

**ASX Clear:  
Guidance Note on  
Clearing Participants Liquidity Risk  
Management Frameworks**

CONSULTATION PAPER

FEBRUARY 2016



**Invitation to comment**

Contacts ASX is seeking submissions on this paper by 29<sup>TH</sup> April 2016

Submissions should be sent to:

E [colm.grace@asx.com.au](mailto:colm.grace@asx.com.au)

Clearing Risk Policy

ASX Limited 20 Bridge Street Sydney NSW 2000

Attention: Mr C.Grace

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 on ASX Clear’s Participant Liquidity Requirements.

**Contacts**

For general enquiries, please contact:

**Mr C.Grace – Senior Manager, Clearing Risk Policy**

T: 02 9227 0439

E [colm.grace@asx.com.au](mailto:colm.grace@asx.com.au)

Media enquiries, please contact:

**Mr Matthew Gibbs– General Manager, Media and Communications**

T 02 9227 0218

E [matthew.gibbs@asx.com.au](mailto:matthew.gibbs@asx.com.au)

## CONTENTS

<b>INTRODUCTION .....</b>	<b>3</b>
EXECUTIVE SUMMARY.....	3
CONSULTATION PERIOD .....	4
<b>EXISTING OBLIGATIONS ON CLEARING PARTICIPANTS IN RELATION TO LIQUIDITY MANAGEMENT.....</b>	<b>4</b>
CORPORATIONS ACT OBLIGATIONS IN RELATION TO LIQUIDITY MANAGEMENT .....	4
ASIC AFSL OBLIGATIONS IN RELATION TO LIQUIDITY .....	4
APRA REQUIREMENTS FOR CPs WHO ARE AUSTRALIAN ADIS .....	4
<b>ASX RISK CONTROL FRAMEWORK.....</b>	<b>5</b>
OVERVIEW .....	5
QUANTITATIVE VS PROCESS REQUIREMENTS.....	6
<b>OBJECTIVES AND TIMELINE OF GUIDANCE NOTE .....</b>	<b>6</b>
OBJECTIVES .....	6
TIME-LINE FOR COMPLIANCE .....	7
<b>EXEMPTIONS FROM REQUIREMENTS OF GUIDANCE NOTE .....</b>	<b>7</b>
ADIS.....	7
<b>PROPOSED MINIMUM REQUIREMENTS RE CP LIQUIDITY RISK FRAMEWORK.....</b>	<b>7</b>
OVERALL REQUIREMENT .....	7
ANNUAL LIQUIDITY PLAN.....	7
RESPONSIBILITY FOR LIQUIDITY MANAGEMENT .....	8
CONTROLS, SYSTEMS AND DOCUMENTATION .....	8
MANAGEMENT REPORTING .....	9
OPERATIONAL PROCESSES .....	9
<b>QUESTIONS FOR CONSULTATION.....</b>	<b>10</b>



## Introduction

### Executive Summary

The ultimate responsibility for a Clearing Participant's ("CPs") liquidity management lies with the CP's board as part of its obligations under the Corporations Act to ensure that the CP remains solvent and can meet its financial obligations as they become due. In addition, as AFSL holders, CPs must as a condition of their licence have sufficient resources to meet anticipated cash flow expenses.

It has become apparent, both from the default of BBY Limited in 2015 and more generally through discussions with CPs during 2015, that there is a lack of consistency across CPs in the standard of liquidity risk management in place to meet these requirements. As a result, ASX Clear is now looking to assist the boards of CPs by establishing a minimum "baseline" standard for CP liquidity management through the introduction of a guidance note for liquidity risk management frameworks. By assisting the boards of CPs in better managing their liquidity, ASX Clear would also be strengthening the controls designed to reduce the likelihood of a CP default.

The high-level objectives of such a guidance note were discussed at the December 2015 ASX Clear Risk Consultative Committee with broad agreement on the objectives and the planned approach. The high level objectives and approach have also been discussed on a bi-lateral basis with several CPs - feedback received has been generally supportive.

The guidance note would be issued under Rule 3.5.1 (Organisational Requirements) and would apply to all CPs other than those directly subject to equivalent regulation by an approved prudential regulator. It would represent a formal identification of the minimum liquidity management standards ASX would reasonably expect to be in place to meet pre-existing CP requirements under Rule 3.5.1.

