



Central Counterparty Recovery

Response to Consultation Feedback on Exposure Draft Operating Rules to implement loss allocation and replenishment tools for clearing participant default and non-default loss

BNE	BPO	BTT	CAG	CCP	CFF	CHR	CLR	CNN	CPN	CPV	CSV	CTD	CUE	CUL	CUP	CUV	CUX	CVC	CVE	CVR	CXY	CYA	CYC	CYB	CYL	CYD	CYF	CYH	CYY	CZD	CZL	CZM	DDR	DOT	DEG	DGH	DGI	DGO	DGR	DGX	DIG	DIN	DIS	DJS	DJW	DLC	DLS	DMA	DMG	DML	DMP	DMX	DMY	DNA	DON	DOW	DRA	DRG	DRK	DRM	DRX	DSB	DSN	DTE	DTM	DUE	DUE	DUE
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CONTENTS

Response to Consultation Feedback	3
Revised Operating Rules	4
Next steps	4
SCHEDULE 1 - Questions/Comments and ASX Response on Exposure Draft Operating Rules for Recovery	5

Response to Consultation Feedback

On 21 April 2015, ASX released a [Consultation Paper on Central Counterparty Recovery](#) seeking comment on the proposed amendments to the Operating Rules of the ASX Group central counterparties, ASX Clear and ASX Clear (Futures) to implement new loss allocation and replenishment tools for clearing participant default and non-default loss as required by domestic and international regulatory standards.

ASX received 2 formal submissions from Clearing Participants. ASX has published the non-confidential submission at http://www.asx.com.au/documents/public-consultations/JPM_Letter_to_ASX_Recovery_Rules.PDF. ASX also held a number of bilateral meetings with interested Clearing Participants. A high level summary of unattributed feedback and ASX's responses is set out in Schedule 1.

ASX does not propose to make material changes to the Exposure Draft Operating Rules. ASX has made a number of minor amendments to the Operating Rules to address feedback from Clearing Participants and regulators and other matters identified by the ASX CCPs during the consultation period including to:

- clarify how the Default Period is extended where there are multiple defaults (refer to Recovery Rule 2.7)
- clarify the circumstances in which Recovery Assessments must be called to ensure that final default losses are allocated to Recovery Assessments before Payment Reduction (refer to Recovery Rule 3.2)
- clarify the conditions to Complete Termination relating to the inability to make non-haircuttable payments from Default Resources to refer to "net" payments and to exclude payments in respect of Initial Margin (which are not payable from Default Resources) (refer to Recovery Rule 3.5)
- refine the resignation process to clarify when the conditions to resignation must be satisfied and to remove the ability of the ASX CCPs to refuse to accept a notice of resignation if those conditions are satisfied (refer to Recovery Rule 4.3)
- clarify the application of the \$75m first allocation of Investment Losses to ASX CCP capital for related Investment Losses (refer to Recovery Rule 6.2)
- provide for annual review of the \$75m threshold for Investment Loss allocation and consultation with the Risk Consultative Committees on any change to the threshold (refer to Recovery Rule 6.2)
exclude investment losses resulting from the fraud of, or material non-compliance with the investment policy by, the ASX CCPs from Investment Losses that may be allocated to participants (refer to Recovery Rule 6.2)
- clarify the timing and mechanism for payment of the final cumulative adjustment to Payment Reductions (refer to Recovery Rule, Schedule 2, Rule 8)
- clarify the basis on which Clearing Participants will be able to determine the allocation of contracts to be partially terminated amongst their accounts (refer to Recovery Rules, Schedule 3, Rule 1(b)(ii))
- clarify the replenishment obligations in respect of OTC Commitments and Futures Commitments in ASX Clear (Futures) (refer to Recovery Rules, Schedule 5, Rules 4 and 5)
- clarify how the existing default waterfall and provisions relating to Commitments and Contributions will apply after replenishment of the Default Fund (refer to Recovery Rules, Schedule 5, Rule 8)
- provide for enhanced notification and consultation in relation to various aspects of the Recovery Rules.

ASX thanks all those who shared their views and expertise during the consultation period.

ASX recognises that industry thinking and regulatory requirements are continuing to evolve in relation to recovery and resolution. ASX will continue its active engagement with regulators, Clearing Participants and industry and will keep its Recovery Rules under review to address any material developments. ASX will also continue to develop additional disclosure to assist Clearing Participants and their clients in understanding the potential implications of the Recovery Rules.

