

ASX Limited
20 Bridge Street
Sydney
NSW 2000

4 February, 2016

Attention: Janine Ryan, General Manager, Legal

By Email: Janine.ryan@asx.com.au

Dear Sirs,

Central Counterparty Recovery – Consultation on Exposure Draft Rules for Interim Replenishment of Default Funds– submission to ASX Limited (“ASX”) by J.P. Morgan Markets Australia Pty Limited (“J.P. Morgan”)

We refer to the ASX Consultation Paper of December 4, 2015 - “*Central Counterparty Recovery – Consultation on exposure draft rules for interim replenishment of default fund*” (“**Consultation Paper**”).

J.P. Morgan appreciates the opportunity to provide feedback on the Consultation Paper and provides a summary of its views on the proposed recovery tools for ASX Clear and ASX Clear Futures (together hereinafter “ASX”) below.

1. Introduction

From the Consultation Paper we understand that ASX is encouraged by its regulator the Reserve Bank of Australia (“RBA”) to be able to return to minimum levels of *prefunded* financial cover on a more rapid basis in case the funded Default Fund (“DF”) has been used in whole or in part following one or more member defaults.

In particular, we understand that RBA is of the opinion that an issue may arise during the relatively long period of 22 business days after the completion of the default management process (“DMP”), during which ASX may go unfunded or underfunded for an extended period of time. This potential for underfunding stems from the fact that ASX only has the ability to replenish the DF after the aforementioned 22 business day period following the end of the DMP.

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This 22 business day period may be restarted several times in case there are subsequent defaults after the DMP, but still within the 22 business day window.

In order to ensure that ASX does not go unfunded for an extended period of time, and in order to comply with the recommendations made by RBA having regard to applicable regulatory standards, ASX intends to amend its Recovery Rules so as to introduce an Interim Replenishment of the DF. Such interim replenishment will comprise of a maximum of AU\$200m for ASX Clear Futures and AU\$75m for ASX Clear and will be split equally between ASX and its respective member base. The Interim Replenishment can be used to absorb any losses during the 22 business day cool off period and is in addition to the assessment tools already available to ASX under its Recovery Rules.

2. Views of J.P. Morgan

In 2015 ASX introduced its Recovery Rules which allow ASX to call its members for a fixed number of assessments during the time comprising of both the 22 business day cool off period and the DMP. Accordingly, in a scenario whereby ASX applied all prefunded DF resources, it still has the ability to call its members for assessments to absorb losses which arose as a result of the default. As the only differences between the Interim Replenishment and the assessment are that the former are prefunded for subsequent defaults during the cooling off period and are in addition to the resources available under the assessments, J.P. Morgan is not supportive of this proposed replenishment mechanism, as this would defeat the purpose of the (limited number of) cash calls on members. In addition, we believe that adding additional resources to the default waterfall should not be required considering that ASX introduced its Recovery Rules late last year, and were based on extensive research and analysis as to the required number of assessments –which should capture the potential for further defaults during the 22 business day cooling off period- and, therefore, capture the financial resources needed in circumstances that would stretch beyond “extreme but plausible scenarios”.

In order to achieve equivalent results as RBA prescribes, we would encourage ASX to consider a structure whereby at least one assessment will be immediately funded in case the DF is used, or is very likely to be used. In that case ASX will have immediate resources available to itself to absorb residual losses that may crystallize from the DMP. Should these funded assessments not be used up, these should automatically convert into a DF replenishment at the end of the 22 business day cool off period. Additionally, ASX could call for a difference amount if the DF size

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is below the minimum requirements at the start and during the 22 day cooling off period for subsequent defaults, but this should continue to be subject to the existing cap amount in the form of limited number of assessments. This form of prefunding recommendation is in line with J.P. Morgan's views on ensuring that the financial resources of a CCP are (mostly) prefunded, as per our white paper of September 2014¹. A similar structure is used by SGX, CME and Ice Europe (F&O).

In addition, in order to mitigate RBA's concern that ASX may go unfunded for extended periods of time, we would encourage ASX to limit the number of times the 22 business day cool-off period can be restarted following an event of default during such period.

Finally we understand that any Interim Replenishment made by members will be deducted from the maximum amount to be paid by members for a DF replenishment after the 22 business day cool off period(s). As the Interim Replenishment could have been used during the cool off period as well, we wonder whether deducting any Interim Replenishment amount from the newly sized DF, may lead to a potential underfunding of the new DF size. We note that such potential underfunding would not occur if the aforementioned assessment tool is used.

3. Closing statements

We have set out our views on the ASX's proposed Interim Replenishment of Default Funds for ASX Clear and ASX Clear Futures. Whilst we recognize the concerns of RBA and ASX's corresponding proposal, we believe these concerns can be addressed more appropriately by applying ASX's existing ability to call for limited assessments instead of introducing an additional financial resource and introducing an additional layer of rulebook complexity.

¹ "What is the resolution plans for CCPs", J.P.Morgan Chase, September 2014

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If you would like to discuss our comments and views in more detail, please reach out to:

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Sincerely,

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