

CIRCULAR



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**To: Back Office Accounting Suppliers
Clearing Members**

39/98

No:

SFECH Acceptance of Currencies and Securities as Collateral for Initial Margins

Introduction

From **6 July 1998** SFECH will accept USD, NZD, Australian Commonwealth Government Securities, as collateral for SFE initial margins in addition to AUD. For NZFOE initial margins we will be accepting USD & AUD in addition to NZD.

It should be noted that members are still required to settle any settlement losses in the currency that the contract is denominated in, (ie currently AUD for SFE & NZD for NZFOE).

The implementation date for acceptance of the above mentioned collateral is **6 July 1998** (subject to satisfactory results of system testing.)

The details below provide a description of the policies and major issues surrounding the acceptance of:

- 1) Local and Foreign Currencies as Collateral
- 2) Commonwealth Government Securities (CGS) as Collateral

1) Local and Foreign Currencies as Collateral

Standing Cash Instructions

Members are required to complete new Standing Cash Instructions due to SFECH accepting foreign currencies. The Standing Cash Instructions form requires Members to outline details of their standing cash instructions for local currency (AUD for SFE and NZD for NZFOE) and foreign currency(s).

A separate form must be completed for the House Clearing and Client Clearing account and these need to be returned to SFECH no later than **Friday, 12 June 1998**. See attachment 1.

Daily Cash Settlement Instructions

Members wishing to deposit or withdraw AUD, NZD or USD for SFE and/or NZFOE are required to submit a Daily Cash Settlement form by **9:30am** (AEST). (This is currently required by 10.00am for

SFE, however the change in time is necessary to ensure all payments to SFECH are received by the appropriate cut off time, including AUD under a Real Time Gross Settlement environment).

Members should note, where they are depositing or withdrawing foreign currency(s), SFECH will assume that there will be no local currency cashflow(s) for that particular account, unless advised otherwise via the Daily Cash Settlement form. This business rule applies irrespective of any Standing Cash Instructions that may already exist.

Members who have lodged Daily Cash Settlement Instructions advising SFECH that they will deposit USD, but who have missed the 9.30am cut off time will be required to re-lodge the form and settle the entire amount in the local currency. (ie AUD for SFE and NZD for NZFOE)

Cut off times for the lodgement of correct documentation and payment of funds to SFECH will be strictly enforced and SFECH does at all times reserve the right to call and pay funds in the local currency of the Exchange.

Members will have the option to nominate whether they would like to make a book transfer (of the same currency) by completing the "Non-Cash Book Transfer" column on the Daily Cash Settlement form. The use of book transfers will result in balances being transferred within SFECH systems, as opposed to via physical cashflow. Clearing members will be required to maintain their own account entries. EG: Member X has an AUD excess on SFE & a NZD Initial Margin shortage on NZFOE. The AUD excess can be transferred to the NZFOE as a book entry by SFECH, thus eliminating the need to have a AUD cash withdrawal & a subsequent AUD cash deposit between SFECH and Member X.

Book transfers are only possible under the following scenarios within the same Entity:

1. Across Exchanges from House to House,
2. Across Exchanges from House to Client &
3. Within Exchanges from House to Client. (refer to "Currency Holidays Section " for exceptions to these 3 rules).

See attachment 2.

Daily Cashflows

The deposit of AUD amounts (to cover SFE or NZFOE initial margins) and NZD amounts (to cover NZFOE or SFE initial margins) will be payable by Members via Austraclear (Sydney) and Austraclear (NZ) respectively by **10.30am** (AEST).

NZFOE or SFE initial margins) will be made available to Members via Austraclear (Sydney) and (NZ) respectively by **12.00pm** (AEST).

The deposit of USD amounts (to cover SFE or NZFOE initial margins) must be received into SFECH's BOA account from Members by **9.30am** (AEST). SFECH has set up a bank account with Bank of America (BOA) (see below for details), payments into this account must be of an irrevocable and cleared nature.

Given the timing differences associated with cleared and irrevocable USD currency amounts, Members may be required to deposit USD amounts on the day prior to the following day's margin call. Members must familiarise themselves with these timing issues to ensure they are in a position to deposit USD for the correct value date.

The withdrawal of USD (covering SFE or NZFOE initial margins) will be made via direct deposit into Members accounts by **12.00pm** (AEST). These amounts will in practice only be available (New York time) next day.

SFECH USD Bank Account Details

Account name : Sydney Futures Exchange Clearing House Pty Ltd
Bank : Bank of America NT & SA
Branch: New York Branch
1 World Trade Center, 11th Floor
New York NY 10048-1191 USA
Account Number: 6550 4 89482
S.W.I.F.T.: BOFAUS3N
CHIPS U.I.D: 389006
CHIPS Participant: 0959
Fedwire Number: 026-00-9593

Members who wish to make USD deposits and withdrawals will need to complete the USD Settlement Details form (see attachment 3), & return to SFECH by no later than **Friday, 12 June 1998** (where applicable). This form must be delivered prior to any USD cashflows occurring.

