Operators of Clearing and Settlement Facilities

ASX Submission to ASIC CP 120

19 November 2009

EXECUTIVE SUMMARY

- ASX welcomes ASIC's decision to release a Regulatory Guide (RG) in relation to CS licensing. We agree that the creation of an RG has the potential to provide a useful source of information for existing and prospective CS facility operators.

- ASX has suggested a number of areas where ASIC guidance would be useful – particularly in articulating what is meant by a CS facility's services being provided "in a fair and effective way". In the absence of such clarification, the purpose of ASIC having an unspecified oversight role alongside the RBA's clearly articulated systemic risk–based oversight role remains unclear.

- We envisage this new guidance about what it means to provide risk management functionality to clearing and settlement intermediaries fairly and effectively would replace that part of the draft guidance which treats investor protection as if it were one of the purposes of CS facility oversight regime. We would welcome a description of how ASIC's interpretation of the licence obligation to provide services to clearing and settlement intermediaries "in a fair and effective way" is consistent with the actual purpose of the regime, as evidenced by the legislation and the surrounding historical context, namely to avert the consequences of a CS facility not effectively managing relevant systemic and financial stability risks.

- ASX agrees with the proposition in CP 120, that exemptions from CS licensing provisions should only be recommended when there is no policy reason for licensing the facility. In the absence of clarification of the purpose of ASIC's oversight role, there is no satisfactory basis for assessing whether exemptions should only be recommended when a facility's activities are irrelevant to systemic risk and to the objectives of Financial Stability Standards.

- ASX strongly disagrees with the proposal that a facility could be exempt from the CS licensing regime and instead regulated under the AFS or market licence regimes. The regulatory objectives of these respective licences are different, and the licences should not be used inter-changeably. The licensing regime may be undermined if the content of regulation bears no relationship to the rationale for the licensing regime.

- When considering regulatory equivalence of overseas regimes, ASIC should bear in mind that overseas regimes for the oversight of clearing and settlement facilities typically do not involve a rule review process but tend to involve more holistic oversight by reference to identifiable principles. Furthermore, overseas principles are not consistent in different jurisdictions. This means that assessing 'equivalence' can be problematic, and that there is a risk in assuming that the oversight of overseas CS facilities by different regulators applying different sets of principles provides the same level of comfort as Australia's regulatory regime.

- As previously advised to ASIC and to the RBA, ASX is concerned that a lack of equivalent treatment in relation to rule change requirements could unfairly disadvantage CS licensed (domestic) facilities vis-à-vis CS licensed (overseas) facilities if this central feature of ASIC's oversight were to be ignored in assessing equivalence.

Introduction

ASX welcomes ASIC's decision to release a Regulatory Guide (RG) in relation to CS licensing. We agree that the RG has the potential to be a useful source of information for existing and prospective CS facility operators. However, we suggest several areas where additional commentary needs to be added to the current draft in order to improve the quality of the guidance provided and hence achieve this objective.

For example, there are several instances where references are made to investor protection being a regulatory objective for CS licensing, even though the legislative framework does not refer to this outcome. On the contrary, the legislative framework in relation to CS facility operators is based on there being two sets of objectives, one of which is very clear (the objectives of system stability and systemic risk reduction, for which the RBA has oversight responsibility) and the other which is very opaque (provision of services to clearing and settlement intermediaries in a fair and effective way, for which ASIC has oversight responsibility). Similarly, there are references to the size or sophistication of the market, as if the sophistication of participants in the underlying product market is a relevant consideration to the separate regulatory objectives relevant to clearance and settlement of those products.

ASIC has invited comments on the subject of applications to operate a CS facility that will compete with an existing CS facility licensee. We invite ASIC to consider how it defines 'competition' in this context. For example, a CS facility could apply to clear and settle products where that trade has been executed on ASX, in competition with the existing CS facilities. Alternatively, it could apply to clear and settle products that are listed on ASX, but that have been traded elsewhere – either OTC or on another licensed market platform. Competition could also take the form of clearing and settlement of OTC products that share the same fundamental characteristics as products that are traded on a licensed market and cleared through an existing CS facility – for example forward rate agreements or interest rate options.

