



6 May 2015

Repo Central Clearing Consultation
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By email: RepoCCPConsultation@rba.gov.au

Dear Ms Hancock

Central Clearing of Repos in Australia

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the consultation paper on Central Clearing of Repos in Australia.

Summary

There is general support within our membership for the principle of central clearing of repos. Issues raised in the member responses are practical ones around whether it would be viable for a central clearer to provide a central clearing service to the Australian market and if they were to do so it would need to offer attractive pricing to encourage participants to use its service. Members indicate that cost and the scope of netting benefits are key determinants to whether it would be desirable to use. Broad participation by the market is also seen as an important feature to attract firms to its use. It would however be dependent on the broadest possible take up by market participants.

There is also a further strategic question about the move to automation across a range of functions and related markets. Repo markets are directly connected to the bond markets so the functioning of existing clearing services for debt instruments and the trading and data systems including trade reporting needs to be carefully considered when integrating repo clearing.

Australian Repo Market Today

The repo market is crucial to the efficient functioning of our financial markets. Its importance reflects the fundamental nature of its functions:

- ***Providing an efficient source of money market funding.***
By offering deposits secured against liquid high-quality assets, and by diversifying the credit exposure of cash investors beyond the banking sector and by disintermediating traditional but less competitive financial channels, the repo market mobilises cheaper and deeper funding for financial intermediaries, which in turn lowers the cost of financial services to investors and issuers.
- ***Broadening and stabilising the money market.***
The collateralised nature of repo allows a wider array of borrowers and lenders into the wholesale money market than just commercial banks. The resulting breadth and diversification creates a deeper and more robust market, which facilitates liquidity management between financial intermediaries and mitigates systemic risk.
- ***Facilitating central bank operations.***
The repo market provides a ready-made collateral management framework which enables the RBA to implement monetary policy so efficiently under normal market conditions and act as a lender of last resort in a highly stressed market. Central bank repo feeds seamlessly into the commercial repo market.

One of the pillars of the new global regulatory framework being constructed under the direction of the G20 and within the Basel process is the collateralisation of financial transactions, directly and through mandatory clearing of standardised transactions. Collateral needs to be traded because collateral requirements differ between collateral-takers such as central banks, CCP, payment systems and lenders, and mismatches inevitably arise between particular collateral requirements and the holdings of collateral-givers. The repo market is the principal venue for trading collateral. It is where, for example, securities can be converted into the cash collateral typically required by CCP or where a security not eligible as collateral in a payments system can be exchanged for another security that is eligible. Without the ability to trade collateral, it is likely that cash balances would have to increase, for direct use as collateral or to allow other types of collateral to be purchased when needed. Increased cash holdings are inefficient. They also assume that firms have access to a secure money market in which to place this money.

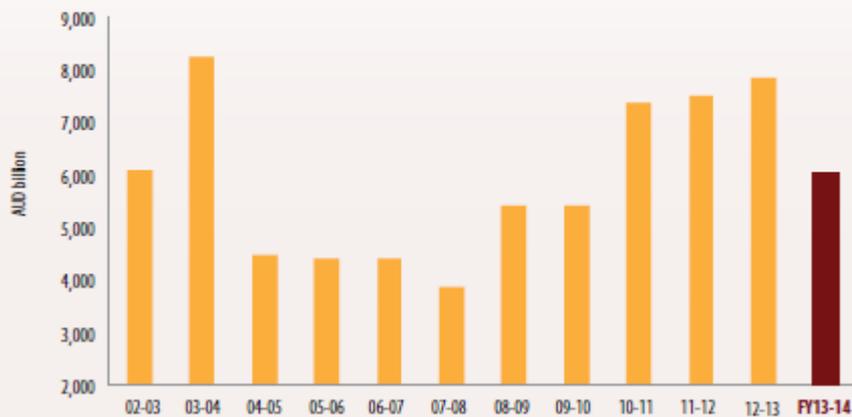
The Australian repo market is evolving to meet changing demands. Over the last two years there has been greater interest in term financing, with general collateral (GC) transactions out to six months taking place on a more frequent basis and a pick-up in reverse enquiries. This trend towards a greater use of term financing is partly evident in AFMA's 2014 Australian Financial Markets Report, there being a decline in repo turnover, which overall was down 24% from 2013, and largely flat against 2013, excluding in-house transactions.

The introduction of the Reserve Bank of Australia's (RBA) same day settlement of Direct Entry (DE) payments in late November 2013 has seen some structural change in the markets, necessitating behavioural changes by market participants in order to adjust to the new system and how to respond to the resultant increase in second-round operations conducted by the RBA. The effect of this, along with other factors, has been a general increase in secure funding rates relative to the cash rate continues to be a feature of this market.

The RBA's Committed Lending Facility (CLF), which came into effect on 1 January 2015, as part of the introduction of Basel III liquidity standards, is also having an impact on repo market liquidity, as are other regulatory changes, such as the Supplementary Leverage Ratio (SLR) in the United States and the Financial Stability Board's (FSB) recommendations on securities lending and repos. These, will continue to have an impact on our market, as will the move to T+2 settlement of securities.

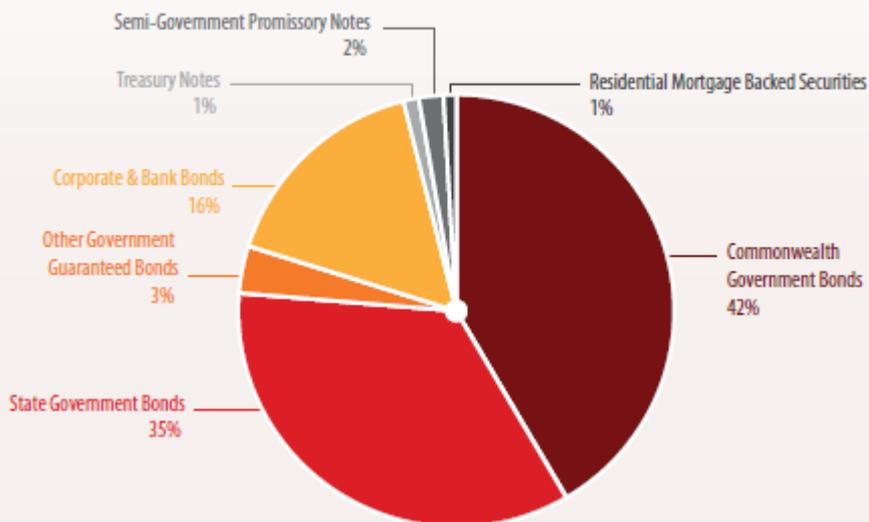
The regular issuance of bonds by the Australian Office of Financial Management (AOFM), and whose net issuance for 2014-15 is expected to be in excess of \$40 billion, continues to be a feature of this market and which ensures a regular supply of trading stock for the repo market.

FIGURE 1: ANNUAL TURNOVER



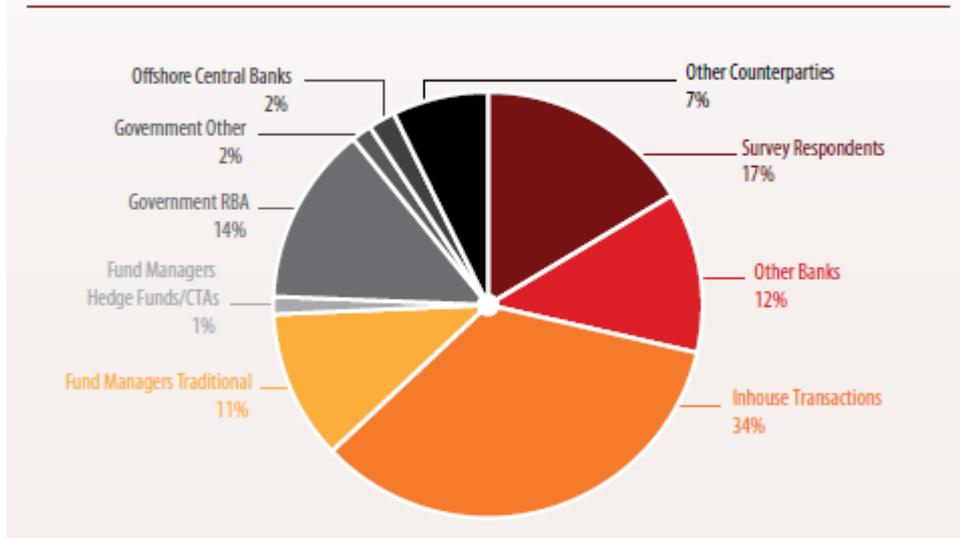
Source: AFMA

FIGURE 2: TURNOVER BY INSTRUMENT



Source: AFMA

FIGURE 3: TURNOVER BY COUNTERPARTY



Source: AFMA

Overview

1. *Do you believe the availability of a repo CCP in Australia could improve the functioning of the Australian repo market and its capacity to safely, efficiently and continuously support the funding and liquidity needs of the Australian financial system? Why/Why not?*

We start from the proposition that there is broad in-principle support for the idea of central clearing of repo. Balance sheet netting, collateral and regulatory capital reductions in addition to lower counterparty credit exposures would be key benefits. However, the level of benefits obtained through CCP clearing, particularly multilateral netting, would be critically dependent on the level of CCP participation achieved.

For a CCP to efficiently optimise its capabilities it would need to be fully inclusive for fixed income products.

The reasons for using a CCP are generally common with those for derivatives.

- Reducing capital requirements
- Reducing funding requirements
- More efficient margining
- Balance sheet netting
- Managing and reducing internal balance sheet footings.

In addition, a specific benefit for the repo market is operational efficiency, straight through processing and matching of offsetting positions and transaction netting each assisting in dealing with circles and shaping.

2. *Would you use a repo CCP if there was such a CCP in the Australian market? Why/why not?*

Members indicate that cost and the scope of netting benefits are key determinants to whether it would be desirable to use. Broad participation by the market is also seen as an important feature to attract firms to its use. It would however be dependent on the broadest possible take up by market participants. The Bond and Repo Clear experience demonstrates that a lack of participants and a fragmented market led to constant settlements issues and ultimately the abandonment of the service.

Firms will need to undertake an evaluation of the potential benefits of a repo CCP, such as the amount of balance sheet netting that might be achieved in the context of the scale of their existing and future likely business growth before committing. Some preliminary analysis indicates that the amount of netting benefits obtainable might be relatively small. It would also be necessary to consider the costs and requirements of being a CCP participant which are likely to be determined by its ex ante controls including such factors as position limits, minimum capital requirements and fixed costs of CCP participation (e.g. default fund contributions).

