

## ASX Client Clearing Service for derivatives

### Fact Sheet

#### Introduction to the two clearing account types available for ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives

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.
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.  Under ASX's operating rules, the clients of clearing brokers may communicate with ASX directly and enforce certain rights against ASX in the event of their clearing broker's default.
Collateral	The term 'collateral' refers to money, securities or other property deposited with ASX by a clearing broker to cover its initial margin obligations.
Default	The term 'default by a clearing broker' or 'clearing broker default' refers to a clearing broker's failure to meet its obligations to ASX.  The term 'defaulting clearing broker' refers to a clearing broker that has failed to meet its obligations to ASX.

#### 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 describe the two different account types that ASX has made available to clearing brokers for use by their clients. The fact sheet explains the implications for clients in the different accounts if a clearing broker defaults.

This fact sheet is not an exhaustive statement of all the risks and benefits involved in derivatives clearing generally, those associated with each account type or those which may be important in choosing a clearing broker. Clients should seek their own professional advice about those matters.



## The two account types

Clearing brokers can offer two different account types to their clients. These are:

Pooled accounts	Pooled accounts (also known as Omnibus accounts) are for the derivative contracts of multiple clients pooled together.
Individual accounts	Individual accounts are for the derivative contracts of individual clients.

Clearing brokers may choose to offer one or both of these account types to their clients.

**IT IS IMPORTANT** for the clients of clearing brokers to be aware of the existence of the two account types and the relative advantages and disadvantages of each account type. If a clearing broker defaults, there are different implications for clients depending on the account type selected. These implications are summarised below.

## The initial margin deposited by clearing brokers with ASX

Clearing brokers are required to deposit initial margin with ASX to cover the performance of positions held on behalf of clients. ASX informs clearing brokers how much initial margin it requires from the clearing broker, as described in the table below.

Pooled accounts	ASX calculates the initial margin on the net position in a pooled account across all clients in that account.
Individual accounts	ASX calculates the initial margin on the positions in an individual account for the individual client in that account.

The clearing broker may fund its initial margin obligation to ASX by requiring margin from clients.

The amount of initial margin that the clearing broker deposits with ASX may be different from the amount received by the clearing broker from the client.

For clients in pooled accounts, the initial margin deposited with ASX by the clearing broker is usually less than the amount clients have provided to the clearing broker, because contracts held for one client in a pooled account are netted for ASX's margining purposes with those of another pooled client. The difference between the net margin deposited by the clearing broker with ASX, and the gross margin collected by the clearing broker from its pooled clients, is typically retained and invested by the clearing broker.

For clients in individual accounts, the clearing broker deposits with ASX the initial margin calculated by ASX for the individual account. There is no netting effect as with pooled accounts. The clearing broker may require a client in an individual account to provide additional margin, which is retained by the clearing broker.

Irrespective of a client's choice of account type, ASX accepts no responsibility for client margin that is retained by the client's clearing broker. However, the clearing broker is usually required by law to keep those monies in a segregated account for the benefit of those clients.



## The collateral value of each client account

ASX calculates a collateral value for each client account of a clearing broker. This is the amount which ASX will transfer or return in respect of the client account in the event of the clearing broker's default, as described in the next section ('If a clearing broker defaults').

The collateral value for a pooled account is the value of initial margin calculated by ASX in respect of the pooled account as at the last end-of-day time at which the clearing broker settled its initial margin obligations prior to its default.

A client who elects to use an individual account may request that the collateral which they provide to their clearing broker for their derivative contracts is passed through to ASX and attributed to their account. This requires:

- the agreement of the clearing broker; and
- notice by the clearing broker to ASX in respect of the collateral to be attributed to the client's account.

The collateral value for an individual account is the greater of:

- the value determined by ASX of all collateral (if any) attributed by ASX to the client's account as at the time at which the client's clearing broker defaults; and
- the value of initial margin calculated by ASX in respect of the client's account as at the last end-of-day time at which the client's clearing broker settled its initial margin obligations prior to its default.

## If a clearing broker defaults

If a clearing broker defaults, ASX initiates a process to:

- transfer or terminate the derivative contract(s) of the client, and
- transfer or return the collateral value for the client account. Any amount returned will be net of applicable costs and losses, as explained below.

This process differs for the two account types.

