

Financial Market Infrastructure Regulatory Reforms

A Consultation Paper by the
Council of Financial Regulators

November 2019

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Request for feedback and comment

This consultation paper seeks stakeholder views on the issues raised by the Council of Financial Regulators in relation to the regulatory regime for market operators, benchmark administrators, clearing and settlement facilities and derivative trade repositories.

Submissions should include the name of your organisation (or your name if the submission is made as an individual) and contact details for the submission, including an email address and contact telephone number where available.

While submissions may be lodged electronically or by post, electronic lodgement is strongly preferred. Please email responses in a Word or RTF format to support accessibility requirements. An additional PDF version may also be submitted.

In the interests of transparency, the CFR intends to publish all submissions.

All information (including name and contact details) contained in submissions will be made available to the public on the CFR website. If you would like all or part of your submission to remain in confidence please indicate this. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain confidential should provide this information marked as such in a separate attachment. Any future request made under the *Freedom of Information Act 1982* for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Closing date for submissions: **20 December 2019, 5.00 pm.**

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Glossary

2011 Regulation Review Consultation	<i>Council of Financial Regulators: Review of Financial Market Infrastructure Regulation</i> (November 2011)
2015 Resolution Consultation	<i>Australian Government Consultation Paper: Resolution Regime for Financial Market Infrastructures</i> (February 2015)
2015 Overseas CSFL Consultation	<i>Overseas Clearing and Settlement Facilities: The Australian Licensing Regime</i> (March 2015)
ACCC	Australian Competition and Consumer Commission
ADI	Authorised deposit-taking institution
AML	Australian market licensee
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
BAL	Benchmark administrator licensee
CCP	Central counterparty
CFR	Council of Financial Regulators
Corporations Act	<i>Corporations Act 2001</i>
CPMI	Committee on Payments and Market Infrastructures
CSFL	Clearing and settlement facility licensee
Domestic CSFL	A body corporate that is incorporated in Australia and holds an Australian clearing and settlement facility licence under section 824B(1) of the Corporations Act
DTRL	Derivative trade repository licensee
FMI	Financial market infrastructure
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSS	Financial Stability Standards
IMF	International Monetary Fund
Licensed Entities	Collectively, AMLs, BALs, CSFLs and DTRLs
OTC	Over-the-counter
Overseas CSFL	A body corporate that holds an Australian clearing and settlement facility licence under section 824B(2) of the Corporations Act
PFMI	Principles for Financial Market Infrastructure
RBA	Reserve Bank of Australia
Regulators	ASIC and the RBA

Executive Summary

The term financial market infrastructures (FMIs) refers to institutions that perform fundamental activities in financial markets. They include operators of financial markets, benchmark administrators, clearing and settlement facilities and derivatives trade repositories. FMIs are critical to the smooth and efficient functioning of the financial system. FMIs licensed in Australia support transactions in securities with a total annual value of \$16 trillion and derivatives with a total annual value of \$150 trillion. These markets turn over value equivalent to Australia's annual GDP every three business days. Securities and derivatives are used by investors and businesses in order to raise capital and finance, borrow and lend funds, invest in equities and debt securities and manage the risks associated with their activities. Investors rely on FMIs for access to transparent prices and a safe means of transacting in their investments, which include over \$640 billion in superannuation assets held in Australian equities and fixed income assets. A disruption to the services provided by FMIs could have very severe consequences for the Australian financial system and to the investors and businesses that rely on FMIs.

International reforms following the 2008 financial crisis have increased both the role of FMIs in the financial system and the risks they face. Clearing and settlement facilities in particular are now critically important due to increased central clearing of over-the-counter (OTC) derivatives. OTC derivatives are widely utilised by financial institutions to manage their exposure to risk and there are now around \$60 trillion (notional value) of Australian OTC derivative contracts outstanding, with a significant proportion of these centrally cleared.

This paper sets out the Council of Financial Regulator's (CFR's) proposed reforms to the regulation of FMIs. The reforms aim to ensure the effective regulation of the systems, services and facilities that underpin Australia's financial system.

The package includes changes to the licensing and supervision frameworks for financial market operators, benchmark administrators, clearing and settlement facilities and derivatives trade repositories, and a new crisis management regime for clearing and settlement facilities. These proposals aim to provide the Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia (RBA) (the Regulators) with strong and effective powers to continue to fulfil their regulatory responsibilities.

The proposed reforms will address the recommendations of several reviews of Australia's financial system, which concluded that the current regulatory regime for FMIs should be enhanced to increase its effectiveness and align to international best practice. These reviews include the 2014 Financial System Inquiry, the 2019 International Monetary Fund (IMF) Financial Sector Assessment Program (FSAP) and previous work by the CFR. The reforms build on recent improvements to the regulation of authorised deposit-taking institutions (ADIs) and insurers and will help ensure the Australian economy is supported by a strong, well-functioning financial system.

This paper includes both new proposals and proposals that were the subject of previous consultation undertaken by the CFR. The CFR is primarily concerned with stakeholder feedback on new or changed reform proposals, but existing proposals are included in this paper to provide a complete picture of the proposed regulatory reform package.

Chapter 1 of this paper provides the rationale for reform and a brief overview of the current regulatory arrangements and the powers and functions of each of the Minister, ASIC and the RBA under the current legislation.

Chapter 2 outlines proposals designed to make sure the licensing regimes for relevant entities will be fit for purpose and effective into the future. The CFR proposes to change the roles of the Regulators so that operational licensing and related decisions sit with the Regulators and not the Minister. The Minister would retain powers in relation to strategic matters. This chapter also includes

proposals to clarify when operators need to be licensed, and place additional responsibilities and obligations on licensees, reflecting their importance to the Australian financial system.

Chapter 3 outlines a number of proposals to enhance the supervisory powers of the Regulators. This includes enhancements to directions powers and information-gathering powers, a new rule-making power for ASIC, new arrangements in relation to changes in control of licensees, and the introduction of a fit and proper regime for key decision-makers.

Chapter 4 proposes the introduction of a resolution regime for clearing and settlement facilities, concentrating on modifications to proposals set out in an earlier consultation on this regime. Key proposals include expanding the scope of certain resolution powers to allow the resolution authority to take action in respect of related bodies corporate of a clearing and settlement facility licensee (CSFL) in resolution, and introducing resolution planning and resolvability powers. The CFR does not propose that the resolution regime will cover trade repositories at this time.

1. Introduction

1.1 Reviewing the regulatory regime

The stability of a modern financial system relies on the resilience of its markets and supporting infrastructure. Operators of FMIs including financial markets, clearing and settlement facilities, benchmark administrators and derivative trade repositories facilitate, support, clear, settle and record a wide and increasing range of financial transactions.¹

In Australia, FMIs support transactions in securities with a total annual value of \$16 trillion and derivatives with a total annual value of \$150 trillion.² These markets turn over value equivalent to Australia's annual GDP every three business days. Financial markets supported by FMIs are used to raise capital, borrow and lend funds, invest in equities and debt securities, and transact in derivatives for risk management purposes. Investors rely on FMIs for access to transparent prices and a safe means of transacting in their investments, which include over \$640 billion in superannuation assets held in Australian equities and fixed income assets.³ These activities are vital to the smooth functioning of the financial system and to the economy more broadly.

The importance of FMIs to the financial system is growing. International reforms to the regulation of financial markets since the global financial crisis have led to a greater proportion of financial transactions flowing through FMIs. For example, a significant proportion of the around \$60 trillion (notional value) of Australian OTC derivative contracts outstanding are now centrally cleared due to mandatory clearing rules.⁴ This has led to a concentration of risks in the clearing and settlement facilities themselves.

Disruption at an FMI or the failure of its operations would prevent some or all of the usual activity that it facilitated taking place, severely undermining the operation of the financial system. ADIs, insurers, superannuation funds and other financial services firms rely on access to financial markets and clearing and settlement facilities to undertake their operations. The price of many financial products is tied to financial benchmarks, and regulators and others rely on accurate derivative trade data.

The CFR is proposing a broad package of reforms to improve the regulation of FMIs in Australia.

These reforms will address the findings of several independent reviews of Australia's financial system, including the 2014 Financial System Inquiry and the 2019 IMF FSAP. These reviews recommended the strengthening of crisis management powers for FMIs.⁵ The latter also found that Australia's current regulatory regime for some FMIs (particularly clearing and settlement facilities) should be enhanced to increase its effectiveness and align to international best practice.

The issues identified in these reviews include: the need to strengthen supervisory and intervention powers available to the Regulators; a less than optimal distribution of decision-making authority and

¹ Payment systems are also FMIs, but are not regulated under the Corporations Act and are therefore not considered in this paper.

² Figures reflect the value of securities trades and notional value of derivatives trades for the year to 30 June 2019.

³ Fixed income assets may include some loans made by superannuation funds that do not rely on FMI services.

⁴ Source: DTCC Data Repository Singapore, RBA. The Government has adopted the G-20 commitment to introduce mandatory clearing rules, subsequently implemented by ASIC.

⁵ See Recommendation 5 of the *Financial System Inquiry Final Report* (2014). Available at <<http://fsi.gov.au/publications/final-report/>>. The IMF FSAP *Technical Note on Supervision, Oversight and Resolution Planning of Financial Market Infrastructures* (2019). Available at <<https://www.imf.org/en/Publications/CR/Issues/2019/02/13/Australia-Financial-Sector-Assessment-Program-Technical-Note-Supervision-Oversight-and-46609>>.

regulatory powers between the Regulators and the Government; and inconsistent regulatory rules applying to different types of FMI.

The Minister, ASIC and the RBA each have a regulatory role in respect of FMIs. The Minister has a range of licensing powers, including the power to: grant licences to operators of clearing and settlement facilities and financial markets; issue directions; and disallow operating rules for these licensees. Since 2016, a number of the Minister's operational powers have been delegated to ASIC.

ASIC is the primary regulator for Australian market licensees (AMLs), benchmark administrator licensees (BALs) and derivative trade repository licensees (DTRLs). It co-regulates CSFLs with the RBA. All such entities are regulated under the *Corporations Act 2001* (Corporations Act). AMLs, BALs, CSFLs and DTRLs are together referred to as 'Licensed Entities' throughout this paper. Where a proposal in this paper relates to only a sub-set of Licensed Entities, they are referred to individually.

ASIC is responsible for monitoring and enforcing compliance with the Corporations Act by Licensed Entities and, in addition, AMLs' provision of fair, orderly and transparent markets and CSFLs' provision of fair and effective clearing and settlement services.

The RBA is responsible for supervising CSFLs in respect of financial stability, including through the determination of Financial Stability Standards (FSS) and assessment of compliance with the FSS by CSFLs.

The proposed reforms involve redistributing current decision-making authority and supervisory powers between the responsible Minister and the Regulators; and giving the Regulators new or strengthened powers to address identified weaknesses in the current framework.

If implemented in full, the proposed reforms would:

- increase the efficiency, transparency and accountability of the FMI regulatory regime by ensuring an independent regulator is responsible for all operational licensing decisions
- improve the effectiveness of the regulatory regime by providing to each of ASIC and the RBA appropriate powers to achieve their respective objectives
- align oversight of FMIs with their importance to the financial system and bring regulatory powers into line with those available to the Australian Prudential Regulation Authority (APRA) for ADIs and insurers. Implementing these changes involves streamlining the use of existing regulatory powers, increasing the effectiveness of existing powers, and giving the Regulators new powers where necessary
- substantially increase the resilience of the financial system by introducing a crisis resolution regime for clearing and settlement facilities. This regime is similar to the recently enhanced resolution regime for ADIs and insurers and will give the RBA the ability to step in to take control of a failing facility to maintain its critical functions and hence financial stability.

1.2 The need for reform

Enhanced licensing and supervisory powers

Given the critical role played by the Licensed Entities in the financial system, it is important that the Regulators have strong powers to monitor licensees' compliance with their obligations and to be able to take action where they identify deficiencies.

