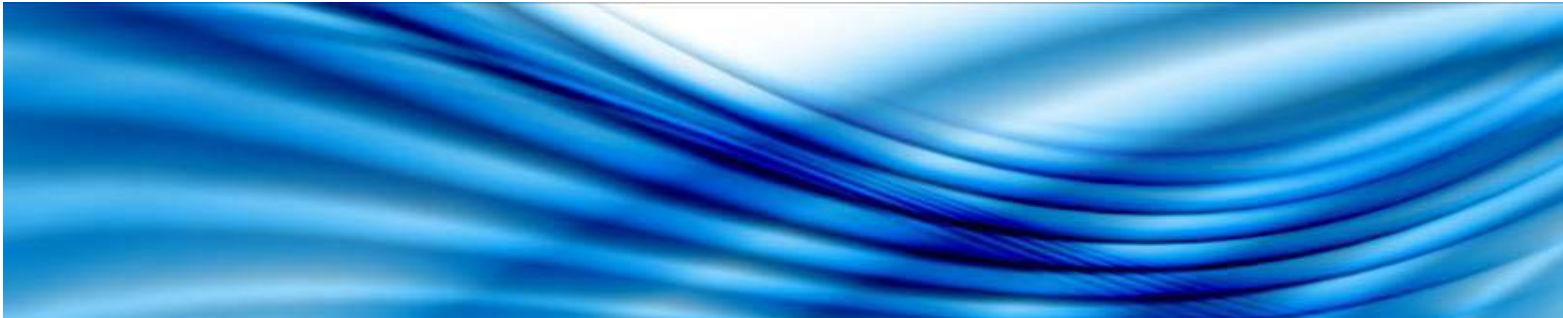




Cash Market Margining



Frequently Asked Questions

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Introduction to Cash Market Margining (“CMM”): FAQ

Note: The Operating Rules supporting the concepts outlined in this document are subject to regulatory clearance. Accordingly, this document should be used for information purposes only

Why is the CMM margin applied to the Clearing Participant and not their underlying clients?

Cash Market margining is a “principal to principal” margin between the Clearing House and the Clearing Participant to ensure that in the event of a default of Clearing Participant the Clearing House can close out the Clearing Participant’s net novated obligations with minimal impact on the rest of the market.

Clearing Participants do not maintain accounts with the Clearing House at the underlying client level. Therefore all net novated positions are treated as “house” positions, as the obligation to settle the novated transaction resides with the Clearing Participant.

The margin is applied to the Clearing Participant to ensure that we have a “user pays” infrastructure and that where possible the default of a Clearing Participant does not have a material knock on impact to the rest of the market.

Why Clearing Participants cannot use their underlying client monies and property to satisfy the margin obligations?

As Cash Market margining operates on a net novated “house” position it is not possible for the transactions to be broken down and provided to the Clearing Participant at the client level.

If ASX were to accept Clearing Participants lodging client funds and stock against their Cash Market margin obligations, ASX would have no way of ensuring that the client for whom the monies and property had been lodged was the client whom the net novated transaction related to.

In addition, in the event of the default of a Clearing Participant, any client monies and property being held by ASX Clear would become the property of the administrator and not accessible by ASX Clear to offset any potential losses.

ASIC have requested that ASX include the following rule into the ASX Clear Operating rules:

“Participant must not Call Clients to meet margin call for Cash CCP Transactions

A Participant must not:

- (a) call a Client for margin; or*
- (b) use Cash or Collateral that belongs to a Client,*

for the purpose of meeting the Participant’s margin obligations to ASX Clear in connection with Cash CCP Transactions whether those Cash CCP Transactions were entered into on behalf of the Client or otherwise.”

This is consistent with the objective of Cash Market Margining, which is to deal with the default of a participant, not their end client.

In addition the annual “Key Risks and Internal Systems” attestation required under ASX Clear Operating Rule Procedure 4.4 has been updated to include additional wording to the effect that the Participant has complied with the above new rule.

What type of margin model will ASX use to calculate a Clearing Participant's margin requirement?

Margin requirements will be calculated daily (phase II) and intraday (phase III) using a model based on Historic Value at Risk (VaR) simulation for liquid securities (as tracked by the All Ordinaries index), with an alternate flat rate methodology for securities which are less liquid or have insufficient price history.

Feedback from the consultation process indicated a strong preference for the adoption of a VaR-based margin methodology over the alternatives originally proposed. Participants deemed this model to most accurately reflect market exposures and thereby achieve risk management objectives whilst minimising the chances of over margining and unnecessary costs.

