CDS Procedures

Guarantee Fund

1.1 Purpose of guarantee (Amended 11/4/2008)

To ensure financial integrity in the securities market, CDS has put in place a guarantee that trades will be settled among Participants (i.e. that the selling Participant will deliver the securities and that the buying Participant will effect payment);

CDS does not protect clients against losses they may suffer as a result of an Investment Dealer failure or malpractice. This type of protection would be provided by a compensation fund contemplated in the Securities Act 2005.

1.2 Avoidance of failure

To guarantee settlement, CDS has put in place a series of lines of defence - financial safeguards - that allow it to manage settlement risk.

Risk management requires that CDS:

1. identifies risks (as detailed in 1.3);
2. take preventive measures to minimise the risk of settlement failure (as detailed in 1.4)
3. put in place a contingency plan - a guarantee mechanism - in the event a Participant fails to honour his settlement obligations (as detailed in 1.5)

1.3 Two types of settlement risks.

There are two types of settlement risks: the risk that a Participant fails to deliver the securities and the risk that a Participant fails to effect payment.

In the first case **- securities settlement failure -** the financial risk is equal to the difference between the price of the trade and the price at which replacement securities can ultimately be bought.

In the second case **- funds settlement failure -** the financial risk is equal to the net settlement obligation of the Participant

1.4 Preventive measures taken by CDS

1.4.1 Prevention of securities settlement failure (Amended 17/9/2001, 11/4/2008)

As a trade is posted to an account, CDS checks that the securities balance in that account is sufficient to effect settlement. A trade will be posted to the Investment Dealer's own account in the following cases;

a) If the Participant fails to post a trade to a client account before the prescribed deadline on T, or

b) If he attempts to post it to an account which has an insufficient balance, or

c) If a trade that has been allocated to a client account registered with a Custodian Bank is not confirmed by the latter.

If the balance in the Participant's account is insufficient, he must rectify the situation ***before T+3, 9:30 a.m.*** CDS will monitor the situation and impose a daily fine of 0.02% of the value of the securities until rectification (See 1.5.1 Dealing with securities settlement failure)

1.4.2 Prevention of funds settlement failure (Amended 30/07/1999, 11/4/2008, 14/6/2010, 11/03/2013)

For each Participant, CDS will set a Settlement Limit which will be determined by the following formula:

$$\mathbf{SL} = \frac{\mathbf{(RLC + ALC + GFC)}}{\mathbf{18\%}} + \mathbf{CSP}$$

where, for each Participant

SL	: Settlement Limit		
RLC	: Required Letter of Credit	(See 1.7	- Required Letter of Credit)
ALC	: Additional Letter of Credit	(See 1.7.1	- Additional Letter of Credit)
GFC	: Guarantee Fund Contribution	(See 1.6	- The Guarantee Fund)
CSP	: Capital Surplus	(See 2.6 Requirements)	- Schedule of Financial Resource

Any additional cash contribution to the Fund will increase the Settlement Limit of that Participant accordingly.

The Participant whose total cumulative settlement obligation has reached or exceeded its Settlement Limit will not be allowed to increase its total cumulative settlement obligation (i.e. it will not be allowed to buy more shares) unless it provides additional cover to CDS by way of an additional Letter of Credit or alternatively, CDS may accept a cash deposit. For the purpose of monitoring its Settlement Limit, on each business day the total cumulative settlement obligation of each Participant will be calculated in Mauritian Rupee by converting the cumulative settlement obligations in USD, Euro, GB Pound and South African Rand to Mauritian Rupee using the CDS Conversion Rate (CCR) on that day and by aggregating the converted cumulative settlement obligations and the cumulative settlement obligation relating to securities denominated in Mauritian Rupees. The respective CCR for converting the USD, Euro, GB Pound and South African Rand is calculated as follows:

CDS Conversion Rate (CCR) = Average Par rates of the settlement banks

Where, Par Rate = <u>T.T Buying Rate + T.T Selling Rate</u>

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This restriction will be imposed by the SEM upon notification by CDS. The FSC will be immediately informed of any such restriction.

