# Central Securities Clearing System Plc

## Assessment report on the observance of the CPMI-IOSCO principles for Financial Market Infrastructure

January 2016

# Central Securities Clearing System Disclosure Report

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| Responding institution: | Central Securities Clearing System Plc |
| Head Office Address: | Nigerian Stock Exchange Building<br>2/4 Customs Street, P.O.Box 3168, Marina<br>Lagos, Nigeria |
| Jurisdiction(s) in which the FMI operates: | Nigeria |
| Authorities regulating, supervising or Overseeing the FMI: | Securities and Exchange Commission, Nigeria |
| The date of this disclosure is: | 4th January 2016 |
| The disclosure can also be found at: | www.cscsnigeriaplc.com |
| For further information, please contact: | info@cscsnigeriaplc.com |

## I. Executive Summary

**Brief overview of CSCS.**

The Central Securities Clearing System (CSCS) was incorporated on 29 July 1992 as a Financial Market Infrastructure (FMI) for the Nigerian Capital Market. It was commissioned in April, 1997 and commenced operations on 14th April 1997. On 16th May 2012, CSCS became a Public Limited Company (Plc) by a special resolution.

The Securities and Exchange Commission (SEC) issued its license as an Agent for Central Depository, Clearing and Settlement of transactions in the Nigerian capital market. It operates a computerized depository, clearing, settlement and delivery system for securities transactions in the Nigerian Capital Market.

CSCS facilitates the delivery and settlement of securities transacted on the approved Nigerian Exchanges and Over-The-Counter (OTC) platforms. It enables securities to be processed in an electronic book-entry form thereby substantially reducing the period it takes a transaction to commence and end.

CSCS has made visible strides in the Nigerian capital market and will continue to respond to the needs of the securities market to further enhance transparency and speedy settlement of transactions.

**The functions of CSCS are to:**

- Provide Central Securities Depository (CSD) and sub-registry services for Nigerian Capital Markets covering the following products; Equities, Debt instruments, Global Depositary Receipts (GDR), Exchange Traded Funds (ETF) and Electronic Warehouse Receipt (E-WR) e.t.c

- Provide electronic clearing and settlement services using the principle of Delivery vs Payment (DvP).

- Assign International Securities Identification Number (ISIN), Legal Entity Identifier (LEI) number, Domestic Symbol codes, Classification of Financial Instruments (CFI) codes and Financial Instruments Short Name (FISN) codes for eligible securities.

- Issue Central Clearing House Number (CHN) to facilitate investors' identification.

**Brief overview of the legal and regulatory framework**

CSCS is regulated by the Nigerian Securities and Exchange Commission (SEC) and registered by Corporate Affairs Commission (CAC).

In Nigeria, securities law and securities regulation is contained within the Investments and Securities Act (ISA) of 2007. Securities and Exchange Commission (SEC) has prescribe rules and regulations (RAR) governing the Nigeria capital market.

The Securities and Exchange Commission Rules 134 – 150 of RAR specifically relate to the operations of the Depository, while rules 151 – 175 relate to the activities of the participants in the depository. Also relevant are rules 176 and 177 that are specific to a Securities Clearing and Settlement Company. RAR also contain a Code of Conduct for Capital Market Operators and their Employees and a Code of Corporate Governance for Public Companies that are relevant to CSCS.

**Indication of the primary risks**

The risks that CSCS is exposed to are:

- **Asset Commitment Risk** - ***The period of time from when control of securities or cash is given up until receipt of Countervalue.***

  This risk concerns the time period during which a participant's assets, either cash or stock, are committed within the CSD and payment system pending final settlement of the underlying transaction(s). Following settlement, the risk period is extended until the transfer of funds and stock becomes irrevocable. It excludes any periods when assets, cash or stock, are committed to a market participant including brokers, banks and custodians, not caused by CSD processing

- **Liquidity Risk - *The risk that insufficient securities and or funds are available to meet commitments; the obligation will be covered some time later*.**
  This is where for certain technical reasons (e.g., stock out on loan, stock in course of registration, turn round of recently deposited stock is not possible) one or both parties to the trade has a shortfall in the amount of funds (credit line) or unencumbered stock available to meet settlement obligations when due. These shortfalls may lead to settlement 'fails' but do not normally lead to a default.

- **Counterparty Risk - *The risk that a counterparty (i.e., a participant) will not settle its obligations for full value at any time.***

  This is simply the total default of a direct participant of the CSD. This is the event when a participant is unable to meet its financial liability to the CSD and possibly other creditors. This risk only goes as far as direct participants of the CSD and excludes clients of direct participants that default on liabilities to such participants, even if such a default should systemically cause the direct participant to subsequently default.

- **Financial Risk** - ***The ability of the CSD to operate as a financially viable company*.**
  This risk concerns the financial strength of the depository and if its capital is sufficient to meet the on-going operation of the organisation.

- **Operational Risk** - ***The risk that deficiencies in information systems or internal controls, human errors or management failures will result in losses.***
  The risk of loss due to breakdowns or weaknesses in internal controls and procedures. Internal factors to be considered in the assessment include ensuring the CSD has formalised procedures established for its main services. The CSD should have identified control objectives and related key controls to ensure operation and proper control of established procedures. Systems and procedures should be tested periodically. There should be external audit processes in place to provide third-party audit evidence of the adequacy of the controls.

- **Asset Safety Risk - The risk that assets held in custody at the CSD may be lost or misappropriated, either due to a default or an omission, misuse, or breakdown of controls (legal, operational or other).**
  The CSD should protect against the risk of loss of assets of the participant or their clients due to an insolvency, the CSD's negligence, misuse of assets, fraud, poor administration, inadequate recordkeeping or other failure to protect a participant's assets. Asset segregation at the CSD and/or the domestic custodian by account structure and naming convention, assertion of liens, form and nature of securities (e.g. dematerialised, physical, bearer, registered), certain key concepts in local law (e.g. recognition of nominees), reconciliation of holdings, vault controls and the

nature and placing of client cash deposits, are all factors taken into consideration in the assessment.

- **Governance & Transparency** - ***The risk that a participant may incur a loss arising from the depository not acting according to its rules and regulations or not providing full and accurate information on its activities and the activities of the market.***
  This risk arises when a participant places reliance on the depository to act in a fit and proper manner according to its rules and regulations and to provide full and accurate disclosure of information about itself and the depository and settlement activities of the market. There is an obligation on the management and the directors to ensure that the depository is operated according to high international management standards which includes ensuring that information and data relating to its activities and the activities of the market it represents is freely available to participants and the public in a timely manner. If the depository fails either to provide full and accurate information or to strictly abide by its own rules and regulations then the participant and public may be misled and may suffer a loss for which the depository may not accept liability.

- **Legal risk is faced by a CSD when there is the unusual or unexpected application of a regulation or law or when a law or regulation is open to different interpretations.**

- **General business risk is faced by every entity and it refers to the risk from the administration and operation of an entity.**
  This risk could stem from the administration or management of CSCS or where it embarks into value added business operations outside of its custody and settlement business. This risk is addressed by the Board in approving CSCS's plan and budget for the year.

**Indication of the risk management and other relevant practices**

CSCS has an Enterprise Risk Management (ERM) department that develops processes and procedures to identifies, assess, measures, monitors and set controls that help manage the key risks that CSCS faces. CSCS has implemented British Standards Institution (BSI) with ISO 27001 to ensure that the risks embedded in its processes, systems, data processing and procedures are considerably mitigated. There is a Risk Management committee of the Board.

**II. Summary of major changes since the last update of the disclosure**

This is the first disclosure report.

i. **Basic data and performance statistics on CSCS's services and operations**

1. Volume and value statistics by product type (year 2014 data)

| Product Types | Total Value (NGN million) | Total Volume million units) |
|---|---|---|
| Equities (NSE) | 1,338,597.47 | 108,472.47 |
| Equities (NASD OTC) | 2,323.61 | 120.40 |
| State Bonds | 110,362.53 | 104.95 |
| Corporate Bonds | 38,869.98 | 37.95 |
| Agency Bonds | 289,123.13 | 1,235.27 |
| Federal Bonds (OTC) | 102,298.00 | 101.96 |
| Federal Bonds (ATS) | 295.06 | 0.27 |
| Supranational bonds (OTC) | 1,021.56 | 1.0 |

2. Volume and value statistics by product type (year 2015 data)

| Product Types | Total Value (NGN million) | Total Volume million units) |
|---|---|---|
| Equities (NSE) | 953,026.11 | 92,861 |
| Equities (NASD OTC) | 50,922.30 | 1,895 |
| State Bonds (OTC) | 101,065.01 | 101 |
| Corporate Bonds (OTC) | 73,565.84 | 72 |
| Agency Bonds (OTC) | 1,600,779.94 | 1,683 |
| Federal Bonds (OTC) | 5,147 | 5 |
| Bonds (ATS) | 399.26 | 0 |
| Supranational bonds (OTC) | 0 | 0 |

3. Custody – Volume (quantity) and Value

| | 2014 | | 2015 | |
|---|---|---|---|---|
| Product Types | Quantity (million Units) | Value (NGN million) | Quantity (Units) | Value (NGN million) |
| Equities (NSE) | 844,479 | 8,591,805.11 | 948,297 | 9,229,001.77 |
| State Bonds | 462 | 461,622.72 | 486 | 486,104.77 |
| Corporate Bonds | 2,728 | 2,727,513.26 | 189 | 189,095.78 |
| FGN Bonds | 4,345 | 4,255,930.32 | 61 | 61,021.42 |
| Supranational bond | 12 | 12,000.00 | 25 | 24,950.00 |
| Agency bond | 2,149 | 2,148,731.86 | 10,108 | 10,107,524.71 |
| Commercial Paper | 1 | 532.98 | 39 | 38,701 |
| Equities (NASD OTC) | 7,051 | 31,407.20 | 20,447 | 61,202.04 |

4. Operational Measures

| Operational Measure | Outcome (for 2014) | Target |
| --- | --- | --- |
| Service Availability | Availability of all critical systems is 99.9% | Typically systems should be available 99.9% |
| System Capacity | Server storage utilized capacity is 47.53% (52.47% available). | Available memory (processing) capacity over and above peak usage should be at least 75%. Storage capacity should be above 50%. |
| Settlement Delays | No settlement delays. | Target should be no delays to settlement – all settlements on time |
| DRP Testing | One live test over one week in October. Test was successful. | Tests should be regarded as successful if all trial participants connected and processed transactions. |
| Penetration Testing | Annual penetration test – no significant weaknesses emerged. | Testing should reveal failure for all attempts to penetrate firewalls and infiltrate systems |

b. **General organization of CSCS**

i. **Governance policies and structure**

CSCS has an organizational structure that includes Board of Directors, an independent internal auditor and a management team with responsibility for departmental activities.

CSCS Board through its various committees oversee the operations and activities of CSCS are responsible for developing the Company's strategy utilizing available resources. The Board has supervisory oversight of management to ensure that the affairs of CSCS are conducted in a manner that is beneficial to all CSCS stakeholders. It is also responsible to ensure that the CSCS governance structure aligns with the SEC Code of Corporate Governance for Public Companies.

The Chief Executive Officer is responsible for the implementation of CSCS's strategy and manages it day-to-day operations.

The Board has eleven (11) members comprising of one (1) executive and ten (10) non-executives directors. Two (2) of the non-executives are independent directors. The Chairman of the board of directors is a non-executive director. The appointment of the independent directors follows strict compliance with the criteria set out in the SEC Code and the Company's Memorandum and Article of association.

The Board is governed by a charter that specifies the roles and responsibilities of the Board and its committees. The Board charter makes it clear that the Board exists to create shareholder value including the protection and enhancement of the value of its shareholder assets. In undertaking this it is required to assess and ensure systems are in place to manage the risks of CSCS' business. The Board also sets the attitude and disposition of CSCS towards compliance with applicable laws, environmental, safety and health policies, financial practices and reporting. The Board is also accountable to government authorities, and other stakeholders (employees, communities and the public).

There are five committees that have been established to support the Board in fulfilling its oversight functions:

1. **Stakeholders Committee**: The Committee's primary functions are to assist the Board in its assessment of potential partnerships and alliances with financial market operators. The Committee would also be responsible for working with management to identify influencers & participants, and to ensure close working relationship with these categories of stakeholders.

2. **Corporate Governance and Remunerations Committee**: The Committee's primary functions are to set a criteria for board and board committee memberships, review qualifications for appointment and continued service of Board members and senior management staff.

   The CG&R committee's duties are further broken down into two:

- Human Resources - Responsibilities:
  i. The Committee determines the compensation of the Chief Executive Officer and other senior management as well as review their corporate goals, objectives and performance targets.
  ii. Selection, retention and succession planning of senior management
  iii. HR Policies
- Finance and Investment – Responsibilities
  i. Ensure regular and accurate monitoring and accountability for funds of the Company.
  ii. Determine the Company's risk tolerance and ensure investment objectives and policies are constant and correct.

3. **Statutory Audit Committee:** The Committee's primary functions include review of accounts & accounting policies and review of financial reporting and internal control procedures. Also, the Committee carries out compensation, retention and oversight of independent auditors and internal auditors.

4. **Technical Committee:** The Committee's functions include providing the Board with an oversight of the Company's information technology systems and network related infrastructure.

