



Issues Paper: Impact of Multiple Trade Execution Platforms for ASX Listed Securities on ACH Clearing Participant Operations and Systems

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1. Purpose of the Document

As foreshadowed in Australian Clearing House (ACH) Circular 154/08 of 31 March 2008 and the ASX Consultation Paper "Access to Central Counterparty (CCP) and Securities Settlement Facility (SSF) CHESS Services No.1", ASX is undertaking a consultation process with ACH Clearing Participants (CPs) to obtain information on the likely impact of clearing multiple trade execution platforms for ASX-listed securities.

This consultation paper:

- Provides contextual background on the timetable for creating an access regime for all market licensees;
- Outlines the high-level relationships that need to be established, for comment and to assist with CPs' responses;
- Seeks further details on the means by which CPs may need to amend their operational processes to cater for a multiple-trading platform environment and;
- Requests CPs to identify areas in which additional or amended functionality or information will be required from ACH/ASTC.

Changes to accommodate the multi-trading platform environment are expected to affect all ACH CPs both in terms of operational/systems changes and the probable impact on timelines for other ACH projects. **ASX wishes to receive input from all CPs, whether or not they expect to clear trades from multiple trading platforms.** Following a Government announcement on details of any proposed regulatory framework, ASX will seek further input from CPs in order to refine the operational and systems solutions through further consultation and/or a series of bilateral meetings.

Please provide your feedback in writing by Monday 5 May to Anne Brown, Chief Risk Officer at anne.brown@asx.com.au. In your response, please indicate whether your comments are based on the assumption that your organisation will or will not be clearing trades from multiple trade-execution-only platforms. For any queries on this document, please call 02 9227 0233.

2. Background

ASX has received requests to engage in business and technical discussions on access to CCP and SSF CHES Services from aspirant market licensees for trade-execution-only platforms for ASX listed securities. In response, on 19 March 2008, ASX issued a public consultation document entitled "ASX Consultation Paper – Access to Central Counterparty (CCP) and Securities Settlement Facility (SSF) CHES Services No.1" (ASX Consultation Paper No.1). That document provides:

- Contextual background – outlining the events initiating this consultation and the activities undertaken by ASX so far, including discussions with key regulators;
- Transparency regarding the process being undertaken by ASX to identify, assess and manage risks and issues involved in provision of such access in a manner that does not compromise the stability of ASX's clearing and settlement facilities or increase systemic risk in the wider financial system;
- An indicative framework and timetable within which ASX will determine the access regime and standards to be utilised.

To ensure full acquaintance with the context and relevant issues prior to responding to this issues paper, Clearing Participants are encouraged to read ASX Consultation Paper No. 1, a copy of which is available on the ASX website at the following address:

http://www.asx.com.au/about/pdf/asx_consultation_paper_access_to_ccp_and_ches_1.pdf

