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ASX SUBMISSION: INCREASING THE THRESHOLD FOR THE APPLICATION OF THE FINANCIAL STABILITY STANDARDS FOR SECURITIES SETTLEMENT FACILITIES

ASX welcomes the opportunity to comment on the Reserve Bank's proposed change to the settlement value thresholds for the application of the Financial Stability Standards for Securities Settlement Facilities (FSS). The FSS play a critical role in ensuring that licensed clearing and settlement facilities conduct their affairs in a way that is consistent with financial system stability. Recently, the Government has announced and implemented significant changes to the regulatory regime for financial market infrastructures (FMIs) which raise questions about whether a threshold for the application of the FSS remains appropriate in light of their role in promoting financial stability. This consultation provides an important opportunity to consider these changes and re-evaluate the existing and proposed threshold.

The first change is the recent passage of legislation allowing ASIC to write rules for CS services under Part 7.3A of the *Corporations Act 2001* (Corporations Act). This change allows ASIC to enforce the CFR's policy statements governing the monopoly and competitive provision of CS services, including by a securities settlement facility (SSF). The CFR's policy statements make clear that competing SSFs would be expected to interoperate, but the settlement value threshold governing the application of the FSS means that ASX may then be required to interoperate with an SSF which is not subject to the FSS. This could allow the transmission of risk from an SSF which is not systemically important to an SSF which is, while also allowing the possibility of competition on the basis of less onerous risk controls.

The second is the application of the Government's announced FMI resolution regime. With the release of exposure draft legislation implementing the CFR's 2020 recommendations to Government to implement a CS facility resolution regime, it appears likely that this regime will not be limited in its scope or application to SSFs which are subject to the FSS, but rather to any CS facility licensee. ASX submits that the application of the FMI resolution regime to a CS facility which is not subject to the FSS is inconsistent with the CS facility resolution regime's role as a mechanism of last resort. In order for the CS facility resolution regime to operate as a last resort, it is necessary for entities within scope of the resolution regime to be subject to at least some regulatory obligations under the FSS.

To minimize these risks, ASX submits that the Bank should adopt a more flexible approach that allows for the application of certain Standards to a low volume SSF while exempting it from others. ASX considers that there are a number of Standards which should apply to all SSFs regardless of their gross settlement volumes. This approach will better balance the need to reduce the regulatory burden on new or prospective entrants while ensuring that key risks are appropriately controlled. It would also be more consistent with the approach adopted in other CFR policy statements and would ensure the recent changes to the regulatory regime more broadly do not create unwanted regulatory gaps.

ASX also submits that the application of the FSS should be revisited when a new SSF emerges. This will ensure that the application of the FSS can be tailored to the risks posed by a particular SSF with the benefit of clarity about that SSF's business model, as well as ensuring that any exemption thresholds can be properly aligned with the rest of the

regulatory regime. This could be achieved by a public commitment to review the thresholds and consider what other protections may be required during the assessment of a prospective entrant's licence application.

If the approach outlined in the Bank's consultation paper is implemented, ASX considers that the transitional provisions should be changed to provide more certainty about the time between when a SSF first exceeds the proposed threshold and the point at which it must comply with the FSS. The consultation paper states that the operator of an SSF need only meet the FSS in the financial year following the point when it exceeds the proposed $40 billion for the first time. ASX considers that this is likely to lead to different periods of time before an SSF must comply with the FSS depending on when in a given financial year it first exceeded the threshold. A preferable approach would be to provide for a fixed time period from when an SSF first exceeds the proposed threshold before it must comply with the FSS of up to 12 months. This would provide more certainty to industry and lead to less variable outcomes. This could be based on the time that an SSF notifies the Bank that it has exceeded the proposed threshold.

CFR policy statements and the FSS

In September 2017, the CFR published the *Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia* (Minimum Conditions (Settlement)). Minimum Condition (Settlement) 3 clearly outlines the CFR's view that competing SSFs be interoperable:

> *"…in order to facilitate market functioning in a structure with competing SSFs, the Agencies are of the view that it would be necessary to ensure that securities can be accessed by, and moved between, all of the SSFs. The nature of this link will depend on the particular model. It would also be necessary to have a process in place to prevent the risk of the same security holding being used multiple times during settlement."*[1]

This policy position now has legislative backing following the passage of the *Treasury Laws Amendments (2023 Measures No. 3) Act 2023.* Schedule 3 of the Act implemented the competition in clearing and settlement legislative reforms in the new Part 7.3A of the Corporations Act, which in turn allows ASIC to write rules to support competition, including by writing rules to enforce the CFR's policy statements.

The CFR's policy position on interoperability may result in ASX being required to interoperate with an SSF which is not subject to the FSS under either the existing or proposed thresholds. Interoperability would necessitate the transfer of critical data – such as in relation to settled transactions and corporate actions – between SSFs. Standard 17: FMI Links directly addresses such transfers. For example, Standard 17.1 outlines that:

> *"Before entering into a link arrangement, and on an ongoing basis once the link is established, a securities settlement facility should identify, monitor and manage all potential sources of risk arising from the link arrangement. Link arrangements should be designed such that the securities settlement facility is able to comply with these SSF Standards."*[2]

If an interoperating SSF was not also subject to the FSS, then designing a link arrangement which was capable of managing all potential sources of risk arising from the link arrangement would be difficult, because the interoperating SSF would itself be a source of risk. This means it is essential that interoperating SSFs are subject to the same regulatory obligations rather than being left to commercial negotiation by competing parties.