It should be noted that a Clearing Member transacting USD for Client Clearing accounts on NZFOE and SFE will be required to set up separate accounts unless prior SFE approval is granted.

Currency / Exchange Holidays

No actual currency payments or receipts for a specific currency will be allowed for that particular currency when on holiday. (If no transactions can be processed for a currency within the banking system then it is deemed a currency holiday).

No actual currency payments or receipts relating to any currency (relevant to that Exchange) will be allowed where that Exchange is on holiday.

No inter-market book transfers (SFECH system) will be allowed for currencies which are on holiday, except USD. (Market is defined as SFE market or NZFOE market).

Intra-market book transfers (SFECH system), House to Client within Exchanges, will be allowed for all currencies if market is open irrespective of whether it is a currency holiday for a particular currency.

Currency Valuation Haircut (CVH)

By accepting foreign currencies for initial margins, SFECH may be potentially exposed to adverse exchange rate movements. (Exposures would only be realised if a Member was to default and foreign currencies had to be converted to that of the underlying contract.)

To protect against such movements a buffer, known as a CVH, will be applied to amounts not covered in the currency of the underlying contract.

A buffer of 4% for AUD and NZD initial margins will be applied to the shortage being covered by foreign currencies.

These CVH are displayed on the Member Members Financial Status Advices (FSA) when foreign currencies are lodged and may change from time to time, similar to initial margin rates.

FX Rates

Besides displaying foreign exchange rates on FSA's, they will also be available on Reuters page "AUEODFIX1" from after 4.30pm daily. These rates will be those used by SFECH to value foreign currencies in the overnight clearing process.

Interest Adjustment Details

Acceptance of USD collateral creates a number of timing issues due to the time zone difference between Sydney and New York.

In a normal processing day, an interest adjustment will have to be made for one days interest because for the SFECH to recognise a receipt on the current day, the money effectively has to be deposited on the previous day in New York. This results in one extra days interest being earned as compared to what is calculated by SFECH. Where such interest adjustments are necessary, SFECH will distribute an additional USD Interest Adjustment Statement (see attachment 4). These adjustments will then be identified on the Monthly Fee, Commissions, Interest & Miscellaneous Member Statement that is distributed to Members on the second business day of each month.

For USD to be effective on a Monday, they will have to be deposited on the previous Friday, meaning that an adjustment for three days worth of interest will be made.

Interest adjustments for deposits made on the last business day of the month will be reflected in the following months Interest Statement, and therefore not be settled as part of the Monthly Fee, Commissions & Interest settlement amount until the following month.

2) Commonwealth Government Securities (CGS) as Collateral for SFE Initial Margins

Acceptable Securities

SFECH will accept Commonwealth Treasury Bonds which are published weekly by the Reserve Bank of Australia in their "Turnover of selected Commonwealth Government Securities" (CGS) (commonly referred to as the 'hot stocks') along with Commonwealth Government Treasury Notes with limitations detailed below. For more information concerning which Stocks are contained on the "hot stocks" report contact the RBA or SFECH Risk department.

SFECH will only accept:

- Commonwealth Government Bonds with a minimum maturity of 6 *months*;
- Commonwealth Treasury Notes with maturities greater than 2 weeks;
- The minimum holding of any series of stock for each clearing account is set at \$2 *million* and
- The minimum RITS transaction size that SFECH will allow is \$1 *million*.

It should be noted that the Reserve Bank Information and Transfer System (RITS) is the only acceptable transfer mechanism by which CGS can be transferred (SFECH RITS code is SFEL20).

Members will need to complete a Security Agreement form once, prior to **lodging securities** as collateral for initial margins. (See attachment 5)

The above securities if lodged for the House Clearing account must be accompanied by a duly authorised CGS Collateral Lodgement form (see attachment 6) and if lodged for the Client Clearing account a Notice of Client Consent form for each security must be additionally completed. (See attachment 7).

Previously accepted securities which become ineligible will be given a nil valuation and required to be immediately withdrawn. A CGS Collateral Release form will need to be completed. (See attachment 8).

CGS Collateral Lodgement & Release form procedures

Members wishing to lodge CGS to cover initial margins will be required to submit a CGS Collateral Lodgement and have the securities in RITS matched by **9:45am**. Members wishing to lodge CGS as collateral on behalf of their Client Clearing account will be required to provide a signed underlying Notice of Client Consent Form along with the standard CGS Collateral Lodgement form.

The lodgement of CGS as collateral will require Members (House or Clients RITS account) to sell

securities to SFECH for nil (\$0) consideration settled by **10.30am** same day.

