9 October 2013

Office of General Counsel
ASX Limited 20 Bridge Street
Sydney NSW 2000
By email: gregory.haynes@asx.com.au

Attention: Mr Gregory Haynes

Dear Greg

ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service - Consultation on Draft Operating Rules

The Australian Financial Market Association (AFMA) welcomes the opportunity to make comment on the Consultation on Draft Operating Rules (DOR) in respect of the ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service. Our comments to the questions posed in the consultation paper are attached.

Before addressing the consultation questions, there are a couple of general observations we would like to make.

Consultation period

There has been broad concern with the brief consultation period. The DOR represent a complex legal drafting exercise and there is a general sense that time has been too short to ensure that they achieve their intended purpose and do not duplicate other rules or regulation. It has been indicated to us that a number of technical drafting issues have been raised with you by members and it would be desirable therefore to have a second round of consultation to ensure that this redrafting does not raise additional difficulties and that all problems are effectively addressed. It is appreciated that the ASX is seeking to meet the expectations of ASIC in setting such short deadlines, but these rules deal with client money protection and need to work effectively within a broader statutory set of rules; so it is critically important that they are working as intended from the outset.

Australian Financial Markets Association
ABN 69 793 968 987
Level 3, Plaza Building, 95 Pitt Street GPO Box 3655 Sydney NSW 2001
Tel: +612 9776 7955 Fax: +61 2 9776 4488
Email: info@afma.com.au Web: www.afma.com.au

Multi-level client structures

The rules appear to address only a single-level of client clearing and not a multi-level one where an end user may be the client of a broker that is itself a client of a Clearing Participant. Multi-level client structures are common and need to be addressed specifically.

Please contact me at dlove@afma.com.au or on (02) 9776 7995 if further clarification or elaboration is desired.

Yours sincerely

David Love
Director – Policy & International Affairs

ASX 24 Exchange-Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service – Consultation on Draft Operating Rules

October 2013

TABLE OF CONTENTS

1. Segregated Client Account Structure

A1 ASX proposes not to require Clearing Participants to offer both account types to Clients. Do you agree with ASX's proposed approach? If not, why not?

Yes.

This is in accord with the Reserve Bank of Australia's (RBA) supplementary interpretation of the Financial Stability Standards (FSS) for central counterparties (CCPs); that the CCP employ an account structure that enables its participants to offer their customers a choice between individual and omnibus segregation.

Clearing Participants should be able to decide whether they will make changes to their service offering based on the interest they see from clients and the commercial nature of the solutions themselves. Some Clearing Participants may not necessarily have the desire to make changes to their service offering for commercial reasons or face regulatory barriers to offer clients a choice of account types. The proposal gives Clearing Participants the option not to invest in the operational system, and as a result, fee structures for clients may differ across Clearing Participants according to the investment in systems required.

This proposal will enable clients to choose between different offerings by Clearing Participants to find the type of account structure that best suits their needs.

A2 Will the Individual Client Account structure enable ASX's indirect customers that are ADIs to gain the optimal capital treatment of their cleared trade exposures to ASX under APRA Prudential Standard APS 112? If not, why not?

Under paragraph 25 of APS 112, a 2 per cent risk-weight for Authorised Deposit-taking Institutions (ADIs) accessing clearing as clients applies, so long as certain requirements on account segregation and portability are met and if collateral supporting the offsetting transactions is held in a manner that prevents any losses to the client ADI due to the joint default or insolvency of the clearing member and any of its other clients. If this last condition cannot be satisfied, a risk-weight of 4 per cent is to be applied. Accordingly the optimal capital treatment of a 2 per cent risk-weighting is dependent on the collateral being held in a bankruptcy remote manner.

To summarise, the answer is no based on the initial proposed collateral holding structure because it is not bankruptcy remote.

A3 ASX's Client Clearing Service will not offer a 'bankruptcy remote' collateral holding structure initially. Feedback is requested, especially from Clients, on the relative priority of such arrangements, taking into account the incremental benefits and costs of implementation as well as other service enhancements that may be desirable (such as a 'with excess' individual client account option).

Members would like the ASX to explain why it cannot implement a bankruptcy remote structure, given the previous participant support for ASX implementing such a structure.

Further clarification is also sought on the cost of the current model being proposed and when Options 3 and 4 will be made available. In order to determine priorities, Clearing Participants would need to know the cost of such a structure and how long it would take to develop as well as for other Client Protection Models (CPM) including the "with excess" model. The information is crucial to making decisions on the CPM and the structure to be used.

2. Default Management and Portability

B1 The 'porting windows' for ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives are up to 24 and 48 hours respectively. Are the porting windows appropriate? If not, why not? In your response, please consider the potential trade off between the length of the porting windows and the level of initial margin requirements.

The 24 hour porting window for ASX 24 Exchange Traded Derivatives is generally appropriate. However this should be considered by the Risk Committee in the context of the positions.

