



ASIC

Australian Securities & Investments Commission

REPORT 322

**Response to submissions on
CP 186: Clearing and
settlement facilities:
International principles and
cross-border policy (Update
to RG 211)**

December 2012

About this report

This report highlights the key issues that arose out of the submissions received to Consultation Paper 186 *Clearing and settlement facilities: International principles and cross-border policy (update to RG 211)* (CP 186) and details our response in relation 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).

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A Overview/consultation process

- 1 In Consultation Paper 186 *Clearing and settlement facilities: International principles and cross-border policy (update to RG 211)* (CP 186), we consulted on proposals to amend the existing Regulatory Guide 211 *Clearing and settlement facilities: Australian and overseas operators* (RG 211) to:
 - (a) adopt the Committee on Payment and Settlement Systems of the Bank for International Settlements' (CPSS) and the Technical Committee of the International Organization of Securities Commissions' (IOSCO) *Principles for financial market infrastructures* (CPSS–IOSCO Principles) for clearing and settlement (CS) facilities, to the extent possible in our jurisdiction; and
 - (b) provide certainty and transparency on how we intend to put in place measures and update our existing guidance to ensure there is appropriate regulatory influence over cross-border CS facilities, as envisaged under the Council of Financial Regulators' (the Council) framework described in its paper *Ensuring appropriate influence for Australian regulators over cross-border clearing and settlement facilities* (cross-border CS facilities paper).
- 2 This report highlights the key issues that arose out of the submissions received to CP 186 and details our response to those issues.
- 3 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 186. We have limited this report to the key issues raised by industry.
- 4 For a list of the non-confidential respondents to CP 186, see the appendix. Copies of these submissions are available on the ASIC website at www.asic.gov.au/cp under CP 186.
- 5 This report should be read in conjunction with the updated RG 211.

Responses to consultation

- 6 We received six written submissions to CP 186 from a range of stakeholders, including industry associations representing market participants and other stakeholders, a current CS facility licensee, a market operator and a CS facility operating in another jurisdiction. We are grateful to respondents for taking the time to send us their comments.

- 7 The submissions generally agreed with the proposals to amend RG 211; however, some submissions sought more clarity on regulatory cooperation generally: see Section B.
- 8 Individual sections of this report deal with the issues raised by respondents in relation to our proposals to amend RG 211 to:
- (a) adopt the CPSS–IOSCO Principles (see Section C); and
 - (b) provide certainty and transparency on how we intend to ensure there is appropriate regulatory influence over cross-border CS facilities, as envisaged by the Council’s cross-border CS facilities paper (see Section D).

Issues outside scope of this consultation

- 9 The responses to CP 186 raised a number of issues outside the narrow scope of the proposed amendments to RG 211, including:
- (a) changes to the market structure for clearing services, including competition in clearing services;
 - (b) assessments of CS facility licence applications, including the public interest test and awareness of investors of the implications of using offshore clearing facilities;
 - (c) the *Australia in the Asian century* white paper, released by the Australian Government in October 2012; and
 - (d) the powers available to Australian regulators to preserve financial stability.
- 10 We note that RG 211 is not under general review. CP 186 was not intended to be a comprehensive review of the regulatory framework and guidance around CS facilities. The scope of CP 186 was intentionally limited to deal with two specific developments, the release of the CPSS–IOSCO Principles and the Council’s cross-border CS facilities paper. The additional issues raised in submissions will be considered as part of the Council’s ongoing review of competition in clearing services.
- 11 We also note that the public interest test already sits within existing legislation. Under the *Corporations Act 2001* (Corporations Act), the Minister is obliged to take into account a number of factors, including public interest. The public interest test potentially encompasses a wide range of issues. A range of measures already exist to mitigate consumer protection risks, including market operator disclosure obligations.
- 12 CP 186 stated that it dealt with the Council’s framework, as set out in the cross-border CS facilities paper, for ensuring appropriate influence for Australian regulators over cross-border CS facilities under the existing legislation and that it did not cover proposed legislative changes. If changes

are necessary to Australian regulators' powers to preserve financial stability, these would be considered as part of these legislative amendments. Any changes necessary to RG 211 following legislative changes will be consulted on in a separate process.

