Notice No.: RISK-2022-010 **Issue Date:** 18 April 2022

Subject: Member Consultation Notice

Notice to all Members,

1. Introduction

1.1 As Members will be aware the DGCX Group (comprising of DGCX, or "the Exchange", and DCCC, or "the CCP") are undertaking a technology migration project which will see the market transition to Nasdaq-provided technology at the beginning of Q2 2023. Members, other market participants and stakeholders have been advised of the progress of this project and at the initial market-wide webinar, held 0n 14 April 2021, were made aware of significant changes to the way in which the DGCX Group operates its market today. One of the key changes was the move from the current pre-trade margin model to the post-trade margin model which is the more globally-adopted model.

1.2 This Notice sets out the DGCX Group's initial thinking as to the appropriate risk management framework ("the Framework") that should be implemented to accompany the post-trade margin model, and invites comments from Members, market participants and stakeholders in a number of areas, detailed below.

1.3 It will be noted that some aspects of the Framework are mandated either by regulation, global best practices or DGCX By-Laws and/or DCCC Clearing Rules, and as such, whilst comments may be submitted the potential for change is limited. However, the DGCX Group considers it appropriate to set out the complete Framework in order that comments submitted are able to be considered against the Framework as a whole, rather than just the particular aspect upon which comments have been sought.

1.4 In developing the Framework, the DGCX Group has had regard to the work undertaken by the Futures Industry Association (FIA) over many years, where it has sought to allocate roles and responsibilities across market participants – i.e. trading members, clearing members, exchanges and CCPs – with the result that the Framework is similar in many aspects to that in place in many other markets around the globe.

1.5 As the name suggests, this is a framework as to how the market will operate and as such does not address every individual item – e.g. treatment of public holidays – but further, more detailed information will be provided in due course.

1.6 Finally, the Framework, and the responses to this Notice will be submitted to SCA for their consideration and comment and as such may be subject to further change.

1.7 Comments should be submitted in writing to email address: clearing@dccc.co.ae by no later than **Friday 13 May 2022**. Comments received after this time may be considered by the DGCX Group at its absolute discretion.

T.: (+9714) 36 11 616
F.: (+9714) 36 11 617
E.: info@dccc.co.ae
Level UP (Floor 37), Gold Tower (AU)
Cluster I, Jumeirah Lakes Towers (JLT)
PO. Box 37736, Dubai, UAE

2. Background

2.1 Before setting out the Framework, it is worth noting that the current pre-trade risk management approach places the responsibility for risk management upon the CCP (DCCC). By this it is meant that no trading can take place, indeed no orders can be placed into the market, unless collateral is lodged with the CCP at one of the accredited settlement banks. This collateral then sets a limit on how much, in collateral or margin terms can be traded, and if breached then no more trading is permitted – other than risk-reducing transactions – until such time as additional collateral is lodged with the CCP.

2.2 In this model, there is no requirement for Members, be they trading or clearing, to consider the market risk appetite that either they or they clients have, or should have, and so any pre-trade controls would simply be limited to ensuring that they hold sufficient funds on behalf of clients to meet any margin calls issued by the CCP. In turn, the Exchange has no need to implement any form of price controls on the market and can rely upon a single post-trade price validation process that seeks to either adjust a trade price or invalidate a transaction.

2.3 A CCP is responsible for the financial integrity of the markets for which it provides clearing services, but it is not responsible for assessing the market exposure appetite of Members or their clients, or for ensuring market integrity. This latter point is the responsibility of an exchange, which is why most exchange rule-books contain sections relating to prohibited practices (e.g. wash transactions, price manipulation and market abuse etc.). Maintaining market integrity is vitally important for the credibility of any marketplace but for a CCP it is financial integrity that is paramount.

2.4 Therefore, a risk management approach which places the entire responsibility for risk management with a single market participant – be it the CCP or the exchange – will fail to take into consideration those other aspects for risk management which should rightly be the responsibility of other market participants. Further, it should be noted that a pre-trade risk management approach does not prevent Clearing Member defaults, nor does it lessen the impact of such an event – indeed, it could be argued that the aftermath of such an event could be exacerbated should other market participants wish to undertake transaction in the market but are prevented from doing so by a temporary delay in lodging additional collateral with the CCP.