5. **Risk Committee:** The Committee's functions include providing the Board with an oversight on the adequacy and efficiency of the Company's risk policies, strategies and controls.

The Head of Internal Audit has a direct reporting line to the Board through the Audit Committee and an indirect reporting line to the Chief Executive Officer (CEO).

**ii. Management structure**

The management group is headed by the Chief Executive Officer, who is also a member of the Board of directors and attends all Board and committee meetings. He is required to establish a long-term strategic goals of CSCS as well as its policies and proposed actions and present them to the Board for approval. A management charter has been issued that governs the work scope and the modus operandi of the CSCS management group.

The management group meets on a regular basis with an established fortnightly meeting schedule. Under the chairmanship of the CEO the management group is required to:

- Formulate, agree and implement the strategies and policies of CSCS;
- Submit relevant information to the Board;
- Manage the affairs of CSCS;
- Prioritize the allocation of human resources;
- Establish best management practices and functional standards; and
- Attend to staff appointments and performance monitoring.

As a part of these overall requirements the management team must:

- Carry out the functions required of CSCS within the delegated authorities contained in the Board charter;
- Set key performance indicators (KPIs) and monitor the overall performance against the established KPIs;
- Communicate CSCS's vision, strategy and culture throughout the business;
- Manage capital and operating expenditure between business units within defined capital and expenditure frameworks;
- Formulate treasury management strategy and financial strategy to ensure the financial sustainability of CSCS through effective use of resources;
- Identify and manage strategic and operational risks; and
- Agree and monitor Health, Safety, Environment and Sustainability policies.

**iii. Risk management framework**

A Risk management framework resides within the governance and management structure of CSCS. At a Board level there is the Risk Committee and at management level there is a centralized Risk Management function (Enterprise Risk Management) that reports to Management Risk Committee (MRC) as well as an independent Internal Audit function. In addition each business unit has a designated risk champion that liaises with the Enterprise Risk Management department to identify and manage risk across CSCS' operations, information technology and other business areas that own and manage various forms of risk.

c. **Legal and regulatory framework**

i. **An overview of CSCS's legal and regulatory framework. Includes**

1. **Legal and ownership structure of CSCS**

CSCS is a private limited liability company that was incorporated on 29 July 1992 under the Companies and Allied Matters Act 1990.

CSCS is owned by a variety of capital market and financial institutions including The Nigeria Stock Exchange, Participant Banks, Brokers, Registrars and other Institutional Investors.

2. **Legal basis for each material aspect of CSCS' activities**

The legal basis for each material aspect of CSCS's activities is based on law, regulations and CSCS rules.
There is no specific CSD law in Nigeria. *Instead* the securities law and securities regulation rule is contained within the Investments and Securities Act (ISA) of 2007 and the Securities and Securities and Exchange Commission rule.

3. **Regulatory, supervisory and oversight framework for CSCS**

CSCS is regulated by the Nigerian Securities and Exchange Commission as a Capital Market Self-Regulatory Organization (SRO) for both its activities as a depository and as a securities clearing and settlement company.
The Investments and Securities Act of 2007 provides the legal basis for the regulation of the capital markets including securities exchanges; capital market operators, Self-Regulatory Organization (such as CSCS); securities offered for sale or subscription; mergers, acquisitions and combinations; collective investment schemes and borrowings by Federal, States, Local government and other government bodies.

The key regulations that is issued pursuant to the Act is the Securities and Exchange Commission Rules and Regulations 2013 which sets out the obligations of the depository and the clearing and settlement company.

d. **System design and operations**

i. **An explanation of Clearing System**

The clearing and settlement process differs for on-exchange and OTC transactions. CSCS clears all trades that have been matched on the Nigerian Stock Exchange (NSE). Once it receives the matched instructions it puts a hold on the securities in the seller's account.
For on-exchange transactions, all trades concluded on the NSE or other organized securities market are subject to clearing and settlement through CSCS. For this purpose there is a tight-coupling between CSCS's clearing and settlement system and the NSE's trading system. The NSE system will check to ensure that the selling dealing member has the securities to be traded in their account at CSCS.

Once the trade is matched at NSE, CSCS will clear the trade. This involves calculating by 4.00pm on trade date the broking firm's net financial obligation and advising their respective settlement bank. (All participants are required to appoint a settlement bank that will clear the cash leg of the trade.) The information from CSCS alerts the settlement bank about their client's commitment on settlement day (trade day plus 3).

On the second day after trade day (T+1), the settlement bank is required to alert CSCS by 12pm (noon) of any stock broking firm that will be unable to meet their financial obligation on settlement day. Stock broking firms are also required to verify to CSCS their ability to meet their financial obligations for the following day.

By 5.00pm on T+1, CSCS will send final advice of the net financial obligations of the brokers for settlement on the following day to their respective settlement banks. By 4:00pm on T+2, CSCS forwards the inter-bank settlement instructions to Nigerian Interbank Settlement System (NIBSS) for processing on the following day.

All settlement participants are required to comply with CSCS settlement guidelines. Broker/Dealer, Broker and Custodians are expected to make cash available in their cash settlement account on or before 4:00pm on T+2.

**ii. An explanation of the Depository System**

CSCS as a central securities depository provides a depository service whereby participants hold their securities with CSCS in book-entry form.

Participants may deposit securities into or withdraw securities from CSCS. Deposits will be credited to the account of the participant. On the instruction of the participants, CSCS will transfer securities from one participant account to another participant account.

All deposits, withdrawals and transfers of securities are recorded in the book-entry system and statements and reports are provided to participants on a daily basis or whenever there is account activity. Statements and report are also provided to the investor on request.

**Rating Summary**

Below is the rating summary of CSCS's self-assessment conducted in respect of the CMPI-IOSCO principles compliance.

| Assessment | Principle |
|---|---|
| Observed | 2,3,7,9,10,11,12,13,15,16,17,18,21,23 |
| Broadly Observed | 1,4,8 |
| Partly Observed | 22 |
| Not Observed | |
| Not Applicable | 19,5,6,20,24 |

### III. Principle-by-principle summary narrative disclosure

<table>
<tr><td colspan="2">Principle –by-principle summary narrative disclosure</td></tr>
<tr><td colspan="2">Principle 1: Legal Basis<br>An FMI should have a well-founded, clear, transparent and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions.</td></tr>
<tr><td>Summary narrative</td><td>o Central Securities Clearing System Plc operates as a Central Securities Depository (CSD) and Clearing House for equities, bonds and treasury bills within a defined and robust legal framework.<br>o The Investments and Securities Act of 2007 provides the legal basis for the regulation of Nigeria's capital markets covering capital market operators (CMOs), Self-regulatory Organization (SRO) such as CSCS.<br>o The Securities and Exchange Commission Rules and Regulations 2013 (Rules 134, 135 and 136) sets out the obligations of the depository, its participants and the clearing and settlement company.<br>o The depository rules (Amended Rules of Central Securities Clearing System PLC) clarify CSCS's obligations.</td></tr>
<tr><td>Rating of Principle</td><td>Broadly Observed</td></tr>
<tr><td><u>Key Consideration 1.</u></td><td>“The legal basis should provide a high degree of certainty for each material aspect of an FMI's activities in all relevant jurisdictions.”<br><br>Broadly Observed</td></tr>
<tr><td>Material Aspects and Relevant Jurisdiction<br><br><br><br><br><br><br><br><br><br><br><br><br>Legal Basis for each Material Aspect.</td><td>As a CSD, the material aspects of CSCS's custody activities that require legal certainty are:<br>o Immobilization / dematerialization of securities<br>o Nominee ownership<br>o Depository<br><br>As a SSS, the material aspects of CSCS ‘s clearing and settlement activities that require legal certainty are:<br>o Netting;<br>o DvP settlement<br>o Finality of settlement<br>o Guarantee of settlement<br>o Default management<br><br>The only relevant jurisdiction is Nigeria.<br><br>o CSCS's operations are governed by the SEC rules and regulations together with its CSD rules. SEC rules 134 – 150 cover the</td></tr>
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| | operations of a depository while rules 151 - 175 cover the depository participants. Rules 176 – 177 cover the Securities Clearing and Settlement Company.<br><br>o The following material aspects are covered as outlined below, through SEC rules or CSCS's own rules.<br><br>**Immobilization / Dematerialization of Securities**<br>o SEC rule 139 specifies the securities eligible for dematerialization. It indicates that the depository 's rules must state the securities eligible for dematerialization and indicates a number of security types that must be stated including shares, bonds, debentures, money market instruments and government securities.<br>o Other rules (136, 140, 141) mention dematerialized securities including requiring the depository rules to provide for certificated securities to be converted to un-certificated securities and for issuers to issue un-certificated securities. Also the SEC rules relating to the participant refer to dematerialized securities.<br>o Articles 38 and 58 of CSCS Rules comment on dematerialization of physical securities deposited with CSCS.<br>o Rule 3.6 of the Amended CSCS Rules covers the dematerialization and re-materialization of securities while Rule 3.7 covers immobilization of securities.<br><br>**Nominee Ownership**<br>o The SEC rules covering Custodian of Securities, specifically rule 132 on Use of Nominees identifies the requirements covering nominee ownership. It provides for the use of nominees where the nominee acts in accordance with client instructions in relation to holding of securities and accepts responsibility in writing to its clients for the nominee's actions.<br>o The amended rules of CSCS do recognize nominees e.g. in Rules 6.6.4 and 6.8.1.<br><br>**Account Segregation**<br>o The SEC Rules specifies account segregation for clients of participants in Rule 156 (1), whereby separate accounts are to be opened by every participant in the name of each client and the securities of each client are to be segregated and not to be mixed with the securities of other clients or with the securities of the participant.<br>o Article 24 of CSCS Rules specifies the types of securities accounts that can be opened. This article does not specifically indicate that each client of a participant should have a separate client account.<br>o Article 39 of CSCS Rules indicate that each dealing member can only open one cash trading account with a settlement bank that is used in making payments to CSCS for their clients' transactions. |

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| | o Rule 3.2 of the Amended rules provides for a greater range of accounts. Rule 5.3.1 stipulates that each dealing member can only open one cash trading account with a settlement bank that is used in making payments to CSCS for their clients' transactions.<br><br>**Netting**<br>o CSCS Rules refer to the netting of obligations as a service CSCS provides (Articles 2 and 35 and in the transaction timetable in Article 39). CSCS renders the services of determining, calculating, netting and facilitating the settling of obligations, arising from securities transactions concluded on Exchange (trading) platform or other organized securities market with book-entry transfer of securities in the participants' accounts and cash transfer.<br><br>o Also in the amended rules, rule 5.1 mentions net financial obligations. In addition, the netting procedure and the specific authority to net obligations is provided for in the amended rules.<br><br>o However netting is not mentioned in the SEC rule.<br><br>**DvP Settlement**<br>o The requirement to provide DVP settlement is specified in the SEC rules relating to the Securities Clearing and Settlement Company (rule 177(4)) that specifies that the company shall link securities transfers to funds transfers to achieve DVP settlement. DVP is also mentioned as a requirement that the participant demonstrate an ability to settle a trade on a DVP basis (SEC rule 152 – 1(m)).<br>o CSCS Rules refer to assuming DVP settlement in Article 39. In the amended rules, Rule 5.4.4 explained how DVP is assured at CSCS.<br><br>**Finality of Settlement**<br>o SEC rule 177(2) for Securities Clearing and Settlement Company mentions that the company in its rules should provide the period for the final settlement of transactions.<br>o CSCS Rules deal with the final and irrevocable settlement of cash (Article 40) and securities (Article 41).<br>o In the amended rules, Rules 5.4.4 (cash) and 5.5.1 (securities) specify transactions to be final and irrevocable.<br><br>**Guarantee of Settlement**<br>Cash settlement is guaranteed by the use of Central Bank money while security settlement is guaranteed by blocking the traded security on trade date for settlement. Rules 5.6.3, 5.6.5 and 5.6.6 in the Amended Rules refer to the use of the Settlement Guarantee Fund in the event of default in funding of a trading account. |

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| | o Guarantee of settlement is not mentioned in the SEC Rules<br><br>**Default Management**<br>o Article 52 of CSCS Rules indicates that CSCS may impose a surcharge on a participant for a violation of the Rules or Procedures for errors, delays or for other conduct impeding the operations of CSCS.<br><br>o Rule 5.6 of the Amended rules deals with the procedure where there is a default by a stock broking firm in funding a trading account. There is a default management procedure and governance policy for the management of settlement guarantee fund<br><br>o CSCS has developed a well-defined rules and procedures to manage the default and orderly wind down of any of its failed participant in the event of default. The default management was presented to all stakeholders including Association of Stockbroking Houses of Nigeria (ASHON), the settlement banks and the custodians.<br><br>o However, default management is not mentioned in the SEC rules. |
| Key Consideration 2. | ***"An FMI should have rules, procedures, and contracts that are clear, understandable, and consistent with relevant laws and regulations."***<br><br>**Observed** |
| Clear and understandable rules, procedures and contracts | CSCS has an established set of rules that are in the process of being amended. The amended rules are being prepared in line with the law (The Investment and Securities Act), the regulator's rules (The Rules and Regulations of the Securities and Exchange Commission) and the Master Terms and Conditions. CSCS has reviewed these documents and undertaken the appropriate legal analysis to ensure consistency with relevant laws and regulations.<br><br>The Rules provide that participants are to construe the Rules in accordance with relevant statutory provisions. Additionally, the Rules also provide that in the event of inconsistencies, the relevant law or regulation will prevail over CSCS's Rules.<br><br>Rule 1.5 of the Amended Rules provide that in the event of any inconsistency or conflict between the Rules and the Participation Agreement or Master Terms or any other agreement between CSCS and its participants, the provisions of the Rules will prevail. |

