Resolution Regime for Financial Market Infrastructures

Consultation Paper

February 2015

Glossary

ADI	Authorised deposit-taking institution
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
Banking Act	*Banking Act 1959*
Business Transfer Act	*Financial Sector (Business Transfer and Group Restructure) Act 1999*
CCP	Central counterparty
CFR	Council of Financial Regulators
CMG	Crisis management group
Corporations Act	*Corporations Act 2001*
Covered CS facility	A clearing and settlement facility that is incorporated in Australia and holds a domestic CS facility licence
Covered FMI	A covered CS facility or a covered TR
Covered TR	A trade repository that is incorporated in Australia and is identified as being systemically important in Australia
CPMI	Committee on Payments and Market Infrastructures (formerly the CPSS)
CPSS	Committee on Payment and Settlement Systems (now the CPMI)
Cross-border Insolvency Act	*Cross-border Insolvency Act 2008*
CS	Clearing and settlement
FMI	Financial market infrastructure
FOI	Freedom of information
FSB	Financial Stability Board
FSS	Financial stability standards
IOSCO	International Organization of Securities Commissions
KA	*Key Attributes of Effective Resolution Regimes*
OTC	Over-the-counter
PFMI	*Principles for Financial Market Infrastructure*
PSN Act	*Payment Systems and Netting Act 1998*
RBA	Reserve Bank of Australia
Regulators	ASIC, APRA and the RBA
Reserve Bank Act	*Reserve Bank Act 1959*
SSF	Securities settlement facility
TR	Trade repository
TR rules	*Derivative Trade Repository Rules 2013*

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1 INTRODUCTION AND EXECUTIVE SUMMARY

The Australian Government — acting on the advice of the Reserve Bank of Australia (RBA), the Australian Securities and Investments Commission (ASIC), the Australian Prudential Regulation Authority (APRA) (jointly, the Regulators) and the Australian Treasury — seeks stakeholder views on legislative proposals to establish a special resolution regime for clearing and settlement (CS) facilities and trade repositories (TRs), together referred to as financial market infrastructures (FMIs), consistent with international standards. Some of the legislative proposals in this paper relating to directions powers and international regulatory cooperation also extend to operators of domestically incorporated and licensed financial markets.

Considerable work has been done in recent years, both domestically and internationally, to develop best practice standards for bank resolution regimes. Attention has now turned to the establishment of similar regimes for FMIs.

Although robust risk management significantly reduces the likelihood of an FMI failure, the possibility of such failure is not entirely eliminated. With increasing dependence on centralised infrastructure, motivated in part by regulatory reforms, it is vital that the official sector clarifies how it would address a situation of FMI distress. The particular focus of this consultation paper is on resolution: actions taken by public authorities to either return an FMI to viability or facilitate its orderly wind-down. The associated concept of recovery refers to actions taken by a distressed FMI itself to return to viability.

The set of proposals described in this paper aims to ensure, as appropriate, the timely and effective resolution of a failing FMI in a manner that maintains financial system stability while avoiding the use of public funds to the maximum extent possible.

1.1 BACKGROUND

For the purposes of this paper, FMIs are defined as multilateral systems used to clear, settle and record financial transactions.

- **Clearing** is a post-trade and pre-settlement function performed by financial market participants to manage trades and associated exposures. Through the legal process of novation, a central counterparty (CCP) interposes itself between counterparties to transactions executed in the markets it serves, becoming principal to each transaction so as to ensure performance of obligations.

- **Settlement** is the point at which the counterparty exposures associated with a transaction are eliminated. In securities markets, settlement is facilitated by securities settlement facilities (SSFs).

- **TRs** are facilities that centrally collect and maintain records on over-the-counter (OTC) derivatives transactions and positions for the purpose of making those records available to regulators and, to an appropriate extent, the public.

Internationally, the Financial Stability Board (FSB), the Committee on Payments and Market Infrastructures (CPMI, formerly the Committee on Payment and Settlement Systems (CPSS)) and the International Organization of Securities Commissions (IOSCO) have progressed work on international guidance for FMI recovery and resolution. The FSB adopted the

Key Attributes of Effective Resolution Regimes for Financial Institutions (the KAs) in October 2011, and the G20 Leaders endorsed these KAs in November 2011.[1] The FSB subsequently added guidance for applying the KAs to FMIs (the FMI Annex to the KAs) in October 2014. Together, the KAs and the FMI Annex to the KAs identify the powers and limits of a resolution framework for financial institutions, including FMIs. CPMI and IOSCO also published guidance on the development of recovery plans for FMIs in October 2014.[2] The guidance provided in these documents extends to CS facilities and TRs, but not financial markets.

The FSB is monitoring jurisdictions' progress in implementing the KAs, including in respect of FMIs, through a series of peer reviews. The first such review was published in April 2013 and noted that resolution regimes for FMIs were generally less developed than corresponding regimes for banks. Australia was one of sixteen jurisdictions identified in the report as having no administrative authority responsible for resolution of FMIs.

This gap had already been identified by the Council of Financial Regulators[3] (the CFR) in its 2011 review of FMI regulation, which resulted in a recommendation to Government in February 2012 to develop a special resolution framework for CS facilities and financial markets. The CFR's review and recommendations did not apply to TRs, as TRs were not at that time subject to licensing and regulation under Chapter 7 of the *Corporations Act 2001* (the Corporations Act).[4] In particular, the CFR noted that 'the absence of a specialised resolution regime' for CS facilities and financial markets represented a gap in the current regulatory framework. The CFR's key recommendations were to:

- strengthen the ability of regulators to deal with distress situations at key CS facilities and financial markets by streamlining and clarifying the directions powers provided in the legislation;
- enhance the ability of regulators to maintain financial stability in times of stress by establishing a statutory management (step-in) regime allowing ASIC and the RBA to take control of a domestically licensed CS facility or financial market in certain defined circumstances.

In principle, if a comprehensive recovery plan could be executed effectively, resolution would not be necessary. However, in some circumstances, an FMI may be unable to fully implement its recovery plan without direct public intervention. In others such intervention may be desirable in the interests of financial system stability, even if recovery actions could be taken. The availability of a special resolution regime as an alternative to general insolvency would allow actions to be taken by a resolution authority with a system-wide perspective. In particular, the resolution authority would seek to restore critical services to viability, while allowing non-critical services to be wound down in an orderly manner. Ancillary powers would be provided for the resolution authority to pursue alternative means of maintaining service continuity, such as a transfer of operations to another entity.

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1 FSB, *Key Attributes of Effective* Resolution *Regimes for Financial Institutions*, October 2014, available at: www.financialstabilityboard.org/2014/10/r_141015/

2 CPMI-IOSCO, *Recovery of financial market infrastructures*, October 2014, available at: www.bis.org/cpmi/publ/d121.htm

3 The Australian Treasury, the Reserve Bank of Australia, the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority.

4 See the CFR's recommendations to government on recommendations from its review of FMI regulation. The CFR's letter to the then Deputy Prime Minister and Treasurer is available at: www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/CFR-Financial-Market-Infrastructure-Regulation

A legislative framework that clearly identified the tools and powers available to a relevant resolution authority would provide valuable certainty to market participants. This would be particularly important in times of stress.

1.2 Legislative proposals

In developing legislative proposals for an Australian FMI resolution regime, the Government has sought to ensure consistency with the KAs, as well as the recommendations of the 2011-12 CFR review of FMI regulation.

In globalised financial markets, international standards for resolution regimes provide an important common benchmark for all jurisdictions to follow. It is therefore proposed that the domestic regime be consistent with the KAs and the FMI Annex to the KAs, which apply to CS facilities and TRs. Attachment A includes a table that maps the proposed regime against the KAs and the FMI Annex.

The proposals in this paper are also designed, where relevant, with reference to powers available to APRA under the *Banking Act 1959* (the Banking Act) and the *Financial Sector (Business Transfer and Group Restructure) Act 1999* (the Business Transfer Act) for the resolution of authorised deposit-taking institutions (ADIs).

1.2.1 Institutional scope, objectives and resolution authority

The legislative proposals in this paper extend to:

- all CS facilities that are incorporated in Australia and hold a domestic CS facility licence;
- all TRs that are incorporated and licensed in Australia and that are identified as being systemically important in Australia.

Some of the legislative proposals in this paper also extend to financial markets that are incorporated in Australia and hold a domestic market licence.

Consistent with the CFR's published framework for regulatory influence over cross-border CS facilities, additional amendments to the Corporations Act are proposed to require all systemically important cross-border CS facilities that are strongly connected to the Australian financial system and real economy to operate from an entity incorporated in Australia, and hold a domestic CS facility licence. This would bring them within the scope of the resolution powers proposed in this paper.

Once an FMI was in resolution, certain powers would also extend to any related entity that provided the FMI with critical services or funding support under ex-ante legal arrangements.

It is proposed that the RBA would act as resolution authority for CS facilities, and ASIC as resolution authority for TRs. An overarching objective for the RBA in taking resolution actions in relation to CS facilities would be to maintain overall stability in the financial system.[5] Consistent with maintaining system stability, an additional common key objective of both resolution authorities would be to maintain the continuity of CS facility and TR services that are critical to the smooth functioning of the financial system. These objectives would be complemented by a set of considerations for the resolution authorities, covering

5 ASIC does not have a financial stability mandate in relation to TRs.

matters such as maintenance of market confidence and integrity, protection of public funds, and minimisation of the costs of resolution to creditors and shareholders.

1.2.2 Resolution powers

The objectives of the resolution authority may be best pursued by taking actions in accordance with an FMI's own operating rules, including the allocation of uncovered losses. These actions would be supported by a range of powers available to the resolution authority.

The legislative proposals draw a distinction between general conditions (those that establish the case for public intervention) and specific conditions (those that are used to select between particular resolution actions) for the exercise of resolution powers. The powers proposed for the resolution authority in relation to FMIs are:

- **Statutory management.** The power to appoint an individual, company or the resolution authority itself to temporarily administer a distressed FMI in a manner consistent with the objectives of the resolution regime. The statutory manager would assume the powers of the FMI's board, including carrying out recovery measures and other actions in accordance with the FMI's rulebook. The exercise of powers by the statutory manager would be overseen by the resolution authority.

