

**Achievement of Market-Friendly Initiatives and Results Program  
(AMIR 2.0 Program)**

**Funded By U.S. Agency for International Development**

**Middle East New Exchange  
( ME-NEX )  
Clearance & Settlement Rules**

Final Report

**Deliverable for Capital Markets Component, Task No. 635.28  
Contract No. 278-C-00-02-00201-00**

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MEMORANDUM

TO : ME-NEX Executive Committee

FROM : Project Manager

RE : **Clearance & Settlement Rules Issues**

DATE : January 22, 2002

The ME-NEX Rules Team held a meeting in Amman on Dec 27<sup>th</sup> – 28<sup>th</sup> to discuss the Clearance & Settlement Rules for ME-NEX. During the meeting, various clearance & settlement issues were discussed and the Team came up with certain recommendations on how to formulate the ME-NEX rules. The Team did a great job of mapping out the relevant issues and recommendations thereto.

What follows is a list of these issues and relevant recommendations which require approval of the ME-NEX Executive Committee. Once the Executive Committee decides on these issues, the draft Clearance & Settlement Rules will be finalized.

**I. Unique Identification Number**

Jordan, Dubai and Bahrain are using different Identification Numbers. The Team recommends the use of system-generated numbers for ME-NEX investors as a unique number while saving the NIN from their country of origin (if any) in a reference field for future use.

**II. Transfers and Movements**

To reduce the workload on ME-NEX while at the same time maintaining the authority to verify the correctness of a transaction, the Team recommends that participants enter and post the transfer and movement transaction, then send the proper documentation to ME-NEX for approval on the system.

### III. Pledges and Liens

To have control over the operations of pledge and lien, and to be sure that pledged / under-lien securities are not traded, not even by mistake, the Team recommends to do pledges and liens through registry accounts (participant / broker-owned accounts are sent back to registry for pledge and lien).

### IV. Clearing and Settlement Cycle

The Team assumed the settlement cycle will be based on multilateral netting and left the details of money transfers between the three countries to be detailed in the agreement with the settlement bank.

### V. Trading Days and Trading Schedule

In order to be able to define cut-off times for the operations carried out by the clearing and settlement unit, it is necessary for the Team to have the time-zone used, trading schedule (days and times), and holidays identified for trading as agreed to by the Executive Committee.

### VI. Fees, Charges and Penalties

Fee structure for transactions need to be decided (in a separate set of rules). For the purpose of the Clearing and Settlement Rules, Article (22), the following needs to be addressed:

*22.1 Notwithstanding the fees provided for in the Internal Regulations, and the Resolutions passed thereunder, ME-NEX shall adopt, and may from time-to-time amend, a non-discriminatory schedule of charges for services rendered according to these Rules.*

*22.2 Notwithstanding any charges levied by ME-NEX Internal Regulations and the Resolutions passed thereunder for any violation, ME-NEX may impose a surcharge for conduct likely to impede the operations of the ME-NEX, provided that no surcharge for any given offence shall exceed the sum of \$ \_\_\_\_\_.*

*Subject to Article (22.2) above, ME-NEX shall impose on the Participant who fails to discharge its clearing and settlement obligations on T+3, a default charge of \$ \_\_\_\_\_ for a transaction not exceeding \$ \_\_\_\_\_, and \$ \_\_\_\_\_ for each \$ \_\_\_\_\_ thereafter. The charge shall be imposed for each day of default, until the failing Participant discharges its clearing and settlement obligation in full.*

The Executive Committee is kindly requested to determine the above fees and charges. These fees and charges will be part of the fee schedule for ME-NEX.

## **VII. Deposit and Withdrawal of Certificates**

Is ME-NEX going to allow the deposit and withdrawal of certificates?

The Team recommends to go for a dematerialized environment (no certificates involved).

Additionally, the Team recommends the following:

- a. On dual listing: If the company is already listed on its home market, the share book should be split between ME-NEX and the home market.