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| | According to Article 53 of CSCS Rules, the Board of Directors of CSCS may amend the Rules. CSCS may notify participants of any proposed changes and participants' comments or submissions are to be filed with CSCS's records. The Board of Directors must confirm all amendments to the Rules and Procedures.<br><br>Also Article 51 indicates that participants shall be promptly notified of any proposed amendment to the Procedures and the Procedures will only become effective after confirmation by the Board of Directors.<br>Essentially the participants are given the opportunity to comment on the draft rules following which they are presented to the Board of CSCS for approval before being submitted to the Securities and Exchange Commission for final approval. |
| **Key Consideration 3** | ***"An FMI should be able to articulate the legal basis for its activities to relevant authorities, participants, and, where relevant, participants' customers, in a clear and understandable way."***<br><br>***Observed*** |
| | CSCS provides an explanation of the legal basis for its activities in its Rules, (Rule 1.1) whereby it indicates that the Rules are issued pursuant to the powers granted to CSCS by the Investment and Securities Act as a Self-Regulatory Organization.<br>CSCS also uses presentations and meetings with participants to explain the legal basis for its activities.<br><br>CSCS generally does not need to articulate the same to the regulator but will use the opportunity to clarify how its activities comply with the legal requirements, especially with the Investment and Securities Act (ISA) and the Rules and Regulations of the Securities and Exchange Commission. Any amendment to the rules needs the SEC's approval and this provides an appropriate opportunity to discuss the changes and how they are consistent with the legal position. |
| Key Consideration 4 | *"An FMI should have rules, procedures, and contracts that are enforceable in all relevant jurisdictions. There should be a high degree of certainty that actions taken by the FMI under such rules and procedures will not be voided, reversed, or subject to stays."*<br><br>**Partly observed** |
| | CSCS has undertaken its own legal analysis to ensure that its rules, procedures and contracts are consistent with Nigeria's laws and enforceable in Nigeria. In some areas e.g. default of a participant, netting arrangement need to be recognized by apex regulator SEC to ensure the arrangements adopted by CSCS will be enforceable. |

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| | Also all foreign incorporated bank participants have a branch in Nigeria that is regulated by the Central Bank of Nigeria and all settlement banks are subject to Nigerian laws. The relevant legislation is contained in the Banks and Other Financial Institutions Act of 2004.<br><br>As CSCS does not presently operate in jurisdictions outside of its territory, its contracts only need to be enforceable within Nigeria. However, CSCS will examine these contracts to determine their enforceability in any other jurisdiction that it plans to operate in. Specifically it is involved in a West Africa Capital Markets Integration (*WACMI*) and this could require its rules and contracts to be enforceable in West African territories (Ghana, Sierra Leone, Cote D I'voire, Gambia, Guinea and Liberia). |
| Key Consideration 5 | *"An FMI conducting business in multiple jurisdictions should identify and mitigate the risks arising from any potential conflict of laws across jurisdictions."*<br><br>**Not applicable** |
| | Currently CSCS does not operate outside Nigeria. However it is involved in the WACMI project and this will require it to examine the laws of those West African countries that are also included in the project. This will help to identify any conflict of law and thus what specific risks that CSCS may face in operating in those territories. |

| **Principle 2: Governance**<br>An FMI should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders. | |
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| Summary narrative | CSCS has reviewed and updated its governance arrangements in the past 3 years. The Board adopted the SEC Code of Corporate Governance for public companies, which has general application across the Nigerian market. It has developed charters for the board including board committees that clarifies their roles and responsibilities.<br>There is a code of conduct that applies to all Board members including the Chairman and a Board Charter. CSCS commenced a process of annual Board evaluations in 2013. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | ***"An FMI should have objectives that place a high priority on the safety and efficiency of the FMI and explicitly support financial stability and other relevant public interest considerations."***<br><br>**Observed** |

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| | The Value statement of CSCS is published in the 2014 annual report and on CSCS website, includes specific statements on safety and efficiency. This demonstrates CSCS commitment in placing a high priority on the safety and efficiency criteria. In addition the Chairman comments on financial stability matters in the annual report and seeks ways to increase the revenue base.<br><br>The revised CSCS Strategic Plan 2015 (for the years 2016 – 2017) has as one of the objective to expand CSCS revenue base. CSCS also has strategic drivers for this objective. Another objective is to **Increase** efficiencies in depository, clearing and settlement services which supports a financial stability objective.<br><br>CSCS has also developed various mechanisms to ensure that public interests are identified and are reflected in developing the overall strategy of the Company. One of the strategic driver of the company's objective is to achieve Customer & Stakeholder Satisfaction Index of 80%. This indicator is being reviewed and monitored on a quarterly basis.<br><br>The Company regularly reviews and measure the performance of its objective using Balanced Score Card approach. |
| Key Consideration 2. | ***"An FMI should have documented governance arrangements that provide clear and direct lines of responsibility and accountability. These arrangements should be disclosed to owners, relevant authorities, participants, and, at a more general level, the public."***<br><br>**Observed** |
| | There is a Corporate Governance and Remuneration Committee Charter and a Code of Conduct for Board members that specifies the duties and responsibilities of the Board members. There are also charters for each of the Board committees. (Risk Committee, Statutory Audit, Corporate Governance and Remunerations Committee and Technical Committee). Breaches of the Code may result in disciplinary action, which could include the removal of the Board member from the Board.<br>The Board members are required to sign up to the Code.<br><br>CSCS publishes a Corporate Governance Report in its Annual Report, five (5) consecutive years annual reports are publicly available on the CSCS website. The Corporate Governance Report gives details of the corporate governance arrangements including the role and responsibilities of the Board committees. |

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| Key Consideration 3. | *"The roles and responsibilities of an FMI's board of directors (or equivalent) should be clearly specified, and there should be documented procedures for its functioning, including procedures to identify, address, and manage member conflicts of interest. The board should review both its overall performance and the performance of its individual board members regularly. "*<br><br>**Observed** |
| | The roles and responsibilities of the CSCS Board are contained in the Board Charter, Committee charters and the Code of Conduct for Directors. In addition the Annual Report for 2014 contains a Corporate Governance Report that identifies the responsibility of the Board in terms of developing the Company's strategy and undertaking supervisory oversight of management activities to ensure that the affairs of the company are conducted in a manner beneficial to all stakeholders of the company. The Board has created a number of committees to help in the discharge of its oversight responsibilities. The role of the Chairman and the Chief Executive Officer are specified in the Corporate Governance Report. The Chairman is responsible for providing leadership and setting the standards of business conduct for the Board. The CEO is responsible for providing direction to management and communicates the direction and sentiments of the Board through attendance at Board and committee meetings.<br><br>Potential conflicts of board members are managed by adopting a Code of Conduct and in requiring at least 2 members to be independent and the Chairman to be a non-executive member of the Board. The Code of Conduct for Board Members specifies the need for directors to avoid conflicts of interest and to disclose to the Chairman any situation where a conflict exists. The Chairman is then responsible for investigating the conflict, making a decision and communicating the decision to the Board member in a timely manner.<br><br>The Corporate Governance and Remuneration Committee (CGRC) Charter indicates that the committee has the responsibility to ensure that the Board undertakes an annual evaluation of its performance. The first annual evaluation was undertaken in 2013 on a self-assessment basis. Furthermore the committee is required to make recommendations on the experience required by Board Committee members and Committee appointments and removals.<br><br>The CSCS Board has adopted the SEC Code of Corporate Governance for Public Companies in Nigeria that specifies:<br>- Responsibilities of the Board<br>- Duties of the Board<br>- Board Committees<br>- Performance Evaluation of the Board |

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| | - Conflicts of Interest<br>- Orientation and Training of the Directors<br>The responsibility for compliance with the principles and provisions of the Code is primarily with the Board.<br>The Code specifies that the Board should establish a system to undertake a formal and rigorous evaluation of its performance, that of its committees, its Chairman and individual directors. The evaluation system should include the criteria, the key performance indicators and targets for the Board, its Committees, the Chairman and each individual committee member. The Board may engage external consultants to help with the evaluations. |
| Key Consideration 4. | *"The board should contain suitable members with the appropriate skills and incentives to fulfill its multiple roles. This typically requires the inclusion of non-executive board member(s)."*<br><br>**Observed** |
| | The SEC Code of Corporate Governance provides guidelines for the composition and structure of the Board. It indicates that the Board should contain a mix of executive and non-executive directors with non-executive directors in the majority and there should be at least one independent non-executive director. It also provides guidance on the desirable characteristics of Board members and indicates that the Board should be independent of management to enable it to carry out its supervisory roles in an objective and effective manner. The CSCS Board of Directors Charter incorporates these requirements.<br><br>The CGRC Charter requires the committee to periodically evaluate the skills, knowledge and experience required on the Board and make recommendations on the experience required by Board Committee members, Committee appointments and removal of committee members. The Committee is also required to evaluate and ensure the independence of each member of each committee of the Board of Directors and is required to be composed of independent directors.<br><br>The Corporate Governance Report specifies that the CSCS Board is composed of a combination of non-executive directors and executive directors totaling 10 members. The Chairman is a non-executive director and there are two independent non-executive directors. It also indicates that Board members are individuals who have distinguished themselves in their respective enterprises and are well versed in Board matters.<br><br>CSCS follows the guidelines in the SEC Code of Corporate Governance as to the definition of an independent director. |

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| | A list of the directors and the profile for each director is published in the Annual Report and on the CSCS website |
| Key Consideration 5. | *"The roles and responsibilities of management should be clearly specified. An FMI's management should have the appropriate experience, a mix of skills, and the integrity necessary to discharge their responsibilities for the operation and risk management of the FMI."*<br><br>***Observed*** |
| | The Corporate Governance Report indicates that the Chief Executive Officer is responsible for providing direction to management.<br><br>The CGRC Charter requires Committee members to:<br>- review and recommend for Board approval the promotion, hiring and dismissal of Management staff ;<br>- to determine and assess Key Performance Indicators for Executive Directors; and<br>- to ensure a succession policy and plan exist for the positions of CEO/MD and other Management staff.<br><br>There is also a Management Team Charter that outlines the roles and responsibilities of the Management Committee. The Job descriptions of the management team include an outline of the skills and experience required for each position.<br><br>CSCS publishes the names of management staff (heads of departments) in its Annual report. It also states that as a part of its Human Resources policy it aims to recruit individuals based on a standard of merit and competence. |
| Key Consideration 6. | *"The board should establish a clear, documented risk-management framework that includes the FMI's risk-tolerance policy, assigns responsibilities and accountability for risk decisions, and addresses decision making in crises and emergencies. Governance arrangements should ensure that the risk- management and internal control functions have sufficient authority, independence, resources, and access to the board."*<br><br>***Observed*** |
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| | Risk Committee has been established to assist the Board in its oversight of the Company's risk management framework, policies and practices. The specific responsibilities of the Committee include:<br>- Reviewing the Company's enterprise risk framework and policies for identifying, monitoring and managing significant business risks across the Company and considering whether the enterprise risk framework and internal controls effectively identify areas of potential material risk<br>- Considering the effectiveness of CSCS's internal control system recognizing those matters in respect of which the Board relies on to provide oversight.<br><br>The Annual Report includes an Enterprise Risk Management Report that reports on CSCS's approach to the establishment of a structured risk management framework.<br><br>Within CSCS an Enterprise Risk Management (ERM) unit has been established with dedicated resource. In addition the individual business units have designated risk personnel that liaise with ERM to identify and manage risk across CSCS's operations. The approach includes the collection of data that helps to evaluate each unit's risk profile.<br><br>ERM also examines the business goals and aligns CSCS's risk appetite with those goals to ensure that it is not taking on excessive risk in performing its role.<br><br>The Risk Management framework also includes the audit activity, primarily from the internal audit unit, which provides advisory and independent assurance of CSCS's internal controls. To preserve the independence of the internal audit unit the head of internal audit reports directly to the Board Audit and Risk Committee with a report line to the CEO for administration purposes.<br><br>The ERM framework examines 8 key risks:<br><br>- Operational risk;<br>- Liquidity and Participant Default risk;<br>- Business Continuity risk;<br>- Information Security risk;<br>- Regulatory compliance risk ;<br>- Asset Commitment Risk;<br>- Counterparty Risk;<br>- Asset Safety Risk;<br><br>The internal structures established to manage risk within CSCS include:<br>- Board Audit and Risk Committee. This committee oversees CSCS management activities in respect of day- |

