

## CCP Default Management General Application Principles

The circumstances where Takasbank CCP members shall be considered in default have been described in the Market Directives and Procedures, primarily in the CCP Regulation and in addition, have been inserted into the Membership Procedures. Under the first paragraph, Article 35 of the Takasbank CCP Regulation, if a CCP member fails to promptly and fully meet the collateral and guarantee fund top up, delivery or payment obligations set for each market or capital market instrument and the delivery and payment obligations related to its transactions, it is deemed to be in the default without the need for any notice

The procedure that shall be applied to a CCP member deemed in default for any reason, is laid down in the Market Directive and Procedures, while how the business and transactions in relation to default will be handled by Takasbank is laid down in the Regulation on Takasbank CCP Default Management Implementation Principles.

In the Regulation mentioned above, which aims to regulate the application of principles regarding default management activities in the markets where Istanbul Clearing, Settlement and Custody Inc. (Takasbank) operates as Central Counterparty (CCP), primarily the matters concerning;

- General Principles
- The definition of default, Default Notification and Central Counterparty Default Committee
- Pre-default Conditions and Management
- Default Management Tools and Default Management
- Default Management Resources and their Use

have been regulated. Procedures may be issued to provide guidance for the business, transaction and rules that will be followed during the application of the principles in the Regulation.

Takasbank, has designed the default management resources to be resorted to in case of default, and the recovery of such resources in the markets where it offers CCP Service, by taking into account international principles and best practices and a default management system has been constructed to ensure sustainability of CCP services by Takasbank even under extreme conditions.

The measures and actions that will be taken upon default in the markets where Takasbank offers CCP service, is based on Capital Market Law numbered 6362 and the regulations issued in reliance upon this Law, are laid down in the relevant market Directive and Procedures, moreover have been arranged as rights and liabilities enabling legal pursue and enforcement through Membership Agreements agreed between two parties.

The default management processes that are implemented in the markets where Takasbank offers CCP service are presented in the diagram below; the regulations, where public disclosure is regarded as favorable, enacted by the Regulation are summarized in the following pages;



*Diagram 1 Takasbank Central Counterparty Default Management Process*

## General Principles

In the course of the defaults, which may occur in the markets operated as CCP, it is essential from Takasbank and market participants' view to ensure the continuity of the operation in a healthy manner. In this process, Takasbank's financial responsibility as CCP is the amount arising from acting as the guarantor in the transactions by means of replacing the opposite party, for every such party.

Takasbank is not liable for neither the members' obligations to their clients or the general central counterparty members' to the trading organizations. Takasbank's respondents are direct or general CCP members. Takasbank's liability to the member as central counterparty starts the instance the buy/ sell and bid / offer orders are matched and ends with the completion of settlement.

The clearing is completed by means of the transfer of the debt and receivables originating from the positions created by matched orders, among accounts or to the relevant entrusted accounts. The instance that the asset transfer is materialized between the accounts to fulfill the obligation is considered as the instance clearing is completed. Following Takasbank's performing the obligation to complete the clearing, the losses that the counterparties may be facing for whatsoever reason cannot be associated with the default management resources set within the framework of the CCP Regulation.

The collateral related to the client positions held in the individual accounts associated with CCP members may only be expended in the liquidation of such client's obligations. In the CCP served markets, announcement of default and the measures that will be taken in the course of the default and assignments are under the responsibility of the CCP Default Management Committee (DMC) established under the presidency of Takasbank's General Manager. In the matters that are not explicitly regulated in the relevant legislation DMC may consider international principles and applications.

DMC, in the default event of the member, employs default management tools such as migration/ closing out of the positions, sale via auction or compulsory transfer, the restriction of profit distribution in derivatives market and risk protection, also taking into account market impact. DMC is authorized to take measures it deems necessary taking into regard the relevant legislation, agreements signed with members and international principles.

