

Regulatory Developments in Financial Market Infrastructures

The Reserve Bank works with other regulators (both domestically and abroad) on issues relevant to the regulation and oversight of Financial Market Infrastructures. In Australia, much of this work has been coordinated by the Council of Financial Regulators and, internationally, the Bank engages closely with relevant international standard-setting bodies.

The Bank continues to work with other regulators on issues relevant to the regulation of FMI. Where relevant to the Board's responsibilities, the Board has been kept updated on developments and members' input and guidance have been sought.

The agencies of the CFR have continued to progress their implementation of the G20's OTC derivatives reforms, with mandatory CCP clearing of IRDs denominated in Australian dollars and the major currencies coming into effect in April.

In light of the international implementation of mandatory CCP clearing for OTC derivatives, the resilience of CCPs remains a strong focus in the global standard setting bodies. These bodies have established a joint CCP Workplan to examine potential risks to stability arising from the increasingly prominent role of CCPs, and to consider the need for additional policy guidance.

Bank staff have been closely engaged in this international work, given its relevance to domestic regulatory standards. Domestically, the Bank has also contributed to CFR-led work to develop a special resolution regime for FMI, as well as continued work on competition in the clearing of Australian cash equities. A new and increasingly important area of focus for the Bank

and other CFR agencies has been the application of DLT by FMI.

Mandatory Clearing of OTC Derivatives

Since the global financial crisis, international policymakers have sought to strengthen practices in OTC derivatives markets, including by committing that all standardised OTC derivatives would be cleared through CCPs. While contributing to the CFR's OTC derivatives market policy is a broader responsibility of the Bank, the Board's views have been sought. This has especially been the case in respect of mandatory clearing, given potential implications for the Bank's role in CCP oversight and supervision.

Further to recommendations by the APRA, ASIC and the Bank in 2014, in August 2015 the government issued a ministerial determination and a set of amendments to the *Corporations Regulations 2001*.²⁶ These documents defined the broad product and institutional scope for mandatory clearing in Australia. Consistent with the government's recommendations, it was

²⁶ The ministerial determination is available at <<https://www.legislation.gov.au/Details/F2015L01392>> and the Corporations Regulations are available at <<https://www.legislation.gov.au/Details/F2015L01411>>.

determined that the mandate should cover trades between internationally active dealers in IRD denominated in Australian dollars, US dollars, euros, British pounds and Japanese yen.

Within this scope, ASIC drafted Derivative Transaction Rules that set out the details of the mandatory clearing requirement. In accordance with obligations under the Corporations Act, ASIC consulted with APRA and the Bank. These rules were finalised in December 2015 and the clearing obligation commenced in April.²⁷

Implementation Monitoring

Since the PFMI were finalised, CPMI and IOSCO have been monitoring their implementation internationally. During the past year CPMI and IOSCO have published three assessments that consider implementation of the PFMI in Australia:

- *Implementation of the Responsibilities.* The PFMI not only establish a set of principles that set expectations for the design and operation of FMIs, but also five 'Responsibilities for Authorities' that have regulatory responsibility for FMIs. These responsibilities cover the scope of the regulatory regime, the powers and resources available to the relevant authorities, the disclosure of policies, the adoption of the PFMI, and cooperation between authorities. During 2015, the IMSG assessed 28 jurisdictions' implementation of the responsibilities for all FMI types. The report, published in late November, found that good progress had been made across jurisdictions, with 16 of the 28 jurisdictions – including Australia – assessed as fully observing all five responsibilities across all FMI types.²⁸
- *Implementation of the PFMI in Australia.* Also during 2015, CPMI and IOSCO conducted a peer review of the completeness and consistency of legal and regulatory measures to implement the PFMI in Australia. The review, published in December, covered implementation measures for all FMI types.²⁹ The report confirmed that Australia's implementation was complete and consistent in most respects. A small number of minor observations were nevertheless made.
- *Consistency in outcomes of CCP's implementation of the PFMI.* CPMI and IOSCO have also recently published their first assessment of the consistency in outcomes achieved by FMIs' implementation of the PFMI, beginning with an assessment of financial risk management and recovery arrangements at ten derivatives CCPs.³⁰ The scope of this review included three CCPs that are licensed in Australia: ASX Clear (Futures), CME and LCH.C Ltd's SwapClear service. The review found that the ten surveyed CCPs had made important and meaningful progress in implementing arrangements consistent with the PFMI, including in those areas where the PFMI had 'raised the bar'. The report nevertheless identified that some CCPs' implementation measures were not fully consistent with the requirements in the PFMI on recovery planning, ongoing coverage of financial resources and liquidity stress testing. CPMI and IOSCO have committed to a targeted follow-up review of CCPs' progress in addressing these three issues in the first half of 2017. This review will cover a wider range of CCPs and product classes, with progress to be assessed as of end December 2016.

