ISDA Safe, Efficient Markets

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ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation Paper on Draft Operating Rules

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] welcomes the opportunity to provide comments on the Australian Securities Exchange ("**ASX**") *Draft Operating Rules for ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service* ("**Consultation Paper**") released on 28 August 2013.

Individual members will have their own views on different aspects of the Consultation paper, and may provide their comments to ASX independently.

General observations

Before we address the questions posed in the Consultation paper, we would like to make a few general observations.

We are very concerned about the enforceability of close-out netting and insolvency set-off between a Clearing Participant and a Client under the proposed Client Protection Model ("**CPM**"). Under the Part 10, Rule 113.1(b) of the in the ASX Clear (Futures) Operating Rules ("**Futures Rules**"), "each Clearing Participant, the Client and ASX Clear (Futures) is a party to, and is bound by, these Open Contracts and Open Positions in accordance with these Rules and is taken to have entered into the legal relationship which constitutes those Open Contracts and Open Positions"[2]. Given the tri-party nature of the Open Contract and Open Positions, we are

[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC 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 including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

[2] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, August 2013, Rule 113.1, Page 1005.

concerned that the mutuality requirement in Section 553C[3] of the Corporations Act 2001 ("**Corporations Act**") may be affected by the proposed CPM. We believe the right to set-off between the Clearing Participant and the Client should be preserved and we seek further clarity from ASX on this matter. We further believe a further round of consultation may be needed to effectively address some of the issues raised here and any subsequent amendments to the ASX Client Clearing Service.

It is extremely important that the enforcement of close-out netting will not be affected by the proposed CPM. Although Rule 31.8 of the Futures Rules states that the Open Contracts are market netting contracts, it is unclear to us that the enforcement rights of a Clearing Participant will be applicable in the instance when a Client defaults. A netting market is defined in the Payment Systems and netting Act 1998 as an arrangement that is "a licensed market or a licensed CS facility as defined in section 761A of the Corporations Act 2001"[4]. It infers that netting market will apply to a Licensed CS facility but not to the Clearing Participant or Client as they are neither a licensed market nor a Licensed CS facility. Consequently, we hope ASX will be able to provide a clean netting opinion on the CPM and the impact on its Clearing Participant in relation to the enforcement of close-out rights, in the event, of the default of a Client or a Clearing Participant.

We are extremely concerned with the proposed tri-party legal arrangement as the Clearing Participant acts as agent in under certain circumstances and acts as Principal in other situations. The Consultation Paper proposes a tri-party legal agreement between ASX, the Client and the Clearing Participant but also proposes no "partnership, agency, fiduciary relationship, joint venture, distribution or any other category of commercial or personal relationship"[5] between ASX and the Client. Uncertainty is created as there is a tri-party legal agreement with ASX, the Client and the Clearing Participant on one hand but "no relationship" on the other hand between ASX and the Client. For example: with the tri-party legal agreement, would a Client be expected to contribute to the default fund of ASX? How would the credit limits be applied to ASX for a Clearing Participant's Client transactions? There needs to be clear rules on when the agency relationship applies and when the principal relationship applies and what rights and obligations a Clearing Participant, a Client and ASX will have in those instances.

Response to specific questions

The remainder of this letter sets out our comments in relation to the specific questions posed in the Consultation paper as it relates to OTC Clearing. The questions used below correspond to the questions used in the Consultation paper.

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[3] http://www.comlaw.gov.au/Details/C2013C00568/Html/Volume_2, Corporations Act 2001, Volume 2, Section 553C, 1 Jul 2013.

[4] http://www.comlaw.gov.au/Details/C2013C00382/Html/Text#_Toc362956084, *Payment Systems and Netting Act 1998*, Part 1, Section 5, Definitions, 19 July 2013.

[5] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Rule 112.1(h), Page 1004.

