

# Regulatory Developments in Financial Market Infrastructures

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Throughout the year, the Payments System Board has remained engaged with a number of important domestic and international regulatory initiatives relevant to its responsibilities in relation to payments and clearing and settlement (CS) facilities. These include two ongoing initiatives of the Council of Financial Regulators (the Council) – a review of the regulatory framework for financial market infrastructures (FMIs) in Australia; and the development of a framework for over-the-counter (OTC) derivatives regulation – and an international initiative under the auspices of the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) to develop a strengthened and harmonised set of *Principles for Financial Market Infrastructures* (the Principles).<sup>41</sup>

## Review of the Regulatory Framework for Financial Market Infrastructures

In April 2011, the Council was asked by the Treasurer to consider possible changes to the regulation of FMIs to strengthen regulators' ability to provide effective oversight and manage risks to both stability and market integrity. In response, a Working Group, chaired by the Treasurer and comprising the Reserve Bank, Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA), developed a series of proposals which were released for consultation in October 2011.<sup>42</sup> Having reviewed submissions and engaged directly with stakeholders, the Council recommended to the Treasurer a program of legislative reform in line with the proposals in its original consultation paper. The Treasurer released the Council's advice publicly in March 2012, inviting further consultation with stakeholders on the final framework for implementation of the Council's proposals.<sup>43</sup> Three elements of the package under consideration are particularly worthy of note.

### Resolution of financial market infrastructures

One core concern of regulators is how to ensure the continuity of critical services when an FMI is in financial distress (and possibly insolvent). If an FMI is unable to implement an effective recovery plan, regulators may need to intervene in order to maintain continuity of services while organising a recapitalisation or orderly wind-down (resolution) of the FMI. The Council therefore recommended legislative change to provide for the appointment of a statutory manager to a distressed FMI (so-called 'step in'). A similar power is available to APRA with respect to authorised deposit-taking institutions (ADIs) under the *Banking Act 1959*. Under the

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41 CPSS-IOSCO (2012), *Principles for Financial Market Infrastructures*, April. Available at <<http://www.bis.org/publ/cpss101a.pdf>>.

42 Council of Financial Regulators (2011), *Review of Financial Market Infrastructure Regulation*, October. Available at <[http://archive.treasury.gov.au/documents/2201/PDF/CFR\\_review\\_of\\_FMI\\_regulation\\_issues.pdf](http://archive.treasury.gov.au/documents/2201/PDF/CFR_review_of_FMI_regulation_issues.pdf)>.

43 The Council of Financial Regulators' letter to the Deputy Prime Minister and Treasurer is available at <[http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2012/Council%20of%20Financial%20Regulators%20Working%20Group%20on%20Financial%20Market%20Infrastructure%20Regulation/Key%20Documents/CoFR\\_Letter\\_to\\_Deputy\\_PM.ashx](http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2012/Council%20of%20Financial%20Regulators%20Working%20Group%20on%20Financial%20Market%20Infrastructure%20Regulation/Key%20Documents/CoFR_Letter_to_Deputy_PM.ashx)>.

Banking Act, APRA is able to appoint itself or a third party as statutory manager of a distressed ADI, replacing the management and board and assuming their powers. Implementation of the Council's recommendation needs to be considered in the context of broader international work on resolution of FMIs. Particularly relevant here is a consultation paper released by CPSS and IOSCO in July 2012, which addresses key issues in the design of an effective resolution regime for FMIs.<sup>44</sup> The paper, which builds on the Financial Stability Board's (FSB) *Key Attributes of Effective Resolution Regimes for Financial Institutions*, identifies the power to appoint a statutory manager as one of a number of potential tools to be applied as part of a broader resolution plan.<sup>45</sup>

In conjunction with further development of policy on FMI resolution, the Reserve Bank will also continue to work with the other Council agencies to consider the implementation of enhancements to directions powers and sanctions under the *Corporations Act 2001*. These enhancements were also recommended in the Council's advice to the Treasurer.

