

**LCH.CLEARNET LIMITED****The Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001, Part IV****DEFAULT RULES**

1. Save where expressly stated to the contrary these Default Rules (“Rules”) have effect with regard to the provision of clearing services for all markets cleared by the Clearing House.
2.
  - (a) Words and expressions defined in the Clearing House’s Rulebook shall have the same meanings in these Rules, save that in relation to the provision of clearing services by an FCM Clearing Member, words and expressions defined in the Clearing House’s FCM Regulations shall have the same meanings in these Rules and such meanings shall prevail over any other meaning given to the relevant word or expression in the Clearing House’s Rulebook;
  - (b) A reference to a numbered Regulation in these Rules is a reference to the Regulation so numbered in the Regulations section of the Rulebook and a reference to a numbered FCM Regulation is a reference to the FCM Regulation so numbered in the FCM Regulations. A reference to a numbered Rule is a reference to the Rule so numbered in these Rules;
  - (c) The expression “relevant office-holder” in these Rules has the meaning given to it by section 189 of the Companies Act 1989 and a reference to the defaulter shall include where the context permits a reference to the relevant office-holder; and
  - (d) A reference to an agreement in these Rules is a reference to that agreement as amended, modified or varied from time to time.
3. In the event of a Clearing Member appearing to the Clearing House to be unable, or to be likely to become unable, to meet its obligations in respect of one or more Contracts, the Clearing House may (or upon the occurrence of an Automatic Early Termination Event, in which case such contracts will automatically terminate, the Clearing House will) take such steps listed in Rule 6 as in the circumstances appear to it best calculated:
  - (a) to discharge all the Clearing Member’s rights and liabilities under or in respect of all Contracts to which it is party or upon which it is or may be liable, and
  - (b) to complete the process set out in Rule 8.

Before taking any such step the Clearing House shall have regard to the interests of the members of any market that the Clearing Member may belong to and shall, where in the circumstances it is reasonably practicable to do so without prejudice to those interests if applicable or the interests of the Clearing House, consult any relevant Exchange to whose Exchange Rules open contracts registered in the name of the Clearing Member are subject. As soon as practicable after the Clearing House has elected to take any such step in relation to a Clearing Member (or in the case of an Automatic Early Termination Event as soon as practicable after the occurrence of such

event) the Clearing House shall send to such Clearing Member: (a) a notice of such step being taken or notice of the occurrence of an Automatic Early Termination Event (a "**Default Notice**"), and shall publish a copy of the Default Notice; and (b) in relation a defaulter who is a SwapClear Clearing Member, copies of any written notices received from the Individual Segregated Account Clearing Client(s) and/or any of the Omnibus Net Segregated Clearing Client(s) of that defaulter confirming their instructions for the Clearing House to arrange for a transfer or termination, close-out and re-establishment of their open SwapClear Contracts to/with the relevant Back-up SwapClear Clearing Member(s), provided, however, that the Clearing House shall have no liability for any failure to deliver such notices.

4. A Clearing Member (i) in respect of whom the Clearing House has issued a Default Notice under Rule 3; or (ii) in respect of whom an Automatic Early Termination Event has occurred is in these Rules called a "defaulter".
5. Without prejudice to the generality of Rule 3, the Clearing House may take any or all of the events under paragraphs 5(a) to (q) below to show that a Clearing Member is or is likely to become unable to meet its obligations in respect of one or more Contracts. Also, the Clearing House may from time to time by publication in a circular to Clearing Members specify criteria (including but not limited to the jurisdiction of incorporation of a Clearing Member) according to which an event under paragraphs 5(i) to (p) below will constitute an Automatic Early Termination Event:
  - (a) the Clearing Member fails duly to perform or is in breach of the Regulations, the FCM Regulations, the Procedures, or any of the terms of any agreement, understanding or arrangement with the Clearing House or the right of the Clearing Member to receive a transfer or termination, close-out and re-establishment of contracts pursuant to a Link has been suspended under Participating Exchange Rules, or a Clearing Member is a Defaulter (as defined in a Member Link Agreement to which the Clearing Member is a party);
  - (b) the Clearing Member is in breach of the terms of membership of, or is declared to be in default by, or is suspended or expelled from membership of, an Exchange, a Participating Exchange or any other recognised, designated or overseas investment exchange or clearing house;
  - (c) the Clearing Member is in breach of any Exchange Rules, Participating Exchange Rules or the rules of any recognised, designated or overseas investment exchange or clearing house;
  - (d) the Clearing Member is in breach of the terms of membership of, or is refused an application for or is suspended or expelled from membership of, a Regulatory Body or is in breach of the rules of a Regulatory Body to which it is subject or its authorisation by a Regulatory Body is suspended or withdrawn;
  - (e) a Regulatory Body takes or threatens to take action against or in respect of the Clearing Member under any statutory provision or process of law;
  - (f) the Clearing Member is in default in the payment of any sum whatsoever due and payable to the Clearing House;

- (g) the Clearing Member is in default in making or accepting a tender pursuant to Regulation 19 or in performing an open contract subject to tender or a delivery contract;
  - (h) the Clearing Member fails to pay any sum due and payable, or is otherwise in default under the terms of any agreement or threatens to suspend payment or to default under the terms of any agreement;
  - (i) in respect of the Clearing Member, a bankruptcy petition is presented or bankruptcy order made or a voluntary arrangement is approved;
  - (j) in respect of the Clearing Member, a receiver, manager or administrative receiver is appointed or a composition or scheme of arrangement is approved by the court;
  - (k) an assignment or composition is made by the Clearing Member for the benefit of creditors or any of them;
  - (l) a petition is presented for the winding up of the Clearing Member;
  - (m) an order is made for the winding up of the Clearing Member, or a resolution is passed for the winding up of the Clearing Member (save for the purpose of its amalgamation or reconstruction);
  - (n) in respect of the Clearing Member, a petition is presented or order made for the appointment of an administrator;
  - (o) the Clearing Member, being a partnership, is dissolved, or being a registered company, is dissolved or suffers its name to be struck off the register of companies;
  - (p) any step analogous to those mentioned in paragraphs (i) to (o) is taken in respect of the Clearing Member in any jurisdiction; or
  - (q) any distress, execution or other process is levied or enforced or served upon or against any property of the Clearing Member.
6. The steps which may be taken by the Clearing House under Rule 3 in respect of the defaulter or otherwise are:
- (a) to register an original contract or an FCM SwapClear Transaction (as the case may be) in the name of the defaulter or to decline to register an original contract or an FCM SwapClear Transaction (as the case may be) in the name of the defaulter or otherwise to exercise the Clearing House's discretion with regard to the defaulter under Regulation 9(c) or, in the case of an FCM Clearing Member, FCM Regulation 5(h);
  - (b) to effect a closing-out in respect of an open contract of the defaulter (whether by the entering into of a closing-out contract or otherwise) and at the option of the Clearing House to settle such contracts or to effect the transfer or termination, close-out and cash-settlement of an open contract of the defaulter by applying a price determined by the Clearing House in its discretion;
  - (c) to settle any open contract of which settlement might have been requested by the defaulter pursuant to Regulation 15(e) or 16;

- (d) to invoice a Contract, other than a SwapClear Contract or an FCM SwapClear Contract or a ForexClear Contract, of the defaulter back by way of compulsory settlement in accordance with Regulation 28 at a price or premium determined under paragraph (d) of that Regulation;
- (e) to sell any security deposited by the defaulter pursuant to Regulation 12 or, in the case of a defaulter who is an FCM Clearing Member, FCM Regulation 10, or any agreement made between the defaulter and the Clearing House by public or private sale for account of the defaulter without being obliged to obtain the defaulter's consent or any order of a court of law, and to appoint any person to execute any document for such purpose in the name and on behalf of the defaulter;
- (f) subject to the Procedures, to exercise an option of the defaulter on its behalf notwithstanding that such exercise may take place on a day which is not a day prescribed for such exercise by any relevant Exchange Rules;
- (g) to transfer an open contract of the defaulter to the account of another Clearing Member or to close-out and terminate such open contract and re-establish it with another Clearing Member, being a Clearing Member entitled and willing to have such open contract registered in its name or to transfer an open contract from the account of another Clearing Member to the account of the defaulter for the purposes of closing out an open contract registered in an account of the defaulter or for any other reason which the Clearing House considers appropriate in the circumstances without requiring the consent of any relevant Exchange;
- (h) to take such steps as may be desirable, including crediting or debiting of accounts (including margin accounts), entry into new contracts, transfer of existing contracts, reversal of contracts, or termination, close-out and re-establishment of contracts, or any other step, to preserve as far as possible the position of any client of the Clearing Member. Where an open contract is transferred or closed-out, terminated, and re-established under paragraph (g), without requiring the consent of the relevant Exchange, to transfer (whether by way of transfer or by way of termination, close-out and re-establishment of positions) to the Clearing Member to whom the open contract is transferred (or with whom the replacement open contract is re-established) such cover held as security for the defaulter's obligations to the Clearing House on that account as the Clearing House may deem appropriate;
- (i) tender or receive a tender in the defaulter's name;
- (j) to perform an open contract subject to tender or a delivery contract by either delivery of or accepting delivery of the commodity the subject of such contract to or from, as the case may be, the defaulter, its agent or a third party in any manner permitted by the terms of the Contract and the Exchange Rules (if any);
- (k) where the defaulter is party to an open contract subject to tender, to declare the defaulter's rights and liabilities in respect of performance thereof discharged, whereupon the provisions of Rule 7 shall apply to the defaulter in respect of the open contract;
- (l) to make or procure the making of one or more contracts, including (without limitation) original contracts for the purpose of hedging market risk to which

the defaulter is exposed, and to register the same in the defaulter's name under the Regulations or the FCM Regulations (as the case may be);

- (m) to make or procure the making of one or more contracts, whether or not in the terms of exchange contracts, for the sale, purchase or other disposition of a commodity, and to register the same in the defaulter's name under the Regulations;
- (n) to designate a currency as a currency of account, and at the defaulter's expense to convert any sum payable by or to the defaulter in another currency into the currency of account;
- (o) to take any step which in the circumstances is open to the Clearing House under any applicable Exchange Rules including, without limitation, to transfer (whether by way of transfer or by way of termination, close-out and re-establishment) an open contract of the defaulter to a Participating Exchange to be registered at the Participating Exchange in accordance with its rules;
- (p) without prejudice to any other right of the Clearing House under the Regulations, to take such action as the Clearing House may deem necessary for its protection in the name and at the expense of the defaulter with regard to any open contract standing in its name;
- (q) in respect of Contracts standing in the defaulter's name, to charge to its account the amount (or, if the amount is not finally known, the estimated amount) of any expenses incurred by the Clearing House with regard to or in consequence of the circumstances mentioned in Rule 3 or the steps which are or may be taken under this Rule, the Regulations or the FCM Regulations (as the case may be) and any expenses incurred with regard thereto under Rule 11 and the amount of any losses, costs or expenses incurred or suffered by the Clearing House referred to in paragraph (g) of Regulation 42 and any other amounts referred to in such paragraph;
- (r) any other step calculated by the Clearing House to complete the process set out in Rule 8; and
- (s) to obtain such advice or assistance, whether legal advice or otherwise, as the Clearing House may deem necessary and at the expense of the defaulter for any matter arising out of or in connection with the default,

PROVIDED that in the case of SwapClear Contracts, the steps which shall be taken by the Clearing House shall be set out in the SwapClear DMP Annex to these Default Rules, and

PROVIDED further that in the case of ForexClear Contracts, the steps which shall be taken by the Clearing House shall be set out in the ForexClear DMP Annex to these Default Rules.

