8 February 2021

Bill Woods
Principal, Participants Compliance
ASX Limited
Sydney NSW

By email: participants.compliance@asx.com.au

Trust and Client Segregated Accounts

Dear Mr Woods

The Australian Financial Markets Association (AFMA) is making comment on the *Consultation on proposed changes to the ASX Clear Operating Rules, Procedures and Guidance Note regarding trust and client segregated account* (ASX Clear Rules) and (Consultation).

While there is general support for improving the operation of the ASX Clear Rules with regard to trust and client segregated accounts, there is some concern that the proposed changes intersect with the law on client money supervised by ASIC. Accordingly, some points requiring further consideration and clarification are noted below, with a more fundamental issue raised as to whether client money should be left totally to the law administered by ASIC to avoid divergent rules.

Removing Reconciliation

The Consultation proposes removing the word "*reconciliation*" from the ASX Clear Rules and guidance note references to "*reconciliation of client money requirements*". This has problematic consequences. Importantly, the removal in respect of Rule 4.23.2 would have the effect of broadening the scope to enable action to be taken where a participant has not complied with Division 2 of Part 7.8 of the *Corporations Act* (the Act), where relevant client money is received in connection with Market Transactions pursuant to ASX Clear Rule 19.11 and the powers granted by that provision. This change departs from the equivalent provision in the *ASIC Market Integrity Rules (Securities Markets) 2017* (ASIC MIRs), which aligns Part 3.5.1 with the specific sections of the Act directing such monies to be held in trust.

AFMA requests ASX to clarify the purpose of these amendments given that we are concerned that any breach of the relevant provisions of the Act could require notification to ASX under the current drafting.

ASIC Regulation harmonisation

The Consultation proposes the term a "nominated time" be added to ASX Clear Rule 4.23.5 and its related Procedure, on the basis that it would reflect the *ASIC Client Money Reporting Rules 2017* (ASIC CMRR) introduced in respect of derivatives retail client money. In addition, Footnote 1 to Guidance Note 10 has instructed participants to have regard to ASIC Regulatory Guide (RG) 212 written in respect of Client Money for dealing in OTC derivatives. The cross-referencing to the ASIC rules appears to broaden the scope of the ASX Clear Rules beyond the reconciliation of client money.

This broadening of scope increases operational complexity, particularly as such rules and guidance have been developed for a specific category of client money supervised under a separate regime. Harmonised or consolidated obligations and guidance on client monies (including reconciliation requirements) would be a logical way to proceed. As the law takes precedence, the obvious place for harmonisation is under the ASIC supervisory regime so rules are consistent across all products, enabling participants to harmonise their arrangements, reduce duplicative reporting and consolidate oversight of all trust accounts.

The consultation has a number of proposals including Rule 4.23.5 and Rule 4.23.7 that have adopted elements of the ASIC CMRR. ASIC has specifically excluded retail client money traded on licensed domestic exchanges from those provisions on the basis that it considers the existing arrangements are adequate, per RG 212.60 and 212.61:

> *"For the purposes of the client money reporting rules, 'reportable client money' is derivative retail client money that relates to derivatives which are not traded on a licensed domestic exchange (i.e. derivative retail client money that relates to overseas exchange-traded derivatives and OTC derivatives). An exemption is provided in relation to client money held for derivatives traded on licensed domestic exchanges, as the participants of those exchanges are already subject to stringent reporting and reconciliation requirements under the ASIC market integrity rules. We are responsible for supervising compliance with the market integrity rules and therefore there is already greater regulatory transparency in relation to that client money."*

It is unclear why elements of the ASIC CMRR have been included in the context of ASIC's guidance. An explanation of the rationale for doing this would be helpful to participants.

Standardisation

There is general support for an improved reconciliation process proposed in the Consultation through the requirement to reconcile to the client level on each business day, standardising reconciliations across the industry and recommending auditors have regard to the ASX Clear Rules when conducting their FS 71 annual audit. Notwithstanding this, there are concerns with a number of proposals where the administrative burden outweighs the regulatory gain. ASX is requested to have regard to some practical challenges the drafting presents for participants, who will be required to introduce a number of specific operational and compliance arrangements to support the ASX Clear client money regime including, but not limited to:

- a process to nominate a reconciliation time and to notify ASX of this time and any subsequent changes to it;
- aligning systems to issue prescribed reconciliation-related reports at a specified time or issue alerts where an operational / external issue may delay such reports; and
- preparation and review of prescribed details for ASC Clear Rule 4.23.7 related notifications regardless of the scale of the failure or deficiency.

Reconciliation breaks

The Consultation sets out a proposed clarification in the ASX Clear Rules which will require ASX to be notified of a deficiency of funds in a participant's trust account regardless of the amount of the deficiency identified. In relation to the proposed amendments to ASX Clear Rule 4.23.7, ASX's proposal to require participants to supply the information prescribed by Procedure 4.23.7(d) for all failures and deficiencies, regardless of their scale, is unnecessary and excessively onerous. AFMA requests the ASX to clarify how it expects this to work in practice, as it is current general market practice that where a break in a reconciliation is identified that can be explained or reconciled so that you are able to balance the figures, this would not be considered the identification of a deficit in the client trust account. Rather, it would only be notifiable if the reconciliation itself, after accounting for these balancing items, concludes there is a deficit in the trust account.

Under the current rule, participants can submit a timely notification to ASX followed by supporting documents on an as-needs basis. To assist the ASX in its thinking, here are some common occurrences where data feed differences can cause a break. In each of the examples listed below, the reason for the discrepancy would be investigated and accounted for in the reconciliation as a "balancing item" under current practice:

- A break in initial margin / collateral valuations due to the use of different data sources for collateral valuations used by participant systems vs those used by the ASX.
- Client trades booked to the house suspense account due to not having received allocations in time which can result in a premium break. Once allocations are received the trades and associated premiums are then moved to client and trust account.
- Trade misallocation between client accounts if collateral has not been booked in a participant's back office system or if the ASX has taken collateral for a client and they have booked it differently on their side.

Preparation of all supplementary documentation at the point of notification increases the administrative and compliance burden on participants and we believe adopting a more measured approach would not compromise the objective of the proposal.

Returning to the proposed amendments requiring participants to elect a "nominated time", it is important that ASX Clear allows flexibility for participants to complete reconciliations within a reasonable range of the nominated time without having to submit notifications to ASX. While there is general agreement with the definition of nominated time (Section 7 of GN10), the member view is that the existing "close of business"

requirement enables flexibility for participants to manage operational and/or external provider issues, whilst being able to complete its reconciliations in accordance with the rules. The requirement to nominate a specific time will add undue pressures to this process and the requirement to notify ASX of changes to this time is considered an unnecessary administrative step.

Transition

For most participants, an IT change would be required to implement the proposed changes. A period of 12 months would be needed to implement the required changes. In terms of the proposed transition period, AFMA members support a 1-year transition.

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

David Love
General Counsel & International Adviser