ASIC
Australian Securities & Investments Commission

REPORT 194

Response to submissions on CP 120 Operators of clearing and settlement facilities

April 2010

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 120 *Operators of clearing and settlement facilities* (CP 120) and details our responses to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see Regulatory Guide 211 *Clearing and settlement facilities: Australian and overseas operators* (RG 211).

Contents

A Overview/consultation process

1 In Consultation Paper 120 *Operators of clearing and settlement facilities* (CP 120), we consulted on proposals outlining our intended approach to regulating clearing and settlement (CS) facilities in Australia. CP 120 discussed when an entity would be required to hold an Australian clearing and settlement facility licence (CSF licence) and when an exemption would be granted from holding a CSF licence.

2 CP 120 specifically sought comment in the following areas:

(a) the objectives of CS facility regulation;

(b) the desired regulatory outcomes;

(c) the factors that affect achievement of the regulatory outcomes;

(d) our approach to interpreting the statutory definition of a CS facility;

(e) our approach to determining when a CS facility is 'operating in this jurisdiction';

(f) our approach to assessing when the cost of regulation outweighs the benefits of achieving the regulatory outcomes;

(g) our approach to determining sufficient equivalence of an overseas CS facility regime; and

(h) the sufficiency of examples provided in the draft regulatory guide.

CP 120 also included a draft version of the regulatory guide *Clearing and settlement facilities: Australian and overseas operators*.

3 This report highlights the key issues that arose out of the submissions received in relation to CP 120 and our responses to those issues.

4 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 120. We have limited this report to the key issues.

5 For a list of the non-confidential respondents to CP 120, see Appendix 1. Copies of the submissions are on the ASIC website at www.asic.gov.au/cp, under CP 120.

Responses to consultation

6 We received seven responses to CP 120 from a variety of sources, including an existing CSF licensee, a law firm and an industry body. We are grateful to respondents for taking the time to send us their comments.

7 There was widespread support for the release of a regulatory guide. In general, respondents considered that a regulatory guide would provide useful guidance about our approach to CS facility regulation.

8 The main issues raised by respondents related to:

- competition for clearing and settlement services;
- interpreting 'fair and effective';
- how we would assess whether a CS facility is operating in Australia;
- our approach to recommending exemptions; and
- our approach to assessing 'sufficient equivalence'.

B Competition for clearing and settlement services

Key points

A majority of respondents commented on competition for clearing and settlement services. Most respondents who commented on the issue supported competition for clearing and settlement services.

Some respondents queried the meaning we would ascribe to competition and suggested that we take into account various considerations when defining competition. Other respondents outlined impediments to alternative market operators due to an absence of competition for clearing and settlement services.

Comments on competition

9 Of the four respondents who commented on the issue of competition, three were supportive of competition for clearing and settlement services. Of these three respondents, one felt that competition would enhance market operation and effectiveness, which could in turn help establish Australia as a regional and global leader in financial markets.

Defining competition

10 Two respondents commented on the need for us to define what competition means. One respondent sought greater clarity on what we understand 'competition' to mean, because in their submission a new CS facility providing services to participants of an aspirant market licensee gives rise to different considerations as compared to a new CS facility providing services to existing participants of an existing market. The other respondent invited us to consider how we define competition and to outline what consultation process we intend to follow if we receive an application to operate a competing CS facility.

ASIC's response

We believe that competition has different meanings in different contexts and do not see any immediate benefit in attempting to provide a definition, as we are not intending to address competition in RG 211. Therefore, we think it best to consider issues arising from different forms of proposed competition on a case-by-case basis.

The consultation process (if any) that we adopt for a CSF licence or exemption application will depend on the nature of the proposed operation of the competing CS facility. We will tailor any consultation process in each case, so we do not think it necessary to detail that process in the regulatory guide.

Impediments due to an absence of competition

11 One respondent submitted that some participants who have been declined services by a CS facility for no good reason might have no recourse to alternatives because of a lack of competition. Another respondent supported competition in pricing because clearing and settlement fees are high in Australia.

12 Overall, respondents suggested that we should consider how we should deal with these and other impediments caused by an absence of competition for clearing and settlement services.

ASIC's response

We welcome the comments from respondents on competition and we will consider those comments when handling any future CSF licence or exemption application to operate a CS facility that will compete with existing CSF licensees.

We do not intend to cover specific issues concerning competition for clearing and settlement services in the regulatory guide we are currently issuing. However, we consider the regulatory guide will assist potential CSF licence applicants (including potential competitors). We also confirm that we will approach the administration and supervision of the CSF licensing regime on a basis that is fair to all CSF licensees and applicants. Lastly, we do not believe that requiring new CSF licensees to meet the regulatory outcomes outlined in RG 211 creates an unfair barrier to competition by new entrants.

