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Mr Patrick Mahony
Senior Adviser
Banking, Insurance and Capital Markets Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: crisismanagement@treasury.gov.au

Dear Mr Mahony

APRA's Crisis Management Powers

The Australian Financial Markets Association (AFMA) is commenting on the exposure draft of the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017* (Draft Bill).

AFMA in response to the 2012 review which initiated the preparation of the Draft Bill commented that the proposals were complex and that further detailed consultation with industry on the detailed components before finalisation was highly desired. AFMA considers the release of a highly complex and large draft piece of legislation with only three weeks consultation period shortly prior to introduction falls well short of the Government's own consultation practice guidelines. There is no obvious rationale for the haste, given the very long gestation that these proposals have had.

In the context of our limited analysis, while AFMA supports in principle the strengthening of APRA's powers consistent with the Financial Stability Board's (FSB) Key Attributes of Effective Resolution Regimes (Key Attributes), this support cannot be given unequivocally given the limited time to make an effective assessment of the integrity of the Draft Bill. Given the Draft Bill's complexity it is possible that inadvertent technical errors such as mistaken cross-references may exist, which thorough industry consultation could assist in identifying.

Australian Financial Markets Association
ABN 69 793 968 987
Level 25, Angel Place, 123 Pitt Street GPO Box 3655 Sydney NSW 2001
Tel: +612 9776 7995
Email: dlove@afma.com.au

1. Effectiveness of netting and collateral arrangements

AFMA has previously emphasised to the Treasury the importance of legal certainty for the enforceability of the netting and collateral arrangements. Such arrangements are fundamental to the reducing risk in the OTC derivatives markets and are fundamental to supporting credit risk management in line with the Government regulatory framework for these products. Therefore the consequential amendments made to the *Payments System & Netting Act 1998* (PSN Act) to cover the extensions to stays, moratoriums for statutory and judicial management, and extensions for group entities are considered to be of high importance.

2. Extent of write-off stay conversions

The Draft Bill makes amendments which enable capital instruments to be converted or written down as required by APRA and stops counterparties from denying an obligation; accelerating a debt; closing-out any transaction; and enforcing a security. Paragraph 6.14 of the Explanatory Memorandum (EM) describes the scope in very broad terms as –

> *The occurrence of an event (which may be the making of a determination (however described) by APRA) that results in a relevant instrument being required to be converted or written off for the purposes of the conversion and write-off provisions.*

The breadth of the amending provisions in the Draft Bill referred to in the above paragraph could encompass many events which are not relevant to the instrument, including a substantive default under an OTC derivative contract. As this opens up the possibility that any event not connected with action by APRA could permit a relevant instrument to be converted or written off. While it may countered that APRA of course would not allow such a situation to arise this does not address the concern. It is the theoretical possibility which the draft opens up that creates the problem from a credit risk perspective. The policy intention is to deal with early termination rights which are not directly related to the conversion or write-off not being stayed.

It is critical that the close-out rights of counterparties which arise in the event of a substantive default, which include a failure to pay or deliver, are not stayed. This create uncertainty for counterparty rights when facing an APRA regulated entity or related body corporate of a serious nature a permanent stay of counterparties' close-out-rights. The protections of the PSN Act do not prevail in this circumstance so we would be returning a situation of legal uncertainty with regard to close-out netting in certain circumstances similar to the situation that had to be remedied last year by the *Financial System Legislation Amendment (Resilience and Collateral Protection) Bill 2016*.

AFMA considers that the formulation should be adjusted from an occurrence in general to an occurrence of an event taken by APRA that results in the relevant instrument being required to be converted or written off for the purposes of the conversion or write-off provisions.

In our view this formulation is in accord with the actual policy intent as indicated by the commentary quoted above in the EM which refers to the making of a determination (however described) by APRA.

3. Foreign Branches

3.1. Cross-border regulatory cooperation

In the part dealing with Foreign branches, paragraph 7.7 of the EM states that –

> *Where appropriate, APRA will be able to give due consideration to using the powers to facilitate the resolution of the relevant entity by its home resolution authority. In other circumstances, APRA may consider using the powers in instances where foreign authorities are unable or unwilling to intervene, or intervene in a manner that is inconsistent with the interests of Australia depositors or policyholders, or with financial system stability in Australia.*

AFMA considers that a coordinated and cooperative approach to the resolution of a cross-border financial institution is very important to better protect financial stability across home and host jurisdictions and is in the interest of all parties. Cross-border financial institutions rely on regulatory cooperation amongst authorities to maximize the recoverable value of the firm during resolution. While the above statement in the EM is generally consistent with the Key Attributes, AFMA believes that a legal framework for regulatory cooperation (e.g. by way of recognition or support) which is clearly enacted in law and which is based on the presumption of cooperation unless material concerns speak against it is the best approach. Art. 95 of the EU's BRRD may be a helpful cross-reference in this respect, outlining instances in which it may not be appropriate to recognize a foreign resolution proceeding. Such a presumption of cooperation would help to improve transparency and efficiency in the resolution of cross-border financial institutions and provide legal certainty in relation to the resolution of foreign ADIs. In addition, we strongly encourage APRA to continuously develop its collaboration with foreign resolution authorities.

