Overseas Clearing and Settlement Facilities: The Australian Licensing Regime

ASX Submission to the Council of Financial Regulators

ASX Submission

8 May 2015

Contacts
For general enquiries, please contact:

Gary Hobourn – Senior Economic Analyst, Regulatory & Public Policy
T 02 9227 0930
E gary.hobourn@asx.com.au

Media enquiries, please contact:

Mr Matthew Gibbs – General Manager, Media and Communications
T 02 9227 0218
E matthew.gibbs@asx.com.au

CONTENTS

Executive summary.....3

ASX response to Consultation Questions.....4

Executive summary

ASX welcomes the opportunity to provide our views on the proposed framework for licensing overseas clearing and settlement facilities. We understand that another consultation will be conducted on the implementation and application of the framework which will provide more detailed guidance on the criteria to determine if a facility will require an Australian license or need to seek a specific exemption.

Clearing and settlement facilities undertake important risk management functions and provide confidence to investors and those that use financial markets that payment and delivery obligations will be met. Australian investors and market users expect that ASIC and RBA will have direct oversight of operators that provide these services to them. Accordingly, the onus should be on an operator which has any domestic connection to argue why it should not be required to apply for a domestic licence.

The central concept and measures defining a *material domestic connection* to Australia as the criteria to assess whether a facility requires an Australian license seems appropriate.

The framework should ensure that facilities providing services to Australian investors and/or to systemically significant financial markets are governed by Australian licensing. Exceptions to this should only be contemplated where the market/products they are servicing are not now, or expected in the future, to be systemically significant.

This approach combined with any additional regulatory requirements (such as domestic location requirements) imposed on a licensed overseas clearing facility consistent with CFR's *Regulatory Influence Framework for Cross-border Central Counterparties* will deliver a robust post-trade infrastructure for Australia.

ASX supports a clear policy framework, applied consistently to systemically significant markets (with rare exceptions where the market is never likely to be systemically significant) as it provides appropriate protections to Australia's national interest and certainty for prospective service providers. A 'graduated' approach that increase regulatory requirements as a facility's operations grow does not work as once liquidity shifts offshore it become problematic to try and impose conditions to seek to move the activity back onshore.

Protecting the interests of Australian users of the overseas facility and maintaining the ability of domestic regulators to have appropriate controls over systemically important markets should continue to be paramount factors in the Minister's decision on approving a licence application, the nature of that licence and any conditions attached to it.

A transparent and robust framework on how the arrangements will work in practice should provide clearing participants, their customers, and the broader community with confidence that facilities servicing the Australian market are governed by appropriate standards and regulatory oversight.

Full implementation of this framework involves legislative change, with amendments to the Corporations Act and/or associated regulations, to codify the approach where appropriate. Detailed guidance on how the test will be applied in practice, particularly given that many of the criteria proposed are subjective, will be helpful.

The framework should also set out the disclosure that needs to be made to ensure that investors and users of the markets understand the consequences of not dealing with a domestically licensed operator. It might be instructive to test if the framework proposed does result in users of the market understanding these consequences.

ASX response to Consultation Questions

Consultation Questions
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?**
ASX agrees that factors that constitute a "domestic connection" for the purpose of this test should include any of the following: • the facility's operations being located in Australia; • the services relating to Australian financial products, • the services being provided to Australian participants; or • the services involving arrangements between the facility and the operator of a domestically licensed or exempted financial market or CS facility. The criteria needs to be sufficiently broad and flexible so that Australia's regulators have appropriate direct oversight of any facility that provides risk management or settlement certainty in circumstances that users would reasonably expect. ASX's experience is that domestic investors and users of Australia's financial markets expect that services, which provide risk management and settlement certainty, that are conducted in connection with financial markets operated in Australia will be directly supervised by ASIC and RBA and regulated under Australian law.
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'?
Yes, subject to the onus being on those who seek to assert that any connection is not material. The materiality of a CS facility's connection to the Australian financial system can reflect either a single important characteristic or a combination of characteristics. Making a determination will require the exercise of judgement by ASIC, in consultation with the RBA. That said, the proposed approach should provide some degree of additional clarity to operators considering clearing and settlement services for the Australian market.
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?
While none of the criteria listed in the consultation paper are controversial, it is the weighting applied to each factor and how the authorities will assess some of the more subjective factors that will determine the ultimate regulatory outcome. These judgements need to be considered in the context of the expectations of investors and users of the markets set out in Response 1. The further consultation later this year on the criteria should seek to provide as much transparency as possible as to how the test will work in practice, while acknowledging that the approach will require a subjective assessment by the authorities on a number of factors. These include a judgment about the expected future scale and scope of the

Consultation Questions

facilities activities and participation by Australian participants.

Where a facility provides clearing or settlement services in a systemically important Australian market it should always be required to have an Australian clearing and settlement facility licence.

Protecting the interests of users of the facility and the ability of domestic regulators to have appropriate controls over systemically important markets should be paramount factors in the Minister's decision on approving a licence application, the nature of that licence and any conditions attached to it.

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?

The onus should be on those who have a domestic connection to establish a compelling reason why they should not hold a domestic licence. Codifying key elements of the proposed framework, such as the overarching test and the factors that constitute a material domestic connection to Australia, in the Corporations Act and associated regulations provides more certainty for all stakeholders as to how the arrangements would work into the future.

Given the subjective nature of many of the criteria published guidance on how the authorities would approach these matters would also be appropriate.

5. Do you have any comment on the requirement for a CS facility that has a domestic connection to notify the regulators?

This should be a requirement. A facility, which has a clear description of the criteria will be well-positioned to self-assess their position against the nature of the service they are considering providing. Incentives need to be put in place to ensure that a correct self-assessment is encouraged by the regulatory framework and so that operators do not commence providing a service to Australian customers without the appropriate licence.

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?

It is appropriate that there is close coordination between ASIC and the RBA in determining if a facility has a material connection to Australia, given their respective responsibilities for licensing clearing and settlement facilities, investor protection, the efficient operation of markets and for managing financial stability. The regulators should consider whether there should also be a public consultation process before a final determination is made.