C Interpreting 'fair and effective'

Key points

We received one response that suggested we explain what is meant by a CS facility's services being provided in a 'fair and effective' way.

This respondent recommended that the approach we take to interpreting both 'fair' and 'effective' should be consistent with the purpose of averting the consequences of a CS facility not effectively managing relevant systemic and financial stability risks.

Ensuring clearing and settlement services are provided in a 'fair and effective' way

13 One respondent described oversight of CS facilities—to ensure the provision of services in a 'fair and effective' way—as our most significant licensing obligation, and submitted that it was unable to ascertain how we interpret this obligation through reading the draft regulatory guide.

Explanation required

14 This respondent suggested that the regulatory guide should explain what is meant by a CS facility's services being provided in a 'fair and effective' way. The respondent commented that they would welcome an interpretation that was consistent with what they perceive to be the actual purpose of the regime, namely to avert the consequences of a CS facility not effectively managing the relevant systemic and financial stability risks.

A definition for 'fair and effective'

15 To this end, the respondent submitted a proposed definition for the term 'fair and effective':

(a) 'fairness' means avoiding inappropriate differentiation between users of the services (clearing participants); and

(b) 'effectiveness' means that any changes to the structure, process or relationships which constitute the CS facility are consistent with achieving the fundamental outcomes for which it has been designed.

The respondent submitted that the above interpretation be adopted to apply to all CS facilities in future.

ASIC's response

We believe that it is not necessary to elaborate further on our understanding of the obligation to provide fair and effective services, and reaffirm our view, as outlined in the draft regulatory guide, that the ordinary meanings of 'fair' and 'effective' should be used. This is consistent with our approach to the other general expressions of obligations in Ch 7 of the *Corporations Act 2001* (Corporations Act).

We note that the obligation to provide fair and effective services is a distinct obligation from the obligation to comply with the financial stability standards and to reduce systemic risk.

We also note that the objectives of Ch 7 of the Corporations Act go beyond reducing systemic risk and the maintenance of financial stability. In light of these objectives, in our view it is inappropriate to adopt a restrictive approach to the interpretation of fair and effective.

D Operating in Australia

Key points

Three respondents addressed the issue of when a CS facility is considered to be operating in Australia.

Two respondents commented on the factors we should consider in assessing whether a CS facility operates in Australia. Another respondent considered that through our draft guidance we had extended our jurisdictional reach beyond that given under the CSF licensing regime.

Overseas CS facilities

Weighting of factors

16 One respondent submitted that although we identified all the factors in assessing whether a CS facility operated in Australia, the factors outlined in RG 211.62(b) and (c) should be given less weight when all the other factors indicate that the CS facility is not operating in Australia and where the Australian participants are subject to regulatory oversight. Another respondent suggested that we should state how the factors in assessing whether a CS facility is operating in Australia are to be taken into account.

ASIC's response

We think that we need to assess each of the factors in the particular circumstances. It is not possible to indicate the weighting that we will give to factors without considering those circumstances.

We will consider and weigh all the factors listed in RG 211.62 on a case-by-case basis.

Extending jurisdictional reach

17 Another respondent submitted that, in Section B of the draft regulatory guide, we appeared to extend our jurisdiction with respect to overseas CSF licences, in a manner beyond the actual jurisdictional reach afforded under Pt 7.3 of the Corporations Act.

ASIC's response

We have stressed in our policy that our assessment of whether a CS facility is operating in Australia will turn on whether there is a

nexus between the operation of the regular mechanism provided by the facility and Australia. We think this position reflects the position in the Corporations Act and so we will be maintaining the explanation of the expression 'operating in Australia' as set out in Section B of RG 211 and will assess all the factors listed in that section when considering whether a CS facility is operating in Australia.

E Our approach to recommending exemptions

Key points

Three respondents addressed our approach to recommending exemptions from the CSF licensing regime.

One respondent did not support our approach to recommending exemptions and did not agree that it might be appropriate to regulate a facility that fell within the CS facility regime as a market or financial service licensee.

Other respondents respectively submitted that all domestic retail trading activity should be cleared and settled through an ASIC-regulated CS facility and that we should give more guidance on factors we would consider in recommending an exemption.

When exemptions are appropriate

Our approach for operators holding other types of licences under the Corporations Act

18 One respondent disagreed that a CS facility could be exempted from the CSF licensing regime and instead be regulated under the Australian financial services (AFS) licensing or Australian market licensing regimes.

