Allocation of Investment Losses

Response to consultation feedback on proposed changes to the ASX Recovery Rules to allocate US settlement bank investment losses between the ASX CCPs and their clearing participants

29 August 2022

ASX is available to meet with interested parties for bilateral discussions on these matters.

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ASX

Response to consultation feedback

On 11 February 2022, ASX released a Consultation Paper seeking comments on proposed changes to the ASX Recovery Rules to allocate US settlement bank investment losses between the ASX CCPs and their clearing participants. ASX received submissions from two industry bodies and three clearing participants – in addition, the consultation was an agenda item at the ASX Clear Futures Risk Consultative Committee on 22 March 2022.

As a result of the feedback received ASX intends to make two amendments to the proposed changes as set out below.

Amendments as a result of feedback

1. Loss allocation to a defaulting clearing participant

The Consultation proposed excluding a **defaulting clearing participant** from US settlement bank loss allocation.

Comments were received that ASX should use any residual collateral (after clearing default losses) from the defaulting participant to absorb an element of any settlement bank loss. This proposal is a logical extension of the original approach in the Consultation the aim of which was to ring-fence collateral from a defaulting participant so as to maximize collateral available to cover default related clearing losses.

Therefore the rules will be modified so that a defaulting participant may be allocated a US settlement bank loss once ASXCLF has restored its matched book (through close-out and/or porting of the defaulting participant's cleared positions).

The loss allocation amount for such a defaulting clearing participant will be the lower of:

(i) the residual (i.e. net of default losses) amount of collateral held from the participant (if any); and

(ii) the loss allocation amount the participant would have been allocated had it not been not in default.

Any such allocation will mean that non-defaulting participants will be reimbursed an element of the original loss allocated to them.

2. Approach to the "user pays" component of loss allocation

Diverging views were received as to how to approach the determination of the "user pays" component of loss allocation.

One view expressed was that Component 3 (share of USD cash collateral provided) should be removed as it disadvantaged non-AUD-based banks and that Component 2 (default fund contributions of in-scope participants) should be the sole mechanism to achieve "user pays". Another view suggested retaining Component 3 but with a waterfall approach (using Component 2, 3 and 1 in that order) rather than a weighted average approach as proposed.

ASX considers that the amount of USD cash collateral a clearing participant has actually provided (i.e. Component 3) is an important component in determining the clearing participant's loss allocation percentage and will be retaining Component 3. However, given the feedback, the weightings for Components 2 and 3 are being re-balanced from 20%/40% to 30% for both Components. ASX also considers a pro-rata averaging rather than a waterfall approach is more appropriate to achieve an appropriate balance between "user pays" vs "mutualisation" as it ensures a mutualisation element for the allocation of all losses and not just those losses beyond a certain size.

As a result, the weightings applied to two of the three components used to calculate an individual clearing participant's relative share of the total US settlement bank loss will be slightly amended as follows:

Component	Original weighting	Revised weighting
1: Clearing participant's Default Fund contribution as a % of total contribution from all clearing participants	40%	40%
2: Clearing participant's Default Fund contribution as a % of total contributions from clearing participants within the scope of 2am call	20%	30%
3: Average USD cash called over previous 3 months as a % of the total average USD cash called over the previous 3 months	40%	30%

Other feedback received

Feedback was also received on a number of matters in addition to those outlined above. These included ASX's level of SITG ("Skin-in-the-Game") to cover US settlement bank losses, the specific wrong way risk arising because of the links between most US settlement banks used and clearing participants, allocation of losses to clients, collection of allocated losses and ongoing reporting of potential exposures to clearing participants.

Comments received and ASX's response to them are set out in the attached schedules.

- Schedule 1 covers comments made in relation to the loss allocation methodology and related matters
- Schedule 2 covers comments made in relation to collateral that can be used in the 2am call and the US banks themselves.

Revised draft rule amendments

The revised draft rule amendments incorporating the changes referred to above which have been made by ASX in response to consultation feedback (refer to yellow shading), are included as Schedule 3. The Client Fact Sheet is included as Schedule 4.

Next Steps

ASX will formally lodge the amended ASX Recovery Rules with ASIC for regulatory clearance. Subject to regulatory clearance, the amended ASX Recovery Rules and Handbook are expected to take effect on 1 November 2022. ASX will publish a market notice to confirm the effective date closer to the time.

