



# ASX Clear Pty Limited

Consultation on Capital Requirements

October 2013

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## Invitation to comment

ASX Clear Pty Limited is seeking submissions on the proposed changes canvassed in this paper by Friday 08 November 2013

Submissions should be sent to:

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or

Office of General Counsel  
ASX Limited  
20 Bridge Street  
Sydney NSW 2000

ASX prefers to receive submissions in electronic form

Submissions not marked as 'confidential' will be made publicly available on ASX's website

If you would like your submission, or any part of it, to be treated as 'confidential', please indicate this clearly in your submission.

ASX is available to meet with interested parties for bilateral discussions

## Contacts

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## Introduction

### Purpose

Participant capital requirements are a key risk management tool used by ASX Clear Pty Limited (ASXCL) to promote systemic stability.

ASXCL clearing participants are subject to risk based capital requirements and the issue of minimum core capital requirements for direct participants has been subject to review since July 2008. ASX Clear Corporation Notice 064/12 dated 3 December 2012 notified the market that ASXCL would consult on the minimum core capital requirements in 2013. This paper seeks feedback on whether or not the minimum core capital for "Direct" clearing participants should remain at \$5 million or be raised to \$10 million as originally proposed.

In addition ASXCL has been approached by several clearing participants who have advised that the minimum core capital requirement of \$20 million for a "General" clearing participant is a barrier to entry, if the clearing participant only wishes to clear for a related third party or provide clearing services to a limited number of participants. Accordingly this paper seeks feedback on the introduction of a tiered capital arrangement.

### Frequently Used Terms

Terms that are frequently used in this Consultation Paper are defined below.

Term	Meaning
ADMS	ASX Derivatives Margining System
AIM	Additional Initial Margin
ASIC	Australian Securities and Investments Commission
ASXCL	ASX Clear Pty Limited
CBPL	Capital Based Position Limit
CCPs	Central Counterparty
CMM	Cash Market Margining
CPs	Clearing Participants admitted under the ASX Clear Operating Rules
DCP	Direct Clearing Participant
ETOs	Exchange Traded Options
GCP	General Clearing Participant
MCCR	Minimum Core Capital Requirement
RBA	Reserve Bank of Australia
SPAN	Chicago Mercantile Exchange's Standard Portfolio Analysis of Risk
STEL	Stress Test Exposure Limit
TPC	Third Party Clearer

## Summary of Recommendations

ASX Clear is seeking market feedback on two proposals, that:

- the minimum core capital requirement for direct clearing participants should remain at \$5 million; and
- a tiered minimum core capital requirement should be introduced for general clearing participants that reflects the nature and number of clients for whom they provide clearing services.

## Submission Details

ASXCL welcomes feedback from stakeholders on the various proposals contained in this paper.

While specific questions are posed throughout the document, ASX welcomes any additional feedback you may have on any of the topics covered.

All responses should be addressed to Marisa Khan (Manager, Counterparty Risk Assessment) and should be submitted via email to [marisa.khan@asx.com.au](mailto:marisa.khan@asx.com.au). **ASX requires responses to be received by Friday 08 November 2013.**

Comments received as a result of this consultation will be considered by ASX in implementing the proposals outlined in this paper. Implementation dates will vary for each proposal depending on the complexity of the proposal and the extent of any rule changes and/or system changes that may be required. ASX will look to provide feedback on the responses received by the end of November 2013 and keep clearing participants informed on progress should it proceed with implementation of any changes.

# Minimum Capital Requirements for Direct Clearing Participants

## Background

ASX Clear Corporation Notice 064/12 dated 3 December 2012 notified the market that the planned introduction of the \$10 million minimum core capital requirement for direct clearing participants had been deferred from 1 January 2014 to 1 January 2015 at the earliest. It also notified the market that ASXCL would consult again on the minimum core capital requirements in 2013.

## Chronology of Events

The following is a chronology of events relating to the increases in minimum core capital requirements:

### July 2008

ASXCL announced that the minimum core capital requirements for all direct clearing participants would increase from \$100,000 in two stages – to \$2 million by the end of 2008 and then to \$10 million by the end of 2009.

### December 2008

Rule changes accommodating both of the increases received regulatory clearance from the Minister who also initiated a Reserve Bank of Australia (RBA) / Australian Securities and Investments Commission (ASIC) review of the changes and impacts.

### January 2009

The revised minimum core capital requirements of \$2 million became effective for Direct Clearing Participants (DCPs) and General Clearing Participants (GCPs).

### April 2009

RBA and ASIC released their "Review of Participation Requirements in Central Counterparties<sup>1</sup>". ASXCL also released its response to the RBA and ASIC report indicating that it was in broad agreement with the report's conclusions and would amend the implementation timetable accordingly. ASXCL stated<sup>2</sup> that it would increase DCP minimum core capital to \$5 million (effective 1 July 2010) and then \$10 million (effective 1 January 2012). It also announced that GCP core capital requirements would increase to \$10 million on 1 July 2010 and that the ASX would "undertake additional analysis with a view to further increasing the minimum core capital for ASXCL GCPs effective 1 January 2012".

### July 2010

The further stage capital increase was implemented: DCPs to \$5 million and GCPs to \$10 million.

### December 2010

ASXCL announced a deferral of DCP increases to \$10 million minimum capital from January 2012 to January 2013, subject to a review in late 2011 including an assessment of development in third party clearing.