There are two key limitations in the current supervisory arrangements for Licensed Entities. First, for some types of Licensed Entities, the distribution of powers and decision-making authority between the Regulators and the Minister is inefficient. Best practice internationally is to provide clear

separation between the operational responsibilities of independent regulators and the strategic role of Government. The fact that certain operational licensing, directions and enforcement powers currently sit with the Minister is inconsistent with international best practice. These types of powers are more suitable as powers of the Regulators.

Second, there is scope to strengthen the Regulators' powers to monitor the ongoing conduct of Licensed Entities and to require Licensed Entities to comply with their obligations. It is critical for the Regulators to be able to identify risks in Licensed Entities as they emerge and to have the ability to intervene effectively before those risks escalate. For example, APRA has a broader toolkit of oversight and enforcement powers in its equivalent role regulating ADIs and insurers.

Enhancements to supervisory powers were first proposed by the CFR in its 2011 *Review of Financial Market Infrastructure Regulation* (2011 Regulation Review Consultation). Other CFR consultations since then have proposed further enhancements. In its 2019 FSAP report, the IMF recommended that Australia strengthen the independence of the Regulators in supervisory oversight of CSFLs, and enhance the Regulators' enforcement powers to promote compliance with regulatory requirements.⁶

The CFR notes that progress has already been made in some areas. For example, in 2018, legislation was passed to introduce a regulatory regime for financial benchmarks.⁷

This paper introduces a proposal for certain powers that currently sit with the Minister to be transferred to the Regulators. It also introduces new proposals to enhance the supervisory regimes for Licensed Entities, and confirms some proposals that have previously been consulted on. The proposals outlined in this paper would bring the powers of each Regulator into line with its responsibilities.

Reforms to regulatory powers would mean that each Regulator has appropriate tools to achieve its objectives. The Minister and Government would retain overarching responsibility for strategic matters and matters of national importance, but operational decisions would move to the Regulators, where they more appropriately sit.

Introducing a resolution regime for clearing and settlement facilities

The failure of a CSFL that provides clearing and settlement services that are critical to the smooth functioning of the financial system would have a significant adverse effect on market participants. Disruption would likely spread rapidly across the financial sector, with flow-on effects to the real economy. The Financial Stability Board (FSB) has led international work to develop best practice principles for resolution regimes that enable regulators to step in, if required, to provide continuity of critical services and protect the financial system.

There is currently no resolution regime for CSFLs in Australia. If a CSFL failed, the Government would either have to attempt to resolve it without any dedicated powers to achieve resolution, or allow it to be dealt with under general corporate insolvency provisions. Such an outcome would risk disruption to critical clearing and settlement services and pose a major threat to financial stability. In 2014, the Financial System Inquiry recommended that a dedicated resolution regime be developed for FMIs, and the IMF supported this recommendation in its 2019 FSAP report.

In February 2015, the CFR consulted on proposals for the design of a resolution regime. Proposals in that consultation were based on the FSB's 2014 *Key Attributes of Effective Resolution Regimes for Financial Institutions*.⁸ Since then, additional international guidance and lessons from the

⁶ *Technical Note on Supervision, Oversight and Resolution Planning of Financial Market Infrastructures* (2019).

⁷ *Treasury Laws Amendment (2017 Measures No. 5) Act 2018*.

⁸ *Key Attributes of Effective Resolution Regimes for Financial Institutions* including an FMI Annex, and *Guidance on Central Counterparty Resolution and Resolution Planning*. Available at <<https://www.fsb.org/work-of-the->

development of enhancements to APRA's crisis management regime have become available. This consultation puts forward proposals modified from those contained in the *Australian Government Consultation Paper: Resolution Regime for Financial Market Infrastructures* (2015 Resolution Consultation) and in some places provides more detail on earlier proposals.

The 2015 Resolution Consultation also sought stakeholder views on legislative proposals to establish a special resolution regime for DTRLs. The paper proposed that any resolution regime apply to DTRLs that are incorporated and licensed in Australia, and that are identified as being systemically important in Australia.

Given the current derivative trade repository landscape in Australia, the CFR proposes to defer development of a resolution regime for DTRLs until such a time as a DTRL is likely to be within scope of a regime; that is, until there is more likely to be a domestically incorporated,⁹ systemically important derivative trade repository in Australia. By such time, the development of a DTRL resolution regime may also be able to benefit from greater international and domestic precedent and lessons that may arise over time.

The resolution regime proposed in this paper will therefore apply to CSFLs only.

The introduction of a resolution regime for CSFLs would facilitate the continued provision of clearing and settlement services during a crisis, greatly assisting ongoing financial stability.

Competition in clearing and settlement of cash equities

There is currently only one provider of clearing services, and one provider of settlement services, for cash equities in Australia. Both entities are part of the same corporate group that also provides trading services for cash equities in Australia. A lack of competition in the provision of clearing and settlement services could result in higher prices for users than would be the case in a competitive market. It could also result in barriers to transparent and non-discriminatory access to those services and/or limited responsiveness to users' evolving needs. This would be contrary to the objectives of maintaining competitive and efficient financial markets. The emergence of a competing provider could address these concerns, but it is important that any competition emerges in a safe and effective manner given the critical role played by cash equity CSFLs. If competition does not emerge, then it is important that regulators have appropriate powers to address the potential for anti-competitive conduct of any incumbent.

The CFR and the Australian Competition and Consumer Commission (ACCC) consulted on these issues in 2012, 2015 and 2017, providing advice to the Government in 2012 and 2015. Consistent with the Government's announced response to the 2015 advice, the CFR and the ACCC have released policy statements detailing regulatory expectations for the conduct of a monopoly provider of clearing and settlement services for cash equities and a set of minimum conditions that would support safe and effective competition in clearing and settlement of cash equities if a competing clearing or settlement facility was to emerge.¹⁰

The CFR and the ACCC's 2015 advice also proposed the introduction of rule-making and arbitration powers. ASIC would be given the power to enforce the regulatory expectations and set minimum conditions for competition in clearing and settlement services for cash equities. The ACCC would be given the power to arbitrate access disputes between parties for cash equity clearing and settlement services. In March 2016, the Government announced its commitment to implement these legislative

fsb/policy-development/effective-resolution-regimes-and-policies/key-attributes-of-effective-resolution-regimes-for-financial-institutions/>.

⁹ In this document, 'domestically incorporated' refers to a body corporate that is registered under Chapter 2A of the Corporations Act.

¹⁰ *Australian Cash Equity Settlement Services: Policy Statement* (7 September 2017). Available at <<https://cfr.gov.au/news/2017/mr-17-01.html>>.

changes.¹¹ Therefore, this paper does not seek further feedback on this issue. This information has been provided for context to the other reforms proposed in this paper.

1.3 Design principles

The CFR has considered the following high-level principles in the design of the reforms set out in this paper. These principles take into account the *Principles of Best Practice Regulation* set out by the Council of Australian Governments,¹² and the Organisation for Economic Co-operation and Development *Best Practice Principles on the Governance of Regulators*.¹³

Principle 1 – Clear purpose and objectives

Effective regulation should serve clearly identified policy goals and be effective in achieving those goals. Where regulatory regimes have more than one goal or purpose, the framework should clearly set out the mechanisms to prioritise each objective and coordinate regulatory activities to achieve the desired regulatory outcome.

Principle 2 – Clarity of regulators' roles and responsibilities

Effective regulatory regimes rely on each regulator having well-defined responsibilities and objectives, and having sufficient powers to achieve the objectives of the regulations for which it is responsible.

Individual regulators should not have responsibility for conflicting or competing functions. Where a regulator's responsibilities overlap with those of another regulator, there should be established mechanisms to coordinate regulatory actions.

Principle 3 – Regulatory consistency

In order to minimise costs for both regulated entities and regulators, policymakers should aim to align the operation of regulatory regimes that regulate similar sectors and aim to achieve similar objectives. Where differing approaches are taken, they should be justified by differing circumstances. Alignment should be based around the most fit-for-purpose model for the needs of the regime.

Principle 4 – Proportionality

The powers available under regulatory regimes should be proportionate to the scale and nature of the problems those regimes are trying to address. This may mean that certain powers are available only to regulators in circumstances that justify the use of those powers.

Regulatory regimes should not impose an undue compliance burden on the regulated entities, nor should they unduly constrain the activities of regulated entities.

1.4 Relationship to previous consultations

As noted above, the proposals set out in this paper build on a number of previous consultations by the CFR and Government. In developing these proposals, the CFR has taken into account feedback from these previous consultations and will consider that feedback as well as new submissions when preparing its advice to Government following the current consultation.

¹¹ *Turnbull Government to open competition in share clearance* (30 March 2016). Available at <<http://ministers.treasury.gov.au/ministers/scott-morrison-2015/media-releases/turnbull-government-open-competition-share-clearance>>.

¹² Available at <https://www.pmc.gov.au/sites/default/files/publications/COAG_best_practice_guide_2007.pdf>.

¹³ Available at <https://www.oecd-ilibrary.org/governance/the-governance-of-regulators_9789264209015-en>.

While the focus of this consultation is on new and enhanced proposals, a recap of proposals from previous consultations is provided so that the full extent of the proposed change from current arrangements can be understood.

Each section of this paper includes a box summarising proposals that are new or have changed since previous consultations, to assist stakeholders in identifying proposals that they have not previously had the opportunity to comment on. Stakeholders may wish to focus their comments on these areas.

The following table provides details of previous CFR consultations referenced in this paper.

2011 Regulation Review Consultation	<p><i>Council of Financial Regulators: Review of Financial Market Infrastructure Regulation</i> (October 2011)</p> <p>https://treasury.gov.au/sites/default/files/2019-03/CFR_review_of_FMI_regulation_issues.pdf</p> <p>Letter to the Deputy Prime Minister: <i>Review of Financial Market Infrastructure Regulation</i> (10 February 2012)</p> <p>https://treasury.gov.au/sites/default/files/2019-03/CoFR_Letter_to_Deputy_PM.pdf</p>
2015 Resolution Consultation	<p><i>Australian Government Consultation Paper: Resolution Regime for Financial Market Infrastructures</i> (February 2015)</p> <p>https://treasury.gov.au/sites/default/files/2019-03/C2015-009_resolutionregime_fmi.pdf</p> <p><i>Resolution Regime for Financial Market Infrastructures: Response to Consultation</i> (November 2015)</p> <p>https://www.cfr.gov.au/publications/consultations/2015/resolution-regime-financial-market/pdf/report.pdf</p>
2015 Overseas CSFL Consultation	<p><i>Overseas Clearing and Settlement Facilities: The Australian Licensing Regime</i> (March 2015)</p> <p>https://www.cfr.gov.au/publications/consultations/2015/overseas-clearing-and-settlement-facilities-australian-licensing-regime/pdf/overseas-clearing-and-settlement-facilities-australian-licensing-regime.pdf</p> <p><i>Overseas Clearing and Settlement Facilities: The Australian Licensing Regime: A response to consultation by the Council of Financial Regulators</i> (November 2015)</p> <p>https://www.cfr.gov.au/publications/consultations/2015/ocsf-aus-licensing-regime/pdf/report.pdf</p>

2. Enhancing the licensing regimes

2.1 Key points

- This chapter sets out a number of proposed reforms so that the licensing regimes for financial markets, clearing and settlement facilities, derivative trade repositories and benchmark administrators are fit for purpose and efficient into the future.
- It is proposed to change the roles of the Minister and the Regulators so that operational licensing and supervisory functions related to conduct and compliance sit with ASIC. For CSFLs, regulatory powers related to financial stability would sit with the RBA. The Minister would retain powers in relation to strategic matters including powers to review certain regulatory decisions.
- The proposed reforms also include clarifying when a person is required to hold an Australian market licence or clearing and settlement facility licence and imposing responsibilities and obligations on licensees that reflect their importance to the Australian financial system.

2.2 Background

Financial regulation has seen a significant wave of reform in the decade following the global financial crisis. For example, Australia has implemented the Principles for Financial Market Infrastructures (PFMI) and associated guidance set out by the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO), and mandated the reporting and central clearing of OTC derivatives. These and other developments have increased the importance of FMIs in the Australian financial system and heightened the importance of risk management by FMIs. Given these changes, it is appropriate to consider whether Australia's regulatory regime remains sufficiently robust. In doing so, the CFR has also considered international experience and other financial institution regulatory regimes in Australia.

