

A1.2 ASX Clear (Futures)

ASX Clear (Futures) is a wholly owned subsidiary of ASX Clearing Corporation Limited (ASXCC), itself a wholly owned subsidiary of ASX Limited (see 'ASX Group Structure' in Section 2.3.1). ASX Clear (Futures) acts as the central counterparty (CCP) for all futures and options products that are traded on the ASX 24 market. In July 2013 ASX Clear (Futures) began offering a clearing service for over-the-counter (OTC) interest rate derivatives.

Principle 1: Legal basis

A central counterparty should have a well-founded, clear, transparent, and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions.

Rating: Observed

ASIC's and the Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 1. The legal basis of ASX Clear (Futures) is described in further detail under the following Key Considerations.

1.1 The legal basis should provide a high degree of certainty for each material aspect of a central counterparty's activities in all relevant jurisdictions.

Legal basis

ASX Clear (Futures) novates and nets transactions submitted for clearing by its participants. These activities require a high degree of legal certainty. Key components of the legal framework under which the CCP operates are:

- ASX Clear (Futures) holds a clearing and settlement (CS) facility licence, under Part 7.3 of the *Corporations Act 2001*. This licence is administered by ASIC in consultation with the Bank, with the Minister acting as ultimate decision-maker on licensing matters.
- ASX Clear (Futures) has defined Operating Rules and Procedures. Under section 822B of the Corporations Act, these Rules and Procedures have effect as a contract under seal between: ASX Clear (Futures) and each of its participants; each participant and each other participant.
- ASX Clear (Futures) is protected as a 'netting market' under Part 5 of the PSNA (see also Key Consideration 1.4).

The legal basis of ASX Clear (Futures)' activities is reviewed by ASX Legal whenever there are material amendments to the Operating Rules or Procedures. Two such reviews occurred for ASX Clear (Futures) during 2013/14.

Legal entity

ASX Clear (Futures) is a wholly owned subsidiary of ASX Clearing Corporation Limited, which is itself a wholly owned subsidiary of ASX Limited. As a separate legal entity, ASX Clear (Futures)' central clearing activities are separate from the activities conducted by ASX's other CS facilities and the rest of the ASX Group, notwithstanding the sharing of operational resources across multiple entities within the group.

ASX Clear (Futures)' services are limited to CCP clearing of futures and options products that are traded on the ASX 24 market and certain OTC derivatives in accordance with the ASX Clear (Futures) Operating Rules and Procedures, the OTC Rules and the OTC Handbook. Accordingly, ASX Clear (Futures) does not provide any services that have a distinct profile from, or pose additional risks to, its activity of operating a CCP.

Rights and interests

The rights and interests of ASX Clear (Futures), its participants and, where relevant, its participants' customers in cleared positions and collateral are defined in ASX Clear (Futures)' Operating Rules and Procedures, OTC Rules and OTC Handbook. The OTC Handbook sets out the procedures, timings, contract terms and other details of the OTC derivatives clearing service. Changes to the Operating Rules were made during 2013/14 to support client clearing arrangements. These changes give the customers of participants a contractual right to deal directly with ASX Clear (Futures) in the event of the default of the direct participant that acts as their clearing agent (see Key Consideration 14.3). ASX Clear (Futures) has obtained legal advice confirming the enforceability of these arrangements and establishing that the arrangements do not interfere with protections for close-out netting arrangements between participants and their customers under the PSNA.

1.2 A central counterparty should have rules, procedures and contracts that are clear, understandable, and consistent with relevant laws and regulations.

Section 822A of the Corporations Act establishes a framework to prescribe the matters that must be dealt with in the Operating Rules and those that may instead be considered under the Procedures. Rule changes are subject to a Ministerial disallowance process. The Corporations Act also establishes how any inconsistency between the licensed facility's rules and applicable laws and regulations (in particular, derivative transaction rules and derivative trade repository rules) would be resolved.

The ASX Clear (Futures) Operating Rules and Procedures are supplemented with explanatory material, published on the ASX public website and the ASX restricted participant website, to support participants' (and prospective participants') understanding of the risks they face through participation in the system. Publicly available material includes high-level descriptions of ASX Clear (Futures)' risk management framework, the Standard Portfolio Analysis of Risk (SPAN) margining methodology, business continuity arrangements and the Default Management Framework (DMF). Participants have access to additional manuals, reports and explanatory notes covering such topics as the application process for new participants, compliance, technical and operational details, counterparty risk assessment and fees.

There is a clear process for changing ASX Clear (Futures)' Operating Rules and Procedures. Proposed rule changes may be submitted informally to ASIC. In consultation with the Bank, ASIC will consider the changes and advise ASX of any regulatory concerns. Once such concerns are satisfactorily addressed, ASIC will invite formal submission of the proposed changes, which triggers a 28-day 'disallowance' period, during which the Minister may choose to disallow the changes. The Minister considers a number of factors, including whether the proposed changes are consistent with the public interest. To assist the Minister in this process, ASIC provides detailed advice to the Minister, incorporating the views of the Bank as appropriate. If changes to the Operating Rules are not disallowed by the Minister, they are notified to participants via the ASX website.

1.3 A central counterparty should be able to articulate the legal basis for its activities to relevant authorities, participants, and, where relevant, participants' customers, in a clear and understandable way.

The legal basis for the activities of ASX Clear (Futures) and the facility's protection as an approved netting market under the PSNA – see also Key Consideration 1.4 – are described on the ASX public website in its Disclosure Framework document, which sets out in detail how each CS facility meets the requirements of each Principle within the *Principles for Financial Market Infrastructures* (PFMIs) developed by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) (see Key Consideration 23.2).¹

ASX, on behalf of ASX Clear (Futures), submits an Annual Group Licence Report to ASIC and the Bank. This report sets out the legal basis for the CS facilities' activities under their licence obligations, and is used by ASIC in the preparation of ASIC's Market Assessment Report for the ASX Group.

ASX Clear (Futures) may seek independent legal opinions on relevant legal matters relating to significant new services, including any implications that their introduction may have for the legal basis of existing functionality. These opinions may, in some circumstances, be shared with participants or other stakeholders, for their information, particularly to demonstrate that new Operating Rules will have the intended legal effect.

1.4 A central counterparty should have rules, procedures, and contracts that are enforceable in all relevant jurisdictions. There should be a high degree of certainty that actions taken by the central counterparty under such rules and procedures will not be voided, reversed, or subject to stays.

ASX 24's Operating Rules state that trades executed on the trading platform are extinguished and replaced by contracts with ASX Clear (Futures) upon registration of the trades with ASX Clear (Futures), and the ASX Clear (Futures) Operating Rules set out the risk controls that apply against clearing exposures. Such risk controls are calibrated to participants' net obligations to the CCP. Payment obligations arising from clearing, including those related to margin obligations, are settled in Austraclear. The point at which settlement of these obligations is final and irrevocable is established in Austraclear's Regulations.

Novation and netting

Part 5 of the PSNA protects the effectiveness of market netting contracts, including contracts entered into in accordance with the rules of a netting market. ASX Clear (Futures) is an approved netting market. This protection from the application of any other law, including insolvency provisions, is relevant to the function of a CCP. In particular, it provides protection for:

- novation, the process whereby matched trades between participants are replaced by separate contracts between the buyer and the CCP and the seller and the CCP
- the process of reducing each participant's contracts to a net exposure (reflecting the exposure to the participant's portfolio of contracts)

¹ Available at <http://www.asx.com.au/documents/regulation/pfmi_disclosure_framework.pdf>.

- the CCP's rules covering default, such that future exposures may be terminated and a net payout obligation calculated
- payments made on a net basis, by protecting against the voiding of net payments in the event of insolvency of a participant.

Settlement finality

Payment obligations arising between ASX Clear (Futures) and its participants are settled in Austraclear. The legal certainty of settlement finality is supported by Austraclear's approval as a real-time gross settlement system under Part 2 of the PSNA. This approval provides protection against application of the so-called 'zero-hour rule' in insolvency law, whereby transactions settled after the point at which an insolvency is legally deemed to have started could potentially otherwise be reversed. Any interbank transactions arising from these settlements are settled in real time in the Reserve Bank Information and Transfer System (RITS), across Exchange Settlement Accounts (ESAs) held with the Bank. Finality of funds transfers in RITS is again supported by the approval of RITS under Part 2 of the PSNA.

Assumption of risk

Through novation, the obligations of ASX Clear (Futures) are to each participant as principal – although new client clearing arrangements also establish a legal relationship between clients and the CCP (see Principle 14). Equally, participants' obligations are to ASX Clear (Futures) for all transactions that have been novated (i.e. both proprietary and client transactions).

Importantly for the legal protections provided under the PSNA, the point of novation is established by ASX Clear (Futures)' Operating Rules. For exchange-traded transactions, ASX Clear (Futures)' Operating Rules specify that a transaction on the ASX 24 market is novated upon the registration of a matched trade by the market, which occurs in ASX 24's SYCOM system. Non-market trades are novated once their details have been approved and registered by ASX Clear (Futures). Acceptance rules for registration of OTC derivatives trades are set out in the OTC Rules. Requirements include, for example, that the OTC transaction has been submitted in accordance with procedures and eligibility criteria in the OTC Handbook, that participants are authorised and not in default, and that the transaction passes limit checks. If an OTC transaction satisfies the requirements and is accepted by ASX Clear (Futures) for registration, the transaction is novated with effect from the time at which the transaction details were received by ASX Clear (Futures).

Enforceability of ASX rules while under external administration

ASX Legal has analysed the legal enforceability of ASX Clear (Futures)' Operating Rules upon the CCP's entry into external administration. ASX Clear (Futures) has also obtained legal advice to confirm the enforceability under Australian law of Operating Rules under which novated contracts may be closed out in the event that ASX Clear (Futures) was subject to an insolvency event. No material legal risks to enforceability have been identified. During 2013/14, ASX Clear (Futures) introduced rules giving participants the right to terminate novated contracts in the event that ASX Clear (Futures) defaulted on its obligations, with calculation of a net obligation to or from each participant on termination ('close-out netting'). Close-out netting rights are a prerequisite for participants that are authorised deposit-taking institutions (ADIs) to apply capital requirements to their net (rather than gross) trade exposures to CCPs, and similarly to report these exposures as net in their financial accounts. The rules do not interfere with ASX Clear's existing liquidity management arrangements, and

ASX will review the continued appropriateness of close-out netting rights in light of future developments in FMI recovery and resolution.

1.5 A central counterparty conducting business in multiple jurisdictions should identify and mitigate the risks arising from any potential conflict of laws across jurisdictions.

Although participants of ASX Clear (Futures) include subsidiaries and branches of entities that are based in foreign countries (including France, Germany, Hong Kong, Switzerland, United Kingdom and United States), the Operating Rules are governed by Australian law and require that all participants submit to the exclusive jurisdiction of New South Wales courts. ASX has obtained an external legal opinion in relation to foreign participation that has identified no material legal risks.

Principle 2: Governance

A central counterparty should have governance arrangements that are clear and transparent, promote the safety and efficiency of the central counterparty, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders.

Rating: Observed

ASIC's and the Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 2. ASX Clear (Futures)' governance arrangements are described in further detail under the following Key Considerations.

2.1 A central counterparty should have objectives that place a high priority on the safety and efficiency of the central counterparty and explicitly support financial stability and other relevant public interest considerations.

The high-level objectives of ASX Clear (Futures) are set out in the CS Boards' Charter, which is available on the ASX public website. The objectives prioritise the Boards' responsibilities in the area of risk management and, in particular, ASX Clear (Futures)' responsibility for complying with the Bank's Financial Stability Standards (FSS), which are aligned with stability-related requirements of the Principles.

ASX Clear (Futures)' objectives recognise the public interest. These objectives are reflected in the ASX Limited Board Charter, which provides that the Board has a responsibility to oversee the conduct of the affairs of the ASX Group consistent with licence obligations, as well as public policy objectives directed at financial market and payments system integrity. The CS Boards' Charter also specifically acknowledges the Board's public interest responsibilities, as well as its obligations under Part 7.3 of the Corporations Act. These include that ASX Clear (Futures), to the extent it is reasonably practicable to do so, comply with relevant FSS and do all other things necessary to reduce systemic risk arising from its services, and do all things necessary to ensure that its services are provided in a fair and effective way.

To support the interests of its customers, ASX has developed a Customer Charter, which is referenced in the CS Boards' Charter. The Customer Charter commits that ASX: work with its customers to deliver products and services that meet their needs and provide them with choice; make its products and services available on a non-discriminatory basis and on reasonable commercial terms; and manage its businesses and operations on a commercial basis to benefit its customers and provide appropriate returns to ASX shareholders. The

Customer Charter recognises ASX's role as a provider of critical infrastructure to the Australian financial markets and commits to make the necessary investments to ensure it can fulfil this role and provide confidence to market participants, investors and regulators.

ASX Clear (Futures)' governance arrangements allow for appropriate consideration of stakeholder views. When considering major operational or risk management changes, or new services, ASX uses stakeholder forums, and formal and informal consultation processes to communicate proposed changes to relevant stakeholders (see Key Consideration 2.7). Consultations and responses to consultations are made available on the ASX website. In addition, the ASX Group has disclosure obligations under the Corporations Act and Listing Rules which it manages in accordance with those laws and rules.

2.2 A central counterparty should have documented governance arrangements that provide clear and direct lines of responsibility and accountability. These arrangements should be disclosed to owners, relevant authorities, participants and, at a more general level, the public.

The governance arrangements of ASX Clear (Futures) are documented on the ASX public website. This documentation includes the Charters of the ASX Limited Board, the CS Boards (including that of ASX Clear (Futures)), and other subsidiary boards and committees. The charter documents provide information about the role and composition of the CS Boards and board committees, as well as the key senior managers of the clearing facilities; namely the Managing Director and CEO, the Chief Risk Officer, and the Executive responsible for settlement risk. Profiles of all CS facility directors are also publicly available online. Key governance policies and charters are reviewed regularly by the relevant boards and committees.

The ASX Limited Annual Report provides information about ASX Group's risk management arrangements, including the role of boards, key committees, key subsidiary boards (e.g. ASX Compliance), and the roles of senior group executives who report directly to the Managing Director and CEO. Explanatory documentation on the website also describes: the FSS and the CPSS-IOSCO Principles; group and business structure, including an organisational chart showing senior group executives; and risk management policies (in summary form).

Under the Corporations Act, ASX must notify ASIC as soon as practicable after a person becomes or ceases to become a director, secretary or senior manager of ASX Clear (Futures), including when a person changes from one of those positions to another. Changes to senior risk management personnel are also notified to the Bank.

2.3 The roles and responsibilities of a central counterparty's board of directors (or equivalent) should be clearly specified, and there should be documented procedures for its functioning, including procedures to identify, address and manage member conflicts of interest. The board should review both its overall performance and the performance of its individual board members regularly.

Ultimate responsibility for oversight of the risks faced by ASX Clear (Futures) lies with the ASX Limited Board and the ASX Clear (Futures) Board. The ASX Limited Board Charter delegates certain responsibilities to the ASX Clear (Futures) Board, including the review and oversight of the management of ASX Clear (Futures)' clearing- and settlement-related risks, and its compliance with the FSS. The CS Boards' Charter elaborates on other roles and responsibilities of the ASX Clear (Futures) Board. The CS Boards' Charter places requirements

on the structure of the CS Boards, including that the majority of directors and the Chair be independent. The ASX Clear (Futures) Board meets regularly (seven times in 2013/14) and receives detailed reports on ASX Clear (Futures)' business and operations, risk management and financial performance.

Board performance is dealt with periodically in private session by the relevant boards. The process may be facilitated by external independent consultants. A number of tools are used, which may include private session review, skills matrices and surveys, and externally facilitated group discussions. Details of Board performance reviews are set out in the ASX Limited Annual Report (the same process applies for the key subsidiary boards).

The CS Boards' Charter sets out how the Boards address directors' interests and potential conflicts. Directors of the CS Boards must disclose all material personal interests (such as shareholdings, directorships and consultancy arrangements) which may potentially conflict with their duties at the time of their appointment. If there is a change in a director's material personal interests, the director must notify that change at the next meeting. If there is a real possibility of a material conflict of interest and duty on a matter subject to vote at a meeting of the CS Boards, the director must not be present for the discussion or vote related to that matter.

2.4 The board should contain suitable members with the appropriate skills and incentives to fulfil its multiple roles. This typically requires the inclusion of non-executive board member(s).

At the end of June 2014, the ASX Limited Board had eight members, comprising the ASX CEO and seven independent, non-executive directors. As set out in the CS Boards' Charter, the CS Boards, in consultation with the Nomination Committee and the ASX Limited Board, determine the composition of the CS Boards, with directors selected based on relevant skills and expertise. Currently, the ASX Clear (Futures) Board comprises one executive director (the ASX CEO) and six non-executive directors. During 2013/14, one non-executive director resigned and two new directors were appointed. Three of the non-executive directors, including the Chair, are also members of the ASX Limited Board, while the remaining three are external directors appointed for their expertise in clearing and settlement operational and risk management matters. This ensures that directors have the capacity to conduct informed independent review of relevant issues. During 2013/14, ASX made changes to the composition of the CS Boards. Previously, all four CS Boards shared common directors; now, the ASX Clear (Futures) and Austraclear Boards share common directors, but two of these directors do not serve on the ASX Clear or ASX Settlement Boards. This change was made primarily for business reasons, but also supports ASX's conflict handling arrangements (see below under 'Group structure').

ASX has adopted a policy that the majority of directors on each of its CS Boards must be independent. The Board Policy and Guideline to Relationships Affecting Independent Status is available on the ASX website. The independence of directors is assessed according to this policy, which is aligned to the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* for listed companies. The policy requires, for example, that independent directors be free of business or other relationships that could interfere with the independent exercise of the director's judgement. Specifically considered is whether the director is a substantial shareholder of ASX, as well as whether in the last three years the director was previously employed by ASX or was an adviser to ASX. The biographies of the

directors, which show their relationship with other ASX Group companies, are set out on the ASX website.²

Selection, succession planning and training for board members are dealt with in private session by the Nomination Committee and Boards at appropriate intervals. New directors receive a comprehensive induction from Board and Nomination Committee members, as well as senior managers and other key staff. Directors' fees at both ASX Limited and ASX Clear (Futures) are considered by the ASX Limited Remuneration Committee, recognising the level of skill and expertise that a director must have to effectively meet its responsibilities. Remuneration of directors is determined in private session by the ASX Limited Board on the recommendation of the Remuneration Committee at regular intervals. The ASX Limited Board reviews its fees regularly to ensure ASX non-executive directors are remunerated fairly for their services, recognising the level of skill and experience required. It also reviews its fees to ensure that it has in place a fee scale that enables ASX to attract and retain appropriately skilled and qualified non-executive directors. Non-executive directors' fees are broadly aligned to the top quartile of the marketplace. In conducting a review, the Board may take advice from an external remuneration consultant. The process involves benchmarking against a group of peer companies. The last fee review took place at the end of 2013 following changes to relevant governance and regulatory arrangements. The revised fees took effect on 1 January 2014.

Group structure

The potential for intragroup conflicts arising from ASX's group structure is addressed by 'intragroup' service agreements, which set out the basis on which other group entities will provide services to the CS facilities and specify that the entities providing the services must have sufficient financial and other resources to meet their obligations. These agreements provide that ASX Group staff are under a duty to act in the best interests of the facility that is receiving the services.

ASX's governance arrangements are designed to ensure that shared directorships within the ASX Group cannot compromise each CS facility's compliance with its licence obligations and the Principles. ASX considers that there is limited potential for shared directorships to create conflicts between ASX's group-wide commercial interests and the risk management function of the CS facilities. More broadly, it considers that conflicts between directors' roles on the CS Boards and the ASX Limited Board are unlikely given the distinct roles the separate entities perform, and in view of group-wide arrangements to manage matters such as operations and compliance. If a conflict were to arise, a director sitting on multiple CS Boards would be expected to make decisions in the best interests of each facility.

The restructuring of the CS Boards to reduce the number of common directors between each of the CS facilities and ASX Limited further limits the potential for conflict. Two directors will now be able to form a quorum of the ASX Clear (Futures) Board, allowing matters that raise potential conflicts of interest to be considered and voted on without the involvement of directors that are also on the ASX Limited Board.

2.5 The roles and responsibilities of management should be clearly specified. A central counterparty's management should have the appropriate experience, mix of skills and

² Available at < <http://www.asx.com.au/about/board-and-management.htm>>.

integrity necessary to discharge their responsibilities for the operation and risk management of the central counterparty.

ASX has clear and direct reporting lines between management and the CS Boards. These are set out in the CS Boards' Charter, along with the roles and responsibilities of the Managing Director and CEO, the Chief Risk Officer (CRO), and the Group Executive, Operations (GE, Operations). The Managing Director and CEO has responsibility for the overall operational and business management and profit performance of ASX, while the CRO has responsibility for the overall clearing risk management of the CS facilities and for ensuring that CS facility licence obligations are met. The CRO has a direct reporting line to the CS Boards and is entitled to attend and be heard at CS Board meetings.

ASX has a comprehensive remuneration policy and performance management framework in place, which aims to ensure that management personnel have an appropriate mix of skills and experience to discharge their responsibilities. The ASX Limited Remuneration Committee has delegated responsibility from the ASX Limited Board to conduct detailed examination of certain matters including oversight of the remuneration and incentive framework, succession plans, recruitment, retention and termination strategies, and the remuneration of the Managing Director and CEO and ASX Group non-executive directors. The Committee members are appointed by the ASX Limited Board, and must consist of only non-executive directors, with at least three members, a majority of independent directors, and an independent chair who is not Chairman of ASX Limited. The Committee has direct access to ASX senior management and the authority to seek independent advice. The CS Boards have delegated responsibility to the Committee for compensation arrangements and performance management processes relating to the CRO and the GE, Operations. The CS Boards provide input on the setting of Key Performance Indicators and may review the performance outcomes for the CRO and the GE, Operations

ASX carries out succession planning and management processes in order to ensure leadership continuity in key positions, and develop intellectual depth and business knowledge. This includes the biannual review of a 'talent assessment tool' by Group Executives and Human Resources to identify and manage the development of high potential staff according to individual and business needs. Succession and contingency planning is conducted for Group Executives, General Managers and other key staff.

2.6 The board should establish a clear, documented risk management framework that includes the central counterparty's risk tolerance policy, assigns responsibilities and accountability for risk decisions, and addresses decision-making in crises and emergencies. Governance arrangements should ensure that the risk management and internal control functions have sufficient authority, independence, resources and access to the board.

ASX has a documented risk management framework, which is described under Key Consideration 3.1. The CS Boards are responsible for approving and reviewing high-level risk management policy relevant to clearing and settlement operations. The Boards approve all new clearing and settlement risk policies and standards, as well as material changes to existing clearing and settlement policies and standards. The Boards consider these policies and standards at a concurrent meeting; where the policy or standard is relevant to more than one facility, the Boards of those facilities would simultaneously determine whether to approve the policy or standard. If the policy requirements under consideration differ across facilities, the Boards of each relevant facility would separately determine whether to approve

the policy or standard (during the concurrent meeting). Board feedback is incorporated before risk policies and standards are approved.

Responsibilities under the high-level risk management policy are distributed as follows:

- Key policies and standards, such as margin policy, stress-testing standards and investment mandates, are reviewed by the CS Boards on an annual basis. Detailed reporting to the CS Boards occurs quarterly on the operation of the CCPs and their compliance with risk management policies and standards, and on broader management and operational matters. Internal Audit conducts a rotational risk-based audit program, which includes ensuring that relevant operational units comply with Board-approved policies and standards, where necessary using external specialists to assist with reviews. The CS Boards may also request external reviews. Clearing and settlement risk management policies and standards were reviewed during 2013/14. The reviews, along with the development of new policies and standards, will be continued during 2014/15.
- The Audit and Risk Committee has responsibility for the oversight of the Enterprise Risk Framework.
- The Enterprise Risk Management Committee, comprising executives from across the departments, is responsible for enterprise risk management policy and reviewing controls, processes and procedures to identify and manage risks. This committee is also responsible for formally approving significant operational risk policies prepared by individual departments.
- Individual departments are responsible for: identifying business-specific risks; applying controls; maintaining risk management systems; reporting on the effectiveness of risk controls; and implementing enhancements and taking remedial action as appropriate. Each department is required to maintain a record of its risk profile, reviewing this on a six-monthly basis and updating as appropriate. This record includes 'Key Risk Indicators' and action plans to address any identified risk that is not adequately mitigated. Policies are formally reviewed every 18 months to three years. More frequent reviews are undertaken where there are potential changes to technology, legal or regulatory requirements, or business drivers.

The CRO has a direct reporting line to the CS Boards. Within ASX's management structure, those departments primarily responsible for CCP financial risk management report to the CRO, who in turn reports directly to the CEO. The CRO is not responsible for any other functions, and none of the departments within the CRO's portfolio have a primary revenue or profit objective. There are four functional departments with at least some responsibility for CCP financial risk management: the Clearing Risk Strategy and Policy department; the Clearing Risk Quantification (CRQ) department; the Clearing Risk Management department; and the Portfolio Risk Manager. The CRQ department was created specifically to maintain and validate risk and pricing models, allowing Clearing Risk Strategy and Policy to focus on higher level risk policies and longer term initiatives. In addition, ASX maintains a number of executive committees that have some responsibility for financial risk management.

Directors are entitled to obtain independent advice. The Annual Report addresses directors' access to information, management and advice. To the extent that directors wish to seek independent advice, they can raise this in board meetings, with the Managing Director and

CEO, or with the Chairman. The new participant Risk Committee (see Key Consideration 2.7) also provides advice to the ASX Clear (Futures) Board on risk management matters.

Model validation

The Boards of ASX Clear and ASX Clear (Futures) (the 'Clearing Boards') regularly review and discuss with management matters of risk policy, including changes to margin and stress-testing methodologies.

ASX has developed a framework for model validation. This framework identifies models to be validated, defines what constitutes 'model validation', describes the model validation approach to be applied to the identified models, and specifies model validation governance arrangements. Key models at ASX Clear (Futures) include SPAN margining for exchange-traded derivatives, the OTC IRS Historic VaR model for OTC derivatives, the pricing system for derivatives and the capital stress-testing model. Governance arrangements specify criteria for ranking model risk, validation roles and responsibilities, validation frequency, the assessment approach and whether the validation should be carried out by an internal or external expert. ASX assigns each of its risk models a weighted risk score between one and five to determine how critical it is, based on factors such as the internal and external impact of the model, frequency of use and complexity. ASX uses the risk score to determine the frequency of comprehensive independent model validations and whether models are to be validated internally or externally. Model validation is performed on a regular basis according to the risk ranking.

The approach to model validation is based on objective statistical tests, including sensitivity analysis, with each model validation strategy to be reviewed and approved by an internal management committee known as the Risk Quantification Group (RQG). Backtesting is used to provide systematic comparison of model forecasts with observed outcomes. Model validation reviews are coordinated by Internal Audit, including the use of external experts as required under the framework or where this is deemed necessary by the RQG or Internal Audit. ASX Clear (Futures)' approach to model validation is discussed in more detail under Key Considerations 4.5, 6.7 and 7.9.