Revised Operating Rules

The revised Operating Rules, incorporating the changes made by ASX in response to consultation feedback, are available as follows:

- ASX Recovery Rulebook – the Recovery Rulebook will operate as a stand-alone rulebook which will apply to both ASX CCPs - http://www.asx.com.au/documents/public-consultations/ASX_Recovery_Rulebook_Clean.pdf
- ASX Recovery Handbook - the Recovery Handbook contains the procedures applicable to the Recovery Rulebook and will apply to both ASX CCPs – http://www.asx.com.au/documents/public-consultations/ASX_Recovery_Handbook_Clean.pdf
- consequential and related amendment to the ASX Clear Operating Rules- http://www.asx.com.au/documents/public-consultations/ASX_Clear_Rules_Markup_against_current_version.pdf
- consequential and related amendments to the ASX Clear (Futures) Operating Rules - http://www.asx.com.au/documents/public-consultations/ASX_Clear_Futures_Rules_Markup_against_current_version.pdf

A mark-up of the amendments to the proposed Operating Rules from those contained in the April Consultation Paper are available at <http://www.asx.com.au/services/clearing/ccp-recovery-and-resolution.htm>

Next steps

ASX will formally lodge the amended Operating Rules for ASX Clear and ASX Clear (Futures) with ASIC for regulatory clearance. Subject to regulatory clearance, the amended rules and procedures for the ASX CCPs are expected to take effect in Q4 2015. ASX will publish a market notice to confirm the effective date closer to the time.

SCHEDULE 1 - Questions/Comments and ASX Response on Exposure Draft Operating Rules for Recovery

Comment	ASX response
Recovery Assessments	
Can ASX provide an estimate of the participant's current cap on assessments for ASX Clear?	<p>ASX has amended the terminology in the ASX Recovery Rulebook to refer to the ASX Clear Maximum Assessment (refer to Recovery Rules, Schedule 1, Rule 3(a)).</p> <p>ASX Clear will provide participants with their ASX Clear Maximum Assessment on a quarterly basis in accordance with the Recovery Handbook. ASX Clear will issue to Clearing Participants the first formal notification of their ASX Clear Maximum Assessment within 14 days of implementation of the operating rules with respect to the then current quarter.</p> <p>In the interim, ASX will provide an estimate to participants on request.</p>
What steps does ASX have in place to monitor participant ability to pay assessments? Can ASX consider doing more to increase the requirements on CP's to have financial resources /access to funding to meet EAs?	<p>ASX has an existing credit review process for clearing participants. ASX is considering enhancing its liquidity management requirements for participants. This may include the introduction of participant liquidity stress testing under a range of stress scenarios one of which could be a CCP recovery scenario in which assessment payments are required.</p>
Payment Reduction	
Is ASX required to call assessments before implementing Payment Reduction?	<p>ASX may be required to implement Payment Reduction before it has called and received Recovery Assessments (for example, if there is an immediate need for liquidity before Recovery Assessments can be called and received). However, ASX has amended the rules to make it clear that the ASX CCPs must call Recovery Assessments if required to ensure that final losses are allocated to Recovery Assessments before they are allocated to Payment Reductions (refer to Recovery Rule 3.2).</p> <p>The rules have also been amended to give the ASX CCP the discretion to repay amounts reduced by Payment Reduction at any time from available Default Resources (including Recovery Assessments subsequently received) if it considers appropriate (refer to Recovery Rule 5.3).</p>
CCP should be required to notify of proposed Payment Reductions.	<p>ASX has revised the rules to make it clear that the ASX CCP will use its best endeavours to provide notice of any anticipated Payment Reduction (refer to Recovery Rules, Schedule 2, Rule 5). The Payment Reduction on any day may need to be adjusted to reflect any additional shortfall on that day (for example, as a result of a failure by a participant to pay expected amounts due on that day). The ASX CCP will notify each participant of any such adjustment to Payment Reductions on any day.</p>

