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**FMI Regulatory Reforms Consultation Submissions**

FMI Section, Payments Policy Department  
Reserve Bank of Australia  
GPO Box 3947  
Sydney NSW 2001

By email to [FMIconsultation@cfr.gov.au](mailto:FMIconsultation@cfr.gov.au)

**Financial Market Infrastructure Regulatory Reforms**

Thank you for the opportunity to make a submission to the Council of Financial Regulators' (CFR) consultation paper, *Financial Market Infrastructure Regulatory Reforms*.

As a provider of financial market infrastructure (FMI), ASX agrees with the consultation paper that 'the stability of a modern financial system relies on the resilience of its markets and supporting infrastructure'. In turn, these financial markets are themselves important foundations of the Australian economy, helping companies raise (and investors deploy) capital as well as managing financial risks.

ASX operates infrastructure that supports financial markets (cash equity and derivatives); provides important clearing services for both of those markets; settlement services for the cash equity and fixed income markets; and also administers two significant financial benchmarks.

These services are currently provided within a robust regulatory framework that requires facility operators to be licensed, subject to regulatory oversight (from ASIC and, in some cases, the RBA) and to comply with a range of license and other regulatory obligations. These include obligations related to: regulatory capital; an appropriate operating rule structure; robust risk management practices; as well as technology and other resourcing requirements.

The existing regulatory system works well, but it is appropriate to periodically review the framework to ensure that it remains fit for purpose and reflects industry developments. Where gaps, overlaps or inconsistencies are identified it is also appropriate to consider whether these could be corrected.

The consultation paper summarises a range of policy measures that have been proposed in recent years to bolster the regulatory framework applying to FMIs, particularly post-trade facilities. These changes were prompted, in the wake of global financial crisis, in part by the increasing reliance on these facilities to promote financial stability. The consultation paper also proposes some additional policy changes and seeks feedback on them.

We have responded below to the new policy measures proposed in the current consultation. As a general comment, these seem focused on achieving sensible policy objectives. However, they are articulated at a relatively high level, which does make it challenging to provide detailed comments on the impact of some specific proposals, including whether they will deliver those objectives efficiently and effectively.

We acknowledge that there will be further consultation on the draft legislation to implement the final policy positions, and that more detail will be available at that time. We would welcome the opportunity to provide detailed feedback during the legislation drafting process and further consultations.

We also make the general observation that while understanding the regulatory flexibility that can be achieved by expressing some of the new powers in very broad terms, this comes at the cost of increased uncertainty for regulated entities about how these powers may be interpreted and exercised in the future.

20 Bridge Street  
Sydney NSW 2000

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We would see great value in policy positions that are expressed in legislation that is clear, detailed and proportionate, and that minimises the delegation of rule-making to the regulators who are tasked with enforcing those rules.

Where it is not possible to include all the detail of an obligation in the legislation, this might be supplemented by regulatory guidance. However, regulatory guidance is not determinative of the extent or requirements of an obligation, and so cannot provide the clarity and certainty of clear statements by the legislature of the law as it relates to specified matters.

The following sections of this submission provides some high level feedback on some of the specific policy proposals. We have particularly focused on areas where we would find more granular detail very helpful in forming a considered position.

### Enhancing the licensing regimes

Aligning regulatory powers and responsibilities is a sensible objective and one that ASX would generally support. We also think that it is important that the Government retains the responsibility to determine the policy settings within which regulators and regulated entities operate. This might mean maintaining a distinction between operational matters where it can be useful and appropriate for regulators to have the ability to make and enforce rules, and policy or other matters for Government. We note that the proposed framework includes Parliamentary oversight and comment that it is important that this is real oversight, with appropriate challenge of proposed regulatory changes, including a genuine regulatory impact assessment.

#### Alignment of regulatory powers and responsibilities

ASX notes the proposal to formally transfer to ASIC, and where appropriate the RBA, the Ministerial powers for licensing and related powers (involving an Australian Market Licensee (AML) and clearing and settlement facility licensee (CSFL)) that are currently delegated to regulators. This transfer appears likely to have a minimal practical impact on the licensing and supervision decisions related to the FMI, given the Minister's decisions are normally based on advice from the regulators. We comment only that it would be appropriate for the delegated functions and the extent of Ministerial oversight to be clearly specified.

#### Other changes to licensing arrangements

ASX has no issue with the proposal to extend the circumstances under which a regulator has the discretion to suspend or cancel the licence of an AML or CSFL to instances where they have not, within a specified time, carried out the activities for which authorisation was required.