In default event, the Member is obliged to pay the default interest at the rate specified in the relevant legislation. If Takasbank has incurred a loss beyond the default interest due to the Member's default, the Member is obliged to meet such loss as well. Takasbank has clearing, set-off and retaining rights over all kinds of rights and receivables of the Member, all accounts of the Member with Takasbank excluding client assets, for the Member's due debt, all kinds of interest and expense and loss beyond default interest arising from such debt.

## Pre-default Conditions

The member deemed to be in default, may be assigned a period as per the relevant Market Procedures, to fulfill its obligation in accordance with the 35/3 Article of the CCP Regulation. Such period which may be granted for defaults which do not arise from “financial incompetency”, are defined as “technical default” or “operational default” in the international principles and application and in the Regulation on Takasbank CCP Default Management Implementation Principles as “pre-default”.

The default circumstances, whereby the Member is delaying the fulfillment of the obligation at the outmost until the end of the period allowed in the relevant directives and procedures, and is not interrupting the continuity of the member’s activities shall be considered as pre-default.

The pre-default period is restricted to the period normally assigned for the liquidation of the default by the Member or Takasbank in the relevant market directives and procedures. (In Derivatives Market and Securities Lending market the pre-default has to be closed out until the end of the succeeding business day) .The CCP Default Management Committee may extend the pre-default period for one business day for the default that is not arising from “financial incompetency”. In the pre-default period, collateral withdrawal is not permitted from accounts with collateral shortfall and risk/position-enhancing transactions may be obstructed.

In the frequently occurring default circumstances, DMC is authorized to decide upon possible measures to take, including such mentioned below.

- a) The suspension of the trading authority over the member and/or client account which is the origin of default and demanding the disciplinary penalties laid down in the Takasbank Central Clearing Regulation’s Disciplinary Provisions titled 7<sup>th</sup> Section, for the member,
- b) In the borrowing transactions, if the pre-default is concentrating on certain securities and such concentration is due to the poor liquidity for this security, restricting borrowing on such security.

Pre-default condition should not be considered as a condition requiring the absolute termination of CCP membership despite the disciplinary penalties that might be applied as long as the defaults are closed out in the set period. However, it is not plausible that, a member deemed in default due to financial incompetency based on CCP Committee’s ruling, henceforth along with its associated clients, being exposed to Takasbank’s CCP Default Management actions, remain unaffected and proceed their transactions as normal. The default notification which will be delivered on the basis of financial incompetency and the subsequent default management actions, simultaneously shall start a process whereby the CCP membership shall be interrupted and most probably consequently terminated.

## Default Conditions and Default Notification

The Member, is deemed in default in the event of failure to perform obligations in accordance with the procedures and principles in the related legislation on the date the debt becomes due, without the need for protest, warning, grace period assignment and any legal pursuit or action proceeding. The members' debt becomes due in the following cases.

