

## Chapter 2

# Recognition requirements

2.17 Recognition requirements relating to the default rules of UK RIEs

2.17.1 G The text of part of regulation 3 (Interpretation) of and Parts II and IV of the Schedule to the *Recognition Requirements Regulations* is set out below.

2.17.1A UK Regulation 3 (Interpretation) of the Recognition Requirements Regulations:

..."default fund" means the sum of the default fund contributions by the members or designated non-members of a *[recognised investment exchange]* to that exchange or by one *[recognised investment exchange]* to another or by the members of a *[recognised clearing house]* to that clearing house or by one *[recognised clearing house]* to another to the extent those contributions have not been returned or otherwise applied;

"default fund contribution" has the same meaning as in section 188(3A) of the Companies Act [1989];"...

2.17.2 UK Schedule to the Recognition Requirements Regulations, Part II

- Paragraph 10 (Default rules in respect of market contracts)
- (1) The *[UK RIE]* must have *default rules* which, in the event of a *member* of the *[UK RIE]* being or appearing to be unable to meet his obligations in respect of one or more *market contracts*, enable action to be taken in respect of unsettled *market contracts* to which he is party.
  - (2) The *[default rules]* may authorise the taking of the same or similar action in relation to a *member* who appears to be likely to become unable to meet his obligations in respect of one or more *market contracts*.
  - (3) The *[default rules]* must enable action to be taken in respect of all unsettled *market contracts*, other than those entered into for the purposes of or in connection with the provision of clearing services for the *[UK RIE]*.
  - (4) Sub-paragraph (5) applies where the exchange has arrangements for transacting business with, or in relation to common members of, a *[recognised clearing house]* or another *[recognised investment exchange]*.
  - (5) A *[UK RIE]* must have *[default rules]* which in the event of the clearing house or the investment exchange being or appearing to be unable to meet its obligations in respect of one or more *[market contracts]*, enable action to be taken in respect of unsettled *[market contracts]* to which that person is a party.
- Paragraph 11 (Content of rules)

- (1) This paragraph applies as regards contracts falling within section 155(2)(a) of the Companies Act [1989].
- (2) The [default rules] must provide -
  - (a) for all rights and liabilities between those party as principal to unsettled *market contracts* to which the defaulter is party as principal to be discharged and for there to be paid by one party to the other such sum of money (if any) as may be determined in accordance with the [default rules];
  - (b) for the sums so payable in respect of different contracts between the same parties to be aggregated or set off so as to produce a net sum; and
  - (c) for the certification by or on behalf of the [UK RIE] of the net sum payable or, as the case may be, of the fact that no sum is payable.
- (3) The reference in sub-paragraph (2) to rights and liabilities between those party as principal to unsettled *market contracts* does not include rights and liabilities -
  - (a) in respect of margin; or
  - (b) arising out of a failure to perform a *market contract*.
- (4) The [default rules] may make the same or similar provision, in relation to [designated non-members] designated in accordance with the procedures mentioned in sub-paragraph (5), as in relation to members of the [UK RIE].
- (5) If such provision is made as is mentioned in sub-paragraph (4), the [UK RIE] must have adequate procedures -
  - (a) for designating the *persons*, or descriptions of person, in respect of whom action may be taken;
  - (b) for keeping under review the question which *persons* or descriptions of person should be or remain so designated; and
  - (c) for withdrawing such designation.
- (6) The procedures must be designed to secure that -
  - (a) a *person* is not, or does not remain, designated if failure by him to meet his obligations in respect of one or more *market contracts* would be unlikely adversely to affect the operation of the market; and
  - (b) a description of persons is not, or does not remain, designated if failure by a *person* of that description to meet his obligations in respect of one or more *market contracts* would be unlikely adversely to affect the operation of the market.
- (7) The [UK RIE] must have adequate arrangements -
  - (a) for bringing a designation or withdrawal of designation to the attention of the *person* or description of persons concerned; and
  - (b) where a description of *persons* is designated, or the designation of a description of persons is withdrawn, for ascertaining which *persons* fall within that description.

## Paragraph 12 (Content of rules)

- (1) This paragraph applies as regards contracts falling within section 155(2)(b) or (c) of the Companies Act [1989].
- (2) The [default rules] must provide -