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QUESTIONS

	Question	Feedback
A1	ASX proposes not to require Clearing Participants to offer both account types to Clients. Do you agree with ASX's proposed approach? If not, why not?	Yes, we agree with ASX's proposed approach to allow Clearing Participants flexibility in the account types it offers it clients. We do not believe that ASX should restrict or interfere with the Clearing Participant's ability to structure its business as appropriate. We commend ASX for attaining equivalence under Article 25[6] of the European Market Infrastructure Regulations ("**EMIR**"). However, it should be noted that under Article 39[7] of EMIR, a central counterparty ("**CCP**') is required to offer both omnibus and individual client segregation accounts, whereby an individual client segregation account refers to a fully segregated account which allows for asset tracking.
A2	Will the Individual Client Account structure enable ASX's indirect customers that are ADIs to gain optimal capital treatment of their cleared trade exposures to ASX under APRA Prudential Standard APS 112? If not, why not?	No, as APS 112, Attachment C, section 25 and 26 states the following: Paragraph 25. "An ADI that: (a) clears through a QCCP indirectly as a client of a clearing member acting as a financial intermediary (i.e. the clearing member completes an offsetting transaction with the QCCP); or (b) enters into a transaction with the QCCP, with the clearing member guaranteeing its performance must treat its exposure to the clearing member or QCCP, respectively, as if it were a clearing member's exposure to the QCCP and risk-weight its exposure according to paragraph 23 when the following conditions are met: (i) the offsetting transactions are identified by the QCCP as client transactions, and the collateral to support the offsetting transactions is held in a manner that prevents any losses to the client ADI due to either the default or insolvency of the clearing member, or the default or insolvency of the clearing member's other clients. Additionally, upon request, the client ADI must provide to APRA an independent, legal opinion, in writing, that proves the validity of this condition in the presence of any legal challenges under relevant laws; (ii) collateral supporting the offsetting transactions is held in a manner that prevents any losses to the client ADI due to the joint default or insolvency of the clearing member and any of its other clients. Additionally, on request, the client ADI must provide to APRA an

[6] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF, *Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade repositories*, page L201/29.

[7] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF, *Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade repositories*, page L201/36.

		independent legal opinion, in writing, that proves the validity of these conditions in the presence of any legal challenges under relevant laws; and (iii) in case the clearing member defaults or becomes insolvent, the relevant laws, rules, contractual or administrative arrangements provide that offsetting transactions are highly likely to continue to be indirectly transacted through the QCCP, or by the QCCP. In such circumstances, the client positions and collateral with the QCCP will be transferred at market value unless the client ADI requests closing out the position at market value. If only conditions (i) and (iii) are satisfied, a risk-weight of four per cent must be applied to the ADI's exposure to the clearing member. In any other cases, the ADI must, for capital purposes, treat its exposure to the clearing member as bilateral trades, including the calculation of the CVA risk capital charge. Paragraph 26. An ADI (either as a clearing member or a client of a clearing member) that has posted collateral must risk-weight those assets in accordance with the risk weights that otherwise apply under this Prudential Standard or APS 113 as applicable, if the collateral is held in the banking book, or under APS 116, if the collateral is held in the trading book, regardless of the fact that such assets have been posted as collateral. In addition, an ADI must apply risk-weights to posted collateral reflecting the circumstances under which the collateral is held and the creditworthiness of the entity holding the collateral. In particular: (a) an ADI that is a clearing member: (i) must apply a two per cent risk-weight to posted collateral held by the QCCP where that collateral is included in the definition of trade exposures to a QCCP and not held in a bankruptcy-remote manner; and (ii) may apply a zero risk-weight to posted collateral (including cash, securities and excess initial and variation margin) held by a custodian where that collateral is bankruptcy remote from the QCCP; (b) an ADI that is a client of a clearing member: (i) may apply a zero risk-weight to posted collateral held by a custodian where the collateral is bankruptcy remote from the QCCP, the clearing member, and the clearing member's other clients; (ii) must apply a two per cent risk-weight to posted collateral held by the QCCP if the collateral is not bankruptcy remote from the QCCP, and all conditions (i), (ii) and (iii) in paragraph 25 of this Attachment are all satisfied; and (iii) must apply a four per cent risk-weight to posted collateral held by the QCCP if the collateral is not bankruptcy remote from the QCCP, and only conditions (i) and (iii) in paragraph 25 of this Attachment are all satisfied.[8]"

[8] http://www.apra.gov.au/adi/PrudentialFramework/Documents/Basel-III-Prudential-Standard-APS-112-(January-2013).pdf, Australian Prudential Regulation Authority, *APS 112*, Attachment C, Paragraphs 25 and 26, C-25 – C-26, Jan 2013.

