ASX OTC Interest Rate Derivatives

Proposed Client Clearing Service

Frequently Asked Questions – CPs

CONTENTS

Frequently Asked Questions

Document Purpose

The purpose of this document is to provide guidance on commonly asked questions that Clearing Participants ("CP") may have about the ASX OTC Interest Rate Derivatives Client Clearing Service ("ASX OTC Client Clearing Service"). This document is focused on practical and operational issues with regard to the service.

There will be further detail in the procedural documentation, service description and the ASX Clear (Futures) Operating Rules which will be circulated at a later date.

The ASX OTC Client Clearing Service described in this document is a proposal only and is subject to public consultation. The final design of the ASX OTC Client Clearing Service will require regulatory clearance before implementation. Accordingly, the contents of this document may be subject to significant change and should not be relied upon. This document has been provided to you for guidance only and is intended as a broad overview. This document does not, and does not purport to, contain a detailed description of its subject matter. This document does not constitute legal or financial advice.

While some of the information in this document is relevant for ASX 24 Exchange Traded Derivatives Client Clearing, ASX intend to issue a specific FAQ document to deal with ASX 24 Exchange Traded Derivatives Client Clearing at a later date.

Client and Account Set-up

What clients will the ASX OTC Client Clearing service be available to?

The ASX OTC Client Clearing service will be available initially only to Clients that are connected with Australia (as outlined below) and 'wholesale clients' as defined in the Corporations Act 2001 (Cth).

Clients must be connected with Australia in that they are:

- incorporated or carrying on business in Australia; or
- acting on behalf of an entity or entities, in respect of contracts to be registered in the client account maintained for the Client, that are incorporated or carrying on business in Australia.

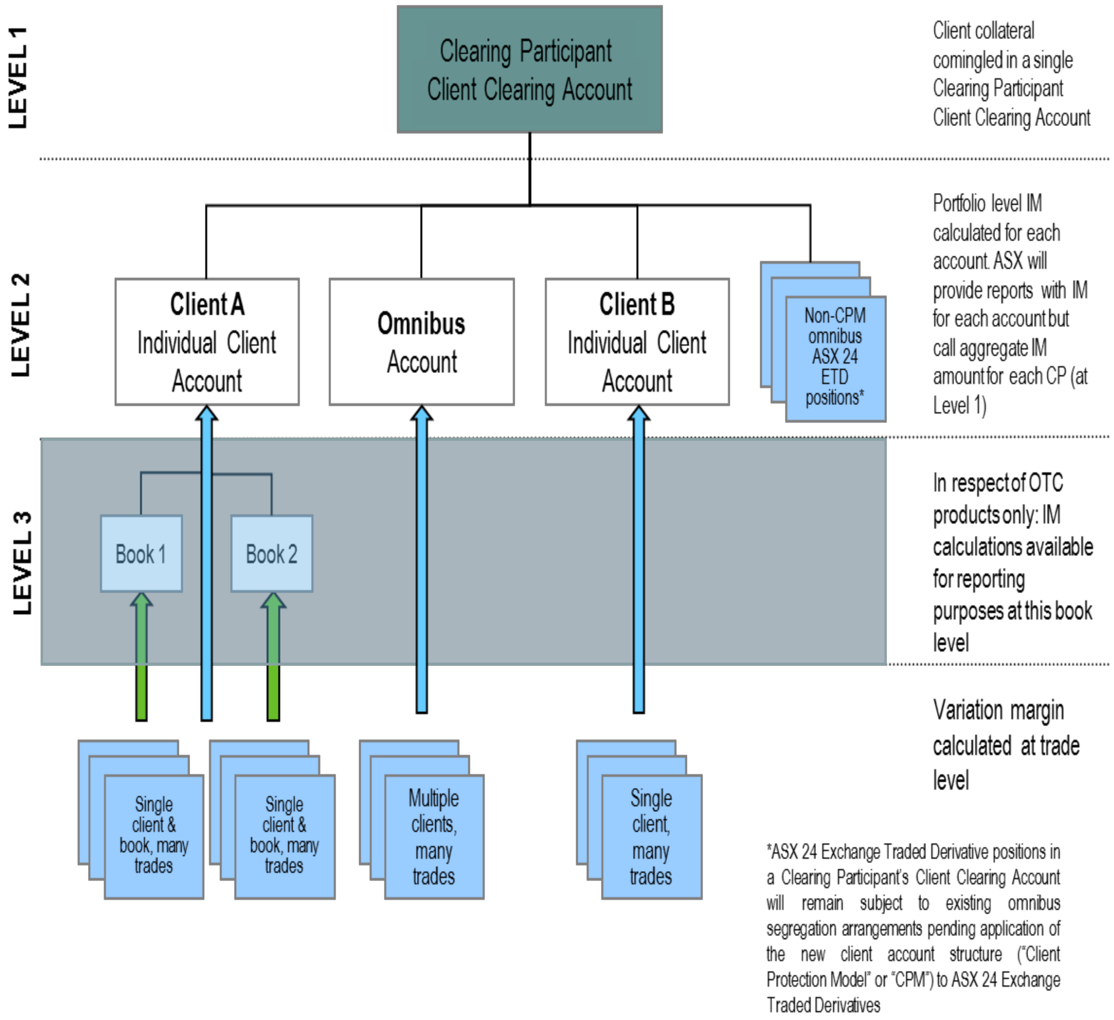
What accounts will be available for OTC client clearing?

ASX intends to support two Client Account Options for OTC Interest Rate Derivatives:

1. **Omnibus client account** – records open positions held by a CP on behalf of one or more Clients. The clearing house calculates initial margin on the net position in that account. In the case of a CP default, Clients should expect to be closed out.

2. **Individual client account 'without excess'** – records open positions held by a CP on behalf of one Client only. Initial margin is calculated on the basis of the Client's positions exclusively. This allows the clearing house to port the Client's positions and associated initial margin in the event of the CP's default. If the Client's positions are not ported, the clearing house will close out the positions and return the associated initial margin to the Client directly, less any losses, costs and expenses attributable to closing out the positions. Collateral is not segregated at the individual client account level and therefore collateral held by the clearing house in excess of the initial margin requirement with respect to the Client's positions cannot be ported with the positions and associated initial margin.

Each CP can have multiple Client Omnibus accounts and Individual Client accounts. The diagram below shows an example of the accounts that a CP could have under its Client account. Please refer to Risk Management and Glossary for further detail of the margin calculations.



How will collateral be protected in each account type?

Each CP posts collateral (cash or eligible securities) to ASX to satisfy the initial margin requirement calculated by ASX with respect to the participant's Client Accounts. All collateral posted by a CP with respect to Client Accounts is comingled (mixed) by ASX in a single account. Clients have no legal right or interest in collateral posted to ASX.

However, as collateral posted by a CP for initial margin with respect to its Client Accounts is in general funded by the CP's Clients, ASX treats the *value* of initial margin calculated with respect to each Client Account as belonging to the relevant Clients (in the case of an Omnibus Account) or Client (in the case of an Individual Client Account).

This value may be less than the value of assets actually provided by the Clients or Client to the CP. It is often the case that the CP will retain this difference and will not post it to ASX. However, where a CP posts collateral to ASX in excess of the amount of its initial margin obligation in respect of its Client Accounts ("**excess collateral**"), the excess collateral is exposed to the risk of losses that may arise in any of its Client Accounts, in the event of the CP's default.

Client Account Option	Key features	Advantages and disadvantages
Omnibus Client Account	The value of ASX's initial margin requirement for the account: • is not exposed to losses on the defaulting CP's 'House' (proprietary) positions or positions in other Client Accounts; • is exposed to losses on positions of all Clients in the account.	• Each Client in the account is exposed to the risk ('fellow customer risk') that, if the CP defaults, losses incurred by ASX in closing out positions of other Clients in the account will reduce (or exhaust) the collateral available to ASX to return in respect of the account (refer "Return of collateral", below). • Excess collateral is at risk, not only to 'fellow customers' in the same account, but to the risk of losses arising in any Client Account of the CP in the event that it defaults.
Individual Client Account	The value of ASX's initial margin requirement for the account: • is not exposed to losses on the defaulting CP's 'House' (proprietary) positions or positions in other Client Accounts; • is not exposed to losses on positions of other Clients (as the account consists of a single Client only).	• The Client is not subject to fellow customer risk. • Excess collateral is at risk to losses arising in any Client Account of the CP in the event that it defaults.

What are the porting options in a default scenario for each account type?

