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ASX Limited
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Attention: Bailie Yan
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Dear Sirs/Madams

Consultation on Amendments ASX Clear (Futures) Operating Rules to:

- 1. Introduce a Framework for Default Management Auctions of Exchange Traded Derivatives; and**
- 2. Extend the existing Default Indemnity**

FIA¹ appreciates the opportunity to respond to the proposals (collectively, the “**Proposals**”) set out in the “Consultation on amendments to ASX Clear (Futures) Operating Rules to: (1) Introduce a Framework for Default Management Auctions of Exchange Traded Derivatives; and (2) Extend the existing Default Indemnity” issued by ASX on 30 September 2020.

FIA members are strongly in favour of consultations with a CCP’s wider membership on default management arrangements.

We believe that the objective of an auction is to liquidate a defaulter’s portfolio while disrupting the market to the least extent possible. As the same time, costs to the defaulter, the CCP and non-defaulting members should be minimised. These objectives should apply both in normal times and stressed market conditions.

We would also like to draw ASX’s attention to the joint FIA and ISDA “Response to the CPMI-IOSCO discussion paper on central counterparty default management auction²” and FIA’s “Recommendations for CCP Risk Management³” that includes recommendations on default management.

While we are generally supportive of the Proposals, we wish to highlight some specific comments for consideration by ASX.

Unless otherwise defined, capitalised terms used in this letter will bear the same meanings ascribed to them in the Proposals.

¹ FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA’s membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA’s mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA’s member firms play a critical role in the reduction of systemic risk in global financial markets. Further information is available at www.fia.org.

² <https://www.fia.org/resources/fia-and-isdas-comment-design-ccp-default-management-auctions>

³ <https://www.fia.org/resources/fia-issues-updated-ccp-risk-management-recommendations>

No.	Consultation Question	Comments
Participation in default management auctions		
1.	Do you support ASXCLF in establishing a panel of prospective pre-approved auction participants (prior to an event of default) in order to expedite the auction process?	<p>Yes, an established panel in this instance will allow for the expediency of the auction process. However, we would like to reinforce that establishing a pre-approved panel of auction participants is only desirable for specialized products like electricity futures. In that regard, ASX rules should clearly articulate either eligibility or name contracts which will fit the scope for pre-approved panel. This will facilitate client discussions for Clearing Participants.</p> <p>Once the pre-approved panel of auction participants has been formed, participation in an auction, following a default, should be mandatory. In addition, it should be mandatory for all selected auction participants to take part in fire drills. This is the best way of ensuring participants have the operational capacity to bid successfully.</p> <p>Given the specialized nature of the contracts, it is unlikely that Clearing Participants beyond the pre-approved panel will have the appetite or even an active book on these contracts. This will restrict their ability to appropriately price the trades. As such, there will be no real benefit of fall back on Clearing Participants outside the pre-approved panel.</p> <p>However, we seek clarity on how ASXCLF will ensure transparency and equitability across all members if a member not on the established panel would also be interested in bidding.</p> <p>We would also highlight that inadequate participation from the pre-approved panel will mean a possibility of multiple rounds of auction and with each round, the pricing of the defaulter's portfolio will become less competitive. This creates uncertainty in the overall time estimated for close-out and difficulty in modelling the MPOR assumptions within the IM model.</p> <p>For other contracts, ASXCLF should consider open auctions where eligibility for participation is broader and derived on the basis of recent activity of the Clearing Participants (e.g. open positions in that contract in the past 30 days).</p> <p>A CCP should also consider various other factors in determining who should take part in an auction, for example:</p> <ul style="list-style-type: none"> • only participants who have successfully completed the default management fire drills should be allowed to take part in auctions to ensure that they have the operational capacity to bid successfully; and • participants whose portfolios, operational and risk management capabilities and capital are commensurate with bidding on the defaulter's portfolios.