#### Overseas entities – requirement to be licensed

ASX supports providing clarity and legal certainty about the circumstances where a foreign-based FMI is required to be licensed to operate in Australia (or be formally exempted from that requirement). This includes imposing requirements on foreign FMIs to provide information to assist the authorities when determining whether the FMI has a 'material domestic connection' to Australia. Extending the 'connectivity test' to foreign operators of financial markets (in addition to post-trade facilities) is also supported.

#### Prescribed financial market – declaration power

ASX has no issue with the proposal to streamline the process for prescribing a financial market by removing the requirement for an amendment to the Corporations Regulations 2001 and providing ASIC with the power to update the list.

#### Widely held market body – declaration power

ASX supports the proposal to change the existing process for approving an increase in voting power in ASX Limited above 15 per cent. Removing the need for a regulation to be drafted and tabled in the Parliament to approve an increase in ownership and delegating that decision to the Minister if they are satisfied it is in the national interest is consistent with a recommendation of the Financial System Inquiry. The proposal simplifies the current process while retaining the role of the Minister to consider the broader national interest implications of the change in control.

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ASX has no issue with the proposal to delegate to ASIC the power to declare a body to be a widely held market body (based on existing criteria) or the proposal that the Minister would continue to approve changes of control in such bodies.

### Enhancing supervision and enforcement

ASX is supportive, in principle, of the proposed changes in this section, subject to having the opportunity to review the final drafting of the legislation (or other supporting material) which will provide more detail on the specifics of the proposals.

#### Fit and proper standard

The proposal to extend the population covered by a fit and proper standard for individuals involved in a FMI is sensible. It would more closely align the approach for FMIs with that applied in other parts of the financial system. Key individuals responsible for making decisions in these FMIs should have the appropriate skills and good character given the important role they play.

It would make sense to, where appropriate, align the definition of the population of individuals to be subject to these new obligation with other similar regimes being established to avoid inconsistencies and make compliance simpler for entities who may be subject to more than one regime.

It is noted that the Government also intends to consult separately on its proposal to extend the Banking Executive Accountability Regime (BEAR) to entities including financial market operators and clearing and settlement facilities. While BEAR is aimed at a different issue, the individuals included should also be used as a point of reference when considering how all the different governance regimes will fit together to avoid inconsistencies arising.

ASX considers that the new fit and proper standard should be applied to individuals currently involved with existing licensees as well as individuals taking up designated positions in the future.

#### Change in control

ASX has no issue with the proposal to extend the requirement for approval of changes in control above 15% of licensees that are widely-held market bodies, or to remove the responsibility for approval from the Minister to ASIC.

#### Rule-making power

ASX notes the proposal to provide ASIC with the power to make rules for clearing and settlement facilities. We understand that the intention of this new power is to allow rules to be made to fill “gaps” in the Financial Stability Standards (FSS).

ASX has no issue with the objective of ensuring that the regulatory framework within which clearing and settlement facilities operate is complete.

However, we would encourage CFR to consider whether the design principles of the new legislation would be met by this proposal, or whether a better proposal would be to take steps to codify the obligations of clearing and settlement facilities in a revised set of FSS administered by the RBA.

Our observation, from the perspective of a regulated entity, is that there is an opportunity for regulatory clarity and efficiency. Conversely, the introduction of a new set of rules which would operate alongside the FSS but with a different regulatory framework, would, we suggest, unnecessarily create regulatory complexity and uncertainty.

At a minimum, to the extent that this proposal is taken forward in its current form, we would suggest that any rule making power should be clearly and specifically defined by reference to the identified “gaps” in the FSS, and that steps be taken to address the risks of regulatory overlap and inconsistency.

We note the proposals for Ministerial and Parliamentary oversight of this rule making power. Again, we would comment that it is important that this is real oversight, with appropriate challenge of proposed regulatory changes, including a genuine regulatory impact assessment.

As a general principle, we also submit that any power of a regulatory agency to make rules of this kind should be subject to formal accountability mechanisms, consistent with the Government’s general approach to access to justice.

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## Information gathering

It is understood that there may be occasions where regulators want to commission their own independent third-party reports on specific matters where they may need to draw on additional technical, or other, expertise. This would be in addition to the existing power they have to require a licensee to commission a third-party report.