In the event of a CP's default, ASX will have the power to transfer (or "port") open positions in a Client Account, with cash collateral to the value of the associated initial margin requirement (as satisfied by the CP at the last end-of-day calculation) to an alternate CP nominated by the Clients (in the case of an Omnibus Account) or Client (in the case of an Individual Client Account). This is dependent on the alternate CP agreeing to the transfer within a defined period of time from ASX's declaration of default (OTC derivatives: up to 48 hours; ASX 24 derivatives: up to 24 hours).

The likelihood of the "portability" of open positions and cash collateral for the associated initial margin is affected by the Client Account Option chosen by the Client.

Client Account Option	Key features	Advantages and disadvantages
Omnibus Client Account	Positions recorded in the account are not able to be ported in practice, as porting is dependent on all Clients nominating, and being accepted by, a single alternate CP. It is possible that a Client's positions may be ported without collateral (for initial margin to the alternate CP). ASX will close out (terminate) positions that cannot be ported.	High risk of loss of positions on the CP's default; Clients should expect to have their positions closed out. Porting of positions without collateral is at ASX's discretion. The Client would have to re-collateralise ported positions with the alternate CP. Client exposed to risk of loss on close out of its positions and those of any other Client in the account.

Client Account Option	Key features	Advantages and disadvantages
Individual Client Account	Offers a high likelihood of portability where the Client can procure acceptance of its positions by an alternate CP within the prescribed period. The Client has the opportunity to nominate an alternate CP at any time. ASX strongly encourages the Client to have alternate clearing arrangements in place at all times. Positions which are not ported will be closed out.	Positions can be ported, subject to timely acceptance by alternate CP. Specific collateral posted by a Client to the CP (i.e. specific non-cash assets) will not be ported. ASX will liquidate all collateral posted by the CP upon default, and port the value of the associated initial margin requirement.

Please see Default Management.

How many accounts can a client have?

There is no restriction as to how many individual accounts a client can have, but a client can only be part of one Omnibus account for OTC interest rate derivatives transactions per CP.

Can a client use the same account for another CP?

No, there is a separate account set up for each CP that clears trades for the client.

What is required to start client clearing?

- Authorisation from ASX to become an OTC Participant in accordance with the OTC Rules.
- CP Client Clearing Accounts opened by ASX
- CP name, Identifier (LEI or other recognised identifier), address
- Nomination of Account type (Individual Client Account or Omnibus Account)
- MarkitWire Participant Id
- Contact information: Legal contacts, Operations contacts

The Clearing Process

What products will be covered by ASX's OTC Client Clearing Service?

Initial Product Coverage/trades eligible for clearing:

- A$ IRS
    - AUD Fixed/Float out to 30 years- 3M, 6M BBSW index
- A$ Single Ccy Basis Swaps
    - AUD Float/Float out to 3 years- 3M, 6M BBSW index
- A$ OIS
    - AUD Fixed/Float out to 3 years- AUD-AONIA-OIS-COMPOUND

Please visit the ASX website OTC clearing handbook for further details of eligibility criteria.

Is an OTC CP required to clear both futures and OTC products?

No, an OTC CP is not required to clear both but if it does not clear ASX 24 Exchange Traded Derivatives, it must appoint a CP on its behalf who does clear ASX 24 Exchange Traded Derivatives.

What transaction types does the ASX OTC Client Clearing Service cover?

The ASX OTC Client Clearing Service will provide coverage of the following transaction types which, with the exception of Transfers, are conducted via the Approved Trade Source System (MarkitWire):

- New Trades
- Trade and position transfers (note these are conducted outside of MarkitWire)
- Backloading
- Trade amendments and terminations
- Block trade allocations

The general principles that all transaction types are subject to are as follows:

- They must be submitted via the Approved Trade Source System (currently MarkitWire) and bilaterally agreed between the counterparties of the transaction (and the new party of the transaction in the case of transfers).
- ASX reserves the right to approve or reject the transactions where they are not within ASX's acceptability criteria and/or exceed a CP's risk limits.

ASX OTC Clearing Hours

When will ASX be open to process transactions submitted via MarkitWire?

The OTC Client Clearing Service will enable transactions to be submitted and processed between 6:00am and 9:00pm Australian Eastern Standard Time (AEST) or Australian Eastern Daylight Time (AEDT).

What happens if a transaction is submitted outside of ASX Clearing open hours?

Transactions taken up by CPs and submitted by MarkitWire outside of 6:00am and 9:00pm will remain in the Approved Trade Source System (MarkitWire) and not be novated and accepted for clearing until the next time that the ASX Clearing Service opens.

For example, if a new trade was submitted on Friday, 12th of April 2013 at 10:00pm AEST, ASX would process this trade for Clearing shortly after 6:00am on Monday, the 15th of April 2013.

What happens if a transaction requiring ASX intervention is not approved before ASX closes?

In situations where a transaction (excluding a backloaded transaction) requires ASX's approval (e.g. collateral shortfall or limit breach) and ASX is not able to provide approval before the closing time of the ASX Clearing service, the transaction will be rejected and will be required to be re-submitted on the following business day.

New Trades

How will a new trade be executed?

Trades will be initiated and executed in exactly the same way as bilateral trades with the following additional steps and information provided:

At time of agreeing the trade and in addition to agreeing normal trade terms the client will also agree the following with its executing broker:

a) That the trade is to be cleared

b) Who the Clearing Broker should be

c) The allocation of trade if necessary (please refer to Block Trade Allocations)

d) The venue where the trade will be cleared i.e. ASX

The trade will need to be entered and affirmed on MarkitWire.

How is the CP notified of a trade where a client has selected them as their CP?

There may be a direct process agreed between a CP and its clients in relation to notifying the CP of new trades. In clearing an electronic record of the trade being affirmed and then accepted by the CP needs to be evidenced. This is achieved when the client affirms the trade in MarkitWire and nominates its Clearing Broker (CP). MarkitWire will then send the details of the trade to the CP. The CP will check the trade details against criteria already agreed with its client, e.g. credit limits etc. and if the trade is accepted by the CP it will send a notification back to MarkitWire taking up the trade on the client's behalf. In MarkitWire this is referred to as Prior Take-up. As soon as MarkitWire receives this notification of prior take-up acceptance from the CP it will send the trade to ASX for clearing.

What happens to a client trade once a CP has accepted it for clearing?

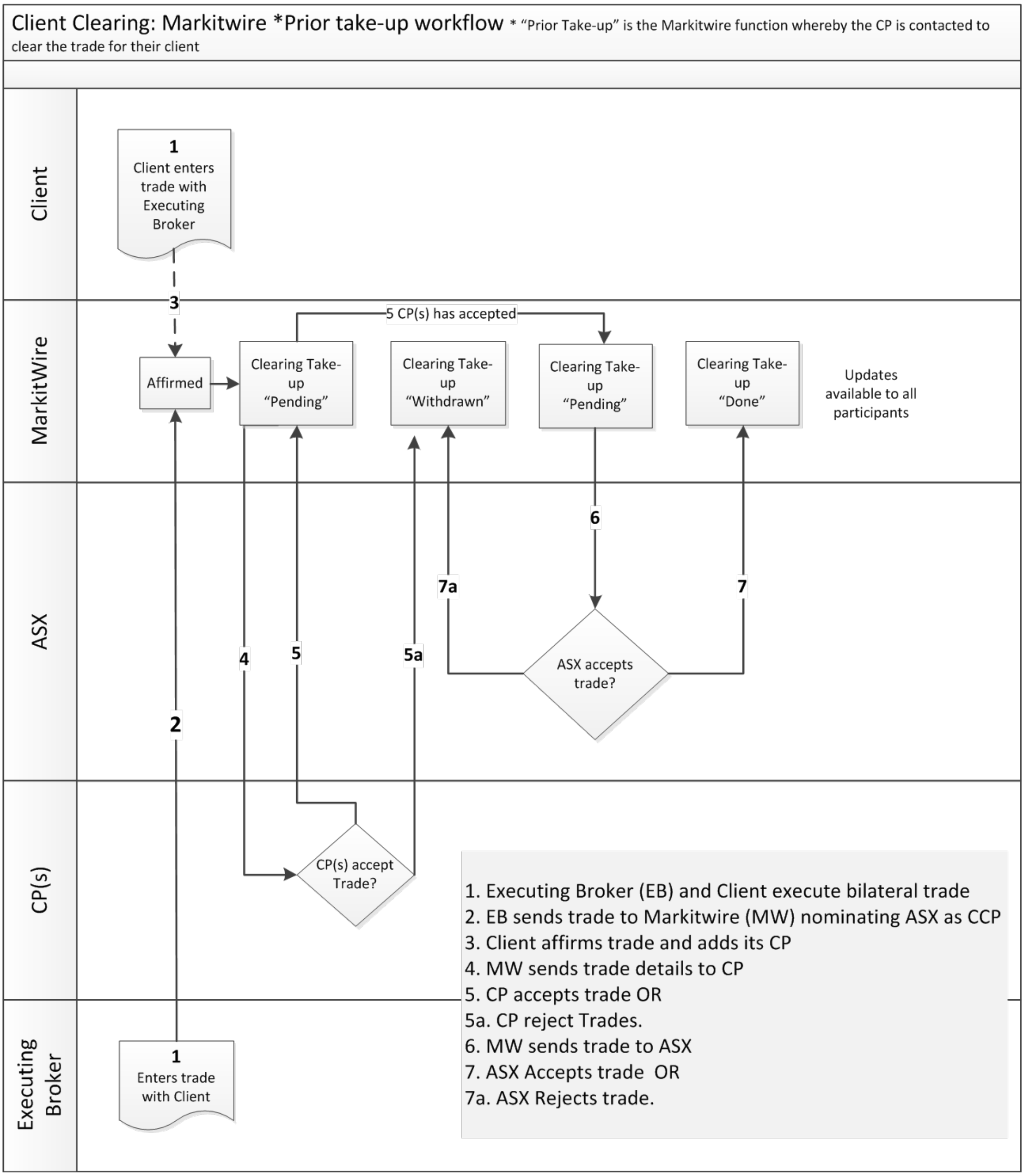
When the CP has consented to clear a trade on behalf of its client, MarkitWire will submit the trade to ASX for clearing. ASX has implemented "futures style novation" which enables ASX to automatically novate new trades when they are submitted for clearing provided that they meet ASX eligibility requirements and provided that each CP has sufficient risk exposure limit available for ASX to continue clearing new trades for that CP's clients.