### December 2011

ASXCL announced a further deferral of DCP increases to minimum capital from January 2013 to January 2014 at the earliest, subject to further review in late 2012.

### January 2012

The GCP minimum core capital requirement increase to \$20 million became effective.

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<sup>1</sup> See <http://www.rba.gov.au/payments-system/clearing-settlement/review-requirements/index.html>

<sup>2</sup> See [http://www.asxgroup.com.au/media/PDFs/mr070409\\_capital\\_requirements\\_update.pdf](http://www.asxgroup.com.au/media/PDFs/mr070409_capital_requirements_update.pdf)

December 2012

ASXCL announced another deferral of DCP increases to minimum capital from January 2014 to January 2015 at the earliest and its intention to consult on this in 2013.

## Introduction of Additional Margins

In December 2012 ASX migrated from the ASX Derivatives Margining System (ADMS) to the Chicago Mercantile Exchange's Standard Portfolio Analysis of Risk (SPAN) margining methodology for the margining of Exchange Traded Options (ETOs). ASXCL migrated to SPAN because it provides a better estimation of risk by accounting for changes in volatility and time as well as the underlying price, something that was not available in ADMS.

In addition, in June 2013 ASXCL introduced end of day margining of all Cash Equities positions. Cash Market Margining (CMM) is a "principal to principal" margin between the Clearing House and the clearing participants to ensure that in the event of a default of a clearing participant the Clearing House can close out the clearing participant's net novated obligations with minimal impact on the rest of the market.

## International Comparison

A sample comparison of international CCPs (covering Canada, Europe, Germany, Hong Kong, Italy, Japan, Singapore, Sweden, Switzerland, UK and USA) shows that all have some form of CMM or upfront collateralisation in place and that apart from the European CCPs all have minimum capital requirements below \$10 million and in most cases below \$5 million.

## Recommendation

While increasing minimum core capital could reduce the "probability of a participant default", cash market margining is a more effective means to cover a "loss given default" and provide greater protection to the Clearing House and its other participants.

Accordingly ASXCL is recommending that the minimum core capital for DCPs remains unchanged at \$5 million.

## Industry Consultation

ASXCL is seeking responses from interested parties to the following questions:

- Q1. Do you think that the current minimum core capital requirement of \$5 million for DCPs is appropriate?*
- Q2. If you do not consider the \$5 million requirement to be appropriate:*
  - (a) Should ASXCL proceed with increasing the minimum core capital requirement for DCPs and why?*
  - (b) What level should it be increased to?*
  - (c) Should the increase be implemented in stages or all at once?*
  - (d) What should the effective date of the increase(s) be?*
- Q3. Are there any other factors that ASXCL should take into consideration in determining the appropriate course of action with respect to minimum core capital requirements?*

# Tiered Minimum Core Capital Requirements for General Clearing Participants

## Background

Minimum Core Capital Requirements (MCCR) for GCPs (Third Party Clearers (TPC)) currently set at \$20 million; have increased significantly since the global financial crisis and in line with RBA and ASIC requirements for greater capital robustness of clearing participants.

Subsequent to these changes, there has been a shift in the competitive landscape for general clearing services with some participants exiting the market and a lack of third party clearing choices for retail brokers. Importantly, since the last increase in capital requirements was considered the clearing house has transitioned to a SPAN margin methodology for ETOs (December 2012) and has introduced cash market margining (June 2013). The combination of these factors has strengthened its position in managing a potential default and minimising losses to the Clearing House.

The current MCCR of \$20 million has been identified (by participants) as a barrier to entry for the provision of these services for either related or unrelated parties as a one size fits all approach does not adequately reflect the risks associated with the nature and level of activity being undertaken.

## Proposal

ASX proposes to offer the following tiered minimum core capital obligations for GCPs.

Type	# of TP's	Customers cleared	MCCR	Comments
Direct <sup>3</sup>	1 to 5	Internal and/or Wholly Owned Group Entity	\$5m	Self-clearing or clearing for Wholly Owned Group Entities
Transitional General Clearing Participant	1	External	\$5m	Equivalent to MCCR for a Direct Clearing Participant assuming no other clients are cleared.
Transitional General Clearing Participant	2	Self and one external	\$10m	Increments of \$5m per individual entity.
Transitional General Clearing Participant	3	Self and two externals	\$15m	Increments of \$5m per individual entity.
Full General Clearing Participant	4+	Self and many externals	\$20m	Ability to clear for an unlimited number of Trading Participants.

## Existing Risk Measures for TPC

Transitional general clearing participants will still be subject to a Stress Test Exposure Limit (STEL) and monitoring against their Capital Based Exposure Limit (CBPL) which could potentially result in an Additional Initial Margin (AIM) call being applied to the clearing participant if their business grows larger than their capital base can support.

## Industry Consultation

With regard to the proposed changes outlined above, ASXCL is seeking responses from interested parties to the following questions:

- Q1. Do you think a tiered minimum core capital requirement for GCPs is appropriate?*
- Q2. If "Yes" to Q1, is ASX's tiering proposal appropriate? If not, what would you propose?*
- Q3. Do you think there should be a time limit for transitional capital arrangements?*
- Q4. Are there any other factors that ASX Clear should take into consideration in determining the appropriate course of action with respect to tiered minimum core capital requirements for GCPs?*

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<sup>3</sup> "Direct Participant" means a Participant which is a Market Participant admitted by ASX Clear to clear a category of Market Transaction for itself, and its own Clients and Market Participants that are Wholly-Owned Group Entities and their clients.