Q&A on the Target Business Model – Cash Market

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1. Introduction

This document is prepared to address potential queries that could be raised by investors regarding the Target Business Model.

2. Questions and Answers

- **What is the role of a CCP?**

CCP is the counterparty to all brokers since trade inception. Due to its position, the CCP nets off the bulk of settlement obligations of the brokers. This brings significant efficiencies in terms of risk management and capital allocation. The CCP also allows brokers to enrich trade data after order matching at the trading system level.

- **Who is guaranteed by the CCP?**

CCP takes over counterparty risk from the broker. This means it guarantees the actual delivery or compensation to its clearing member in case of settlement failure on the other end or, worst case scenario, default.

Such CCP guarantee is backed by the collateral and fund contributions posted by the clearing members vs. the CCP, alongside the funds also contributed by the CCP itself. Therefore, the CCP guarantee mutualizes the risks that – otherwise - clearing members would have bilaterally against each other.

As a consequence, it should be noted that when the same broker executes both legs of a trade, no counterparty risk arises and therefore the CCP does not act as a guarantor.

CCP does not guarantee investors against their brokers. Investors will only benefit indirectly from the guarantee offered by the CCP to the clearing member of their brokers, whenever this broker is trading against others.

- **Are investors required to deposit collateral to the CCP?**

In general, investors are not required to deposit collateral to the CCP. Only investors who hold individual segregated accounts at the CCP are required to deposit collateral to the CCP via their clearing members.

- **Is the current settlement cycle going to be changed with the introduction of the new Model?**

No, settlement cycle will be T+2. In addition, different settlement cycle options are introduced for negotiated deals ranging from T+0 to T+5.

- **As an investor can I sell intraday securities I don't own?**

Yes. It should be noted that ownership is acquired upon settlement. Since the settlement cycle in the Saudi market moved from T+0 to T+2 in 2017, any investor can sell securities previously acquired but not settled (i.e. not owned) yet. This is based on the so-called ‘selling power’ or entitlement that the investor gains upon order execution and is not dependent at all on having a CCP in the market. Having a CCP does not change anything in this regard.

However, intraday trading activity under a market structure benefits from the efficiencies provided by a CCP. In specific, margin requirements may be minimized - or even neutralized - in the event that the net position of the investor is, by the end of the day, close to 0 or even equal to 0.

- **As an investor can I buy securities without depositing cash with my broker? Who decides on this matter: the broker, CCP, or clearing member?**

Before placing a buy order in the market, the broker must verify or confirm with the client that there will be enough cash deposited in the relevant account to be used for settlement by intended settlement date (ISD). This means that the broker must require its clients to deposit enough cash to honor the obligation on ISD – this can be done upfront or not. In addition, should the client not have (nor be entitled to have) the needed cash, the client may also ask for a loan from either the broker or a bank. The latter is known as ‘margin trading’ and is governed by CMA regulations when intermediated by brokers.