### Regulatory influence over cross-border financial market infrastructures

Another important element of the package of regulatory reform measures recommended by the Council for FMIs is cross-border policy. This speaks to the question of how Australian regulators could ensure adequate influence – and continuity of service – in respect of a CS facility (or market operator) with cross-border operations; either an overseas licence holder, where Australian regulators would rely, at least to some degree, on the regulator in the facility's home jurisdiction, or a domestic licence holder seeking to outsource parts of its operations offshore.<sup>46</sup>

In order for the Reserve Bank and ASIC to carry out their regulatory responsibilities with respect to cross-border CS facilities, they must have sufficient influence over the activities and risk-management practices of such facilities, including in stressed circumstances. Accordingly, the Council recommended giving the regulators explicit powers under the Corporations Act to support a 'proportional and graduated' location policy that could require certain elements of a licensed facility's operations to be located in Australia. To give stakeholders further clarity on the specific measures that might be applied under such a policy, the Council issued a supplementary paper in July 2012 describing a framework within which incremental requirements could be imposed on cross-border facilities that are systemically important in Australia, or that have a strong connection to the Australian financial system and real economy.<sup>47</sup> Most of the specific measures envisaged under the framework are subject to ongoing consultation in the context of proposed revisions to the Bank's Financial Stability Standards (FSSs), as discussed below, and ASIC's Regulatory Guide 211 (RG 211) on Australian and overseas clearing and settlement facilities.

### Competition in clearing and settlement

In its advice to the Treasurer, the Council noted that it was continuing its work with the Australian Competition and Consumer Commission to develop further analysis of issues around competition in clearing and settlement. The first phase of the agencies' work on these issues comprised development of a discussion

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44 CPSS-IOSCO (2012), *Recovery and Resolution of Financial Market Infrastructures: Consultative Report*, July. Available at <<http://www.bis.org/publ/cpss103.pdf>>.

45 FSB (2011), *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October. Available at <[http://www.financialstabilityboard.org/publications/r\\_1111104cc.pdf](http://www.financialstabilityboard.org/publications/r_1111104cc.pdf)>.

46 An overseas licence holder, in this context, is a facility licensed under section 824B(2) of the Corporations Act.

47 See Council of Financial Regulators (2012), *Ensuring Appropriate Influence for Australian Regulators over Cross-border Clearing and Settlement Facilities*, July. Available at <<http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/cross-border-clearing>>.

paper on competition in the clearing of cash equities, which was released in June 2012.<sup>48</sup> While recognising the potential benefits, the paper acknowledges that the entry of competing CCPs could significantly alter the way in which key financial markets operate. Stakeholder feedback was therefore sought on a number of policy matters relevant to the responsibilities of the Council agencies, and possible responses. These include changes to the structure of and participation in trading and clearing markets, the stability and continuity of clearing services, and effective access to ASX Settlement (the vertically integrated settlement facility operated by the ASX Group) for competing CCPs.

Following consultation, the Council may make recommendations to the Australian Government. ASIC and the Reserve Bank may also publish regulatory guidance on assessment of CS facility licence applications, licence conditions and other relevant matters.

## CPSS-IOSCO Principles for Financial Market Infrastructures

In April 2012, CPSS and IOSCO released the final version of the Principles, a single set of standards for all FMI that is intended to replace three pre-existing sets of standards for payment systems, CCPs and securities settlement systems. The Principles aim to strengthen and harmonise the operational standards to which FMIs are held internationally.

The Reserve Bank proposes to implement the international standards set out in the Principles through revisions to its FSSs for CS facilities, and in carrying out its regular self-assessments of the Reserve Bank Information and Transfer System (RITS). A consultation paper outlining the Bank's intended approach was released in August 2012 for stakeholder feedback.<sup>49</sup> The new standards will be finalised as soon as possible following the consultation period.

Under this proposal, the structure of the FSSs will change significantly. The current FSSs create a broad requirement for CS facility licensees to conduct their affairs in such a way as to promote stability in the Australian financial system. More detailed accompanying measures identify relevant considerations in determining a CS facility's compliance with each FSS. To more clearly articulate the standard which CS facility licensees must meet, and to align closely with the structure of the Principles, the revised FSSs will adopt a more granular approach, replacing the overarching standard with a set of more specific standards covering risk management and other practices that a licensee must observe.