1.5 Steps taken by CDS in case of settlement failure

1.5.1 Dealing with securities settlement failure (Amended 4/2/2000, 17/9/2001, 11/4/2008)

If a Participant still does not have securities in the account on ***T+3, 9:00 a.m***, the trade is temporarily suspended and a buy-in procedure is initiated in accordance with Procedure 16. The SEM and FSC are immediately notified. The Participant is required to make a cash deposit of 50% to CDS and pay a daily fine of 0.20% of the value of the securities (marked to market daily) until the buy-in is completed or the situation is corrected.

CDS may abort the buy-in procedure in the following circumstances:

1. The Custodian Bank confirms the trade after T+3, 9:00 a.m and such confirmation is submitted to CDS before T+5, 9:00 a.m.
2. The defaulting Participant reports to CDS a loan transaction to settle the trade and the duly completed CDS Loan Forms reach the CDS by T+5, 9:00 a.m.

When buy-in is aborted, the original failed trade together with all turnaround trades linked to it will be reinstated and will be settled on the next Business Day in accordance with Procedures 24.6.4 – 24.6.7.

If the buy-in is successful or the trade is subsequently confirmed or a loan transaction is reported to settle the trade, then CDS will return the cash deposit to the defaulting Participant.

When buy-in is completed, notwithstanding whether it is successful or not, the CDS will use the cash deposit to compensate all the buyers involved in each turnaround trade linked to the failed trade, except the buyers involved in the last transaction in each chain of turnaround trades, by paying them an amount equal to 50% of the difference between the price at which they bought the securities and the price at which they subsequently sold the securities.

If after 5 trading sessions the buy-in is unsuccessful, CDS will also use the cash deposit to compensate the buyers in the last transaction in each chain of turnaround trades linked to the failed trade, by paying them an amount equal to 15% of the value of the securities that remain undelivered after the buy-in and CDS will request the SEM to cancel the failed trade together will all turnaround trades linked to it.

In a situation where there is no turnaround trade linked to the failed trade, the failed trade will be treated as the last transaction in a chain of turnaround trades.

If after 5 trading sessions the buy-in is partially successful, then CDS will proceed as follows:

- CDS will use the cash deposit to compensate the buyers in the last transaction in each chain of turnaround trades linked to the failed trade on a pro-rata basis, by paying them an amount equal to 15% of the value of the securities that remain undelivered after the buy-in;
- CDS will request the SEM to amend the failed trade together will all turnaround trades linked to it by subtracting the amount of securities that remain undelivered from the initial quantity traded.

The Participant also bears all losses and expenses associated with the buy-in. Such losses and expenses accruing to CDS during the buy-in shall form part of the funds settlement obligation of the defaulting Participant.

When buy-in is completed, CDS will return any remaining balance of the cash deposit to the defaulting Participant after deducting all compensation to buyers, losses and expenses associated with the buy-in. If the cash deposit made by the defaulting Participant is not sufficient, the latter will be required to make additional payment to compensate all the buyers concerned and to pay for the losses and expenses. If the Participant fails to make the additional payment, section 1.5.2 of the Guarantee Fund Procedures will be applied.

Buy-in procedures will not apply if the defaulting Participant is also the buyer Participant in the failed trade and if there is no turnaround trade linked to the failed trade. CDS will request the SEM to cancel the trade and the defaulting Participant will be charged a penalty fee equal to 1% of the value of the failed transaction.

1.5.2 Dealing with a funds settlement failure (Amended 06/11/1998, 11/4/2008, 16/11/2011)

A particular Participant may fail to satisfy his funds settlement obligations as a result of:

Either a) He cannot pay the Securities he bought - he or his client cannot pay.

Or b) He cannot pay CDS the Securities that CDS has to buy on his behalf because he did not have sufficient Securities to deliver on settlement

Or c) He cannot meet a financial obligation towards CDS in connection with the Guarantee Fund or otherwise.