- **Moratorium on payments to general creditors.** The power to suspend an FMI's payment obligations to general creditors. This would exclude payments made in relation to core FMI activities (such as margin payments and settlement of securities transactions).

- **Transfer of operations to a third-party or bridge institution.** The power to compulsorily transfer all or part of an FMI's operations to a willing third-party purchaser, or a temporary bridge institution established by public authorities. A transfer to the latter would be intended as an interim step towards a return to private sector ownership under new governance arrangements.

- **Temporary stay on early termination rights.** The power to impose a temporary stay of up to 48 hours on termination rights (with respect to future obligations) that may be triggered solely by an FMI's entry into resolution. It is also expected that FMIs would ensure that such termination rights were not included in their rules or contracts with critical third-party suppliers.

1.2.3 Safeguards and funding arrangements

The powers available to the resolution authority have the potential to significantly impact participants and other stakeholders that have dealings with FMIs. The legislative proposals provide a right to compensation from the Commonwealth should participants or other stakeholders be left worse off in resolution than they would have been had the FMI entered general insolvency.[6] The proposals also include an immunity from liability for the resolution authority, statutory manager and others acting in compliance with the directions of the resolution authority.

6 A modified compensation test could apply where resolution actions were taken to address a deficiency in financial resources that was not large enough to trigger insolvency, or other non-insolvency related threats to service continuity.

It is envisaged that in some resolution scenarios, there could be a need to draw on public funds to provide temporary liquidity, to ensure the timely disbursement of operating expenses, or in some extreme cases to meet a small shortfall required to complete an FMI's closeout processes. In each of these cases the Government would seek to recover any expenditure from participants and shareholders of the FMI.

1.2.4 International cooperation and supporting requirements

The institutional scope of the proposed resolution regime does not extend to overseas-based FMIs. However, the proposals recognise that Australian authorities should also have the capacity to take limited action in support of resolution actions by overseas authorities in respect of overseas-based FMIs and financial markets that are licensed to operate in Australia. It is not currently expected that legislative change would be required to enable the relevant authorities to engage in information-sharing with foreign authorities or to participate fully in multilateral cooperative crisis management arrangements for such FMIs and financial markets. The proposal nevertheless considers measures to give a legislative basis for the cooperation of a foreign authority responsible for oversight of any overseas-based FMI or financial market that holds an Australian licence.

The proposals also address several matters required to support the practical implementation of the resolution regime, although these are not expected to require specific legislation. These include the development and maintenance of recovery and resolution plans, and assessments of the feasibility of resolution plans for each FMI.

1.2.5 Directions powers

While not a particular focus of the KAs, the legislative proposals set out a range of enhancements to the powers of regulators and resolution authorities to give directions to FMIs and financial markets. These powers, primarily designed to support the successful implementation of recovery and resolution actions, also develop some more general recommendations made by the CFR following the 2011-12 consultation. They would introduce a streamlined process for the timely issuance of directions, and also strengthened sanctions for a failure to comply, including criminal sanctions.

Among the recommendations, it is proposed that the RBA be granted the power to issue directions to CS facilities on its own behalf in respect of matters relevant to its financial stability responsibilities. In addition, it is proposed that ASIC and the RBA would each be granted the power to issue directions to support an FMI's recovery actions and its own resolution actions. These powers would extend to ASIC's regulatory role in respect of financial markets. Resolution-related directions powers would extend to related entities of an FMI that provided critical services or funding to the FMI under **ex-ante** legal agreements (for example, the holding company of an FMI, or an operational affiliate).

1.3 Outline of consultation paper

The remainder of the paper is structured as follows. Section 2 discusses the intended institutional scope of the special resolution regime, as well as the statutory objectives and the proposed resolution authority for each of CS facilities and TRs. Section 3 discusses the relationship between an FMI's own recovery measures and resolution, going on to consider the triggers for entry into resolution and the range of powers and tools that would be made available to the resolution authority. Sections 4 and 5 respectively cover safeguards and funding arrangements, and international cooperation. Section 6 closes with proposals for

enhancements to the directions powers available to ASIC and the RBA, both to support recovery and resolution actions and day-to-day oversight activities.

2 Institutional scope and resolution authority

2.1 Institutional scope

The FSB's FMI Annex to the KAs notes that all systemically important FMIs, other than those owned and operated by a central bank, should be subject to a resolution regime that applies the KAs in a manner appropriate to the specific characteristics of the type of FMI in question and its critical role in financial markets. The FMI Annex references the presumption in the CPSS-IOSCO *Principles for financial market infrastructures* (PFMIs)[7] that CS facilities and TRs are systemically important in the jurisdiction where they are located, unless a jurisdiction clearly identifies that a particular FMI is not systemically important, or discloses the criteria used to identify which FMIs it regards as systemically important.

Consistent with **KA 1,** it is proposed that a special resolution regime for Australian FMIs ('covered FMIs') extend to:

- all CS facilities that are incorporated in Australia and hold a domestic CS facility licence ('covered CS facilities');
- all TRs that are incorporated and licensed in Australia and are identified as being systemically important in Australia ('covered TRs').

It is further proposed that once a covered FMI was in resolution, a resolution authority should have certain powers over related entities that provide the FMI with critical services or funding support under ex-ante legal arrangements.

While it is proposed that financial markets would be outside of the scope of the resolution regime, some of the legislative proposals relating to directions powers and international regulatory cooperation also extend to financial markets that are incorporated in Australia and hold a domestic market licence.

Finally, although systemically important payment systems are within the scope of the KAs, the sole Australian high-value payment system is owned and operated by the RBA. Accordingly, it is proposed that payment systems would currently be outside of the scope of the regime.

2.1.1 Domestically licensed CS facilities

The proposed design of the resolution regime as it would apply to CS facilities accepts the presumption that CS facilities are systemically important in the jurisdiction in which they are located, but at the same time acknowledges that the systemic implications of a particular CS facility's failure will be dependent on the circumstances.

7 CPSS-IOSCO, Principles for financial market infrastructures, April 2012, available at: www.financialstabilityboard.org/cos/cos_120418.htm. Paragraph 1.20 considers the criteria for systemic importance of FMIs.

Rather than define in advance the CS facilities that 'could be systemically significant or critical in the event of failure', it is proposed that all CS facilities that are incorporated in Australia and hold a domestic CS facility licence would be potentially within scope. The resolution authority (proposed to be the RBA, see Section 2.3) would then have the capacity, but not the obligation, to take resolution actions with respect to any covered CS facility in accordance with the objectives of the regime (see Section 2.2), or to allow the facility to be wound down under general insolvency law if that was deemed appropriate. That is, at the point intervention was being considered, the resolution authority would form a judgement as to whether to exercise resolution tools or to leave the distressed CS facility licensee to be dealt with under the general insolvency regime.

To support this regime, the RBA would conduct resolvability assessments of covered CS facilities as part of its day-to-day oversight of CS facility risk management (see Section 5.2.1). The RBA's Financial Stability Standards (FSS) already require the following: '[A CS facility] should organise its operations, including any outsourcing of critical service provision arrangements, in such a way as to ensure continuity of service in a crisis and to facilitate effective crisis management actions by the Reserve Bank or other relevant authorities. These arrangements should be commensurate with the nature and scale of the [CS facility's] operations.' This requirement applies equally to critical services provided by affiliated group entities and third parties.

Under such arrangements, for instance, licensed CS facilities have established ex-ante legal arrangements with relevant affiliated group entities and third parties that support the continued provision of funding or critical services in a crisis.

These resolution planning requirements are subject to the concept of proportionality in the FSS. For example, obligations placed on CS facilities to maintain contractual arrangements that would support the continued provision of critical services do not apply to facilities that, by virtue of the limited range and scale of their activities, are not subject to the RBA's FSS.

2.1.2 Feedback sought

Question 1

Do you agree with the proposal that all CS facilities that are incorporated in Australia and hold a domestic CS facility licence should be potentially within the scope of the resolution regime and that a judgement would be made at the point intervention was being considered as to whether to exercise resolution tools or to leave the distressed CS facility licensee to be dealt with under the general insolvency regime?

2.1.3 Cross-border CS facilities

It is crucial that resolution powers could be exercised in relation to any licensed CS facility that, in the event of failure, could cause significant disruption to the functioning of the Australian financial system. This was an important consideration in the CFR's March 2012 recommendation for legislative change to underpin the imposition of graduated 'location requirements' on cross-border CS facilities.

Accordingly, legislative amendments are proposed that will establish with clarity the circumstances in which a licensed overseas CS facility — that is, an overseas CS facility operating in this jurisdiction with an Australian CS facility licence granted under s 824B(2) of the Corporations Act — should be brought under the primary regulation of ASIC and the

RBA by becoming incorporated domestically and applying for a domestic licence under s 824B(1) of the Corporations Act. This would also bring the CS facility within the scope of a domestic resolution regime.[8] Consistent with the CFR's policy on cross-border regulatory influence[9], these proposals would extend to any licensed overseas CS facility deemed to be both systemically important and to have a strong connection to the domestic financial system or real economy.

It is proposed that a combination of licence conditions and other enforceable commitments would be used to ensure that CS facilities could be brought sufficiently under the influence of Australian regulators. These licence conditions and commitments would ensure that adequate arrangements existed to exercise appropriate influence over a cross-border CS facility to manage any implications of the activities of the CS facility for systemic risk, market confidence and integrity.