2.3 Alignment of regulatory powers and responsibilities

New proposal

That licensing and related powers held by the Minister (and currently delegated to ASIC) be transferred to the Regulators.

A fit-for-purpose regulatory regime ideally aligns the powers available to regulators with their responsibilities under the regime, to provide the most effective means of achieving desired regulatory outcomes. The current distribution of powers between the Minister, ASIC and the RBA in Chapter 7 of the Corporations Act does not fully achieve this objective.

The current regulatory framework provides for the Minister to make licensing and supervisory decisions in respect of market operators based on advice from ASIC, and in respect of clearing and settlement facilities, based on advice from ASIC and the RBA.¹⁴ Since April 2016, the Minister has delegated to certain ASIC staff most licensing and related powers with respect to AMLs and CSFLs.¹⁵ The delegation of these powers was made to improve the efficiency of licensing and supervision of AMLs and CSFLs. ASIC staff exercise the delegated powers in accordance with Ministerial guidelines.

¹⁴ Sections 798B, 827B and 827C of the Corporations Act. The Minister does not have powers in relation to licensing of BALs and DTRLs.

¹⁵ Section 1101J of the Corporations Act.

The Minister is able to exercise the powers that have been delegated, or withdraw the delegation, at any time.

The extensive role of the Minister in Australia's licensing and supervisory regimes for AMLs and CSFLs is unusual, both in comparison to overseas regimes and with other Australian financial sector regimes (for example, APRA's authorisation and supervision of ADIs).

The current regime also provides no directions power to the RBA, despite its role as co-regulator of CSFLs.

The CFR proposes that the Minister's powers that are currently delegated to ASIC be transferred from the Minister to ASIC, and to the RBA where appropriate in relation to CSFLs, as independent regulators. With respect to CSFLs, the CFR proposes to require that the Regulators consult each other in the exercise of their respective powers. Having responsibility for licensing and supervision matters sitting with regulators is in line with APRA's regime for ADIs and with comparable overseas jurisdictions, including Canada, the United Kingdom and the United States of America. It is also in line with the IMF's 2019 *Technical Note on Supervision, Oversight and Resolution Planning of FMLS* prepared as part of its FSAP, which recommended regulatory independence be strengthened in Australia.

The current delegation from the Minister to ASIC for AMLs and CSFLs includes powers in the following categories:¹⁶

- Licensing: issue or vary a licence; impose, vary, and revoke licence conditions; suspend or cancel a licence, or to revoke a suspension.
- Operating rule changes: disallow operating rule changes.
- Exemptions: issue, vary or revoke an exemption from compliance with all or part of Part 7.2 or 7.3 of the Corporations Act.
- Information: require a special report, direct that annual reporting to ASIC be audited.
- Directions: promote compliance by the licensee with its obligations as a licensee under Chapter 7 of the Corporations Act.
- Compensation regimes for financial markets: approve compensation arrangements; decide on revocation of approvals; give directions; approve changed compensation arrangements; disallow changes to the Securities Exchanges Guarantee Corporation rules; and give directions to require the preparation of risk assessment reports.

Proposals to reallocate information-gathering and directions powers, and proposed enhancements to these powers, are described in more detail in Chapter 3.

For clearing and settlement facilities, the proposal to transfer the power to exempt a CSFL from compliance with obligations would be shared between the Regulators according to their respective areas of responsibility under Part 7.3 of the Corporations Act. The RBA would have the power to exempt a CSFL from obligations related to complying with the FSS and the requirement to do all other things necessary to reduce systemic risk. ASIC would have the power to exempt from all other provisions in Part 7.3.

The CFR proposes that, in addition to the exemption power, ASIC (for operators of markets, financial benchmarks, clearing and settlement facilities and derivative trade repositories) and the RBA (for operators of clearing and settlement facilities) be able to declare that certain provisions apply to a person or class of persons as if omitted, modified or varied, in a similar manner to ASIC's existing

¹⁶ *Ministerial Powers (ASIC) Delegation 2019*. Available at <<https://www.legislation.gov.au/Details/F2019N00034>>.

declaration power for Australian financial services licensees.¹⁷ This would enable the Regulators to grant exemptions more efficiently in particular circumstances.

The Minister would retain powers that are not currently delegated to ASIC, as these are generally matters of strategic or national importance rather than operational matters. These powers include the nomination of a body corporate as the Securities Exchanges Guarantee Corporation¹⁸ and the approval of large shareholdings of a widely held market body on national interest grounds.¹⁹ The Minister would also retain a role in reviewing certain decisions made by the Regulators.²⁰

2.4 Other changes to licensing arrangements

Suspension or cancellation of a licence

New proposal

Specifying circumstances in which a licence may be suspended or cancelled when the licensee has not commenced or has ceased to carry out the activity for which they are licensed.

A regulatory licence is granted for specific purposes and is accompanied by stringent obligations for the entity that is licensed. It is important that licences are used in appropriate ways and can be suspended or cancelled if they are not being used appropriately. This includes cases where a Licensed Entity is warehousing a licence rather than carrying out the activities that the licence has authorised them to undertake. Such conduct risks bringing the Australian regulatory regime into disrepute.

Currently, the Minister has the power to suspend or cancel the licence of an AML or CSFL in certain circumstances.²¹ As outlined earlier in this chapter, the CFR proposes that these powers be transferred from the Minister to ASIC, with the involvement of the RBA for CSFLs.

One of the grounds for suspension or cancellation of an Australian market licence is that the licensee ceases to carry on the business of operating the market.²² There are corresponding provisions for BALs, CSFLs and DTRLs.²³ The CFR proposes adding a level of specificity by including some circumstances in which this power may be exercised.

The CFR now proposes changes to clarify that ASIC is able to suspend or cancel a licensee's authorisation to conduct an activity in the following specific circumstances:

- where the entity has not commenced operating the activity which requires authorisation within three years of becoming licensed; or
- where, for a period of 12 months, the entity has not carried out the activity which requires authorisation.

¹⁷ Section 926A(2)(c) of the Corporations Act.

¹⁸ Section 890A of the Corporations Act. Under the Corporations Act, operators of financial markets must have an eligible compensation scheme to protect investors. The Securities Exchanges Guarantee Corporation administers the National Guarantee Fund, a compensation scheme that applies to members of the Securities Exchanges Guarantee Corporation. The National Guarantee Fund provides compensation for retail and wholesale clients who incur a loss in their dealings with participants in four circumstances, as set out in the *Corporations Regulations 2001*.

¹⁹ Section 851B of the Corporations Act.

²⁰ For example, see sections 798G(3), 798J(5), 823D(8), 901K, 903H, 908BU, and 908CM of the Corporations Act.

²¹ Sections 797B, 797C, 826B, and 826C of the Corporations Act.

²² Section 797B of the Corporations Act.

²³ Sections 826B, 905H and 908BI of the Corporations Act.

For BALs that have more than one benchmark specified in their licence, the CFR proposes that the licence could be varied to remove the benchmark which has not commenced or is not being generated in the circumstances outlined above, while retaining other benchmarks.

The additional circumstances proposed will constrain entities from warehousing and commoditising licences. This proposal would better align the regulatory regimes for the Licensed Entities with recommendation 24 of the ASIC Enforcement Review Taskforce, which recommended that Australian financial services licensees and credit licensees be required to commence business within six months of being granted a licence. However, the CFR proposes a longer period than six months for the Licensed Entities given the nature of the activities requiring authorisation, as there can be significant lead times before activity commences.

The power to cancel a licence is discretionary and would not necessarily be exercised if one of the conditions is met.

The CFR also proposes that ASIC (after consultation with the RBA in relation to CSFLs) should have the power to suspend or cancel a licence for an overseas market or an Overseas CSFL if there is a material deterioration in the cooperation or information-sharing arrangement with the licensee's home regulator. This proposal was consulted on in the 2015 Resolution Consultation.

Overseas entities – requirement to be licensed

New proposals

Extending to overseas market operators proposed changes to the requirement for overseas clearing and settlement facilities to be licensed or exempt.

Introducing information-gathering powers and reporting obligations to enable ASIC to assess whether an overseas clearing and settlement facility or overseas market operator has a domestic connection and the materiality of that connection.

Introducing appropriate transitional arrangements.

The increasingly global nature of many financial markets, combined with regulatory reforms, has prompted an increasing number of overseas entities to contact the Regulators to seek clarity on whether they fall within the scope of the licensing regime.

Under the current licensing framework, an operator of a financial market or a clearing and settlement facility is required to be licensed or exempt from Part 7.2 of the Corporations Act if it 'operates ... a financial market in this jurisdiction' or Part 7.3 of that Act if it 'operates ... a clearing and settlement facility in this jurisdiction'.²⁴ The Corporations Act does not comprehensively set out the circumstances in which an entity is operating a financial market or clearing and settlement facility in this jurisdiction.²⁵

The CFR's previous consultation *Overseas Clearing and Settlement Facilities: The Australian Licensing Regime* (2015 Overseas CSFL Consultation) sets out a revised approach intended to provide greater clarity and legal certainty in relation to the requirement to be licensed. Under those proposals, an overseas clearing and settlement facility would be required to be licensed or exempt from Part 7.3 of the Corporations Act if ASIC determined that it had a 'material domestic connection' to this jurisdiction.²⁶

²⁴ Sections 791A and 820A of the Corporations Act.

²⁵ See sections 791D and 820D of the Corporations Act. Note also ASIC Regulatory Guides 172 and 211.

²⁶ Sections 3 and 5.

The CFR proposed the following:

- Domestic connection: the first component of the test – a clearing and settlement facility’s domestic connection – would establish, on the basis of objective factors set out in the legal framework, if the facility’s operations were in any way connected to the Australian financial system. A clearing and settlement facility that had a domestic connection would be required to notify the Regulators.
- Materiality: the second component of the test would assess the materiality of any domestic connection. Where ASIC (in consultation with the RBA) considered a clearing and settlement facility’s domestic connection to be material on the basis of the assessment of factors set out in the legal framework, ASIC would make a determination to that effect, and the facility would be required to become licensed or exempt from Part 7.3 of the Corporations Act.

The CFR proposes to proceed on the basis of the 2015 Overseas CSFL Consultation, with the following proposed additions:

- ASIC would have an information-gathering power to assess whether an overseas clearing and settlement facility had a domestic connection and the materiality of that connection.
- Where ASIC did not consider an overseas clearing and settlement facility’s domestic connection to be material, an ongoing reporting requirement would apply to enable ASIC to assess any changes to materiality over time.
- Appropriate transitional arrangements would apply for any unlicensed overseas clearing and settlement facilities assessed to have a material domestic connection.

The CFR also proposes that, as was foreshadowed in the CFR’s response to the 2015 Overseas CSFL Consultation, these arrangements will apply to operators of financial markets.

Location requirements

New proposal

This section contains no new proposals.

The Regulators must have appropriate regulatory influence over AMLs and CSFLs that are essential to the smooth operation of the Australian financial system.

Consistent with the proposals in the 2011 Regulation Review Consultation, the 2015 Resolution Consultation and 2015 Overseas CSFL Consultation, the CFR proposes that ASIC have the power (having received advice from the RBA in the case of a CSFL) to impose location requirements on AMLs and CSFLs. This will involve requiring the licensee to transfer from an overseas licence²⁷ to a domestic licence²⁸ held by a domestically incorporated entity.

This will enable the Regulators to strengthen their influence over the licensee by assuming the role of primary regulator. This would also enable a CSFL to be brought within the scope of the proposed resolution regime (see Chapter 4).

²⁷ Granted under section 795B(2) or 824B(2) of the Corporations Act.

²⁸ Granted under section 795B(1) or 824B(1) of the Corporations Act.

Domestic clearing and settlement facility licences

New proposal

This section contains no new proposals.

As noted in the 2015 Resolution Consultation,²⁹ so that holders of a domestic Australian clearing and settlement facility licence³⁰ could be effectively dealt with under the resolution regime, it is proposed that domestic licences only be available to clearing and settlement facility operators that are domestically incorporated.

