Financial Market Infrastructure Regulatory Reforms

A Response to Consultation by the
Council of Financial Regulators

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2011 Regulation Review Consultation	*Council of Financial Regulators: Review of Financial Market Infrastructure Regulation* (November 2011)
2015 Resolution Consultation	*Australian Government Consultation Paper: Resolution Regime for Financial Market Infrastructures* (February 2015)
2015 Overseas CSFL Consultation	*Overseas Clearing and Settlement Facilities: The Australian Licensing Regime* (March 2015)
2019 Regulatory Reforms Consultation	*Financial Market Infrastructure Regulatory Reforms* (November 2019)
ADI	Authorised deposit-taking institution
AML	Australian market licensee
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
BAL	Benchmark administrator licensee
CCP	Central counterparty
CFR	Council of Financial Regulators
Corporations Act	*Corporations Act 2001*
CPMI	Committee on Payments and Market Infrastructures
CSFL	Clearing and settlement facility licensee
Domestic CSFL	A body corporate that is incorporated in Australia and holds an Australian clearing and settlement facility licence under section 824B(1) of the Corporations Act
DTRL	Derivative trade repository licensee
FMI	Financial market infrastructure
FSB	Financial Stability Board
FSS	Financial Stability Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
Licensed Entities	Collectively, AMLs, BALs, CSFLs and DTRLs
Overseas CSFL	A body corporate that holds an Australian clearing and settlement facility licence under section 824B(2) of the Corporations Act
PFMI	Principles for Financial Market Infrastructure
RBA	Reserve Bank of Australia
Regulators	ASIC and the RBA

Executive Summary

Financial market infrastructures (FMIs) are the key entities that enable, facilitate and support trading in Australia's capital markets. FMIs include financial market operators, benchmark administrators, clearing and settlement facilities and derivative trade repositories.The financial system's reliance upon FMIs, particularly central counterparties (CCPs), has increased significantly following the 2008 crisis as a result of reforms intended to reduce systemic risk. Today, FMIs in Australia support transactions in securities with a total annual value of $16 trillion and derivatives with a total annual notional value of $185 trillion. A disruption to the orderly provision of services by an FMI could cause a disruption to the wider financial system, which may have large economic costs.

FMIs face a wide variety of risks. The 2008 crisis illustrated the financial and counterparty risks to which financial institutions, including FMIs, are exposed. More recently, the operational disruption and market volatility associated with the economic fallout from the coronavirus disease (COVID-19) has highlighted the potential for an unforeseen event to impact the smooth functioning of FMIs. In the most extreme cases, these risks could threaten the viability of these critical infrastructures.

As the regulators of FMIs, the Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia (RBA) (together, the Regulators) need strong and dependable powers to carry out their mandates and mitigate the risk of disruption to FMI services. The Regulators currently have a range of powers with respect to FMIs. However, the options available to the Regulators to address the potential insolvency of an FMI or other severe threats to its continued operation are very limited. The proposed reforms are also needed to improve the ability of the Regulators to manage such risks ahead of any potential crises, by enhancing the day-to-day regulatory regime and introducing powers to prepare for the orderly resolution of a clearing and settlement facility. In addition, the current distribution of these regulatory powers does not always reflect the responsibilities of each Regulator, and the legislation provides a number of operational powers to the Minister (which are currently delegated to ASIC).

The Council of Financial Regulators (CFR) considers that the limitations of the current framework, combined with the current heightened global risk environment and the growing systemic importance of FMIs means that reforms to existing powers – as well as some additional powers to manage the risks associated with FMIs and promote the reliability and integrity of the markets that FMIs support – are required. This has been acknowledged in a number of independent reviews including the 2014 Financial System Inquiry and the International Monetary Fund's (IMF's) 2019 Financial Sector Assessment Program review.

The CFR consulted on a consolidated set of reforms to the licensing, supervision and resolution of FMIs in November 2019. The CFR received written submissions from a broad range of stakeholders, including from licensees, their participants, industry associations and interested individuals. The CFR considered the feedback received in formulating its proposals for a package of reforms for the Government. This response summarises stakeholders' feedback to the consultation and the CFR's response.

The submissions that were received supported many of the proposed enhancements to the FMI regulatory regime, while also drawing attention to concerns and potential limitations or drawbacks of some of the proposed reforms. The CFR has considered this feedback and some of the proposals have been amended or adapted to address the feedback provided during the consultation. Where this is the case, the new proposed approach is outlined in this response.

Stakeholders will have the opportunity to engage further with the proposed reforms in greater detail at a later stage in the process, should the proposed reforms proceed, once draft legislation to enact the reforms is released publicly.

1. Introduction

This document sets out the CFR's response to the submissions received through the *Council of Financial Regulators: Financial Market Infrastructure Regulatory Reforms Consultation* (2019 Regulatory Reforms Consultation).[1] In addition to addressing specific issues raised in submissions to the consultation, this response details where this feedback has led to a reconsideration of the proposed approach and clarifies how the CFR intends to proceed on each of the proposed reforms.

1.1. Background

The reforms set out in this response focus on the four classes of FMI currently licensed under Chapter 7 of the *Corporations Act 2001* (Corporations Act). These are:

- financial market operators;
- clearing and settlement facilities;
- financial benchmark administrators; and
- derivative trade repositories.

In Australia, FMIs support transactions in securities with a total annual value of $16 trillion and derivatives with a total annual value of $185 trillion.[2] Without clearing and settlement facilities, and access to financial benchmarks, many financial markets could not operate. These markets turn over value equivalent to Australia's annual GDP every three business days. Financial markets supported by FMIs are used to raise capital, borrow and lend funds, invest in equities and debt securities, and transact in derivatives for risk management purposes. Investors rely on FMIs for access to transparent prices and a safe means of transacting in their investments, which include over $640 billion in superannuation assets held in Australian equities and fixed income assets.[3] Australian governments rely on the Austraclear system to issue debt securities used to raise funds, and most holdings of government debt securities are kept in the Austraclear system. These activities are vital to the smooth functioning of the financial system and to the economy more broadly.

1.2. The need for regulatory reform

FMIs' importance to the financial system continues to grow. International reforms led by the G20 since the global financial crisis, including the mandates to clear and report certain types of trades, have led to a greater proportion of financial transactions flowing through financial markets, clearing and settlement facilities and derivative trade repositories.

These changes have also been accompanied by an evolution of business models under which FMIs are operated. Where previously many FMIs were mutually owned and operated by market participants, they are increasingly run as for-profit entities that are exposed to commercial pressures that may create tensions between profitability and resilience. Meanwhile, the sudden outbreak of COVID-19 has highlighted the serious operational and financial risks to which FMIs are exposed. During this event, FMIs had to rapidly transition to

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1 See *Council of Financial Regulators: Financial Market Infrastructure Regulatory Reforms Consultation* (2019), available at <https://www.cfr.gov.au/publications/consultations/2019/consultation-on-financial-market-infrastructure-regulatory-reforms/>.

2 Figures reflect the value of securities trades and notional value of derivatives trades for the year to 31 December 2019.

3 APRA-regulated superannuation funds; does not include assets held by self-managed superannuation funds. Fixed income assets may include some loans made by superannuation funds that do not rely on FMI services.

remote working at the same time as managing record transaction volumes and responding to highly volatile markets; the mismanagement of any one of these steps could have had catastrophic consequences in a highly stressed market. In addition, the increasing complexity and interconnectedness of systems is increasing operational risk and the FMI's exposure to growing cyber security threats.

The significance of FMIs as central elements of the financial system, the increased risks they face, the business models they operate, and the fact that use of FMIs is now in some cases officially mandated, mean that effective supervision and regulation are critical. In particular, regulators need strong powers to promote financial stability and financial markets that are stable, fair, orderly, and transparent. As the number of financial products and transactions increase each year, financial benchmarks and derivative trade repositories grow in importance which means regulators must be able to safeguard their quality, reliability and integrity. Meeting these regulatory objectives will be of significant benefit to the direct and indirect users of these facilities, and the broader financial system.

While the regulatory framework currently provides the Regulators with some of these powers, the regime still suffers from the following weaknesses and inefficiencies:

- the distribution of powers between the Minister, ASIC and the RBA does not correspond to their legislative mandates or international best practice. In particular, the distribution of powers between ASIC and the RBA does not appropriately reflect their respective mandates, and the Minister exercises some operational powers that more appropriately sit with the Regulators;
- the Regulators do not have sufficient supervisory or enforcement powers to most effectively monitor or manage the risks posed by FMIs to the orderly provision of services and financial stability; and
- the Regulators do not have crisis management powers to resolve a distressed clearing and settlement facility.