There should be greater detail provided up-front about the circumstances when regulators could commission their own independent third-party report (at the expense of the licensee). While, in principle, ASX does not object to this new power, it should be governed by clear guidelines so that it is only used where really necessary, and that it does not amount to the outsourcing of normal regulatory activities. It would also be useful to understand what controls might apply to ensure the process is efficient and cost-effective.

## Directions powers

ASX notes the proposal that the Minister's power to make a direction to a licence holder should be transferred to ASIC (for market licence matters) or to ASIC or RBA (for clearing and settlement facility matters). The new power for the RBA would be to direct a facility in relation to its compliance with its FSS obligations.

It is also proposed that the RBA be given the power to make directions where it reasonably considers actions are necessary to support financial stability. This is a very broad articulation of the power and should be governed by a clearer indication of the nature of what these 'targeted' interventions may involve.

It is also proposed to remove the 'reasonably practicable' qualifier with regard to a CSFL's compliance with the FSS (including when a regulator makes a direction). It is argued that this change is necessary because 'in some situations' the qualifier may make it difficult to establish if the entity has actually breached its FSS obligations. However, no examples have been provided where the existence of the qualifier has hindered the regulator's ability, in practice, to enforce FSS obligations.

The consultation paper indicated that removing the qualifier would not increase the regulatory burden on CSFLs because an assessment of reasonableness would always form part of the consultation process when determining if the entity is in compliance with its FSS obligations. It could be equally be argued in that case that retaining the qualifier should not be a significant impediment for the regulator.

It is also proposed that the obligation to do all things necessary to reduce systemic risk would continue to be subject to the 'reasonably practicable' qualifier.

ASX does not believe there has been a case made for the need to remove the 'reasonably practicable' qualifier. If there is a perceived problem with the enforcement of particular FSS obligations this should be addressed directly through reframing those obligations.

It was previously proposed that the 21 day time limit that currently applies to certain directions would be removed. While understanding the rationale for this decision, and being generally supportive of the principle of ensuring that the power is one that can be used effectively, there should be a mechanism to ensure that the direction is only valid for as long as is required to take the required action and does not risk becoming open-ended. When Parliament originally established the directions power it considered that it was appropriate that it was time-limited and subject to review.

## Crisis management and resolution

ASX acknowledges that the establishment of an effective and efficient resolution regime for FMIs provides an important mechanism for the authorities to step-in to maintain critical services if the facility's risk management tools (including its recovery plan) have been insufficient to deal with a particular financial crisis.

The proposed crisis management powers over CSFLs have been developed over a number of years including an earlier consultation in 2015 and the new measures in this consultation paper build on this earlier framework.

It is accepted that the exact scope and nature of a future crisis event that may require the use of the resolution powers is difficult to anticipate even with the best pre-planning. As such, it is understandable that the regulators desire the maximum flexibility to deal, in real-time, with a crisis situation.

However such flexibility comes at the cost of increased uncertainty for CSFLs, their participants, and other affected parties about the impact of the resolution regime.

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The implicit tension is unavoidable given the nature of the policy problem being addressed however it is important that the regulatory framework provides some degree of comfort that when the resolution strategy is being developed the authorities are governed by a set of high-level principles that consider the interests of affected parties, even if it is acknowledged that financial stability remains the primary objective.

The comments on the proposals in this section focus particularly on the articulation of the objectives of the resolution regime and also understanding better how the extended resolution tools may be applied to related body corporates of the CSFL.

### Objectives of the resolution regime

As noted above, providing expanded flexibility for the resolution authority to use a range of tools in a resolution situation can create inherent uncertainty for FMs and other stakeholders. However, that impact can be ameliorated to some extent by clearly articulating objectives and principles that will guide the actions of the resolution authority, even if the precise outcome will be determined in practice by the nature of the specific crisis.

The 2015 consultation processes set out a few additional considerations which provided more colour on what factors the authorities would take into account. This provided a framework to indicate the range of factors that may be considered by the resolution authority when undertaking a resolution.

It is acknowledged that in a crisis situation it may be difficult, if not impossible, to undertake an analysis against all of these factors. However, having these factors expressed publicly provides some reassurance for stakeholders.

In particular, the CFR's response to the 2015 resolution consultation process identified some considerations that could complement the overarching objectives of maintaining financial stability and continuity of services. These included: the maintenance of market confidence and integrity; protection of public funds; and minimisation of the costs of resolution to creditors and shareholders.

It is important that participants in, and creditors to, the CS facilities have some indication that their interests are amongst the matters being considered when a resolution is undertaken. Without such a degree of comfort it may discourage them from interacting with the facility.