- 7. (a) Where the Clearing House declares the defaulter's rights and liabilities under an open contract subject to tender discharged under Rule 6(k):
  - (i) those rights and liabilities and the rights and liabilities of the Clearing House under the open contract shall be discharged, and,
  - (ii) there shall arise between the defaulter and the Clearing House in respect of the open contract an obligation to account, as directed by

the Clearing House, for a settlement amount determined by the relevant Board under this Rule.

- (b) The settlement amount referred to in paragraph (a) shall be an amount which, at the request of the Clearing House, the relevant Board determines to represent adequate compensation (in the circumstances known to the Board) for the discharge of the mutual rights and liabilities of the defaulter and the Clearing House under the open contract. The Board's determination shall be conclusive. The Clearing House shall direct how the settlement amount is to be accounted for between the defaulter and itself.
  - (c) Neither the Clearing House nor any relevant Board or Exchange shall have any liability whatsoever for anything done or omitted in the determination of a settlement amount under this Rule.
8. Upon the discharge of the defaulter's rights and liabilities under or in respect of all Contracts to which it is party the following process shall, subject to any contrary provision in Rule 16, be completed by the Clearing House:
- (a) there shall be brought into account all sums payable: (i) by or to a defaulter in respect of Contracts (other than FCM SwapClear Contracts); any other sum due under the Regulations; any sum due in respect of any breach of the Regulations; (except, if the Clearing House so determines at its discretion, any sum payable under a Contract as the price for the commodity the subject of such Contract delivered or to be delivered to the Clearing House by or on behalf of the defaulter); and/or any amount due from the defaulter to the Clearing House in respect of any Treasury Contract; or (ii) by or to a defaulter in respect of FCM SwapClear Contracts; any other sum due under the FCM Regulations; and/or any sum due in respect of any breach of the FCM Regulations;
  - (b) the sums so payable shall be aggregated or set off so as to produce a net sum or as many net sums as required by Rule 10; and
  - (c) such net sum, or each such net sum:
    - (i) if payable by the defaulter to the Clearing House, shall be set off against any cover standing to the credit of the defaulter's account so as to produce a further net sum, or shall be aggregated with any debit balance of the defaulter's account, or
    - (ii) if payable by the Clearing House to the defaulter, shall be aggregated with any cover standing to the credit of the defaulter's account, or shall be set off against any debit balance of the defaulter's account so as to produce a further net sum.
  - (d) Where an amount is payable by the Clearing House to the defaulter in respect of a balance on its Proprietary Account or accounts, and there are amounts due to the Clearing House in respect of any client account or any FCM Omnibus OTC Client Account with LCH (as the case may be) operated by it, the balance on the Proprietary Account or accounts may be applied to meet the shortfall on the client account or accounts or on the FCM Omnibus OTC Client Account(s) with LCH (as the case may be) in any way which the Clearing House may determine.

For the purposes of paragraph (a) of this Rule the Clearing House may assess the sum payable by or to the defaulter in respect of any breach of the Regulations or the FCM Regulations (as the case may be) in such reasonable manner as it thinks fit.

9. The sum, or each sum, finally payable by the defaulter to the Clearing House or by the Clearing House to the defaulter, or the fact that no sum is finally payable by either such party to the other, as the case may be upon completion of the process set out in Rule 8, shall be forthwith certified by the Clearing House. The certificate of the Clearing House under this Rule shall be conclusive as to the discharge of the defaulter's rights and liabilities in respect of the Contracts to which it relates. The Clearing House shall, as soon as practicable after issuing a Default Notice in respect of a Clearing Member, appoint a day on which any net sums certified under this Rule to be due to the defaulter are to be paid by the Clearing House. The day so appointed may fall before or after the effective date of termination of the defaulter's Clearing Membership Agreement but shall not fall on a day before the process specified in Rule 8 can be completed.
10.
  - (a) Where the defaulter has more than one account with the Clearing House, the defaulter's accounts shall be combined for the purpose of Rules 8 and 9 as follows: an account which is an FCM Omnibus OTC Client Account with LCH of the defaulter may only be combined with other FCM Omnibus OTC Client Accounts with LCH of the defaulter; an account which is a Proprietary Account of the defaulter may be combined with any other Proprietary Accounts of the defaulter and (if the Clearing House so elects) Treasury Accounts of the defaulter (subject to Rule 8(d) and 10(d) of the Default Rules); and an account which is a Treasury Account of the defaulter may only be combined with other Treasury Accounts and (if the Clearing House so elects) Proprietary Accounts of the defaulter. Notwithstanding the foregoing, in no circumstances may an account which is an Individual Segregated Account of the defaulter or an Omnibus Net Segregated Account of the defaulter be combined with any other account of the defaulter.
  - (b) For the purposes of this Rule 10, each Individual Segregated Account of the defaulter and each Omnibus Net Segregated Account of the defaulter shall constitute a separate "kind of account". Where the defaulter has more than one kind of account with the Clearing House, the process set out in Rule 8 shall be separately completed in respect of each kind of account. In the case of each kind of account of the defaulter which is not an Omnibus Net Segregated Account, the sum finally payable in respect of that kind of account following completion of the process set out in Rule 8 shall be separately certified under Rule 9. In the case of each kind of account of the defaulter which is an Omnibus Net Segregated Account, the sum finally payable in respect of that kind of account following completion of the process set out in Rule 8 will be allocated by the Clearing House (pro rata as it sees fit in its sole discretion) between the Omnibus Net Segregated Clearing Clients sharing in that Omnibus Net Segregated Account. Each sum so allocated to an Omnibus Net Segregated Clearing Client shall be separately certified under Rule 9.
  - (c) In Rule 8(c) the "defaulter's account" means:
    - (i) with regard to a net sum produced by reference to Contracts registered in an Individual Segregated Account of the defaulter, that Individual Segregated Account;

- (ii) with regard to a net sum produced by reference to Contracts registered in an Omnibus Net Segregated Account of the defaulter, that Omnibus Net Segregated Account;
  - (iii) with regard to a net sum produced by reference to FCM SwapClear Contracts registered in one or more FCM Omnibus OTC Client Accounts with LCH of the defaulter, that FCM Omnibus OTC Client Account with LCH, or (if there is more than one) all those FCM Omnibus OTC Client Accounts with LCH combined;
  - (iv) with regard to a net sum produced by reference to Contracts registered in one or more Proprietary Accounts of the defaulter, that Proprietary Account or those Proprietary Accounts combined and (if the Clearing House has elected in accordance with Rule 10(a)) any Treasury Accounts of the defaulter; and
  - (v) with regard to a net sum produced by reference to one or more Treasury Accounts of the defaulter, that Treasury Account or those Treasury Accounts combined, and (if the Clearing House has elected in accordance with Rule 10(a)) Proprietary Accounts.
- (d) Notwithstanding any provision of the Rulebook to the contrary, any loss which relates to a Treasury Account may not be treated as a Default Loss (as defined in Rule 23(b)), whether or not cover has been applied in respect of such loss. Nothing in this Rule 10(d) requires the Clearing House to apply cover in respect of any such loss instead of any other amount referred to in Rule 8(a), except that the Clearing House may not apply cover in respect of any such loss to the extent that doing so would give rise to an Excess Loss (as defined in Rule 15).
11. Without further authorisation, permission or cooperation from the defaulter, the Clearing House may appoint any person to take or assist it in taking any step under these Rules or to complete or assist it in completing the process set out in Rule 8.
12. The Clearing House may co-operate, by the sharing of information and otherwise, with any Regulatory Body or relevant Exchange, any relevant office-holder acting in relation to the defaulter or its estate and any other authority or body having responsibility for, or any Clearing Member having an interest in, any matter arising out of or connected with the circumstances mentioned in Rule 3.
13. In addition to such copy report as it supplies under section 162(3) of the Companies Act 1989, the Clearing House shall report to the defaulter, or any relevant office-holder acting in relation to the defaulter or its estate, on steps taken in relation to the defaulter under Rule 6.

**SWAPCLEAR DMP ANNEX****1. SCOPE AND INTERPRETATION**

- 1.1 The Clearing House has established a SwapClear DMP which will apply to SwapClear Contracts following the issue of a Default Notice relating to a SwapClear Clearing Member and in respect of which, for the avoidance of doubt, the Clearing House will have no recourse to the process of invoicing-back. The fundamental principles of the SwapClear DMP are elaborated to the fullest extent possible in this Annex. Where exhaustive detail cannot be laid out in the provisions of this Annex, the SwapClear DMP will be undertaken on the basis of the principles contained herein.
- 1.2 The Clearing House has an obligation to ensure the on-going integrity of the SwapClear service and SwapClear Contracts in the interests of the Non-Defaulting SCMs. When a SwapClear Clearing Member defaults, Non-Defaulting SCMs are required to supply impartial expertise through the SwapClear DMG and to bid for the Auction Portfolios of a Defaulting SCM, as laid out in this Annex. In addition, most SCMs or their parent companies or subsidiaries or fellow subsidiaries, have direct interests in that integrity, notably as contributors to the various default funds of the Clearing House. Each SCM shall take all steps and execute all documents necessary or required by the Clearing House to comply with its obligations as a SCM arising out of this SwapClear DMP Annex.
- 1.3 The initial margining of SwapClear Contracts will be such so as to ensure that the acceptance of bids for the Auction Portfolios of a Defaulting SCM will recognise risk premiums, and that equivalent premiums will be paid by the Clearing House in closing-out large positions in other Contracts traded on exchange or ATS-organised markets.
- 1.4 In this Annex:

"**AIP**" has the meaning given in Rule 2.4 of this Annex;

"**Auction**" means the process of bidding by SwapClear Clearing Members for an Auction Portfolio prescribed by the Clearing House following consultation with the SwapClear DMG from time to time in accordance with Rule 2.3 of this Annex;

"**Auction Currency**" means in relation to an Auction, the currency of an Auction Portfolio which is the subject of that Auction;

"**Auction Losses**" has the meaning given in Rule 2.5.2 of this Annex;

"**Auction Portfolio**" means (i) a Portfolio; or (ii) a group of SwapClear Contracts resulting from the splitting of a Portfolio pursuant Rule 2.1 of this Annex including any connected hedging trades concluded by the Clearing House through Risk Neutralisation;

"**Bankruptcy Code**" means the U.S. Bankruptcy Code, as amended;

"**CEA**" means the U.S. Commodity Exchange Act, as amended;

"**CFTC**" means the U.S. Commodity Futures Trading Commission;

**"Currency Participant"** means, in respect of a specific SwapClear currency, a Non-Defaulting SCM who at the time the Clearing House declares a Default has SwapClear Contracts for that SwapClear currency registered in its name;

**"Derivatives Clearing Organization"** means an organisation designated and registered as such by way of United States Code Title 7, Chapter 1, paragraph 7a-1;

**"Equal Bid"** has the meaning given in Rule 2.3.5 of this Annex;

**"FCM House Business"** means the FCM SwapClear Contracts entered into by an FCM Clearing Member for its own account or for the account of an Affiliate;

**"Guidance"** means guidance, in the form of one or more written notices, issued from time to time pursuant to Rule 1.2 of this Annex by or on behalf of the Clearing House to SwapClear Clearing Members, supplementing the detail or conduct of any aspect of the SwapClear DMP;