2.5 Prescribed financial market – declaration power

New proposal

Empower ASIC to declare a financial market to be a prescribed financial market.

The concept of a ‘prescribed financial market’ allows for the selective application of some provisions in the Corporations Act in relation to certain financial markets.

Prescribing a financial market, including in the event of the issuance or variation of an Australian market licence, currently requires amending the *Corporations Regulations 2001* to add that financial market to the list of prescribed financial markets.³¹ Amending regulations in this way is a cumbersome and slow process involving the preparation and drafting of a new disallowable legislative instrument that must be tabled in Parliament before becoming law.

The CFR proposes to replace the current process for adding a financial market to the list of prescribed financial markets with a declaration power for ASIC. The declaration power will enable the list of prescribed financial markets to be updated on a more timely basis. Parliamentary oversight of the process for updating the list of prescribed financial markets will be retained.³²

2.6 Widely held market body – declaration power

New proposals

Allow the Minister to approve increases in voting power in ASX Limited above 15 per cent.

Empower ASIC to declare a body to be a widely held market body.

The Corporations Act contains restrictions on the acquisition of shares in AMLs and CSFLs (and their holding companies) that are ‘widely held market bodies’.³³ A person’s voting power in a widely held market body cannot be greater than 15 per cent unless there is ministerial approval or, in the case of ASX Limited, approval via a regulation. The Minister may provide approval if the Minister is satisfied that it is in the national interest.

²⁹ Section 2.1.3.

³⁰ Granted under section 824B(1) of the Corporations Act.

³¹ ‘Prescribed financial market’ is defined in section 9 of the Corporations Act.

³² Declarations would be in the form of a disallowable legislative instrument.

³³ Division 1 of Part 7.4 of the Corporations Act and regulation 7.4.01 of the *Corporations Regulations 2001*.

The CFR proposes that a change of control in ASX Limited be subject to the ministerial approval process, rather than requiring a regulation.³⁴ This would align the approval process for ASX Limited with other widely held market bodies.

Currently the list of widely held market bodies is prescribed by regulation. Similar to the process for prescribing a financial market, the process for updating the list of widely held market bodies is a cumbersome process involving the preparation and drafting of a disallowable legislative instrument that must be tabled in Parliament before becoming law.

The CFR therefore proposes that ASIC be empowered to declare a body to be a widely held market body. This will allow ASIC to update the list of entities in a more timely manner, for example, to reflect changes in name or corporate group structure. The criteria for an entity to be a widely held market body will stay the same, that is, if it is assessed to be of national significance in accordance with current guidelines.³⁵ Parliamentary oversight of the process for updating the list of widely held market bodies will be retained.³⁶ Any changes in control of widely held market bodies will remain subject to the ministerial approval process.

³⁴ This proposal is consistent with Recommendation 44 of the November 2014 *Final Report of the Financial System Inquiry*, which recommended that ASX be subject to the same ownership restrictions as other entities in the financial sector.

³⁵ *Financial Services Reform Bill 2001*, Explanatory Memorandum, Paragraph 9.8. Available at <<https://www.legislation.gov.au/Details/C2004B00956/Explanatory%20Memorandum/Text>>.

³⁶ Declarations would be in the form of a disallowable legislative instrument.

3. Enhancing supervision and enforcement

3.1 Key points

- Effective supervisory arrangements provide regulators with powers to require supervised entities to conduct their operations in accordance with the objectives of regulation.
- The Minister and the Regulators have a range of tools to achieve their objectives but, under the current framework, the available tools could be better aligned with the mandates of the Regulators empowered to use them.
- To facilitate effective ongoing supervision, the CFR proposes a range of new powers for the Regulators, including the transfer of some powers that currently sit with the Minister. Some of these proposals have been covered in previous consultations, but have not yet been implemented, while others are being publicly consulted on for the first time.

3.2 Background

Strong supervisory powers are essential for the Regulators to effectively regulate the conduct of Licensed Entities and achieve the objectives of Chapter 7 of the Corporations Act.³⁷ It is important that ASIC is able to: effectively intervene where there may be a disruption to the fair, orderly and transparent functioning of markets or the fair and effective provision of clearing and settlement services; and set regulatory parameters for Licensed Entities to promote the objectives of Chapter 7 of the Corporations Act.

Robust supervisory powers for the RBA in respect of CSFLs are important in order to support action to address emerging financial stability risks arising from clearing and settlement activities.

The Regulators currently have a range of tools to set regulatory standards as well as monitor and address compliance of Licensed Entities with their obligations under the Corporations Act. These include the power to make and publish assessments of Licensed Entities' compliance, directions powers and, in some instances, rule-making powers. However, while the Regulators have been able to make effective use of the tools available to them to date, these tools and their allocation between the Regulators can be improved to maintain best practice, reflecting international developments and evolving market and clearing structures. This has been noted in independent reviews of the Australian financial system, including in a recent assessment by the IMF as part of its FSAP.

In the 2011 Regulation Review Consultation and 2015 Resolution Consultation, the CFR proposed changes to enhance supervisory powers to achieve the above objectives, including:

- better aligning the Regulators' powers with their respective mandates
- introducing a fit and proper regime
- streamlining the process for the use of existing directions powers and providing additional sanctions for non-compliance with directions
- providing directions powers for the RBA, including to support a CSFL that is implementing recovery arrangements.

More recent consideration by the CFR of the current regulatory arrangements has identified some further areas where the framework could be improved.

³⁷ Appendix A provides additional information on the objectives of Chapter 7 of the Corporations Act.

This section sets out the CFR's proposed reforms to the regulatory framework for regulation and supervision of Licensed Entities.

3.3 Fit and proper standard

New proposal

Expand the population covered by a fit and proper standard to encompass:

- a broader range of individuals involved in a Licensed Entity
- all Licensed Entities, not only AMLs and CSFLs.

The compliance of any regulated entity with its regulatory obligations relies on decisions made by key individuals. It is therefore important that regulators have some level of scrutiny over whether these individuals are appropriate for their role of influence.

Under the current regulatory regime, ASIC may declare that an individual who is involved in a Licensed Entity or is involved in an applicant for such a licence, is disqualified.³⁸ A disqualified individual must not be involved in a Licensed Entity. An individual is involved in a licensee or applicant if they are a director, secretary or senior manager of, or have more than 15 per cent of the total voting power in the licensee, applicant or a holding company of a licensee or applicant.

ASIC may make such a declaration only if satisfied that, because the individual is unfit to be involved in the licensee or applicant, there is a risk that the licensee or applicant will breach its obligations under Chapter 7 of the Corporations Act if the declaration is not made. In deciding whether an individual is unfit, ASIC must take into account such matters as the individual's fame, character and integrity. The disqualified individual test does not consider factors such as competence, experience, knowledge or other such attributes.³⁹

The CFR proposes to implement a fit and proper standard for those involved in Licensed Entities. Such a standard would include consideration of a broader range of factors including competence, knowledge and experience, in addition to the current disqualified individual test. This would align the FMI regulatory toolkit more closely with regulatory arrangements in other parts of the financial system.

Following the 2011 Regulation Review Consultation, the CFR recommended to Government in 2012 that key persons involved directly or indirectly in the management of the affairs of FMIs should be subject to a fit and proper standard similar to that determined by APRA in relation to ADIs. APRA's minimum requirements for ADIs in determining the fitness and propriety of individuals to hold positions of responsibility are set out in APRA's Prudential Standard CPS 520.⁴⁰

The CFR also recommended, in response to the 2011 Regulation Review Consultation, that it would be more appropriate for a fit and proper standard not to have the additional requirement to demonstrate that, because of the unfitness of the person involved, there is a risk that the relevant licensee or applicant would breach its obligations under Chapter 7 of the Corporations Act.

In considering the concept of key persons from the 2012 CFR recommendation, the CFR proposes that the scope of individuals covered by a fit and proper standard should be aligned more closely with the population of individuals that are 'involved in' an operator.⁴¹ This reflects the importance

³⁸ Division 2 of Part 7.4 of the Corporations Act.

³⁹ Section 853C of the Corporations Act.

⁴⁰ APRA *Prudential Standard CPS 520 Fit and Proper* (July 2019) contains the concept of competence, character, diligence, honesty, integrity and judgement for determining whether a person is fit and proper to hold a responsible person position. Available at <<https://www.legislation.gov.au/Details/F2018L01390>>.

⁴¹ Section 853B of the Corporations Act.

of those who have influence over a licensee's operations and can make key decisions having competence, knowledge and experience commensurate with their roles, in order to drive good governance and culture in Licensed Entities. It follows that a fit and proper standard should encompass not only directors but also those who manage and control FMI. Under this proposal, the fit and proper standard would apply to:

- a director, secretary or senior manager of a licensee or an applicant for a licence, or in a holding company of the licensee or applicant; or
- an individual who has more than 15 per cent of the total voting power (directly or indirectly) in a licensee or an applicant for a licence, or in a holding company of the licensee or applicant.

Licensing regimes for BALs and DTRLs did not exist at the time of the 2011 Regulation Review Consultation. Individuals involved in these licensees are now also covered by the disqualified individuals provisions in the Corporations Act.⁴² In order to more closely align the 2011 proposal with the current regulatory frameworks contained in the Corporations Act, the CFR now proposes that the fit and proper standard apply to those involved in BALs and DTRLs.

The Government is planning to consult separately on proposals to extend the Banking Executive Accountability Regime to apply to a broader range of financial services entities. The consultation will clarify the proposed scope of the regime, including the extent to which it applies to the Licensed Entities. Those proposals are distinct from the fit and proper standard described above, focusing instead on establishing a responsibility and accountability framework for directors and senior executives.

3.4 Change in control

New proposal

ASIC's consent will be required for a person to hold more than 15 per cent voting power in a Licensed Entity.

Large shareholders in a licensee can influence the business and operations of the licensee in a way that has an effect on its compliance with its obligations as a licensee. Currently, there is a requirement to notify ASIC of certain changes in the control of an AML, CSFL or DTRL.⁴³

Further, for a licensee that is a widely held market body, changes of control above a certain threshold are subject to approval by the Minister.⁴⁴ A widely held market body is an AML or CSFL, or a holding company of an AML or CSFL, that has been prescribed as such by regulation. The widely held market body arrangements are designed to ensure that Australia's national interest is taken into account in the ownership of specified AMLs and CSFLs.

However, unlike other licensing arrangements elsewhere in the financial system, such as for entities licensed by APRA, there is no change in control consent mechanism for entities that are not prescribed as widely held market bodies. A change in control consent mechanism would enable ASIC to assess the effect of the proposed change in control on the licensee's compliance with its obligations.

The CFR proposes that, for Licensed Entities that are incorporated in Australia, a person cannot hold more than 15 per cent voting power (directly or indirectly) in a licensee without ASIC's consent. ASIC

⁴² Division 2 of Part 7.4 of the Corporations Act.

⁴³ Sections 792B and 821B of the Corporations Act. Section 2.6.3 of the *ASIC Derivative Trade Repository Rules* 2013.

⁴⁴ Division 1 of Part 7.4 of the Corporations Act.

must give consent if ASIC has no reason to consider that the revised ownership structure will impede the ability of the licensee to meet its obligations under the Corporations Act. A time limit will apply for ASIC to decide whether to grant consent to facilitate commercial certainty.

The proposal to require consent, and to deal with the consequences of failing to do so, is based on the change in control framework which applies to registrable superannuation entities.⁴⁵ This proposal is intended to permit ASIC to review the potential effect on the licensee and its ability to meet its obligations that could occur as a result of the change in control. CFR proposes that transitional arrangements be included to ensure that existing holders would not be in breach for current ownership holdings. This proposal to require consent will operate alongside, and not replace, the current widely held market body arrangements. The latter arrangements consider whether the change is in the national interest of Australia, while the proposed new arrangements consider the effect on the licensee's continued compliance with its licence obligations.

3.5 Rule-making power

New proposal

ASIC may make rules for CSFLs for the purpose of promoting the fair and effective provision of clearing and settlement facility services.