For example, a guiding principle in the exercise of resolution powers should be that the resolution authority, as far as is practicable, adheres to the loss allocation and other recovery powers in the central counterparty's (CCP) operating rules. This will significantly enhance commercial certainty and market confidence in the CCP as well as being likely to deliver the most effective and least disruptive outcome for all parties.

This still provides sufficient flexibility for the resolution authority to pursue a different approach in the most extreme crisis event if the normal processes are considered to be inadequate to maintain the continuity of service.

These other factors could be set out in legislation or contained in some other document to provide transparency to affected stakeholders.

### Information gathering

The proposal that the resolution authority would have the power to request (from a domestic CSFL and its related bodies corporate) information considered necessary for the performance of its resolution functions appears reasonable. It would be helpful if the draft legislation (or associated material) provided more detail and clarity on the information to be sought, particularly what may be required from related bodies corporate. The paper notes that the information of interest could include any information 'which could potentially affect the domestic CSFL'. Again, while appreciating the objective of flexibility for regulators, this language is very broad and ideally should be avoided when translating the policy position into legislation as it does not assist entities in understanding the extent of the obligation.

### Obligation to notify the resolution authority of certain matters

ASX has no issue in principle with the proposed requirement to promptly advise of any matters that may affect the ability to meet its obligations (including continuity of service), solvency, or viability of a domestic CSFL or its related bodies corporate. It would assist entities to manage their compliance arrangements if the draft legislation (or associated material) provided more detail on the specific matters that are likely to be required.

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### Resolution planning and resolvability

As part of its role, the resolution authority will conduct assessments and develop strategies and operational plans. The CFR proposes the inclusion of specific powers and obligations to assist them in preparing for the possible use of their resolution powers. The resolution authority will have the power to direct a CSFL or related body corporate to take particular actions if they believe they are required for the entity to meet the FSS standard or to address aspects of their business arrangements if they are considered impediments to the effective exercise of the resolution powers.

The direction will be subject to merits review by the Administrative Appeals Tribunal.

ASX acknowledges the need for an effective framework for resolution planning and resolvability assessments.

### Conditions for resolution

It is acknowledged that speed of action by the resolution authority can be critical in a crisis situation and may require flexibility in the application of different resolution tools. The proposal that a set of general conditions would be determined that, if any were met, would allow the authority to use any of its resolution powers seems to provide appropriate flexibility for the resolution authority to react promptly to the circumstances at the time. ASX notes that the resolution authority's use of a specific tool would still be subject to any specific conditions that must also be satisfied.

### Rationale for expanded scope of key resolution powers

It is noted that the CFR is proposing potentially significant (and even open-ended) powers for the resolution authority to act in relation to the activities of a related body corporate. This goes beyond the more limited powers to intervene in a related body corporate previously put forward in the 2015 consultation. The earlier proposal was that the resolution authority could direct a related body corporate to provide services and/or funding to meet the commitments made under ex-ante contractual arrangements entered into with the CSFL. ASX believes this earlier position remains the appropriate policy framework – extending the powers of the resolution authority to intervene in the operations of the related body corporate beyond these contractual commitments (which have been subject to regulatory oversight through the FSS) is not appropriate.

While it is true the proposed expansion of powers provides more flexibility for the resolution authority to act in a manner it considers necessary to maintain continuity of service, this comes at the expense of increased uncertainty for the shareholders and creditors of a group corporate structure within which a CS facility sits. More detail would be required (for each of the new powers over assets transfers, appointment of statutory management, and resolution directions) on how this would operate in practice to avoid the perception that this constitutes a blank cheque obligation on a related body corporate.

The related body corporate would have already made significant commitments of capital and operational resources to the CS facility to manage the risks associated with a potential crisis as well as a recovery plan to deal with participant defaults. These arrangements have been developed over time and are subject to regular review under the FSS. A related body corporate should not be exposed to an effectively open-ended commitment should a crisis lead to the need to move to the resolution of the CSFL.

The combination of these broader powers to intervene in related bodies corporates and the removal of some of the more detailed objectives of the resolution regime (see comments above) creates heightened uncertainty about how the resolution regime may operate in practice. More detail on the scope of this extended power is necessary before the potential impacts on a CSFL operating within a corporate group structure can be considered.