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| | to-day responsibilities for managing risks. It is responsible for reviewing the work and independence of the external auditor and considering the appointment of the external auditor. It also reviews the annual audit plans and activities for the Internal audit function, reviews the performance, independence and effectiveness of the internal audit function and review and concur on the appointment of the Head of Internal Audit.<br>- Management risk committee. This committee is headed by the Chief Risk officer and provides the framework to help the Board Audit and Risk committee achieve its oversight functions. |
| Key Consideration 7. | *"The board should ensure that the FMI's design, rules, overall strategy, and major decisions reflect appropriately the legitimate interests of its direct and indirect participants and other relevant stakeholders. Major decisions should be clearly disclosed to relevant stakeholders and, where there is a broad market impact, the public."*<br><br>***Observed*** |
| | CSCS has undertaken a review of its rules. As a part of this review, CSCS notifies participants of any proposed changes and participants' comments or submissions are filed with CSCS's records. The Board of Directors must then confirm all amendments to the Rules and Procedures.<br><br>Article 51 of the amended rules indicates that participants shall be promptly notified of any proposed amendment to the Procedures and the Procedures will only become effective after confirmation by the Board of Directors.<br><br>Once the Board of CSCS has given its approval to the rule changes they are submitted to the Securities and Exchange Commission for final approval.<br><br>CSCS engages stakeholders on projects and change initiatives through special meetings. CSCS has also established User Groups for Settlement Banks, Brokers, Custodians and Registrars.<br><br>The Annual Report also reports on major decisions and this is available to the public. |

| **Principle 3: Framework for the Comprehensive Management of Risks.**<br>An FMI should have a sound risk-management framework for comprehensively managing legal, credit, liquidity, operational and other risks. | |
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| Summary narrative | CSCS has established an enterprise risk management framework. This framework is the responsibility of the Board in its oversight role. The Board Charter makes the Board responsible to have an understanding of the principal risks associated with CSCS businesses and ensure that appropriate systems are in place which effectively monitor and manage those risks. The Board has established the Risk Committee to help in the discharge of this responsibility with its primary purpose being the oversight of CSCS's risk management framework. CSCS management is responsible for executing CSCS's risk management and audit policies including the design, implementation and maintenance of an effective risk program. CSCS has appointed a Head of Enterprise Risk Management to manage CSCS's risks on a consolidated basis under the CSCS risk management framework, which provides line business managers the responsibility for managing risks in their areas of responsibility. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *"An FMI should have risk-management policies, procedures, and systems that enable it to identify, measure, monitor, and manage the range of risks that arise in or are borne by the FMI. Risk-management frameworks should be subject to periodic review."*<br><br>**Observed** |
| | CSCS has developed a robust risk management framework and as a part of this framework it is putting in place its policies and procedures. The risk framework and procedure were approved by the Board Audit and Risk Committee.<br><br>The processes and structures that form the risk management framework have been established and are operational.<br><br>The framework incorporates both a top-down and a bottom-up approach to managing risk. There is a Board Audit and Risk committee that reports to the full Board with the Head of Internal Audit reporting directly to the Committee. The Head of Enterprise Risk Management who is responsible for managing CSCS's risks on a consolidated basis also reports into the Committee and attends meetings (at least four per annum).<br><br>The Committee is responsible for overseeing the CSCS risk management framework, including the significant policies and practices used in identifying, monitoring and managing all kinds of risk affecting CSCS's business. It also needs to consider on an on-going basis whether the |

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| | enterprise risk management framework and internal controls effectively identify all areas of potential material risk.<br><br>The Committee reports to the Board of Directors regarding the CSCS risk portfolio, the risk management framework and the overall adequacy of the Risk Management function.<br><br>From a bottom-up perspective it is the line business managers that are responsible for managing risks in the areas for which they are responsible. The line managers are supported by an Enterprise Risk Management (ERM) unit and a Management Risk committee. The ERM manages CSCS's risks on a consolidated basis. The unit also provides overall leadership and direction on the risk management framework, the independent risk management function and risk governance processes, including risk measurement, risk monitoring, risk control and risk reporting.<br><br>The key risks that have been identified and managed through the risk management framework are:<br><br>- Operational risk;<br>- Liquidity and Participant Default risk;<br>- Business Continuity risk;<br>- Information Security risk;<br>- Regulatory compliance risk ;<br>- Asset Commitment Risk;<br>- Counterparty Risk;<br>- Asset Safety Risk;<br><br>CSCS is currently in the process of acquiring a system for the monitoring of risks. |
| Key Consideration 2. | *"An FMI should provide incentives to participants and, where relevant, their customers to manage and contain the risks they pose to the FMI."*<br><br>***Observed*** |
| | There is an advisory role undertaken by the Enterprise Risk management Group to provide information and advice to participants.<br><br>Within the Amended Rules of CSCS, Rule 8 refers to risk management. This rule imposes some requirements on participants to manage risk. It makes clear that CSCS will monitor participants and require reports from participants. |

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| | It also imposes requirements on the participants to have and maintain internal controls and procedures that are continuously monitored by the participant, that it must conduct a full Disaster recovery test bi-annually, it must appoint compliance officers and it must take all reasonable security measures to protect information, data, records, certificates, documents of title and other documents relating to clients.<br><br>CSCS also has disincentives in the form of penalties that it imposes on participants in the event they do not comply with market standard settlement requirements. |
| Key Consideration 3. | *"An FMI should regularly review the material risks it bears from and poses to other entities (such as other FMIs, settlement banks, liquidity providers, and service providers) as a result of interdependencies and develop appropriate risk-management tools to address these risks."*<br><br>**Observed** |
| | CSCS has developed a risk management approach that takes into account interdependencies with participants.<br><br>The Amended Rules of CSCS outline the approach to risk management for Liquidity and Counterparty risk whereby CSCS monitors participants to measure potential risks to CSCS and the Services provided by CSCS. The monitoring is to address liquidity and counterparty risk for failure or default of a participant.<br><br>To ensure continuity of operations, CSCS maintains a Disaster Recovery system and Business Continuity Plan that is quarterly tested. CSCS, Nigeria Stock Exchange and other market participants conducted 2 full market-wide test in 2014. It also requires its participants to likewise conduct a full Disaster Recovery test bi-annually on its systems and infrastructure. (Rule 8.3.6)<br><br>CSCS also provides for the inability to operate from its premises by having established alternative premises for such eventualities. |
| Key Consideration 4. | *"An FMI should identify scenarios that may potentially prevent it from being able to provide its critical operations and services as a going concern and assess the effectiveness of a full range of options for recovery or orderly wind-down. An FMI should prepare appropriate plans for its recovery or orderly wind- down based on the results of that assessment. Where applicable, an FMI should also provide relevant authorities with the information needed for purposes of resolution planning."*<br><br>**Observed** |

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| | CSCS has a robust business continuity and disaster recovery plans. it continually exam scenarios that may impact its operations and services as a going concern. Some of the extreme scenarios are:<br>- The default of a number of the largest participants that would render a systemic situation;<br>- A prolonged downturn in business that impacted market conditions for a considerable period, e.g. a drastic (50 percent) drop in volumes for an extended period, or perhaps forced the closure of the market for a number of months;<br>- a significant fraud that impacted CSCS and its participants that 'wiped out' CSCS reserves and left it liable to claims from participants that it would be unable to compensate;<br>- a cyber-attack that corrupted data and/or stole data;<br>- a catastrophic system failure;<br>- the total destruction of its premises that required it to operate from its DRP and BCP facilities without any further back-up;<br>- the demise of key management and operational staff that left the company without leadership and lacking key personnel that held the requisite skills to effectively manage and operate CSCS.<br><br>A recovery and resolution plan for standard disaster recovery situation has been developed. This is being tested annually. |

<table>
<tr><td colspan="2">Principle 4: Credit Risk<br>An FMI should effectively measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes. An FMI should maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.</td></tr>
<tr><td>Summary narrative</td><td>This principle applies to those CSDs like CSCS that operate as a SSS. (Many of the key requirements are only relevant to CCPs.)<br>It is directed at an SSS knowing its credit exposure to participants and having appropriate policies to manage such exposures.<br><br>CSCS has arranged for the settlement banks to guarantee the transactions undertaken by the brokers. This leaves the credit risk with the settlement banks. To cover this there is a Settlement Guarantee Fund (SGF) which is stress tested quarterly. The governance, use and replenishment of the Fund been address in CSCS participant default management procedure and the Amended Rules.</td></tr>
<tr><td>Rating of Principle</td><td>Broadly observed</td></tr>
<tr><td>Key Consideration 1.</td><td>“An FMI should establish a robust framework to manage its credit exposures to its participants and the credit risks arising from its payment, clearing, and settlement processes. Credit exposure may arise from current exposures, potential future exposures, or both.”<br><br>Broadly observed</td></tr>
<tr><td></td><td>The settlement banks guarantee the settlement of broker trades. This arrangement eliminates credit risk to participants in most situations.<br><br>The cash settlement is undertaken on a net basis. This means that the magnitude of settlement risk in respect of cash settlement is reduced.<br><br>Settlement banks acts as the authorized cash settlement agent in the market. Cash settlement default occurs when a Bank is unable to meet cash settlement obligation on settlement date or the Bank is insolvent and therefore unable to fund settlement obligations. Each settlement Bank has a revolving pledge of a minimum of fifteen billion naira (N15billion) worth of Treasury bills and Federal Government bonds with Central Bank of Nigeria (CBN).<br><br>In the event that a settlement bank goes into bankruptcy the Real Time Gross Settlement (RTGS) System automatically request for intraday liquidity facility using the pledged clearing collaterals to settle the obligation. This is done by the Central Bank of Nigeria and built into CSCS default management procedure.</td></tr>
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The settlement banks are regulated by the Central Bank of Nigeria. They impose capital requirements that adhere to international standards. The Nigerian banks are currently implementing Basel II capital requirements.

CSCS operates four lines of defense to provide guarantee that settlement will occur as and when due.

- First Line of Defense – Collateral covering 110% of the value of daily settlement obligation pledged daily by settlement banks with CBN as settlement guarantee in the event of settlement obligation default.

- Second Line of Defense - the portfolio value of the defaulting Dealing member.

  In the event dealing member default, the settlement bank will have lien over the underlying securities, the proprietary account of the dealing member and may request for the liquidation of both the underlying securities and the securities in the proprietary account to replenish bank's money.

- Third Line of defense - Settlement bank collateral & Central Bank intraday liquidity Facility (ILF)

  All settlement banks maintain a minimum of N15Billion with Central Bank as collateral for settlement obligations against default. This can only be used in an extreme scenario that a settlement bank becomes insolvent and cannot fulfil its obligation to the capital market. In this case, CBN will utilize its intraday liquidity Facility to cover any settlement requirement from the capital market.

- Fourth Line of Defense – Settlement Guarantee Fund. Settlement guarantee fund was established to help mitigate liquidity and settlement risk in the Nigerian capital market. SGF is a contributory fund with an initial contribution of N100, 000 from all dealing members.

  All settlement banks maintain a minimum of N15Billion with Central Bank as collateral for settlement obligations against default. This can only be used in an extreme scenario that a settlement bank becomes insolvent and cannot fulfil its obligation to the capital market. In this case, CBN will utilize its intraday liquidity Facility to cover any settlement requirement from the capital market.

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| Key Consideration 2. | *"An FMI should identify sources of credit risk, routinely measure and monitor credit exposures, and use appropriate risk-management tools to control these risks."*<br><br>**Observed** |
| | As mentioned, CSCS has little credit risk exposure apart from the possibility of default by a settlement bank. The default of brokers is managed through the guarantees provided by the settlement banks.<br><br>The default of a settlement bank could stem from a number of sources:<br><br>1. Losses made on its own account<br>2. The default of its clients<br>3. General losses made on other business activities<br><br>The possible default or insolvency of any of the brokers and bank are managed using four lines of defense to provide guarantee that settlement will occur as and when due.<br><br>The Nigerian Capital Market operates four lines of defense to provide guarantee that settlement will occur as and when due.<br><br>• First Line of Defense – Collateral covering 110% of the value of daily settlement obligation pledged daily by settlement banks with CBN as settlement guarantee in the event of settlement obligation default.<br><br>• Second Line of Defense - the portfolio value of the defaulting Dealing member.<br>In the event dealing member default, the settlement bank will have lien over the underlying securities, the proprietary account of the dealing member and may request for the liquidation of both the underlying securities and the securities in the proprietary account to replenish bank's money.<br><br>• Third Line of defense - Settlement bank collateral & Central Bank intraday liquidity Facility (ILF)<br>All settlement banks maintain a minimum of N15Billion with Central Bank as collateral for settlement obligations against default. This can only be used in an extreme scenario that a settlement bank becomes insolvent and cannot fulfil its obligation to the capital market. In this case, CBN will utilize |