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2.	Do you have any suggestions on how to incentivise auction participants to bid in the auction?	<p>One main incentive for members and clients to bid in an auction is to avoid the CCP invoking recovery tools like variation margin gains haircutting (VMGH) or partial tear-up if the pricing by the market is appropriate.</p> <p>Other incentives are:</p> <ul style="list-style-type: none"> • The aim to support the CCP in its default management process. • The chance to acquire a portfolio at an attractive price. <p>Often, CCPs also employ additional tools to incentivize Clearing Participants like juniorization of their default fund contribution in the waterfall.</p> <p>Effective hedging of the trades, prior to auction will likely increase the chances of competitive bidding from the pre-approved panel and hence its critical for ASX to work out a hedging strategy, in consultation with the Default Management Group.</p>
Auction Pools and Auction Format		
3.	Noting that ASXCLF will determine auction pools with the intention of maximising the likelihood of a successful auction, do you support ASX's "all or nothing" approach?	<p>Yes, we would support an approach that makes the process as operationally efficient as possible for both the ASXCLF and members.</p> <p>However, the success of an "all or nothing" approach is dependent on auction participants being able to bid on <u>all</u> of the products contained in each individual auction pool. If a participant cannot bid on an individual product as they are not set up to clear or risk manage it they will not be able to bid for the entire portfolio. Therefore, it is important for ASX to consult with all potential auction participants to understand such restrictions and design auction pools accordingly.</p>
4.	<p>Direction, size, tenor and regional characteristics of positions in a defaulter's portfolio have been referenced above as factors that may be considered by ASXCLF in the determination of an auction pool.</p> <p>Are there other key attributes that you consider important in determining how the portfolio should be split into appropriate auction pools?</p>	<p>We expect that more granular auction packages will attract more and better bids as they will be accessible for more participants. Therefore, we agree that smaller portfolios, where positions are grouped together according to their asset class, are potentially easier to price and to absorb.</p> <p>Relevant factors include size, asset class, product type, segment, currency and maturity. We would suggest also considering open interest and concentration level among members. ASXCLF should consult and review the portfolio parameters with potential auction participants to ensure maximum participation.</p> <p>ASXCLF might also want to consider grouping contracts that are frequently traded together as part of a spread or trading strategy.</p> <p>Our members also seek clarification on the below points:</p> <ol style="list-style-type: none"> a. In the event the defaulter also has positions in the OTC segment, how will the formation of 'priority group' and creating of auction pools be impacted due to inclusion of ETD contracts?

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		<p>b. Will ASX set out in its default management handbook, which ETD contracts will qualify for auction (i.e. define eligibility criteria)? It is recommended that this is clearly articulated, especially as Clearing Participants will need to have upfront discussions with their clients given that clients can also participate.</p> <p>c. Since only the less liquid ETD contracts will qualify for auction, the eligibility of participants would be based on open interest as of default day or a longer look back period like 30 or 60 days? It is recommended that participants who qualify should be mandated to participate in the auction, else subject to juniorization of their default fund.</p>
Bids		
5.	Do you support the proposed approach for expressing an auction bid (ie. that bids are to be expressed as a percentage of discount or premium to the last DSP)?	<p>While the proposed approach would simplify the process, it could be challenging to price different expiry months (especially if there are quite a few of them) within the auction portfolio.</p> <p>We would also encourage ASX to adopt international standards for auctions that have been developed by CCPs in the ‘Uniform CCP Terminology for Default Management Auctions⁴’.</p>
6.	What other approach or approaches do you consider are appropriate for expressing an auction bid?	Pricing per contract month, using the same percentage of discount or premium.
Operational Considerations		
7.	Do you support the proposed approach that contemplates that ASXCLF will provide information about the default portfolio directly to the panel of auction participants (including end-user clients)?	<p>Communication during the whole DMP should be transparent, consistent and frequent to ensure equitable treatment to market participants while ensuring it does not impact the success of the auction.</p> <p>We seek clarity on how ASXCLF will ensure transparency and equitability across all members, especially if a member not on the established panel would also be interested in bidding.</p> <p>To prevent erroneous bids, participants should also be provided some risk metrics of the auction portfolios, for instance last day’s mark-to-market (MtM) or sensitivities (IRO1, CS01) as of the last settlement run.</p>

⁴ https://www.cftc.gov/sites/default/files/idc/groups/public/@aboutcftc/documents/file/mrac062716_uniformccp.pdf

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8.	The proposed process is for Clearing Participants to approve their clients' bids prior to submitting to ASXCLF. Do you support this approach? Should Clearing Participants be allowed to pre-approve up to a certain price range and/or volume?	<p>We support the need for Clearing Participants to approve their clients' bids as this will put in place a required safety measure to ensure that the clients' risks are managed appropriately and commensurate with what the respective Clearing Participant expects.</p> <p>There shouldn't be a need to have a threshold on price range and/or volume as the assumption is that with the Clearing Participant approving the bid, considerations of price and volume should already have been factored into the decision process.</p> <p>The consultation paper also proposes that ASXCLF CCP will have authority on evaluating the suitability of clients before they participate in the auction. We would recommend that, in addition to approving their client bids prior to submission to ASXCLF, Clearing Participants should have the ability to identify which clients qualify based on risk profile of such clients. Since the Clearing Participants indemnify the CCP for client default, participation and winning of the auction will create additional credit risk on such clients. More often than not, this incremental risk also needs to be pre-approved by the credit risk functions within the Clearing Participants' structure.</p>
Proposed Structure		
9.	Are there any reasons why ASX should not seek to ensure consistency of default management powers available to both ASXCL and ASXCLF?	<p>We are supportive ASX ensuring consistency.</p> <p>Again, we would also encourage ASX to adopt international standards for auctions that have been developed by CCPs in the 'Uniform CCP Terminology for Default Management Auctions'.</p>

We welcome the opportunity to work with ASX to address these comments before the implementation of the Proposals.

Please feel free to contact myself at bherder@fia.org or TzeMin Yeo, Head of Legal & Policy, Asia Pacific at tmyeo@fia.org should you wish to further discuss.

Yours



Bill Herder
Head of Asia-Pacific, FIA