



SFE Bulletin No: 132/02

From: SFE Corporation Limited ABN 74 000 299 392

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RECEIPT OF INITIAL AND VARIATION MARGINS AND SELF REPORTING OF MARGIN BREACHES

Participants are referred to SFE Bulletin 06/02 in relation to exercising discretion to close out a client's positions on non receipt of margin calls. The Business Conduct Committee (the Committee) has considered this issue further following submissions received from a number of Participants.

Participants are reminded of the SFE's requirements to ensure that margins are satisfied by payment or cover within twenty-four (24) hours for domestic clients and forty-eight (48) hours for overseas clients of the request or the call.

General By-Law G.21 of the SFE's Rules gives the Participant the right to close out all or any existing futures positions in any market held by the Participant on account of a client or Local Participant without further notice if the client is in default by failing to pay a call.

Bulletin 06/02 advised that the Committee expected Participants to exercise their right to close out the positions held by clients if they fail to meet a margin call. After further consideration of this issue by the Committee, it directed that Participants be advised that the decision by a Participant not to exercise its discretion may be acceptable in some circumstances. The Committee will of course consider all of the circumstances of each event when presented with breaches of the margin requirements. An example of where it may be acceptable for a Participant to not exercise its discretion to close out a client's positions on non receipt of margins is as follows:

- Where the Participant is certain that the funds will arrive from the client but they are late in arriving due to delays by the paying bank or electronic payment delays. In such circumstances, it is recommended that the Participant request evidence from the client, if at all possible, that the payment has been made but not received by the Participant.

The Committee would expect that a Participant would consider exercising its discretion to close out a client's positions as soon as there is **ANY** doubt, to a reasonable person, that the funds will not arrive from the client.

Notwithstanding any of the above, the Committee will always have regard to all of the relevant circumstances of any particular breach in deciding whether to impose a penalty upon the Participant for the failure to receive a margin.

S F E B U L L E T I N C O N T I N U E D

The non receipt of margins by clients within the required timeframes is considered a breach of the Exchange's Rules. However, the Committee has directed that Participants be advised that they are now required to self report breaches of the Exchange's margin rules only when a margin call has not been met by a client and the Participant has chosen not to exercise its discretion to close out the client's positions and there is any doubt that the funds will not arrive from the client. The breach must be self reported to the Exchange as soon as this doubt arises. Circumstances which the Committee considers might reasonably cause such doubt to arise include, but are not limited to, where the client cannot be contacted, where no evidence is forthcoming from the client as to the payment status or instructions, and where there is a pattern of previous behaviour.

As a condition of not being required to self report all margin breaches to the Exchange, Participants are now required to maintain a register of all incidents of non-receipt of margins. This register must contain the following details:

- Name of the client
- Amount of the call
- Time and date of the initial call and any subsequent calls
- Details of escalation and other relevant steps taken by the Participant
- Details of whether the Participant exercises its discretion to close out the client's positions and if not, why not?
- Date and amount of funds received or details of action taken by the client

This register must be made available to Compliance & Surveillance staff of the Exchange on demand. Compliance and Surveillance staff will conduct spot checks of Participants' registers. Please note that in the event of any significant market volatility, Participants may be required to furnish a copy of its register to Compliance & Surveillance staff of the Exchange on a daily basis.

Finally, the Committee has directed that where Participants have clients that have reasonable or recurring difficulty in meeting payment of margins within the required timeframe, Participants should consider arranging formal approved credit facilities for these clients. In this regard, Participants are referred to Practice Note 3: "Provision of Credit to Clients", attached to this Bulletin.

Should you have any queries please contact the undersigned on 9256-0580 or mwagner@sfe.com.au



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PNOTE.03

PRACTICE NOTE

SUBJECT: PROVISION OF CREDIT TO CLIENTS

**RELEVANT LAW/
BUSINESS RULE:** GENERAL BY-LAWS G.20, G.22, G.46, G.47 AND G.48

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PRACTICE NOTE NO: 3

General By-Laws G.20(a)(iii), G.20(b)(ii), G.22(a), G.46(b)(i), G.46(b)(iii), G.47(a)(i) and G.48(d) make provision for the payment of initial and variation margins either by cash or approved securities.

General By-Law G.20(a)(iii) states that initial Margin requirements must be satisfied by payment unless the Full Participant or Associate Participant agrees to accept and receives Cover by way of Approved Securities as described in Part A of the First Schedule.

General By-Law G.20(b)(ii) states that calls for Variation Margin must be satisfied by payment unless the Full Participant or Associate Participant agrees to accept and receives Approved Securities as described within Part A of the First Schedule.

General By-Law G.22(a) states that where a request is made for the lodgement of Cover and/or a Call is made for Initial or Variation Margin the Participant shall stipulate the time for payment or lodgement. Payment or lodgment shall be made within twenty-four (24) hours of the request or the Call. Where a Client is overseas then lodgement of Cover or payment of a Call must be made within 48 hours. No Participant shall provide credit or Cover for a Client or a Local Participant beyond these periods. Time shall be of the essence in respect of the lodgement of Cover or payment of a Call.

General By-Law G.46(b)(i) states that initial Margin requirements of the Client must be satisfied by payment unless the Participant agrees to accept and receives Cover by way of Approved Securities as described in Part A of the First Schedule.

General By-Law G.47(a)(i) states that calls for Variation Margin must be satisfied by payment unless the Participant agrees to accept and receives Approved Securities as described within Part A of the First Schedule.

General By-Law G.48(d) states that where a request is made for the lodgement of Cover and/or a Call is made for the payment of Initial or Variation Margin the Participant shall stipulate the time for payment. Payment or lodgement shall be within twenty-four (24) hours of the request or the Call. Where a Client is overseas then lodgement of Cover or payment of a Call must be made within 48 hours. No Participant shall provide credit or Cover for a Client or a Local Participant beyond these periods. Time shall be of the essence in respect of the lodgement of Cover or payment of any Call.

The list of approved securities is contained in Part A of the First Schedule (copy attached).

Paragraph (i) of the list of approved securities reads:

“Such other security or credit facility and on such terms as may be approved by the Business Conduct Committee from time to time.”

The Committee has recently reviewed the policy it will adopt in relation to the exercise of its discretion under this provision to permit credit lines to be granted to clients.

The Committee reaffirmed the basic principle that the payments of margins by cash or some other form of realisable security is fundamental to the financial integrity of the SFE Corporation Limited and its Participants.

In the past, the Committee has used discretion when in very limited circumstances granting permission for credit facilities to be provided by a Participant.

The Committee has directed that in future such discretion will only be exercised in the case of a Participant which is a bank within the meaning of the Banking Act, and where:-

- (a) The monies are lent by a separate credit division of the bank;
- (b) Such monies are lent in accordance with normal credit policy of the bank, and SFE Corporation Limited compliance staff have access to the relevant approval by the credit division;
- (c) the facility is used to pay obligations for initial and variation margins and that such obligations are met by actual payment into the clients' segregated account of the Participant through a direct call on the facility.

No approval will be given for any facility which involves the waiver of initial or variation margin requirements for any period.

The Committee is also aware of arrangements where a related entity of the Participant provides credit to clients of the Participant to meet initial and variation margins. The Committee finds this situation acceptable on the basis that the credit is provided by a related entity whose core business activity is the provision of credit to clients and also that the related entity is not a subsidiary of the Participant.

NOTE: The above information is for the guidance of Participants and does not purport to be legal advice. The note should be read in conjunction with the legislation and any ASIC practice notes. Where appropriate, legal or other professional advice should be sought.