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| | its intraday liquidity Facility to cover any settlement requirement from the capital market.<br><br>• Fourth Line of Defense – Settlement Guarantee Fund. Settlement guarantee fund was established to help mitigate liquidity and settlement risk in the Nigerian capital market. SGF is a contributory fund with an initial contribution of N100, 000 from all dealing members.<br><br>All settlement banks maintain a minimum of N15Billion with Central Bank as collateral for settlement obligations against default. This can only be used in an extreme scenario that a settlement bank becomes insolvent and cannot fulfil its obligation to the capital market. In this case, CBN will utilize its intraday liquidity Facility to cover any settlement requirement from the capital market.<br><br>The size of the SGF is N75 million this is being stress tested quarterly to determine it adequacy which is done by examining the potential default of the two largest clearing members. This will help to provide quantitative data on the necessary size of the SGF.<br><br>Other approaches that CSCS uses to control its credit risk is through the active monitoring of clearing members. The arrangement to monitor participants is covered in Rule 8 of the Amended Rules. As a part of this CSCS undertakes a daily liquidity concentration study and a watch list monitoring of certain category of brokers. |
| Key Consideration 3. | *"A payment system or SSS should cover its current and, where they exist, potential future exposures to each participant fully with a high degree of confidence using collateral and other equivalent financial resources (see Principle 5 on collateral). In the case of a DNS payment system or DNS SSS in which there is no settlement guarantee but where its participants face credit exposures arising from its payment, clearing, and settlement processes, such an FMI should maintain, at a minimum, sufficient resources to cover the exposures of the two participants and their affiliates that would create the largest aggregate credit exposure in the system."*<br><br>**Observed** |
| | CSCS's exposure to broker participants is covered by the guarantees given by the settlement banks. The arrangement is between the settlement bank and the Central bank of Nigeria. |
| Key Consideration 7. | |

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| | *"An FMI should establish explicit rules and procedures that address fully any credit losses it may face as a result of any individual or combined default among its participants with respect to any of their obligations to the FMI. These rules and procedures should address how potentially uncovered credit losses would be allocated, including the repayment of any funds an FMI may borrow from liquidity providers. These rules and procedures should also indicate the FMI's process to replenish any financial resources that the FMI may employ during a stress event, so that the FMI can continue to operate in a safe and sound manner."*<br><br>**Observed** |
| | The Draft Amended Rules (Rule 5.6) and CSCS participants default management procedure outline the procedure in the situation where there is a default in the funding of a trading account.<br><br>It provides that the liquidation of the underlying security that generated the debit and the proprietary accounts of the dealing members. The SGF will only be used in the event that the total recovery from the liquidation is not enough to offset the initial debit. |

| **Principle 5: Collateral**<br>An FMI that requires collateral to manage its or its participants' credit exposure should accept collateral with low credit, liquidity, and market risks. An FMI should also set and enforce appropriately conservative haircuts and concentration limits. | |
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| Summary narrative | This principle only applies to those CSDs like CSCS that operate as a SSS. (Many of the key requirements are more relevant to CCPs.)<br>It is directed at an SSS that operates a Guarantee or Risk Fund that accepts different forms of collateral for contributions.<br><br>CSCS has a Settlement Guarantee Fund but only accepts cash as collateral. |
| Rating of Principle | **Not applicable** |

| **Principle 6: Margin**<br>A CCP should cover its credit exposure to its participants for all products through an effective margin system that is risk-based and regularly reviewed. | |
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| Summary narrative | This principle only applies to CCPs and does not apply to CSCS.<br><br>**Not applicable** |

| **Principle 7: Liquidity Risk.**<br>An FMI should effectively measure, monitor and manage its liquidity risk. An FMI should maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the FMI in extreme but plausible market conditions. | |
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| Summary narrative | CSCS has developed a risk management framework to enable it to better manage its risks. The framework is reviewed annually. CSCS has effectively manage any liquidity risk that might arise from participant or settlement default by the use of the earlier discussed lines of defenses. CSCS has also put in controls to manage this risk including establishing an Enterprise Risk Management Department, monitoring participants and stress testing the TGF |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *"An FMI should have a robust framework to manage its liquidity risks from its participants, settlement banks, nostro agents, custodian banks, liquidity providers, and other entities."*<br><br>***Observed*** |
| | CSCS has established an Enterprise Risk Management group to improve the management of its risks. It recognizes that currently the size of the SGF is insufficient to cover the default of its largest participant.<br><br>CSCS manages the liquidity risks from its participants with the greatest exposure being the failure of a settlement bank.<br><br>CSCS participants are brokers, custody and settlement banks. Settlement banks guarantee the broker trades so there is effectively no risk if a broker defaults. Settlement banks defaults are management by CBN as banks Each settlement Bank has a revolving pledge of a minimum of fifteen billion naira (N15billion) worth of Treasury bills and Federal Government bonds with Central Bank of Nigeria (CBN). In the event of any net debit position for a Bank with insufficient funds, the Real Time Gross Settlement (RTGS) System automatically request for intraday liquidity facility using the pledged clearing collaterals to settle the obligation. |
| Key Consideration 2. | *"An FMI should have effective operational and analytical tools to identify, measure, and monitor its settlement and funding flows on an ongoing and* |

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| | *timely basis, including its use of intraday liquidity."*<br><br>**Observed** |
| | CSCS conduct liquidity studies to identify and manage liquidity risk that might arise from its operations. CSCS also stress test the adequacy of the settlement guarantee fund on a monthly basis.<br><br>CSCS facilitate cash settlement by calculating the net settlement obligations and provides this to CBN on a daily basis. The cash payments are made in one transfer at the end of the day thus the need for intraday liquidity is not important as it would be if CSCS operated a real time system.<br><br>Securities settlement is under the control of CSCS. Securities settle on a gross basis. As there is a 'tight-coupling' between the CSCS system and the Nigerian Stock Exchange's trading system there is a pre-validation of securities before the trade is effected. Once CSCS receives confirmation of a matched trade from NSE it blocks the securities in the seller's account. In this respect CSCS is actively monitoring the security trades. |
| Key Consideration 3. | *"A payment system or SSS, including one employing a DNS mechanism, should maintain sufficient liquid resources in all relevant currencies to effect same-day settlement, and where appropriate intraday or multiday settlement, of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate payment obligation in extreme but plausible market conditions."*<br><br>**Observed** |
| | CSCS guarantee settlement by the use and enforcement of its four line of defense as provided below. Each line is regularly review and stress tested.<br><br>The Nigerian Capital Market operates four lines of defense to provide guarantee that settlement will occur as and when due.<br><br>First Line of Defense – Collateral covering 110% of the value of daily settlement obligation pledged daily by settlement banks with CBN as settlement guarantee in the event of settlement obligation default.<br><br>Second Line of Defense - the portfolio value of the defaulting Dealing member.<br>In the event dealing member default, the settlement bank will have lien over the underlying securities, the proprietary account of the dealing |

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| | member and may request for the liquidation of both the underlying securities and the securities in the proprietary account to replenish bank's money.<br><br>Third Line of defense - Settlement bank collateral & Central Bank intraday liquidity Facility (ILF)<br>All settlement banks maintain a minimum of N15Billion with Central Bank as collateral for settlement obligations against default. This can only be used in an extreme scenario that a settlement bank becomes insolvent and cannot fulfil its obligation to the capital market. In this case, CBN will utilize its intraday liquidity Facility to cover any settlement requirement from the capital market.<br><br>Fourth Line of Defense – Settlement Guarantee Fund. Settlement guarantee fund was established to help mitigate liquidity and settlement risk in the Nigerian capital market. SGF is a contributory fund with an initial contribution of N100, 000 from all dealing members.<br><br>All settlement banks maintain a minimum of N15Billion with Central Bank as collateral for settlement obligations against default. This can only be used in an extreme scenario that a settlement bank becomes insolvent and cannot fulfil its obligation to the capital market. In this case, CBN will utilize its intraday liquidity Facility to cover any settlement requirement from the capital market. |
| Key Consideration 4: | A CCP should maintain sufficient liquid resources in all relevant currencies to settle securities-related payments, make required variation margin payments, and meet other payment obligations on time with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate payment obligation to the CCP in extreme but plausible market conditions. In addition, a CCP that is involved in activities with a more-complex risk profile or that is systemically important in multiple jurisdictions should consider maintaining additional liquidity resources sufficient to cover a wider range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their affiliates that would generate the largest aggregate payment obligation to the CCP in extreme but plausible market conditions.<br><br>**No applicable** |
| Key Consideration 5 | *"For the purpose of meeting its minimum liquid resource requirement, an FMI's qualifying liquid resources in each currency include cash at the central bank of issue and at creditworthy commercial banks, committed lines of credit, committed foreign exchange swaps, and committed repos, as well* |

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| | *as highly marketable collateral held in custody and investments that are readily available and convertible into cash with prearranged and highly reliable funding arrangements, even in extreme but plausible market conditions. If an FMI has access to routine credit at the central bank of issue, the FMI may count such access as part of the minimum requirement to the extent it has collateral that is eligible for pledging to (or for conducting other appropriate forms of transactions with) the relevant central bank. All such resources should be available when needed."*<br><br>**No applicable** |
| Key Consideration 6. | *"An FMI may supplement its qualifying liquid resources with other forms of liquid resources. If the FMI does so, then these liquid resources should be in the form of assets that are likely to be saleable or acceptable as collateral for lines of credit, swaps, or repos on an ad hoc basis following a default, even if this cannot be reliably prearranged or guaranteed in extreme market conditions. Even if an FMI does not have access to routine central bank credit, it should still take account of what collateral is typically accepted by the relevant central bank, as such assets may be more likely to be liquid in stressed circumstances. An FMI should not assume the availability of emergency central bank credit as a part of its liquidity plan."*<br><br>**No applicable** |
| Key Consideration 7. | *"An FMI should obtain a high degree of confidence, through rigorous due diligence, that each provider of its minimum required qualifying liquid resources, whether a participant of the FMI or an external party, has sufficient information to understand and to manage its associated liquidity risks, and that it has the capacity to perform as required under its commitment. Where relevant to assessing a liquidity provider's performance reliability with respect to a particular currency, a liquidity provider's potential access to credit from the central bank of issue may be taken into account. An FMI should regularly test its procedures for accessing its liquid resources at a liquidity provider."*<br><br>**Not applicable** |
| Key Consideration 8. | *"An FMI with access to central bank accounts, payment services, or securities services should use these services, where practical, to enhance its management of liquidity risk."*<br><br>**Not applicable** |
| Key Consideration 9. | *"An FMI should determine the amount and regularly test the sufficiency of its liquid resources through rigorous stress testing. An FMI should have clear procedures to report the results of its stress tests to appropriate decision makers at the FMI and to use these results to evaluate the adequacy of and adjust its liquidity risk-management framework. In conducting stress testing, an FMI should consider a wide range of relevant scenarios. Scenarios* |

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| | *should include relevant peak historic price volatilities, shifts in other market factors such as price determinants and yield curves, multiple defaults over various time horizons, simultaneous pressures in funding and asset markets, and a spectrum of forward-looking stress scenarios in a variety of extreme but plausible market conditions. Scenarios should also take into account the design and operation of the FMI, include all entities that might pose material liquidity risks to the FMI (such as settlement banks, nostro agents, custodian banks, liquidity providers, and linked FMIs), and where appropriate, cover a multiday period. In all cases, an FMI should document its supporting rationale for, and should have appropriate governance arrangements relating to, the amount and form of total liquid resources it maintains."*<br><br>**Not applicable** |
| Key Consideration 10. | *"An FMI should establish explicit rules and procedures that enable the FMI to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations on time following any individual or combined default among its participants. These rules and procedures should address unforeseen and potentially uncovered liquidity shortfalls and should aim to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations. These rules and procedures should also indicate the FMI's process to replenish any liquidity resources it may employ during a stress event, so that it can continue to operate in a safe and sound manner."*<br><br>**Not applicable** |

<table>
<tr><td colspan="2">Principle 8: Settlement Finality.<br>An FMI should provide clear and certain final settlement, at a minimum by the end of the value date. Where necessary or preferable, an FMI should provide final settlement intraday or in real time.</td></tr>
<tr><td>Summary narrative</td><td>CSCS's draft amended rules do provide for finality and irrevocability of settlement. Settlement of securities takes place by 8:00am at CSCS while cash is settled by CBN during the first clearing session which takes place about the same time (8:00am).<br><br>CSCS has also defined timelines within settlement day (SD) to ensure that the ultimate investor receives cash on SD.<br><br>The timelines listed below was finally agreed;<br>o CBN to settlement banks 8:00am on T+3<br>o Settlement banks to brokers Before 10:00am on T+3<br>o Broker to investors Before 11:59pm on T+3</td></tr>
<tr><td>Rating of Principle</td><td>Broadly observed</td></tr>
<tr><td>Key Consideration 1.</td><td>"An FMI's rules and procedures should clearly define the point at which settlement is final."<br><br>Broadly observed</td></tr>
<tr><td></td><td>Finality is not clearly enshrined in the local laws (ISA). However the Draft Amended Rules of CSCS do refer to payments being final and irrevocable (see Rule 5.4.4) and that record-entry settlement of securities are final and irrevocable (Rule 5.5.2) after the receipt of the funds by the designated stock broking firm's banks.<br><br>Also CSCS has defined that trades received from any trade point including The Nigeria Stock Exchange are final and irrevocable.</td></tr>
<tr><td>Key Consideration 2.</td><td>"An FMI should complete final settlement no later than the end of the value date, and preferably intraday or in real time, to reduce settlement risk. An LVPS or SSS should consider adopting RTGS or multiple- batch processing during the settlement day."<br><br>Observed</td></tr>
<tr><td></td><td>Final settlement is completed around 8.00am on settlement date.</td></tr>
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| | Securities are transferred at 8.00am on settlement date, being three days after trade date.<br><br>Cash settlement takes place at the same time at CBN on settlement date.<br><br>There is only the one batch settlement cycle and no real time settlement. |
| Key Consideration 3 | *"An FMI should clearly define the point after which unsettled payments, transfer instructions, or other obligations may not be revoked by a participant."*<br><br>**Partly observed** |
| | The CSCS Draft Amended rules do clearly refer to payments and securities transfers being final and irrevocable. Also defined that trades received from any trade point including The Nigeria Stock Exchange are final and irrevocable. |

