

Ms. Janine Ryan  
Office of General Counsel  
ASX Limited  
20 Bridge Street  
Sydney NSW 2000

By Email: [janine.ryan@asx.com.au](mailto:janine.ryan@asx.com.au)

**4 February 2016**

Dear Sir/ Madam,

**Re: Consultation on Exposure Draft Rules for Interim Replenishment of Default Funds**

**Introduction**

The International Swaps and Derivatives Association, Inc. (“**ISDA**<sup>1</sup>”) appreciates this opportunity to respond to the above referenced Consultation on Exposure Draft Rules for Interim Replenishment of Default Funds (“**Consultation**”) published by the ASX Group central counterparties, ASX Clear and ASX Clear (Futures) (“**ASX CCPs**”) on 4 December 2015.

We are in constant dialogue with our members, including global, regional and national financial institutions, end-users and many other financial market participants. Our comments are derived from this experience and our active involvement across the globe with regulators in various jurisdictions such as the United States, the European Union and Asian jurisdictions such as Japan, Hong Kong and Singapore. We note that our members may choose to make their own individual submissions to the ASX CCPs on this Consultation.

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<sup>1</sup> Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 67 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on ISDA's web site: [www.isda.org](http://www.isda.org).

## Comments on the Consultation

- 0. Overview:** We commend the ASX CCPs' efforts to revise their Recovery Rules in compliance with the applicable regulatory standards, including the *Financial Stability Standards* determined by the Reserve Bank of Australia ("RBA"), *Recovery of Financial Market Infrastructures* published by Committee on Payments and Market Infrastructures ("CPMI") and the International Organisation of Securities Commissions ("IOSCO") ("CPMI-IOSCO") and the findings of the 2014/2015 assessment of the ASX CCPs' compliance with the regulatory standards conducted by the RBA ("RBA Assessment").

Our members were generally supportive of the Consultation, and agreed that this amendment to the Recovery Rules would better ensure timely financial cover of the default funds as necessitated by the relevant regulatory standards. Our members generally believe that the obligations of the participants are fair, and strongly support capping the obligations of participants.

- 1. Sizing of the Minimum Fund Size:** However, to answer if the Minimum Fund Size is adequate, we request further details on the testing of its size. The Consultation provided a broad explanation that the Minimum Fund size would reduce the average value and amount of Additional Initial Margin called. We would appreciate further details and specifics used in the calibration of the testing, any assumptions used in the testing (regarding, *e.g.*, market conditions at the time of stress), as well as the specific results of the testing. This would better furnish our members with the basis to determine the adequacy and sufficiency of the Minimum Fund Size.

In this regard, we also enquire if the ASX CCPs would re-assess the sizing of the Minimum Fund Size and if so, what the methodology and timing of the re-assessment would be. As with regular stress testing, we strongly believe regular testing and re-sizing of the Minimum Fund Size should be provided *ex ante* by the rules to ensure transparency and to reinforce the adequacy of the Minimum Fund Size.

- 2. Treatment of Initial Margin:** Our members also request clarifications on ASX CCPs' indication that "if interim contributions were fully depleted by further defaults during the default period, the ASX CCPs would rely on initial margin and additional margin calls to meet the minimum level of cover for the remainder of the default period" (p.10 of the Consultation). Our members raise concerns that this statement could *prima facie* be interpreted as non-defaulting participants' initial margin being applied to cover default losses, which is not consistent with the generally accepted standards on loss allocation at CCPs and the treatment of initial margin.

ISDA does not support such initial margin haircutting and strongly believes that it undermines the objective of CCP recovery and continuity as it creates incentives for clearing participants to close all open positions (as a means to protect their margin) and

thus may further destabilize the CCP while it is in the process of re-establishing a matched book. Because IM haircutting incentivizes a clearing participant to flatten its positions (to reduce IM), clearing participants would end up competing with the CCP for the hedges it requires to auction and/or liquidate a defaulting clearing participant's portfolio. In fact, the possibility of IM haircutting undermines the whole recovery process as it is likely to dis-incentivize clearing participants' participation in the auction process. In addition, IM haircutting is not a comprehensive recovery tool (i.e. it may not be sufficiently large to cover losses), and is highly pro-cyclical, as it will immediately trigger additional margin to be posted at what is likely to be a stressful time for the market.

Therefore, we urge the ASX CCPs to clarify that if a participant's initial margin and additional margin is called when the interim contribution is depleted, it will only be used for that participant's own default and not to cover the default of another participant.

- 3. Recovery Assessments:** We note that some of our members were opposed to the Consultation proposals. Our members viewed the Consultation as imposing unnecessary burden on the participants by requiring interim contributions to the Minimum Fund Size while the current Recovery Rules were recently introduced to ensure that there is enough financial cover for a participant default. With the Recovery Assessment powers of the ASX CCPs, we question if the concerns raised in the RBA Assessment wouldn't be sufficiently addressed if the Recovery Assessment powers of the ASX CCPs were exercised as soon as practicable. In this regard, we ask the ASX CCPs to clarify why the Consultation's introduction of the Minimum Fund Size is needed, especially in relation to the Recovery Assessment powers of the ASX CCPs.

### Additional Comments

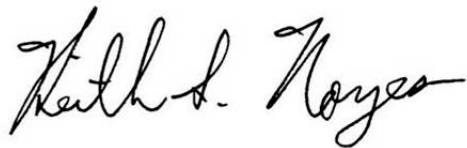
We also request the ASX CCPs to illustrate how full financial cover is provided during the default management process to facilitate continued functioning. As you may be aware, this is required by *Recovery of Financial Market Infrastructures* mentioned above as well as the *Principles for Financial Market Infrastructures* released by the CPMI-IOSCO in April 2012. CCPs are required to maintain a continued provision of their critical service when its viability as a going concern is threatened. Our members would like the ASX CCPs to further clarify if and how they have addressed this requirement.

### Conclusion

We thank you for the opportunity to respond to the Consultation. We would be very happy to discuss this matter further at your convenience. Please do not hesitate to contact Keith Noyes, Regional Director, Asia Pacific ([knoyes@isda.org](mailto:knoyes@isda.org)) or Hyelin Han, Assistant Director, Policy ([hhan@isda.org](mailto:hhan@isda.org), +852 2200 5900) if we may be of further assistance.

Yours sincerely,

**For the International Swaps and Derivatives Association, Inc.**



Keith Noyes

Regional Director, Asia-Pacific



Hyelin Han

Assistant Director, Policy