Several independent reviews of Australia's financial system have come to similar conclusions, including the 2014 Financial System Inquiry and the IMF's 2019 Financial Sector Assessment Program review. The IMF assessment recommended strengthening the Regulators' independence and supervisory and enforcement powers, and finalising the FMI resolution regime.[4]

Australia's financial system has not yet faced events that would expose the weaknesses in the current regime. As highlighted by COVID-19, it is possible for unexpected risks to emerge suddenly with severe and unpredictable effects. The conduct of licensees has also rarely required the Regulators to take explicit enforcement action. Experience in other parts of the financial sector, including examples highlighted by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, suggests that it cannot be assumed that such conduct will continue indefinitely, particularly if new entrants, or changes in ownership or management, were to negatively affect the conduct of licensees. Without reform, the Regulators will have limited ability to intervene in the event of misconduct or poor risk management by FMIs or an inadequate response by FMIs to an unexpected and severe event which could inflict significant costs on the financial system and, ultimately, the broader economy.

[4] See Recommendation 5 of the *Financial System Inquiry Final Report* (2014). Available at <http://treasury.gov.au/publication/c2014-fsi-final-report>. The IMF FSAP *Technical Note on Supervision, Oversight and Resolution Planning of Financial Market Infrastructures* (2019). Available at <http://www.imf.org/en/Publications/CR/Issues/2019/02/13/Australia-Financial-Sector-Assessment-Program-Technical-Note-Supervision-Oversight-and-46609>.

1.3. Policy development principles

In developing the proposed reforms, the CFR has been guided by the following regulatory design principles:

Principle 1: Clear purpose and objectives: The reforms should clearly identify policy goals; and set out a mechanism for prioritising those goals and coordinating regulatory activities to achieve the desired outcome.

Principle 2: Clarity of regulators' roles and responsibilities: Each regulator should have well-defined responsibilities and objectives, and have sufficient powers to achieve them. Regulators should not have conflicting functions. If there is an overlap in responsibilities, there should be a mechanism to coordinate regulators' actions.

Principle 3: Regulatory consistency: To minimise costs for both regulators and regulated entities, the reforms should aim to achieve similar objectives and align the regulatory regimes of similar sectors. Where different approaches are taken, they should be justified by differing circumstances. Alignment should be based around the most fit-for-purpose model for the needs of the regime.

Principle 4: Proportionality: The powers available under regulatory regimes should be proportionate to the scale and nature of the problems those regimes address. Regulatory regimes should not impose an undue compliance burden on regulated entities, nor should they unduly constrain the activities of the regulated entities. This may mean that certain powers are only available in certain circumstances.

1.4. Proposed reforms

The CFR's proposed reforms are designed to better equip the Regulators to identify and address emerging risks pursuant to their respective mandates. For ASIC, this is for fair, orderly and transparent markets; fair and effective clearing and settlement services; and to promote the quality, integrity, availability, reliability and credibility of financial benchmarks. For the RBA, this is for promoting the reduction of systemic risk by clearing and settlement facilities.

While some of these proposals could increase costs to industry, the CFR considers these costs are outweighed by the benefits of increased resilience and maintaining financial stability. Clearer and stronger powers that better enable the Regulators to meet their respective mandates more effectively will increase the confidence of market participants and other users of FMI services. The reforms will also support regulatory action to increase the resilience of Australia's FMIs, contributing to reduction in the overall level of risk in the financial system and reducing the likelihood that market participants will be exposed to substantial losses from a systemic risk event.

Most of the proposals in this response are based on relevant international standards and guidance, as well as other financial regulation in Australia, including those applying to authorised deposit-taking institutions (ADIs).

The proposed reforms can be grouped into three categories:

1. Redistributing existing powers and decision-making authority between the Regulators and the Minister to reflect their respective responsibilities.
2. Strengthening the Regulators' supervision and enforcement powers.
3. Introducing a crisis management regime for licensed clearing and settlement facilities.

The first group of proposed reforms would redistribute existing regulatory powers and decision-making authority between the RBA, ASIC and the Minister. Currently, the Minister has powers that more appropriately sit with the Regulators, while ASIC has powers that more appropriately sit with the RBA. Formally redistributing

these powers will better distinguish the Regulators' operational responsibilities from the strategic role of Government and align the Regulators' powers with their respective mandates.

The second group of proposed reforms would strengthen the Regulators' supervisory powers, including information-gathering powers, and broaden the range of enforcement tools they have available. This will give the Regulators significantly more capability to monitor the ongoing conduct of FMIs, identify risks as they emerge, and take appropriate action to prevent those risks escalating.

The final group of proposed reforms relate to the introduction of a crisis management regime for clearing and settlement facilities. A crisis management regime would give a resolution authority the tools to take action in respect of a distressed clearing and settlement facility and to support the continuity of the facility's critical market functions. These proposals broadly implement the international standards for resolution regimes for financial institutions adopted by the Financial Stability Board (FSB). Most major economies have put in place, or are putting in place, similar powers for regulators to intervene in systemically important failing institutions. These proposals have also considered the crisis management powers available to the Australian Prudential Regulation Authority (APRA).

1.5. Consultation process

The CFR consulted on these proposals in November 2019. The 2019 Regulatory Reforms Consultation brought together the CFR's views from a number of earlier consultations, along with extensions to some of the arrangements covered by those consultations, and a number of new proposals. The paper set out a broad set of proposals covering licensing, regulation, supervision and crisis management powers.

Feedback was received from 18 stakeholders, including operators of FMIs, participants and industry associations.[5] The CFR has considered the feedback and refined its proposals in light of written submissions and engagement with stakeholders.

[5] The CFR has published a list of submitters that did not request confidentiality, and their submissions, available at <https://www.cfr.gov.au/publications/consultations/2019/consultation-on-financial-market-infrastructure-regulatory-reforms>.

2. Proposals, feedback and policy approach

This section summarises proposals in the 2019 Regulatory Reforms Consultation, sets out the feedback received from stakeholders on each proposal and gives the CFR's response to that feedback, including what will be reflected in the CFR's recommendations for Government. The proposals are grouped according to the three main categories for reform: enhancing the licensing regimes for FMIs; enhancing the supervision of FMIs; and the introduction of a crisis management regime for clearing and settlement facility licensees (CSFLs) (corresponding to chapters two, three and four of the 2019 Regulatory Reforms Consultation respectively).

All of the submissions to the consultation provided feedback on one or more of the proposed enhancements to FMI licensing and supervisory powers and eight provided feedback on the crisis management proposals.

A number of the crisis management proposals received little or no feedback beyond general support – other than in relation to the proposed extension of powers to related bodies corporate of a CSFL in resolution, which is discussed separately in section 2.4.3. These were:

- Information gathering
- Resolution planning and resolvability
- Conditions for resolution
- Transfer powers
- Resolution directions
- Aspects of the resolution regime that are unchanged from the Australian Government Consultation Paper: Resolution Regime for Financial Market Infrastructure (2015 Resolution Consultation).[6]

In addition, the proposal for ASIC to be given a declaration power for prescribed financial markets also received little feedback beyond general support. These proposals will not be addressed in this paper. The CFR will proceed with its advice to Government based on these proposals as set out in the 2019 Regulatory Reforms Consultation.

2.1. General feedback

In most cases stakeholder feedback was related to a specific proposal included in the 2019 Regulatory Reforms Consultation. However, there were also some general themes that emerged across a number of the submissions.

2.1.1. Governance, accountability and oversight

A number of stakeholders raised the need to ensure proper governance, accountability and oversight of proposals set out in the 2019 Regulatory Reforms Consultation. This feedback was particularly focused on proposals that sought to transfer or grant new powers to ASIC. One stakeholder referenced a perceived lack of an effective independent review process into the work of the ASIC executive within the current ASIC governance structure. There was also feedback on governance in relation to ASIC's exercise of Ministerial powers if they are transferred to ASIC, which is discussed further in section 2.2.1.

[6] See *Resolution regime for financial market infrastructures* (2015), available at <http://treasury.gov.au/consultation/resolution-regime-for-financial-market-infrastructures>.

The CFR acknowledges that appropriate governance structures are critical to ensuring regulation is fair, just and transparent, and that the importance of effective governance increases when the Regulators receive additional powers.

The CFR notes that ASIC announced in December 2019 that it had strengthened governance and accountability measures. ASIC's governance and accountability framework articulates how ASIC's Commission collectively exercises its functions and powers to deliver ASIC's statutory objectives.

Oversight and accountability of ASIC's use of its regulatory powers is achieved through arrangements which include certain decisions being subject to merits review by the Administrative Appeals Tribunal and judicial review by the Australian courts. ASIC decisions are also subject to review by the Commonwealth Ombudsman, Office of Australian Information Commissioner and Privacy Commissioner. With respect to the regulatory framework for FMIs, some ASIC powers are also subject to Ministerial review or consent. ASIC is accountable to the Australian Parliament through the:

- Parliamentary Joint Committee on Corporations and Financial Services;
- Senate Standing Committee on Economics; and
- House of Representatives Economics Committee.