2.5 Most CCPs globally have adopted a post-trade margin model which has proved to be both resilient and successful in providing price risk management services to a wide range of market participants – from individuals, to hedge funds, investment banks, commodity funds, physical commodity institutions etc. As with a pre-trade model, this approach has not avoided Clearing Member defaults but those which have occurred have most typically been the result of a build-up of open positions over an extended period of time often accompanied by a breakdown of controls and procedures in the defaulting firm.

T.: (+9714) 36 11 616
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3. The Framework

3.1 The post-trade model proposed to be adopted by the DGCX Group would still require Members to post a minimum clearing commitment prior to commencing trading on the Exchange. Currently the levels are as follows:

3.1.1 General Clearing Member (GCM): $75,000

3.1.2 Direct Clearing Member (DCM): $50,000

3.1.3 Trade Clearing Member (TCM): $25,000

3.2 DCCC intends to increase these levels prior to the technology migration in Q2 2023, as the DGCX Group does consider them to be low when compared with other markets. For example, it is $3,500,000 for Singapore Exchange (SGX), . Indeed, even for those markets that operate a pre-trade margining system the levels are higher, for example, $2,700,000 for Dubai Financial Market (DFM); $2,000,000 for Abu Dhabi Exchange (ADX).

Q1: Do market participants agree that the current minimum clearing commitment levels are low by international standards?

Q2: Bearing in mind the membership structure of the DGCX Group, what level(s) do market participants consider to be more appropriate?

3.3 In addition to minimum clearing commitment all members must comply with the requirement to maintain Net Current Tangible Assets (NCTA) at or above relevant minimum levels at all times, and the current levels are:

3.3.1 General Clearing Member (GCM): $500,000

3.3.2 Direct Clearing Member (DCM): $350,000

3.3.3 Trade Clearing Member (TCM): $100,000

3.3.4 Trade Member (TM): $100,000

3.3.5 Broker Member (BM): $250,000

3.4 In most other markets NCTA is not used as a measure of financial good-standing but instead it is more usual to see paid-in capital/shareholder funds used. Further, as with minimum clearing commitment, the NCTA levels imposed by DGCX Group are low when compared with other markets. For example, $8,000,000 of minimum paid-in capital for the brokers at DFM , $3,500,000 base capital for Clearing Members at SGX, and $10,000,000 minimum capital requirement for ICE Clear Europe.

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Q3: Do market participants agree that DGCX Group should replace NCTA requirement with a more appropriate measure of capital adequacy?

Q4: Bearing in mind the membership structure of the DGCX Group what level(s) do market participants consider to be more appropriate?

3.5 For the avoidance of doubt, any changes to the minimum clearing commitment and/or capital adequacy requirements will be subject to further consultation and any changes will not be implemented as part of the technology migration project.

3.6 Turning to the individual component parts of the Framework, the first element is the provision of Pre-Trade Risk Management (PTRM) functionality. DGCX By-Laws already contain a requirement covering this topic, as follows:

"D5.1(e)

A Member shall ensure that all employees that it allows access to the Automated Trading System (ATS) are sufficiently trained, are aware of all relevant By-Laws, and that appropriate procedures and controls are in place to govern all activities undertaken on the ATS. ***These shall include, but not be limited to, pre-trade risk controls*** *and monitoring for Prohibited Practices as set out in By-Law D.3."* [emphasis added]

3.7 DGCX Group has determined that all orders submitted to the market must be subject to some form of PTRM check, that this will be a mandatory requirement to be complied with by all Members.

3.8 Order submission is either by FIX protocol or manually using the Exchange-provided front end (Nasdaq Core Desktop or NCD). It is likely that existing FIX users will already have some form of PTRM configured as part of their order management system and as such no additional work will be needed to be undertaken to comply with the new mandatory requirement. However, for those members who will be seeking to use NCD to enter orders directly to the market, they will be required to use the Exchange-provided PTRM solution, which will be provided free of charge.