3. *If a repo CCP is desirable, what should be its instrument scope? For example, clearing of repos against general collateral only; or both general collateral and specific collateral? And should it also clear outright purchases/sales of debt securities?*

The FSB has said repos held against high-quality, liquid collateral potentially lend themselves to clearing. For this reason HQLA Assets as locally defined should be considered as General forms of collateral and find acceptance if they are sufficiently liquid. The repo market currently operates with defined GC baskets such as GC1 and GC2. It is likely to be more beneficial in terms of market liquidity to follow these groups, or possibly, just RBA GC. Generally, our members have indicated that it would be desirable to clear both Repo and the outright securities transactions underlying the Repos.

By broadening the scope of instruments / collateral available the netting benefits and collateral efficiencies are increased. Acceptance for clearing of a broader range of instruments could increase multilateral benefits for participants, dependent on model and risk management considerations.

Given the relatively small scale of the existing repo market, the inclusion of clearing capabilities for outright cash positions would be a net benefit as business volumes would be greater which is likely to be a critical economic factor that any commercial provider would need to consider.

4. *If a repo CCP is desirable, what additional services should it provide in order to maximise the net benefits of central clearing? For example, auto-collateralisation through a centralised collateral management service, substitution or re-use of collateral, novation of both legs of the repo, (anonymous) trading on an electronic platform?*

There is a role in the market for CCPs, whose direct customers are its clearing participants, as well as a role for clearing participants whose customers are end users. Determining the appropriate mix of responsibilities between groups is best left to the market. Other considerations are the CCP functionalities to be included, such as whether it has name give up or allows anonymous trading, each of which affects choices. Anonymous trading of repos could be made an available option that could be introduced in conjunction with the introduction of a CCP. A number of these aspects intersect with currently available collateral management and triparty services and processes.

By offering more services a CCP will appeal to a broader cross-section of counterparties. If the introduction of a CCP creates greater participation and depth to the market then this is a positive development. Other benefits can also accrue via trade compression and reduction of gross notional balances via trade compression. If settlement risk is considered an issue, then novation in favour of a CCP is generally viewed a positive development.

Another feature suggested is to differentiate the types of clearing accounts, i.e. one allowing re-hypothecation and one not (which would be decided via the bilateral terms agreed between counterparties and CCP).

To maximise netting benefits, adoption of the "Cleared Swaps Model" is seen as important, where the CCP novates both legs of the trade (buyer to every seller, seller to every buyer). This facilitates a greater level of multi-lateral netting so reducing the size of outstanding positions, resulting in lower exposures for clearing participants which would lead to a reduction in the balance sheet along with the BCBS-intended preferable treatment imposing lower capital requirements. This should also facilitate lower replacement costs for the CCP in the event of default management.

A CCP partnership with tri-party collateral agents is integral to the post-execution, risk management and ongoing maintenance of the securities collateral. The provision of securities substitution, asset servicing, and other collateral related activities such as eligibility and concentration limit testing are all services that have been traditionally managed by global tri-party collateral agents.

5. *To what extent is non-centrally cleared repo trading constrained by counterparty credit concerns? Have such concerns increased in recent years? Is activity typically more constrained during periods of high market volatility?*

There are two potential causes for repo markets to shut down during a crisis. The first relates to counterparty risk. Counterparty risk is normally limited when collateral is of high quality and very liquid, and this is particularly the case where government debt is used as collateral. High quality collateral thus significantly limits although does not eliminate potential losses from a counterparty insolvency. In addition, repo transactions are mostly short-term, limiting the price and liquidity risks associated with the collateral. Rollover risk, however, plays a more important role. Since repos are short-term financing tools, they need to be rolled over quite frequently. If market participants expect liquidity to be low in the future, as uncertainty about counterparty risk mounts, they are less willing to lend out short-term funds for two reasons: First, if they, themselves, need liquidity in the short-run, they might have difficulty procuring it. And, second, the likelihood of default increases when a counterparty, even though solvent, cannot fulfil its obligations due to the impossibility of rolling over a loan. Consequently, a market could break down purely as a result of a coordination failure if financial institutions hoard liquidity because they expect that they will be unable to obtain such liquidity when they need it themselves.

6. Do you believe that it would be commercially viable for a CCP to offer a repo clearing service in Australia? Why/why not?

AFMA in recent comments on competition for central clearing services and resolution regimes for financial market infrastructure has noted the importance of economies of scale in the clearing business. History plays a particular role with regard to this question because of the closure of the Bond and Repo Clear (BRC) by the then SFE after a short period of operation in 2004.

Critical mass in clearing services is important to the sustainability of a commercial service and to clearing participants looking to obtain netting benefits. AFMA has noted that a number of Australian OTC markets, based on past experience, are not of the scale to readily support specialised domestic-only clearing services. Cross border operators may have the scale to add an Australian service at marginal cost but how such an offering could be viably configured in a commercial and practical sense given that the main pool of securities is situated in Austraclear is a matter of speculation.

7. Are there alternatives to CCP clearing that would improve the functioning of the Australian repo market and its capacity to safely, efficiently and continuously support the funding and liquidity needs of the Australian financial system? If so, please explain.

Overall, it is considered that wider use of tri-party services, which offer a number of the benefits available through CCP clearing, i.e. collateral optimisation, operational efficiencies and default management, may be considered as an alternative.

8. Would there be any material impediments to the safe and efficient operation of a repo CCP in Australia? Are there likely to be aspects of a CCP's design that could not readily accommodate Australian repo market practices? Would there be likely to be material challenges in transition to a centrally cleared environment?

Overall, there are no unique impediments to clearing in Australia, but the potential interaction between cleared products is worth noting. Government bond futures traded at ASX24 are cash settled based on dealer quotes, rather than physical delivery, which is different than the typical mechanism for government bond futures. There are a myriad of potential issues with either choice but the cash, financing, and derivative markets are closely related. The repo market should not be seen in isolation and clearing rules would have to apply across all affected markets.

Repo is unlike a number of other products cleared through CCPs; it involves full settlement of principal amounts at maturity rather than net settlement of financial gains and losses. As such, the CCP must have reliable access to potentially large sources of contingent liquidity in order to manage the default of a CCP participant. Direct access to central bank liquidity would be highly desirable. It is uncertain whether a small group of direct clearing members would be able to meet the liquidity needs of a CCP in a crisis situation.

At an operational level where repo trades are executed on a trading platform it would be possible to implement straight through processing connectivity to participants and/or directly to a CCP as part of transitioning to a centrally cleared environment.

Access

9. To what extent would you expect a repo CCP's participation requirements to affect some participants' access to clearing? Are there particular types of repo market participant that you believe would have difficulties in accessing central clearing, either as a direct participant or as a client?

We have previously remarked on the desirability of widespread market participation in repo clearing, and it is envisaged that funds and custodians would be encouraged to utilise the service. They will benefit from increased trading lines due to the novated nature of the clearing service. However, there are practical reasons why such widespread participation might be unlikely to occur without regulatory support. For example, buy-side participation is an important question. Smaller banks and funds may find it difficult to justify the expense associated with the setup, resourcing or operating as a clearing participant. Where buy side participants are restricted from participating in CCP loss mutualisation an important pool of potential participants are lost. A CCP's participation requirements are likely to be

quite influential and traditional membership approaches may not provide a whole answer.

10. If there were a repo CCP in Australia, would you expect there to be demand from buy-side clients to centrally clear their repo transactions with dealers? Why/why not?

Currently, there is a low level of buy-side participation in the repo market. As is usual, changes from business-as-usual meet with initial reluctance to engage and there would need to be a significant educational campaign on the benefits of clearing.

Drawing from experience in other jurisdictions where buy-side firms participate in repo clearing, it is likely that given the right features including cost structure they might be convinced to participate. While the availability of trade infrastructure is generally viewed as a positive, required system and platform spending can be a barrier to participation. Trade flow, margins and returns in the domestic market tend to be minimal. Likewise, the local market does not operate with the same depth of participation as some offshore markets. If buy side clients could trade anonymously and benefit from improved operation and settlement processes, then they might see an attraction. Similarly the freeing up of credit limits may allow for a wider spectrum of pricing and liquidity.

However, uncertain accounting treatment of client clearing would make it difficult for buy-side participants to carry out an accurate cost/benefit analysis. Costs may outweigh any natural demand from other potential benefits such as reduced counterparty credit risk and netting benefits may not be so attractive to buy-side clients.

11. Are there alternative models for access to CCPs that you believe would address concerns about smaller institutions' access to central clearing?

In the U.S. the Fixed Income Clearing Corporation (FICC), a subsidiary of the Depository Trust Clearing Corporation (DTCC) offers a number of repo clearing facilities. Of these one of the most relevant for smaller firms is the “netting and settlement” service. FICC netting members are allowed to net positions before facing the clearinghouse, meaning their margin is determined on a net rather than a gross basis. Smaller firms that are capital constrained, and also holding relatively balanced books, would therefore face a smaller incremental cost from moving to cleared repo when using this service. It is advisable that any new cleared repo offering, as well as the corresponding regulations, explore the possibility of allowing for netting at the firm level.

The points about the economics of offering a clearing service in Australia mean that the expectation would be that bilateral repo clearing is likely to remain the norm for smaller institutions. Nevertheless, the use of FMI is expanding in other areas and Buy-side

participants are already becoming more knowledgeable in the way they package their service requirements together, something that will progress further as central clearing for other products (interest rate swaps for example) becomes more prevalent. This should mean smaller institutions can find an entity which is able to service its needs in the cleared world.

12. To what extent would you expect a CCP's position limits to restrict activity in the Australian repo market?

This is another question around which a considerable number of variables would come into consideration. Participant limits are dependent on their credit assessment and collateral credit quality, as well as the degree and scope of netting. Intraday limits imposed by a CCP's haircut margins are an important consideration (especially if variable during periods of heightened volatility)

Looking to overseas experience, while it is true that concentration of a particular issue at a single firm could potentially create a shortage, a lending facility like the Federal Reserve Bank of New York's System Open Market Account (SOMA) is designed to alleviate shortages at market rates, rather than a large fixed penalty. It would take a relatively small change to the Australian Office of Financial Management's procedures for a similar function to be introduced in Australia. Restrictions like positions limits are often necessary to compensate for subsidies, for example free "daylight" borrowing of notes. However, an alternative to the "subsidy / restriction" model would be for participants to pay market rates. Traders facing incrementally more costly special rates, as they do with the SOMA program, bear the full costs of their activity, which may make concentration limits unnecessary. It is assumed that any impact would be dependent on the CCP access model and the specific nature of the associated limits.

Counterparty Credit risk

13. Q13. To what extent is there scope to reduce the size of counterparty credit exposures in Australian interdealer repos through multilateral netting? What proportion of market activity is contributed by participant types with primarily one-way transactions?