In addition to clarifying what it means by 'competition', we also invite ASIC to outline what consultation process it intends to follow if it does receive an application to operate a CS facility that will compete with an existing facility. Similarly, we invite ASIC to commit to consultation in respect of any exemption applications. We believe that ASIC would benefit from receiving comments on the issues that an application for exemption poses – such as the possibility of regulatory arbitrage issues arising in respect of different rule disallowance requirements.

To overcome the competitive neutrality issues associated with the rule disallowance provisions, we submit that ASIC should either: i. ensure that all organisations (foreign domiciled and local) are subject to the same rule oversight process by ASIC (given that such processes don't exist elsewhere) or, ii. arrange for legislative amendment to remove the rule oversight process on the basis that the obligation to meet financial stability standards is a better substitute. ASX's preference is for the latter approach.

We reiterate our agreement with several of the themes in the Reserve Bank of Australia's (RBA's) October 2008 consultation paper on Variation of the Financial Stability Standard for Central Counterparties: Oversight of Overseas Facilities, notably, the need for a competitively neutral, level (regulatory) playing field, free of regulatory arbitrage, and the need for information-sharing among CCPs and their regulators.

Purposes of the CS Facilities Regulatory Regime

At paragraph 000.2, CP 120 lists four purposes of regulating CS facilities. It is a fundamental principle of regulation that those who are charged with administering the regime and those who must comply can identify what the regime is designed to achieve. After several years of operating licensed CS facilities, ASX is unable to discern from any publicly available document published by ASIC, how ASIC interprets the most significant licensing obligation which ASIC is charged with oversighting, namely that the CS facility provides its services to clearing and settlement intermediaries in a fair and effective way.

The origin of the concept of a licence category for CS facilities separate from market operator licensing is to be found in Recommendation 24 of the Financial System Inquiry (Wallis Committee) Final Report. Their rationale for licensing clearing facilities used by exchanges was to provide oversight of how "fairly and efficiently" central counterparty clearers were managing the financial risks which they incur.

There was no suggestion that:

- Settlements systems not involving central counterparty clearing needed to be licensed;
- The Reserve Bank (rather than ASIC) should have a role in providing this oversight of central counterparty clearers; or
- There was an investor protection rationale for this oversight that went beyond the indirect benefit to end users of financial products traded on exchanges that they receive from knowing that the financial risks which a CS facility incurs are being properly managed.

It was the then Government which, instead of following the Wallis Committee recommendations to the letter, decided to bifurcate the oversight responsibility between the Reserve Bank and ASIC. This created a problem: how to explain the rationale for whatever oversight role ASIC was expected to continue performing, when the entirety of the rationale espoused by the Wallis Committee had been allocated to the Reserve Bank. The unsatisfactory compromise was to use an expression, devoid of any linkage with an identifiable market failure or other clearly identifiable need - namely, oversight directed at whether a CS facility is providing clearing services to its immediate customers (the intermediaries which provide clearing and settlement services to market users) "fairly and effectively" - and vest this responsibility in ASIC.

Creating a Regulatory Guide to give some meaning to this oversight responsibility, in spite of the absence of any conceptual underpinning, is a necessary but not sufficient solution. The Government should be invited to revisit the legislative provisions and only vest oversight responsibilities that respond to clearly identifiable needs.
The remainder of this submission involves attempting, in the meantime, to patch up the legislative deficiencies to the greatest extent practicable by interpreting the words "fairly and effectively" in a manner that is as aligned as possible with the Wallis Committee's original articulation of the relevant need. In our submission, this would involve interpreting "fairly and effectively" along the following lines: fairness avoids inappropriate differentiation between users of the services (clearing participants). Effectiveness means that any changes to the structure, process or relationships which constitute the clearing and settlement facility are consistent with achieving the fundamental outcomes for which it has been designed. Refer Attachment A for further detail. In the absence of any judicial interpretation or administrative guidance to date, this is the interpretation which ASX has been adopting for some years.

To the extent that “fair and effective” remains the relevant legislative test, we invite the Government to adopt these definitions through legislative amendment and to confirm that they will apply to all CS facilities. The greater particularity could usefully be contained in either the legislative amendments or the explanatory memorandum. We

encourage ASIC to promote such an approach with Government and to amend the RG accordingly.

