

EXPLANATORY STATEMENT for ASIC Class Rule Waiver [CW 17/740]

Prepared by the Australian Securities and Investments Commission

Corporations Act 2001

The Australian Securities and Investments Commission (ASIC) makes ASIC Class Rule Waiver [CW 17/740] under subrule 1.2.1(1) of the *ASIC Market Integrity Rules (ASX 24 Market) 2010* (the **ASX 24 Rules**).

Under subrule 1.2.1(1), ASIC may relieve any person or class of persons from the obligation to comply with a provision of the ASX 24 Rules.

Capitalised terms in this Explanatory Statement refer to defined terms in the ASX 24 Rules.

1. Background

Rules 7.2.2(4), 7.2.5, 7.2.6 and 7.2.8 (the **Relevant Rules**) of the ASX 24 Rules impose various obligations on Trading Participants to Call Margins from their Clients. Margin Calls can be satisfied by the Trading Participant accepting either cash or Approved Securities from their Clients. 'Approved Securities' is defined under Rule 7.1.1 of the ASX 24 Rules with a prescribed list.

The purpose of a Margin Call is to mitigate counterparty credit risk i.e. the risk that a party to a Trade in a Futures Contract will default on their obligations under that Trade. Mitigating counterparty credit risk promotes investor confidence and market orderliness.

Trading Participants that are Clearing Participants also have an obligation under the Operating Rules of ASX Clear to post Margins.

The role of ASX Clear is to mitigate counterparty credit risk, and it does this by calling Margins from Clearing Participants. ASX Clear determines what it considers to be acceptable collateral for the purposes of Clearing Participants satisfying Margin Calls. ASX Clear publishes a list of securities, collateral and other property that it will accept as Margin, which is amended by ASX Clear as required.

There are some inconsistencies between ASX Clear's current list and the definition of 'Approved Securities' in Rule 7.1.1 of the ASX 24 Rules. This causes confusion and complexity for Trading Participants that are also Clearing Participants.

For example, the list published by ASX Clear includes US Treasury Bills. The definition of 'Approved Securities' in Rule 7.1.1 of the ASX 24 Rules is based on the definition of 'Approved Securities' that existed in the Operating Rules of the Sydney Futures Exchange (SFE) prior to the transfer of market supervision to ASIC on 1 August 2010. We understand that US Treasury Bills were not included in SFE's prescribed list because there wasn't a demand for them at that time.

2. Purpose of the instrument

ASIC received an individual application from a Trading Participant for relief from the definition of 'Approved Securities' under Rule 7.1.1 of the ASX 24 Rules. The Trading Participant requested that they instead be permitted to use the list published by ASX Clear.

In reviewing this application, ASIC considered that other Trading Participants may also be impacted by the inconsistency between Rule 7.1.1 of the ASX 24 Rules and ASX Clear's list of accepted collateral.

The instrument provides relief from the Relevant Rules to the extent that those rules apply the definition of 'Approved Securities'. It introduces a new term 'Approved Collateral' which refers to securities, collateral and other property accepted by ASX Clear.

The effect of the instrument is to allow Trading Participants to rely on the list of accepted collateral published by ASX Clear to meet their obligations under the Relevant Rules.

The instrument ensures that the Relevant Rules continue to effectively mitigate counterparty credit risk in the context of Trading Participants and their Clients. It reduces uncertainty and complexity for Trading Participants that are also Clearing Participants, and provides flexibility in the Relevant Rules to respond to market changes. This is because ASX Clear can update their list if required (e.g. due to changes in the liquidity of certain securities) by publishing a new list.

3. Operation of the instrument

Definitions

Paragraph 4(1) of the instrument provides that:

- 'Approved Collateral' means securities or other collateral or property accepted by ASX Clear under the Clearing Rules;

- ‘Cover’ means cash and/or Approved Collateral held by a Market Participant against a Client’s liability from time to time.

Calling Initial Margin

Paragraph 5(1) of the instrument relieves a Trading Participant which has agreed to accept and has received Cover by way of Approved Collateral from the obligation to comply with subrule 7.2.2(4) of the ASX 24 Rules.

Satisfaction of Calls for Margin

Rule 7.2.5(1)

Paragraph 6(1)(a) of the instrument relieves a Trading Participant which has agreed to accept Cover by way of Approved Collateral from the obligation to comply with subrule 7.2.5(1) of the ASX 24 Rules.

This waiver is subject to the condition in paragraph 9(1) of the instrument that the Trading Participant’s Client agreement must provide that Calls for Initial Margin and Variation Margin must be satisfied by payment unless the Trading Participant agrees to accept, in lieu of payment, Approved Collateral.

Rule 7.2.5(2)

Paragraph 6(1)(b) of the instrument relieves a Trading Participant which has agreed to accept Cover by way of Approved Collateral from the obligation to comply with subrule 7.2.5(2) of the ASX 24 Rules.

This waiver is subject to the condition in paragraph 9(2) of the instrument that the Trading Participant’s Client agreement must provide that:

- (a) Approved Collateral received as Cover shall be retained by the Trading Participant until such time as the liability of the Client is extinguished either by the relevant contracts being Closed Out or payment being made by a Buyer or delivery in accordance with the ASX 24 Rules being effected by a Seller; and
- (b) if the liability of the Client is not extinguished, as set out in paragraph (a), then the Approved Collateral may be realised by the Trading Participant and the proceeds applied against the liability.

Rule 7.2.5(3)

Paragraph 6(1)(c) of the instrument relieves a Trading Participant which has agreed to accept Cover by way of Approved Collateral from the obligation to comply with subrule 7.2.5(3) of the ASX 24 Rules.

