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FMI Regulatory Reforms Consultation Submissions
FMI Section
Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

By email: FMIconsultation@cfr.gov.au

Dear Sir/Madam

Consultation Paper on Financial Market Infrastructure Regulatory Reforms

Chi-X Australia Pty Ltd (**Chi-X**) is grateful for the opportunity of providing a submission in response to the consultation paper released by the Council of Financial Regulators on Financial Market Infrastructure Regulatory Reforms (the CP).

This submission is segmented as follows:

(a) overarching comments in this covering letter on:

- The Resolution Proposals;
- The Nature of Financial Market Infrastructure and FMI Providers;
- Competition Issues;
- Further work to be done;

(b) a table in **attachment one** that lists the CP proposals and CXA feedback on each.

Chi-X is supportive of some proposals in the CP but is of the view that the groundwork has not been undertaken to justify some new measures identified in **attachment one**. In circumstances where the regulations could have a negative impact on competition between providers of financial market infrastructure, this defect needs to be addressed before those identified measures become law. It is not clear to Chi-X how the proposals for these measures will comply with the Government's Best Practice Guidelines unless a further consultation process is undertaken in respect of each.

The Resolution Proposals

The CP fails to identify and discuss critical issues in the practical ability of Australia to properly implement a globally aligned resolution regime. Some of those issues were a feature of the IMF's

report on the Supervision, Oversight, and Resolution Planning of Financial Market Infrastructures[1]. Chi-X appreciates the context provided by the global genesis of the resolution proposals and the desire of the Council of Financial Regulators (CFR) to align the theoretical legislative framework with global best practice. However, Chi-X is of the view that it may not be practically possible for Australia to comply with global best practice as long as ASX remains the wholly integrated entity it is today.

This is no doubt one reason why the IMF has recommended that:

> *"[the ASX} should consider addressing CCP-specific risks more directly…..ASX should consider establishing CCP specific internal risk committees, dedicated CCP-specific risk arrangements and staffing, risk management systems, and resolution friendly shared services agreements that account for intra-group inter-dependencies"[2].*

The practical issues relating to the proposed resolution regime are apparent from the ASX submission to the FSB Consultation on Financial resources to support CCP resolution and the treatment of CCP equity in resolution – see https://www.fsb.org/wp-content/uploads/ASX.pdf. ASX highlights that a resolution regime enabling Australian regulators to step in at parent level, which may be essential for the effective resolution regime at any wholly integrated entity that does not have a standalone CCP, would likely result in ASX restructuring their operation:

> *The ability to step in at parent level or to give rights to claim compensation against parent company equity would likely result in integrated groups restructuring their operation. A decision to de-integrate a CCP for this reason could result in the loss of significant efficiencies derived from the CCP's membership of the broader financial market infrastructure group, and a consequential increase in the cost of clearing.*

The Nature of Financial Market Infrastructure

Financial market infrastructure is integral to the economic well-being of Australia and all Australians. It plays a critical and central role in the efficient and transparent raising and allocation of capital to economically productive and job creating areas. Globally competitive financial market infrastructure is essential if Australia is to continue to grow its regulated financial markets and presence among the world's leading markets.

It is relevant to note that at a time when the regulatory burden on regulated markets is increasing, alternate, less transparent forms of raising capital are emerging and growing.

While it may seem obvious, it is also worthwhile emphasising that FMI Providers are not banks and do not provide financial advice, trade in financial products on a personal or agency basis, or hold client money. They are not all multi-billion dollar companies.

[1] See https://www.imf.org/en/Publications/CR/Issues/2019/02/13/Australia-Financial-Sector-Assessment-Program-Technical-Note-Supervision-Oversight-and-46609

[2] See paragraphs 59 and 60 on page 25 of the IMF's report.

The CFR is therefore not entitled to assume that it is appropriate to apply the same enforcement and supervision regimes to FMI providers, which are in place for entities that are banks, or do provide financial advice, trade as principal or agent, or hold client money.

