



ASX Clear: Removal of Registered Holder Collateral Cover Authorisation Form

**Consultation on amendments to the ASX
Settlement Operating Rules and ASX Clear
Operating Rules and Procedures**

3 April 2018

Invitation to comment

ASX is seeking submissions on the proposed rule and procedure amendments canvassed in this paper by 15 May 2018. Submissions should be sent to:

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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 this consultation.

Contacts

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Introduction

In response to market feedback, ASX proposes to remove the Registered Holder Collateral Cover Authorisation form for client accounts (**RHCCA form**) from the ASX Clear Operating Rules Procedures. ASX intends to replace the RHCCA form with a rules framework that preserves ASX Clear's interest in, and rights to use and dispose of, CHESSE securities lodged as collateral for clients trading options market contracts. The removal of the RHCCA form will improve the operational efficiency of the collateral lodgement process.

ASX also proposes minor amendments to the ASX Clear Operating Rules to enable a third party to take a security interest over collateral and excess cash where the parties to the security interest agree between themselves in writing that ASX Clear's security interest has priority.

The proposed amendments to the ASX Settlement Operating Rules and ASX Clear Operating Rules and Procedures to support the removal of the RHCCA form and maintain the priority of ASX Clear's rights to collateral and excess cash are outlined in this Consultation Paper and available [here](#).

Subject to consultation feedback and regulatory clearance, ASX expects to implement the amendments in Q3 2018.

Responses to this Consultation Paper should be submitted to ASX by 15 May 2018.

Amendments to the ASX Settlement Operating Rules and ASX Clear Operating Rules and Procedures

Background on RHCCA form

Where a client of a Clearing Participant holds positions in options market contracts, the Clearing Participant may be required to provide collateral to ASX Clear as security for the obligations of the Clearing Participant to ASX Clear in respect of those options market contracts. The Clearing Participant will ordinarily require the client to provide the collateral in respect of the liabilities arising from the client's option market contracts. Collateral may take the form of securities in CHESSE belonging to the client or a third party or cash.

Under the existing rules framework, when a registered holder of securities in CHESSE agrees to their securities being given as collateral to secure the obligations of a Clearing Participant:

- the registered holder signs an RHCCA form which authorises their Controlling Participant to reserve the securities in a subposition in CHESSE in favour of ASX Clear to secure obligations of a named Clearing Participant in respect of particular client account number(s) listed in the form;
- the Clearing Participant retains the original of the form and sends a scanned copy to ASX Clear;
- the securities are reserved in the subposition, meaning those securities remain in the name of the registered holder but they are controlled by ASX Clear and cannot be dealt with by the registered holder or their Controlling Participant. Only ASX Clear can authorise the release of those securities from the subposition; and
- ASX Settlement notifies the registered holder of the collateral lodgement.

The benefits of removing the RHCCA form

Market feedback indicates that the RHCCA form is not efficient.

Under the existing ASX Clear Operating Rules and Procedures, a Clearing Participant must arrange execution of the RHCCA form by a registered holder and then send a copy of that form to ASX Clear:

- before the registered holder first provides collateral for a client account;
- if the client's Clearing Participant changes; or
- if the client accounts the RHCCA form covers change.

Examples where the execution of the RHCCA form can become more burdensome include circumstances where there is:

- a mass transfer of clients of a Clearing Participant, for example in the context of a sale of business. In that case, the new Clearing Participant must have each client that wishes to lodge securities as collateral sign a new RHCCA form ahead of the business transfer or otherwise require the client to lodge cash collateral; and
- a Clearing Participant default and ASX has determined that it can support a porting window. In that case, the receiving Clearing Participant needs to have new RHCCA forms signed and lodged with ASX Clear within the porting window (for example 24 hours) for any client relying on non-cash collateral. This administrative requirement has the potential to be a hindrance and could affect the chance of a client being able to port their positions to another Clearing Participant.

