Regulatory Developments in Financial Market Infrastructures

The Reserve Bank works with other regulators (both domestically and abroad) on issues relevant to the regulation and oversight of Financial Market Infrastructures. In Australia, much of this work has been coordinated by the Council of Financial Regulators and internationally, the Reserve Bank engages closely with regulators of Financial Market Infrastructures.

The Reserve Bank continues to work with other regulators on issues relevant to the regulation of Financial Market Infrastructures (FMIs).

Domestically, much of this work has been coordinated through the Council of Financial Regulators (CFR), which over the last year has consulted on four FMI-related issues:

- competition in clearing Australian cash equities
- a resolution regime for FMIs
- a proposed new approach to assessing whether an overseas clearing and settlement (CS) facility is 'operating in Australia'
- consideration of a repo central counterparty (CCP) in Australia.

The CFR agencies have also progressed their implementation of the G20's over-the-counter (OTC) derivatives reforms, with the government and the Australian Securities and Investments Commission (ASIC) consulting on the details of mandatory CCP clearing of interest rate derivatives (IRDs) denominated in Australian dollars and the major currencies.

Internationally, the Bank has remained closely engaged with overseas regulators of FMIs, including in relation to regulatory equivalence assessments and cooperative arrangements for the supervision and oversight of cross-border FMIs.

Since these issues are relevant to the Board's responsibilities in respect of CS facilities, Board members' input has been sought throughout the respective processes.

Competition in Clearing Australian Cash Equities

In 2012, the CFR and the Australian Competition and Consumer Commission (ACCC) – together, the Agencies – carried out a review of competition in clearing Australian cash equities. In light of stakeholder feedback, the CFR recommended that a decision on any licence application from a competing cash equity CCP be deferred for two years. The government endorsed this recommendation in February 2013.

With the two-year deferral period ending in early 2015, the government announced on 11 February that the Agencies would commence a review of the policy position on competition in clearing Australian cash equities. Following the announcement, the Agencies released a consultation paper seeking stakeholder feedback on a range of issues and policy options:

- *Competition.* Lift the moratorium on competition in the clearing of Australian cash equities, either immediately or after a further defined period to allow a transition to full competition.
- *Monopoly.* Establish an effective monopoly by recommending that competition in clearing be deferred indefinitely, implementing one of

three approaches to regulate the activities of the Australian Securities Exchange's (ASX) cash equity CS facilities:

- *Self-regulation*. Consistent with the current arrangements, retain ASX's existing *Code of Practice for the Clearing and Settlement of Cash Equities in Australia* as a formal commitment to the industry.
- *Partial regulation*. Retain a Code and strengthen some specific aspects through regulatory action.
- *Full regulation*. Regulate all functions of ASX's cash equity CS facilities as monopoly services.

Stakeholders were asked to provide feedback on whether any ancillary policy or legislative measures would be necessary under each policy approach to ensure the continued safe and effective functioning of clearing and settlement in the equity market. It was also noted that these policy approaches could be pursued either independently or in combination.

The Agencies received 20 submissions, of which eight were non-confidential and published.[26]

A Resolution Regime for FMIs in Australia

In February, the Government, on the advice of the CFR, released a consultation paper seeking stakeholder views on proposals to establish a special resolution regime for FMIs. The CFR had recommended in 2012 that such a regime be established, but the work was ultimately delayed by the launch of the FSI. However, it is now proceeding in light of a recommendation in the FSI that the process recommence.

The key proposals set out in the consultation paper were that:

- the regime would extend to all domestically incorporated and licensed CS facilities
- the Bank would be the resolution authority for CS facilities, with an overarching objective to maintain overall stability in the financial system and an additional key objective to maintain the continuity of critical FMI services
- the powers of the resolution authority and safeguards under the regime would be aligned with the Financial Stability Board's (FSBs) *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes).

The consultation paper also proposed that licensing arrangements be amended to underpin the requirement that all systemically important and strongly domestically connected CS facilities incorporate domestically and become domestically licensed, so as to fall within the scope of the proposed special resolution regime.

The government received eight written submissions from stakeholders (two of which were confidential), including from currently licensed FMIs and relevant industry associations.[27] Feedback from consultation revealed strong support for the establishment of a special resolution regime for FMIs. Stakeholders agreed that it was essential that authorities had sufficient powers, supported by legislation, to prevent the disorderly failure of an FMI, particularly in the case of CS facilities. This was seen as a complement to existing work by FMIs themselves to develop plans to recover from any threat to their continued viability. A number of respondents explicitly agreed that the resolution framework should be consistent with the Key Attributes and align with emerging international practice in this area where possible. The FSB is currently reviewing member jurisdictions' current or planned approaches to FMI resolution, which should provide additional insights into the direction of international implementation.

