COMPENSATION CALCULATION IN THE EVENT OF A DEFAULT IN DVP ENVIORNMENT

The following mechanism is applicable to determine the compensation amounts to the aggrieved parties in case of a trade default as highlighted in **section 11 of the CDS rules** with a view to facilitate the implementation of the Delivery Versus Payment (DVP) settlement mechanism.

Introduction

The CSE has identified two instances where a default may occur during the settlement process. A Fund Default by a Buyer on the settlement date where he has not produced sufficient funds for the purchases he made and a Securities Default by a Seller on the settlement date where adequate cleared balance is not available in the CDS account for the delivery.

In the aforesaid two scenarios, a Compensation shall be paid by the defaulting investor to the innocent investor. Accordingly, a compensation will be paid by the Buyer to the Seller in the event of a fund default by a buyer on the settlement date and a compensation will be paid by the Seller to the Buyer in the event of a Security default on the settlement date.

The Compensation amounts in both instances shall be adequate to compensate the opportunity loss and the three-day price risk of the innocent investor. Hence, to compute the compensation, the CSE will take in to account the price fluctuation of the security until the settlement date against the original purchase or sale price. As part of the compensation, a component will also be paid to the Stockbroker of the innocent party for the foregone brokerage loss due to the default trade.

Recommended Compensation Payment Procedure (Buyer Default)

The original Seller will be compensated for the 3-day price risk and the opportunity loss. Following formula will be used to do the computation;

Compensation amount = P * Q + X%

Where,

P = Sale price - lowest trade price between T to T+2 cycle (the period between trade date and one day prior to the settlement date)

Q = Quantity of defaulted securities

X = 0.8%*

*A fixed percentage of 0.8% of the defaulted trade value will be charged from the defaulting investor and this component shall be retained by the Stockbroker of the innocent investor when passing the compensation to the innocent party.

Recommended Compensation Payment Procedure (Seller Default)

The original Buyer will be compensated for the 3-day price risk and the opportunity loss. Following formula will be used to do the computation;

Compensation amount = P * Q + X%

Where,

P = Highest trade price between the T to T+2 cycle (the period between trade date and one day prior to the settlement date) – Purchase price

Q = Quantity of defaulted securities

X = 0.8%*

*A fixed percentage of 0.8% from the defaulted trade value will be charged from the defaulting investor and this component shall be retained by the Stockbroker of the innocent investor when passing the compensation to the innocent party.