Conditions imposed on an overseas licence could include trigger events (such as activity thresholds) linked to the systemic importance or degree of domestic connection of the CS facility. In order to ensure that systemically important CS facilities that also had a strong domestic connection were brought within the scope of the Australian FMI resolution regime, it is proposed that the Minister would have the power to require that a CS facility holding an overseas licence transition to a domestic licence if relevant trigger events referenced in licence conditions were to occur. The licensed overseas CS facility would then be required to transition to a domestic licence within a reasonable period (determined by the Minister with reference to the advice of regulators and any prior commitments provided by the CS facility). This would include the requirement that the overseas licence holder establish an Australian subsidiary to apply for a domestic licence, and transfer the relevant business operations to that subsidiary if the licence was granted. Failure to achieve this transition would result in the application of appropriate sanctions, potentially including the revocation of the CS facility's overseas licence.[10]

More broadly, in order to ensure that holders of a domestic Australian CS facility licence could be effectively dealt with under the resolution regime, it is proposed that domestic licensing be restricted to domestically incorporated entities. CS facilities incorporated in other jurisdictions could operate in Australia only if granted an overseas licence.

2.1.4 Feedback sought

Question 2:

Do you agree with the proposal to introduce enforceable commitments and a new category of licence conditions to support the influence of Australian regulators and resolution authorities over cross-border CS facilities?

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8 The licensing regime for trade repositories does not include separate licensing provisions for 'overseas' licensees.

9 See CFR, 'Ensuring Appropriate Influence for Australian Regulators over Cross-border Clearing and Settlement Facilities', July 2012, available at: www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/cross-border-clearing; and CFR, 'Application of the Regulatory Influence Framework for Cross-border Central Counterparties', March 2014, available at: www.cfr.gov.au/publications/cfr-publications/2014/application-of-the-regulatory-influence-framework-for-cross-border-central-counterparties/.

10 It is proposed that the Minister would have discretion to extend the transition period if necessary.

Question 3:

Do you have any comment on the proposed power for the Minister to require a licensed overseas CS facility that is systemically important with a strong domestic connection to transition to a domestic licence?

Question 4:

Do you have any comment on the proposal to restrict the availability of a domestic CS facility licence to domestically-incorporated entities?

2.1.5 Application to TRs

It is proposed that the special resolution regime extends to covered TRs, that is, TRs that are incorporated and licensed in Australia and that are identified as being systemically important in Australia.

Currently, there is only one TR licensed in Australia, and that is a foreign TR based in Singapore. It is expected that a foreign TR would be subject to the resolution regime in the foreign jurisdiction in which it is incorporated. Similar to the approach for CS facilities, it is proposed that only domestically incorporated TRs would be within scope of the resolution regime.

As noted in the introduction to Section 2.1, the PFMIs envisage that jurisdictions will define criteria for systemic importance and may identify that a particular FMI is not systemically important. The PFMIs identify criteria that may be relevant to authorities in determining the systemic importance of FMIs in their jurisdiction. These criteria aim to capture the potential to trigger or transmit systemic disruptions. They include: the critical role the FMI plays in the financial system; the number and value of transactions processed; the number and type of participants; the markets served; the market share controlled; the interconnectedness with other FMIs and other financial institutions; and the available alternatives to using the FMI at short notice.[11] In its advice to Government in February 2012, following the 2011-12 CFR review of FMI regulation, the CFR recommended that criteria aligned with those in the PFMIs be applied to determine the systemic importance of CS facilities and financial markets.

In the case of CS facilities that are subject to the FSS, which either assume financial exposures as principal (in the case of CCPs) or provide a means for participants to extinguish financial obligations (in the case of SSFs), there is a clear presumption of systemic importance. In the case of TRs, by contrast, there is less of a case for such a presumption, particularly given TRs do not take on the sorts of large-scale economic exposures to systemically important financial institutions that CCPs undertake, and instead have the role of receiving and distributing reports of transactions. That said, a TR has the potential to play a critical role in providing timely and accurate information about OTC derivative exposures to regulators and, potentially, market participants and other financial market infrastructures. For that reason, a TR may be systemically important in Australia where the TR holds a material volume of information on transactions involving systemically important Australian financial institutions, and if it was also incorporated in Australia could be identified as a covered TR.

11 See paragraph 4.1.2 of the PFMIs.

In considering the application of resolution requirements to TRs, existing requirements in Australia in relation to the recovery and resolution of a licensed TR should be taken into account. ASIC's *Derivative Trade Repository Rules 2013* (the TR rules) include requirements for licensed TRs to establish, implement, maintain and enforce policies, procedures and plans designed to:

- identify scenarios that may potentially prevent the TR operator from being able to provide the TR's critical operations or services as a going concern and assess the effectiveness of a full range of options for recovery or orderly wind-down;

- provide for the recovery or orderly wind-down of the TR's critical operations or services based on the results of that assessment (see Rule 2.4.11(1)).

Under those rules, a licensed TR must, if requested to do so, also provide ASIC, the RBA or APRA with information reasonably required for purposes of resolution planning in respect of the licensed TR or its users (see Rule 2.4.11(2)).

Supplementing these requirements, the Minister and ASIC have powers under sections 904F, 904G and 904H of the Corporations Act to issue directions to a licensed TR requiring the TR to comply with the Corporations Act and applicable rules or to provide special reports. ASIC also has the power under s 904K of the Corporations Act to issue a direction that requires a former TR licensee to transfer derivative trade data to another licensed TR, which may be used as part of a TR resolution.

TRs are also subject to a range of requirements under the rules in relation to retention of derivative trade data, risk management, integrity and security of computer systems and other systems for transmitting and storing derivative trade data, operational reliability, business continuity planning and outsourcing of functions. Further, ASIC may impose licence conditions that set financial resource requirements, taking into consideration financial resources that could be necessary to support recovery or orderly wind-down of critical operations and services (see RG 249.50).

2.1.6 Feedback sought

Question 5:

Do you agree that there is less of a presumption of systemic importance for TRs than for CS facilities?

Question 6:

Do you have any comments on the proposal that a domestically incorporated TR may be identified as being systemically important where it holds a material volume of information on transactions involving systemically important Australian financial institutions, bringing it within the scope of the domestic resolution regime?

Question 7:

Do you have any comments on the proposal to exclude licensed TRs that are not incorporated in Australia from the scope of the domestic resolution regime?

Question 8:

Do you have any comments on the application of the domestic resolution regime proposed in this paper to covered TRs, having regard to the existing regulatory provisions relating to recovery and resolution of licensed TRs?

2.1.7 An FMI's holding company and other non-regulated group entities

An FMI may be part of a corporate group. The continuing operations of the FMI may rely on the provision of essential services or funding by the holding company and other entities within the group. In addition, essential services such as critical IT operating systems may be provided by third parties that are external to the FMI's corporate group.

As discussed in Section 2.1.1, there are provisions in the FSS that require a CS facility to organise its operations, including any outsourcing of critical service provision arrangements, in such a way as to ensure continuity of service in a crisis. These may be arrangements with the CS facility's holding company or another non-regulated group entity. Should the CS facility's holding company or associated group entity become distressed at the same time as the CS facility, however, there is a risk that that the holding company or associated group entity is placed into receivership or liquidation. This could compromise actions taken by the resolution authority of the CS facility.

ASIC's TR rules also include general requirements in respect of outsourcing of functions, including that documented policies and procedures are established and maintained that ensure the TR is able to comply with its obligations under the Corporations Act and the TR Rules.

In order to buttress these existing provisions, it is proposed that the Corporations Act be amended to provide that any liquidator or receiver appointed over a related body corporate of a covered CS facility must comply with any directions given by the facility's resolution authority. This would be supported by a protection from liability for external administrators in complying with directions from the resolution authority (see Section 4.2). A similar power is proposed in respect of covered TRs.

As noted in Section 2.1.1 in the context of CS facilities, the key service providers of a licensed FMI may not be related bodies corporate. Accordingly, we are also seeking feedback on whether the proposal should be extended to all service providers for key outsourced functions, even if those service providers are not related bodies corporate.

2.1.8 Feedback sought

Question 9:

Do you have any comments on the proposal that the Corporations Act be amended to provide for any liquidator or receiver appointed over a related body corporate of a covered FMI to comply with any directions given by the FMI's resolution authority?

Question 10:

Do you have any comments on the proposal to extend these powers to all service providers for key outsourced functions, even if those service providers are not related bodies corporate?

2.1.9 Application to market operators

As noted in Section 1.1 of this paper, the CFR made a recommendation to the Government in February 2012 to strengthen the resolution framework in relation to all domestically incorporated and licensed CS facilities and market operators. In particular, it was recommended that the ability of regulators to deal with distress situations through directions powers be strengthened, and that the ability of regulators to maintain financial stability in times of stress be enhanced by establishing a statutory management (step-in) regime.

The CFR recommendation recognised that the disorderly failure of a financial market could result in severe disruption to the financial system, particularly where the services provided by the financial market were not substitutable or the market was part of an interconnected group that provides other FMI services.

Since the time of the CFR recommendation, there have been a number of international developments, including the release of the PFMIs and KAs, which apply to CS facilities and TRs, but not to financial markets. Internationally, the development of resolution regimes for FMIs has been focused on systems for clearing, settlement, and recording of monetary and other financial transactions, rather than systems for trading, consistent with the PFMIs and KAs.

The FMI Annex to the KAs acknowledges that systemically important FMIs should, in the event of failure, be subject to a resolution regime that applies the KAs in a manner appropriate to the specific characteristics of the FMI in question and its critical role in financial markets, taking into account:

- the risk profile of the FMI, including its exposure to credit, liquidity and general business risks and, in particular, whether it takes credit risk through exposures to its participants as principal;
- any recovery measures taken by the FMI.

The key objectives of an effective Australian resolution regime for FMIs, as described in Section 2.2, are related to stability and smooth functioning of the financial system. Having regard to those objectives and to developments internationally, the case for applying a complete resolution regime to market operators — and in particular, statutory management powers — is less clear-cut.

The existing regulatory framework under Chapter 7 of the Corporations Act recognises that systemic risk concerns are most relevant to CS facilities. While the failure of a market operator has the potential to cause significant disruption to the trading activities of market participants, and have an adverse impact on market integrity, market operators are not exposed to the same financial risks as CS facilities. Moreover, where market operator services are provided in a competitive environment, the impact of an operational or technological failure of a market may be reduced, as trading activities may migrate to other providers.

