



National Australia Bank Submission to the Consultation Paper on Reassessing the Case for Central Clearing of Bonds and Repos in Australia

NAB, as a significant participant in the domestic repo market, welcomes the opportunity to provide feedback on the proposed introduction of central clearing for bonds and repos in Australia. We have a keen interest in the development of a safe, efficient, and resilient market infrastructure.

Question 1: Have the potential benefits of central clearing the Australian bond and repo markets increased in recent years? What costs/benefits do you view as being the most relevant for consideration of central clearing in the Australian bond and repo markets?

While we acknowledge the potential benefits of central clearing in mitigating counterparty risk for both bonds and repos, we believe the most significant opportunities for efficiency gains and risk reduction lie in the repo market. Bond clearing, while desirable, is primarily focused on mitigating settlement risk, which is already largely addressed through existing industry practices.

The primary benefit of repo clearing is the potential for reduced counterparty risk through novation and netting. These costs are currently driven by Capital held as a regulatory requirement. This is particularly relevant given the significant growth in the Australian repo market, with outstanding positions increasing from approximately \$175 billion in 2015 to around \$380 billion in 2023. However, the implementation of central clearing for repos will incur costs, including system upgrades, human capital investments, clearing fees, and margin requirements.

Question 2: What do you consider to be the minimum product scope and participation necessary to support effective central clearing in Australian bond and repo markets? Do you envisage any issues arising if a prospective CCP was to clear for a single segment of the market (e.g., bonds only or repos only)?

We believe that a phased approach to central clearing, starting with repos and gradually expanding to bonds, is appropriate. Focusing initially on the repo market, where the potential benefits are most pronounced, will allow for a smoother implementation and minimise operational challenges. As such starting with a single segment of the market should not create any issues. In fact it may be necessary in order to start the implementation.

Question 3: Under what conditions would you participate in a bond and repo CCP if there was one servicing the Australian market?

NAB, as a major market participant, would likely participate in a Bond and Repo CCP under the following conditions:

- A clear demonstration of the cost-benefit case for participation particularly around the margining requirements and the fees to be charged by a CCP.
- Robust risk management frameworks and recovery and resolution plans
- Efficient integration with existing systems and processes
- It is our preference to have 2 CCPs to mitigate systemic risk and provide global access to AUD Repo Clearing solutions. Therefore, we suggest that both ASX and LCH as clearing houses for AUD Repo in line with the model for AUD OTC Derivatives clearing.
- Existing CCPs are a preference given the business disruption risk is too high for a un tested provider.
- There is sufficient engagement across the CFR to ensure that the Capital Treatment of Cleared Trades is consistent with bilateral arrangements. Changes to the current framework would also be required to ensure global regulatory consistency to encourage additional global participation.
- Broad market participation to maximises the efficiency and netting benefits of a CCP.

Question 4: In your experience, including with bond and repo CCPs in other jurisdictions, are there likely to be material challenges faced by the Australian market in transitioning to a centrally cleared environment and how might these be overcome?

The transition to a centrally cleared environment will require significant investment in technology and human capital. Challenges may include system integration, data management, and operational changes. Industry collaboration and regulatory support will be essential to mitigate these challenges.

Question 5: What do you view as being material impediments, if any, to the safe and efficient operation of a bond and repo CCP in Australia? Please consider the effects of an extended disruption on your business (such as liquidity and risk management), as well as broader effects such as those related to financial stability and market confidence.

A robust regulatory framework, including effective oversight and recovery and resolution planning, is essential for the safe and efficient operation of a CCP. The CCP must also have adequate liquidity and capital buffers to withstand market shocks. Diversifying CCP providers would provide a more stable model.

Question 6: How material are issues with settlement chains on the safety and efficiency of the Australian bond and repo markets? In your experience, what are the factors behind these issues? What steps, if any, should a prospective bond and repo CCP or its participants take to mitigate the risk of issues associated with settlement chains?

While settlement chain issues have historically been managed through industry practices, a CCP could potentially improve efficiency in this area by providing a central point of settlement. However, the effectiveness of this will depend on the CCP's design and integration with existing settlement systems.

Question 7: Are there any aspects of the bond and repo markets that in your view are not functioning efficiently? For example, would enhanced transparency in bond and repo markets improve the efficiency of these markets?

Enhanced transparency can improve market efficiency by reducing information asymmetries and facilitating price discovery. A CCP can contribute to this by providing market data and analytics. Enhanced transparency would be a natural consequence of the improved market access a CCP provides to a wider range of counterparties. This can only be achieved if the costs of participation on a CCP is lower than the regulatory costs of the current state. Otherwise, the increased participation will not occur.

Position and Payments netting does not occur efficiently in the Repo market currently. Design of an efficient Position and Payments netting process is essential to the successful functioning of a CCP.

Penalties around failure of delivery are inconsistent in bilateral Repo arrangements currently. A CCP would standardise and enforce financial penalties.

Question 8: What actions could regulators or industry take to improve the efficiency and/or resilience of the bond and repo markets, including to reduce information asymmetry and improve price and liquidity discovery?

Industry collaboration and data standardisation can contribute to improved market efficiency. Regulatory initiatives to promote transparency and competition could also be beneficial. Given the RBAs significant role in the Australian repo market, a clearly articulated approach to Open Market Operations (OMO) and other RBA activities involving Repo would be required to reduce information asymmetry and improve price and liquidity discovery. Some of these issues have been raised in the recent "Consultation on the Future System for Monetary Policy Implementation, the output of which should be considered in this consultation.

Question 9: Some other major jurisdictions have CCPs operating bond and repo clearing services in their domestic markets. What are your views on an overseas operator providing clearing services for the Australian bond and repo markets?

While an overseas CCP might offer certain advantages, such as economies of scale, there are also risks associated with cross-border operations. A careful evaluation of the regulatory environment, data privacy, and operational resilience of the overseas CCP would be necessary.

Question 10: Based on your experience, including in other jurisdictions and markets, what features of an overseas-based CCP could present difficulties or introduce risks in the Australian context? How are these challenges managed in other jurisdictions and are they managed successfully?

Potential challenges include regulatory differences, data sovereignty, and the ability to enforce legal rights in case of disputes. This is particularly the case where the CCP is domiciled in a jurisdiction with a lower regulatory standard than in Australia. Effective cross-border cooperation and clear regulatory frameworks are essential to mitigate these risks. Leveraging existing OTC derivatives frameworks and practices for overseas based CCP's could mitigate this risk and bring the benefit of existing offshore experience in repo clearing in other jurisdictions.

Question 11: With the increasing internationalisation of Australian bond and repo markets, do you consider it desirable for a potential bond and repo service to have effective links to trading and settlement services, including international central securities depositories?

Effective links to international trading and settlement services are important for the efficient functioning of the Australian bond and repo markets. A CCP should consider how it can facilitate cross-border transactions and settlements.

NAB would be happy to provide further information or engage in discussions on any of the points raised in this submission.