**"Higher Bid"** and **"Higher Bidder"** have the meanings given in Rule 2.5.3 of this Annex;

**"Initial Resources"** has the meaning given in Rule 2.5.2 of this Annex;

**"Losing Currency"** has the meaning given in Rule 2.5.4 of this Annex;

**"Losing Currency Original SCM"** has the meaning given in Rule 2.5.4 of this Annex;

**"Losing Currency Unfunded SCM"** has the meaning given in Rule 2.5.7 of this Annex;

**"Margin Cover"** has the meaning given in Rule 16(1) of the Default Fund Rules;

**"Non-defaulters' Contributions"** means the SwapClear Contributions made by Non-Defaulting SCMs to the SwapClear Default Fund;

**"Original Contributions"** has the meaning given in Rule 2.5.3 of this Annex;

**"Portfolios"** means, in respect of each SwapClear currency, the SwapClear Contracts in such currency registered in the name of a Defaulting SCM, and, where relevant, includes any connected hedging trades concluded by the Clearing House through Risk Neutralisation;

**"Potential Unfunded Contributions"** has the meaning given in Rule 2.4.2 of this Annex;

**"Recognised Clearing House"** mean an organisation which is declared to be a recognised clearing house by a recognition order (that is for the time being in force) made under section 290(1)(b) of the Financial Services and Markets Act 2000;

**"Relevant Original Contributions"** has the meaning given to it in Rule 2.5.3 of this Annex;

**"Relevant Unfunded Contributions"** has the meaning given to it in Rule 2.5.6 of this Annex;

**"Remaining Original Short Bidder"** has the meaning given in Rule 2.5.3 of this Annex;

**"Remaining Unfunded Short Bidder"** has the meaning given to it in Rule 2.5.6 of this Annex;

**"Risk Neutralisation"** means the process of reducing the market risk associated with a Defaulting SCM's obligations to the Clearing House under SwapClear Contracts by hedging the exposure prior to the auction process as described in Rule 2.2 of this Annex;

**"Short Bidder"** has the meaning given in Rule 2.5.3 of this Annex;

**"SwapClear Default Management Process Completion Date"** means the date when the SwapClear Default Management Process in relation to a Default has been completed as determined by the Clearing House in consultation with the SwapClear DMG and notified to all SCMs;

**"SwapClear DMG"** means the advisory Default Management Group established by the Clearing House pursuant to the terms of this Annex;

**"SwapClear DMP or SwapClear Default Management Process"** means the processes of the Clearing House outlined in this Annex, as the same may be supplemented and/or amended from time to time in accordance with this Annex; and

**"Worst Case Loss"** means, in respect of an Auction Portfolio or all of the SwapClear Contracts of a Non-Defaulting SCM denominated in a particular currency, the largest loss which could be incurred by the Clearing House in respect of the relevant group of SwapClear Contracts, as determined by the Clearing House using the SwapClear PAIRS margining algorithm based on 1250 historical scenarios (5 years history) and a holding period of 5 days.

- 1.5 Terms used in this Annex which are not defined herein shall have the meanings given to them in the Regulations and in the FCM Regulations.

## 2. SWAPCLEAR CLEARING HOUSE BUSINESS AND FCM HOUSE BUSINESS

The SwapClear Default Management Process in respect of SwapClear Clearing House Business and FCM House Business shall involve the stages described in this Rule 2.

### 2.1 Portfolio Splitting

The Clearing House, in consultation with and the assistance of the SwapClear DMG, shall determine the composition of each Auction Portfolio and shall have the discretion to divide a Portfolio into two or more individual Auction Portfolios with the aim of facilitating the efficiency of, and reducing the risk associated with, the auction process provided for in Rule 2.3 of this Annex. The overriding principle is that the Clearing House will structure Auction Portfolios with the intention of ensuring a SwapClear DMP which best protects the resources of the Clearing House, subject to compliance with applicable provisions of the CEA and regulations of the CFTC regarding segregation of client assets. Therefore, nothing in this Rule 2.1 shall be deemed to imply: (a) that the Clearing House is under any obligation to split a particular Portfolio of a Defaulting SCM

(regardless of the number of SwapClear Contracts that such Portfolio contains); or (b) any particular requirements as to the composition of an individual Auction Portfolio, except that, subject to overriding risk procedures it is broadly anticipated that the parameters of any Auction Portfolio shall not be materially different to those set out in the Clearing House's fire drill.

## 2.2 Risk Neutralisation

The Clearing House will, in consultation with and with the assistance of the SwapClear DMG, reduce the market risk associated with a Defaulting SCM's obligations to the Clearing House so far as is reasonably practicable by hedging the Clearing House's exposure in open SwapClear Contracts to which the Defaulting SCM is party. All such hedging shall be undertaken by the Clearing House with SCMs, on the basis of separate agreements between the Clearing House and each such SCM. The aim of Risk Neutralisation is to reduce market exposure to within defined tolerance limits expressed as deltas or other measures of market risk and as established from time to time by the Clearing House in consultation with the SwapClear DMG or as may reasonably be determined by the Clearing House in consultation with the SwapClear DMG once a Default has been declared under the Default Rules. For the avoidance of doubt, Risk Neutralisation may happen prior to, concurrently with and/or subsequently to the splitting of a Portfolio pursuant to Rule 2.1 above.

## 2.3 Auction

- 2.3.1 Following the completion of Risk Neutralisation, the Clearing House shall auction each Auction Portfolio to Non-Defaulting SCMs. The Clearing House, in consultation with the SwapClear DMG, shall prescribe such procedures (in addition to those set out herein) for the conduct of the auction process as it considers reasonably appropriate from time to time.
- 2.3.2 The Clearing House shall notify each SCM of all details that may be reasonably required in relation to an Auction Portfolio prior to the relevant Auction.
- 2.3.3 The auction process may take place over a number of days and Auctions of different Auction Portfolios may take place at different times.
- 2.3.4 SCMs will submit bids to the Clearing House representatives on the SwapClear DMG, who will ensure that the identities of the bidders are not revealed to the SCM representatives on the SwapClear DMG. For the avoidance of doubt, an SCM shall be entitled to submit a bid on behalf of one or more affiliated SCMs. The SwapClear DMG will oversee the bidding process in a manner which it considers best protects the resources of the Clearing House and ensures an orderly process.
- 2.3.5 The Clearing House in consultation with the SwapClear DMG will have full discretion in deciding whether or not to accept a particular bid in an Auction and, in so deciding, will take into account the relevant factors that determine risk premiums, as well as the range of bids received relative to initial margin held and, subject to their availability, the Clearing House resources as set out in Rule 16 of the Clearing House's Default Fund Rules. In the event that more than one SCM submits a bid of the same value (each an "**Equal Bid**"),

the Clearing House will, subject to its discretion to reject all such Equal Bids, select the bid which was received first in time.

2.3.6 In the case of an Auction in which no bid is accepted or received (as the case may be), one or more further Auctions will be held in relation to the relevant Auction Portfolio. As soon as practicable following an Auction:

- (a) in the event that a bid was accepted, the Clearing House will notify those Currency Participants in the relevant Auction Currency together with any other SCMs who participated in the Auction that a bid was accepted and shall notify the SCM who submitted the accepted bid that its bid was accepted;
- (b) in the event that no bid was accepted, the Clearing House will notify all SCMs of the details of any further Auction.

2.3.7 The SCM agrees to use all reasonable efforts to make a bid in an Auction for an Auction Portfolio in respect of which such SCM is a Currency Participant.

## 2.4 Auction Incentive Pools

2.4.1 Before commencing the auction process, the Clearing House will calculate an auction incentive pool (each an “AIP”) for each individual Auction Portfolio for the purposes of providing an initial allocation of the resources potentially available to it to satisfy any loss incurred in the Auction of each such Auction Portfolio. Notwithstanding such initial allocation, any resources utilised by the Clearing House will be allocated in accordance with Rule 2.5 below.

2.4.2 For each AIP, the resources shall be allocated as follows:

- (a) the resources of the Defaulting SCM (in the form of: (i) that part of the Margin Cover for the SwapClear Contracts of the Defaulting SCM pursuant to Rule 16(1) of the Default Fund Rules and (ii) the SwapClear Contribution made by the Defaulting SCM to the SwapClear Default Fund) available pursuant to Rule 16(2) of the Default Fund Rules at the time of the auction process will be allocated to the AIPs based on the proportion that (a) the risk of the relevant Auction Portfolio bears to (b) the aggregate of the risks (on an absolute basis) for all Auction Portfolios; the portion of the Capped Amount applied to the SwapClear Business of the Defaulting SCM pursuant to Rule 16(3) of the Default Fund Rules will be allocated to the AIPs based on the proportion that (a) the risk of the relevant Auction Portfolio bears to (b) the aggregate of the risks (on an absolute basis) for all Auction Portfolios; and
- (b) the Non-defaulters’ Contribution of each SCM and the total value of the SwapClear Unfunded Contributions which would be callable but have not been called by the Clearing House from the relevant SCM in respect of the relevant Default in accordance with Rule S8 of the Default Fund Rules (the “**Potential Unfunded Contributions**”) will, subject to Rule 2.4.3 below, be allocated between the AIPs relating to the Auction Portfolios in which the relevant SCM is a Currency Participant based on the proportion that: (a) the risk of the SwapClear Contracts of such SCM denominated in the relevant currency bears to (b) the aggregate of the amounts calculated in (a) in respect of each currency in which the relevant SCM is a Currency Participant.

2.4.3 Where a Portfolio for a particular Swapclear currency has been split into two or more Auction Portfolios, the Non-defaulters' Contributions and Potential Unfunded Contributions allocated to the AIP related to the relevant Portfolio will be further divided for the purposes of allocation into AIPs relating to the relevant Auction Portfolios based on the proportion that (a) the risk of the SwapClear Contracts in each such Auction Portfolio bears to (b) the aggregate of the amounts calculated in (a) for each of the Auction Portfolios in the relevant currency.

## 2.5 Loss Attribution

2.5.1 Following the completion of all Auctions of all Auction Portfolios of the Defaulting SCM, the Clearing House will determine whether losses incurred by it as a result of such Auctions are such that the Non-defaulters' Contributions must be utilised. Where applicable, such losses will be allocated to Non-defaulters' Contributions in accordance with the loss attribution process described in Rules 2.5.2 to 2.5.8 of this Annex.

2.5.2 For each Auction Portfolio, losses to the Clearing House will be met using the resources as set out in Rule 16. In applying those resources, the Clearing House will allocate the losses in respect of each Auction Portfolio (the "**Auction Losses**") by reference to the resources allocated to the AIPs related to such Auction Portfolios in accordance with Rule 2.4 of this Annex. Where there are no Auction Losses in respect of an Auction Portfolio or the Auction Losses in respect of an Auction Portfolio do not require the full amount of the resources referred to in sub-paragraphs (a) and (b) of Rule 2.4.2 of this Annex allocated to the AIP related to the relevant Auction Portfolio (the "**Initial Resources**") to be fully utilised, the relevant surplus Initial Resources will be allocated pro rata between those AIPs relating to Auction Portfolios in respect of which there are Auction Losses requiring the utilisation of resources beyond the Initial Resources available in the relevant AIP in accordance with Rule 16(1), 16(2) and 16(3) until such time as all Initial Resources have been fully utilised.