B Working with other regulators

Key points

Respondents to CP 186 sought clarity on how the Reserve Bank of Australia (RBA) and ASIC will work together in the annual assessment process to avoid duplication.

They also requested greater clarity on our approach to equivalence assessments and how we work with overseas regulators.

Avoidance of duplication: RBA and ASIC

- 13 In relation to the proposals generally, respondents sought clarity on how the RBA and ASIC will work together in the annual assessment process to avoid duplication.
- 14 In 2002, ASIC and RBA entered into a memorandum of understanding (MOU) covering their respective responsibilities under the Corporations Act in relation to CS facilities.
- 15 The RBA has specific responsibilities under the Corporations Act for setting financial stability standards, monitoring compliance with these standards and ensuring that licensed CS facilities do all things reasonably practicable to reduce systemic risk.
- 16 ASIC has responsibility under the Corporations Act for monitoring compliance with all other legislative obligations imposed on CS facility licensees. These include a requirement to provide financial services in a fair and effective manner, including by having arrangements in place to enforce compliance with operating rules and to resolve complaints from facility participants.
- 17 ASIC also has responsibility under the Corporations Act for taking action to enforce compliance with all obligations imposed on CS facility licensees.
- 18 The MOU sets out a framework for cooperation between ASIC and the RBA that is intended to promote transparency, help prevent unnecessary duplication of effort and minimise the regulatory burden on facilities. It covers information sharing, notification and other arrangements intended to achieve these aims.

ASIC's response

We note that the RBA and ASIC have their own mandates with different responsibilities in relation to CS facilities. Formally, RBA's remit is to assess CS facilities against the financial stability standards and how well they do all other things necessary to reduce systemic risk. Among other functions, ASIC performs regular assessments of CS facilities covering, broadly, the extent to which they are operated in a fair and effective manner in compliance with the Corporations Act.

Operationally, we have a close relationship with the RBA. We work closely to share information and ensure duplication of regulation is minimised. RBA and ASIC can coordinate in relation to assessments to avoid duplication.

We will work with licensees and applicants on a bilateral basis to give greater clarity on how we intend to coordinate our individual due diligence processes and our approach to areas of joint interest (e.g. governance, risk management).

Equivalence assessments

- 19 A number of submissions highlighted the importance of international coordination and noted that different jurisdictions may be at different stages in their implementation processes.
- 20 One respondent stated that the assessment of an overseas application should not be based on a rule-by-rule approach and should look at the substantive regulatory outcome (where appropriate) on a holistic level.

ASIC's response

RG 211 contains guidance on what we consider to be 'sufficiently equivalent': see RG 211.113–RG 211.134. When we consider an application and the equivalence assessment, the degree to which a home regulator has implemented (or is implementing) the CPSS–IOSCO Principles will be taken into account.

This approach to the broader consideration of equivalence appears to be consistent with Asia–Pacific regulators and in line with a joint letter from ASIC, the Hong Kong Monetary Authority, the Monetary Authority of Singapore, RBA and the Securities and Futures Commission (Hong Kong) to the US Commodity Futures Trading Commission on the cross-border application of the *Dodd–Frank Wall Street Reform and Consumer Protection Act 2010* (US) with regards to participants.

RG 211 outlines how we will work with a home regulatory authority. We recognise that different jurisdictions may be at different stages of implementing the CPSS–IOSCO Principles and we will deal with this on a case-by-case basis when we consider any CS facility licence applications from overseas CS facility

providers. As a jurisdiction progressively comes into compliance with the CPSS–IOSCO Principles, we will take a facilitative approach and revisit the equivalence assessment in a relatively short period of time.