For further details regarding the cash market margin model, please see the [‘Cash Market Margining: Model Documentation and Report User Guide’](#) under the CMM website section entitled, ‘Historic Reference Materials’.

Why does ASX use two different methodologies to calculate the margin obligation?

The mark to market component of the margin (called “variation margin”) covers the movement between the time of the transaction and the current market price. This will result in either a debit or credit of the margin to the participant depending which way the market has moved.

The historical VaR / flat rate risk margin covers any future losses that may be incurred when closing out the portfolio in the event of a default (known as “initial margin”). Future losses are determined by looking at historical returns for each security over an observed period to capture plausible market movements.

The regulatory standards for CCPs recognise the need to operate margin models that consider both variation and initial margin. Standard 6 of the Reserve Bank of Australia – Financial Stability Standards for Central Counterparties states:

“A central counterparty should mark participant positions to market and collect variation margin at least daily to limit the build-up of current exposures”. And:

“A central counterparty should adopt initial margin models and parameters that are risk based and generate margin requirements sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default”.

What products/transactions will be included in the cash market margin calculation?

All novated transactions in all cash market products: equities, warrants and interest rate securities. This is inclusive of the following:

- Transactions reported to ASX Clear for registration in the names of different delivering and receiving Clearing Participants;

- Transactions executed on an alternative trading platform utilising ASX Clear's Trade Acceptance Service (TAS);
- Securities trading on a deferred settlement basis;
- Corporate Actions; and
- Securities undergoing a trading halt.

For further information, please refer to the CMM website section entitled, 'Historic Reference Materials'.

What products/transactions will not be included in the cash market margin calculation?

All non-novated transactions. The following types are examples of transactions that will not be included in the calculation:

- Cash market transactions (i.e. Crossings) involving the same Clearing Participant (i.e. same Clearing Participant delivering and selling) which are not novated;
- Matched non-novated DvP transactions; and
- IPO's/Placements of securities which are yet to commence official quotation on the official list.

When will the margining proposal be implemented?

The CMM project will be delivered in three distinct phases in order to allow for a smooth implementation across the market.

- Phase I which went live on 19 July 2012 comprised the development of the margin engine and the production of daily reports to enable Clearing Participants to improve their awareness of the manner in which the unsettled novated transactions impact the final margin obligation. These reports are now available for access via ASX Online Market Information Services. Phase I does not involve the calling of funds from Clearing Participants to cover their cash margin requirements.
- Phase II will be delivered Q2 2013. This will see the introduction of system enhancements to CHESS and associated changes to collateral and settlement mechanisms to allow the commencement of calling of margin from Clearing Participants on an end-of-day basis.
- Phase III due to be released in the second quarter 2014, will allow for the introduction of intraday margining.

Any changes to the above timeline are communicated via ASX Market Notices, the CMM website and at Working Group forums. Please direct any queries you may have to cashmarket.margining@asx.com.au

Can ASX Clear estimate my margin requirement?

With the launch of CMM Phase I, Clearing Participants have the ability to access their individual margin reports in conjunction with the prices, parameters and outstanding settlements used to calculate their margin obligations which will be called later under Phase II of the project.

The reports can be accessed via the ASX Online Market Information service using designated CMM login credentials. Administrator level credentials have been distributed to the key CMM contact in each participant which can then be used to authorise other individuals within the firm or contracted service providers to access the reports.

If the key contact in your organisation is yet to receive Administrator credentials – please let ASX know via email at cashmarket.margining@asx.com.au.

For further details regarding accessing and interpreting the reports, please see the '[Cash Market Margining: Model Documentation and Report User Guide](#)' under the CMM website section entitled, 'Historic Reference Materials'.

Will Settlement Participants, Trading Participants or their end clients be margined by ASX Clear through this proposal?

No. ASX Clear will call margin from Clearing Participants, who are the CCP's counterparties to the novated transactions processed through CHESSE. The ASX Clear Operating Rules will not require Clearing Participants to call margin from clients (including Trading Participants of Third Party Clearers.) The ability of Clearing Participants to “pass on” cash market margins to clients is governed by the client money provisions in Division 2, Part 7.8 of the Corporations Act. ASIC is the responsible authority for those client money provisions.

Whether or not the Clearing Participant elects to recover the cost of cash market margins through alternative mechanisms is a matter for each Clearing Participant to determine taking into account the potential operational complexity of recovering the margin in a T+3 settlement context and the benefits associated with netted settlement obligations in a single account structure.

Do other clearing houses require upfront collateralisation/margin from Clearing Participants in the cash market?

Yes, as highlighted in the initial consultation document, 13 of the 15 CCPs in the international comparator group require margin or other forms of up front Clearing Participant collateralisation in respect of the cash market exposures to the CCP.