2.5.3 In the case of each Auction for which there are Auction Losses in respect of which the Non-defaulters' Contributions must be utilised, those Non-defaulter's Contributions, not including, for these purposes, any part of such Non-defaulters' Contributions that reflect any SwapClear Unfunded Contribution deposited with the Clearing House pursuant to the Default in respect of which the relevant Auction was held (the "**Original Contributions**") and which have been allocated to the AIP relating to the relevant Auction Portfolio (the "**Relevant Original Contributions**") will be used first in the following order:

- (a) The Auction Losses will be attributed to the Relevant Original Contributions of those SCMs who are Currency Participants in the Auction Currency and who did not bid in the relevant Auction. Auction Losses will be attributed to the Relevant Original Contribution of an individual SCM pursuant to this sub-paragraph (i) based upon the proportion that: (a) the value of the Relevant Original Contribution of such SCM bears to (b) the total value of the Relevant Original Contributions of all SCMs who are Currency Participants in the Auction Currency and who did not bid in the relevant Auction;

- (b) If and to the extent that there are Auction Losses outstanding after the attribution process referred to in sub-paragraph (i) above, those Auction Losses will be attributed to the Relevant Original Contributions of the Short Bidders. For the purposes of this sub-paragraph (ii) and sub-paragraph (ii) of Rule 2.5.6 of this Annex the term "Short Bidder" means any SCM who is a Currency Participant in the Auction Currency and who submitted an unsuccessful bid in the relevant Auction save for any SCM who submitted a higher bid in an Auction than the bid accepted by the Clearing House in accordance with Rule 2.3.4 of this Annex (each such SCM, a "Higher Bidder" and each such bid, a "Higher Bid").

Auction Losses will be attributed to an individual Short Bidder pursuant to this sub-paragraph (ii) based upon the proportion that (a) the variance of the bid of such Short Bidder from the winning bid (denominated in units of the relevant Auction Currency) bears to (b) the sum of the variances of the bids of all Short Bidders from the winning bid (denominated in units of the relevant Auction Currency);

Where the value of the Auction Losses attributed to an individual Short Bidder pursuant to this sub-paragraph (ii) is greater than the value of the Relevant Original Contribution of such Short Bidder, the relevant excess Auction Losses will be attributed to each Short Bidder whose Relevant Original Contribution exceeds the value of the Auction Losses which have been attributed to it pursuant to this sub-paragraph (ii) (each a "Remaining Original Short Bidder") by (a) calculating the amount which is the bid of the relevant Remaining Original Short Bidder divided by the sum of the bids of all Remaining Original Short Bidders; and (b) multiplying such amount by the value of the relevant excess Auction Losses;

The Clearing House will repeat the loss attribution process described in this sub-paragraph (ii) until the first to occur of (a) the Auction Losses being fully met; and (b) the Relevant Original Contributions of all Short Bidders being fully attributed; and

- (c) If and to the extent that there are Auction Losses outstanding after the attribution process referred to in sub-paragraph (ii) above, those Auction Losses will be attributed to the Relevant Original Contribution of the SCM who submitted the winning bid, together with, where applicable, the Relevant Original Contribution of any SCM who submitted a bid which is an Equal Bid or a Higher Bid in relation to that winning bid. The outstanding Auction Losses will be attributed to the Relevant Original Contribution of an individual SCM pursuant to this sub-paragraph (iii) based upon the proportion that: (a) the value of the Relevant Original Contribution of such SCM bears to (b) the total value of the Relevant Original Contributions of (i) the SCM who submitted the winning bid; (ii) any SCMs who submitted an Equal Bid to such winning bid; and (iii) any SCMs who were Higher Bidders, in the relevant Auction.

If, for an Auction Portfolio, there remain Auction Losses outstanding after the attribution process referenced to in sub-paragraph (iii) above, and there are AIPs relating to other Auction Portfolios in the same Auction Currency in which the Relevant Original Contributions have not been fully utilised, the Clearing House shall attribute the remaining

Auctions Losses amongst such Remaining Original Contributions through the attribution process set out in sub-paragraphs (i) to (iii) above.

- 2.5.4 If and to the extent that there are Auction Losses outstanding following the attribution process referred to in Rule 2.5.3 above, those Auction Losses will be attributed to the Original Contributions of those SCMs who are Currency Participants in any other Auction Currency in relation to which Auction Losses have arisen to the extent that Non-defaulters' Contributions must be utilised (each a "**Losing Currency**") and whose Original Contributions have not yet been fully utilised (each a "**Losing Currency Original SCM**"). Such remaining Auction Losses will be attributed to any remaining Original Contribution of each such SCM pursuant to this Rule 2.5.4 based upon the proportion that: (a) the risk of all of the SwapClear Contracts of such SCM denominated in each of the Losing Currencies bears to (b) the aggregate of the amounts calculated in (a) for all Losing Currency Original SCMs. The Clearing House will repeat the loss attribution process described in this Rule 2.5.4 until the first to occur of (a) the Auction Losses being fully met; and (b) the Original Contributions of all Losing Currency Original SCMs being fully attributed.
- 2.5.5 If and to the extent that there are Auction Losses outstanding following the attribution process referred to in Rule 2.5.4 above, those remaining Auction Losses will be allocated to the Original Contributions of each SCM who is not a Currency Participant in any of the Losing Currencies based upon the proportion that (a) the value of each such Original Contribution bears to (b) the aggregate of the amounts calculated in (a) for each of such SCMs.
- 2.5.6 If and to the extent that there are Auction Losses outstanding following the attribution process referred to in Rule 2.5.5 above, the SwapClear Unfunded Contributions which have been allocated to the AIP relating to the relevant Auction Portfolio (the "**Relevant Unfunded Contributions**") will be used first in the following order:
- (a) The Auction Losses will be attributed to the Relevant Unfunded Contributions of those SCMs who are Currency Participants in the Auction Currency and who did not bid in the relevant Auction. Auction Losses will be attributed to the Relevant Unfunded Contributions of an individual SCM pursuant to this sub-paragraph (i) based upon the proportion that: (a) the value of the Relevant Unfunded Contribution of such SCM bears to (b) the total value of the Relevant Unfunded Contributions of all SCMs who are Currency Participants in the Auction Currency and who did not bid in the relevant Auction;
  - (b) If and to the extent that there are Auction Losses outstanding after the attribution process referred to in sub-paragraph (i) above, those Auction Losses will be attributed to the Relevant Unfunded Contributions of the Short Bidders in the relevant Auction. Auction Losses will be attributed to an individual Short Bidder pursuant to this sub-paragraph (ii) based upon the proportion that (a) the variance of the bid of such Short Bidder from the winning bid (denominated in units of the relevant Auction Currency) bears to (b) the sum of the variances of the bids of all Short Bidders from the winning bid (denominated in units of the relevant Auction Currency);

Where the value of the Auction Losses attributed to an individual Short Bidder pursuant to this sub-paragraph (ii) is greater than the value of the Relevant Unfunded Contribution of such Short Bidder, the relevant excess Auction Losses will be attributed to each Short Bidder whose Relevant Unfunded Contribution exceeds the value of the Auction Losses which have been attributed to it pursuant to this sub-paragraph (ii) (each a “**Remaining Unfunded Short Bidder**”) by (a) calculating the amount which is the bid of the relevant Remaining Unfunded Short Bidder divided by the sum of the bids of all Remaining Unfunded Short Bidders; and (b) multiplying such amount by the value of the relevant excess Auction Losses;

The Clearing House will repeat the loss attribution process described in this sub-paragraph (ii) until the first to occur of (a) the Auction Losses being fully met; and (b) the Relevant Unfunded Contributions of all Short Bidders being fully attributed; and

- (c) If and to the extent that there are Auction Losses outstanding after the attribution process referred to in sub-paragraph (ii) above, those Auction Losses will be attributed to the Relevant Unfunded Contribution of the SCM who submitted the winning bid, together with, where applicable, the Relevant Unfunded Contribution of any SCM who submitted a bid which is an Equal Bid or a Higher Bid in relation to that winning bid. The outstanding Auction Losses will be attributed to the Relevant Unfunded Contribution of an individual SCM pursuant to this sub-paragraph (iii) based upon the proportion that: (a) the value of the Relevant Unfunded Contribution of such SCM bears to (b) the total value of the Relevant Unfunded Contributions of (i) the SCM who submitted the winning bid; (ii) any SCMs who submitted an Equal Bid to such winning bid; and (iii) any SCMs who were Higher Bidders, in the relevant Auction.

If, for an Auction Portfolio, there remain Auction Losses outstanding after the attribution process referenced to in sub-paragraph (iii) above, and there are AIPs relating to other Auction Portfolios in the same Auction Currency in which the Relevant Unfunded Contributions have not been fully utilised, the Clearing House shall attribute the remaining Auctions Losses amongst such Remaining Unfunded Contributions through the attribution process set out in sub-paragraphs (i) to (iii) above.

- 2.5.7 If and to the extent that there are Auction Losses outstanding following the attribution process referred to in Rule 2.5.6 above, those Auction Losses will be attributed to the SwapClear Unfunded Contributions of those SCMs who are Currency Participants in any other Losing Currency and whose SwapClear Unfunded Contributions have not yet been fully utilised (each a “**Losing Currency Unfunded SCM**”). Such remaining Auction Losses will be attributed to any remaining SwapClear Unfunded Contributions of each such SCM pursuant to this Rule 2.5.7 based upon the proportion that: (a) the risk of all of the SwapClear Contracts of such SCM denominated in each of the Losing Currencies bears to (b) the aggregate of the amounts calculated in (a) for all Losing Currency Unfunded SCMs. The Clearing House will repeat the loss attribution process described in this Rule 2.5.7 until the first to occur of (a) the Auction Losses being fully met; and (b) the SwapClear Unfunded Contributions of all Losing Currency Unfunded SCMs being fully attributed.