We also note that the Financial Stability Board and CPSS–IOSCO will be conducting peer reviews of the implementation of the CPSS–IOSCO Principles.

More broadly, we would not recommend to the Minister that a new CS facility licence is granted to an overseas facility unless a cooperation arrangement is in place with the home state regulator.

Working with overseas regulatory authorities

- 21 A respondent highlighted the importance of liaison between national regulators to ensure the proposed RG 211 amendments will interact positively with other regulatory initiatives impacting CS facilities and markets.
- 22 Another respondent suggested that the assessment methodology needs to recognise that Australian regulators retain an ability to impose super-equivalent requirements on CS facilities operating in the domestic market if they deem it necessary in the context of the size and character of Australian markets. If Australian regulators choose to impose requirements over and above the CPSS–IOSCO Principles, these should be applied equally to both domestic and overseas CS facility licensees.

ASIC's response

We are working with fellow regulators in various forums to tackle and eliminate, as far as possible, conflict in the implementation of cross-border reform, including in the derivatives market.

If there are any differences in requirements that need addressing, ASIC has the ability to recommend that the Minister impose conditions on a licence. This assessment would be made on a case-by-case basis and take into consideration the significance of the difference. A recommendation to the Minister to impose conditions would only be made where necessary and appropriate given the circumstances.

Our approach to equivalence when dealing with domestic and overseas CS facility licensees is outlined in Section D of RG 211.

C CPSS–IOSCO Principles for financial market infrastructure

Key points

In CP 186 we made proposals about our use and adoption of the CPSS–IOSCO Principles, disclosure framework and assessment methodology when considering CS facility licence applications and assessing CS facilities.

Respondents generally agreed with these proposals, but expressed concerns about our approach to the annual assessment process.

- 23 In CP 186, we proposed to:
- (a) adopt the CPSS–IOSCO Principles relevant to ASIC’s regulatory remit by recognising them as a matter we will consider in framing our advice to the Minister about a CS facility licence application and on an ongoing basis; and
 - (b) take into account the CPSS–IOSCO disclosure framework and assessment methodology in considering whether the CS facility meets the CPSS–IOSCO Principles.
- 24 We proposed that the amendments would take effect immediately from the time the updated RG 211 is published.
- 25 Respondents generally agreed with these proposals.
- 26 However, one respondent noted that assessment reports contain information important to market participants and that those reports should be made available to participants. Another respondent questioned whether ASIC will be revising its existing approach to the annual assessment process.

ASIC’s response

Generally, ASIC’s assessment reports for CS facility licensees are made public on its website.

We will not revise our approach to annual assessments at this stage. Section F of RG 211 states that in conducting our assessments, we will also consider any relevant standards and recommendations promulgated by international bodies such as IOSCO and CPSS. We will be using the CPSS–IOSCO methodology as a reference tool when conducting annual assessments.

We have amended RG 211 to:

- adopt the CPSS–IOSCO Principles relevant to ASIC’s regulatory remit by recognising them as a matter we will consider in framing our advice to the Minister about a CS facility licence application and on an ongoing basis; and
- take into account the CPSS–IOSCO disclosure framework and assessment methodology when considering whether the CS facility meets the CPSS–IOSCO Principles.

D Cross-border CS facilities

Key points

In CP 186 we proposed to amend RG 211 to put in place measures and build on existing guidance to ensure there is appropriate regulatory influence over cross-border CS facilities as envisaged under the Council's framework.

Respondents generally agreed with the approach to provide more clarity and transparency on these measures. However, respondents sought further clarity in relation to a number of issues, including:

- practical application of graduated measures (see paragraphs 30–34);
- the exact metrics used to determine systemic importance and strength of domestic connection (see paragraphs 35–37);
- the application of the graduated approach in the case where a licensed facility provider may operate a range of discrete services (see paragraph 38);
- imposition of conditions (see paragraphs 39–43);
- communication about outsourcing or moving operations overseas (see paragraphs 44–45); and
- providing additional examples (see paragraph 46).