The fourth point at paragraph 000.2 relates to protecting investors dealing in financial products and users of CS facilities. We can find no basis for this proposition in the legislative framework. To the extent that it refers to "investors", we believe that whatever "fair and effective " means, the licensing regime is predicated on the notion that the interests of users of underlying product markets in having their transactions settled will be achieved if the relationships between a CS facility provider and participants in that facility are appropriately oversighted. This oversight is not being conducted in order to "protect" the interest of those participants but in order to enable those participants to provide a clearing and settlement service to their customers.

It may be that the use of the shorthand expression "protect investors" to characterise ASIC's overarching responsibility, set out in the very first section of its enabling Act, to "strive" (when exercising its powers and functions) to "promote the confident and informed participation of investors and consumers in the financial system" is the source of this overreaching.

Properly applied to its function of oversighting the delivery of services by a CS facility operator to its direct participants, the legislative injunction to strive to promote the confident and informed participation of investors in cleared products is a guidepost as to what it is, about a settlement facility, that would enhance their confidence about investing. Intuitively, the most obvious thing that any investor, retail or wholesale, is looking for is confidence that if they have bought a financial product or had it bought on their behalf, they will actually get what they contracted to buy. Similarly, they are looking for a basis for confidence that if they sold a financial product or had it sold on their behalf, they will receive the money that was agreed. Notwithstanding these comments, we do not agree with the statement that protecting investors dealing in financial products and users of CS facilities is a purpose of regulating CS facilities under the Corporations Act. The fact that it may be a purpose that ASIC ought to be pursuing as a result of its own legislative obligations should not be confused with the regulatory obligations of a CS provider.

- The existence of appropriate regulatory oversight of the management by a CS facility of its financial risks can be expected to promote the take-up of financial products that are traded on financial markets and cleared and/or settled through licensed CS facilities. To that limited extent there is an element of "investor protection" if, and only if, ASIC is using this expression in the draft RG as shorthand for its statutory responsibility to strive for the confident and informed participation of investors in financial markets. Apart from referencing this derivative notion of informed participation in underlying market activity as a by-product of its regulatory oversight, the RG should avoid any articulation of the purposes of CS facility oversight in terms of "investor protection", given the clear inconsistency of this notion with the legislative framework and, in particular, with a CS facility operator's licence obligations.

At paragraph 000.4, CP 120 states that ASIC will consider the "relevance of regulatory outcomes and how you achieve them" with reference to a list of characteristics. We have a number of questions in relation to that list (using your numbering):

(d) in relation to size, the guidance would be more informative if it indicated how size of a facility is to be measured. For the RG to be consistent with the presumed underlying purpose of this characteristic being listed in the Corporations Act (as a factor to which the Minister must have regard), it would need to be referable to the systemic risk and financial stability considerations which constitute the primary reasons for requiring CS facilities to be licensed.

(e) the statement “type of your participants and who they represent” suggests that ASIC would seek to analyse the clients of clearing or settlement facility participants. A CS facility is a principal to principal business with no visibility of, and no direct relationship whatsoever with, the end client. It is not clear why the clients represented by the participant is a relevant factor, or how ASIC would obtain this information. If ASIC’s intention is to differentiate between retail and professional end-clients, then we refer you to our commentary below where we set out reasons rejecting the retail/professional distinction as a relevant factor. If the information is sought for some other reason, then we note that may not be a straightforward matter to identify who a participant represents. For example, a cash equity market clearing participant may clear trades executed by a market participant, who technically is the clearing participant’s client. Orders may be submitted to the market participant by a fund manager, who in turn has taken the order from a financial adviser, who has taken the order from an end-client. Another example could be a participant settling trades on behalf of a nominee company or trustee with a diverse client base. We suggest that this be deleted from the list.