The potential for netting is determined by the composition of a portfolio at any point in time, and is therefore quite difficult to estimate. In other jurisdictions substantial netting benefits are obtained. At present netting benefits applied throughout the Repo market are low, although this appears to be increasing with interbank dealers. As much as 75% of market activity is predominantly one-way transactions. To the extent that a participant's positions with different counterparties are offsetting, multilateral netting through novation would result in lower overall exposure

Bilateral exposures are measured with no recognition of accounting netting in most cases. As noted in Question 4, adoption of the "Cleared Swaps Model" would maximise the net benefits of central clearing.

14. To what extent would clearing interdealer repos reduce the regulatory capital banks are required to hold against such exposures, including under the proposed leverage ratio? And in the absence of central clearing, to what extent would you expect some participants' repo market activity to be affected by the BCBS large exposures framework?

The regulatory capital charge is a function of exposure and risk weight with respect to the exposure. Based on experience with derivatives we would expect the regulatory capital charge for the exposure to be significantly lower.

15. To what extent would a CCP strengthen processes for margining and collateral valuation in the interdealer repo market, relative to existing bilateral arrangements?

Margining as a standard market practice in the Australian repo market is a relatively new procedure coming into effect three years ago so standardisation procedures would promote uniformity of practice. Margining within a CCP means relative uniformity across the market. Uniformity should mean a simpler daily reconciliation process, with lower requirements for portfolio reconciliation (relative to bilateral) and no issues with dispute resolution. The margin setting process of the CPP would have to provide comfort to the clearing participants that they are sufficiently robust to withstand periods of market disruption.

16. Overall, to what extent would you expect central clearing to deliver collateral efficiencies?

Outcomes are likely to be dependent upon factors such as the number of market participants and the scale of their businesses. As a general proposition, multilateral netting of bilateral positions reduces the size of collateral requirements. However this would have to be weighed up against increased initial margin requirements which feeds into funding activities. It depends largely on the size of the open position, the size of activity and level of participation.

17. Would you perceive a significant benefit from a CCP coordinating the management of the default of a repo market participant? Why/why not?

A key rationale for central clearing is that it provides for the orderly management of a single participant default, this ensuring that such an event is managed under pre-determined and well understood rules. CCPs should face lower replacement costs when managing the default of a market participant given their ability to perform multi-lateral netting. They also have access to the default fund resources, underlining again the importance of setting sufficiently high membership requirements.

As is well understood, the strength of the CCP's risk management and default management procedures is important. For example, a premature suspension and auction of a participant's positions could result in a worse outcome than that from bilateral markets. In contrast, a successful auction or pledge of a defaulter's securities under liquidity arrangement could avoid collateral fire-sales and impacts to underlying bond markets. For example, it could depend upon the individual circumstances of the counterparty, whether it is a foreign bank branch or a domestic clearer with possible systemic risk considerations.

In the event that the CCP is facilitating cross-margining with other correlated products, significant benefits accrue to that CCP in the way they manage the default as they will have access to the full portfolio during the process, better enabling lower market risk - for example, large basis trades would be much easier to unwind as a package rather than managing the two legs separately. Products that are margined together should default together.

18. To what extent are repo trades processed in a straight-through manner? Are there particular aspects of processing repos that require material manual intervention?

Major banks do largely have straight through processing systems where trades can be simply matched. Manual intervention increases where repo transactions are net settling, or where trades are split, or if there is a circle. These operational issues are discussed further below in relation operational efficiencies. Use of an electronic trading platform enables leveraging off the STP functionality that is available in such systems.

It is also noted that repo trades with the RBA follow a different settlement process in Exigo. Where the market will generally use Fixed Income Buy/Sell to settle each leg of a repo trade (and often a net of several trades in the same stock), the RBA will use the Repo function in Exigo, and this requires manual entry into Exigo. Also, some institutions report that, as these trades are washed from another entity back into the main repo trading entity, there is manual intervention as a means to ensure the wash entity is not encumbered with positions due to fails.

Operational Efficiencies

19. Would central clearing of such trades encourage more trading on electronic platforms? Why/why not?

Electronic trading depends on standardisation and could make the market more efficient and easier to understand thereby encouraging greater participation. As well, trade detail affirmation would occur at initiation of the trade so trades could feed directly to a clearing house for net settlement without additional matching at settlement level, requiring much less operational effort.

Given most counterparties are unable to receive netting benefits bilaterally or across multi products, then electronic trading could be attractive to them. The market would in such case move away from open trades to maximise netting benefits and this could also encourage more term trading on electronic platforms.

20. To what extent do you see benefit in auto-collateralisation of repos through a centralised collateral management service such as ASX Collateral? How would you expect central clearing of repos to affect the use of such a service?

Auto-collateralisation of repos including the maintenance of collateral, management of substitutions, testing of eligibility and the ability to use global assets held at local CSDs and ICSDs is generally seen as desirable. Addressing the operational challenges of repo also enables additional liquidity providers to enter the market.

The current ASX collateral management service as a system is generally viewed in a positive light as it enables efficient use of bond holdings and easily allows for substitution / collateralisation of positions rather than requiring manual intervention by front-office or operational staff. This facility and its highly straight-through-processing nature is very efficient and significantly less manual than normal OTC repo that needs to be renegotiated and repriced regularly. Members report that it has been the commercial consideration about the cost of the service which has hampered the uptake of this service offering not its functionality and utility.

The clearing of repos and use of tri-party collateral agents can be complimentary to each other with CCPs focusing on the execution and clearing of trades and collateral agents managing the ongoing maintenance of the posted collateral. An example is the US FICC GC program where FICC manages the execution but the settlement and maintenance of collateral is tied to the clients underlying clearing bank and collateral agent.

Firms also need to consider giving client's global collateral processes and connectivity to existing tri-party agents. Ideally centralised collateral agents should be able to connect to both local CSDs and ICSDs so that all relevant securities can be utilised.

21. Overall, to what extent would you expect central clearing of repos to encourage greater automation and operational efficiencies in the Australian repo market? Are there other mechanisms that might be equally effective in encouraging such efficiencies?

Standardisation brings efficiencies in terms of operational process, and enables scale. Past experience with other asset classes which have moved to central clearing shows that vendors are keen to develop middleware solutions to aid market automation. There are already a number of existing service providers, including global tri-party agents, trade matching and trading platforms who have offerings which could assist market participants

especially the buy-side. Automation and ease of operational participation would promote liquidity.

There is ample evidence of how automation assists the market in Europe and the US. However doubts are voiced because of the uncertainty about whether the market is big enough to support viable service offerings, not with inherent value of automation. Between Australian domestic participants central clearing could significantly increase automation and operational efficiencies if broadly taken up by the market. However there are a significant number of counterparties that transact through custodians in the Australian market as well as a large amount of transactions that are moved in and out of Euroclear/Clearstream. Unless these type of participants, such as custodians and other ICSDs settling AUD bonds, were able to utilise the facility, the efficiency gains would be limited. As long as considerable back office time needs to be spent on time-intensive phone calls and manual email communications, any manual system's capacity to expand will be limited and be open to simple errors that automation avoids. Automation also allows valuable staff time to be directed to the more value added activity of risk surveillance and mitigation.

Settlement arrangements

22. Q22. Do you agree that settlement issues arising from chains of trades are unlikely to cause problems in the current market? And do you agree that settlement issues would not be an impediment to the effective functioning of a repo CCP? If not, why not?

Settlement issues arising from chains do cause problems in the current market. Many counterparties facilitate settlement through custodians or move positions in and out of ICSDs such as Euroclear and Clearstream. Members report that difficulties are regularly encountered when inactive custodians fail to facilitate circle / netting of transactions which then holds up the full chain of transactions. Significant delays are also seen because of Euroclear/Clearstream bridge runs, which can lead to a rush at end of day to push through stock positions after bridge movements and realignments between settlement systems. Based on the assumption that a clearing house is going to try and achieve a flat position (cash and securities), to counter the risk of a counterparty failing to deliver to the clearing house on the valuation date a clearing house would need to hold a large reserve of securities so that they can meet their delivery obligations despite being failed upon themselves. This would potentially have an impact on their cash position late in the day. Between current market participants settlement fails are actually low, although considerable amount of operational effort is devoted to avoiding fails.

This implies that custodians and Euroclear/Clearstream would also need to participate in a CCP to get operational benefits and improved efficiency, as the positions would still have to move around the settlement market to facilitate flow with any non-participants. A primary source of the failure of BRC is attributed to settlement chains. This reinforces the message that as broad a participation as

possible is highly desirable if not essential to make central clearing work well and to obtain operational benefits.

23. Do you see benefit in settlement netting by line of security? Do you believe that 'shaping' of settlement obligations would be beneficial in the settlement of repos in Australia? Why/why not?

Operational stresses are being observed in the current market. Counterparties are becoming less and less inclined to do circles due to the credit risk concerns of breaking up the movement of stock and cash. Bond redemptions are becoming increasingly larger creating settlement bottlenecks on settlement date. This creates stress on the settlement system to the point where there is not sufficient time for lines of stock to pass hands to finish up with the end user. This also becomes an even greater issue when bond redemptions coincide with end of month, quarter or year.

Netting all settlement obligations against one counterparty would invariably enhance the market settlement process. Netting by line of security minimises settlement costs and overall settlement volumes, as well as mitigating the overall number of transaction chains and circles. Shaping, being the process of sequencing partial settlements, can assist this process by reducing the number of circles, if counterparties are able to partially settle based on holdings or available cash for payment. Shaping could also conceivably be a valuable tool for a clearing house during a participant default, although several questions would need to be resolved prior to its deployment.

Shaping through a clearing house programme could also reduce the operational time and effort required for agreeing net transactions between counterparties in the market. However it is quite common in the current market that custodians are unable to net/split/shape transactions unless instructed by underlying client (who are often based out of Australian hours) so this would again only be beneficial from a clearing perspective if a broad number of market participants were part of the clearing house.

AFMA would be pleased to provide further comment if desired. Please contact Murray Regan (mregan@afma.com.au) or David Love (dlove@afma.com.au) if further clarification or elaboration is desired.