With regard to the OTC timelines, they parallel those of other CCPs, for example, LCH and Eurex are both 48 hours for the porting of OTC positions. However, operational timezone considerations also need to be taken into account for Australian-based infrastructure. Thought needs to be given to the situation of an overseas client with up to 48 hours to pay margin. In that case an additional period of 24 hours may be needed for porting which would result in a 72 hour window.

The practical consideration for clients putting in place economic porting arrangements means that demand is hard to assess. In order to port, clients will need to have in place active clearing arrangements with their alternative Clearing Participant. This means that all relevant client on-board actions have been completed, such as account set ups, and connectivity with affirmation platforms. It is a matter of commercial speculation as to whether clients who wish to have porting arrangements in place will have the ability to find more than one Clearing Participant interested in providing clearing services. For clients, the splitting of their books could mean some margin inefficiency, and will also

potentially increase the overhead in connecting to multiple counterparties. Overall the commercial viability of providing porting is an area of considerable uncertainty, and is likely to vary significantly from client to client and between Clearing Participants. There is also the consideration of what they will need to pay their Clearing Participants in order to achieve the potential to port, since higher levels of client protection are likely to increase the cost of the service.

Related to the above, it is important to note that the concept of 'guaranteed portability' does not exist in the market. Even where clients are able to have in place active alternative Clearing Participants, the ability of those Clearing Participants to accept the positions will depend on a number of factors including credit appetite and resource constraints.

Porting would be positively supported by having porting windows/timelines clearly defined. Settling on the appropriate period of a porting window needs to also reference the speed at which an alternative Clearing Participant can receive information from the ASX in the event of another Clearing Participant's default. During what would be a period of market distress, immediate access to data in a useable format would greatly assist in enabling a more timely response. This means that system requirements for informing Clearing Participants need to be settled with regard to what format clients' exposures will be provided and, in addition to the Initial Margin and the positions, how Variation Margin exposure information on positions would be provided. Given the uncertainty surrounding porting due to likely market conditions at the time, it will be important to know whether positions have been ported or closed out. The speed at which this information is required by the client of a Clearing Participant is also an important consideration.

B2 ASX proposes not to require Clients utilising Individual Client Accounts to maintain a nominated Alternate Clearing Participant. Do you agree with ASX's proposed approach? If not, why not?

Yes.

Consistent with the previous responses, clients should be allowed the freedom to choose the account model that best suits their needs. All market participants should be able to decide for themselves what they need based upon their risk profiles and business requirements. Some clients, for example, may choose Individual Client Accounts for reasons other than portability. Clients should have the freedom to choose the service arrangements that are in their interests. In addition, it may not necessarily be possible for all clients to source an alternative Clearing Participant.

3. Client Protection Model: Legal Relationships

C1 Unlike ASX's existing client clearing arrangements, which are based on the principal model, the Client Protection Model creates a direct legal relationship between ASX and the Client. Do you consider this may have any unintended consequences for Clients or Clearing Participants? If so, please explain why?

Yes. There are a number of matters around which concerns may be raised or on which there is some uncertainty.

3.1. Freedom of Contract

There is concern that the Client Protection Model (CPM) unduly interferes with client agreements between Clearing Participants and clients. This is because the Rules prevail over client agreements in the event of any inconsistency. However the term "inconsistency" is unclear in the Rules, and there is a potential for the Rules to render whole parts of client agreement provisions unenforceable. As discussed in Question E1 (5.4) below, it is suggested that the Rules be tightened to reduce the impact of the "inconsistency" term to have the least effect necessary for the CPM to function.

3.2. Close-out Netting

It is important that close-out netting between Clearing Participant and client is not affected by the CPM. The definition of "close-out netting contract" in the *Payment Systems and Netting Act* 1998 does not expressly refer only to bilateral contracts however we understand that there is a market perception that this is the case.

In addition, the lack of a reference to clients in Rule 1.3 and Section 822B of the Corporations Act 2001 (as discussed in part 3.9 below) causes us some concern as to whether the Rules together with client agreements constitute close-out netting contracts.

The ASX should provide a clean close-out netting opinion on the CPM to its Clearing Participants in relation to the default of Client or Clearing Participant. We query whether legislative change is required prior to the CPM receiving regulatory approval to ensure statutory close-out netting protection (with the attendant systemic risk benefits this brings).

3.3. Insolvency Set-off

The tri-party nature of Open Contract and Open Positions under the CPM may potentially interfere with the mutuality requirement for insolvency set-off under Section 553C of the Corporations Act in the case of Client, Clearing Participant or CCP. Further clarification would be welcome on this issue by ASX. This might raise the question of

whether an amendment to the Corporations Act is appropriate to preserve such set-off prior to the CPM receiving regulatory approval.