The key proposed requirements to be included in this liquidity guidance note are as follows:

- CPs must have a formal liquidity risk framework
- The framework must include preparation of a board approved annual liquidity and funding plan and rolling 12 month liquidity forecasts, together with robust liquidity related operational processes and management reporting
- The overall responsibility for liquidity management should be allocated to a named individual (who is effectively the "Treasurer" of the CP) with appropriate segregation of duties for settlement and reporting
- The framework should be appropriate/right-sized to the nature, scale and business scope/complexity of the CP's activities and should be reviewed annually, and
- Liquidity management should consider both normal and stressed business and market conditions

The complete proposed requirements are set out below.



This consultation document seeks market feedback on these proposed requirements.

### Consultation Period

Submissions should be made by 29<sup>th</sup> April, 2016. ASX welcomes opportunities for bilateral discussions with interested parties. ASX contact details are provided on page 2.

## Existing obligations on Clearing Participants in relation to Liquidity Management

### Corporations Act obligations

The ultimate responsibility for a CP's liquidity management lies with the CP's board as part of its obligations under the Corporations Act to ensure that the CP remains solvent and can meet its financial obligations as they become due.

The proposed requirements of the liquidity guidance note are intended to assist the Boards of CPs in meeting these legal obligations through the specification of the minimum components of an effective liquidity risk framework and requiring their implementation.

### ASIC AFSL obligations

As set out in ASIC's Regulatory Guide 166 "Licensing: Financial Requirements, a CP who holds an AFSL must, as a condition of their licence, have sufficient resources to meet anticipated cash flow expenses (the "cash needs requirement"). RG166 sets out several options to satisfy this cash needs requirements. RG166 also contains requirements relating to cash flow projections and management of the risk of a cash shortfall.

The proposed requirements of the liquidity guidance note would sit alongside and in effect compliment the requirements in RG166.

### APRA requirements for CPs who are Australian ADIs

CPs who are Australian authorised deposit-taking institutions ("ADIs") and regulated by the Australian Prudential Regulator (APRA) must meet the requirements of APRA's "Prudential Standard APS 210 Liquidity". Given this prudential regulation, as noted below it is proposed to exempt such CPs from the requirements of the liquidity guidance note.

### Existing ASX obligations in relation to liquidity management

Under Rule 3.5.1 (organisational requirements) a CP "...must have adequate resources and processes to comply with its obligations...under the Rules". In this rule, "resources" are defined to include financial resources and "processes" are defined to include management supervision and risk management.



In addition, Guidance Note 1 “Admission as a participant” expects that applicants “...to have documented its key processes for meeting its obligations under the relevant Operating Rule”. For this purpose, key processes include

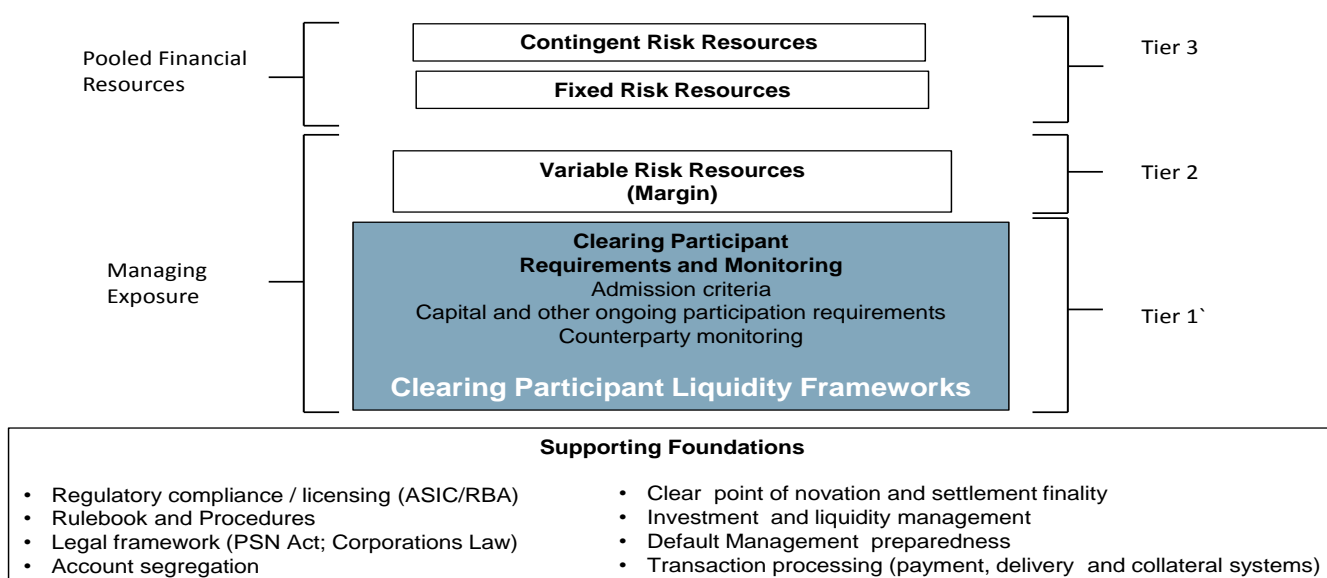
- an applicant’s risk management framework
- “its process for meeting its net payment obligations to ASX (including how it will forecast and monitor those obligations and the funding lines it will have in place for that purpose)”
- “its processes for meeting any clearing fund contributions or emergency assessment ASX may seek to impose (including any funding line it will have in place for that purpose)”