| **Principle 9: Money Settlements.**<br>An FMI should conduct its money settlements in central bank money where practical and available. If central bank money is not used, an FMI should minimize and strictly control the credit and liquidity risk arising from the use of commercial bank money. | |
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| Summary narrative | Money settlement is conducted in central bank money through accounts held by the settlement banks at the Central Bank of Nigeria (CBN). The timing for the transfer of funds is clearly specified and understood by the settlement banks, the CBN and CSCS.<br><br>CSCS has established criteria for the appointment of a bank as a settlement bank and monitors the settlement banks against the criteria and the requirements set out in the draft Rules. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *"An FMI should conduct its money settlements in central bank money, where practical and available, to avoid credit and liquidity risks."*<br><br>**Observed** |
| | Money settlements in CSCS are undertaken using both commercial bank money and central bank money.<br><br>CSCS calculates the net settlement obligation on the day prior to settlement day and advises participants of the net obligations that are due on settlement day. CSCS also sends the net settlement obligations to the Central Bank of Nigeria (CBN) via the Nigerian Inter-Bank Settlement System (NIBSS) on settlement date.<br>Brokers are required to make funds available in their accounts at their selected settlement banks on or before T+2 (trade day plus two) Settlement Day. Currently there are 20 settlement banks in Nigeria. The settlement banks must have funds in place in their settlement accounts with CBN. CBN transfers the cash between settlement accounts by 8:00am.<br><br>Central Bank money is used as outlined above. |
| Key Consideration 2. | *"If central bank money is not used, an FMI should conduct its money settlements using a settlement asset with little or no credit or liquidity risk."*<br><br>**Not applicable** |
| | Settlement is in central bank money as outlined above. |
| Key Consideration 3. | *"If an FMI settles in commercial bank money, it should monitor, manage, and* |

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| | *limit its credit and liquidity risks arising from the commercial settlement banks. In particular, an FMI should establish and monitor adherence to strict criteria for its settlement banks that take account of, among other things, their regulation and supervision, creditworthiness, capitalisation, access to liquidity, and operational reliability. An FMI should also monitor and manage the concentration of credit and liquidity exposures to its commercial settlement banks."*<br><br>**Not applicable** |
| Key Consideration 4. | *"If an FMI conducts money settlements on its own books, it should minimise and strictly control its credit and liquidity risks.*<br><br>**Not applicable** |
| | CSCS does not conduct money settlement on its own books. |
| Key Consideration 5. | *"An FMI's legal agreements with any settlement banks should state clearly when transfers on the books of individual settlement banks are expected to occur, that transfers are to be final when effected, and that funds received should be transferable as soon as possible, at a minimum by the end of the day and ideally intraday, in order to enable the FMI and its participants to manage credit and liquidity risks."*<br><br>**Observed** |
| | CSCS has an agreed settlement time with CBN, settlement banks and dealing members for the transfer of funds. The timings are as outlined below;<br><br>o CBN to settlement banks 8:00am on T+3<br>o Settlement banks to brokers Before 10:00am on T+3<br>o Broker to investors Before 11:59pm on T+3<br><br>These timelines are included in the draft agreements with the settlement banks, CBN and the dealing members. |

| **Principle 10: Physical Deliveries.**<br>An FMI should clearly state its obligations with respect to the delivery of physical instruments or commodities and should identify, monitor, and manage the risks associated with such physical deliveries. | |
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| Summary narrative | CSCS only deals with immobilized or dematerialized securities. It does not transfer physical securities. Prior to trading and settlement, the participant must lodge the physical jumbo share certificate with CSCS after verification. For securities that are dematerialized, CSCS receives from the registrar by electronic means the details of the transfer and certificate deposit forms. |
| Rating of Principle | **Not applicable** |
| Key Consideration 1. | *"An FMI's rules should clearly state its obligations with respect to the delivery of physical instruments or commodities."*<br><br>**Not applicable** |
| Key Consideration 2. | *"An FMI should identify, monitor, and manage the risks and costs associated with the storage and delivery of physical instruments or commodities."*<br><br>**Not applicable** |
| | CSCS does not deal in physical instruments or commodities. |

| **Principle 11: Central Securities Depositories.**<br>A CSD should have appropriate rules and procedures to help ensure the integrity of securities issues and minimize and manage the risks associated with the safekeeping and transfer of securities. A CSD should maintain securities in an immobilized or dematerialized form for their transfer by book entry. | |
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| Summary narrative | CSCS's Draft Amended Rules provide for the lodgment of dematerialized and immobilized securities. It includes a procedure for the process. Securities are only held in dematerialized or immobilized form within CSCS and transferred by book-entry. Reports on securities transfers and portfolio holdings are provided to all participants and all registrars. Reconciliations are conducted by the registrars and Internal Audit undertakes daily checks of securities positions. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *"A CSD should have appropriate rules, procedures, and controls, including robust accounting practices, to safeguard the rights of securities issuers and holders, prevent the unauthorized creation or deletion of securities, and conduct periodic and at least daily reconciliation of securities issues it maintains."*<br><br>**Observed** |
| | CSCS Rules do provide for the lodgment of securities (Rule 7.2) for dematerialization (Rule 3.6) or immobilization (Rule 3.7) and there are processes and controls in place in respect of the lodgment and withdrawal of securities from the depository.<br><br>CSCS provides data of all traded securities to all registrars through the Data Exchange System on a daily basis. However, it is not clear that all of the registrars can auto-reconcile this data in a timely manner.<br><br>CSCS is not a registrar for any of the securities issued by issuers but it is recognized as a sub-register for all quoted securities (Rule 2.13.2(h)). There are approximately 30 registrars in Nigeria. |
| Key Consideration 2. | *"A CSD should prohibit overdrafts and debit balances in securities accounts."*<br><br>**Observed** |
| | CSCS does not allow debit balances in securities accounts. This is not automatically prevented by the system but securities balances are being monitored daily. |
| Key Consideration 3. | *"A CSD should maintain securities in an immobilised or dematerialised form for their transfer by book entry. Where appropriate, a CSD should provide* |

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| | *incentives to immobilise or dematerialise securities."*<br><br>**Observed** |
| | CSCS maintains securities in an immobilized or dematerialized form and transfers are via book-entry.<br><br>CSCS Amended Rules cover the dematerialization (Rule 3.6) and immobilization (Rule 3.7) of securities. Only securities dematerialized within CSCS can be traded on the Nigerian Stock Exchange. |
| Key Consideration 4. | *"A CSD should protect assets against custody risk through appropriate rules and procedures consistent with its legal framework."*<br><br>**Observed** |
| | CSCS has Draft Amended Rules that cover the dematerialization and immobilization of securities. There are also rules on the lodgement of securities (Rule 7.2) and procedures associated with the deposit of securities and the pledge of securities.<br><br>The Rules indicate that the participants may hold securities in the name and account of the participant or in the name and for the account of the participant's clients. The latter option is the preferred option to minimize custody risk.<br><br>CSCS provides daily transaction reports to participants electronically. Portfolio reports are also produced in hardcopy and couriered to participants when requested. Data is also sent to all registrars to allow registrars to update their registers. Reconciliation data is provided electronically to registrars on a daily basis. These procedures help to minimize custody risk. |
| Key Consideration 5. | *"A CSD should employ a robust system that ensures segregation between the CSD's own assets and the securities of its participants and segregation among the securities of participants. Where supported by the legal framework, the CSD should also support operationally the segregation of securities belonging to a participant's customers on the participant's books and facilitate the transfer of customer holdings."*<br><br>**Observed** |
| | CSCS has a system that allows for segregation. CSCS assets are segregated from securities of the participants and participants' securities are segregated from each other. CSCS provides a sub-accounting system whereby participants can segregate the securities of their clients. |

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| | However, it is possible and common practice for custodians to hold clients' securities in omnibus accounts. |
| Key Consideration 6. | *"A CSD should identify, measure, monitor, and manage its risks from other activities that it may perform; additional tools may be necessary in order to address these risks."*<br><br>**Observed** |
| | CSCS has the facilities to support the borrowing and lending of securities but this activity has not yet commenced. There are no other activities that it undertakes. |

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| **Principle 12: Exchange-of-value Settlement Systems**<br>If an FMI settles transactions that involve the settlement of two linked obligations (for example, securities or foreign exchange transactions), it should eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other. | |
| Summary narrative | Principle risk has been eliminated from CSCS systems as settlement is on a DVP basis. CSCS oversees all settlement processes to enable both cash and securities are available before settlement. Securities are committed and blocked in sellers account immediately after trading to ensure availability and delivery on settlement day. Cash is on the other side irrevocably guaranteed by the bank. Each settlement bank has a revolving pledge of a minimum of fifteen billion naira (N15billion) worth of Treasury bills and Federal Government bonds with Central Bank of Nigeria (CBN) against settlement.<br><br>In practice, security and cash are simultaneously, irrevocably and finally settled at 8:00am on settlement day. CSCS transfer the interbank net position to CBN through NIBSS prior to settlement. CBN settles cash during the 8:00am session on settlement day. While security is settled in CSCS at 8:00am. CSCS also receives settlement confirmation from NIBSS. Settlement banks have irrevocably committed to settle all transactions done by the dealing members linked to them. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *"An FMI that is an exchange-of-value settlement system should eliminate principal risk by ensuring that the final settlement of one obligation occurs if and only if the final settlement of the linked obligation also occurs, regardless of whether the FMI settles on a gross or net basis and when finality occurs."* |

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| | **Observed** |
| | Principle risk has been eliminated from CSCS systems as settlement is on a DVP basis. Securities are transferred at 8.00am in CSCS at the same time cash is transferred in CBN. |

<table>
<tr><td colspan="2">Principle 13: Participant default rules and procedures.<br>An FMI should have effective and clearly defined rules and procedures to manage a participant default. These rules and procedures should be designed to ensure that the FMI can take timely action to contain losses and liquidity pressures and continue to meet its obligations.</td></tr>
<tr><td>Summary narrative</td><td>CSCS has developed a well-defined rules and procedures to manage the default and orderly wind down of any of its failed participant in the event of default. The default management was presented to all stakeholders including Association of Stockbroking Houses of Nigeria (ASHON), the settlement banks and the custodians.<br><br>The plan is being tested annually which involve participants and key stakeholders. The results of the test are included are sent to Management Risk Committee for review.</td></tr>
<tr><td>Rating of Principle</td><td>Observed</td></tr>
<tr><td>Key Consideration 1.</td><td>“An FMI should have default rules and procedures that enable the FMI to continue to meet its obligations in the event of a participant default and that address the replenishment of resources following a default.”<br><br>Observed</td></tr>
<tr><td></td><td>The draft, amended rules of CSCS do provide a procedure in the event of a default in the funding of a trading account (Rule 5.6). The settlement bank is required to settle the default when a stock broker defaults. Stock purchases of the defaulting firm will be allowed to settle but will then be frozen, later liquidated to offset the bank.<br><br>In the event dealing member default, the settlement bank will have lien over the underlying securities, the proprietary account of the dealing member and may request for the liquidation of both the underlying securities and the securities in the proprietary account to replenish bank’s money. The Trade Guarantee Fund will only be used to cover any shortfall that may arise after the liquidation.<br><br>The Risk Management department is responsible for handling a default and has developed a procedure on the actions to be taken in a default scenario. In a default, the proprietary account of the dealing member, underlying securities and SGF are the resources available guarantee.</td></tr>
<tr><td>Key Consideration 2.</td><td></td></tr>
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| | *"An FMI should be well prepared to implement its default rules and procedures, including any appropriate discretionary procedures provided for in its rules."*<br><br>**Observed** |
| | CSCS has default management plan and procedure. This procedure reviewed and tested annually or on need basis. |
| Key Consideration 3. | *"An FMI should publicly disclose key aspects of its default rules and procedures."*<br><br>**Observed** |
| | CSCS has developed its default rules and procedures. This was shared with the participants for their inputs. The default procedure is available to all participants. The default management procedure will be published on the CSCS website when the updated rule is finalized. |
| Key Consideration 4. | *"An FMI should involve its participants and other stakeholders in the testing and review of the FMI's default procedures, including any close-out procedures. Such testing and review should be conducted at least annually or following material changes to the rules and procedures to ensure that they are practical and effective.*<br><br>**Observed** |
| | CSCS has developed its default rules and procedures. The plan is being tested annually which involve participants and key stakeholders. The results of the testing will be reviewed by the CSCS Board.<br><br>CSCS conducts quarterly disaster recovery test with the NSE and all market participants. |

| **Principle 14: Segregation and portability.**<br>A CCP should have rules and procedures that enable the segregation and portability of positions of a participant's customers and the collateral provided to the CCP with respect to those positions. | |
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| Summary narrative | Does not apply to CSDs or SSSs |
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| **Principle 15: General business risk.**<br>An FMI should identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that it can continue operations and services as a going concern if those losses materialize. Further, liquid net assets should at all times be sufficient to ensure a recovery or orderly wind-down of critical operations and services. | |
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| Summary narrative | CSCS has developed a comprehensive Risk Management Framework that has been tested and implemented enterprise wide. CSCS has identified business risks, which are monitored on an on-going basis through the Enterprise Risk Management department. Liquid net assets in the form of cash and cash equivalents (short term deposits and treasury bills) are maintained by CSCS equivalent to around 4 years of operating profits, which is regarded as more than sufficient to cover any potential general business loss, should it materialize and any recovery or orderly wind-down of operations and services if warranted. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *“An FMI should have robust management and control systems to identify, monitor, and manage general business risks, including losses from poor execution of business strategy, negative cash flows, or unexpected and excessively large operating expenses.”*<br><br>**Observed** |
| | CSCS has developed a comprehensive Risk Management Framework that has been tested and implemented enterprise wide. CSCS has identified business risks, which are monitored on an on-going basis through the Enterprise Risk Management group.<br><br>CSCS has comprehensive risk management and control systems for managing this risk although Enterprise Risk Management (ERM) also monitors and manage uncertainty in achieving business objectives.<br><br>Business strategy is determined by the Board and reports are provided that monitor new business initiatives. These could also include audit reports. The Board also receives financial reports including budgets prepared by management and it tracks expenditure against the budgets as approved.<br><br>The risk of fraud is monitored through established controls, financial audits and staff awareness. |
| Key consideration 2. | *“An FMI should hold liquid net assets funded by equity (such as common* |