Members would like ASX to provide a clean set-off opinion on the CPM to its Clearing Participants.

3.4. Client Default

Rule 118.1(b) appears to contemplate the transfer of all, and not less than all, Open Positions of a client in default from a Client Account to the Clearing Participant's House Account if the Clearing Participant notifies ASX that a client has defaulted and so requests.

Several reservations about this provision are raised. First, it is queried whether it is appropriate that client segregation can be lost simply by a Clearing Participant notifying ASX that a client is in default and requesting transfer, particularly since this precludes porting if the Clearing Member subsequently Defaults and may significantly alter the Client's position in a bankruptcy. At present there is no limitation on the ability of a Clearing Participant to declare a client in default and request a transfer. For example there is no requirement for a Clearing Participant to act in good faith, or commercially reasonably, or to consider the best interests of clients (cf ASIC Market Integrity Rules (ASX 24 Market) 2010 (MIR) rule 3.1.13) when doing so.

Secondly, as drafted Rule 118.1(b) appears to contemplate an 'all or nothing' transfer of Client Open Positions. Integrity Rule 7.2.8(1) contemplates that if a client is in default by failing to pay a margin call then the Trading Participant is to close-out Open Positions "to the extent necessary to counter the Call". This may mean that less than all Open Positions are to be closed out in relation to a defaulting client. In addition, total loss of segregation may be wholly uncommercial in a situation where the default is minor or technical or is subsequently cured.

Thirdly, it is not clear what credit the client must be given for the value of its Open Positions which have been transferred to the House Account.

Fourthly, it is not certain whether this approach is compatible with the client segregation rules in foreign client jurisdictions such as the EU and the United States to which Clearing Participants may be subject.

It is desirable for the ASX to clarify its rationale for the approach it is proposing in light of these concerns.

3.5. Preservation of Existing Futures Model

There is a desire for ASX to keep the existing omnibus futures model available to Clearing Participants. Clearing Participants want the ability to opt-in to CPM rather than ASX making a determination under Rule 111.1 that CPM mandatorily applies. If a Clearing Participant elects not to opt-in it should not have to make any operational or documentation changes to its clearing business simply because other Clearing Participants have opted in. This approach gives Clearing Participants maximum flexibility to structure their clearing business as they wish.

If the Rules are implemented as drafted Clearing Participants will have no choice and will have to make numerous changes to their clearing business, even if neither a Clearing Participant nor its clients wants to do so, and even if a Clearing Participant is not clearing OTC Derivatives. Other CCPs overseas such as LCH and Eurex have implemented OTC client clearing in a way which causes less disruption to existing practices.

3.6. Conflicts of Law

The CPM potentially amplifies conflicts of law issues for all Clearing Participants and clients operating in a cross border context.

The Rules are governed by New South Wales law. However, ASX 24 Client Clearing Clients may be incorporated outside Australia, and ASX 24 client agreements may be governed by non-Australian laws. There is uncertainty as to whether the Rules may be enforceable under non-Australian laws, particularly in the insolvency of a non-Australian Client. Conflicts issues are amplified under the CPM due to the Client being brought in under the Rules and the potential for the Rules to interfere with client agreements governed by non-Australian laws.

Clarification by ASX is sought on the steps it is taking to minimise conflicts of law issues as part of implementing the CPM. For example, seeking all possible statutory enforceability protection for the Rules under key foreign legal systems and making legal opinions available in relation to Clearing Participants and Clients in key foreign jurisdictions.

3.7. Unintended Override

The final sentence of Rule 113.1 leads to some unexpected results. The sentence provides:

> *When a Clearing Participant is acting on behalf of a Client, each reference in these Rules to a Clearing Participant as a party to a Market Contract … or to the rights and obligations of a Clearing Participant under a Market Contract … is taken to be a reference to the Client and to the Clearing Participant acting in this capacity.*

As a result of this, the definition of 'Client' becomes circular: "In relation to a Client and to a Clearing Participant any person, firm or corporation on behalf of whom the Client or Clearing Participant enters into, acquires or disposes or a Market Contract…". The definition of Guarantor Clearing Participant is similarly affected. Rule 9A.3.8 is amended to refer to "a Clearing Participant, Client or CPM Client", which creates duplication in client references. The Client becomes obliged to pay ASX fees for the registration of Market Contacts under Rule 34.1. ASX becomes entitled to deduct fees from the account of the Client pursuant to Rule 34.2. The Client becomes obliged to post Intra Day Margin to ASX under Rule 45.1. Provisions of Part 10 become unintelligible due to the deemed references to "Client" whenever the Clearing Participant is referred to. Many other clauses throughout the Rules are similarly affected.

It is suggested that the impact of the final sentence of Rule 113.1 could benefit from further consideration by ASX.

