SFE BULLETIN

www.sfe.com.au

30 Grosvenor Street
Sydney NSW 2000 Australia
Telephone 61 2 9256 0555
Facsimile 61 2 9256 0666

PO Box N680
Grosvenor Place
NSW 1220 Australia

SFE Clearing Bulletin No: **31 / 03**

From: SFE Clearing Corporation Pty Ltd ABN 91 050 615 864

Date of Issue: 29 Aug 2003

Effective Date: 29 September 2003

Calling of Additional Initial Margins Referable to Stress Testing Results

As part of the processes involved in ensuring compliance with the Reserve Bank of Australia's Financial Stability Standards, SFE Clearing has been reviewing the adequacy of the Clearing Guarantee Fund (CGF) and margining arrangements.

In particular, the Board of SFE Clearing has reviewed the capacity to meet losses postulated from stress testing of Clearing Participants' positions under various extreme scenarios. As a result, supplementary pro-active risk control measures have been adopted which take account of the existence of the excess margin monies which are typically deposited with SFE Clearing by Clearing Participants.

Essential features of the revised risk control processes are:

- Each Clearing Participant will be allocated a stress test credit exposure limit (reviewed monthly), with the current maximum limit – for those with a credit rating of A1 or better – being $80M. For other Clearing Participants, the limit is 50% of their reported NTA (currently capped at $80M).

- Additional initial margins will be formally called from relevant Clearing Participants in respect of open positions in excess of the stress tested outcomes. Such calls will be made on a daily basis when required, and must be satisfied on the same day in accordance with the SFE Clearing By-Laws. In the first instance, additional initial margin calls will be made separately to the daily settlement process (i.e. intra-day), however it is intended to incorporate additional initial margin calls as part of the daily settlement process in due course.

- The additional initial margin requirements will be calculated according to the pre-defined financial capacity of the Clearing Participant relative to its own potential exposure, rather than the potential exposure of any other Clearing Participant.

- SFE Clearing will <u>not</u> take the standard initial margin haircut on interest payable on these additional margins – i.e. the additional initial margins will attract the same interest rate as excess margin monies (for cash amounts lodged).

- The new regime will become operationally effective on 29 September 2003.

From a review of past market activity, it is not envisaged that there will be any significant financial impact upon most Clearing Participants as a result of the introduction of these new measures. Any such impact will be further reduced by those Clearing Participants who continue to leave excess margin monies on deposit with SFE Clearing.

A worked example providing further details of how the additional initial margins are calculated is provided in the Attachment to this bulletin.

Should you have any queries, please contact Mark Tooher on 9256-0553 or at mtooher@sfe.com.au .

Anne T. Brown
General Manager, Business Risk

WORKED EXAMPLE OF ADDITIONAL INITIAL MARGIN (AIM) CALCULATION PROCESS

Day 1

Assume the following excess margin monies, pre-defined credit limits and potential loss exposure for open positions at the end of a given trading day (Day T zero) for each Clearing Participant as shown in Table 1 below.

AIM calls would be identified and calculated on a daily basis as follows:

Stage 1 – On Day T+1, collate potential loss exposures per Clearing Participant as a result of applying SFE Clearing stress-testing methodology against open positions as at close of trading.

Stage 2 – Compare the loss exposures for each Clearing Participants against their pre-defined stress testing credit exposure limits to identify limit breaches – see Table 1 (column D1) below.

Stage 3 – Call AIM to the extent of the limit breaches identified.