		If conditions (i) and (iii) of paragraph 25 are not met, an ADI that is a client to a Clearing Participant will not be able to recognize the lower risk weight. As ASX only guarantees the return of the initial margin ("**IM**"), the ADI is not protected from loss of a Clearing Participant or another Client in either the Omnibus or the Individually Segregated Client model, therefore the conditions cannot be met and a lower risk weight can not be recognized by an ADI that is a client to a Clearing Participant. We expect that there may be certain ADIs which would choose not to be a Clearing Participant and may choose to be a Client of a Clearing Participant instead. These ADIs would benefit greatly from the lower risk weights to their trade exposures and collateral exposures from a regulatory capital perspective.
A3	ASX's Client Clearing Service will not offer 'bankruptcy remote' collateral holding structure initially. Feedback is requested, especially from Clients, on the relative priority of such arrangements, taking into account the incremental benefits and costs of implementation as well as other service enhancements that may be desirable (such as a 'with excess' individual client account option).	We believe ASX should offer a 'bankruptcy remote' collateral holding structure as banks who are looking to become Clients to a Clearing Participant would need to ensure its collateral is 'bankruptcy remote' in order to attain a lower risk weight for regulatory capital purposes.
B1	The 'porting windows' for ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives are up to 24 and 48 hours respectively. Are the porting windows appropriate? If not, why not? In your response, please consider the potential trade off between the length of the porting windows and the level of initial margin requirements.	Yes, we agree that 48 hours porting window is generally appropriate for OTC Interest Rate Derivatives. <u>48 hours porting window</u> Further consideration is required when the Client base is expanded to include Client based in other jurisdictions. Due to time zone differences, a Client based in another jurisdiction, such as New York, may require an additional 24 hours, which would increase the porting window required for OTC Interest Rate Derivatives. Please note, the current ASX requirement for OTC Interest Rate Derivatives is 5 days for close-out, therefore, the proposed window will be within the anticipated close-out period, even if it is extended out by an additional 24 hours. If cross-margining is allowed, the porting window needs to be reassessed as the ASX requirement for Futures is 2 days for close-out. In such an instance, Clients which utilize cross-margining of their futures and OTC Rate Derivatives may require a longer period of close-

		out for their futures positions. As a practical matter, the on-boarding process with a new Clearing Participant cannot be done within 48 hours. Consequently, Clients would need to have completed the on-boarding process and connectivity to an Alternate Clearing Participant before it can port its positions to the Alternate Clearing Participant in the event of its Clearing Participant's default. A Client would most likely need to nominate a second Alternate Clearing Participant, in the event, the first Alternate Clearing Participant declines to accept the Client's portfolio. In such an event, will the first Clearing Participant be given a time limit by ASX to respond to the porting request of a Client before an automatic rejection is logged and communicated to the Client? <u>Client porting before a Client Participant's default</u> In the Consultation Paper, no consideration is given to allow Clients' to port their positions during a non-default scenario. From a risk management perspective, it would be beneficial to allow Clients to port their positions to their Alternate Clearing Participants before a Clearing Participant is declared to be in default. This would allow ample time for the Alternate Clearing Participant to assess, review and analyze the Client's portfolio as well as time to fund any additional default fund or margin requirements. This would also provide sufficient time to allow a Client to nominate a second Alternate Clearing Participant if the first Alternate Clearing Participant declines to take on its portfolio. If more Clients are able to port their positions to Alternate Clearing Participants, this would reduce the risk of the Clients' portfolio being closed out or auctioned with the defaulting Clearing Participant's portfolio. It would also reduce the risk of the non-defaulting Clearing Participants' default fund contribution being utilized to offset the loss arising from the defaulted Clearing Participant's portfolio.
B2	ASX proposes not to require Clients utilizing Individual Client Accounts to nominate Alternate Clearing Participant. Do you agree with ASX's proposed approach? If not, why not?	Yes, we agree with this approach as it allows for flexibility. We agree that it should not be mandatory for clients to nominate an Alternate Clearing Participant in advance. As long as a Client is aware of the risks, a Client should be allowed the flexibility of deciding what suits it best. It should be noted that the various documentation elements are quite time consuming, it is generally assumed that Clients will have an Alternate Clearing Participant in place prior to a Clearing Participant's default as it is unrealistic to expect a Client to be able to establish a new Clearing Participant relationship within 48 hours, especially during a time of market stress and multiple Clients approaching the same