SCHEDULE 1 - LOSS ALLOCATION METHODOLOGY AND RELATED MATTERS: COMMENTS AND ASX RESPONSE

Comment	ASX response
Loss allocation to defaulting clearing participants	
The consultation proposes excluding a defaulting CP from settlement bank loss allocation. ASX should use any residual collateral (after clearing default losses) from the defaulting participant to absorb an element of any settlement bank loss.	This proposal is a logical extension of the original approach in the consultation the aim of which was to ring-fence collateral from a defaulting participant so as to maximize collateral available to cover default related clearing losses. Therefore, the rules will be modified so that a defaulting participant may be allocated a US settlement bank loss once ASXCLF has restored its matched book (through close-out and/or porting of the defaulting participant's cleared positions). The loss allocation amount for such a defaulting clearing participant will be the lower of: (i) residual (i.e. net of default losses) amount of collateral held from the participant (if any) and (ii) loss allocation amount for the participant had it not been not in default. Any such allocation will mean that non-defaulting participants will be reimbursed an element of the original loss allocated to them.
Components of loss allocations – "user pays" vs "mutualisation"	
Diverging views were received as to how to approach this matter. One view expressed was that Component 3 (share of USD cash collateral provided) should be removed as it dis-advantaged non-AUD-based banks and that Component 2 (default fund contributions of in-scope participants) should be the sole mechanism to achieve "user pays". Another view suggested retaining Component 3 but with a waterfall approach (using Component 2, 3 and 1	ASX considers that the amount of USD cash collateral a clearing participant has actually provided (i.e. Component 3) is an important component in determining the clearing participant's loss allocation percentage and will therefore be retaining Component 3. However, given the feedback received, ASX will re-balance the weightings between Components 2 and 3 from 20%/40% to 30%/30% to give relatively more weight to Component 2 and relatively less weight to Component 3. ASX also considers a pro-rata averaging rather than a waterfall approach is more appropriate to achieve an appropriate balance between "user pays" vs "mutualisation" as it ensures a mutualisation element for the allocation of all losses and not just those losses beyond a certain size.

Comment	ASX response
in that order) rather than a weighted average approach as proposed.	
Rationale for weightings of loss allocations	
What is the rationale behind the weightings for each loss allocation component?	As described in the consultation, the weightings allocated to each component are intended to achieve several objectives: • An approximate equivalence between "**Mutualisation**" (given that all clearing participants benefit from the overnight margin process - Component 1 and Component 2 (part)) and **"User pays"** (where clearing participants whose activities have or could result in USD settlement bank exposures incur a higher share of any loss - Component 2 (part) and Component 3) • Avoid the risk of concentration of loss allocation to a small number of clearing participants • Provide a benefit to clearing participants within the scope of the overnight margin process who reduce the amount of risk to USD settlement banks through the use of non-cash collateral and/or maintaining an additional AUD buffer. The actual percentage weightings set for each of the three components (modified as per above) are in ASX's judgement the most appropriate settings to achieve these objectives – i.e. they are the result of the exercise of "expert judgement" rather than being analytically determined.
ASX SITG ("Skin-In-The-Game") for US settlement bank losses	
ASX should increase its share of US settlement bank losses from its current AUD75m given the increase in exposures due to the calling of collateral to cover mark-to-market exposures in the 2am margin process. One way of achieving this could be to re-allocate capital from the ASXCLF default fund.	ASX acknowledges that prior to the change to the 2am margin process, individual bank limits were set at the same level as ASX's SITG for settlement bank losses ($75m) so that clearing participants were effectively not exposed to the US settlement banks used by ASXCLF to collect USD cash collateral. Increasing individual bank limits to greater than $75m and leaving the ASX SITG unchanged results in clearing participants now being exposed to the US settlement banks. However, ASX is still of the view that $75m is still an appropriate amount of SITG, particularly given that it incurs the first tranche of any loss up to this amount.

