losses have been funded by the defaulter's prefunded resources (in line with the Rules), any remaining funds will be returned to the defaulter. Prior to any unutilized funds being released back to the defaulter, all applicable fees and charges that arose during the default management process will be settled.

After the conclusion of default activities, a full reconciliation of the default management process will be conducted. This reconciliation will include a review of the actions of the DMGC, the sale of the defaulter's portfolio in terms of process, prices and proceeds, and the sale of collateral.

JSE Clear will conduct a solvency assessment on its own operations, which will include regulatory and economic capital, and will implement appropriate actions to ensure that the prescribed thresholds are re-established.

JSE Clear will check that all accounts that were ported have appropriate legal documentation concluded.

APPENDIX 1 - JSE CLEAR RISK COMMITTEE AND BOARD ACTIONS

No.	Ref	Action Item	Frequency	Applicable Governance Forum
1.	5	The JSE Clear Board is responsible for approving the Default Management policy, upon recommendation by the JSE Clear Risk Committee.	Annual	<ul style="list-style-type: none"> • JSE Clear Risk Committee • JSE Clear Board
2.	6.1	The JSE Clear Risk Committee should agree on the scenario to be tested prior to the fire-drill date	Annual	<ul style="list-style-type: none"> • JSE Clear Risk Committee
3.	6.1	The JSE Clear Risk Committee should be briefed on the outcome of the fire-drills shortly after their completion.	Annual	<ul style="list-style-type: none"> • JSE Clear Risk Committee
4.	9	The DMGC will also immediately communicate the decision to institute default management activities to the JSE Clear Board and JSE Clear Risk Committee, and will keep members of both committees abreast of actions being taken throughout the default management process	Not specified	<ul style="list-style-type: none"> • DMGC