In the UK, the Government consulted in August 2012 on the possibility of applying a complete resolution regime for non-CCP FMIs, including market operators.[12] The feedback from stakeholders was that a complete resolution regime for market operators was not necessary, because:

- most non-CCP FMIs do not assume financial exposures analogous to those faced by CCPs, and any failure is more likely to be operational or technological;
- running costs are historically low, which means any costs associated with the failure of a non-CCP FMI are likely to be relatively low;
- the costs associated with failure of a non-CCP FMI could be easily absorbed by the owners and members of these FMIs (which, in the UK, are primarily the main UK banks and building societies);
- the reputational risk of a significant disruption to, for example, a payment system, was too great for the members and owners to allow.[13]

Absent the implementation of a special resolution regime for financial markets, there remains a strong case for enhancing the regulatory regime for dealing with the failure of a systemically important domestically licensed market operator. One alternative regime under consideration is a regime under which:

- such market operators would be required to develop a comprehensive recovery plan in accordance with CPMI-IOSCO Guidance on *Recovery of financial market infrastructures* (see Section 3);
- ASIC would have strengthened directions powers in relation to the market operator, including powers to ensure the market operator is implementing its recovery plan effectively (see Section 6).

2.1.10 Feedback sought

Question 11:

Do you have any comments on whether the resolution regime for market operators should be different to that for FMIs as defined in Section 1?

Question 12:

Do you have any comments on whether, given the different risk profile of market operators, it would be appropriate for a regulator to have statutory management powers in relation to market operators?

Question 13:

Do you have any comments on an appropriate alternative regime for market operators, and how market disruption in the event of failure of such entities could be mitigated?

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12 HM Treasury: Financial sector resolution: broadening the regime, August 2012, available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/81400/condoc_financial_sector_resolution_broadening_regime.pdf.

13 HM Treasury: Financial sector resolution: summary of responses, October 2012, available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/190259/condoc_financial_sector_resolution_broadening_regime_responses.pdf.

2.2 OBJECTIVES OF THE RESOLUTION REGIME

Clear objectives are essential to establish the goals of the regime and to guide the resolution authority's choice between alternative resolution actions. They also help to set expectations for the operators of FMIs and related entities.

The KAs establish that an effective resolution regime should 'make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation'. They emphasise that the choice of resolution powers for FMIs should be guided by 'the need to maintain continuity of critical FMI functions'. **KA 2** also provides that the resolution authority should:

- avoid the unnecessary destruction of value and seek to minimise the overall costs of resolution in home and host jurisdictions and losses to creditors, where that is consistent with the other statutory objectives;
- duly consider the potential impact of its resolution actions on financial stability in other jurisdictions.

Consistent with this approach, and in accordance with the Corporations Act, it is proposed that the overarching objective of the resolution authority for CS facilities under Australia's regime would be to maintain the overall stability of the financial system. An additional key objective of the resolution regime, which would apply equally to both CS facilities and TRs, would be to maintain the continuity of FMI services that are critical to the smooth functioning of the financial system.

To provide additional guidance, it is proposed that the legislation would set out a number of more detailed considerations for the resolution authority when seeking to take resolution actions. They include to:

- maintain confidence in the stability of the financial system;
- maintain the fair and effective provision of FMI services;
- minimise the costs of resolution and losses to creditors and provide for the allocation of losses to creditors in a manner that respects the hierarchy of claims in insolvency and preserves market discipline;
- limit recourse to public funds;
- provide for the orderly wind-down of FMI services that are not critical to the smooth functioning of the financial system and which are not financially viable.

2.2.1 Feedback sought

Question 14:

Do you have any comments on the proposed objectives of the resolution regime? Are there other relevant objectives or considerations that should be included?

2.3 Resolution Authority

2.3.1 Resolution authorities

KA 2 calls upon each jurisdiction to designate an administrative authority (or authorities) as responsible for exercising resolution powers over entities within the scope of the resolution regime. Moreover, **KA 2** acknowledges that there may be multiple resolution authorities within a jurisdiction. In this case, the mandate, role and responsibilities of each should be clearly defined and coordinated. This section sets out the considerations relevant to the choice of resolution authority for each type of FMI.

Consistent with **KA 2**, the choice of resolution authority should reflect consideration of two core capacities:

- **Familiarity with the design and operation of FMIs.** The regulator tasked with prudential oversight of a given FMI will generally be the most familiar with issues relevant to the resolution of that FMI. Furthermore, since resolution actions would most likely be triggered only once an FMI's recovery actions had failed to restore it to viability, familiarity with ex ante recovery plans is important.

- **Resources and expertise in implementing resolution actions.** Implementing resolution actions requires certain capacities, including relevant legal knowledge, the capacity to engage effectively with insolvency practitioners and other relevant stakeholders, and the capacity to select and direct a statutory manager.

For each type of FMI, one regulator would be designated as the lead resolution authority, with a network of agreements established between regulators to ensure access to additional resources and expertise as required to support a resolution process. The powers described in Section 3 would be exercised by this authority. Since the resolution authority would be required to take actions in accordance with stated resolution objectives, the potential for conflicts would be minimised if these objectives were closely aligned with the relevant authority's broader statutory mandate. Accordingly, it is proposed that the RBA would act as lead resolution authority for CS facilities and ASIC as lead resolution authority for TRs.

The resolution authority would be expected to consult with other relevant authorities. Should there be disagreement or conflict of powers between authorities, it is expected that this would first be discussed among the regulators in the CFR. Should a conflict persist, the Minister would be empowered to make the final decision.

In the specific scenario of a group of bodies corporate where multiple resolution authorities have responsibility for multiple distressed FMIs within that group, a process is required to determine the lead resolution authority for the group.[14] The specification of a process for determining the group resolution authority and coordination arrangements would be set out in a memorandum of understanding between the regulators.

14 There is no reason to expect that the resolution of one licensed group entity would necessarily require the resolution of other licensed entities within the same group.

2.3.2 Feedback sought

Question 15:

Do you have any comments on the proposed choice of resolution authority for each FMI type?

Question 16:

Do you have any comments on the proposal that the determination of an FMI group resolution authority be governed by a memorandum of understanding between the regulators?

2.3.3 Legal protection for resolution authorities

KA 2 provides that the resolution regime should provide to the resolution authority and its staff, legal protection against liability for actions taken or omissions made while discharging their duties in good faith and acting within the scope of their powers, including any actions to support foreign resolution proceedings. Those affected by actions taken by the resolution authority or its agents in the course of an FMI resolution would remain within the scope of the compensation arrangements discussed under Section 4.1. Additional protections would be extended to others acting in accordance with the resolution regime, discussed in Sections 3.2.1 (for statutory managers) and 4.2 (for third parties acting in accordance with actions taken by a resolution authority).

3 RESOLUTION POWERS

The objectives of the resolution authority may be best pursued by taking actions in accordance with an FMI's own operating rules, including measures contemplated in the FMI's recovery plan. Recovery planning is the process by which FMIs prepare for potential threats to their viability, and establish tools and powers within the rules that govern their operations. Although recovery plans should be comprehensive and robust to very extreme circumstances, even well-crafted recovery plans could prove difficult to implement effectively in practice. For example, in the case of a CCP, management may be reluctant to take extreme recovery actions such as to completely tear up contracts. Alternatively, participants could choose to 'walk away' from the FMI rather than fulfil their financial obligations in loss allocation or replenishment when due. Although authorities could take actions, such as the issuance of directions, to support recovery measures (see Section 6.2.3), there could be circumstances in which the FMI nevertheless failed to recover.

In such circumstances, intervention by a resolution authority would be likely to be most effective and least disruptive if the resolution authority could simply complete the actions contemplated in the FMI's own recovery plan. Therefore, while recovery planning is primarily the responsibility of the FMI, such plans also need to be consistent with the framework for resolution.

The recent CPMI-IOSCO guidance on recovery planning sets out a number of tools that FMIs could use to achieve recovery. These include tools to address losses associated with the default of a participant (including mechanisms to allocate an uncovered loss or liquidity

shortfall),[15] tools to address other losses, and tools to address structural weaknesses in governance or risk management that may have contributed to the losses suffered by the FMI. Under the proposals, a statutory manager appointed by the resolution authority would be able to use such tools to restore viability if recovery actions could not be successfully implemented by the FMI itself (see Section 3.2). The power to implement recovery measures should be supported by ancillary resolution powers that provide flexibility to pursue alternative means of maintaining continuity of service.

Australian licensed CS facilities are expected to introduce a number of the tools elaborated in the CPMI-IOSCO guidance over the coming period to support their recovery planning efforts.

As noted in Section 2.1.3, ASIC rules for licensed TRs already require them to engage in distress scenario identification and planning for recovery or orderly wind-down (see TR Rule 2.4.11). The CPMI-IOSCO guidance provides valuable context for TRs in discharging their obligations under this Rule.

In a similar vein, there could be circumstances in which proceeding to resolution and selecting from a wider range of alternative actions was preferable to completing actions in accordance with an FMI's own recovery plan. This might be the case, for instance, if the temporary injection of funds to meet a small shortfall in a CCP's financial resources was likely to be less disruptive than the tear up of all open contracts.

3.1 ENTRY INTO RESOLUTION

KA 3 requires that a resolution regime include clear criteria that specify when resolution can be initiated. Generally, the regime should support the timely entry into resolution while also ensuring that there are adequate safeguards in place to guard against misuse by authorities. **KA 3** provides that resolution should be initiated when a firm is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so. Moreover, resolution authorities should have a range of powers available to help them resolve an FMI in distress, although it is likely that a resolution authority would only use a subset of these powers to resolve a particular FMI.

It is proposed that a distinction would be drawn between general and specific conditions for the exercise of resolution powers:

- **General conditions** would establish the case for public intervention. These would be related to the solvency or viability of an FMI, or serious non-insolvency related threats to the continuity of critical services. Consistent with the CFR's recommendations, it is proposed that ASIC and the RBA be given the power to intervene in circumstances that include the threat of insolvency, significant operational outage or distress, or a significant and persistent failure to comply with licence obligations or directions.
- **Specific conditions** would be used to select between particular resolution actions, including to allow a distressed covered FMI to enter general insolvency where appropriate. These conditions would be based on the resolution objectives and associated considerations, and would be designed to ensure that resolution actions were appropriately tailored to the objectives of resolution as they applied in particular circumstances.