3.8. Unintended Trusts

Page 22 of the Consultation Paper includes a statement that "Participant is trustee for client in holding client positions and margin." Rule 113.2 states that: "Without limitation, the Clearing Participant holds these rights and entitlements on behalf of the Client", which seems to support the notion of trusts existing under the Rules. However Rule 4.9 states that "ASX Clear (Futures) shall not be required to recognize any trust in relation to any [rights as a Clearing Participant]". In addition, Rule 124.4 provides that no Clearing Participant can allow a trust to subsist or be created over Secured Initial Margin.

Further clarification from ASX on the existence or otherwise of trusts under the Rules would be welcomed. To the extent that trusts do exist, further clarification on the scope of trustee duties is also desirable. If no trusts are envisaged, an express statement to this effect is desired.

3.9. Section 822B

Section 822B of the Corporations Act 2001 provides that the operating rules of a licensed Clearing & Settlement facility have effect as a contract under seal between, among others, the licensee and each participant in the facility. However the position of clients under the CPM is unclear. Rule 1.3 only refers to the Rule constituting a contract between ASX and Clearing Participants without any reference to clients. This could entail a need to amend the Corporations Act to clarify that the Rules take effect as a contract under seal in relation to clients as well. Rule 1.3 should also be considered.

3.10. Allocations

The CPM Provisions do not appear to contemplate block trading and post-trade Allocations. For example, Rule 114.1 refers only to registration in a single Client Sub-Account. Clarification from ASX around how block trading and Allocations operate under the CPM is desired.

4. Operational Processes

D1 Do you agree with the primary operational role of the Clearing Participant under the Client Clearing Service or should Clients have more direct operational engagement with ASX? If Clients should have more operational engagement, please indicate why that would be the case and what form the engagement might take.

The meaning of "primary operational role" is important to Clearing Participants as there are on-boarding steps that need to be completed between the client and the clearing house so the demarcation line is important. A Clearing Participant is best placed to face the client from an operational basis; as the Know Your Client (KYC) process, credit checks, visibility to positions on other exchanges as well as other asset classes give Clearing Participants a better picture of the client profile than the CCP can expect to have. The operational support of clients is part of the Clearing Participant's service provision, and is an area of their expertise.

Operationally, under a default a Clearing Participant has a role in porting positions, monies and discussions with clients. For example, Futures Rule 115 and verifying that the client meets the criteria in OTC Rule 2.16 would need operational engagement between ASX Clear (Futures) and the Client in a pre-default scenario.

The ASX is making position and guaranteed initial margin value reports available to clients. Would the ASX make data available direct to clients utilising the ICA? Are clients able to query these direct with the ASX? Similarly, can clients query the Fact Sheet direct with the ASX as well?

One suggestion is that there could be some form of 'helpdesk' type arrangement for clients, which could be in particular demand in the event of a Clearing Participant default. Detailed reporting of information such as margins, collateral, fees, and interest to ensure transparency would be of value. Consideration of undue operational burden on the Client of a CCP needs to be taken into account.

5. Clients

E1 Do you have any comments on the restrictions that apply to Clients in relation to OTC Client Clearing?

5.1. Definition of Client

The definition of 'Client' is considered to be too broad. The structure of a number of AFMA member client clearing businesses is such that, occasionally, some end-user clients contact the Clearing Participant directly, notwithstanding their clearing broker relationship is with a non-Australian Related Body Corporate of the Clearing Participant. For this reason it is crucial that these end-user clients are not considered 'Clients' under the Rules.

The final part of the definition of 'Client' refers to a person "from whom the Clearing Participant accepts instructions to enter into, acquire or dispose of a Market Contract".
It is suggested that the definition of 'Client' should be restricted so that only persons on-boarded with ASX by a Clearing Participant as clients should be considered to be 'Clients' This will avoid potential issues arising simply due to connectivity between a Clearing Participant and end-users the Clearing Participant does not wish to treat as clients.

5.2. Concentration Limit

The restriction in Rule 4.14(l) should receive further consideration in relation to the CPM. A client clearing model under which the Clearing Participant has a Related Body Corporate as its client which faces end-users will likely find that such a client represents a significant percentage of its business operations. Further clarification on the scope of this rule is desired.

5.3. Drafting Comments

It is suggested that Rule 9A.3.8 should refer to 'Clients' rather than 'CPM Clients'. This would give ASX the ability to exempt any Client in appropriate circumstances. This is relevant due to the likelihood that a person will be both a Client and a CPM Client at the same time in relation to different Market Contracts.

Rules 112-121 use the term 'Client' rather than 'CPM Client'. This is not consistent with Rule 9A.3.8 which uses the term 'CPM Client'. It is our understanding that a person can be both a Client and a CPM Client at the same time, if some of the Market Contracts such person transacts have been determined by ASX to be subject to Part 10, and others have not. Since Rules 112-121 only apply to CPM Clients, it is suggested that drafting is conformed to refer only to CPM Clients. For example, the representations in Rule 112 would only be given by a CPM Client in relation to Open Contracts and Open Positions arising from Market Contracts determined to be subject to Part 10. As drafted, a

possible interpretation is that once a Client becomes a CPM Client in relation to any Market Contract, such Client is subject to Rules 112-121 in all cases.

