



SFE NOTICE NO.

058/07

Date of Issue: 17 May 2007  
Effective Date: 25 June 2007

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## Stress Test Induced Additional Initial Margin Regime Enhancements

Clearing Participants were previously advised in Notice 156/06 of the enhanced Additional Initial Margins (AIMs) methodology which was originally scheduled for implementation on Monday 5 February 2007.

Clearing Participants are advised that the enhancements to AIMs will become operationally effective on 26 June 2007 for AIM obligations arising from open positions as at the close of business 25 June 2007. Participants should refer to the indicative AIMs calls emailed out each week up until the effective date as a guide to the size of calls that will be made.

As part of the AIMs enhancements, the list of acceptable non-cash collateral for satisfying AIMs requirements has been amended, including the addition of ADI Bank Bills/ NCDs and Letters of Credit. (Refer to Attachment 1 for a full list)

Daily AIMs Requirements will continue to be advised to Clearing Participants by 7am each trading day via the OM Net application along with the daily Financial Status Advice (FSA). Clearing Participants will be required to incorporate any AIMs obligation as part of the daily settlement process. Accordingly excess margin monies left on deposit with SFE Clearing will be used against any AIMs obligations when calculating daily cash movements. Monies deposited with SFE Clearing for AIMs and excess margins will attract interest payable at the RBA Target Cash Rate applicable for that day.

SFE will continue to review and seek to improve its stress testing and AIMs methodologies and acceptable collateral, with input from Clearing Participants.

For further information on the AIMs procedures please contact Simon McCarthy on (02) 9227 0161 or Eddie Farah on (02) 9227 0236. Worked examples providing further details of how the additional initial margins are calculated are provided in Attachment 2.

A handwritten signature in black ink, appearing to read 'Eddie Farah', is positioned to the left of a vertical red line.

Eddie Farah  
Senior Risk Analyst

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NOTICE ATTACHMENT 1

EXTENDED SECURITIES APPROVED TO COVER STRESS TEST INDUCED ADDITIONAL INITIAL MARGINS

Subject to approval, on such conditions as SFE Clearing may determine from time to time, the following Australian dollar denominated collateral may be used to cover Additional Initial Margins:

Approved Cover For AIMS Requirement	Valuation Requirement	Haircut Valuation	Lodgement Process and timing (S refers to Settlement Day)
Bank Bill/NCDs	<ul style="list-style-type: none"> <li>Paper Issued by National Australia Bank, Commonwealth Bank of Australia, Westpac Banking Corporation, Australia and New Zealand Banking Corporation, Citibank NA, Deutsche Bank, HBOS Treasury Service plc, BNP Paribas.</li> <li>No parental/self-issued,</li> <li>Duration between 2 weeks and 95 days,</li> <li>minimum parcel size of \$50M.</li> <li>Subject to Issuer Limits</li> </ul> <p>(Note: the ongoing acceptability of and exposure limits against the Issuers listed is subject to change at the absolute discretion of SFE Clearing.)</p>	3% Haircut on the Face Value	Lodgement Notification by 4pm on S-1, Exigo Transaction by 9.30am on S
Letter of Credit*	<ul style="list-style-type: none"> <li>Issuer must be a third party bank with a short-term S&amp;P rating of A-1+ (or equivalent)</li> <li>Subject to Issuer Limits</li> </ul>	0% Haircut on the Face Value	Lodgement Notification by 4pm on S-5
Commonwealth Government Securities	<ul style="list-style-type: none"> <li>AUD Treasury Bonds with maturity greater than 6 months (Minimum holding: AUD\$500,000)</li> </ul>	<ul style="list-style-type: none"> <li>5% for CGS with a maturity of less than one year.</li> <li>10% for CGS with a maturity of greater than one year.</li> </ul>	Lodgement Notification by 4pm on S-1, Exigo Transaction by 9.30am on S
AUD Cash	N/a	N/a	Lodgement Notification by 9.30am on S

\*Letters of credit issued by an Authorised Deposit Taking Institution within the meaning of Section 5 of the Banking Act 1959 (Cwth) which is in a class of Australian-owned banks, foreign subsidiary banks or branches of foreign banks as published from time to time by the Australian Prudential Regulation Authority pursuant to Section 9C of the Banking Act 1959 (Cwth).