15 Examples of such tools in the context of a CS facility may include cash calls on participants, haircuts applied to variation margin payments, or the termination of contracts.

Entry into resolution should not be a justification to automatically revoke the FMI's licence or other authorisations necessary for its continued operation.

3.1.1 Feedback sought

Question 17:

Do you have any comments on the proposed conditions for entry into resolution and use of resolution powers, and, in particular, the distinction between general and specific conditions? Is there another option you prefer? If so, why?

3.2 Statutory management

KA 3 requires that resolution authorities have the capacity to appoint an administrator to take control of and manage a distressed FMI with the objective of restoring the FMI, or parts of its business, to ongoing and sustainable viability; or to facilitate its orderly wind-down. It is proposed that such a power would be provided to both the RBA and ASIC as the relevant resolution authorities for covered CS facilities and covered TRs, respectively.

Consistent with **KA 3**, it is proposed that the relevant resolution authority would have the power to appoint itself or a third party as a statutory manager in the event that the general conditions for intervention were met.[16] The third party may be an experienced individual or a company with the necessary skills and resources.

3.2.1 Powers of a statutory manager

It is proposed that the objectives of the statutory manager would reflect the objectives of the resolution authority (see Section 2.2). To enable the statutory manager to pursue its objectives, a statutory manager should have all the powers and functions of the Board of Directors under the relevant provisions of the Corporations Act. However, the statutory manager should be exempt from insolvent trading laws. Moreover, to support legal certainty for the actions taken, the statutory manager should have legal protection against liability for actions taken or omissions made while discharging its duties in good faith and acting within the scope of its powers, including any actions to support foreign resolution proceedings.

The appointment of a statutory manager should also override an external administration arising from any other action, and during the term of the statutory manager, appointment of an external administrator should not be permitted, except with the consent of ASIC or the RBA. Furthermore, the appointment of a statutory manager would suspend the rights of shareholders. It is also proposed that the statutory manager would be given the power to facilitate recapitalisation, similar to provisions in the Banking Act.[17] Shareholders would remain eligible to seek **ex-post** compensation, where applicable (see Section 4.2).

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16 This process was referred to as 'step-in' in the CFR's 2011-12 review of FMI regulation.

17 Shareholders rights may be terminated if, absent the intervention of the resolution authority, the FMI would have entered insolvency.

3.2.2 Feedback sought

Question 18:

Do you have comments on the proposed powers of a statutory manager? Are there additional powers that should be included? If so, why?

Question 19:

Do you have any comments about the proposal that an external administrator cannot be appointed to an FMI during the term of the statutory manager, except with the consent of ASIC or the RBA?

Question 20:

Do you have any comments on whether the appointment of a statutory manager to an FMI should suspend or terminate the rights of shareholders, subject to ex-post compensation? Moreover, do you agree that the statutory manager should have the ability to facilitate recapitalisation where an FMI would otherwise be insolvent?

3.2.3 Directions to statutory manager

The appointed FMI statutory manager would be required to report to the resolution authority on request and be subject to directions issued by the resolution authority. The directions power provides a check and balance on the actions of the statutory manager. Moreover, the resolution authority may use the power to smooth an exit from statutory management by directing a transfer of an FMI's business to a private-sector third party or to a bridge institution (see Section 6.2.3).

The resolution authority would have the power to dismiss or replace the statutory manager as required. It is proposed that the appointment of new directors to replace the statutory manager be a condition for termination of statutory management. This is consistent with the approach under the Banking Act which imposes an obligation on APRA to ensure a resolved ADI has a Board of Directors prior to removing a statutory manager appointed to the resolved ADI.

3.2.4 Feedback sought

Question 21:

Do you have comments on the proposals related to issuance of directions to a statutory manager? Are there other relevant considerations?

3.3 Moratorium on payments to general creditors

KA 3 provides that the resolution authority should have the power to impose a moratorium on an FMI's payments to unsecured general creditors, while protecting the enforcement of eligible netting and collateral arrangements. To do so, the scope of the moratorium would exclude payments and property transfers to the FMI and those directly arising from payment, clearing and settlement processes. Further, the moratorium would apply only to liabilities outstanding at the point an FMI entered into resolution, and would operate only for a limited period.

It is noted that the moratorium would additionally temporarily suspend non-enforcement proceedings, for example proceedings in a court case or referral of a dispute to an arbitrator. The FMI would be required to meet any liabilities incurred and suspended legal proceedings would re-commence after the moratorium lapsed. Compensation arrangements would apply to parties suffering loss as a result of the moratorium (see Section 4.2).

3.3.1 Feedback sought

Question 22:

Do you have any comments on the proposal to empower the resolution authorities to impose a limited moratorium on outgoing payments from an FMI? Do you have comments on the proposed limitations applied to the scope of the moratorium? Is there another option you prefer? If so, why?

3.4 Transfer of critical operations to a solvent third party

Consistent with **KA 3**, it is proposed that the resolution authority be given the power to transfer ownership of all or part of an FMI's critical operations to a solvent third party purchaser or bridge institution. The power to transfer to another entity some (for example, clearing in a set of specific products that are free of netting interdependencies with other products) or all of the business of a licensed FMI in distress could support the continuation of the FMI's critical functions as a going concern. For example, such flexibility could be used to facilitate the sale of certain operations of the FMI to one or multiple buyers.

To be able to ensure the continuity of critical operations, the resolution authority should be able to effect the transfer of an FMI's assets and liabilities (including participant assets in the custody of the FMI), legal rights and obligations (including service-level agreements with providers), as well as data and systems. Furthermore, it should be clarified that any transfer of assets or liabilities under this power would not constitute a default or termination event under any contract to which the FMI in resolution was a party.

It is proposed that a decision by the resolution authority to affect a transfer of all or part of an FMI's business would not require the consent of any interested party of the FMI in resolution, such as its creditors and participants. However, the resolution authority would be required by legislation to obtain consent from the transferee (including, as appropriate, its shareholders).[18] Protection of the rights of creditors and shareholders would be provided under an *ex-post* right to compensation (see Section 4.2).

The Business Transfer Act provides a compulsory business transfer power to APRA with respect to ADIs. The power enables APRA to require the transfer of all or part of an ADI's business without the consent of the ADI's shareholders, but subject to compensation arrangements. It is proposed that ASIC would be granted a compulsory business transfer power in respect of covered TRs, and that the RBA would be granted a similar power in respect of covered CS facilities. However, since a business transfer in the case of a covered CS facility could have licensing implications, the RBA would be required to consult with ASIC before sanctioning any such transfer.

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18 Additionally, while the transfer of a participant's assets would not be contingent on obtaining consent from that participant, there should be nothing preventing such a participant from subsequently transferring its assets from the transferee to another FMI (where available) in accordance with its rights in relation to those assets.

Since this mechanism overrides the rights of an FMI's shareholders or creditors, it is proposed that additional limitations and safeguards would be put in place to provide certainty that a resolution authority could not 'cherry-pick' individual contracts for transfer (see Section 4.3).

3.4.1 Feedback sought

Question 23:

Do you have any comments on the proposed powers for business transfer and the proposed conditions for such a transfer? Are there any changes you would propose? If so, why?

3.5 BRIDGE INSTITUTIONS

For some FMIs there will be no alternative providers of their critical services to which their operations could be transferred on a timely basis. In some circumstances, potential transferees may be unwilling to agree to a rapid transfer of assets and liabilities, perhaps due to legacy legal claims or the need to carry out other due diligence. Consistent with **KA 3**, in such situations it would be helpful if the resolution authority could establish a temporary 'bridge' institution to take over and continue operating for a period certain critical functions of the failed FMI, pending completion of a business transfer, without incurring liability for any legacy claims.

The use of a temporary bridge institution would support continuity and stability. Its objective would ultimately be the sale of some or all of the business to one or more private sector purchasers. While a resolution authority could also seek to wind down the business of the bridge institution, this would only occur if a transfer was not possible within a reasonable timeframe and if to do so would be consistent with the objectives of the resolution authority. It would be clarified that a bridge arrangement was not to be permanent and that the resolution authority would seek to exit the arrangement as soon as was reasonably possible.

The resolution authority would have the power to:

- Establish terms and conditions under which the bridge institution had the capacity to operate as a going concern, including:
  - its ownership structure;
  - the source of its capital, operational financing and liquidity support;
  - the applicable regulatory requirements, including licence conditions and FSS;
  - the applicable corporate governance framework; and
  - the process for appointing the management of the bridge institution and its mandate.
- Enter into legally enforceable agreements by which the resolution authority transferred, and the bridge institution received, assets and liabilities of the failed FMI, including access to payment systems and rights to services provided under contracts with third parties.

- Arrange the sale or wind-down of the bridge institution, or the sale or transfer of some or all of its assets and liabilities to a third-party legal entity, subject to the objectives of resolution.

3.5.1 Feedback sought

Question 24:

Do you have any comments on the proposed powers for establishment of a temporary bridge institution? Are there any changes you would propose? If so, why?

3.6 Temporary stays on early termination rights

In commercial contracts in Australia, entry into insolvency generally provides a trigger for the solvent party to terminate.[19] Consequently, entry into resolution of an FMI or the appointment of a statutory manager (or exercise of other resolution powers) is a potential trigger for counterparties to financial and other contracts with the FMI to terminate future obligations. In particular, it is noted that the *Payment Systems and Netting Act 1998* (the PSN Act) provides particular protection to the right to net and close out obligations under market netting contracts as defined in the PSN Act, even prior to insolvency.[20] In the case of CS facilities, the contractual relationships between CS facilities and their participants are enshrined in market netting contracts, and are therefore subject to the provisions of the PSN Act.