5.4. Representations

The representation in Rule 112.1(h) seems to be inconsistent with the underlying principles of the CPM. Each Client and its Clearing Participant are asked to represent that: "these Rules do not … represent or imply … [any]… relationship between ASX Clear (Futures) and any Client recognised at law or in equity as giving rise to forms of specific rights and obligations."

This representation is difficult to reconcile with the CPM which does create a legal category being a "contract" between ASX and Clients. For example, Rule 113 makes clear that Open Contracts and Open Positions create a legal relationship between ASX, the Clearing Participant and the Client. We believe the representation in Rule 112.1(h) should be removed or qualified to apply "except as expressly set out in these Rules".

The representation in Rule 112.1(k) seems to be too broad. Each client and its Clearing Participant are asked to represent that: "the holding of Open Positions in respect of Open Contracts in a Client Sub-Account with respect to it will not cause ASX Clear (Futures) to breach any law, regulatory requirement or official directive, ruling or determination of any jurisdiction."

The effect of this representation is to put the regulatory risk of ASX onto Clearing Participants and Clients. Clients and Clearing Participants are not in a position to determine all legal requirements ASX faces. We believe this representation should be removed or qualified by the reasonable knowledge of Clearing Participants and Clients.

We believe the representation in Rule 112.1(m) is overly broad. Each Client and its Clearing Participant are asked to represent that: "to the extent of any inconsistency with any agreement between the Client and its Clearing Participant … these Rules prevail."

The concern with this is that the representation potentially interferes with the risk allocation in contracts between the Client and its Clearing Participant. The key issue is the meaning of the term "inconsistency" in the Rules. The Rules create a limited agency relationship between the Client and the Clearing Participant. However the Rules do not contain any provisions limiting the scope of the fiduciary and other duties that arise as a result of the agency as between the Clearing Participant and the Client. This should mean that the Clearing Participant remains free to agree a modified agency or other contractual relationship with its Clients, and to exclude fiduciary duties as appropriate. Such agreements should be able to sit side-by-side with the agency recognised by ASX in the Rules. However it is unclear whether this approach is possible under Rule 112.1(m).

It is suggested that the scope of Rule 112.1(m) is narrowed, so that the Rules as stated only override agreements between the Clearing Participant and Client "to the narrowest extent necessary to ensure the effectiveness of these Rules". In addition, the Rules should only prevail when there is a clear and direct inconsistency, such that effect cannot reasonably be given to both clauses. This approach preserves freedom of contract between Clearing Participants and clients to the greatest extent possible.

5.5. Fundamental Breach

Concern is raised about the final sentence of Rule 112.1 which states: "These representations, acknowledgments and agreements by a Client… are a fundamental condition to the Client's rights and entitlements under these Rules."

The concern is that the term "fundamental condition" introduces uncertainty as to the consequence of breach by a client. It is not clear what the expression "fundamental condition" means, and we note its similarity to the doctrine of "fundamental breach" at common law, which gives rise to specific rights of contractual termination in addition to entitling a suit for damages under general contract law. It is unclear to us whether the Rules intend to evoke the doctrine of fundamental breach by designating terms as "fundamental conditions". The suggestion is that this should be clarified. In principle, the breach of Rule 112.1 by a client should be treated as a Client Default under Rule 118. The reference to "fundamental condition" should be removed.

5.6. Inconsistent Porting Rules

It is unclear as to the interaction between Rule 74 (Clients Not in Default to Clearing Participant in Default) and Rules 119 and 120. These rules all deal with porting of client positions but operate differently. For example, Rule 74 permits ASX to have regard to the liability of ASX and any other relevant matter before deciding whether to permit client porting. Rule 119.4 requires porting without such a wide discretion on the part of ASX. Conditions around porting should be simplified and clarified to ensure there are no inconsistencies in the Rules. This will also assist in making a determination that porting is "highly likely" for capital adequacy purposes.

5.7. Connected with Australia

The restrictions include that client clearing "…will be available initially only to Clients that are connected with Australia…" It is desirable to explain what "initially" means. For dealers, this restriction means they need to look to other CCPs when trading AUD OTC Interest Rate Swaps (IRS) with clients who do not satisfy these requirements (i.e. "US" persons). This creates some inefficiency from a capital and operational perspective and the need for additional documentation and due diligence procedures.

6. Affiliated Clients

F1 Where a Client that is a related body corporate of the Clearing Participant acts as principal or as agent for other related bodies corporate only, ASX proposes to permit the Client's positions to be designated as 'Client' positions, on condition that the positions are allocated to an Individual Client Account that is maintained for the Client, and the Clearing Participant maintains a separate Clients' Segregated Account (outside the clearing facility) for funds in respect of those positions.