Proposed amendments to remove the RHCCA form

Overview of proposal

ASX proposes to replace the RHCCA form with amendments to the ASX Settlement Operating Rules and ASX Clear Operating Rules and Procedures that have the effect that:

- ASX may always assume that a Controlling Participant's reservation of collateral in the subposition is authorised by the registered holder; and
- when such reservation is made, that collateral becomes subject to a security interest in favour of ASX Clear granted under the ASX Clear Operating Rules.

The proposed rules framework will preserve ASX Clear's interest in, and rights to use and dispose of, CHES securities lodged as collateral for clients trading options market contracts.

Key changes proposed

A comparison of the existing and proposed operational frameworks (including key points to note) is set out in **Attachment A**.

The proposed amendments are not intended to change the settlement risks for Clearing Participants where financial products are controlled by third parties (refer to ASX Clear Operating Rules Guidance Note 11).

Enhanced communications to registered holders

With the removal of the RHCCA form, ASX expects Controlling Participants to disclose to registered holders the risks associated with providing CHES securities as collateral for client accounts (particularly in circumstances where the client account belongs to an unrelated third party).

In turn, ASX proposes to enhance the communications that it makes to registered holders that provide CHES securities as collateral. ASX intends to notify a registered holder when:

- their HIN is first linked to a client account at the instruction of a Clearing Participant or the Clearing Participant for the linked client account changes due to a transfer. This notice will explain the effect of creating this link between the Clearing Participant, HIN and client account, namely that:
 - their Controlling Participant may reserve financial products in their CHES Holding in favour of ASX Clear as security for the obligations of the Clearing Participant relating to options market contracts registered in the linked client account;
 - when financial products are reserved in favour of ASX Clear, the right of the registered holder to transfer, convert or otherwise deal with those financial products will be restricted; and
 - in the event that the Clearing Participant defaults, ASX Clear may sell (or otherwise deal with) reserved financial products to satisfy the Clearing Participant's obligations to ASX Clear in respect of the linked client account.

- financial products in their CHES Holding are reserved in favour of ASX Clear as security for the obligations owed by the Clearing Participant in respect of options market contracts registered in a linked client account.

Key Operating Rules:

ASX Clear Operating Rules, Section 2 (Definitions), Rule 14.6.7 (ASX Clear entitlement to Collateral)

ASX Clear Operating Procedures, Annexure 1 (Collateral Procedures), Annexure 2 (Clearing Forms)

ASX Settlement Operating Rules, Rule 7.2.2 (Mandatory provisions of a Sponsorship Agreement), Rule 14.7.2 (Participant as Holder of Financial Products), Rule 14.7.3 (If Participant is not Holder of Financial Products), Rule 14.6.4 (Security under the rules of the relevant Approved Clearing Facility)

Consultation Questions:

1. *Do you support the removal of the RHCCA form and the proposed rule and procedure changes outlined above? If not, why not?*
2. *If you are a Controlling Participant, will your existing processes and documentation enable you to confirm that you have been authorised by a registered holder to grant a security interest in favour of ASX Clear (regardless of the identity of the Clearing Participant)? Does removing the RHCCA form cause any process or evidentiary issues for you? If so, how do you think these could be resolved?*

Proposed amendments to facilitate third party security interest over collateral and excess cash

Under the ASX Clear Operating Rules, all collateral and excess cash must be unencumbered or free of any other security interest, except where ASX Clear has agreed in writing. In the past, ASX Clear has agreed to the creation of third party security interests (including under margin lending arrangements) only where the security provider and taker have recognised the priority of ASX Clear's security interest in writing. This helps to ensure that ASX Clear maintains the priority of its rights to collateral and excess cash in the event of a Clearing Participant default.

In the interests of operational efficiency, ASX now proposes to step out of this 'approval' process. Instead parties that wish to grant or take a security interest over collateral or excess cash must agree between themselves in writing that ASX Clear's security interest in respect of the collateral or excess cash has priority over that security interest and the parties must hold the benefit of such agreement on trust for the benefit of ASX Clear. This is a change to operational process, rather than the substantive obligation already imposed on Clearing Participants under the ASX Clear Operating Rules.