		Alternate Clearing Participant. We propose that a Client may only be permitted to port its positions to an Alternate Clearing Participant if it has no further obligations owed to the current defaulting Clearing Participant. This is to avoid the scenario when a Client fails to post IM to the Clearing Participant but the Clearing Participant posts collateral to ASX on its behalf and defaults before it is able to collect IM from the Client. Upon the default of the Clearing Participant, the Client's IM (also known as the "**Guaranteed Initial Margin Value**") and positions will be transferred to an Alternate Clearing Participant that accepts the Client's portfolio. As ASX will transfer the IM amount regardless of whether the IM was funded by the Client or the defaulted Clearing Participant, it is unclear how the defaulted Clearing Participant will be able to recover the IM it has funded on behalf of the Client or how close-out netting would work under the proposed tri-party legal arrangement. <u>Initial margin and Excess Collateral</u> ASX will liquidate any non-cash collateral posted by the defaulting Clearing Participant as margin for the transfer of IM. Any shortfall in the liquidated value of the non-cash or cross currency collateral will be offset, in the first instance, against the value of excess collateral (if any) in the defaulting Clearing Participant's Client Clearing Account[9]. Additionally, any excess collateral posted by the Clearing Participant to its Client Clearing Account will be used by ASX to offset any losses incurred by ASX upon close-out termination of positions in any client account of the defaulting Clearing Participant that exceed the IM requirement of that particular account[10]. Although the Consultation Paper states that "little need was identified by stakeholders in leaving excess collateral with Clearing Participants, as clearing via ASX takes place in the same operational time zone, which reduces the need for collateral buffers to be maintained with Clearing Participants"[11], one of the functions of a buffer is to allow the Clearing Participant to fund the intra-day margin calls for a particular Client account. Potentially, for the OTC Interest Rate Client Clearing Service, the Client base may be expanded beyond entities incorporated in Australia or carrying on business in Australia. Consideration should then be given to Clients incorporated in foreign jurisdictions which may

[9] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Page 17.

[10] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Page 14.

[11] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Page 11.

		need to fund their margin requirements in a different time zone and the Clearing Participant would then potentially require a buffer for these Clients. As excess collateral will applied to any losses incurred by ASX or shortfalls due to insufficient collateral haircuts for Client's accounts (both Omnibus and Individual Client Accounts), and any excess collateral will be returned to the external administrator of the defaulting Clearing Participant[12], this does not incentivize Clients to post excess margin as a buffer. It also increases the operational burden on Clearing Participants as they would be required to transfer collateral in and out of the Client Clearing Accounts to avoid an excess of collateral being held in those accounts as there is no incentive to hold excess collateral in the client accounts. Under rule 119.6, for Individual Client Accounts, the Client is entitled to the Guaranteed Initial Margin Value less any allocated losses, costs and expenses[13]. However, any gains that arise from the close-out of positions in a client account will form part of the excess collateral and returned to the defaulting Clearing Participant's external administrator. We seek further understanding on this point and if the intention is for losses to be segregated and gains to be shared? <u>Initial Margin after Porting</u> As end-of-day payments to and from each Clearing Participant's Client Clearing Account will be netted to a single flow per currency per day, the Clearing Participant is responsible for unwinding that net flow into gross flows with each of its Clients[14]. If the Clearing Participant defaults while unwinding the net flow between it and ASX and the gross flows to each of its Clients after it has received funds from one Client and before it disburses them to another Client, there is a risk that a Client, which is being ported, may have insufficient IM as a result of this. In such an instance, will the Client be expected to reimburse the Alternate Clearing Participant for the shortfall in IM? Will the shortfall in IM, in such an instance, be allocated out amongst the various Clients of the defaulting Clearing Participant?

[12] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Page 14.

[13] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Rule 119.6, Page 1017.

[14] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Page 15.