To be effective, regulatory tools should be targeted and flexible, enabling the obligations of regulated entities to be tailored to relevant circumstances and adapted in response to new and emerging issues as financial markets evolve and innovate. Other than through the imposition of licence conditions under Ministerial delegation, ASIC cannot impose tailored conduct and business operation requirements on classes of CSFLs. This is inconsistent with ASIC's powers in relation to AMLs, BALs and DTRLs where ASIC can make rules imposing obligations on certain persons.⁴⁶

Although licence conditions may be imposed in relation to a broad range of matters, they are not well suited to imposing detailed obligations, or obligations that need to be imposed on multiple licensees. Furthermore, while the Minister has the ability to vary or impose conditions on an existing clearing and settlement facility licence (currently delegated to ASIC), this generally only occurs when there is a change to the facility's operations or the conditions under which it is operating. Rule-making powers provide the regulator with flexibility to adapt to changing market structures, practices and conditions, and to international developments, including for mutual recognition with overseas regulatory regimes that facilitates cross-border operations and competition.

The CFR proposes that ASIC is empowered to make rules for CSFLs for the purpose of promoting the fair and effective provision of clearing and settlement facility services. For example, rules could be written to implement those parts of the PFMLs for which ASIC has primary regulatory responsibility (i.e. those relating to efficiency and effectiveness, and communication procedures). The Minister's consent would be required before ASIC could make such a rule.

An ASIC rule-making power in relation to the fair and effective provision of clearing and settlement facility services would create the potential for overlap between an ASIC rule and the RBA's FSS. The CFR proposes that, to the extent of any conflict, the FSS would prevail. However, to ensure coordination between the Regulators in the exercise of their respective powers, the CFR proposes that ASIC be required to seek advice from the RBA about any proposed rules and that the RBA have the opportunity to give advice to the Minister as part of the process for seeking the Minister's consent to the making of the rules.

⁴⁵ Division 8 of Part 2A of the *Superannuation Industry (Supervision) Act 1993*.

⁴⁶ Sections 798G, 903A, 908CA, and 908CD of the Corporations Act.

The procedures and safeguards for this power would be consistent with ASIC's other rule-making powers for Market Integrity Rules, Derivative Transaction Rules, Derivative Trade Repository Rules, Financial Benchmark Rules and Client Money Reporting Rules.⁴⁷ This includes a requirement to consult, being subject to the consent of the Minister and being subject to parliamentary disallowance.

3.6 Information gathering

New proposals

ASIC (in relation to Licensed Entities) and the RBA (in relation to CSFLs) be able to obtain a report from an independent expert on specified matters.

The RBA be able to direct a CSFL to provide information.

It is critical that the Regulators, have access to accurate and timely information about the operations of licensees to enable them to form an accurate view of the adequacy of licensees' policies, procedures and operations in meeting their obligations under the Corporations Act. To this end, Licensed Entities currently have obligations to notify ASIC and the RBA of certain matters⁴⁸ and an obligation to give such assistance to the Regulators in relation to the performance of their respective functions that is reasonably requested.⁴⁹

The Minister has the power (currently delegated to ASIC) to require an AML or CSFL to provide a special report (including requiring an audit report on the special report) to ASIC.⁵⁰ ASIC has a similar power to require a BAL or DTRL to provide a special report.⁵¹ In addition, ASIC has broad information-gathering powers as the corporate regulator.⁵²

As detailed in Chapter 2, the CFR proposes that the power to require an AML or CSFL to provide a special report should be transferred from the Minister to ASIC, and to the RBA in relation to CSFLs.

The CFR proposes that, in addition to the power to commission a special report, and audit report on that special report, ASIC should be able to obtain a report from an expert on specified matters in respect of a Licensed Entity, and the RBA should have a corresponding power in respect of a CSFL. This additional power provides the Regulators with an avenue to access appropriate expertise from an independent source. In line with overseas regimes, the licensee would bear the costs and expenses of the expert.⁵³

The CFR also proposes a new specific information-gathering power for the RBA in relation to CSFLs to address situations where current notification and assistance powers may be insufficient. The power would allow the RBA to direct a CSFL to provide information related to the RBA's powers and functions as co-supervisor of CSFLs under the Corporations Act. The RBA must provide the CSFL with reasonable time to provide the information.

⁴⁷ Sections 798G, 901A, 903A, 908CA, 908CD, and 981J of the Corporations Act.

⁴⁸ Sections 792B, 821B, 821BA, 904C and 908BQ of the Corporations Act.

⁴⁹ Sections 792D, 821C, 904D and 908BR of the Corporations Act.

⁵⁰ Sections 794B and 823B of the Corporations Act.

⁵¹ Sections 904H and 908BV of the Corporations Act.

⁵² For example, Division 3 of Part 3 of the *Australian Securities and Investments Commission Act 2001*.

⁵³ For example, section 166(9) of the UK *Financial Services and Markets Act 2000*.

3.7 Directions powers

New proposals

The RBA be able to give directions in relation to specific matters where the RBA reasonably considers action is required to support financial stability.

The qualifier that compliance is required only when 'reasonably practicable' be

- removed from a CSFL's obligation in the Corporations Act to comply with the FSS
- absent from the RBA's new power to direct a CSFL to take action to comply with the FSS.

Remove the 21-day time limit on ASIC directions.

Reassignment of current directions powers

Under the Corporations Act, the Minister has the power to direct an AML or a CSFL to comply with their obligations under the Act.⁵⁴ ASIC has the power to direct an AML for the protection of people dealing in a financial product, including to suspend dealings in that product.⁵⁵ In addition, ASIC has the power to direct a CSFL for the protection of people dealing in a financial product, or if ASIC considers that the CSFL has not done all things reasonably practicable to ensure the facility's services are provided in a fair and effective way, or has not done all things reasonably practicable to reduce systemic risk.⁵⁶

Although it is a co-regulator of CSFLs, the RBA has no power to issue a direction to a CSFL. While the RBA may request that ASIC issue a direction in relation to the reduction of systemic risk, ASIC is not required to meet this request.⁵⁷ As discussed in Chapter 2, providing the Regulators with directions powers that align with their respective responsibilities and mandates will enable the Regulators to more effectively perform their designated roles under the Corporations Act.

This regulatory approach is consistent with the *Principles of Best Practice Regulation*, which state that regulators should have clear mandates, and should have the powers, resources and independence to enforce those mandates.

As set out in Chapter 2, the CFR proposes that the Minister's power to direct an AML or CSFL be transferred to ASIC, and the RBA in the case of a CSFL, in a manner appropriate to their respective responsibilities. In addition, it is proposed that ASIC's power to give a direction to a CSFL if it considers that the CSFL has not done all things reasonably practicable to reduce systemic risk be transferred to the RBA.

Taken together, these changes would allow the RBA to give directions to a CSFL in relation to its compliance with the FSS and the reduction of systemic risk.⁵⁸ ASIC would be able to give a direction to a CSFL for any other matters relating to the CSFL's compliance with its obligations under Part 7.3 of the Corporations Act and for the protection of people dealing in a financial product through a regulated facility.

⁵⁴ Sections 794A and 823A of the Corporations Act.

⁵⁵ Section 794D of the Corporations Act.

⁵⁶ Sections 823D and 823E of the Corporations Act.

⁵⁷ Section 823E(8) of the Corporations Act.

⁵⁸ The relevant obligations of the CSFL would be those in sections 821A(1)(aa), 821BA, 821C(3) and (4) of the Corporations Act.

Ancillary changes

The 2011 Regulation Review Consultation and 2015 Resolution Consultation also proposed a number of reforms ancillary to the reassignment of directions powers. These related to streamlining of the use of ASIC's current directions powers, protections for parties complying with a direction, and penalties for failing to comply with a direction. The CFR proposes that those changes be implemented.

The CFR consulted on streamlining ASIC's directions powers in 2011 and 2015.⁵⁹ The current model for many ASIC-issued directions to AMLs, CSFLs and DTRLs is based on a two-stage process. ASIC is required to explain to the relevant licensee why the direction is required and give them time to respond. At this stage, ASIC must decide whether the direction is still required and only then is a licensee required to comply.⁶⁰

The CFR proposes to streamline this process by removing the two-step process so that directions can be issued in a timely manner once an issue is identified. Where a regulator identifies a failure of a licensee to comply with its obligations, it is important that they are able to respond quickly and efficiently.

In 2011 and 2015, the CFR also noted that certain directions can only have effect for up to 21 days.⁶¹ The CFR now proposes that the 21-day time limit be removed so that a direction can remain in place for as long as is required for the licensee to take the required action, which may be longer than 21 days.

In 2015, the CFR consulted on a requirement for a systemically important domestically licensed market operator to develop a recovery plan. The CFR also consulted on a directions power for ASIC to support the implementation of recovery actions and the ability to direct a financial market to implement elements of its recovery plan in order to maintain financial system stability.⁶² These proposals have not changed since the 2015 Resolution Consultation, and are provided for context.

Statutory immunities will apply in connection with any reasonable actions taken in good faith by a CSFL, and other relevant parties (such as directors or officers), to comply with a direction by the RBA in relation to its financial stability mandate. This will reduce the risk that licensees delay compliance with a direction due to concerns that this conflicts with other obligations of the licensee (such as conflicts with directors' duties). A delay in complying with a direction during a crisis has the potential to exacerbate the financial stability risks that the direction is intended to address.

Sanctions for breach of directions and licence conditions

The CFR's response to the 2011 Regulation Review Consultation and the 2015 Resolution Consultation recommended broadening the range of sanctions available where licensees fail to comply with directions and licence conditions.⁶³ Earlier in 2019, the penalty framework across the Corporations Act was strengthened in response to recommendations from the ASIC Enforcement Review Taskforce. One of the CFR's recommendations in 2012 was that the scope of sanctions be extended to individual directors and officers of the licensee. The CFR is not proposing changes to this recommendation, except that that it be extended to also apply to BALs and DTRLs.

⁵⁹ Section 7.2 of the 2011 Resolution Consultation and section 6.3.2 of the 2015 Resolution Consultation.

⁶⁰ Sections 794D, 823D and 904G of the Corporations Act.

⁶¹ Sections 794D, 823D and 904G of the Corporations Act.

⁶² Sections 2.1.9 and 6.2.3 of the 2015 Resolution Consultation.

⁶³ Page 4 of the CFR's response to the 2011 Regulation Review Consultation and section 7.3 of the 2015 Resolution Consultation.

Specific RBA directions powers

In addition to the transfer to the RBA of ASIC's current power to direct a CSFL in respect of a breach of its obligations to comply with the FSS and do all other things necessary to reduce systemic risk, the CFR proposes that the RBA be given powers to make directions in relation to specific matters where it reasonably considers action is required to support financial stability. This reflects the significant financial stability consequences that decisions of a CSFL can have, even in circumstances where an actual breach of FSS obligations has not occurred.

For example, a central counterparty (CCP) typically has discretion to take actions to manage and mitigate the impact of a participant default. This is necessary because the nature of a default is unpredictable and requires a flexible response. However, this carries the risk that the CCP may take discretionary actions to protect itself that are harmful to broader financial stability. For example, these actions could harm the objective of maintaining continuity of access to FMI services by an ADI in resolution. The proposed powers would allow the RBA to make targeted interventions to prevent actions that may have unintended financial stability consequences or to require actions be taken to mitigate such consequences.

The form of these directions could include, for example:

- taking an action provided for under a CSFL's rules or procedures
- amending a CSFL's rules or procedures
- changing the share or other capital of a CSFL
- exercising rights (including termination rights) under a third-party agreement such as with a critical service provider or linked FMI.

Removal of the 'reasonably practicable' qualifier in FSS compliance

Compliance with the FSS is intended to promote CSFL conduct that is consistent with the overall stability of the Australian financial system. It is important that it is clear what CSFLs must do in order to comply with the FSS, and what conduct constitutes a breach of these requirements. However, the Corporations Act currently places a qualification on the requirement for CSFLs to comply with the FSS. CSFLs are required to comply only 'to the extent that it is reasonably practicable to do so'.⁶⁴

This qualifier means that in some situations it may be difficult to establish whether a CSFL has breached its FSS compliance obligations. In turn, this limits the enforceability of the FSS, as the CSFL may argue that additional compliance measures are not 'reasonably practicable'.