Where other elements of the regulatory framework (such as regulations) impose new obligations on stakeholders, it is intended that additional public consultation will be undertaken. Where appropriate, ASIC intends to issue regulatory guidance that provides transparency on how it will use its new powers.

2.1.2. Deference and alignment with foreign jurisdictions

The responses received on proposals that may alter the regulatory landscape for non-domestic FMIs commonly contained feedback that urged the Regulators to practise deference or, at the very least, alignment with other jurisdictions that have similar standards.

These responses expressed concern that the application of Australian rules to overseas FMIs may harm Australia's image, deter new providers from doing business in Australia and potentially drive overseas service providers to leave the market. Submitters argued that this would fragment the Australian market and impair the ability of Australian financial institutions to manage their business risks.

Submitters also urged the CFR to align proposed regulation outlined in the 2019 Regulatory Reforms Consultation with regulation in jurisdictions that presently impose similar rules. They argued that, if Australia fails to align with other jurisdictions, this risks creating new opportunities for regulatory arbitrage.

As outlined in the CFR's response to the *Overseas Clearing and Settlement Facilities: The Australian Licensing Regime* consultation (2015 Overseas CSFL Consultation),[7] the Australian regulatory regime already reflects the principle of deference and provides for recognition of oversight by an overseas regulatory authority. In particular, the Corporations Act provides alternative licensing routes for operators of overseas markets and clearing and settlement facilities. These alternatives are available where the operator of a market or clearing and settlement facility is subject to regulatory requirements and supervision in its home jurisdiction that are sufficiently equivalent to those in Australia.

ASIC has issued guidance for both markets and clearing and settlement facilities which acknowledges that the alternate overseas licensing routes for markets and clearing and settlement facilities is intended to facilitate

[7] See *Overseas Clearing and Settlement Facilities: The Australian Licensing Regime* (2015), available at <http://www.cfr.gov.au/publications/consultations/2015/overseas-clearing-and-settlement-facilities-australian-licensing-regime/>.

competition and avoid regulatory duplication. For markets, this is done while maintaining investor protection and market integrity; for clearing and settlement facilities, while promoting reduction in systemic risk and the fair and effective provision of services. In its published approach to supervising and assessing CSFLs, the RBA draws specific distinctions with respect to overseas licensees, including areas where reliance is placed on home regulators.[8] The CFR has publicly articulated that the Regulators' approach is to place reliance on information and reports provided by the facility's home regulator in assessing the licensee's compliance with its licence obligations.[9]

The CFR notes that the obligations in the CFR proposals on operators of overseas markets and clearing and settlement facilities are intended to be principles-based and outcomes-focused, rather than prescriptive, which will facilitate deference and should avoid conflicting regulations between the operator's home and Australian regulatory regimes. The CFR agrees that alignment with other jurisdictions is important as it will reduce regulatory arbitrage, and this will be taken into account when developing the details of the proposals for implementation.

2.1.3. Requests for greater detail

In some cases, stakeholders did not express a view on proposals, cited the high-level treatment in the 2019 Regulatory Reforms Consultation, and expressed a preference to defer comment until such time as the proposals are approved and draft legislation is consulted on. In other cases, stakeholders expressed in-principle agreement with proposals but noted that they would like further detail before providing a final view.

The CFR notes that the 2019 Regulatory Reforms Consultation was intended to seek feedback on broad policy proposals, in order to inform the CFR's recommendations to Government. The CFR appreciates that for some proposals further details will need to be published before more comprehensive feedback can be given. If approved by the Government, greater detail on the proposals will be provided via draft legislative amendments that will be subject to public consultation. Where relevant, it is intended that other elements of the regulatory framework, such as regulations, will also be consulted on and issued at a later stage.

2.2. Enhancing the licensing regimes

The proposed reforms aim to increase the efficiency of the licensing regimes by redistributing existing powers and decision-making authority between the Minister and the Regulators. A more efficient licensing regime will deliver better outcomes to the public and its regulated population. The proposals also included new powers for the Regulators designed to strengthen the licensing regime and align it with international best practice.

2.2.1. Alignment of regulatory powers and responsibilities

CFR proposal

The CFR proposed that powers of the Minister under the Corporations Act that are currently delegated to ASIC in relation to licensing and supervision of Australian market licensees (AMLs) and CSFLs should be transferred to ASIC, and to the RBA where appropriate in relation to CSFLs. With respect to CSFLs, the CFR proposed to require that the Regulators consult each other in the exercise of these powers.

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8 See *The Reserve Bank's Approach to Supervising and Assessing Clearing and Settlement Facility Licensees* (2019). Available at <https://www.rba.gov.au/payments-and-infrastructure/financial-market-infrastructure/clearing-and-settlement-facilities/standards/approach-to-supervising-and-assessing-csf-licensees.html>.

9 For further detail, see *Ensuring Appropriate Influence for Australian Regulators over Crossborder Clearing and Settlement Facilities* (2012). Available at <http://treasury.gov.au/publication/ensuring-appropriate-influence-for-australian-regulators-over-cs-facilities>.

The current delegation from the Minister to ASIC in relation to AMLs and CSFLs includes powers in respect of licensing, operating rule changes, exemptions, information-gathering, directions and compensation regimes for financial markets.

The Minister would retain powers that are not currently delegated to ASIC, as these are generally matters of strategic or national importance, rather than operational matters. These powers include the approval of large shareholdings of a widely held market body on national interest grounds. The Minister would also retain a role in reviewing certain decisions made by the Regulators.

Stakeholder feedback

Stakeholders were generally supportive of this proposal.

It was noted in the feedback that the proposal may involve efficiency gains, and appeared likely to have a minimal practical impact on licensing and supervision decisions related to FMIs.

One stakeholder requested clarification on any guidelines that ASIC would be required to follow if the delegated powers were to be transferred to them.

Another stakeholder was of the view that any implementation of this proposal should be accompanied by regulations formalising some of the governance steps initiated by ASIC itself in relation to the separation of day-to-day business and more strategic review and oversight.

CFR response

The CFR intends to proceed with this proposal.

Further details around governance, accountability and oversight, particularly in connection with the use and oversight of new powers granted to ASIC, are set out in 2.1 above.

2.2.2. Grounds for suspension or cancellation of a licence

CFR proposal

The CFR proposed clarifying the circumstances in which a licence can be suspended or cancelled. These are where: the entity has not commenced the activity for which a licence has been granted within three years; or the licensee has not carried out the licensed activity for a period of 12 months. This will apply to all Licensed Entities (AMLs, benchmark administrator licensees (BALs), CSFLs and derivative trade repository licensees (DTRLs)). For BALs with more than one benchmark specified in their licence, the CFR proposed that the licence could be varied to remove a specified benchmark.

The Minister's power to suspend or cancel a licence, currently delegated to ASIC, was proposed to be transferred to ASIC.

The CFR also proposed that ASIC (after consultation with the RBA in relation to Overseas CSFLs) should have the power to suspend or cancel the licence of an overseas market or an Overseas CSFL if there is a material deterioration in the cooperation or information-sharing arrangements with the licensee's home regulator.

These proposals were discussed in section 2.4 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

There were no objections to the proposal to specify the circumstances in which a licence may be cancelled or suspended where the licensee has not commenced or ceases to carry out the business of operating the market.

Two stakeholders also requested clarification on how this power would be applied with respect to the cancellation or suspension of a licence if a licensee did not use one feature of a licence related to a certain

product. They sought clarification on whether a licence could be varied to remove authorisation for an unused feature of the licence.

One stakeholder suggested extending the 12-month period where the licensee did not carry out the licensed activity by a further six months. The justification given for this recommendation was that an 18-month period may better align to market cycles.

There were no objections to the proposal that a material deterioration in the cooperation or information-sharing arrangements with an Overseas CSFL's home regulator should be grounds for suspension or cancellation of the licence.

CFR response

The CFR intends to proceed with these proposals.

It is important that licences are used in appropriate ways and can be suspended or cancelled if they are not being used appropriately. This includes cases where a Licensed Entity is warehousing a licence rather than carrying out the activities that the licence has authorised it to undertake.

In response to submissions, the CFR confirms that this power is intended to be exercised only to cancel or suspend authorisation for a market, clearing and settlement facility, derivative trade repository or financial benchmark as a whole, not to remove authorisations from a licence in respect of particular products. It is intended that additional guidance will be published about the circumstances in which such a discretionary power would be exercised.