In adopting this more granular approach, the proposed new FSSs implement the requirements of the Principles in full, where relevant to issues of financial stability and the activities of the two CS facility types – CCPs and securities settlement facilities. Since the scope of the Principles is broader than that of the current FSS measures, it is proposed that new standards will be introduced in several areas. These include new requirements for segregation and portability of client positions and collateral; standards to address risks arising from interdependencies between FMIs and tiered participation; and expectations around the management of general business risks. Some existing requirements arising from the Reserve Bank's implementation of the current FSSs are, however, not explicitly covered in the Principles, and therefore the proposed new FSSs incorporate some modifications to the Principles to ensure that existing standards for CS facility licensees

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48 See Council of Financial Regulators (2012), *Competition in the Clearing and Settlement of the Australian Cash Equity Market: Discussion Paper*, June. Available at <<http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Competition-in-the-clearing-and-settlement-of-the-Australian-cash-equity-market>>.

49 See RBA (2012), *Consultation on New Financial Stability Standards*, August. Available at <<http://www.rba.gov.au/payments-system/clearing-settlement/consultations/201208-new-fin-stability-standards/index.html>>.

are upheld. The revised FSSs will also incorporate relevant aspects of the framework to enhance regulatory influence over cross-border facilities referenced above.

In parallel, ASIC is consulting on revisions to its RG 211 to integrate the Principles into its regulatory approach.

## Over-the-counter Derivatives

At the G-20 summit in Pittsburgh in 2009, the Australian Government joined other jurisdictions in committing to substantial reforms to practices in OTC derivatives markets; specifically:

- the reporting of all OTC derivatives to trade repositories
- the clearing of all standardised OTC derivatives through CCPs
- the execution of all standardised OTC derivatives on exchanges or electronic trading platforms, where appropriate.

In June 2011 the Council released a discussion paper on central clearing as the basis for detailed consultation with interested stakeholders.<sup>50</sup> Further to this consultation, the Council provided a report to the Australian Government outlining its view that, in the first instance, industry-led solutions should be the preferred route to increasing the use of central clearing within the Australian OTC derivatives market, but that the capacity to mandate central clearing should be developed through legislation.<sup>51</sup>

The Australian Government recently consulted on a proposed legislative framework to ensure the implementation of the three key G-20 commitments, through amendments to the Corporations Act.<sup>52</sup> An exposure draft bill was released for comment in July 2012.<sup>53</sup> Throughout the development of this policy framework, the Board has been regularly updated on policy matters and the Reserve Bank's involvement in this work stream.

The framework will require that, where a CCP seeks to be an eligible facility through which market participants might meet any clearing obligations, the CCP must be a licensed CS facility under Part 7.3 of the Corporations Act or a CCP of a kind prescribed by regulations. As a consequence, there may be an increase in the number of CCP licence applications for which the Reserve Bank must provide advice to the Minister, as well as an increase in the number of regular assessments of licensed CCPs it must consider. The Board is also likely to have a role in contributing to periodic assessments of market conditions that will support the provision of advice to the Minister on the need to introduce mandatory requirements.

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50 Council of Financial Regulators (2011), *Central Clearing of OTC Derivatives in Australia*, June. Available at <<http://www.rba.gov.au/publications/consultations/201106-otc-derivatives/index.html>>.

51 Council of Financial Regulators (2012), *OTC Derivatives Market Reform Considerations*, March. Available at <<http://www.rba.gov.au/payments-system/clearing-settlement/otc-derivatives/201203-otc-der-mkt-ref-con/index.html>>.

52 The Treasury (2012), *Implementation of a Framework for Australia's G20 Over-the-counter Derivatives Commitments*, April. Available at <[http://treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2012/Over%20the%20counter%20derivatives%20commitments%20consultation%20paper/Key%20Documents/PDF/OTC%20Framework%20Implementation\\_pdf.ashx](http://treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2012/Over%20the%20counter%20derivatives%20commitments%20consultation%20paper/Key%20Documents/PDF/OTC%20Framework%20Implementation_pdf.ashx)>.

53 The Treasury (2012), *Exposure Draft: Corporations Legislation Amendment (Derivative Transactions) Bill 2012*, July. Available at <<http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2012/derivative%20transactions/key%20documents/pdf/ExposureDraft.ashx>>.