The liquidity guidance note would represent a more specific articulation of what is required to meet these pre-existing requirements.

## ASX Risk Control Framework

### Overview

In acting as a CCP, ASX Clear is exposed to the counterparty credit risk of its CPs whereby, in the event of a CP default, ASX Clear takes on the cleared open exposures of that CP. ASX Clear manages this counterparty credit risk through a framework of tiered risk controls, which are summarised in the diagram below. Tier 1 controls are designed to reduce the likelihood of a CP default while tiers 2 and 3 provide resources to absorb shortfalls arising from managing a default. The specification in a guidance note of minimum requirements for CPs liquidity risk frameworks would represent an additional “Tier 1” control alongside the existing Minimum Core Capital and Risk Capital Requirements.



## Quantitative vs process requirements

Unlike the capital requirements which are quantitatively prescriptive and require ongoing reporting to the ASX, the proposed requirements in the liquidity guidance note are intended to ensure an appropriate liquidity risk management framework is in place so that all CP's have the ability to determine and effectively manage their own liquidity and funding needs. This more "generic" approach should allow CPs to meet the new requirements irrespective of differing business models, management structures, or process/control environments. For this reason it is not intended to include a prescriptive quantification of a required minimum amount of liquidity in the liquidity guidance note.

## Objectives and timeline of the liquidity guidance note

### Objectives

The objectives of specifying liquidity management requirements in a guidance note are to ensure that:

- There is clear and appropriate accountability for a CP's liquidity management.
- The liquidity and funding implications of a CP's business plans and strategy are properly recognised and aligned.
- CPs have appropriate processes in place to ensure there are sufficient funds available to meet all obligations as and when they fall due and, to provide adequate advance warning if this is in doubt.
- There is adequate transparency to, and approval by the Board of, the CP's liquidity and funding arrangements.
- There is a clear mechanism within a CP for reporting, escalating and actioning liquidity related issues.

The proposed requirements, which are set out below, reflect the minimum arrangements which the ASX believe are necessary to achieve these objectives. It is the responsibility of Management and the Board of each CP to determine, given the particular characteristics, size and nature of their business and environment, whether additional liquidity management arrangements are necessary.

A CP's assessment of their compliance with the requirements set out in the liquidity guidance note will be expected to include an evaluation of the extent to which these objectives are being met.

It is not proposed to require a formal annual review by a CP's external auditor of compliance with the requirements of the guidance note. However, ASX will reserve the right at its discretion to require such a review to be carried out for an individual CP where it believes such a review is warranted.



## Time-line for compliance

The proposed requirements are to a large extent a formal identification of what ASX reasonably expects to be already largely in place for most of the larger CPs.

ASX would expect CPs to carry out a gap analysis of current arrangements versus the requirements of the guidance note and take appropriate steps to close any gaps within a 6 month timeframe from the date of the guidance note's formal release.

## Exemptions from requirements of the liquidity guidance note

### ADIs

As with the current ASX Clear Capital Requirements, ASX is proposing to allow exemptions from the requirements of the guidance note if a CP is subject to a regulation by an approved prudential regulator. ASX Clear, may however still require financial information from such CPs. In order to be eligible for an exemption from the guidance note requirements, a CP must be an authorised deposit taking institution (ADI) regulated by the Australian Prudential Regulation Authority (APRA). The exemption would not be available to non-bank subsidiaries of ADIs given these are not subject (at an entity level) to prudential regulation.