ASX eligibility requirements include trade level validation of trade attributes acceptable to the ASX and a PV01 trade limit check to ensure that new trades have not been submitted in error.

If a trade is ineligible it will be rejected. Otherwise assuming there are no CP collateral shortfalls, the trade will generally be cleared within 60 seconds of receipt by ASX.

In respect of each CP, ASX maintains exposure limits which are actively managed alongside the CP's Client collateral balance. Where ASX determines that the uncollateralised exposure to a CP's clients is likely to exceed the intraday exposure limits set, ASX will contact the CP and ask it to post additional collateral intraday. If the CP is unable to post additional collateral (or if the ability to post such collateral is not available due to Austraclear being closed or for some other reason), then ASX may advise the CP that no further trades will be novated for that Business Day.

The following diagram provides an overview of the trade clearing process.



Is the CP required to be connected to MarkitWire?

Yes the CP must be connected to MarkitWire. MarkitWire is currently the only affirmation platform that can submit trades to ASX for clearing. This is achieved through the MarkitWire prior take-up functionality.

Does an executing broker need to be a CP?

The ASX does not require that the Executing Broker on a trade also be a CP. MarkitWire's functionality will facilitate the request for consent process for both sides of the trade in the event that the CP is neither the Executing Broker nor an affiliate of the Executing Broker.

The ASX service capabilities enable the Clearing Participants of both counterparties to participate in the request for consent process which in turn will facilitate Executing Brokers using non-related CPs and the clearing of Client to Client transactions.

Is there a time limit for agreeing to take-up a trade?

It is good practise to reply to take-up requests as soon as possible and it is likely that legislation will in future require that trades are accepted and MarkitWire updated within a very short time after execution.

What happens if a CP rejects a trade?

The CP is selected during trade affirmation in MarkitWire. If the CP is unable to clear the trade on its client's behalf it is possible for the client to select an alternate CP that is has clearing arrangements with. If a client does not have another CP or no other CP will accept the trade on its behalf then the trade remains a bilateral trade between the client and the executing broker.

Trade and Position Transfers

What happens if a client wishes to transfer trades to another CP?

There are two scenarios under which positions transfers are initiated:

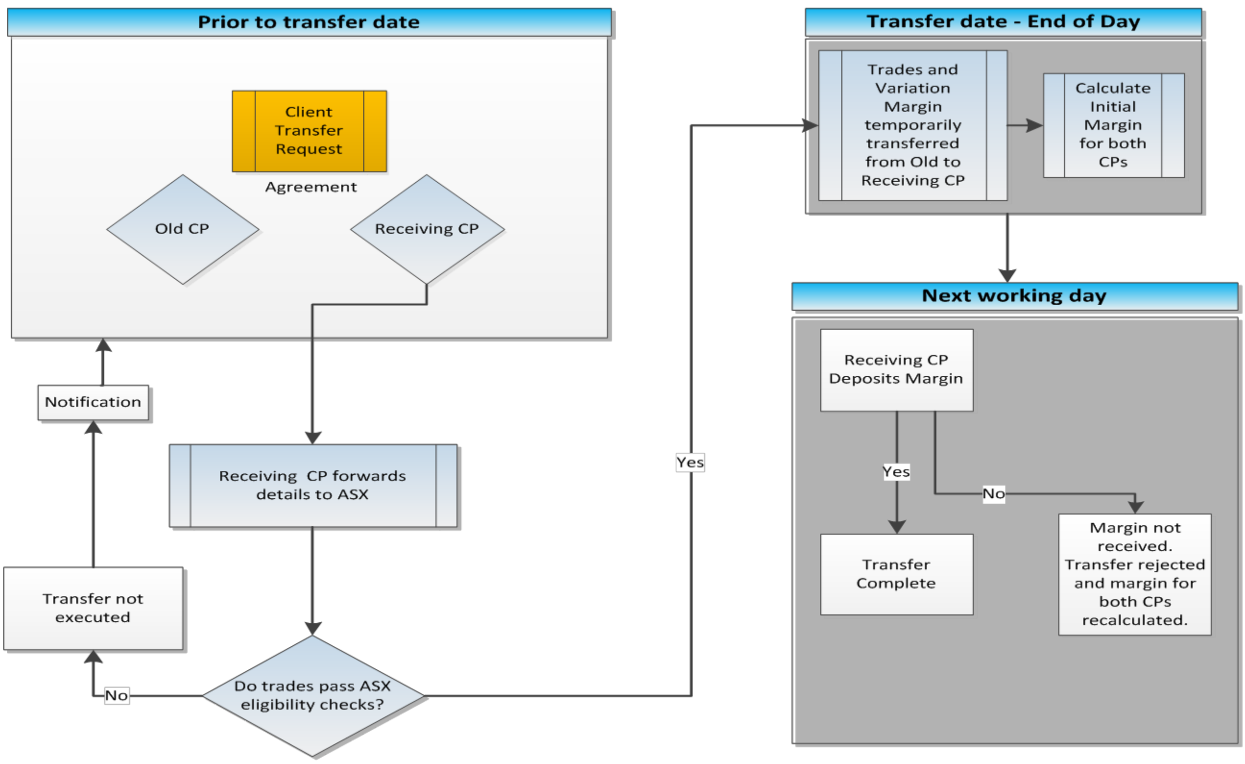
- The default of a CP. This process is known as "porting". This scenario is described in the Default Management section.
- In a Business-As-Usual scenario when a client wants to move some or all of their positions and collateral to another CP.

<u>Business As Usual:</u>
Clients can transfer their entire portfolio of part thereof to another CP in a Business-As-Usual ("BAU") scenario. To initiate the process, clients must notify the receiving - CP(s) who they wish to transfer their positions to. Clients need to consider the following when transferring their trades to another CP:

- The extent to which an agreement between the client and the receiving CP must be newly signed and or updated
- The Margin impact of the transfer

Once the receiving CP has received the transfer request from the client and agreed to take on the positions, the receiving CP would liaise with ASX to initiate the transfer process (subject to ASX approval).

The following diagram provides a high level overview of the transfer process:



Can a client transfer trades from a Client Omnibus to an Individual Client account and vice versa?

Yes, this is an account type transfer (i.e. moving a client's position from a Client Omnibus account type to an Individual client account type and vice versa) and can occur either within the client's existing CP or to a new CP.

Clients need to consider the following when transferring their trades to another account type:

- The extent to which an agreement between the client and the receiving CP must be newly signed and or updated
- The Margin impact of the transfer

Actual transfer of IM is not required as it is facilitated by the margin call process.

Why could a transfer fail?

Any or a combination of the following may lead to a transfer request to fail:

- Trades requested for transfer fail eligibility checks at the receiving CP;
- Margin requirements are not met;
- Trades transferred do not match what the receiving CP has agreed t

Trade Terminations and Netting

Can cleared trades be fully or partially terminated?

Yes, an equal and opposite trade (with same economic terms) must be executed and cleared in order to fully or partially terminate an existing trade. If the amount on the offsetting trade is the same as the original trade, both trades can then be netted and terminated. If the notional amount differs but the remaining economic terms are the same then then only part of the original trade will be terminated.