Regulatory Outcomes and Mechanisms, and Factors Affecting Achievement of Regulatory Outcomes for CS Facilities

We find the use of the table setting out ‘regulatory areas’ and ‘regulatory outcomes’ as a means of meeting the ‘regulatory purposes’ in the Corporations Act, supplemented by a list of things to be done to achieve the regulatory outcomes, to be an unnecessarily complicated approach. The RG would be more useful if it simply articulated what a CS facility must do in order to meet its Corporations Act obligations. This, in turn, involves articulating what is expected in order to be regarded as doing all things necessary to reduce systemic risk and providing services fairly and effectively.

The relationship between the regulatory areas (table 1), and the four purposes of regulating CS facilities, is not immediately clear. Investor protection does not appear in the table at all (correctly, in our view), and it is not clear which of the regulatory outcomes are, in ASIC’s view, directed towards protecting investors. In the fourth box in the table titled ‘Risk management’, ASIC has listed “risks relating to default and...market risk...”. We are not sure in what sense market risk would be a risk relating to default for a CS facility. The typical models for both central counterparty clearing and delivery versus payment settlement systems involves structuring the offering so that the provider of the facilities is, as far as possible, not exposed to market risk.

Factors in Deciding Whether to Advise the Minister to Grant a CS Facility Licence

The diagram at paragraph 000.31 is intended to illustrate the concepts of CS arrangements and a CS facility. The diagram seems to suggest that operation of a CS facility only covers a small subset of clearing and settlement activity, whereas other ‘arrangements’ comprise the bulk of CS activity. We do not consider that this is accurate. Also, we did not understand the reference to 'forwarding relevant documents' in respect of CS arrangements. On balance, we are not convinced that the diagram adds to the written description of CS arrangements and facilities, and in fact may confuse or mislead readers. We suggest that ASIC delete the diagram.

At paragraph 000.36, CP 120 lists factors to be taken into account in the decision to license a CS facility. The factors appear to be derived from section 827A of the Corporations Act, which sets out matters the Minister must have regard to when granting, varying or suspending a licence.

We readily acknowledge that a number of the legislative indicia could benefit from being reviewed as to whether they represent the optimal range of issues to which attention should be paid when licences are being granted or rule changes are being made. For example, we question whether the characterisation of end users of the

underlying financial products as being retail or wholesale is of any relevance to the regulatory objectives underpinning licensing of clearing and settlement facilities.

However, since the legislation provides that the Minister "must" have regard to these considerations, applicants and existing licensees alike can be expected to take a keen interest in what ASIC considers when it attempts to give advice that is consistent with the statutory provisions.

As noted above, the guidance would be more useful if it indicated what measures of size will be used. We are not sure what is meant by "sophistication" of the market. We are concerned that CP 120 implies that a facility offering services to a market that satisfies some unspecified test of "sophistication" should be treated differently to another facility. Additional clarity around the significance of there being retail market users would also add value to the RG.

We reiterate comments made by ASX in an earlier submission to ASIC (CP116), where we cast doubt on the merits of different licensing regimes based on notions of 'specialised markets' or retail versus professional market users. These comments are even more pertinent in relation to oversight of CS facility operators. The premise in CP 120 appears to be that relevant regulatory outcomes for "sophisticated" markets may not be the same as those for other markets. ASIC has not defined what it means by "size and sophistication of the market", although it appears that the presence of retail investors is one factor. We submit that any detailed consideration of sophistication of the market would conclude that it is not a viable construct for these purposes. The regulatory objectives underpinning licensing of a CS facility are equally as relevant regardless of the sophistication of facility users, or the products that are cleared or settled on the facility.

In order to sustain the premise that sophisticated markets may require a different test for licensing of a CS facility, it is necessary to conclude that the potential unwanted outcomes which warrant regulatory intervention in respect of licensed CS facilities will vary based on the end-user of the facilities' services. Only if these differences can be identified, can it be convincingly argued that different regulatory objectives should apply. As set out in ASX's earlier submission to ASIC, we suggest that ASIC give further thought to this issue, including taking into account international trends in this area. Comparable countries appear to be moving towards a view that regulatory objectives should be the same across financial markets because the potential market failures (including the likelihood of default, which may impact on CS facilities) are the same.

In paragraph 000.39, CP 120 states "there may be instances that regulating the facility under the market licence regime is more appropriate when considering the nature of the facility's operations and all the relevant circumstances of the case." We strongly disagree with this statement. It is akin to saying that there may be instances where regulating an airline as if it were an airport may be more appropriate than regulating it as an airline.