C1	Unlike ASX's existing client clearing arrangements, which are based on the principal model, the Client Protection Model creates a direct legal relationship between ASX and the Client. Do you consider this may have any unintended consequences for Clients or Clearing Participants? If so, please explain why.	We are concerned about the CPM as it affects the client agreements between Clearing Participants and Clients. Rule 112.1(m) of the Futures Rules states that "to the extent of any inconsistency with any agreement between the Client and its Clearing Participant (including, without limitation, an agreement entered into in accordance with Rule 4.14(j)), these Rules prevail.[15]" As the term "inconsistency" is not defined, there is a possibility that existing client agreements may be rendered unenforceable as they have been deemed by ASX as "inconsistent" This would not aid ASX's approach to minimize the requirement for any changes to documentation between Clearing Participants and their Clients[16]. We believe Rule 112.1(m) should be tightened to limit the extent to which the Rules will prevail over the client agreements but still enable the CPM to function. Rule 112.1(h) which states that "these Rules do not, are not intended to, and will not be construed to represent or imply a partnership, agency, fiduciary relationship, joint venture, distribution or any other category of commercial or personal relationship between ASX Clear (Futures) and any Client recognized at law or in equity as giving rise to forms of specific rights and obligations"[17] is inconsistent with Rule 113.1(b) which states that the Clearing Participant, the Client and ASX Clear (Futures) have a legal relationship[18]. The relationship between ASX and the Client needs to be further clarified and defined. However, in so doing, the contractual rights of the Clearing Participant and the Client should in no way be diminished or superseded by ASX's contractual rights in the event of a Client default as the Clearing Participant is fully liable as principal to ASX for the performance of all its Client's obligations. Would ASX be able to provide a legal opinion that close-out netting between a Clearing Participant and a Client will be enforceable despite the tri-party structure proposed in the Consultation Paper? We are very concerned that the proposed client clearing model would affect the mutuality requirement under the Corporations Act 2001. <u>Client Defaults</u> We believe Rule 118.1 should be further clarified to include a consideration for a Clearing Participant to act in good faith, or a

[15] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Page 1005.

[16] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Page 28.

[17] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Page 1004.

[18] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Rule 113.1(b), Page 1005.

		commercially reasonable, or in consideration of the best interests of its Clients when making a determination that a Client is in default and requesting for a transfer. Furthermore, Rule 118.1(b) infers that the defaulting Clients entire Open Positions will be transferred to the House Account of the Client Participant. We believe that a degree of flexibility should be considered in the situations whereby the default is minor or technical or is subsequently addressed, such as a Client's failure to pay a margin call. If a transfer of a defaulting Client's Open Position to a Clearing Participant's House Account occurs, we seek clarity on what value it will be transferred at and if there will be any monies returned to the defaulting Client in such an instance. Clearing Participant Defaults In either the Omnibus Account or the Individual Client Account, we believe the first step should always be the porting of these Clients' Open Positions to another Clearing Participant. The handling of the defaulting Clearing Participant's House Accounts and Client Accounts should be handled separately; however, the role of a CCP in this instance is to ensure minimal market disruption, the continuation of the contracts (if possible) and minimal loss to the Clients. Accordingly, the default management process needs to be further clarified or defined to include the handling of Client Accounts as part of the default management process. Under the Individual Client Account, IM is returned directly to the Client by ASX upon the default of a Clearing Participant, otherwise known as "guaranteed IM". This is counter to the likely documentation that a Clearing Participant has in place with a Client. For example: in the Futures segment, there is a "Liquidation Amount" which uses the IM amount as part of its calculation. If IM has been paid by ASX, in the event of a Clearing Participant's default, the IM will need to be removed from the calculation of the "Liquidation Amount" in the existing client agreement. As mentioned earlier, this reiterates our concern regarding Rule 112.1(m) of the Futures Rules. Trustees In Figure 4[19] in the Consultation Paper, ASX will deal with a Client if a Clearing Participant defaults when the Clearing Participant is trustee for the Client in holding the Client's positions and margin. This is further supported by Rule 113.2[20] which provides a Client with the rights and entitlements against ASX Clear (Futures) as set out in the CPM

[19] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Figure 4, Page 22.

[20] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Rule 113.2, Page 1006.