That said, it is not clear that it is in the interests of financial stability if a resolution framework is put in place that had the unintended consequence of discouraging a CS facility from being part of a broader corporate group that can provide economic benefits through the scale, breadth, and financial strength of the group's operations.

### Transfer powers/statutory management/resolution direction powers

ASX has no issue in principle with the proposal that the resolution authority should have the power to transfer a domestic CSFL from a distressed group to a solvent body, to appoint a statutory manager to take temporary control of the CSFL, and/or to issue directions to a domestic CSFL if it is considered necessary to facilitate a resolution action.

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As noted above, CFR proposes extending these powers to enable the resolution authority to also be able take these actions against a related body corporate of the CSFL. This power is deliberately designed to be wide-ranging to provide maximum flexibility for the resolution authority. Should the Government proceed with the extension to a related body corporate there needs to be clearly defined criteria for determining when such interventions could take place and the scope of that action, and the use of these powers should be linked to the preservation of specific activities.

In the case of authorising a transfer of a business or shares, the consultation paper notes that it is appropriate that the Minister has responsibility for making the declaration that would initiate any transfer process. It is argued this is necessary given the significance of the action and the Minister's overarching responsibility for strategic matters and those of national importance.

The Minister should also have responsibility for authorising the use of the other powers as they apply to related bodies corporates. For example, the consultation paper indicated the resolution authority could direct a related body corporate to: retain funds or certain assets during the CSFL resolution so that the financial viability of the group can be maintained; and take action to facilitate the recapitalisation of the CSFL. These could potentially represent a significant imposition on a corporate group, including deferring a dividend payment or a requirement to conduct a capital raising to fund a recapitalisation.

ASX believes the Minister should also retain a 'reserve powers' to issue directions based on broader economic considerations that may go beyond the strict regulatory remits of ASIC and the RBA.

#### Stays

ASX has no issue in principle with the proposed ability of the resolution authority to temporarily suspend the contractual termination rights of a counterparty to the CSFL and to require a related body corporate to continue to supply services or facilities to enable the effective operation of the resolution.

It is critical that the proposed stay regime, to the extent that there is no set time limit, is not out of step with international resolution regimes and doesn't negatively impact bank capital requirements (which could prompt liquidity to head offshore). The drafting should clearly maintain a right for counterparties of novated contracts to terminate if the resolution authority fails to meet payment obligations.

However, if the stay is extended beyond the initial 48 hour period it may be necessary for the Government to publicly announce support for the FMI's future obligations in resolution to avoid further destabilisation of the affected markets.

#### Moratorium

ASX supports the proposal that a moratorium would apply to prevent a person from taking certain litigation and enforcement actions during the statutory management or transfer of a CSFL or related body corporate.

#### Confidentiality

ASX has no issue in principle with the proposal that the resolution authority should be able to issue a secrecy determination or a confidentiality notice to certain parties when the release of information may negatively affect market confidence and/or financial stability. However, there needs to be clarity around how this secrecy requirement will interact with continuous disclosure obligations if one of the directed parties is a listed entity or if an entity is materially impacted by a direction to a related body corporate. It will also be necessary to set out how a secrecy direction impacts on information flows between the CSFL and its related bodies corporates or with other contractual arrangements where failure to disclose could give rise to legal liabilities.

#### Unchanged aspects of the resolution regime

It is noted that no material change is proposed to the provision of statutory immunities for directed entities (and others including related bodies corporate, officers, senior managers and employees) in respect of 'reasonable actions taken in good faith to comply with a resolution direction'. ASX submits that it is important that this qualified statutory immunity aligns with the unqualified obligation for an entity to comply with a direction from the resolution authority. In our view, either the immunity should be unqualified or the obligation similarly qualified, otherwise there is a risk of legal prejudice to a person who is required to comply with a direction, and related delay and uncertainty in compliance.

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While not directly related to the specific issues in the current consultation, ASX makes the comment that where the policy objective is to support financial stability and enhance the resilience of financial markets, any regulatory review should also extend beyond licensed FMIs – to encompass other financial service providers performing critical functions within the end-to-end financial markets transactions chain, but which may be unlicensed and only lightly regulated. ASX would encourage the regulatory authorities to closely consider any systemic risks associated with these other key infrastructure providers and how these can be managed.

ASX is available to expand on any of the points made in this submission and looks forward to continuing to engage with the regulatory authorities to provide additional feedback on the proposals when the draft legislation is released for consultation.

Yours sincerely



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**Gary Hobourn**  
Senior Economic Analyst  
Regulatory and Public Policy