How and when does netting occur?

ASX netting functionality enables clients to close out existing trades. The netting process can be either automatic or manual depending on the client's arrangement with their CP. For manually flagged accounts the client will contact their CP and identity those trades to be netted. The CP will in turn nominate those trades and at EOD ASX's system process will then validate those nominations and net those trades which meet the ASX's netting criteria.

For automatically flagged accounts, ASX EOD ASX's system process will automatically identify and net those trades eligible under ASX's netting criteria.

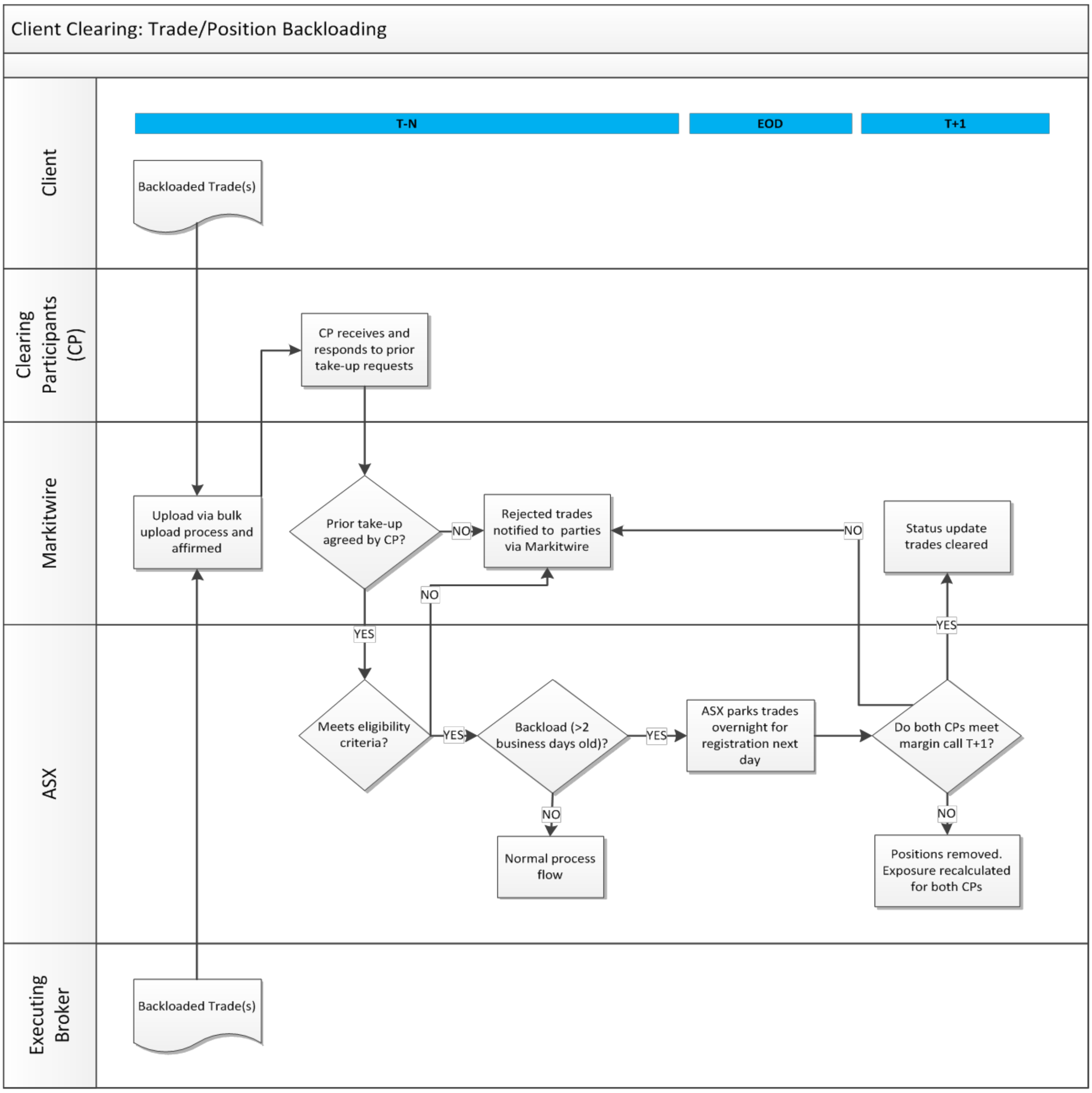
Backloading

What is backloading?

Backloading is the process for enabling previously bilaterally agreed trades (over a certain age) to be submitted for clearing. The ASX definition of backloading is the clearing of any trade greater than two business days old. Backloading can include individual trades or batches.

How does a client backload transactions for clearing?

ASX will support the backloading of existing transactions for clients of CPs of the ASX service. The expectation is that Backloading of large portfolios will require a level of prior planning and scheduling to ensure the implications from a risk and margin perspective are well understood by all parties and whether any separate collateralisation arrangements are also likely to be required. The process is likely to be the following:



Block Trade Allocations

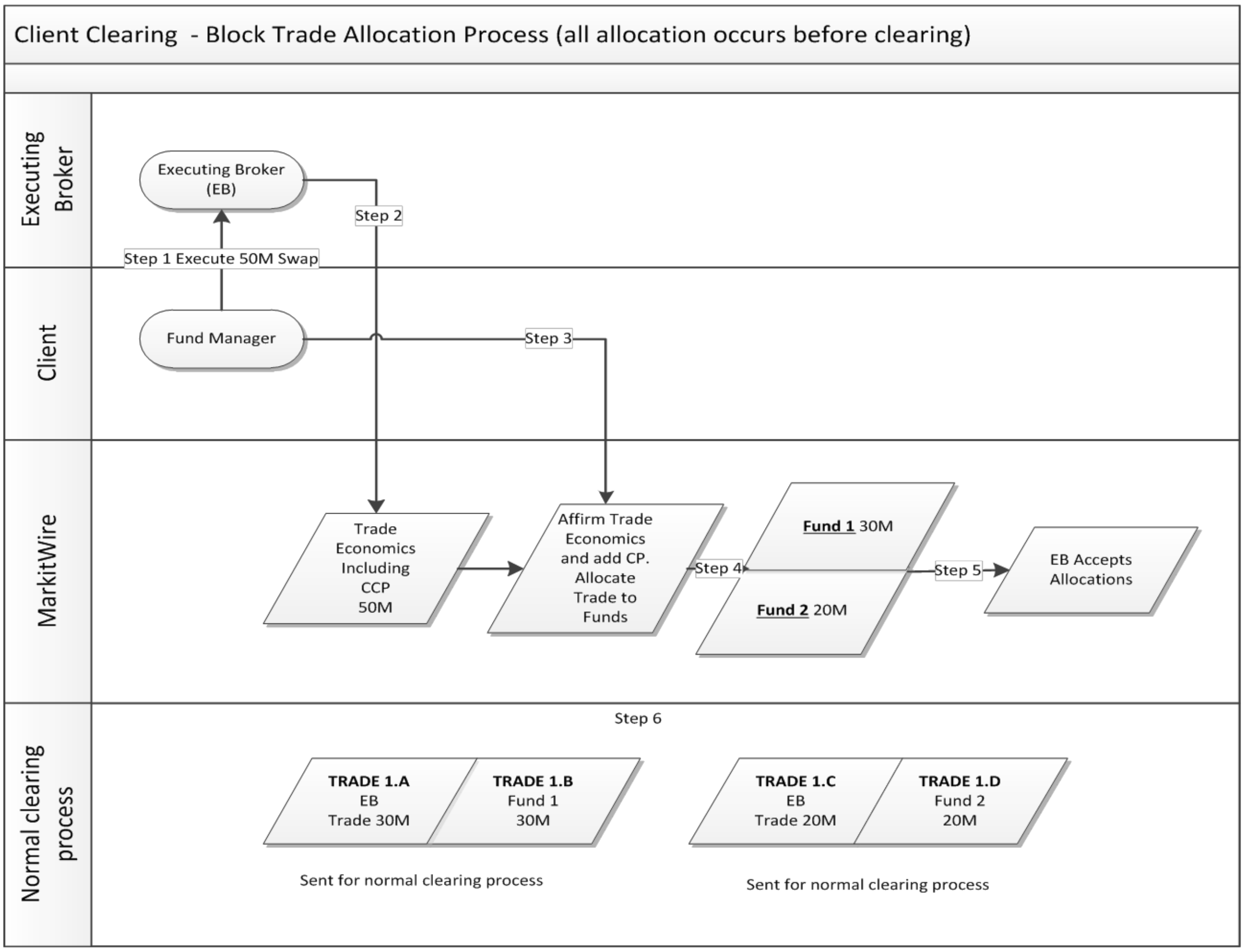
Will the ASX OTC client clearing Service support block trade allocations?