Since the initial consultation document the remaining two CCPs (Hong Kong and Singapore) have also now implemented cash market margining.

For further information, please refer to the materials, particularly the initial consultation paper - [Australian Clearing House Central Counterparty Risk Management Controls - Consultation Paper & Request for Comment](#) under the CMM website section entitled, 'Historic Reference Materials'.

What is the purpose of the Working Group and when was it set up?

The Cash Market Margining Working Group was set up in November 2010 to enable ASX and affected participants to work together in optimising the CMM solution by:

- Providing a mechanism for ASX to communicate information to stakeholders regarding cash market margining (without being restricted to the formal consultation process);
- Accommodating external input from Participants and Systems providers in relation to operationalising the margin process;
- Encouraging prompt action to create a common understanding of the CMM solution and account for business planning activities of affected participants; and
- Allowing timely identification of potential risks and concerns to permit more comprehensive solutions to be developed.

I am located interstate and am not able to participate in the Working Group session. Is there any other way I can communicate my queries/suggestions to the ASX?

If you wish to provide feedback or have queries in relation to the CMM project, but you are not able to attend Working Group meetings held at the ASX Sydney Offices, please contact us at cashmarket.margining@asx.com.au. An ASX representative will contact you with regard to alternate arrangements and additional information which may assist with your query.

How can I contribute/find out more about Cash Market Margining?

To find out more about the current and upcoming phases for CMM, please contact cashmarket.margining@asx.com.au and an ASX representative will address your enquiry promptly.

ASX will continue to notify all participants regarding any changes, upcoming workshop sessions, important dates and resources to ensure that you are kept aware of important updates. In addition all notices and documentation are maintained on the CMM project website under 'Historic Reference Materials'.

Where can I find out more information about other initiatives introduced as part of the Cash Market Margining project?

The consultations and workshop sessions held since the commencement of the project have helped to identify concerns Clearing Participants had with the introduction of CMM. The majority of the feedback received centred around two major themes; the first being the cost associated with covering margin obligations, and the second being liquidity risk of funding large changes in margin obligations, due to the nature of the T+3 Settlement Cycle. As part of this project, there have been a number of new initiatives and processes introduced to help alleviate Participant concerns.

For additional information on the above items, please refer to the cash market margin materials under the CMM website section entitled, 'Historic Reference Materials'.

What rate of interest will I earn on Cash lodged to cover CMM Obligations and how will it be calculated?

ASX Clear has not yet finalised its interest policy on Excess Cash or Cash Cover. The policy will be determined as part of a wider Clearing Fee review currently underway and expected to be published in Q1 2013.

Further information on this topic will be communicated to Participants in due course.

Will Clearing Participants be permitted to use existing capital held for ASX Clear minimum core capital purposes to assist with satisfying margin calls?

Clearing Participants will be able to utilise existing capital (or part thereof) to meet their margin requirements. This is based on the premise that margin requirements will not impact a Clearing Participant's net assets. In addition, ASX Clear's intention is to allow cash deposited as margins, including excess cash, to count towards Clearing Participants' Liquid Capital. For the purposes of calculating a Clearing Participants Counterparty Risk Requirement, it is proposed that margined ASX cash market products will continue to be reported under the Non-Margined Financial Instruments Method. Rule amendments to effect the changes are subject to regulatory clearance as at the time of writing (February 2013).

Cash Market Margining Phase I: FAQ

What was delivered in July 2012 as part of the CMM Phase I release?

The CMM Phase I implementation provided Clearing Participants with the ability to access their individual margin reports in conjunction with the prices, parameters and outstanding settlements used to calculate their margin obligations. Clearing Participants are able to either browse the site manually or use a provided java app to automate the process of logging onto the site and downloading the files to their own environment for subsequent processing.

At a high level, Clearing Participants should have the following since July 2012:

1. Report Access: ASX Online Portal Administrator Credentials;
2. Supporting Documentation: Cash Market Margining Model Documentation and Reporting User Guide;
3. Daily Margin Obligation Reports at the Clearing Participant Level; and
4. Daily Position, Prices and Margin Model Parameter Reports needed for Margin Reconciliation

ASX has recommended that Clearing Participants use this opportunity to understand the nature of their margin requirements and communicate any relevant impacts to their stakeholders in preparation for the calling of margins in Phase II.

Should you experience difficulties or have queries relating to any of the above, please contact us at cashmarket.margining@asx.com.au.

Where can I find more information regarding the reports and their content launched as part of Phase I in July 2012?