Consistent with **KA 4**, it is proposed that resolution actions should not by themselves allow any counterparty of a FMI under a market netting contract to set-off obligations or exercise contractual acceleration and early termination rights. However, such rights remain exercisable where the FMI or other person in control of the FMI fails to meet payment or delivery obligations (i.e. an event of default not directly related to entry into resolution or exercise of the relevant resolution power) when due in accordance with its rules. An FMI could meet its obligations despite adjustments to standard payments or deliveries (such as the application of haircuts to variation margin payments) where these adjustments are consistent with loss allocation rules within its rulebook.

The intent is to provide a limited amount of time (up to 48 hours) for the resolution authority to determine whether a covered FMI should be wound up or restored to financial viability. In the context of a covered CS facility, the exercise of early termination rights could challenge the financial and operational resources of the CS facility, potentially preventing it from continuing critical operations and services. In particular, a CS facility could be left with a residual portfolio of unbalanced positions that exposed it to market risk. Moreover, a disorderly exit of participants may pose broader financial system risks.

If the resolution authority decides at the expiry of the 48 hour period (or sooner) that the FMI should be wound up, that determination would provide a trigger for termination rights. However, if the resolution authority determines and announces prior to the expiry of the 48 hour period that the FMI may be restored to financial viability, or the resolution authority

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19 This is known as an ipso facto clause. Under US law ipso facto clauses in insolvency are generally not enforceable, whereas in the UK and Australia they are.

20 PSN Act, section 16. It is noted that subsection 16(3) states that the provisions in section 16 override any other legislation.

provides an assurance that it will be restored to financial viability,[21] the stay on termination would remain in place.

3.6.1 Feedback sought

Question 25:

Do you have any comments on setting a timeframe for the duration of a temporary stay (for example, 48 hours)? Do you agree that there may be circumstances in which it would be necessary to extend the duration of the stay in order to support financial system stability?

4 Safeguards and Funding Arrangements

4.1 Respect of Creditor Hierarchy and 'No Creditor Worse Off' Principle

Consistent with **KA 5**, it is proposed that resolution powers be exercised with due regard to the hierarchy of claims under insolvency law. The proposed arrangement nevertheless provides for flexibility to depart from the principle of equal treatment for creditors of the same class, if necessary, to contain the potential systemic impact of the FMI's failure or to maximise the value of the FMI to the benefit of all creditors.[22] The reasons for any departure should also be subject to appropriate transparency. Unlike a bank, an FMI that assumes financial exposures would be expected to have loss allocation and other recovery-related powers built into its operating rules. Any such rules should be respected in resolution.

As in the KAs, a 'no creditor worse off' principle should also be applied. That is, a participant or other creditor should be no worse off as a result of a covered FMI being dealt with under a resolution regime than if it were liquidated under general insolvency, taking into account any allocation of uncovered losses under the FMI's operating rules. The KAs provide that a creditor should have a right to compensation where it does not receive, at a minimum, what it would have received in a liquidation of the FMI under general insolvency. A modified compensation test could apply where resolution actions were taken to address a deficiency in financial resources that was not large enough to trigger insolvency, or other non-insolvency related threats to service continuity.

It is proposed that a mechanism be established for *ex-post* compensation along the lines of s 69E of the Banking Act and in accordance with paragraph 51(xxxi) of the Constitution. Paragraph 51 requires that where laws made by the Commonwealth Parliament acquire property from persons, this be done on just terms.

4.1.1 Feedback sought

Question 26:

Do you have any comments on the proposed provisions, especially with respect to compensation arrangements?

21 For a CCP, where an auction is required to restore a balanced book and that auction cannot be completed, the termination of all of that CCP's open contracts may be necessary.

22 Section 556 of the Corporations Act specifies the debts and claims that must be paid in priority to all other unsecured debts and claims in the winding up of a company. Section 559 of the Corporations Act provides that debts of a class should rank equally between themselves.

4.2 Indemnities and other protections

As noted in Sections 2.1.4 and 3.2.1, the legislative proposals include a statutory indemnity for actions taken in good faith by the resolution authority and statutory manager. The proposals also extend immunity from liability to third parties acting in accordance with resolution actions, including for actions taken pursuant to the directions of the resolution authority. Third parties that would be subject to such protections may include the FMI itself, related entities, or managers and directors of the FMI or its related entities.

4.2.1 Feedback sought

Question 27:

Do you agree with the scope of proposed protections for those that act in accordance with the resolution authority's binding instructions?

4.3 Additional limitations

In the event of a business transfer, the resolution authority would be able to select which assets, rights and liabilities should be transferred to best achieve resolution objectives. However, it is proposed that there would be additional limitations on the exercise of discretion by the resolution authority:

- all financial contracts with the same counterparty and subject to the same netting agreement must be transferred together or both left behind;
- where a liability is secured by collateral, the liability and the associated collateral must be transferred together or both left behind.

However, application of these limitations may be waived if necessary for the purposes of an orderly resolution in line with statutory objectives, or if any party disadvantaged due to exercise of discretion by the resolution authority would otherwise be adequately protected by other safeguards in the regime (such as the availability of **ex-post** compensation rights described in Section 4.1).

4.4 Funding arrangements

Consistent with **KA 6**, it is proposed that appropriate arrangements would be put in place to provide temporary funding to facilitate and implement resolution actions. **KA 6** further states that provision should be made to recover from shareholders, unsecured creditors (including FMI participants) or, if necessary, participants in the financial system more widely, any public funding applied for this purpose.

For example, in the event that a temporary bridge institution was established, the Government may need to inject capital or other financial resources into the entity as well as the operating costs of the bridge institution. The Government could also face liability in other circumstances, such as in the interim between appointment of a statutory manager and recapitalisation — particularly where this involved a change in ownership.

4.4.1 Feedback sought

Question 28:

Do you have any comments on the provisions that need to be put in place to recover any public funding? Who should be liable to contribute to the recovery of costs — shareholders, unsecured creditors (including FMI participants) and/or participants in the financial system more widely?

5 International cooperation and supporting requirements

5.1 Resolution of overseas-based FMIs and financial markets

The KAs require that national recovery and resolution frameworks allow domestic resolution authorities to cooperate with foreign authorities to the fullest extent possible in resolution actions for FMIs and financial markets that have a principal place of business located overseas. In particular, the following key requirements are stated:

- the legal framework should not contain provisions that trigger automatic action such as the revocation of licences because of the initiation of resolution in another jurisdiction;
- national laws should not discriminate against creditors on the basis of nationality or location;
- resolution authorities should have adequate powers over local operations and assets of foreign FMIs and the capacity to use these powers to support a resolution carried out by a foreign authority;
- there should be processes for recognising and giving effect to foreign resolution measures.

It is intended that the Australian regime would be consistent with these requirements, although pending further progress on international cross-border cooperative arrangements, no specific proposals are made at this time other than some minor amendments to the *Cross-Border Insolvency Act 2008* (Cross-Border Insolvency Act).

5.1.1 Existing legal framework

The Australian insolvency framework does not discriminate against creditors on the basis of nationality or location. There are also no provisions that trigger automatic action in the case where a resolution action is initiated in another jurisdiction. Furthermore, the resolution and directions powers proposed in this consultation paper would only extend to any domestically incorporated and licensed subsidiary of a foreign FMI or financial market. Although overseas-based FMIs and financial markets licensed to provide services in Australia would be outside of the scope of the resolution regime, it is intended that the resolution authority would have sufficient powers to support a resolution carried out by foreign authorities.

The Cross-Border Insolvency Act adopts the Model Law on Cross-Border Insolvency drafted by the United Nations Commission on International Trade Law. It provides:

- a procedure by which foreign proceedings can be recognised;
- foreign insolvency representatives with rights necessary to administer foreign proceedings in Australia; and
- obligations for domestic courts and insolvency practitioners to cooperate with foreign counterparts.

It is noted that the Cross-Border Insolvency Act prohibits discriminating against the claims of foreign creditors on the basis of their nationality. Currently, Australian FMIs and financial markets are subject to the provisions in the Act. However, ADIs, general insurers and life companies are excluded on the grounds that they are subject to special regulatory regimes; the operation of which may be disturbed if effect was given to a foreign insolvency proceeding.

5.1.2 Rights of regulators with respect to recognition of foreign insolvency proceedings

It is expected that Australian regulators would not ordinarily object to the recognition of foreign insolvency proceedings for FMIs or financial markets, especially where such proceedings were taken in respect of an Australian-licensed FMI that had its main operations based outside Australia.

However, the Cross-Border Insolvency Act also applies to domestically incorporated and licensed FMIs and financial markets. It is possible that a party could seek recognition for a foreign insolvency proceeding against such a FMI or financial market without taking full account of the wider implications of this action, including implications for the stability of the Australian financial system. It is proposed, therefore, that in such circumstances Australian regulators would have the right to prevent an application from being made to the court.

5.1.3 Feedback sought

Question 29:

Do you agree with the proposal that Australian regulators should have the right to prevent an application from being made to the court? Are there any other amendments to the Cross-Border Insolvency Act that may be necessary?

5.1.4 Crisis management groups

KA 8 requires the establishment of Crisis Management Groups (CMGs) for all FMIs that are systemically significant in more than one jurisdiction. Membership of a CMG should include relevant authorities from any jurisdiction in which the FMIs has operations that could be material to its resolution.

In accordance with **KA 9**, cross-border cooperation agreements should also be established between relevant authorities, including members of a CMG. These agreements should clarify the respective roles of these authorities, both pre-crisis and during a crisis, and detail such matters as the legal basis and processes for information-sharing and coordination of actions.

Since the resolution framework for FMIs has not yet been fully developed in most jurisdictions, CMGs have not yet been established for those cross-border FMIs that are relevant to the Australian financial system. It is expected that progress will be made in this area in the future, in conjunction with other jurisdictions. The establishment of CMGs and other cooperation arrangements may not require amendments to the Australian legal framework. Hence no specific proposals are being put forward at this time. The Government will nevertheless consider any regulatory issues that may emerge at a later date.

5.1.5 Feedback sought

Question 30:

Do you agree that no specific action to amend the legal framework is required at this stage with respect to the formation of CMGs? If not, why not, and what do you think needs to be done?