		Provisions. This is contradicted by Rule 113.5 which states that ASX is "entitled to deal with each Client as principal and not as trustee, as agent or as acting in any other capacity"[21]. We seek clarity on ASX's view of trusts under the CPM. Collateral As variation margin is calculated at trade level and initial margin is calculated at a book level as per Figure 2[22] of the Consultation Paper, this would result in a gross amount for variation margin and a net amount for initial margin. Initial margin and variation margin are usually calculated at the same level, i.e., book level or portfolio level. We seek understanding on the intent in calculating variation margin on a trade level and initial margin on a portfolio level. In such an instance, would the gross variation margin be deemed as "excess collateral" and will therefore not be returned to the Client as excess collateral is used to offset against losses[23] arising from a Clearing Participant's default? Section 822B of the Corporations Act 2001 Section 822B[24] of the Corporations Act 2001 grants a contract under seal between the licensee and each participant in the facility; and between a participant in the facility and each other participant in the facility. As there is no mention of a Client under Section 822B of the Corporations Act 2001, is there a need to amend Section 822B to extend the contract under seal to include transactions with Clients?
D1	Do you agree with the primary operational role of the Clearing Participant under the Client Clearing Service or should Clients have more direct operational engagement with ASX? If Clients should have more operational engagement, please indicate why that would be the case and what form the engagement	We agree that the primary operational role should belong to the Clearing Participant. We would agree that interaction between the client and ASX should be limited. Reports may be made available to the clients directly but the list should be vetted by the Clearing Participant beforehand.

[21] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Rule 113.5, Page 1007.

[22] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Figure 2, Page 13.

[23] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Where porting does not occur, Page 17-18

[24] http://www.comlaw.gov.au/Details/C2013C00003/Html/Volume_4, Corporations Act 2001, Section 822B, 3 Jan 2013.

	might take.	
E1	Do you have any comments on the restrictions that apply to Clients in relation to OTC Client Clearing?	For the initial phase for OTC Client Clearing, we have no comments on the restrictions to wholesale client that is incorporated in Australia; or is carrying on business in Australia; or the Client is acting on behalf of an entity or entities, that are incorporated or carrying on business in Australia. However, we seek further guidance as to what level of business a corporate must undertake in Australia to qualify as a Client that is "incorporated or carrying on a business in Australia". We note the following contraction that arises from Rule 113.5 in which ASX will not deal with a client as trustee, as agent or in any other capacity. If one of the criteria to become a Client as defined in Rule 2.16 of the ASX OTC Rulebook allows a Client acting on behalf of an entity or entities, i.e., as an agent, Rule 113.5 needs to be further clarified in such an instance.
F1	Where a Client that is a related body corporate of the Clearing Participant acts as principal or as agent for other related bodies corporate only, ASX proposes to permit the Client's positions to be designated as 'Client' positions, on condition that the positions are allocated to an Individual Client Account that is maintained for the Client, and the Clearing Participant maintains a separate Clients' Segregated Account (outside the clearing facility) for funds in respect of those positions. Is it desirable to permit positions of a related body corporate of the Clearing Participant in these circumstances to be designated as 'Client' positions? Why or why not? Are the conditions to designation of such positions as 'Client' positions, as	We agree that any positions with related body corporates, in which the Clearing Participant acts directly or through a chain of entities in the same corporate group or as agent for unrelated end user clients may be held in a segregated client account and designated as 'Client' positions. This enables risk segregation between the legal entities as well as preventing co-mingling with other client monies. This is in-line with CCPs in Europe that provide for affiliated positions to be designated as 'Client' positions. For the segregated client account to work, it will need to address the client confidentiality across multiple locations and possibly multiple CCPs. The operational issues that may arise from attaining client consent should be factored into any decision ASX makes regarding this issue. It should be noted that the Corporations Act 2001 does not require a licensee to treat money received from a related body corporate that is a client any differently from money received from a non-related body corporate. As "Client" monies will be treated by the licensee according to the requirements in the Corporations Act 2001, how wills ASX's proposal for related body corporate affect or interact with the requirements in the Corporations Act 2001?