The 'reasonably practicable' qualifier is mirrored in ASIC's related directions power (that is proposed to be transferred to the RBA).⁶⁵ The current power requires that, for ASIC to give a direction in relation to compliance with the FSS, it must consider that the CSFL has not done all things reasonably practicable to reduce systemic risk in the provision of the facility's services. The issuance of such a direction may be open to challenge on the basis that the measures sought by the regulator to achieve compliance with the FSS are not 'reasonably practicable'. Even if such a challenge was unsuccessful, it could delay the implementation of actions required to address critical risks in a CSFL's operations.

The CFR proposes that a CSFL's obligation to comply with the FSS not be subject to the 'reasonably practicable' qualifier.⁶⁶ The CFR does not consider that this will place an increased regulatory burden on CSFLs, since the RBA must already consult prior to determining FSS, and takes into account the practicability of compliance as part of this process. It is also proposed that the RBA be able to issue

⁶⁴ Section 821A(1)(aa) of the Corporations Act.

⁶⁵ Section 823E(1)(a) of the Corporations Act.

⁶⁶ Section 821A(1)(aa)(i) of the Corporations Act.

a direction to comply with the FSS if it considers that the CSFL is not meeting its obligation to comply with the FSS; there will not be any qualification on this condition.

A similar qualification exists in relation to the obligation for a CSFL to do all other things necessary to reduce systemic risk,⁶⁷ and for ASIC's related directions power (proposed to be transferred to the RBA).⁶⁸ It is not proposed that these provisions be changed other than the transfer of the directions power to the RBA (i.e. they will retain the 'reasonably practicable' qualifier).

⁶⁷ Section 821A(1)(aa)(ii) of the Corporations Act.

⁶⁸ Section 823E(1)(b) of the Corporations Act.

4. Crisis management and resolution

4.1 Key points

- This chapter sets out some enhancements to crisis management powers over clearing and settlement facilities proposed in the 2015 Resolution Consultation.
- The CFR proposes that the resolution authority has the power to take control of a distressed clearing and settlement facility to facilitate the continuity of critical clearing and settlement services.
- The presence of a resolution regime will facilitate the continuity of critical clearing and settlement services during a crisis and increase the confidence that participants in Australian CSFLs have in the stability of the financial system should a crisis occur.

4.2 Background

Clearing and settlement facilities have become increasingly important to the financial system since the global financial crisis. They contribute to the interconnectedness of the global financial system through direct linkages between some facilities and through common participation by financial institutions and others that use their services. This heightens the need for their resilience and risk management arrangements to be robust. Regulators have therefore focused on clearing and settlement facilities having effective risk management and recovery arrangements.⁶⁹

As the PFMI recognises, if the risk management arrangements at a clearing and settlement facility were to fail, the flow-on effects to other parts of the financial system would be more likely to occur and to be disruptive. Such effects could arise as a result of a clearing and settlement facility:

- unwinding or reversing payments or deliveries;
- delaying settlement or the close out of transactions; or
- liquidating collateral, margin or other assets at fire sale prices.

Despite the extensive efforts to increase resilience of clearing and settlement facilities, their financial resources and recovery arrangements may not be sufficient to address losses in a way that is consistent with financial stability during a major crisis.

An economic shock of sufficient magnitude could threaten financial stability in a number of ways. A clearing and settlement facility could implement certain types of loss allocation arrangements in their operating rules that could adversely affect the overall stability of the Australian financial system, participants could lose confidence in a clearing and settlement facility and attempt to exit the service, or a clearing and settlement facility could fail in a disorderly fashion.

If any of these occurred, or a CSFL ceased to provide critical clearing and settlement services for any other reason, there could be severe implications for the Australian financial system. The proposed resolution regime would give a resolution authority the powers necessary to maintain the continuity of critical clearing and settlement services and support the overall stability of the Australian financial system.

⁶⁹ Under the internationally agreed PFMIs, implemented in Australia through the FSS, clearing and settlement facilities are required to have substantial financial resources available to absorb losses and to withstand a variety of 'extreme but plausible' stress scenarios. Clearing and settlement facilities must also have comprehensive recovery arrangements to return to normal following a stress event.

Internationally, regulators have recognised the need to have resolution powers in addition to requiring operators to have robust resilience and recovery arrangements. Resolution regimes for CCPs have been, or are being, put in place in a number of jurisdictions, including Europe, Hong Kong, New Zealand, Singapore, the United Kingdom and the United States of America.⁷⁰

In 2015, the CFR consulted on a proposed resolution regime for clearing and settlement facilities and derivatives trade repositories. This chapter builds on the outcome of that consultation, making a number of further proposals in relation to the design of the regime.

Changes to the CFR's proposed resolution regime reflect domestic and international developments since the 2015 Resolution Consultation. These include the legislation to enhance APRA's crisis management powers for ADIs and insurers that was enacted in 2018 and the *Guidance on Central Counterparty Resolution and Resolution Planning* released by the FSB in July 2017.

The CFR proposes to develop a resolution regime for Domestic CSFLs only, and not for DTRLs at this time. Development of a resolution regime for DTRLs is being deferred until such a time as there is likely to be a domestically incorporated systemically important DTRL in Australia.

4.3 Objectives of the resolution regime

New proposal

Omit the previously proposed detailed considerations from the objectives of resolution.

The objectives of the resolution regime should be concise and clear, allowing the resolution authority to operate with a well-defined purpose throughout the resolution of a Domestic CSFL.

Consistent with proposals in the 2015 Resolution Consultation, the CFR proposes that the objectives of the resolution regime are to:

- maintain the overall stability of the financial system
- provide for the continuity of clearing and settlement services that are critical to the smooth functioning of the financial system.

The CFR does not propose to include the more detailed considerations outlined in the 2015 Resolution Consultation, on the basis that this approach more clearly communicates the purpose of the resolution regime.

4.4 Information gathering

New proposals

Domestic CSFLs and their related bodies corporate will be obliged to give assistance to the resolution authority.

Powers for the statutory manager and resolution authority to gather information from third parties during resolution.

It is critical that the resolution authority has access to accurate and timely information about the operations of Domestic CSFLs and their related bodies corporate. The resolution authority requires information to develop resolution plans and assess whether resolution powers would be effective for individual Domestic CSFLs. The resolution authority may be interested in information about

⁷⁰ The focus on CCPs reflects the greater risks that they face.

services provided by, and arrangements of, other group entities on which the operation of the clearing and settlement services rely, or which could potentially affect the Domestic CSFL.

If a crisis occurs, timely access to information about the crisis events and potential exposures of the Domestic CSFL will be crucial to the resolution authority being able to evaluate possible resolution strategies and implement a resolution plan. Delays caused by uncertainty around whether or not the resolution authority has the power to request particular information could impede resolution.

The 2015 Resolution Consultation did not recommend specific information-gathering powers for resolution. However, the CFR now believes they should be included in the regime so that it is clear that the resolution authority can require the provision of information.

The CFR proposes the following information-gathering powers:

- Obligation to assist the resolution authority – an obligation for Domestic CSFLs and their related bodies corporate to give such assistance to the resolution authority as it reasonably requests in relation to the performance of its resolution functions. These functions include resolution planning, assessing resolvability of a CSFL and conducting a resolution.
- Powers to gather information from other individuals during resolution – a statutory manager may require that a current or former officer of an entity under statutory management provide any information relating to the business of that entity. In addition, during the resolution of a Domestic CSFL, the resolution authority may require any person to give them information relating to the business of the Domestic CSFL in resolution, or their related bodies corporate, where it reasonably believes they have such information and the resolution authority reasonably requires the information for the performance of its functions.

4.5 Obligation to notify the resolution authority of certain matters

New proposal

Obligation on Domestic CSFLs and their related bodies corporate to notify the resolution authority of certain matters.

The financial position or viability of a Domestic CSFL and its related bodies corporate could deteriorate quickly in a period of market stress. If an emerging crisis affects the solvency or viability of a Domestic CSFL or its related bodies corporate, the resolution authority will need to be promptly informed of the possible need for resolution, and to be able to respond in a timely manner as needed.

The CFR proposes a new obligation for Domestic CSFLs and their related bodies corporate to immediately inform the resolution authority once they become aware of certain circumstances relating to the ability of the entity to meet its obligations, the financial position of the entity or its corporate group, or threats to the continuity of critical clearing and settlement services. These proposals are similar to requirements imposed upon ADIs.⁷¹

The appointment of an external administrator⁷² to a Domestic CSFL or to a related body corporate could constitute a default event in a contract entered into by the Domestic CSFL or related bodies corporate. If, based on such a default event, a termination right was exercised in respect of a significant contract with a third-party service provider, the continuity of the clearing and settlement services operated by the Domestic CSFL could be jeopardised. For this reason, the CFR also proposes that any person seeking to appoint an external administrator to a Domestic CSFL, or a related body

⁷¹ Sections 13(3) and 62A of the *Banking Act 1959*.

⁷² Any of a liquidator (including a provisional liquidator), a receiver, manager, managing controller, receiver and manager or other controller, a voluntary administrator or administrator of a deed of company arrangement or a person administering a scheme of arrangement.

corporate of a Domestic CSFL, must give one week's prior written notice to the resolution authority.⁷³ Meeting this requirement would be necessary for the valid appointment of the external administrator to occur.

4.6 Resolution planning and resolvability

New proposals

An obligation for the resolution authority to conduct resolution planning.

The power for the resolution authority to assess the resolvability of Domestic CSFLs.

The power for the resolution authority to determine resolvability standards.

The power for the resolution authority to give resolvability directions.

The resolution authority will need to conduct resolution planning to maximise the likelihood of successful resolution. This will include conducting resolvability assessments, which are assessments of the operations of a Domestic CSFL to determine whether there are any obstacles to the effective use of resolution powers.

In the 2015 Resolution Consultation, the CFR proposed that the resolution authority conduct resolvability assessments and develop resolution strategies and operational resolution plans, but did not propose specific powers to undertake these functions. Having further considered the conduct of resolution planning and resolvability assessments, the CFR now proposes the inclusion of specific powers and obligations relating to preparing for the possible use of resolution powers.

The CFR proposes:

- an obligation for the resolution authority to conduct resolution planning with respect to Domestic CSFLs that are considered by the resolution authority to provide clearing and settlement services that are critical to the functioning of the Australian financial system
- a power for the resolution authority to assess the resolvability of Domestic CSFLs
- a power for the resolution authority to determine resolvability standards to require that the affairs of Domestic CSFLs and their related bodies corporate are conducted in such a way that they do not impede resolution of the Domestic CSFL
- where the resolution authority considers that a Domestic CSFL or related body corporate is not complying with a resolvability standard, the resolution authority will be empowered to direct them to take specified measures which the resolution authority considers are required for them to observe those standards
- a power for the resolution authority to direct a Domestic CSFL or related body corporate to address aspects of its business arrangements that the resolution authority considers are impediments to the effective exercise of resolution powers.

Taken together, these powers will allow the resolution authority to plan for resolution and remove obstacles to the effective exercise of resolution powers.

The CFR proposes that a decision of the resolution authority to give a resolvability direction will be subject to merits review by the Administrative Appeals Tribunal.

The CFR notes that the expanded resolution powers, proposed below, would increase the flexibility of the resolution authority to respond to a crisis. However, those additional powers do not remove

⁷³ This proposal is similar to the requirement under section 62B of the *Banking Act 1959*.

the need for resolvability powers, as impediments may exist that could prevent effective resolution. It is preferable, where feasible, to deal with potential impediments before a crisis occurs.

4.7 Conditions for resolution

New proposal

The resolution regime will not contain specific conditions to select between resolution powers. Instead, once a general condition is satisfied, a range of resolution powers will be enlivened. Particular powers may have additional specific or alternate conditions.

Clear conditions for resolution are required to ensure that resolution powers are available to regulators as soon as they are needed during a crisis. Additionally, legislating conditions for resolution provides transparency about the circumstances in which resolution powers will be available to the resolution authority.

