

# ASX OTC Interest Rate Derivatives Clearing

Consultation on OTC Rule and Handbook amendments  
related to Default Management processes

CONSULTATION PAPER

FEBRUARY 2017



# CONTENTS

## Invitation to comment

ASX is seeking submissions on the matters canvassed in this paper by 10 March 2017. Submissions should be sent to:

E [catherine.eakin@asx.com.au](mailto:catherine.eakin@asx.com.au)

Office of General Counsel ASX Limited  
20 Bridge Street Sydney NSW 2000

Attention: Catherine Eakin

ASX prefers to receive submissions in electronic form. Submissions not marked as 'confidential' will be made publicly available on ASX's website.

If you would like your submission, or any part of it, to be treated as 'confidential', please indicate this clearly in your submission. ASX is available to meet with interested parties for bilateral discussions on the matters under consultation.

## Contacts

For general enquiries, please contact:

**Bailie Yan**, Senior Manager, Default Management and Recovery  
T 02 9227 0368  
E [bailie.yan@asx.com.au](mailto:bailie.yan@asx.com.au)

<b>Introduction</b>	<b>3</b>
<b>Proposed OTC Rule and Handbook Amendments</b>	<b>3</b>
Proposed changes to ASX Default Management Group (DMG) membership arrangements	3
Default Management Hedging	4
Regular DMG Meetings	4
Default Management Auctions (DM Auctions)	4
Miscellaneous changes	5
<b>Next Steps</b>	<b>5</b>
<b>Appendix A: Proposed changes to ASX Default Management Group (DMG) membership arrangements</b>	<b>6</b>



## Introduction

ASX seeks feedback from OTC Participants in relation to ASX's proposal to amend the OTC Default Management Group framework to reflect feedback from OTC Participants and learnings from recent OTC default simulations ('fire drills').

ASX's proposed amendments to the OTC Rules and Handbook outlined in this Consultation Paper are available [here](#).

OTC Participant responses to this Consultation Paper should be submitted to ASX by Friday 10 March 2017.

## Proposed OTC Rule and Handbook Amendments

### Proposed changes to ASX Default Management Group (DMG) membership arrangements

Some OTC Participants have indicated that if a defaulting institution was a participant in ASX and several other OTC derivative clearing houses, some non-defaulting participants may be unable to comply in a timely way with their obligation to assist each clearing house with its default management process. Participants cited the limited availability, and in some cases offshore location, of qualified personnel who could contribute to ASX's default management process in circumstances where a large institution had defaulted.

At present, ASX's practice is to invite all eight (8) of its OTC Participants to participate in each 12 month term of the OTC Default Management Group (DMG). Under the operating rules, OTC Participants which are invited by ASX to participate in the DMG, have an obligation to participate by nominating staff to represent their institution on the DMG. (Each participating institution is represented on the DMG by a "DMG Member" and "DMG Deputy", each of whom must satisfy the eligibility criteria set out in the DMG Procedures.) Attendance by DMG Members (or DMG Deputies) at DMG meetings is compulsory.

In response to the concerns of OTC Participants, ASX proposes some changes to membership arrangements for the DMG, set out in Appendix A. The intent is to enable OTC Participants to better manage their commitment to assist with default management processes at multiple CCPs while ensuring that ASX has access to the expertise and execution capability of OTC Participants to hedge and auction the default portfolios. Under the changes, OTC Participants that accept ASX's invitation to participate in the DMG must appoint DMG Members (and DMG Deputies) to attend all DMG meetings held during a DMG term (1 July-30 June), including those meetings called by ASX following an OTC Participant default. Subject to consultation feedback, the changes will take effect from (and including) the DMG term commencing in 2017, unless an OTC Participant requests ASX in writing to reconstitute the DMG under the modified arrangements prior to that time.

The proposed changes will have no effect on OTC Participants' other obligations in relation to the OTC default management process, including the obligation to participate in auctions.

### **Key Operating Rules:**

OTC Rules Schedule 3 (Default Management Process) – Paragraphs 1.1-1.4

OTC Handbook Schedule 3 (Default Management Group Procedures) – Paragraphs 3-7 and 10.3

### **Consultation Questions:**

- (1) Do you support ASX's proposed changes to the ASX DMG membership arrangements? If not, why not?
- (2) Do you think a minimum membership of five (5) institutions is appropriate?



## Default Management Hedging

DMG Members indicated through fire drills conducted in 2015 and 2016 that:

1. ASX should not need to consult the DMG before seeking to substantially hedge the defaulting Participant's portfolio using exchange traded futures; and
2. DMG Members would ordinarily expect to be consulted by ASX before OTC swaps are executed to further hedge the portfolio.

Accordingly, ASX proposes to amend the OTC Rules to make it clear that if an OTC Participant defaults ASX has the right to commence executing hedges using ASX 24 exchange traded derivatives without first seeking or obtaining the advice of the DMG. ASX will not execute hedges in the OTC derivatives market without first obtaining the advice of the DMG unless ASX reasonably determines it is necessary to manage its risk or otherwise meet its continuing regulatory obligations.

