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LAWYERS

RESERVE BANK OF AUSTRALIA CONSULTATION PAPER
**VARIATION OF THE FINANCIAL STABILITY STANDARD FOR CENTRAL
COUNTERPARTIES: OVERSIGHT OF OVERSEAS FACILITIES**

**SUBMISSIONS
BY
HENRY DAVIS YORK
LAWYERS**

25 NOVEMBER 2008

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INTRODUCTORY

We thank the Reserve Bank of Australia (**Reserve Bank**) for the opportunity to provide our submissions on the Reserve Bank Consultation Paper entitled "Consultation on Variation of the Financial Stability Standard for Central Counterparties: Oversight of Overseas Facilities", issued in October 2008 (**Consultation Paper**).

Henry Davis York is a major Australian law firm based in Sydney. We have a practice which focuses on the banking and financial services industries as well as the government and corporate sector. In particular we have a highly developed practice in financial markets and derivatives. We have acted for many of the major world exchanges including Sydney Futures Exchange, London Metals Exchange, Hong Kong Futures Exchange, and Chicago Mercantile Exchange, as well as providing advice and representation for smaller markets.

We also have extensive experience advising on clearing and settlement issues and we have acted on the establishment, recognition in Australia and development of operational and clearing and settlement rules for many derivatives exchanges.

Further comments or discussion in relation to these submissions should be directed to:

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GENERAL SUBMISSIONS AND OBSERVATIONS

1. **General support for reform of the current FS Standard as it applies to overseas facilities**

We support the Reserve Bank's proposal, as outlined in the Introduction section of the Consultation Paper, to modify the FS Standard to clarify that, subject to certain conditions, the FS Standard will not apply to an overseas facility that is subject to an overseas regulatory regime deemed to be sufficiently equivalent to that in Australia, namely, a facility licensed under Section 824B(2) of the Corporations Act 2001 (Cth) (**Corporations Act**).

The proposal, to rely on offshore regulation by appropriately recognised regulators of offshore facilities such as offshore derivatives clearing houses, is a simpler and more appropriate way ensuring that the Reserve Bank's standards are met.

We believe that any reform proposals which will reduce costs and unnecessary administrative burdens for overseas facilities seeking to operate in Australia, will be welcomed by the industry and have the capacity to encourage the growth of independent, professional clearing facilities in Australia.

Lastly, we support the general theme of due recognition by the Reserve Bank of appropriate levels of offshore regulation, without undue emphasis on the "sufficiently equivalent" criteria.

2. **The growth of new facilities and the development of offshore facilities in Australia should not be discouraged**

We appreciate that it is not the Reserve Bank's role to encourage the establishment and development of new Australian facilities. However, any system for regulating facilities in Australia, including any system for sensible regulation of certain overseas facilities, should ensure that the establishment of new facilities in Australia, particularly overseas facilities seeking to operate in Australia, is not discouraged.

In particular, mature professional offshore facilities which are subject to a recognised and equivalent regulatory regime in their home jurisdiction, and which otherwise meet appropriate criteria, should be exempted from complying with the entire FS Standard, in addition to the "substantially equivalent" test under Part 7.3 of the Corporations Act. If they are not, then there is a risk that they may decide not to proceed with the development of an Australian facility.

COMMENTS ON SPECIFIC ISSUES IDENTIFIED IN THE CONSULTATION PAPER

Feedback on Section 4

1. **The general approach proposed for regulation of overseas facilities in respect of matters related to stability**

- We support what the Reserve Bank is trying to achieve in considering this reform, having recognised the 'need to establish a framework for regulation of overseas facilities that does not impose an unnecessary regulatory burden, while ensuring competitive neutrality'.

- We commend the Reserve Bank for its desire to ensure that its regulatory arrangements 'reflect the changing nature of the international landscape for financial infrastructure', whereby:
 - there is increasing use of international, independent clearing houses and a move away from the earlier model of one clearing house per exchange; and
 - in the United States of America (**USA**), the regulators are now giving greater recognition to the emergence of international clearing houses which clear multiple markets in various jurisdictions.

Facilitating competitive neutrality and reducing unnecessary regulatory burdens is consistent with these industry developments.

- The current Financial Stability Standard for Central Counterparties (**Current Standard**) has been devised having regard to traditional securities clearing houses, such as Austraclear Limited. We submit, therefore, that it is not always appropriate to apply the Current Standard to derivatives clearing houses such as the overseas facility identified in the Attachment and that the proposed Standards and Guidance would be more suitable to such entities.

Accordingly, we are pleased to see that the Reserve Bank recognises that to impose the Current Standard on overseas facilities that are licensed and subject to ongoing regulation offshore can be unduly onerous.

- We support the Reserve Bank's goal of having open, ongoing and flexible dialogue with the overseas facility about regulatory matters. We also support direct communication between the Reserve Bank and offshore regulators wherever appropriate and possible.

Proposed wording of the variation to the FS Standard and the nature of the proposed conditionality

- We generally support the thrust of the proposed wording, however we would suggest making the following minor changes:

"This standard applies to all CS facility licensees with the exception of any CS facility licensed under Section 824B(2) of the Corporations Act, on the condition that the Reserve Bank receives an annual statement that the licensee has complied with the requirements of the overseas regulator related to matters affecting stability, in a form and at a time agreed with the Reserve Bank."

Form of the annual statement of compliance and, in particular, whether the facility should be exempt only if it is able to provide a statement from its overseas regulator

- We consider that it could be potentially onerous for a facility to be required to obtain a statement of compliance from its overseas regulator, which may, for policy reasons, not be prepared to provide such a statement. Accordingly, we support the Reserve Bank's recognition, in the Guidance, that this may not always be possible and that, accordingly, the Reserve Bank may rely on indirect provision of the regulator's assessment of compliance via the licensee itself or self-certification by the facility's directors.

- We suggest that, where it is not possible or practicable for the overseas regulator to provide the statement of compliance, the statement of compliance could alternatively be provided by the facility's internal or external auditors.

Proposed wording of guidance for Section 842B(2) licensees and, in particular, the additional information requirements proposed

- We note that the overseas facility would be expected to provide the Reserve Bank with:
 - additional information, on a pre-agreed frequency - we submit half-yearly would be appropriate intervals - about its activities and conduct of its business; and
 - sufficient information to enable the Reserve Bank to assess compliance with any measures underpinning the FS Standard that are not considered under the overseas regulatory regime.

Accordingly, we suggest that it would be very helpful if, in the Guidance, the Reserve Bank could provide further suggestions about the sort of information which it envisages would need to be provided here.

- We also suggest making a few minor drafting changes to the Guidance, as follows:
 - to reflect our suggested changes to the drafting of the varied FS Standard;
 - consistent with our comments above, to allow for a facility's internal or external auditors to provide the statement of compliance; and
 - to clarify that a facility is required to provide details of material changes in its activities, processes or people only to the extent there have been changes which adversely impact upon the facility's financial stability.

Nature of proposed information-sharing arrangements between the Reserve Bank, the overseas facility and the overseas regulator

As stated above, we endorse the Reserve Bank's desire for open, ongoing and flexible dialogue with overseas facilities and overseas regulators about regulatory matters and support the Reserve Bank's desire to implement a framework for exchanging information between the Reserve Bank, overseas facilities and overseas regulators.

Henry Davis York
25 November 2008

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