

The Terms of Reference of the Default Management Group

1. Purpose

- 1.1 The Default Management Group (the “**Group**”) shall be appointed by the board of directors (the “**Board**”) of OTC Clearing Hong Kong Limited (“**OTC Clear**”) to assist the Board with the Default Management Process.

2. Membership

- 2.1 Subject to casual vacancies from time to time, the Group shall consist of the following members to be appointed by the Board:

- (a) Group Head of Financial Risk Management of HKEX or his/her nominee;
- (b) Chief Executive of OTC Clear or Deputy Chief Executive of OTC Clear or his/her nominee;
- (c) Chief Risk Officer of OTC Clear or his/her nominee; and
- (d) for each product class, up to four DMG Representatives and one Back-Up DMG Representative (each term as defined below) from Clearing Members of OTC Clear, where the same person may be appointed as a DMG Representative or a Back-Up DMG Representative for one or more product classes.

- 2.2 The head of the Group (the “**Head of the Group**”) shall be appointed by the Board and shall be the Group Head of Financial Risk Management of HKEX or his/her nominee referred to in paragraph 2.1(a).

3. DMG Representatives

- 3.1 The appointment of members to the Group under paragraph 2.1(b) and the continuing membership of such persons shall be subject to the following requirements:

- (a) Each Clearing Member must nominate two of its employees and/or directors as delegates for the Group for each product class it clears (each a “**DMG Delegate**”), for consideration by the Board. A DMG Delegate nominated by a Clearing Member may, at the same time, act as a DMG Delegate for different product classes.
- (b) Each DMG Delegate is expected to have structuring and/or trading experience in the relevant product class.

- (c) In respect of each product class, each Clearing Member will designate one of its DMG Delegates as a primary delegate (each a “**Primary DMG Delegate**”), and the other as alternate delegate (each an “**Alternate DMG Delegate**”), and ensure that at least one of them resides in Hong Kong.
- (d) The Board, the chairman of OTC Clear Board, the Risk Management Committee, and/or, the Group may request a Clearing Member to provide a substitute DMG Delegate if it considers any of such Clearing Member’s nominated DMG Delegates is conflicted for his/her role as a DMG Delegate or does not have the requisite structuring and/or trading experience in the relevant product class.
- (e) Having regard to the knowledge and experience of the nominated DMG Delegates, the Head of the Group will in consultation with the Risk Management Committee, recommend to the Board up to four Primary DMG Delegates for each product class to act as members of the Group (“**DMG Representatives**”).
- (f) If a Primary DMG Delegate is unable to participate in the Group for any reason or if the Head of the Group so requests, the Alternate DMG Delegate for such Primary Delegate will be required to participate.
- (g) The Board will appoint one Primary DMG Delegate to act as back-up for a DMG Representative (a “**Back-Up DMG Representative**”) for each product class.
- (h) The Back-Up DMG Representative will only participate in the Group if a DMG Representative (both its Primary DMG Delegate and its Alternate DMG Delegate) is unable to participate in the Group for any reason or if the Head of the Group so requests.
- (i) The Head of the Group may decide whether a DMG Representative or a Back-Up DMG Representative of a Defaulting Clearing Member can continue to participate in the Group whilst such Defaulting Clearing Member remains in default, taking into account whether such representative is conflicted for his/her role as a DMG Representative or a Back-Up DMG Representative, and may remove such representative by notice to him/her in writing. Unless removed by the Head of the Group, a DMG Representative or a Back-Up DMG Representative of a Defaulting Clearing Member may continue to participate in the Group.

4. Term of office of DMG Representatives

- 4.1 The term of appointment for the DMG Representatives will normally be for one year.

- 4.2 A DMG Representative is eligible for re-nomination as a DMG Delegate by a Clearing Member. Subject to availability of DMG Delegates, sufficient nominations of DMG Delegates having been made by Clearing Members and the Board's policy to appoint at least one new DMG Representative for each product class every year, DMG Representatives are eligible for re-appointment as Group members.
- 4.3 The Board may fill any casual vacancies that may occur in the Group by reason of resignation, retirement, termination or otherwise.
- 4.4 If a DMG Representative is no longer an employee or a director of the Clearing Member who nominated him/her or the Clearing Member becomes aware that its DMG Representative's employment or directorship will be terminated, such Clearing Member will notify OTC Clear in writing as soon as practicable and such DMG Representative will be removed from the Group. Such Clearing Member will then nominate another employee or director to be a DMG Delegate.

5. Duties, powers and functions

- 5.1 Generally, the Group will advise the Board on matters relating to the Default Management Process, and conduct Hedging on behalf of OTC Clear, to mitigate, to the extent commercially practicable, any risk or economic exposure which arises as a result of the occurrence of a DMP Event.
- 5.2 More specifically, the Group will:
 - (a) advise OTC Clear on matters relating to termination, close-out or transfer of a portfolio of products, including but without limitation to:
 - (i) hedging the risk associated with the portfolio, structuring the portfolio for auction, administering the auction, liquidation and/or transfer to a Non-Defaulting Clearing Member of the portfolio;
 - (ii) settlement pricing and market liquidity including curve construction, interpolation methodologies and liquidation risk margin modeling;
 - (iii) auction pricing; and
 - (iv) reviewing and assessing the Default Management Process and the results of any drills conducted for Clearing Members;
 - (b) present Hedging strategies for the approval by OTC Clear and execute the agreed Hedging strategy; and
 - (c) submit its recommendations in relation to the above matters to OTC Clear and/or the Board for consideration.

6. Frequency and proceedings of meetings

- 6.1 The meetings and proceedings of the Group shall be governed by OTC Clear's Articles of Association.
- 6.2 The Group will meet:
 - (a) immediately following the occurrence of a DMP Event, and at sufficiently frequent intervals thereafter for a period so long as may be necessary to assist OTC Clear in the implementation of the Default Management Process; or
 - (b) at such other times as OTC Clear may deem appropriate and/or necessary from time to time.
- 6.3 Meetings will be in Hong Kong at such place and time as will be determined by OTC Clear.
- 6.4 The quorum of a meeting for the relevant product class will be a majority of members for such product class.
- 6.5 The Group shall meet for the dispatch of business, adjourn and otherwise regulate its meetings in accordance with the rules of procedures (including rules governing members' conflict of interest) which are issued by the Board from time to time.
- 6.6 The Head of the Group may invite other people to provide support to the Group and attend Group meetings in a non-voting capacity. These may include staff from OTC Clear or Hong Kong Exchanges and Clearing Limited, representatives or staff of Defaulting Clearing Member(s) or Non-Defaulting Clearing Member(s), and such other independent experts or professional advisors as the Head of the Group considers appropriate.

7. Reporting Procedures

- 7.1 The Group will report to the Board or its delegate(s) on a regular basis and shall keep the Board or its delegate(s) properly informed as to the findings and recommendations of the Group. As a general rule, the Group will report to the Board or its delegate(s) on each Default Management Process and any recommendations of the Group at the next Board meeting following the completion of such Default Management Process.

8. Definitions and Interpretations

- 8.1 Unless otherwise stated, any capitalised terms not defined in these Terms of Reference will have the meaning given to them in the rules published by OTC Clear, as amended from time to time.
- 8.2 References to one gender shall include all genders.

– END –

November 2023