We refer again to comments made in our earlier submission to ASIC (CP 116), where we clearly distinguished between the regulatory objectives and mechanisms to achieve those objectives in the AFSL and the market licence. The point we made in that submission was that an AFSL could not be used to effectively achieve the regulatory objectives of a market licence, as the objectives for each licence type are different and the tools available under the Corporations Act to administer one regime are not the correct tools to administer the other regime. A similar analogy applies in respect of the CS licence. As CP 120 states, the purposes of the CS licence relate to maintaining financial system stability, reducing systemic risk and ensuing services are provided in a fair and effective way. These are quite different from the regulatory objectives that apply to a market licence. The primary function of a market licence is to ensure market integrity. A key tool is the obligation on licensees to conduct markets that are fair,

orderly and transparent (FOT). We submit that ASIC is mistaken in thinking that a CS facility could be licensed as a market. There is a fundamental misalignment of regulatory objectives that cannot be overcome through the use of conditions attached to the market licence to achieve the purposes of CS regulation.

Factors in Assessing Whether a Facility is Operating in Australia

In paragraph 000.63, CP 120 lists factors to be taken into account in assessing whether a CS facility is operating in Australia. The guidance may be more useful if it stated how the factors are to be taken into account. For example, it appears to us that several overseas CS facilities could currently be seen as satisfying factor (e). We note that LCH.Clearnet, Eurex Clearing and CME Clearing all provide clearing services for licensed overseas financial markets operating in Australia (LME, Eurex and CME respectively).[1]

Given these facilities are not characterised as "operating in Australia", we consider that it would be of assistance to potential overseas CS facility applicants if ASIC could publish, via its website, conclusions it has drawn from its analysis both of CS facilities that are considered to be operating in Australia because they have triggered one or more of the factors in paragraph 000.63 and of those facilities (such as those above) that are not considered to be operating in Australia because they have not sufficiently triggered the relevant factors, notwithstanding that there is reason to consider that there is a nexus between the entity's operations and Australia.

Costs and Benefits of Regulation - Types of CS Licence

We conclude from reading CP 120 that there are at least five possible categories of CS facility that may legally operate in Australia. These are:

1. CS licence (domestic) (para 000.28)
2. CS licence (overseas) (para 000.92)
3. Exempt CS facility (para 000.73)
4. Exempt CS facility obliged to hold an AFS Licence (para 000.86)
5. Exempt CS facility licensed as a market operator (para 000.39)

We strongly agree with ASIC's statement at paragraph 000.74 that the Minister's exemption power should only be used when there is no satisfactory policy reason for regulating the arrangements as a licensed CS facility. Presumably, on this basis, there is extremely limited scope for facilities to operate in Australia on the basis of categories 3-5 set out above. Notwithstanding that categories 4 and 5 may not in fact be used in practice, we do not agree with the proposal in CP 120 that these are an appropriate means for a CS facility to operate in Australia.

As set out above, and in our earlier submission to ASIC (CP 116), the AFS, market and CS licences are not interchangeable. We submit that each licence has been designed to achieve different regulatory objectives and that the licensing regime as a whole could be undermined through the granting of licenses in circumstances other than those anticipated by the legislature.

In paragraph 000.80, CP 120 lists factors to be taken into account in making a cost-benefit assessment of regulating a CS facility. The guidance would be more useful if it stated how the factors are to be taken into account. For example, in relation to

[1] See: http://www.asic.gov.au/asic/asic.nsf/byheadline/Licensed+overseas+financial+markets+operating+in+Australia)

paragraph (d), “whether you operate any other CS facilities”, is the existence of other facilities operated by the same entity more or less likely to result in a recommendation that a CS licence is required? Similarly, in respect of paragraph (h) regarding the nature of the financial products, what characteristics are more (or less) likely to result in a recommendation that a licence is required?

In respect of the factors regarding who the participant entities represent and whether the products traded are commonly traded by retail investors, we refer to our comments above questioning the usefulness of this approach.

