



29 April 2016

Clearing Risk Policy
ASX Limited
20 Bridge St
Sydney NSW 2000

By email: colm.grace@asx.com.au

Dear Mr Grace

Consultation Paper - Guidance Note on Clearing Participants Liquidity Risk Management Frameworks

The Australian Financial Markets Association (AFMA) has consulted its relevant members about the ASX consultation paper on the *Guidance Note on Clearing Participants Liquidity Risk Management Frameworks* (Guidance Note).

There is broad agreement with the proposals in the Guidance Note. AFMA has the following comments to make in respect of the questions posed in the consultation paper.

- 1. The guidance note proposes the implementation of a process and governance based approach to defining appropriate liquidity requirements for Clearing Participants and does not propose the implementation of specific quantitative measures. Do you dis-agree with this approach and if so, what quantitative measures should be considered?***

There is agreement with not having specific quantitative measures.

The preference is to focus on qualitative measures rather prescriptive quantitative requirements so that Clearing Participants (CP) have the ability to determine and effectively manage their own liquidity and fund needs. This is because each CP will have a different business model and ASX regulatory capital requirements already prescribe strict daily calculations to measure risk to a CP's solvency risk.

It would, however, be helpful for there to be an alignment between demonstrating compliance with the capital calculations and liquidity requirements. For example, the operational process of forecasting liquidity for 5 days under normal/stress requirements should be based on a forecast of regulatory capital requirements instead of a separate liquidity metric. This would avoid confusion associated with having too many indicators and/or metrics.

- 2. It is not proposed to extend the exemption for ADIs from the requirements of the guidance note to non-banking subsidiaries of ADIs given these are not subject (at an entity level) to prudential regulation. Do you disagree with this approach and if so for what reasons?**

AFMA considers the approach to be too restrictive and not necessarily compatible with global group arrangements for contingent funding that CPs may use. The exemption for ADIs should extend to their subsidiaries. It is suggested this could be done in either of two ways:

- 1) Extend to their subsidiaries provided that the ADI also complies with minimum liquidity requirements (both APRA and head office requirements)
- 2) Extend upon application to ASX provided that the CP can demonstrate a robust liquidity management framework managed by the ADI (locally and at head office) and that the liquidity framework includes forecasts of liquidity positions for the clearing participant.

Entity level regulation is not necessary to provide satisfactory prudential safeguards as in these alternative scenarios the ADI liquidity support is effectively provided to the subsidiary.

- 3. It is not proposed to require a formal annual review of compliance with the requirements of the guidance note by a CPs external auditor. Do you think such a requirement should be introduced and if so for what reasons?**

A requirement for an external compliance audit of CPs is not required.

CPs already have external auditors reviewing the capital calculations performed for exchange clearing participants and compliance with these calculations is required on a daily basis.

- 4. The guidance note will require CPs to carry out a “gap analysis” vs the requirements and remediate any gaps within 6 months of the date of formal issuance of the guidance note. Do you think this period is reasonable and, if not, then how long do you think it should be?**

If the liquidity requirements remain qualitative in nature, then 6 months is an appropriate period of time.

If a quantitative liquidity measure is set then a longer period of time to develop systems / processes will be required (e.g. 12 months, similar to timeframes for liquidity consultation / implementations proposed by APRA).

5. *Would compliance with the proposed requirements of the guidance note require significant changes in your company and/or result in significant additional one-off or ongoing costs?*

Yes, compliance with the proposed requirements in the Guidance Note require significant changes.

Compliance with the proposed requirements would likely require establishment of an updated liquidity risk management framework, added reporting, and resource commitments which may be excessive for an entity with limited complexity requiring short term cash flows as well as unrestricted funding access from the global parent. A qualitative approach will require less cost and resources than a quantitative approach. CPs have already invested significant resources in developing a robust system for daily regulatory capital calculations.

6. *Do you have any other comments on the proposed requirements for a CP's liquidity management framework to be set out in the guidance note?*

With regard to the proposal for a CP to have a liquidity risk framework which includes preparation of a board approved annual liquidity and funding plan and rolling 12 month liquidity forecasts, together with robust liquidity related operational processes and management reporting, it has been noted that CP's business flows and resulting liquidity requirements are largely dictated by market conditions and clients' investment and trading views rather than a specific business plan. As such, it is somewhat difficult and impractical to develop a funding and liquidity plan that spans a 12 month horizon.

A more pragmatic approach for the liquidity risk framework is suggested which would:

- 3) Provide regular reporting on the forward forecast (forecast liquidity requirements based on transactions booked/expected).
- 4) Establish a regular process to review business activities in the context of their anticipated funding and liquidity requirements, in the context of the importance of alignment between the entity's funding and liquidity resources with the business.
- 5) Calibrate appropriate liquidity requirements based on historical settlement/clearing statistics during past time intervals of liquidity stress.

Not all CPs have localised liquidity reporting. CPs which are not ring-fenced can borrow freely from offshore affiliates. Borrowing from offshore affiliates can occur where the Australian CP entity requirements are part of a global, consolidated reporting and monitoring framework, where contingent funding is reserved at the global parent level, ready to be accessed as needed by the CP. CPs which can do this want to continue to maintain this model.

AFMA would be pleased to provide further comment if desired. Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

A handwritten signature in blue ink that reads "David Love". The signature is written in a cursive style with a light blue background behind it.

David Love
General Counsel & International Adviser