The actual allocation of block trades occurs during the affirmation process and prior to clearing. ASX effectively treats each allocation as a separate trade. The following is an explanation of this process prior to ASX receiving trades for clearing.

A block trade is used when the client wishes to allocate portions of a trade to different funds that it has traded on behalf of.

In the example below, the client allocates portions of a trade using the allocation function in MarkitWire.

Step 1 - A trade of 50M is transacted with the executing broker (EB) and they clear the trade at ASX.
Step 2 - The EB sends the transaction details to MarkitWire.
Step 3 - The client affirms the trade and selects the CP it is clearing the trade through and
Step 4 - allocates 30M of the trade value to Fund 1 and 20M to Fund 2.
Step 5 - The trades with the allocation are accepted by the EB.
Step 6 - MarkitWire will create paired trades for each allocation. In clearing these allocated trades are treated as any other trade as all the allocation is done before the trade is received for clearing.



Risk Management

What is ASX's Risk Methodology?

The ASX Clear (Futures) Risk Management approach is based on methodologies that are commonly used and considered to be international best practice. Margin requirements calculated are a primary daily obligation that a CP is required to collateralise with the ASX on a client's behalf. It should be noted that the amount of margin the client is expected to collateralise with its CP may not match ASX calculations, for example a CP may charge an additional amount on top of any initial margin requirements calculated by ASX.

Is it possible to predict margin?

Yes, ASX will have a margin simulation tool that will allow CPs and clients to calculate the margin associated with a trade or a portfolio of (cross margined) trades.

In addition to Variation Margin (VM) and Initial Margin (IM), are there any other types or components of margin?

Yes, three other concepts: Price Alignment Interest (PAI), Liquidity Multipliers and Additional Initial Margins (AIMs). PAI is automatically applied, while the other two may apply in certain circumstances.

What is PAI?

Price Alignment Interest (PAI) is directly linked to the VM on a portfolio. As VM represents a realisation of profit or loss on a collateralised portfolio, there is therefore compensation of funding costs applied via the application of interest to the outstanding VM balance i.e. NPV of the portfolio. Every day a calculation is made of the daily interest owing based on the overnight cash rate relevant to the portfolio and a net debit or credit settlement is made. As with VM, PAI is always in the same currency as the underlying product, with the ASX being net zero across all its CPs and clients.

What are Liquidity Multipliers and how are they calculated?

Liquidity Multipliers represent additional margin required to cover any large concentrated positions. The multipliers are based on a survey that ASX conducts with the Clearing Participants on a regular basis, and represents any additional perceived cost that ASX may have to pay to close out a concentrated portfolio in a default scenario. Liquidity multipliers are calculated and applied on an account by account basis; there is no aggregation with CP or other client exposures.

What are AIMs?

Additional Initial Margins (AIMs) are additional requirements that may arise through ASX's stress testing regime, where an additional margin requirement may be imposed on a CP as a result of a breach in monitoring their stressed exposures against an ASX assigned Stress Test Exposure Limits (STEL). Stress testing exposures will look at hypothetical losses generated on all positions in extreme but plausible market conditions. Calculations are performed at an account level before being aggregated to a CP total. In monitoring these exposures, an AIMs call will only be made where total losses exceed a CPs assigned STEL.

Although ASX does not directly charge the client AIMs, reporting is provided to CPs detailing exposures across all accounts. If an AIMs call is made, the CP may choose to recoup the costs or pass on a portion of that AIMs requirement to the end client.

What is ASX's intraday margining approach?

ASX's intraday calculations seek to assess two main components of a CP or client's portfolio: the change in value and risk on the existing portfolio and any increased risk associated with new trades. Should there be sufficient initial margin erosion as a result of new positions, or movement in prices, an intraday margin call may be made to reduce ASX's intraday exposures. Note: to preserve segregation there is no offset across client accounts, therefore the CP will be required to meet an increase in obligation from any of its clients.

How do exposure limits work?

The exposure limits and the monitoring of exposure thresholds follow the same approach as dealer clearing, and form the basis of intraday calls. In addition, there are concentration thresholds set at the individual client level which will assist ASX Risk Management in managing risk of clients to their CP and to ASX, particularly where a client has a large risk relative to their CP. All limits are set at the discretion of ASX.

What happens when exposure thresholds are breached?

If the CP is approaching their exposure threshold, ASX Risk Management will determine whether to call for additional margin from the CP and assess if further action is required.

Is there netting of intraday margin credits and deficits?

For all account types, margin requirement netting does not occur intraday. This is done to avoid any client's margin surplus being netted with other clients' margin deficit, and hence to minimise fellow customer risk. There is no repayment of excess intraday.

What is Capital Based Position Limit additional margin?

ASX Risk Management may call additional margin where a CP's exposure relative to its financial capability is seen as excessive. Alternatively, a CP may inject more capital on to its balance sheet to enable it to continue to run the exposure without paying additional margin. Where a CP's IM liabilities exceed the Capital Based Position Limit (CBPL), which is based on their capital a margin call will be made. As a CP approaches their CBPL, ASX Risk Management may call the CP for additional margin. Client positions will contribute to the exposure of a CP in measuring CBPLs.

Collateral Management

What is the margin call procedure?

ASX will calculate margin requirements at scheduled intervals intraday and at the end of each business day on both OTC and futures positions. End of day calculations are performed after the close of the clearing service and requirements are notified to CPs the following morning for settlement at 11.00am.

In addition to end of day calculations, there are scheduled intraday margin calculations that run each business day at 8:30am and 11:00am that re-value positions and recalculate Initial Margin requirements. Please refer to the Risk Management section for the explanation of the margin components. If sufficient Initial Margin erosion has occurred on positions, an intraday call will be made. ASX will contact the CP via phone and provide an emailed report (Margin & Position Listing Report) which identifies the amount that the CP needs to settle (on behalf of its clients). Intraday margin calls must then be settled by the CP with $A cash, within 2 hours of receiving notification.

ASX may also from time to time initiate an ad hoc intraday margin run in response to stressed or volatile market conditions.

What happens if a client disputes a margin call?

ASX has no direct relationship with the client therefore any dispute the client may have about the amount of margin the CP requests for the client's positions will need to be resolved between the client and its CP.

What collateral does ASX accept?

All Variation Margin payments are required to be settled in cash in the currency of the cash flow; however Initial Margin can be collateralised with cash in an approved non matching currency and or with non-cash collateral in accordance with delivery times specified by ASX.

The following tables list the current eligible collateral and associated valuation haircuts:

<u>CASH</u>

Approved Cover	Current Valuation Haircut	Payment
A$ Cash	6%	The Valuation Haircut is not applicable if the currency is the same as that in which the ASX ETD contract is denominated.
NZ$ Cash	6%	
EUR Cash	11%	
JPY Cash	13%	
USD Cash	10%	
GBP Cash	8%	

Non-Cash Collateral

Approved Cover	Current Valuation Haircut
A$ Treasury Notes	2%
A$ Treasury Bonds	▪ Maturity less than 3 Years: 2% ▪ Maturity greater than 3 Years: 6%
US Treasury Bills	1%

What are haircuts and how are they applied?

A haircut is a percentage reduction on the market value of the collateral that represents the potential movement in value (in stressed market conditions) before ASX can liquidate in the event of a CP default. A CP may advise of alternative haircut arrangements for clients when collateralising margin requirements, however this will need to be discussed directly with your CP.

What are the options for a CP when posting collateral?

For securities collateral, the CP can either:

a) Lodge the exact collateral with ASX or

b) Hold the client's collateral and lodge other collateral at ASX.

In all cases, ASX receives all collateral related to margin requirements via the CP (or a third party e.g. custodian if there is an arrangement in place).

How does client collateral get valued?

The collateral that is sent by the CP to ASX is valued daily by ASX and reported back to the CP.

What is excess collateral?

Excess collateral is any collateral value in excess of initial margin requirements on the CPs Client Clearing Account. For the initial launch of OTC Client Clearing, any excess collateral lodged by the CP on behalf of a client, will not be distinguished as belonging to specific accounts. As a result, and in the event that a CP does lodge excess collateral on an individual client account, ASX will be unable to determine which client account(s) the excess collateral relates.

Accordingly, in the event of a Clearing Participant default, only the cash value of initial margin will be ported (where porting arrangements are in place), with the remainder being returned to the CP appointed external administrator. Excess collateral may be utilised by ASX to offset:

- losses incurred by ASX upon close-out or termination of positions in any client account of the defaulting Clearing Participant that exceed the initial margin requirement in respect of the account; and

- shortfalls in the liquidated value of non-cash or cross-currency collateral as a consequence of insufficient collateral haircuts.