Internal audit

ASX maintains an internal audit plan that provides for a three-to-five year review cycle of key operational and risk management processes, and internal control mechanisms that are governed by ASX's Enterprise Risk Framework, business continuity framework, enterprise compliance framework and internal audit methodology. The internal audit plan is approved by the ASX Limited Audit and Risk Committee and the audit work that is relevant to the CS Boards and ASX Compliance Board is endorsed by those Boards. The key governance frameworks are reviewed by external independent experts, as required. ASX's internal audit arrangements are set out in an Internal Audit Charter which is reviewed and approved by the ASX Limited Audit and Risk Committee on an annual basis and made available on ASX's public website.

The Internal Audit department is a separate department within ASX that reports to the CRO for administrative purposes, and the Audit and Risk Committee and Managing Director and CEO for audit purposes. The Internal Audit department's reporting structure also includes reports to the CS Boards and ASX Compliance Board. Internal Audit's principal objective is to 'provide independent, objective assurance and consulting services designed to add value and improve the operations of ASX'. Its scope covers the policies, processes and procedures of all risk

management and internal control systems. The General Manager of Internal Audit has direct access to the ASX Limited Audit and Risk Committee, CS Boards and ASX Compliance Board. Members of the Internal Audit department are required to hold appropriate undergraduate and postgraduate qualifications relevant to their roles.

The role and performance of the Internal Audit function is regularly reviewed by the ASX Limited Audit and Risk Committee. Internal Audit is also reviewed by external independent auditors on a three-year cycle. The last such audit was carried out in 2011, with the next assessment scheduled for October/November 2014.

ASX has a clearly defined methodology for internal audit, based on the International Professional Practices Framework set out by the Institute of Internal Auditors.³ The audit process includes phases for planning, fieldwork, reporting, final sign-off, and issues logging and follow-up. The planning phase includes the preparation of terms of reference that define the purpose, timing, approach and scope of the audit.

The internal audit methodology allows for ad hoc reviews if, for example, material new risks are identified or other changes to ASX's business occur. This is a matter which the General Manager, Internal Audit and the Audit and Risk Committee consider. The ASX Compliance Board and the CS Boards may also request ad hoc reviews.

2.7. The board should ensure that the central counterparty's design, rules, overall strategy and major decisions reflect appropriately the legitimate interests of its direct and indirect participants and other relevant stakeholders. Major decisions should be clearly disclosed to relevant stakeholders and, where there is a broad market impact, the public.

The interests of direct and indirect participants and other relevant stakeholders are recognised in the ASX Limited Board Charter, the CS Boards' Charter and the ASX Customer Charter.

The views of participants and other stakeholders are sought through formal and informal means. ASX Clear (Futures) routinely conducts public consultations when considering major changes to existing services or new service offerings. These consultations allow for written submissions and discussion in both bilateral and open forums. Participants' views may also be gathered through the induction program for new participants, as well as ongoing participant liaison and compliance checks. ASX Clear (Futures) has formalised in its Operating Rules a requirement that it consult participants on proposed rule amendments, except those requested by its regulators or required to enable ASX Clear (Futures) to comply with its CS facility licence or other regulatory obligations.

During 2013/14, ASX Clear (Futures) implemented additional formal structures for participant consultation. The first meeting of the ASX Clear (Futures) Risk Committee, comprising representatives from 18 futures and OTC participants, was held in April. It is a self-governing body chaired by an elected member. The Risk Committee is consulted on material changes to the margin methodology, the default fund, position or liquidity limits, participation criteria, new products, and other changes affecting either the risk model or the rules. The Risk Committee's proposals and recommendations are presented to the ASX Clear (Futures) Board, which is not obliged to accept the Risk Committee's advice but is required to provide

³ The Institute of Internal Auditors is the leading international organisation representing internal auditors. It has developed a set of standards that provide a framework for carrying out and evaluating the performance of internal audits.

reasons for any decision not to follow such advice. ASX established an OTC Product Committee that advises ASX Clear (Futures) on the types of OTC derivatives transactions that are eligible for clearing and material changes to the terms of OTC derivatives contracts, new product timelines and service releases. ASX intends to establish an ASX Clear (Futures) Product Committee in the December Quarter 2014, which will have a wider remit than the OTC Product Committee and will cover similar matters relating to the product scope of exchange-traded futures.

ASX Clear (Futures) has also established a Default Management Group (DMG), comprised of experts from OTC participants selected on a rotational basis, each for an annual term. The DMG met twice in June 2014. The DMG will be consulted on aspects of the default management process as set out in the Operating Rules, and while the ASX Clear (Futures) Board is not obliged to accept the DMG's advice, it is required to provide reasons for any decision not to follow such advice.

Principle 3: Framework for the comprehensive management of risks

A central counterparty should have a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, and other risks.

Rating: Broadly observed

The Bank's assessment is that ASX Clear (Futures) broadly observes the requirements of Principle 3. In order to fully observe Principle 3, ASX Clear (Futures) should:

- implement plans to enhance its recovery plan consistent with forthcoming CPSS-IOSCO guidance on recovery planning.

ASX Clear (Futures)' risk management framework is described in further detail under the following Key Considerations.

3.1 A central counterparty should have risk-management policies, procedures, and systems that enable it to identify, measure, monitor, and manage the range of risks that arise in or are borne by the central counterparty. Risk-management frameworks should be subject to periodic review.

Identification of risk

ASX's high-level framework for risk management is described in its Enterprise Risk Management Policy. This policy divides risks identified by ASX into two broad categories: strategic risks and operational risks. Operational risks are further categorised into financial risks, legal and regulatory risks, and technological and operational risks. Specific risks identified by ASX are described within these broad categories. For each identified risk, ASX judges how likely it is the risk event will occur within the next 12 months and the potential impact. Reputational and participant impacts are considered along with the financial, operational and regulatory impacts of risks.

Comprehensive risk policies, procedures and controls

ASX's Enterprise Risk Management Policy has been developed with reference to the international standard ISO 31000 *Risk Management – Principles and Guidelines* (see Key

Consideration 2.6).⁴ At a high level, the ASX Enterprise Risk Management Policy outlines: the overall risk environment in the ASX Group; the objectives of risk management policies; the process by which risks are identified and assessed; the controls in place to detect and mitigate risks; and how risks are monitored and communicated. ASX's stated tolerance for financial, operational, legal and regulatory risks is 'very low'.

ASX uses key risk indicators to measure levels of risk in the organisation and categorise risk levels according to a scale: satisfactory; within risk tolerance but requiring action to further control the level of risk; exceeding ASX's risk tolerance.

The Enterprise Risk Management Policy also assigns specific risk responsibilities across the ASX Group, including to the ASX Limited Board of Directors, the Audit and Risk Committee, the Enterprise Risk Management Committee, the General Manager, Enterprise Risk and managers of individual business units. Managers of each business unit are responsible for identifying and monitoring risks relevant to their unit's activities, as well as for designing and implementing risk management policies and controls to manage identified risks. Business unit managers assess the appropriateness and operational effectiveness of these controls twice a year; these assessments are reviewed by Internal Audit and the Enterprise Risk Management Committee.

In 2012/13, ASX adopted an updated and formalised Clearing Risk Policy Framework to better align both it and related governance structures with the requirements of the Principles embedded in the FSS. The Clearing Risk Policy Framework sets out a comprehensive set of clearing and treasury risk policies to support the risk management approach of ASX's CCPs, including ASX Clear (Futures). These policies govern more granular internal standards, which in turn govern detailed procedures for the management of clearing and treasury risk. The structure of policies, standards and procedures reflects the requirements of the FSS. During 2013/14, ASX has developed or updated standards covering most relevant aspects of the FSS. The Bank will continue to monitor the maintenance of existing policies and standards, and the finalisation of remaining policies and standards by ASX over 2014/15.

A number of boards and internal committees oversee clearing risk management policy, including:

- *The CS Boards.* Each CS facility has a board (see Key Consideration 2.3 and 'ASX Group Structure' in Section 2.3.1), which shares members with the other ASX CS facilities, has oversight of the Clearing Risk Policy Framework, and is responsible for any significant amendments. Policies and designated key standards under the framework are governed by the CS Boards.
- *The Clearing Risk Policy Committee (CRPC).* The CRPC was formed in June 2013, to review and approve clearing risk policies and standards prior to submission to the CS Boards. The CRPC is chaired by the CRO and includes the ASX Group Legal Counsel, CFO and GE, Operations. It will generally meet quarterly in line with meetings of the CS Boards.
- *The Capital and Liquidity Committee (CALCO).* CALCO is constituted to ensure the structural integrity and efficient use of the liquidity, on- and off-balance sheet assets,

⁴ ISO is an international standard-setting body and ISO 31000 is considered to be relevant guidance for enterprise risk management. The ISO 31000 standard has been reproduced by Standards Australia and Standards New Zealand as AS/NZS 31000.

liabilities and capital resources of the ASX Group. CALCO advises on changes to the clearing risk policies related to capital, liquidity and balance sheet management, CALCO is chaired by the CRO and comprises senior managers and executives from Finance, Risk and Internal Audit. CALCO generally meets on a quarterly basis.

- *The CCP Risk, Operations and Compliance Committee (CROCC)*. CROCC is chaired by the GE, Operations and is made up of senior managers and executives from the clearing and settlement risk management, operations and compliance areas of ASX. The committee acts as an information-sharing and discussion body for the purpose of enhancing ASX's ability to identify, assess and reduce systemic risk, operational or compliance risk, and manage clearing risk. The CROCC currently meets on a monthly basis.
- *Risk Quantification Group*. ASX established the RQG in early 2013 to strengthen the technical oversight of risk management policy. The RQG is chaired by either the CRO, the General Manager, CRQ, or the General Manager, Clearing Risk Strategy and Policy, and is made up of key staff from ASX's CRQ, Clearing Risk Strategy and Policy and Clearing Risk Management departments most familiar with ASX's margin and other risk management models. The focus of the group is the review and application of quantitative risk policies and the Model Validation Framework, including oversight of model governance and regular reviews of margining and stress test models. The group meets at least on a monthly basis or more frequently as required.
- *Default Management Steering Group (DMSG)*. ASX formed the DMSG in 2010/11 to provide oversight of the CCPs' DMF. The DMSG is chaired by the CRO and comprises key representatives from ASX Legal, Compliance, Operations and Risk. The DMSG currently meets at least on a monthly basis or more frequently as required.

Information and control systems

ASX Clear (Futures) employs information systems that provide timely and accurate information relevant to its risk policies, procedures and controls. This includes information on risk exposures to individual participants, as well as aggregated information on risk exposures across the central counterparty. Key information systems include:

- *Margining*. ASX Clear (Futures) uses the CME SPAN system for margining of exchange-traded derivatives and the Historical Simulation of Value at Risk (HSVaR) based Calypso margin system for OTC derivatives.
- *Capital and liquidity stress testing*. Stress testing is carried out daily to gauge the adequacy of ASX Clear (Futures)' financial resources and to monitor the risks associated with individual participants' positions. Capital stress testing estimates the loss that would result from the realisation of extreme but plausible price changes. Liquidity stress testing estimates the liquidity exposures that would result from extreme but plausible price changes.

ASX Clear (Futures) monitors daily risk management reports produced by its information management systems to identify changes in positions that may require mitigating action. ASX Clear (Futures)' information systems also provide information to participants about positions and margin requirements, which assists in their management of credit and liquidity positions. ASX publishes detailed margining information on its website, including descriptions of the margining methodology, schedules of margin rates, and daily SPAN margin parameter files. This information is sufficient for participants to perform their own margin calculations on

hypothetical or actual portfolios. To facilitate this, third-party vendors use this information to provide margin estimation software to participants. ASX has also developed a web portal to estimate margin requirements for OTC derivatives portfolios.

Internal controls

ASX's risk management policies are generally reviewed formally every 18 months to 3 years, although more frequent reviews may occur depending on changes to technology, business drivers or legal requirements. Reviews are conducted by specific working groups and committees. Final approval of reviews for more significant policies is the responsibility of the Enterprise Risk Management Committee. Under the Enterprise Risk Management Policy, ASX's business units are required to update a risk profile every six months, which identifies relevant risks and sets out planned actions to respond to those risks.

Risk management arrangements are also subject to periodic review by Internal Audit. Such audits provide assurance that the risk management framework continues to be effective. Risk management arrangements may also be subject to review by external experts from time to time. The last such review of the Enterprise Risk Management Policy was undertaken by PricewaterhouseCoopers in 2011 and the next review is scheduled for the second half of 2015.

Previously, the Enterprise Risk Management Policy was reviewed by the Audit and Risk Committee approximately every three years, with the committee informed of material changes in the interim. Following the most recent review in August 2013, future reviews will be conducted on a two year cycle.

3.2 A central counterparty should provide incentives to participants and, where relevant, their customers to manage and contain the risks they pose to the central counterparty.

The use of margin and additional margin at ASX Clear (Futures) creates an incentive for participants to manage the exposures that they bring to the CCP, as does the requirement to contribute to pooled financial resources in proportion to initial margin obligations. Participants are also required to post additional collateral or increase their capital levels if they create exposures that are large relative to the size of their capital. ASX is proactive in monitoring participant exposures and utilises conservatively set triggers for additional monitoring or action, such as requiring participants to actively manage down exposures (see Key Consideration 4.2).

ASX Clear (Futures) may also apply sanctions to, or place additional requirements on, participants that fail to comply with its Operating Rules. Participants may ultimately be required to seek alternative clearing arrangements.

3.3 A central counterparty should regularly review the material risks it bears from and poses to other entities (such as other financial market infrastructures, settlement banks, liquidity providers, and service providers) as a result of interdependencies, and develop appropriate risk-management tools to address these risks.

ASX Clear (Futures) reviews the material risks that it bears from and poses to other entities in the context of its ongoing review of enterprise risks (such as the six-monthly update of business unit risk profiles, see Key Consideration 3.1), and its processes for identifying risks associated with new activities. In the case of new products and services, ASX undertakes risk assessments when undertaking an expansion of its activities or in the event of material changes to its business. Risk assessments are built into ASX's Project Management Framework (see Key Considerations 15.1, 17.4).

For instance, ASX Clear (Futures) has identified risks to its operational activities arising from participants' increased usage of third-party vendors for back-office systems, and participants outsourcing their back-office processing offshore. ASX Clear (Futures) has also identified interdependencies with service providers. ASX Clear (Futures)' response to these interdependencies is outlined in Key Consideration 17.4.

Interdependencies with Austraclear for the settlement of margin and other payment obligations are managed within the context of ASX Group's broader risk management framework (see Principle 20).

3.4 A central counterparty should identify scenarios that may potentially prevent it from being able to provide its critical operations and services as a going concern and assess the effectiveness of a full range of options for recovery or orderly wind-down. A central counterparty should prepare appropriate plans for its recovery or orderly wind-down based on the results of that assessment. Where applicable, a central counterparty should also provide relevant authorities with the information needed for purposes of resolution planning.

ASX Clear (Futures) has developed a basic recovery plan that identifies scenarios that could threaten its ongoing provision of critical clearing services and sets out how it would respond to such scenarios on the basis of its existing powers under its Operating Rules and Procedures. The recovery plan sets out the likely sequence of actions that ASX would take under each identified recovery scenario, and analyses the advantages and disadvantages of tools available to ASX Clear (Futures) to respond to such scenarios. In particular, ASX's analysis has identified that ASX Clear (Futures)' existing Operating Rules do not provide it with sufficient tools to be able to fully address uncovered credit losses and liquidity shortfalls, and replenish financial resources following a participant default or a non default-related financial loss (see also Key Considerations 4.7 and 7.9).

ASX has commenced work to develop a more comprehensive recovery plan supported by tools to fully address uncovered credit losses and liquidity shortfalls, and replenish financial resources. It intends to base these tools on forthcoming CPSS-IOSCO guidance on recovery planning, expected to be published in late 2014. ASX intends to consult on its proposed recovery approach in the second half of 2014.

Principle 4: Credit risk

A central counterparty should effectively measure, monitor and manage its credit exposures to participants and those arising from its payment, clearing and settlement processes. A central counterparty should maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. In addition, a central counterparty that is involved in activities with a more-complex risk profile or that is systemically important in multiple jurisdictions should maintain additional financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their affiliates that would potentially cause the largest aggregate credit exposure to the central counterparty in extreme but plausible market conditions. All other central counterparties should maintain additional financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would potentially cause the largest aggregate credit exposure to the central counterparty in extreme but plausible market conditions.

Rating: Broadly observed

The Bank's assessment is that ASX Clear (Futures) broadly observes the requirements of Principle 4. In order to fully observe Principle 4, ASX Clear (Futures) should:

- implement mechanisms consistent with forthcoming CPSS-IOSCO guidance on recovery planning that fully address any uncovered credit losses and replenish financial resources following a participant default
- complete the full validation of its capital stress-test model by external experts.

ASX Clear (Futures)' approach to managing its credit risk is described in further detail under the following Key Considerations.

4.1 A central counterparty should establish a robust framework to manage its credit exposures to its participants and the credit risks arising from its payment, clearing, and settlement processes. Credit exposures may arise from current exposures, potential future exposures, or both.

ASX Clear (Futures) maintains a comprehensive framework for managing credit exposures to its participants. This framework comprises: a stress-testing regime (see Key Consideration 4.5); the use of variation margin to mark positions to market (see Principle 6); and the maintenance of pre-funded financial resources. These financial resources comprise initial margin (see Principle 6), other collateral calls based on participants' positions, and fully prefunded pooled financial resources of \$650 million (see Key Consideration 4.4). Financial resources received in cash are invested in high-quality assets in accordance with ASXCC's treasury investment policy (see Principle 16).

4.2 A central counterparty should identify sources of credit risk, routinely measure and monitor credit exposures, and use appropriate risk management tools to control these risks.

ASX's Clearing Risk Management (CRM) unit is responsible for monitoring participants' credit standing and credit exposures to participants.

Within CRM, the Exposure Risk Management team monitors day-to-day developments in, among other things, market price moves, open positions and settlement obligations to the CCPs. Participants' positions are marked to market and ASX Clear (Futures) calculates initial and variation margin requirements at the end of each business day. ASX Clear (Futures) also has in place intraday margining processes to ensure that it calculates and manages credit risk exposures on a timely basis.

For exchange-traded products, ASX Clear (Futures) performs automated intraday margin calculations at 8.30 am and 11.30 am each business day, and may also perform ad hoc calculations if there is significant movement in the prices of individual contracts. Based on these calculations, intraday margin calls are made if margin coverage is eroded by 25 per cent or more (decreased from 40 per cent during 2013/14), and if intraday margin calculations exceed \$100 000 for a portfolio (see Key Consideration 6.4). ASX is considering whether to modify the timing of intraday calls to better align with overnight margin calls, and take into account price movements and changes in position later in the day.

For OTC derivatives positions, including cross-margined futures, ASX Clear (Futures) recalculates its exposures to participants on approximately an hourly basis. To manage the additional credit risk exposure arising from offering real-time novation of OTC products,

ASX Clear (Futures) places a limit on the interest rate sensitivity of new transactions (currently set to \$500 000), conducts frequent portfolio exposure checks and may prevent further novation until an intraday margin call is met. By imposing pre-novation limits on the interest-rate sensitivity of each trade (set using the maximum present value of a basis point shift in interest rates), ASX Clear (Futures) minimises the possibility that novating a single large trade results in a significant increase in credit exposure. The approximately hourly portfolio exposure checks by CRM reveal circumstances in which the sum of initial and variation margin owed (beyond excess collateral held by ASX Clear (Futures)) exceeds \$1 million, at which point ASX Clear (Futures) would call for intraday margin (see Key Consideration 6.4). The threshold is based on the most recent collateral data and is reviewed at least daily by CRM. From July 2014, margin erosion thresholds for intraday margin calls have been set at 10 per cent for OTC derivatives only portfolios, or 20 per cent for cross-margined OTC and exchange-traded derivatives portfolios.

ASX Clear (Futures) conducts daily stress testing to monitor the effects of extreme but plausible scenarios on participants' portfolios. Where stress-test results are above a defined limit, Additional Initial Margin (AIM) is called (see Key Consideration 4.4).

Within CRM, the Counterparty Risk Assessment (CRA) team is responsible for ongoing monitoring, assessment and investigation of matters relating to financial requirements (including participants' monthly financial statements). CRA is also responsible for determining and reviewing participants' credit standing, drawing in part on information provided by participants in regular financial returns to ASX. ASX determines an Internal Credit Rating (ICR) for each participant. The ICR takes into account the participant's external credit rating as appropriate. Other metrics monitored by CRA, including factors used in determining the CROCC watch list (see below), can be used as an alternative or supplementary means for ICR determination where these indicate an assessment of credit risk that differs from external credit ratings. In other cases, the ICR is based on the participant's capital position (or that of its parent where that parent is unrated but provides a formal guarantee to the CCP).

CRM also coordinates a 'watch list' of participants deemed to warrant more intensive monitoring. Inclusion on the watch list is based on a range of factors, such as: concentration risk; concerns emerging from a specific event or media report; significant changes in a participant's own share price, bond yield or credit default swap price; ICR downgrades; calls for AIM; operational issues; compliance issues; or issues arising from ASX's routine review of financial returns (for example regular losses or breaches of minimum capital requirements). The assessment of watch list factors monitored by CRA, ASX Compliance and the Operations Division is coordinated by the CROCC. Based on such an assessment, ASX Clear (Futures) may decide to place restrictions on a participant's trading, clearing and settlement activities. During 2013/14, there were no ASX Clear (Futures) participants on the watch list.

Participants on ASX's watch list may be subject to trading restrictions, or additional credit risk controls. For instance, they may be subject to calls for additional margin, higher capital requirements, additional capital reporting requirements, or a reduced STEL (such that additional margin would be called at a lower level of capital stress-test exposure (see Key Consideration 4.5)). CRM typically also carries out a detailed credit review of participants on the watch list.

ASX Clear (Futures) will also call capital-based position limit (CBPL) AIM from a participant with a large portfolio (measured by initial margin requirements) relative to its net tangible assets, or may make an additional cover call where it has other counterparty credit risk concerns.

During 2013/14, ASX undertook a broad review of concentration risk. As a result of this review, ASX developed a formal Concentration Risk Standard, setting out a risk-based approach to monitoring concentration risks in three areas:

- Concentrations in participants' exposures to their clients (discussed under Principle 19).
- Concentrations of individual participants' positions in particular products. Evidence of such concentration indicates individual participant exposure to large price movements in a particular product that could challenge its capacity to meet obligations to the CCP. CRM monitors the concentration of participants' exchange-traded positions in single products, by number of contracts or value of underlyings. Further review would be triggered should exposure to a particular product exceed a specified share of a participant's total portfolio, subject to a materiality threshold.
- Concentration of positions in a market in a single participant. Evidence of a single participant accounting for a large share of positions in a particular market segment could indicate the potential for complications in closing out or transferring these positions if the participant were to default. CRM monitors the market shares of participants in each exchange-traded product. Further review would be triggered if a single participant held more than 25 per cent of the contracts in the market for that product and the size of the position (relative to average market turnover for that product) suggested that it could take more than two days to close out that participant's position.

If a trigger were met under its Concentration Risk Standard, ASX would not automatically take action. In determining whether further investigation or action was warranted, ASX would take into account a number of factors, including the materiality of the breach and the credit standing and activity profile of the relevant participant (see CCP Standard 4.3).

Under its risk-based approach to monitoring concentration risk, ASX Clear (Futures) has prioritised formal concentration monitoring for exchange-traded products over OTC products. This reflects the currently relatively low level of exposures generated by OTC derivatives transactions. ASX Clear (Futures) nevertheless monitors concentration risks in OTC products via its ongoing monitoring of participant credit exposures.

For details of ASX Clear (Futures)' other participation requirements and participant monitoring arrangements, see Principle 18.

- 4.3 A payment system or securities settlement facility should cover its current and, where they exist, potential future exposures to each participant fully with a high degree of confidence using collateral and other equivalent financial resources (see Principle 5 on collateral). In the case of a deferred net settlement payment system or deferred net settlement securities settlement facility in which there is no settlement guarantee, but where its participants face credit exposures arising from its payment, clearing and settlement processes, such a financial market infrastructure should maintain, at a minimum, sufficient resources to cover the exposures of the two participants and their affiliates that would create the largest aggregate credit exposure in the system.**

Key Consideration 4 is not relevant to central counterparties.

- 4.4 A central counterparty should cover its current and potential future exposures to each participant fully with a high degree of confidence using margin and other prefunded financial resources (see Principle 5 on collateral and Principle 6 on margin). In addition, a**

central counterparty that is involved in activities with a more complex risk profile or that is systemically important in multiple jurisdictions should maintain additional financial resources to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their affiliates that would potentially cause the largest aggregate credit exposure for the central counterparty in extreme but plausible market conditions. All other central counterparties should maintain additional financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would potentially cause the largest aggregate credit exposure for the central counterparty in extreme but plausible market conditions. In all cases, a central counterparty should document its supporting rationale for, and should have appropriate governance arrangements relating to, the amount of total financial resources it maintains.

During 2013/14, ASX Clear (Futures) increased its total prefunded pooled financial resources to \$650 million, from \$370 million at the end of June 2013. \$180 million of the additional funds was sourced from a capital raising conducted in June 2013, while \$100 million was contributed by participants of ASX Clear (Futures)' OTC derivatives clearing service. ASX Clear (Futures) also replaced \$20 million of contributions from futures clearing participants with funds from a subordinated loan from ASX Limited. Following these changes, pooled financial resources consist of (in order of application in the event of a futures participant default): \$30 million of ASXCC equity; a \$90 million subordinated loan from ASXCC (ultimately funded by a subordinated loan from ASX Limited); \$100 million from futures participants (the ordering of OTC and futures participant contributions would be switched in the event of an OTC participant default); \$150 million of ASXCC equity; \$100 million from OTC participants; and \$180 million of ASXCC equity. The increase in pooled financial resources reflects the launch of the OTC derivatives clearing service, and the move to testing the adequacy of financial resource against the default of the two largest participants plus affiliates. The magnitude of the increase reflects stress tests of participant portfolios provided to ASX Clear (Futures) as part of a design study for the OTC derivatives clearing service carried out in 2012.

ASX Clear (Futures) conducts daily stress tests to ensure that the level of its prefunded financial resources is sufficient to cover the default of the two participants (and their affiliates) that would potentially cause the largest aggregate credit exposure to the CCP under a wide range of scenarios (see Key Considerations 4.5, 4.6). Since ASX Clear (Futures) clears primarily transactions in exchange-traded futures and OTC interest rate swap (IRS) derivatives, the Bank does not consider that ASX Clear (Futures) is involved in activities with a complex risk profile. However, ASX Clear (Futures) is systemically important within Australia. The Bank has issued supplementary interpretation of the FSS that clarifies how it will determine systemic importance in multiple jurisdictions. One indicator, among other things, is the need to seek 'recognition' in other jurisdictions. Reflecting this supplementary interpretation, the Bank has concluded that ASX Clear (Futures) is systemically important in multiple jurisdictions and therefore subject to higher financial resource requirements (i.e. to cover the default of two participants and their affiliates).