It is not enough for the CFR to assert that FMI Providers have influence and should therefore be regulated in the same way as other entities that have influence. There are many entities that have significant influence on Australia's financial markets that are subject to little or no regulation: for example, some infrastructure vendors provide a significant percentage of the order/transaction management systems for Australian market participants and are not regulated. The impact of these regulatory differences on competition and Australian markets generally, is not considered in the CP.

These features of the CP may result in any implementation of the proposals giving rise to unintended consequences which, given the critical importance of the market infrastructure function, should be avoided if possible.

Proposals that may have a fundamental impact on FMI must therefore be subject to a considered and thorough analysis of their costs, benefits and potential knock on effects, taking into account the idiosyncrasies of the Australian market. That analysis should ensure that proposed measures are specifically addressed to correct identified breakdowns or gaps in the application of local regulations and are not generally worded, broadly defined proposals capable of potential implementation that is not clearly understood by all stakeholders. Chi-X is concerned that the CP:

(a) contains proposals that impose new regulatory burdens without identifying:

  (i) why existing regulations and powers do not work;

  (ii) the detailed circumstances in which the proposed powers would be exercised; and

(b) does not analyse the costs, benefits and potential knock on effects of the proposals becoming law.

Competition is Critical

Global players dominate the supply side of Financial Market Infrastructure providers. Any consideration of the impact of the legislative proposals in the CP must have regard to the impact they will have on the relative attraction of Australia as a place to invest in and provide market infrastructure. This analysis is largely absent from the CP.

The then global parent of Chi-X Australia provided a submission on the 2011 consultation by the CFR on many of the same proposals contained in the current CP, in which it stated:

We believe the following outcomes may result if the reforms are implemented as proposed:

- *It will become increasingly difficult to compete with entrenched incumbents such as the Australia Securities Exchange (ASX) for trading and clearing services in both the*

cash equity and derivatives markets. This in turn will lead to less efficiency, fewer options for participants and higher trading costs;

- *The Australian market will become less attractive to foreign service providers due to increased operational risk and restrictive regulation that is often inconsistent with global best practice;*
- *Risk will concentrate into single points of failures for trading and clearing that are "too big to fail;" and*
- *Certain business activities may shift offshore or transact in the OTC market which in turn will degrade the quality of the public and "on-exchange" market.*

The introduction of any new policy risks unforeseen and unintended consequences. As such, whenever possible, industry stakeholders should be consulted and international comparables should be taken into consideration. Unlike 2008 when actions had to be taken quickly, regulators now have the benefit of time to carefully review and analyze what, if any new powers or controls are required to protect markets from systemic risk. As the proposals in the CP diverge significantly from current practice, we are surprised that no information was provided about what background analysis was conducted to justify the purpose of the reforms. We also note the absence of a cost benefit analysis and any discussion about alternatives considered. Given that no immediate risk threatens the Australia market, we would strongly urge the Ministry to take the time to publish a supplement to the CP laying out this analysis. We would also encourage the Ministry to convene working groups consisting of industry stakeholders to discuss the major issues laid out in the CP. Soliciting feedback from the industry will equip the Ministry with a better understanding of the potential impact of the proposals and also may lead to alternative solutions.

…

The benefits of competition differ for each service in the value chain. We believe that not only is a country's central depository a national asset but that a central counterparty reduces overall risk and allows for better oversight. Unlike trading and clearing, a central depository that is operated as a utility provides the greatest cost savings to participants. With regard to trading and clearing services, as long as inter-operability exists between clearing agencies, we believe that competition can help lower costs, drive efficiencies and lead to product innovation.