Members may lodge additional CGS over and above required margin call cover at any time during the day, to be complete in RITS by **4pm**.

Members wishing to withdraw CGS will be required to submit a CGS Collateral Release Form by **9:30am** and if in shortage provide alternate cash cover by **10:30am**. (Note, USD cut off time is 9.30am). The release of CGS as collateral will only occur **once** per day and will require Members (House or Client RITS account) to *buy* securities from SFECH for nil (\$0) consideration available for settlement from **12 noon**.

Members should note, where they are lodging or releasing CGS, SFECH will assume that there will be no cashflow, unless advised otherwise via the Daily Cash Settlement form. This business rule applies irrespective of any Standing Cash Instructions that may already exist.

CGS Valuation Of Security Holdings and Valuation Haircuts

SFECH will value existing CGS holdings using closing market prices from the day prior and will compare to Member initial margin liabilities per clearing account which will be reported on the Member FSA.

Once market value has been calculated a valuation haircut will be applied to give a final SFECH '**Collateral Value**'. A valuation haircut is a buffer for risk management purposes which covers changes in CGS values provided as collateral. Commonwealth Government Bonds and Notes valuation haircuts will be:

- 5% if less than 1 year to maturity
- 10% if more than 1 year to maturity.

SFECH will provide each Member with a Daily Non-Cash Collateral Statement, (see attachment 9) which will display securities lodged, the coupon, the maturity, the issuer, the face value, yield, market value and the collateral value.

CGS Coupon Payment

Any coupon payments that fall due while the SFECH is holding Government Bonds as collateral, will be paid to SFECH on the coupon payment day. On the day payable it will be credited to the Members Clearing account and shown on the Members FSA.

CGS Public Holidays

Members will not be able to lodge or release CGS on business days when RITS is not open or as otherwise specified by SFECH.

CGS Yields

CGS will be revalued once per day at 4:30pm using current market yields. The revalued yields will be those used in the overnight clearing process. These revalued yields will be available from Reuters pages "RBA28" & "RBA30" from after 4.30pm daily and on the Members Non-Cash Collateral Statements.

Insufficient Collateral Provided By CGS

If a Member fails to provide sufficient CGSs by 9:30am, then the Member will be required to provide the

outstanding balance in local currency by 10:30am, as directed by SFECH.

Financial Statement Advices

Members should note that the Overdraft Limit displayed on the new FSA's will not be used initially.

The amounts due for settlement will now be displayed on the new FSA under the heading "Expected Receipt / Payment this Currency" as opposed to "Excess" or "Shortage" on the old FSA's.

See attachment 10.

General

Appendix 1 contains a summary of deadlines relating to lodgement of currency & CGS as collateral.

Please direct any queries or if you require more information to Ben Hatcher (02 9256 0585) or Katrina Maunder (9256 0636) at SFECH.

Appendix 1

Summary Timetable

Time (AEST)	Form/System	Detailed Summary
07:00		Financial Status Advices available to Clearing Members.
09:30	Daily Cash Settlement form	Members to advise SFECH of local and foreign currency cashflows.
09.30	USD Settlement Details form	Only required if Members are depositing/ withdrawing USD and have not previously advised SFECH of bank account details.
09:30	CGS Collateral Lodgement & Release form (1)	Members to advise SFECH of details of CGS that are to be lodged/released from RITS.
09.30	Notice of (Client) Consent Form	Members to supply for Client Accounts together with the CGS Collateral Lodgement form.
09.30		Members to have ensured USD have been received by SFECH (as per Daily Cash Settlement form).
09.45	RITS	Members to have matched CGS lodgements to SFECH.
10:30	Austraclear (Sydney)	Members to have confirmed AUD payments to SFECH.
10:30	Austraclear (NZ)	Members to have confirmed NZD payments to SFECH.
10.30	RITS	Members to have settled CGS lodgements to SFECH.
12:00	Austraclear (Sydney)	SFECH to release AUD cashflows to members as per Standing Cash Instructions / Daily Cash Settlement form.
12:00	Austraclear (NZ)	SFECH to release NZD cashflows to Members as per Standing Cash Instructions / Daily Cash Settlement form.
12.00	RITS	SFECH to release CGS as per CGS Collateral release form.
12:00		SFECH to release USD cashflows to Members as per Standing Cash Instructions / Daily Cash Settlement form.
16.00	RITS	Additional Lodgements in RITS (for value next business day) to be complete.
After 16.30	Reuters	FX and Security rates will be available to Members.

1. Prior to lodging securities, a Security Agreement form must be completed.

Copies of the attachments are unable to be attached with this electronic copy of the Circular. Please refer to the distributed hard copy.

**Ben Hatcher
Risk Manager**

01/06/98

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