Comment	ASX response
Use of Payment Reduction should be limited in time and not be allowed to drag on. The current period is too uncertain.	ASX recognises the participant desire for certainty in relation to the implementation of the recovery tools. However, ASX considers that implementation of a time limit may undermine the effectiveness of the recovery process and may lead to the premature implementation of others tools including complete termination. ASX has included a mandatory “checkpoint” for review, in conjunction with the Risk Consultative Committee, of continuing use of Payment Reduction (refer to Recovery Rule 7.2).
Partial termination	
Can this be implemented while losses are still within waterfall? Should only be used where auction unsuccessful.	An ASX CCP may be required to implement partial termination while losses are within the waterfall and prior to the completion of the default management process in respect of any default including where necessary to close out illiquid positions that cannot be closed out through other means. ASX can only partially terminate in these circumstances if it is able to pay the Termination Value in respect of those contracts from available default resources.
Partial termination should be limited to a specified % of market before it can be used.	ASX considers that implementation of a limit may undermine the effectiveness of the recovery process and may lead to the premature implementation of others tools including complete termination.
Partial termination is still a loss allocation mechanism because termination price is different to replacement cost. The ASX CCP should compensate the participant for the replacement cost.	The cost for participants to replace terminated positions is not known ex ante by the ASX CCP and is not controllable by the ASX CCP. For this reason, ASX does not consider it appropriate to provide compensation based on replacement cost. The Recovery Rule provisions in relation to pricing on termination are intended to provide “fair value” on partial termination, while recognising that one of the reasons for using partial termination may be the non-existence of a market in the relevant position which may affect determination of termination prices for the relevant positions as well as the ability of the participant to replace those positions.
Complete termination	
What happens if the CCP defaults/becomes insolvent? Will close out netting provisions still apply?	The close out netting provisions in each of the ASX Clear and ASX Clear (Futures) operating rules (Rules 15.11.1 and 76.1), which apply upon the occurrence of certain insolvency and payment default events applicable to the relevant ASX CCP, will continue to apply in accordance with their terms (refer to Recovery Rule 8.2). These operating rules must be read in the context of the proposed FMI resolution regime of the Australian Government.

Replenishment	
What rules apply to contributions after replenishment eg can participant still resign and withdraw commitment?	The rules have been amended to make it clearer that the existing operating rules in relation to Contributions/Commitments (for example, quarterly recalculations and repayment of contributions upon resignation) will continue to apply subject to the specific changes set out in the Recovery Rulebook and the Recovery Handbook (refer to Recovery Rulebook, Schedule 5, Rule 8).
Is it appropriate to have a cap on size of the replenished default fund when we don't know what event might cause default and therefore what the new fund size may need to be?	<p>In developing the replenishment proposal, ASX has attempted to balance a number of requirements including returning to cover 2 in a timely manner, providing participants with a cap on their initial replenishment obligations, managing the liquidity impact of initial replenishment and facilitating rescaling of the default fund over time. ASX considers the proposed arrangements to cap initial replenishment obligations provide an appropriate balance of the various requirements. The ASX CCPs retain the ability to rescale the default fund over time to meet regulatory requirements.</p> <p>As noted in the April Consultation, ASX has agreed to consult further in FY16 on potential changes to the replenishment arrangements to facilitate a more rapid return to mutualised default cover as contemplated by international guidance. ASX will consider the cap on initial replenishment and subsequent rescaling as part of that consultation process.</p>
Will contributions in ASX CLF still be split between Futures and OTC?	The contributions in ASX Clear (Futures) will still continue to be split between Futures and OTC participants. ASX has amended the rules to clarify how the replenishment obligations will apply to Futures and OTC participants in ASX Clear (Futures) (refer to Recovery Rules, Schedule 5, Rule 4(b)(ii)).
Will ASX pay interest/accommodation fees on contributions to ASX Clear?	ASX Clear (Futures) currently pays interest and accommodation fees on participant contributions to the default fund. ASX has amended the rules to enable ASX Clear to pay interest and accommodation fees if participants are required to make contributions to the ASX Clear default fund (refer to Rule 8.1.7). The amount of any interest and accommodation fees would be determined at the time.
ASX should consider rescaling on a monthly basis post replenishment.	<p>In developing the replenishment proposal, ASX has attempted to balance a number of requirements including replenishing in a timely manner, providing participants with a cap on their initial replenishment obligations, managing the liquidity impact of initial replenishment and subsequent rescaling and consistency with the current quarterly recalculation regime. ASX considers the proposed arrangements provide an appropriate balance of the various requirements.</p> <p>As noted in the April Consultation, ASX has agreed to consult further in FY16 on potential changes to the replenishment arrangements to facilitate a more rapid return to mutualised default cover as contemplated by international guidance. ASX will consider the frequency of rescaling as part of that consultation process.</p>