Yours sincerely



David Love
General Counsel & International Adviser

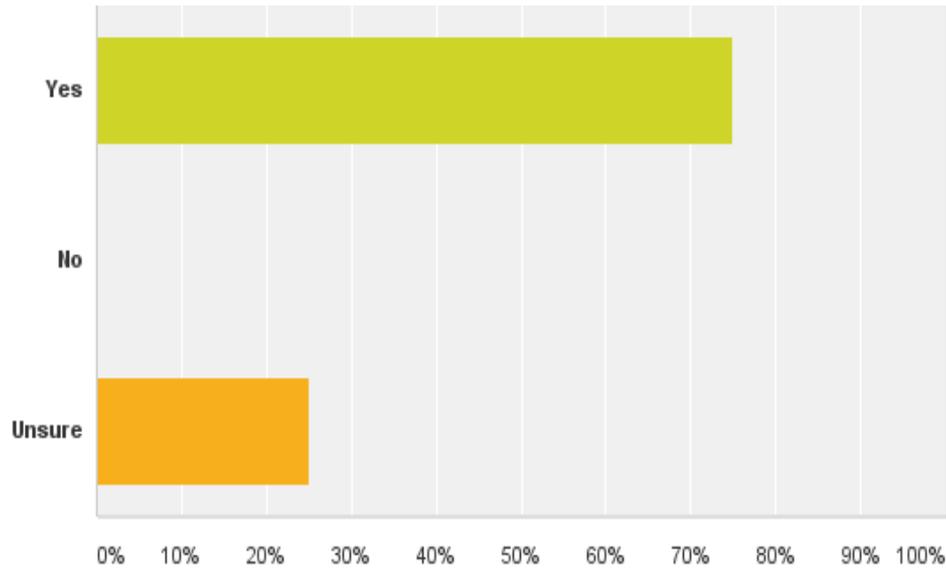
ATTACHMENT



AFMA Repo Market Participant Survey on RBA's Consultation: Central Clearing of Repos in Australia –Summary

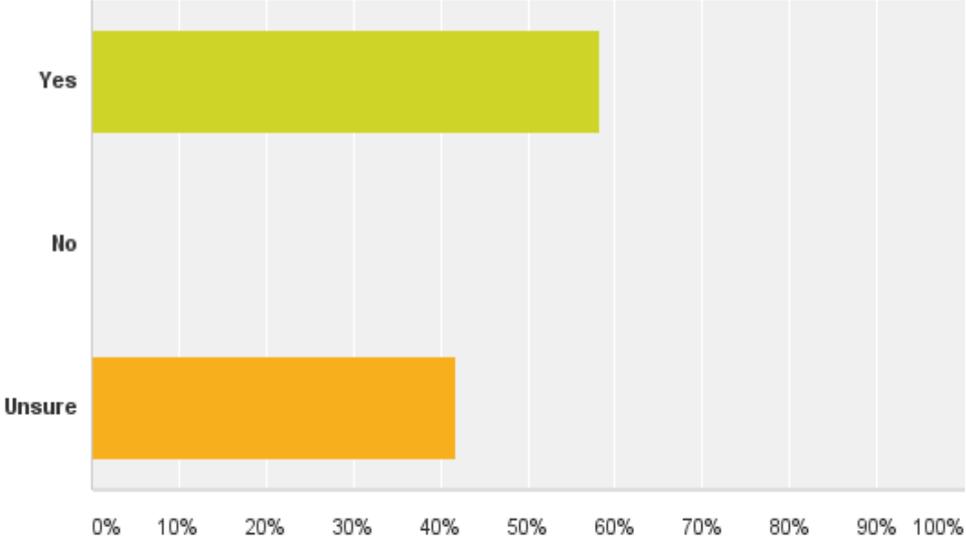
April 2015

Q1: Overview: Do you believe the availability of a repo CCP in Australia could improve the functioning of the Australian repo market and its capacity to safely, efficiently and continuously support the funding and liquidity needs of the Australian financial system? Why/Why not?



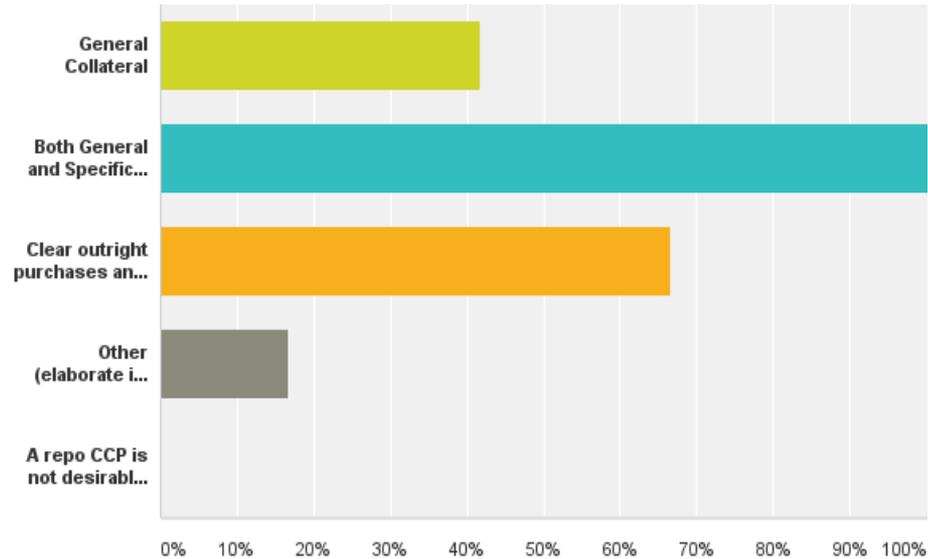
Answer Choices	Responses
Yes	75.00% 9
No	0.00% 0
Unsure	25.00% 3
Total	12

Q2: Overview: Would you use a repo CCP if there was such a CCP in the Australian market? Why/why not?



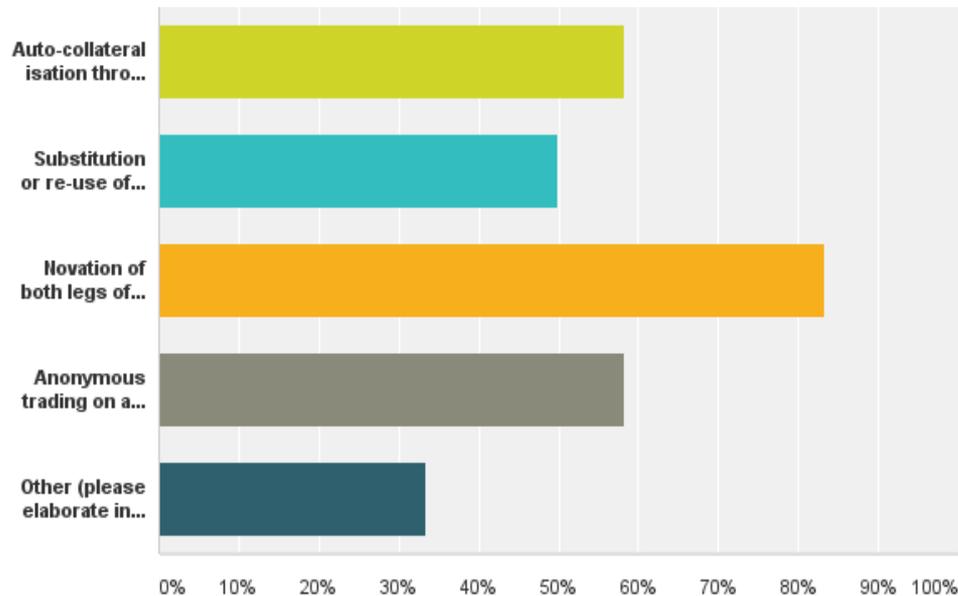
Answer Choices	Responses
Yes	58.33% 7
No	0.00% 0
Unsure	41.67% 5
Total	12

Q3: Overview: If a repo CCP is desirable, what should be its instrument scope? For example, clearing of repos against general collateral only; or both general collateral and specific collateral? And should it also clear outright purchases/sales of debt securities? Please check all that are applicable



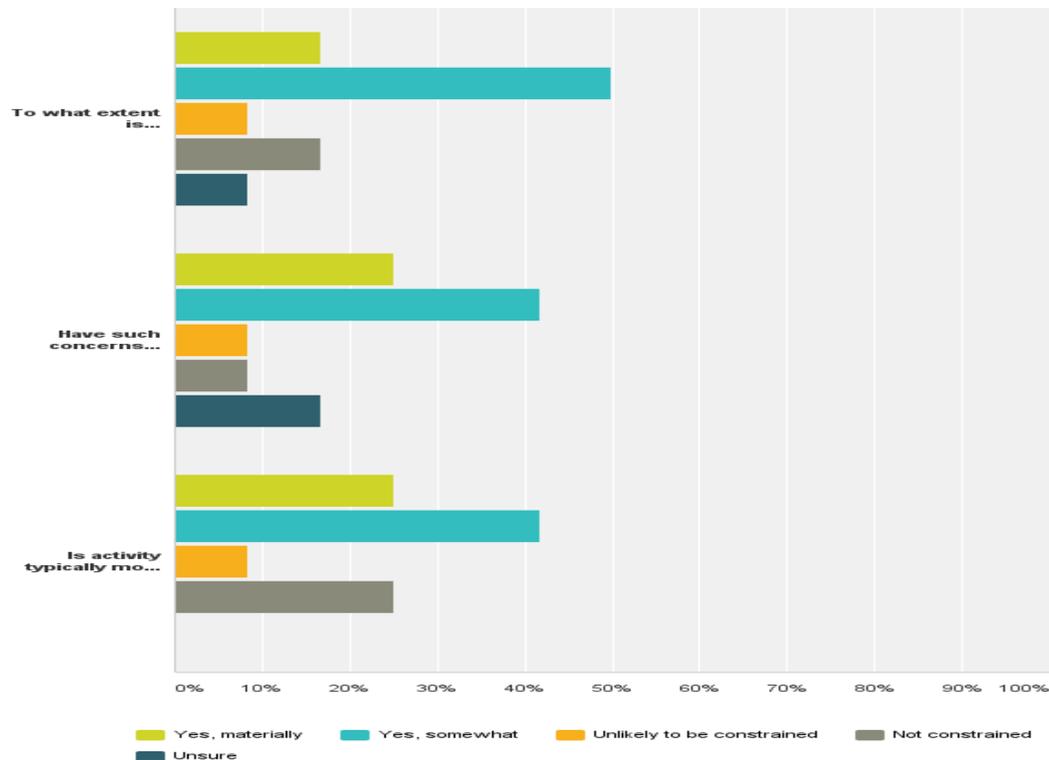
Answer Choices	Responses
General Collateral	41.67% 5
Both General and Specific Collateral	100.00% 12
Clear outright purchases and sales of debt securities	66.67% 8
Other (elaborate in Comments field)	16.67% 2
A repo CCP is not desirable for the Australian market	0.00% 0
Total Respondents: 12	

Q4: Overview: If a repo CCP is desirable, what additional services should it provide in order to maximise the net benefits of central clearing? For example, auto-collateralisation through a centralised collateral management service, substitution or re-use of collateral, novation of both legs of the repo, (anonymous) trading on an electronic platform? Please check all that are applicable.