This approach also risks facilitating competition on the basis of less onerous risk controls. Both the Bank and ASIC have previously stated that this possibility should be minimised through the equivalent application of the regulatory regime:

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[1] *Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia* (Minimum Conditions (Settlement)), p. 5
[2] *Financial Stability Standards for Securities Settlement Facilities*, Reserve Bank of Australia, p. 14

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"The Bank and ASIC consider that equivalent application of the regulatory framework across competing SSFs should limit any scope for competition on the basis of less onerous risk controls, such that the market continues to function in a safe and effective manner.

Application of the existing regulatory framework for CS facilities in a multi-SSF environment is also expected to be sufficient to address any additional risks to central counterparties, for example from mismatches in timing of settlement across SSFs and 'un-netting' of trades during the settlement process."[3]

ASX considers that, while an SSF settling less than $40 billion of gross volume may not in and of itself pose systemic risks to Australia's financial stability, the application of the FSS to these SSFs nevertheless addresses critical risks which, if allowed to materialise, could undermine investor and industry confidence in other FMIs or the clearing and settlement (CS) facility regulatory regime more broadly.

FMI resolution regime

On 15 December 2023, the Government released exposure draft legislation for a CS facility resolution regime. The explanatory materials to the exposure draft legislation outlines that the Bank will be empowered to exercise certain powers to facilitate the resolution of a CS facility, including by taking control of the distressed domestic CS facility licensees and initiating the transfer of its business or shares.[4] This will be supported by a $5 billion standing appropriation per event.[5]

ASX understands that, in exercising these powers, the Bank's primary objectives will be to maintain financial stability and provide for the continuity of CS facility services that are critical to the functioning of the financial system.[6] ASX appreciates that most of the risks the resolution regime addresses are concentrated in CCPs rather than SSFs, and that CCPs pose far greater risks to financial stability than SSFs. However, ASX notes that a failure of a non-systemically important SSF could trigger the use of resolution powers under the proposed resolution regime.[7]

Given that the FMI resolution regime is intended as a last resort, ASX submits that it is important that the Bank retain the appropriate regulatory tools to minimize the risks of failure at an SSF. This will likely better balance the need to reduce the regulatory burden on prospective entrants with the need to ensure that the regulatory regime can effectively minimize the risks posed by a CS facility's failure before the conditions in the proposed section 831A are met.

Proposed approach

ASX suggests that the Bank consider applying, at a minimum, the following Standards to all SSFs whether or not they exceed the proposed gross settlement value threshold:

- Standard 1: Legal basis
- Standard 3: Framework for the comprehensive management of risks
- Standard 7: Settlement finality
- Standard 17: FMI Links

The Standards listed above should not be considered exhaustive, as it is difficult to assess the merits and risks of the Bank's proposed approach in the absence of a new or prospective entrant's business model. A new entrant's business model may give rise to risks which can only be adequately controlled by the application of other Standards not

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[3] *Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia*, Council of Financial Regulators, September 2017, p. 3

[4] *Exposure draft explanatory materials, Financial Sector Reform (Financial Market Infrastructure) Bill 2022, p. 11*

5 Ibid., p. 18

6 Ibid., p. 11

7 See proposed section 831A in Treasury Laws Amendment (Measures for Consultation) Bill 2023: FMI resolution authority, which applies to CS facility licensees.

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identified above. For example, a new entrant's business model may require the following Standards be applied to appropriately control the risks they pose:

- Standard 9: Central Securities Depositories
- Standard 10: Exchange-of-value Settlement Systems
- Standard 14: Operational Risk

ASX also submits that it is important that the application of the FSS to any SSF be revisited at the time an entrant emerges. This will ensure that the application of the FSS can be tailored to the risks posed by a particular SSF with the benefit of clarity about that SSF's business model. This could be done by a public commitment to review the thresholds and other protections which may be required during the assessment of a prospective entrant's licence application.

This approach would also be consistent with the approach taken in the CFR's *Regulatory Expectations for Conduct in Operating Cash Equity Clearing and Settlement Services in Australia* (the Regulatory Expectations), the *Minimum Conditions for Safe and Effective Competition in Cash Equity Clearing In Australia* (the Minimum Conditions (Clearing)), and the Minimum Conditions (Settlement). These include commitments to review the relevant policy statements in the event an entrant emerged or in the event of a material change to the operating environment or market structure for clearing or settlement services.[8]

ASX appreciates that the proposed alternative approach would result in a change from the status quo which currently applies a threshold. However, as noted above, changes in the regulatory regime raise questions about whether the current approach continues to be appropriate. With the potential emergence of an entrant becoming more likely, and the recent and proposed legislative reforms relating to competition and resolution, this consultation provides a timely opportunity to consider the usefulness of the gross value threshold from first principles having regard to the purpose of the FSS and the CS facility regulatory regime.

We would welcome the opportunity to discuss the Bank's proposal and our submission. Please do not hesitate to contact me if you have any questions.

Kind regards

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[8] *See Regulatory Expectations pp3-4, Minimum Conditions (Clearing) p5, and Minimum Conditions (Settlement) p2.*

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