This waiver is subject to the condition in paragraph 9(3) of the instrument that the Trading Participant must ensure liability of a Client for Initial Margin is Covered at all times.

Time for payment of Margins

Paragraph 7(1) of the instrument relieves a Trading Participant which has agreed to accept Cover by way of Approved Collateral from the obligation to comply with Rule 7.2.6 of the ASX 24 Rules.

This waiver is subject to the condition in paragraph 9(4) of the instrument that:

- (a) where a Call is made for Initial or Variation Margin, the Trading Participant must stipulate the time for payment or lodgement of Approved Collateral, which must not be greater than:
 - (i) 24 hours if the Client's address is within Australia; or
 - (ii) 48 hours if the Client's address is outside Australia;
- (b) the Trading Participant must not provide credit for a Client beyond the periods specified in paragraphs (a)(i) and (ii) unless:
 - (i) permitted by Rule 7.2.10 of the ASX 24 Rules; or
 - (ii) the Trading Participant exercises a reasonable discretion not to Close Out having regard to:
 - (A) the expertise and financial status of the Client;
 - (B) any genuine attempts by the Client to meet the Call within the time prescribed; and
 - (C) whether relevant actions or omissions of third parties resulted in the Client failing to pay the Call; and
- (c) the Trading Participant's Client agreement must provide that time shall be of the essence in respect of payment or lodgement under Part 7.2 of the ASX 24 Rules.

Obligation to Close Out

Paragraph 8(1) of the instrument relieves a Trading Participant which has agreed to accept Cover by way of Approved Collateral from the obligation to comply with Rule 7.2.8 of the ASX 24 Rules.

This waiver is subject to the condition in paragraph 9(5) of the instrument that:

- (a) where a Client is in default by failing to pay a Call (or lodge Approved Collateral) within the time stipulated by the Trading Participant, the Trading Participant must, immediately upon expiry of that time period, Close Out to the extent necessary to counter the Call, all or any existing Open Positions in any Market held by the Trading Participant on account of the Client unless the Trading Participant exercises a reasonable discretion to not Close Out having regard to:
 - (i) the expertise and financial status of the Client;
 - (ii) any genuine attempts by the Client to meet the Call within the time prescribed; and
 - (iii) whether relevant actions or omissions of third parties resulted in the Client failing to pay the Call; and
- (b) the Trading Participant's Client agreement must provide that the Trading Participant shall not be liable to the Client for any loss sustained by the Client as a result of the Trading Participant Closing Out in accordance with paragraph (a).

4. Consultation

ASIC consulted with the Australian Financial Markets Association (AFMA) and its members in relation to the instrument. In addition to the Trading Participant that initially sought relief, AFMA noted that of the five responses received, two Trading Participants submitted that they would rely on the relief in the instrument and one Trading Participant was likely to do so in future.

All respondents were supportive of the relief, noting the benefits of increased flexibility and optionality in collateral management, and the reduction in opportunity costs for Clients and Clearing Participants.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

ASIC CLASS RULE WAIVER [CW 17/740]

ASIC Class Rule Waiver [CW 17/740] is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

Rules 7.2.2(4), 7.2.5, 7.2.6 and 7.2.8 (the **Relevant Rules**) of the ASIC Market Integrity Rules (ASX 24 Market) 2010 (**ASX 24 Rules**) impose various obligations on trading participants to call margins from their clients. Margin calls can be satisfied by the trading participant accepting either cash or ‘Approved Securities’ from their clients. ‘Approved Securities’ is defined under Rule 7.1.1 of the ASX 24 Rules with a prescribed list.

The purpose of margin calls is to mitigate counterparty credit risk, i.e. the risk that a party to a trade in a futures contract will default on their obligations under that trade. Mitigating counterparty credit risk promotes investor confidence and market orderliness.

Trading participants that are clearing participants also have an obligation under the operating rules of ASX Clear (Futures) Pty Limited (**ASX Clear**) to post margins to ASX Clear.

The role of ASX Clear is to mitigate counterparty credit risk, and it does this by calling margins from clearing participants. ASX Clear determines what it considers to be acceptable collateral for the purposes of clearing participants satisfying margin calls. ASX Clear publishes a list of securities, collateral and other property that it will accept as margin, which is amended by ASX Clear as required.

There are some inconsistencies between ASX Clear’s current list and the definition of ‘Approved Securities’ in Rule 7.1.1 of the ASX 24 Rules. This causes confusion and complexity for trading participants that are also clearing participants.

This legislative instrument provides relief from the Relevant Rules to the extent that those rules apply the definition of ‘Approved Securities’ in Rule 7.1.1. It introduces a new term ‘Approved Collateral’ which refers to securities, collateral and other property accepted by ASX Clear.

The effect of the legislative instrument is to allow trading participants to rely on the list of accepted collateral published by ASX Clear, to meet their obligations under the Relevant Rules.

The legislative instrument ensures that the Relevant Rules continue to effectively mitigate counterparty credit risk in the context of trading participants and their clients. It reduces uncertainty and complexity for trading participants that are also clearing participants and provides flexibility in the Relevant Rules to respond to market changes. This is because ASX

Clear can update their list if required (e.g. due to changes in the liquidity of certain securities) by publishing a new list.

Human rights implications

This legislative instrument does not engage any of the applicable rights or freedoms.

Conclusion

This legislative instrument is compatible with human rights as it does not raise any human rights issues.

Australian Securities and Investments Commission