The CFR proposes that the resolution regime contain a set of general conditions that, if any one is met, allow the resolution authority to use any of the resolution powers in the resolution regime (subject to any specific condition that must also be satisfied for the use of a particular power).⁷⁴ This approach gives the resolution authority the flexibility to choose which resolution strategy is appropriate in the circumstances. This is a departure from the 2015 Resolution Consultation which proposed that additional specific conditions would be used to select between particular resolution actions.⁷⁵ This change is proposed because the CFR considers it unlikely that the best possible resolution strategy could be predicted in advance.

The general conditions for resolution will relate to the solvency or viability of a Domestic CSFL and to threats to the continuity of clearing and settlement services, including significant operational outage or distress, or a failure to comply with relevant directions. This is consistent with the general conditions outlined in the 2015 Resolution Consultation paper.⁷⁶

4.8 Rationale for expanded scope of key resolution powers

To maintain the continuity of clearing and settlement services of a Domestic CSFL during resolution, the resolution authority must secure uninterrupted and reliable access to the support services (such as staff, computer infrastructure and other business functions) and resources (including funding) needed to operate the Domestic CSFL. Because these services and resources may be provided by other entities within the Domestic CSFL's corporate group, the resolution authority needs the capability to secure reliable access regardless of the corporate structure of the group.

In many circumstances, the resolution authority may be able to maintain access to these services and resources through the use of its power to direct other entities within the corporate group.

However, there may be some situations when this approach is not effective. For example, timely and decisive action may be prevented where the entity is under operational or financial stress and unable to comply with a direction, or where compliance with a resolution direction could be delayed because of potential perceived conflicts with directors' statutory or other duties to the entity to which they are appointed. In turn, this may compromise the effectiveness of resolution of the Domestic CSFL by disrupting services or funding essential to the continued operation of the clearing and settlement services.

⁷⁴ As noted in section 4.9 below, in respect of transfer powers, a Ministerial declaration could be relied on by the resolution authority instead of a general condition.

⁷⁵ Section 3.1.

⁷⁶ Section 3.1.

The CFR proposes that if the resolution authority considers that it is necessary for the effective resolution of the Domestic CSFL, the resolution authority could use certain resolution powers in relation to a related body corporate. The powers include appointing a statutory manager to a related body corporate in addition to a Domestic CSFL, or transferring the business or shares of a related body corporate along with those of a Domestic CSFL. Use of specific powers in relation to related bodies corporate is discussed further in the relevant sections below.

This approach will provide the resolution authority with more flexibility and control in designing and executing resolution strategies. It will increase confidence that, in a crisis, regardless of the corporate structure and business arrangements of the Domestic CSFL, critical clearing and settlement services will be maintained.

4.9 Transfer powers

New proposals

The power of the resolution authority to transfer the shares of a Domestic CSFL.

The power of the resolution authority to transfer the shares, or all or part of the business, of a related body corporate of a Domestic CSFL where necessary for the effective resolution of the Domestic CSFL.

Transfer powers allow the resolution authority to remove a clearing and settlement facility from a distressed group and transfer it to a solvent receiving body which could be a third-party or government-owned bridge institution.

The 2015 Resolution Consultation proposed the power to transfer the business of a Domestic CSFL. Where a Domestic CSFL is to be resolved using transfer, it may also be necessary to transfer a related body corporate with the Domestic CSFL. For example, the transfer of an intra-group provider of operational services to the bridge entity may be the best way for the resolution authority to secure continued provision of those services to the Domestic CSFL. The CFR now proposes that transfer powers will extend to related bodies corporate of a Domestic CSFL where this is necessary for the effective resolution of the Domestic CSFL.

The CFR also proposes that the resolution authority will have the power to transfer the shares of a Domestic CSFL and any related body corporate (where necessary). A transfer of shares would allow, for example, a transferred Domestic CSFL to retain its Australian clearing and settlement facility licence. The proposal for the resolution authority to have the ability to transfer shares is consistent with APRA's ability to transfer the shares or business of an ADI in resolution.

As envisaged in the response to the 2015 Resolution Consultation, transfer powers would not be able to be exercised in a way that disrupted netting sets, or separated collateral from associated positions. In effecting a transfer, netting sets and related positions and collateral would be required to be transferred intact.

The proposed transfer regime in respect of Domestic CSFLs will be similar to the equivalent regime for ADIs in the *Financial Sector (Transfer and Restructure) Act 1999*. As with the ADI regime, it is proposed that the Minister could declare that a transfer should occur (such that a general condition for resolution would not need to be met). The resolution authority will then determine whether a transfer will occur.

Although reforms proposed elsewhere in this paper provide for operational decisions to move from the Minister to the Regulators, the Minister retains powers in relation to strategic matters. Allowing a Ministerial declaration to initiate the transfer process (as an alternative to a general condition for resolution) recognises the Minister's overarching responsibility for strategic matters and matters of

national importance. This mechanism is designed to provide flexibility and certainty as to when a transfer can be undertaken, as it may be difficult to predict all circumstances where this power may be needed to facilitate resolution. All other relevant specific conditions for transfer, which will include that the resolution authority considers that having regard to the objectives of resolution the transfer is appropriate, must still be satisfied.

4.10 Statutory management

New proposal

The resolution authority may appoint a statutory manager to a related body corporate of a Domestic CSFL where necessary for the effective resolution of the Domestic CSFL.

Under statutory management, the resolution authority, or a person appointed by the resolution authority, would temporarily take control of a distressed Domestic CSFL and manage it in a way that promotes financial stability, with the aim of restoring it to viability so that it can continue to provide its critical clearing and settlement services.

The 2015 Resolution Consultation proposed that the resolution authority be given the power to appoint a statutory manager to a Domestic CSFL if a general condition for intervention was met.⁷⁷ The CFR now proposes that the resolution authority should also be able to appoint a statutory manager to a related body corporate of a Domestic CSFL that is under, or that is to be placed under, statutory management, if the resolution authority considers this is necessary for the effective resolution of the Domestic CSFL. This may include circumstances where the Domestic CSFL's statutory manager cannot obtain reliable access to services or funding or other business services provided by the related body corporate that are necessary for the continuation of the Domestic CSFL's clearing and settlement services. This may be because the related body corporate is unable, or unwilling, to provide the service or funding or to operate its business.

The statutory manager will be able to exercise any power of the Domestic CSFL or related body corporate, or of any of its officers. The statutory manager will also have a range of additional statutory powers to allow it to effectively manage the distressed entity. While the resolution authority will have the power to remove and replace a director, officers will not be automatically removed from office; instead, the exercise of their powers and functions would be suspended for the duration of the statutory management.

As envisaged in the 2015 Resolution Consultation, the CFR proposes that the statutory manager will have legal protection against liability for actions taken or not taken in good faith in the exercise of their powers or performance of their functions or duties, including in respect of insolvent trading.⁷⁸

4.11 Resolution direction powers

New proposal

The resolution authority may direct a related body corporate of a Domestic CSFL where necessary for the effective resolution of the Domestic CSFL.

The CFR proposes that the resolution authority would be able to issue a resolution direction to a Domestic CSFL and, when necessary for the Domestic CSFL's resolution, to a related body corporate. This power will allow the resolution authority to direct a body corporate to take specified actions

⁷⁷ Section 3.2

⁷⁸ Section 3.2.1.

that are necessary for resolution. In some circumstances, this may avoid the need for the use of more invasive resolution powers.

The CFR further proposes that the types of directions that can be given to a related body corporate be expanded beyond the provision of services or funding under ex-ante legal agreements as was proposed in the 2015 Resolution Consultation.⁷⁹ For example, a resolution authority may direct a related body corporate to:

- retain funds or certain assets during the Domestic CSFL's resolution so that the financial viability of the corporate group can be maintained
- take action to facilitate the recapitalisation of the Domestic CSFL.

The CFR proposes that penalties would apply if a directed entity failed to comply with a resolution direction. The resolution authority will also be able to apply to court for an order obliging the directed entity to comply with a resolution direction. So that resolution directions are actioned quickly and with certainty, resolution directions will not be subject to merits review.

4.12 Stays

New proposals

There will not be a time limit on the stay on exercise of contractual rights based on a default event arising from a resolution action.

During resolution, the resolution authority will be able to temporarily suspend contractual termination rights of a counterparty.

During resolution, the resolution authority will be able to require a related body corporate to continue to supply services or facilities necessary to enable a Domestic CSFL in resolution to operate effectively.

As envisaged in the 2015 Resolution Consultation, the CFR proposes that a stay regime operate during resolution to ensure that the ability of a Domestic CSFL to provide its services is not undermined through the termination of key contracts. An effective resolution regime needs to prevent, as far as possible, pre-emptive actions by contractual counterparties impeding the ability of the resolution authority to implement an orderly resolution or the ability of the Domestic CSFL in resolution to continue to operate.

The CFR proposes that exercise of a resolution power will not, by itself, allow a counterparty to a contract (including a market-netting contract) with a Domestic CSFL or related body corporate to exercise early termination or other rights. The exclusion of a resolution action as a trigger for the exercise of termination rights would not prevent counterparties from exercising contractual termination rights for other reasons during resolution, or prevent CCP participants from continuing to clear new transactions, including entering new transactions that would have the effect of closing out existing positions.

This proposal is broadly consistent with the 2015 Resolution Consultation, which proposed that the resolution authority would decide after 48 hours whether the FMI should be wound up (in which case, the stay would be lifted) or whether the FMI would be restored to financial viability (in which case, the stay would remain in place indefinitely).

The CFR now also proposes that the resolution authority will have the power to issue the following notices during resolution:

⁷⁹ Section 6.2.7.

- Notice to suspend termination rights – a notice to a contractual counterparty of a Domestic CSFL or related body corporate temporarily suspending their contractual termination rights during resolution, provided that payment and delivery obligations and the provision of collateral continue to be performed by the Domestic CSFL or related body corporate. This is intended to address, for example, a scenario where a key third-party service provider has an ‘at will’ termination right. The resolution authority must have regard to the impact a suspension of termination rights might have on the overall stability of the financial system before exercising this power.
- Continuity obligations – a notice to a related body corporate service provider of a Domestic CSFL requiring it to continue to provide services or facilities for a specified period, where necessary to enable the Domestic CSFL to continue to operate effectively during resolution. This would be subject to a right of the service provider to receive reasonable consideration.

The proposed stay regime is modelled on comparable international regimes and is consistent with the recommendations of the FSB’s *Key Attributes of Effective Resolution Regimes for Financial Institutions*.

4.13 Moratorium

New proposals

The moratorium will include a prohibition on enforcement proceedings (with exceptions).

So that the resolution objectives are not compromised by time-consuming and costly litigation, the CFR proposes that a moratorium will apply preventing a person from taking certain litigation and enforcement actions in relation to the body corporate or its property during the statutory management or transfer of a Domestic CSFL or related body corporate.

For example, a statutory manager may need unimpeded access to property of a Domestic CSFL to continue to operate the clearing and settlement services, without any creditors enforcing their rights over that property.

The moratorium will apply to creditors and other parties that have rights in relation to the body corporate in resolution or its property. The following actions will be prohibited without the consent of the statutory manager, resolution authority or leave of the Court:

- beginning or continuing a court or tribunal proceeding in relation to the body corporate or its property
- enforcing any security that may be attached to any property that the body corporate owns, uses, possesses, occupies or otherwise has any interest in
- disposing of the body corporate’s property
- claiming, recovering or taking possession of any property that the body corporate uses, possesses or occupies by a secured party, lessor or owner.

These proposals expand upon the 2015 Resolution Consultation, which only proposed a moratorium on non-enforcement proceedings, for example court proceedings or arbitration.⁸⁰

As envisaged in the 2015 Resolution Consultation, it is intended that the protections provided by the *Payment Systems and Netting Act 1998* in relation to approved real-time gross settlement systems, approved netting arrangements, close-out netting contracts and market-netting contracts will not

⁸⁰ Section 3.3.

be disturbed by the moratorium, aside from the prohibition on beginning or continuing court or tribunal proceedings.

4.14 Confidentiality

New proposal

The resolution authority will be able to issue a secrecy determination or a confidentiality notice to certain parties.