Sufficiently Equivalent Overseas Regimes

When considering regulatory equivalence of overseas regimes, ASIC should bear in mind that overseas regimes for the oversight of clearing and settlement facilities typically do not involve a rule review process but tend to involve more holistic oversight by reference to identifiable principles. Furthermore, overseas principles are not consistent in different jurisdictions. This means that assessing ‘equivalence’ can be problematic, and that there is a risk in assuming that the oversight of overseas CS facilities by different regulators applying different sets of principles provides the same level of comfort as Australia’s regulatory regime.

ASX has previously submitted detailed comments on regulatory equivalence to the RBA. We incorporate below the stress testing examples which were set out in that submission.

Case study 1: the UK
CCPs in the UK are regulated as Recognised Clearing Houses (RCHs) by the Financial Services Authority (the FSA). There are a number of criteria to become recognised as an RCH. In terms of financial resources, the FSA requires that:

> *The UK RCH must have financial resources sufficient for the proper performance of its relevant functions as a UK RCH. In determining whether a UK recognised body has financial resources sufficient for the proper performance of its relevant functions, the FSA may have regard to:*
> *(1) the operational and other risks to which the UK recognised body is exposed;*
> *(2) if the UK recognised body acts as a central counterparty or otherwise guarantees the performance of transactions in specified investments, the counterparty and market risks to which it is exposed in that capacity;*
> *(3) the amount and composition of the UK recognised body's capital;*
> *(among other things)…*
> *[And] In assessing whether a UK recognised body has sufficient financial resources in relation to counterparty and market risks, the FSA may have regard to:*
> *(1) the amount and liquidity of its financial assets and the likely availability of liquid financial resources to the UK recognised body during periods of major market turbulence or other periods of major stress for the financial system; and*
> *(2) the nature and scale of the UK recognised body's exposures to counterparty and market risks and, where relevant, the counterparties to which it is exposed.*

However, the recognition requirements do not specify that an RCH must use stress testing, nor do they specify a link between stress testing and financial resources in terms of the number or scale of Clearing Participants which should be used as a standard.

Anecdotally, UK RCHs – or at least those whose arrangements are transparent – do use stress testing and do attempt to maintain financial resources in excess of their

largest Clearing Participant's stress testing losses. However, none of those CCPs call additional margin based on stress testing results. Consequently, stress testing results can be in excess of fixed financial resources for some time, prior to those fixed financial resources being increased. Finally, stress testing may not be conducted daily and the severity of the scenarios may not be calibrated and/or may be subject to qualitative override.

Case Study 2: the US
Derivatives Clearing Organizations (DCOs) in the US are regulated by the Commodity Futures Trading Commission (CFTC). The relevant Core Principle (B) relating to financial resources states that:

> *The applicant shall demonstrate that the applicant has adequate financial, operational, and managerial resources to discharge the responsibilities of a derivatives clearing organization.*
> *In addressing Core Principle B, applicants and registered derivatives clearing organizations may describe or otherwise document:*
> *1. The resources dedicated to supporting the clearing function:*
> *a. The level of resources available to the clearing organization and the sufficiency of those resources to assure that no material adverse break in clearing operations will occur in a variety of market conditions; and*
> *b. The level of member/participant default such resources could support as demonstrated through use of hypothetical default scenarios that explain assumptions and variables factored into the illustrations.*

However, the principle does not specify that a DCO must use stress testing, nor does it specify a link between stress testing and financial resources in terms of the number or scale of Clearing Participants which should be used as a standard.

Anecdotally, US DCOs – or at least those whose arrangements are transparent – do use stress testing. However, they use it largely for management information rather than to determine the adequacy of their financial resources. As a result, stress testing results can routinely be in excess of fixed financial resources. Partly as a result, none of these CCPs call additional margin based on stress testing results. Finally, stress testing is normally not conducted daily.

It is worth noting that DCOs have been used in the US case study because the regulation and risk management practices of equities CCPs in the US are less transparent.