Comment	ASX response
	More generally, ASX considers that it contributes an appropriate level of SITG across the combination of investment/settlement bank losses and clearing participant default losses (ASX contributes $450m to the $650m ASXCLF default fund including the first loss allocation tranche of $120m). At this point ASX does not see the merit of shifting capital out of the ASXCLF default fund so as to increase its SITG exposure to US settlement banks. Such a shift would require an offsetting increase in clearing participant default fund contributions which, unlike exposures to US settlement bank exposures, need actual pre-funding.
ASX should consider changing the basis of its SITG to US settlement bank losses from a fixed amount to a set percentage of the results of stress testing of possible US settlement bank losses.	ASX has a clear preference, for capital management purposes, that its SITG/maximum exposure to US settlement bank loss is a fixed dollar amount rather than being re-set periodically based on a set % of stress test exposures. This is consistent with ASXCLF's contribution to the default fund which is also a fixed dollar amount and which is not periodically re-calibrated. In addition, the stress testing of possible US settlement bank exposures would require the development of a new set of stress test scenarios to explicitly reflect that the driver of exposures to US settlement banks arising from potential market movements from the last AUD intra-day margin call at 1.30pm until the following 2am. By contrast, the current ASXCLF stress test scenarios (used to assess the adequacy of the default fund) are calibrated to a 3 day SPOR (Stress Period of Risk) reflecting the close-out period of a defaulting clearing participant's positions. In addition, the new set of stresses would also have to be applied to the intraday positions at 1:30pm and possible changes thereafter. ASX does not believe that the effort required to generate and maintain what is an additional stress testing framework solely for non-default loss allocation is proportionate to any benefit that may ensue.
SWWR ("Specific Wrong Way Risk") from settlement banks in the same group as a clearing participant	
In order to mitigate the SWWR caused by the US settlement bank being in the same group as a clearing participant, ASXCLF should collect additional pre-funded resources either as : • Increased ASX SITG or	The only near-term practical option available to ASXCLF to collateralise mark-to-market exposures during the night session is USD cash collateral – this temporarily creates exposures to the US settlement banks until the USD cash collateral is replaced with AUD collateral the following morning. There is a limited number of banks available that offer the requisite near real time USD funds transfer capability and visibility, all except one of which are in the same group as a clearing participant. Such

Comment	ASX response
• Additional collateral from the relevant clearing participants.	a limited choice meant that SWRR was unavoidable and preferable to the concentration risk associated with using the one bank without SWRR (which would have required a bank limit in excess of $2bn). Given these circumstances, ASX does not regard it appropriate to “penalise” a particular clearing participant with additional collateral for the fact that it is the same group as one of the US settlement banks used. As outlined above, ASX considers that its current SITG (first $75m of any US settlement bank loss) remains appropriate notwithstanding the 2am margin-change related increases in bank limits. This view is not altered by the SWRR resulting from the limited availability of US settlement banks to choose from.
Control mechanism to ensure CCP exposures are capped and CCP remains solvent	
How does ASXCLF ensure that exposures to US settlement bank limits are not exceeded given the potential solvency implications of such excesses for ASXCLF (i.e. ASXCLF will need to cover any losses related to such excesses with solvency implications for material excesses)?	The calculation of the 2am margin calls from individual clearing participants will be capped by ASXCLF’s margin system so that the aggregate amount called from all those clearing participants paying into the same US settlement bank will not exceed the limit set for that bank. This will ensure that exposures do not exceed the limit set for each bank and thereby avoids any risk that the solvency of ASXCLF could be threatened due to such exposures (given that losses on such exposures are attributable to ASXCLF). The capping calculation will be made separately for each US settlement bank – capping of one group of participants margin calls will have no impact on the calls made on other participants.
Allocation of losses to client accounts	
Clarification was sought as to whether losses would be directly allocated to clients of clearing participants.	As set out in the Consultation, ASX will allocate a clearing participant’s portion of any resulting loss pro rata amongst its various accounts - House, Client Omnibus and ICAs. Overnight USD margin amounts (if any) across those accounts will be reduced before AUD funds. This pro-rata approach is consistent with the existing rules framework that applies to the allocation of investment losses. How (or whether) clearing participants further allocate these losses to individual clients in the Omnibus a/c is a matter for the clearing participant. There is no intention for ASXCLF to allocate losses directly to individual clients in the Omnibus a/c.

