

EXPLANATORY STATEMENT for

ASIC Market Integrity Rules (Futures Markets) Class Waiver

2018/265

Prepared by the Australian Securities and Investments Commission

Corporations Act 2001

The Australian Securities and Investments Commission (ASIC) makes ASIC Market Integrity Rules (Futures Markets) Class Waiver 2018/265 under subrule 1.2.1(1) of the *ASIC Market Integrity Rules (Futures Markets) 2017 (the Rules)*.

Under subrule 1.2.1(1), ASIC may relieve any person or class of persons from the obligation to comply with a provision of the Rules.

Capitalised terms in this Explanatory Statement have the same meaning as in the Rules.

1. Background

As part of its supervisory responsibilities, ASIC reviewed the 14 market integrity rule books in force in late 2016 and identified the need to consolidate certain market integrity rule books which covered substantively similar existing obligations across like domestic licensed markets.

Following public consultation, ASIC made the Rules in November 2017. Generally, the Rules maintain the substance of the regulatory regime embodied in market integrity rules (the **Pre-Commencement Market Integrity Rules**) applicable prior to the commencement of the Rules, including the *ASIC Market Integrity Rules (ASX 24 Market) 2010 (ASX 24 Rules)*. The Rules will repeal the Pre-Commencement Market Integrity Rules on 7 May 2018.

Upon the repeal of the Pre-Commencement Market Integrity Rules, ASIC Waivers made under the Pre-Commencement Market Integrity Rules will also be repealed, including ASIC Class Waiver [CW 17/740].

[CW 17/740] provides relief from Rules 7.2.2(4), 7.2.5, 7.2.6 and 7.2.8 of the ASX 24 Rules to the extent that those rules apply the definition of 'Approved Securities' in Rule 7.1.1. It introduces a new term 'Approved Collateral' which refers to securities, collateral and other property accepted by ASX Clear (Futures). The effect of [CW 17/740] is to allow Trading Participants to rely on the list of accepted collateral

published by ASX Clear (Futures), to meet their obligations under Rules 7.2.2(4), 7.2.5, 7.2.6 and 7.2.8 of the ASX 24 Rules.

Rules 7.2.2(4), 7.2.5, 7.2.6 and 7.2.8 of the ASX 24 Rules correspond to Rules 7.2.2(4), 7.2.5, 7.2.6 and 7.2.8 of the Rules respectively.

In Report 547 *Response to submissions on CP 277 Proposals to consolidate the ASIC market integrity rules (REP 457)* ASIC announced that as part of its project to consolidate the market integrity rules it would remake existing individual and class waivers under the Rules before 7 May 2018.

Rules 7.2.2(4), 7.2.5, 7.2.6 and 7.2.8 (the **Relevant Rules**) of the Rules impose various obligations on Trading Participants to Call Margins from their Clients. Margin Calls can be satisfied by the Trading Participant accepting either cash or Approved Securities from their Clients. 'Approved Securities' is defined under Rule 7.1.1 of the Rules with a prescribed list.

The purpose of a Margin Call is to mitigate counterparty credit risk, i.e. the risk that a party to a trade in a Contract will default on their obligations under that trade. Mitigating counterparty credit risk promotes investor confidence and market orderliness.

Trading Participants that are Clearing Participants also have an obligation under the operating rules of ASX Clear (Futures) to post Margins.

The role of ASX Clear (Futures) is to mitigate counterparty credit risk, and it does this by calling Margins from Clearing Participants. ASX Clear (Futures) determines what it considers to be acceptable collateral for the purposes of Clearing Participants satisfying Margin Calls. ASX Clear (Futures) publishes a list of securities, collateral and other property that it will accept as Margin, which is amended by ASX Clear (Futures) as required.

There are some inconsistencies between ASX Clear (Futures)'s current list and the definition of 'Approved Securities' in Rule 7.1.1 of the Rules. This causes confusion and complexity for Trading Participants that are also Clearing Participants.

For example, the list published by ASX Clear (Futures) includes US Treasury Bills. The definition of 'Approved Securities' in Rule 7.1.1 of the Rules is based on the definition of 'Approved Securities' that existed in the operating rules of the Sydney Futures Exchange (SFE) prior to the transfer of market supervision to ASIC on 1 August 2010. We understand that US Treasury Bills were not included in SFE's prescribed list because there wasn't a demand for them at that time.

2. Purpose of the instrument

The purpose of this instrument is to provide conditional class waiver relief from the Relevant Rules that is consistent with the relief given from the ASX 24 Rules in [CW 17/740] that will be repealed on 7 May 2018 upon the repeal of the Pre-Commencement Market Integrity Rules.

The instrument provides relief from the Relevant Rules to the extent that those rules apply the definition of ‘Approved Securities’. It introduces a new term ‘Approved Collateral’ which refers to securities, collateral and other property accepted by ASX Clear (Futures).