27 The Derivative Transaction Rules (Clearing) are available at <<https://www.legislation.gov.au/Details/F2015L01960>>.

28 The report is available at <<http://www.bis.org/cpmi/publ/d140.htm>>.

29 The report is available at <<http://www.bis.org/cpmi/publ/d139.htm>>.

30 *Implementation Monitoring of PFMI: Level 3 assessment – Report on the Financial Risk Management and Recovery Practices of 10 Derivatives CCPs.* Available at <<http://www.bis.org/cpmi/publ/d148.htm>>.

CCP Workplan

In light of the increasing systemic importance of CCPs, the FSB has been taking a deeper interest in CCP resilience. Since this interest cuts across the existing mandates of CPMI, IOSCO and the Basel Committee on Banking Supervision (BCBS), the chairs of these standard-setting bodies have developed a joint CCP Workplan.³¹ The Workplan identifies priorities and establishes principles for coordination among the standard-setting bodies.

As discussed in 'Accountability and Communication', the Bank is closely involved in two of the main workstreams, both of which are well progressed:

- *CCP resilience and recovery measures.* CPMI and IOSCO are currently consulting on additional guidance that seeks to clarify and elaborate on existing requirements in the PFMI related to CCP resilience and recovery.³² The proposed additional guidance, which has been informed by related implementation monitoring work, addresses a number of aspects of CCPs' risk frameworks, including stress test and margin practices and associated governance arrangements.
- *CCP resolution.* The FSB Cross-border Crisis Management Group for Financial Market Infrastructures (fmiCBCM) has been tasked with considering whether more detailed standards or guidance are required to support the development of effective strategies and plans for resolution of CCPs. This work builds on an FMI-specific annex to the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (the Key Attributes). The fmiCBCM recently issued for comment a

discussion note on the design of resolution strategies for CCPs, covering matters such as the timing of entry into resolution, the adequacy of financial resources in resolution, and cross-border cooperation.³³ The fmiCBCM expect to issue more detailed guidance for consultation by early 2017.

A third workstream is analysing international interdependencies between CCPs, including via common participants. This work is expected to be progressed by early 2017.

A Resolution Regime for FMIs in Australia

Following consultation early in 2015 on proposals to establish a special resolution regime for FMIs, the CFR published a response in November.³⁴ The response observed that consultation respondents had universally supported the principle of establishing an FMI resolution regime, and had agreed that the Australian regime should be aligned with the FSB's Key Attributes and emerging international practice. The response also addressed feedback in a number of specific areas related to the design and scope of the regime.

During 2016, the CFR has continued to advise the government on the development of draft legislation consistent with the proposals in the February 2015 consultation and the response to consultation. Development of this draft legislation is expected to proceed alongside legislative changes to enhance crisis management powers for APRA in respect of the entities that it regulates. Since under the proposed legislation the Bank would be the

³¹ The Workplan and an update on implementation as of September 2015 are available at <<http://www.bis.org/cpmi/publ/d134.htm>>.

³² *Resilience and Recovery of Central Counterparties (CCPs): Further Guidance on the PFMI – Consultative Report.* Available at <<http://www.bis.org/cpmi/publ/d149.htm>>.

³³ *Essential Aspects of CCP Resolution Planning.* Available at <<http://www.fsb.org/2016/08/essential-aspects-of-ccp-resolution-planning/>>.

³⁴ *Resolution Regime for Financial Market Infrastructures: Response to Consultation.* Available at <<http://www.cfr.gov.au/publications/cfr-publications/2015/resolution-regime-financial-market/pdf/report.pdf>>.

resolution authority for CCPs and SSFs, Bank staff are also working with CFR colleagues to develop more practical plans and arrangements for the use of its prospective resolution powers. As noted, the Bank is also actively involved in international work to develop further guidance to support CCP resolvability and resolution planning.