In respect of the appropriate length of time before this ground is triggered, the CFR emphasises that the proposed power is discretionary, and ASIC can approach each case on the particular circumstances. The proposed three-year period during which a licensee may hold a licence without commencing the licensed activity before the exercise of this power is intended to facilitate innovation and new business and reflect market cycles.

2.2.3. Overseas entities – requirement to be licensed

CFR proposal

The CFR proposed a revised 'two-step test' approach to the licensing of an operator of an overseas market or an overseas clearing and settlement facility.

Operators of markets and clearing and settlement facilities that have a connection or nexus to the Australian financial system ('domestic connection' – first step), based on objective criteria to be set out in the legal framework, would be required to notify ASIC of this fact, and provide information to ASIC to enable it to assess the materiality of that connection, including on an ongoing basis.

An entity must then become licensed or exempted if ASIC (in consultation with the RBA for clearing and settlement facilities) determines that the market's or clearing and settlement facility's domestic connection is material (second step).

ASIC should have access to sufficient information to enable it to make an informed decision when assessing whether an overseas financial market or clearing and settlement facility has a material domestic connection to Australia.

This proposal was discussed in section 2.4 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Most stakeholders were broadly supportive of the proposal for a two-step test to provide greater clarity and certainty around licensing requirements for overseas operators, including the extension of such a model to

market operators, as well as clearing and settlement facility operators. Some responders recognised the role of adequate information-gathering powers in allowing the Regulators to monitor developments and collect information for the purpose of conducting these tests. One stakeholder also encouraged the Regulators to continue engaging bilaterally with foreign entities, as a complement to the proposed new model and in the interest of a high degree of transparency and certainty.

Nevertheless, some stakeholders observed that the first step of the test (domestic connection) is likely to capture a large number of overseas markets and clearing and settlement facilities. In particular, two stakeholders highlighted how this broad range of entities would then be subject to notification and reporting requirements, which they saw as an unwarranted additional regulatory burden. The stakeholders opined that overseas entities' reactions to the imposition of such requirements could affect access to offshore services by Australian participants. As a result, some of the stakeholders suggested narrowing down the range of entities that would be captured by these requirements. For example, one stakeholder suggested the criteria should focus more on the extent of Australian participation rather than the offering of Australian-related products.

With regard to the second step (materiality), some stakeholders remarked that any licensing requirement on overseas operators should be conditional on there being a significant nexus between the facility and Australia. In this context, they recommended the use of objective quantitative criteria to define a material connection, in order to provide a high degree of certainty for foreign operators. Some responders sought further guidance as to how the Regulators' discretion would be applied in determining materiality.

From the participants' perspective, one stakeholder favoured the publication of a list of overseas operators of markets and clearing and settlement facilities with a domestic connection that were not determined to be material, to avoid participants breaching any requirements, or being indirectly associated with an operator or venue breaching such requirements.

CFR response

The CFR intends to proceed with these proposals.

The proposed two-step test is intended to provide an adequate level of transparency as to an entity's current (and future) position within the Australian regulatory regime, and facilitate its commercial decisions.

The CFR expects that bilateral engagement with overseas entities will continue and is consistent with this proposal. This proposal provides a clearer framework for dialogue and information-sharing between Australian regulators and foreign operators. In today's regulatory regime, engagement between the Regulators and an overseas operator is in the nature of repeated ad hoc conversations regarding an operator's status in Australia. The proposed structure will have the advantage of providing clarity for the operator on when and how to engage with the Regulators. In addition, the proposed framework and the objective criteria of the first step should address industry concerns by providing transparency and confidence for the wider market on when operators are subject to particular requirements and when they are not.

The new approach will be applied to overseas operators of markets and clearing and settlement facilities. It is expected that separate criteria for the two steps for the two types of entities will be published in the legal framework and set to reflect differences in the profiles of these two types of entities.[10] For example, in the current public guidance, the offering of Australian-related products is a relevant factor in assessing whether an

[10] For examples of criteria considered for overseas clearing and settlement facilities see Tables 1 and 2 of the *Overseas Clearing and Settlement Facilities: The Australian Licensing Regime* (2015), available at <http://www.cfr.gov.au/publications/consultations/2015/overseas-clearing-and-settlement-facilities-australian-licensing-regime/pdf/overseas-clearing-and-settlement-facilities-australian-licensing-regime.pdf>.

overseas clearing and settlement facility is operating in this jurisdiction, but it is not a relevant factor in the context of overseas market operators. It is intended that ASIC will publicly consult on these sets of criteria.

It is not the CFR's expectation that the objective criteria result in a very large number of entities having a domestic connection. Further, information collected under the notification and reporting requirements is not intended to be onerous in either quantity or frequency. Other jurisdictions require forms of licensing or recognition when a simple connection is established, which is not proposed for Australia. The 'light touch' information collection framework proposed for Australia is designed to provide more predictability and transparency of obligations for operators than current ad hoc engagements. At a high level, reporting will focus on a limited number of specific data selected to monitor changes in the materiality of an entity's connection to Australia, to be provided once or twice per year. It is intended that the Regulators weigh information needs and compliance costs when setting the frequency and scope of these requirements. Stakeholders will have an opportunity to provide feedback on these and other factors during a further consultation period prior to reporting obligations being implemented.

The requirement to become licensed or exempted will only apply where a connection is determined by ASIC to be material. It is intended that materiality circumstances would be published as part of the legal framework and that guidance will outline case studies to demonstrate how the proposed test would be likely to be applied. However, the CFR has concluded that to adopt quantitative thresholds would unduly restrict the Regulators in weighing the various factors relevant to determining the materiality of a domestic connection.

To enhance clarity and transparency for participants, determinations of which domestic connections are material will be made public. Information on markets and clearing and settlement facilities with a known domestic connection to Australia could also be published. Further guidance could also be provided for participants to increase transparency over the period between ASIC's determination and licensing.

2.2.4. Location requirements

CFR proposal

The CFR proposed that ASIC have the power to impose a 'location requirement' on an overseas AML or Overseas CSFL. This would require the entity to transition from an overseas licence to a domestic licence held by a domestically incorporated entity.

This proposal was discussed in section 2.4 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

In their feedback, stakeholders generally sought greater certainty and clarity around the application of the location requirement, including the circumstances in which the power would be able to be exercised. One stakeholder suggested that such a requirement should only be enacted after a detailed impact analysis, covering risk to participants and the financial system, and cost to end users. A key theme was that relocation may bring into question the commercial viability of doing business in Australia.

Potential risks and costs that stakeholders suggested could arise from a location requirement included: market dislocation, reduced access for Australian participants, concentration of risk in participants intermediating between CCPs, reduced market efficiency and liquidity, and an increase in costs for end users.

CFR response

The CFR intends to proceed with a modified proposal.

In response to feedback, the CFR no longer intends to propose that ASIC will have the power to impose a location requirement. In order for the Regulators to retain an appropriate degree of regulatory influence over the activities of overseas AMLs and CSFLs in Australia that could pose a substantial risk to the functioning of

the Australian financial system, it is instead proposed that licence conditions could be imposed to limit the scope and level of their activity in Australia. This change in approach is not anticipated to have any adverse effect on the intended outcomes of the original policy. Overseas licensees would be required to demonstrate their ability to observe any limit which may be imposed on their Australian-related activities. ASIC would have the power to enforce these limits. An overseas licensee that wanted to further increase its presence in Australia beyond the limits imposed under its licence conditions would retain the option to apply for a domestic licence provided it met the required criteria. Consistent with the proposal discussed in section 2.2.5, for CSFLs this would include the applicant for the domestic licence being a domestically incorporated entity.

For Overseas CSFLs, it is envisaged that any limits would be set at a level where ASIC and the RBA consider it absolutely necessary to protect against systemic risk, and where other regulatory measures are not appropriate to mitigate these risks. Appropriate limits and relevant activity metrics would be discussed with any operator of a market or CSFL before such limits were imposed. It is intended that any limits imposed on a licensee through a licence condition would be published, thereby providing all participants with greater certainty when formulating their business plans. It is intended that regulatory guidance would be published outlining how these limits may be applied.

2.2.5. Domestic clearing and settlement facility licences

CFR proposal

The CFR proposed to require holders of a domestic Australian clearing and settlement facility licence to be domestically incorporated.

This proposal was discussed in section 2.4 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Feedback questioned how this proposal would affect competition in Australia for clearing, including for products traded on international markets.

CFR response

The CFR intends to proceed with this proposal.

This reform will facilitate the exercise of any resolution powers in respect of entities that hold a domestic Australian clearing and settlement facility licence. Unless exempt by ASIC, Domestic CSFLs would be required to be incorporated under, and therefore be primarily governed by, the laws of Australia so that the resolution authority will be able to resolve Domestic CSFLs effectively. ASIC would be able to exempt an entity from this particular requirement on a case-by-case basis.