The government will consider its response to the FMI resolution consultation as part of its broader response to the FSI recommendations. In parallel, it is expected that the CFR will develop a high-level proposed response to consultation.

26 The public submissions are available at <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Review-of-competition-in-clearing-Australian-cash-equities/Submissions>.

27 Public submissions are available at <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Resolution-regime-for-financial-market-infrastructures/Submissions>.

'Operating in Australia'

The CFR released a consultation paper on 27 March proposing amendments to the *Corporations Act 2001* that would implement a new approach to assessing whether an overseas CS facility should be subject to regulation in Australia. The proposal rests on a test of the materiality of a CS facility's connection to the Australian financial system. The implementation of this approach would not be expected to change the current scope of Australia's CS facility licensing regime. Rather, the proposal is intended simply to provide clarity to all stakeholders on the scope of the existing regime.

The proposed framework in the consultation paper builds on concepts introduced in the CFR's policy *Ensuring Appropriate Influence for Australian Regulators over Cross-border Clearing and Settlement Facilities*. The ultimate objective of the proposal is that an overseas CS facility must be licensed (or exempted from licensing) if, and only if, it has a material domestic connection. This is to ensure appropriate regulation of CS facilities that could have an effect on the functioning of the Australian financial system, while at the same time ensuring that the scope of regulation does not over-reach.

The proposal comprises two components and clarifies the relevant matters for consideration under each component.

- *First component: domestic connection*. The first component would be a test to establish objectively whether there was any connection at all to the Australian financial system – for instance, due to the location of some operations in Australia, the provision of CS services for financial products connected with Australia, the provision of CS services to one or more Australian direct participants, or vertical links to a domestic market operator or CS facility. This would provide a high degree of legal certainty as to when a CS facility was out of the scope of the regime.
- *Second component: materiality of the connection*. Where it was established that a particular overseas CS facility had some connection to Australia, the second component would assess the materiality of that connection from a public policy perspective. This would ensure that there was appropriate regulation of facilities that might be used by Australians or that might otherwise be relevant to the functioning of the Australian financial system. A CS facility's domestic connection would be considered to be material if its current or expected activities were likely to have implications for the safe, efficient and effective functioning of the Australian financial system or the confident, fair and effective dealings in financial products by Australian investors. To capture reliance on the facility by Australian investors, the tests under the second component would look beyond direct participation to a broader definition of 'user'.

Given the narrow scope of this consultation, there were relatively few submissions. Most agreed that, relative to the current approach, the proposed framework provided greater clarity on whether a CS facility should be licensed in Australia or exempt from licensing. Respondents also generally agreed with the CFR's proposal to define the high-level test in the Corporations Act and to supplement revisions to the Corporations Act with more specific regulatory guidance. This was seen as striking an appropriate balance between legal certainty and the need for flexibility in any revised framework. Some respondents nevertheless stressed the importance of retaining flexibility within the framework.

Bank staff will continue to work closely with ASIC and the Australian Treasury to respond to the feedback from this consultation, with a view to developing formal proposals on amendments to the Corporations Act and to consequently update ASIC's *Regulatory Guide 211 – Clearing and Settlement Facilities: Australian and Overseas Operators*.

Central Clearing of Repos in Australia

In 2013, as part of a broader set of recommendations on securities lending and repo markets, the FSB recommended that member jurisdictions evaluate

the costs and benefits of CCP clearing in their respective inter-dealer repo markets. In response to this recommendation, the Bank issued a consultation paper seeking feedback on the costs and benefits of central clearing of repos in Australia. The paper provided an overview of the Australian repo market and discussed possible implications of CCP clearing for the market. In particular, stakeholder views were sought on how the design and operation of a repo CCP might affect the functioning of the Australian repo market and the management of risk, in both normal and stressed market conditions.

The paper noted that since the Bank was counterparty to around a third of the value of repos outstanding, its decision regarding participation would affect other market participants' evaluation of the private costs and benefits of using a repo clearing service. Accordingly, the Bank undertook to consider its position in light of stakeholder feedback from the consultation.