3.9 This PTRM solution will allow for limits to be set for each product that is made available for trading by DGCX, and also for combination orders submitted to the market – e.g a calendar spread for DINR M1/M2. The limits that can be set are as follows:

3.9.1 Max Order Size – maximum allowed quantity for an order;

3.9.2 Max Order Value – maximum allowed order value (order price x quantity);

3.9.3 Price Deviation – maximum allowed percentage deviation from the reference price;

3.9.4 Traded Bought/Sold – maximum quantity of traded contracts on the buy or sell side;

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3.9.5 Traded Net – maximum quantity of absolute value of (traded bought – traded sold) contracts;

3.9.6 Total Buy/Sell – maximum quantity of Open Buy/Sell and Traded Bought/Sold contracts; and

3.9.7 Total Net Buy/Sell – maximum quantity of absolute value of (Total Buy – Total Sell).

3.10 In addition to the above controls, the PTRM solution will also include both “kill switch” and “mass cancel” functionality, as well as the ability to restrict access to certain products if required.

3.11 Whilst these limits can be set by any user of PTRM – i.e. either a Clearing Member or Trading Member – DGCX Group considers it appropriate to restrict the setting and maintenance of limits to Clearing Member only. This is based upon the fact that it is the Clearing Member that has the financial responsibility to meet the margin calls issued by the CCP in respect of the open positions carried by the Clearing Member for all of its client, be they Trading Members (House Trading) or customers.

3.12 DGCX Group is mindful that Clearing Members have a much greater understanding of the trading practices of their clients than either the Exchange or CCP, and as such seeks to provide flexibility in approach when setting limits, within the overall requirement that all orders must be subject to limit validation. Therefore, DGCX Group will mandate that only Minimum Net Volume Traded limits (or equivalent for FIX users) be set and maintained, although Clearing Members may determine that it would be appropriate to implement other limits, either for all clients or a sub-set thereof.

3.13 It should be noted that PTRM provides for limits to be set at Member, User (i.e. individual trader) or Account level as appropriate, thereby providing considerable flexibility in implementing limits which a Clearing Member would consider to be most appropriate for its clients.

3.14 PTRM provides the ability for the users to set warning threshold against each set of limits that have been set up, and for automated emails to be generated when such thresholds have been breached.

Q5. Do market participants agree that DCGX Group should not make mandatory limits other than for Minimum Net Volume Traded?

Q6. If not, what other limits should DGCX Group make mandatory?

3.15 The introduction of PTRM will be new for market participants and to assist with the additional work that will be required to implement and maintain the relevant limits, DGCX Group is proposing that for a transitional period – say 6 months from go-live – it will manage the limit-setting in PTRM, acting upon requests submitted by Clearing Members. However, in doing so, it should be noted that DGCX Group will assume no

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responsibility for any errors in implementing or amending levels or for any consequent trading activity that may ensue.

Q7. Would market participants want DGCX Group to provide transitional assistance as set out in section 3.15 above?

3.16 In addition to PTRM, DGCX Group will be introducing dynamic price limits as check to ensure that pricing integrity is maintained. Dynamic price limits are a well-established feature of most markets, providing protection against "fat finger" errors, and the functionality to be implemented by DGCX Group will be broadly similar to that seen in other markets. Price limits will be published by the Exchange and reviewed periodically, and these limits will create a price sleeve around a reference price, which will result in bids submitted above the upper limit and offers submitted below the lower limit being automatically rejected by the matching engine.

3.17 Where the market moves such that it results in resting orders at prices that would otherwise fall outside of the then prevailing dynamic price limits, those orders will remain in the market and hence may be traded against. It is the responsibility of the member to ensure that at all times they are aware of all orders that they have in the market.

3.18 A key part of the Framework will be the introduction of a daily intra-day variation margin call. Currently, margin is called once per day, based upon end-of-day positions and includes both initial and variation margin. Given that in a post-trade margin market it is possible for open positions to be built-up during the course of the day and that such open positions would not be subject to any margin calculation until the end of the day, then that represents a risk not only to the CCP but to the market as a whole.

3.19 Other markets have addressed this risk through the introduction of an additional margin call, and whilst DCCC has the powers under the Clearing Rules to make an intra-day margin call, this has typically been viewed as an ad hoc measure to address significant market volatility, although it should be noted that to date no such intra-day call has been made. However, DGCX Group considers it appropriate to implement a routine, daily, intra-day margin call.