We have amended RG 211 as proposed in CP 186. In response to feedback, we have also amended RG 211 to:

- state that we will clarify the indicative factors on a case-by-case basis during bilateral discussions with prospective CS facility licensees at the application stage, and on an ongoing basis for current and future licensees. This will enable us to be adaptive to the nature of the entity, the service it is providing and any other relevant circumstances at that time;
- state that we will consult with applicants and licensees about the type of conditions we may recommend before we give our advice to the Minister. We may also consult with stakeholders on any conditions we may recommend;
- state that we expect that a CS facility would ordinarily publish its annual report;
- extend our expectation that a domestic CS facility licensee would speak to us about any intention to move or outsource critical functions offshore to overseas CS facility licensees; and
- include an additional example from the Council's cross-border CS facilities paper.

27

In CP 186 we proposed to amend RG 211 to put in place measures and build on existing guidance to ensure there is appropriate regulatory influence over

cross-border CS facilities, as envisaged under the Council's framework. We proposed to:

- (a) clarify that if a CS facility is systemically important with a strong domestic connection, we would ordinarily recommend that the applicant apply for a domestic operator licence. We proposed to include guidance in RG 211 on the indicative factors we may take into consideration to determine if a CS facility has a strong domestic connection and is systemically important;
- (b) amend existing RG 211.148, which lists the examples of circumstances where we may advise the Minister to impose conditions, to include the following examples:
 - (i) facilitating our ability to conduct periodic and/or activity-based reviews to determine if there have been changes that mean that a domestic licence and a domestic legal presence should be required;
 - (ii) requiring the CS facility to report to ASIC regularly on its overseas activities and presence;
 - (iii) requiring the CS facility to establish a domestic operational presence, either for human resources or other aspects of their operations, for either all or part of their functions; and
 - (iv) requiring a CS facility to set controls around how they deal with outsourcing of critical functions (e.g. core risk management function);
- (c) amend existing RG 211.152(a) to include an expectation that a CS facility licence application will include detailed information about whether any operations are performed overseas;
- (d) insert a new paragraph under existing RG 211.204 to state that specific licence conditions may be imposed to ensure appropriate influence by ASIC over cross-border CS facilities;
- (e) insert a new paragraph under existing RG 211.206 to provide an example of additional conditions that may be required to achieve regulatory outcomes in the circumstances of:
 - (i) a domestic CS facility seeking to move some or all of its operations overseas; or
 - (ii) an overseas CS facility that is systemically important with a strong domestic connection;
- (f) amend existing RG 211.215 to state that we may require, through a cooperative agreement with a CS facility licensee, information to be included in the licensee's annual report about whether any operations have been moved or outsourced overseas;
- (g) insert a new paragraph under existing RG 211.215 stating that we would expect a domestic CS facility licence holder to speak to us about

any intention to move or outsource critical functions overseas so that we can understand any potential regulatory impact and ensure any necessary measures are put in place; and

(h) amend Examples 4 and 6 in Table 2 of RG 211.

28 We proposed that the amendments would take effect immediately from the date updated RG 211 is published.

29 Respondents generally agreed with the approach to provide more clarity and transparency on these measures. However, respondents sought further clarity in relation to a number of issues. These are addressed in paragraphs 30–46.

Practical application of graduated measures

30 The Council’s framework outlines measures that may be applied to CS facilities to ensure appropriate influence for Australian regulators under existing legislative arrangements. In the cross-border CS facilities paper, the Council acknowledged that CS facilities may differ significantly in the nature of their activities, their scale, the products and participants, and their importance to the Australian financial system. In recognition of this, the Council proposed that specific requirements for cross-border CS facilities be applied in a graduated and proportionate manner.