Can a client get its excess collateral returned?

If the client holds excess with its CP, and the client wishes this excess to be returned in a Business-As-Usual ("BAU") situation the client should liaise with their CP for specific timings of when they will receive any excess back from their CP.

What happens if the client does not have eligible collateral?

If the client does not have collateral that is eligible under ASX definitions, then it will be at the CP's discretion as to whether they accept non-eligible collateral and substitute it with eligible collateral. ASX does not offer collateral transformation services to clients and CPs.

Cross Margining

What is cross margining?

Cross margining is the concept of allowing trades in instruments in the same or similar asset classes (belonging to the same counterparty) to be included in the calculation of Initial Margin requirements. Positions in multiple asset classes would be included in one portfolio where there is some perceived margin benefit.

Will it be possible to cross margin eligible ASX 24 Exchange Traded Derivatives and OTC positions?

Yes, ASX will provide this feature. Eligible ASX 24 Exchange Traded Derivatives will be combined with the OTC portfolios for margining purposes. Initial Margin will then be calculated based on the net risk of the combined OTC/Futures portfolio, i.e. including offsets. The client may elect to allocate eligible ASX 24 Exchange Traded Derivatives for portfolio margining by notifying their CP. Note that the client must have both a separate OTC and Futures Individual Client Account with the same CP to take advantage of cross margining.

By what time does the CP need to allocate the client's eligible ASX 24 Exchange Traded Derivatives to the OTC Client Clearing account to achieve portfolio margining value?

Eligible ASX 24 Exchange Traded Derivatives allocations must be completed by 7:00pm AEST or AEDT on each Clearing Business Day for inclusion in the end of day margin run.

If eligible ASX 24 Exchange Traded Derivatives positions are nominated correctly by this time, they will be included in the End of Day OTC calculations and provide portfolio-margining value accordingly.

How do margin values and cashflows get reconciled across OTC and eligible ASX 24 Exchange Traded Derivatives?

ASX intends to provide daily reporting which can be accessed by CPs to reconcile OTC and eligible ASX 24 Exchange Traded Derivatives margin values. A full breakdown of all margins and cashflows will be provided.

What happens when cross margined futures positions are nearing expiry?

5 Business Days prior to expiry of the cross margined eligible ASX 24 Exchange Traded Derivatives, the positions will no longer be eligible for cross margining and will be treated as 'ineligible products'. As 'ineligible products' these positions will be SPAN-margined and included in the ASX 24 Exchange Traded Derivatives Initial Margin value for the CP.

What eligible ASX 24 Exchange Traded Derivatives contracts are eligible for cross margining

The following eligible ASX 24 Exchange Traded Derivatives contracts are eligible for cross margining:

Eligible ETD Contract Code	Contract Name
IB	ASX 30 Day Interbank Cash Rate Futures
IR	ASX 90 Day Bank Accepted Bill Futures
YT	ASX 3 Year Treasury Bond Futures
XT	ASX 10 Year Treasury Bond Futures

Default Management

What constitutes a default of a CP?

The ASX Clear (Futures) Operating Rules set out a number of events which ASX may treat as a default event. This includes, but is not limited to, bankruptcy of the entity or failure to meet a margin call.

What happens if a client's CP goes into default?

In the event of a CP's default, ASX has the power to transfer (or "port") open positions in a Client Account, with cash collateral to the value of the associated initial margin requirement as at the last end-of-day calculation that the defaulting CP successfully settled. Porting will only be carried out where a Client, with an individually segregated account has nominated an alternate CP and that CP is willing to accept the portfolio (within the specified time frame). Clients that are constituents of a Client Omnibus account will only be ported where all clients agree, and have in place, an alternate clearing arrangement with the same alternate CP.

Once a CP is declared in default, all clearing activity of the CP and its clients is stopped. There are several options for ASX once a CP goes into default:

- Terminate the defaulting CP's open positions
- Hedge the positions
- Port the client positions to an alternate CP
- Conduct auctions to enter into new risk reducing positions

What happens to a client's cross-margined positions if the CP goes into default?

In the case of cross-margined positions, the entire portfolio of the OTC and futures positions must be ported together to the alternate CP. Therefore, if cross-margining, alternate CPs must be set up to clear both OTC and futures. It is worth noting that in the event that the portfolio is unable to port, the portfolio(s) can be merged with the CP house portfolios for hedging and auction purposes (however clients will remain ring-fenced from losses on the defaulting CPs house account).

What is the timeframe for a client to port / find an alternate CP?

48 hours, which is why it is advisable to ensure an alternate CP has been selected in advance e.g. ideally as part of the onboarding process. Where a client has made arrangements for alternate CPs, in the event of the client's primary CP defaulting, the client's portfolio information is sent out to the alternate CPs simultaneously for the CPs to assess the portfolio. The first CP to accept will take the positions.

How does an alternate CP decide whether it wishes to accept the client's positions?

ASX will provide details of the portfolio in the event of the client's primary CP being in default, this will facilitate the decision process.

What happens if the client is unable to port / find an alternate CP?

ASX reserve the right to close out the position, which means that the trades are terminated and the client (in the case of an individual Client Account) or the CP (in the case of an Omnibus Account) will receive only any residual initial margin value, as calculated by ASX in respect of the account after deducting close out costs.

What is the treatment of collateral in a default scenario?

In the event of a default the collateral to be ported to an alternate CP by ASX in respect of a client account, is a cash amount equal to the value of the initial margin requirement calculated by ASX in respect of the client account at the last time at which the defaulting CP settled its end of day initial margin obligations with ASX.

For Individual Client account type, only the CP will know which specific collateral is attributable to each client. The CP can choose what collateral they send to ASX to fulfil the margin obligation, and this may not necessarily be the exact same collateral that the client sent to their CP. However, it is planned in a future release that fully segregated accounts with a specific link between a client and its collateral will be made available hence allowing the return of the exact collateral.

What is the treatment of excess collateral in a default scenario?

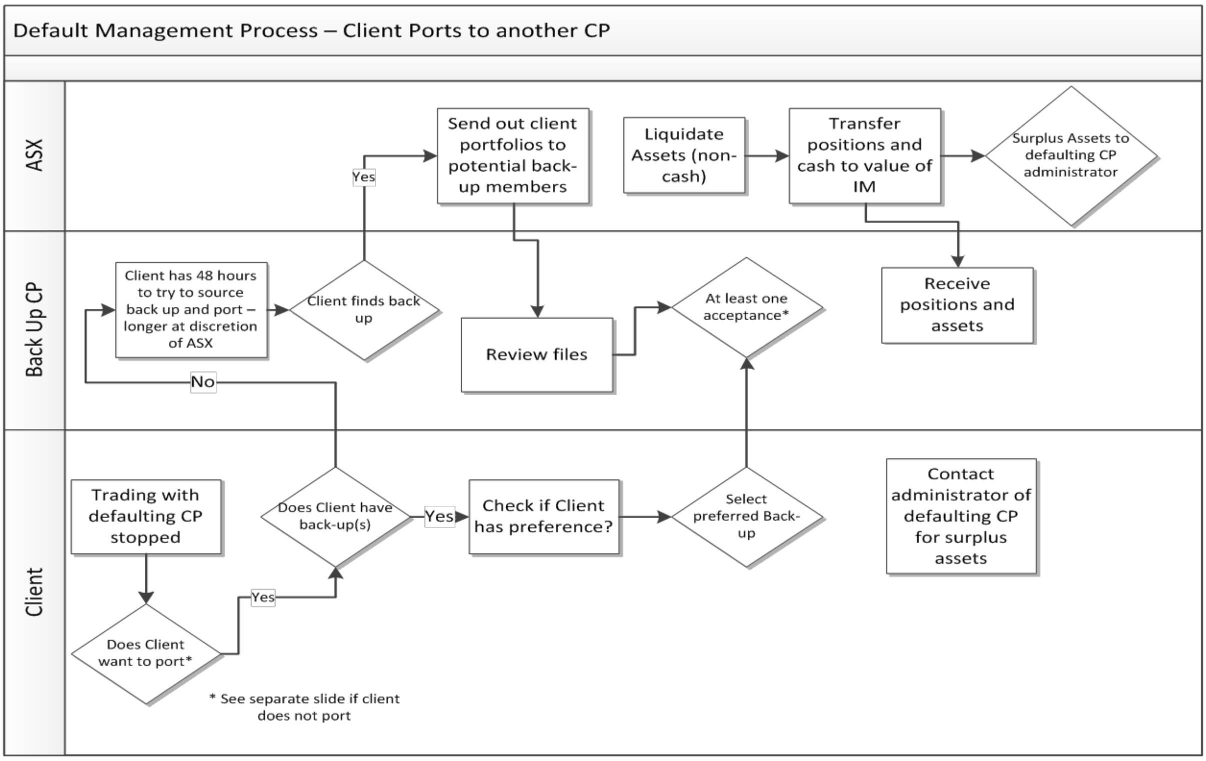
In the event that a clearing participant defaults and positions cannot be ported, a cash amount to the value of initial margin and excess collateral less any costs, losses and expenses incurred by ASX in closing out the positions on all accounts will be returned to the client.