An operator of a clearing and settlement facility that is an overseas incorporated company would continue to have a route to be licensed as an operator of an overseas clearing and settlement facility if it meets the relevant requirements under the Corporations Act.

2.2.6. Widely held market body – declaration power

CFR Proposal

The CFR proposed that ASIC be empowered to declare a body to be a widely held market body.

The CFR also proposed that a change in control of ASX Limited be subject to the Minister's approval rather than requiring a regulation.

These proposals were discussed in section 2.6 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Support was expressed for both proposals, i.e. to empower ASIC to declare a body to be a widely held market body, and for the Minister to approve changes in voting power above 15 per cent at ASX Limited, removing the need to make a regulation in these circumstances.

Stakeholders raised some concerns beyond the specific CFR proposals and spoke to other aspects of the widely held market body regime.

One stakeholder brought up the possibility of aligning the existing 15 per cent voting power limit with the 20 per cent limit within the *Foreign Acquisitions and Takeovers Act 1975* (FATA) and the *Financial Sector (Shareholdings) Act 1998* (FSSA) that applies to non-FMI financial sector companies. The stakeholder noted that the FSSA was amended in 2018 to increase the ownership limit to 20 per cent to bring it in line with FATA as there was no policy rationale for the discrepancy between these two regimes.

A stakeholder stated their objection to the proposed and current shareholding approval provisions for widely held market bodies. This objection was on the grounds that shareholding restrictions are anachronistic and protectionist in nature, which fails to promote Australia's business image abroad and dissuades foreign participants entering the Australian market.

The same response also questioned the necessity of having such a regulatory framework if other proposals from the 2019 Regulatory Reforms Consultation are adopted, specifically the fit and proper standard and for change in control in Australian FMIs to require ASIC approval.

CFR response

The CFR intends to proceed with these proposals.

The CFR does not intend to propose any change to the current 15 per cent voting power limit above which Ministerial approval is required.

2.3. Enhancing supervision and enforcement

The proposed reforms to enhance supervision and enforcement in relation to Licensed Entities aim to provide the Regulators with strong powers to regulate the conduct of Licensed Entities and enforce their compliance with their obligations under Chapter 7 of the Corporations Act. This will promote the provision of their services in a fair and effective manner and increase their resilience against an external shock.

2.3.1. Fit and proper standard

CFR Proposal

The CFR proposed that a fit and proper standard apply to individuals 'involved in' a Licensed Entity. The CFR also proposed that a fit and proper concept should encapsulate attributes such as competence, experience and knowledge, alongside those attributes already provided for under current legislation – fame, character and integrity. Under existing legislation, an individual is 'involved in' an entity if he or she is a director, secretary, senior manager or an individual who has more than 15 per cent of the total voting power.

The CFR proposed that the fit and proper standard should not include a requirement for ASIC to demonstrate that there is a risk that the licensee or applicant will breach its obligations under the Corporations Act.

This proposal was discussed in section 3.3 of the 2019 Regulatory Reforms Consultation.

Stakeholder Feedback

There was mixed support for the proposal to implement a fit and proper standard to individuals involved in a Licensed Entity. Responders who expressed support acknowledged that the important individuals within a Licensed Entity should possess the appropriate skills and be of good character.

Many stakeholders (including domestic and overseas licensees) expressed particular concerns about the application and implications of this proposal on overseas FMIs, citing consequences including: increased regulatory costs for entities that are subject to other regulatory regimes, diminishing the competitive position of Australia as a place for FMIs to do business; erecting unnecessary barriers to entry into the Australian market for new FMIs, which may also cause existing FMIs to withdraw; and constraining the rights of shareholders of foreign FMIs to elect members of the management body.

One stakeholder suggested that withdrawal of foreign FMIs would likely increase market fragmentation and impair the ability of Australian participants to manage their business risks which could also increase systemic risk.

Suggestions from stakeholders ranged from either aligning this requirement with other regimes or deference of this requirement to the home regime.

CFR response

The CFR intends to proceed with this proposal.

The imposition of a fit and proper standard is not intended to impose a significant regulatory burden. As a matter of sound corporate governance, the individuals 'involved in' a Licensed Entity ought to consider their own competence, as commensurate and relevant to their role and responsibilities, in undertaking to be involved in a Licensed Entity. In that respect, the fit and proper requirements would be a responsibility of the relevant individual, as well as the Licensed Entity.

The CFR proposes that the feedback from stakeholders be addressed in the following ways.

First, ASIC is able to issue guidance to provide clarity and assist industry in complying with fit and proper requirements. There are precedents in other regulatory contexts which provide examples of regulatory guidance on fit and proper criteria.

Second, the CFR is cognisant that the manner in which fit and proper requirements are implemented could potentially generate a compliance burden on individuals and Licensed Entities, and will endeavour to minimise compliance costs while meeting its policy objective. The CFR notes this proposal does not include a process for the pre-approval of appointees that may create an additional compliance burden.

Third, it is important that all licensees, domestic and overseas, are subject to a fit and proper standard in order to promote good governance and require that those involved in a licensee have the competence, knowledge and experience commensurate with their role and responsibilities in the licensee. For overseas licensees, the Regulators have and will continue to defer to the supervision of the home regulator in assessing an entity's compliance with its obligations. One of the purposes of the overseas licensing regime is to avoid duplicated regulation. It is intended that the fit and proper standard be aligned as far as possible with other precedents of fit and proper requirements to further the goal of harmonisation. It is intended that the content of the proposed standard will be consulted on.

2.3.2. Change in control

CFR proposal

The CFR proposed that ASIC's consent would be required for a person to hold more than 15 per cent voting power in a Licensed Entity that is incorporated in Australia.

The proposal would operate alongside, and not replace, current provisions for 'widely held market body' approvals by the Minister. A transitional arrangement would apply to current ownership holdings in existing licensees.

This proposal was discussed in section 3.4 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Stakeholders requested further clarification on the process and factors that ASIC would consider, accompanied by further consultation.

CFR response

The CFR intends to proceed with this proposal.

In response to stakeholder feedback, it is intended that ASIC will issue guidance on the information it will require and considerations that it will take into account when approaching a proposed change of control transaction under this proposed regime.

2.3.3. Rule-making power for Domestic CSFLs

CFR proposal

The CFR proposed that ASIC be empowered to make rules for Domestic CSFLs to promote the fair and effective provision of clearing and settlement services. The procedures and safeguards for rule-making in respect of Domestic CSFLs would be consistent with ASIC's current rule-making power in respect of AMLs, BALs and DTRLs, including the requirement to consult before making a rule, Ministerial consent being required for the making of a rule, and being subject to parliamentary disallowance.

Should there be an overlap between a rule and the RBA's Financial Stability Standards (FSS), the latter would prevail to the extent of any conflict. To ensure coordination between the Regulators in the exercise of their respective powers, ASIC would be required to seek advice from the RBA about any proposed rules and the RBA would have the opportunity to give advice to the Minister as part of the process for Ministerial consent for the making of a rule.

This proposal was discussed in section 3.5 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Most stakeholders expressed approval of the proposal to empower ASIC to make rules for Domestic CSFLs to promote the fair and effective provision of clearing and settlement services. One stakeholder suggested instead that the FSS be revised to address matters relevant to ASIC's mandate and the Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO) *Principles for financial market infrastructures (PFMI*) that are not currently covered.[11] The stakeholder expressed concern that having two, possibly conflicting, sets of rules operating in conjunction could create unnecessary regulatory complexity and uncertainty for licensees.

CFR response

The CFR intends to proceed with this proposal.

The purpose of the rule-making power is to support ASIC's mandate, not the RBA's mandate, and therefore it is appropriate that the rule-making power should sit with ASIC.

The CFR now also proposes that regulations may prescribe additional entities that must comply with the rules. It is intended that rules will initially only apply to Domestic CSFLs, but ASIC would consider recommending that

[11] See *Principles for financial market infrastructures* (2012), available at <https://www.bis.org/cpmi/publ/d101.htm>.

the Government introduce regulations to include other entities (such as participants of a clearing and settlement facility) if the need arises. Any such regulations would be subject to government consultation processes.

2.3.4. Information gathering

The CFR proposed that the Minister's power to require an AML or CSFL to provide a special report, currently delegated to ASIC, be transferred to ASIC, and to the RBA in the case of CSFLs.

The CFR also proposed that ASIC have the power to obtain a report from an expert on specified matters in respect of a Licensed Entity, and the RBA have a corresponding power in respect of a CSFL. The licensee may be required to bear the costs and expenses of obtaining the expert report.