In paragraph 000.81, the CP notes that maintaining operating rules in accordance with the Corporations Act is a burden associated with CS licensing. We agree with this observation, and further note that it is a requirement at odds with comparable overseas regulatory regimes. The fact that licensed domestic CS facilities are subject to a rule disallowance process whereas overseas operators are not (section 822E Corporations Act) raises concerns about how ASIC will maintain a level playing field. The absence of a rule disallowance process clearly gives overseas CS facilities a competitive advantage, enabling them to move more swiftly and at a lower cost than a licensed domestic CS facility. For example, an overseas CS facility would be able to improve their risk management (e.g. to increase financial resources or clearing participant net capital requirements) or meet regulatory demand for systemic risk mitigation (e.g. relating to OTC clearing) both at greater speed and lower cost. The lack of equivalence on this issue between licensed domestic CS facilities and overseas CS facilities should be a factor taken into account by ASIC when considering what advice to provide the Minister in relation to considering equivalence, and conditions to impose upon an overseas CS facility.

We submit that ASIC should either: i. ensure that all organisations (foreign domiciled and local) are subject to the same rule oversight process by ASIC (given that such processes don't exist elsewhere) or, ii. arrange for legislative amendment to remove the rule oversight process on the basis that the obligation to meet financial stability standards is a better substitute. ASX's preference is for the latter approach.

At paragraph 000.105, CP 120 considers the issue of whether an overseas facility is the 'same facility' as the facility that will be operated in Australia. Additional criteria that should be made explicit in the RG are whether the facility will be operated by the same legal entity and with the same financial resources as the overseas facility. We submit that these criteria are equally relevant and arguably less subjective than the factors listed.

It is proposed at paragraph 000.130(e) that an overseas operator would notify ASIC of proposed changes to the range of financial products and transactions in respect of which the facility's services are provided. To the extent that proposed changes to the range of products/transactions undertaken by a domestic CS facility may require rule changes (and hence trigger the disallowance process), we invite ASIC to consider ways to level the competitive playing field so that overseas facility operators do not receive an unfair competitive advantage because their primary regulator does not have a comparable rule approval/disallowance process.

At paragraph 000.195, reference is made to ASIC's expectation that a CS facility licensee will discuss all prospective rule changes with ASIC, and that "extensive discussion and negotiation" with ASIC may be required in some cases. We have two comments to make in relation to this point. First, we invite ASIC to provide indicative timeframes in which it will engage with the CS licensee in relation to prospective rule changes. We are aware of previous rule changes that have taken many months to finalise, and believe that a transparent timetable for communication with ASIC will reduce the likelihood of lengthy delays in this negotiation and discussion phase.

Secondly, we submit that the RG should refer to the legislative context in which the Ministerial disallowance power (and by extension, ASIC's advice to the Minister) is to be exercised. Specifically, we refer to the reference to the Minister having regard to the consistency of the change with a CS facility licensee's obligations under section 821A(aa) and (a), being in relation to RBA financial stability standards, systemic risk, and provision of services in a fair and effective way.

Paragraph 000.198 states that changes to procedures do not need to be discussed with ASIC beforehand. We query whether this represents a change in approach from ASIC? At present, when considering rule changes, ASIC asks ASX to provide details of any related procedure changes. We invite ASIC to clarify if it is no longer adopting this approach, or whether the comment relates only to procedure changes in the absence of rule change.

ATTACHMENT A: ASX Definition of "Fair and Effective"

Providing a Clearing and Settlement Facility's Services in a Fair and Effective Way

An operator of a clearing and settlement facility could be expected to satisfy this obligation if it:

- avoids inappropriate differentiation between users of the services (clearing participants).[2] — FAIR
- ensures that any changes to the structure, process or relationships which constitute the clearing and settlement facility are consistent with achieving the fundamental outcomes for which it has been designed.[3] — EFFECTIVE

2 By analogy with a "fair" market being one which does not tolerate intermediaries taking unfair advantage of clients, a "fair" clearing and settlement facility is one in which the end users are not improperly disadvantaged in achieving settlement of transactions by the way in which the facility provider interacts with different clearing participants. An example of an appropriate differentiation between clearing participants is one made by reference to legitimate differences in risk or services provided.

3 As any company has a commercial interest in providing its services effectively, there is unlikely to be any aspect of the license obligation to provide services "effectively" which requires the operator to do anything more than is in its own interests in this respect.