- 2.5.8 If and to the extent that there are Auction Losses outstanding following the attribution process referred to in Rule 2.5.7 above, those remaining Auction Losses will be allocated to the SwapClear Unfunded Contributions of each SCM who is not a Currency Participant in any of the Losing Currencies based upon the proportion that (a) the value of each such SwapClear Unfunded Contribution bears to (b) the aggregate of the amounts calculated in (a) for each of such SCMs.
- 2.6 For the purposes of Rules 2.4 and 2.5 above, all references to the risk associated with an Auction Portfolio or with all of the SwapClear Contracts of a Non-Defaulting SCM denominated in a particular currency shall be references to such risk as determined by the Clearing House in its sole discretion on the basis of Worst Case Loss.
- 3. DEFAULT MANAGEMENT IN RESPECT OF SWAPCLEAR CLEARING CLIENT BUSINESS AND FCM CLIENT BUSINESS**
- 3.1 The SwapClear DMP in respect of any contract which is a SwapClear Contract in respect of SwapClear Clearing Client Business shall involve the stages described in Regulation 52B.
- 3.2 The SwapClear DMP in respect of any contract which is an FCM SwapClear Contract in respect of FCM Client Business shall be conducted in accordance with FCM Regulation 9(g).
- 4. TRANSFER OF CASH FLOWS AND REGISTRATION OF POSITIONS**
- 4.1 Following the disposal of an Auction Portfolio by way of Auction (and notwithstanding that other Auction Portfolios of the Defaulting SCM may not yet have been auctioned) the Clearing House, will, with the co-operation of the SCMs, transfer to the SCM whose bid won that Auction Portfolio the rights and obligations, from the Defaulting SCM, arising out of the positions which that SCM has successfully bid for under the SwapClear Default Management Process. Such transfer may take place by way of registration of new positions with the Clearing House in the name of the relevant SCM, or novation of rights and obligations to the relevant SCM. All such registrations shall be made in a way that recognises the variation margin paid or received in relation to the SwapClear Contracts of the Defaulting SCM representing such new positions.
- 4.2 In order to effect the transfer of positions, the Clearing House shall prescribe such procedures and timetable as it considers reasonably appropriate in the circumstances. SCMs will be required to exercise best endeavours to comply with such requirements as may be established by the Clearing House, after consultation with the SwapClear DMG, to effect the transfer of positions, including but not limited to the payment of any sums due as a result of the winning bid and the provision of cover in an amount required by the Clearing House for initial margin and variation margin in respect of positions which are to be registered in their names. The Clearing House agrees that in such procedures it shall make provision for set-off by the Clearing House of amounts owed by the Clearing House to the SCM as a result of the operation of the SwapClear DMP against sums owed by the SCM to the Clearing House in respect thereof.
- 4.3 Where, as a result of an Auction, the Clearing House is required to make a payment to a SCM in respect of a winning bid, the Clearing House shall not be permitted to register any position, whether as a new position or as a novation of existing rights and obligations, to any such SCM if the Clearing House does not simultaneously

credit that SCM with the requisite amount. If any position is so registered without such payment, such registration shall be deemed void *ab initio* and unenforceable against the relevant SCM. For the avoidance of doubt, the Clearing House will utilise the resources available to it pursuant to Rule 16 of the Default Fund Rules for the purposes of making such a payment notwithstanding that other Auction Portfolios of the Defaulting SCM may not yet have been auctioned and that the loss attribution process provided for by Rule 2.5 of this Annex has not yet occurred.

## **5. INFORMATION REGARDING THE SWAPCLEAR DMP**

Whenever the SwapClear DMP is implemented by the Clearing House in respect of a Defaulting SCM, the Clearing House will, with the assistance of the SwapClear DMG, provide such ongoing information to SCMs as the Clearing House deems reasonably appropriate in respect of the progress of the SwapClear DMP.

Nothing in this Rule 5 shall require the Clearing House to disclose information in respect of the SwapClear DMP which, in the reasonable opinion of the Clearing House, may be subject to obligations of confidentiality, may constitute market sensitive data or is, in the Clearing House's reasonable opinion, inappropriate for disclosure to SCMs.

## **6. BANKRUPTCY CODE AND RELATED ISSUES**

Notwithstanding any other provision of this Annex in the event of a Default by an FCM Clearing Member, the completion of any and all actions, including but not limited to any transfers or transactions, permitted or required to be taken by the Clearing House hereunder shall be subject in all respects to the provisions of the Bankruptcy Code, Part 190 of the regulations of the CFTC, the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, and the receipt of any approvals required under the Bankruptcy Code or such regulations.

## **7. CEA ISSUES**

Notwithstanding any other provision of this Annex in the event of a Default by an FCM Clearing Member, the operation of this Annex shall in all respects be subject to applicable provisions of the CEA and CFTC regulations regarding the handling, custody, liquidation, transfer and disposition of client positions and assets, including but not limited to those provisions requiring segregation of client assets and prohibiting application of the assets of non-defaulting clients to amounts owed by defaulting clients.

## **8. MISCELLANEOUS**

8.1 Subject to Rules 2.4 and 2.5 of this Annex, the resources available to the Clearing House and their order of use are defined in Rule 16 of the Default Fund Rules as modified and/or supplemented by the SwapClear Default Fund Supplement.

8.2 The Clearing House may from time to time supplement the details of any of the stages set out in Rule 2 of this Annex or any other aspects of the SwapClear DMP, in consultation with the SwapClear DMG, either by way of further Guidance or immediately on notice to SCMs on a case-by-case basis where the Clearing House deems it appropriate to do so in the circumstances of the Default, provided that the Clearing House may not take any such action that effects a material change to the terms of this Annex without the written consent of 50% of all SwapClear Clearing Members unless such change is invoked unilaterally against all SCMs and is necessary to manage the Clearing House's risk or otherwise to meet the Clearing

House's continuing regulatory obligations including those applicable to it as a Recognised Clearing House and a Derivatives Clearing Organization. The Clearing House agrees that, in the ordinary course, it shall discuss any such Guidance with the SwapClear DMG prior to bringing the Guidance into effect except that it shall not be required to do so where (i) the Guidance is not material to the rights and obligations of the SCMs or (ii) the Clearing House deems it inappropriate to do so in the circumstances of the Default and it is not possible to convene the SwapClear DMG in timely fashion.

- 8.3 The timetable for implementation of the stages of the SwapClear Default Management Process following issue of a Default Notice by the Clearing House shall be either (1) as prescribed by the Clearing House from time to time in consultation with the SwapClear DMG and set out in Guidance; or (2) imposed by the Clearing House without prior notice to the SCMs on a case-by-case basis where the Clearing House, in consultation with the SwapClear DMG, deems it appropriate to do so in the circumstances of the Default.

## **9. ROLE AND CONSTITUTION OF SWAPCLEAR DMG**

- 9.1 The SwapClear DMG shall meet at regular intervals in order to:

9.1.1 keep under review the SwapClear DMP, together with any Guidance issued in respect thereof;

9.1.2 keep under review the terms of reference of the SwapClear DMG to ensure they remain appropriate;

9.1.3 consider appropriate supplements or amendments to the SwapClear DMP and/or Guidance in order to improve the procedures in place; and

9.1.4 consider any other business relevant to the SwapClear DMP which any member of the SwapClear DMG from time to time sees fit to raise at such meetings.

- 9.2 The members of the SwapClear DMG shall also meet within one hour, or as soon as reasonably practical, following notification by the Clearing House that a Default Notice has been served upon an SCM, and at sufficiently frequent intervals thereafter for so long as may be necessary to assist the Clearing House in the implementation of the SwapClear DMP as contemplated under this Agreement. Such implementation shall include, without limitation, the provision of general default management advice with regard to: (1) the ongoing obligations of the Clearing House to its non-defaulting members; (2) the neutralisation and closing-out of the individual obligations of the Defaulting SCM; and (3) the splitting of Portfolios and the disposal of Auction Portfolios in accordance with the SwapClear DMP. Where it is not possible or practicable for the SCM to provide its nominated representative within an appropriate timeframe, it shall provide an alternate of suitable experience and expertise to participate on the SwapClear DMG.

- 9.3 The SwapClear DMG shall be made up of the following individuals who, unless stated otherwise, shall be appointed by the Clearing House which shall ensure that the composition is such as to provide effective review of the SwapClear DMP and suitable expertise and representation of market-making capacity in the event of a Default:

9.3.1 in the event of the issuance of a Default Notice, the chief executive or deputy chief executive of the Clearing House, who shall act as chairman;

- 9.3.2 representatives of at least five SCMs, being senior executives with appropriate skills and expertise;
  - 9.3.3 at least one director (staff member of director grade) of the Clearing House's Risk Management department; and
  - 9.3.4 such other individuals as the SwapClear DMG considers appropriate from time to time in relation to individual meetings.
- 9.4 For the purpose of SwapClear DMG meetings convened to deal with a specific Defaulting SCM, the Clearing House may, after consultation with the SwapClear DMG, invite the Defaulting SCM to nominate one or more representatives to join the SwapClear DMG to assist it in carrying out its functions in the SwapClear DMP for that Defaulting SCM, and also request representatives from any other SCMs. In the event of receiving such request, the SCM shall be obliged to provide its nominated representative, or an alternate with appropriate skills, experience and expertise, as if the SCM were a member of the SwapClear DMG.
- 9.5 In establishing the SwapClear DMG, the Clearing House agrees that in the normal course of events (not including the Clearing House's declaration of a Default and the invocation of the processes as outlined in Rules 2, 3 and 4 of this Annex) it will, as far as practicable, and in accordance with the terms of reference of the SwapClear DMG, rotate the membership of the SwapClear DMG on a regular basis and amongst all SCMs. The SCM agrees that, when requested to do so by the Clearing House, it will make available a representative to participate in the SwapClear DMG. The Clearing House shall agree with the SCM the identity of such representative and shall be able to request a substitute where it believes the SCM's nominated representative does not have the requisite skills or expertise.
- 9.6 Each SCM who makes available a representative to serve on the SwapClear DMG agrees, and shall procure that, to the extent applicable, its representative agrees:
- 9.6.1 to ensure that such representative will be fully available, at any time and for such periods of time as the Clearing House may require during the course of a Default, to perform his function as a member of the SwapClear DMG including attending meetings, considering and advising the Clearing House upon aspects of the SwapClear DMP. The SCM shall ensure that a representative's other work commitments do not affect his availability for this purpose;
  - 9.6.2 to take all steps to respect the confidential capacity in which such a representative receives information through the SwapClear DMG and to establish adequate procedures to prevent the disclosure or use for any commercial purpose outside the scope of the SwapClear DMP of any such confidential information by the SCM or its representative. Such procedures shall normally include, without limitation, the establishment of Chinese walls within the SCM; and
  - 9.6.3 to be bound by and to ensure that it and any of its executives or directors serving on the SwapClear DMG complies with the requirements contained in the Procedures or the FCM Procedures (as the case may be).
- 9.7 Each SCM shall accept that:

- 9.7.1 representatives of SCMs serving on the SwapClear DMG are doing so in order to assist the Clearing House in ensuring the on-going integrity of the SwapClear service in the interests of Non-Defaulting SCMs; and
  - 9.7.2 representatives of SCMs serving on the SwapClear DMG and their employers shall have no liability for any disinterested advice or actions, mandated or otherwise, that are undertaken as part of the SwapClear Default Management Process, provided, however, that nothing in this Rule 8.7.2 shall exclude the liability of such representatives and employers for any personal injury or death caused by their negligence or for any fraud or wilful default on the part of such representatives and employers.
- 9.8 The Clearing House agrees that, in exercising its rights and obligations in consulting with the SwapClear DMG pursuant to this Agreement, it will use all reasonable commercial endeavours to agree a common position with the SwapClear DMG, provided that nothing in this Rule shall prevent the Clearing House acting in a way which it reasonably determines necessary to manage its risk or otherwise meet its continuing regulatory obligations including those applicable to it as a Recognised Clearing House and a Derivatives Clearing Organization.

**FOREXCLEAR DMP ANNEX****1. Scope and interpretation**

- 1.1 The Clearing House has established a ForexClear DMP which will apply to ForexClear Contracts following the issue of a Default Notice relating to a ForexClear Clearing Member and in respect of which, for the avoidance of doubt, the Clearing House will have no recourse to the process of invoicing-back. The fundamental principles of the ForexClear DMP are elaborated to the fullest extent possible in this Annex. Where exhaustive detail cannot be laid out in the provisions of this Annex, the ForexClear DMP will be undertaken on the basis of the principles contained herein.
- 1.2 The Clearing House has an obligation to ensure the on-going integrity of the ForexClear service and ForexClear Contracts in the interests of the Non-Defaulting FXCCMs. When a ForexClear Clearing Member defaults, Non-Defaulting FXCCMs are required to supply impartial expertise through the ForexClear DMG and to bid for the Auction Portfolios of a Defaulting FXCCM, as laid out in this Annex. In addition, most FXCCMs or their parent companies or subsidiaries or fellow subsidiaries, have direct interests in that integrity, notably as contributors to the various default funds of the Clearing House. Each FXCCM shall take all steps and execute all documents necessary or required by the Clearing House to comply with its obligations as a FXCCM arising out of this ForexClear DMP Annex.
- 1.3 The initial margining of ForexClear Contracts will be such so as to ensure that the acceptance of bids for the Auction Portfolio of a Defaulting FXCCM will recognise risk premiums, and that equivalent premiums will be paid by the Clearing House in closing-out large positions in other Contracts traded on exchange or ATS-organised markets.