Under ASX Clear (Futures)' AIM methodology, a participant is required to post additional collateral should stress-test outcomes reveal that the potential loss arising from its positions (as at the close of the previous day) exceeds a predetermined STEL (Key Consideration 4.5). The objective of this regime is to provide additional participant-specific cover against non-systematic spikes in individual participants' exposures. This mitigates the risk that the default of a participant with a large exposure, in more extreme market conditions than are

contemplated by regular initial margin, may deplete or even exhaust prefunded pooled financial resources. By upholding the 'defaulter pays' principle, the AIM regime also provides an incentive for participants to manage the risk they bring to the CCP. However, it is not a substitute for holding sufficient pooled financial resources. There are potential shortcomings to relying too heavily on variable calls related to stress-test exposures, particularly given lags in the calculation and settlement of such calls (see Key Consideration 4.5).

- 4.5 A central counterparty should determine the amount and regularly test the sufficiency of its total financial resources available in the event of a default or multiple defaults in extreme but plausible market conditions through rigorous stress testing. A central counterparty should have clear procedures to report the results of its stress tests to appropriate decision makers at the central counterparty and to use these results to evaluate the adequacy of and adjust its total financial resources. Stress tests should be performed daily using standard and predetermined parameters and assumptions. On at least a monthly basis, a central counterparty should perform a comprehensive and thorough analysis of stress-testing scenarios, models and underlying parameters and assumptions used to ensure they are appropriate for determining the central counterparty's required level of default protection in light of current and evolving market conditions. A central counterparty should perform this analysis of stress testing more frequently when the products cleared or markets served display high volatility, become less liquid, or when the size or concentration of positions held by a central counterparty's participants increases significantly. A full validation of a central counterparty's risk management model should be performed at least annually.**

ASX Clear (Futures) uses daily capital stress tests to monitor risk exposures to individual participants and the adequacy of its financial resources. Capital stress tests are based on a range of scenarios covering extreme price moves and volatility shifts at the market-wide, sector and individual-stock levels (see Key Consideration 4.6). The scenarios have been developed based on statistical analysis of historical market movements, which takes into account correlations between contracts and uses the 'student t distribution' (allowing for more extreme events than a normal distribution). On a daily basis, ASX reviews the scenarios which underpin the capital stress-testing regime for ASX Clear (Futures), and on a monthly basis carries out a review of market conditions to determine whether there is any evidence of stress that would support a change to scenarios. Any observed changes in price, volatility or interest rate curves in excess of the stress-test scenarios would constitute an event beyond what was previously considered to be extreme but plausible. Accordingly, it is likely that a revision to the relevant stress-test scenario would be presented for consideration by the Clearing Boards. In addition, ASX conducts monthly reverse stress tests to confirm the sufficiency of pooled financial resources and to cross-validate the capital stress-test scenarios (see Key Consideration 4.6).

ASX's Model Validation Standard requires that all models that are critical to ASX (as measured against a series of risk factors) undergo a full annual validation (see Key Consideration 2.6). Under this framework the capital stress-test model must be externally validated annually. ASX has engaged external experts to conduct a validation of the capital stress-test model during the third quarter of 2014. The Bank will monitor the outcome of this validation.

Reporting and use of stress test results

Capital stress test exposures are routinely reported to ASX management, the Clearing Boards and the Bank. Participant stress test losses are used to gauge the adequacy of ASX Clear

(Futures)' available financial resources, with widespread and/or large STEL breaches an indicator that resources may need to be increased. STEL breaches are reported to management and persistent breaches are escalated in the first instance to the CRO and CALCO. The CS Boards and ASX Limited Board are responsible for approving any increase to pooled prefunded financial resources where this is considered necessary (see below).

Each participant in ASX Clear (Futures) is allocated a STEL based on its ICR. The maximum STEL represents one half of ASX Clear (Futures)' total pooled prefunded financial resources, reflecting that ASX Clear (Futures) holds prefunded resources to cover multiple participant defaults. ASX Clear (Futures) made a number of adjustments to STELs during the Assessment period, reflecting the move to cover multiple participant defaults, and increases in pooled prefunded financial resources (including contributions received from OTC participants).

Where the projected stress-test losses of a participant exceed its STEL, ASX will call for STEL AIM. Like other margins, STEL AIM is calculated overnight, notified to participants by approximately 8.00 am the next day, and must be met by 11.00 am. Participants may meet these obligations using cash or non-cash collateral, including Australian Government securities and bank bills or negotiable certificates of deposit from ADIs. ASX Clear (Futures) does not accept collateral issued by a clearing participant or associated entity, in order to reduce the possibility that it might face the default of both a clearing participant and a collateral issuer.

In deciding whether ASX Clear (Futures) has sufficient pooled financial resources, ASX considers the size, frequency, duration and distribution of AIM calls across participants. ASX Clear (Futures) would consider increasing these resources if stress-test results in excess of pre-funded pooled resources were persistent, significant and widespread. In other cases, ASX Clear (Futures) would generally rely on additional collateral collected under the AIM regime.

4.6 In conducting stress testing, a central counterparty should consider the effect of a wide range of relevant stress scenarios in terms of both defaulters' positions and possible price changes in liquidation periods. Scenarios should include relevant peak historic price volatilities, shifts in other market factors such as price determinants and yield curves, multiple defaults over various time horizons, simultaneous pressures in funding and asset markets, and a spectrum of forward-looking stress scenarios in a variety of extreme but plausible market conditions.

ASX Clear (Futures) uses its capital stress test to establish the overall adequacy of financial resources and to determine whether a participant is required to post AIM (see Key Considerations 4.4, 4.5).

The stress-testing regime comprises a suite of portfolio and single-contract stress-test scenarios based on statistical analysis of historical market movements. Scenarios are tailored to ASX Clear (Futures)' risk tolerance, as defined by its Board. All stress-test scenarios are based on historical observations and aim to capture extreme market moves that have a probability of occurrence of once in 30 years for single-asset scenarios, and once in 100 years for multi-asset scenarios. To meet these targeted probabilities, stress-test scenarios are calibrated to cover 99.987 per cent of daily price and volatility movements for the single-asset scenarios and 99.996 per cent of daily price and volatility movements for the multi-asset scenarios, based on a sample distribution constructed from 20 years of price and volatility data. The sample distribution used by ASX Clear reflects the period in which ASX has judged historical data as consistent and relevant to current market structures.

ASX Clear (Futures) uses 30 scenarios that involve movements of price and volatility across the four major futures contracts: SPI 200; 90-day bank accepted bill; 3-year bond; and 10-year bond.

- Twenty 'multi-asset' scenarios model combinations of price movements across all four contracts. Sixteen of these scenarios model a range of tilts, twists and bends of the yield curve, as represented by different price shocks across the 90-day, three-year and 10-year contracts; for example, the 'tilt (back end up)' scenario has progressively increasing price shocks from short-term to long-term interest rate contracts, with a 0 per cent move in the price of the 90-day contract, a 2 per cent move in the price of the three-year contract, and a 5 per cent move in the price of the 10-year contract. The remaining four of the multi-asset scenarios model moves in equities with balanced movements in the three interest rate contracts, equivalent to a 'parallel' move of the yield curve.
- Eight 'single contract' scenarios model extreme price movements in the four contracts individually.
- Two scenarios model large movements in the interest rate contracts with no movement in equities.

For participants that clear OTC derivatives, ASX Clear (Futures) applies the same multi-asset and single-asset scenarios, with extensions to capture movements in the bank bill swap rate (BBSW) and Australian overnight index average (AONIA) for overnight indexed swaps. Accordingly, the scenarios test shocks to exchange-traded derivatives and IRS simultaneously. The BBSW and AONIA curves are split into segments based on differences in participation and activity in the underlying market. The price shocks are calibrated using 20 years of data history for the Australian interest rate derivatives market, and take into account the assumed five-day close-out period for OTC derivatives transactions. As for the futures-only scenarios, the combined futures and OTC scenarios are sized to be equivalent to one in 30 year price movements for single-asset shifts, and one in 100 year outcomes for multi-asset shifts.

In February 2014, ASX added 10 new scenarios that consider various forms of basis risk. Two of these new scenarios expand on two pre-existing scenarios modelling the basis risk that results from a potential change – either temporary or permanent – in the economic relationship between interest rate futures and IRS. Two other new scenarios model the effect of a change in the spread between AONIA and BBSW rates at various tenors, while six new scenarios model changes in the tenor spread for BBSW. Each pairwise basis risk spread has been sized to a once in 100 year event. The new scenarios bring the total number of capital stress-test scenarios for OTC participants to 42.

In addition to the active scenarios for OTC derivatives, ASX introduced 14 internal scenarios in early 2014. These model shocks affecting a single tenor, the effect of assuming an increased close-out period and the impact of an absolute interest rate shock. Review of scenarios used in ASX Clear (Futures)' capital stress test against observed market movements also occurs on a daily basis and against overall market conditions on a monthly basis (see Key Consideration 4.5).

Over the course of 2013/14, ASX developed a reverse stress test for ASX Clear (Futures) that takes into account the impact of systematic shocks across multiple contracts and considers changes to other model assumptions. For instance, an assumed change in equities prices (up

or down), which affects the size of exposures on SPI-200 positions, is combined with an assumed change to the level or shape of the interest rate curve (e.g. to steepen, twist, or effect a parallel shift up or down) which affects the three major interest rate futures contracts. In developing these combinations of market movements, ASX considers the prevailing capital stress-test scenarios, and observed historical and statistical relationships between the relevant market variables. The reverse stress test then simulates a level shift to this fixed combination of market movements to discover the point at which pooled financial resources would be exhausted.

In order to test the sensitivity of the stress-test models to other model assumptions, the reverse stress test is repeated for a wide range of scenarios. These include assuming the default of multiple participants beyond the available financial resources of ASX, and varying assumptions on the size, concentration or directionality of participants' portfolios. To test these assumptions, reverse stress tests are applied to participant portfolios that exhibit certain characteristics, such as concentrated exposure to certain products or a highly directional interest rate exposure. ASX also conducts tests of extreme hypothetical portfolios that would generate losses sufficient to exhaust pooled financial resources under plausible market scenarios.

In interpreting the results of reverse stress testing, ASX considers the plausibility of any scenarios that could exhaust pooled financial resources. Any recommended changes to stress-test scenarios or pooled financial resources would first be considered by the RQG and then escalated to the Clearing Boards for approval. A summary of reverse stress testing outcomes is reported alongside the monthly margin backtesting and capital stress test review reports and included in quarterly risk management reports to the Clearing Boards.

The Bank will continue to monitor the implementation of these enhancements to ASX Clear (Futures) approach to reverse stress testing.

4.7 A central counterparty should establish explicit rules and procedures that address fully any credit losses it may face as a result of any individual or combined default among its participants with respect to any of their obligations to the central counterparty. These rules and procedures should address how potentially uncovered credit losses would be allocated, including the repayment of any funds a central counterparty may borrow from liquidity providers. These rules and procedures should also indicate the central counterparty's process to replenish any financial resources that the central counterparty may employ during a stress event, so that the central counterparty can continue to operate in a safe and sound manner.

In March 2014, ASX finalised a basic recovery plan that relies on existing tools and powers within the CS facilities' Operating Rules. In preparing the plan for ASX Clear (Futures), ASX identified that the existing Operating Rules do not provide the CCP with sufficient tools to be able to fully address any uncovered credit losses and replenish financial resources following a participant default (see Key Consideration 3.5). While ASX's recovery plan identifies measures that could be used to mitigate this in part (such as adjustments to STELs and the collection of additional margin), additional measures will be required to comprehensively allocate uncovered losses and adequately and reliably replenish financial resources.

In relation to replenishment, responsibility for determining if resources will be replenished and, if so, how this should be achieved, ultimately lies with the ASX Limited Board, which would make this decision in consultation with the ASX Clear (Futures) Board. ASX has

documented replenishment intentions, which include several options; the particular approach taken to replenishment would depend on the specific circumstances, including the severity of the loss and the market environment (see Key Consideration 13.1). ASX Limited has also committed to maintaining a certain level of equity capital in ASX Clear (Futures) (including via ASXCC), provided certain conditions are met, including that the CCP is solvent.

ASX has commenced work to develop a more comprehensive recovery plan supported by tools to fully address uncovered credit losses and replenish financial resources. It intends to base these tools on forthcoming CPSS-IOSCO guidance on recovery planning, expected to be published in late 2014. ASX intends to consult on its proposed recovery approach in the second half of 2014.

Principle 5: Collateral

A central counterparty that requires collateral to manage its or its participants' credit exposure should accept collateral with low credit, liquidity and market risks. A central counterparty should also set and enforce appropriately conservative haircuts and concentration limits.

Rating: Observed

The Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 5. ASX Clear (Futures)' collateral acceptance policies are described in further detail under the following Key Considerations.

5.1 A central counterparty should generally limit the assets it (routinely) accepts as collateral to those with low credit, liquidity and market risks.

The acceptable collateral depends upon the type of margin called.

- Futures participants generally meet their initial margin obligations using AUD cash, although they may also use high-quality non-cash collateral, such as eligible debt securities, and deposits in major foreign currencies. The acceptable types of non-cash collateral are Australian Government and some semi-government securities, and US Treasury bills. Acceptable foreign currencies are NZD, EUR, JPY, USD and GBP. Acceptable collateral is reviewed annually, with haircuts applied to all non-cash collateral posted and all cash collateral that is not in the same currency as the product being covered.
- Participants may meet STEL AIM obligations using AUD cash or non-cash collateral, including Australian Government and some semi-government securities, bank bills and negotiable certificates of deposit from ADIs. Foreign currencies are not eligible for STEL AIM calls.
- Variation margin and intraday margin must be settled in cash.

ASX Clear (Futures) does not accept collateral that is issued by a clearing participant or associated entity for any margin calls. This reduces the possibility that it might face the default of both a clearing participant and a collateral issuer ('wrong-way risk'). In April 2014, an amendment to the ASX Clear (Futures) Operating Rules removed the ability for participants to use letters of credit to meet contributions to pooled financial resources.

During 2013/14, ASX formally documented its approach to collateral in a Collateral Policy and a Collateral Standard. These documents set out ASX's collateral eligibility criteria, procedures

for review of eligibility, the basis for calibrating haircuts and arrangements for the review of collateral settings.

ASX Clear (Futures) takes into account market liquidity in determining the eligibility of collateral. ASX Clear (Futures) considers the debt securities that it will accept as collateral – Australian Government and some semi-government securities, US Treasury bills, bank bills and negotiable certificates of deposit from Australian ADIs – to be sufficiently liquid that the eligibility of these assets as collateral will not have any material impact on market liquidity or price. In light of the depth of liquidity in these assets, ASX Clear (Futures) would also expect to be able to liquidate such collateral in a timely fashion as required. These assets are also commonly accepted in the Australian market, including by the Bank.

5.2 A central counterparty should establish prudent valuation practices and develop haircuts that are regularly tested and take into account stressed market conditions.

Since the eligible assets for non-cash collateral at ASX Clear (Futures) – Australian Government and some semi-government securities, US Treasury bills, bank bills and negotiable certificates of deposit from Australian ADIs – are highly liquid, price information is readily available. ASX revalues non-cash collateral on a daily basis using end-of-day prices.

ASX Clear (Futures) sets haircuts on non-cash collateral to cover a fall in the collateral value of stocks over a one-day period under extreme but plausible scenarios. Haircuts are calculated based on the same methodology that is used to calculate price falls of contracts in capital stress-test scenarios (see Key Consideration 4.6). Haircuts are also applied to cash collateral lodged to meet margin requirements for products denominated in a currency other than the collateral (currently between 6 and 10 per cent, depending on the currency). Collateral haircuts are reviewed at least annually to take into account any changes to historically observed volatility trends. Collateral haircuts were most recently reviewed in January 2014, with a supplementary review of haircuts applied to foreign currencies in June 2014. In addition, since collateral haircuts are calibrated to the same stress scenarios as those used in the stress-testing regime, the ongoing review of capital stress test scenarios also verifies the appropriateness of haircut rates (see Key Consideration 4.4).

5.3 In order to reduce the need for procyclical adjustments, a central counterparty should establish stable and conservative haircuts that are calibrated to include periods of stressed market conditions, to the extent practicable and prudent.

ASX Clear (Futures)' collateral haircutting policy is designed to cover extreme but plausible scenarios based on market price and volatility movements observed in the past 20 years, which includes the extreme volatility observed during the 2008–09 financial crisis. This is intended to ensure that haircuts remain stable over the business cycle, even in stressed market conditions.

5.4 A central counterparty should avoid concentrated holdings of certain assets where this would significantly impair the ability to liquidate such assets quickly without significant adverse price effects.

During 2013/14, ASX developed a risk-based policy for managing concentration risks in its CCPs (see Key Considerations 4.2, 19.4); however, this policy does not address concentrations in collateral holdings since non-cash collateral has made up only a small proportion of total collateral received. The maximum holding of non-cash collateral during 2013/14 was \$111 million (around 4 per cent of total margin). Cash remains the sole form of collateral

utilised by the majority of participants. ASX also considers that the assets eligible for non-cash collateral – Australian Government and some semi-government securities, US Treasury bills, bank bills and negotiable certificates of deposit from Australian ADIs – are sufficiently liquid that concentration is unlikely to be a significant concern. Concentration risk in foreign currencies is considered whenever a participant approaches ASX for approval to lodge foreign currency collateral (see Key Consideration 5.5). As the materiality of non-cash collateral increases, restrictions on concentrations are expected to align with those of the investment mandate (see Key Consideration 16.4). The Bank will continue to discuss with ASX its approach to monitoring collateral concentration risks.

5.5 A central counterparty that accepts cross-border collateral should mitigate the risks associated with its use and ensure that the collateral can be used in a timely manner.

ASX Clear (Futures) accepts cross-border collateral for initial margin in the form of selected foreign currencies and US Treasury bills. During 2013/14, maximum foreign cash holdings were around \$499 million (AUD equivalent) in comparison to average total collateral holdings of around \$3.3 billion (daily average of initial margin held over 2013/14), while no US Treasury bills were held. Holdings of non-AUD collateral in excess of 25 per cent of liquid assets held by ASXCC trigger escalation to senior management. Haircuts are applied to both foreign cash collateral and US Treasury bills (see Key Consideration 5.2). Participants must lodge a request to post foreign currency, which is reviewed and then approved or denied by the Portfolio Risk Management team. In making this determination, the Portfolio Risk Manager will take into account the limits on foreign currency, as well as the concentration risk in accepting the request. ASX Clear (Futures) has the ability to use foreign exchange swaps to facilitate the timely use of collateral in foreign currencies. Arrangements for the settlement of foreign currencies are described in Principle 9.

5.6 A central counterparty should use a collateral management system that is well designed and operationally flexible.

Collateral management system

ASX Clear (Futures) manages the calculation and execution of margin calls through internal risk analysis and margin management systems. These are linked to its core Genium system for information on positions, and Austraclear's EXIGO system for the lodgement of settlement instructions. These systems accurately monitor initial and variation margin levels and flows on an intraday basis. The direct link to Austraclear facilitates the timely deposit, withdrawal and substitution of non-cash collateral and settlement of cash collateral.

ASX Clear (Futures)' participants can also make use of ASX's collateral management service, ASX Collateral, for the management of non-cash collateral lodged with the CCP. However, ASX Collateral was not used for the lodgement of any collateral at ASX Clear (Futures) during 2013/14.

Re-use of collateral

ASX Clear (Futures) does not re-use non-cash collateral posted by participants and the re-use of such collateral is not supported under its Operating Rules.

Principle 6: Margin

A central counterparty should cover its credit exposures to its participants for all products through an effective margin system that is risk based and regularly reviewed.

Rating: Broadly observed

The Bank's assessment is that ASX Clear (Futures) broadly observes the requirements of Principle 6. In order to fully observe Principle 6, ASX Clear (Futures) should:

- complete the full external validation of its SPAN and OTC IRS Historic VaR margin models by external experts.

ASX Clear (Futures)' margin system is described in further detail under the following Key Considerations.

6.1 A central counterparty should have a margin system that establishes margin levels commensurate with the risks and particular attributes of each product, portfolio, and market it serves.

ASX Clear (Futures) applies initial and variation margin to all derivatives products. Initial margin provides protection to a CCP in the event that a participant defaults and an adverse price change occurs before the CCP can close out the defaulted participant's positions (potential future exposure). Variation margin is levied to reflect observed price movements (current exposure); it is collected from the participant with a mark-to-market loss and (typically) passed through to the participant with a mark-to-market gain.

Exchange-traded derivatives

ASX Clear (Futures) has adopted a variant of the internationally accepted SPAN methodology for calculation of initial margin. For exchange-traded derivatives products, initial margin is calibrated so as to cover the higher of three standard deviations of the 60-day and 252-day historical distribution of price movements, using the higher of one- or two-day price movements. ASX Clear (Futures) also evaluates margin rates against multiple look-back periods, incorporating both short- and long-term periods (7 business days, 120 business days and 12 months). All margin rates are reviewed on a three-monthly cycle, supplemented with ad hoc reviews during especially volatile market conditions. ASX Clear (Futures) also levies variation margin on positions at least daily to reflect observed price movements.

OTC derivatives

ASX Clear (Futures) margins OTC derivatives portfolios (including interest rate futures that participants have allocated for cross-margining with OTC derivatives positions (see Key Consideration 6.5)), using a historical simulation of value at risk model within the Calypso margin system. The OTC IRS Historic VaR model is calibrated so as to cover three standard deviations (99.7 per cent) of the five-year historical distribution of five-day price movements. By calculating initial margin requirements on a portfolio basis using the historical distribution of price movements, this methodology adjusts for observed price volatility and correlation. The five-day close-out period reflects the lower liquidity in OTC derivatives products. This approach is closely aligned with the methodology used at other OTC derivatives CCPs internationally.

6.2 A central counterparty should have a reliable source of timely price data for its margin system. A central counterparty should also have procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable.

ASX Clear (Futures) has access to timely price data for its exchange-traded products.

To value cleared OTC derivatives products, ASX Clear (Futures) uses a range of BBSW, ICAP and Reuters pricing points, as well as the official cash rate, pricing from 90-day bank bill futures contracts, and swap yields for contracts greater than three years. These sources provide sufficient pricing points to value the OTC derivatives products that ASX Clear (Futures) clears, even when some pricing data are not readily available or reliable.

Participants are given all information necessary to create the end-of-day yield curve and independently calculate the net present value of any contract. Although the OTC IRS margin system can accommodate hourly updated pricing, ASX Clear (Futures) is implementing a system of manually 'approved' prices, and will focus on end-of-day and midday updates to ensure that valuation is based on prices that accurately reflect market pricing. ASX Clear (Futures) will consider introducing more frequent price updates as the service develops.

- 6.3 A central counterparty should adopt initial margin models and parameters that are risk-based and generate margin requirements sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default. Initial margin should meet an established single-tailed confidence level of at least 99 per cent with respect to the estimated distribution of future exposure. For a central counterparty that calculates margin at the portfolio level, this requirement applies to each portfolio's distribution of future exposure. For a central counterparty that calculates margin at more granular levels, such as at the sub portfolio level or by product, this requirement must be met for the corresponding distributions of future exposure. The model should (a) use a conservative estimate of the time horizons for the effective hedging or close out of the particular types of products cleared by the central counterparty (including in stressed market conditions), (b) have an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products, and (c) to the extent practicable and prudent, limit the need for destabilising, procyclical changes.**

Exchange-traded derivatives

ASX Clear (Futures) calculates initial margin requirements for each portfolio of positions using the SPAN methodology. House and omnibus client accounts are considered as separate portfolios. Further to the introduction in July 2014 of an account structure that supports individual client segregation, ASX Clear (Futures) positions held in these will also be considered as separate portfolios (see Principle 13).

The key parameters in the SPAN methodology are the 'price scanning range' (PSR) and 'volatility scanning range' (VSR). These scanning ranges are individually calibrated to the distribution of price and volatility movements for a set of related contracts under normal market conditions. The scanning ranges inform a set of 16 hypothetical risk scenarios used to measure the loss from a portfolio under alternative combinations of changes in price and volatility. For example, in one risk scenario, price increases by one-third of the PSR and volatility falls by the full VSR, while in another scenario price falls by the full PSR and volatility rises by the full VSR. The margin rate is then based on the highest estimated loss across the 16 scenarios.

ASX Clear (Futures) bases the scanning ranges on key volatility statistics; namely, the higher of three standard deviations (a confidence interval of 99.7 per cent) of a 60-day or 252-day sample distribution, using the higher of one- or two-day price movements. The sample period

reflects a preference for incorporating recent market conditions. The inclusion of two-day price movements reflects a conservative assumption that a defaulter's positions may take up to two days to close out. ASX also evaluates margin rates against multiple look-back periods incorporating both short- and long-term periods (1 day, 1 week, 120 business days and 12 months).

ASX Clear (Futures) also applies a series of adjustments within SPAN to account for correlations and specific risks.

- *Intra-commodity spread charge.* This is an adjustment to the margin requirement for a given set of related contracts, to account for less-than-perfect correlation between contracts with different expiries. This adjustment is based on a participant's actual net position at each expiry month multiplied by an 'intra-commodity charge rate', which is itself based on observed price correlations between the different expiries. The default setting is to apply a single charge rate. However, for some contracts ASX utilises SPAN's charge-rate tiering functionality. This allows charge rates to vary depending on the temporal difference in the pair's expiries.
- *Inter-commodity spread concession.* ASX Clear (Futures) also applies offsets designed to account for reliable and economically robust correlations across different contract types (Key Consideration 6.5). These offsets reflect that, while the scanning risk for each related contract – a 'combined commodity' in SPAN terminology – is set based on the worst-case risk scenario for that combined commodity, it may be highly unlikely that the set of worst-case scenarios occurs simultaneously. This is particularly the case if a participant holds net long and net short positions in different related contracts that have a robust positive correlation. The inter-commodity spread concession is calculated by applying (in a defined order) a spread ratio and concession rate to a participant's actual net positions in pairs of related contracts. The spread ratio determines the number of net positions in one related contract required to offset a position in another related contract. The concession rate is specified as a percentage of the scanning risk for both contracts in the pair. For example, at ASX Clear (Futures), for 10-year bond futures relative to 90-day bank bill futures, a spread ratio of 1:4 and a concession rate of 65 per cent would mean that one net position in the 10-year bond contract is offset against four net positions in the 90-day bank bill contract, and that the concession for that pairing will be 65 per cent of the scanning risk of the contracts subject to the offset. ASX calculates these parameters in the same manner as the price movement for the intra-commodity spread charge.
- *Other adjustments.* ASX Clear (Futures) applies an adjustment to cover its exposure on the day of contract expiry, since expiring positions are otherwise not included in that day's initial margin calculations. ASX also maintains a minimum margin requirement on short positions to ensure the collection of margin on deep out-of-the-money options that would otherwise return no scanning range.