Note: As per prevailing policy, the current basis point fee applied to Initial Margin requirements will not apply to AIM requirements.

## WORKED EXAMPLE OF ADDITIONAL INITIAL MARGIN (AIM) CALCULATION PROCESS

### KEY STEPS

- Step 1: Identify the three<sup>1</sup> stress test scenarios which contain the maximum potential loss exposures generated by the House account, the Client account and the combined House and Client accounts.
- Step 2: Determine the House account's AIM obligation for each of these scenarios by calculating any shortfall between the potential loss exposure and the Board-approved stress test exposure limit (STEL).
- Step 3: Determine the Client account's AIM obligation for each of the scenarios by calculating any shortfall between the potential loss exposure and the remaining STEL (which has not been previously allocated to the House account position).
- Step 4: Having established a set of provisional AIM requirements, determine the final AIM obligation for each account. For the House account, the final AIM obligation is simply the maximum of the provisional AIM obligations. For the Client account, the final AIM obligation requires an additional consideration and is determined by comparing the maximum of the provisional House and Client account total potential loss exposures to the STEL after taking into account the final AIM obligation of the House account.
- Step 5: Incorporate the AIMs requirement into the daily settlement process. Using the Initial Margin requirement and Excess/Shortage amounts on the FSA, each Participant is required to net their total daily Payment/Receipt obligations when confirming the daily margin movement by the prescribed time (currently 9.30am for Sydney transactions) each day..

### WORKED EXAMPLE

**Example 1** - ABC is a non-ADI<sup>2</sup>, non-rated Clearing Participant with an NTA of \$80M. Its calculated STEL is \$40M. Its current House IM requirement is \$27M and its Excess/Shortage position is \$40M CR; its current Client IM requirement is \$32M and its Excess/Shortage is \$6M DR.

Assuming the stress test potential loss exposures for ABC are as outlined in Table 1 overleaf, then ABC's AIMs obligation and its daily settlement payment/receipts obligations can be calculated as follows:

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<sup>1</sup> Note that the number of relevant scenarios may be less than 3 when the maximum loss generated by an account happens to be the same scenario that generates the combined maximum loss and /or the other account's maximum loss.

<sup>2</sup> Authorised Deposit-taking Institution.



### /Example 1

Step 1: Identify scenarios that contain largest House account, Client account and combined House and Client accounts potential loss exposure losses.

Scenario with largest House account potential loss exposure is Scenario 5: \$73,000,000

Scenario with largest Client account potential loss exposure is Scenario 11: \$58,000,000

Scenario with largest combined House and Client account potential loss exposure is Scenario 6: \$83,000,000

Steps 2/3: Based on the scenarios selected at Step 1, the provisional AIMs obligations (given the STEL of \$40M) are as follows:

- Under scenario 5 the provisional House account AIMs obligation is \$33M (\$73M - \$40M). The corresponding Client provisional AIMs obligation in this instance is \$0.
- Under scenario 11 the provisional House account AIMs obligation is \$0M. The corresponding Client provisional AIMs obligation in this instance is \$18M (\$58M - \$40M).
- Under scenario 6 the provisional House account AIMs obligation is \$0M (28M - \$40M). The corresponding Client provisional AIMs obligation in this instance is \$43M (\$55M - residual STEL after House allocation [\$40M - \$28M = \$12M]).

Step 4: Determine final AIMs obligations

- The maximum provisional House AIMs obligation is \$33M. **The final House AIMs obligation is therefore \$33M.**
- The maximum combined House and Client account potential loss exposure is \$83M which is \$43M more than its STEL. **The total AIMs call is therefore \$43M.**
- **The final Client account AIMs obligation is therefore \$10M (i.e. the maximum combined call \$43M less the House account's AIMs contribution \$33M).**

Step 5: Participants are required to net their total daily settlement Payment/Receipt obligations into one Austraclear transaction.

#### ***House Account***

- In this instance the House AIMs obligation is \$33M, and given the IM requirement is \$27M and Excess/Shortage is \$40M CR, the House daily settlement obligation would be \$7M CR which will be paid by SFE Clearing to the Participant via Austraclear.