	proposed by ASX, appropriate? Why or why not?	
F2	Do you consider there may be any unintended consequences of the proposed amendments to the definitions of "Client" or "Clients" Segregated Account" in Futures Rule 1.1?	Part 10 of the ASX Clear (Futures) Operating Rules refer to "Clients" instead of "CPM Clients". As ASX may determine the time at which application of the CPM Provisions apply based on its determination at different times for different Market Contracts, Clearing Participants or Clients. Consequently, there will be 2 types of Clients, those that have been determined by ASX under Rule 111.1[25], in which case, these Clients will become "CPM Clients" and those that have not had any determination made will be considered as "Clients". To avoid confusion, the term "CPM Client" should be used in Part 10 of the ASX Clear (Futures) Operating Rules. If a Market Contract is determined to be subject to Part 10 of the ASX Clear (Futures) Operating Rules, would a Client be subject to all the CPM Provisions or would only the affected Market Contract and corresponding Open Position be subject to the CPM Provisions?
F3	In order for an end user to gain the protection of the Individual Client Account option, where the Clearing Participant chooses to offer it, the end user client would need to have entered into a client agreement with the Clearing Participant on terms consistent with the minimum terms prescribed by ASX. What consequence flow from the requirement for a client agreement in these circumstances? Please provide details of any financial or regulatory implications of a Clearing Participant contracting directly with end user clients that wish to take up the Individual Client	Please refer to our response to question C1. We believe Rule 112.1(m) should be narrowed as the current draft is too broad. The Clearing Participant should remain free to agree any contractual relationship with its Clients as it sees fit. This would allow the Clearing Participant to agree to terms that it is able to meet and deliver. As ASX has no direct relationship with the Client except in the event of a Clearing Participant and the sole liability resides with the Clearing Participant acting as agent to the Client, the terms and conditions, beyond Part 10 of the ASX Clear (Futures) Operating Rules, should be determined by the Clearing Participant and preserves the freedom of contract between the parties involved. Rule 112.1(k) should be narrowed as each Client and each of its Clearing Participant is required to represent and acknowledge to ASX that "the holding of Open Positions in respect of Open Positions in a Client Sub-Account with respect to it will not cause ASX Clear (Futures) to breach any law, regulatory requirement or official directive, ruling or determination of any jurisdiction"[26]. A Clearing Participant and its Client will not be able to determine which law, regulatory requirement, official directive, ruling or determination will cause ASX to breach these laws or regulatory requirement. ASX would need to

[25] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Rule 111.1, Page 1003.

[26] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Rule 112.1, Page 1004.

	Account option. Are those implications (if any) likely to affect Clearing Participants' ability to offer the Individual Client Account option or end user client demand for it? If so, why?	determine its legal requirements and compliance with the various laws and regulations. We seek clarity on what constitutes a "fundamental condition" as seen in Rule 112.1, which states that "these representations, acknowledgements and agreements by a Client are included in the terms of each Open Contract and are a fundamental condition to the Client's rights and entitlements under these Rules"[27]. In the event of a breach of a "fundamental condition", what would be the consequence to the Client?
G1	What impact will the introduction of ASX's Client Clearing Service have on existing client documentation, both for ASX 24 Exchange Traded Derivatives and OTC Interest rate Derivatives?	In addition to our response in question C1, we are concerned with Rule 112.1(g) which states that "the Client's Clearing Participant has provided the Client (and each other person on whose behalf the Client is acting, as notified to the Clearing Participant by the Client) with, or directed the Client (or other person, as applicable) to, a copy of the Client Protection Model Client Fact Sheet"[28]. As a Related Body Corporate of a Clearing Participant may be deemed a Client, this would infer that it would be required to provide a Client Protection Model Client Fact Sheet to all its end clients. Rule 112.1(g) does not indicate if there is a look back period in trying to implement this CPM Provision as some Clients of a Related Corporate Body may not necessarily have transacted recently and may be existing Clients who are dormant. We believe ASX should not impose this requirement to the Clients of a related Corporate Body with respect to the Client Protection Model Client Fact Sheet. The obligation of the Clearing Participant should be the disclosure of the Client Protection Model Client Fact Sheet to their Clients. This will be consistent with the approach ASX has taken in other areas such as margin calculation.
G2	ASX has sought to avoid taking a prescriptive approach to documentation between Clearing Participants and Clients. Should ASX be more prescriptive, for example by prescribing the form of clearing arrangement to be	Contractual freedom should be preserved as much as possible between the bilateral parties involved, i.e., the Client and the Clearing Participant.

[27] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Rule 112.1, Page 1005.