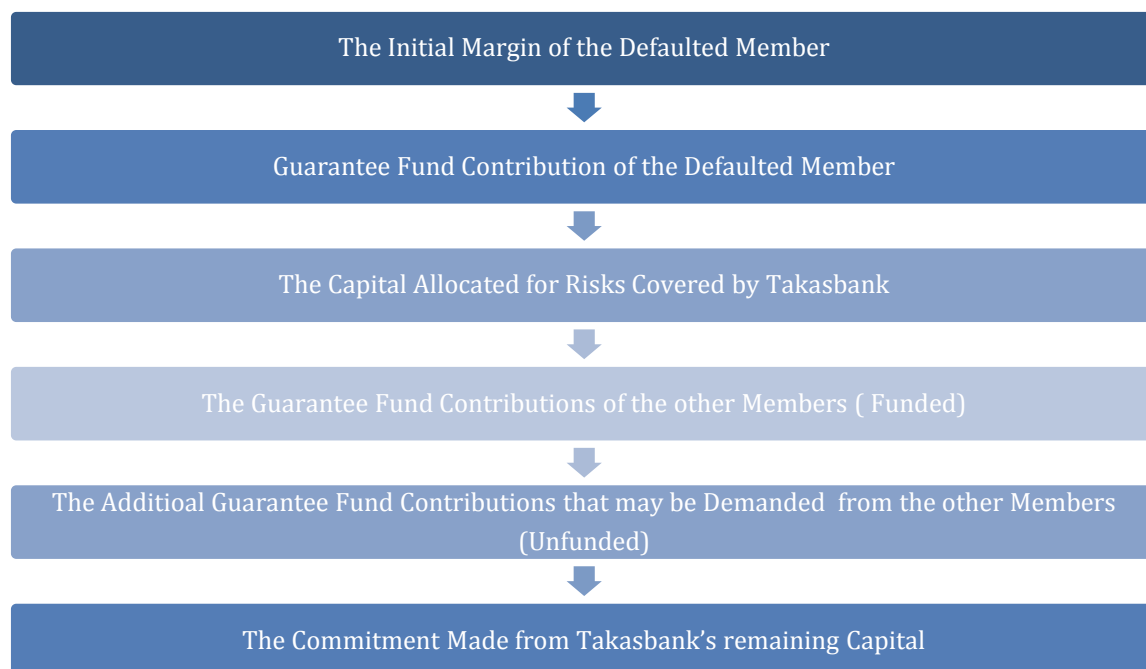
- a) Meeting margincall; failure to fulfill ordinary (deposited) guarantee fund and additional guarantee fund obligations, in the periods laid down in the related market directives and procedures;
- b) Failure to deposit membership fee, transaction fee and commission in the predetermined periods;
- c) Failure to fulfill delivery obligations in the period determined in the market directives and procedures;
- d) The suspension or termination of the Member's operations or any reason including termination of membership, requiring Takasbank to liquidate the Member's obligations.

In the event of CCP Default Management Committee's decision to apply default management measures subsequent to the prediction that the member shall not be able to full obligations to Takasbank, DMC's denial to grant additional period or member's failure to fulfill obligations still at end of such period, with the exception of pre-default conditions whereby it is concluded that such failure is not due to a permanent incompetency to fulfill the obligations, in accordance with the CCP Regulation "Member notification requirement" titled Article 13, the institutions which may be relevant such as , the Board, BIAS (Borsa Istanbul Inc.), CRA (MKK,Central Registry Agency), CBRT (TCMB, Central Bank Republic of Turkey) and BRSA (BDDK, Banking Regulations and Supervision Agency) and the defaulted member are immediately notified. In the notification default, management measures are laid down.

Following default notification, unless otherwise prescribed by the DMC, besides suspending the member's authority to transact in any way on behalf of its accounts , the trading authority of the member and if exists the trading organization for whom it is acting as clearing agency, are removed. The default member's cash collateral may be excluded from remuneration.

## Default Management Resources

Default management resources and their deployment sequence is regulated in the CCP Regulation Article 36 as demonstrated below.



*Diagram 2 Takasbank Default Management Resources*

In Takasbank's CCP default management process both the markets and Takasbank's security have been taken into account at the outmost level. Takasbank's capital may be deployed in the CCP default management process in 2 different portions, allocation and commitment. It is compulsory to deploy the portion allocated for CCP default management before the guarantee fund contributions of the solvent members. The second portion allocated from Takasbank's capital shall be deployed after the funded and unfunded guarantee fund obligations of the solvent members.

Pre-default cannot be ended with the member's initial margin with the exception of the pre-default conditions in the Borrowing and Lending Market (SLM, ÖPP). Since transaction based gross collateral is applied in the Security Lending Market, Takasbank's operational units, instead of waiting for the member to fulfill its obligation, within the knowledge of the member, may close out the position in default by obtaining the related security from the market by using the cash collateral received for the borrowing transaction.

Excluding the exceptional case applied in the Securities Lending Market, the deployment of other default management resources in the close out of members' positions in default, including the initial margin of the member in default and/ or guarantee fund contribution, is enabled only upon the notification of the CCP Default Management Committee's ruling and the member's default to Capital Markets Board and relevant organizations.

## Default Management Process

In the default management process, not to be restricted to such, one or several or all of the steps below may be applied simultaneously or according to the sequence determined by CCP Default Management Committee.

