

# **Default Procedures under the Rules of Bursa Malaysia Derivatives Clearing Berhad (Rules of Bursa Clearing (D)) in Respect of Contracts Traded on Bursa Malaysia Derivatives Berhad**

## **Frequently Asked Questions (FAQs)**

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**Q1. What default provisions are in place to cover a Clearing Participant's default?**

**A.** Chapter 10 of the Rules of Bursa Clearing (D) sets out the default procedures in relation to a Clearing Participant's default. The Rules of Bursa Clearing (D) are available on Bursa Malaysia website. <http://www.bursamalaysia.com>

**Q2. Do the default procedures in Chapter 10 of the Rules of Bursa Clearing (D) apply to a default by a third party of the third party's obligations to a Clearing Participant?**

**A.** No, it only governs the relationship between Bursa Clearing (D) i.e. the Clearing House and a Clearing Participant in default and does not extend to cover a default by a third party of any of the third party's obligations to a Clearing Participant.

**Q3. What are the grounds for default action against a Clearing Participant?**

**A.** Rule 1000 sets out the grounds for default action and includes the following:

- Financial default
  - (a) Fails to meet in full a call for Margin;
  - (b) Fails to pay the sum of money which is the consideration for the grant of an Option or any settlement difference;
  - (c) Fails to meet in full its Clearing Fund Contributions; and
  - (d) Being a Direct Clearing Participant, fails to meet in full its Direct Clearing Participant Deposit;
- Delivery default
  - (a) Fails to deliver the underlying asset as required;
  - (b) Fails to accept delivery of the underlying asset as required.
- Other Circumstances
  - (a) Fails to promptly meet its obligations under the terms of an Open Contract;
  - (b) Ceases to be an Affiliate of an Exchange due to termination of its participation by such Exchange or its participation of an Exchange is suspended;
  - (c) Unable to pay its debts as and when they fall due in the ordinary course of business; and

- (d) Files a petition for the winding up of its affairs, or, has been ordered to wind up its affairs (voluntary or involuntary winding up).

**Q4. What are the actions the Clearing House can take in the event of a Clearing Participant's default?**

**A.** Rules 1001 and 1002 set out the actions the Clearing House can take in the event of a Clearing Participant's default and are summarised as follows:

- (a) Liquidating or novating (or both) the rights and obligations under the Open Contracts of the Clearing Participant in default;
- (b) Liquidating any Approved Collateral and calculating the sum of all assets of the Clearing Participant in default including its Security Deposit, Direct Clearing Participant Deposit, Clearing Fund Contribution, cash and any other assets held by the Clearing House; or
- (c) Setting-off any loss incurred by the Clearing House under paragraph (a) above against the monies recovered under paragraph (b) and dealing with any surplus monies or deficit accordingly.

**Q5. In the event of a default by a Clearing Participant, the Clearing House can liquidate any approved collateral to cover the default amount. Please provide the order of priority for collateral liquidation.**

**A.** The current practice of the Clearing House is to liquidate the approved collateral in their order of priority as follows:

1. Cash – local currency;
2. Foreign currency collateral;
3. Letters of credit; and
4. Equities

The Clearing House may, at its discretion and at any time, vary this order of priority.

**Q6. What are the actions the Clearing House can initiate in novating or liquidating open positions of a Clearing Participant in default?**

**A.** The actions the Clearing House can initiate in relation to liquidation of Open Positions of a Clearing Participant in default include:

- (a) taking over the position;
- (b) transferring the position under the Clearing House's supervision;
  - Under this circumstance, the Clearing House will appoint one or more Clearing Participants to take over the defaulting Clearing Participant's positions for further action.
- (c) closing out the position.

**Q7. In the event the Clearing House has exhausted all the actions set-out in the answer to Q4 and there are still losses outstanding, how will the Clearing House cover such losses?**

**A.** Generally, the remaining amount of losses will be mitigated by the Clearing House through the application of Clearing Fund and if the Clearing Fund is still insufficient to cover the remaining amount of losses, the Clearing House will call for Variable Contribution to the Clearing Fund from all the Clearing Participants. The Clearing House will thereafter initiate legal proceedings to recover the losses from the Clearing Participant in default.

**Q8. What is the quantum of the Clearing Fund?**

**A.** As at 31 March 2009, the Clearing Fund stood at RM21 million made up of RM1 million fixed contribution from each Clearing Participant.

**Q9. In the event there are losses arising from a default by a Clearing Participant relating to the Clearing Participant's proprietary business, will the Clients' cash and collateral be protected?**

**A.** In the event there are losses arising from a default by a Clearing Participant relating to the Clearing Participant's proprietary business, only the cash and collateral from the Unsegregated Account (the account for the Clearing Participant's proprietary business) can be used to cover the default amount. Cash and collateral from the Segregated Account (the client's segregated account required under the CMSA as described below) cannot be used to cover a default relating to the Clearing Participant's proprietary business.

**Q10. How are Client's monies and collateral protected should a Clearing Participant go bankrupt?**

**A.** The monies and collateral of a client of a Clearing Participant that is a holder of a Capital Markets Services Licence to trade in futures contracts are maintained in the client's segregated account as provided for by the Capital Markets & Services Act 2007 (CMSA). The segregation of assets between a Clearing Participant and its client provides the required protection for the client's monies and collateral as these assets will not be available to the Clearing Participant for reasons other than as permitted by the CMSA. As such, these monies and collateral are protected should the Clearing Participant go bankrupt.