Excess collateral may be applied by ASX to offset: losses incurred by ASX upon close-out or termination of positions in any client account of the defaulting Clearing Participant that exceed the initial margin requirement in respect of the account; and shortfalls in the liquidated value of non-cash or cross-currency collateral as a consequence of insufficient collateral haircuts.

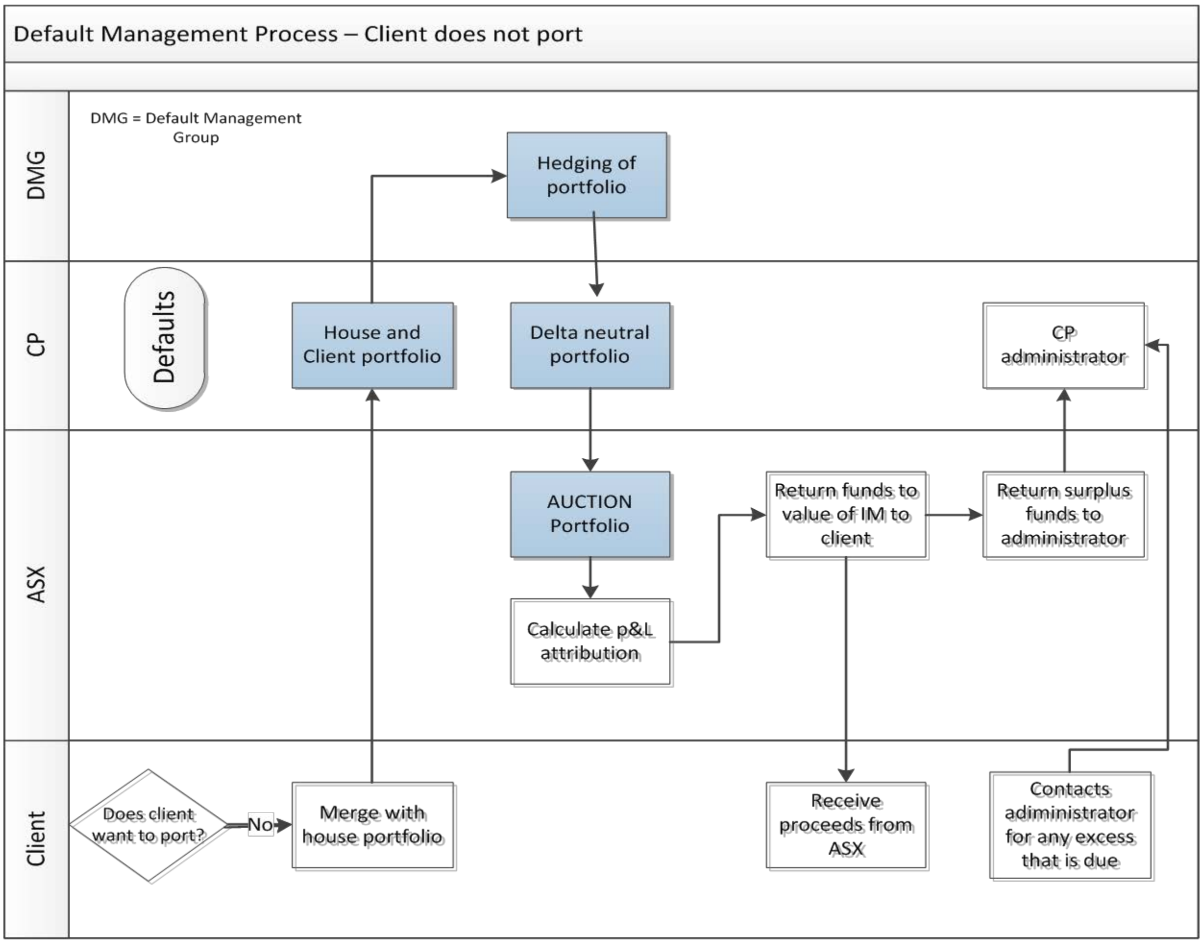
The balance of any excess collateral will be returned to the defaulting CPs appointed administrator.

What is the default management process?

The workflow process for default management where the client's portfolio is able to be ported is shown below.



The workflow process below is when the client's portfolio is not able to be ported.



What happens if the client goes into default?

In the event only the client defaults, it is the CP's obligation to cover for the client's positions. ASX can assist the CP to transfer the positions and assets into their house account. The CP can choose to unwind the defaulting client's positions and return any excess to the client.

What is the default fund?

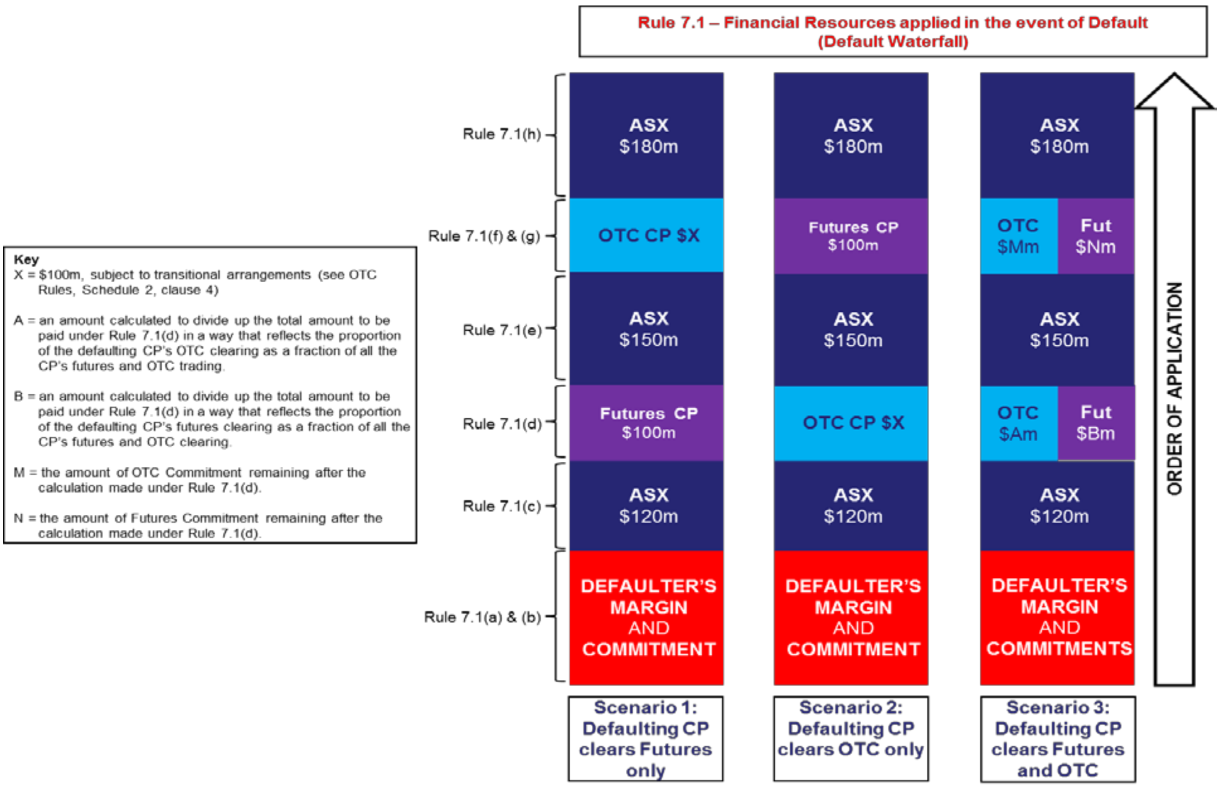
The default fund is the financial resources that the ASX has available to cover the losses that have been incurred following the closing out of positions for a defaulting participant after all the defaulting participants margins and commitments have been exhausted. The financial resources comprise of commitments from participants and funds provided by the ASX group.

What is the risk waterfall?

The risk waterfall determines in which order the financial resources available to ASX are allocated to the losses.

What is the structure of the risk waterfall?

ASX has a risk waterfall with a high level of its own capital that is at risk. Depending on the type of default the following loss allocation scenarios are as below:



How do default fund contributions work?