The CFR further proposed that the RBA have the power to direct a CSFL to provide specified information related to the RBA's powers and functions in respect of CSFLs under the Corporations Act.

These proposals were discussed in section 3.6 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Stakeholders generally agreed with the proposals. However, there were concerns about the potential cost to licensees if the Regulators used these powers regularly.

Some responders requested greater clarity about the circumstances in which a special or expert report would be required. Two stakeholders asked that controls be put in place to ensure that requests to obtain expert reports are reasonable, justified, and do not result in undue costs to licensees.

One stakeholder objected to the proposal on the basis that it constitutes regulatory overreach in its application to offshore entities. Another stakeholder noted that it is not clear how the proposal compares globally and so it was not clear what the impact may be on the competitive position of Australia.

CFR response

The CFR intends to proceed with this proposal.

The powers are necessary to ensure that the Regulators have access to sufficient information in order to assess licensees' compliance with their Corporations Act obligations, and to support enforcement action where required. Since overseas licensees have obligations under the Corporations Act, it is necessary for these powers to apply to them as well as domestic licensees. The CFR notes the Regulators' existing information-gathering powers already apply to overseas licensees and that similar powers are available in comparable overseas regimes.

Procurement by a Regulator of any expert report would be undertaken in accordance with the Commonwealth Procurement Rules. Achieving value for money is the core rule of the Commonwealth Procurement Rules.[12]

2.3.5. Directions powers – RBA

CFR proposal

The CFR proposed the transfer to the RBA of ASIC's power to direct a CSFL in certain circumstances to take specified measures to comply with the FSS or any other action that ASIC considers will reduce systemic risk in the provision of the CSFL's services.

[12] See rule 3.2 of the *Commonwealth Procurement Rules 20 April 2019*, available at: <http://www.finance.gov.au/sites/default/files/2019-11/CPRs-20-April-2019_1.pdf>.

The CFR also proposed that the RBA be able to give directions to Domestic CSFLs in relation to specific matters where the RBA reasonably considers action is required to support financial stability. This type of direction could be given even in circumstances where a breach of the entity's FSS obligations has not occurred.

The CFR proposed that a statutory immunity be introduced in respect of reasonable actions taken by a CSFL and other relevant parties (such as directors or officers) in good faith to comply with a direction by the RBA.

These proposals were discussed in section 3.7 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Stakeholder feedback on these proposals was limited and mixed.

Some stakeholders supported the proposed transfer of the relevant directions powers to the RBA.

Other stakeholders expressed concerns in respect of the proposal that the RBA be able to give directions in relation to specific matters where the RBA reasonably considers action is required to support financial stability. One stakeholder sought a clearer indication of the nature of the targeted interventions that the RBA might make to support financial stability in such cases. Two other stakeholders highlighted the risk that a specific direction to an offshore CSFL may impose requirements that are inconsistent or irreconcilable with those of the CSFL's home country regulator.

CFR response

The CFR intends to proceed with this proposal.

The CFR notes that it is not intended that the 'specific directions' power be applicable to Overseas CSFLs.

Feedback will be addressed by additional detail in the legislation and the RBA will consider the publication of guidance on the use and application of directions in relation to specific matters where the RBA reasonably considers action is required to support financial stability.

2.3.6. Streamlining of directions powers – ASIC

CFR proposal

The CFR proposed that ASIC's directions powers be streamlined to remove the current two-stage process which requires ASIC to explain why the direction is required, provide time for the relevant licensee to respond, and then decide whether the direction is still required. The CFR also proposed that the time limit of up to 21 days on the period of effect of the direction would also be removed.

This proposal was discussed in section 3.7 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Stakeholder feedback was limited and mixed.

One stakeholder was generally supportive of the proposal to remove the time limit placed on certain directions. This view was subject to the condition that the direction is only valid for as long as is required to undertake the direction and there is no risk the direction will become open-ended.

There was no feedback on the proposal to streamline ASIC's directions powers to remove the current two-stage process.

CFR response

The CFR intends to proceed with these proposals.

It is intended that there will be clarity as to when an obligation under a direction must be complied with.

The CFR notes it does not propose to remove the Ministerial review process from the relevant powers.

2.3.7. Other directions related proposals

CFR proposal

The CFR proposed that the scope of sanctions available for a failure to comply with a direction be broadened to include BALs and DTRLs so that these sanctions would apply to all Licensed Entities. The CFR also proposed that sanctions would be broadened beyond the current application to the licensee only to include individual officers (including directors) of the licensee.

These proposals were discussed in section 3.7 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

One stakeholder opposed the proposed broadening of the application of sanctions to include BALs and DTRLs. The stakeholder argued that the proposal does not currently satisfy the requirements in the Government's Best Practice Guidelines because it does not, for example, establish a case for action or consider the effects on competition.

CFR response

The CFR intends to proceed with these proposals. This proposal will promote compliance with directions which is particularly important given the nature of FMIs and the critical role they play in the financial system.

The BAL and DTRL regimes did not exist at the time this proposal was first consulted on in the 2011 *Council of Financial Regulators: Review of Financial Market Infrastructure Regulation* (2011 Regulation Review Consultation).[13] BALs and DTRLs play a critical role as FMIs in the financial system and therefore it is important that there are sufficient incentives for them to comply with directions from the Regulators.

The CFR notes that proposals for a Financial Accountability Regime (FAR) were released subsequent to the 2019 Regulatory Reforms Consultation, and may create some overlap with these proposals when the FAR is expanded to cover the Licensed Entities in the future. Any such potential overlap may need to be managed during the implementation of the proposals in legislation.

2.3.8. Removal of the 'reasonably practicable' qualifier in FSS compliance

CFR proposal

The CFR proposed the removal of the qualifier in the Corporations Act that a CSFL is only required to comply with the FSS to the extent that it is 'reasonably practicable' to do so. It further proposed that the RBA's proposed power to direct a CSFL to take action to comply with the FSS not be qualified in a similar manner.

It was not proposed to remove this qualifier from the obligation for a CSFL to do all things necessary to reduce systemic risk, nor the related directions power.

This proposal was discussed in section 3.7 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Stakeholder feedback on these proposals was limited but raised some objections.

One stakeholder objected to the proposal on the basis that it constitutes regulatory overreach in its application to offshore entities. The stakeholder expressed concern that the removal of the 'reasonably practicable' qualifier from the obligation of a CSFL to comply with the FSS removes an administrative safeguard to the use

[13] See *Council of Financial Regulators: Review of Financial Market Infrastructure Regulation* (2011), available at <http://treasury.gov.au/sites/default/files/2019-03/CFR_review_of_FMI_regulation_issues.pdf>.

of the power and increases the risk of conflicting regulatory requirements under the Australian and home country regimes.

Feedback from another stakeholder argued that it was not clear that the 'reasonably practicable' qualifier currently hinders the Regulators' ability to enforce FSS obligations in practice. It was argued that if there was difficulty in enforcing obligations currently, these should instead be reframed.

CFR response

The CFR intends to proceed with this proposal.

The qualifier that a CSFL is only required to comply with the FSS to the extent 'reasonably practicable' means that in some situations it may be difficult to establish whether a CSFL has breached its FSS compliance obligations. It also limits the enforceability of the FSS, as a CSFL may argue that remediation actions are not 'reasonably practicable'. Even if the RBA was eventually successful in proving that the required actions are 'reasonably practicable', the delay in enforcing the original requirement may undermine the financial stability objectives of the FSS. In due course, the RBA intends to reframe obligations in the FSS so that they are more easily enforceable when required. However, without the removal of the 'reasonably practicable' qualifier, the enforcement of any amended FSS could still be subject to challenge and delay on the basis of that qualifier.

The possibility of conflicting regulatory requirements for offshore entities will be addressed by the existing requirement for the RBA to consult prior to determining or varying the FSS, providing CSFLs with the opportunity to identify any potential conflicts that may affect their ability to comply. The potential for conflict is also minimised by the requirements that an Overseas CSFL be subject to sufficiently equivalent regulation in its home jurisdiction.

2.4. Crisis management and resolution

Of the 18 submissions to the consultation, eight provided feedback on aspects of the proposed resolution regime. These responders were generally supportive of the need for a resolution regime for clearing and settlement facilities, although a number expressed concerns about particular proposals.

Some submissions reiterated concerns raised in response to the 2015 Resolution Consultation around the need for resolution actions to preserve the integrity of netting sets and collateral arrangements. The CFR wishes to reassure stakeholders that these concerns have been noted, and that the final resolution framework will reflect this.

The rest of this section of the paper will focus on the submissions to the resolution-related proposals that were set out in the 2019 Regulatory Reforms Consultation, and the CFR's response. As noted at the start of this chapter, the proposals that did not receive specific feedback are not addressed.

