

# Overseas Clearing and Settlement Facilities: The Australian Licensing Regime

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A Consultation Paper by the  
Council of Financial Regulators

March 2015



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# Consultation Process

## ***Request for feedback and comments***

This Consultation Paper seeks stakeholder views on a proposed new approach to assessing whether an overseas clearing and settlement facility falls within the scope of the Australian clearing and settlement facility licensing regime.

Submissions should include the name of your organisation (or your name if the submission is made as an individual) and contact details for the submission, including an email address and contact telephone number where available.

While submissions may be lodged electronically or by post, electronic lodgement is strongly preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

All information (including name and contact details) contained in submissions will be made available to the public on the CFR website, unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information clearly marked as such in a separate attachment. Any future request made under the *Freedom of Information Act 1982* for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Closing date for submissions: **8 May 2015**

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## 1. Introduction

The increasingly global nature of many financial markets, combined with regulatory reforms, has prompted increased participation by domestic financial institutions in overseas clearing and settlement (CS) facilities. A number of overseas CS facilities have also recently begun, or expressed interest in, providing CS services that may be relevant to the safe, efficient and effective functioning of the Australian financial system, or confident, fair and effective dealings in financial products by Australian CS facility users.

Alongside these developments, the Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia (RBA) are receiving an increasing number of queries regarding whether certain overseas CS facilities fall within the scope of the licensing regime under Part 7.3 of the *Corporations Act 2001* (Corporations Act). These queries have arisen primarily due to a lack of clarity around whether, for the purposes of the Corporations Act, an overseas CS facility is ‘operating in this jurisdiction’. This is the threshold that determines whether a CS facility must be either licensed or exempted from Part 7.3 of the Corporations Act.

The Council of Financial Regulators (CFR) considers that there is a case to provide greater clarity, to the extent practicable, regarding the circumstances in which a CS facility must be either licensed in Australia or exempted from Part 7.3 of the Corporations Act. While ASIC has issued guidance that sets out a number of non-exhaustive factors that it would consider in assessing whether a CS facility is operating in this jurisdiction,<sup>1</sup> greater clarity in legislation and accompanying regulation would provide increased legal certainty for overseas CS facilities and their participants.

This consultation seeks preliminary views on legislative change as part of the CFR’s ongoing consideration of the cross-border regulation of CS facilities. Any legislative change will ultimately be a matter for the government to consider.

This paper proposes a new approach to assessing whether an ‘overseas’ CS facility (i.e. a CS facility that is not operated by a body corporate registered under Chapter 2A of the Corporations Act) must be either licensed in Australia or exempted from Part 7.3 of the Corporations Act. The proposal rests on a test of the materiality of the CS facility’s connection to the Australian financial system. ASIC, in consultation with the RBA, will make a determination about whether a CS facility’s activities are material for the purposes of this test. The purpose of this proposal is to promote Australian entities’ access to a diverse range of CS options, both in Australia and overseas, by providing clarity to all stakeholders on the scope of the Australian CS facility licensing regime.

It is not expected that the proposed new approach would result in additional CS facilities being within the scope of Australia’s CS facility licensing regime, and the rest of the Australian CS facility licensing regime would remain unchanged. The factors relevant to a consideration of the materiality of a CS facility’s connection to the Australian financial system by ASIC and the RBA (together, the regulators) are already listed in ASIC’s *Regulatory Guide 211 – Clearing and Settlement Facilities: Australian and Overseas Operators* (RG 211). Rather, the proposed new approach formalises how these factors are currently, and in the future will be, weighed in reaching judgements around regulatory scope so as to provide clarity and transparency for prospective future CS facility licence applicants.

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<sup>1</sup> See ASIC (2012), *Regulatory Guide 211 – Clearing and Settlement Facilities: Australian and Overseas Operators*, December. Available at <<http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-211-clearing-and-settlement-facilities-australian-and-overseas-operators/>>.

## 2. Background

CS facilities are regulated in Australia under the Corporations Act in order to maintain financial system stability, reduce systemic risk and ensure CS services are provided in a fair and effective way. These objectives are the basis for the scope of the Australian CS facility licensing regime.

The Corporations Act currently provides that a CS facility must only be operated in this jurisdiction (i.e. operated in Australia) if its operator holds an Australian CS facility licence or the facility is exempt from Part 7.3 of the Corporations Act. While section 820D of the Corporations Act provides that a CS facility is taken to be operating in this jurisdiction if it is operated by a body corporate registered under Chapter 2A of the Corporations Act, it does not limit the circumstances in which a CS facility is operated in this jurisdiction. ASIC's RG 211 sets out a number of non-exhaustive factors that it would consider when assessing whether a CS facility operates in this jurisdiction. These factors are:

- the location of the CS facility's technical infrastructure
- whether the CS facility has one or more Australian users or participants
- the volume and value of transactions submitted to the CS facility by Australian users or participants
- the nature of the transactions and financial products made available, for example whether these products are denominated in Australian dollars
- whether the CS facility has entered into an arrangement with a financial market operating in Australia to provide CS services to that market.