The default contribution has two parts: there is a fixed contribution amount that is applied equally to all CPs, and a variable contribution amount that is based on each member's combined House and Client Initial margin contributions. The default fund contribution is calculated on a quarterly basis.

Reports

What reports will ASX make available to CPs?

The ASX intends to provide CPs access to the following reports, many of which are of the same nature and structure as the reports provided for OTC Dealer Clearing which additional granularity of details to allow CPs to disseminate the data to their clients.

No	Reports	ITD Run 1	ITD Run 2	Ad-Hoc	End of Day	End of Month
1	Cash Flow Projection				x	
2	Price Alignment Interest				x	
3	EOD Cash Flow				x	
4	Intraday Cash Flow	x	x	x		
5	Daily Fees				x	
6	Monthly Fees					x
7	Daily Margin	x	x	x	x	
8	Cross-Margin Offset	x	x	x	x	
9	Cumulative Variation Margin	x	x	x	x	
10	Trade – Cleared	x	x	x	x	
11	Trade - De-cleared	x	x	x	x	
12	Trade – Rejected	x	x	x	x	
13	Trade – Pending	x	x	x	x	
14	Trade - Cumulative Monthly Cleared					x
15	Trade - Cumulative Monthly De-Cleared					x
16	Trade - Daily Open				x	
17	Rate Reset				x	
18	Curve - Discount Factor	x	x	x	x	
19	Curve - Underlying Quotes	x	x	x	x	

No	Reports	ITD Run 1	ITD Run 2	Ad-Hoc	End of Day	End of Month
20	Curve - Curve Points	x	x	x	x	
21	Curve - Zero Points	x	x	x	x	
22	Curve - Par Rates	x	x	x	x	

Additional reports available to CPs are retrievable through a combination of ASX Online, OmNet and Email distribution by ASX directly to the CPs.

No.	Reports	Mode of Retrieval	File Format	ITD Run 1	ITD Run 2	Ad-Hoc	EOD	End of Mth.	End of Qtr.
23	Financial Status Advice	OMNet/ ASX Online	.pdf / .csv				x		
24	Non-Cash Collateral Statement	OMNet/ ASX Online	.pdf				x		
25	Interest Earned Statement	OMNet/ ASX Online	.pdf / .csv				x		
26	OTC Margin and Positions Report	ASX Online/ OMNet/ Email	.pdf	x	x	x			
27	Quarterly Participant Commitment Obligation#	Email	.pdf				x		x
28	Quarterly Participant Commitment Accommodation#	Email	.pdf					x	x

How does the CP access the reports?

As per current OTC dealer reports.

What reports will ASX make directly available to clients for OTC client clearing?

The ASX intends to provide clients with access to the following reports:

Client Static Data report

This report will provide each client with the ability to regularly review and ensure accuracy of static data, account types and account options that have been provided to and set-up in ASX.

Report contents:

- MarkitWire ID
- Legal Entity Identifier
- Account Type
- Settings for trade netting
- Address Information
- CP (& back-up CP information)
- Legal, Operations and Default Event contact details and methods

Client Trade - Open Trade report

This report lists all live, Cleared OTC trades for each Client account and enables clients to reconcile positions with those reported by the CP.

Report contents:

- Trade economic data e.g. dates, rates, amount
- Trade source and reference data e.g. MarkitWire trade reference, ASX trade reference
- Trade Status e.g. clearing status, backload pending, transfer pending

<u>Market Data report</u>

These reports will contain the rates and yield curves used by ASX to calculate NPV for each trade. The reset rates used for reference rate fixings will also be provided.

Report contents:

- Rate resets e.g. daily reference/fixing rate values
- Curve information e.g. discount factors

Contact Us

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Glossary

Alternate CP – a secondary CP nominated by a client to port a client's positions and assets to in the case the client's primary CP is declared to be in default. . It is preferable but not mandatory for back-up CPs to be nominated in advance of a default.

ASX - ASX Clear (Futures) Pty Limited

Backload - The process by which a portfolio of trades are loaded into the clearing system from a bilateral state. The standard guideline for a backloaded trade is a trade that was originally transacted more than two days ago and is currently not in clearing.

Central Counterparty ("CCP") –Market infrastructure that sits between the two original parties to the transaction, taking care of post-trade considerations and guaranteeing performance throughout the life of the transactions. A trade must be novated to face the CCP in order for it to perform these functions.

CP ("CP") - A market participant that joins ASX directly as a 'participant' to clear their own trades and/or those of their clients. In the context of client clearing, a CCP enables its direct CPs "CPs" to intermediate between itself (the CCP) and the indirect Clients (i.e. market participants who are not direct CPs of the clearing service) to facilitate clearing of OTC IRD transactions. The CP must segregate house business and client business and these are referred to as follows in the document:

- CP House account – this is the account through which the CP must clear all its own business.
- CP Client account – this is the account which is used to settle the clearing business of all clients of that CP. Margins are settled as one amount.

Client – Indirect participants who do not have direct membership to the ASX and who must clear their OTC IRD transactions through CPs (Direct participants). Clients can be standalone or consist of a group of related entities.

Client Clearing Cross Margining ("X-M") account – Records the CP's client clearing futures positions which are eligible to be portfolio-margined with OTC Interest Rate Derivatives and have been selected by the client to be portfolio-margined with OTC Interest Rate Derivatives

Client Omnibus – Client positions and client assets are held in one account and the CCP cannot identify the individual end client. The CP can cross-utilise client margins and may not place assets with the CCP. Portability with this account structure is only possible if all clients of a defaulting CP port to the same alternate CP.

Cross-Margining - The concept of allowing trades in instruments in different asset classes (belonging to the same counterparty) to offset each other for the purpose of measuring Initial Margin.

Entity – Entities are sub accounts of a client. They may be legal entities in their own right or branches/divisions of the Client account

Executing Broker (EB) – An executing broker is the party with whom the client executes the transaction and with whom the client affirms the trade with on Markitwire.

Excess collateral - Collateral posted in excess of margin liabilities or headroom created against existing collateral through a decline in associated margin liabilities. In the event of the CP's default, excess collateral will be at risk to losses arising in respect of any Omnibus Account or Individual Client Account of the CP.

Guaranteed Initial Margin Value – The collateral to be ported by ASX in respect of a client account is a cash amount equal to the value of the initial margin requirement calculated by ASX in respect of the client account at the last time at which the defaulting CP settled its end of day initial margin obligations with ASX ("**Guaranteed Initial Margin Value**"). That amount excludes the value of end of day margin calls not settled by the defaulting CP and intraday margin calls whether settled or not. Where porting of positions in a client account does not occur, the amount to be returned by ASX is the Guaranteed Initial Margin Value for the account net of losses, costs and expenses attributable to closing out the positions in the account.

Individual Client Account –This structure legally separates positions, but operationally comingles them and the associated collateral. CP's assets and client positions for client clearing are identifiable by the CCP, and cannot be utilised for margining of other clients of the CP. Assets held in a CP's Client Clearing account are not directly attributable to individual clients. The CCP only recognises collateral to the value of initial margin as at the last settlement. In the event of a CP default, it is this amount that would be ported to an alternate CP or (less expenses) returned to the client.

Initial Margin ("IM") Initial Margin (IM) represents the estimated worst probable forward looking losses in normal market conditions that may incur on the portfolio in the event of a clearing participant default. ASX use a Value at Risk model to quantify risk associated with OTC products using 5 day holding period assumptions.

Intraday Margin ("ID") – In periods of extreme market volatility, ASX may call its CPs for additional collateral intraday. ASX intends to have a mix of scheduled and ad hoc intraday margin calls throughout the day and based on the level of market volatility relative to existing margin cover.

MarkitWire – A financial infrastructure platform used for the recording (via affirmation) and booking of OTC Trades. Frequently a major source of trades for OTC Clearing houses as well as a bilateral records.

Portability – The transfer of positions and assets of a client to an alternate CP in the event that their primary CP goes into default.

Variation Margin ("VM") – Variation Margin (VM) represents the Mark to Market or Net Present Value of the complete OTC Cleared portfolio. It is calculated using ASX's methodology which aligns with standard market practise. ASX construct a yield curve using market data and utilities it to calculate VM. Details of the end of day yield curve are published daily and are available to CPs and clients. VM is calculated on a trade by trade basis and is aggregated at the CP client level and can be either a positive or negative amount depending on the CP and the aggregate of client VMs.

Every end of day there is a recalculation resulting in a net movement representing gains or losses on the cleared portfolio including new trades, this is the VM movement. All VM settlement needs to be in paid in cash and in the same currency of the underlying products. Additionally, intraday revaluations are performed that may result in intraday calls.