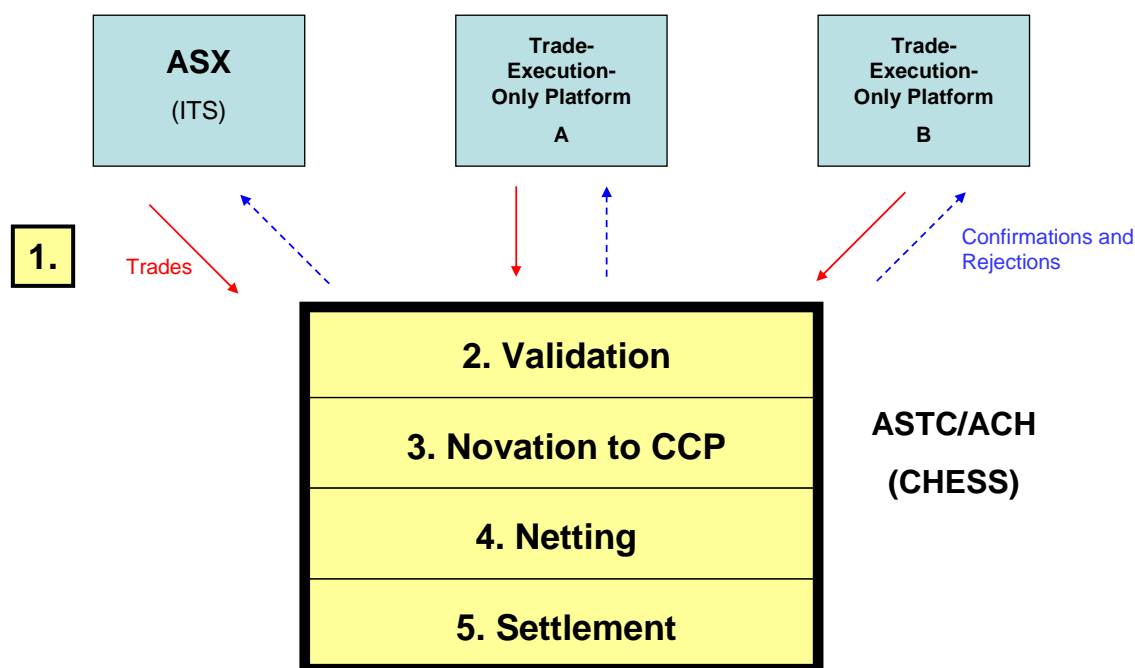
3. Clearing and Settlement Process

3.1. Overview of Responsibilities and Key Processes

In order to facilitate feedback from Clearing Participants, this section provides a high-level overview of the relationships that need to be established to enable ASX to provide access to ACH CCP services for multiple trade-execution-only platforms. Figure 1 below provides a diagrammatic representation of the key components of this process, with additional commentary provided on each component. The approach is designed to ensure that ACH's risk and operational standards are not degraded and thereby ensure continued compliance with the CCP's obligations as a Clearing and Settlement facility licensee.

To clear the trades of a trade-execution-only platform through ACH, a Participant of a trade-execution-only platform must also become a CP of ACH and obtain the required permissions to clear trades from the specified platform. The same principle applies to third party clearing arrangements for Non-Clearing Participants of a trade-execution-only platform.

Figure 1 – Overview of relationships to enable ACH to clear multiple trading platforms



1. On execution of a trade, the trading platform will immediately supply real-time, trade-level settlement data to CHES in relation to trades undertaken on the respective trading platform. The technical solution for this process is under investigation.
2. On receipt, ACH will first validate the transaction to ensure that the format and information received is acceptable and that the security and its trade basis are ones on which ACH offers the CCP clearing service to the counterparties involved. Acceptances and rejections will be sent back to the operator of the trading platform, with rejections being handled in accordance with the Rules of each Market Operator.
3. Having passed these validation checks, the eligible transactions will be immediately novated to ACH and be processed in accordance with the ASTC and ACH Rulebooks. Acting as the counterparty to each CP for these

transactions, performance of these novated trades will be supported by ACH's financial resources in the event of a default by any Clearing Participant.

4. All novated trades, regardless of the source trading platform, will continue to be netted after the close of business two days prior to settlement in accordance with the existing CHESSE procedure. Between the point of novation and this netting cycle, the source trading platform for each 'trade level' settlement will be identifiable to CHESSE Settlement Participants.
5. Finally, at the outset of these new arrangements, settlement will be undertaken (typically on T+3) using an unchanged, single daily batch settlement process¹. Subsequently, ASTC will advise the issuer of the appropriate amendment to the register, following the existing process. Settlements arising from trading on all trading platforms will be subject to the same CHESSE settlement calendar and corporate action processing. Amendments to fee structures may also be required.

3.2 Key Components

The rationale for the key characteristics of the approach is outlined below:

1. “Terms of Trade”: In order for the trading activity sourced from multiple trade-execution-only platforms to be novated and netted with settlements arising from other trading platforms, ACH will require that the “terms of trade” reflected in each Market Operator's Rulebook do not create an unacceptable increase to ACH's risk profile and thereby jeopardise its compliance with its obligations as a Clearing & Settlement facility licensee.
2. Point of Novation: Currently, novation occurs at point of trade on the ASX equity market. To minimise bilateral counterparty risk exposure from trading on trade-execution-only platforms, ACH must minimise the period between trade execution and novation. In order to adequately risk manage ACH's exposures, trade-execution-only platforms will be required to send each trade immediately after execution and ACH will novate the transaction once the resulting trade has been validated.
3. Single Netting and Settlement Batch: ASX has considered the feasibility and risks of both single and multiple batch CHESSE settlement to accommodate the new multiple trading platform environment. Settlement efficiency is maximised by netting all novated obligations from all trading platforms and netting the resulting payments across all novated and non-novated transactions into a single daily batch payment. In order to permit such netting, ACH will review the Rules of the proposed Market Operators seeking to participate in the settlement process to ensure that it is satisfied that all settlements are fungible. Once again it should be noted that ongoing consideration of the systemic implications of recent market events may result in the current single batch and settlement process being revised.

¹ Note that following recent market events, ASX, in consultation with regulators, is reviewing the CHESSE batch payment netting arrangements in respect of novated and non-novated transactions and, irrespective of the changes to accommodate the multiple trading platform environment, may amend the current CHESSE settlement processes.