3.20 Notwithstanding this decision the DGCX Group is mindful if the issues that exist in transferring funds to the region and takes into account the practical issues when seeking to address the risks posed by the build-up of open positions intra-day. Therefore, the pragmatic and prudent approach proposed would see variation margins calculated intra-day, with only negative variation margin called for from Clearing Members – i.e. whilst initial margin calculations would be performed by the CCP throughout the day, the result would not be called for unless there were exceptional circumstances that warranted such a call.

3.21 It is envisaged that the intra-day negative variation margin call would be undertaken at 14:00 GST, and that Clearing Members would have until 16:00 GST to meet any such

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margin call. Failure to do so would be deemed an Event of Default under the Clearing Rules, and the Clearing Member would be declared in default.

3.22 Clearing Members with any excess collateral held by the CCP would be able to use that to meet any intra-day negative variation margin call, and in so doing, it is hoped that this will lessen the practical implications of such a call. Similarly, for those members that will be ending up with a positive variation margin at the end of the day, will have the chance to transfer the positive balance directly to their collateral account with the DCCC.

Q8: Do market participants agree that the intra-day margin call should be restricted to negative variation margin only?

Q9: If not, what should the intra-day margin call consist of?

Q10: Do market participants agree with the proposed timings and frequency (only once a day 14:00 GST) of the intra-day margin call?

Q11: If not, what alternative times would market participants wish to see?

Q12: Would market participants want VM profits allocated to collateral accounts by the CCP for both proprietary and client business?

3.22. In addition to the above, DGCX Group will be providing Clearing Members with access to the Nasdaq Real Time Clearing application, which will allow Clearing Members to view positions in real-time, together with near real time variation and initial margin calculations. As is the case today, SPAN files will be created five times during each day and made available to Clearing Members.

3.23. The Exchange and CCP will continue to monitor all order and trading activity and will take such actions as may be necessary to ensure a fair and orderly market and the financial integrity of the market.

4. Conclusion

4.1. DGCX Group considers that the Framework detailed above would result in an appropriate and pragmatic risk management approach that is suitable for the current market structure, whilst at the same time providing a platform for further evolution as the market continues to develop through new products and services. It is hoped that market participants will take this opportunity to participate in the development of the Framework, recognizing as they do, the important role that all market participants play, be they members, the Exchange and the CCP, in providing price risk management services to investors.

4.2. Appendix I contains the questions that can be found detailed above, together with an additional question that invites market participants to submit other comments which they wish DGCX Group to consider as part of this initiative. DGCX Group will carefully review all responses and, where appropriate, will schedule further discussions with

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market participants such that the resulting final version of the Framework will have taken into consideration the views and opinions of market participants.

For Dubai Commodities Clearing Corporation

Eren Gegin
Head of Clearing and Risk Management

T.: (+9714) 36 11 616
F.: (+9714) 36 11 617
E.: info@dccc.co.ae

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Appendix I

Questions

Q1: **Do market participants agree that the current levels are low by international standards?**

Q2: **Bearing in mind the membership structure of the DGCX Group, what level(s) do market participants consider to be more appropriate?**

Q3: **Do market participants agree that DGCX Group should replace NCTA requirement with a more appropriate measure of capital adequacy?**

Q4: **Bearing in mind the membership structure of the DGCX Group what level(s) do market participants consider to be more appropriate?**

Q5. **Do market participants agree that DCGX Group should not make mandatory limits other than for Minimum Net Volume Traded?**

Q7. **Would market participants want DGCX Group to provide transitional assistance as set out in section 3.14 above?**

Q6. **If not, what other limits should DGCX Group make mandatory?**

Q8: **Do market participants agree that the intra-day margin call should be restricted to negative variation margin only?**

Q9: **If not, what should the intra-day margin call consist of?**

Q10: **Do market participants agree with the proposed timings and frequency (only once a day 14:00 GST) of the intra-day margin call?**

Q11: **If not, what alternative times would market participants wish to see?**

Q12: **Would market participants want VM profits allocated to collateral accounts by the CCP for both proprietary and client business?**

Q13: **Are there any other comments that you wish DGCX Group to consider when developing the Framework?**

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