1) Closing out the positions in the member's account in case of such demand from the member after default notification, in a manner that shall not give rise to any obligation on Takasbank's behalf

2) To ensure that the collateral of the defaulted member is migrated fully or partially to a solvent member, along with the collateral related to positions in solvent accounts,

3) Closing out the open positions, where migration to another member is not possible even in the absence of collateral shortage, by means of reverse market positions opened for these accounts.

4) Mutual closeout or net-off of several or all the positions with the same maturity offsetting positions in the other accounts associated with the defaulted member, by Takas bank independently,

5) Cashing in the non-cash collateral and guarantee fund contribution shares in the defaulted members' proprietary accounts and associated collateral-short client accounts,

6) The deployment of defaulted member's excess trade collateral in the other markets in default management subject to CCP Default Management Committee's ruling,

7) The deployment of the defaulted member's guarantee fund contribution in other markets in default management, subject to the member carrying no risk in such market, by means of CCP Default Management Committee's ruling,

8) The initiation of the deployment of solvent member's guarantee fund contributions in accordance with the CCP Default Management Committee's ruling,

9) Demanding solvent members to deposit the committed additional guarantee fund contribution,

10) Arranging auctions for positions that cannot be closed-out,

11) Closing out the positions that cannot be closed-out or transferred via auction, with the offsetting positions that shall be selected from among the positions in the solvent members' associated portfolios or client accounts, compulsory transfer or termination through cash settlement,

12) Resorting to measures for extraordinary circumstances laid down in the CCP Regulation, Article 48, primarily suspension of daily profit distribution, if it is judged that the default is occurring under extraordinary circumstances and may give rise to extreme results,

The CCP Default Management committee may rule that, besides open and non-migratable positions, hedging may also be allowed for the risky positions predicted to be non-migratable

following pre-default, without waiting for the end of the set period for default notifications. The cost and loss of the hedging transaction may be met from the defaulted accounts' and member' collateral, where not sufficient, from other default management resources.

The auctions for positions may be arranged with a purpose to generate open (offsetting) positions to migrate to or to close out such positions. The legal pursuit process is initiated following the ruling of the CCP Default Management Committee, to collect from defaulted members, the resources not belonging to them but deployed during the default period.

If the solvent members' guarantee fund contributions have been resorted to by the end of the default management procedure, such amount whose collection depends on legal pursuit process is reported to the members via CCP Default Management Committee ruling.

### **Migration of the Positions and Collateral**

In the event of a default in Central Counterparty service enabled markets, to migrate the positions held in the individual account associated to the defaulted member and their related collateral; if a CCP member has been determined as transferee between the relevant member and Takasbank, the migration may be performed without seeking defaulted member's consent and approval again. In the event of failing to migrate within 24 hours for any reasons, other measures may be taken.

If a transferee has not been assigned, subject to an agreement between the defaulted member and a CCP member desiring to be transferee or procurement of such a member by the clients or Takasbank, the migration transactions may be performed indefinitely. However in this regard, the search for migration alternatives should not constitute an impediment to Takasbank's closing-out the positions by also using the relevant collateral.

In this process the Capital Markets Board's instructions, with respect to the defaulted member shall also be crucial. Since Takasbank's respondent in CCP services is the member, if there is no previous assignment with respect to migration, without seeking the member or the liquidation office's consent, Takasbank is allowed to establish transactions as per the client demands only by means of the Capital Market's instructions on the matter.

In the migration transaction, the general principle is the valuation of the position that shall be migrated and the related collateral with current value, as long as default management recourses are adequate and otherwise is not the case. However in circumstances that require using different price, Takasbank is authorized to execute the relevant transactions.

The transferee CCP member's authority to withdraw the current collateral in the account may be restricted until reconciliation is reached between the defaulted CCP member's accounts and Takasbank records.

In the migration transaction, reconciliation is reached between Takasbank and the transferee with respects to the positions and collateral amount to be transferred. A sample of the reconciliation is urgently reported to Capital Markets Board and the defaulted member or those authorized to legally represent and bind.



To be able to migrate joint accounts, common instruction from all clients who possess a position or collateral in the accounts is required.