- 1.4 In this Annex:

"**AIP**" has the meaning given in Rule 2.4 of this Annex;

"**Auction**" means the process of bidding by FXCCMs for an Auction Portfolio, prescribed by the Clearing House, following consultation with the ForexClear DMG from time to time in accordance with Rule 2.3 of this Annex;

"**Auction Currency Pair**" means in relation to an Auction, the Currency Pair of an Auction Portfolio which is the subject of that Auction;

"**Auction Losses**" has the meaning given in Rule 2.5.2 of this Annex;

"**Auction Portfolio**" means (i) a Portfolio: or (ii) a group of ForexClear Contracts resulting from the splitting of a Portfolio pursuant to Rule 2.1 of this Annex including any connected hedging trades concluded by the Clearing House through Risk Neutralisation;

"**Currency Pair**" bears the meaning set out at Part A of the Schedule to the ForexClear Regulations;

"**Currency Pair Participant**" means, in respect of a specific Currency Pair, a Non-defaulting FXCCM who at the time the Clearing House declares a Default has ForexClear Contracts for that Currency Pair registered in its name;

"**Defaulting FXCCM**" means an FXCCM who is a defaulter;

**"Derivatives Clearing Organization"** means an organisation designated and registered as such by way of United States Code - Title 7, Chapter 1, paragraph 7a-1;

**"Equal Bid"** has the meaning given in Rule 2.3.5 of this Annex;

**"ForexClear DMG"** means the advisory ForexClear Default Management Group established by the Clearing House pursuant to the terms of this Annex;

**"ForexClear Default Management Process"** or **"ForexClear DMP"** means the processes of the Clearing House outlined in this Annex, as the same may be supplemented and/or amended from time to time in accordance with this Annex;

**"ForexClear Default Management Process Completion Date"** means the date when the ForexClear Default Management Process in relation to a Default has been completed as determined by the Clearing House in consultation with the ForexClear DMG and notified to all FXCCMs;

**"Guidance"** means guidance, in the form of one or more written notices, issued from time to time pursuant to Rule 5.2 of this Annex by or on behalf of the Clearing House to FXCCMs, supplementing the detail or conduct of any aspect of the ForexClear DMP

**"Higher Bid"** and **"Higher Bidder"** have the meanings given in Rule 2.5.3 of this Annex;

**"Initial Resources"** has the meaning given in Rule 2.5.2 of this Annex;

**"Losing Currency"** has the meaning given in Rule 2.5.4 of this Annex;

**"Losing Currency Original FXCCM"** has the meaning given in Rule 2.5.4 of this Annex;

**"Losing Currency Unfunded FXCCM"** has the meaning given in Rule 2.5.7 of this Annex;

**"Margin Cover"** has the meaning given in Rule 16(1) of the Default Fund Rules;

**"Non-defaulters' Contributions"** means the ForexClear Contributions made by Non-Defaulting FXCCMs to the ForexClear Default Fund;

**"Original Contributions"** has the meaning given in Rule 2.5.3 of this Annex;

**"Portfolio"** means, in respect of each Currency Pair, the ForexClear Contracts in such Currency Pair registered in the name of a Defaulting FXCCM, and, where relevant, includes any connected hedging trades concluded by the Clearing House through Risk Neutralisation;

**"Potential Unfunded Contributions"** has the meaning given in Rule 2.4.2 of this Annex;

**"Recognised Clearing House"** mean an organisation which is declared to be a recognised clearing house by a recognition order (that is for the time being in force) made under section 290(1)(b) of the Financial Services and Markets Act 2000;

"**Relevant Original Contributions**" has the meaning given to it in Rule 2.5.3 of this Annex;

"**Relevant Unfunded Contributions**" has the meaning given to it in Rule 2.5.6 of this Annex;

"**Remaining Original Short Bidder**" has the meaning given in Rule 2.5.3 of this Annex;

"**Remaining Unfunded Short Bidder**" has the meaning given to it in Rule 2.5.6 of this Annex;

"**Risk Neutralisation**" means the process of reducing the market risk associated with a Defaulting FXCCM's obligations to the Clearing House under ForexClear Contracts by hedging the exposure prior to the auction process as described in Rule 2.2 of this Annex; and

"**Short Bidder**" has the meaning given in Rule 2.5.3 of this Annex.

1.5 Terms used in this Annex which are not defined herein shall have the meanings given to them in the General Regulations.

## 2. FOREXCLEAR DEFAULT MANAGEMENT PROCESS

The ForexClear Default Management Process in respect of ForexClear Clearing House Business shall involve the stages described in this Rule 2.

### 2.1 Portfolio Splitting

The Clearing House, in consultation with and the assistance of the ForexClear DMG, shall determine the composition of each Auction Portfolio and shall have the discretion to divide a Portfolio into two or more individual Auction Portfolios with the aim of facilitating the efficiency of, and reducing the risk associated with, the auction process provided for in Rule 2.3 of this Annex. The overriding principle is that the Clearing House will structure Auction Portfolios with the intention of ensuring a ForexClear DMP which best protects the resources of the Clearing House. Therefore, nothing in this Rule 2.1 shall be deemed to imply: (a) that the Clearing House is under any obligation to split a particular Portfolio of a Defaulting FXCCM (regardless of the number of ForexClear Contracts that such Portfolio contains); or (b) any particular requirements as to the composition of an individual Auction Portfolio, except that, subject to overriding risk procedures it is broadly anticipated that the parameters of any Auction Portfolio shall not be materially different to those set out in the Clearing House's fire drill.

### 2.2 Risk Neutralisation

The Clearing House will, in consultation with and with the assistance of the ForexClear DMG, reduce the market risk associated with a Defaulting FXCCM's obligations to the Clearing House so far as is reasonably practicable by hedging the Clearing House's exposure in open ForexClear Contracts to which the Defaulting FXCCM is party. Hedging may be undertaken in a number of sessions, but should be undertaken as quickly as is compatible with efficient execution. All such hedging shall be undertaken by the Clearing House with FXCCMs, on the basis of separate agreements between the Clearing House and each such FXCCM. The aim of Risk Neutralisation is to reduce market exposure to within defined tolerance limits expressed as deltas or other measures of market risk and as established from time

to time by the Clearing House in consultation with the ForexClear DMG or as may reasonably be determined by the Clearing House in consultation with the ForexClear DMG once a Default has been declared under the Default Rules. For the avoidance of doubt, Risk Neutralisation may happen prior to, concurrently with and/or subsequently to the splitting of a Portfolio pursuant to Rule 2.1 above.

## 2.3 Auction

- 2.3.1 Following the completion of Risk Neutralisation, the Clearing House shall calculate the AIP for each Auction Portfolio under Rule 2.4 and then shall auction each Auction Portfolio to Non-Defaulting FXCCMs. The Clearing House, in consultation with the ForexClear DMG, shall prescribe such procedures (in addition to those set out herein) for the conduct of the auction process as it considers reasonably appropriate from time to time.
- 2.3.2 The Clearing House shall notify each FXCCM of all details that may be reasonably required in relation to an Auction Portfolio prior to the relevant Auction.
- 2.3.3 The auction process may take place over a number of days and Auctions of different Auction Portfolios may take place at different times.
- 2.3.4 FXCCMs will submit bids to the Clearing House representatives on the ForexClear DMG, who will ensure that the identities of the bidders are not revealed to the FXCCM representatives on the ForexClear DMG. For the avoidance of doubt, an FXCCM shall be entitled to submit a bid on behalf of one or more affiliated FXCCMs. The ForexClear DMG will oversee the bidding process in a manner which it considers best protects the resources of the Clearing House and ensures an orderly process.
- 2.3.5 The Clearing House in consultation with the ForexClear DMG will have full discretion in deciding whether or not to accept a particular bid in an Auction and, in so deciding, will take into account the relevant factors that determine risk premiums, as well as the range of bids received relative to initial margin held and, subject to their availability, the Clearing House resources as set out in Rule 16 of the Clearing House's Default Fund Rules. In the event that more than one FXCCM submits a bid of the same value (each an "Equal Bid"), the Clearing House will, subject to its discretion to reject all such Equal Bids, select the bid which was received first in time.
- 2.3.6 In the case of an Auction in which no bid is accepted or received (as the case may be), one or more further Auctions will be held in relation to the relevant Auction Portfolio. As soon as practicable following an Auction:
- a in the event that a bid was accepted, the Clearing House will notify those Currency Pair Participants in the relevant Auction Currency Pair together with any other FXCCMs who participated in the Auction that a bid was accepted and shall notify the FXCCM who submitted the accepted bid that its bid was accepted;
  - b in the event that no bid was accepted, the Clearing House will notify all FXCCMs of the details of any further Auction.
- 2.3.7 The FXCCM agrees to use all reasonable efforts to make a bid in an Auction for an Auction Portfolio in respect of which such FXCCM is a Currency Pair Participant.

## 2.4 Auction Incentive Pools

2.4.1 Before commencing the auction process, the Clearing House will calculate an auction incentive pool (each an "AIP") for each individual Auction Portfolio for the purposes of providing an initial allocation of the resources potentially available to it to satisfy any loss incurred in the Auction of each such Auction Portfolio. Notwithstanding such initial allocation, any resources utilised by the Clearing House will be allocated in accordance with Rule 2.5 below.

2.4.2 For each AIP, the resources shall be allocated as follows:

- a the resources of the Defaulting FXCCM (in the form of: (i) that part of the Margin Cover for the ForexClear Contracts of the Defaulting FXCCM pursuant to Rule 16(1) of the Default Fund Rules and (ii) the ForexClear Contribution made by the Defaulting FXCCM to the ForexClear Default Fund) available pursuant to Rule 16(2) of the Default Fund Rules at the time of the auction process will be allocated to the AIPs based on the proportion that (a) the risk of the relevant Auction Portfolio bears to (b) the aggregate of the risks (on an absolute basis) for all Auction Portfolios;
- b the portion of the Capped Amount applied to the ForexClear Business of the Defaulting FXCCM pursuant to Rule 16(3) of the Default Fund Rules will be allocated to the AIPs based on the proportion that (a) the risk of the relevant Auction Portfolio bears to (b) the aggregate of the risks (on an absolute basis) for all Auction Portfolios; and
- c the Non-defaulters' Contribution of each FXCCM and the total value of the ForexClear Unfunded Contributions which would be callable but have not been called by the Clearing House from the relevant FXCCM in respect of the relevant Default in accordance with Rule F8 of the Default Fund Rules (the "**Potential Unfunded Contributions**") will, subject to Rule 2.4.3 below, be allocated between the AIPs relating to the Auction Portfolios in which the relevant FXCCM is a Currency Pair Participant based on the proportion that: (a) the risk of the ForexClear Contracts of such FXCCM denominated in the Currency Pair bears to (b) the aggregate of the amounts calculated in (a) in respect of each Currency Pair in which the relevant FXCCM is a Currency Pair Participant.