If a CS facility is operating in this jurisdiction, its operator must apply to the Minister, through ASIC, for an Australian CS facility licence or an exemption from Part 7.3 of the Corporations Act (see Figure 1). The Corporations Act provides for two classes of Australian CS facility licence: a 'domestic' licence, granted under section 842B(1); and an 'overseas' licence, granted under section 824B(2).<sup>2</sup> The Minister may grant an overseas licence to a CS facility operator if the requirements of section 824B(2) are met, including that the operator is authorised to operate the CS facility in the foreign country in which the principal place of business is located, and the regulatory regime in that country is sufficiently equivalent to that in Australia.

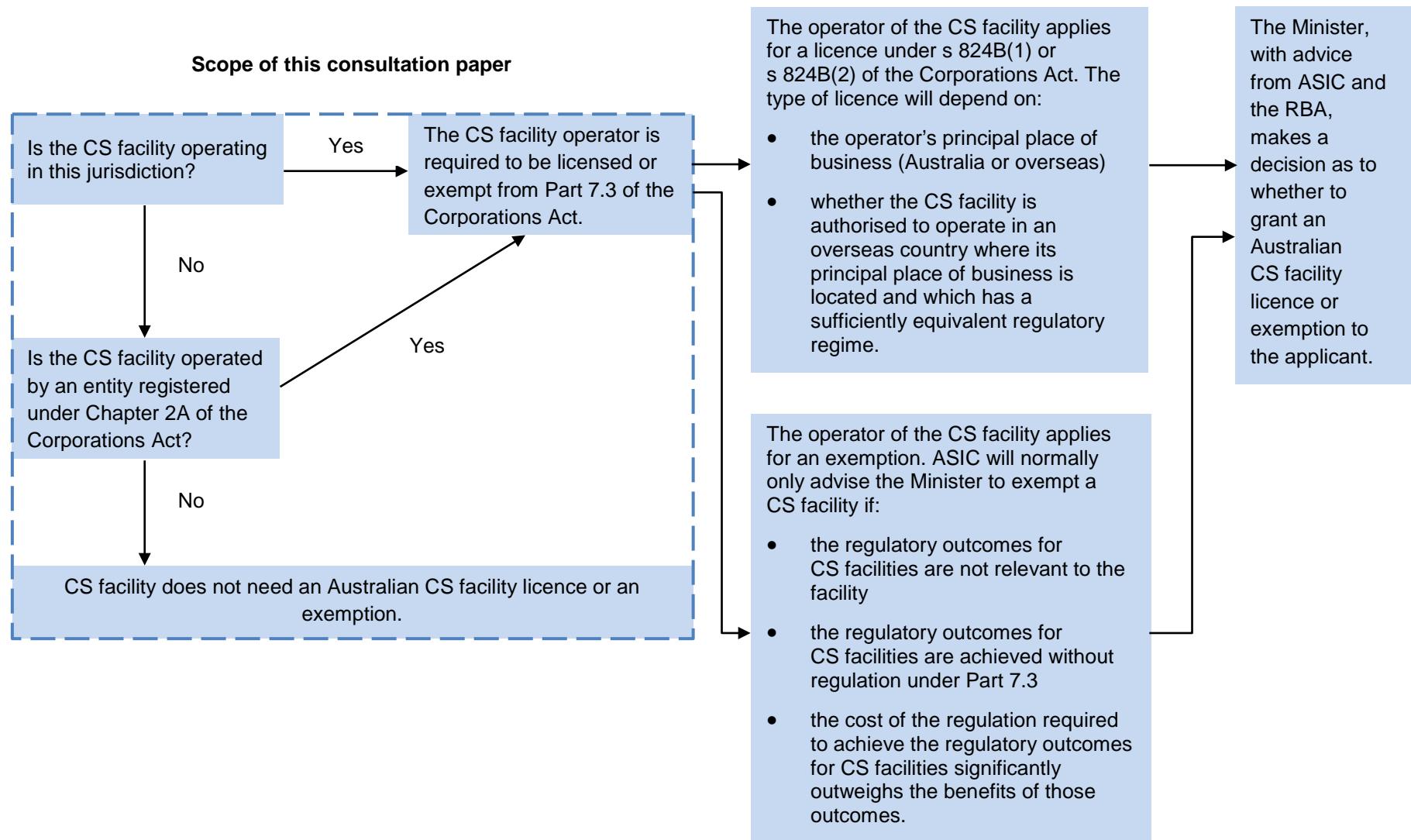
An operator can also apply to the Minister for an exemption from the requirement to hold an Australian CS facility licence (i.e. an exemption from Part 7.3 of the Corporations Act). ASIC will recommend an exemption when it is satisfied that there is no policy reason for regulating the operator of a CS facility in this jurisdiction as a licensee. ASIC will normally only advise the Minister to exempt a particular CS facility if:

- the regulatory outcomes for CS facilities are not relevant to its CS facility
- the regulatory outcomes for CS facilities are achieved without regulation under Part 7.3
- the cost of the regulation required to achieve the regulatory outcomes for CS facilities significantly outweighs the benefits of those outcomes.

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<sup>2</sup> The two separate classes of Australian CS facility licence ensures the appropriate regulatory influence is accorded to CS facilities operating in this jurisdiction. For example, a systemically important CS facility with a strong domestic connection would be required to incorporate locally and hold a domestic licence, such that ASIC and the RBA would be the primary regulators. Further consideration was given to this matter in the Australian Government's February 2015 consultation paper 'Resolution Regime for Financial Market Infrastructures', available at <<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Resolution-regime-for-financial-market-infrastructures>>.

**Figure 1: Current Australian CS Facility Licensing Regime**



### 3. Proposed Amendments

The policy intention behind Australia's CS facility licensing regime is to capture facilities with operations that have, or are expected to have, implications for the safe, efficient and effective functioning of the Australian financial system or the confident, fair and effective dealings in financial products by Australian investors; that is, to capture facilities that have a *material domestic connection*. It is proposed that the existing concept of operating in this jurisdiction be replaced by the concept of a material domestic connection for overseas CS facilities.

It is proposed that:

- a body corporate that is registered under Chapter 2A of the Corporations Act must only operate, or hold out that it operates, a CS facility if the body corporate has an Australian CS facility licence, or the facility is exempt from the operation of Part 7.3<sup>3</sup>
- a CS facility operator, other than a body corporate registered under Chapter 2A, must only operate, or hold out that it operates, a CS facility that has a material domestic connection to Australia if the CS facility operator has an Australian CS facility licence, or the facility is exempt from the operation of Part 7.3.

The test would include two components, both of which must be met for the requirement for an overseas CS facility to be either licensed or exempted from the operation of Part 7.3 of the Act (see Figure 2).

#### First Component: A CS Facility's Domestic Connection

The first component of the test – a CS facility's domestic connection – would establish objectively if the operations of a CS facility were in any way connected to the Australian financial system. It is intended that this component provide a high degree of certainty for all stakeholders as to when a CS facility was out of the scope of the Australian CS facility licensing regime. The factors that would constitute a domestic connection include: the location of a CS facility's operations in Australia; the provision of CS services for financial products connected with Australia; the provision of CS services to one or more Australian participants; or having arrangements with the operator of a domestically licensed or exempted financial market or CS facility. These factors are set out in Section 5 of this paper.

This component of the test aims to ensure that CS facilities relevant to the functioning of the Australian financial system are identified as *potentially* within the scope of the Australian CS facility licensing regime. The materiality of these facilities' domestic connection would then be assessed under the second component of the test (described below), to establish whether they should indeed be subject to licensing (or exemption from the regime).

In defining a domestic connection for the purposes of this component of the test, the CFR has aimed to strike a balance between public policy relevance and appropriate cross-border reach. That is, the CFR has sought to ensure that the potential scope of the regime is neither too broad nor too narrow. For example, a connection that arose solely from Australian users' indirect participation in an overseas CS facility in relation to activities in non-Australian-related products would not fall within the proposed definition, on the basis that too large a number of overseas CS facilities would then potentially be within the scope of the regime. In striking this balance, the CFR has taken into account that non-participant users would be likely to be accorded the appropriate protections via the implementation of the CPMI-IOSCO *Principles for Financial Market Infrastructures* by the CS facility's primary regulator(s). For example, Principle 14 relating to the segregation and portability of positions of a participant's customers and the collateral provided to the CS facility with respect to those positions.

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<sup>3</sup> This has the same effect as section 820D of the Corporations Act; however, it is not linked to the concept of 'operating in this jurisdiction'.

The CFR also acknowledges that this component of the test should balance the need to provide regulatory certainty for all stakeholders with the need for flexibility to account for future changes in the nature of the provision of CS services – for example, through evolution in the participation models offered by CS facilities. For this reason the CFR is seeking feedback on whether the factors constituting a domestic connection are appropriate to accommodate such future changes and whether any other factors should be considered.