## **Auction, Compulsory Transfer and Compulsory Cash Settlement**

An auction may be arranged to transfer or close out the un-migratable positions. The participation to the auction is allowed for all members and via members to the clients, however for CCP member's participation is compulsory. The auction in whole or on portfolio basis or position basis can be canceled by Takasbank.

Post-migration, in the event that incurred losses are leading to Takasbank's remaining capital falling below the amount specified in the BRSA regulation subsequent to hedging or close-out transaction or the auctions arranged for remaining positions, and / or lack of counterparty due to poor market depth and liquidity, positions may be terminated by compulsory transfer to the CCP members or cash settlement

In determining the compulsory transferee member portfolio accounts, issues such as members' risk limits, the positions assumed in the auction and the existence of counterparty with respect to the positions that shall be taken over, are taken into consideration. In compulsory transfers, theoretical prices, accepted auction prices or the prices set by considering the loss limit under the framework of the relevant legislation, are used.

Despite all the actions taken for default management, it may be decided to terminate the open positions via compulsory transfer to client accounts and compulsory cash settlement rather than only compulsory transfer. In compulsory cash settlement, the offsetting positions in the solvent members' associated portfolio or client accounts are coincidentally selected and used.

The prices, which will be used in compulsory cash settlement of the positions, are determined at a level considering the status of the solvent accounts selected to offset the positions, such that the remaining capital following deployment of Takasbank's default management resources shall not fall below the capital level set by the BRSA regulation.

## **Liquidation of the Collateral and Deployment of the Guarantee Fund Contributions**

The non-cash assets, and guarantee fund contributions and assets provided by other members as guarantee fund contribution under certain conditions to the defaulted client account and/or to the defaulted member's portfolio account, are liquidated following the CCP Default Management Committee's ruling without the need for any consent or auction.

Under the framework of the contracts agreed with the members, the capital market instruments which are the subject of the collateral assumed by Takasbank, if quoted in stock exchange or organized other markets, could be put up for sale at market price in these markets or set off against the debtor's obligations. The assets that are not quoted in the Stock Exchange or other organized market are valued in accordance with the valuation principles laid down in the Central Counterparty Collateral Method Communique and liquidated. If the legislation allows, the assets,

which are the subject of the assumed collateral, may be expended as collateral against borrowing instead of being liquidated.

In the circumstance that require recourse to the guarantee fund, withdrawal from the guarantee fund is not allowed in the period until the loss incurred due to default is recovered. The distribution of the loss attributed to the guarantee fund, to the solvent members, is based on the members' share of the guarantee fund. The Members, are obliged to re-deposit, the guarantee fund contributions deployed under the framework of default management, in 3 business days.

When it is foreseen that the loss that could be attributed to the guarantee fund could extend beyond 50% of the fund, the members are asked to deposit committed additional contributions. The members are obliged to deposit the contributions in the 5 business days following such demand. Additional contribution demands may also be made in parts. Partial or unused additional contributions expended to end the default, are returned. If despite the demand, it has been returned in whole, without expending to end the default, it is regarded as not having demanded such contribution.

The contribution that could be demanded from the Member for a period of one month, due to the other members' default cannot exceed the sum of the deposited contribution for the month and additional guarantee fund contribution liability incurred upon demand. The additional guarantee fund contribution that could be demanded within a month cannot exceed the deposited contribution amount. For each year starting from April, until end of March the following year, Members can be asked for additional contribution, for 4 times at the most.

In the event of the partial or complete depletion of the additional guarantee fund contribution demanded from the members due to default, the members are called upon to bring the fund up to the calculated limit as per the Paragraph 1, section (d) of the Central Counterparty Communique's Article 36. However in the same month, if the guarantee fund contributions imposed upon the member in case of the other members' default, exceeds the maximum loss limit, such contributions may solely be expended until the end of the month for their own default.