5.2 Supporting requirements

5.2.1 Recovery and resolution planning and resolvability assessments

KA 11 requires that authorities develop resolution strategies and operational resolution plans for systemically important FMIs, and also that the relevant authorities conduct resolvability assessments of these FMIs. For FMIs that are systemically important in more than one jurisdiction, this should be done by their CMGs. **KA 10** provides further guidance on the contents of resolution plans and key issues they should address, as well as the conduct and focus of resolvability assessments.

The FSS already require CS facility licensees to organise their operations in such a way as to support potential resolution actions. The RBA will review licensees' compliance with this requirement as part of its annual assessment process. It is expected that detailed expectations for this requirement, including supporting a formal resolvability assessment process, will be set following the implementation of the FMI resolution framework. A similar approach to resolvability assessments of TRs would be adopted by ASIC.

As noted under Section 2.1, the proposed resolution framework includes all domestically incorporated and licensed FMIs, but the ex-ante arrangements required of FMIs to support resolution actions would be proportional to the likely impact of distress or failure affecting

the FMI. The appropriate arrangements would be discussed with FMIs as part of the resolvability assessment process.

Again, it is not clear at this time that any amendments to the legal framework are required to give effect to formal resolution strategies, operational resolution plans and resolvability assessments. The Government will consider any regulatory issues that may emerge at a later date.

5.2.2 Feedback sought

Question 31:

Do you agree that it is too early for detailed consideration of regulatory issues associated with the development of resolution strategies, operational resolution plans and resolvability assessments for covered FMIs? If not, why not, and what do you think needs to be done?

5.2.3 Access to information and information sharing

KA 12 includes general requirements for resolution authorities to be able to share information with relevant foreign authorities. In August 2013, the FSB issued a consultative document titled '*Information Sharing For Resolution Purposes*' setting out further detail with respect to the legal framework governing the sharing of confidential information.[23] The main concerns raised in the document are to ensure that the legal framework allows the disclosure of all relevant confidential information to all types of foreign authorities that could be involved in resolution actions, that such information is subject to an adequate level of protection in the hands of the receiving authority, and that disclosure is permitted for the full range of purposes relevant to resolution actions. A specific requirement proposed in the consultative document is that information received from foreign authorities for resolution purposes should not need to be disclosed under freedom of information (FOI) legislation.

Both the RBA and ASIC have extensive provisions for confidentiality and secrecy in their respective enabling legislation.[24] It is considered that both frameworks provide the RBA and ASIC with adequate powers to share confidential information with foreign authorities for resolution purposes as required by the FSB. It is noted that both frameworks were recently amended by the *Corporations and Financial Sector Legislation Amendment Act 2013*.[25] In particular, the amendments in this Act addressed a number of gaps in the *Reserve Bank Act 1959* (the Reserve Bank Act). As a result, the powers of the RBA and ASIC to share protected information are now broadly equivalent, even though some differences of detail remain.

Since the Australian legislative framework for information sharing is consistent with the expectations in the KAs, no amendments to the framework are proposed at this time. However, in view of the reliance that would be placed on the foreign authority with primary responsibility for the resolution of a licensed overseas FMI or financial market, it would be desirable that elements of the licensing regime for such FMIs and financial markets were enhanced to further support the cooperation arrangements underpinning this approach. These changes would also support other aspects of the oversight of licensed overseas CS facilities, consistent with the CFR's policy for ensuring appropriate regulatory influence over cross-border CS facilities (see Section 2.1.3).

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23 Available at: www.financialstabilityboard.org/publications/r_130812b.htm.

24 For ASIC see the ASIC Act, Part 2, Division 7, and for the RBA see the Reserve Bank Act, section 79A.

25 Passed by Parliament on 20 June 2013.

Specifically, it is proposed that a material adverse change in cooperation or information-sharing arrangements with the foreign authority responsible for oversight of a licensed overseas FMI or financial market would provide grounds for the Minister to suspend or cancel the licence of the FMI or financial market. Suspension or cancellation would not automatically follow a material deterioration in cooperation or information-sharing arrangements, but would be available if continued provision of the FMI's or financial market's services in such circumstances would be contrary to the objectives of the Corporations Act. In order to support this change, it is further proposed that licensed overseas CS facilities be required to inform the RBA of any significant change to the facility's home regulatory regime or if its home jurisdiction licence is revoked. Currently only ASIC is required to be informed of such events.

5.2.4 Feedback sought

Question 32:

Do you agree that no specific action is required at this stage with respect to the ability of ASIC and the RBA to share information with foreign authorities?

Question 33:

Do you agree with the proposal to make a material adverse change in cooperation or information-sharing arrangements with a licensed overseas FMI's or market operator's home regulator a grounds for licence suspension or revocation?

6 DIRECTIONS POWERS

As a complement to the resolution regime, enhancements are proposed to the directions powers that currently support day-to-day oversight of FMIs and financial markets, consistent with recommendations of the CFR's 2011-12 review of FMI regulation. New powers are also proposed for regulators to give directions to FMIs and financial markets with respect to recovery and, in the case of FMIs, resolution. Consistent with references elsewhere in this document, recovery refers to actions taken by a distressed FMI itself to return to viability after a financial shock, while resolution refers to actions taken by public authorities to either return an FMI to viability or facilitate its orderly wind-down.

6.1 CURRENT DIRECTIONS POWERS

6.1.1 Framework

Existing directions powers under the Corporations Act are shared between the Minister and ASIC. While the RBA can request that ASIC issue a direction to a CS facility, it does not itself have the power to issue directions. The directions powers currently available under the Corporations Act are set out below.

In respect of CS facility licensees:

- The Minister may give directions under s 823A of the Corporations Act (if the Minister considers the licensee is not complying with its obligations) or s 823B (if the Minister requires a special report on specified matters).

- ASIC may give directions under s 823D of the Corporations Act (if it considers these necessary or in the public interest to protect people dealing in financial products or considers the licensee has not done all things reasonably practicable to ensure the facility's services are provided in a fair and effective way). However, these directions can only have effect for a maximum period of 21 days.

- ASIC, following consultation with the RBA, may give directions under s 823E of the Corporations Act (if it considers the licensee has not done all things reasonably practicable to reduce systemic risk).

In respect of TRs:

- The Minister may give directions under s 904F of the Corporations Act (if the Minister considers the licensee is not complying with its obligations).

- ASIC may give time-limited directions under s 904G of the Corporations Act (if ASIC considers the licensee is not complying with its obligations). These directions can have effect for a maximum period of 21 days.

- ASIC may also give a direction under s 904H of the Corporations Act (if ASIC requires a special report on specified matters), or under s 904K relating to the handling of derivative trade data if a TR ceases to be licensed. The latter power is particularly relevant to a resolution situation.

- ASIC can also make emergency derivative trade repository rules under s 903J of the Corporations Act without consultation and subject to Ministerial disallowance, if ASIC is of the opinion that it is necessary, or in the public interest, to do so, that licensed TRs would be required to comply with.

In respect of market operators:

- The Minister may give directions under s 794A (if the Minister considers the licensee is not complying with its obligations) or s 794B of the Corporations Act (if the Minister requires a special report on specified matters).

- ASIC may give directions under s 794D of the Corporations Act (if in ASIC's opinion it is necessary or in the public interest to protect people dealing in financial products). However, these directions can only have effect for a maximum period of 21 days.

In the event that the licensee breaches a direction, ASIC may apply for a court order requiring the licensee to comply with the direction. Breach or non-compliance with a direction given to a market licensee, CS facility or TR exposes the licensee to a penalty of up to 100 penalty units a day (a penalty unit is currently $170) for each day the contravention persists.[26] Failure to comply with such an order would also render the licensee liable for prosecution for contempt. In contrast, under the Banking Act, failure to comply with a direction from APRA exposes the licensee to a penalty of 50 penalty units a day for each day the contravention persists. In the case of a body corporate being responsible for the contravention, the fine may be five times this penalty.

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26 For financial markets, this is the case for ASIC directions issued under s 794D of the Corporations Act. For TRs, this is the case for ASIC directions issued under s 904G of the Corporations Act. The penalty for non-compliance with other directions are 100 penalty units and/or 2 years imprisonment, or 5 penalty units in accordance with s 1311(5) of the Corporations Act.

6.1.2 CFR recommendations

In the recommendations arising from its 2011-12 review of FMI regulation, the CFR identified a number of areas in which the existing directions powers could usefully be enhanced to improve the effectiveness of FMI and financial market regulation. These included:

- providing the RBA with the power to issue directions to CS facilities in relation to matters affecting financial stability (Section 6.2.1);
- stronger sanctions for breaching directions (Section 6.3.1); and
- streamlined processes for the issuance of directions (Section 6.3.2).

It is proposed that the CFR's recommendations be progressed in conjunction with legislative amendments to give effect to a resolution regime for FMIs, including recovery and resolution-related directions powers (Sections 6.2.2 and 6.2.3).

6.2 NEW AND ENHANCED DIRECTIONS POWERS

6.2.1 Day-to-day oversight

Certain types of directions may play a role in the day-to-day oversight of FMIs and financial markets, such as directions to enforce the FMI's or financial markets' compliance with its ongoing regulatory obligations (including licence conditions and, for CS facilities, applicable FSS). While ASIC is solely responsible for the oversight of market operators and TRs, including giving, or advising the Minister in relation to giving, directions to TRs, it shares responsibility with the RBA for the day-to-day oversight of CS facilities. However, under current legislation the RBA is reliant on ASIC to issue directions relevant to its day-to-day oversight of CS facilities in respect of financial stability. A key recommendation of the CFR's review of FMI and financial market regulation was that the RBA be able to issue directions with regard to CS facilities in its own right, in recognition that such a power would:

- better align the RBA's powers with its responsibilities under the Act;
- provide clarity to CS facilities;
- allow for more certain action, since the RBA would not have to rely on ASIC to issue a direction at its request; and
- allow for more timely action, since the RBA would not have to first advise ASIC.