Six submissions were received, two of which were confidential.[28] The most detailed submission was from the Australian Financial Markets Association (AFMA), which reflected a survey of 12 of its members. The majority of AFMA's membership were supportive of central clearing of repos. In particular, AFMA members believed that central clearing would improve the management of operational risk, particularly if central clearing was introduced as part of an integrated chain of infrastructure to trade, clear, collateralise and settle repos. AFMA also saw the potential for enhanced infrastructure to encourage broader participation and saw some benefit from standardised margining practices and coordinated default management. However, there were some caveats. First, the netting benefits could be limited, given the participation structure of the market and particularly the significant share of repo transactions with the Bank as cash lender. Second, stakeholders questioned the cost and commercial viability of a domestic repo CCP.

On the basis of the feedback from the consultation, the Bank will now develop its conclusions, working towards a report for publication in October.

OTC Derivatives

Since the global financial crisis, international policymakers have also sought to strengthen practices in OTC derivatives markets. To this end, in 2009, the G20 leaders committed that all OTC derivatives transactions would be reported to trade repositories, that all standardised OTC derivatives would be executed on electronic trading platforms, as appropriate, and cleared through CCPs, and that higher capital requirements would apply to non-centrally cleared OTC derivatives. In November 2011, G20 leaders added to these commitments, agreeing that international standards on margining of non-centrally cleared OTC derivatives should be developed. While contributing to the CFR's development of OTC derivatives market policy is a broader responsibility of the Bank, the Board's views have been sought. This has particularly been the case with respect to mandatory clearing, given the potential implications for the Bank's role in CCP oversight and supervision.

Mandatory clearing requirements

Further to recommendations by the Australian Prudential Regulation Authority (APRA), ASIC and the Bank, and a government consultation in December 2014, the government is proceeding with the implementation of a central clearing mandate for trades between internationally active dealers in Australian dollar-, US dollar-, euro-, British pound- and Japanese yen-denominated IRDs. A Ministerial determination and of a set of amendments to the *Corporations Regulations 2001* implementing the proposed mandate were published in September.[29]

28 Public submissions are available at <http://www.rba.gov.au/payments-system/reforms/submissions/central-clearing-of-repos-in-australia/index.html>.

29 The Ministerial determination is available at <https://www.comlaw.gov.au/Details/F2015L01392> and the Corporations Regulations are available at <https://www.comlaw.gov.au/Details/F2015L01411>.

Under the Corporations Act, a mandatory clearing obligation can only be fulfilled by clearing through a CCP that is licensed in Australia, or in certain circumstances, a 'prescribed' CCP.[30] Accordingly, the Corporations Regulations identify a proposed list of prescribed CCPs and set out the criteria ASIC must use when prescribing additional CCPs.

In anticipation of the Ministerial determination, ASIC consulted on Derivative Transaction Rules (DTRs) that set out the details of the mandatory clearing requirement. The proposed DTRs provide more detail on the institutional and product scope of the requirement, and how those subject to the requirement can demonstrate compliance. Consistent with obligations under the Corporations Act, ASIC consulted with APRA and the Bank.

Mandatory trade reporting

The Corporations Regulations also provide relief from trade reporting for entities with less than $5 billion gross notional OTC derivatives positions outstanding, where the counterparty to the trade is already required to report. The rules for reporting by these smaller OTC derivatives market participants constitute the last phase of implementation of trade reporting in Australia, with all other financial entities having been subject to reporting obligations since 1 April – or earlier, for larger institutions.

All trades subject to a reporting requirement under ASIC rules must be reported to a licensed or prescribed trade repository. The only trade repository currently licensed is DTCC Data Repository (Singapore) Pte Ltd (DDRS), which was licensed by ASIC in September 2014. All Australian entities are currently required to report to DDRS. There are currently no trade repositories located in Australia. Overseas entities that are subject to ASIC's reporting requirements may report to prescribed trade repositories. Currently, the prescribed trade repositories are those in the DTCC group as well as UnaVista (which is located in the European Union (EU)) and the Hong Kong Monetary Authority.

The Bank is entitled to access trade repository data relevant to its mandates. To facilitate this access, the Bank signed, in February and April respectively, memoranda of understanding (MoUs) with the European Securities and Markets Authority (ESMA) and the Monetary Authority of Singapore (MAS). Under the MoUs, ESMA and MAS, respectively, commit to giving the Bank access to data held in the trade repositories locating in their jurisdictions where relevant to support the Bank's mandate.

International Equivalence, Recognition and Cooperation

International consistency benefits were an important consideration in the regulators' advice to government on the introduction of mandatory clearing obligations for interest rate derivatives. Since new OTC derivatives- and CCP-related regulations in both the EU and the United States (US) have cross-border application, regulators in both jurisdictions have been considering the extent to which they are prepared to defer to Australian regulators in respect of EU and US entities' OTC derivatives activity in Australia, and whether they are prepared to admit Australian CCPs under their respective regimes.