In the default management process the guarantee funds deposited by member following the relevant default event are not expended. On the date the default occurred, all the members with deposited guarantee funds are liable to additional guarantee fund payment. The unreturned- due to the period set under the consideration of the average maturity of the current positions in the market- guarantee funds belonging to the members that asked to leave CCP membership before the default event, are expended in default management. Such members can be asked to pay up additional guarantee fund contributions as much as the deposited contribution, in the period until the return of their available deposited guarantee funds, and only for once.

The recourse to the contributions are started from the most liquid assets and worked in the order of ability to be converted to cash. In the non-cash portion of the guarantee fund, the amount which is cashed in but not expended, is returned to the members whose non-cash collateral has been expended, on a pro rata basis.

## **The Resources Deployed in course of the Default Management Process and Distribution of the Losses**

The non cash collateral and guarantee fund contributions belonging to defaulted member or other members, may be expended in the default management process and under the framework of the legislation, may be pledged to CBRT (Central Bank Republic of Turkey) or other banks for borrowing purpose.

The resources outside default management that Takasbank shall use prior to the default notification to fulfill the obligations of the defaulted member as central counterparty and the interest and costs that may arise due to the borrowing transaction are met by the default management resources.

The guarantee fund contributions of the defaulted -in any one of the markets- CCP member allotted to guarantee funds established in the other markets, may be expended towards its obligations in the market of default and in succession to the deployment of guarantee fund contributions, subject to absence of member's risk in the respective markets or liquidation of all of its positions. Such resource may be expended to complete the clearing or to liquidate the debt in succession to transaction collateral, which is the first resource to have recourse to leaving aside the defaulted CCP member's collateral and guarantee fund contributions, and provided that its other assets with Takasbank are available.

Takasbank, in case of the deployment of the capital committed to covered risks, for default, recovers the amount reduced in a month's time. The committed capital amount, which shall be recovered as such in a year's time, cannot exceed the amount determined at the beginning of the term. If a default occurs again, in the one month period until the recovery of the reduced capital, if exists, remaining portion of the committed capital is expended. The solvent members' guarantee fund is resorted to for the shortfall. The recovery of the capital does not require the return of the expended guarantee fund contributions.

### **Returning the Resources Following the Default Management Process**

The collateral which becomes available subsequent to the close-out of the positions due to failing to migrate un-defaulting accounts of the the defaulted member to another member, with the condition to be returned to the respective account holders, is paid or delivered to the authority/ authorities laid down in the Law, taking also into account the Board regulations.

The defaulted CCP member's available portion, if exists, of the collateral and guarantee fund contributions and the resources that will be provided from the legal pursuit of such member, at the outset, shall be expended towards, if exists, the debt acquired to liquidate the CCP member's obligations and the resources outside the default management.

Following the disposal of debt and other external resources outside the default management method, if there is a remainder portion of resources from the the pursuit of the CCP member, these funds are used towards the payment of resources starting from those deployed last in the default management, proceeding to the prior deployments.

Until the liquidation of all primary and secondary obligations arising from the default, including the allocation from Takasbank's capital, no payment or return by Takasbank to the defaulted is allowed.

Following the migration and liquidation of the collateral and positions in the accounts associated with the CCP members, who are in the process of legal and administrative liquidation, the remaining collateral belonging to the respective CCP member or its clients, are paid or delivered to the authority/ authorities laid down in the Law under consideration of the Board's regulations.

### **Default Management Tests**

Takasbank performs default management tests, to check the effectiveness of the default management process and identify improvements that may be needed, with the participation of market participants that it shall select. During the simulation, the participants that fail to provide the expected contribution to the default management processes, are expected to correct such deficiencies.

### **Termination of CCP's Activities**

In the event that the CCP service offered by Takasbank is terminated for any reason the current position and collateral may be migrated to another organization which shall be assigned as the central counterparty by the Board in accordance with the legislation or where the Capital Markets Board deems appropriate, Takasbank is allowed to offer its clearing and collateral management services without acting as the central counterparty.

If such circumstances prevail that Takasbank shall not be able to continue its clearing or central counterparty services and the positions and collateral cannot be migrated to another organization, such position and collateral is liquidated in accordance with the principles that shall be set by the Board.