Under ASX's internal Margin Standard, the Manager of Exposure Risk Management (part of CRM) can approve adjustments to margin rate settings jointly with the CRO, or with the General Manager of either CRM, Clearing Risk Strategy and Policy or CRQ. Such adjustments may be made if application of the standard statistical analysis would result in inappropriate outcomes; for example, if the backward-looking statistical analysis does not take appropriate account of expected future price movements. Other reasons for using management

discretion include insufficient historical data (e.g. where a product is new), seasonality in some products, and isolated spikes in price movements that result in a distortion of statistical recommendations. The ASX Margin Standard also allows exceptions to the normal margin rate setting process based on a broader risk assessment – such exceptions require the approval of the General Manager of Clearing Risk Strategy and Policy and the General Manager of CRQ.

OTC derivatives

ASX Clear (Futures) uses an HSVaR model to calculate margin requirements for OTC derivatives, based on a minimum five-year sample period. Observations within the sample period are weighted according to an exponential decay factor (currently 0.97), placing greater weight on more recent observations and applying a volatility scaling floor. To ensure that the methodology remains conservative and to limit the need for procyclical changes, ASX Clear (Futures) continues to include the extreme observations from the quarter ending in December 2008 within its sample period, even though these fall outside the five-year window. ASX Clear (Futures) calibrates initial margin based on a 99.7 per cent confidence interval with an assumed close-out period of five days. Under ASX Clear (Futures) client clearing arrangements for OTC derivatives, the close-out period for client positions is seven rather than five days in order to allow time to achieve a transfer of positions (see Principle 14). However, ASX applies the same margin settings for client positions as it does for participants' house positions (i.e. a five-day holding period). ASX's modelling indicates that margin requirements are typically higher under a five-day holding period calibrated to a 99.7 per cent confidence level than they would be under a seven-day holding period calibrated to a 99.5 per cent confidence level, consistent with the Bank's supplementary interpretation of the FSS requirements that correspond to this Key Consideration.

6.4 A central counterparty should mark participant positions to market and collect variation margin at least daily to limit the build-up of current exposures. A central counterparty should have the authority and operational capacity to make intraday margin calls and payments, both scheduled and unscheduled, to participants.

Margin requirements for both futures and OTC participants are calculated overnight, with variation margins based on closing prices each day, and notified to participants the next morning. All margin obligations are settled via Austraclear and regular calls must be met by 10.30 am.

ASX Clear (Futures) may make intraday calls where there is significant erosion in the margin cover provided by individual participants. Intraday margin calls reflect changes in participants' positions and price movements.

- For exchange-traded products, intraday margin calculations are carried out routinely at 8.30 am and 11.30 am each business day. ASX is considering whether to modify the timing of intraday calls to better align with overnight margin calls, and take into account price movements and changes in position later in the day. ASX Clear (Futures) tracks the price movements of all contracts in real time through the day. An ad hoc calculation may be performed if the change in price of an individual contract exceeds 100 per cent of its margin rate (the PSR in SPAN). To determine if intraday margin is required, a nominal call amount is calculated for each portfolio of the participant (house and client) based on the combined initial and variation margin that would be due at the time of the intraday calculation. This is compared with the total margin posted by the participant. If available

margin has eroded by more than 40 per cent, and if the nominal call amount is greater than \$100 000 and the participant has not already lodged excess collateral sufficient to cover the nominal amount, an intraday call is made. Participants are notified of the call by phone and email, and must make the payment within two hours of notification.

- For OTC derivatives positions, including cross-margined futures, ASX Clear (Futures) recalculates its exposures to participants on an approximately hourly basis. In the event that ASX Clear (Futures)' exposure to any OTC participant has risen beyond a specified threshold, intraday margin is called (see Key Consideration 4.2).

Under ASX Clear (Futures)' AIM methodology (discussed above in relation to Principle 4), a participant is required to post additional collateral should stress-test outcomes reveal potential losses that exceed a predetermined STEL or if participants have large portfolios relative to their capital (see Key Consideration 4.5).

If a margin payment is not made by the required time, ASX will contact the participant to determine the reasons for the delayed payment. Delayed payments are not common. When they do occur, they are typically the result of communication or technical issues involving the participant and/or its payment provider. Early communication by ASX aims to ensure that, in such cases, payment can still be made within a short period of the required time. In the event that the matter was more serious, ASX would investigate to decide whether a default event should be declared and, if so, how the default should be managed (see Principle 13).

6.5 In calculating margin requirements, a central counterparty may allow offsets or reductions in required margin across products that it clears or between products that it and another central counterparty clear, if the risk of one product is significantly and reliably correlated with the risk of the other product. Where two or more central counterparties are authorised to offer cross-margining, they must have appropriate safeguards and harmonised overall risk management systems.

In applying the SPAN methodology to futures transactions, ASX allows offsets in the form of 'inter-commodity spread concessions' (see Key Consideration 6.3). These offsets reduce margin requirements to account for reliable and economically robust correlations observed across related contracts. Inter-commodity spread concessions are only applied where measures of correlation between contracts exceed 30 per cent and the correlation is based on economic fundamentals. ASX uses sensitivity analysis to verify the reliability of assumed correlations between products used in calculating inter-commodity spread concessions. Changes to inter-commodity spread concessions must be approved by the RQG, which considers whether changes identified by SPAN appropriately reflect underlying economic relationships, including in periods of market stress.

ASX Clear (Futures) also offers OTC participants the ability to choose to cross-margin specific directly cleared interest rate futures by allocating these positions to their OTC derivatives portfolio. If participants choose to do so, the allocated interest rate futures are margined under the OTC IRS Historic VaR model, rather than using the SPAN methodology. While HSVaR margining can result in less conservative estimates of correlations, interest rate futures in the pool under the OTC IRS Historic VaR methodology will be subject to a five-day rather than a one to two day close-out assumption. As a result, ASX has indicated that, absent an offset, cross-margined interest rate futures would generally be subject to higher margin requirements under the OTC IRS Historic VaR methodology than under the SPAN methodology.

Cross-margining recognises the economic relationship between AUD IRS and AUD interest rate futures and, to the extent that positions are indeed offsetting, would be expected to result in a reduction in the amount of initial margin required relative to the case in which positions were margined independently. Notwithstanding the economic relationship between AUD IRS and AUD interest rate futures, analysis of historical data demonstrates that the basis does vary over time, particularly during times of stress. This observed change of basis is captured through the VaR margining process. The robustness of the empirical relationship between AUD IRS and AUD interest rate futures in stressed market conditions is addressed through the introduction of stress-test scenarios that capture basis risk, as discussed above under Key Consideration 4.6. In addition, margin sensitivity analysis that varies the length and composition of the historical simulation period is used to test the effect on margin coverage of variations in observed correlations across products over time. In particular, the inclusion of periods of stress in the historical simulation period tests whether changes in the relationship between products in times of stress affects margin coverage (see Key Consideration 6.6).

ASX Clear (Futures) does not currently have any cross-margining arrangements with any other CCPs.

6.6 A central counterparty should analyse and monitor its model performance and overall margin coverage by conducting rigorous daily backtesting and at least monthly, and more frequent where appropriate, sensitivity analysis. A central counterparty should regularly conduct an assessment of the theoretical and empirical properties of its margin model for all products it clears. In conducting sensitivity analysis of the model's coverage, a central counterparty should take into account a wide range of parameters and assumptions that reflect possible market conditions, including the most volatile periods that have been experienced by the markets it serves and extreme changes in the correlations between prices.

During 2013/14, ASX made significant enhancements to its backtesting and sensitivity analysis of margin models, introducing improvements to daily backtesting procedures supplemented by more comprehensive periodic backtesting and sensitivity analysis of its margin models.

Under ASX's Model Validation Standard, daily backtesting of both the SPAN and OTC IRS Historic VaR margin models is used to test, on an ongoing basis, whether the margin models reliably cover price movements to a 99.7 per cent confidence interval. Daily backtesting is performed against both dynamic and (for the OTC IRS Historic VaR model) static actual portfolios. Backtesting against actual dynamic portfolios involves the comparison of actual initial margin collected from each participant against actual variation margin collected over the following one or two days (for SPAN), depending on which is the larger amount, or the following five days for the OTC IRS Historic VaR model. One limitation of using variation margin on dynamic portfolios to model changes in the value of a portfolio over the close-out period is that it is influenced not only by market movements but also by changes in the composition of the portfolio. To address the limitations of dynamic portfolio analysis, static portfolio backtests are used to hold the portfolio composition constant over time. For actual static portfolios, ASX calculates hypothetical variation margin obligations for each day of the validation period based on historical price movements, and compares these to initial margin calculated on the actual portfolio on the day of the backtest. Under both types of backtest, when variation margin is greater than initial margin an 'exception' is recorded. CRM compares the number of exceptions to the expected number of exceptions, based on a 99.7 per cent confidence interval.

A report summarising the results of backtesting is automatically generated and circulated to relevant staff in the Risk division. Further analysis is undertaken when an exception is recorded, both to investigate model performance and to investigate the potential financial implications of the exception given the particular participant and portfolio affected. Further investigation also takes place if the actual number of exceptions exceeds the expected number. By investigating further, ASX determines whether any follow-up actions are required, such as the calling of additional margin or the managing down of positions.

Daily backtesting reports are aggregated into a monthly backtesting report which compares the number of observed exceptions to expected exceptions for the previous month, quarter and year. This report, which also includes the results of sensitivity analysis (see below) is reviewed by the RQG and used to identify the need for further investigation of margin model performance. RQG will take into account the frequency and magnitude of any breaches in determining whether to commission additional analysis from CRQ.

On a periodic basis, approximately every four months, ASX performs a more comprehensive backtesting analysis of each of its margin models. The periodic reviews allow ASX to examine the model in more detail and provide a basis for recommending changes to the model or further analysis. Hypothetical portfolios extend the analysis, allowing ASX to test the performance of margin models when applied to portfolios with certain characteristics (e.g. mix of contracts, concentrations, directionality) that may be particularly adversely affected by market conditions during the validation period.

ASX applies sensitivity analysis to its margin models as part of its quarterly margin rate reviews for SPAN, and alongside periodic margin backtesting for the OTC IRS Historic VaR model. Sensitivity analysis allows ASX to test the performance of a model beyond the boundaries of its existing assumptions, potentially also examining the implications of assumptions that would not reasonably be expected to hold. ASX has developed internal guidance setting out its approach to sensitivity analysis for margin models, which highlights three main assumptions that it varies when conducting sensitivity analysis: the confidence interval, close-out period and look-back period. In addition, ASX investigates the impact of varying the historical simulation period for the OTC IRS Historic VaR model and the application of floors to model parameters in SPAN. If varying particular inputs reveals weaknesses in the model, ASX considers how plausible these varied assumptions are when considering whether to make adjustments to the model. Where sensitivity analysis identifies potential weaknesses in margin models, the RQG will consider recommended changes to address these.

6.7 A central counterparty should regularly review and validate its margin system.

ASX Clear (Futures)' margin methodologies are also be subject to a comprehensive annual validation and ongoing review under ASX's Model Validation Standard (see Key Consideration 4.5). The RQG is responsible for performing regular reviews of models, while Internal Audit coordinates the independent validation process with CRQ input. ASX's Model Validation Standard requires that all models that are critical to ASX (as measured against a series of risk factors) undergo a full annual validation (see Key Consideration 2.6). Under this framework the SPAN model must be externally validated annually, while the OTC IRS Historic VaR must be externally validated once every two years. ASX has engaged external experts for a three-year period to conduct annual validations of ASX's key risk models, including both the SPAN and OTC IRS Historic VaR margin models. The first validations of these models will occur during the second half of 2014. The Bank will monitor the outcome of these validations.

At ASX, the margining process is governed by an internal Margin Standard, which is reviewed annually, with material changes approved by the Clearing Boards. The authorisation and documentation process for margin parameter changes and guidelines for the application of management discretion are also reviewed annually. ASX publishes detailed margining information on its website, including descriptions of the margining methodology, schedules of margin rates, and daily SPAN margin parameter files. These files allow participants to perform margin calculations on hypothetical or actual portfolios.

Principle 7: Liquidity risk

A central counterparty should effectively measure, monitor and manage its liquidity risk. A central counterparty should maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the central counterparty in extreme but plausible market conditions.

Rating: Broadly observed

ASIC and the Bank's assessment is that ASX Clear (Futures) broadly observes the requirements of Principle 7. In order to fully observe Principle 7, ASX Clear (Futures) should:

- implement mechanisms consistent with forthcoming CPSS-IOSCO guidance on recovery planning that would fully address any uncovered liquidity shortfall following a participant default
- complete the full validation of its liquidity stress-test model by external experts.

ASX Clear (Futures)' arrangements to measure, monitor and manage its liquidity risk are described in further detail under the following Key Considerations.

7.1 A central counterparty should have a robust framework to manage its liquidity risks from its participants, commercial bank money settlement agents, nostro agents, custodians, liquidity providers and other entities.

Sources of liquidity risk

The primary source of liquidity risk in ASX Clear (Futures) is the potential default of a participant with Australian dollar payment obligations to the CCP. To the extent that the CCP relies on such incoming payment flows to meet its obligations to other participants, it could face a liquidity shortfall. Payment obligations to and from participants typically take the form of initial and variation margin, although they may also relate to the cash settlement of contracts. ASX Clear (Futures) does not rely on commercial bank money settlement agents, nostro agents, custodians or liquidity providers in meeting its Australian dollar payment obligations.

Managing liquidity risk

ASX Clear (Futures) minimises the size of its liquidity obligations to participants through daily and intraday settlement of variation margin. This prevents the build-up of large (credit and) liquidity exposures. ASX Clear (Futures)' framework for managing its remaining liquidity risks involves the monitoring of liquidity exposures through daily stress testing (see Key

Consideration 7.9) and the maintenance of sufficient liquid resources to be able to meet payment obligations in the event of a participant default (see Key Consideration 7.4).

ASX Clear (Futures) also provides participants with information to help them manage their liquidity needs and risks, which in turn protects the CCP. Participants are provided with sufficient information to understand their intraday margin call obligations, and replicate stress test outcomes. ASX publishes a daily SPAN margin parameter file that allows participants to estimate payment obligations associated with margin requirements for actual or hypothetical portfolios. ASX provides advance warnings and communications in respect of calls for additional margin, and margin rate changes. For example, participants are notified if their stress-testing results approach their STELs. Additionally, ASX works closely with participants where new obligations are likely to affect their liquidity needs.

7.2 A central counterparty should have effective operational and analytical tools to identify, measure and monitor its settlement and funding flows on an ongoing and timely basis, including its use of intraday liquidity.

Daily cash flows and investment of funds across the ASX CCPs are monitored and managed by an experienced Portfolio Risk Manager. In addition, the CRM department reviews a daily report of key risk indicators, related to liquidity demands. Any issues are escalated to the CRO. Funding arrangements, such as settlement flows and foreign currency lodgements, are also monitored in real time by the CRM and Treasury functions.

Portfolio Risk Management uses reports provided by CRM to monitor SPAN-calculated margin flows originating from ASX Clear (Futures)' Collateral Management System, which feed into ASX's Treasury Management System. Portfolio Risk Management enters trades required to manage daily cash flows into ASX's Treasury Management System. Clearing and Settlement Operations uses daily settlement reports produced by the Treasury Management System to generate settlement instructions in Austraclear. Resulting cash flow movements are monitored in RITS. Margin payments from participants must be matched in Austraclear by 10.30 am and settled by 11.00 am, while outward payments to participants are manually managed in the RITS queue and are only released once all incoming margin obligations have been settled (generally by 12.00 pm).

ASX Clear (Futures) mitigates potential liquidity risks in several ways. ASX Clear (Futures)' pooled financial resources are entirely prefunded (see Principle 13). ASX Clear (Futures)' liquid assets are invested and managed on its behalf by ASXCC (see 'ASX Group Structure' in Section 2.3.1). ASXCC's Investment Mandate establishes a clear definition of liquid assets: liquid assets must be available for use within two hours and held in the form of either a restricted set of highly liquid securities or securities eligible for repurchase with the Reserve Bank (see Key Consideration 7.5).

7.3 A payment system or securities settlement facility, including one employing a deferred net settlement mechanism, should maintain sufficient liquid resources in all relevant currencies to effect same-day settlement, and where appropriate intraday or multiday settlement, of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate payment obligation in extreme but plausible market conditions.

Key Consideration 7.3 is not relevant to central counterparties.

7.4 A central counterparty should maintain sufficient liquid resources in all relevant currencies to settle securities-related payments, make required variation margin payments, and meet other payment obligations on time with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate payment obligation to the central counterparty in extreme but plausible market conditions. In addition, a central counterparty that is involved in activities with a more complex risk profile or that is systemically important in multiple jurisdictions should consider maintaining additional liquidity resources sufficient to cover a wider range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their affiliates that would generate the largest aggregate payment obligation to the central counterparty in extreme but plausible market conditions.

ASX Clear (Futures)' liquid resources include margin and other collateral posted by participants, as well as its own holdings of liquid assets. ASX Clear (Futures)' holdings of liquid assets and cash collateral posted by participants are invested on its behalf by ASXCC in accordance with its Investment Mandate. The ASXCC Investment Mandate requires that ASX hold liquid assets sufficient to cover:

- *The Default Liquidity Requirement (DLR) across the ASX CCPs.* The DLR is the amount required to cover the estimated cash requirement of the largest participant (and its affiliates, as measured by payment obligations to the CCP) on ASX Clear and the two largest participants on ASX Clear (Futures) in the event of their joint default under stressed market conditions used in each CCP's liquidity stress test.
- *An 'ordinary liquidity requirement'.* This is intended to cover day-to-day liquidity requirements, such as the return of margin to participants, and is specified as a percentage of the ASXCC portfolio. This is calibrated to the maximum margin outflow in normal market conditions over the last 12 months and is reviewed quarterly.

The requirement that ASXCC cover the DLR across both CCPs takes a conservative approach in that it provides for the simultaneous default, under extreme but plausible market conditions, of the largest participant and its affiliates in ASX Clear and the two largest participants (and their affiliates) in ASX Clear (Futures).

7.5 For the purpose of meeting its minimum liquid resource requirement, a central counterparty's qualifying liquid resources in each currency include cash at the central bank of issue and at creditworthy commercial banks, committed lines of credit, committed foreign exchange swaps and committed repos, as well as highly marketable collateral held in custody and investments that are readily available and convertible into cash with prearranged and highly reliable funding arrangements, even in extreme but plausible market conditions. If a central counterparty has access to routine credit at the central bank of issue, the central counterparty may count such access as part of the minimum requirement to the extent it has collateral that is eligible for pledging to (or for conducting other appropriate forms of transactions with) the relevant central bank. All such resources should be available when needed.

ASXCC holds an ESA at the Bank to facilitate money settlements on behalf of ASX Clear (Futures) (and ASX Clear) (see Key Consideration 7.8). As an ESA holder, ASXCC is eligible for access to Australian dollar liquidity under the Bank's overnight and intraday liquidity facilities

(against eligible collateral specified by the Bank that is held within its investment portfolio), including in times of market stress.

The ASXCC Investment Mandate requires the Portfolio Risk Manager to maintain high-quality liquid assets to meet ASX Clear (Futures)' minimum liquidity requirements, consistent with the definition of qualifying liquid assets under this standard. Liquid assets must be available for use within two hours and held in either a restricted set of highly liquid securities or securities eligible for repurchase transactions with the Bank. Investments held in the form of bank bills, negotiable certificates of deposit and floating rate notes issued by approved counterparties or obligors are required to be tradable on a robust secondary market. At 30 June 2014, term deposits accounted for 36.4 per cent of the ASXCC investment portfolio, at-call deposits 16.4 per cent, with holdings of other approved securities making up the balance. Eligible investment counterparties are discussed under Principle 16.

- 7.6 A central counterparty may supplement its qualifying liquid resources with other forms of liquid resources. If the central counterparty does so, then these liquid resources should be in the form of assets that are likely to be saleable or acceptable as collateral for lines of credit, swaps or repos on an ad hoc basis following a default, even if this cannot be reliably prearranged or guaranteed in extreme market conditions. Even if a central counterparty does not have access to routine central bank credit, it should still take account of what collateral is typically accepted by the relevant central bank, as such assets may be more likely to be liquid in stressed circumstances. A central counterparty should not assume the availability of emergency central bank credit as a part of its liquidity plan.**

ASX Clear (Futures) does not supplement its qualifying liquid resources with other forms of liquid resources.

- 7.7 A central counterparty should obtain a high degree of confidence, through rigorous due diligence, that each provider of its minimum required qualifying liquid resources, whether a participant of the central counterparty or an external party, has sufficient information to understand and to manage its associated liquidity risks, and that it has the capacity to perform as required under its commitment. Where relevant to assessing a liquidity provider's performance reliability with respect to a particular currency, a liquidity provider's potential access to credit from the central bank of issue may be taken into account. A central counterparty should regularly test its procedures for accessing its liquid resources at a liquidity provider.**

The Portfolio Risk Manager, in consultation with the CRO, is responsible for the provision of timely liquidity to fund margin and settlement obligations to non-defaulting participants. The DMF (see Key Consideration 13.1) covers liquidation of participant non-cash collateral, as well as the liquidation of treasury investments representing participant cash collateral and other prefunded financial resources. While the order of use of particular collateral types will depend on the particular circumstances, a typical order of use may be AUD cash first, followed by non-cash collateral. The order of liquidation of non-cash collateral to meet funding requirements will depend on factors such as prevailing market conditions, liquidity needs and the amount of funds required relative to the size of each collateral lodgement. Procedures for dealing with liquid assets in the treasury investment portfolio are documented, and are available for Portfolio Risk Management staff at both primary and backup sites. Non-cash collateral is limited to highly liquid government securities (see Key Consideration 5.1).

7.8 A central counterparty with access to central bank accounts, payment services or securities services should use these services, where practical, to enhance its management of liquidity risk.

ASXCC holds an ESA. Accordingly, ASX Clear (Futures) may, via ASXCC, access Australian dollar liquidity under the Bank's overnight and intraday liquidity facilities (against eligible collateral specified by the Bank). ASXCC's Investment Mandate clarifies its ability to make use of these services, by specifying the list of securities (from the Bank's approved list) available for repurchase, including the securities of the Commonwealth, certain states and major banks (see Principle 16).

ASX Clear (Futures) uses ASXCC's ESA to settle its AUD margin and cash settlement obligations in RITS (see also Principle 9).

7.9 A central counterparty should determine the amount and regularly test the sufficiency of its liquid resources through rigorous stress testing. A central counterparty should have clear procedures to report the results of its stress tests to appropriate decision-makers at the central counterparty and to use these results to evaluate the adequacy of, and adjust, its liquidity risk management framework. In conducting stress testing, a central counterparty should consider a wide range of relevant scenarios. Scenarios should include relevant peak historic price volatilities, shifts in other market factors such as price determinants and yield curves, multiple defaults over various time horizons, simultaneous pressures in funding and asset markets, and a spectrum of forward-looking stress scenarios in a variety of extreme but plausible market conditions. Scenarios should also take into account the design and operation of the central counterparty, include all entities that might pose material liquidity risks to the central counterparty (such as settlement banks, nostro agents, custodian banks, liquidity providers and linked financial market infrastructures), and where appropriate, cover a multiday period. In all cases, a central counterparty should document its supporting rationale for, and should have appropriate governance arrangements relating to, the amount and form of total liquid resources it maintains.

ASX Clear (Futures) uses a daily liquidity stress-testing model to assess the adequacy of its liquidity arrangements. Until August 2013, the model, which is based on ASX Clear (Futures)' capital stress tests (described under Principle 4), calculated the maximum liquid funds that ASX Clear (Futures) would need to access in order to meet obligations arising in the event of the joint default of a clearing participant and its affiliates. Since there were no affiliated participants in ASX Clear (Futures) during 2013/14, liquidity stress tests addressed scenarios involving an individual default. However, further to the introduction of the OTC derivatives clearing service, ASX Clear (Futures) adjusted its liquidity stress tests in August 2013 to take into account potential affiliations between participants involved in OTC and futures clearing. At the same time, the liquidity stress tests formally adopted the more stringent requirement of testing the sufficiency of liquid resources against the joint default of the two participants (plus affiliates) that would create the largest liquidity exposure for ASX Clear (Futures). The liquidity stress tests assume that a default occurs just prior to receipt of the previous day's variation margin payments, if owed by the defaulter, or just after any variation margin payments have been paid, if owed to the defaulter. The stress tests thereby calculate the worst-case liquidity requirement under each stress-test scenario.

All stress-test scenarios are based on historical moves and have been set so that they replicate extreme market moves that have a probability of occurrence of once in 30 years for single-asset scenarios and once in 100 years for multi-asset scenarios (see Key Consideration

4.6). There are 30 scenarios involving movements of price and volatility across the four major contracts (SPI 200 futures, 90-day bank accepted bill futures, 3-year bond futures and 10-year bond futures). 20 multi-asset scenarios model balanced movements of each of the four major contracts and corresponding movements on OTC interest rate contracts, as well as a range of tilts, twists and bends of the yield curve. Eight 'single contract' scenarios model extreme movements in the four contracts individually. In addition, 12 scenarios analyse various forms of basis risk arising from changes in the spread between IRS and futures, and between AONIA and BBSW rates at various tenors. Two 'internal' scenarios that model large movements in the exchange-traded interest rate contracts with little impact on equities and 14 'internal' scenarios for OTC used to further analyse the effects of basis risk between contracts of different tenor, are used for internal risk analysis only.

The results of the liquidity stress tests generate the DLR, which is compared with ASX Clear (Futures)' AFR (set to \$650 million from January 2014, see Key Consideration 4.4). A stress-test result above the AFR for three consecutive trading days is considered a breach of the AFR and triggers a detailed investigation into the breach. When assessing the materiality of a liquidity stress-test breach, the CCPs will consider contributing and mitigating factors, such as changes in the ICR of the participant, atypical trading activity, and any AIM that is being held. Given that liquidity resources are maintained on an aggregate basis (in ASXCC), in order to test the sufficiency of ASX's overall liquid resources the results of liquidity stress testing for each CCP are aggregated to calculate the total DLR.

The results of liquidity stress testing are regularly reported to ASX senior management, the Clearing Boards and the Bank. All liquidity stress-test breaches are reported to the CRO, the General Manager of Clearing Risk Strategy and Policy, and the Portfolio Risk Manager. A sustained or widely distributed breach may lead to a review of the adequacy of the AFR.

Validation

Since stress scenarios are common across both capital and liquidity stress tests for ASX Clear (Futures), the same reverse stress testing approach is used in sensitivity analysis of both models (see Key Consideration 4.6).

ASX's Model Validation Standard requires that all models that are critical to ASX (as measured against a series of risk factors) undergo a full annual validation (see Key Consideration 2.6). Under this framework the liquidity stress-test model must be externally validated annually. ASX has engaged external experts to conduct a validation of the liquidity stress-test model by the end of 2014. The Bank will monitor the outcome of this validation.