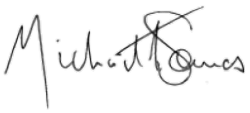
We are concerned that the following proposals in the CP will effectively eliminate competition by making it less attractive to foreign market service providers 1) location requirement 2) pre-approval of Directors of holding companies of domestic service providers, and 3) the step-in power for ASIC to take over a FMI or direct a third party to take over the FMI. As a global operator of markets two main factors are assessed when considering entering a new market; the business opportunity and the existing (and any proposed) regulatory framework. With regard to the regulatory framework, a balance needs to be struck where the framework is sufficiently robust to ensure investor confidence while at the same time not being overly burdensome to interfere with business operation. We believe that when considered as a collective set of reforms, the proposals mentioned above will risk Australia's global competitive position without necessarily lowering systemic risk.

Chi-X is of the view that these views remain applicable to the proposals in the current CP. Chi-X commends the CFR for modifying the step in powers proposed in 2011, by removing their application to non-CCP FMI providers.

Chi-X would welcome the opportunity to work with the CFR, other operators, participants and stakeholders, to deliver a clearer and more certain regime for FMI providers. A goal of that regime could be to mandate easily determined and well understood standards expected of the regulated FMI community that are necessary to enhance Australia's markets, protect investors and enable well intentioned firms to achieve those standards.

I hope this submission is of assistance in your important work in this area, please do not hesitate to contact us is if you have any queries.

Yours sincerely



Chi-X Australia Pty Ltd

ATTACHMENT ONE - _ TABLE OF ANSWERS

CP Reference Number	Question	Chi-X Response
2.3	That licensing and related powers held by the Minister (and currently delegated to ASIC) be transferred to the Regulators.	Chi-X is supportive of this proposal. Chi-X is of the view that any new regulation to effect this change, should be accompanied by regulations formalising some of the governance steps initiated by ASIC Itself in relation to the separation of, for example, the day to day business of ASIC undertaken by executive staff, and the more strategic review and oversight responsibilities of the ASIC Commissioners. Some of the reforms suggested in the ASIC Competency review may also be worthwhile to consider in this context. Chi-X is concerned that the current ASIC governance structure, at a formal level, does not entrench an effective independent review process into the work of the ASIC executive, which becomes increasingly essential the more the executive is given legislative and direct licencing powers.
2.4	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.	Chi-X is supportive of this proposal but is also of the view that it emphasises the need for an increase in the formal governance structure and requirements of a regulatory authority that can: (a) Develop the relevant policy and then legislate the circumstances in which a licence may be cancelled; (b) Conduct supervision of the firm in question; (c) Investigate and prosecute a licence cancellation

CP Reference Number	Question	Chi-X Response
		(d) Decide upon and enforce that cancellation. There is also a lack of detail in the proposal: for example, can the failure to use one feature of a licence (eg the lack of trading on class of financial products?) trigger a cancellation process?
2.4	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.	Chi-X is of the view that there is more to consider in relation to this proposal than is set out in the CP. Any proposed regulatory regime in this area should take into account the standards imposed globally, particularly by similar jurisdictions in our region, with a view to ensuring a new regulatory framework does not create a regulatory arbitrage opportunity for competitive advantage, for those competing centres relative to Australia.
2.4	The CFR proposes that ASIC have the power (having received advice from the RBA in the case of a CSFL) to impose location	Location requirements will make Australia a less attractive option for global operators. This negative consequence is not discussed at all in the CP and needs to be.