FSA Initial Margin Requirement:	\$27,000,000 DR
FSA Excess/Shortage:	\$40,000,000 CR
AIMs Requirement:	<u>\$33,000,000 DR</u>
Expected Cash settlement amount:	<b>\$ 7,000,000 CR</b>

#### ***Client Account***

- In this instance the Client AIMs obligation is \$10M, and assuming the Initial Margin requirement is \$32M and Excess/Shortage is \$6M DR. The Client daily settlement obligation is \$16M which must be paid by the Participant to SFE Clearing via Austraclear within the daily settlement prescribed time.



## /Example 1

FSA Initial Margin Requirement:	\$32,000,000 DR
FSA Excess/Shortage:	\$ 6,000,000 DR
AIMs Requirement:	<u>\$10,000,000 DR</u>
Expected Cash Settlement amount:	<b>\$16,000,000 DR</b>

**Example 2** - DEF is a rated Clearing Participant and an ADI with an NTA in excess of \$3B. Its calculated STEL is \$200M. Its current House IM requirement is \$27M and its Excess/Shortage position is \$40M CR; its current Client IM requirement is \$32M and its Excess/Shortage is \$6M DR.

Assuming the stress test potential loss exposures for DEF are also those outlined in Table 1 overleaf, then DEF's AIMs obligation and its daily settlement payment/receipts obligations can be calculated as follows:

Step 1: Scenario with largest House account potential loss exposure is Scenario 5: \$73,000,000  
Scenario with largest Client account potential loss exposure is Scenario 11: \$58,000,000  
Scenario with largest combined House and Client account potential loss exposure is Scenario 6: \$83,000,000.

Steps 2/3: Based on the scenarios selected at Step 1, provisional AIMs obligations (given the STEL of \$200M) are as follows:

- Under scenario 5 the provisional House account AIMs obligation is \$0M (\$73M - \$200M). The corresponding Client provisional AIMs obligation in this instance is \$0.
- Under scenario 11 the provisional House account AIMs obligation is \$0M. The corresponding Client provisional AIMs obligation in this instance is \$0M (\$58M - \$200M).
- Under scenario 6 the provisional House account AIMs obligation is \$0M (28M - \$200M). The corresponding Client provisional AIMs obligation in this instance is \$0M (\$55M - residual STEL after House allocation [\$200M - \$28M = \$172M]).

Steps 4/5: Not applicable. **No AIM obligations due for DEF.**

**Example 3** - GHJ is a non-ADI, non-rated Clearing Participant with an NTA of \$150M. Its calculated STEL is \$100M. Its current House IM requirement is \$27M and its Excess/Shortage position is \$40M CR; its current Client IM requirement is \$32M and its Excess/Shortage is \$6M DR.

Assuming the stress test potential loss exposures for GHJ are also those outlined in Table 1 overleaf, then GHJ's AIMs obligation and its daily settlement payment/receipts obligations can be calculated as follows:

Step 1: Scenario with largest House account potential loss exposure is Scenario 5: \$73,000,000  
Scenario with largest Client account potential loss exposure is Scenario 11: \$58,000,000



### /Example 3

Scenario with largest combined House and Client account potential loss exposure is Scenario 6: \$83,000,000

Steps Based on the scenarios selected at Step 1, provisional AIMs obligations (given the STEL 2/3: of \$100M) are as follows:

- Under scenario 5 the provisional House account AIMs obligation is \$0M (\$73M - \$100M). The corresponding Client provisional AIMs obligation in this instance is \$0.
- Under scenario 11 the provisional House account AIMs obligation is \$0M. The corresponding Client provisional AIMs obligation in this instance is \$0M (\$58M - \$100M).
- Under scenario 6 the provisional House account AIMs obligation is \$0M (28M – \$100M). The corresponding Client provisional AIMs obligation in this instance is \$0M (\$55M – residual STEL after House allocation [\$100M - \$28M = \$72M]).