The effect of the instrument is to allow Trading Participants to rely on the list of accepted collateral published by ASX Clear (Futures) to meet their obligations under the Relevant Rules.

The instrument ensures that the Relevant Rules continue to effectively mitigate counterparty credit risk in the context of Trading Participants and their Clients. It reduces uncertainty and complexity for Trading Participants that are also Clearing Participants, and provides flexibility in the Relevant Rules to respond to market changes. This is because ASX Clear (Futures) can update their list if required (e.g. due to changes in the liquidity of certain securities) by publishing a new list.

3. Operation of the instrument

Name of legislative instrument

Section 1 of the instrument provides that it is the ASIC Market Integrity Rules (Futures Markets) Class Waiver 2018/265.

Commencement

Section 2 of the instrument provides that the instrument commences on the later of 7 May 2018 and the day after the instrument is registered on the Federal Register of Legislation.

Authority

Section 3 of the instrument provides that it is made under subrule 1.2.1(1) of the Rules.

Definitions

Paragraph 4(1) of the instrument provides that:

- ‘Approved Collateral’ means securities or other collateral or property accepted by ASX Clear (Futures) under the Clearing Rules;
- ‘Cover’ means cash and/or Approved Collateral held by a Market Participant against a Client’s liability from time to time.

Calling Initial Margin

Section 5 of the instrument provides that a Trading Participant of the ASX 24 Market which has agreed to accept and has received Cover by way of Approved Collateral does not have to comply with subrule 7.2.2(4) of the Rules.

The relief in section 5 of the instrument does not affect a Trading Participant's obligations in subrule 7.2.2(1) – (3) of the Rules.

Satisfaction of Calls for Margin

Waiver

Subsection 6(1) of the instrument provides that a Trading Participant of the ASX 24 Market which has agreed to accept Cover by way of Approved Collateral does not have to comply with any of the following provisions of the Rules:

- (a) subrule 7.2.5(1);
- (b) subrule 7.2.5(2);
- (c) subrule 7.2.5(3).

Conditions

Subsection 6(2) of the instrument provides that it is a condition of the relief in paragraph 6(1)(a) that the Trading Participant's Client agreement must provide that Calls for Initial Margin and Variation Margin must be satisfied by payment unless the Trading Participant agrees to accept, in lieu of payment, Approved Collateral.

Subsection 6(3) of the instrument provides that it is a condition of the relief in paragraph 6(1)(b) that the Trading Participant's Client agreement must provide that:

- (a) Approved Collateral received as Cover shall be retained by the Trading Participant until such time as the liability of the Client is extinguished either by the relevant contracts being Closed Out or payment being made by a Buyer or delivery in accordance with the Rules being effected by a Seller; and
- (b) if the liability of the Client is not extinguished, as set out in paragraph (a), then the Approved Collateral may be realised by the Trading Participant and the proceeds applied against that liability.

Subsection 6(4) of the instrument provides that it is a condition of the relief in paragraph 6(1)(c) that the Trading Participant must ensure the liability of a Client for Initial Margin is Covered at all times.

Time for payment of Margins

Waiver

Subsection 7(1) of the instrument provides that a Trading Participant which has agreed to accept Cover by way of Approved Collateral does not have to comply with Rule 7.2.6 of the Rules.

Conditions

Subsection 7(2) of the instrument provides that it is a condition of the relief in subsection 7(1) that:

- (a) where a Call is made for Initial or Variation Margin, the Trading Participant must stipulate the time for payment or lodgement of Approved Collateral, which must not be greater than:
 - (i) 24 hours if the Client's address is within Australia; or
 - (ii) 48 hours if the Client's address is outside Australia; and
- (b) the Trading Participant must not provide credit for a Client beyond the periods specified in subparagraphs 7(2)(a)(i) and (ii) of the instrument unless:
 - (i) permitted by Rule 7.2.10 of the Rules; or
 - (ii) the Trading Participant exercises a reasonable discretion not to Close Out having regard to:
 - (A) the expertise and financial status of the Client; and
 - (B) any genuine attempts by the Client to meet the Call within the time prescribed; and
 - (C) whether relevant actions or omissions of third parties resulted in the Client failing to pay the Call; and
- (c) the Trading Participant's Client agreement must provide that time shall be of the essence in respect of payment or lodgement under Part 7.2 of the Rules.

Obligation of Close Out

Waiver

Subsection 8(1) of the instrument provides that a Trading Participant which has agreed to accept Cover by way of Approved Collateral does not have to comply with Rule 7.2.8 of the Rules.