	(a)	for all rights and liabilities of the defaulter under or in respect of unsettled <i>market contracts</i> to be discharged and for there to be paid by or to the defaulter such sum of money (if any) as may be determined in accordance with the [default rules];
	(b)	for the sums so payable by or to the defaulter in respect of different contracts entered into by the defaulter in one capacity for the purposes of section 187 of the Companies Act [1989] to be aggregated or set off so as to produce a net sum;
	(bb)	if relevant, for that sum to be aggregated with, or set off against, any sum owed by or to the investment exchange by or to AP under an indemnity given or reimbursement or similar obligation in respect of a margin set off agreement in which the defaulter chose to participate so as to produce a net sum;
	(c)	for the net sum referred to in [(2)](b) or, if relevant, the net sum referred to in [(2)](bb) -
	(i)	if payable by the defaulter to the exchange, to be set off against -
		(aa) any property provided by or on behalf of the defaulter as cover for margin (or the proceeds of realisation of such property);
		(bb) to the extent (if any) that any sum remains after set off under (aa), any default fund contribution provided by the defaulter remaining after any application of such contribution;
	(ii)	to the extent (if any) that any sum remains after set off under (i), to be paid from such other funds, including the default fund, or resources as the exchange may apply under its <i>default rules</i> ;
	(iii)	if payable by the exchange to the defaulter, to be aggregated with -
		(aa) any property provided by or on behalf of the defaulter as cover for margin (or the proceeds of realisation of such property);
		(bb) any default fund contribution provided by the defaulter remaining after any application of such contribution; and
	(d)	for the certification by or on behalf of the [UK RIE] of the sum finally payable or, as the case may be, of the fact that no sum is payable.
(2A)		In sub-paragraph (2), "margin set off agreement" means an agreement between the exchange and AP permitting any eligible position to which the Participant Member is party with the exchange and any eligible position to which the Participant Member is party with AP to be taken into account in calculating a net sum owed by or to the Participant Member to either the exchange or AP and/or margin to be provided to, either or both, the exchange and AP.
(2B)		In sub-paragraph (2) - <p>"AP" means a [recognised clearing house] or another [recognised investment exchange] of whom a Participant Member is a member;</p> <p>"eligible position" means any position which may be included in the set off calculation;</p> <p>"Participant Member" means a person who</p>

	<p>(a) is a member of the exchange;</p> <p>(b) is a member or participant of AP; and</p> <p>(c) chooses to participate, in accordance with the rules of the exchange, in such agreement.</p>
(2C)	The property, contribution, funds or resources referred to in (2)(c), against which the net sum is to be set off (or with which it is to be aggregated) are subject to any unsatisfied claims arising out of the default of a defaulter before the default in relation to which the calculation is being made.
(3)	<p>The reference in sub-paragraph (2) to the rights and liabilities of a defaulter under or in respect of an unsettled <i>market contract</i> includes (without prejudice to the generality of that provision) rights and liabilities arising in consequence of action taken under provisions of the [default rules] authorising -</p> <p>(a) the effecting by the [UK RIE] of corresponding contracts in relation to unsettled <i>market contracts</i> to which the defaulter is party;</p> <p>(b) the transfer of the defaulter's position under an unsettled <i>market contract</i> to another member of the [UK RIE];</p> <p>(c) the exercise by the UK RIE of any option granted by an unsettled <i>market contract</i>.</p>
(4)	A "corresponding contract" means a contract on the same terms (except as to price or premium) as the <i>market contract</i> but under which the person who is the buyer under the <i>market contract</i> agrees to sell and the person who is the seller under the <i>market contract</i> agrees to buy.
(5)	Sub-paragraph (4) applies with any necessary modifications in relation to a <i>market contract</i> which is not an agreement to sell.
(6)	The reference in sub-paragraph (2) to the rights and liabilities of a defaulter under or in respect of an unsettled <i>market contract</i> does not include, where he acts as agent, rights or liabilities of his arising out of the relationship of principal and agent.
<b>Paragraph 12A (Content of rules)</b>	
The rules of the [UK RIE] must provide that, in the event of a default, any default fund contribution provided by the defaulter shall only be used in accordance with paragraph 12(2)(c)(i) or (ii).	
<b>Paragraph 13 (Notification to other parties affected)</b>	
The [UK RIE] must have adequate arrangements for ensuring that -	
	<p>(a) in the case of unsettled <i>market contracts</i> with a defaulter acting as principal, parties to the contract are notified as soon as reasonably practicable of the default and of any decision taken under the [default rules] in relation to contracts to which they are a party; and</p> <p>(b) in the case of unsettled <i>market contracts</i> with a defaulter acting as agent, parties to the contract and the defaulter's principals are notified as soon as reasonably practicable of the default and of the identity of the other parties to the contract.</p>
<b>Paragraph 14 (Cooperation with other authorities)</b>	
The [UK RIE] must be able and willing to cooperate, by the sharing of information and otherwise, with the Secretary of State, any relevant office-holder and any other authority or body having responsibility for any matter arising out of, or connected with, the default of a member of the [UK	

*RIE] or any [designated non-member] or the default of a [recognised clearing house] or another [recognised investment exchange].*

2.17.3 UK [deleted]

2.17.4 G [deleted]

2.17.5 G [deleted]

2.17.6 G The Companies Act 1989 contains provisions which protect action taken by a *UK recognised body* under its *default rules* from the normal operation of insolvency law which might otherwise leave this action open to challenge by a *relevant office-holder*.