31 The Council’s framework does this by taking the following approach:

- (a) imposing basic requirements on all cross-border CS facility licensees, both domestic and overseas, which largely clarify and interpret general licence obligations under Pt 7.3 of the Corporations Act;
- (b) expecting that the basic requirements would be met by all licensees, but allowing that some specific measures may not in practice apply unless a facility had material Australian-based participation or provided services in Australian-related products (e.g. Australian dollar-denominated products, or securities issued by Australian-domiciled issuers); and
- (c) applying other requirements only if the licensee is deemed to be, or over time becomes, systemically important in Australia, and/or exhibits a particularly strong connection with the Australian financial system and real economy. Determination of which specific measures should apply to a given facility would reflect a case-by-case assessment of the benefits from enhanced influence for the regulators, relative to the costs of imposing additional requirements.

32 In CP 186, we proposed changes to our guidance in RG 211 to implement the graduated measures, including outlining the relevant factors that we would take into account when assessing the systemic importance of a facility

in Australia and whether it has a strong domestic connection. These factors have been taken from the Council’s cross-border CS facilities paper.

33 In response to CP 186, one respondent submitted that they do not agree that a graduated approach is an appropriate way of imposing regulatory standards on foreign CS facilities servicing important Australian markets. The submission stated that such an approach is both inconsistent with a public interest test and practically difficult to implement.

34 Some responses consider greater clarity is needed for a CS facility licensee to determine if it requires a domestic CS facility licence or if an overseas CS facility licence is acceptable and, crucially, whether it will be required to comply with any related domestic location requirements, domestic legal requirements or provide for greater regulatory participation in its risk management arrangements, among other things.

ASIC’s response

The graduated approach is part of the framework established and recommended by the Council.

We will provide tailored guidance to applicants on a bilateral basis to help manage practical difficulties associated with the graduated approach.

Exact metrics used to determine systemic importance and strength of domestic connection

35 In CP 186 we proposed to clarify that if a CS facility is systemically important with a strong domestic connection, we would ordinarily recommend that the applicant should apply for a domestic CS facility licence. We also proposed to include guidance in RG 211 on the indicative factors we may take into consideration to determine if a CS facility has a strong domestic connection and is systemically important. CP 186 stated at paragraph 58:

The Council states in its paper that the determination of systemic importance will be made by the Regulators, as appropriate, and may require a degree of judgement in some cases. The Council has outlined relevant factors that would ordinarily be considered in assessing the systemic importance of a facility in Australia.

36 CP 186 proposed that RG 211:

- (a) set out the factors outlined by the Council;
- (b) state that the factors are indicative only and neither exhaustive nor determinative; and

- (c) state that determining whether the CS facility is systemically important will require an assessment of all the facts and circumstances pertaining to the CS facility.

37 Responses to CP 186 sought clarity on the exact metrics to be used to determine systemic importance and the strength of the domestic connection. Submissions noted that it is important, when considering the opportunities to provide services to Australian participants, that any facility be able to gauge (before developing a service proposition) the requirements that it can expect to face.

ASIC's response

We will use the Council's indicative factors to the level they have been presented by the Council for consistency with other agencies and the Council's broader framework.

We have amended RG 211 to state that we will clarify the indicative factors on a case-by-case basis during bilateral discussions with prospective CS facility licensees at the application stage, and on an ongoing basis for current and future licensees. This will enable us to be adaptive to the nature of the entity, the service it is providing and any other relevant circumstances at that time: RG 211.71.

Application of the graduated approach in cases where a CS facility licensee operates a range of discrete services

38 A respondent sought clarification on the potential application of the graduated approach in cases where a CS facility licensee operates a range of discrete services. The respondent submitted that each service would have its own characteristics and it is very likely that some will be systemically important while others are not, and also some may have a strong domestic connection while others will not.

ASIC's response

The focus of our regulatory regime is on CS facility operators, not services, and our general approach is that licence conditions apply to operators rather than services.