The CFR notes that transparency around the use of resolution powers is important and that in many circumstances market confidence will be best served by participants having a clear and timely understanding of actions that are being taken by the resolution authority to support continuity of clearing and settlement services and to promote financial stability. However, the resolution authority must have the capacity to impose confidentiality when required.

The release of information about the use of resolution powers, or even preliminary discussions with the resolution authority, may detrimentally affect market confidence in a Domestic CSFL before and during a crisis, and may contribute to financial system instability. To minimise this risk, the resolution authority will have the ability to impose confidentiality requirements on certain parties.

The CFR now proposes that the resolution authority will be able to issue a confidentiality notice to certain parties (including a Domestic CSFL, related body corporate or bidders in a sale process) requiring that specified information or documents provided by the resolution authority in the course of resolution be kept confidential.

In addition, the CFR now proposes that the resolution authority will be able issue a secrecy determination with a resolution direction. The determination will restrict the directed entity from disclosing that the direction had been given.⁸¹

4.15 Cross-border issues

New proposal

The resolution authority may recognise the resolution of an Overseas CSFL and use resolution powers to cooperate with foreign authorities.

Power of the resolution authority to direct an Overseas CSFL in resolution in respect of its Australian business, assets and liabilities.

For the most part, the resolution powers outlined in this chapter will be exercisable only in relation to domestically incorporated holders of an Australian clearing and settlement facility licence. However, it is necessary to consider how the resolution authority would respond to resolution of overseas incorporated holders of an Australian clearing and settlement facility licence. It is expected that, in the event of a crisis affecting an Overseas CSFL, their home regulator would be primarily responsible for resolution.

Consistent with the approach outlined in the 2015 Resolution Consultation, the CFR proposes that Australian authorities should have the capacity to take limited action to support resolution by overseas authorities in respect of those Overseas CSFLs.

⁸¹ This is based on a similar power that is part of APRA's crisis management regime for ADIs and insurers; section 11CH of the *Banking Act 1959* and 109 of the *Insurance Act 1973*.

The CFR proposes that:

- the resolution authority be empowered to recognise the resolution of an Overseas CSFL and to use its resolution powers in support
- clearing and settlement facilities be excluded from the application of the Model Law on Cross-Border Insolvency, as applied by the *Cross-Border Insolvency Act 2008*, on the basis that they would have a specialised insolvency regime (as is the case for ADIs and insurers).

As envisaged in the response to the 2015 Resolution Consultation, the CFR proposes that recognition of an Overseas CSFL's resolution would be supplemented by a power of the resolution authority to give a direction to the Overseas CSFL with respect to its Australian assets and liabilities.⁸² Such a directions power may be used, for example, where a home resolution authority acted in a way that adversely affected Australian interests. This is consistent with the *Key Attributes of Effective Resolution Regimes for Financial Institutions*, which contemplates powers for a resolution authority to support a foreign resolution or, in exceptional cases, to take measures on its own initiative to preserve local financial stability.⁸³

4.16 Unchanged aspects of resolution regime

New proposal

There are no new proposals in this section.

A number of proposals have not changed materially since the 2015 Resolution Consultation. These include:

- arrangements for temporary public funding during resolution⁸⁴
- statutory immunities for directed entities (and others including related bodies corporate, officers, senior managers and employees) in respect of reasonable actions taken in good faith to comply with a resolution direction⁸⁵
- arrangements for reasonable compensation along the lines of section 69E of the *Banking Act 1959* and in accordance with paragraph 51(xxxi) of the Australian Constitution (concerning the acquisition of property on just terms).⁸⁶

⁸² Section 3.4.

⁸³ Section 7.3.

⁸⁴ Section 4.4. Approaches to addressing the costs of resolution remain an area of focus for international regulators. For example, the FSB's *Financial resources to support CCP resolution and the treatment of CCP equity in resolution: Discussion paper for public consultation*. Available at <<https://www.fsb.org/2018/11/financial-resources-to-support-ccp-resolution-and-the-treatment-of-ccp-equity-in-resolution/>>. Once this work is completed the agencies will consider whether changes to the proposed resolution regime are appropriate.

⁸⁵ Section 4.2.

⁸⁶ Section 4.1.

Appendix A

A.1 The role of FMIs in the financial system

This consultation paper covers several types of entities – collectively called FMIs – that play a role in the operation of financial markets and the financial system more broadly.

Financial markets are facilities through which offers to buy and sell financial products, such as securities or derivatives, are regularly made and accepted. Financial markets may also have a listing function.

Clearing and settlement facilities provide a regular mechanism for the parties to transactions relating to financial products to meet obligations to each other that arise from entering into the transactions. Clearing and settlement facilities can include the following, among others:

- *CCPs* are facilities that undertake clearing, which is a post-trade and pre-settlement function to manage trades and associated exposures. A CCP interposes itself between counterparties to transactions executed in the markets it serves, becoming principal to each transaction and undertaking to perform obligations under these trades. In doing so, it assumes the counterparty risk for the trade.
- *Securities settlement facilities* facilitate settlement of securities transactions. Settlement is the point at which title is transferred via the facility and the counterparty exposures associated with a transaction are eliminated.

Derivative trade repositories are facilities that centrally collect and maintain records on OTC derivative transactions and positions. These records are made available to regulators and, to an appropriate extent, the public.

Benchmark administrators are entities that administer financial benchmarks. These are used to: determine the pay-out or value of financial products or contracts (for example the bank bill swap rate); determine the price at which a financial instrument may be dealt or its value; or to measure the performance of a financial instrument.

Each of the functions performed by these types of entities is important to the smooth functioning of the Australian financial system.

A.2 The existing regulatory framework

This section briefly sets out the current regulatory arrangements, with a focus on the responsibilities of regulators.

Relevant legislation

Entities covered by this paper are regulated under Chapter 7 of the Corporations Act.

The main objects of Chapter 7 of the Corporations Act are to promote:⁸⁷

- confident and informed decision-making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services
- fairness, honesty and professionalism by those who provide financial services

⁸⁷ Section 760A of the Corporations Act.

- fair, orderly and transparent markets for financial products
- the reduction of systemic risk and the provision of fair and effective services by clearing and settlement facilities.

The following entities are among those regulated under Chapter 7 of the Corporations Act:

- AMLs. Operators of financial markets in Australia are regulated under Part 7.2 of the Corporations Act.
- BALs. Unless exempt, administrators of significant financial benchmarks are regulated under Part 7.5B of the Corporations Act.⁸⁸
- CSFLs. Operators of clearing and settlement facilities are regulated under Part 7.3 of the Corporations Act.
- DTRLs. Operators of derivative trade repositories identified as being required to be licensed under the Corporations Regulations are regulated under Part 7.5A of the Corporations Act.

Minister

The Minister currently has the power (after considering any relevant advice from ASIC and the RBA) to grant Australian clearing and settlement facility licences and Australian market licences. The Minister may also exercise a range of powers relating to AMLs and CSFLs. These include the powers to impose and vary conditions on a licence, and the power to suspend or cancel a licence. The Minister may also give directions to these types of Licensed Entities, and can review directions given by ASIC. The Minister also has an operating rule disallowance power for domestic AMLs and CSFLs.

Some of the Minister's powers have been delegated to ASIC since 2016. Under delegation arrangements, the Minister's delegate is acting as the Minister, not as a representative of ASIC. Delegation is at the Minister's discretion and could be withdrawn at any time.

The Minister has not delegated responsibility for a range of more strategic powers, such as consenting to ASIC making Market Integrity Rules, approval of applications to exceed the 15 per cent voting power limit in respect of widely held market bodies, or certain provisions in respect of compensation arrangements for markets.

Australian Securities and Investments Commission

ASIC is the primary regulator for AMLs, BALs and DTRLs, and co-regulates CSFLs with the RBA. It is responsible for granting Benchmark Administrator licences and derivative trade repository licences. ASIC supervises the Licensed Entities, and focuses on monitoring and enforcing compliance of Licensed Entities with their obligations under Part 7 of the Corporations Act. In relation to CSFLs, ASIC has an additional focus on the operator's obligation to operate the clearing and settlement facility in a fair and effective manner. In relation to AMLs, ASIC has an additional focus on the operator's obligation to ensure the market is fair, orderly and transparent. ASIC has primary responsibility for enforcement activities with respect to the Licensed Entities.

ASIC has the power to issue directions, although the Minister may override certain ASIC decisions and ASIC's use of these powers is constrained in some instances by the drafting of the current directions powers and procedural steps required before action can be taken. ASIC has a rule-making power for AMLs, BALs and TRLs, but not CSFLs.

⁸⁸ An administrator of a financial benchmark that is not a significant financial benchmark may nevertheless apply to be licensed in Australia.

In performing its functions and exercising its powers, ASIC must strive to:⁸⁹

- maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy
- promote the confident and informed participation of investors and consumers in the financial system
- administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements
- receive, process and store, efficiently and quickly, the information given to ASIC under the laws that confer functions and powers on it
- ensure that information is available as soon as practicable for access by the public
- take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it.

Reserve Bank of Australia

The RBA regulates CSFLs alongside ASIC. The RBA has the power to determine FSS⁹⁰ and to assess whether CSFLs comply with the FSS⁹¹ and do all other things necessary to reduce systemic risk. The RBA, under the oversight of its Payments System Board, is required by the *Reserve Bank Act 1959* to exercise its powers in relation to CSFLs in a way that will best contribute to the overall stability of the financial system.⁹²

The RBA's focus on financial stability complements ASIC's focus on the fair and effective provision of services by CSFLs, requiring close cooperation between the two regulators to manage the interaction between their respective mandates. The RBA has limited compliance and enforcement powers to carry out its responsibilities, although it may ask ASIC to issue a direction to a CSFL in relation to the reduction of systemic risk.

Other regulators

The ACCC currently has no specific powers under the Corporations Act for the regulation of the four types of Licensed Entities. However, it has responsibility for promoting competition and fair trading in the Australian economy, and the Licensed Entities must comply with the *Competition and Consumer Act 2010*. The ACCC also plays a non-legislative advocacy role in competition in clearing and settlement of cash equities in Australia, working with the CFR.

⁸⁹ Section 1(2) of the *Australian Securities and Investments Commission Act 2001*.

⁹⁰ Section 827D of the Corporations Act. The FSS are based on the CPMI-IOSCO PFMI.

⁹¹ Section 823CA of the Corporations Act.

⁹² Section 10B(3)(c) of the *Reserve Bank Act 1959*.

Appendix B

B.1 Summary of proposals

This table summarises the entity scope for proposals set out in chapters 2 and 3 of this paper. Existing powers that are not to be changed or enhanced are not shown in this table.

Section	Proposal	AML	BAL	CSFL	DTRL
Chapter 2 – Enhancing the licensing regimes					
2.3	Transfer to ASIC of the Minister’s powers in relation to licensing and related matters that are currently delegated to ASIC	Blue	Green	Blue	Green
2.4	Grounds for suspension or cancellation of licence	Blue	Blue	Blue	Blue
2.4	Overseas entities – requirement to be licensed	Blue	Grey	Blue	Grey
2.4	Location requirements	Blue	Grey	Blue	Grey
2.4	Domestic clearing and settlement facility licences	Grey	Grey	Blue	Grey
2.5	Prescribed financial market – declaration power	Blue	Grey	Grey	Grey
2.6	Widely held market body – declaration power	Blue	Grey	Blue	Grey
Chapter 3 – Enhancing supervision and enforcement					
3.3	Fit and proper standard	Blue	Blue	Blue	Blue
3.4	Change in control consent	Blue	Blue	Blue	Blue
3.5	ASIC rule-making power	Green	Green	Blue	Green
3.6	ASIC and RBA (CSFL only) power to require a special report or an expert report	Blue	Blue	Blue	Blue
3.7	RBA direction to comply with FSS or reduce systemic risk, information gathering and specific directions	Grey	Grey	Blue	Grey
3.7	ASIC directions powers – streamlining	Blue	Grey	Blue	Blue
3.7	Remove ‘reasonably practicable’ qualifier from obligation to comply with the FSS	Grey	Grey	Blue	Grey

Key:

Blue: New or amended power in this paper

Green: An equivalent or comparable power exists

Grey: Not applicable to this type of entity