Comment	ASX response
Reporting of potential loss allocation to each clearing participant	
ASX should regularly report to each clearing participant an estimate of the largest loss that would be allocated to that participant.	The planned reporting to each participant on a bi-lateral basis as outlined in the Consultation is being enhanced to provide greater transparency to clearing participants of their potential loss allocation in the event of a US settlement bank loss. As previously advised, each clearing participant's percentage share of US settlement bank losses will be calculated every three months in line with the methodology set out in the consultation and fixed until the next three month calculation (in a similar way to the approach taken in calculating clearing participants default fund contributions and using the same three month period). This percentage is calculated before the impact of a clearing participant in default (a clearing participant in default is not initially allocated a US settlement loss as discussed in this response to consultation). If a clearing participant is actually in default when a US settlement bank loss is allocated, the percentage share of all other non-defaulting participants will be increased pro-rata to absorb the percentage share that would have been allocated to the defaulting participant had it not been in default. As described above, all except one US settlement bank used are in the same group as a clearing participant. Therefore, if a US settlement bank defaults, it is very likely that a clearing participant will also be in default at the same time. Given this, the quarterly reporting of the loss allocation percentage to each individual clearing participant will reflect the largest settlement bank loss allocation assuming that any related clearing participant is also in default. Details of the US settlement bank actual limit amounts as well as the actual US settlement bank exposures over the preceding period will be reported at each Risk Consultative Committee. In conjunction with the above bi-lateral participant reporting, this will allow each participant to prudently quantify the size of the maximum loss allocation to it (other than in the case of the default of a clearing participant which is not in the same group as a US settlement bank loss) and also understand the actual US settlement bank exposures relative to the limits for these banks.

Comment	ASX response
Collection of losses allocated to participants	
What clearing participant funds will be accessed by ASXCLF to collect the US settlement bank loss allocated to the participant?	The basis of collecting the loss allocated to a clearing participant is set out in the Consultation (under Rule 6.4 – Allocation to Participant Investment Loss). ASXCLF will collect the loss through a deduction from funds already received by ASXCLF from each clearing participant as follows: 1. Loss will deducted from the US overnight margin held from the participant - this means that the US amount returned to the participant will be reduced accordingly. 2. If the US overnight margin is insufficient, then the remaining loss will be deducted from the participant's AUD funds paid to ASXCLF (including margin, commitment and excess cash) which the participant will then have to replenish as appropriate at the next business day margin call. 3. If 1 and 2 do not cover the participant's loss allocation, the remainder will be allocated to other clearing participants relative to their original loss allocation.
What are the implications if the collateral held from the clearing participant is less than the amount of the US settlement loss allocated to the participant?	As outlined above, any excess of the loss allocated to a clearing participant over the collateral held from that participant will be re-allocated to other clearing participants relative to their original loss allocation. The need to re-allocate such an excess is not an event of default for the relevant clearing participant.

SCHEDULE 2 – COLLATERAL AND SETTLEMENT BANKS - COMMENTS AND ASX RESPONSE

Comment	ASX response
COLLATERAL: Paying 2am margin call in other currencies	
The future ability to pay 2am margins in AUD was strongly supported. In addition, ASX should consider broadening in the near term the currencies in which cash collateral is accepted for the 2am margin call to help reduce the risk to US settlement banks	Given the feedback received regarding paying the 2am margin call in AUD, ASX is now focused on determining the feasibility of so doing. There are two elements to this. The first relates to payment connectivity. As previously flagged, ASX is investigating the potential for the NPP ("New Payment Platform") to allow clearing participants to pay the 2am margin call in AUD. An assessment of alternative connectivity options is currently in progress – ASX intends to discuss with clearing participants during Q1 FY23 a high level overview of the possible approach regarding connectivity. The second element relates to liquidity and funding. Payment of 2am margin calls in AUD would have significant implications for clearing participants and their banks in terms of liquidity management and funding, given that they would occur whilst the Australian domestic funding markets are closed. ASX therefore intends engaging with key industry stakeholders (including clearing participants and bank treasury desks) during H1 FY23 to determine the implications, and therefore both the feasibility and desirability, of making 2am margin payments in AUD.
COLLATERAL: Paying 2am margin call in US Treasuries or JGBs	
ASX should consider broadening collateral accepted to include non-cash collateral, specifically US Treasuries and JGBs.	The operational implications of accepting each type of non-cash collateral will need investigating. Some work has already been done for US Treasuries. At this stage, ASX does not envisage any change in this respect for the foreseeable future given the focus on AUD cash collateral (per above).
COLLATERAL: ASX's Treasury ability to switch USD collateral to AUD in the event of a default	
ASX should provide assurance to clearing participants that it can generate AUD liquidity from USD cash collateral in the event of a clearing participant default.	This has already been provided in a paper to the ASXCLF Risk Consultative Committee on 22 March 2022 which set out ASX's capacity to convert USD held from the 2am VM-inclusive margin process into AUD in the event of the default of a clearing participant.