Investment loss allocation	
<p>What is ASX's investment policy and is it publicly available? What rights will participants have in determining the investment policy?</p>	<p>A summary of the ASX investment policy is available on the ASX website at http://www.asx.com.au/documents/clearing/asxcc-investment-policy.pdf.</p> <p>Additional disclosure in relation to the investment portfolio has been provided on a confidential basis to participant representatives on the ASX Clear and ASX Clear (Futures) Risk Consultative Committees. ASX continues to work with RBA in relation to additional disclosure for participants in relation to the ASX CCPs investment risk profile.</p> <p>The ASX CCPs will consult with the Risk Consultative Committees in relation to the investment policy.</p>
<p>How does investment loss allocation apply to multiple losses within a period?</p>	<p>ASX has amended the rules to enable a series of related Investment Losses (as determined by the ASX Clearing Corporation) to be treated as a single Investment Loss (refer Recovery Rule 6.2).</p>
<p>How is \$75m calculated? Should it be a percentage of portfolio size? Will it be reviewed over time? The amount should be subject to a minimum and ring-fenced. ASX should consult with industry on the setting of the \$75m and regularly review this number.</p>	<p>The \$75m first allocation of Investment Losses to CCP capital (Investment Loss Threshold) is equal to the amount currently held by ASX on behalf of the ASX CCPs to cover non-default losses as required by regulatory standards. This capital is held on behalf of the ASX CCPs at the ASX Group level to ensure that it cannot be applied to meet losses caused by participant default.</p> <p>ASX considers it appropriate to set the Investment Loss Threshold by reference to the risk of Investment Loss rather than by reference to the size of the investment portfolio which is not a direct proxy for the risk of the portfolio.</p> <p>Any change in the \$75 million would require an amendment to the rules and compliance with ASX's usual regulatory clearance processes.</p> <p>ASX has also amended the rules to provide that it will review the amount of the Investment Loss Threshold at least on an annual basis. ASX will consult with the Risk Consultative Committees in relation to any proposed changes in this number (refer to Recovery Rule 6.2 and 7.1(h))</p>
<p>Could participants have an option to opt in to certain types of investments and thereby be liable for loss of those investments?</p>	<p>Cash collateral provided to the ASX CCPs is currently invested on a pooled basis. For this reason, ASX considers participant driven investment selection would be administratively unmanageable and costly.</p>
<p>What investment losses are included for investment loss allocation? Is fraud covered? Are losses from non-compliance with the investment policy covered?</p>	<p>The rules have been amended to clarify that Investment Losses caused by fraud of the ASX CCP or material non-compliance with the investment policy will not be allocated to participants (refer to Recovery Rule 6.2).</p>

<p>What happens with losses in value of non-cash collateral?</p>	<p>Participants may post non-cash collateral to the ASX CCPs (for example, shares in ASX Clear, government bonds in ASX Clear (Futures)). However, non-cash collateral is not invested by the ASX CCPs. Non-cash collateral is limited to collateral that can be liquidated in a timely fashion. Non-cash collateral is subject to material valuation haircuts and is marked to market each day.</p> <p>Unlike Investment Losses which are incurred by the CCP, if there is a reduction in value of non-cash collateral, the participant would be required to provide further collateral. If the participant has defaulted and non-cash collateral is insufficient to cover losses on their portfolio, the difference would be treated as part of the default loss and funded using the CCP's default resources.</p>
<p>Participants should not bear losses resulting from restructuring or similar event. Such a loss may arise from ASX CC's investment decision.</p>	<p>ASX does not control restructuring events implemented by investment counterparties so does not consider that these losses should be treated differently to other Investment Losses in the loss allocation process.</p>
<p>Will participants share in any gains from investment returns if they are to bear risk?</p>	<p>ASX does not intend to increase the current investment returns to participants on cash collateral and contributions to the default fund.</p>
<p>Is participant exposure limited to collateral with CCP?</p>	<p>A participant's exposure for Investment Loss is limited to the amount of cash collateral (including initial margin, additional initial margin and excess cash) provided to the CCP and invested by the CCP at the time of declaration of the Investment Loss (refer to Recovery Rule 6.4).</p>
<p>Does the reduction in collateral for an investment loss hit the client account?</p>	<p>Reductions in collateral as a result of Investment Loss allocation will be applied on a pro-rata basis across all accounts, including client accounts (refer to Recovery Rule 6.4).</p>
<p>ASX should provide sufficient information to a participant about how the investment loss is split between the client and house accounts.</p>	<p>ASX will provide participants with notice of the size of the Investment Loss and the allocation of Investment Loss to the Accounts of the Participant (refer to Recovery Rule 6.4).</p>
<p>Clarify that participants repaid from recoveries before ASX.</p>	<p>ASX has revised the rules to make it clear that that ASX won't receive any recoveries (other than costs and expenses) from an investment counterparty until participants have been repaid (refer to Recovery Rule 6.5).</p>
<p>General comments on rules</p>	
<p>International CCPs have sequential use of tools. Agree with tools but want certainty of order. Discretion around use of tools should be qualified by reasonableness and by reference to the ASX CCPs licence obligations.</p>	<p>While ASX recognises the desire for participant certainty, ASX considers that flexibility in the sequencing of the tools is required to ensure the recovery tools are most effective.</p> <p>The Recovery Rules require the ASX CCP to exercise their discretion in good faith and having regard to their licence obligations (refer to Recovery Rule 12.4).</p>