The '[Cash Market Margining: Model Documentation and Report User Guide](#)', has been designed to assist Clearing Participants in navigating the reports and understanding the margin model specification. This can be found on both ASX Online (via your individual user accounts provided) and the CMM project website under 'Historic Reference Materials'.

If you have any questions regarding the reports, please contact ASX via email at cashmarket.margining@asx.com.au.

Which CMM Reports will help me identify reasons for significant changes in margin obligations?

There are different CMM reports that can be referred to depending on the level of detail that is required. If a more general overview is required, the Daily Margins report will assist you in identifying the types of securities that are causing an increase. For example, the Daily Margins report will help identify whether an increase in margin obligation is attributed to securities that use the HsVaR methodology or Flat Rate methodology to calculate Risk Margin.

If you are more specifically interested in identifying the securities that are causing the change, you will be able to use the Change in Top 10 Security Margin Contributions report. This report identifies the 10 largest security margin contributions for each component of the model, and the changes in security level margin contributions over the previous three business days. For example, if you have identified that changes in your cash market margin obligation are related to HsVaR margin contributions, then the HsVaR Margin

Contributions tab in the Change in Top 10 Security margin contributions reports will help to identify the securities that are contributing to that increase.

Are there any reports that identify the Cash Flow requirement?

No, however the Cash Flow requirement can be worked out by using the CMM Monthly Margins report that is currently provided to Clearing Participants on a daily basis.

What time are the CMM Reports available through ASX Online?

Our aim is to have the reports available through ASX Online by no later than 11pm. However where technical difficulties occur we will attempt to notify key contacts at each Clearing Participant via an email broadcast.

Therefore it is imperative that Clearing Participants provide up to date contact details of those responsible for the monitoring of CMM, in order to assist with Market Communications in the event of a system failure. Notifications of key contact can be provided via cashmarket.margining@asx.com.au. The email address supplied should be generic to optimise the ongoing maintenance of the distribution list.

How do I register for ASX Online access?

Correspondence was forwarded in early June 2012 to the key CMM contact in each Clearing Participant about establishing user access to ASX Online Market Information. Upon acknowledging the term and conditions, the key contact would have received an email with their Administrator User ID and Password which in turn allowed them to create individual logins and passwords for relevant members of their organisation.

If you are a Clearing Participant and the key CMM contact in your organisation has yet to receive login credentials, please contact ASX at cashmarket.margining@asx.com.au.

Who do I contact if there is a change of key contacts in my organisation for the CMM project?

If there are any CMM related key contact changes within your organisation, please contact us immediately on cashmarket.margining@asx.com.au in order for us to update our list and ensure information is being received by the appropriate person in your organisation in a timely manner.

Cash Market Margining Phase II: FAQ

Which systems are being enhanced to cater for CMM?

CHESS Release 8.0 will be released into Production in Q2 2013 which includes additional CHESS messages covering daily margin settlement confirmation and lodging of non-cash collateral against margin obligations. Information related to the CHESS release required to accommodate Cash Market Margining can be found in the following document: 'CHESS Release 8.0; Business and Technical Overview' on the CMM project website under 'Historic Reference Materials'.

Any additional information will be communicated via Participant Notifications.

When will the Testing and Accreditation period begin?

For CHESS Release 8.0 the test system was made available from the beginning of February 2013 with accreditation taking place in March and April 2013. Further information on this topic will be communicated via Participant Notifications closer to the time.

If you have additional queries in relation to how the accreditation process will work, please email Clearing and Settlement Operations via chesshelp@asx.com.au

Do we need to accredit for all CHESS messages specified in CHESS Release 8.0 Business and Technical Overview Document?

No, the new suite of CHESS messages have been categorised into messages that are mandatory messages, those that are optional for Clearing Participants (and not relevant to Settlement Participants) and messages that are optional for Clearing and Settlement Participants. For further details on which messages have been given what classification please refer to Participant Notice P2012_531 on 26 October 2012 on the CMM project website under "Historic Reference Materials".

As advised via Participant Notice 005 on 15 February 2013 the STP Collateral Removal message suite that was an optional part of CHESS Release 8 has been deferred following further assessment of the Prolonged Margining initiative.

You need to ensure that you have discussed with your system provider as to what messages they will be making available in addition to the mandatory messages. Also you need to ensure that if not all messages are being provided that your system provider has catered for the scenario where an unaccredited message is sent to you in error.

For Clearing Participants that use an external system provider, a list of vendors and their accreditation (e.g. accreditation for which processes) will be publically available on the CMM project website once the accreditation period has closed in 2013.

Will I still be margined if I have control of my client's stock?

Yes. The purpose of Cash Market margining is to protect the Clearing House from the potential default of one of its Clearing Participants. In the event that a Clearing Participant defaults ASX is unable to access or utilise the client's stock even if it has been transferred to the Participant's Settlement Entrepot.