2.4.1. Objectives

CFR proposal

The CFR proposed that the objectives of the resolution regime be to:

- maintain the overall stability of the financial system; and
- provide for the continuity of clearing and settlement services that are critical to the smooth functioning of the financial system.

The CFR proposed that other factors that the resolution authority would consider as it undertakes resolution could be detailed in a guidance document.

This proposal was discussed in section 4.3 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

One submission supported the inclusion of the additional considerations in the legislation. The submission noted that it is important that participants in, and creditors of, clearing and settlement facilities have some indication that their interests are among the matters being considered when a resolution is undertaken, and having these factors expressed publicly provides some reassurance for stakeholders.

CFR response

The CFR intends to proceed with this proposal.

The CFR acknowledges the importance of transparency and clear communication of the factors influencing the resolution authority's actions. The CFR's view is that legislating only for core objectives, and potentially detailing other factors to be considered by the resolution authority in guidance, strikes the best balance between transparency for stakeholders and flexibility for the resolution authority to respond effectively in a crisis.

2.4.2. Obligation to notify resolution authority of certain matters

CFR proposal

The CFR proposed an obligation for a Domestic CSFL and its related bodies corporate to immediately inform the resolution authority once they become aware of certain circumstances relating to the ability of the entity to meet its obligations, the financial position of the entity or its corporate group, or threats to the continuity of critical clearing and settlement services.

The CFR also proposed that any person seeking to appoint an external administrator[14] to a Domestic CSFL, or a related body corporate, must give one week's prior notice to the resolution authority in order for a valid appointment to occur.

This proposal was discussed in section 4.5 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

One stakeholder acknowledged that prior notice of an appointment of an external administrator was important, but was concerned that mandating a one-week prior notice period may create an unnecessary delay in the appointment of an external administrator, which may have detrimental flow-on effects for creditors (with a potentially amplified risk with regard to related bodies corporate).

The stakeholder was also concerned that delay in the appointment of an external administrator could potentially expose directors to liability for insolvent trading.

CFR response

The CFR intends to proceed with these proposals, modified as outlined below.

The appointment of an external administrator to a Domestic CSFL or related body corporate could constitute a default event (and trigger a termination right) in a contract entered into by the Domestic CSFL or its related bodies corporate. If, based on such a default event, a third party service provider exercised a termination right in respect of a significant contract with the Domestic CFSL or its related body corporate, the continuity of the Domestic CSFL's clearing and settlement services could be jeopardised.

[14] Any of a liquidator (including a provisional liquidator), a receiver, manager, managing controller, receiver and manager or other controller, a voluntary administrator or administrator of a deed of company arrangement or a person administering a scheme of arrangement.

While preventing the appointment of an external administrator in all circumstances is undesirable, the resolution authority should be informed of a proposed appointment in advance, so that it may take the necessary actions to maintain the provision of critical clearing and settlement services.

In a situation where the resolution authority is notified of a proposed appointment, it is expected that prompt action would be taken. Such actions by the resolution authority could include:

- consenting to the proposed appointment;
- directing the entity not to appoint an external administrator (with any attendant statutory protections for compliance); or
- appointing a statutory manager to the body corporate (which would effectively prevent the appointment of an administrator).

The CFR now proposes to include an exemption to a director's statutory duty to prevent insolvent trading[15] for a limited period from the time of notice being given to the resolution authority of a prospective appointment of an external administrator, in respect of debts reasonably incurred in the ordinary course of business. The exemption would not apply where the director's failure to prevent the company from incurring a debt was dishonest.[16]

2.4.3. Expanded scope of key resolution powers

CFR proposal

The CFR proposed that the resolution authority could use certain resolution powers – including statutory management, transfer and directions – in relation to a related body corporate of a Domestic CSFL where it considers it necessary for the effective resolution of that Domestic CSFL.

Stakeholder feedback

One stakeholder indicated that it did not consider the extension of powers of the resolution authority to related bodies corporate beyond any ex ante contractual commitments (as put forward in the 2015 Resolution Consultation) was appropriate. While acknowledging the need for the resolution authority to have flexibility to act in a manner it considers necessary to maintain continuity of service, it suggested that the proposed extension would come at the expense of increased uncertainty for the shareholders and creditors of affected entities.

It was suggested that related bodies corporate should not be exposed to an open-ended commitment to support a distressed clearing and settlement facility, and that this may have the unintended consequence of discouraging a CSFL from being part of a broader corporate group that can provide economic benefits.

It was recommended that the Minister should have responsibility for authorising the use of resolution powers as they applied to related bodies corporate.

CFR response

The CFR intends to proceed with this proposal.

The CFR acknowledges stakeholder concerns with the extension of resolution powers beyond the licensee itself to related bodies corporate.

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[15] Section 588G(2) of the Corporations Act, as well as section 588V(1).

[16] See section 588G(3) of the Corporations Act.

As noted in the 2019 Regulatory Reforms Consultation, to maintain the continuity of clearing and settlement services of a Domestic CSFL during resolution, the resolution authority must secure uninterrupted and reliable access to the support services (including staff, computer infrastructure and other business functions) and resources (including funding) needed to operate the facility. Where appropriate, this would be achieved without the use of any powers in respect of other entities within the corporate group of the Domestic CSFL.

Where, however, these services and resources are provided to the Domestic CSFL by other entities within its corporate group, the resolution authority needs the capability to secure reliable access by way of resolution powers. The CFR proposes that the resolution authority will only be able to exercise such powers with respect to related bodies corporate of a Domestic CSFL where necessary to facilitate the resolution of the Domestic CSFL and the continued provision of clearing and settlement services.

On the role of the Minister, the CFR view is that the resolution authority should be independent and, except in limited circumstances, empowered to act on a timely basis, independently of government. This means that resolution action can be taken decisively by an entity with appropriate personnel, skills and expertise, according to a clear legislative objective.

Transfer powers is a special case where the CFR recommends Ministerial input into decision-making. In some scenarios, transfer will occur between a Domestic CSFL in resolution and a government-owned bridge entity which will need to be capitalised with public funds, giving the Minister a direct interest in any decision to make a transfer.

2.4.4. Statutory management

CFR proposal

The CFR proposed that, once a general condition for resolution has been met, a statutory manager may be appointed to a Domestic CSFL. The statutory manager may be the resolution authority and/or a person appointed by the resolution authority, and will have all powers of the body corporate or any of its officers, including control of its business and the power to sell or dispose of assets or the business itself.

This proposal was discussed in section 4.10 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Responses to this proposal were relatively limited. However, one submitter suggested that it would be appropriate for any appointed statutory manager to have relevant experience in managing clearing and settlement facilities. Another queried the degree of oversight the resolution authority would have in relation to an appointed statutory manager.

CFR response

The CFR intends to proceed with the proposal.

It is intended that the resolution authority would establish a panel of potential statutory managers with relevant experience, skills and expertise to perform the role. The resolution authority may also decide to engage independent external advisors, to ensure that a range of different parties with complementary skills can be drawn upon to assist in the resolution process if required. It is likely that existing staff would continue to operate the facility during statutory management.

Ultimately, statutory managers will be accountable to the resolution authority, and the resolution authority will have mechanisms to oversee statutory managers. The resolution authority will also have the power to direct a statutory manager.

2.4.5. Stays

CFR proposal

The CFR proposed that the exercise of a resolution power will not, by itself, allow a counterparty to a contract (including a market-netting contract) with a Domestic CSFL or related body corporate to exercise early termination or other rights. The stay would operate indefinitely.

The CFR proposed that the resolution authority would have the power to issue, during resolution of a Domestic CSFL, a notice temporarily:

- suspending termination rights of a contractual counterparty of the Domestic CSFL or a related body corporate during resolution, provided that the relevant Domestic CSFL or related body corporate continues to perform its substantive obligations;
- requiring a related body corporate of the Domestic CSFL to continue to supply necessary services or facilities during resolution (subject to a right to receive reasonable consideration).

These proposals were described in section 4.12 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Feedback emphasised that the proposed stay should not prevent contractual counterparties of a Domestic CSFL or related body corporate from exercising any termination rights based on a failure to comply with payment obligations (or any other reason not related to the exercise of a resolution power).

In respect of the stay operating indefinitely (and beyond 48 hours), stakeholders gave the following feedback:

- a suggestion that 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;
- a request for further background as to whether it was still proposed that a determination would be made at the expiration of 48 hours (or sooner) as to whether the FMI would be wound up, as referred to in the 2015 Resolution Consultation (with a winding up determination ending the stay);
- an assertion that the proposed stay regime would not follow an FSB recommendation that stays be strictly limited in time.

