Answer 3 questions about multilateral clearing arrangement

Law

Multilateral Clearing Arrangement Q1 The origin of the default must be determined to establish the rights of the liquidator. If it is a proprietary default, as when it involves the member's own funds and property, the liquidator can initiate the transfer of customer funds and positions to members of good standing, take control of or liquidate the customers' positions as well as the proprietary positions, apply the member's margin to the default and if insufficient, apply all the customer margins with the defaulting member to the default. If the default originated from the failure of proprietary transactions of the member, the liquidator can initiate the transfer of all customer positions held by the member in default to other members of good standing, take control or liquidate the defaulting member's proprietary positions, use the margin and security deposits of the member towards the default. In the event that all of the above are still insufficient to cover the default, the liquidator can still apply other funds such as guaranty funds paid by all members and insurance, if any (Dale 1998, pp. 23-24). Q2The clearing house does not have a right to institute liquidation proceeding against ' K' as of 4: 30 pm because there was no default yet. Default is the inability of a party to pay its obligations and in this case, its failure to complete a transfer of funds or securities in accordance with the rules of the clearing house, when it is due. Since there was no demand yet for ' K' to pay at 4: 30, considering that under this particular clearing house rules the business day ends only at 5 and demand to pay at 7 pm, ' K' is not yet considered in default. Due process demands that ' K' is notified of its obligations, be given time to contest, and a demand for payment on it be made. Only when payment is due and a party is not able to pay can it be

deemed in default and be made subject to a liquidation process.

Q3Initially, the clearing house must impose stringent membership rules on potential participants. These rules must require members to have, not only adequate capital, but also to adhere to strict financial and operational requirements upon admission as members such as maintaining a certain net capital as well as separate customer funds and property from their own funds and property. Moreover, members must also satisfy the clearing house that they are operating under sound risk management control. As a risk management control on the part of the clearing house, it could institute a predetermined threshold for each member, which when breached during the day by any of the member it could react to by requiring from that member additional margin or advanced payment against its end-of-the day position. Other clearing houses are also known to settle transactions only the day after the transactions (T+1) are made to give time to members to remedy their situation during the night (Dale 1998, pp. 23-24).

The clearing house can also institute additional measures such as restricting position limits, establishing insurance fund and include a regulation allowing itself to transfer a defaulting member’s positions to other members who are in good standing. It could institute position limits or reduce them, if called for under the circumstances, in accordance with the member’s adjusted net capital. The position limit restricts the size of the total positions a member can carry as a participant in the clearing house and any member that exceeds its predetermined position limit should be assessed additional margin requirements. The clearing house could also require members to contribute to a pool fund that could be used by the house as additional

resources to assist a defaulting member where the margin held by the house for that member is insufficient to pay the amount of the default. Finally, a clearing house should be empowered to transfer all open positions of a defaulting member to other members of good standing so that customers can still manage their risk exposures (Dale 1998, pp. 23-24).

References:

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