

Attachment 6

The Reserve Bank's Approach to Assessing Clearing and Settlement Facility Licensees

Under section 823CA of the *Corporations Act 2001*, the Reserve Bank must, at least once each year, 'do an assessment of how well each [clearing and settlement (CS)] facility is complying with its obligation under paragraph 821A(aa); that is, 'to the extent that it is reasonably practicable to do so: (i) comply with [the *Financial Stability Standards* (FSSs)]; and (ii) do all other things necessary to reduce systemic risk'. This guidance sets out the Reserve Bank's approach to carrying out a formal annual assessment, drawing a distinction between the approach that it will take in respect of domestic facilities licensed under section 824B(1), and that in respect of overseas facilities licensed under section 824B(2).

All Facilities

In the case of both domestic and overseas facilities, the Reserve Bank will seek sufficient information at the time a facility submits its licence application to be able to assess whether the facility would comply with the FSSs.

Thereafter, on an ongoing basis, the CS facility licensee would be required to provide the Reserve Bank with timely information on any material developments relevant to the services provided under its CS facility licence and its compliance with the FSSs. As far as practicable, the facility would be expected to notify these developments sufficiently in advance of their implementation – or as soon as practicable after the relevant change has occurred – to allow the Reserve Bank to seek further information and/or discuss the impact of the changes with the licensee, as appropriate. Material developments would include, but would not be limited to, the introduction of or changes to:

- new products
- key personnel
- governance arrangements
- ownership or control of the licensee or any holding company (direct or ultimate) of the licensee
- the size and composition of risk resources
- risk management policies
- stress-testing methodology
- margining methodology
- operational processes and arrangements (including payment arrangements and co-sourcing and outsourcing arrangements)
- participation criteria
- Australian-based clearing participation.

Domestic Facilities

In the case of a domestic licensee, consideration of information on material developments will be supplemented by periodic regulatory reporting, and regular activity, risk and operational data. The FSSs provide for the regular provision of information and data. Precise requirements, and the form and frequency of data provision, are to be agreed with the Reserve Bank. At a high level, these will include:

- quarterly risk management reports, including detailed information on margining and stress testing, to support assessment of the adequacy of financial resources
- periodic activity, risk and operational data, with coverage, form and frequency to be agreed with the Reserve Bank
- financial and internal audit reports, and any external independent reviews of operational, risk management and control functions.

The Reserve Bank will also expect to gather information through an open and ongoing dialogue with the licensee, including through scheduled periodic meetings and ad hoc targeted meetings on specific topics. In the case of domestic facilities, scheduled meetings will be expected to include:

- Semiannual high-level review meetings to discuss strategy and relevant market developments, involving the Chief Executive Officer and other relevant board members.
- Quarterly executive-level meetings to discuss developments relevant to compliance with the FSSs, involving the Chief Risk Officer, Chief Compliance Officer, General Counsel and other members of the facility's management team.
- In the case of CCPs, quarterly risk management meetings, involving managers responsible for clearing risk policy and the implementation of risk management arrangements.
- Quarterly operations meetings, involving the Chief Operations Officer and other members of the management team responsible for implementation of operational strategy, management of operational risk and business continuity planning.

The formal annual assessment of compliance with the FSSs will be guided by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO), *Assessment Methodology for the Principles for FMs and the Responsibilities of Authorities* (Assessment Methodology), which provides a framework for assessing and monitoring observance of the *Principles for Financial Market Infrastructures* (the Principles) and the responsibilities of authorities.¹ Within the parameters of the Assessment Methodology, the Reserve Bank's formal assessment of a facility's compliance against all of the FSSs will comprise:

- A discussion of material changes, and their implications for compliance with the FSSs, over the assessment period.
- A more comprehensive and granular assessment against a subset of the FSSs (annual 'special topics'). It is proposed that these special topics would be selected according to:
 - material developments over the preceding period
 - a risk-based assessment of potential implications for financial stability

¹ A draft version of the Assessment Methodology was released for consultation in April 2012: see CPSS-IOSCO (2012), *Assessment Methodology for the Principles for FMs and the Responsibilities of Authorities*, Consultative Report, April, available at <<http://www.bis.org/publ/cps101b.pdf>>. See also CPSS-IOSCO (2012), *Principles for Financial Market Infrastructures*, Bank for International Settlements, April, available at <<http://www.bis.org/publ/cps101a.pdf>>.