These amendments will enable ASX to take steps immediately to reduce its exposure to a defaulting OTC Participant, without needing to wait until the DMG is convened (see OTC Rules Sch 3 (DMP) para 2).

## Regular DMG Meetings

ASX proposes to amend the OTC Handbook to enable:

- a DMG Deputy to attend 'regular' DMG Meetings together with a DMG Member. This amendment will assist all DMG attendees to keep up to date with developments in the ASX default management framework (see OTC Handbook Sch 3 (DMP) paras 10.2 and 10.8).
- ASX to call 'regular' DMG meetings with one week's notice (rather than two weeks) (see OTC Handbook Sch 3 (DMP) para 9.1).

## Default Management Auctions (DM Auctions)

ASX proposes to update the OTC Handbook and form of specific terms for DM Auctions to:

- enable an OTC-only Participant to share information about the futures contracts comprised in a DM Auction portfolio with its Futures clearer for the purpose of obtaining the agreement of the Futures clearer to clear Futures Contracts which the OTC-only Participant may acquire in the DM Auction. This amendment is required so that OTC-only Participants can confirm their Futures clearer's willingness to accept cross-margined futures so that they can bid on DM Auction portfolios that contain cross-margined futures; and
- align the format and terms of the specific terms for DM Auctions with the version adopted in the 2016 fire drill with which OTC Participants are familiar (see OTC Handbook Sch 4 (DM Auction Procedures) para 4.2 and Annex).

### **Key Operating Rules:**

OTC Rules Schedule 3 (Default Management Process)

OTC Handbook Schedule 3 (Default Management Group Procedures), Schedule 4 (Default Management Auction Process) and Annex (Form of Specific Terms for DM Auctions)

### **Consultation Questions:**

- (1) Do you support ASX's proposed changes to the default management framework? If not, why not?



## Miscellaneous changes

ASX also proposes to update Schedule 1 (Relationship with Futures Rules) of the OTC Rules to reflect changes to the Futures Rules made as a result of ASX's Reducing Red Tape initiative (June 2015) and Recovery Rule amendments (October 2015) (OTC Rules, Schedule 1).

## Next Steps

ASX seeks OTC Participants' views on the draft amendments to the OTC Rules and Handbook. Submissions should be made by Friday 10 March 2017.

ASX welcomes the opportunity to discuss the draft amendments with interested parties (refer to the contact details on page 2).

ASX will continue to review the efficacy of the Default Management Process through fire drills, OTC Participant feedback and, where relevant, recommendations of industry committees and global regulatory developments.

## Appendix A: Proposed changes to ASX Default Management Group (DMG) membership arrangements

	Proposed change	Reason
1	Subject to the minimum membership requirement (refer 2 below), OTC Participants which are invited by ASX to participate in the DMG will <b>not</b> have an obligation to participate.	<p>This will enable OTC Participants to better manage their commitments to assist with default management processes at multiple CCPs.</p> <p>ASX will continue its practice of inviting all OTC Participants to participate in each 12 month term of the DMG. This maximises the opportunity for participation by all institutions that wish to participate.</p>
2	If fewer than five (5) OTC Participants accept ASX's invitation to participate in the DMG for a given term, ASX may nominate non-accepting OTC Participants to ensure a minimum membership of five institutions.	A minimum membership of five institutions is required to ensure the DMG has adequate capacity to execute hedge transactions in accordance with the DMG's Dealing Code of Conduct (i.e. two hedge execution teams, each comprising two DMG Members, with a fifth member available to step in if one of the other four DMG Members represents the defaulting OTC Participant).
3	ASX will use reasonable endeavours to nominate a non-accepting OTC Participant pursuant to the minimum membership requirement (refer 2 above), for no more than two (2) consecutive DMG terms.	ASX will seek to spread the burden of DMG participation evenly among those OTC Participants who would prefer not to participate in the DMG.
4	<p>If more than ten (10) OTC Participants accept ASX's invitation to participate in the DMG for a given term, ASX will select ten of the accepting institutions to participate in the DMG for the term, giving priority to:</p> <ul style="list-style-type: none"> <li>• first, institutions which have open contracts in the relevant OTC Transaction Type at the time of selection; and</li> <li>• secondly, any institution which accepted ASX's invitation, but was not selected, to participate in the immediately preceding DMG term.</li> </ul>	<p>This 'future-proofs' the modified DMG arrangements for an increase in membership of ASX's OTC derivative clearing service.</p> <p>No change to the maximum number of DMG participating institutions (10) is proposed at this time.</p>
5	ASX may invite an OTC Participant which is not a DMG participating institution, to attend a DMG meeting.	It may be advantageous to the DMG for an OTC Participant which is not a DMG participating institution, to attend a DMG meeting, e.g. to offer a 'second opinion' or act as a 'sounding board' to DMG Members.