If the company starts the listing on ME-NEX and then wishes to list on its home market in addition to being listed on ME-NEX, a partial delisting from ME-NEX is to take place whereby the share book is split between the two markets.

- b. On delisting: If a company wants to delist from ME-NEX and list on its home market only, there is no problem as this is a straight forward delisting procedure.

## **VIII. Tightly-Coupled Environment versus Loosely-Coupled Environment**

Team recommendation is to start out with a tightly coupled environment.

## **IX. Bank Guarantee, Settlement Guarantee Fund, and Liquidity Reserve**

The Rules Team recommends the use of the following risk control mechanisms:

- a. Bank Guarantee and Trading Limit;
- b. Settlement Guarantee Fund; and,
- c. A Liquidity Reserve (use and percentage- 10%).

### *Bank Guarantee and Trading Limit:*

The Team recommends the use of a Bank Guarantee to cover the ceiling of the Participants' Trading Limit (Trading Cap). The question is how to calculate the Trading Limit? There are two options.

One option is based on a formula that takes into consideration the participant's capital (used by BSE):

$$\text{Cap Limit} = \frac{\text{Collateral} + (\text{Capital} \times \text{Risk Factor})}{(\text{Number of Settlement Days} + \text{Reserve Settlement Days}) \times \text{Maximum Risk}}$$

The second option is based on the average Net-to-Pay position of a participant over a period of time (used by DFM). In this case, the cap/limit should be calculated based on the cumulative position of the participant on each day of the settlement cycle, as the participant's position will be affected daily and payment or an increase of cap/limit should be affected.

As it is difficult to study the history of trading of participants with regards to ME-NEX in the beginning, it is recommended that cap/limit be an estimate of past trading volumes of the participant for the last six months on its home market. This shall apply until a new six-month track record is established on ME-NEX. The ME-NEX six-month track record shall be applied for future cap/limits.

As to the issue of bank guarantees, the Team recommends that arrangements be made between the ASE, DFM and BSE whereby guarantees already submitted by members are partially used for ME-NEX purposes. This arrangement can last until trading volumes on ME-NEX increase to a level that warrants revisiting this issue.

*Settlement Guarantee Fund:* The Team recommends the use of a Settlement Guarantee Fund. Participants' contribution into the Fund can be determined by averaging the daily Net-to-Pay position of participant for a period of one month, for example. To start with, it is recommended that ME-NEX calculate this amount based on the last month of trading by each participant on its home market.

*Liquidity Reserve:* The Rules Team recommends the use of a Liquidity Reserve to be paid on the morning of T+1 as 10% of Net-to-Pay positions of Participants. This is useful as an initial warning for the participants ability to pay their dues on T+3. However, there are two options on the action to be taken against defaulting participant:

- a. If Participant did not pay Liquidity Reserve amount on T+1, suspend only "buys" of the Participant, and allow its "sells" in order to give the participant the chance to recover the shortage. At the same time this can be risky as the participant may attempt to direct the funds generated from these sales into other payments.

- b. If Participant did not pay Liquidity Reserve amount on T+1, suspend all the Participant's activities (both buys and sells). This can also protect the market from chain effect of the Participant's failure as addressed by point (a) above, yet it does not give the participant the chance to recover.

The Executive Committee also needs to decide which one of these two options to apply in the case of a participant defaulting to pay its dues on settlement day.

The Team could not decide which of the two options to recommend.

#### **X. Buy-in/ Sell-out**

The Team could not reach consensus on the following points:

- a. Who will initiate buy-in/sell out order? Is it the participant or ME-NEX?
- b. Is it initiated on apparent failure or on actual failure?
- c. Are buy-in/sell-out transactions to be done through the trading system or as part of the CDS system?
- d.

#### **XI. Review by the Legal Committee**

The Team recommends that the "Clearing and Settlement Rules" be reviewed by the Legal Team to ensure consistency with the other rules of ME-NEX, especially Membership Rules.