4. Feedback

4.1. Input on the Overview of Responsibilities and Key Processes

- a. In reference to Section 3, do Clearing Participants agree with
- i. The overview of responsibilities and the associated processes as outlined?
 - ii. The robustness of the underlying rationale?

If there are any aspects that you wish to see amended, please outline the reasoning and benefits of such a change.

- b. In acting as a CCP, ACH is counterparty to each Clearing Participant in respect of all novated transactions and relies upon all of its financial resources to support its activities should a Clearing Participant default. The sufficiency and composition of these arrangements comply with the RBA's Financial Stability Standards. Currently these arrangements comprise:
- \$150mn of ASX Group capital;
 - \$100mn of default insurance;
 - (a variable amount of) Clearing Participant contributions, and;
 - \$300mn of emergency assessments immediately callable from Clearing Participants.
- i. Clearing Participants should understand that all Clearing Participant contributions and emergency assessments will be applied to default losses arising from novated settlements related to trades executed on all other trading platforms, irrespective of the platforms on which the Clearing Participant is participating. Does this raise any concerns for Participants?
 - ii. In light of the likely change in size and source of cleared transactions as a result of the introduction of multiple trading platforms, what are Clearing Participants' preferred means for increasing or changing the composition of the ACH's financial backing? Please outline the assumptions on which these preferences are based.

4.2 Specific Impacts upon Clearing Participants

Clearing Participants are also asked to review Section 3 and respond to the following questions:

1. What changes do Clearing Participants envisage as a result of the change to a multi-trading platform environment?
2. What impact would this have on your organisation?
3. Are there any further requirements of the ACH service that will facilitate Clearing Participants' needs in a multiple-trading platform environment?

In answering these questions, please include in your consideration the following activities:-

- risk management operations;
- business operations;
- regulatory compliance;
- back office and other systems.

4.3 Changes in Clearing Participants' Approach to Key Processes

ASX has identified some key processes on which it requires further information from Clearing Participants to assist with ACH's high-level design of a clearing service that accommodates multiple trading platforms. In respect of the processes outlined below, **Clearing Participants that anticipate clearing for more than one trading platform are asked to:**

1. outline their proposed approaches to these processes, stating any assumptions made and;
2. respond to the individual questions in the sections below:
 - a. CHES Reporting: As highlighted in Section 3, CHES will receive trade-level settlement information from multiple trading platforms. Do these additional activities create a need to produce additional or modified reporting from CHES?
 - b. Reconciliation: To facilitate trade and settlement data reconciliation from multiple trading platforms, are there any additional requirements of ACH/ASTC?
 - c. ACH Rulebook Compliance: All Clearing Participants must continue to comply with the ACH Rulebook, irrespective of the nature and number of trading platforms for which the Clearing Participant offers clearing services. In a multi-trading platform environment, are there any aspects of the current ACH Rulebook or Compliance that would require clarification/amendment or require additional functionality from ACH? In particular, Clearing Participants are asked to consider the need, on an intraday basis, to comply with the ACH minimum capital requirements.
 - d. Rejected Trades: Where a trade submitted to ACH fails to meet the criteria of a cleared trade e.g. an ineligible product or counterparty, ACH would send a rejection to the trading platform. The transaction would then be handled as determined by the Market Operator's Rulebook. What information is required from ACH/ASTC to assist Clearing Participants manage this process?
 - e. Client Risk Management: Is there any additional functionality required from ACH and ASTC systems to support Clearing Participants' ability to quantify, monitor and mitigate client exposures across multiple trading platforms? In the event of a client default, are Clearing Participant procedures affected?
 - f. Fees: In order to reflect the variation in inherent risks and costs arising from the clearing of each trading platform, transactions from differing trading platforms may attract different fees. What would be the impact on Clearing Participants' reconciliation processes, accounting systems and the passing-on of fees to clients?
 - g. Trade Cancellations: In the event that Market Operators' Rules applying to trade cancellations are not identical, are there any additional processes that Clearing Participants will need to undertake? Do these generate additional requirements for ACH/ASTC?

4.4 Implementation Considerations

The extension of ACH's clearing services to a multi-trading platform environment will require operational and systems development by Clearing Participants. ASX wishes to ascertain the degree of impact on Clearing Participants and factors affecting the scheduling of such activity.

1. Are there any factors of which ASX should be aware that will impact development timeframes? Please consider the needs of any third-party system providers and any organisation-wide, system development restrictions that may impact your schedules.
2. What priority does your organisation attach to the extension of ACH clearing services to trade-execution-only platforms? How does this prioritisation relate to other ASX projects including the ACH/SFECC harmonisation/integration process?