CP Reference Number	Question	Chi-X Response
	requirements on AMLs and CSFLs. This will involve requiring the licensee to transfer from an overseas licence to a domestic licence held by a domestically incorporated entity.	It is unclear what will be achieved by the proposed location requirement that can not be satisfied today through Australia's existing regulatory licensing framework. Australia is not unique in how it regulates exchanges and clearing agencies. The need to meet recognition criteria in order to operate is required in most other jurisdictions. Likewise, reliance on the oversight of a foreign regulator when considering issuing an off-shore license is a well adapted approach. When a license is granted, additional terms and conditions can be included in the recognition order that is required in order for the license to be maintained. This allows any specific concerns to be addressed on a case-by-case basis. For example, concerns where a domestic clearing agency controlled by an off-shore holding company is not able to recapitalize, can be addressed through additional capital or margin requirements set out in the recognition order. In addition, as referenced above providing this power to ASIC increases the need for formal changes to the governance framework at ASIC.
2.4	So that holders of a domestic Australian clearing and settlement facility licence 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	Chi-X opposes this proposal and is of the view that any such proposal should be the subject of a transparent cost benefit analysis on the impact it may have on the competitive position of Australia. For example, how does this standard compare to relevant global benchmarks in our region and elsewhere? For example, the clearing of euro and US$ swap/repo/forex and interest rate transactions?

CP Reference Number	Question	Chi-X Response
2.5	Empower ASIC to declare a financial market to be a prescribed financial market.	Chi-X supports this proposal, but suggests that at the same time the regulatory changes are implemented, the requirements for an enhanced formal governance regime at ASIC are also legislated.
2.6	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	Chi-X is not supportive of this proposal or the current legislative provisions, and is of the view that the powers in this area are out of date and reflect a 'fortress Australia' position that is unhelpful in promoting Australia as a destination for global firms wanting to invest in or provide FMI services for the Australian market. The CP does not consider why this regulatory framework is necessary if the other proposals in the CP are adopted: for example, why is this particular framework required at all if there is a fit and proper/prior consent requirement for market operators?
3.3	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.	Chi-X does not support this proposal, which is not justified by any or any proper analysis of the cost and benefits of the proposals or the deficiencies of current framework. By many global benchmarks, the standards that could be imposed by the proposed regulation have the potential to be oppressive and diminish the competitive position of Australia as a place for global FMI providers to do business. This is not because FMI Providers will seek to engage persons are not fit and proper, but because of the regulatory burden imposed on them in circumstances where:

CP Reference Number	Question	Chi-X Response
		(a) there may be a significant number of persons who come within the range of persons 'involved' in the FMI Provider, and (b) an information gathering and submission process that is not yet defined in the proposals, must be satisfied in respect of each of those persons; (c) that information gathering and submission process is not in place at any other jurisdiction in which the entity does business. It is important that this proposal be reviewed by the CFR after further engagement with interested stakeholders.
3.4	New proposal ASIC's consent will be required for a person to hold more than 15 per cent voting power in a Licensed Entity.	Chi-X is of the view that It is not possible to usefully comment on this proposal given: (a) The lack of global benchmarking (the UK for example, has no such requirement); (b) Lack of identification of any problem that needs fixing; (c) The lack of detail in the proposed rule; (d) Lack of any scoping of the regulatory burden that will be imposed. The proposed rule should therefore be the subject of further consultation.
3.5	ASIC may make rules for CSFLs for the purpose of promoting the fair and effective	Chi-X is supportive of this proposal.

CP Reference Number	Question	Chi-X Response
	provision of clearing and settlement facility services	
3.6	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.	Chi-X is of the view that it is not clear how the current framework is deficient in providing the requisite power to CFR Members to undertake this task. It is also not clear how this proposal compares globally and therefore what impact it may have on the relative competitive position of Australia as a place to provide/invest in FMI services.
3.7	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.	Chi-X does not wish to express a view on this proposal.

CP Reference Number	Question	Chi-X Response
	Remove the 21-day time limit on ASIC directions	
Page 23 – Sanctions for breach of directions and licence conditions	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.	Chi-X is opposed to this proposal, which does not currently satisfy the requirement in the Government's Best Practice Guidelines, for example it does not: (a) establish a case for action; (b) consider a range of options; (c) consider the effects on competition; (d) quantify the net benefits for the community.
Crises Management & Resolution Proposals – Chi-X has not answered the individual questions on the Proposed Resolution Reforms, rather some of the fundamental issues raised by a proposed resolution regime in Australia, are addressed in the covering letter.		