ASIC's response

We think we should maintain our current guidance on exemptions from the CSF licensing regime but we will elaborate on the point. We decided against altering our guidance because we need to allow for the situation where it is not appropriate to regulate a facility as a CS facility but rather as a market or financial service. However, we do not view the market licensing and AFS licensing regimes as a complete substitute for, or totally interchangeable with, the CSF licensing regime. There are, however, circumstances where the definitions of 'CS facility' and 'financial market' would arguably apply to the same activity and we need to retain flexibility to regulate such activity in the most appropriate manner.

We have therefore revised paragraph RG 211.38 of the regulatory guide to clarify our position about the market licensing regime. In relation to the AFS licensing regime, we think that paragraph RG 211.85 already makes it clear that holding an AFS licence is just one of the conditions that we may recommend if we advise the minister to grant an exemption. Paragraph RG 211.76 spells

out our criteria for advising the Minister to grant an exemption. Holding an AFS licence is not one of the criteria. Accordingly, we think no further clarification is necessary about a CS facility operator holding an AFS licence.

Consultation

19 That respondent also proposed that we should commit to consultation on every exemption application.

ASIC's response

There may be cases where the cost of public consultation outweighs the benefit. It is more appropriate to determine when consultation will occur on a case-by-case basis than to commit to conducting consultation on all applications. This approach is consistent with our approach to exemptions from the requirement to hold a market licence under Pt 7.2 of the Corporations Act.

Factors to be taken into account

20 Another respondent submitted that although we had identified all the factors to be taken into account when assessing an application for exemption, we should nevertheless provide quantitative or concrete guidance on how we would assess each factor. These factors include volume and value of transactions cleared, number and type of Australian participants, nature of the financial products cleared and whether the financial products are commonly traded by retail investors. The respondent referred to in paragraph 18 also suggested that the regulatory guide should state how the factors in making cost and benefit assessments under RG 211.79 are to be taken into account. A third respondent proposed that all domestic retail trading activity be supported by an ASIC-regulated CS facility.

ASIC's response

We will process any exemption application on a case-by-case basis and do not consider it appropriate to introduce specific quantitative or more concrete measures in the regulatory guide, as we need to consider each factor in the context of the particular CS facility.

We do not think a change in the draft regulatory guide to indicate that we will always require trading activity undertaken by retail investors to be cleared and settled by an ASIC-regulated CS facility is necessary. Retail participation is one factor we will consider when determining whether to recommend an exemption.

F ‘Sufficient equivalence’

Key points

Our approach to applying the CPSS-IOSCO Recommendations was not addressed by any respondent, although one respondent commented that compliance with the CPSS-IOSCO Recommendations should be independently assessed and outcomes made publicly available.

One respondent submitted that some overseas regulatory regimes did not give the authorities the right to disallow operating rule changes and this should be a factor in assessing ‘sufficient equivalence’.

Assessing ‘sufficient equivalence’

Application of the CPSS-IOSCO Recommendations

21 In CP 120, we sought feedback on any limitations that should be adopted in applying the CPSS-IOSCO Recommendations for Central Counterparties and CPSS-IOSCO Recommendations for Securities Settlement Systems.

22 No respondent addressed this question directly although a respondent suggested we should ensure that compliance with the CPSS-IOSCO Recommendations be independently assessed, and the outcomes publicly disclosed.

ASIC’s response

We will maintain our position that we will consider whether the foreign regime achieves the high-level outcomes of the CPSS-IOSCO Recommendations, in determining whether there is sufficient regulatory equivalence between the foreign regime and Australia’s regulatory regime.

However, we have revised the draft regulatory guide to reflect the fact that international standards and recommendations may change over time.

Rule disallowance process

23 One respondent commented that the Australian regime subjects a domestic CS facility to the rule disallowance process whereas some overseas regimes do not. Therefore, whether or not an overseas regime subjects a CS facility to a rule disallowance process should be a factor to be taken into account when assessing sufficient equivalence.

ASIC's response

The different rule change process with respect to an overseas CSF licensee is a characteristic of our CSF licensing regime as reflected in the Corporations Act. As explained in RG 211.126, it is our view that as long as the overseas regime achieves the key outcomes of our regime, we will not require the regulatory mechanisms to be the same as ours. We believe that our approach (of assessing the regulatory outcomes rather than the regulatory mechanisms adopted to achieve those outcomes) is consistent with the legislative purpose.

Appendix 1: List of non-confidential respondents

- Australasian Compliance Institute
- Australian Securities Exchange
- Fortis Clearing Sydney Pty Ltd
- Freehills
- Vyapar Capital Market Partners LLC