



19 October 2012

Mr Tony Richards
Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

Email: pysubmissions@rba.gov.au

Dear Mr Richards

Consultation on New Financial Stability Standards

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the Consultation on New Financial Stability Standards (FSS).

AFMA agrees with the Bank's proposal to align the Australian regulation of licensed clearing and settlement facilities under the FSS with new international standards, the Principles for Financial Market Infrastructures (Principles), developed by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO). The Principles reflect the regulatory reliance and expanding role played by financial market infrastructures, including clearing and settlement facilities, in the financial system and aim to strengthen and harmonise the operational standards to which they are held internationally.

As Australia reforms its regulation of financial market infrastructure AFMA believes it is important to ensure the regulatory framework for clearing and settlement facilities is made to operate harmoniously with the broader global framework. In this context the statements by the Bank and ASIC are welcomed, to the effect that they are moving forward to implement the Principles within their respective regulatory mandates to ensure that clearing and settlement facilities licensed to operate in Australia conduct their affairs in accordance with international best practice.

In response to selected questions posed in the consultation paper we have the following specific comments.

Collateral Eligibility

Question 4: *In balancing the system wide impact of restricting collateral eligibility to High Quality Liquid Assets (HQLA) against the risk that lower quality or less liquid assets may not hold their value in a stressed market should any other collateral eligibility be considered?*

The IMF's Global Financial Stability Report¹ warns that -

Tying up high-quality collateral in CCP guarantee funds and initial margin to improve CCP solvency profiles may reduce liquidity in OTC derivative markets and, more generally, in repo markets; as a result, various shocks could lead to price spikes and shortages of high-grade collateral.

As one of its key conclusions and policy implications, the IMF Global Financial Stability Report notes that –

The use of safe assets as collateral for CCP default funds – in the context of the anticipated move of OTC contracts to CCPs – is another area where demand pressures can be alleviated by some flexibility in the definition of acceptable safe assets. By ensuring that CCP oversight allows for a broad range of collateral (with appropriate risk-based haircuts and minimum criteria for inclusion) alongside other risk management practices, undue pressures on certain types of safe assets can be avoided without compromising the soundness of the CCP.

The Bank² itself has observed that there will be a significant further increase in demand for High Quality Liquid Assets (HQLA) flowing from the Basel III liquidity standards and as a result the demand for Australian dollar-denominated HQLA is likely to increase much faster than the projected increase in the supply of CGS and semi-government securities. In addition it is being observed in the U.S. market that the velocity of collateral has been falling, partly due to regulation as well as increased demand from clients for collateral assets to be protected.

In the light of these observations, it is appropriate for the Principles to have taken into account the environment and suggest that central counterparties should accept a broader set of collateral assets beyond just HQLA is desirable from the systemic and collateral management perspectives. The FSS should follow this path.

One consequence of following this path may be an increase in demand for 'collateral transformation' services. This refers to services which facilitate the transformation of CCP-ineligible collateral into CCP-eligible collateral through the use of the various collateral markets (e.g. repo and securities lending). Collateral transformation services allow lower-quality collateral to be exchanged and markets to function even in an environment of scarce supply and growing demand for safe and liquid collateral. This

¹ International Monetary Fund, Global Financial Stability Report, April 2012

² A Heath, M Manning, RBA Bulletin, Financial Regulation and Australian Dollar Liquid Assets, September Quarter 2012.

would involve market participants other than CCPs that may be able to hold risks that are deemed inappropriate for CCPs. While such services are of clear operational benefit to market participants they do increase interconnectedness within the financial system. The possible systemic implications such a structural change will need to be assessed and monitored. One point of consideration would be whether or not such collateral transformation services themselves would remain resilient under stressed market conditions and an assessment made of what the consequence would be of such services being reduced in stressed market conditions.

Question 7: Should settlement arrangements utilised by CCPs, or offered by SSFs, be allowed to settle using DvP model 2 where trade values are small and operational requirements dictate its use, or should all facilities be required to settle according to DvP model 1 or 3 (proposed CCP Standard 11, SSF Standard 10)?

The mandating of DvP Models 1 or 3 raises practical operational concerns for market participants because of time zones differences for currencies and securities. Contemporaneous settlements, whether on a transaction basis or multilateral net basis, may not be possible.

AFMA requests the Bank to adopt the approach of allowing the CCP and its clearing members to determine which settlement arrangement best suits the circumstances with which they are dealing.

Structural Requirements

Question 8: Would a change from a principal-to-principal model to an agency model for indirect participants of a CCP allow for effective portability arrangements in the case of a clearing participant default (proposed CCP Standard 13)? What would be the costs and consequences of such a change?

The issue of passing losses beyond direct participants to indirect participants or underlying clients should be left to agreement between direct participants and the indirect participants or the clients for which they act. The same principle should apply to clients whose assets are held in identified segregated accounts or omnibus segregated accounts.

Assessment Approach

Question 17: Is the assessment approach articulated in Attachment 5 consistent with the objective to deliver a framework for regulation of overseas licensees that does not impose an unnecessary regulatory burden, while ensuring competitive neutrality in the Australian regulatory environment?

AFMA has previously expressed its support for the graduated framework of measures set out in the Council of Financial Regulators' paper of earlier this year, 'Ensuring Appropriate Influence for Australian Regulators over Cross-border Clearing and Settlement Facilities' designed to ensure that the Bank and ASIC have adequate

regulatory influence over clearing and settlement facilities which have a cross-border element because they are based overseas.

AFMA considers that the assessment approach allows for appropriate modulation of regulation of off-shore clearing and settlement facilities to take account of the international regulatory environment and global nature of the markets which they serve.

Please contact me at dlove@afma.com.au or on (02) 9776 7995 if further clarification or elaboration is desired.

Yours sincerely



David Love
Director – Policy & International Affairs