We can apply separate conditions to different services that are part of the single CS facility under one licence. We note that some conditions may apply to the CS facility as a whole regardless of its individual services (i.e. requiring a licensee to include in its annual report whether any operations have been moved or outsourced overseas).

Imposition of conditions

Types of conditions

- 39 One respondent expressed concerns about the conditions we may advise the Minister to impose on a licence, such as requiring a CS facility to:
- (a) establish a domestic operational presence;
 - (b) have a domestic legal presence; or
 - (c) allow regulatory participation in its risk management processes if it is a systemically important CS facilities.
- 40 One respondent noted that the imposition of undefined conditions, including location requirements, on a large central counterparty may make it impossible for such central counterparties to continue to undertake Australian-related business in the future.
- 41 Another respondent considers that, where there are two or more CS facilities competing in providing services to the same market, there should be competitive neutral outcomes.
- 42 One respondent suggested additional examples of conditions that could be imposed on a licence.

ASIC's response

In CP 186 we proposed to include examples of conditions we may recommend that the Minister impose. These examples have been taken from the Council's recommendations in the cross-border CS facilities paper. We do not intend to include additional examples at this stage.

We acknowledge that the location requirements may have a potential deterrent effect, but to mitigate this we have provided public guidance in RG 211 and will provide private guidance to applications on a bilateral basis.

We will achieve competitive neutrality through the equivalence assessment and a recommendation to the Minister to impose conditions for any differences. This will give us a comparable level of regulation, taking into account home regulatory requirements and any conditions we recommend the Minister imposes.

Consulting with stakeholders

- 43 A respondent suggested that ASIC should consult all stakeholders, including members of overseas CS facilities, on the recommendation to impose conditions.

ASIC's response

The existing regulatory framework enables ASIC to advise the Minister to impose conditions on a licence. The additional examples are those that have been recommended by the Council as part of its framework.

RG 211.160 explains that we will consult with an applicant before advising the Minister to impose conditions.

We will consider the costs and benefits of imposing conditions before making any recommendation to the Minister. We expect that the process of consulting with an applicant will illuminate any effects on that applicant.

Depending on the circumstances, an applicant itself may be expected to consult with its members during the application process. In the case of an application from an overseas CS facility, we may consult more broadly. We will consider our approach on a case-by-case basis.

We have amended RG 211 to state that we will consult with applicants and licensees about the type of conditions we may recommend before we give our advice to the Minister. We may also consult with stakeholders on any conditions we may recommend: RG 211.160 and RG 211.221.

Communication about outsourcing or moving operations overseas

- 44 In CP 186, we proposed to require, via the cooperation agreement, a CS facility licensee to include information in its annual report about whether any operations have been moved or outsourced offshore. One respondent suggested that such information should also be made available through the annual assessment report process.
- 45 Another respondent suggested that we extend our expectation that a domestic CS facility licensee speak to us about any intention to move or outsource critical functions offshore to overseas CS facility licensees, to ensure competitive neutrality.

ASIC's response

CP 186 proposed to amend RG 211 to state (in relation to cooperation agreements):

For example, we may require you to include in your annual report details about whether any operations have been moved or outsourced overseas.

We have amended RG 211 to state that we expect that a CS facility would ordinarily publish its annual report: RG 211.232.

We intend to take into account in our annual assessment report details about whether any operations have been moved or been

outsourced overseas. This information will be made available in the annual assessment report.

We have amended RG 211 to include our expectation that overseas CS facility licensees will speak to us about any intention to move or outsource critical functions offshore: RG 211.233.

Additional examples

- 46 One respondent has asked for additional examples of how the regulatory approach will apply.

ASIC's response

We have amended RG 211 to include an additional example from the Council's cross-border CS facilities paper: see Example 7 of Table 2 in Appendix 1 of RG 211.

Appendix: List of non-confidential respondents

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- Australian Bankers Association
 - Australian Financial Markets Association
 - ASX Limited
 - International Swaps and Derivatives Association
 - Chi-X Australia
 - LCH.Clearnet
-