3.2. Revocation of authorisation of a foreign regulated entity

There appears to be some inconsistencies within the EM and the Draft Bill on the circumstances that may lead to the revocation of the authorisation of a foreign regulated entity. It is unclear whether the revocation of a foreign regulated entity's authorisation by APRA is limited to where the entity's authorisation is revoked by its home jurisdiction / home regulator (EM – P. 16, P.125, P.133 (heading before para 7.39)) or if APRA may also revoke the authorisation of a foreign regulated entity in Australia if that entity's authorization is revoked by a foreign regulator / in a foreign country other than in the home jurisdiction / in the home regulator. (EM – P.127, P.133 (para 7.39 and 7.40), Draft Bill – P.9)

AFMA is of the view that the first case to be the policy intention as it is consistent with the existing local authorisation requirements. The authorisation of a foreign branch in Australia should not be affected if the entity has its authorisation revoked in a third country other than the home jurisdiction.

It would be helpful to the APRA regulated entities to have clarified the circumstances and make clear in the legislation that the authorisation can be revoked only if the entity's authorisation is revoked by its home jurisdiction / home regulator.

3.3. Definition of Australian business assets and liabilities

The second part of the definition of 'Australian business assets and liabilities' refers to *"any other assets and liabilities that the foreign regulated entity has as a result of its operations in Australia*". The meaning of 'as a result of its operations in Australia' is potentially very broad and the scope is not entirely clear, e.g. where a foreign ADI adopts a global booking model with trades booked in a branch or subsidiary of the foreign ADI outside Australia, are these intended to be captured by the definition? If trades / transactions conducted by the Australian branch of a foreign ADI are booked in a branch or subsidiary of the foreign ADI outside Australia, will the assets and liabilities resulting from these transactions be subject to APRA's power of statutory management and / or compulsory transfer? There should be clarification of the scope of this second part of the definition. If it is intended that part two of the definition captures such assets and liabilities in another jurisdiction resulting from the foreign ADI's operations in Australia, then it should be made clear how APRA will exercise its powers in relation to other regulators.

3.4. Applicability of APRA's powers to foreign regulated entities

The Draft Bill proposes to enhance APRA's powers in relation to an Australian branch of a foreign regulated entity. The proposed amendments empower APRA to appoint a statutory manager to the Australian business assets and liabilities of a foreign regulated entity, appoint a statutory manager to a 'related body corporate' of a regulated entity, appoint a statutory manager to a 'target body corporate' of a regulated entity and to harmonize the power to direct a foreign regulated entity not to transfer assets out of Australia. The Draft Bill extends various powers of APRA to authorised non-operating holding companies (NOHCs) of regulated entities, subsidiaries of authorised NOHCs and subsidiaries of regulated entities. In addition, various stay provisions may be triggered where a statutory manager is appointed to a related body corporate of a regulated entity, or by an act done by a statutory manager of a related body corporate of the regulated entity.

In this context, it is not clear to AFMA if the policy intention is to extend these powers to non-APRA regulated Australian subsidiaries of a foreign ADI and whether APRA's powers would be limited to the foreign ADI's *"Australian business assets and liabilities"*. Particularly given the uncertainty of the language used in the second part of the definition of 'Australian business assets and liabilities', as mentioned in our

comments above. And also whether Australian incorporated and/or foreign incorporated subsidiaries of the foreign regulated entity are intended to be in scope.

AFMA considers that clarification is needed on the extent to which APRA's powers apply to the subsidiaries of a foreign regulated entity, whether incorporated in Australia or in another jurisdiction.

4. Safeguards on direction powers

We note that the enhanced directions powers proposed under the Exposure Draft (as outlined in Chapter 3 of the EM), empower APRA to issue directions, among others, requiring entities to take specified actions to facilitate resolution, whether in normal times or during a crisis. It should be made clear that a resolution direction given by APRA under existing and enhanced powers is a 'reviewable decision of APRA' under section 51A of the *Banking Act* and accordingly, subject to review under Part VI of the *Banking Act*.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

David Love
General Counsel & International Adviser