- 7.10 A central counterparty should establish explicit rules and procedures that enable the central counterparty to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations on time following any individual or combined default among its participants. These rules and procedures should address unforeseen and potentially uncovered liquidity shortfalls and should aim to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations. These rules and procedures should also indicate the central counterparty's process to replenish any liquidity resources it may employ during a stress event, so that it can continue to operate in a safe and sound manner.**

In March 2014, ASX finalised a basic recovery plan that relies on existing tools and powers within the CS facilities' Operating Rules. In preparing the plan for ASX Clear (Futures), ASX

identified that the existing Operating Rules do not provide the CCP with sufficient tools to be able to fully address any uncovered liquidity shortfalls following a participant default (see Key Consideration 3.4). While ASX's recovery plan identifies measures that could be used to mitigate this in part (such as the collection of additional margin or seeking to realise non-liquid assets such as term deposits), additional measures will be required to comprehensively address a liquidity shortfall.

ASX has commenced work to develop a more comprehensive recovery plan supported by tools to fully address uncovered liquidity shortfalls. It intends to base these tools on forthcoming CPSS-IOSCO guidance on recovery planning, expected to be published in late 2014. ASX intends to consult on its proposed recovery approach in the second half of 2014.

Standard 8: Settlement finality

A central counterparty should provide clear and certain final settlement, at a minimum by the end of the value date. Where necessary or preferable, a central counterparty should provide final settlement intraday or in real time.

Rating: Observed

The Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 8. ASX Clear (Futures)' arrangements for ensuring finality of its settlements are described in further detail under the following Key Considerations.

8.1 A central counterparty's rules and procedures should clearly define the point at which settlement is final.

The vast majority of ASX Clear (Futures) settlements involve AUD cash payments between participants and the CCP for the purposes of margin payments and the settlement of cash-settled derivatives contracts. Each day, ASX Clear (Futures) calculates the net obligations of each of its participants. Those participants with a net obligation to the CCP are required to make payments to ASX Clear (Futures) by 11.00 am, for both AUD and NZD-denominated contracts. Once these payments have been received, ASX Clear (Futures) makes payments to those participants with a net obligation from the CCP. AUD cash settlements occur via Austraclear, with interbank obligations settled on a real-time gross settlement (RTGS) basis across ESAs at the Reserve Bank of Australia, via RITS.

In some cases, the settlement of derivatives contracts cleared by ASX Clear (Futures) involves the transfer of a security or physical asset, with a corresponding transfer of cash. For each type of security or asset, ASX Clear (Futures)' arrangements ensure that delivery occurs if, and only if, payment occurs. For 90-day bank bill futures, ASX Clear (Futures) utilises the standard settlement process in Austraclear. For grain and wool contracts, delivery is via commodity warehouses, with ASX Clear (Futures) retaining title documentation until payment has been made.

ASX Clear (Futures) also accepts as collateral for initial margin certain highly liquid debt securities, such as Australian Government securities, and cash collateral in NZD and a small number of other foreign currencies. ASX Clear (Futures) has accounts at Austraclear and NZClear, an SSF owned and operated by the Reserve Bank of New Zealand, for settling AUD- and NZD-denominated collateral, respectively. Collateral denominated in other currencies is settled indirectly via relationships with private banks.

The settlement of obligations in ASX Clear (Futures) is final according to the terms of ASX Clear (Futures)' and, for exchange-traded derivatives, ASX 24's Operating Rules and Procedures, which set out the means of settlement. For payments and securities obligations settled in Austraclear, settlement is final according to Austraclear's Regulations and Procedures and its approval under Part 2 of the PSNA. This approval protects the finality of payments made through Austraclear in the event of a participant entering external administration (see Appendix A2.2, Key Consideration 8.1). Any interbank transactions arising from these settlements are settled in real time across ESAs held with the Bank. Payments within this system are also final and irrevocable; this is again supported by the approval of RITS under Part 2 of the PSNA. With this approval, a payment executed in RITS at any time on the day on which a RITS participant enters external administration has the same standing as if the participant had gone into external administration on the next day. Accordingly, in the event of insolvency all transactions settled on the day of the insolvency are irrevocable and cannot be unwound.

NZD obligations that are settled through NZClear are deemed final in accordance with its System Rules. In particular, NZClear System Rule 11.8 provides that final and irrevocable settlement occurs when the requirements of a trade have been matched and the trade is recorded in the relevant accounts of the respective members. The NZClear settlement system has been declared a 'designated settlement system' for the purposes of Part 5C of the *Reserve Bank of New Zealand Act 1989* (NZ), which establishes the validity and enforceability of the rules of a designated settlement system and the irrevocability of transactions settled through the system.

8.2 A central counterparty should complete final settlement no later than the end of the value date, and preferably intraday or in real time, to reduce settlement risk. A large-value payment system or securities settlement facility should consider adopting real-time gross settlement or multiple-batch processing during the settlement day.

The settlement of obligations in ASX Clear (Futures) is governed by ASX Clear (Futures)' and, for exchange-traded derivatives, ASX 24's Operating Rules and Procedures. These set out settlement arrangements, with procedures and timetables.

Margin payments and settlement of cash-settled derivatives

The majority of settlements in ASX Clear (Futures) are cash settlements made on a net basis (as described above) for the purposes of regular margin payments and settlement of cash-settled derivatives. During 2013/14, the majority of settlements of margin were in cash (AUD or foreign denominated). Initial and variation margin requirements are calculated overnight based on each day's closing contract prices supplemented by additional pricing data for OTC derivatives (see Key Consideration 6.2), and are notified to participants by 6.00 am the next day for payment on that day. Should ASX Clear (Futures)' exposures change significantly during the day, initial and variation margin can be called intraday (see Key Consideration 6.1). Intraday margin payments must be paid in cash within two hours of the participant being notified. End-of-day and intraday margin is settled via Austraclear for AUD payments, and NZClear for NZD payments.

Settlement values for cash-settled derivatives are calculated according to contract specifications, generally on the last trading day, or within one or two days of the last trading

day.⁵ For example, for ASX SPI 200 Index Futures, ASX Clear (Futures) publishes the final settlement price of the contract on the first business day after expiry, with cash flows arising settled on the second business day after expiry (the value date for this contract). These cash flows in Austraclear or NZClear are settled with finality in real time, as are margin-related payments (see Key Consideration 8.1).

Physical delivery

With regard to deliverable contracts, ASX Clear (Futures)' arrangements for physical delivery are described under Principle 10. It has procedures in place to ensure that margin of matched participants is not released until ASX can confirm that both participants have fulfilled their obligations. ASX Clear (Futures) also monitors and enforces compliance with delivery procedures.

The details of final settlement of deliverable contracts vary according to the contract specifications. For example, trading in the contract for 90-day bank accepted bills ceases on noon of the last trading day. This is followed by the exchange of reconciliation and advice notices between participants and the CCP, with final settlement of securities occurring in real time in Austraclear by 3 pm on the day after the last trading day (the value date for this contract).⁶ The delivery period for wool contracts commences on the Friday before the last trading day, with real-time final cash settlement scheduled to occur on the day after delivery.

Options delivery

All options on futures that are cleared by ASX Clear (Futures) either automatically exercise or are abandoned on expiry. In-the-money options automatically exercise unless the holder requests otherwise, and the holder and writer of the options receive their respective positions in the underlying futures contract. All cash flows related to the exercise of options contracts are included in daily settlement flows (along with initial and variation margin payments). There are no up-front premium payments associated with the options over futures contracts that are cleared by ASX Clear (Futures).

8.3 A central counterparty should clearly define the point after which unsettled payments, transfer instructions, or other obligations may not be revoked by a participant.

Participants are not able to revoke a payment or transfer instruction once it has been submitted to ASX Clear (Futures).

Principle 9: Money settlements

A central counterparty should conduct its money settlements in central bank money where practical and available. If central bank money is not used, a central counterparty should minimise and strictly control the credit and liquidity risk arising from the use of commercial bank money.

Rating: Observed

The Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 9. ASX Clear (Futures)' money settlement arrangements are described in further detail under the following Key Considerations.

⁵ Three days for electricity contracts.

⁶ The seller is required to enter the 90-day bank bill into Austraclear by 10 am. This must be matched by the buyer by 11 am and settled by 3 pm.

The description of money settlement arrangements in this Principle draws a distinction between ‘money settlement agents’ – the entities whose assets are used to settle the ultimate payment obligation – and ‘settlement banks’, which maintain accounts with the money settlement agent to settle their own obligations or those of other participants.

9.1 A central counterparty should conduct its money settlements in central bank money, where practical and available, to avoid credit and liquidity risks.

AUD and NZD money settlements in ASX Clear (Futures) are settled in central bank money, but collateral in other currencies (including EUR, JPY, USD and GBP) is lodged via arrangements with commercial banks.

AUD settlements, which represent the majority of money settlement in ASX Clear (Futures), are initiated via the submission of standard settlement instructions to Austraclear. Settlement occurs on an RTGS basis across ESAs at the Bank, via RITS. ASX Clear (Futures) uses ASXCC’s ESA to settle its obligations in RITS.

NZD settlements are undertaken in NZClear, which operates on a similar basis to Austraclear in Australia. ASXCC is a non-bank participant in NZClear. Non-bank participant interbank obligations are settled on an RTGS basis across accounts at the Reserve Bank of New Zealand (RBNZ), via the Exchange Settlement Account System (ESAS) of a commercial settlement bank (known as a ‘Participating ES Accountholder’). Transfers are made in ESAS between the RBNZ Exchange Settlement account of ASXCC’s Participating ES Accountholder and the Exchange Settlement accounts of ASX Clear (Futures) participants or their Participating ES Accountholders. Settlement occurs in central bank money in real time; ASX Clear (Futures) manages credit and liquidity exposures in respect of post-settlement balances held with its Participating ES Accountholder in accordance with the ASXCC investment mandate (see Principle 16).

9.2 If central bank money is not used, a central counterparty should conduct its money settlements using a settlement asset with little or no credit or liquidity risk.

Cash payments in foreign currencies other than NZD (e.g. EUR, JPY, USD and GBP) are settled in commercial bank money via arrangements with commercial banks. Commercial bank money settlement agents and commercial settlement banks used for settlement of foreign currency transactions must be highly rated and subject to appropriate prudential regulation in order to limit any credit or liquidity risk associated with settlement in commercial bank money (see Key Consideration 9.3).

9.3 If a central counterparty settles in commercial bank money, it should monitor, manage, and limit its credit and liquidity risks arising from the commercial settlement banks. In particular, a central counterparty should establish and monitor adherence to strict criteria for its settlement banks that take account of, among other things, their regulation and supervision, creditworthiness, capitalisation, access to liquidity, and operational reliability. A central counterparty should also monitor and manage the concentration of credit and liquidity exposures to its commercial settlement banks.

A commercial bank must meet certain criteria before it can be used by ASX Clear (Futures) as either its money settlement agent for foreign currency payments other than NZD, or its commercial settlement bank for NZD settlements in the ESAS system. Commercial banks must be rated A1+ and offer a banking platform and connectivity that are in line with ASX systems. Commercial banks used by ASX Clear (Futures) are APRA-regulated ADIs, and therefore are

subject to prudential standards encompassing, for example, capital adequacy, liquidity, credit quality, business continuity management and public disclosure. ASX Clear (Futures)' commercial settlement bank in NZClear must also meet operational requirements set by the Reserve Bank of New Zealand. Arrangements for settlement of other foreign currencies make use of standard web interfaces for banking, with instructions via phone available as a contingency.

All foreign currency lodgements are monitored by ASX Clear (Futures)' risk management and treasury functions, and ASX Clear (Futures) is in regular contact with the participant until funds are received. ASX Clear (Futures) limits the amount of collateral held that is denominated in foreign currency. Participants must lodge a request to post foreign currency, which is reviewed and then approved or denied by the Portfolio Risk Management team. In determining whether the foreign currency cover request is approved or denied, the Portfolio Risk Manager will take into account the limits on foreign currency, as well as the concentration risk in accepting the request.

It is standard practice for participants that lodge foreign currencies other than NZD to lodge excess funds with ASX Clear (Futures). This avoids having to make daily (or frequent) margin settlements. ASXCC also maintains funds in foreign currencies to cover its exposure to liquidity risk if it needed to repay a participant in a foreign currency. During 2013/14, foreign currency holdings peaked at around \$499 million – around 15 per cent of average total collateral levels at ASX Clear (Futures) during the year. The aggregate level of foreign currency payments at ASX Clear (Futures) is low, comprising around 2 per cent of total money settlements.

9.4 If a central counterparty conducts money settlements on its own books, it should minimise and strictly control its credit and liquidity risks.

ASX Clear (Futures) does not conduct money settlements on its own books.

9.5 A central counterparty's legal agreements with any settlement banks should state clearly when transfers on the books of individual settlement banks are expected to occur, that transfers are to be final when effected, and that funds received should be transferable as soon as possible, at a minimum by the end of the day and ideally intraday, in order to enable the central counterparty and its participants to manage credit and liquidity risks.

Payments in foreign currencies made via commercial banks are generally covered by standard terms and conditions for commercial accounts at those banks, including general information about timing of transactions and availability of funds. ASX maintains close contact with its commercial banks in order to monitor and manage the risk of its foreign currency payments. As noted, standard practice is for participants to lodge excess foreign currency margin, thereby reducing credit and liquidity risk to the CCP and liquidity risk to the participant.

Principle 10: Physical deliveries

A central counterparty should clearly state its obligations with respect to the delivery of physical instruments or commodities and should identify, monitor, and manage the risks associated with such physical deliveries.

Rating: Observed

The Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 10. ASX Clear (Futures)' arrangements for physical deliveries are described in further detail under the following Key Considerations.

10.1 A central counterparty's rules should clearly state its obligations with respect to the delivery of physical instruments or commodities.

In some cases, the settlement of derivatives contracts cleared by ASX Clear (Futures) involves the transfer of a security or physical asset. Examples of contracts that require delivery are 90-day bank accepted bills futures, wool, wheat and other grain futures, and renewable energy certificates. ASX Clear (Futures)' Operating Rules and Procedures clearly state its obligations with respect to physical delivery.

10.2 A central counterparty should identify, monitor, and manage the risks and costs associated with the storage and delivery of physical instruments or commodities.

ASX Clear (Futures) Operating Rules and Procedures define detailed mandatory arrangements for delivery of a security or physical asset. Securities delivered for the 90-day bank accepted bill contract must meet ASX Clear (Futures)' specifications, which include the acceptable types of paper, maturity dates, parcel sizes and approved banks. Deliveries of commodities must follow a maturity calendar, approved warehouses and locations, guides for buyers and sellers, and rules for delivery documentation (including appropriate certification).

ASX Clear (Futures) mitigates the risks associated with physical delivery by minimising its involvement in the storage and delivery process. Participants that have delivery obligations are matched with those due to receive the commodities or documents, and any legal recourse of the receiving participant in respect of the delivered goods is to the delivering participant. Participants may cash settle contracts in the event of a default by the delivering party.

ASX Clear (Futures) nevertheless monitors and enforces compliance with delivery procedures. In particular, there is regular monitoring of deliveries by Clearing and Settlement Operations in the lead up to expiry, including a daily review and reconciliation of contracts versus holdings via a physical position reconciliation report. Overnight reporting to participants occurs on current commodity holdings. ASX Clear (Futures) communicates directly with participants to confirm their intentions on delivery and lodgement of physical assets. In addition, compliance reviews are undertaken on targeted topics, as well as ad hoc compliance investigations arising from referrals from ASX's operations areas. These compliance checks aim to ensure that participants have the necessary systems and resources to be able to fulfil their physical delivery obligations.

Principle 11: Central securities depositories

A central securities depository should have appropriate rules and procedures to help ensure the integrity of securities issues and minimise and manage the risks associated with the safekeeping and transfer of securities. A central securities depository should maintain securities in an immobilised or dematerialised form for their transfer by book entry.

Rating: Not applicable

Principle 11 is not relevant to central counterparties.

Principle 12: Exchange-of-value settlement systems

If a central counterparty settles transactions that involve the settlement of two linked obligations (for example, securities or foreign exchange transactions), it should eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other.

Rating: Observed

The Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 12. ASX Clear (Futures)' arrangements for DvP settlement of linked obligations are discussed in further detail under the following Key Considerations.

12.1 A central counterparty that is an exchange-of-value settlement system should eliminate principal risk by ensuring that the final settlement of one obligation occurs if and only if the final settlement of the linked obligation also occurs, regardless of whether the central counterparty settles on a gross or net basis and when finality occurs.

In those cases where settlement of derivatives contracts involves the transfer of a security or physical asset, with a corresponding transfer of cash, ASX Clear (Futures)' arrangements ensure that delivery occurs only if payment occurs. Settlement of securities transactions in Austraclear arising from the settlement of futures contracts in ASX Clear (Futures) occurs on a DvP model 1 basis. This involves the simultaneous transfer of cash and securities obligations between the buyer and seller on an item-by-item basis through the settlement cycle.

For 90-day bank bill futures, ASX Clear (Futures) utilises the standard DvP settlement process in Austraclear; that is, sellers deliver and receive payment for their bills, and buyers pay for and take delivery of the bills as a single exchange of value (see Appendix A2.2, Key Consideration 12.1). For grain and wool contracts, delivery is via commodity warehouses, with ASX Clear (Futures) retaining title documentation until payment has been made.

Principle 13: Participant default rules and procedures

A central counterparty should have effective and clearly defined rules and procedures to manage a participant default. These rules and procedures should be designed to ensure that the central counterparty can take timely action to contain losses and liquidity pressures and continue to meet its obligations.

Rating: Observed

ASIC's and the Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 13. ASX Clear (Futures)' default management arrangements are described in further detail under the following Key Considerations.

13.1 A central counterparty should have default rules and procedures that enable the central counterparty to continue to meet its obligations in the event of a participant default and that address the replenishment of resources following a default.

Rules and procedures

The Operating Rules and Procedures provide ASX Clear (Futures) with the authority and flexibility to deal with a participant default using a variety of methods to manage its exposure. ASX Clear (Futures) has the ability to close out any open contracts, to exercise or

terminate open contracts, or to seek to transfer (port) client positions. The specific close-out method will depend on market conditions and the products in question.

The formal Rules and Procedures are supplemented by an internal DMF, applicable to both ASX Clear and ASX Clear (Futures), to assist in the management of a clearing participant default. The DMF is based on high-level principles regarding the management of a default that have been approved by the CS Boards. In particular, these principles specify that the key aim in handling a default is to minimise the impact of the event on the CCP, clearing participants and the market. The DMSG provides oversight and review of the DMF, including discussion of proposed changes prior to submission to the CS Boards.

The DMF covers each stage of a default, from the identification of a default event, to the management of the defaulter's position, real-time monitoring of financial solvency, and financial offset and reconciliation. It is intended to be flexible, rather than prescriptive, and may be developed and adapted as appropriate.

The DMF outlines the key roles and responsibilities in managing a clearing participant default. The ASX Group has established a Default Management Committee (DMC), comprising senior management from relevant policy and operational areas, to be the primary decision-making forum for the management of a default. The DMC's responsibilities range from recommending declarations of default and suspensions, to devising a risk neutralisation plan and overseeing its implementation.

In July 2013, ASX Clear (Futures) amended its default management arrangements for the introduction of its OTC derivatives clearing service. In the event of the default of an OTC participant, ASX Clear (Futures) would convene the relevant DMG, which comprises non-defaulting clearing participants, seconded on a rotating basis. Currently there is only one DMG, since ASX Clear (Futures) clears only one category of OTC derivatives – AUD interest rate derivatives. The DMG would advise and be consulted by ASX Clear (Futures) on each stage of the management of a default. ASX Clear (Futures) is not obliged to follow the recommendations of the DMG, but would provide reasoning where it did not accept the DMG's advice.

Use and sequencing of financial resources

Following a declaration of default, ASX Clear (Futures) would suspend the defaulted participant's authority to clear. Suspension, rather than termination, ensures that the participant remains bound by the central counterparty's rules. There would be no further payments or collateral movements to the clearing participant following declaration of a default. This enables the central counterparty to 'crystallise' the defaulted participant's position and generate detailed account and position data (including collateral held). This establishes the basis for the close out of exposure to the defaulted participant.

In the first instance, ASX Clear (Futures) would meet obligations arising from a participant default using collateral lodged by that participant. Collateral may be in the form of cash or eligible securities (see Key Consideration 5.1). In the event that the defaulted participant's contributions were insufficient, ASX Clear (Futures) could draw upon pooled financial resources (see Principle 4). Under the amended default arrangements introduced in July 2013, these resources are commingled across futures and OTC products. While not essential, the commingled default fund adopted by ASX Clear (Futures) simplifies the default management process when the defaulter's portfolio contains both OTC derivatives and cross-margined futures positions. ASX regards the commingling of financial resources as

appropriate in light of the homogeneity of both the products to be cleared and the clearing participants. The order in which survivors' contributions to pooled financial resources would be used (i.e. the default waterfall) would, however, be proportional to the scope of the defaulter's activities. The proportion of futures and OTC participant contributions that would be used after each tranche of ASX capital will be based on the defaulter's share of initial margin for exchange-traded compared with OTC derivatives products (including cross-margined futures) over the previous 90 days. ASX conducted an initial review of commingling arrangements in the first half of 2014, which was presented to the Risk Committee and CS Boards. The review concluded that the arrangements remained appropriate, particularly in light of the currently small size of exposures generated by OTC derivatives relative to futures. ASX Clear (Futures) will conduct another review of default fund arrangements in late 2014.

ASX has documented, in an internal paper provided to the ASX Limited Board, a process for making decisions regarding replenishment of ASX Clear (Futures)' financial resources following any draw down arising from a participant default. Responsibility for determining whether to replenish financial resources and how this might best be achieved ultimately lies with the ASX Limited Board. The decision would be taken in consultation with the ASX Clear (Futures) Board. ASX's documented replenishment intentions canvass several options, including the injection of additional funds from within the ASX Group, from participants or from third-party institutions. The particular approach taken would depend on the specific circumstances, including the severity of the loss and the market environment (see also Key Consideration 4.7). ASX Limited has also committed to maintaining a certain level of equity capital in ASX Clear (Futures) (including via ASXCC) provided certain conditions are met, including that ASX Clear (Futures)' is solvent. ASX plans to consult on enhancements to its replenishment arrangements as part of its broader consultation on enhancements to its recovery plans (see Key Consideration 3.4 and Key Consideration 4.7).

Default management – futures

The DMF and the Operating Rules and Procedures allow ASX Clear (Futures) to employ a variety of methods to close out or otherwise manage the positions of a defaulted participant. These include transfer, on- or off-market liquidation, expiry, exercise, compulsory settlement (generally considered to be a last-resort method of closing out, and not available in respect of OTC products) and hedging (see Key Consideration 13.2 for more information on close-out arrangements).

Default management – OTC derivatives

In the event of default of an OTC participant, ASX Clear (Futures) would first suspend the defaulted participant and terminate its open positions, then look to hedge its exposure to non-defaulting participants. ASX Clear (Futures) may engage one or more participating members of the relevant DMG to assist in this process. ASX Clear (Futures) would then conduct one or more auctions to establish new open contracts equivalent to those terminated (including hedges). ASX Clear (Futures) may set a reserve price on the default auction(s).

All OTC participants that have positions in the relevant products are required to bid in the auction of a defaulter's portfolio. In early 2014 ASX implemented a 'juniorisation' mechanism designed to ensure that non-defaulting participants bid competitively in the auction of a defaulter's portfolio. For the participants obliged to take part in the auction, the juniorisation mechanism determines the order in which their contributions to the ASX Clear (Futures) default fund are applied to losses on the default in the event that the auction crystallises

losses beyond the defaulter's margin and the first tranche of ASX capital. The order of application is related to the size of participants' bids in the auction, so that the winner of the auction has its contribution applied last and the participant with the lowest bid has its contribution applied first, subject to bids exceeding a minimum threshold determined by ASX. Participants that are not required to take part in an auction (for example participants that lack the capacity to manage particular product types within an auction pool) would have their contributions applied at the same point as the winner of the auction. ASX Clear (Futures), in consultation with the DMG, could conduct the auction in one of the following forms:

- The defaulted participant's portfolio could be auctioned in a single pool to the single highest bidder, or split into multiple identical units auctioned off to several bidders. In the latter case, the order of application of participant contributions to losses would be based on the lowest bid for any unit within the pool.
- Alternatively, the defaulted participant's portfolio could be broken up into separate pools with shared characteristics (for example currency, product, tenor, carry or trade volume), with separate auctions in respect of each pool. Each of these pools could be auctioned off in a single unit or multiple identical units. The application of bidding participants' contributions to losses would be based on the ranking of bids in each of these pools, weighted according to the relative risk of each pool.

As an alternative to an auction, ASX Clear (Futures) could agree the transfer of equivalent contracts with a non-defaulting participant if this would not result in losses requiring the application of non-defaulting participants' commitments.

13.2 A central counterparty should be well prepared to implement its default rules and procedures, including any appropriate discretionary procedures provided for in its rules.

To facilitate early identification of a default event, the ASX Clear (Futures)' Operating Rules and Procedures require that a participant inform ASX Clear (Futures) immediately in the event of a default, or if there is a reasonable expectation of such an event. This requirement is legally binding and would continue to apply even in the event that an external administrator was appointed to the clearing participant. The Operating Rules and Procedures envisage a number of possible events of default. These include: becoming subject to external administration; being unable to meet obligations relating to open contracts; default of the clearing participant at another CCP or exchange; and being in breach of the CCP's risk-control requirements, such as failing to fulfil margin or other payment obligations to the CCP.

Although the ASX Clear (Futures) Operating Rules set out specific events of default, declaration of a default would never be automatic. Instead, ASX Clear (Futures) maintains the right to investigate a potential default fully, taking into account any extenuating circumstances. The process of investigating, and the subsequent handling of, a potential default would depend on its nature. Specifically, the rules distinguish between 'operational', 'compliance' and 'financial' defaults. This differentiation appropriately reflects the gravity and potential ramifications of a declaration of default. Ultimately, the declaration of any default is the responsibility of the Managing Director and Chief Executive Officer of ASX, under delegated responsibility from the CS Boards.

The DMF and the Operating Rules and Procedures allow ASX Clear (Futures) to employ a variety of methods to close out or otherwise manage the positions of a defaulted participant. These include hedging, transfer, on- or off-market liquidation, expiry, exercise and

compulsory settlement (generally considered to be a last-resort method of closing out). For the OTC derivatives clearing service, ASX Clear (Futures) may conduct an auction of the defaulted participant's OTC derivatives positions.