Comment	ASX response
COLLATERAL: Ring fencing of non-cash collateral covering 2am margin calls	
ASX should give clearing participants the ability to provide non-cash collateral which is ring-fenced to cover possible 2am margin calls.	This ability now exists. All eligible AUD non-cash collateral can be provided as an optional buffer against the 2am margin call as well as to satisfy the mandatory AUD buffer requirement.
SETTLEMENT BANKS: Details of which banks used and ongoing reporting of exposures	
Clearing participants need to have full transparency over which US settlement banks are used and the amount of exposures to these banks on an ongoing basis.	The reporting to each ASXCLF Risk Consultative Committee will include full details of the US settlement banks and the exposures to them over the reporting period.
SETTLEMENT BANKS: Clarification of status/nature of exposures to US settlement banks	
What is the status of the USD placed with the US settlement banks?	The USD from clearing participants is held in a transaction account in the name of ASXCC with the US bank concerned. In the event of the insolvency of the US bank, ASXCLF's position would be as an unsecured creditor/depositor of the bank.
	Each of the US settlement banks is insured by the Federal Deposit Insurance Corporation (FDIC) (noting that the standard insurance amount is USD250,000 per insured bank).

ASX RECOVERY RULES

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SECTION 6 ALLOCATION OF INVESTMENT LOSSES

6.1 ASX Investments and ASX Clearing Corporation

Investments of funds received by ASX Clear and ASX Clear (Futures) are made by ASX Clearing Corporation Limited (referred to as ***ASX Clearing Corporation***). These investments are referred to in this Rule 6 as ***ASX Investments***.

6.2 Investment Default, Investment Default Declaration and Investment Loss

Either of the following is an ***Investment Default***:

(a) the insolvency or default of the issuer of an ASX Investment, or the counterparty to ASX Clearing Corporation in respect of the ASX Investment. In the case of an ASX Investment which is a deposit, this includes the deposit-taking institution; or

(b) a loss which has been recognised with respect to, or other recognised diminution in value of, an ASX Investment (including such loss or diminution which arises in connection with a restructuring or similar event which occurs in respect of the ASX Investment),

except to the extent that is a direct result of:

(i) the fraud of ASX Clear, ASX Clear (Futures) or ASX Clearing Corporation; or

(ii) a material non-compliance by the ASX CCP with its investment policy. For the avoidance of doubt, a material non-compliance by the ASX CCP with its investment policy does not preclude the occurrence of an Investment Default.

If an Investment Default occurs, then ASX Clearing Corporation may declare that an Investment Default has occurred (referred to as an ***Investment Default Declaration***) and determine, in its reasonable discretion, that a loss has been caused by or arises out of that Investment Default.

If ASX Clearing Corporation determines that the aggregate amount of losses following one or more related Investment Defaults (as determined by ASX Clearing Corporation in its reasonable discretion) is in excess of A$75 million (referred to as the ***Investment Loss Threshold***) then the amount of that excess (as determined by ASX Clearing Corporation) is the ***Investment Loss*** in respect of those Investment Defaults. For the purpose of determining the amount of an Investment Loss, if the ASX CCP has materially exceeded investment limits that it has approved in accordance with its investment policy then ASX Clearing Corporation must disregard losses to the extent that they exceed those approved investment limits.

Each ASX CCP will review the Investment Loss Threshold on at least an annual basis and, will consult with the Risk Committee in relation to any proposed changes in accordance with the ASX CCP Rules.

6.3 Allocation of Investment Loss to Participants~~SX CCP Investment Loss and Participant Investment Loss~~

Each Investment Loss is to be allocated to each Participant in the following way:

(a) ASX Clearing Corporation is to allocate an amount of the Investment Loss to the ASX CCP. This is to be determined on the basis of ASX Clearing Corporation's calculation of the interest which the ASX CCP holds in the total amount of ASX Investments. The amount so allocated to the ASX CCP is the ***ASX CCP Investment Loss***; and

(b) the ASX CCP is to allocate the ASX CCP Investment Loss which has been allocated to it to each Participant as at the time of the Investment Default Declaration. This allocation is to be determined on the basis of the ASX CCP's calculation of the amount representing funds which the Participant has paid to the ASX CCP in accordance with the Rules (including Participant Commitment, margin and excess cash) and which has been invested in ASX Investments as at the time of the Investment Default Declaration. The amount so allocated to a Participant in this manner is the ***Participant Investment Loss***,~~.~~

provided that any Investment Loss incurred on an ASX Investment of Overnight Margin Monies, is to be allocated to each Participant that is not in Default at the time of the allocation in the following way:

(c) ASX Clearing Corporation is to allocate the Investment Loss to ASX Clear (Futures). The amount so allocated to ASX Clear (Futures) is the ***ASXCLF OM Investment Loss***; and

(d) ASX Clear (Futures) is to allocate the ASXCLF OM Investment Loss to each Participant that is not in Default at the time of the allocation as follows:

(i) 40 per cent of the ASXCLF OM Investment Loss is to be allocated in proportion to the Participant's Adjusted Commitment;

(ii) 30 per cent of the ASXCLF OM Investment Loss is to be allocated only to those Participants that ASX Clear (Futures) has notified prior to the Investment Default are in scope to pay Overnight Margin Monies to ASX Clear (Futures) in proportion to the Participant's Adjusted Commitment; and

(iii) 30 per cent of the ASXCLF OM Investment Loss is to be allocated based on the proportion of the total average Overnight Margin Monies paid by the Participant in the Calculation Period in respect of which the Participant's Adjusted Commitment was calculated.

The amount so allocated to a Participant in this manner is the ***Participant OM Investment Loss***.

The determination of these amounts is final and binding on the Participant, absent manifest error.

For the purpose of this Rule 6:

(a) "Adjusted Commitment" means for a Futures Participant, that Participant's Futures Commitment as last notified to the Participant by ASX Clear (Futures) and for an OTC Participant that Participant's OTC Commitment as last notified to the Participant by ASX Clear (Futures) adjusted by reference to the OTC/Futures margin ratio for the Calculation Period used to size the Futures Commitment.

(b) “Calculation Period” has the same meaning as the term when it is used in Schedule 10 of the ASX Clear (Futures) Rules.

(c) “Overnight Margin Monies” means cash margin paid in United States Dollars to ASX Clear (Futures) in accordance with its overnight margining process and deposited with a US Settlement Bank.

(d) “US Settlement Bank” means a bank established in the United States that holds Overnight Margin Monies.

6.4 Allocation of Participant loss between Accounts~~to Participant Investment Loss~~

The ASX CCP is to allocate the Participant Investment Loss for a Participant amongst the amounts representing funds which that Participant has paid to the ASX CCP in accordance with the Rules (including Participant Commitment, margin and excess cash) and which has been invested in ASX Investments as at the time of the Investment Default Declaration on a pro-rata basis across its relevant Accounts (including any Client Accounts). ASX Clear (Futures) is to allocate the Participant OM Investment Loss for a Participant across the Participant’s Accounts (including any Client Accounts) on a pro rata basis, provided that such loss is allocated first to the Overnight Margin Monies (if any) paid by the Participant to ASX Clear (Futures) in respect of those Accounts and then to the amounts representing all other funds which the Participant has paid to ASX Clear (Futures) (including Participant Commitment, margin other than Overnight Margin Monies and excess cash) in accordance with the Rules and which has been invested in ASX Investments as at the time of the Investment Default Declaration. For these purposes ASX Clear (Futures) will use the exchange rate of the foreign currency transaction it has entered into (or the average rate of such transactions if there are more than one) in connection with the allocation of the Participant OM Investment Loss.

Each such amount is immediately reduced by the amount so allocated to it provided that no amount can be reduced to less than zero. If the amount of a Participant’s Participant OM Investment Loss is greater than the funds (including Overnight Margin Monies) the Participant has paid to ASX Clear (Futures) and which have been invested in ASX Investments as at the time of the Investment Default Declaration, then the residual portion of the Participant’s Participant OM Investment Loss will be reallocated among the other Participants of ASX Clear (Futures) with available funds in accordance with Rule 6.3.

With respect to a Participant Investment Loss or a Participant OM Investment Loss, ~~T~~the Participant is to reinstate the amount of such a reduction (other than a reduction in Overnight Margin Monies) on or before the next Business Day in the manner specified in the Recovery Handbook.

The ASX CCP will notify each Participant of its Participant Investment Loss or Participant OM Investment Loss and the allocation of such Participant Investment Loss or Participant OM Investment Loss across each of its relevant Accounts. However, a failure to provide such a notification does not affect the allocation of the Participant Investment Loss or Participant OM Investment Loss for a Participant in accordance with this Rule 6.4.