Is it desirable to permit positions of a related body corporate of the Clearing Participant in these circumstances to be designated as 'Client' positions? Why or why not? Are the conditions to designation of such positions as 'Client' positions, as proposed by ASX, appropriate? Why or why not?

It is proposed that the Clearing Participant should be able to treat Client positions as 'Client' positions, or otherwise –

- Where the client acts, directly or through a chain of entities in the same corporate group, as agent for unrelated end user clients, we have no issue with these being designated as 'Client' positions. This is in line with current market practice.
- Where the Client acts in any other capacity (i.e. as principal or as agent for other related bodies corporate only), we would recommend that clients have the ability to opt-in to 'Client', but as default remain 'House' (as is currently the case).

If any related body corporate wants to opt-in to the ISA, in order for the proposed changes to work the ASX would need to have the ability to see and monitor client Segregated Accounts outside of the ASX clearing facility. This would involve addressing client confidentiality across multiple clearing houses and locations and as such this complication would need to be considered in any solution and specifically ASX jurisdiction. If the requirement is to maintain two Separate Client Segregation pools and calculations, then this would be likely have an impact on operations and business processes and would need to be considered in light of these. Clearing Participants would additionally need to consider the regulatory impact on body corporate accounts being designated as 'Client' with regards to such items as the inclusion in Client Segregated Funds daily calculation requirements.

Under the Corporations Act, a related body corporate that is a client is not treated any differently, in terms of client money provisions, to a non-related body corporate. Therefore, money received from both is client money and must be treated in accordance with the Corporations Act.

The rules appear to be attempting to regulate one part of a licensee's business to a greater degree than what would apply to other parts of the licensee's business. There is nothing in the Corporations Act that would require a licensee to treat money relating to a client that is a related body corporate in any different fashion to money of a non-related body corporate.

These rules have the apparent effect of changing the way a licensee deals with its clients in relation to potentially only one small part of its business through its trading on ASX. For the rest of the licensee's business, there is no obligation to treat money received from clients that are related body corporates differently depending on who they are acting for. This adds another level of complexity and risk for global brokers who are going to have to consider whether they need different processes in place for RBC clients depending on whether they are dealing on ASX or otherwise.

There is a broader question on the appropriateness of ASX operating rules dealing with the treatment of client money when this is an area regulated by the Corporations Act.

F2 Do you consider there may be any unintended consequences of the proposed amendments to the definitions of "Client" or "Clients' Segregated Account" in Futures Rule 1.1?

This introduces a high degree of complexity and client account proliferation.

As noted above, we question why it is necessary for ASX to impose these requirements on Clearing Participants when the Corporations Act already regulates the handling of client money. There is no articulation in the Consultation Paper on the reason why a Clearing Participant needs to maintain a CSA. In practice, this represents additional regulation over the handling of client money. In an environment where there are existing conflicts between the Corporations Act and the ASIC Market Integrity Rules (MIR) this is a troublesome development. In addition, the rules need to consider that the larger brokers are global brokers and are attempting to manage client money for activities on multiple markets.

F3 In order for an end user client to gain the protection of the Individual Client Account option, where the Clearing Participant chooses to offer it, the end user client would need to have entered into a client agreement with the Clearing Participant on terms consistent with the minimum terms prescribed by ASX. What consequences flow from the requirement for a client agreement in these circumstances? Please provide details of any financial or regulatory implications of a Clearing Participant contracting directly with end user clients that wish to take up the Individual Client Account option. Are those implications (if any) likely to affect Clearing Participants' ability to offer the Individual Client Account option or end user client demand for it? If so, why?

It is not practical to impose the requirement that underlying clients document directly with the local Australian booking model; as there are consequences that flow from the requirement for end user clients to have entered into a client agreement with the Clearing Participant if they want individual client account protection since licensing restrictions may prevent an offshore domiciled client from entering into an agreement directly with the Australian ASX 24 Participant. Booking models for global organisations have been structured in a way to ensure any local licensing restrictions are adhered to.

For example:

- European Economic Area (EEA) based client - In order to provide financial services to EEA based clients, the entity providing the service that the client enters into the agreement with must be MiFID passported. It is often the case that the Australian ASX 24 Participant is not licensed under MiFID and would be prevented from entering into an agreement directly with an EEA client.
- US based client - Licensing laws in the US require a US registered FCM to provide clearing services to US domiciled clients. Under CFTC Part 30.10 exemptions, offshore entities are only permitted to provide execution only services in certain circumstances. US clients may be prevented from obtaining the protection on offer if entering into a clearing agreement directly with the Australian entity is a condition.

