

KEY ASPECTS OF THE DEFAULT MANAGEMENT PROCEDURES OF NASDAQ CLEARING AB

Circumstances which constitute a “default”

The circumstances when a clearing member of Nasdaq Clearing AB could be considered to be in default are stated in section 1.8 in the Clearing Rules of Nasdaq Derivatives Markets (“FIN rules”) and in section 8 in the General terms of the Clearing Rules – Commodity Derivatives (“COM rules”), respectively (together “Rules and Regulations”). These include an actual or an anticipated breach of the Rules and Regulations governing Nasdaq Clearing’s operations and circumstances where a clearing member is no longer deemed suitable, e.g., as a consequence of its insolvency, the withdrawal of its license or its suspension from another exchange or clearing house.

The default process and decision-making

The Default Committee is the decision-making body within Nasdaq Clearing for declaring a clearing member in default and deciding which actions to be taken as permitted under the Rules and Regulations of Nasdaq Clearing as well as any applicable legal agreements.

Default situations due to clearing members not having met their end-of-day margin requirement, default fund requirement or intra-day margin call requirement two hours past the deadline, will be escalated directly to the Default Committee. Other types of default situations might first be escalated to the Credit Committee and then handed over to the Default Committee, if the Credit Committee assesses that the Default Committee should evaluate whether it should be assessed as a default event. The compositions of the Default Committee and the Credit Committee are made to ensure that all decisions made are well informed.

Members of the Credit Committee:

- Chief Risk Officer (Chairperson)
- Chief Executive Officer (CEO)
- Head of Clearing Risk (Secretary)
- Legal Counsel
- Head of CCP Treasury
- Internal Audit (Observer)

A Credit Committee quorum comprises at least three members of the Credit Committee.

Members of the Default Committee:

- Head of Clearing Risk (Chairperson)
- Chief Risk Officer (Secretary)
- Chief Executive Officer (CEO)
- Legal Counsel
- Head of CCP Treasury
- Chief Compliance Officer (CCO) (observer)
- Any other person(s) deemed appropriate by the chairperson of the Default Committee during a default situation (observer)

A Default Committee quorum comprises at least three members of the Default Committee and must include the chair and either the CRO or the CEO. The Chief Compliance Officer only has an advisory role.

Management of non-compliant members

Nasdaq Clearing is continuously reviewing clearing members to ensure that they fulfill the member requirements, as stipulated in the Rules and Regulations of Nasdaq Clearing. In case of a breach of any of the requirements, the breach will be escalated to the Credit Committee. The Credit Committee will decide on actions, depending on the breach and in accordance with Rules and Regulations of Nasdaq Clearing, to mitigate the risk with the situation. The Credit Committee will escalate the situation to the Default Committee as a default situation, if the Credit Committee assesses that the Default Committee should consider this as situation or circumstances that will not be solved within two months.

Possible risk mitigating actions include:

- Extra-ordinary margin add-on (Credit Committee)
- Reduce exposure (Credit Committee)
- Decrease exposure limit (Credit Committee)
- Suspension (Default Committee)
- Termination (Default Committee)
- Default declaration (Default Committee)

Default management measures

If a clearing member is declared in default Nasdaq Clearing has the right to, at the expense of the defaulting party, to take one or more of the measures listed in § 1.8.18 of the FIN rules and § 8.2 of the COM rules, provided that client accounts must be treated in accordance with the rules and procedures for segregation and porting. Unless otherwise specified, Nasdaq Clearing has the right to take such measures without consulting the defaulting party in advance.

Default notification procedures

Nasdaq Clearing will announce the default on the website and through an exchange notice which will be sent out to all subscribers. Please note that only subscribers of such notice will be able to receive notifications of defaults through exchange notices. We recommend that members and members' clients subscribe to exchange notices to ensure that you receive timely and relevant information about defaults.

Nasdaq Clearing will keep relevant regulators and authorities informed throughout the default process.

Client accounts and portability

Nasdaq Clearing shall take the necessary steps to facilitate transfer of clearing transactions and collateral to a back-up member in accordance with the conditions set out in the Rules and Regulations. It is the responsibility of the client(s) of the defaulted member to nominate a back-up member committed to take on positions and collateral recorded on the defaulted member and inform Nasdaq Clearing accordingly. In the case of an individual client segregated account, the transfer of transactions and related collateral will be subject to a timely request by the individual client. In the case of an omnibus account, all clients must nominate the same back-up member committed to take on positions and collateral recorded on the same omnibus account. Nasdaq Clearing will trigger the default porting procedure unless all omnibus clients within the same omnibus account object to such transfer. The back-up clearing member shall be obliged to accept those assets and positions only where it has previously entered into a contractual relationship with the clients by which it has committed itself to do so.

The time limit for porting is 24 hours from calling the default. Where conditions for porting are not met within said time limit, Nasdaq Clearing will apply one or more of the measures listed § 1.8.18 of the FIN rules and § 8.2 of the COM rules for the relevant account and apply collateral provided against such positions as necessary, and pay out any remaining balance in the account to the relevant client(s) directly or, if the identity of the client(s) is not known to Nasdaq Clearing, to the defaulting clearing member for the account of the client(s).

Nasdaq Clearing's Risk Disclosure document¹ provides further details on the levels of protection and risks associated with the different levels of segregation in a default situation. This includes the treatment of both proprietary and client positions, funds and assets, the mechanisms to address a CCP's obligations to non-defaulting clearing members and the mechanisms to help address the defaulting clearing member's obligations to its clients.

¹ Available on <https://www.nasdaq.com/solutions/nasdaq-clearing-clearing-model>

Close-out of defaulted portfolios

The following applies if the Default Committee decides that the defaulting portfolio(s) shall be liquidated. The Default Committee has the mandate issued by the Board of Nasdaq Clearing to act in every possible way, provided that this is in accordance with the Rules and Regulations, to reduce the risk in the portfolio, which in turn reduces the risk of the non-defaulting clearing members and Nasdaq Clearing. The Default Committee decides on the close-out strategy, including how to hedge and close-out the portfolio, and will take into consideration internal and external factors at the time of the default event.

Default strategy

Nasdaq Clearing has pre-defined default management strategies for its different clearing services, approved by the Nasdaq Clearing Risk Committee. The strategies are revised at least annually and regularly tested. The default strategies include instructions in relation to:

- Risk assessment of the portfolio, including relevant risk measures
- Different options for close-out, hedging and auctioning of defaulted portfolios
- Means of execution (hedging, auction, orderbook, brokers, close out providers etc.)