2.4.3 Where a Portfolio for a particular Currency Pair has been split into two or more Auction Portfolios, the Non-defaulters' Contributions and Potential Unfunded Contributions allocated to the AIP related to the relevant Portfolio will be further divided for the purposes of allocation into AIPs relating to the relevant Auction Portfolios based on the proportion that (a) the risk of the ForexClear Contracts in each such Auction Portfolio bears to (b) the aggregate of the amounts calculated in (a) for each of the Auction Portfolios in the relevant Currency Pair.

## 2.5 Loss Attribution

2.5.1 Following the completion of all Auctions of all Auction Portfolios of the Defaulting FXCCM, the Clearing House will determine whether losses incurred by it as a result of such Auctions are such that the Non-defaulters' Contributions must be utilised. Where applicable, such losses will be

allocated to Non-defaulters' Contributions in accordance with the loss attribution process described in Rules 2.5.2 to 2.5.8 below.

2.5.2 For each Auction Portfolio, losses to the Clearing House will be met using the resources as set out in Rule 16 of the Default Fund Rules. In applying those resources, the Clearing House will allocate the losses in respect of each Auction Portfolio (the "**Auction Losses**") by reference to the resources allocated to the AIPs related to such Auction Portfolios in accordance with Rule 2.4. Where there are no Auction Losses in respect of an Auction Portfolio or the Auction Losses in respect of an Auction Portfolio do not require the full amount of the resources referred to in sub-paragraphs (a) and (b) of Rule 2.4.2 allocated to the AIP related to the relevant Auction Portfolio (the "**Initial Resources**") to be fully utilised, the relevant surplus Initial Resources will be allocated pro rata between those AIPs relating to Auction Portfolios in respect of which there are Auction Losses requiring the utilisation of resources beyond the Initial Resources available in the relevant AIP in accordance with Rule 16(1), 16(2) and 16(3) of the Default Fund Rules until such time as all Initial Resources have been fully utilised.

2.5.3 In the case of each Auction for which there are Auction Losses in respect of which the Non-defaulters' Contributions must be utilised, those Non-defaulter's Contributions, not including, for these purposes, any part of such Non-defaulters' Contributions that reflect any ForexClear Unfunded Contribution deposited with the Clearing House pursuant to the Default in respect of which the relevant Auction was held (the "**Original Contributions**") and which have been allocated to the AIP relating to the relevant Auction Portfolio (the "**Relevant Original Contributions**") will be used first in the following order:

- a The Auction Losses will be attributed to the Relevant Original Contributions of those FXCCMs who are Currency Pair Participants in the Auction Currency Pair and who did not bid in the relevant Auction. Auction Losses will be attributed to the Relevant Original Contribution of an individual FXCCM pursuant to this sub-paragraph (i) based upon the proportion that: (a) the value of the Relevant Original Contribution of such FXCCM bears to (b) the total value of the Relevant Original Contributions of all FXCCMs who are Currency Pair Participants in the Auction Currency Pair and who did not bid in the relevant Auction;
- b If and to the extent that there are Auction Losses outstanding after the attribution process referred to in sub-paragraph (i) above, those Auction Losses will be attributed to the Relevant Original Contributions of the Short Bidders. For the purposes of this sub-paragraph (ii) and sub-paragraph (ii) of Rule 2.5.6, the term "**Short Bidder**" means any FXCCM who is a Currency Pair Participant in the Auction Currency Pair and who submitted an unsuccessful bid in the relevant Auction save for any FXCCM who submitted a higher bid in an Auction than the bid accepted by the Clearing House in accordance with Rule 2.3.4 (each such FXCCM, a "**Higher Bidder**" and each such bid, a "**Higher Bid**").

Auction Losses will be attributed to an individual Short Bidder pursuant to this sub-paragraph (ii) based upon the proportion that (a) the variance of the bid of such Short Bidder from the winning bid in

USD bears to (b) the sum of the variances of the bids of all Short Bidders from the winning bid in USD;

Where the value of the Auction Losses attributed to an individual Short Bidder pursuant to this sub-paragraph (ii) is greater than the value of the Relevant Original Contribution of such Short Bidder, the relevant excess Auction Losses will be attributed to each Short Bidder whose Relevant Original Contribution exceeds the value of the Auction Losses which have been attributed to it pursuant to this sub-paragraph (ii) (each a "**Remaining Original Short Bidder**") by (a) calculating the amount which is the bid of the relevant Remaining Original Short Bidder divided by the sum of the bids of all Remaining Original Short Bidders; and (b) multiplying such amount by the value of the relevant excess Auction Losses;

The Clearing House will repeat the loss attribution process described in this sub-paragraph (ii) until the first to occur of (a) the Auction Losses being fully met; and (b) the Relevant Original Contributions of all Short Bidders being fully attributed; and

- c If and to the extent that there are Auction Losses outstanding after the attribution process referred to in sub-paragraph (ii) above, those Auction Losses will be attributed to the Relevant Original Contribution of the FXCCM who submitted the winning bid, together with, where applicable, the Relevant Original Contribution of any FXCCM who submitted a bid which is an Equal Bid or a Higher Bid in relation to that winning bid. The outstanding Auction Losses will be attributed to the Relevant Original Contribution of an individual FXCCM pursuant to this sub-paragraph (iii) based upon the proportion that: (a) the value of the Relevant Original Contribution of such FXCCM bears to (b) the total value of the Relevant Original Contributions of (i) the FXCCM who submitted the winning bid; (ii) any FXCCMs who submitted an Equal Bid to such winning bid; and (iii) any FXCCMs who were Higher Bidders in the relevant Auction.

If, for an Auction Portfolio, there remain Auction Losses outstanding after the attribution process referenced to in sub-paragraph (iii) above, and there are AIPs relating to other Auction Portfolios in the same Auction Currency Pair in which the Relevant Original Contributions have not been fully utilised, the Clearing House shall attribute the remaining Auction Losses amongst such Remaining Original Contributions through the attribution process set out in sub-paragraphs (i) to (iii) above.

- 2.5.4 If and to the extent that there are Auction Losses outstanding following the attribution process referred to in Rule 2.5.3 above, those Auction Losses will be attributed to the Original Contributions of those FXCCMs who are Currency Pair Participants in any other Auction Currency Pair in relation to which Auction Losses have arisen to the extent that Non-defaulters' Contributions must be utilised (each a "**Losing Currency Pair**") and whose Original Contributions have not yet been fully utilised (each a "**Losing Currency Pair Original FXCCM**"). Such remaining Auction Losses will be attributed to any remaining Original Contribution of each such FXCCM pursuant to this Rule 2.5.4 based upon the proportion that: (a) the risk of all of the ForexClear Contracts of such FXCCM denominated in any of the

Losing Currency Pairs bears to (b) the aggregate risk of the amounts calculated in (a) for all Losing Currency Pair Original FXCCMs. The Clearing House will repeat the loss attribution process described in this Rule 2.5.4 until the first to occur of (a) the Auction Losses being fully met; and (b) the Original Contributions of all Losing Currency Pair Original FXCCMs being fully attributed.

2.5.5 If and to the extent that there are Auction Losses outstanding following the attribution process referred to in Rule 2.5.4 above, those remaining Auction Losses will be allocated to the Original Contributions of each FXCCM who is not a Currency Pair Participant in any of the Losing Currency Pairs based upon the proportion that (a) the value of each such Original Contribution bears to (b) the aggregate of the amounts calculated in (a) for each of such FXCCMs.

2.5.6 If and to the extent that there are Auction Losses outstanding following the attribution process referred to in Rule 2.5.5 above, the ForexClear Unfunded Contributions which have been allocated to the AIP relating to the relevant Auction Portfolio (the "**Relevant Unfunded Contributions**") will be used first in the following order:

a The Auction Losses will be attributed to the Relevant Unfunded Contributions of those FXCCMs who are Currency Pair Participants in the Auction Currency Pair and who did not bid in the relevant Auction. Auction Losses will be attributed to the Relevant Unfunded Contributions of an individual FXCCM pursuant to this sub-paragraph (i) based upon the proportion that: (a) the value of the Relevant Unfunded Contribution of such FXCCM bears to (b) the total value of the Relevant Unfunded Contributions of all FXCCMs who are Currency Pair Participants in the Auction Currency Pair and who did not bid in the relevant Auction;

b If and to the extent that there are Auction Losses outstanding after the attribution process referred to in sub-paragraph (i) above, those Auction Losses will be attributed to the Relevant Unfunded Contributions of the Short Bidders in the relevant Auction. Auction Losses will be attributed to an individual Short Bidder pursuant to this sub-paragraph (ii) based upon the proportion that (a) the variance of the bid of such Short Bidder from the winning bid in USD bears to (b) the sum of the variances of the bids of all Short Bidders from the winning bid in USD;

Where the value of the Auction Losses attributed to an individual Short Bidder pursuant to this sub-paragraph (ii) is greater than the value of the Relevant Unfunded Contribution of such Short Bidder, the relevant excess Auction Losses will be attributed to each Short Bidder whose Relevant Unfunded Contribution exceeds the value of the Auction Losses which have been attributed to it pursuant to this sub-paragraph (ii) (each a "**Remaining Unfunded Short Bidder**") by (a) calculating the amount which is the bid of the relevant Remaining Unfunded Short Bidder divided by the sum of the bids of all Remaining Unfunded Short Bidders; and (b) multiplying such amount by the value of the relevant excess Auction Losses;

The Clearing House will repeat the loss attribution process described in this sub-paragraph (ii) until the first to occur of (a) the Auction

Losses being fully met; and (b) the Relevant Unfunded Contributions of all Short Bidders being fully attributed; and

- c If and to the extent that there are Auction Losses outstanding after the attribution process referred to in sub-paragraph (ii) above, those Auction Losses will be attributed to the Relevant Unfunded Contribution of the FXCCM who submitted the winning bid, together with, where applicable, the Relevant Unfunded Contribution of any FXCCM who submitted a bid which is an Equal Bid or a Higher Bid in relation to that winning bid. The outstanding Auction Losses will be attributed to the Relevant Unfunded Contribution of an individual FXCCM pursuant to this sub-paragraph (iii) based upon the proportion that: (a) the value of the Relevant Unfunded Contribution of such FXCCM bears to (b) the total value of the Relevant Unfunded Contributions of (i) the FXCCM who submitted the winning bid; (ii) any FXCCMs who submitted an Equal Bid to such winning bid; and (iii) any FXCCMs who were Higher Bidders, in the relevant Auction.

If, for an Auction Portfolio, there remain Auction Losses outstanding after the attribution process referenced to in sub-paragraph (iii) above, and there are AIPs relating to other Auction Portfolios in the same Auction Currency Pair in which the Relevant Unfunded Contributions have not been fully utilised, the Clearing House shall attribute the remaining Auction Losses amongst such Remaining Unfunded Contributions through the attribution process set out in sub-paragraphs (i) to (iii) above.