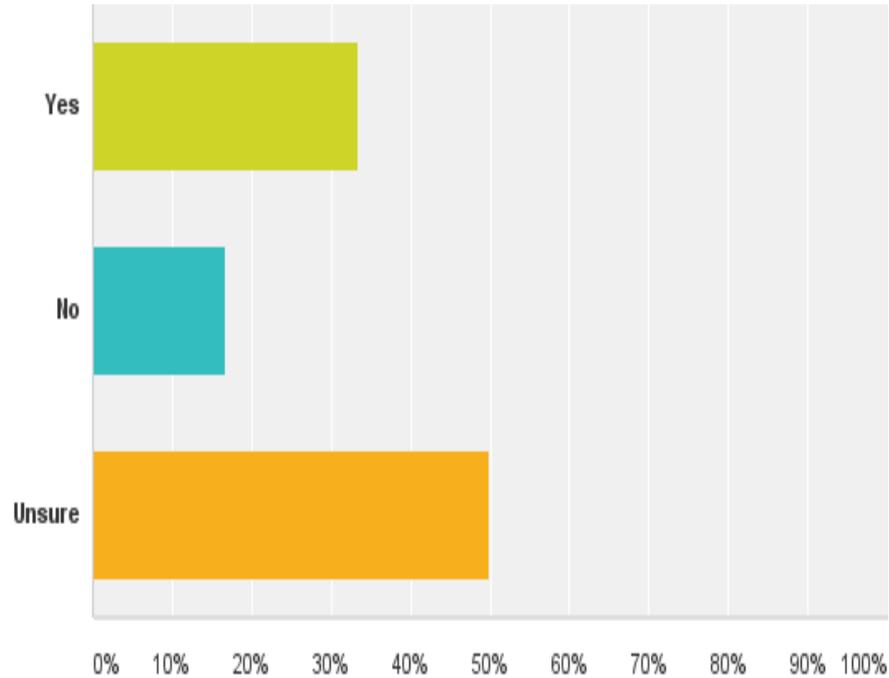
Answer Choices	Responses
Auto-collateralisation through a centralised collateral management service	58.33% 7
Substitution or re-use of collateral	50.00% 6
Novation of both legs of the repo	83.33% 10
Anonymous trading on an electronic platform	58.33% 7
Other (please elaborate in the comments field)	33.33% 4
Total Respondents: 12	

Q5: Overview: To what extent is non-centrally cleared repo trading constrained by counterparty credit concerns? Have such concerns increased in recent years? Is activity typically more constrained during periods of high market volatility?



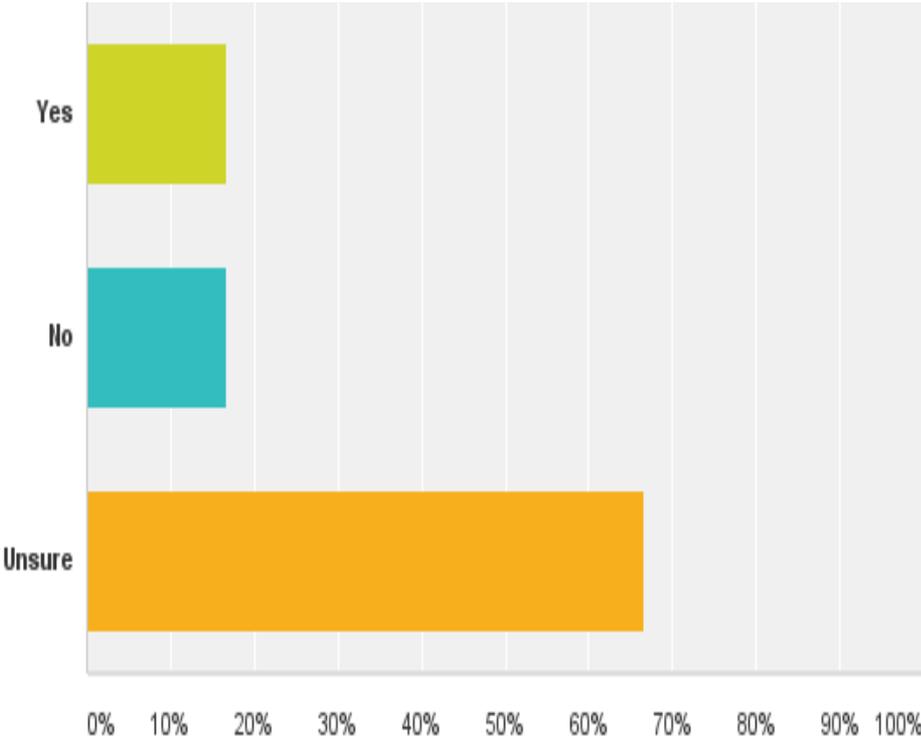
	Yes, materially	Yes, somewhat	Unlikely to be constrained	Not constrained	Unsure	Total
To what extent is non-centrally cleared repo trading constrained by counterparty credit concerns?	16.67% 2	50.00% 6	8.33% 1	16.67% 2	8.33% 1	12
Have such concerns increased in recent years?	25.00% 3	41.67% 5	8.33% 1	8.33% 1	16.67% 2	12
Is activity typically more constrained during periods of high market volatility?	25.00% 3	41.67% 5	8.33% 1	25.00% 3	0.00% 0	12

Q6: Overview: Do you believe that it would be commercially viable for a CCP to offer a repo clearing service in Australia? Why/why not?



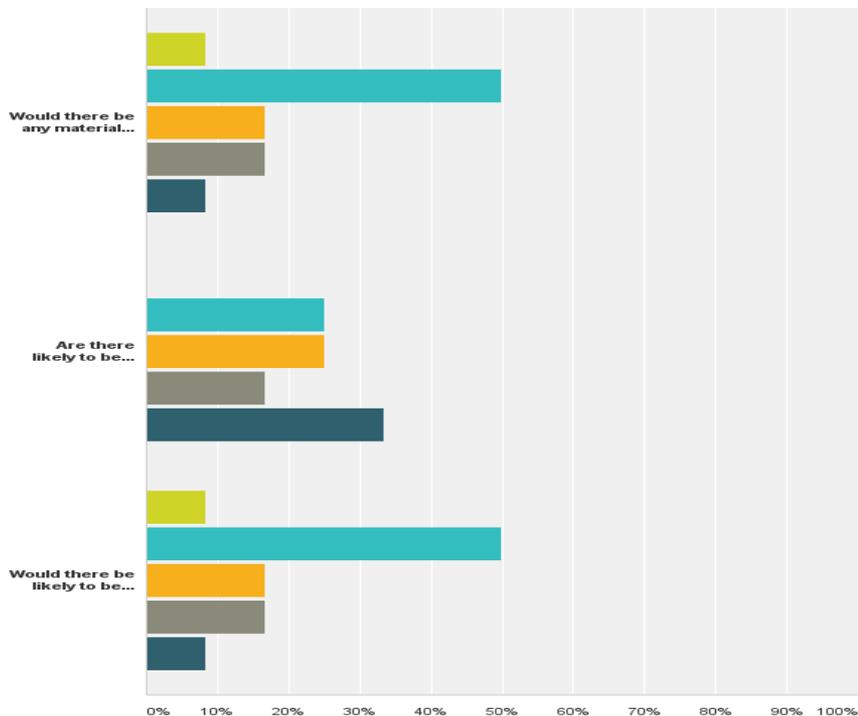
Answer Choices	Responses
Yes	33.33% 4
No	16.67% 2
Unsure	50.00% 6
Total	12

Q7: Overview: Are there alternatives to CCP clearing that would improve the functioning of the Australian repo market and its capacity to safely, efficiently and continuously support the funding and liquidity needs of the Australian financial system? If so, please explain.



Answer Choices	Responses
Yes	16.67% 2
No	16.67% 2
Unsure	66.67% 8
Total	12

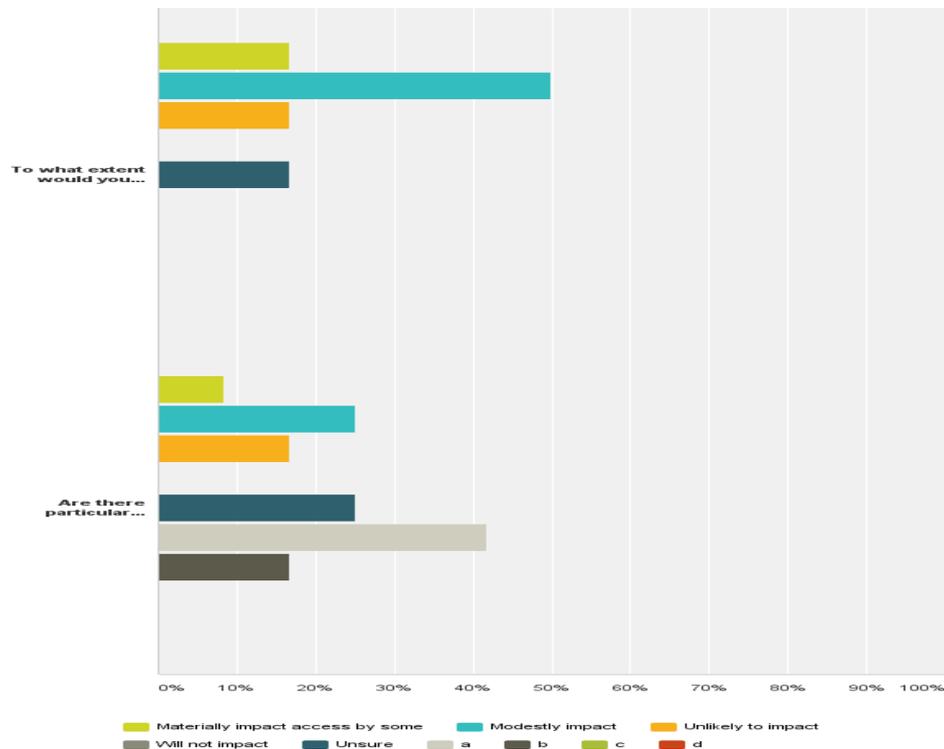
Q8: Overview: Would there be any material impediments to the safe and efficient operation of a repo CCP in Australia? Are there likely to be aspects of a CCP's design that could not readily accommodate Australian repo market practices? Would there be likely to be material challenges in transition to a centrally cleared environment?