A Participant of ASX Clear (Futures) must provide each Client with, or direct each Client to, a copy of the Investment Loss Fact Sheet, in accordance with the Procedures.

6.4A Use of a defaulting Participant's Remaining DM Resources to reimburse a Participant OM Investment Loss

Notwithstanding Rule 6.3(d), if a Participant in default has Defaulted Participant Assets remaining after ASX Clear (Futures) has applied those assets to satisfy the ASX CCP Loss (or a related body corporate of ASX Clear (Futures) has applied those assets to satisfy losses incurred in connection with the Participant's default) and closed out or ported all of the Participant's positions (**Remaining DM Assets**) then ASX Clear (Futures) will:

(a) calculate the Participant OM Investment Loss that would have applied to the Participant under Rule 6.3(d); and

(b) apply the Participant's Remaining DM Assets to reimburse the Participants which suffered a reduction in the amount representing funds which the Participants have paid to ASX Clear (Futures) in accordance with the Rules in aggregate up to an amount capped at the defaulting Participant's OM Investment Loss. This is to be reimbursed (by the means which ASX Clear (Futures) decides is appropriate) pro rata to those Participants up to the amount of the relevant reduction.

However, ASX Clear (Futures) is not required to account to any Participant for any amount which is necessary to discharge any other overdue debt obligation of the Participant to ASX Clear (Futures) at that time.

6.5 Reimbursement of Recovered Amounts

If the ASX CCP exercises its powers under this Rule 6 in respect of an Investment Default and the ASX CCP subsequently recovers an amount in respect of any ASX Investment which was the subject of the Investment Default, then the amount recovered, less any costs and expenses incurred by either the ASX CCP or ASX Clearing Corporation in connection with the recovery, is the ***Recovered Amount*** for that Investment Default.

The ASX CCP must use the Recovered Amount in respect of an Investment Default to reimburse the Participants which suffered a reduction in the amount representing funds which the Participants have paid to the ASX CCP in accordance with the Rules (including Participant Commitment, margin including Overnight Margin Monies or excess cash) because of their Participant Investment Loss or Participant OM Investment Loss with respect to that Investment Default. This is to be reimbursed (by the means which the ASX CCP decides is appropriate) pro rata to those Participants up to the amount of the relevant reduction. Participants will be reimbursed up to the amount of the relevant reductions prior to the ASX CCP being reimbursed for any losses incurred in connection with the relevant Investment Defaults (excluding any costs and expenses incurred by the ASX CCP in connection with the applicable Investment Defaults).

However, the ASX CCP is not required to account to any Participant for any amount which is necessary to discharge any other overdue debt obligation of the Participant to the ASX CCP at that time.

Explanatory Note: Reimbursement of a Participant under Rule 6.5 will take into account any reimbursement made to the same Participant under Rule 6.4A.

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ASX RECOVERY HANDBOOK

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SECTION 6 ALLOCATION OF INVESTMENT LOSSES

6.4 Allocation of Participant loss between Accounts~~to Participant Investment Loss~~

For the purpose of a Participant reinstating the amount of a reduction which has occurred in accordance with Rule 6 (Allocation of investment Losses), a Participant must pay the amount to be reinstated via a Cash Payment transaction in Austraclear which must be at the "Settled" state at the same time as applies in respect of payments of margin payable on that day or as otherwise required by the ASX CCP.

Upon commencement of the ASXCLF OM Investment Loss rules, a Participant of ASX Clear (Futures) must provide each new Client with, or direct the new Client to, a copy of the Investment Loss Fact Sheet, before the Participant holds an Open Position for that Client.

Within three months of the commencement of the ASXCLF OM Investment Loss rules, a Participant of ASX Clear (Futures) must provide each existing Client with, or direct the existing Client to, a copy of the Investment Loss Fact Sheet.

ASX Clear (Futures) may require a Participant to attest annually that it has provided the Investment Loss Fact Sheet to its Clients in accordance with the Rules and Procedures.

For the purpose of Rule 6.4 and this Procedure, the term "Investment Loss Fact Sheet" refers to the document entitled "Investment Loss Fact Sheet" published on the ASX website as amended by ASX Clear (Futures) from time to time.