There are advantages and disadvantages to each close-out method and therefore the specific method used in practice would depend on market conditions and the products in question. For example, subject to other legal and practical impediments, the account structure used by the CCP would be a relevant factor in determining whether client positions could be transferred following a default event. ASX Clear (Futures) has introduced individual client accounts for both OTC derivatives (in April) and exchange-traded derivatives (in July), which are more likely to be able to support the transfer of client positions following a default (see Principle 14). However, both OTC and exchange-traded derivatives clients can opt to clear via an omnibus account with net margining, which may make the transfer of individual client positions in a default event difficult due to possible under collateralisation of individual positions. As described in Key Consideration 13.1, ASX policy establishes a preference for controlling the risk associated with a defaulted participant's OTC derivatives positions through a process of hedging then auction. While ASX Clear (Futures) provides a window of 24 or 48 hours for futures or OTC clients of a defaulted participant with individually segregated accounts to transfer their positions to another participant, it retains the flexibility to shorten this window if circumstances require a more rapid close-out process.

13.3 A central counterparty should publicly disclose key aspects of its default rules and procedures.

ASX Clear (Futures)' Operating Rules and the OTC Rules and OTC Handbook are available on the ASX public website. These rules outline when ASX Clear (Futures) may take action against a participant and the powers of ASX Clear (Futures) in the event of a default, including the ability of ASX to transfer clients' positions to other participants. ASX Clear (Futures)' Operating Rules set out the treatment of proprietary and customer positions. In addition, ASX has published a high-level overview of its approach to managing a participant default on its website. The OTC Handbook provides a description of the default management auction process for OTC derivatives, including numerical examples of the juniorisation process.

13.4 A central counterparty should involve its participants and other stakeholders in the testing and review of the central counterparty's default procedures, including any close-out procedures. Such testing and review should be conducted at least annually or following material changes to the rules and procedures to ensure that they are practical and effective.

The DMF is reviewed on an annual basis, or more frequently as needed, and is regularly tested by in-house default management 'fire drills'. These tests ensure that relevant ASX personnel are familiar with the default management process and identify areas where the DMF should be updated. Findings, including any recommended enhancements to the DMF, are reported to the DMSG after each fire drill. ASIC and the Bank observed the ASX fire drill exercise conducted in early 2014 and will continue to observe future fire drills. In recent years, the DMF has been updated on several occasions: during 2011/12 to incorporate lessons learned from the default of MF Global; in 2012/13 in anticipation of the launch of the OTC derivatives clearing service; and again in May 2014, to account for the use of offsetting transaction arrangements in ASX Clear.

Currently, participants are not directly involved in default management fire drills that test general default management procedures in ASX Clear (Futures). This allows ASX to more freely incorporate scenarios based on actual participants and portfolios into its fire drills, involving the use of confidential information that cannot be shared with other participants. Nevertheless, after each fire drill a sample order file is sent to each of the default brokers that would be used by ASX to execute close-out trades, in order to test the compatibility of the file with their systems.

With the introduction of the OTC clearing service, separate fire drills are conducted by the DMG, the first of which took place in June 2014. The DMG comprises representatives of all OTC clearing participants, who are tasked with periodically convening to review the default management process and recommend amendments. Each OTC derivatives clearing member is involved directly in default simulations, including testing of the auction process.

In addition to the default management information provided on its website, ASX provides detailed responses to any targeted requests for information by clearing participants. Clearing participants have the ability to provide feedback and seek further information on default processes through this mechanism.

The default arrangements in ASX Clear (Futures) take into account, as far as possible, the implementation of any resolution regime that governs the CCP's participants. ASX has undertaken analysis on the impact of ADI resolution proceedings on a CCP's default management processes. While acknowledging that ADI resolution authorities may have broad powers to intervene in the arrangements of an insolvent ADI participant, the analysis suggests that, in general, resolution proceedings should not impede a CCP's default management processes. ASX will be conducting further analysis on the interaction between ADI and FMI resolution once international work on FMI resolution and the proposed domestic framework for FMI resolution have been finalised.

Principle 14: Segregation and portability

A central counterparty should have rules and procedures that enable the segregation and portability of positions of a participant's customers and the collateral provided to the central counterparty with respect to those positions.

Rating: Observed⁷

ASIC's and the Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 14. ASX Clear (Futures)' segregation and portability arrangements are described in further detail under the following Key Considerations.

14.1 A central counterparty should, at a minimum, have segregation and portability arrangements that effectively protect a participant's customers' positions and related collateral from the default or insolvency of that participant. If the central counterparty additionally offers protection of such customer positions and collateral against the

⁷ While ASX Clear (Futures) is assessed as observing Principle 14, the Bank has assessed that ASX Clear (Futures) broadly observes the corresponding CCP Standard 13. This difference in ratings is due to an additional requirement under the Bank's supplementary interpretation of CCP Standards 13.2 and 13.3 that ASX Clear (Futures) offer an account structure that provides protection for client collateral in excess of margin requirements lodged with the CCP.

concurrent default of the participant and a fellow customer, the central counterparty should take steps to ensure that such protection is effective.

During 2013/14, ASX Clear (Futures) introduced client-clearing arrangements for OTC derivatives, with clients of OTC participants offered the choice of holding their positions in either an individually segregated account or a client omnibus account. From July 2014, an individually segregated account structure has also been introduced for exchange-traded derivatives alongside the pre-existing client omnibus account structure.

While in the individually segregated structure client positions are held in individual accounts, the collateral posted to support these positions is held in a single commingled account. ASX nevertheless maintains a record of the value of initial margin attributable to each segregated client account and guarantees each client the transfer or return of this value (net of any close-out costs), even if the return of the specific securities posted is not possible under the current segregation model (see Key Consideration 14.2). ASX Clear (Futures) has commenced a consultation on enhancing its segregation arrangements for client collateral, including to allow lodgement of excess collateral with ASX Clear (Futures).

ASX Clear (Futures) has the capacity to transfer (port) participants' clients' positions and collateral under its Operating Rules (see Key Consideration 14.3). Part 5 of the PSNA supports the transfer of client collateral in the event of the default of a clearing participant as provided for in its Operating Rules without the need to seek approval from the defaulted participant's external administrator.

14.2 A central counterparty should employ an account structure that enables it readily to identify positions of a participant's customers and to segregate related collateral. A central counterparty should maintain customer positions and collateral in individual customer accounts or in omnibus customer accounts.

With effect from July 2014, ASX Clear (Futures) offers clients of both OTC and exchange-traded futures participants the choice of holding their positions in either an individually segregated account or a client omnibus account. ASX Clear (Futures) launched its OTC client clearing service in April 2014, and in July began offering an individually segregated client account for exchange-traded derivatives in addition to the pre-existing omnibus client account structure for these products. Initial margin is calculated separately for positions held in each individual or omnibus client account. Cross-margining of interest rate futures against OTC positions is only permitted for clients that have individual client accounts for both types of products with the same participant.

Under the individually segregated account structure, only positions are segregated at the individual client account level. Collateral is not segregated; operationally, gross collateral requirements are aggregated across all client accounts and managed by the participant within a single commingled client collateral account. In the event of a default, the value of the initial margin applied to the client's position in an individual client account would either be transferred to another participant or returned to the client (net of any close-out costs). Any excess collateral would be returned to the administrator of the defaulted participant. That is, ASX Clear (Futures) guarantees only the transfer or return of the value of each client's collateral, not the individual collateral securities that may have been posted.

This approach is similar to the internationally used 'Legally Segregated Operationally Commingled' segregation model. However, under such a structure variation margin payments

(and other cash flows) to and from clearing participants are netted. Accordingly, there is a risk that a participant could default before passing on to each client the gross flows underlying the net payment. ASX is currently consulting on extending its segregation model to allow excess collateral to be protected and also on options to make client collateral 'bankruptcy remote' from a default by ASX Clear (Futures) itself.

Since under either an individually segregated or an omnibus structure, the positions and collateral of clients are separate and identifiable from those of clearing participants, clients are not directly exposed to losses related to their participant's proprietary (house) activity in the event of that participant's default. Where a client opts to use an individually segregated account, its positions are also separately identifiable from those of other clients, as is the value of its margin obligations.

Clearing participants are not obliged to offer both individually segregated and omnibus client accounts, but must provide their clients with a client fact sheet, developed by ASX, which explains the types of accounts that are available, and the advantages and disadvantages of each option (see Key Consideration 14.4).

14.3 A central counterparty should structure its portability arrangements in a way that makes it highly likely that the positions and collateral of a defaulting participant's customers will be transferred to one or more other participants.

ASX Clear (Futures) has the power under its Operating Rules to transfer client positions and collateral following a participant default. The availability of individually segregated client accounts for both OTC and exchange-traded derivatives increase the likelihood that client positions and collateral could be transferred to another participant in the event of a clearing participant default. Under individual client segregation, margin requirements are calculated on a gross basis for the positions held by each client. This supports portability by making it more likely that clients would have sufficient initial margin transferred with their positions to ensure that their full margin requirements could be met after transfer. Portability is further supported by Part 5 of the PSNA (see Key Consideration 14.1). However, portability cannot be guaranteed since it relies on the willingness and capacity of another participant to take on the affected clients within a short period of time.

ASX Clear (Futures) has established a direct legal relationship with clients to underpin the acceptance of instructions in the event of a participant default. In the absence of a default, ASX Clear (Futures) does not interact directly with clients and the participant remains responsible as principal for its client's obligations to ASX Clear (Futures). However, if the participant were to default, the client would have the right to communicate with ASX and directly enforce the Operating Rules relating to segregation and portability of client positions and the associated value of initial margin held on its behalf.⁸ To accommodate structures involving indirect clients – that is, clients of clients – ASX Clear (Futures) allows clients to hold multiple individually segregated accounts and to nominate, as appropriate, an end client for each account. In the event of the default of the relevant clearing participant, the nominated end client would have the right to communicate directly with ASX in relation to the porting of positions in that individually segregated account (and associated value of initial margin).

⁸ This right is limited to clients that maintain individual client accounts and are not themselves in default.

In the event of a default, ASX allows a window of 24 hours for porting of exchange-traded derivatives client positions and 48 hours for OTC derivatives client positions. Clients may nominate in advance an alternative ('back-up') clearing participant to which it would seek to port its positions (and associated collateral value) in the event of its clearing participant default. Advance nomination of a back-up clearing participant is optional, and even if nominated a 'back-up' clearing participant may in the event be unwilling or unable to take on the positions. However, given the short timeframe for decisions in the event of a default, pre-nomination should increase the likelihood that a successful transfer could be achieved.

In the event that a transfer could not be achieved, ASX Clear (Futures) would hedge, close out and/or auction client positions as it would those of the defaulted clearing participant (see Principle 13). The Operating Rules give ASX Clear (Futures) some flexibility to close the porting window if it quickly became clear that a transfer could not be achieved, or if market conditions dictated that it would be beneficial to proceed with other default management processes to reduce ASX Clear (Futures)' exposure.

14.4 A central counterparty should disclose its rules, policies, and procedures relating to the segregation and portability of a participant's customers' positions and related collateral. In particular, the central counterparty should disclose whether customer collateral is protected on an individual or omnibus basis. In addition, a central counterparty should disclose any constraints, such as legal or operational constraints, that may impair its ability to segregate or port a participant's customers' positions and related collateral.

Current arrangements for segregation and portability are described in the ASX Clear (Futures) Operating Rules and Procedures (including the OTC Rulebook and Handbook). ASX has also published an overview of clearing participant default arrangements, which outlines the implications of different account structures and discloses the current operational constraints to portability. ASX will be updating the overview to reflect default management implications of both the OTC derivatives clearing service and the new client clearing arrangements, and to incorporate learnings from the DMG's OTC derivatives default management fire drill.

ASX has published a client fact sheet outlining segregation and portability arrangements in ASX Clear (Futures) and the rights of clients in the event of a default. Participants are required make this fact sheet available to all of their direct clients. The fact sheet is also available on ASX's public website.⁹ In addition, during 2013 and 2014, ASX has publicly consulted stakeholders on segregation and portability arrangements for both OTC and exchange-traded derivatives. These consultations have outlined the implications of different account structures used by ASX Clear (Futures) and identified operational constraints to portability.

Principle 15: General business risk

A central counterparty should identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that it can continue operations and services as a going concern if those losses materialise. Further, liquid net

⁹ The client fact sheet is available at <http://www.asx.com.au/documents/about/ASX_client_clearing_client_fact_sheet.PDF>. A related fact sheet describing the legal model used in ASX Clear (Futures)' client clearing arrangements is available at <<http://www.asx.com.au/documents/clearing/client-protection-model-fact-sheet.pdf>>.

assets should at all times be sufficient to ensure a recovery or orderly wind-down of critical operations and services.

Rating: Broadly observed

ASIC's and the Bank's assessment is that ASX Clear (Futures) broadly observes the requirements of Principle 15. In order to fully observe Principle 15, ASX Clear (Futures) should:

- carry out plans to enhance its recovery plan in line with forthcoming CPSS-IOSCO guidance, and ensure that the capital it holds under Key Consideration 15.2 continues to be sufficient to fund the enhanced plan. As ASX Clear (Futures) further develops its recovery plan, it should also review and integrate its recapitalisation processes with its broader recovery planning arrangements.

ASX Clear (Futures)' management of general business risk is described in further detail under the following Key Considerations.

15.1 A central counterparty should have robust management and control systems to identify, monitor, and manage general business risks, including losses from poor execution of business strategy, negative cash flows, or unexpected and excessively large operating expenses.

ASX's approach to business risk is consistent with its overall Enterprise Risk Management Policy and Framework (see Principle 3). Under the framework, formal policies are in place for individual risk categories such as accounting, authorisations, business continuity, technology, fraud control and procurement.

ASX monitors a variety of financial business risks, including market risk, credit risk, liquidity risk and capital risk.

- Group funds (as distinct from collateral lodged by participants) may be exposed to market risk due to changes in market variables such as interest rates, foreign exchange rates and equity prices. Mitigants for market risk include hedging of foreign exchange risk and monitoring of equity price risk, with appropriate capital allocation.
- Credit risk for the Group's general business activities arises in the collection of receivables, which principally comprise fees from market participants, issuers, users of market data and other customers. Mitigants include active collection procedures on trade receivables and 'ageing' of receivable amounts.
- Liquidity risk arises from the Group's time-critical payables, and is mitigated by prudent liquidity management, with forward planning and forecasting of liquidity requirements.
- ASX may be exposed to capital risk if equity in group entities falls below prudent or regulatory minimum levels. ASX manages its capital at a group level, in accordance with an objective of maintaining a prudent level of surplus net tangible equity. Ongoing monitoring of cash flows and capital adequacy is conducted via quarterly meetings of CALCO.

ASX undertakes periodic strategic risk assessments in the context of its overall business plans. Through this process, ASX identifies new strategic business initiatives, such as the projects that delivered the ASX Collateral and OTC derivatives clearing services. These are subject to financial analysis, which includes high, low and base case revenue assumptions and forecasts. Impacts on capital are also determined and analysed.

ASX undertakes risk assessments when undertaking any expansion of its activities or in the event of material changes to its business. Risk assessments are built into ASX's project management framework (see Key Consideration 17.4). Under this framework, an initial high-level risk indication is defined at the project concept stage. This is followed by a formal project risk assessment covering both project delivery risks and impacts to business activities. The assessment of the OTC derivatives clearing service, for example, identified: risks associated with impact on CCP liquidity; changes required to the default waterfall; potential legal issues with regulatory requirements; and a significant dependence on outsourced software services. ASX typically conducts a series of workshops involving project staff to discuss risks associated with any planned new service. Prior to the approval of a project for launch/production, ASX prepares an operational readiness summary and conducts a final workshop to discuss possible risks associated with initial launch. This includes consideration of potential failure scenarios and workarounds, procedures for escalation of issues, and help desk and key staff availability.

Following launch, the risks of a new activity are captured in risk profiles that are prepared by department management every six months. CALCO also monitors actual and forecast capital and liquidity requirements on a quarterly basis, including requirements related to new projects.

15.2 A central counterparty should hold liquid net assets funded by equity (such as common stock, disclosed reserves, or other retained earnings) so that it can continue operations and services as a going concern if it incurs general business losses. The amount of liquid net assets funded by equity a central counterparty should hold should be determined by its general business risk profile and the length of time required to achieve a recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken.

ASX has set aside \$232 million for operational and business risk across the four ASX Group CS facilities, \$60 million of which has been attributed specifically to ASX Clear (Futures)' operational and business risks. Since ASX has identified constraints to making business risk capital bankruptcy remote within the CCP, this capital is held at the ASX Group level to ensure that it cannot be applied to meet losses caused by a participant default. Each CS facility has a separate allocation for business risk capital that is explicitly recognised within group-wide capital holdings. These holdings include an additional buffer against potential losses sustained elsewhere in the group. During 2013/14, ASX made amendments to the ASX Group Support Agreement, placing an obligation on ASX to maintain sufficient capital to support ASX Clear (Futures)' continued operations in the event of general business losses. These amendments support the legal certainty of ASX Clear (Futures)' access to business risk capital as required.

In determining the sufficiency of the \$60 million in operational and business risk capital set aside for ASX Clear (Futures), ASX has estimated the capital required to cover six months of current operating expenses (see Key Consideration 15.3), plus that required to cover operational and legal risk, non-covered credit and counterparty credit risk, non-covered market risk, business risk and an additional capital buffer. It has calculated these components

consistent with the methodology used by CCPs in the EU, under the *European Regulation on OTC derivatives, central counterparties and trade repositories* (EMIR).¹⁰

- 15.3 A central counterparty should maintain a viable recovery or orderly wind-down plan and should hold sufficient liquid net assets funded by equity to implement this plan. At a minimum, a central counterparty should hold liquid net assets funded by equity equal to at least six months of current operating expenses. These assets are in addition to resources held to cover participant defaults or other risks covered under the financial resources principles. However, equity held under international risk-based capital standards can be included where relevant and appropriate to avoid duplicate capital requirements.**

ASX Clear (Futures) has developed a plan setting out options for its recovery or wind-down based on its existing Operating Rules, and has commenced work towards enhancing this plan in line with forthcoming CPSS-IOSCO guidance on recovery planning (see Key Consideration 3.4). In calculating the quantum of business risk capital described under Key Consideration 15.2, ASX has sought to ensure access to sufficient liquid net assets to fund operations during the execution of ASX Clear (Futures)' recovery plan, or to cover a minimum of six months of current operating expenses.

- 15.4 Assets held to cover general business risk should be of high quality and sufficiently liquid in order to allow the central counterparty to meet its current and projected operating expenses under a range of scenarios, including in adverse market conditions.**

The risk capital for ASX's CS facilities is invested in accordance with the ASX Limited and ASX Operations Pty Limited Investment Mandate. The Investment Mandate specifies investment objectives, responsibilities, approved products and counterparties, and audit and maintenance of the mandate. Approved products are generally highly rated and liquid products such as: cash deposits; bank bills, negotiable certificates of deposit and floating rate notes issued by APRA-approved ADIs; foreign exchange in specified currencies; Commonwealth Government securities; and selected semi-government securities. Limits are applied against counterparty, liquidity and market risks. Liquidity limits are specified for maximum instrument maturity and weighted average maturity.

- 15.5 A central counterparty should maintain a viable plan for raising additional equity should its equity fall close to or below the amount needed. This plan should be approved by the board of directors and updated regularly.**

As noted, ASX Limited manages its operational and business risk capital at the group level. The ASX Limited Board monitors the ongoing capital adequacy of the ASX Group as part of its regular capital planning activities. The Board determines the most appropriate means of raising additional capital when needed, giving due consideration to prevailing market conditions and available alternative financing mechanisms. For example, in June 2013, ASX Limited conducted a capital raising by way of a \$553 million share entitlement offer, with the bulk of the funds being used to increase the business risk capital of the CS facilities and their

¹⁰ The EMIR methodology requires, for example, that ASX Clear (Futures) set aside funds for: winding down or restructuring the business based on monthly gross operating expenses multiplied by the time span required to wind down or recover; operational and legal risk based on a basic indicator approach (e.g. a percentage of average income over several years) or advanced measurement approach; non-covered credit and counterparty credit risk based on a percentage of risk-weighted exposure amounts; non-covered market risk based on own capital requirements; and business risk based on the higher of the CCP's own estimate or one quarter of annual gross operating expenditures.

pooled financial resources to deal with participant default. Recapitalisation processes will be reviewed and integrated with broader recovery planning arrangements as ASX Clear (Futures) further develops its recovery plan in line with forthcoming CPSS-IOSCO guidance.

Principle 16: Custody and investment risks

A central counterparty should safeguard its own and its participants' assets and minimise the risk of loss on and delay in access to these assets. A central counterparty's investments should be in instruments with minimal credit, market, and liquidity risks.

Rating: Broadly observed

ASIC's and the Bank's assessment is that ASX Clear (Futures) broadly observes the requirements of Principle 16. In order to fully observe Principle 16, ASX Clear (Futures) should:

- implement plans to further reduce the concentration of unsecured exposures to the large domestic banks under its treasury investment policy. The Bank has opened a dialogue with ASX on the detail of its expectations for the credit and liquidity risk profile of ASXCC's investment portfolio, as well as the time frame over which these expectations should be met.

ASX Clear (Futures)' management of custody and investment risks is described in further detail under the following Key Considerations.

16.1 A central counterparty should hold its own and its participants' assets at supervised and regulated entities that have robust accounting practices, safekeeping procedures, and internal controls that fully protect these assets.

The assets of ASX Clear (Futures) and its participants are administered and held within the ASX Group. Intragroup arrangements allow ASX Clear (Futures) to fully understand the nature of its risk exposure to ASXCC and other group entities such as Austraclear (for safekeeping of AUD-denominated debt securities). This exposure is managed within the context of ASX's overall Clearing Risk Policy Framework. ASX has robust accounting practices, safekeeping procedures and internal controls to protect its own and its participants' assets (as described under Key Consideration 2.6).

Non-cash collateral is held in ASX Clear (Futures)' account in Austraclear. ASX Clear (Futures)' Operating Rules and Procedures define how collateral is used. ASX Clear (Futures) does not re-use non-cash collateral posted by participants.

Cash investments, including cash collateral, clearing participant contributions and shareholder funds, are controlled by ASXCC, of which ASX Clear (Futures) is a subsidiary (see 'ASX Group Structure' in Section 2.3.1). ASXCC makes its investments in accordance with its Investment Mandate and ASX's Investment Policy, which together define investment objectives, investment specifications, and audit and maintenance of the policy (see Key Consideration 16.4).

16.2 A central counterparty should have prompt access to its assets and the assets provided by participants, when required.

ASXCC's Investment Mandate requires that a portion of its portfolio be held in liquid asset form to cover liquidity risks from both general business risks and risks related to ASX Clear (Futures)' clearing activities. Only investments in instruments that can be liquidated or repurchased for cash within two hours are treated as 'liquid' products (see also Key Consideration 7.5).

16.3 A central counterparty should evaluate and understand its exposures to its custodian banks, taking into account the full scope of its relationships with each.

ASXCC does not use custodians to hold assets invested on behalf of ASX Clear (Futures).

16.4 A central counterparty's investment strategy should be consistent with its overall risk-management strategy and fully disclosed to its participants, and investments should be secured by, or be claims on, high-quality obligors. These investments should allow for quick liquidation with little, if any, adverse price effect.

ASXCC is the controlling entity for the investments of both CCPs. In respect of both cash margin collected and pooled risk resources, ASXCC invests funds in accordance with a defined treasury investment policy, endorsed by the Clearing Boards and itself governed by the ASX Enterprise Risk Management Policy. The treasury investment policy, set out in a high-level policy document and the more detailed ASXCC Investment Mandate, articulates the basis for ASX Clear (Futures)' mitigation of investment-related credit, market and liquidity risks (Principle 7). The performance of the investment portfolio within the parameters of this policy is closely monitored by ASXCC, with trigger points to automatically escalate potential issues to the CRO before actual limits are reached. Trigger points are defined for weighted average maturity and percentage of total liquid assets held in non-AUD denominated securities.

The ASXCC Investment Mandate defines investment counterparty eligibility criteria and sets investment limits in order to control counterparty investment risk.

- *Counterparty eligibility criteria.* Counterparties must be Commonwealth or State Government entities (including the Bank), APRA-approved ADIs that are licensed banks in Australia under the *Banking Act 1959*, or (from July 2014) supranational agencies that issue in the Australian bond market. ADIs must also have a Standard & Poor's short-term credit rating of A1 or above, while supranational agencies must have a rating of AAA. The Investment Mandate does not permit investments in securities of ASX Group entities. Nor is ASXCC permitted to create unsecured exposures to any other investment counterparty that is a participant or affiliated with a participant, other than the four major banks.
- *Counterparty investment limits.* Counterparty investment limits are determined according to factors such as the credit quality of the counterparty or obligor, the size of available financial resources, and whether eligible investment counterparties and their affiliates are also clearing participants. Limits are set on both the proportion of the portfolio and the absolute amount that can be invested with a single counterparty.

The Investment Mandate aims for quick liquidation of investments with little, if any, price effect. Only investments in instruments that can be liquidated or repurchased for cash within two hours are treated as 'liquid' products. These are defined based on the depth of market liquidity and the terms of investment, including whether the instruments are eligible for repurchase transactions with the Bank (see Key Consideration 7.5). Investment specifications under the ASXCC Investment Mandate include approved products, approved counterparties and obligors, limits against credit, market and liquidity risk, and other investment restrictions. The policy restricts investments to high-quality liquid assets, such as Commonwealth Government securities, bank bills and certificates of deposit. The policy also sets a 'value-at-risk' limit.

ASXCC's Investment Mandate recognises the primacy of maintaining liquidity and credit quality against achieving investment return, given that funds under management are a critical source of liquidity in the event of a market disruption or clearing participant default. The investment policy and limits are reviewed and approved annually by the ASXCC Board with input from the Risk Committee. The broad approach to investment and investment holdings are disclosed publicly in the ASX Annual Report.

Consistent with the revisions to its Investment Mandate, during 2013/14 ASX reduced the limits applicable to the large domestic banks in recognition of their participation in the new OTC derivatives clearing service, and applied a further reduction in limits as part of the annual review of the ASXCC Investment Mandate. In addition, ASX has taken steps to diversify its unsecured exposures to a broader range of highly rated investment counterparties and has introduced arrangements allowing it to invest cash with selected counterparties on a secured basis. ASX plans to review concentration limits to investment counterparties again in 2015 and is working to further strengthen its capacity to invest on a secured basis. The Bank has opened a dialogue with ASX on the detail of its expectations for the credit and liquidity risk profile of ASXCC's investment portfolio, as well as the time frame over which these expectations should be met.

Principle 17: Operational risk

A central counterparty should identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. Systems should be designed to ensure a high degree of security and operational reliability and should have adequate, scalable capacity. Business continuity management should aim for timely recovery of operations and fulfilment of the central counterparty's obligations, including in the event of a wide-scale or major disruption.

Rating: Observed

ASIC's and the Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 17. ASX Clear (Futures)' arrangements for managing operational risks are described in further detail under the following Key Considerations.

17.1 A central counterparty should establish a robust operational risk-management framework with appropriate systems, policies, procedures, and controls to identify, monitor, and manage operational risks.