A CS facility that had a domestic connection would be required to notify ASIC and the RBA.

## Second Component: Materiality of a CS Facility's Domestic Connection

Where the first component of the test established whether an overseas CS facility had a domestic connection, the second component would assess the materiality of that connection. A CS facility's connection to the Australian financial system would be material if ASIC, in consultation with the RBA, is satisfied that the facility's current or expected activities were material to the safe, efficient and effective functioning of the Australian financial system or the confident, fair and effective dealings in financial products by Australian investors.

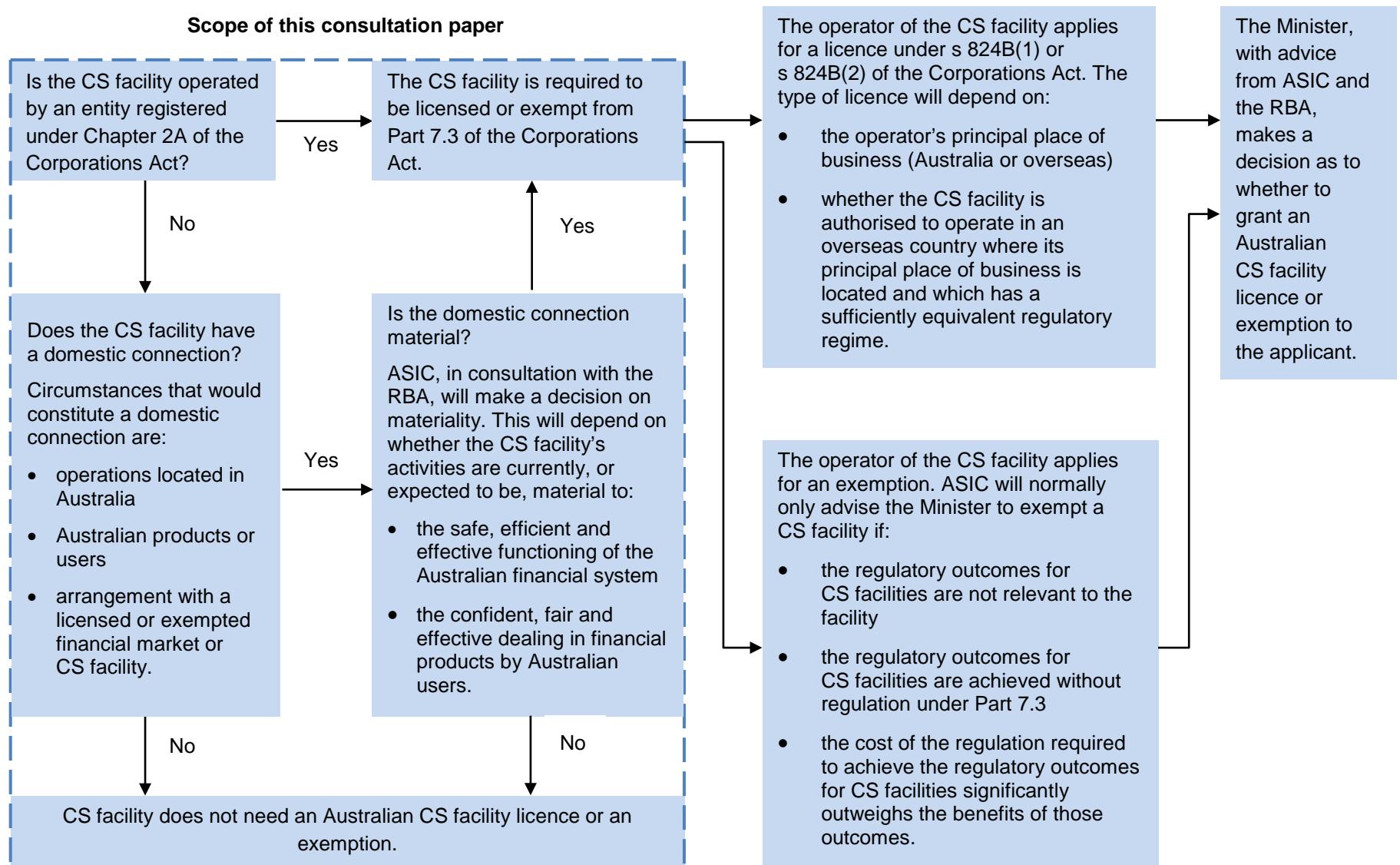
To provide further clarity to stakeholders, the circumstances in which the materiality component of the test is likely to be met and the factors that ASIC and the RBA would take into consideration could be included in Corporations Regulations, other legislative instruments and/or revised regulatory guidance. These details are set out in Section 5 of this consultation paper, and are accompanied by case studies that demonstrate how the revised test would be applied.