Under a revised allocation of directions powers, directions with regard to CS facilities could relate to fair and effective provision of services, which would remain with ASIC; or overall financial system stability, which would be reallocated to the RBA. In the unlikely event that the RBA and ASIC were of a different view regarding the issuance of a direction, it is proposed that this would be resolved by the Minister. In making a decision as to which direction should prevail, the Minister would be required to have regard to any advice received from each regulator. This is consistent with the existing provisions in s 823A of the Corporations Act, which allow for the Minister to make a direction that would overrule any preceding direction issued by ASIC. It is proposed that this separate Ministerial directions power be removed.

6.2.2 Feedback sought

Question 34:

Do you have comments on the proposal to consolidate the directions powers with ASIC and the RBA? Or is there another option you prefer? If so, why?

6.2.3 Recovery directions

In addition to the directions powers in day-to-day oversight, it is proposed that ASIC and the RBA be provided with a directions power supporting the implementation of recovery actions ('recovery directions'). As noted in Section 3, FMIs will be expected to maintain comprehensive and effective recovery plans. However, in some circumstances authorities may be required to intervene to ensure that recovery actions are carried out effectively. These could include circumstances in which an FMI or financial market, or a related entity (see Section 6.2.4) was constrained by potential conflicts with directors' obligations. The protections afforded to entities and individuals acting in accordance with directions issued by a resolution authority would allow the circumvention of any such conflicts (see Section 4.2). If, despite these protections, one or more managers or directors of an FMI or financial market remained unwilling to implement recovery measures, a recovery direction could be used to remove the relevant manager(s) or director(s). Such action might require supplementing remaining management with outside resources through the power to appoint new directors and management.

The directions power would also provide the relevant regulator with the ability to direct an FMI or financial market to implement elements of its recovery plan in order to maintain financial system stability. This power may be required where an FMI or financial market was able to choose between a number of tools in implementing its recovery plan, some of which may have an adverse impact on financial stability. While the intention would be that recovery directions would support an FMI in its recovery without the need for resolution, recovery directions would also provide the resolution authority with the capacity to pre-position an FMI in order to smooth the implementation of resolution measures should recovery fail.

6.2.4 Feedback sought

Question 35:

Do you have any comments on the proposed scope of recovery directions?

6.2.5 Directions in resolution

If entry into resolution by an FMI cannot be avoided via the use of recovery directions, it is proposed that the resolution authority have the ability to issue directions in conjunction with the exercise of its powers to support the continued provision of services by an FMI. Use of these directions would be subject to the objectives of the resolution regime and related considerations for the resolution authority discussed in Section 2.2.

Resolution directions may be required to provide legal certainty to actions taken by the statutory manager, or to remove obstacles to the effective conduct of the statutory management. It is proposed that the resolution authority have a broad power to issue

directions, aligned with the broad directions powers available to regulators in day-to-day oversight. This would be complemented with powers addressing specific situations in which the statutory manager may be constrained by conflicting duties or shareholder rights. It is proposed that these would include the removal of directors and senior internal management, and corporate actions involving the covered FMI's share and debt capital (including the payment of dividends), consistent with similar provisions under s 11CA of the Banking Act.

There may also be situations in which an external administrator is appointed to an FMI or financial market and regulators are either unable to intervene (due to the relevant conditions not being satisfied) or are prepared to allow the external administration to proceed. To ensure that authorities could nevertheless intervene (without the need to take over the administration via a statutory manager) if the external administrator was considering an action that raised serious concerns, it is proposed that regulators should have a power of direction over the external administrator. However, the power could only be used if the relevant regulator concluded that the proposed action was essential for maintaining financial system stability or for any other reason prescribed by regulation. The power would also extend to an administrator appointed to a related entity of an FMI, where the FMI had entered resolution and was reliant on critical services or funding provided by the related entity under an ex-ante legal agreement (see Section 6.2.4).

In some circumstances it may be necessary for Australian authorities to issue directions to support actions taken by the home resolution authority of an overseas-based licensed FMI or financial market (see Section 5.1). Such a power could be exercised only if the overseas-based licensed FMI or financial market was subject to resolution actions in its home jurisdiction, such as the appointment of an external administrator.

It is proposed that recovery directions be exercisable by ASIC with respect to market operators, while both recovery and resolution directions powers be exercisable by ASIC with respect to TRs and the RBA with respect to CS facilities. Before issuing such a direction the RBA would be required to consult with ASIC, in light of ASIC's regulatory responsibilities with respect to CS facilities, especially in relation to licensing matters. Given that a disruption to the continuity of a covered FMI's or financial market's critical functionality may present a significant and imminent risk to financial system stability, both recovery and resolution directions should take precedence over any other regulatory concerns regarding the day-to-day provision of services. In this respect, should there be an inconsistency between recovery or resolution directions issued by a resolution authority and directions issued by another regulator in day-to-day oversight, the former would prevail to the extent of the inconsistency.

6.2.6 Feedback sought

Question 36:

Do you have comments on giving precedence to resolution directions over directions issued in day-to-day oversight? Or is there another option you prefer? If so, why?

Question 37:

Do you agree that ASIC and the RBA should be able to give directions to an external administrator of an FMI or financial market, and the specified conditions under which directions may be given? If not, why not, and what changes should be made?

6.2.7 Non-regulated group entities

As noted in Section 2.1.4, in some circumstances the absence of more direct powers over non-regulated related entities that provide critical services to a covered FMI could prevent the successful implementation of recovery or resolution actions. This may occur if such entities were to make decisions in times of distress that did not support the objectives of recovery or resolution. The FSS already require that CS facilities incorporate provisions in their contractual arrangements with relevant non-regulated group entities to support continuity of critical services or funding (see Section 2.1.1). It is proposed that such requirements be extended to covered TRs in relation to recovery and resolution, and to financial markets in respect of recovery. Given the need for legal certainty in stressed and time-critical circumstances, directions may need to be issued to non-regulated related entities of a covered FMI or financial market to ensure that particular actions supporting recovery or resolution are taken without delays associated with enforcement of contractual provisions through the courts.

The dependence of some FMIs and financial markets on critical services or funding provided by a related entity is also relevant in recovery and the day-to-day oversight of FMIs and financial markets. The proposals therefore extend directions powers in day-to-day oversight, recovery and resolution to related entities that provide critical services or funding to an FMI or financial market under ex-ante legal agreements. If the related entity is an FMI or financial market overseen by another regulator, the direction would be subject to the same consultation requirements and arrangements for resolving a potential conflict that would apply more generally to directions issued to an FMI or financial market (see Sections 6.2.1 and 6.2.3).

6.2.8 Feedback sought

Question 38:

Do you have comments on whether the relevant regulator should have the power to issue directions to non-regulated group entities to enforce ex-ante legal arrangements? Should these powers extend to recovery and day-to-day oversight as proposed?

6.3 HOUSEKEEPING AND SANCTIONS

A number of improvements to the existing directions powers under the Corporations Act are being proposed in relation to the scope of the enforcement regime, legal procedures and sanctions. Certain technical provisions are proposed to govern the effective operation of the directions powers regime, such as limiting ex-post legal recourse for FMIs and financial markets, as well as information provision and confidentiality requirements on the regulators. Importantly, directions will also be supported by legal certainty through ensuring the powers have effect in circumstances where a conflict could arise with the exercise of third party rights or directors' duty to prevent insolvent trading (discussed in Section 4.2).

6.3.1 Sanctions

In order to support the effectiveness of directions powers, it is proposed to strengthen the sanctions regime for non-compliance with a direction. In line with the approach in the Banking Act, the proposals make non-compliance an offence for the FMI as well as directors or officers responsible for ensuring compliance with the direction. In addition to criminal

sanctions, the FMI or financial market and responsible directors or officers of the FMI or financial market may be subject to fines or civil and administrative penalties. Strengthened sanctions, coupled with protections afforded for actions taken in compliance with a direction (see Section 4.2) would provide a strong incentive for prompt compliance by FMIs or financial markets or related entities subject to a direction. Criminal sanctions for directors or officers may be particularly useful for enforcing compliance with directions in circumstances of FMI or financial market distress, where a monetary fine could risk further threatening the solvency of the FMI or financial market.

6.3.2 Streamlined process for issuance

Existing processes that must be followed prior to the issue of directions are inconsistent with the need to ensure continued provision of FMI or financial market services, especially in time-critical situations. For example, ASIC is required to go through a two-stage process in order to issue a binding direction (other than a direction to a CS facility relating to the reduction of systemic risk under s 823E): explain why the direction is required; and provide the licensee with a reasonable time to respond. It is therefore proposed that this process be streamlined, allowing directions to be issued promptly and requiring FMIs or financial markets to comply with these directions within a time frame consistent with the urgency of the matter at hand.

6.3.3 Feedback sought

Question 39:

Do you agree with the proposal to strengthen sanctions for non-compliance with a direction?

Question 40:

Do you agree that the process for issuing a direction should be streamlined?

ATTACHMENT A — MAPPING AGAINST THE KEY ATTRIBUTES AND FMI ANNEX

FSB key attributes		FMI Annex	Proposed resolution regime	Section
1	Scope	Scope	Institutional scope	2.1
2	Resolution authority	Resolution authority	Resolution authority	2.3
3	Resolution powers	Resolution powers	Resolution powers	3.1 to 3.5
4	Set-off, netting, collateralisation, segregation of client assets	Temporary stay on early termination rights	Temporary stay on early termination rights	3.6
5	Safeguards	Safeguards	Safeguards	4.1 to 4.3
6	Funding of firms in resolution	Funding of FMI resolution	Funding arrangements	4.4
7	Legal Framework conditions for cross-border cooperation	Cross-border cooperation	Resolution of overseas-based FMIs	5.1
8	Crisis Management Groups	Cooperation, coordination and information sharing	Crisis Management Groups	5.1
9	Institution-specific cross-border cooperation agreements	Cooperation, coordination and information sharing	Resolution of overseas-based FMIs	5.1
10	Resolvability assessments	Resolvability assessments	Resolvability assessments	5.2
11	Recovery and resolution planning	Recovery and resolution planning for FMIs	Recovery and resolution planning	5.2
12	Access to information and information sharing	Access to information and information sharing	Access to information and information sharing	5.2