ASX's operational risk policies and controls have been developed in accordance with ASX's group-wide Enterprise Risk Management Framework (see Key Consideration 3.1). Under this framework, the ASX Limited Board is responsible for reviewing and overseeing the group's risk management systems (see Key Consideration 2.6). The Board delegates review of the Enterprise Risk Management Framework to its Audit and Risk Committee. An Enterprise Risk Management Committee, comprising executives from across ASX's departments, is responsible for approving enterprise risk policies and reviewing controls, processes and procedures to identify and manage risks, as well as the formal approval of significant operational risk policies prepared by individual departments. Under the Enterprise Risk Management Framework, individual departments are also responsible for: identifying business-specific risks; applying controls; maintaining risk management systems; reporting on the effectiveness of risk controls; and implementing enhancements and taking remedial action. A dedicated security team has responsibility for assessing both physical and cyber security risks, and is overseen by a

Security Steering Committee comprising the Chief Information Officer, head of Internal Audit and other senior executives.

Access to resources

ASX Clear (Futures) has arrangements in place to ensure that it has well-trained and competent personnel operating Genium and Calypso. Staff are provided with relevant policies and guidelines from commencement of employment, with weekly communications thereafter. Staff are evaluated with reference to each defined operational process and broader skills matrices, with training provided for identified areas of weakness. ASX Clear (Futures) has a formal succession planning and management process in place for key staff. ASX has sought to automate routine operational processes and reporting over recent years, freeing up additional staff resources that would otherwise be devoted to these tasks.

To facilitate rapid recovery in the event of an operational disruption, ASX intends to increase the proportion of operational staff based at its secondary operations site (which is also the primary data centre), to around 30 per cent from the current 20 per cent. In case of a disruption to staffing arrangements at the primary site for staff, the secondary operations site has capacity to house 65 per cent of all operational staff.¹¹

Resources shared with a related body

Within the ASX group structure, most operational resources are provided by ASX Operations Limited, a subsidiary of ASX Limited (see 'ASX Group Structure' in Section 2.3.1), under a contractual Support Agreement. In the event that ASX Operations Limited became subject to external administration, to the extent permissible by law, provisions within the Support Agreement provide for ASX Clear (Futures) and the other clearing and settlement corporate entities to retain the use of operational resources.

Major projects

Major projects are overseen by the Enterprise Portfolio Steering Committee (EPSC), which is comprised of representatives of the Group Executive. The EPSC is responsible for determining project priorities across the ASX Group and overseeing the quality of project execution. The EPSC is also tasked with ensuring that ASX has sufficient well-qualified personnel to cope with periods in which it is simultaneously undertaking a number of projects, including those resulting in significant changes to business. Project management of major projects is undertaken by the Project Management Office (PMO). For projects affecting core systems, such as the move from SECUR to Genium, the PMO rates projects to ensure that they receive appropriate access to resources. Projects incorporate testing processes, which verify that systems or services meet benchmarks set prior to implementation. Testing addresses both technical and operational aspects of projects. The project management process includes engagement with customers and third-party vendors of supporting systems where appropriate, particularly in customer testing. Project plans also include formal checkpoints to ensure all appropriate risk management controls are in place prior to live use of a new or updated system or service.

Over recent years, ASX has undertaken work on close to 60 projects, including major projects such as the OTC derivatives clearing service and enhanced client clearing arrangements in ASX

¹¹ ASX currently maintains three main sites for its operations and data processing: a primary operations site (where the majority of staff are located); a secondary operations site that also operates as the primary data centre; and a backup data centre.

Clear (Futures) and the ASX Collateral service. Work on these projects, often to challenging time frames, in addition to work required by ASX to ensure compliance with the new FSS, has tested the capacity of ASX's existing resources. Targeted deadlines for key projects have nevertheless largely been met. In order to meet increased demand for resources associated with these projects and ongoing business requirements, ASX has taken on new staff, employed consultants and utilised partnerships with service providers, including in respect of the OTC derivatives clearing service.

17.2 A central counterparty's board of directors should clearly define the roles and responsibilities for addressing operational risk and should endorse the central counterparty's operational risk-management framework. Systems, operational policies, procedures, and controls should be reviewed, audited, and tested periodically and after significant changes.

The roles and responsibilities for addressing operational risk are defined in the CS Boards' Charter, the Audit and Risk Committee Charter, and the Enterprise Risk Management Framework. As described above, risk responsibilities are shared between the ASX Limited Board, the CS Boards, the Audit and Risk Committee, the Enterprise Risk Management Committee and individual departments.

Policies and procedures are the subject of internal and external review. ASX's Internal Audit department routinely monitors compliance with operational policy, reporting to the Audit and Risk Committee on a quarterly basis. Audit findings may prompt a review of policy, which would be conducted in consultation with key stakeholders. Technology-related security policy is considered by external auditors annually.

ASX benchmarks its operational risk policy against relevant international standards. For example:

- ISO 31000 – Risk Management Principles and Guidelines is used to benchmark ASX's overarching framework for operational risk management.
- The business continuity framework is benchmarked against the Business Continuity Institute's Good Practice Guidelines 2013, the international standard ISO 22301:2012 Business Continuity Management Systems, and the British standard BS 25999 1:2006.
- The technology risk management framework is benchmarked against the ISO 27001:2005 Information Security Management Systems standard. Cyber security strategies are further benchmarked against the Australian Signals Directorate's Strategies to Mitigate Targeted Cyber Intrusions.
- The compliance framework is benchmarked to the AS 3806-2006: Compliance Programs.
- The ASX Fraud Control Policy is benchmarked against AS 8001-2008: Fraud and Corruption Control.

The risk framework defines a variety of control procedures to support the core operational systems. These include audit logs, dual input checks, management sign-off and processing checklists as the primary preventative controls, supported by reconciliations and management reviews of activity. ASX Clear (Futures) operates a separate test environment for its core systems (Genium and Calypso) and has a formal, documented change management process. There are also defined procedures for communicating with participants

and vendors details of technology upgrade releases, which include regular notices to participants of upcoming changes.

17.3 A central counterparty should have clearly defined operational reliability objectives and should have policies in place that are designed to achieve those objectives.

Availability targets are documented and defined formally for critical services. Genium/SECUR and Calypso are required to meet a minimum availability target of 99.8 per cent; during 2013/14, SECUR was available 100 per cent of the time, Genium was available 100 per cent of the time and Calypso was available 100 per cent of the time.

System capacity is monitored on an ongoing basis, with monthly reviews of current and projected capacity requirements. The results are reviewed against established guidance for capacity headroom over peak recorded values for all critical systems; that is, to maintain capacity 50 per cent over peak recorded daily volumes, with the ability to increase to 100 per cent over peak within six months. Capacity data are reported monthly to the CEO. The aggregated average capacity utilisation of SECUR during 2013/14 was 9 per cent, while peak utilisation was 15 per cent;¹² average capacity utilisation of Genium was 8 per cent, while peak utilisation was 10 per cent and average capacity utilisation of Calypso was 1 per cent, while peak capacity utilisation was 3 per cent. ASX Clear (Futures) considers that it has sufficient technical and human resources to operate Genium and Calypso during peak periods, including in the event of operational incidents or system failure.

17.4 A central counterparty should ensure that it has scalable capacity adequate to handle increasing stress volumes and to achieve its service-level objectives.

ASX Clear (Futures)' approach to ensuring scalable capacity adequate to handle increasing stress volumes and to achieve its service level objectives is described under Key Consideration 17.3. As noted above, average capacity utilisation of SECUR during 2013/14 was 9 per cent, while peak utilisation was 15 per cent; average capacity utilisation of Genium was 8 per cent, while peak utilisation was 10 per cent; and average capacity utilisation of Calypso was 1 per cent, while peak capacity utilisation was 3 per cent. All core systems were available 100 per cent of the time over this period.

17.5 A central counterparty should have comprehensive physical and information security policies that address all potential vulnerabilities and threats.

Information security policy is implemented using a risk-based decision process, based on ISO 31000, relevant federal and state legislation, and other best-practice standards. The goal of ASX's information strategy is to create a strong and reliable security environment that meets business and functional requirements for customers and employees while balancing risk to the organisation, the cost of controls, and the richness and flexibility of services. ASX's information security policy applies to all employees, consultants, vendors and contractors of ASX. It also applies to all facilities, equipment and services managed by or on behalf of ASX, including off-site data storage, computing and telecommunications equipment. The policy is reviewed annually or when material or organisational changes are made. The last review was in March 2014.

¹² Genium will provide additional capacity headroom in future.

Information security policy is tested at a number of levels. This includes penetration testing against the ASX perimeter and vulnerability testing within the perimeter. ASX Clear (Futures) performs SECUR security testing on a quarterly basis. ASX operates a suite of controls designed to prevent and detect cyber attacks on its systems, such as denial of service or malware threats. These include steps to monitor suspicious internet traffic, and the maintenance of spare capacity to manage legitimate or malicious surges in internet traffic, as well as steps to regulate access to ASX systems (described below).

Physical access is controlled at both an enterprise and departmental level. The key systems supporting ASX's clearing and settlement processes are operated within a secure building. Clearing operations are separated from general office areas with permitted access determined at a senior manager level and records of access maintained. Physical security arrangements for the primary and backup data centres are broadly equivalent.

User access for the key systems is restricted to prevent inappropriate or unauthorised access to application software, operating systems and underlying data. User activities are uniquely identifiable and can be tracked via audit trail reports. The level of access is authorised by the system owner with users granted the minimum level of access to systems necessary to perform their roles effectively. External access to ASX systems must pass through multiple layers of firewalls and intrusion prevention, and individual networks are segregated.

Application testing is carried out in test environments. Testing reports are documented, with identified problems escalated to management and tracked through to remediation. Similarly, any technology-based operational incidents are reported to senior management and issues are tracked through to resolution via regular updates to management.

- 17.6 A central counterparty should have a business continuity plan that addresses events posing a significant risk of disrupting operations, including events that could cause a wide-scale or major disruption. The plan should incorporate the use of a secondary site and should be designed to ensure that critical information technology (IT) systems can resume operations within two hours following disruptive events. The plan should be designed to enable the central counterparty to complete settlement by the end of the day of the disruption, even in case of extreme circumstances. The central counterparty should regularly test these arrangements.**

Business continuity arrangements

ASX Clear (Futures) maintains extensive contingency plans detailing the appropriate operational response to a CS facility disruption, including coverage of the various lines of authority, means of communication, and failover procedures. These plans are updated periodically. ASX Clear (Futures) policy requires that failover to the backup data centre should occur within two hours for all systems. Plans for recovery of key systems apply to both physical and cyber threats to business continuity.

ASX Clear (Futures) employs a variety of technologies to ensure a high degree of redundancy in its systems – both across sites and within a single site. ASX maintains both primary and backup data centres, with broadly equivalent operational requirements. Key plant and equipment at the primary site are designed to the Uptime Institute Tier 3 standard of

concurrent maintainability.¹³ The main computer network is connected via point-to-point optical fibre, which ASX operates with its own technology, thereby reducing the potential for outages due to operational errors by the telecommunications provider. All core systems employ multiple servers with spare capacity. Front-end servers handling communications with participants are configured to provide automatic failover across sites. Failover of the more critical data servers is targeted to take place within two hours, but would generally be expected to occur within an hour, under the control of management.

Disruption to participants in such circumstances would be mitigated by the high degree of redundancy in the front-end system components. In most circumstances, these would be expected to maintain communications with participants' systems and queue transactions until the data servers were reactivated. The integrity of transactions would be supported by: queuing messages until they could be processed; storing all transactions in the database with unique identifiers, thereby preventing the loss or duplication of transactions; and synchronised replication of database records across both the primary and backup data centres. Furthermore, in the event that a significant part of a system or an operational site failed, ASX Clear (Futures) has contingency arrangements to activate an additional tier of 'cold' redundancy arrangements (either by converting test systems into production systems or rebuilding systems from readily available hardware) within 24 hours to meet the contingency of any further service interruption.

ASX Clear (Futures) has clearly defined procedures for crisis and event management. These procedures cover incident notification, emergency response (including building evacuation), incident response (including overall incident assessment and monitoring), and incident management testing. Since May 2014 these include the use of Twitter to advise stakeholders of market-wide operational or technical incidents. ASX maintains a major incident management team that includes senior representatives of the core business activities, as well as facilities management, business continuity, and media and communications. The procedures identify responsibilities, including for internal communication and external communication to emergency services, the market, industry and media.

ASX Clear (Futures) regularly tests its business continuity arrangements. Dual site operational teams across the primary and secondary operations sites effectively test backup operational processes on a continuous basis. For those teams not located across both sites, connectivity and procedural testing of the secondary site are performed monthly by representatives from ASX Clear (Futures). Live technology tests, where clearing services are provided in real time from the backup data centre, are conducted on a two-year cycle. Test results are formally documented and reported to ASX senior management and are also made available to internal and external auditors. The use of live tests ensures that participant connectivity to the backup data centre is also tested. ASX's business continuity framework is audited externally every three to five years; the most recent audit, conducted in late 2012, found that ASX's business continuity standards were broadly consistent with widely recognised global standards and did not identify any major areas of concern.

Participant continuity arrangements

¹³ The Uptime Institute is an IT consulting organisation that has developed a widely adopted classification system for the level of redundancy arrangements in data centres. 'Tier 3' is the second highest standard of redundancy, indicating that a data centre has redundant components, multiple independent power and cooling systems, and a high degree of availability.

Recognising that effective continuity of operations may depend on the capacity of participants to recover from an operational disruption, business continuity requirements for participants are set out in the ASX Clear (Futures) Operating Rules and Procedures, supplemented by additional guidance issued by ASX on 1 July 2014. These require participants to maintain adequate business continuity arrangements that are appropriate to the nature and size of their business as a participant. The Operating Rules specify that participants must have arrangements that allow for the recovery of usual operations. It is ASX Clear (Futures)' expectation (set out in guidance) that this would be within two hours, and no more than four hours, following a contingency event for large participants. The targeted recovery time for smaller participants is four hours (and no more than six). These arrangements are reviewed as part of the participant admissions process. If a participant fails to maintain business continuity arrangements consistent with these recovery targets, it may become subject to sanctions or restrictions on its activities. Participants are also subject to spot checks of their ongoing compliance with operational requirements. Spot checks may be based on topical themes, in some cases arising from observations of general business developments, and in other cases motivated by a participant that has been experiencing operational problems. These spot checks examine the participant's governance and processes for resilience and business continuity. If a participant fails to implement any recommendations arising from a check, ASX may impose sanctions.

The Operating Rules and Procedures also require more broadly that participants have facilities, procedures and personnel that are adequate to meet technical and performance requirements. ASX's preferred approach to dealing with operational issues is to work collaboratively with the participant to educate them on their obligations. If the matter is serious, ASX may require that the participant remediate the weakness as a matter of priority. ASX may impose conditions on participation, or require that the participant appoint an independent expert to assist with the remediation task.

Participants are involved in the contingency testing of ASX Clear (Futures)' systems, as this testing is conducted in a live environment. ASX conducts comprehensive business continuity testing of key systems at least every two years, with participants being notified of the start and completion of testing. Participants are also involved in testing of major system changes or in advance of the introduction of a new system. ASX Clear (Futures) conducts regular connectivity tests and maintains an external testing environment for system changes.

17.7 A central counterparty should identify, monitor, and manage the risks that key participants, other financial market infrastructures, and service and utility providers might pose to its operations. In addition, a central counterparty should identify, monitor, and manage the risks its operations might pose to other financial market infrastructures.

Interdependencies with participants and other FMIs

ASX identifies and monitors potential dependencies on participants in a number of ways: by holding regular discussions with participants on risk management processes (see Key Consideration 3.1); as part of its assessments of project-related risks (see Key Consideration 15.1); and through its general monitoring of risks under its risk management framework (see Key Consideration 3.1).

For ASX Clear (Futures), ASX has identified risks relating to its operational activities arising from participants' increased usage of third-party vendors for back-office systems, and participants outsourcing their back-office processing offshore.

- If participants use the system of a vendor that experiences difficulties, these participants may have difficulty connecting to ASX's clearing and settlement infrastructure. If a vendor issue requires significant system changes, ASX Clear (Futures)' operations may be affected for an extended period. This risk is managed in part through technical and business continuity requirements placed on participants, but there are limitations to this approach. As a result, and notwithstanding that there are no contractual relationships between ASX and vendors, ASX has implemented a program to develop stronger direct relationships with key participant vendors. This formalises steps taken by ASX to engage with participant vendors, for example to align margin calculations following the introduction of SPAN in ASX Clear in late 2012. The program supports vendors' knowledge of ASX technical updates through early engagement before system changes are rolled out, as well as ASX's knowledge of vendor systems and business continuity arrangements.
- Participants' outsourcing of back-office processes and technology to overseas domiciled hubs or third-party vendors may complicate incident management due to differences in time zones and languages, and in some cases a lack of familiarity with local market practices and conventions. Such factors, if inadequately mitigated, could increase operational risk. ASX is examining options to mitigate these risks. As part of this, ASX Compliance has carried out a spot review on participants' outsourcing arrangements, benchmarking participants against a number of standards, including APRA's outsourcing prudential standard CPS 231. As a follow-up to the review, ASX is developing new guidance on participant outsourcing and has conducted site visits to selected overseas outsourcing providers.

ASX Clear (Futures) has an operational interdependence with Austraclear, which is used to settle margin payments (Principle 20). Operational risk associated with this interdependence is managed within the context of the ASX Group's operational risk management framework. ASX Clear (Futures) does not have significant operational interdependencies with other FMIs.

Dependencies on service and utility providers

ASX has a formal policy that sets out the process for entering into, maintaining and exiting key outsourcing arrangements. If a key service is to be provided by an external service provider, ASX first conducts a tender process in which proposals from potential vendors are assessed against relevant criteria. Arrangements have been implemented under which ASX would consult with the Bank before entering into new agreements with third parties for critical services. ASX also provides the Bank with a list of critical outsourcing arrangements on an annual basis. Issues relating to outsourcing or service provision are escalated as appropriate to executive management via the ASX Technology Vendor Management Group and the relevant operational support area.

ASX assesses the operational performance of its service providers on an ongoing basis against its own operational policies, to ensure that service providers meet the resilience, security and operational performance requirements of relevant domestic and international standards. ASX maintains current information on its service providers' operations and processes through ongoing liaison, and in turn provides relevant updates to service providers regarding ASX operations. Service providers are also assessed through software regression testing when

there is a major system upgrade.¹⁴ Contractual arrangements with critical service providers require the approval of ASX Clear (Futures) before the service provider can itself outsource material elements of its service.

In May 2014, ASX Clear (Futures) upgraded its core exchange-traded derivatives clearing system from SECUR to the Genium clearing system, which is a more recent system offered by the same vendor. ASX Clear (Futures) has responsibility for business continuity arrangements and computer-system support. The vendor provides support where changes to the system components or underlying source code are involved, under an agreement which extends beyond 2014. ASX Clear (Futures) has an escrow arrangement in place that would allow it to access source code for Genium. These arrangements mirror the support agreements in place for SECUR prior to May 2014.

All other ASX Clear (Futures) operational functions are performed within ASX. However, external suppliers are used for utilities, hardware maintenance, operating system and product maintenance, and certain security-related specialist independent services.

ASX has put in place a number of mitigants to address the risks associated with dependencies on utilities and service providers.

- Primary and backup data centres are connected to different electricity grids and telecommunication exchanges.
- Each data centre has backup power generators with capacity to run the site at full load for 72 hours.
- All external communications links to data centres are via dual geographically separated links.
- ASX conducts regular testing of backup arrangements. Major systems are tested on a two-year cycle. Participants are notified of business continuity tests in advance through ASX notices.
- ASX also performs a periodic assessment of suppliers, including consideration of contingency arrangements should externally provided services not be available (such as the use of alternative suppliers), as well as incident escalation procedures and contacts.

ASX has developed a set of standard clauses for inclusion in contracts with third-party service providers of critical services to ASX Clear (Futures). Similar clauses are also included in the Support Agreement between ASX Clear (Futures) and ASX Operations Pty Ltd, which provides all internal operational services for the facilities. The clauses seek to ensure that the agreements meet the resilience, security and operational performance requirements of the FSS (which align with the Principles). ASX applies these clauses to all new agreements with service providers, and has incorporated them into all of its key existing service agreements. This includes ASX Clear (Futures)' agreements with a third-party vendor for support of Genium, which also incorporates EXIGO software support, and another third-party vendor for support of Calypso.

¹⁴ When a component of software is updated, 'regression testing' aims to perform checks on the full software to verify that the operation of other software components has not been inadvertently affected by the update.

ASX's standard clauses for service providers require the provider to grant reasonable access to the Bank in respect of information relating to its operation of a critical function provided to ASX Clear (Futures). In the event that the Bank concluded that the terms of the service provider agreement did not meet FSS requirements, the clauses also require the service provider to negotiate acceptable new terms with ASX in good faith. The clauses require that providers give the Bank notice of any intention to terminate the agreement as a consequence of ASX Clear (Futures)' failure to pay fees, or in the event of the insolvency of ASX Clear (Futures) or any other relevant ASX entity. This is intended to give the Bank an opportunity to take action to remedy the breach or otherwise ensure continued service provision.

ASX Clear (Futures)' arrangements to ensure continuity of operations in the event of a crisis will be shaped by the proposed introduction into Australian law of a special resolution regime for FMIs. This was foreshadowed in consultations undertaken by the Council of Financial Regulators and Treasury in 2011 and 2012. ASX Clear (Futures) will need to ensure that its arrangements to support continuity of operations in a crisis are appropriately adapted to the proposed FMI resolution regime once finalised.

CPSS and IOSCO have developed a draft Assessment Methodology for the oversight expectations applicable to critical service providers.¹⁵ Once finalised, this Assessment Methodology will provide a framework for considering how to apply the oversight expectations for critical service providers set out in Annex F of the PFMI.

Disclosure

The nature and scope of ASX Clear (Futures)' dependencies on critical service providers are disclosed to participants through: Operating Rules; Guidance Notes; Notices and Bulletins; technical documentation available on the ASX participant website; more general information available on the ASX public website; and in one-on-one meetings with participants, both during the induction process for new participants and on an ongoing basis.

Operational Support

ASX Clear (Futures) provides telephone and email support to participants via a helpdesk, which operates from 8 am to 7.30 pm.

Principle 18: Access and participation requirements

A central counterparty should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access.

Rating: Observed

ASIC's and the Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 18. ASX Clear (Futures)' access and participation requirements are described in further detail under the following Key Considerations.

18.1 A central counterparty should allow for fair and open access to its services, including by direct and, where relevant, indirect participants and other financial market infrastructures, based on reasonable risk-related participation requirements.

¹⁵ The draft Assessment Methodology is available at <<http://www.bis.org/publ/cpss115.htm>>.

ASX Clear (Futures) has objective and transparent participation requirements, which are publicly available and form part of its Operating Rules and Procedures. During the Assessment period, ASX developed an internal policy and supporting standards that summarise the financial and operational requirements placed on participants under the Operating Rules and Procedures, and document the responsibilities of the CS Boards, CRPC, CRO and relevant departments for ensuring these requirements are met and periodically reviewed. The Operating Rules and Procedures provide for an appeals process should an application for participation be rejected or a participant's access be terminated.

At the end of June 2013, ASX Clear (Futures) had 19 participants, predominantly large domestic and foreign banks and their subsidiaries. Eight participants are OTC derivatives clearing participants, of which four clear OTC derivatives only.

18.2 A central counterparty's participation requirements should be justified in terms of the safety and efficiency of the central counterparty and the markets it serves, be tailored to and commensurate with the central counterparty's specific risks, and be publicly disclosed. Subject to maintaining acceptable risk control standards, a central counterparty should endeavour to set requirements that have the least-restrictive impact on access that circumstances permit.

ASX Clear (Futures)' participation requirements are designed to promote the safety and integrity of the CCP. They cover minimum capital and financial obligations; requirements related to legal structure, governance and regulatory status; business and managerial requirements; operational resources and capabilities; business continuity arrangements; and risk and liquidity management arrangements. ASX Clear (Futures)' participation requirements promote the efficient operation of the facility and do not impose discriminatory or restrictive access constraints such as minimum turnover levels or location requirements.

Participants that clear futures only are subject to a minimum net tangible asset (NTA) requirement of \$5 million. ASX management has discretion to impose a higher requirement.

Participation requirements for participants that clear OTC derivatives are set out in the publicly available OTC Rules and OTC Handbook. The capital requirement of \$50 million for these participants is significantly higher than that for futures to reflect the increased complexity of OTC derivatives markets, and the potential for a default event to require the closing out of less liquid products than those in the futures market. In particular, it is likely that OTC derivatives participants would be called upon to contribute to the close-out process, including by bidding in an auction of a defaulted participant's positions.

Under the Operating Rules and Procedures, the ASX Clear (Futures) Board must be satisfied that a potential participant has (or will have) the relevant managerial, operational and financial capacity and appropriate complementary business continuity arrangements in place to be able to meet its ongoing obligations. A participant must also demonstrate that it has the capacity to make an immediate transfer of funds, on demand, should this be required to meet its obligations.

ASX Clear (Futures) is considering allowing the admission of participants that are incorporated and base their operations offshore, provided that they can demonstrate the capacity to meet all of the financial and operational requirements described above and that no conflicts of law would arise as a result of their participation. ASX intends to run a pilot scheme prior to allowing such arrangements more broadly.

18.3 A central counterparty should monitor compliance with its participation requirements on an ongoing basis and have clearly defined and publicly disclosed procedures for facilitating the suspension and orderly exit of a participant that breaches, or no longer meets, the participation requirements.

The CRM department, which covers both CCPs and reports to the CRO, is responsible for the risk management of exposures to clearing participants. CRM monitors day-to-day developments regarding, among other things, financial requirements, risk profiles, open positions and settlement obligations to the CCPs. Within CRM, the Counterparty Risk Assessment team is responsible for monitoring, assessing and investigating matters relating to financial requirements, including monitoring participants' monthly financial statements for any matters of concern.

CRM also carries out a range of participant monitoring spot checks and other initiatives designed to validate the accuracy of the financial and operational information that participants submit to ASX Clear (Futures). Participants are required to inform ASX if at any stage their capital falls below the minimum requirement. CRM is also responsible for determining and reviewing participants' ICRs, drawing in part on information provided by participants in their regular financial returns to ASX, and coordinating a 'watch list' of participants deemed to warrant more intensive monitoring (see Key Consideration 4.1). In addition, Operations and ASX Compliance perform regular and ad hoc compliance monitoring activities.

ASX Clear (Futures) has wide-ranging powers to sanction its participants. ASX Clear (Futures) may restrict, suspend or terminate a participant's authority to clear all market transactions in the event of a default, or in the event of a breach of the Operating Rules and Procedures that may have an adverse effect on the CCP. The action taken will depend on a number of factors, including the materiality of the incident, the participant's financial and operational capacity as well as the participant's history. Where a breach has been identified and the participant has taken appropriate steps to rectify it, ASX Clear (Futures) will typically continue to monitor the participant closely for a period of time. Significant breaches are also referred to ASIC and, depending on the nature of the breach, may be investigated by ASX Compliance for formal disciplinary action.