It is proposed that where ASIC, in consultation with the RBA, considers a CS facility's domestic connection to be material, ASIC would make a formal determination to that effect. A CS facility that had a material domestic connection would be required to have an Australian CS facility licence or be exempt from the operation of Part 7.3 of the Corporations Act. Positive decisions on the materiality of a CS facility's domestic connection will be evidenced in the advice on a CS facility's application for an Australian CS facility licence or exemption provided by ASIC and the RBA to the Minister.

This approach would ensure the appropriate regulation of all CS facilities with a connection to the Australian financial system or its users, so that an overseas CS facility with a connection to the Australian financial system that was not material is not required to be either licensed or exempted from Part 7.3 of the Corporations Act.

Under this approach, the materiality of a CS facility's connection to the Australian financial system may reflect either a single characteristic or a combination of characteristics, and it is not possible to establish definitive thresholds for materiality that would apply in all circumstances. Accordingly, this test would require the exercise of judgement by ASIC, in consultation with the RBA. This approach should provide additional clarity to all stakeholders, while also retaining necessary flexibility within the Australian CS facility licensing regime.

**Figure 2: Proposed Australian CS Facility Licensing Regime**



## 4. The Australian Licensing Regime and the Regulatory Influence Framework

Any additional regulatory requirements that needed to be imposed on a licensed CS facility, to exert an appropriate level of regulatory influence over the facility's activities, would be determined separately from the process described above. This would likely occur as part of the licensing process, through the application of the CFR's existing *Regulatory Influence Framework for Cross-border Central Counterparties* (the Regulatory Influence Framework).<sup>4</sup> Under the Regulatory Influence Framework, additional regulatory requirements would be applied to a CS facility licensed to operate in Australia on a graduated basis, according to whether the facility:

- had material Australian participation and/or provided services in respect of Australian-related products
- was deemed to be systemically important in Australia
- had a strong domestic connection.

The revised amendments outlined in Section 3 therefore provide a platform for the Regulatory Influence Framework, as these criteria clearly build up from the entry-level criterion of a material domestic connection. The continuity between the entry-level criterion for the Australian CS facility licensing regime and the Regulatory Influence Framework was also acknowledged in the CFR's original paper setting out the Regulatory Influence Framework. This paper noted that all 'CS facilities that are licensed to operate in Australia will have some domestic connection'.<sup>5</sup>

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<sup>4</sup> See CFR (2014), 'Application of the Regulatory Influence Framework for Cross-border Central Counterparties', March. Available at <<http://www.cfr.gov.au/publications/cfr-publications/2014/application-of-the-regulatory-influence-framework-for-cross-border-central-counterparties/html/summary-july-2012.html>>.

<sup>5</sup> See 'Ensuring Appropriate Influence for Australian Regulators over Cross-border Clearing and Settlement Facilities', July 2012, p 12. Available at <<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/~media/Treasury/Consultations%20and%20Reviews/Consultations/2012/cross%20border%20clearing/key%20documents/pdf/cross-border-provision.ashx>>.

## 5. Implementation and Application of the Test

This Section sets out, on the basis of a preliminary assessment, the potential changes to legislation required for implementation of the test proposed above. The various factors for consideration under each component of the proposed test are articulated in Table 1 and Table 2. Case studies are provided, to demonstrate how the proposed test would be applied by ASIC, in consultation with the RBA.

### Implementation

The proposed overarching test could be incorporated into the Corporations Act through revisions to Part 7.3 of the Corporations Act, in particular to sections 820A and 820D, as discussed in Section 3.

The factors that constitute a domestic connection could be specified in the Corporations Act, a legislative instrument (e.g. a Ministerial determination or regulations) and/or revised regulatory guidance. The circumstances in which a domestic connection would be considered to be material, and the factors to be taken into consideration in making this determination could also be specified in the Corporations Act, a legislative instrument and/or revised regulatory guidance. Including some of this material in a legislative instrument and/or revised regulatory guidance would provide additional flexibility to amend the test in the future, in response to changes in the market environment.

#### What constitutes a domestic connection?

The factors that the CFR considers relevant to assessing whether an overseas CS facility has a connection to the Australian financial system are set out in Table 1, according to the approach described in Section 3. A CS facility would have a connection to the Australian financial system if any one of these factors were met.

#### What constitutes a material domestic connection?

Table 2 proposes a general test for materiality, according to the approach described in Section 3, and the circumstances in which this test would be met. As discussed in Section 3, the materiality of a CS facility's connection to the Australian financial system may reflect either a single characteristic or a combination of characteristics. A proposed set of factors that ASIC, in consultation with the RBA, would take into account when determining the materiality of an overseas CS facility's domestic connection are also included in Table 2.