- length of time since the last detailed assessment.
- An updated detailed assessment against each FSS.

The Reserve Bank will carry out its formal annual assessment at the end of the financial year ending 30 June. Information gathering to support assessment of special topics and material developments will occur on an ongoing basis throughout the year. It is noted, however, that the Reserve Bank will typically submit a supplementary information request towards the end of the financial year, to pose ‘follow-up’ questions and set a time line for provision of financial year-end data requirements.

Overseas Facilities

In assessing overseas licensees, the Reserve Bank will, subject to certain conditions, place reliance on reports and information from the regulator in an overseas licensee’s principal place of business (the overseas regulator). Such reliance is envisaged in the Act, which requires that prior to the Minister granting a licence under section 824B(2), the Minister must be satisfied, among other things, that ‘the operation of the facility in that country is subject to requirements and supervision that are sufficiently equivalent ... to the requirements and supervision to which clearing and settlement facilities are subject under this Act ...’. For the purposes of advising the Minister on a licence application, the Reserve Bank has published guidance on its approach to assessing sufficient equivalence of an overseas jurisdiction in relation to the degree of protection from systemic risk.²

The Minister must also consider under section 827A(3)(d), among other things, ‘whether adequate arrangements exist for cooperation between the Australian Securities and Investment Commission (ASIC), the Reserve Bank of Australia and the authority, or authorities, that are responsible for [the] supervision’ in the foreign country in which the facility’s principal place of business is located. The Council of Financial Regulators has provided guidance on the type of arrangements that may be required for overseas CS facilities that are systemically important, as part of its framework for ensuring appropriate Australian regulatory influence over cross-border CS facilities.³ These may include representation for the Reserve Bank and/or ASIC in any supervisory college established for the facility, and any crisis management group.

Notwithstanding that an overseas regime may be sufficiently equivalent to that in Australia, there may be some differences in the detailed application of principles or standards. The Reserve Bank therefore will only place reliance on a sufficiently equivalent overseas regulator in respect of assessment against those FSSs for which a ‘materially equivalent’ standard is explicitly applied in the overseas regulatory regime. To the extent that other jurisdictions apply the Principles, a materially equivalent standard would be expected to apply in most cases. The exceptions would therefore typically be where the FSSs introduce complementary measures of particular relevance to the Australian context, including regulatory reporting and notification requirements and measures to enhance Australian regulatory influence over cross-border facilities.

Accordingly, the Reserve Bank will assess compliance with each FSS for which there is a materially equivalent standard in the home jurisdiction, with reference to information and reports from the overseas regulator if each of the following conditions is met:

² This guidance is available on the Reserve Bank’s website at <<http://www.rba.gov.au/payments-system/clearing-settlement/standards/overseas-equivalence.html>>.

³ See Council of Financial Regulators (2012), ‘Ensuring Appropriate Influence for Australian Regulators over Cross-border Clearing and Settlement Facilities’, Supplementary Paper to the Review of Financial Market Infrastructure Regulation, July, available at <<http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/cross-border-clearing>>.

- (1) The licensee obtains, for the benefit of the Reserve Bank, an independent legal opinion that the licensee is held to a materially equivalent standard in its principal place of business, and the Reserve Bank is satisfied with the opinion. The opinion should be updated periodically and in the event of material changes to the applicable laws or regulations in the licensee's principal place of business. Applicable laws or regulations would include: those governing or regulating a licensed CS facility; those designed to prevent misconduct or prohibit a specified type of conduct by a licensed CS facility; and those designed to protect the interests of a client or participant of a licensed CS facility.
- (2) The Reserve Bank receives documentary evidence on an annual basis from the licensee's overseas regulator that the licensee has complied in all material respects with the materially equivalent requirements to which it is held by the overseas regulator, and the Reserve Bank is satisfied with the information received.