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| | *stock, disclosed reserves, or other retained earnings) so that it can continue operations and services as a going concern if it incurs general business losses. The amount of liquid net assets funded by equity an FMI should hold should be determined by its general business risk profile and the length of time required to achieve a recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken."*<br><br>**Observed** |
| | CSCS holds liquid net assets in the form of cash (held in cash and fixed deposit accounts).<br><br>CSCS has made profits year on year and although it pays a dividend it also retains a portion of the profits as retained earnings.<br><br>Currently CSCS has minimized its business activities to its custody and clearing operations – it does not operate other business lines including asset servicing. Accordingly its liquid net assets are regarded as reasonable and sufficient to address needs if required for a recovery or orderly wind down. |
| Key Consideration 3. | *"An FMI should maintain a viable recovery or orderly wind-down plan and should hold sufficient liquid net assets funded by equity to implement this plan. At a minimum, an FMI should hold liquid net assets funded by equity equal to at least six months of current operating expenses. These assets are in addition to resources held to cover participant defaults or other risks covered under the financial resources principles. However, equity held under international risk-based capital standards can be included where relevant and appropriate to avoid duplicate capital requirements."*<br><br>**Observed** |
| | CSCS is developing a viable recovery or orderly wind-down plan. However, CSCS holds cash and cash equivalents equal to around 4 years of operating profits. This would appear to be more than adequate to implement the plans that it develops. |
| Key Consideration 4. | *"Assets held to cover general business risk should be of high quality and sufficiently liquid in order to allow the FMI to meet its current and projected operating expenses under a range of scenarios, including in adverse market conditions.*<br><br>**Observed** |
| | The assets held to cover general business risk are cash or cash equivalents being short-term deposits and treasury bills. The latter are high quality and are sufficiently liquid to be able to be converted into cash within a short period of time. |

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| Key Consideration 5. | *"An FMI should maintain a viable plan for raising additional equity should its equity fall close to or below the amount needed. This plan should be approved by the board of directors and updated regularly."*<br><br>**Observed** |
| | CSCS is well capitalized and do not need to raise additional capital at the moment. At the end of December 2014 CSCS has over 300% of total shareholder capital as retained earnings. CSCS keeps its capital under constant surveillance. |

| **Principle 16: Custody and investment risks.**<br>An FMI should safeguard its own and its participants' assets and minimize the risk of loss on and delay in access to these assets. An FMI's investments should be in instruments with minimal market, credit and liquidity risks. | |
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| Summary narrative | CSCS holds assets of participants in securities accounts on its books. There are appropriate controls in place to safeguard the assets. CSCS holds investments in cash or cash equivalents being short-term deposits held with settlement banks, government debt instruments (treasury bills and government bonds) and corporate bonds. All securities have minimal market credit and liquidity risks. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *"An FMI should hold its own and its participants' assets at supervised and regulated entities that have robust accounting practices, safekeeping procedures, and internal controls that fully protect these assets."*<br><br>**Observed** |
| | CSCS holds its cash assets in fixed deposit accounts at settlement banks that are regulated by the Central Bank of Nigeria (CBN). It does not hold assets of its participants with any other entity. Participant assets are held with CSCS in respect of securities and cash is held with settlement banks while settlement banks have accounts at the CBN. |
| Key Consideration 2. | *"An FMI should have prompt access to its assets and the assets provided by participants, when required."*<br><br>**Observed** |

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| | CSCS's cash assets held at settlement banks are freely accessible. CSCS also holds assets in government Treasury Bills. These can be easily converted into cash if required. |
| Key Consideration 3. | *"An FMI should evaluate and understand its exposures to its custodian banks, taking into account the full scope of its relationships with each."*<br><br>**Not applicable** |
| | CSCS does not have any exposure to custodian banks. |
| Key Consideration 4 | *"An FMI's investment strategy should be consistent with its overall risk-management strategy and fully disclosed to its participants, and investments should be secured by, or be claims on, high-quality obligors. These investments should allow for quick liquidation with little, if any, adverse price effect."*<br><br>**Observed** |
| | CSCS's investments are in cash products and treasury bills. The investments are disclosed in the Notes to the Financial Statements in the Annual Report.<br><br>All investments are highly liquid and the treasury bills are not exposed to significant adverse price effect.<br><br>Some investments are held to maturity. These investments are mainly government bonds that could be traded and liquidated if necessary. They also include corporate bonds that are also tradable and able to be liquidated. The bonds do have a credit rating. |

| **Principle 17: Operational risk.**<br>An FMI should identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. Systems should be designed to ensure a high degree of security and operational reliability and should have adequate, scalable capacity. Business continuity management should aim for timely recovery of operations and fulfillment of the FMI's obligations, including in the event of a wide-scale or major disruption. | |
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| Summary narrative | CSCS has established an Enterprise Risk Management (ERM) group as part of the structure that is in place to manage the company's risks. The ERM group manages the company's risks on a consolidated basis and reports to the Audit and Risk Committee of the Board of Directors. The Board has the responsibility for approving the risk management framework. ERM has responsibility to ensure that appropriate systems, policies, procedures and |

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| | controls are in place to manage operational risk while line managers manage operational risk for their areas of responsibility. Although the framework is in place, there is still work to be undertaken to ensure that there is adequate scalable capacity in the IT systems operated and that the business continuity arrangements are capable of ensuring the timely recovery of operations in the event of a major disruption or incident. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *"An FMI should establish a robust operational risk-management framework with appropriate systems, policies, procedures, and controls to identify, monitor, and manage operational risks."*<br><br>**Observed** |
| | CSCS operates an operational risk management framework with appropriate systems, policies, procedures and controls through an Enterprise Risk Management Framework through which the monitoring and reporting of all operational risks is undertaken.<br><br>Operational risks arise from:<br>- Operations in the processing of transactions<br>- Technological systems including security of systems and data<br>- Employees in respect of the skills base and the retention<br>- Fraudulent behavior. |
| Key Consideration 2. | *"An FMI's board of directors should clearly define the roles and responsibilities for addressing operational risk and should endorse the FMI's operational risk-management framework. Systems, operational policies, procedures, and controls should be reviewed, audited, and tested periodically and after significant changes."*<br><br>**Observed** |
| | CSCS's board of directors has responsibility for approving CSCS's risk management framework. It is assisted by the Audit and Risk Committee, which oversees the risk management framework and reports to the Board. It recognizes that CSCS management is responsible for executing CSCS's risk management and audit policies as well as the design, implementation and maintenance of an effective risk program. It is recognized that line managers are responsible for managing risks in the areas for which they have responsibility. The Head of Enterprise Risk Management manages the company's risks on a consolidated basis under the company's risk management framework and reports to the Risk Committee. |

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| | The risk management framework is reviewed and approved annually by the Board.<br>Both internal audit and external auditors review the framework and the implementation regularly. Both the internal and external auditors report on the systems, operational policies, procedures and controls. The reports are commented on by management and monitored by the Audit and Risk Committee. |
| Key Consideration 3. | *"An FMI should have clearly defined operational reliability objectives and should have policies in place that are designed to achieve those objectives."*<br><br>**Observed** |
| | CSCS has specific operational objectives in respect of:<br>- system performance<br>- system capacity<br>- error reporting (staff errors and system problems)<br>Policies in place to support the operational objectives relate to:<br>- software change management and installation process<br>- use of system monitoring tools<br>- operation of a separate test environment for software applications<br>- back-up arrangements for all data and software<br>- testing of disaster recovery arrangements. |
| Key Consideration 4. | *"An FMI should ensure that it has scalable capacity adequate to handle increasing stress volumes and to achieve its service-level objectives."*<br><br>**Broadly Observed** |
| | The current systems in use can handle increased stress volumes. However, CSCS is in the process of changing the system and has included the requirement that the systems be scalable to handle stress volume scenarios. |
| Key Consideration 5. | *"An FMI should have comprehensive physical and information security policies that address all potential vulnerabilities and threats."*<br><br>**Observed** |
| | CSCS office is located on rented premises in the Stock Exchange premises. The floors of the building are only accessible by authorized personnel. There are checks at the entranceway to the building and visitors need to be signed in. Once on the floor there are key-card access and biometric systems that control access to CSCS offices. Same biometric and proxy card |

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| | systems provide access control to the data centre facilities and only selected authorized staff can gain access to these areas. All visitors to the data centre are required to be accompanied by a staff member at all times.<br><br>CSCS has established Information security management system framework with policies and procedure in line with ISO27001:2013. We have deployed technologies to support IT securities such as Data base access monitoring system, data loss prevention system, intrusion detection system, log management and file integrity system.<br><br>CSCS ensures that change management review is conducted for all changes that is carried out on its system to confirm the impact of the change on physical and information security.<br><br>It controls access levels for staff, providing different levels of access according to the needs of staff. All access to all systems require a password, which is changed on a regular basis (every 60 days). CSCS undertakes penetration testing on an annual basis. |
| Key Consideration 6. | *"An FMI should have a business continuity plan that addresses events posing a significant risk of disrupting operations, including events that could cause a wide-scale or major disruption. The plan should incorporate the use of a secondary site and should be designed to ensure that critical information technology (IT) systems can resume operations within two hours following disruptive events. The plan should be designed to enable the FMI to complete settlement by the end of the day of the disruption, even in case of extreme circumstances. The FMI should regularly test these arrangements."*<br><br>**Observed** |
| | CSCS has a business continuity and Disaster Recovery (DR) plan. We conduct quarterly Market-Wide DR test in collaboration with The Nigerian Stock Exchange. We also conduct BCP test annually.<br><br>We presently have dedicated communication between our primary site and the alternative site which are 25km apart. There is a fibre and licensed radio frequency redundancy across the sites. At the primary site our core infrastructure is on high availability architecture with the backup infrastructure – real-time data replication. The infrastructure at the alternative site also mirrors the production at real-time. In addition, we have a functional backup policy for all the critical data.<br><br>In the event the primary site is not functional due to a major disruption, CSCS shall activate it BCP to continue business operations. |

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| | CSCS has the ability to monitor and manage the financial and operational risks that participants might pose. The Draft Amended Rules (Rule 2.4) allow CSCS to make an examination for this purpose. In addition Rule 8.2 allows CSCS to monitor the transactions, settlement obligations and activity in the system of the participant. Rule 8.3 imposes requirements on the participants to provide specific reports to CSCS that will assist with the identification, monitoring and management of risks. |
| Key Consideration 7. | *"An FMI should identify, monitor, and manage the risks that key participants, other FMIs, and service and utility providers might pose to its operations. In addition, an FMI should identify, monitor, and manage the risks its operations might pose to other FMIs."*<br><br>**Observed** |
| | As part of the enterprise risk management CSCS monitor and manage the risks that other FMIs (CBN and NSE) or utility providers might pose to its operations.<br><br>Also CSCS does identify the risks that its operations might pose to other FMIs. The main risk would be in respect of a failure of its operations to clear and settle transactions. In this respect the security and disaster recovery operations are critical. |

| Principle 18: Access and participation requirements<br>An FMI should have objective, risk based and publicly disclosed criteria for participation, which permit fair and open access. | |
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| Summary narrative | CSCS has incorporated objective, risk-based criteria for participation in the CSCS system into the Draft Amended Rules. The Draft Rules provide for the monitoring of participation requirements by CSCS and the suspension and termination of participants who breach or no longer meet the participation requirements.<br><br>The draft Rules is available to the general public on the CSCS website. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *"An FMI should allow for fair and open access to its services, including by direct and, where relevant, indirect participants and other FMIs, based on reasonable risk-related participation requirements."*<br><br>**Observed** |
| | The Draft Amended Rules of CSCS (Rules 2.3, 2.4 and 2.13) provide for fair and open access to participants.<br><br>The Rules (Rule 2.2) specify the class of entities that may be a participant. It allows banks, custodians, stock brokers, clearing corporations, non-bank finance companies, registrars and individuals to be participants.<br><br>The Rules also provide eligibility requirements including the need to fulfill the requirements of the Securities and Exchange Commission (Rule 2.3.1). |
| Key Consideration 2. | *"An FMI's participation requirements should be justified in terms of the safety and efficiency of the FMI and the markets it serves, be tailored to and commensurate with the FMI's specific risks, and be publicly disclosed. Subject to maintaining acceptable risk control standards, an FMI should endeavour to set requirements that have the least-restrictive impact on access that circumstances permit."*<br><br>**Observed** |
| | CSCS participation criteria are in the Draft Amended Rules is publicly disclosed through the CSCS website.<br><br>The criteria support the safety and efficiency of CSCS and the Nigerian capital market while providing for reasonable access for participants. |