## Proposed requirements of the liquidity guidance note

### Overall requirement

CP should have a formal liquidity risk framework in place which:

- Is appropriate/right-sized for the nature, scale and business scope/complexity of the CP's activities.
- Is documented and reviewed on an annual basis where the results of the review are reported to the CP's board.
- Identifies the governance arrangements and in particular the respective roles of the board, CEO, CFO and Treasurer (see below) in relation to liquidity management.
- As a minimum contains the elements specified below.

### Annual Liquidity Plan

A CP should each year prepare a liquidity plan covering the following 12 months. The plan should be approved by the CP's board and as a minimum contain the following:

- Identification of the liquidity requirements arising over the next 12 months under both "normal" and "stress" conditions and how these requirements will be met.



- Identification of how client and non-client monies are segregated and are used to meet the liquidity requirements of the CP.
- Definition of normal and stress conditions – expectation is that stress conditions will include consideration as a minimum of (i) CP specific (ii) market and (iii) customer (including default) stress conditions.
- Key assumptions made in the plan.
- Key risks to achieving the plan and how these risks are to be managed/mitigated.
- A definition of what constitutes liquid resources – in particular how the key aspects of **certainty and timeliness of access of funds** are met..

The liquidity plan should be consistent with/based on the CP’s current business strategy and related business plan for the next 12 months – CPs should ensure that the liquidity implications of business strategy and plans are fully identified, quantified, risks identified and risk mitigations put in place.

### Responsibility for liquidity management

The overall responsibility for liquidity management should be allocated to a named individual (who is effectively the “Treasurer” of the CP) who:

- Has overall responsibility for the preparation of the annual liquidity plan and the operational management of liquidity at the CP (but not for settlement, reporting or bank reconciliations – see below)
- Acts as the first point of contact for ASX in discussions related to the CP’s liquidity risk management framework.
- Has the requisite experience and qualification to manage liquidity risk.

This responsibility should be reflected in the relevant formal job description.

### Controls, systems and documentation

The following controls, reporting and documentation should be maintained:

- An appropriate segregation of duties between those managing liquidity and those:
  - (i) Settling transactions and moving funds (typically an Operations/Settlements function)
  - (ii) Reporting and carrying out bank reconciliations (typically the Finance function)
  - (iii) Performing bank reconciliations (typically the Finance function)
- Reliable management information system/reporting that provides Board and senior management with current and forward looking information on the liquidity position of the CP on a timely basis
- Appropriate control arrangements to ensure data used in liquidity reporting and forecasting is accurate and complete
- Comprehensive and up-to-date documentation for all key procedures relating to liquidity management.





## Management reporting

The following management reporting should be maintained:

- Quarterly “Sources and Uses” reporting to the board of the CPs, including current and forecast liquidity positions, calculated on a rolling 12 month forecast vs Liquidity plan and based on the set of assumptions contained in Liquidity Plan.
- Set of Early Warning Indicators used to alert Senior Management of potential issues in meeting operational liquidity requirements.

## Operational processes

The following operational processes should be maintained:

- Daily forecasting of liquidity over next 5 business days with forecasting based on normal and stress assumptions (as set out in the Annual Liquidity Plan).
- Clear escalation procedures and delegation authorities to deal with liquidity issues.
- Daily reconciliation of all bank accounts.

## Questions for Consultation

1. The guidance note proposes the implementation of a process and governance based approach to defining appropriate liquidity requirements for Clearing Participants and does not propose the implementation of specific quantitative measures. Do you disagree with this approach and if so, what quantitative measures should be considered?
2. It is not proposed to extend the exemption for ADIs from the requirements of the guidance note to non-banking subsidiaries of ADIs given these are not subject (at an entity level) to prudential regulation. Do you disagree with this approach and if so for what reasons?
3. It is not proposed to require a formal annual review of compliance with the requirements of the guidance note by a CPs external auditor. Do you think such a requirement should be introduced and if so for what reasons?
4. The guidance note will require CPs to carry out a “gap analysis” vs the requirements and remediate any gaps within 6 months of the date of formal issuance of the guidance note. Do you think this period is reasonable and, if not, then how long do you think it should be?
5. Would compliance with the proposed requirements of the guidance note require significant changes in your company and/or result in significant additional one-off or ongoing costs?
6. Do you have any other comments on the proposed requirements for a CP’s liquidity management framework to be set out in the guidance note?