### A summary of the key differences between the accounts if a clearing broker defaults

Each client in a pooled account is exposed to the risk that the collateral value for the pooled account will be reduced by losses on positions of other clients in that pooled account. If those other clients do not provide the clearing broker with funds to meet those losses, and the clearing broker is unable to meet the losses from its own resources, then the losses may reduce any payment that may be made by the clearing broker (or its external administrator) to pooled clients.

ASX is not permitted to use the collateral value for a client's individual account to meet losses on positions of other clients.



### A summary of the key differences between the accounts if a clearing broker defaults

ASX is unlikely to be able to transfer the contracts in a pooled account to a backup clearing broker.

ASX will transfer the contracts in an individual account to a backup clearing broker, if certain conditions are satisfied.

ASX will terminate the contracts in a pooled account and return any remaining collateral value to the clearing broker or its external administrator in cash. Clients may experience delays having their share of the cash amount, if any, returned to them by the broker or external administrator.

If an individual account cannot be transferred, ASX will terminate the contracts in the individual account and return any remaining collateral value directly to the client. Clients in individual accounts should experience no delays having the remaining collateral value returned to them.

This summary shows that the two accounts vary in the protection they offer the client. If the clearing broker defaults, the individual account offers clients a higher level of protection. However, pooled accounts may offer clients advantages, such as lower cost, relative to individual accounts.

While there are differences between the account types, there are also similarities. Clients in either type of account are exposed to the risk that if their clearing broker defaults they may not receive in full, or may experience delays in receiving, amounts owed to them by the clearing broker, including:

- gains on the daily revaluation (also known as 'marking to market') of the clients' derivative contracts, that may have arisen since the last time the clearing broker settled its mark to market obligations and before the clearing broker's default was declared by ASX; or
- gains on the termination of the clients' derivative contracts (termination occurs where the contracts cannot be transferred to another clearing broker, as explained on the next page).

This risk arises because amounts that are payable between ASX and a clearing broker for the broker's client accounts, both pooled and individual, are settled by ASX and the clearing broker in a single daily net payment. The clearing broker is responsible for converting the daily net payment between itself and ASX into gross payments to or from each of its clients. If the clearing broker defaults there is a risk to clients that the clearing broker may not be able to meet its obligations to them. For example, the clearing broker may be unable to pay to clients any gains on the revaluation or termination of the clients' contracts, as described above, if one or more other clients fail to pay amounts they owe to the clearing broker. Clients must pursue their claims to any amounts they may be owed against the defaulting broker directly, as ASX is not responsible for paying those amounts to clients. This risk is present for clients in pooled and individual accounts.

### Transferring to a backup broker

If a clearing broker defaults, ASX has the power to transfer (also known as 'porting' or to 'port') the clients' derivative contracts to a backup clearing broker nominated by the client or clients.

As well as transferring these contracts, ASX may also transfer the collateral value for the client account to the backup clearing broker nominated by the client or clients. Where ASX has attributed collateral to an individual account in accordance with a clearing broker's instructions, ASX may meet its obligation to transfer the collateral value for the account to a backup clearing broker by transferring the attributed (or equivalent) collateral (together with cash, if the value of attributed collateral as determined by ASX is less than the initial margin for the account). In all other circumstances, ASX will sell any non-cash collateral (for



example, securities) lodged by the defaulting clearing broker in order to return the cash amount as described below.

The differences between the two accounts: transfer	
Pooled accounts	<p>Transferring contracts with the collateral value for a pooled account is dependent on all clients in the pooled account nominating and being accepted by a single backup clearing broker. This will not be possible where the clearing broker's default was triggered by the default of a pooled client.</p> <p>It is unlikely that a backup clearing broker with whom all pooled clients are satisfied, and who is willing to accept all pooled clients, can be found without delay.</p> <p>Accordingly, clients in a pooled account should expect to have their positions terminated, as described below.</p>
Individual accounts	<p>Clients using an individual account have a limited period of time in which to have their transfer arrangements confirmed:</p> <ul style="list-style-type: none"><li>- up to 24 hours for ASX 24 Exchange Traded Derivatives<sup>1</sup> and</li><li>- up to 48 hours for OTC Interest Rate Derivatives,</li></ul> <p>commencing from the time of ASX's declaration of default.</p> <p>Accordingly, clients should have a backup clearing broker arrangement in place at all times if they wish to achieve a transfer. If acceptance by the backup clearing broker cannot be confirmed within the applicable time period, ASX will terminate the client's positions as described below.</p>

## Termination of the contracts of some clients

If a clearing broker defaults and the clients' derivative contracts cannot be transferred to another clearing broker, ASX will terminate the derivative contracts. The termination process is also known as 'close-out'.