**Table 1: Domestic Connection**

<b>Circumstances that would constitute a domestic connection</b> (Could be included in the Corporations Act)	<b>Factors taken into consideration</b>
The CS facility has operations 'located' in Australia.	<p>A CS facility's operations would be considered to be located in Australia if any of the following held:</p> <ul style="list-style-type: none"><li>• it had a domestic physical presence (e.g. staff or other corporate functions located in Australia)</li><li>• a significant part of its technical infrastructure was located in Australia.</li></ul>
The CS facility provides CS services for financial products connected with Australia.	<p>A CS facility provides CS services for financial products connected with Australia if the financial products are:</p> <ul style="list-style-type: none"><li>• denominated in Australian dollars</li><li>• referenced to an Australian underlying (e.g. an Australian commodity or securities issuer)</li><li>• issued by an Australian entity (e.g. a company or managed investment scheme).</li></ul>
The CS facility provides CS services to one or more Australian participants.	What constitutes a 'participant' will take into account the existing definition in section 761A of the Corporations Act, which refers to a direct participant in the facility subject to the operating rules.
The CS facility has entered into an arrangement with the operator of a financial market or CS facility that is licensed or exempted under the Australian regime.	<p>A CS facility will be considered to have entered into an arrangement with the operator of a financial market or CS facility that is licensed or exempted under the Australian regime in the following circumstances:</p> <ul style="list-style-type: none"><li>• the CS facility entered into an arrangement to provide CCP services for financial products:<ul style="list-style-type: none"><li>– listed or traded on a financial market, the operator of which holds an Australian market licence (AML) granted under section 795B(1) of the Corporations Act (i.e. a 'domestic' AML holder) or section 795B(2) of the Corporations Act (i.e. an 'overseas' AML holder), or an AML exemption granted under section 791C of the Corporations Act</li><li>– for which securities settlement services were provided by a securities settlement facility (SSF), the operator of which holds an Australian CS facility licence (CSFL) granted under section 824B(1) of the Corporations Act (i.e. a 'domestic' CSFL holder) or section 824B(2) of the Corporations Act (i.e. an 'overseas' CSFL holder), or a CSFL exemption granted under section 820C of the Corporations Act</li></ul></li><li>• the CS facility entered into an arrangement to provide SSF services for financial products:<ul style="list-style-type: none"><li>– listed or traded on a financial market, the operator of which holds a domestic AML or overseas AML, or AML exemption</li><li>– for which CCP services were provided by a CCP the operator of which holds a domestic CSFL or overseas CSFL, or CSFL exemption.</li></ul></li></ul>

**Table 2: Materiality**

<b>General test</b> (Could be included in the Corporations Act)	<b>Circumstances that would constitute a material domestic connection</b> (Could be included in Corporations Regulations, other legislative instruments or revisions to regulatory guidance)	<b>Factors taken into consideration</b> (Could be included in Corporations Regulations, other legislative instruments or revisions to regulatory guidance)
<p>The CS facility's domestic connection will be 'material' if ASIC, in consultation with the RBA, is satisfied that the CS facility's activities are currently material to:</p> <ul style="list-style-type: none"> <li>• the safe, efficient and effective functioning of the Australian financial system or</li> <li>• the confident, fair and effective dealing in financial products by Australian users (i.e. direct users – participants; and indirect users – investors, which may be retail or wholesale investors)</li> </ul> <p>or are expected to be so in the future.</p>	<p>1. The size and extent of current or expected future aggregate activity of Australian participants or users of the facility is material to:</p> <ol style="list-style-type: none"> <li>a. the risk management activities of these participants or users or</li> <li>b. the efficient allocation of capital or liquidity to the real economy.</li> </ol> <hr/> <p>2. The size and extent of current or expected activity in a relevant product class offered by the facility is material to:</p> <ol style="list-style-type: none"> <li>a. risk management activities in the Australian financial system or</li> <li>b. the efficient allocation of capital or liquidity to the real economy.</li> </ol> <hr/> <p>3. The CS facility has entered into an arrangement to provide CCP or SSF services to the holder of a domestic AML or CSFL.</p> <hr/> <p>4. The CS facility currently provides, or is expected to provide, CS services to a material number of Australian users.</p>	<ul style="list-style-type: none"> <li>• Current or expected participants or users, for example: <ul style="list-style-type: none"> <li>– the number of Australian participants or users</li> <li>– the nature of Australian participants in, or users of, the CS facility (e.g. banks, retail or wholesale investors).</li> </ul> </li> <li>• Current or expected transactions, for example: <ul style="list-style-type: none"> <li>– the volume and value of transactions submitted for clearing by Australian participants or users</li> <li>– the value of Australian participants' or users' outstanding positions with a CS facility.</li> </ul> </li> <li>• Current or expected products cleared or settled by the CS facility, for example: <ul style="list-style-type: none"> <li>– the nature of a product's connection to the Australian financial system and/or real economy</li> <li>– the volume and value of transactions in the product</li> <li>– the value of outstanding positions in the product.</li> </ul> </li> <li>• The nature and extent of arrangements (i.e. vertical links) between the CS facility and a financial market or CS facility that is licensed or exempted under the Australian regime (see Table 1).</li> <li>• Any other factors the regulators consider relevant.</li> </ul>