	Yes, material impediments/challenges	Yes, some impediments/challenges	Unlikely to be impediments/challenges	No impediments/challenges	Unsure	Total
Would there be any material impediments to the safe and efficient operation of a repo CCP in Australia?	8.33% 1	50.00% 6	16.67% 2	16.67% 2	8.33% 1	12
Are there likely to be aspects of a CCP's design that could not readily accommodate Australian repo market practices?	0.00% 0	25.00% 3	25.00% 3	16.67% 2	33.33% 4	12
Would there be likely to be material challenges in transition to a centrally cleared environment?	8.33% 1	50.00% 6	16.67% 2	16.67% 2	8.33% 1	12

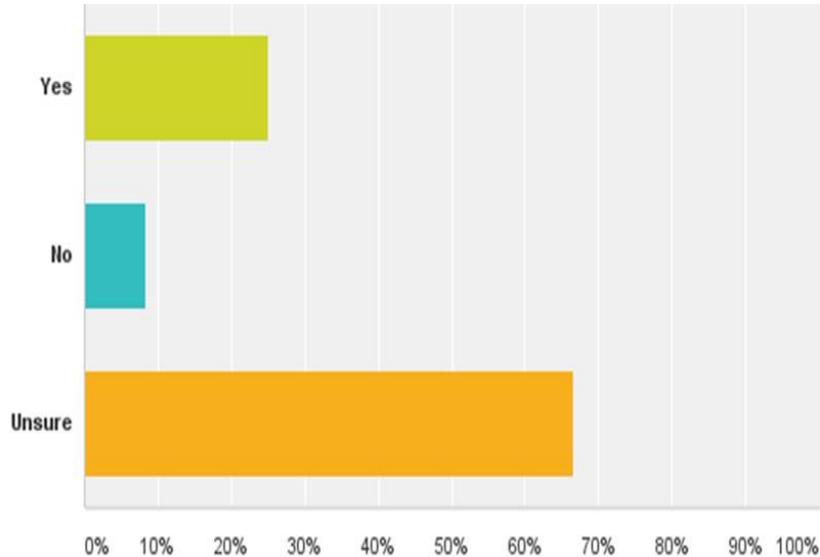
■ Yes, material impediments/ challenges
 ■ Yes, some impediments/ challenges
 ■ Unlikely to be impediments/ challenges
 ■ No impediments/ challenges
 ■ Unsure

Q9: Access: To what extent would you expect a repo CCP's participation requirements to affect some participants' access to clearing? Are there particular types of repo market participant that you believe would have difficulties in accessing central clearing, either as a direct participant or as a client? (please use the comments field to answer this)



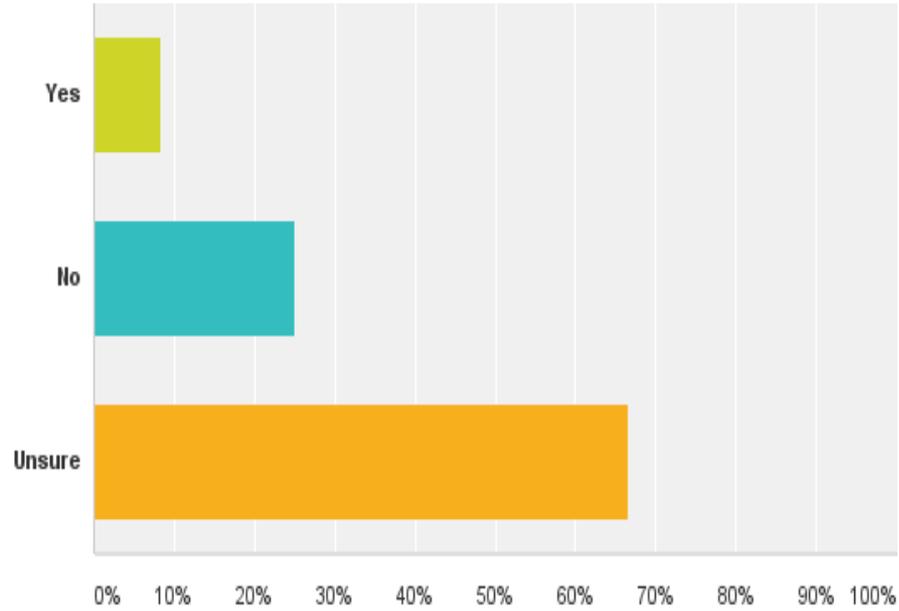
	Materially impact access by some	Modestly impact	Unlikely to impact	Will not impact	Unsure	a	b	c	d	Total Respondents
To what extent would you expect a repo CCP's participation requirements to affect some participants' access to clearing? (Please check only 1 of the first 5 columns)	16.67% 2	50.00% 6	16.67% 2	0.00% 0	16.67% 2	0.00% 0	0.00% 0	0.00% 0	0.00% 0	12
Are there particular types of repo market participant that you believe would have difficulties in accessing central clearing, either as a direct participant or as a client? (please use the last 4 columns and the Comment field to answer this)	8.33% 1	25.00% 3	16.67% 2	0.00% 0	25.00% 3	41.67% 5	16.67% 2	0.00% 0	0.00% 0	12

Q10: Access: If there were a repo CCP in Australia, would you expect there to be demand from buy-side clients to centrally clear their repo transactions with dealers? Why/why not?



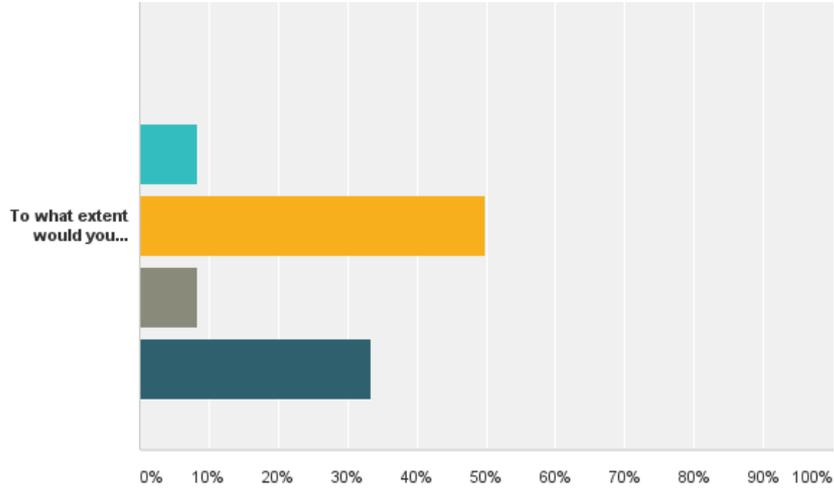
Answer Choices	Responses
Yes	25.00% 3
No	8.33% 1
Unsure	66.67% 8
Total	12

Q11: Access: Are there alternative models for access to CCPs that you believe would address concerns about smaller institutions' access to central clearing?



Answer Choices	Responses
Yes	8.33% 1
No	25.00% 3
Unsure	66.67% 8
Total	12

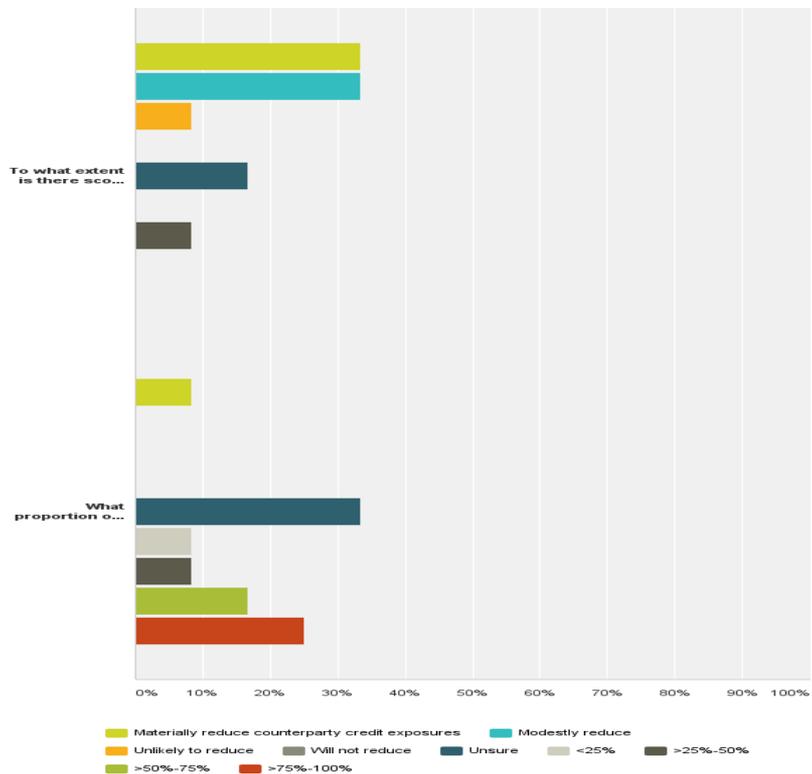
Q12: Access: To what extent would you expect a CCP's position limits to restrict activity in the Australian repo market?



■ Materially restrict activity
 ■ Modestly restrict
 ■ Unlikely to restrict
■ Will not restrict
 ■ Unsure

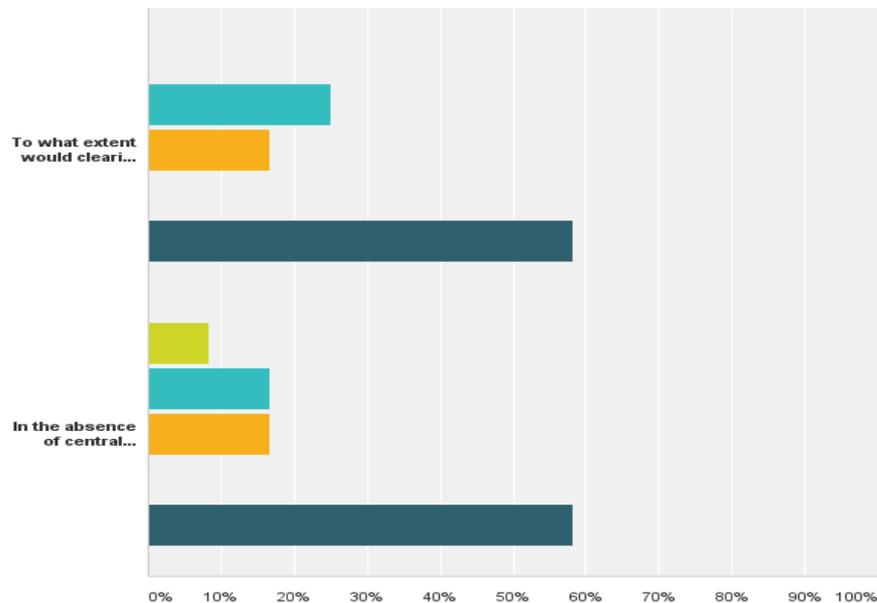
	Materially restrict activity	Modestly restrict	Unlikely to restrict	Will not restrict	Unsure	Total
To what extent would you expect a repo CCP's participation requirements to affect some participants' access to clearing?	0.00% 0	8.33% 1	50.00% 6	8.33% 1	33.33% 4	12

Q13: Counterparty Credit Risk: To what extent is there scope to reduce the size of counterparty credit exposures in Australian interdealer repos through multilateral netting? Please estimate using the first five columns. What proportion of market activity is contributed by participant types with primarily one-way transactions? Please estimate this using the % columns.