The required form of the documentary evidence in (2) would be discussed with the foreign licensee and the overseas regulator, and would be contemplated in the Memorandum of Understanding (MOU) concluded with the overseas regulator at the time the licence is granted. Information received through participation in any cooperative oversight arrangement may also be taken into account. Since the sufficient equivalence of the overseas regulatory regime is a prerequisite of the granting of an overseas licence, the documentary evidence received from an overseas regulator would not be expected to be granular and tailored to the FSSs. It should, nevertheless, include at a minimum, the following:

- details of any assessment carried out by the overseas regulator in respect of the overseas licensee's compliance with the materially equivalent requirements to which it is held, whether or not published
- where applicable, details of any relevant action taken or to be taken by the overseas regulator or the licensee.

Where the Reserve Bank is not satisfied that a materially equivalent standard exists, or is not satisfied with the documentary evidence received from the overseas regulator, the Reserve Bank will directly assess an overseas licensee's compliance with the relevant FSSs.

In order to make direct assessments of an overseas licensee's compliance with relevant FSSs in such circumstances, and to aid the Reserve Bank's understanding of material developments affecting an overseas licensee, the Reserve Bank will gather information through a combination of multilateral and bilateral interactions with the licensee. The Reserve Bank's expectations for such information-gathering arrangements are as follows:

- For an overseas licensee that is systemically important in Australia, the Reserve Bank would expect to be represented on any supervisory college. The frequency of contact with the licensee through college arrangements would be determined by the relevant lead regulator, but should be at least annual. College arrangements would be expected to cover information on licensee strategy, relevant market developments, and material changes to the licensee's business, including risk management, collateral and operational arrangements. College arrangements could also be utilised in respect of overseas licensees that are not systemically important, if made available to the Reserve Bank.
- For other licensees, or in the absence of a supervisory college arrangement, the Reserve Bank would seek periodic and at least annual meetings with the licensee to seek information on a similar range of issues.

- For all overseas licensees, the Reserve Bank will seek additional discussions as appropriate on an ad hoc basis in response to financial, operational or default events affecting the licensee.⁴

Transparency

The Reserve Bank will continue to publish its assessments of licensed CS facilities, as it has since 2007. The Reserve Bank's practice is consistent with the CPSS-IOSCO *Disclosure Framework for Financial Market Infrastructures*, which encourages greater transparency regarding the activities of FMI.s.⁵ The Reserve Bank's future assessments against the FSSs will be guided by the Assessment Methodology and will discuss how well the licensee has observed each high-level standard. These assessments will refer to evidence gathered at the level of each relevant sub-standard. However, except in the case of special topics, the assessment will not separately classify the level of observance of each sub-standard.

In the case of overseas licensees, the level of transparency and depth of analysis included in the Reserve Bank's published annual assessment will be discussed with the overseas regulator and reflected in the MOU concluded at the time the licence is granted.

The Reserve Bank expects its assessments of licensed CS facilities to be subject to external scrutiny, through the assessment programs of international financial institutions, such as the International Monetary Fund and the World Bank. It is expected that these institutions will also use the Assessment Methodology to assess the observance by FMIs and authorities of the Principles, including the associated responsibilities of authorities.

4 A systemically important CS facility licensee (whether overseas or domestic) is required under the FSSs to operate an Exchange Settlement Account at the Reserve Bank. Although not directly relevant for the Reserve Bank's assessment of CS facilities, this will require a systemically important licensee to periodically hold discussions with the Reserve Bank on operational matters relating to its Exchange Settlement Account. Matters raised in these discussions may be utilised by the Reserve Bank in assessing the licensee's compliance with relevant FSSs.

5 A draft version of the *Disclosure Framework for Financial Market Infrastructures* was released for consultation in April 2012: see CPSS-IOSCO (2012), *Disclosure Framework for Financial Market Infrastructures*, Consultative Report, April, available at <<http://www.bis.org/publ/cpss101c.pdf>>.