A number of stakeholders emphasised that the proposed stay should accord with international stay regimes and not negatively impact regulatory capital requirements on clearing members and their clients, in Australia or internationally.

In respect of the proposed notice temporarily suspending termination rights, one stakeholder submitted that any suspension should be strictly limited in time (and not exceed two business days), and must be subject to 'adequate safeguards that protect the integrity of financial contracts (including in relation to netting and collateral rights) and market participants'.

CFR response

The CFR intends to proceed with these proposals.

The CFR does not intend to propose that the resolution regime require the Government to publicly announce support for the FMI's future obligations in resolution or the resolution authority to determine after 48 hours (or sooner) whether the FMI would be wound up or continue operation.

As noted in the 2019 Regulatory Reforms Consultation, the CFR confirms that the exclusion of a resolution action as a trigger for the exercise of any contractual termination rights would not prevent:

- contractual counterparties of a Domestic CSFL or related body corporate from exercising any termination rights for other reasons during resolution; or
- CCP participants from continuing to clear new transactions during resolution (including new transactions that would have the effect of closing out existing positions).

As noted in the 2019 Regulatory Reforms Consultation, the proposed stay regime is modelled on comparable international regimes, and the CFR considers that it is consistent with the recommendations of the FSB's Key Attributes.[17]

The CFR has considered the effect of the proposed stay on regulatory capital requirements in this jurisdiction. If stakeholders are aware of any adverse impact of the proposed stay on any international regulatory capital requirements to which they are subject, they are invited to engage with the CFR and make this known. No specific examples were given by stakeholders in the feedback.

The CFR notes the stakeholder's comments regarding the proposed notice temporarily suspending termination rights, and will consider appropriate safeguards in connection with this proposal.

2.4.6. Moratorium

CFR proposal

The CFR proposed that a moratorium would apply preventing a person from taking certain litigation and enforcement actions in relation to a body corporate or its property during the statutory management or transfer of a Domestic CSFL or a related body corporate.

The moratorium would apply to creditors and other parties with rights in relation to the body corporate in resolution or its property. Actions that would be prohibited without the consent of the statutory manager, resolution authority or leave of the Court include beginning or continuing court proceedings in relation to the body corporate or its property, enforcing any security in relation to property that the body corporate owns or possesses, and taking possession of any property that the body corporate uses or occupies, among other things.

The proposal noted that it is intended that the protections provided by the *Payment Systems and Netting Act 1998* (PSNA) in relation to approved real-time gross settlement systems, approved netting arrangements, close-out netting contracts and market netting contracts would operate despite the new moratorium provisions. The litigation moratorium however, as with the equivalent in ADI resolution, would not be subject to any express reference in the PSNA.

This proposal was described in section 4.13 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Stakeholders raised concerns about the following:

- The potentially detrimental effect of the proposed moratorium on creditors and other stakeholders in the event of a lengthy resolution process.

[17] See Key Attributes 4.2 and 4.3; Appendix I – Annex 5; Appendix II – Annex 1 at 5.1 and 5.2. Note in particular Key Attribute 4.2 and paragraph 5.1 of Appendix II–Annex 1.

- A scenario where a third party security holder would be restricted from enforcing their security over property (such as securities) of a third party grantor held in the clearing and settlement facility.

Clarification was sought as to whether a moratorium on payments by an FMI in resolution to unsecured general creditors (referred to in the 2015 Resolution Consultation) was still intended to be introduced.

CFR response

The CFR intends to proceed with this proposal.

The aim of the proposed moratorium during the period of statutory management and transfer is to prevent the resolution authority, any statutory manager and relevant staff of the Domestic CSFL or related body corporate from having to respond to time-consuming litigation and enforcement actions that have the potential to distract from or interfere with orderly resolution.

In respect of the particular concerns raised, respectively:

- While the proposed moratorium may affect certain third parties, the emphasis in the resolution regime on the continuity of clearing and settlement services that are critical to the smooth functioning of the financial system may provide comfort to third party service providers that payment obligations will continue to be met during resolution.
- A third party security holder that is temporarily restricted from enforcing their security over property of a participant held in the clearing and settlement facility could seek the consent of the statutory manager, resolution authority or leave of the Court to proceed. The CFR will also consider ways of excluding normal business activities from the proposed moratorium on enforcement action in respect of property held by the Domestic CSFL or related body corporate in resolution (such as a central securities depository), where this action does not directly affect the Domestic CSFL or related body corporate, and does not have the potential to disrupt or interfere with resolution.

The CFR confirms that it does not intend that the moratorium on an FMI's payments to general unsecured creditors (proposed in the 2015 Resolution Consultation) proceed on the basis that this is unlikely to be necessary. To support continuity of the provision of clearing and settlement services during resolution, it is anticipated that general unsecured creditors of the Domestic CSFL in resolution, such as third party service providers, will continue to be paid in the normal course during resolution.

2.4.7. Confidentiality

CFR proposal

The CFR proposed that the resolution authority would be able to issue a confidentiality notice to certain parties (including a Domestic CSFL, related body corporate or bidders in a sale process) requiring that specified information or documents provided by the resolution authority in the course of resolution be kept confidential.

The CFR also proposed that the resolution authority would be able to issue a secrecy determination to accompany a resolution direction. The determination would restrict the directed entity from disclosing that the direction had been given.

These proposals were described in section 4.14 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

Submitters were generally comfortable with these proposals. However, some queries were raised around how an Australian confidentiality notice or secrecy determination would interact with continuous disclosure obligations if one of the directed parties was a listed entity, the impact of foreign laws (including those which

may impose disclosure obligations) and any effect on contractual arrangements where failure to disclose could give rise to legal liabilities.

CFR response

The CFR intends to proceed with this proposal.

As noted in the 2019 Regulatory Reforms Consultation, the CFR recognises that in many circumstances the appropriate course of action will be to retain full transparency around resolution actions. However, in some circumstances this will not be the case, and so the resolution authority will require powers to compel certain parties to keep sensitive information confidential.

The CFR acknowledges that, in some cases, requirements under a confidentiality notice or secrecy determination may conflict with other obligations, including around disclosure. The CFR intends to include mechanisms to mitigate the effect of any such conflicts, including statutory protection from civil or criminal liability applicable to certain parties for reasonable actions done in good faith to comply with a secrecy determination that accompanies a resolution direction.

2.4.8. Cross-border issues

CFR proposal

The CFR proposed that the resolution authority may recognise the resolution of an Overseas CSFL in its home jurisdiction and use resolution powers to support its home resolution authority.

The resolution authority would also have a power to give a direction to an Overseas CSFL in resolution with respect to its Australian assets and liabilities. Such a directions power may be used, for example, where a home resolution authority acted in a way that adversely affected Australian interests.

The CFR also proposed that clearing and settlement facilities would be excluded from the application of the Model Law on Cross-Border Insolvency, as applied by the *Cross-Border Insolvency Act 2008*, on the basis that they would have a specialised insolvency regime.

This proposal was described in section 4.15 of the 2019 Regulatory Reforms Consultation.

Stakeholder feedback

One stakeholder, while broadly supportive of the proposal, expressed concern about the potential use of the directions power by the resolution authority in circumstances where the home resolution authority of an Overseas CSFL in resolution acted in a way that adversely affected Australian interests. The concern was that the use of this directions power could potentially result in the FMI being subject to conflicting directions from the resolution authority and the home resolution authority. It was also suggested that this could encourage other international regulators to issue similar directions with the result that the genuine efforts of the home resolution authority to resolve the Overseas CSFL would be undermined.

It was suggested that an objective test should be included for when the power may be used, to restrict its usage to the most necessary of circumstances and to protect the authorities from conflicts. It was also noted that crisis management groups would be an appropriate forum for discussion between resolution authorities.

Another response raised a query about how the proposal would relate to overseas clearing and settlement facilities that were not licensed to operate in Australia, but whose services are used by Australian ADIs. It was queried how Australian regulators would support an overseas resolution in these circumstances.

CFR response

The CFR proposes to proceed with this proposal, as modifed below.

In response to this stakeholder feedback, the CFR intends to impose a condition for the resolution authority's use of the directions power with respect to the Australian assets and liabilities of an Overseas CSFL in resolution in its home jurisdiction. It is proposed that such directions power may only be used if the resolution authority considers that it is necessary, having regard to the stability of the financial system in Australia.

The CFR notes that its members engage with overseas regulators and resolution authorities in a variety of forums, including through crisis management groups of particular Overseas CSFLs. It is expected that, in the event of a resolution of an Overseas CSFL, the resolution authority would engage with its home resolution authority, including through any crisis management group.

The regime is not intended to apply in respect of the resolution of an overseas clearing and settlement facility whose operator does not have an Australian licence, and the resolution authority would not have any powers to support such a resolution.