Table 1 – Extent of Stress Testing Credit Exposure Limit Breaches

Clearing Participant	(A1) Excess Margin Monies $M	(B1) Stress Test Potential Loss Exposure $M	(C1) Stress Test Exposure Credit Limit $M	(D1= B1-C1) Limit Breach $M
CP1	80	138	80	58
CP2	15	100	80	20
CP3	5	70	80	-
CP4	25	42	50	-
CP5	30	29	30	-
CP6	15	29	25	4
CP7	NIL	8	10	
CP8	11	7	5	2
CP9	NIL	5	5	-
CP10	NIL	2	5	-

In this example, the only Clearing Participants with an AIM liability on the day would be CP1, CP2, CP6 and CP8 because the others have not breached their allocated stress testing credit exposure limit. **As long as a Clearing Participant remains within its limit, it will not be liable for AIM irrespective of the potential losses of other Clearing Participants.**

An AIM call would therefore be made intra-day (i.e. after completion of the daily settlement procedures) with the following results:

Table 2 – AIM call outcomes

Clearing Participant	(P1) Today's AIM liability $M	(R1=P1-R0) AIM (surplus) or deficit c/fwd $M	(S1) Excess Margin Monies $M	(T1) Action required $M	(U) Adjusted Excess Margin Monies c/fwd $M
CP1	58	58-0=58	80	Apply $58M excess margins to satisfy whole AIM. No funds transfer by Participant.	22
CP2	20	20-0=20	15	Apply $15M excess margins. Transfer of funds or collateral of $5M by Participant to fulfil call.	NIL
CP6	4	4-0=4	15	Apply $4M excess margins to satisfy whole AIM. No funds transfer by Participant.	11
CP8	2	2-0=2	11	Apply $2M excess margins to satisfy whole AIM. No funds transfer by Participant.	9

In all cases except in relation to CP2, the AIM call can most easily be funded by the excess margin monies already on deposit with SFE Clearing. Unless otherwise previously agreed, SFE Clearing would, in accordance with the Clearing By-Laws, immediately utilise the available excess margins of each Participant to satisfy the margin call, avoiding the need for these 3 Participants to undertake any additional action. The only impact for these Participants will be a reduction in the amount of any excess margins available for re-draw the following day (shown in the 'standing instructions' figure on their Financial Status Advice report distributed the following morning).

However, in relation to CP2, the Participant has only $15M excess margin monies and an AIM call of $20M. A transfer of additional collateral intra-day of $5M is therefore required to satisfy the AIM call – this can take the form of cash or approved non-cash collateral.

Day 2

Assume the following figures apply for the next trading day (after completion of the daily settlement process):

Table 1 – Extent of Stress Testing Credit Exposure Limit Breaches

Clearing Participant	**(A2) Excess Margin Monies $M**	**(B2) Stress Test Potential Loss Exposure $M**	**(C2) Stress Test Exposure Credit Limit $M**	**(D2= B2-C2) Limit Breach $M**
CP1	22	122	80	42
CP2	NIL	95	80	15
CP3	5	82	80	2
CP4	30	40	50	-
CP5	40	29	30	-
CP6	11	36	25	11
CP7	10	16	10	6
CP8	9	4	5	-
CP9	3	4	5	-
CP10	NIL	3	5	-

The AIM liability and related actions on Day 2 would be as follows:

Table 2 – AIM call outcomes

Clearing Participant	**(P2) Today's AIM call $M**	**(R2=P2-R1) AIM (surplus) or deficit c/fwd $M**	**(S2) Excess Margin Monies $M**	**(T2) Action required $M**	**(U2) Adjusted Excess Margin Monies c/fwd $M**
CP1	42	42-58=(16)	22	Release $16M back to excess margins..	38
CP2	15	15-20=(5)	NIL	Release $5M back to excess margins.	5
CP3	2	2-0=2	5	Apply $2 excess margins to satisfy whole AIM. No funds transfer by Participant.	3
CP6	11	11-4=7	11	Apply $7M excess margins to satisfy whole AIM. No funds transfer by Participant.	4
CP7	6	6-0=6	10	Apply $6M excess margins to satisfy whole AIM. No funds transfer by Participant.	4
CP8	2	0-2=(2)	9	Release $2M back to excess margins.	11

On this day, no action would be required by any of the Participants involved to transfer any further funds to satisfy their AIM calls and their next FSA reports would be amended to appropriately reflect the increase or decrease in excess margins available for re-draw.