These are just a selection of the regulatory and other issues that may prevent a Clearing Participant from entering into an agreement with any party other than its own direct client. Given that the objective is for the ASX to have an end user client bound to the Rules so that, in the event of the default of a Clearing Participant, the ASX will have a direct contractual relationship with the client for the purposes of porting the client's positions to a new Clearing Participant, thought may be given to alternative means to achieve the end. One proposal would be to adopt a process similar to 'Registered Holder Collateral Cover Authorisation for Client Account', in the ETO market, under which the Clearing Participant arranges for the client to provide the necessary authorisations to ASX to deal with collateral lodged with ASX in the event of Clearing Participant default.

7. Clearing Participant and Client Documentation

G1 What impact will the introduction of ASX's Client Clearing Service have on existing client documentation, both for ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives?

In addition to the points made in the answer to Questions C1 and E1, there is concern with the potential scope of Rule 112.1(g). This rule contains a representation by each

Client and its Clearing Participant that: "the Client's Clearing Participant has provided the Client (and each other person on whose behalf the Client is acting, as notified to the Clearing Participant by the Client) with, or directed the Client (or other person, as applicable) to, a copy of the Client Protection Model Client Fact Sheet".

A possible interpretation of this rule is that a Client that is a Related Body Corporate of a Clearing Participant must provide the Client Protection Model Client Fact Sheet (Fact Sheet) to all of that Client's unrelated end-user clients. Page 28 of the Consultation Paper appears to support this interpretation, providing:

> *In order to fulfil this regulatory requirement, ASX will … require Clearing Participants to provide their Clients (or, where the Client is a Related Body Corporate of the Clearing Participant, the unrelated end-user client) with a copy of the fact sheet or direct them to the ASX website where it will be published.*

The regulatory requirement referred to in the foregoing is cited to be Standard 13.4 of the FSS for CCPs (Standard 13.4). Standard 13.4 provides:

> *A central counterparty should disclose its rules, policies and procedures relating to the segregation of a participant's customers' positions and related collateral. In particular, the central counterparty should disclose whether customer collateral is segregated on an individual or omnibus basis. In addition, a central counterparty should disclose any constraints, such as legal or operational constraints, that may impair its ability to segregate or port a participant's customers' positions and related collateral.*

There are two reasons for the concerns with Rule 112.1(g). First, it is impractical. A Related Body Corporate Client can have thousands of end-user clients, the majority of whom are outside of Australia. An obligation to send every client the Fact Sheet is unduly burdensome. Some clients may not have transacted an exchange traded derivative for many years. The Consultation Paper provides no indication of the look back period or limit on the requirement vis-à-vis dormant end-user clients.

Secondly, it seems that Rule 112.1(g) goes beyond the requirements of Standard 13.4. We are not clear how Standard 13.4 can be relied on to impose an end-user disclosure obligation on Related Body Corporate Clients.

There should be no look through to the end-users of a Client by ASX in relation to the Fact Sheet. The obligation on Clearing Participants should simply be to disclose the Fact Sheet to their clients. This approach would be consistent with the approach of ASX in other areas such as margin calculation and participation in the Risk Committee.

G2 ASX has sought to avoid taking a prescriptive approach to documentation between Clearing Participants and Clients. Should ASX be more prescriptive, for example by prescribing the form of clearing agreement to be used by Clearing Participants and their Clients?

Some agreement on standardised documentation with minimum terms would reduce legal costs and negotiation time. Clearing Participants competing with each other on the basis of legal terms, especially around segregation and portability, does not promote market efficiency.

This would be of benefit to the introduction of new rules. Rather than prescription, cooperation among Clearing Participants on settling standardised documentation as guidance to the market would be desirable. This is an area where industry bodies, including AFMA can assist. Clearing annexes and addendums for OTC Client Clearing should be consistent where possible with addendums in other jurisdictions, for example with the work done by the Futures and Options Association in Europe.

G3 Should the minimum terms for client agreements in Rules 4.14(j)(v) (Margins) and 4.14(j)(ix) (Right to Refuse to Deal) be disapplied for OTC Client Clearing on the basis that these terms would be expected to be superseded by any bilateral documentation in place between Clearing Participants and their Clients?

Rule 4.14(j)(v) should be disapplied in relation to OTC Client Clearing due to the risk of inconsistency with margining arrangements in place between the Clearing Participant and the Client. As discussed in Question E1(7) above, Rule 112.1(m) could disturb such margining arrangements.

There appears to be no need to disapply Rule 4.14(ix) since this is simply an acknowledgment.

In addition, Rule 4.14(vi) can be disapplied for CPM Clients due to the overlap with Rule 10.9.

Generally, it is suggested that the minimum terms continue to apply unless superseded, or if they are inconsistent with the terms of the new OTC Client Clearing Addendum.