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| | The Rules also require the participant to comply with the criteria set out in the Master Terms.<br><br>A Participant Agreement with CSCS also covers the admission, suspension and cancellation of participation in CSCS.<br><br>A wide range of entities is provided for as participants. |
| Key Consideration 3. | *"An FMI should monitor compliance with its participation requirements on an ongoing basis and have clearly defined and publicly disclosed procedures for facilitating the suspension and orderly exit of a participant that breaches, or no longer meets, the participation requirements."*<br><br>**Observed** |
| | The Draft Amended Rules provide for the ongoing monitoring of participants (Rules 2.4.2 and 8.2 and 8.3). These rules are subject to the approval of the Board and Commission.<br><br>CSCS reviews and monitors all dealing members accesses on a periodic basis and ensure that all participants are in compliance with participating requirement and criteria<br><br>The monitoring arrangements involve an examination by CSCS of the participant's financial and operational capabilities to ensure the participant continues to satisfy the participation criteria.<br><br>On an annual basis and within 90 days of the financial year-end of the participant, the participant is required to report on their internal controls and procedures, their audit procedures, the monitoring of the internal controls and procedures and their maintenance of securities accounts. They are also required to report any material malfunctioning of their controls, procedures and systems as soon as reasonably possible once they are aware. The participants are also required to conduct a full DRP test bi-annually and report the results of the tests to CSCS.<br><br>There are also clear procedures within the Draft Amended Rules for the suspension and orderly exit of a participant that breaches or no longer meets the participation requirements. These procedures are outlined in Rule 2.8 (Suspension) and Rule 2.12 (Termination). The Rules are to be published on the CSCS website once they have been approved by the Board and the Commission. |

| **Principle 19 Tiered participation requirements.**<br>An FMI should identify, monitor and manage the material risks to the FMI arising from tiered participations arrangements. | |
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| Summary narrative | CSCS has limited capacity to identify, monitor and manage the material risks arising from tiered participation arrangements due to the existence of an omnibus account structure and because the current Rules do not require participants to provide information on indirect participants. Where a participant holds securities for its clients in segregated accounts then CSCS can derive some information. However, the Rules do not enable it to actively manage the risks where they may arise. |
| Rating of Principle | **Not applicable** |
| Key Consideration 1. | *"An FMI should ensure that its rules, procedures, and agreements allow it to gather basic information about indirect participation in order to identify, monitor, and manage any material risks to the FMI arising from such tiered participation arrangements.*<br><br>**Not applicable** |
| Key Consideration 2. | *"An FMI should identify material dependencies between direct and indirect participants that might affect the FMI."*<br><br>**Not applicable** |
| Key Consideration 3. | *"An FMI should identify indirect participants responsible for a significant proportion of transactions processed by the FMI and indirect participants whose transaction volumes or values are large relative to the capacity of the direct participants through which they access the FMI in order to manage the risks arising from these transactions."*<br><br>**Not applicable** |
| Key Consideration 4 | *"An FMI should regularly review risks arising from tiered participation arrangements and should take mitigating action when appropriate."*<br><br>**Not applicable** |

| **Principle 20: FMI links**<br>An FMI that establishes a link with one or more FMIs should identify, monitor, and manage link-related risks. | |
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| Summary narrative | CSCS has no established links with other CSDs or FMIs |
| Key Consideration 1. | *"Before entering into a link arrangement and on an ongoing basis once the link is established, an FMI should identify, monitor, and manage all potential sources of risk arising from the link arrangement. Link arrangements should be designed such that each FMI is able to observe the other principles in this report."*<br><br>**Not applicable** |
| | CSCS does not have any links with other FMIs.<br><br>In the future CSCS may establish links with foreign CSDs to facilitate the cross border transfer of securities. Prior to establishing any links, CSCS will enter into negotiations with the foreign CSD and exchange a contract. The contract will address any sources of risk arising from the Link arrangement. |

| **Principle 21: Efficiency and effectiveness**<br>An FMI should be efficient and effective in meeting the requirements of its participants and the markets it serves. | |
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| Summary narrative | CSCS has strived to provide an efficient, effective and safe environment for the delivery of its custody, clearing and settlement operations. It is currently reviewing many of its processes to better meet the needs of its participants and the markets it serves. As a part of this review it is upgrading its IT systems and introducing new processes and structures to better achieve its goals. This includes the development of a comprehensive planning and budgeting process, the establishment of participant user groups and the regular reporting and review of key performance indicators. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *"An FMI should be designed to meet the needs of its participants and the markets it serves, in particular, with regard to choice of a clearing and settlement arrangement; operating structure; scope of products cleared, settled, or recorded; and use of technology and procedures."*<br><br>**Observed** |

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| | CSCS was established in 1992 and commenced operations in 1997 to provide custody, clearing and settlement services for securities listed on the Nigerian Stock Exchange. It has also provided similar services for corporate and government bonds to meet the needs of participants and the market.<br>The services it provides and the products it manages has been determined by the market needs. The requirements are continually being assessed and new products and services are introduced as a need arises.<br><br>It currently settles on a BIS Model 2 basis where securities are settled on a gross basis and cash is settled on a net basis. As the market becomes more sophisticated the possibility of having more flexible arrangements will be examined, especially where both real time and batch processing arrangements can be provided for.<br><br>CSCS continuously enhance its processes and technology it uses to better meet the needs of the market. In this respect it is looking to upgrade its current systems and also introduce SWIFT communications to provide the opportunity for STP for participants. |
| Key Consideration 2. | *"An FMI should have clearly defined goals and objectives that are measurable and achievable, such as in the areas of minimum service levels, risk-management expectations, and business priorities."*<br><br>**Observed** |
| | CSCS has established a strategic plan that sets out specific objectives with timelines for their achievement. The objectives relate to new business enterprises, technological developments, risk management, staff development and revenue growth. For each of the objectives, specific critical success factors have been established and strategies have been developed. There is also an annual plan and budget process whereby business goals are set for the year ahead.<br><br>In addition CSCS has established Key Performance Indicators (KPIs) against service levels.<br><br>CSCS has established user groups for participants (settlement banks, brokers and registrars) whereby there is a forum available for regular discussion and feedback on the strategies and the service levels.<br><br>CSCS has introduced KPIs for all departments within CSCS that relate to financial targets, business development goals and information security. Also CSCS intends to achieve ISO certification. A formalized reporting on outcomes has not yet been established. |

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| Key Consideration 3. | *"An FMI should have established mechanisms for the regular review of its efficiency and effectiveness."*<br><br>**Observed** |
| | The IT division does provide information that measures the effectiveness of the systems. This information is provided to senior management and through to the Technical Board Committee. In addition the Committee is required to provide guidance on the measuring and tracking systems used for the successful innovation and development of technology. The Committee reports the proceedings and recommendations to the Board. |

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| **Principle 22: Communication procedures and standards**<br>An FMI should use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, settlement, and recording. | |
| Summary narrative | CSCS is beginning to adopt internationally accepted communication standards with the introduction of SWIFT on a limited basis in 2013. |
| Rating of Principle | **Partly Observed** |
| Key Consideration 1. | *"An FMI should use, or at a minimum accommodate, internationally accepted communication procedures and standards."*<br><br>**Partly observed** |
| | CSCS uses a proprietary communication platform called Data Exchange for the upload and transfer of files with registrars.<br><br>CSCS has also implemented SWIFT for messages with custodians. |

| Principle 23: Disclosure of rules, key procedures, and market data<br>An FMI should have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks, fees and other material costs they incur by participating in the FMI. All relevant rules and key procedures should be publicly disclosed. | |
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| Summary narrative | CSCS has developed its rules and procedures which was reviewed by market participants but yet to be approved by the Board and the Securities and Exchange Commission.<br><br>CSCS constantly identifies, reviews and documents the risks faced by participants in using CSCS. CSCS also offer training programs to participants to provide further clarity on the risks faced by using the CSD. The CSCS website provides more public information on its services, fees, risks and transaction volumes and values.<br><br>The Disclosure framework will be updated on a regular basis and published on the CSCS website. |
| Rating of Principle | **Observed** |
| Key Consideration 1. | *"An FMI should adopt clear and comprehensive rules and procedures that are fully disclosed to participants. Relevant rules and key procedures should also be publicly disclosed."*<br><br>**Observed** |
| | CSCS has developed its rules and procedures, which are in the process of being amended. These rules and procedures is publicly disclosed to participants on CSCS website. |
| Key Consideration 2. | *"An FMI should disclose clear descriptions of the system's design and operations, as well as the FMI's and participants' rights and obligations, so that participants can assess the risks they would incur by participating in the FMI."*<br><br>**Observed** |
| | The participant's rights and obligations are set out in the Draft Amended Rules and the Master Agreement. The Rules provide an indication of arrangements that enable the participants to assess the risks they would incur by participating in CSCS. |
| Key Consideration 3. | *"An FMI should provide all necessary and appropriate documentation and* |

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| | *training to facilitate participants' understanding of the FMI's rules and procedures and the risks they face from participating in the FMI."* |
| | CSCS has a well-structured user group arrangement and periodically held meetings and training for each group on understanding of the rules and procedures and the risks they face from participation in CSCS.<br><br>Participants have generally demonstrated an understanding of the rules and procedures through their compliance. All queries that participants may have are answered by CSCS personnel. |
| Key Consideration 4. | *"An FMI should publicly disclose its fees at the level of individual services it offers as well as its policies on any available discounts. The FMI should provide clear descriptions of priced services for comparability purposes."* |
| | CSCS provides a breakdown of its fees on its website. The breakdown is in tabular form and indicates any change in fees where the fee schedule has changed.<br>CSCS also provides some explanation of the services it offers.<br>At this stage CSCS does not offer participants discounts or rebates. |
| Key Consideration 5. | *"An FMI should complete regularly and disclose publicly responses to the CPSS-IOSCO Disclosure framework for financial market infrastructures. An FMI also should, at a minimum, disclose basic data on transaction volumes and values."* |
| | CSCS intends to update the disclosure framework on a regular basis.<br><br>CSCS does not disclose data on transaction volumes and values although there is a section on the CSCS website for market information. |

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| **Principle 24: Disclosure of market data by trade repositories.**<br>A TR should provide timely and accurate data to relevant authorities and the public in line with their respective needs. | |
| Summary narrative | Does not apply to CSDs or SSSs. |
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| S/n | Principle No | Principle Narration | Status |
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| 1 | Principle 1: | Legal basis | Broadly observed |
| 2 | Principle 2: | Governance | Observed |
| 3 | Principle 3: | Framework for the comprehensive management of risks | Observed |
| 4 | Principle 4: | Credit risk | Broadly observed |
| 5 | Principle 5: | Collateral | Not applicable |
| 6 | Principle 6: | Margin | Not applicable |
| 7 | Principle 7: | Liquidity risk | Observed |
| 8 | Principle 8: | Settlement finality | Broadly observed |
| 9 | Principle 9: | Money settlements | Observed |
| 10 | Principle 10: | Physical deliveries | Observed |
| 11 | Principle 11: | Central securities depositories | Observed |
| 12 | Principle 12: | Exchange-of-value settlement systems | Observed |
| 13 | Principle 13: | Participant-default rules and procedures | Observed |
| 14 | Principle 14: | Segregation and portability | Not applicable |
| 15 | Principle 15: | General business risk | Observed |
| 16 | Principle 16: | Custody and investment risks | Observed |
| 17 | Principle 17: | Operational risk | Observed |
| 18 | Principle 18: | Access and participation requirements | Observed |
| 19 | Principle 19: | Tiered participation arrangements | Not applicable |
| 20 | Principle 20: | FMI links | Not applicable |
| 21 | Principle 21: | Efficiency and effectiveness | Observed |
| 22 | Principle 22: | Communication procedures and standards | Partly observed |
| 23 | Principle 23: | Disclosure of rules, key procedures, and market data | Observed |
| 24 | Principle 24: | Disclosure of market data by trade repositories | Not applicable |

## IV. List of publicly available resources

The Investments and Securities Act of 2007

The Securities and Exchange Commission Rules and Regulations 2013

Banks and Other Financial Institutions Act 2004

Amended Rules of Central Securities and Clearing Systems PLC

Master Terms

Participant Agreement

Board of Directors Charter

Corporate Governance and Remuneration Committee Charter

Audit & Risk Committee Charter

Code of Conduct for Board Members

SEC Code of Corporate Governance for Public Companies

Management Team Charter

Audit Department Structure

CSCS Annual Report

Enterprise Risk Management Report (contained in CSCS Annual Report 2013)