Schedule 4

ASX Investment Loss Allocation

Fact Sheet for clients

Allocation of investment losses between ASX, clearing brokers and their clients if a US settlement bank holding overnight margin monies defaults

Key terms used in this Fact Sheet	
ASX	The term 'ASX' refers to ASX Clear (Futures) Pty Limited, a licensed clearing house and wholly owned subsidiary of ASX Limited.
ASX Default Fund	The term 'ASX Default Fund' refers to the resources ASX maintains to meet losses if a clearing broker defaults under the ASX Clear (Futures) Operating Rules. Clearing brokers make contributions to the ASX Default Fund on a quarterly basis calculated by reference to the initial margin they paid in the previous quarter.
Clearing broker	The term 'clearing broker' refers to an institution that is authorised to clear and settle derivative contracts with ASX on its own behalf and on behalf of its clients. Clearing brokers are also known as 'clearing participants'.
Client	The term 'client' refers to a person or organisation that has entered into an agreement with a clearing broker under which the clearing broker agrees to clear and settle derivative contracts on their behalf.
Default	The term 'default by a US Settlement Bank' or 'US Settlement Bank default' refers to the insolvency of a US Settlement Bank that holds Overnight Margin Monies.
Overnight Margin Monies	The term 'Overnight Margin Monies' refers to money deposited in United States Dollars with a US Settlement Bank by a clearing broker to cover its overnight margin obligations to ASX. Only clearing brokers who are within the scope of the overnight margin call pay Overnight Margin Monies.
US Settlement Bank	The term 'US Settlement Bank' refers to banks established in the United States that hold Overnight Margin Monies.

Who this fact sheet is for

This fact sheet is for clearing brokers' clients who have invested in, or are considering investing in, ASX 24 Exchange Traded Derivatives or OTC Interest Rate Derivatives.

The purpose of the fact sheet

The purpose of the fact sheet is to provide an overview of how investment losses will be allocated between ASX, clearing brokers and their clients if a US Settlement Bank defaults while it is holding Overnight Margin Monies.

This fact sheet is provided for guidance only and should be read in conjunction with the ASX Clear (Futures) Operating Rules and ASX Recovery Rules. It does not replace or vary those Operating Rules.

Consequences of a US Settlement Bank default

In order to cover exposures generated from trading and market price moves during the overnight trading session, ASX collects Overnight Margin Monies from clearing brokers. These monies are paid by clearing brokers into bank accounts that ASX maintains with several US Settlement Banks. ASX is exposed to the risk that a US Settlement Bank might default while it is holding Overnight Margin Monies.

If a US Settlement Bank defaults ASX may suffer a loss of some or all of the Overnight Margin Monies held by that US Settlement Bank. This would be an 'investment loss.'

Allocation of investment losses

Any investment loss will be allocated between ASX, its clearing brokers and their clients in accordance with the ASX Recovery Rules. Under the ASX Recovery Rules, ASX will bear the first $75 million of an investment loss. However, any loss greater than $75 million will be shared between clearing brokers and their clients.

A clearing broker's share of an investment loss greater than $75 million will be calculated based on three components:

Component		Percentage of investment loss allocated based on component
1	The contribution made to the ASX Default Fund by the clearing broker compared to all other clearing brokers	40%
2	The contribution made to the ASX Default Fund by the clearing broker compared to the other clearing brokers within the scope of the overnight margin call	30%
3	The clearing broker's share of average Overnight Margin Monies paid to ASX in the quarter immediately prior to the clearing broker's latest contribution to the ASX Default Fund	30%

These allocation principles mean that even if a clearing broker is not within the scope of the overnight margin call or has not paid Overnight Margin Monies to ASX at the time of the US Settlement Bank default the clearing broker and its clients will still bear a share of the investment loss.

ASX will allocate a clearing broker's share of an investment loss between its House and Client accounts in proportion to the monies paid to ASX by the clearing broker in respect of each account. However, any Overnight Margin Monies paid to ASX for those accounts will be used to meet the investment loss first before any other funds of the clearing broker or its clients held by ASX.

What this means for you

If there is a US Settlement Bank default this means that you may suffer a loss of some or all of the margins that you have deposited with your clearing broker that they have passed onto ASX. You may be required to make a further payment of margin to ASX via your clearing broker to maintain the positions in your account. If your clearing broker is in default at the time ASX allocates the investment loss, the "collateral value" that we return to you (or your defaulting clearing broker on your behalf) may be reduced taking into account the investment loss allocated to your account (refer to the ASX Fact Sheet entitled "ASX Client Clearing Service for derivatives - Fact Sheet" available on the ASX website).