Steps Not applicable. **No AIM obligations due for GHJ.**  
4/5:

Table 1

Scenario	Account	Initial Margin	Variation Margin	Potential Loss Exposure	Net Exposure
Scenario 1	House	27,000,000	-75,000,000	-48,000,000	-48,000,000
Scenario 1	Client	32,000,000	50,000,000	0	
Scenario 2	House	27,000,000	80,000,000	0	-18,000,000
Scenario 2	Client	32,000,000	-50,000,000	-18,000,000	
Scenario 3	House	27,000,000	-95,000,000	-68,000,000	-68,000,000
Scenario 3	Client	32,000,000	40,000,000	0	
Scenario 4	House	27,000,000	58,000,000	0	0
Scenario 4	Client	32,000,000	10,000,000	0	
Scenario 5	House	27,000,000	-100,000,000	-73,000,000	-73,000,000
Scenario 5	Client	32,000,000	50,000,000	0	
Scenario 6	House	27,000,000	-55,000,000	-28,000,000	-83,000,000
Scenario 6	Client	32,000,000	-87,000,000	-55,000,000	
Scenario 7	House	27,000,000	-1,000,000	0	0
Scenario 7	Client	32,000,000	50,000,000	0	
Scenario 8	House	27,000,000	-20,000,000	0	0
Scenario 8	Client	32,000,000	10,000,000	0	
Scenario 9	House	27,000,000	-10,000,000	0	0
Scenario 9	Client	32,000,000	-30,000,000	0	
Scenario 10	House	27,000,000	-57,000,000	-30,000,000	-30,000,000
Scenario 10	Client	32,000,000	72,000,000	0	
Scenario 11	House	27,000,000	40,000,000	0	-58,000,000
Scenario 11	Client	32,000,000	-90,000,000	-58,000,000	
Scenario 12	House	27,000,000	-35,000,000	-8,000,000	-8,000,000
Scenario 12	Client	32,000,000	30,000,000	0	
Scenario 13	House	27,000,000	-37,000,000	-10,000,000	-10,000,000
Scenario 13	Client	32,000,000	-25,000,000	0	
Scenario 14	House	27,000,000	10,000,000	0	0
Scenario 14	Client	32,000,000	25,000,000	0	
Scenario 15	House	27,000,000	-28,000,000	-1,000,000	-1,000,000
Scenario 15	Client	32,000,000	-2,500,000	0	
Scenario 16	House	27,000,000	-29,000,000	-2,000,000	-2,000,000
Scenario 16	Client	32,000,000	-11,000,000	0	
Scenario 17	House	27,000,000	-5,000,000	0	-13,000,000
Scenario 17	Client	32,000,000	-45,000,000	-13,000,000	
Scenario 18	House	27,000,000	-1,000,000	0	0
Scenario 18	Client	32,000,000	25,000,000	0	
Scenario 19	House	27,000,000	-55,000,000	-28,000,000	-30,000,000
Scenario 19	Client	32,000,000	-34,000,000	-2,000,000	
Scenario 20	House	27,000,000	-2,000,000	0	0
Scenario 20	Client	32,000,000	-15,000,000	0	
Scenario 21	House	27,000,000	-39,000,000	-12,000,000	-55,000,000
Scenario 21	Client	32,000,000	-75,000,000	-43,000,000	
Scenario 22	House	27,000,000	8,000,000	0	-49,000,000
Scenario 22	Client	32,000,000	-81,000,000	-49,000,000	
Scenario 23	House	27,000,000	75,000,000	0	-17,000,000
Scenario 23	Client	32,000,000	-49,000,000	-17,000,000	
Scenario 24	House	27,000,000	81,000,000	0	0
Scenario 24	Client	32,000,000	7,000,000	0	
Scenario 25	House	27,000,000	-13,000,000	0	-48,000,000
Scenario 25	Client	32,000,000	-80,000,000	-48,000,000	
Scenario 26	House	27,000,000	-18,000,000	0	0
Scenario 26	Client	32,000,000	15,000,000	0	
Scenario 27	House	27,000,000	30,000,000	0	-28,000,000
Scenario 27	Client	32,000,000	-60,000,000	-28,000,000	
Scenario 28	House	27,000,000	40,000,000	0	-16,000,000
Scenario 28	Client	32,000,000	-48,000,000	-16,000,000	
Scenario 29	House	27,000,000	-6,000,000	0	0
Scenario 29	Client	32,000,000	-4,200,000	0	
Scenario 30	House	27,000,000	-4,000,000	0	-10,000,000
Scenario 30	Client	32,000,000	-42,000,000	-10,000,000	

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