When terminating derivative contracts in an account, ASX will deduct any costs, losses and expenses incurred in terminating the contracts, from the collateral value for the account.

## Return of collateral value on termination

If ASX has not been able to transfer the contracts in an account and therefore terminates the contracts, ASX will then return the balance - if any - of the collateral value for the account as described below.

The differences between the two accounts: the return of collateral value	
Pooled accounts	<p>ASX returns the collateral value for the pooled account in cash, less applicable costs and losses, to the clearing broker or external administrator (such as a liquidator) of the broker, as appropriate.</p> <p>Clients may experience delays having their share of the cash amount, if any, returned to them by the defaulting broker or external administrator.</p> <p>Access to any portion of the cash amount is subject to the integrity of the defaulting clearing broker's records.</p>

<sup>1</sup> The transfer period applicable to ASX 24 Exchange Traded Derivatives that are accepted for portfolio margining with OTC Interest Rate Derivatives is up to 48 hours.

## The differences between the two accounts: the return of collateral value

Individual accounts	ASX returns the collateral value for the individual account in the form of the actual or equivalent collateral attributed to the account (if any) or cash, less applicable costs and losses, directly to the client. Therefore, the client should experience no delays in the return of the attributed collateral (the value of which may exceed the initial margin for the account) or cash amount to them.
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ASX will sell any non-cash collateral (for example, securities) lodged by the defaulting clearing broker that is not attributed to an individual account in order to return the cash amount as described above. ASX may sell collateral attributed to an individual account to the extent necessary to meet losses and costs applicable to that account.

If the defaulting clearing broker lodged more than ASX required as initial margin and this collateral was not attributed to an individual account, ASX will return this 'excess margin', less any close-out losses on the defaulting broker's client accounts, to the defaulting broker or external administrator (such as a liquidator) of the broker. The defaulting broker's clients must apply to the broker or external administrator for access to the returned excess margin. This is the case for clients in both pooled and individual accounts seeking access to excess margin that has not been attributed to an individual account.

## Nominating a third party

A feature of the individual account is that clients can nominate a third party to communicate and handle dealings with ASX in the event of the clearing broker's default. This 'nominated person' becomes the entity that ASX deals with throughout the default management process being followed for that clearing broker. In the event of the clearing broker's default:

- the client's contracts may be transferred to an account with a backup clearing broker in the name of the nominated person; and
- if the contracts are instead terminated, the remaining collateral value held by ASX for the individual account would be returned to the nominated person.

In those circumstances ASX will deal with the nominated person without reference to the client.

A client may nominate a third party as a nominated person for an individual account by providing to ASX the third party's name, contact details and certain other information.

## Investment of ASX financial resources

ASX invests the funds received from clearing brokers through its immediate holding company, ASX Clearing Corporation Limited. Information about the investment policy that applies to those investments can be found at <http://www.asx.com.au/documents/clearing/asxcc-investment-policy.pdf>.

## ASX's power to manage losses in excess of available financial resources

ASX may incur losses from the default of a clearing broker or the failure of one of ASX's investment counterparties. If ASX's losses may exceed its available financial resources, it has the power to manage its losses by terminating open contracts of, and allocating uncovered losses to, all non-defaulting clearing brokers. ASX can allocate uncovered losses by reducing amounts it owes to non-defaulting clearing brokers (such as gains on daily revaluation and termination payments) and reducing collateral balances. All accounts of a non-defaulting clearing broker, including pooled and individual accounts maintained for clients, can be



subject to termination of open contracts and reduction of payments and collateral balances. The impact of contract terminations or loss allocations on an individual account may be greater than the impact if the equivalent positions had been held by the client in a pooled account, because there is no netting effect as with pooled accounts. The impact can also be affected by the agreement between a client and their clearing broker, as the agreement may authorise the clearing broker to determine how it passes on the cost to all of its clients. Clients should seek their own professional advice about those matters.

## Privacy

ASX may collect, use and disclose the personal information of clients in order to be able to effectively discharge its obligations. Clients are taken by the operating rules to have reviewed ASX Group's privacy statement, available at: [www.asx.com.au/about/privacy-statement.htm](http://www.asx.com.au/about/privacy-statement.htm).