Therefore it is important that Clearing Participants enhance their risk monitoring processes to assess the potential impact of a transaction (that will result in a large “net” long or short delivery obligation) at the time of execution or were possible at the time of order receipt.

Can I lodge non-cash collateral to offset my margin?

Yes. The only non-cash collateral that can be lodged by a Clearing Participant to offset their Cash Market margin is stock (approved by ASX) which is beneficially owned by the Clearing Participant and lodged from a HIN controlled by the Clearing Participant (and notified to ASX Clear).

Clearing Participants will be margined at the legal entity level, meaning that Participant's with multiple clearing PIDs will only receive one CMM figure. For the purposes of lodging non-cash collateral, Clearing Participants with more than one PID can only nominate Direct HINs against one PID.

What effect will securities undergoing corporate actions have on our Cash Market Margin obligations?

There are limited circumstances where the corporate action is novated to the Clearing House and could therefore have an impact on a Clearing Participant's margin obligation. The main types of corporate actions that could display a notable movement in margin obligations occur in the following circumstances:

- Capital Reconstructions
- Renounceable Rights Issues
- Return of Capital
- Capital Distributions (Special Dividends)
- Dividends

Where there is a simultaneous adjustment of units and price, as is the case for Capital Reconstructions, the effect of the corporate action on margin requirements is hard to predict, although it is expected that any change will be minimal. These types of changes have been accommodated within the CMM model. Consequently, if there is a movement in margin, it will likely be the result of the securities moving between different Risk Configuration Groups that more accurately reflect the new risk profile of the security.

The more noticeable impact of corporate actions on margin requirements is generally observed with return of capital, dividends and special dividends. Under these circumstances, Participant's will generally notice an increase in their margin contribution. Although, the move may be perceived as not an 'actual' market risk, the price reflects the price that ASX Clear would need to close out at in the event of a Clearing Participant default. As ASX Clear has no assurance of receiving, or laying claim to the value of the return of capital, dividend or special dividend, it is representative of the risk ASX Clear faces to the Clearing Participant.

What impact will CMM margin have on the small to mid-cap sector?

ASX is cognisant of the need to apply cash market margining to the small and medium sized sector in a manner that appropriately reflects the inherent risks and is not unnecessarily conservative.

ASX continues to review and refine the rates on a regular basis. In particular, we are currently looking at splitting the non-All Ords risk configuration group where the small and mid-cap stocks reside into additional sub groups in an attempt to provide additional granularity and limit the application of the more conservative flat rate margins to a narrower range of stocks. The outcome of this approach should reduce the margin rates applied across the small and mid-cap sector.

Why hasn't ASX moved to a T+1 settlement cycle?

Moving to a T+1 settlement cycle is not something the Clearing House or settlement facility could do in a short period of time. It would require market consultation and significant enhancements to systems at ASX and at Participants. Informal feedback from many participants has suggested a move to a T+1 settlement cycle would be operationally challenging. While this is not something that is currently on our agenda, should the market determine that this was one of the main goals then ASX will consider it.

When is my daily CMM margin payable?

If you have an obligation to pay to ASX Clear then the amount needs to be paid through Austraclear by 10.30am Sydney time (e.g. the Austraclear payment must be released by the bank and at "Settled" state by 10.30am Sydney time) on the day on which the payment is due.

If you have an obligation to receive money from ASX Clear then the amount needs to be received through Austraclear by 10.30am Sydney time (e.g. the Austraclear payment must be at "Matched" state or "Settled" state by 10.30am Sydney time) on the day on which the payment is due.

Therefore you need to ensure that you have the appropriate funding lines in place to meet your CMM obligations.

Keep in mind that not being able to meet your CMM obligation by the 10.30am deadline is a potential act of default.

As a Clearing Participant, what do I need to do next?

Obviously each organisation is different and much will depend on the way your organisation is structured, however listed below are a minimum list of items that each organisation should have considered:

- It is important that you continue to monitor the daily reports that ASX has been providing you since July 2012 and understand the impact that your trading activities have on your CMM obligations;
- You need to re-assess your risk management processes to ensure at the time of receipt of an order or immediately following execution you have a very good understanding of how this transaction will impact your CMM obligations;
- You need to re-assess your risk management processes to ensure that at the time of exercise of ETOs you have a very good understanding of how this transaction will impact your CMM obligations;
- Make sure that you system vendor is prepared and knows your requirements. In particular note that as not all CHES messages are mandatory you need to ensure that you are fully aware of what your system provider will be providing and what impact that will have on your business processes

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