We do not see this as being a significant change because under the existing rules framework Clearing Participants are already expected to have adequate arrangements in place to confirm whether collateral and excess cash lodged to satisfy obligations of the Clearing Participant to ASX Clear in respect of options market contracts are subject to any other security interests and to ensure that if they are, either (i) agreement has been reached that ASX Clear has priority; or (ii) the collateral and excess cash are not lodged with ASX Clear.

Key Operating Rules:

ASX Clear Operating Rules, Rule 14.6.3 (Cover and Excess Cash to be unencumbered)

Consultation Questions:

1. *Do you support the proposed rule changes outlined above? If not, why not?*
2. *Do you foresee any issues arising from ASX Clear stepping out of the 'approval' process?*



Next Steps

ASX seeks participants' views on the draft amendments to the ASX Settlement Operating Rules and ASX Clear Operating Rules and Procedures. Submissions should be made by 15 May 2018.

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

Attachment A: Comparison of existing and proposed operational frameworks

| Process | Existing Framework | Proposed new framework | Key points to note about the proposal |
|---|--|--|---|
| Registered holder to sign RHCCA form | <p>A registered holder signs an RHCCA form which authorises their Controlling Participant to reserve the securities in a subposition in CHESS in favour of ASX Clear to secure obligations of a named Clearing Participant in respect of particular client account number(s) listed in the form.</p> <p>An RHCCA form is required:</p> <ul style="list-style-type: none"> before the registered holder first provides non-cash collateral for a client account; if the client's Clearing Participant changes; or if the client accounts the RHCCA form covers change. | <p>An RHCCA form is no longer required.</p> <p>Instead:</p> <ul style="list-style-type: none"> a Controlling Participant will need to rely on its processes and customer documentation to ensure that it is appropriately authorised by the registered holder to grant a security interest in favour of ASX Clear to secure the performance of obligations of the Clearing Participant, from time to time, that is responsible for the client accounts linked to the registered holder's HIN. In order to facilitate future transfers, this authorisation must be Clearing Participant agnostic; and a Controlling Participant's Sponsorship Agreements will need to contain a provision to the effect that the right of the registered holder to deal with financial products that are reserved in a subposition in accordance with the ASX Settlement Rules is restricted in accordance with the rules relating to subpositions. | <p>A Controlling Participant must ensure that on commencement of the new rules framework:</p> <ul style="list-style-type: none"> it is appropriately authorised by its registered holders to grant security to ASX Clear in relation to both new and existing reservations of non-cash collateral (refer to new ASX Settlement Rule 14.7.3) (the authorisation); the authorisation is Clearing Participant agnostic; and it has considered its current processes and customer documentation to confirm that it will be appropriately authorised. <p>Our initial assessment indicates that the Sponsorship Agreements of the vast majority of Controlling Participants already include a clause to this effect because they are modelled on the pro forma Participant Sponsorship Agreement included in Appendix 3 of the ASX Settlement Operating Rules (refer to clause 3.2.3).</p> |
| Clearing Participant obtains original RHCCA form | The Clearing Participant obtains the original RHCCA form. | No longer required. | <p>Given the proposal applies to new and existing non-cash collateral it would be prudent for a Clearing Participant to conduct its own due diligence to ensure that any Controlling Participant it is currently relying on for the lodgement of non-cash collateral is appropriately authorised by the relevant registered holders and it has a process for conducting due diligence for future lodgements.</p> <p>If the proposed changes are implemented Clearing Participants would need to retain the original RHCCA forms for collateral lodgements but only for the purpose of demonstrating historical compliance with the rules. As noted above, it is proposed that the RHCCA form will be replaced for existing lodgements by the requirement that the Controlling Participant be appropriately authorised by its registered holders to grant security to ASX Clear in relation to reservations of non-cash collateral and that such authorisation be Clearing Participant agnostic.</p> |
| Lodgement of linking request with ASX Clear | The Clearing Participant retains the original RHCCA form and sends a scanned copy to ASX Clear. | The Clearing Participant will provide ASX Clear with a ' Linking Information Request ' in a format prescribed by ASX that identifies a registered holder's HIN and the client options account numbers that are to be linked to that HIN. | |

