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 single decision-making authority 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, while 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)
- Head of Strategy and Client Relations
- Head of Clearing Risk (Secretary)
- Deputy General Legal Counsel
- Head of CCP Finance & Business Management
- Head of Treasury EMEA – APAC (Observer)
- Internal Audit (Observer)
- Global Chief Risk Officer at Nasdaq (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 (CRO) (Secretary)
- Chief Executive Officer (CEO)
- Chief Operating Officer (COO)
- Legal Counsel
- Representative from Treasury
- Chief Compliance Officer (CCO) (observer – no quorum)
- Any other person(s) deemed appropriate by the chair of the Default Committee during a default situation

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

Non-compliant members and default procedures

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 then decide the appropriate actions within its power to handle the situation, 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
- Decrease exposure
- Decrease exposure limit
- Suspension (Default Committee)
- Default declaration (Default Committee)

Default management measures

If clearing members are declared in default, Nasdaq Clearing has the right to elect, 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.
Client accounts

Client collateral and positions may be transferred to a back-up clearing member when so required by the client(s) in the relevant account and where accepted by such back-up clearing member within the so-called porting window (24 hours). The defaulting clearing member’s approval is not required to initiate porting. In the absence of porting (i.e. where porting is not requested or is not successful) 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 Disclosure¹ document 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.

Close out of portfolios

The following is applicable 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. In this respect, there are different ways to reduce and eliminate the risk exposure:

- Open new trades/positions to create synthetic hedges (which do not need to be perfect hedges as long as they have a substantial risk reducing effect)
- Close out trades

The Default Committee decides on the process of closing out trades/reducing risk, but the process will depend on internal and external factors at the time of the default event. The Default Committee shall consider all possible ways to close down positions.

- Close out trades on the OTC market through brokers
- Close out trades directly towards clearing members: collect binding bid/ask prices from clearing members or through an auction
- Supervised close out, i.e letting the defaulting party do the close out trades by itself supervised by Nasdaq Clearing
- Close out trades on the relevant exchange, depending on liquidity and impact on market prices

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 risk measures
- Hedging methods, including available instruments
- Means of execution (auction, orderbook, brokers, close out providers etc.)