Operating in Australia

Also early in 2015, the CFR released a consultation paper proposing amendments to the Corporations Act that would implement a new approach to assessing when an overseas CS facility should be subject to regulation in Australia. The proposal rests on a test of the materiality of a CS facility's connection to the Australian financial system. Given the narrow scope of this consultation, there were relatively few submissions. On balance, stakeholders agreed that the proposed approach would provide useful additional clarity. There was support for the proposed criteria and stakeholders generally acknowledged the need for the test to be flexible.

The CFR released a formal response to consultation in November and is advising the government on the development of draft legislation. It is anticipated that the legislative amendments will proceed alongside the proposed changes to the Corporations Act to implement a special resolution regime for FMI, since the resolution regime would build on the licensing regime.

Competition in Clearing Australian Cash Equities

On 30 March 2016, the government endorsed the recommendations of the review of competition in clearing Australian cash equities carried out by the CFR and the ACCC – together, the

agencies – in the first half of 2015.³⁵ The agencies had identified three core conclusions from their consultation and supporting analysis:

- *The policy approach should be one of openness to competition.* This would recognise the potential benefits of competitive discipline and be consistent with prevailing legislative settings. To prohibit competition would be unprecedented internationally.
- *Competition, even if permitted, may not emerge for some time, if at all.* There remain strong forces in favour of a single provider of clearing services, so a competing CCP may never emerge.
- *The regulators should have powers to deal with an ongoing monopoly.* Regulatory mechanisms may be necessary to discipline ASX's conduct as a monopoly provider.

Reflecting these views, the agencies developed a number of recommendations. These included recommendations that the government confirm a policy stance of openness to competition, and implement legislative reforms giving the relevant regulators rule-making and arbitration powers that would enable them to enforce, as necessary:

- a set of minimum conditions that support competition in the clearing of cash equities, while also ensuring the safety and efficiency of the market
- a set of regulatory expectations for ASX's conduct in operating its cash equity clearing and settlement services until such time as a competitor emerged.

In its announcement, the government committed to develop and consult on legislative changes in accordance with these

³⁵ The conclusions and the government's response are available at <<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Review-of-competition-in-clearing-Australian-cash-equities>>.

recommendations. The government also committed to developing legislative proposals to bring ownership restrictions on ASX into line with similar limits on other important financial sector entities.

Distributed Ledger Technology

An increasing number of FMI, such as ASX (see 'Supervision of Clearing and Settlement Facilities' for details), have started exploring DLT. There is also growing interest in these issues in international forums. As discussed in 'Retail Payments Policy and Developments', the CFR agencies and AUSTRAC have established a working group to assess the potential implications of greater use of DLT for the financial system. Given the Board's responsibility for CS facilities, the Board has begun to give close consideration to how DLT might be applied in the CS space and the regulatory issues that could emerge.

Since trust is paramount in financial markets, it is expected that applications in financial markets will most likely involve private 'permissioned' ledgers, whereby access to the network is granted only subject to an institution meeting certain standards or criteria. In addition, given the need for industry-wide coordination to change existing market practices, changes seem likely to be incremental, working with, rather than against, the prevailing operating environment.

Nevertheless, since the application of DLT could introduce significant changes to the way CS facilities operate, the Bank and other members of the CFR working group will have to assess whether any aspects of the current regulatory framework need to be changed.

Central Clearing of Repos in Australia

In October 2015, the Bank published its conclusions from a consultation on the costs and benefits of CCP clearing of repos in Australia. Given the participation structure of the market and existing risk management practices – and in particular the significant role of the Bank as a cash provider – the Bank concluded that there was no clear financial stability case to actively promote the introduction of a repo CCP in the Australian market. Nevertheless, the Bank recognised the in-principle support for a repo CCP among market participants. The Bank also identified the potential scope for a CCP to be a catalyst for other operational and infrastructural enhancements that could deepen the repo market and improve its functioning. Therefore, should the industry proceed with a proposal for the introduction of such a CCP, the Bank stated that it would engage actively in the debate and that it would be willing to consider participation, subject to certain pre-conditions on continuity, location and design and terms of access.