It is not clear why a Clearing Participant would want to remove the margin or the right to refuse notes from the minimum terms for any centrally cleared product, especially if it is only “expected” that the terms are superseded. If terms in the client agreements are superseded by terms in another agreement, then this should be noted in the second agreement.

G4 Does ASX's proposed approach to client agreements provide adequate legal certainty for Clearing Participants and Clients? Do you consider that further or alternative steps could be taken to give greater certainty, and would that require client agreements to be modified?

As suggested above, more legal certainty is wanted by the ASX providing a NSW legal opinion to all Participants confirming the enforceability of the close-out netting, the portability and the bankruptcy remote arrangements. These should take into account the relevant requirements adopted by key regulators globally to achieve consistency and enable more foreign Participants to meet related requirements more readily. Please see points on legal certainty made in the answers to Questions C1, E1 and G1.

There is also a new Rule 103.2 relating to settlement finality. It is queried whether this additional rule is sufficiently detailed to address the requirements of Standard 8 of the FSS for CCPs. Rule 103.2 only refers to the time when payments and deliveries are "made". Standard 8 also requires a CCP to clearly define the point after which unsettled payments, transfer instructions or other obligations may not be revoked by a participant. Consideration should be given to including more provisions dealing with revocability and more detail on when a payment is "made" in a similar level of detail as LCH's settlement finality regulations and those in other major CCP rulebooks.

G5 Is the Client Fact Sheet sufficiently clear and does it contain enough detail? What other information should be disclosed in the Client Fact Sheet?

Clients opting into any CPM should be directed towards Rule 113, so that they clearly understand the relationship, and the entitlements they have under the same.

The further issue of a short Q&A, updated from time to time, on the ASX website highlighting the most frequently asked questions for easy reference by clients would be helpful.

Clarification is sought from the ASX about the need to mandate the supply of this Client Fact Sheet, since due diligence of the available clearing structures and their relative advantages/disadvantages should be part of the day-to-day business of selecting/selling Clearing Participants by clients. More specifically:

- At what point in client negotiations do clients have to be directed to the Client Fact Sheet?
- What obligations do Clearing Participants have to existing clients on-boarded and documented prior to the change in the Operating Rules to direct them the Client Fact Sheet, especially where the client has not traded ASX24 products?
- Does the obligation exist for clearing clients only?

- What documentation and record keeping requirement are there?
- What format does the direction to the client to the Fact Sheet have to take?
- It is assumed that only direct clients trading ASX24 products need to be directed to the fact sheet. Is this correct?

With regard to further detail that may be included on the Client Fact Sheet:

- ASX should also disclose any differences in cost for the two models at the clearing house level.
- More detail on the Guaranteed Initial Margin Value that is ported in the event that clients adopt an ICA would be beneficial.
- The price at which positions port should be highlighted, i.e. for ETD only transferring within the 24 hours, they port at previous day's settlement price as opposed to original trade price. Also the price at which positions transfer for OTC and associated ETD should be clarified.
- There should be emphasis on the point that the OTC offering is not available to clients unless they are 'wholesale clients' that are connected with Australia.
- There should be mention of the entitlements of the client to deal with the CCP as laid out in Rule 113.
- Hot-links to the relevant operating rules when making references, for example Rule 112.1 on page 1, would be useful.

8. Risk Committee Composition

H1 Under the Financial Stability Standards for Central Counterparties, as interpreted by the Reserve Bank, ASX's Risk Committee must comprise representatives of indirect participants "depending on the scale and nature of client clearing activity". In your view, what scale and nature of client clearing activity warrants Client representation on the Risk Committee?

Reliance on "scale" faces some practical difficulties. If 'scale' is based on size of Initial Margin or outstanding notional, this could potentially include clients who have only a few very long-dated, large notional OTC contracts. This is further complicated because ASX is offering margin reduction by offsetting OTC against ETD so big users of ETD/OTC who run generally flat books could be excluded from the group.

There is also a fundamental question of whether indirect participants should have voting rights within the Risk Committee, since they do not have the same "skin in the game" as Clearing Participants through contributions to the default fund etc.

H2 What nomination and selection procedures should be put in place to select Client representatives for the Risk Committee?

No comment.

9. Security Interest Provisions

I1 Do you have any comments on the proposed security interest provisions in Part 11?

9.1. Securities Interest Registration

If the transfer of Initial Margin is by way of security (instead of absolute transfer), then it is presumed that the CCP will need to register the security on the Personal Property Securities Register (PPSR). The question is raised as to whether this would lead to disclosure of part of the trade position, making it public information. This may cause concern to some clients.

9.2. Foreign Security Interests

The drafting does not appear to fully contemplate the existence of foreign security interests in collateral located outside Australia, nor statutory liens and other security interests that may exist over collateral due to it being lodged in foreign central securities depositories or the subject of triparty collateral management arrangements. This would impact the drafting, for example, of Rules 112.1(j), 124.1, 124.4 and 125.3.

*****