	Materially reduce counterparty credit exposures	Modestly reduce	Unlikely to reduce	Will not reduce	Unsure	<25%	>25%-50%	>50%-75%	>75%-100%	Total
To what extent is there scope to reduce the size of counterparty credit exposures in Australian interdealer repos through multilateral netting?	33.33% 4	33.33% 4	8.33% 1	0.00% 0	16.67% 2	0.00% 0	8.33% 1	0.00% 0	0.00% 0	12
What proportion of market activity is contributed by participant types with primarily one-way transactions?	8.33% 1	0.00% 0	0.00% 0	0.00% 0	33.33% 4	8.33% 1	8.33% 1	16.67% 2	25.00% 3	12

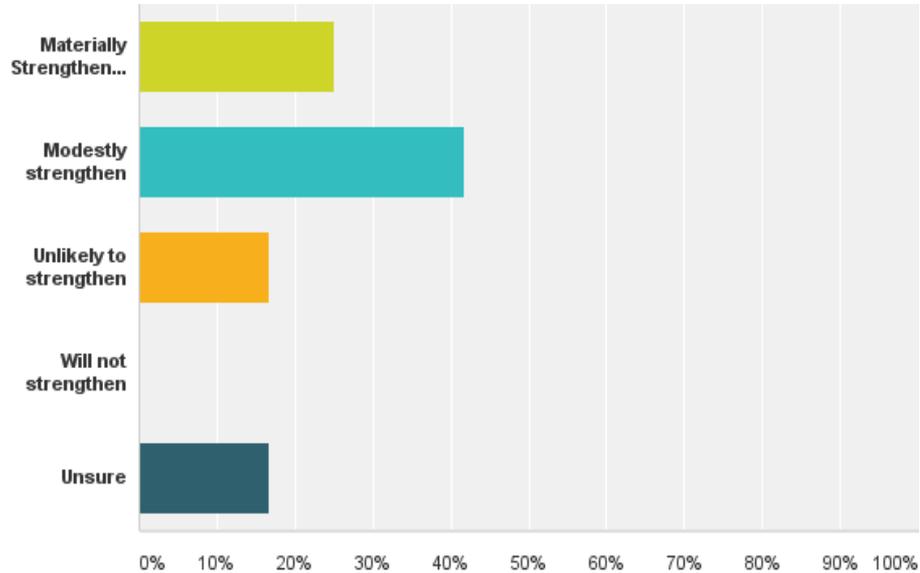
Q14: Counterparty Credit Risk: To what extent would clearing interdealer repos reduce the regulatory capital banks are required to hold against such exposures, including under the proposed leverage ratio? In the absence of central clearing, to what extent would you expect some participants' repo market activity to be affected by the BCBS large exposures framework?



- Materially reduce regulatory capital burden / be affected by BCBS L.E. framework
- Modestly reduce / be affected by BCBS L.E. framework
- Unlikely to reduce / be affected by BCBS L.E. framework
- Will not reduce / be affected by BCBS L.E. framework
- Unsure

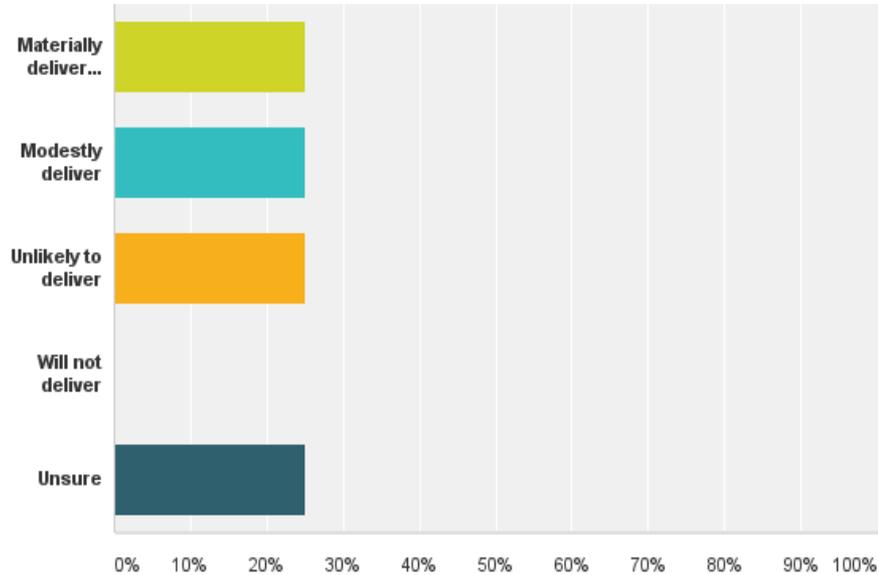
	Materially reduce regulatory capital burden / be affected by BCBS L.E. framework	Modestly reduce / be affected by BCBS L.E. framework	Unlikely to reduce / be affected by BCBS L.E. framework	Will not reduce / be affected by BCBS L.E. framework	Unsure	Total
To what extent would clearing interdealer repos reduce the regulatory capital banks are required to hold against such exposures, including under the proposed leverage ratio?	0.00% 0	25.00% 3	16.67% 2	0.00% 0	58.33% 7	12
In the absence of central clearing, to what extent would you expect some participants' repo market activity to be affected by the BCBS large exposures framework?	8.33% 1	16.67% 2	16.67% 2	0.00% 0	58.33% 7	12

Q15: Counterparty Credit Risk: To what extent would a CCP strengthen processes for margining and collateral valuation in the interdealer repo market, relative to existing bilateral arrangements?



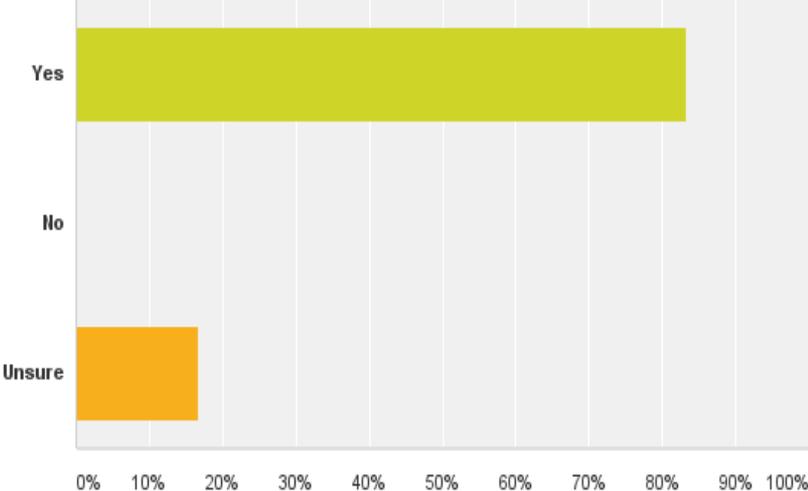
Answer Choices	Responses
Materially Strengthen processes	25.00% 3
Modestly strengthen	41.67% 5
Unlikely to strengthen	16.67% 2
Will not strengthen	0.00% 0
Unsure	16.67% 2
Total	12

Q16: Counterparty Credit Risk: Overall, to what extent would you expect central clearing to deliver collateral efficiencies?



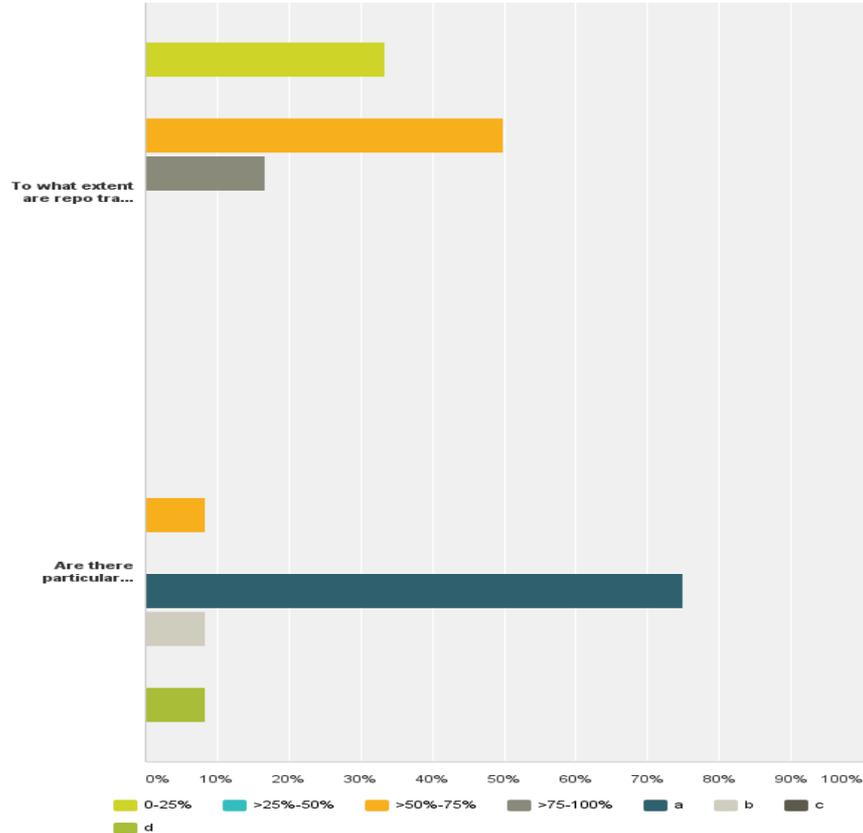
Answer Choices	Responses	
Materially deliver collateral efficiencies	25.00%	3
Modestly deliver	25.00%	3
Unlikely to deliver	25.00%	3
Will not deliver	0.00%	0
Unsure	25.00%	3
Total		12

Q17: Counterparty Credit Risk: Would you perceive a significant benefit from a CCP coordinating the management of the default of a repo market participant? Why/why not?



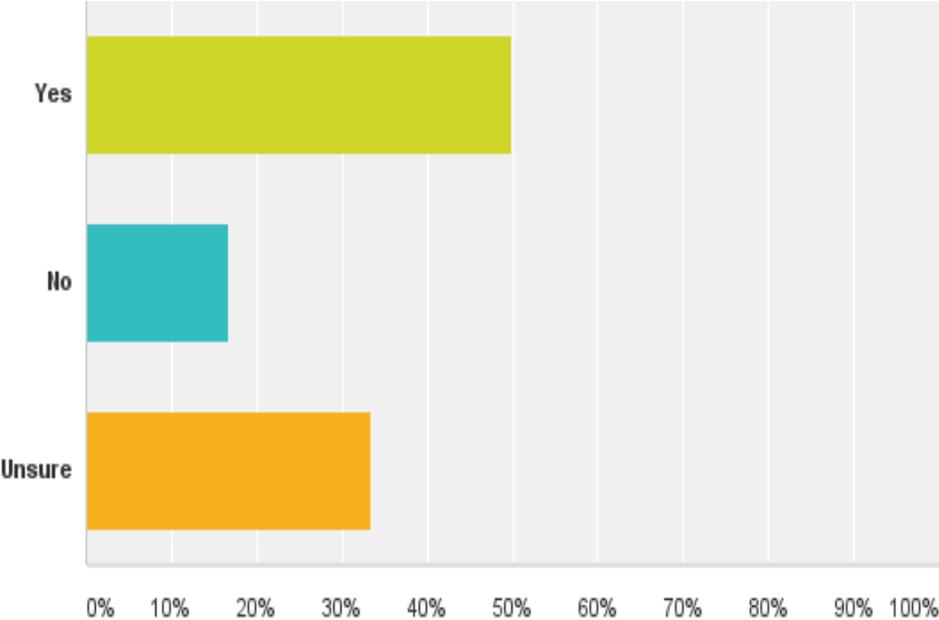
Answer Choices	Responses
Yes	83.33% 10
No	0.00% 0
Unsure	16.67% 2
Total	12

Q18: Operational Efficiencies: To what extent are repo trades processed in a straight-through manner? Are there particular aspects of processing repos that require material manual intervention?