<p>Clarify that recovery tools will only be used after defaulting CPs contribution to default fund is used.</p>	<p>As set out in rule 8.3.1(c) of ASX Clear operating rules and 7.1(b) of the ASX Clear (Futures) operating rules, the Default Waterfalls of the ASX CCPs provide that the defaulting CP's contribution will be applied to default losses before any subsequent amounts are applied to default losses. In some circumstances, the ASX CCPs may utilise recovery tools before the defaulting CP's assets and contribution to the default fund have been used but any final allocation of losses must first be applied against those assets.</p>
<p>Key time frames eg resignation period should be in rules not handbook. Should any amendments require participant approval?</p>	<p>ASX has revised the rules to ensure that the minimum notice period for resignation is included in the rules rather than the procedures (refer to Recovery Rule 4.2). ASX has also amended the rules to clarify that all conditions to resignation, including the giving of notice, must be satisfied 5 business days before the end of the Default Period</p> <p>ASX considers that other material matters have been appropriately addressed through the rules and that ASX should retain the flexibility to amend those matters set out in the Recovery Handbook.</p>
<p>When could ASX reasonably refuse to accept resignation (ASX CLF)?</p>	<p>ASX has amended the rules to provide that the ASX CCP will accept a notice of resignation if the conditions to resignation have been satisfied (refer to Recovery Rule 4.3).</p>
<p>If a participant has resigned and satisfied conditions for resignation, before a default occurs, should they be liable for assessments?</p>	<p>Participants' contributions to the default funds and assessment caps are calculated on a quarterly basis. While ASX recognises the participant desire for certainty of exposure if it has satisfied the conditions for resignation, ASX considers that on balance participants should remain liable for assessments until their resignation has become effective otherwise the ASX CCP would not receive the full amount of assessments if there was a default.</p>
<p>Should set off provisions be mutual? Do set-off provisions affect the close out netting rules?</p>	<p>To maximise the effectiveness of the default management process and recovery tools, ASX considers that it is not appropriate to allow set-off by participants against amounts owing to the CCP except as expressly provided in the rules. The set-off provisions do not affect the ability of participants to effect close-out netting in accordance with the operating rules of the ASX CCPs.</p>
<p>Can ASX formalise its intention to use liquidity facilities before it uses offsetting transaction arrangements (OTAs)?</p>	<p>ASX Clear may determine to inject sufficient liquidity, from the existing \$400million of available liquidity resources, before it implements offsetting transaction arrangements. It is expected that available financial resources would first be injected. However if it is not possible or prudent to rely solely on prefunded liquidity, which may be the case in stressed market circumstances which are likely to accompany a recovery situation. ASX Clear may enter into offsetting transaction arrangements. ASX considers it important to retain this discretion.</p>

<p>Can the time over which OTAs may be utilised be limited?</p>	<p>If a participant defaults on its payment obligations, there is a mismatch between the timing of the payment obligations assumed by the CCP to purchase securities to be delivered to the defaulting participant and the subsequent sale of those securities to close out the CCP's exposures. The offsetting transaction arrangements were put in place to address this mismatch. In normal market circumstances, ASX would expect the settlement of close out trades to occur within 3 business days. In stressed market conditions or where the market is frozen generally or in respect of particular stocks, the close out process may take longer than 3 business days. The length of the close out process may also be affected by subsequent defaults. ASX considers that a time limit may be arbitrary and undermine the effectiveness of the OTAs in recovery situations.</p>
<p>Should the indemnity in rule 12.9 only apply to defaulting participants?</p>	<p>ASX has amended the indemnity in clause 12.9 so it only applies to defaulting participants.</p>
<p>Other comments</p>	
<p>Would like worked examples</p>	<p>ASX will make further worked examples in relation to recovery tools available on its website. ASX will continue to work with RBA, ASIC and participants on additional disclosures that will assist participants in assessing the potential impact of the Recovery Rules.</p>
<p>Will fire-drills be run?</p>	<p>ASX intends to run annual fire drills of the recovery tools in accordance with regulatory requirements.</p>
<p>When will the opinions in relation to partial termination be available?</p>	<p>ASX intends to commission opinions legal and accounting opinions to confirm that that partial termination powers do not undermine netting for accounting and regulatory capital purposes once the rules have been finalised and implemented. Copies of the opinions will be made available to participants once they have been obtained.</p>