Condition

Subsection 8(2) of the instrument provides that it is a condition of the relief in subsection 8(1) that:

- (a) where a Client is in default by failing to pay a Call (or lodge Approved Collateral) within the time stipulated by the Trading Participant, the Trading Participant must, immediately upon expiry of that time period, Close Out to the extent necessary to counter the Call, all or any existing Open Positions in any Market held by the Trading Participant on account of the Client unless the Trading Participant exercises a reasonable discretion to not Close Out having regard to:
 - (i) the expertise and financial status of the Client; and
 - (ii) any genuine attempts by the Client to meet the Call within the time prescribed; and

- (iii) whether relevant actions or omissions of third parties resulted in the Client failing to pay the Call; and
- (b) the Trading Participant's Client agreement must provide that the Trading Participant shall not be liable to the Client for any loss sustained by the Client as a result of the Trading Participant Closing Out in accordance with paragraph (a).

4. Consultation

Before making [CW 17/740] ASIC consulted with the Australian Financial Markets Association (AFMA) and its members in relation to the instrument. All respondents were supportive of the relief, noting the benefits of increased flexibility and optionality in collateral management, and the reduction in opportunity costs for Clients and Clearing Participants.

The instrument is part of a wider project to consolidate the market integrity rules. ASIC consulted extensively with market operators, market participants and industry bodies before making the Rules and the instrument.

The consultation period for Consultation Paper 277 *Proposals to consolidate the ASIC market integrity rules (CP 277)* occurred between 24 January 2017 and 7 March 2017. ASIC held over 25 meetings with stakeholders during and following that period. In addition, ASIC consulted ASIC's Market Advisory Panel on the proposals. ASIC received five non-confidential submissions and six confidential submissions to CP 277 from a broad range of stakeholders including from market participants, market operators and industry associations.

The Office of Best Practice Regulation has assessed the proposals implemented by the Rules and the instrument as having a minor impact on business, community organisations or individuals and confirmed that no further analysis, in the form of a Regulatory Impact Statement is required (OBPR ID 22449).

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

ASIC Market Integrity Rules (Futures Markets) Class Waiver 2018/265

ASIC Market Integrity Rules (Futures Markets) Class Waiver 2018/265 (the **instrument**) is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

The Australian Securities and Investments Commission (**ASIC**) makes instrument under subrule 1.2.1(1) of the *ASIC Market Integrity Rules (Futures Markets) 2017* (the **Rules**).

Under subrule 1.2.1(1) or the Rules, ASIC may relieve any person or class of persons from the obligation to comply with a provision of the Rules, either generally or in a particular case or category, and either unconditionally or subject to such conditions as ASIC thinks fit.

Rules 7.2.2(4), 7.2.5, 7.2.6 and 7.2.8 (the **Relevant Rules**) of the ASIC Market Integrity Rules (Futures Markets) 2017 (**Rules**) impose various obligations on trading participants to call margins from their clients. Margin calls can be satisfied by the trading participant accepting either cash or 'Approved Securities' from their clients. 'Approved Securities' is defined under Rule 7.1.1 of the Rules with a prescribed list.

The purpose of margin calls is to mitigate counterparty credit risk, i.e. the risk that a party to a trade in a contract will default on their obligations under that trade. Mitigating counterparty credit risk promotes investor confidence and market orderliness.

Trading participants that are clearing participants also have an obligation under the operating rules of ASX Clear (Futures) Pty Limited (**ASX Clear (Futures)**) to post margins to ASX Clear.

The role of ASX Clear (Futures) is to mitigate counterparty credit risk, and it does this by calling margins from clearing participants. ASX Clear (Futures) determines what it considers to be acceptable collateral for the purposes of clearing participants satisfying margin calls. ASX Clear (Futures) publishes a list of securities, collateral and other property that it will accept as margin, which is amended by ASX Clear (Futures) as required.

There are some inconsistencies between ASX Clear (Futures)'s current list and the definition of 'Approved Securities' in Rule 7.1.1 of the Rules. This causes confusion and complexity for trading participants that are also clearing participants.

This legislative instrument provides relief from the Relevant Rules to the extent that those rules apply the definition of ‘Approved Securities’ in Rule 7.1.1. It introduces a new term ‘Approved Collateral’ which refers to securities, collateral and other property accepted by ASX Clear (Futures).

The effect of the legislative instrument is to allow trading participants to rely on the list of accepted collateral published by ASX Clear (Futures), to meet their obligations under the Relevant Rules.

The legislative instrument ensures that the Relevant Rules continue to effectively mitigate counterparty credit risk in the context of trading participants and their clients. It reduces uncertainty and complexity for trading participants that are also clearing participants and provides flexibility in the Relevant Rules to respond to market changes. This is because ASX Clear (Futures) can update their list if required (e.g. due to changes in the liquidity of certain securities) by publishing a new list.

Human rights implications

This legislative instrument does not engage any of the applicable rights or freedoms.

Conclusion

This legislative instrument is compatible with human rights as it does not raise any human rights issues.

Australian Securities and Investments Commission