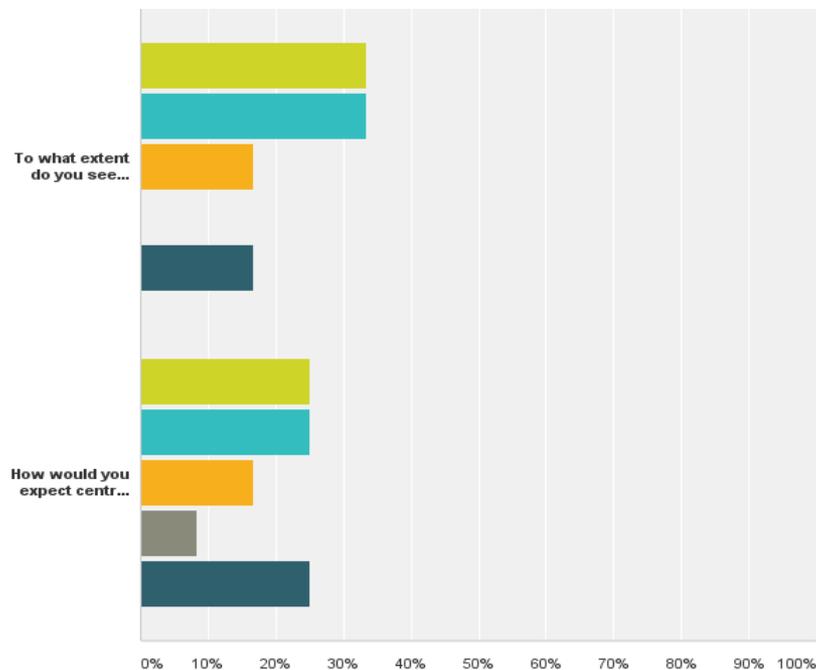
	0-25%	>25%-50%	>50%-75%	>75%-100%	a	b	c	d	Total
To what extent are repo trades processed in a straight-through manner? (Use first 4 columns)	33.33% 4	0.00% 0	50.00% 6	16.67% 2	0.00% 0	0.00% 0	0.00% 0	0.00% 0	12
Are there particular aspects of processing repos that require material manual intervention? (Use last 4 columns)	0.00% 0	0.00% 0	8.33% 1	0.00% 0	75.00% 9	8.33% 1	0.00% 0	8.33% 1	12

Q19: Operational Efficiencies: Would central clearing of such trades encourage more trading on electronic platforms? Why/why not?



Answer Choices	Responses
Yes	50.00% 6
No	16.67% 2
Unsure	33.33% 4
Total	12

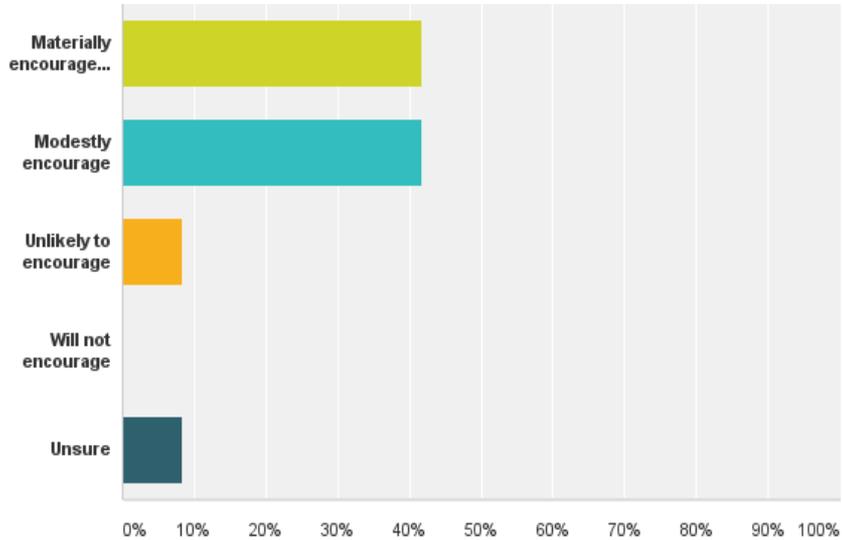
Q20: Operational Efficiencies: To what extent do you see benefit in auto-collateralisation of repos through a centralised collateral management service such as ASX Collateral? How would you expect central clearing of repos to affect the use of such a service?



■ Material benefits / material affect
 ■ Modest Benefits / modest affect
■ Unlikely to have benefits / affects
 ■ Will not have benefits /affects
 ■ Unsure

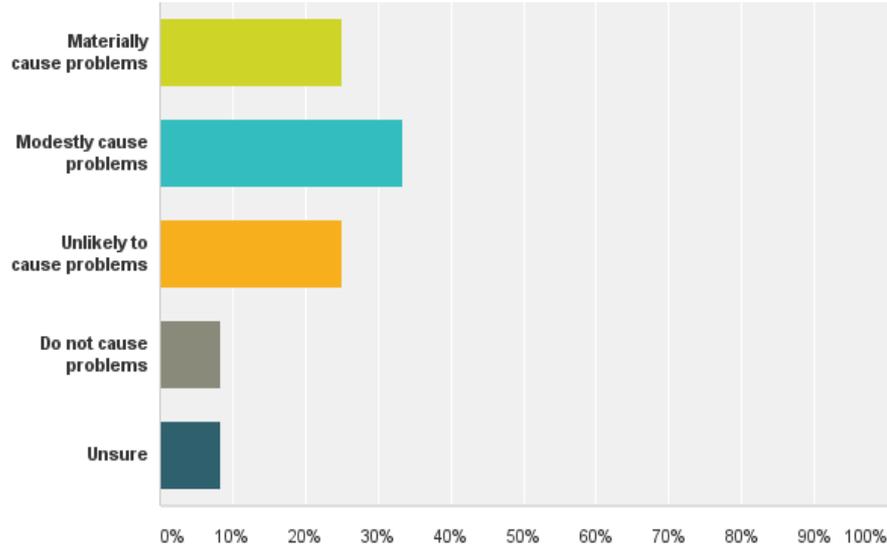
	Material benefits / material affect	Modest Benefits / modest affect	Unlikely to have benefits / affects	Will not have benefits /affects	Unsure	Total
To what extent do you see benefit in auto-collateralisation of repos through a centralised collateral management service such as ASX Collateral?	33.33% 4	33.33% 4	16.67% 2	0.00% 0	16.67% 2	12
How would you expect central clearing of repos to affect the use of such a service?	25.00% 3	25.00% 3	16.67% 2	8.33% 1	25.00% 3	12

Q21: Operational Efficiencies: Overall, to what extent would you expect central clearing of repos to encourage greater automation and operational efficiencies in the Australian repo market? Are there other mechanisms that might be equally effective in encouraging such efficiencies?



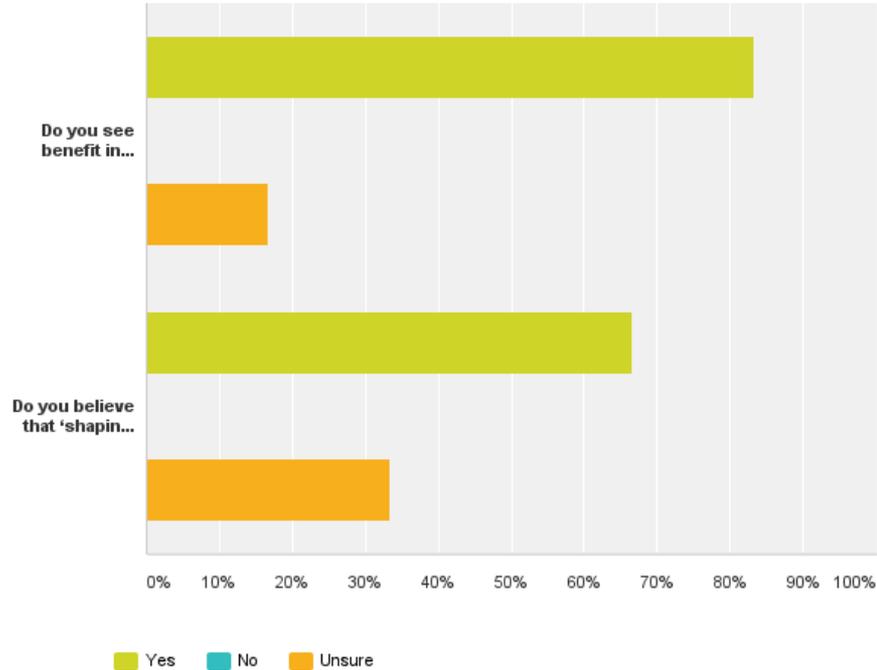
Answer Choices	Responses
Materially encourage greater automation /operational efficiencies	41.67% 5
Modestly encourage	41.67% 5
Unlikely to encourage	8.33% 1
Will not encourage	0.00% 0
Unsure	8.33% 1
Total	12

Q22: Settlement Arrangements: Do you agree that settlement issues arising from chains of trades are unlikely to cause problems in the current market? And do you agree that settlement issues would not be an impediment to the effective functioning of a repo CCP? If not, why not?



Answer Choices	Responses	
Materially cause problems	25.00%	3
Modestly cause problems	33.33%	4
Unlikely to cause problems	25.00%	3
Do not cause problems	8.33%	1
Unsure	8.33%	1
Total		12

Q23: Settlement Arrangements: Do you see benefit in settlement netting by line of security? Do you believe that 'shaping' of settlement obligations would be beneficial in the settlement of repos in Australia? Why/why not?



	Yes	No	Unsure	Total
Do you see benefit in settlement netting by line of security?	83.33%	0.00%	16.67%	
	10	0	2	12
Do you believe that 'shaping' of settlement obligations would be beneficial in the settlement of repos in Australia?	66.67%	0.00%	33.33%	
	8	0	4	12