## Case studies

The following case studies demonstrate how the proposed test would be likely to be applied by ASIC, in consultation with the RBA. These case studies are not intended to be exhaustive of all possible types of CS facilities or potential circumstances that could arise in the future.

**Table 3: Case studies**

<b>Example</b>	<b>Does the company have a material domestic connection to Australia?</b>
<i>Example 1</i>  An overseas-based CS facility operator offers clearing services for European repo transactions. The CS facility has no Australian participants.	No. This company has no connection to the Australian financial system, and is not required to apply for an Australian CS facility licence or an exemption from Part 7.3 of the Corporations Act.  In coming to this conclusion, the regulators would take into account the following: <ul style="list-style-type: none"><li>• the CS facility does not satisfy any of the circumstances that would constitute a domestic connection<ul style="list-style-type: none"><li>– the products cleared by the CS facility have no connection to the Australian financial system</li><li>– the CS facility has no Australian participants.</li></ul></li></ul>
<i>Example 2</i>  An overseas-based CS facility operator offers clearing services for European repo transactions. The CS facility has two Australian participants.  The transactions cleared via this CS facility constitute a very small proportion, by value, of the overall CS activities of the two Australian participants.	No. This company has no material connection to the Australian financial system, and is not required to apply for an Australian CS facility licence or an exemption from Part 7.3 of the Corporations Act.  In coming to this conclusion, the regulators would take into account the following: <ul style="list-style-type: none"><li>• the CS facility's circumstances constitute a domestic connection<ul style="list-style-type: none"><li>– the CS facility has two Australian participants</li></ul></li><li>• the CS facility's domestic connection is not material to the safe, efficient and effective functioning of the Australian financial system<ul style="list-style-type: none"><li>– the size and extent of the Australian participants' current and expected activity in this product class is small, relative to their overall CS activities</li><li>– this activity is not material to the risk management activities of these participants or the Australian financial system</li><li>– this CS facility does not have material implications for the efficient allocation of capital or liquidity to the real economy.</li></ul></li></ul>

Example	Does the company have a material domestic connection to Australia?
<i>Example 3</i>	<p>Yes. This company has a material connection to the Australian financial system, and is required to apply for an Australian CS facility licence or an exemption from Part 7.3 of the Corporations Act.</p> <p>In coming to this conclusion, the regulators would take into account the following:</p> <ul style="list-style-type: none"> <li>• the CS facility's circumstances constitute a domestic connection <ul style="list-style-type: none"> <li>– the CS facility offers clearing services for Australian dollar-denominated OTC IRS</li> </ul> </li> <li>• the CS facility's domestic connection is material to the safe, efficient and effective functioning of the Australian financial system <ul style="list-style-type: none"> <li>– the size and extent of the CS facility's expected activity in Australian dollar-denominated OTC IRS is large, compared with total activity in Australian dollar-denominated OTC IRS</li> <li>– the future activity of the CS facility in Australian dollar-denominated OTC IRS is expected to be material to the risk management activities of its prospective Australian participants and the Australian financial system overall.</li> </ul> </li> </ul>
<i>Example 4</i>	<p>Yes. This company has a material connection to the Australian financial system, and is required to apply for an Australian CS facility licence or an exemption from Part 7.3 of the Corporations Act.</p> <p>In coming to this conclusion, the regulators would take into account the following:</p> <ul style="list-style-type: none"> <li>• the CS facility's circumstances constitute a domestic connection <ul style="list-style-type: none"> <li>– the CS facility offers settlement services for Australian dollar-denominated OTC IRS</li> <li>– the CS facility has several Australian participants</li> </ul> </li> <li>• the CS facility's domestic connection is material to the safe, efficient and effective functioning of the Australian financial system <ul style="list-style-type: none"> <li>– the size and extent of the CS facility's current activity in Australian dollar-denominated securities is large, compared with total activity in these securities</li> <li>– the size and extent of the CS facility's Australian participants' current activity in Australian dollar-denominated securities is large, relative to their overall CS activities</li> <li>– the activity of the CS facility in Australian dollar-denominated securities is material to the risk management activities of its Australian participants and the Australian financial system overall</li> <li>– the activity of the CS facility in Australian dollar-denominated securities could have implications for the efficient allocation of capital and liquidity to the real economy.</li> </ul> </li> </ul>

