Stockbrokers Association of Australia
Incorporating SDIA

ASX Clear Cash Margining
- *Ministerial Non-disallowance of Operating Rules*

Submission

27 May 2013

Introduction

The Stockbrokers Association of Australia would like to make the following comments in relation to the final approval of the operating rules for the introduction of Cash Equities Margining by ASX Clear.

The Association has been involved in consultation which led to the current rules, including responses to the following:

- ASX Settlement and Clearing *Consultation Paper* December 2008;
- ACH Central Counterparty Risk Management Controls *Consultation Paper* 30 October 2009; and
- ACH Central Counterparty Risk Management Controls *Market Consultation Paper* 30 June 2010.

Our Submissions to the above Consultation Papers are attached for your reference[1].
In **summary**, our earlier submissions noted the already strong position of the Australian clearing and settlement system, especially through the events of 2008-9, and expressed concerns that the margining of cash equities trading would –

- adversely impact liquidity and trading activity;
- lead to increased costs and impediments to our Member's businesses; and
- put Australia at a competitive disadvantage to neighbouring markets and impede Australia's efforts to become a Regional Financial Centre.

[1] Stockbrokers Association of Australia (formerly Securities & Derivatives Industry Association) Submissions dated 6 March 2009; 23 December 2009 and 12 August 2010

Comments

While noting our previous comments, with the introduction of cash equities margining imminent, we would also like to make the following comments in relation to its introduction, particularly in relation to the indicative figures from ASX Clear, and the effect of share price shocks, and third party clearing.

1. Indicative Figures from ASX Clear

Since the conclusion of the above consultation, ASX Clear has been proactive in advising individual firms of their likely cash margins based on their actual trading. This has been very helpful to members in giving them detail of the likely effect and additional demands on their business. However, we would like to note the following in relation to the indicative figures:

a) *Significant cost in uncertain times:* they clearly represent a significant and unclear cost to business in systems, procedures and cash-flow. This comes in difficult times which, despite the recent upturn in the market, have been characterized by low turnover and accompanying revenue;

b) *Range of figures difficult to manage:* while the amounts that brokers have been told in the projections given to them by ASX have in some cases been less than first thought, the ranges have been very large. For example, one firm has been given projected obligations of $50,000 - $500,000 and another, $2m-$10m. ASX Clear has indicated that it will review its risk model to better assess the risk of default, particularly in the small to mid-cap stocks. Particularly in the environment where stock is usually sponsored and cash up-front, it is hoped that this review will result in more realistic margin amounts;

c) *Liquid Capital:* cash margins lodged will form part of the firm's liquid capital, so at least firms will get that benefit. However, feedback has suggested that the amounts lodged may be better employed elsewhere in the business. Moreover, the variability of the daily calls (noted above) may make the task of managing liquid capital and cash-flow levels more difficult; and

d) *Indicative figures may be unreliable*: the indicative figures given by ASX Clear are from a time of low trading and volumes and may not be accurate when and if volumes pick up.

2. Effect of 'Shocks'

There is concern that the ASX Clear risk model does not take into account the effect of large corporate actions which may impact on the share price. For example, if a company undertakes a return of capital, naturally the share price (ignoring all other factors) will fall to reflect the amount of capital returned. However, the ASX risk model does not take into account the value of capital returned to the client, just the lower share price. (Indeed, the rules would prohibit calling any of the capital returned to the client, since these are client funds, and cash margining is a principal obligation of the broker.) This can be a very significant matter with large scale capital returns, where share prices may fall 80 – 90%. The resulting cash margin call will be very large. If the broker cannot meet the call, it may even lead to default by the broker. Considering that this is through **no fault of the broker** (or the client), it is **inconceivable** that ASX would want a broker to fail in these circumstances, with all the issues of systemic risk and client losses and inconvenience that would arise. News of such a default, though not truly indicative of a failure by the broker, would spread quickly and **harm Australia's international reputation** for no good reason. The system must be changed so that the appropriate adjustment is made in the event of corporate actions, similar to the options market, otherwise the ASX system itself may cause market disruption.

3. Outsourcing Clearing

We note the following in relation to firms that have or will outsource their clearing operations:

a) *Effect unclear*: For the firms that clear through a third party clearer (General Participant), the precise effect of cash margining is not yet known, particularly whether there will be any benefit or otherwise from netting by the clearer across all the (broker) clients of the clearer; and

b) *More Outsourcing likely*: cash margining may be yet another reason to outsource clearing to a third party clearer. Given the well-known lack of competition in that area, this has consequences for the market in terms of concentration risk and simple economics. Further, having outsourced their clearing, brokers may also consider outsourcing their trading, thus avoiding the cost of being a market participant and compliance with the market integrity rules on one hand, but reducing investor protection on the other.

The introduction of cash equities margining has taken over 4 years. We are now at the point where despite concerns expressed by the industry, its introduction would appear inevitable. Our members will need to bear the additional cost in systems, capital and other expenses to cater for the new requirements, just like they have had to bear the additional costs of market supervision fees and FOFA.

Thank-you for the opportunity to present these comments for consideration by the Minister in the final assessment of the ASX Clear Operating Rules. Should you require any further information, please contact me or Doug Clark, Policy Executive on dclark@stockbrokers.org.au.

David W Horsfield
Managing Director/CEO
Stockbrokers Association of Australia
27 May 2013