The Board has continued to be updated throughout the period on the staff's dialogue with regulators in these, and other, jurisdictions on matters related to regulatory equivalence, recognition and cross-border cooperation, particularly in relation to CCP regulation.

In the case of the EU, ESMA had advised the European Commission in late 2013 that it considered Australia's regulation of CCPs to be

30 By including within the framework the flexibility to prescribe certain CCPs, the government recognises that some CCPs may not meet the criteria to be 'operating in Australia' for the purposes of the Corporations Act, and therefore would not be required to be licensed in Australia; they may nevertheless clear trades in products that are subject to the Australian clearing obligation. A dealer that was subject to the Australian clearing obligation might then be permitted to meet this by clearing through a prescribed CCP. The key proposed requirements for prescription are that the offshore CCP's home jurisdiction has substantially implemented international standards and that there are adequate arrangements for ASIC and the Bank to monitor clearing by Australian participants through that CCP.

equivalent to that in the EU under the European Market Infrastructure Regulation (EMIR). While both EMIR and the Bank's Financial Stability Standards are based on common international standards, the Principles for Financial Market Infrastructures (PFMIs), the EU requirements are drafted at a more detailed level. Accordingly, the Bank issued supplementary interpretation of a subset of standards to provide additional clarity in some areas. Initially, the supplementary interpretation was issued to apply only to derivatives CCPs operating in Australia, since only ASX Clear (Futures) Pty Limited (ASX Clear (Futures)) was seeking recognition in Europe. In October 2014, however, the supplementary interpretation was amended to apply more broadly to all domestically licensed CCPs that provide services to clearing members that are either established in the EU or subject to EU bank capital regulation.[31] This broader application of the supplementary interpretation was a prerequisite for ASX Clear Pty Limited (ASX Clear) also to seek recognition under EMIR.

In October, the European Commission adopted an Implementing Act to give effect to the positive regulatory equivalence decision reached by ESMA in 2013. This was followed, in late November, by the conclusion of an MoU between the Bank, ASIC and ESMA to govern information sharing and cooperation between the signatory authorities in respect of any Australian CCPs recognised under EMIR. With these pre-conditions having been met, and ESMA having considered detailed applications by both ASX Clear (Futures) and ASX Clear, ESMA announced on 29 April that both CCPs had been recognised as third-country CCPs under EMIR. ESMA announced that CCPs in Japan, Hong Kong and Singapore had also been recognised as part of a first group of third-country CCPs to be granted recognition under EMIR.

Separately, on 18 August 2015 ASX Clear (Futures) was granted an exemption from registration as a Derivatives Clearing Organisation (DCO) in the US. The Commodity Futures Trading Commission's (CFTC) decision to grant an exemption to ASX Clear (Futures) follows its previous extension of time-limited no-action relief from the requirement to register as a DCO, initially until the end of 2014. This was ultimately extended to end 2015, subject to ASX undertaking to submit a petition for permanent exemption from registration as a DCO by June 2015. As part of this process, ASX was asked to demonstrate that it was subject to comparable and comprehensive supervision and regulation by its home country regulators (the Bank and ASIC), and that it observed in all material respects the PFMIs. ASX duly submitted its petition on 1 June 2015, and was granted an exemption by the CFTC following a period of public consultation.

In conjunction with ASX's petition, ASIC and the Bank were each asked to provide the CFTC with a letter of regulatory good standing. These letters were provided in February and the petition process is ongoing. Similar letters had been provided to ESMA to support its recognition process. The Bank and ASIC had also concluded an MoU with the CFTC in June 2014, to support cooperation and the exchange of information in the supervision and oversight of CCPs operating on a cross-border basis in both the US and Australia. This MoU was intended to support both the petition for permanent exemption from registration as a DCO in the US by ASX Clear (Futures) and Chicago Mercantile Exchange Inc.'s licence application in Australia, which was ultimately granted in September (see 'Supervision of Clearing and Settlement Facilities').

In addition to these new cooperation arrangements, Payments Policy Department retains a number of other cooperative arrangements for oversight and supervision of cross-border FMIs that operate in Australia (see 'Liaison Activity').

31 The Bank's supplementary interpretation of the Financial Stability Standards is available at <http://www.rba.gov.au/payments-system/clearing-settlement/pdf/supplementary-guidance-domestic-derivatives-ccps.pdf>.