Principle 19: Tiered participation arrangements

A central counterparty should identify, monitor, and manage the material risks to the central counterparty arising from tiered participation arrangements.

Rating: Observed

ASIC's and the Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 19. ASX Clear (Futures)' approach to tiered participation arrangements is described in further detail under the following Key Considerations.

19.1 A central counterparty should ensure that its rules, procedures, and agreements allow it to gather basic information about indirect participation in order to identify, monitor, and manage any material risks to the central counterparty arising from such tiered participation arrangements.

ASX Clear (Futures) gathers basic information on indirect participation in the form of a Daily Beneficial Owner Report (DBOR) from participants. This report provides details of client

positions. These data are aggregated and reviewed to identify positions that may be unusual, result in a concentration of risk, or breach position limits set by the facility for the expiry period. There are, however, practical limitations to the use of these data for the analysis of tiering; in particular, the account codes of an entity or related entities may vary from participant to participant.

In April 2014, ASX Clear (Futures) launched client clearing for OTC derivatives, with the option for individually segregated client accounts. In July 2014, this account structure was extended to exchange-traded derivatives. If clients opt to use individually segregated accounts, ASX will be able to gather better information on client positions to support its monitoring of tiered participation risks (see Key Consideration 19.4).

Under current arrangements, if required, ASX Clear (Futures) may request more detailed information on any indirect client from that client's clearing participant. This information may include further details about the indirect participant's profile or activities, including, but not limited to, its intentions as to open positions or physical delivery. In addition, ASX Clear (Futures) also has an ongoing program of 'thematic' participant reviews, covering risk topics of interest or concern. These could potentially examine tiering risks if ASX Clear (Futures) were to perceive an increased risk from indirect relationships. ASX Clear (Futures) currently considers the risks from concentration of indirect participants to be low.

19.2 A central counterparty should identify material dependencies between direct and indirect participants that might affect the central counterparty.

As noted under Key Consideration 19.1, ASX Clear (Futures) monitors dependencies arising from tiered participation indirectly through a variety of means. These include regular discussions with participants on developments in their business and risk management activities, participants' own risk assessments, discussions with new participants as part of the induction process, expiry monitoring activities, monitoring of delivery risk (e.g. futures options expiries), and ASX Clear (Futures)' broader array of risk management data collection (including the DBOR, described under Key Consideration 19.1) and monitoring activities. Based on this information, ASX Clear (Futures) has not identified any material dependencies between direct and indirect participants.

As discussed under Key Consideration 19.4, the introduction of individually segregated accounts will permit ASX Clear (Futures) to monitor the proportion of a participant's business attributable to a particular client and set triggers for further action based on the proportion of initial margin attributable to that client.

19.3 A central counterparty should identify indirect participants responsible for a significant proportion of transactions processed by the central counterparty and indirect participants whose transaction volumes or values are large relative to the capacity of the direct participants through which they access the central counterparty in order to manage the risks arising from these transactions.

ASX encourages participants to develop appropriate risk control measures in managing their relationships with indirect participants. ASX does not set thresholds, either formal or informal, at which it would encourage direct participation by an indirect participant. ASX's general approach to managing risks associated with participants' business activities is based on a framework that can flexibly detect and respond to new risks as they arise, rather than

setting firm *ex ante* activity limits. This approach has worked well in managing risk events in recent years, notably in managing the default of MF Global in late 2011.

19.4 A central counterparty should regularly review risks arising from tiered participation arrangements and should take mitigating action when appropriate.

During 2013/14, ASX conducted a broad review of its concentration risk policy. This included further consideration of its approach to the risks arising from tiered participation. As a result of this review, ASX developed a formal Concentration Risk Standard, setting out a risk-based approach to monitoring tiered participation risks.

Exposures arising from OTC derivatives clearing remain low relative to exchange-traded derivatives exposures. Furthermore, client clearing arrangements for OTC derivatives were introduced only towards the end of June 2014. Accordingly, ASX has to date focused on the risks from tiered participation arrangements in its exchange-traded derivatives clearing activities.

ASX Clear (Futures) reviews risks arising from tiered participation in exchange-traded derivatives on a daily basis using the DBOR client-level data. A number of predefined triggers are applied to these data to identify positions that may be unusual, result in a concentration of risk, or breach position limits set by the facility for the expiry period. The triggers are defined at the contract level, taking into account factors such as the nature of the contract, the market liquidity, whether the contract has position limits for expiry, and whether it is deliverable. Monitoring of the DBOR data, including the DBOR triggers, is conducted by ASX Participant Compliance as part of its daily monitoring of credit risk (see Key Consideration 4.2) and ASX's broader framework for management of risks (Principle 3).

Once clients commence use of individually segregated client accounts (see Principle 14), ASX Clear (Futures) intends to enhance its monitoring of indirect participation in the exchange-traded derivatives market. In particular, on a daily basis, ASX Clear (Futures) will monitor concentration indicators based on initial margin. If a client's initial margin accounts for over 25 per cent of the clearing participant's total initial margin, further investigation would be triggered. The Concentration Risk Standard notes that indicators may return a number of false positives and escalation of any breaches of triggers will be based on a number of factors, including the materiality of the breach and the credit standing and activity profile of the relevant participant. Clients that continue to clear via an omnibus client account will continue to be monitored using the DBOR data.

Principle 20: FMI links

A central counterparty that establishes a link with one or more financial market infrastructures should identify, monitor, and manage link-related risks.

Rating: Observed

ASIC's and the Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 20. ASX Clear (Futures)' management of link-related risks is described in further detail under the following Key Considerations.

20.1 Before entering into a link arrangement and on an ongoing basis once the link is established, a central counterparty should identify, monitor, and manage all potential sources of risk arising from the link arrangement. Link arrangements should be designed

such that each financial market infrastructure is able to observe the other principles in this report.

Identifying link-related risks

ASX Clear (Futures) maintains two links with other FMIs. A link for the purposes of this standard is any connection that is made to another FMI according to a set of contractual and operational arrangements, irrespective of the complexity or otherwise of the link and whether it is directly with the FMI or through an intermediary.

The first link is with Austraclear. This link supports AUD funds transfers and lodgement of AUD-denominated non-cash collateral. Cash transfers are entered into Austraclear by ASX Clear (Futures), and then matched in Austraclear against the respective clearing participants' cash settlement instructions. Regular margin collections, which make up the majority of cash transfers, are submitted to Austraclear by ASX Clear (Futures)' margin and collateral systems, while intraday margin collections are entered manually. AUD-denominated non-cash collateral is lodged via a collateral lodgement form, and cannot be applied to margin requirements until the day following lodgement of this form. Once ASX Clear (Futures) has received the form, the relevant securities are transferred to ASX Clear (Futures) via a 'free of payment' trade in Austraclear.

The second link is with NZClear. This link supports settlement of NZD payments. ASX Clear (Futures) maintains an account in NZClear to initiate and receive NZD margin payments, with settlement in central bank money via arrangements with a commercial settlement bank (see Key Consideration 9.1).

Managing operational risk

The link to Austraclear is subject to the same operational risk management framework that applies for all the ASX CS facilities. This addresses operational risks associated with software, infrastructure or network failures and manual processing errors. An incident report is required for any significant technical or operational incident, including an assessment of mitigating actions to reduce the risk of reoccurrence. In addition, six-monthly risk profile assessments are prepared and presented to the Audit and Risk Committee, and an independent system-controls audit is conducted annually. Austraclear operations are also covered by the Austraclear System Business Operations Plan, which includes a 'Step-in and Service' agreement with the Bank (see Appendix A2.2, Principle 17).

The potential impact of risks associated with ASX Clear (Futures)' link to NZClear is limited by the small size of NZD margins in comparison with total margins held by ASX Clear (Futures). NZClear is owned, operated and overseen by the Reserve Bank of New Zealand. Any operational issues that arise in NZClear are notified to all members, including ASX Clear (Futures), via email notification. NZClear has the ability to perform transactions on behalf of a member in the event of an operational disruption to ASX Clear (Futures)' link arrangements; in this case, ASX would advise NZClear to perform payment instructions via written instructions signed by ASX's authorised signatories. ASX Clear (Futures) has contingency arrangements that allow for late payment of margin on New Zealand futures products via Austraclear in AUD, with ASX Clear (Futures) applying a haircut to the NZD margin equivalent.

Managing financial risk

ASX Clear (Futures) does not assume any direct financial risks from its links to other FMIs.

- 20.2 A link should have a well-founded legal basis, in all relevant jurisdictions, that supports its design and provides adequate protection to the financial market infrastructures involved in the link.**

ASX Clear (Futures)' link to Austraclear has its legal basis in the Austraclear Operating Rules and Procedures. The finality of settlements via this link is supported by the approval of Austraclear under Part 2 of the PSNA (see Key Consideration 1.4).

The link to NZClear has its legal basis in the system rules of NZClear and Part 5C of the *Reserve Bank of New Zealand Act 1989* (NZ) (see Key Consideration 1.8).

- 20.3 Linked central securities depositories should measure, monitor, and manage the credit and liquidity risks arising from each other. Any credit extensions between central securities depositories should be covered fully with high-quality collateral and be subject to limits.**

Key Consideration 20.3 is not relevant to central counterparties.

- 20.4 Provisional transfers of securities between linked central securities depositories should be prohibited or, at a minimum, the retransfer of provisionally transferred securities should be prohibited prior to the transfer becoming final.**

Key Consideration 20.4 is not relevant to central counterparties.

- 20.5 An investor central securities depository should only establish a link with an issuer central securities depository if the arrangement provides a high level of protection for the rights of the investor central securities depository's participants.**

Key Consideration 20.5 is not relevant to central counterparties.

- 20.6 An investor central securities depository that uses an intermediary to operate a link with an issuer central securities depository should measure, monitor, and manage the additional risks (including custody, credit, legal, and operational risks) arising from the use of the intermediary.**

Key Consideration 20.6 is not relevant to central counterparties.

- 20.7 Before entering into a link with another central counterparty, a central counterparty should identify and manage the potential spill-over effects from the default of the linked central counterparty. If a link has three or more central counterparties, each central counterparty should identify, assess, and manage the risks of the collective link arrangement.**

ASX Clear (Futures) does not have links with other CCPs.

- 20.8 Each central counterparty in a central counterparty link arrangement should be able to cover, at least on a daily basis, its current and potential future exposures to the linked central counterparty and its participants, if any, fully with a high degree of confidence without reducing the central counterparty's ability to fulfil its obligations to its own participants at any time.**

ASX Clear (Futures) does not have links with other CCPs.

- 20.9 A trade repository should carefully assess the additional operational risks related to its links to ensure the scalability and reliability of IT and related resources.**

Key Consideration 20.9 is not relevant to central counterparties.

Principle 21: Efficiency and effectiveness

A central counterparty should be efficient and effective in meeting the requirements of its participants and the markets it serves.

Rating: Observed

ASIC's assessment is that ASX Clear (Futures) observes the requirements of Principle 21. ASX Clear (Futures)' arrangements for ensuring its efficiency and effectiveness are described in further detail under the following Key Considerations.

21.1 A central counterparty should be designed to meet the needs of its participants and the markets it serves, in particular, with regard to choice of a clearing and settlement arrangement; operating structure; scope of products cleared, settled, or recorded; and use of technology and procedures.

ASX Clear (Futures)' participation structure is designed to suit market demand. ASX Clear (Futures) tailors its participation application process and governance framework to the products, client structure and markets that it clears. An ASX Clear (Futures) participant can be authorised to clear futures and options over futures only, OTC interest rate derivatives only, or both futures and OTC derivatives. Subject to meeting operational requirements, all ASX Clear (Futures) participants have the option to clear for third-party participants.

ASX Clear (Futures) offers clearing services across a range of exchange-traded and OTC derivatives products, including commodities, energy, interest rate and equity-based futures and options and interest rate swap products. While most contracts are Australian dollar-denominated, some interest rate and energy futures and options contracts are denominated in New Zealand dollars. Any ASX Clear (Futures) participant that clears New Zealand dollar-denominated contracts is required to be a member of NZClear in order to make margin payments (see Key Consideration 9.1).

ASX Clear (Futures) has formed a participant Risk Committee to advise its Board on both exchange-traded and OTC derivatives risk management and a participant Product Committee to provide recommendations and proposals on broader OTC derivatives product matters, including eligibility for clearing (see Key Consideration 2.7). ASX intends to expand the scope of the Product Committee to cover product matters for exchange-traded derivatives. Any ASX Clear (Futures) participant that is authorised to clear OTC transactions may also nominate a representative to the DMG established to provide advice and assistance to the CCP on default management matters (see Key Considerations 2.7, 13.1).

ASX Clear (Futures) undertakes regular customer engagement to supplement its formal user governance arrangements via the Risk Committee and the OTC Product Committee. Participant feedback provides an important input for ASX Clear (Futures) to assess its performance against efficiency and effectiveness standards, particularly in relation to proposed new services and products, and changes to Operating Rules and Procedures.

ASX Clear (Futures) maintains a comprehensive governance and reporting framework that includes:

- transparent processes to operate ASX Clear (Futures), with well-defined controls, underpinned by written policies and procedures

- the maintenance of sufficient resources (financial, technological and human resources) to operate the facility properly and to meet its obligations under its CS facility licence. ASIC concluded that these resources were adequate when preparing its 2013 ASX Group Assessment Report¹⁶
- conflict handling arrangements that are reviewed and adapted to changing circumstances
- processes to monitor and enforce participants' compliance with the Operating Rules
- liaison processes with ASIC and the Bank
- a continuous improvement program.

21.2 A central counterparty should have clearly defined goals and objectives that are measurable and achievable, such as in the areas of minimum service levels, risk-management expectations, and business priorities.

The ASX Limited Board sets group-level strategic direction and business priorities, including via a three-year strategic plan, which is reviewed on a continuous basis. The ASX Clear (Futures) Board sets goals and objectives specific to its clearing service, and governs and reviews ASX Clear (Futures)' risk management processes, internal controls and compliance systems. The ASX Clear (Futures) Board is also responsible for overseeing the production of the management accounts of ASX Clear (Futures), which are prepared on a quarterly basis, as well as audited full year financial reports and statements. The ASX Clear (Futures) Board is also responsible for the management of clearing risks (see Principles 2, 3).

ASX Clear (Futures) measures its progress against goals and objectives in a number of ways.

- ASX Clear (Futures) measures the effectiveness of its services via participant and user feedback. ASX Clear uses customer engagement and consultative processes described under Key Consideration 21.1 to ensure that it achieves its goals in relation to meeting the requirements of participants.
- ASX Clear (Futures) has set availability targets for critical systems such as the Genium (previously SECUR) and Calypso clearing systems, which are monitored and reported to relevant governance committees, including the ASX Audit and Risk Committee and the ASX Clear (Futures) Board, on a regular basis (see Key Consideration 17.3).
- Senior management report to each meeting of the ASX Clear (Futures) Board, and periodically to the Enterprise Risk Management Committee and the Audit and Risk Committee, on the status of ASX Clear (Futures)' risk management goals and objectives. Reporting and measurement mechanisms include risk model reviews, international benchmarking, risk profiling and analysis, internal audit reviews, regulatory assurance reviews, and periodic analysis and reporting of key system service availability and capacity utilisation metrics (see Principles 3, 15, 17).
- Operating Rules and Procedures, together with other participant communications such as market notices, consultation papers and fact sheets, provide transparency to

¹⁶ ASIC's 2013 *Market Assessment Report: ASX Group*, released 28 July 2014, is available at <<https://www.asic.gov.au/asic/asic.nsf/byheadline/Reports?openDocument>>.

participants and other stakeholders regarding the operation of the ASX Clear (Futures) facility (see Principle 23).

The Audit and Risk Committee has responsibility for considering management reports regarding the effectiveness of ASX Clear (Futures)' risk management framework and processes. The Committee is assisted in this area by Internal Audit, Enterprise Risk and Regulatory Assurance. The Audit and Risk Committee considers reports from these departments on the appropriateness and effectiveness of internal controls, and action taken or proposed in response to assessments conducted by ASIC or the Bank.

21.3 A central counterparty should have established mechanisms for the regular review of its efficiency and effectiveness.

In addition to periodic reporting to the CS Boards and relevant committees under ASX Group's corporate governance framework (see Principle 2 and Key Consideration 21.2), relevant Group Executives also report to the CEO on a monthly basis. Metrics contained within these reports include key measures of system availability and capacity utilisation, and key clearing statistics (such as open interest, option expiry, contract delivery and turnover data), technical incident reporting, and new products/asset classes. Other issues reported include the cause and resolution of problems associated with physical deliveries, and the payment and receipt of cash settlements and margin calls, operational incidents and participant complaints.

The Genium (previously SECUR) and Calypso clearing systems both operate to a 99.8 per cent minimum business service availability target. Capacity utilisation is continually monitored to maintain capacity headroom of 50 per cent above peak utilisation. These objectives were met in 2013/14 (see Key Consideration 17.3).

Responsibility for the regular review of ASX Clear's efficiency and effectiveness is shared between a number of committees and departments within the ASX Group.

- CROCC oversees matters relating to ASX Clear (Futures)' fair and effective obligations under its Australian CS facilities licence. Section 821E of the Corporations Act requires ASX Clear (Futures) to provide a report to ASIC within three months of the end of its financial year on the extent to which the licensee has complied with the conditions of its licence.
- CALCO oversees the structural integrity and efficient use of liquidity, on- and off-balance sheet assets, liabilities and the capital resources of the ASX Group, including ASX Clear (Futures).
- As part of its commitment to continuous improvement, the ASX Operations and Risk divisions have adopted a comprehensive suite of policies and procedures to support the governance and internal review of ASX Clear (Futures). These policies and procedures are reviewed on a regular basis (see Principles 2, 3).
- ASX Compliance monitors and enforces participants' compliance with the ASX Clear (Futures) Operating Rules. Other departments within ASX Group assist ASX Compliance in monitoring ASX Clear (Futures)' performance of its licence obligations.

Principle 22: Communication procedures and standards

A central counterparty should use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, settlement, and recording.

Rating: Observed

ASIC's assessment is that ASX Clear (Futures) observes the requirements of Principle 22. ASX Clear (Futures)' approach to communication procedures and standards is described in further detail under the following Key Consideration.

22.1 A central counterparty should use, or at a minimum accommodate, internationally accepted communication procedures and standards.

ASX Clear (Futures) has procedures in place to determine the impact of and actions required to accommodate changes in internationally accepted communications protocols. ASX Clear (Futures) also has processes and procedures for the notification of changes to users and other relevant stakeholders, including system vendors. Each new business requirement is analysed in order to identify the most appropriate means of integrating changes to communication protocols, with a particular focus on standardisation and open connectivity.

On 19 May 2014, ASX Clear (Futures) migrated from the SECUR 17.2 clearing system to the Genium INET clearing system (see Principle 17). Participants are now able to validate production connectivity either from the Genium Clearing Workstation application or via a proprietary application programming interface (API) directly to Genium. The Genium Clearing Workstation application is supported on Windows 7.

ASX Clear (Futures) uses the OMnet API as an industry recognised communication standard to facilitate and manage the clearing message flow for financial products traded on ASX 24. The OMnet API is used in exchanges in Asia and Europe (e.g. the Singapore exchange and several Scandinavian exchanges). OMnet API clearing messages are distributed over the ASX Net E2 network to central gateways via a single virtual IP address (IP version 4).

Off-market futures block trades, exchange-for-physical trades, telephone trades (in the event ASX 24 is unavailable) and index basket transactions or 'strip' trades are reported to ASX Clear (Futures) via ASX TradeAccept. TradeAccept is a secure, web-based portal application.

ASX Clear (Futures) uses the Calypso clearing system to support the clearing of bilaterally executed OTC interest rate derivatives. Calypso is used internationally by the majority of global OTC derivatives CCPs, with participants able to communicate with ASX Clear (Futures) via Calypso's flexible connectivity framework.

Principle 23: Disclosure of rules, key procedures, and market data

A central counterparty should have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks, fees, and other material costs they incur by participating in the central counterparty. All relevant rules and key procedures should be publicly disclosed.

Rating: Observed

ASIC's and the Bank's assessment is that ASX Clear (Futures) observes the requirements of Principle 23. ASX Clear (Futures)' disclosure of rules, key policies and procedures, and market data is described in further detail under the following Key Considerations.

23.1 A central counterparty should adopt clear and comprehensive rules and procedures that are fully disclosed to participants. Relevant rules and key procedures should also be publicly disclosed.

ASX Clear (Futures)' Operating Rules and Procedures form the basis of all material aspects of the CCP's service to participants. The Operating Rules are disclosed on the ASX public website.¹⁷ The Operating Rules are also posted on the ASX participant website, along with Procedures relevant to participants. The OTC Handbook is also available from the ASX public website.

To assist participants in their understanding of the risks of participating in ASX Clear (Futures), and for the information of other interested stakeholders, ASX publishes a range of additional material on its public website. Information specific to ASX Clear (Futures) includes information about risk management, default management, margins and capital-based position limits, and business continuity arrangements. More general information includes: the ASX Group's regulatory framework; requirements of the Corporations Act for provision of services in a 'fair and effective' way; the ASX Group's other obligations under the Corporations Act; and ASX Group's compliance with the Principles. During 2013/14, ASX redesigned its website, one element of which involved centralising links to information required to be disclosed under the Principles.

Specific disclosure requirements are dealt with under Key Considerations 1.3, 2.2, 13.3, 14.4, 16.4, 18.2 and 18.3.

23.2 A central counterparty should disclose clear descriptions of the system's design and operations, as well as the central counterparty's and participants' rights and obligations, so that participants can assess the risks they would incur by participating in the central counterparty.

General descriptions of ASX Clear (Futures)' system design and operations are available on the ASX public website, including as part of ASX's response to the CPSS-IOSCO Disclosure Framework (see Key Consideration 23.5).¹⁸ The Disclosure Framework document describes the ASX group structure, provides a general description of the CS facilities and their roles, system design and operations, outlines the legal and regulatory framework for clearing and settlement, and provides a description of steps taken by ASX to ensure compliance with the Principles and the corresponding FSS. The ASX public website provides additional information on system design and operations, including descriptions of the exchange-traded and OTC derivatives clearing processes and margining approaches.

ASX maintains on its public website an overview of how the CCPs would manage a clearing participant default, which includes information about the purpose of novation, the point at

¹⁷ Available at <<http://www.asx.com.au/regulation/rules/asx-clear-futures-operating-rules.htm>>.

¹⁸ Available at <http://www.asx.com.au/documents/regulation/pfmi_disclosure_framework.pdf>.

which novation occurs, and the scope of contractual arrangements.¹⁹ Part 3 of the ASX Clear (Futures) Operating Rules sets out the arrangements for registration of market contracts, including the point at which a contract is considered to be registered and at which ASX Clear (Futures) assumes the risk exposure of a trade for transactions on the ASX 24 market (see Key Consideration 1.4). The conditions and timing for the novation of an OTC derivatives trade are outlined in the OTC Rules and the OTC Handbook.

23.3 A central counterparty should provide all necessary and appropriate documentation and training to facilitate participants' understanding of the central counterparty's rules and procedures and the risks they face from participating in the central counterparty.

All applicants for participation in ASX Clear (Futures) are provided with a comprehensive application pack, which includes information regarding key requirements of the facilities. Applicants are provided with access to the Operating Rules, Procedures and Guidance Notes via the ASX website, as well as publicly available information about the facilities, services and participation requirements. When ASX Clear (Futures) has completed an initial assessment of an application, the applicant is also invited to attend formal 'on boarding' meetings with the Compliance, CRM and Operations departments to discuss key areas of importance for participants.

As part of the formal admission process, the applicant must provide supporting evidence of its capacity to comply with the rules. This is reviewed and discussed with the applicant prior to approving admission. For example, participants are required to have a management plan which outlines the governance, risk and compliance arrangements of the participant. When reviewing the submissions, ASX will make enquiries of participants about their risk assessments, the design of the controls to mitigate those risks, and details of participants' arrangements to ensure compliance with the Operating Rules and Procedures.

Where ASX becomes aware or suspects that a participant lacks a satisfactory understanding of the Operating Rules and Procedures, or the risks of participation, ASX will generally work collaboratively with the participant to educate them on their obligations. ASX may become aware of issues through its routine risk monitoring activities or through its regular discussions with participants. Examples of matters that might raise concerns are if a participant was slow in making required payments, or had a high frequency of intraday margin calls arising from delays in the intraday allocation of client positions. Steps available to ASX to address serious matters may include: ASX Clear (Futures) calling for AIM or additional cover from the participant; requiring the participant to hold additional capital; requiring the participant to remediate the weakness; imposing conditions on participation; or requiring that the participant appoint an independent expert to assist with the remediation task (see also Key Consideration 17.7).

23.4 A central counterparty should publicly disclose its fees at the level of individual services it offers as well as its policies on any available discounts. The central counterparty should provide clear descriptions of priced services for comparability purposes.

A full breakdown of the various fees ASX Clear (Futures) charges for the individual services it offers, including available discount and incentive schemes, is published on the ASX website.

¹⁹ Available at <http://www.asx.com.au/documents/clearing/131001_Default_Management_Public_Information_Document_v1.pdf>.

Fee schedules are available for each CS facility ASX operates.²⁰ Fees charged on exchange-traded derivatives are generally bundled as a single trading and clearing registration fee, although separate fees are charged for futures cash settlements, physical deliveries and the exercise of options.

ASX Clear (Futures) publishes a description of its priced services and how its fee structure has been calculated in a variety of ways, including on the ASX website and via participant notices. ASX Clear (Futures) announces changes to its fee structure via notices to participants that are publicly available.

23.5 A central counterparty should complete regularly and disclose publicly responses to the CPSS-IOSCO *Disclosure framework for financial market infrastructures*. A central counterparty also should, at a minimum, disclose basic data on transaction volumes and values.

ASX has published its response to the CPSS-IOSCO Disclosure Framework, including information describing how its CS facilities observe the applicable Principles. This document was revised during 2013/14, expanding on a previous version that summarised ASX's approach to observance of the Principles with greater detail as to how the CS facilities meet the Principles. ASX plans to update this document quarterly and further enhance its disclosure as necessary from time to time.

ASX currently reports basic risk and activity data for the CS facilities via a monthly activity report, as well as through additional data published on its website. In December 2013, CPSS and IOSCO published a draft set of quantitative disclosure standards for CCPs that are intended to complement descriptive disclosures under the Disclosure Framework. Once a finalised version of these standards comes into effect, ASX Clear (Futures) will be expected to expand the range of quantitative risk and activity data that it publicly discloses.

Principle 24: Disclosure of market data by trade repositories

A trade repository should provide timely and accurate data to relevant authorities and the public in line with their respective needs.

Rating: Not applicable

Principle 24 is not relevant to central counterparties.

²⁰ The ASX Clear (Futures) fee schedule is available at <https://www.asxonline.com/intradoc-cgi/groups/participant_services/documents/information/asx_027438.pdf>.