- 2.5.7 If and to the extent that there are Auction Losses outstanding following the attribution process referred to in Rule 2.5.6 above, those Auction Losses will be attributed to the ForexClear Unfunded Contributions of those FXCCMs who are Currency Pair Participants in any other Losing Currency Pair and whose ForexClear Unfunded Contributions have not yet been fully utilised (each a "**Losing Currency Pair Unfunded FXCCM**"). Such remaining Auction Losses will be attributed to any remaining ForexClear Unfunded Contributions of each such FXCCM pursuant to this Rule 2.5.7 based upon the proportion that: (a) the risk of all of the ForexClear Contracts of such FXCCM denominated in any of the Losing Currency Pairs bears to (b) the aggregate risk of the amounts calculated in (a) for all Losing Currency Pair Unfunded FXCCMs. The Clearing House will repeat the loss attribution process described in this Rule 3.5.7 until the first to occur of (a) the Auction Losses being fully met; and (b) the ForexClear Unfunded Contributions of all Losing Currency Pair Unfunded FXCCMs being fully attributed.
- 2.5.8 If and to the extent that there are Auction Losses outstanding following the attribution process referred to in Rule 2.5.7 above, those remaining Auction Losses will be allocated to the ForexClear Unfunded Contributions of each FXCCM who is not a Currency Pair Participant in any of the Losing Currency Pairs based upon the proportion that (a) the value of each such ForexClear Unfunded Contribution bears to (b) the aggregate of the amounts calculated in (a) for each of such FXCCMs.
- 2.6 For the purposes of Rules 2.4 and 2.5 above, all references to the risk associated with a ForexClear Contract shall be references to such risk as determined by the Clearing House in its sole discretion for the purpose of calculating initial margin in accordance with the Procedures.

### **3. TRANSFER OF CASH FLOWS / REGISTRATION OF POSITIONS**

- 3.1 Following the disposal of an Auction Portfolio by way of Auction (and notwithstanding that other Auction Portfolios of the Defaulting FXCCM may not yet have been auctioned) the Clearing House, will, with the co-operation of the FXCCMs, transfer to the FXCCM whose bid won that Auction Portfolio the rights and obligations, from the Defaulting FXCCM, arising out of the positions which that FXCCM has successfully bid for under the ForexClear Default Management Process. Such transfer may take place by way of registration of new positions with the Clearing House in the name of the relevant FXCCM, or novation of rights and obligations to the relevant FXCCM. All such registrations shall be made in a way that recognises the variation margin paid or received in relation to the ForexClear Contracts of the Defaulting FXCCM representing such new positions.
- 3.2 In order to effect the transfer of positions, the Clearing House shall prescribe such procedures and timetable as it considers reasonably appropriate in the circumstances. FXCCMs will be required to exercise best endeavours to comply with such requirements as may be established by the Clearing House, after consultation with the ForexClear DMG, to effect the transfer of positions, including but not limited to the payment of any sums due as a result of the winning bid and the provision of cover in an amount required by the Clearing House for initial margin and variation margin in respect of positions which are to be registered in their names. The Clearing House agrees that in such procedures it shall make provision for set-off by the Clearing House of amounts owed by the Clearing House to the FXCCM as a result of the operation of the ForexClear DMP against sums owed by the FXCCM to the Clearing House in respect thereof.
- 3.3 Where, as a result of an Auction, the Clearing House is required to make a payment to an FXCCM in respect of a winning bid, the Clearing House shall not be permitted to register any position, whether as a new position or as a novation of existing rights and obligations, to any such FXCCM if the Clearing House does not simultaneously credit that FXCCM with the requisite amount. If any position is so registered without such payment, such registration shall be deemed void *ab initio* and unenforceable against the relevant FXCCM. For the avoidance of doubt, the Clearing House will utilise the resources available to it pursuant to Rule 16 of the Default Fund Rules for the purposes of making such a payment notwithstanding that other Auction Portfolios of the Defaulting FXCCM may not yet have been auctioned and that the loss attribution process provided for by Rule 2.5 has not yet occurred.

### **4. INFORMATION REGARDING DEFAULT MANAGEMENT PROCESS**

- 4.1 Whenever the ForexClear DMP is implemented by the Clearing House in respect of a Defaulting FXCCM, the Clearing House will, with the assistance of the ForexClear DMG, provide such ongoing information to FXCCMs as the Clearing House deems reasonably appropriate in respect of the progress of the ForexClear DMP.
- 4.2 Nothing in this Rule 4 shall require the Clearing House to disclose information in respect of the ForexClear DMP which, in the reasonable opinion of the Clearing House, may be subject to obligations of confidentiality, may constitute market sensitive data or is, in the Clearing House's reasonable opinion, inappropriate for disclosure to FXCCMs.

### **5. MISCELLANEOUS**

- 5.1 Subject to Rules 2.4 and 2.5 of this Annex, the resources available to the Clearing House and their order of use are defined in Rule 16 of the Default Fund Rules as modified and/or supplemented by the ForexClear Default Fund Supplement.
- 5.2 The Clearing House may from time to time supplement the details of any of the stages set out in Rule 2 of this Annex or any other aspects of the ForexClear DMP, in consultation with the ForexClear DMG, either by way of further Guidance or immediately on notice to FXCCMs on a case-by-case basis where the Clearing House deems it appropriate to do so in the circumstances of the Default, provided that the Clearing House may not take any such action that effects a material change to the terms of this Annex without the written consent of 50% of all ForexClear Clearing Members unless such change is invoked unilaterally against all FXCCMs and is necessary to manage the Clearing House's risk or otherwise to meet the Clearing House's continuing regulatory obligations including those applicable to it as a Recognised Clearing House and a Derivatives Clearing Organization. The Clearing House agrees that, in the ordinary course, it shall discuss any such Guidance with the ForexClear DMG prior to bringing the Guidance into effect except that it shall not be required to do so where (i) the Guidance is not material to the rights and obligations of the FXCCMs or (ii) the Clearing House deems it inappropriate to do so in the circumstances of the Default and it is not possible to convene the ForexClear DMG in timely fashion.
- 5.3 The timetable for implementation of the stages of the ForexClear Default Management Process following issue of a Default Notice by the Clearing House shall be either (1) as prescribed by the Clearing House from time to time in consultation with the ForexClear DMG and set out in Guidance; or (2) imposed by the Clearing House without prior notice to the FXCCMs on a case-by-case basis where the Clearing House, in consultation with the ForexClear DMG, deems it appropriate to do so in the circumstances of the Default.

## **6. ROLE AND CONSTITUTION OF FOREXCLEAR DMG**

- 6.1 The ForexClear DMG shall meet at regular intervals in order to:
- 6.1.1 keep under review the ForexClear DMP, together with any Guidance issued in respect thereof;
  - 6.1.2 keep under review the terms of reference of the ForexClear DMG to ensure they remain appropriate;
  - 6.1.3 consider appropriate supplements or amendments to the ForexClear DMP and/or Guidance in order to improve the procedures in place; and
  - 6.1.4 consider any other business relevant to the ForexClear DMP which any member of the ForexClear DMG from time to time sees fit to raise at such meetings.
- 6.2 The members of the ForexClear DMG shall also meet within one hour, or as soon as reasonably practical, following notification by the Clearing House that a Default Notice has been served upon an FXCCM, and at sufficiently frequent intervals thereafter for so long as may be necessary to assist the Clearing House in the implementation of the ForexClear DMP as contemplated under this Agreement. Such implementation shall include, without limitation, the provision of general default management advice with regard to: (1) the ongoing obligations of the Clearing House to its non-defaulting members; (2) the neutralisation and closing-out of the individual obligations of the Defaulting FXCCM; and (3) the splitting of Portfolios and

- the disposal of Auction Portfolios in accordance with the ForexClear DMP. Where it is not possible or practicable for the FXCCM to provide its nominated representative within an appropriate timeframe, it shall provide an alternate of suitable experience and expertise to participate on the ForexClear DMG.
- 6.3 The ForexClear DMG shall be made up of the following individuals who, unless stated otherwise, shall be appointed by the Clearing House which shall ensure that the composition is such as to provide effective review of the ForexClear DMP and suitable expertise and representation of market-making capacity in the event of a Default:
- 6.3.1 in the event of the issuance of a Default Notice, the chief executive or deputy chief executive of the Clearing House, who shall act as chairman;
- 6.3.2 at least six representatives of at least four FXCCMs, being senior executives with appropriate skills and expertise;
- 6.3.3 at least one director (staff member of director grade) of the Clearing House's Risk Management department; and
- 6.3.4 such other individuals as the ForexClear DMG considers appropriate from time to time in relation to individual meetings.
- 6.4 For the purpose of ForexClear DMG meetings convened to deal with a specific Defaulting FXCCM, the Clearing House may, after consultation with the ForexClear DMG, invite the Defaulting FXCCM to nominate one or more representatives to join the ForexClear DMG to assist it in carrying out its functions in the ForexClear Default Management Process for that Defaulting FXCCM, and also request representatives from any other FXCCMs. In the event of receiving such request, the FXCCM shall be obliged to provide its nominated representative, or an alternate with appropriate skills, experience and expertise, as if the FXCCM were a member of the ForexClear DMG.
- 6.5 In establishing the ForexClear DMG, the Clearing House agrees that in the normal course of events (not including the Clearing House's declaration of a Default and the invocation of the processes as outlined in Rules 2, 3 and 4 of this Annex) it will, as far as practicable, and in accordance with the terms of reference of the ForexClear DMG, rotate the membership of the ForexClear DMG on a regular basis and amongst all FXCCMs. The FXCCM agrees that, when requested to do so by the Clearing House, it will make available a representative to participate in the ForexClear DMG. The Clearing House shall agree with the FXCCM the identity of such representative and shall be able to request a substitute where it believes the FXCCM's nominated representative does not have the requisite skills or expertise.
- 6.6 Each FXCCM who makes available a representative to serve on the ForexClear DMG agrees, and shall procure that, to the extent applicable, its representative agrees:
- 6.6.1 to ensure that such representative will be fully available, at any time and for such periods of time as the Clearing House may require during the course of a Default, to perform his function as a member of the ForexClear DMG including attending meetings, considering and advising the Clearing House upon aspects of the ForexClear DMP. The FXCCM shall ensure that a representative's other work commitments do not affect his availability for this purpose;

- 6.6.2 to take all steps to respect the confidential capacity in which such a representative receives information through the ForexClear DMG and to establish adequate procedures to prevent the disclosure or use for any commercial purpose outside the scope of the ForexClear DMP of any such confidential information by the FXCCM or its representative. Such procedures shall normally include, without limitation, the establishment of Chinese walls within the FXCCM; and
- 6.6.3 to be bound by and to ensure that it and any of its executives or directors serving on the ForexClear DMG complies with the requirements contained in the Procedures.
- 6.7 Each FXCCM shall accept that:
- 6.7.1 representatives of FXCCMs serving on the ForexClear DMG are doing so in order to assist the Clearing House in ensuring the on-going integrity of the ForexClear Service in the interests of Non-Defaulting FXCCMs; and
- 6.7.2 representatives of FXCCMs serving on the ForexClear DMG and their employers shall have no liability for any disinterested advice or actions, mandated or otherwise, that are undertaken as part of the ForexClear Default Management Process, provided, however, that nothing in this Rule 6.7.2 shall exclude the liability of such representatives and employers for any personal injury or death caused by their negligence or for any fraud or wilful default on the part of such representatives and employers.
- 6.8 The Clearing House agrees that, in exercising its rights and obligations in consulting with the ForexClear DMG pursuant to this Agreement, it will use all reasonable commercial endeavours to agree a common position with the ForexClear DMG, provided that nothing in this Rule shall prevent the Clearing House acting in a way which it reasonably determines necessary to manage its risk or otherwise meet its continuing regulatory obligations including those applicable to it as a Recognised Clearing House and a Derivatives Clearing Organization.