<b>Example</b>	<b>Does the company have a material domestic connection to Australia?</b>
<p><i>Example 5</i></p> <p>An overseas-based CS facility operator provides settlement services for the operator of a domestic entity holding an Australian market licence, granted under section 795B(1) of the Corporations Act.</p>	<p>Yes. This company has a material connection to the Australian financial system, and is required to apply for an Australian CS facility licence or an exemption from Part 7.3 of the Corporations Act.</p> <p>In coming to this conclusion, the regulators would take into account the following:</p> <ul style="list-style-type: none"> <li>• the CS facility's circumstances constitute a domestic connection <ul style="list-style-type: none"> <li>– the CS facility has entered into an arrangement to provide SSF services for financial products listed or traded on a domestically licensed financial market</li> </ul> </li> <li>• the CS facility's domestic connection is material to the safe, efficient and effective functioning of the Australian financial system as a result of this arrangement.</li> </ul>
<p><i>Example 6</i></p> <p>An overseas-based CS facility provides clearing services for an overseas futures market. A number of Australian dollar-denominated contracts referencing the most liquid Standard and Poor's Australian equity indexes, and several Australian short-term interest rate products, are traded on the exchange and cleared by the CS facility. A material number of Australian investors, including fund managers, Australian banks and other wholesale Australian clients, have exposures to these products and are indirect users of the facility.</p>	<p>Yes. This facility has a material connection to Australian users (i.e. wholesale or retail investors), and is required to apply for a CS facility licence or an exemption from Part 7.3 of the Corporations Act.</p> <p>In coming to this conclusion, the regulators would take into account the following:</p> <ul style="list-style-type: none"> <li>• the CS facility's circumstances constitute a domestic connection, as the CS facility provides CS services for financial products that are connected with Australia – that is, these products are denominated in Australian dollars and referenced to an Australian underlying</li> <li>• the CS facility's domestic connection constitutes a material connection as it is material to the confident, fair and effective dealing in financial products by Australian users: <ul style="list-style-type: none"> <li>– the CS facility has a material number of indirect Australian users</li> <li>– the volume and value of transactions submitted for clearing by indirect Australian users is material to these users' overall activity in the product class.</li> </ul> </li> </ul>

## 6. Next Steps

The purpose of this paper has been to propose a new approach to assessing whether CS facilities, and overseas CS facilities in particular, must be either licensed in Australia or exempted from the provisions of Part 7.3 of the Corporations Act. The primary intent of this proposal is to offer further clarity on this matter to all stakeholders. It is not expected that the proposed new approach would result in additional CS facilities being within the scope of Australia's CS facility licensing regime.

The CFR is seeking feedback on the following issues:

1. Do you agree that the proposed circumstances that would constitute a domestic connection and the factors to be taken into consideration under the first component of the test – a CS facility's domestic connection – define the initial scope of the Australian CS facility licensing regime appropriately?
  - (a) Are there other circumstances (such as indirect participation) or factors that should be considered under this component of the test?
  - (b) Are the circumstances that would constitute a domestic connection under this component likely to be sufficiently flexible to account for future changes in the nature of the provision of CS services or the nature of relationships between a CS facility, its participants and participants' clients?
2. Do you agree that the proposed test of a material domestic connection provides additional clarity in determining whether a CS facility must be either licensed in Australia or exempted from the provisions of Part 7.3 of the Corporations Act, relative to the current test of 'operating in this jurisdiction'?
3. Do you have any comment on the proposed circumstances that would constitute a material domestic connection, and the proposed factors for consideration under this second component of the test?
4. Do you have any comment on the proposed approach for implementing the test of a material domestic connection, for example how the factors for consideration and circumstances set out under each component of the test could be specified in the Corporations Act, a legislative instrument and/or revised regulatory guidance?
5. Do you have any comment on the requirement for a CS facility that has a domestic connection to notify the regulators?
6. Do you have any comment on the design that ASIC, in consultation with the RBA, will make a determination about whether a CS facility's activities are material?

The specific measures set out in Section 5 of this paper will also be the subject of further consultation later in the year, in the context of planned revisions to the Corporations Act, ASIC's RG 211 and any legislative instruments required to implement the proposal set out above. In the meantime, the CFR stands ready to discuss with existing Australian CS facility licence holders, prospective Australian CS facility licence applicants and other stakeholders how the proposal set out in this paper might apply in their particular circumstances.