[28] Australian Stock Exchange, *ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Consultation on Draft Operating Rules*, Aug 2013, Rule 112.1(g), Page 1004.

	used by Clearing Participants and their Clients?	
G3	Should the minimum terms for client agreements in Rules 4.14(j)(v)(Margins) and 4.14(j)(x)(Right to Refuse to Deal) be disapplied for OTC Client Clearing on the basis that these terms would be expected to be superseded by any bilateral documentation in place between Clearing Participants and their Clients?	We believe Rule 4.14(j)(v) should be disapplied. Clearing Participant's should be allowed to determine the terms of the client agreements. As long as ASX's margin requirements are met by the Clearing Participant, we do not see a need for Rule 4.14(j)(v) to supersede the bilateral documentation. Additionally, Rule 112.1(m) may affect margining arrangements that are in place. As 4.14(j)(x) is an acknowledgement, we see no reason to disapply this. In addition we suggest that Rule 4.14(vi) can be disapplied for CPM Clients due to the overlap with Rule 10.9.
G4	Does ASX's proposed approach to client arrangements provide adequate legal certainty for Clearing Participants and Clients? Do you consider that further or alternative steps could be taken to give greater clarity, and would that require client agreements to be modified?	Legal certainty needs to be improved, particularly for Clearing Participants in the event of a Client default. As it is a tri-party agreement between ASX, the Client and the Clearing Participant, we believe greater certainty is needed for the Clearing Participant to determine its rights and obligations with respect to the Client's transactions and collateral, in the event of a default by a Client. These rights and obligations should not be superseded by the rights and obligations of ASX in such an instance. Please refer to our response to question C1.
G5	Is the Client Fact Sheet sufficiently clear and does it contain enough detail? What other information should be disclosed in the Client Fact Sheet?	As mentioned earlier, we are concerned with the tri-party legal arrangement as it is unclear when the tri-party legal arrangement applies and when it does not. We note that the Client Fact Sheet may not capture the full nuanced relationship, obligations and rights that a Client may have under the tri-party legal arrangement.
H1	Under the Financial Stability Standards for Central Counterparties, as interpreted by the Reserve Bank, ASX's Risk Committee must comprise representatives of indirect participants "depending on the scale and nature of client clearing	In our view, we believe a Client that is sophisticated, has a large trading volume and has the necessary risk skill set should be a Client representation on the Risk Committee. There should be a rotation schedule that allows different Client firms to be a representative on the Risk Committee as long as they are sophisticated, have the necessary risk skill set and trading volumes. Like LCH Clearnet LLC's Terms for a Risk Committee, the number of Client representations should not exceed a pre-defined percentage of the Risk Committee, for example: for LCH Clearnet LLC, the composition of Client representatives

	activity". In your view, what scale and nature of client clearing activity warrants Client representation on the Risk Committee?	should be no less than 10% but not more than 50% of the Risk Committee[29]. Like the Clearing Participant's requirements, only 1 representative is allowed per Client firm. As Client representatives do not contribute to the default fund contributions, there should be a limitation on what voting rights they are given with regards to the risk management decisions of ASX. As there will be conflicts of interests arising, there needs to be guidance on how this will handled. For example: a Client may support a risk management decision that would place the burden of raising additional funds on the Clearing Participants while still maintaining full client protection.
H2	What nomination and selection procedures should be put in place to select Client representatives for the Risk Committee?	The nomination and selection procedure should be similar to the manner in which ASX selects or nominates representatives for the Risk Committee. A Client representative should be a sophisticated client with a sufficiently large portfolio to be concerned with matters determined by the Risk Committee.
L1	Do you have any comments on the proposed security interest provisions in part 11?	Consideration should be given to foreign security interests in collateral located outside of Australia, statutory liens or other security interests that may exist over collateral lodged in foreign central securities depositories or subject to tri-party collateral arrangements.

Yours sincerely,

For the International Swaps and Derivatives Association, Inc.

Keith Noyes
Regional Director, Asia Pacific

Cindy Leiw
Director of Policy

[29] http://www.lchclearnet.com/Images/LLC%20RiskCo%20terms%20of%20reference%2025%20April%202013_tcm6-62830.pdf, LCH Clearnet LLC, Terms of Reference of the Risk Committee of the Board of Directors, 25 Apr 2013, Part 1.1, Page 1.