The SEM and the FSC will be immediately notified by CDS.

To meet a defaulting Participant's obligation, CDS will proceed in the following sequence:

1. It will use the cash available in the bank account of the Guarantee Fund and the standby line of credit to expedite the settlement of transactions by making good the obligations of the defaulting Participant.
2. It will claim under the Additional Letter of Credit or additional cash deposit of the defaulting Participant
3. It will then claim under the Required Letter of Credit of the defaulting Participant
4. It will request the Participant to provide a new Letter of Credit by noon on the next day to reinstate the amount of that Participant's Required Letter of Credit failing which it will be suspended
5. In case the letters of credit are insufficient to cover the default, it will suspend the defaulting Participant, seize the unpaid Securities and move them to a CDS account over which the Participant has no control, and sell those Securities as soon as possible
6. It will provide funds from that Participant's initial contribution and cash contributions by CDS, based on transactions effected by the Participant, to the Guarantee Fund
7. It will then request the defaulting Participant to make payment to replenish its contribution to the Guarantee Fund to the minimum level as set out in section 1.6.2
8. At this point, if necessary, CDS will provide funds from other Participants' initial contributions and cash contributions by CDS, based on transactions effected by the Participants, to the Guarantee Fund on a pro-rata basis
9. It will then use the Required Letters of Credit of other Participants on a pro-rata basis
10. If the failure has still not been corrected CDS will use its reserves

All amounts drawn from the Fund (including transaction fees, interest and bank charges) that cannot be recovered after the sale of the seized securities are owed to the Fund by the defaulting Participant. The suspension of the defaulting Participant will be lifted only after it has repaid all amounts due to the Fund. All net amounts recuperated from the defaulting Participant are applied:

1. first to repay the bank credit facility, then
2. to contributions of non-defaulting Participants and of CDS to the fund, then
3. to the CDS reserve and lastly
4. to the defaulting Participant's contribution.

If the defaulting Participant is declared insolvent and cannot repay the amounts due to the Fund, the other Participants will be required to pay the amounts due to the Fund following the draw-down and the sale of the seized securities on a pro-rata basis (based on their respective contributions to the Fund prior to the default). Failure to do so is treated as a default and may lead to suspension as a CDS Participant.

1.6 The guarantee fund

1.6.1 Cash contributions by CDS (Amended 06/11/1998)

The fund is constituted of cash contributions by CDS. These cash contributions are initially set at 10% of the CDS fees applicable to the transactions, and may be reviewed as and when the need arises. The contributions coming from transactions effected by each Participant will be recorded separately and will be used in the calculation of the loss sharing in the event of a default and also in the calculation of the Settlement Limit of the Participant as set out in section 1.4.2.

1.6.2 The Initial Contribution by Participants (Amended 06/11/1998, 16/11/2011)

The initial contribution per Participant will be Rs 100 000.

After the Guarantee Fund has been constituted, the initial contribution of any new Participant will be determined using the following formula:

$$X = \text{Rs}\ (100{,}000 \times CV)/\ IV$$

Where X : Contribution of new Participant or contribution of a Participant following a draw-down

CV : Current value of fund (excluding letters of credit), before draw-down in the event of funds settlement failure.

IV : Initial value of fund (excluding letter of credit)

1.7 Required Letter of Credit

Participants must deposit a letter of credit issued by their bank (the "Required Letter of Credit") for 18% of the moving average of the Cumulative Liability (See Annexure I) over the past 12 months.

The minimum contribution of a Participant to the fund may be altered by the Rules or the Procedures and become effective five (5) business days after notification to the Participant.

During the first three months of participation, the required deposit may be increased by CDS. The Participant is required to deposit additional contribution to make good the deficit as required within three (3) business days.

Additional guarantee fund contributions may be required by CDS in exceptional circumstances based on the value, the volatility or portfolio of securities or the volume of transactions of the Participant.

1.7.1 Additional Letter of Credit

Participants may deposit additional letters of credit (the "Additional Letter of Credit") to increase their Settlement Limit. The Settlement Limit will be increased by an amount equal to Additional Letter of Credit divided by 18%.