| Process | Existing Framework | Proposed new framework | Key points to note about the proposal |
|---|---|---|--|
| ASX action to link accounts | ASX will action the Clearing Participant's request to link the HIN with the client account(s) nominated on the RHCCA form. | ASX will action the Clearing Participant's request and link the HIN with the client account(s) nominated in the "Linking Information Request". | |
| ASX issues notification of account linkage | Notification currently does not exist | ASX will issue a CHES notification ("Linking Notice") to the registered holder notifying them of: <ul style="list-style-type: none"> the client account(s) that their HIN has been linked to or removed from, including the name of the client account(s); the name of the Clearing Participant for the linked client account(s); the name of the Registered Holder's Controlling Participant; and information explaining the effect of creating or removing this link between the Clearing Participant, HIN and client account(s). | Note a Linking Notice will be issued in the following circumstances: <ul style="list-style-type: none"> Initial linking Change of Clearing Participant Removal of linking |
| Request to reserve securities in subposition | A registered holder requests its Controlling Participant to lodge collateral against nominated account(s). The Controlling Participant initiates an MT 027 message in CHES to lodge non-cash collateral including Clearing Participant details. | No change to process. | |
| Reserve securities in subposition | ASX Clear reserves the securities in the subposition meaning those securities remain in the name of the registered holder but they are controlled by ASX Clear and cannot be dealt with by the registered holder or their Controlling Participant. Only ASX Clear can authorise the release of those securities from the subposition. | No change to process. | |
| ASX issues notification of collateral lodgement | ASX Settlement notifies the registered holder of the collateral lodgement by issuing a "Lodgement Notice". | No change other than format of the notice. | |
| Request to withdraw securities in subposition | A registered holder requests its Controlling Participant to withdraw non-cash collateral from nominated account(s). The Controlling Participant initiates a MT 029 message in CHES to withdraw collateral including Clearing Participant details. | No change. | |
| Clearing participant notification and/or | If the Clearing Participant is also the Controlling Participant it will receive a notification of the withdrawal request. If the Clearing Participant is different from the Controlling | No change. | |

| Process | Existing Framework | Proposed new framework | Key points to note about the proposal |
|--|---|--|--|
| authorisation of withdrawal | Participant the Clearing Participant is required to authorise the withdrawal. | | |
| Withdraw securities in subposition | Where ASX deems it appropriate it will authorise the release of securities from the subposition. | No change. | |
| ASX issues notification of collateral withdrawal | ASX Settlement notifies the registered holder of the non-cash collateral withdrawal by issuing a “Withdrawal Notice” . | No change other than format of the notice. | |
| Options client transferring to new Clearing Participant | <p>An options client would establish an options account with the new Clearing Participant.</p> <p>A registered holder would need to complete a new RHCCA form (identifying the new Clearing Participant) and both Clearing Participants would sign a C3 Form and send it to ASX. The lodgement processes noted above would apply (where a bulk transfer is conducted a spreadsheet is also provided rather than individual C3 forms for each transfer request).</p> | <p>An options client will establish an options account with the new Clearing Participant. Both Clearing Participants continue to submit a C3 Form and provide it to ASX Clear to action. The receiving Clearing Participant will submit a “Linking Information Request” to ASX Clear.</p> <p>A registered holder will no longer need to execute an RHCCA form ahead of a transfer.</p> <p>Since the registered holder’s authorisation is Clearing Participant agnostic, when the positions in a client account are transferred from one Clearing Participant to another:</p> <ul style="list-style-type: none"> • non-cash collateral which is linked to that client account will automatically secure the obligations of the new Clearing Participant; • the transfer will not require the approval of the registered holder or Controlling Participant; and • once a Clearing Participant change is effected ASX will notify the Registered Holder by issuing a new Linking Notice. | <p>The change to the framework relies on the fact that a Controlling Participant must ensure that on commencement of the new rules framework it is appropriately authorised by its registered holders to grant security to ASX Clear in relation to reservations of non-cash collateral and such authorisation is Clearing Participant agnostic.</p> <p>For any transfer a Controlling Participant should consider their current processes and customer documentation to confirm that they will be appropriately authorised.</p> |