The Additional Letter of Credit in excess of the minimum contribution requirement of a particular Participant will be restricted for its funds settlement only and cannot be used in the case of default of another Participant.

1.7.2 Management of the fund.

The fund is managed in accordance with an investment policy decided by the Business Conduct Committee. The assets are invested in very safe and liquid investments (T-Bills, term deposits, Etc.).

1.7.3 Application of Guarantee Fund

If any Participant fails to discharge any obligation under the CDS Agreement, or if CDS suffers any loss or expense due to a Participant, then CDS can apply the Participant's contribution to the discharge of such obligation, expense or loss.

If the amount of the undischarged obligation, expense or loss exceeds that amount of the Participant's contribution, and if the Participant fails to pay CDS the amount of the deficiency on demand by CDS, the amount of the deficiency is to be paid out of the Guarantee Fund and charged pro rata against all other Participants' contributions. A Participant who fails to pay the deficiency remains liable to CDS for the full amount of such deficiency until payment thereof.

When a pro rata charge is made against a Participant's contribution to the Guarantee Fund, CDS promptly notifies the Participant of the amount of the charge and the reasons therefor.

The amount of any deficiency, obligation, expense or loss is determined by CDS without reference to the possibility of any subsequent recovery in respect thereof, but the net amount of any such recovery is applied in accordance with section 1.5.2.

ANNEXURE I ***(Amended 11/4/2008)***

Initial Required Contribution to Guarantee Fund will be computed as follows

To simplify the illustration of the computation of the minimum contribution, this example is based upon the moving average of the Cumulative Liability over a period of 10 days only.

In practice, computation of the amount of contribution will be based over past 12 months' dealings for each Participant (See 1.6.2 above)

		INVESTMENT DEALER X	**INVESTMENT DEALER Y**	**INVESTMENT DEALER Z**
(A)	Net Daily Settlement (NDS)			
	Day 1	**- 100 000**	+ 300 000	+ 400 000
	Day 2	**- 200 000**	**- 500 000**	**- 600 000**
	Day 3	+ 300 000	+ 600 000	+ 700 000
	Day 4	+ 400 000	**- 400 000**	**- 1 000 000**
	Day 5	**-500 000**	+ 300 000	**- 2 000 000**
	Day 6	**-600 000**	**-500 000**	**-500 000**
	Day 7	700 000	**-400 000**	600 000
	Day 8	**-600 000**	500 000	**-700 000**
	Day 9	**-500 000**	**-300 000**	800 000
	Day 10	200 000	500 000	**-3 000 000**
(B)	CL			
	Day 1 to 3	-300 000	-500 000	-600 000
	Day 2 to 4	-200 000	-900 000	-1 600 000
	Day 3 to 5	-500 000	-400 000	-3 000 000
	Day 4 to 6	-1 100 000	-900 000	-3 500 000
	Day 5 to 7	-1 100 000	-900 000	-2 500 000
	Day 6 to 8	-1 200 000	-900 000	-1 200 000
	Day 7 to 9	-1 100 000	-700 000	-700 000
	Day 8 to 10	-1 100 000	-300 000	-3 700 000
(C)	Moving average of CL	-825 000	-687 500	-2 100 000
(D)	Required Letter of Credit to be deposited (C) x 18%	148 500	123 750	378 000
(E)	Initial Cash Contribution to Guarantee Fund	100 000	100 000	100 000
(F)	**Settlement Limit** $\frac{D+E}{18\%}$	**1 380 555**	**1 243 055**	**2 655 555**

Contribution of new entrant will be computed as follows:		
(CV)	Current Value of Fund (CV) (excluding letter of credit)	**2 500 000**
(IV)	Initial Value of Fund (excluding letter of credit)	**1 100 000**
(X)	Required cash contribution of new Participant RS (100 000 x CV/IV)	**227 272**
	Required letter of credit of new entrant Participant	As for (D) above but based on projections submitted by new entrant Participant