LCH.CLEARNET

The Manager, Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600
Australia

1 December 2011

Dear Sirs

Review of Financial Market Infrastructure Regulation

LCH.Clearnet Group Limited ("LCH.Clearnet" or the "Group") is pleased to provide feedback to the Council of Financial Regulators' consultation paper on financial market infrastructure regulation ("the paper"). LCH.Clearnet is the world's leading clearinghouse group and the most experienced provider of OTC clearing services globally.

The Council of Financial Regulators has issued the paper to consult on changes to the overall regulatory framework for holders of Australian Market Licences and Clearing and Settlement Facility Licences. LCH.Clearnet is providing a response chiefly in relation to clearing and settlement elements of the paper.

General theme

We note that the existing regime for licensees under the Corporations Act 2001 includes specific provision for entities incorporated overseas. Under that regime, such overseas licensees can be exempted from certain elements of supervision (and from the application of the Reserve Bank's Financial Stability Standards), as long as they are subject to requirements and supervision that are sufficiently equivalent under their home state regulatory regime.

We observe that although the paper acknowledges these features of the existing regime, it is less clear about how the new proposals will interact with overseas regimes and the extent to which the Australian authorities intend to apply them to overseas licensees in each case. We consider that it would be helpful if the resulting legislative proposals continued to acknowledge equivalent overseas regulatory regimes, and included safeguards against imposing potentially conflicting requirements on financial market infrastructures serving multiple jurisdictions.

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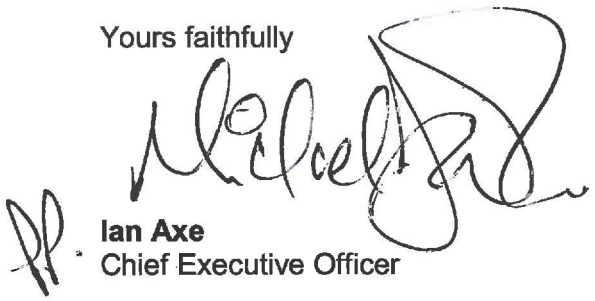
Conclusion

We hope that the authorities find the comments above and in the attachment to be helpful and constructive. We believe that the depth of our experience, combined with our OTC market expertise and the wide geographic scope and deep product breadth of our activities, makes us well-qualified to comment on these matters.

LCH.Clearnet, as the world's pioneering OTC derivatives CCP group, fully shares the Council's goals in ensuring a stable, safe and efficient global financial system. Please do not hesitate to contact us should you have any questions on our submission, or if you would like to discuss any of the matters raised in greater detail.

Yours faithfully



Ian Axe
Chief Executive Officer

Review of Financial Market Infrastructure Regulation

LCH.Clearnet Group Limited ("LCH.Clearnet") response to the consultation paper issued by the Australian Council of Financial Regulators in October 2011

Responses to specific questions raised in the discussion paper

Q1. *Do you have comments on the location requirements proposal?*
The consultation paper raises important issues about the means by which local regulators can gain assurance about the regulation of Financial Market Infrastructures (FMIs) based in other jurisdictions. The existing regime allows a CS facility providing services in Australia to be licensed as an 'overseas facility' as long as it is supervised under a sufficiently equivalent regime by its home regulator. Similarly, the Reserve Bank of Australia (RBA) may exempt operators of overseas facilities from its Financial Stability Standard (FSS) where there is demonstrable compliance with an equivalent regime. LCH.Clearnet considers that this existing framework represents a practical approach that avoids undue duplication of regulatory effort.

LCH.Clearnet considers that section 6.1.2 of the paper actually covers two distinct types of situation in relation to overseas facilities: one in which a particular service is provided by an FMI that serves multiple jurisdictions (an international FMI); and a second, where a domestic FMI outsources some or all of its operations to an offshore location. In each case the FMI in question could be systemically important to Australia; nevertheless, the two situations require distinct approaches.

In the former case, it is likely that the international FMI is also systemically important in its home jurisdiction, and therefore subject to a high degree of supervision by a local regulator. In this situation LCH.Clearnet would consider that, given the increasing harmonisation of international standards for clearing and settlement FMIs under the G20 agreement and CPSS-IOSCO principles, there should only be a limited need for the Australian authorities to apply location requirements. The Australian authorities should, as now, have discretion to rely on supervision by the home regulator (based on reasonable tests of equivalence of the foreign regime).

In the second case, where the FMI outsources elements of its business to an offshore provider, those elements would not be subject to supervision under their local jurisdiction in the same way. In that case, it may therefore be appropriate for the authorities to apply location requirements in relation to the systemically important business that is carried on in Australia.

Q2. *Do you have comments on the flexible, graduated approach for systemically-important FMIs?*
There are advantages to employing a discretionary approach rather

than a strict rules-based approach, to allow the authorities to respond appropriately to different circumstances. However, LCH.Clearnet considers that the degree of discretion anticipated in the consultation paper, and the range of controls described, is wide; it would be valuable for the authorities to set out more explicitly the factors to be taken into account in exercising discretion. These factors should include the adequacy of any foreign regulatory regime that applies to the FMI.

For example, imposing some types of location requirements on international FMIs could make it impossible for them to meet both home and host requirements simultaneously (eg location of critical infrastructure). It would therefore be helpful to acknowledge these practical constraints in the legislation.

Q3. *Do you have comments on the proposed mechanism to allow for the power to impose location requirements?*
As mentioned above, it would be useful if an indication was given of the factors taken into account in determining whether to apply location requirements; these should be based on specific risks rather than purely on systemic importance.

Q4. *Do you agree with the proposed power of pre approval of directors of FMIs and their parent entities? Are there alternative approaches you consider more appropriate? If so, why?*
LCH.Clearnet considers that it is important that FMIs are operated by management that has appropriate expertise and a high level of integrity. It would therefore, in principle, be appropriate to impose such a pre-authorisation requirement. However, LCH.Clearnet suggests that in the interests of practicality, such a requirement should only apply to domestic FMIs; locally-incorporated subsidiaries of overseas operators; and to individuals required to be located in Australia as a result of a location requirement imposed under the proposals in section 6.1.4 of the paper.

Application to directors of FMIs incorporated overseas and of holding companies might again lead to duplication of regulatory effort.

Q5. *Do you agree with the adoption of a fit and proper standard similar to that in the Banking Act?*
LCH.Clearnet agrees with a standard consistent with that imposed on directors of Authorised Depository Institutions (ADIs).

Q6. LCH.Clearnet has no comment on listing rules for market licensees.

Q7. *Do you have comments on the proposal to extend the power of directions to directors and officers of relevant licensees?*
In relation to the more general point about streamlining the process of issuing directions, it seems reasonable to introduce a more rapid procedure where it is deemed necessary due to circumstances.

However, in the view of LCH.Clearnet, there are significant issues with imposing sanctions on individuals in relation to failings of the corporate entity, which they may have had no real power to prevent.
In addition, LCH.Clearnet considers that the "other obligations"

mentioned in the final paragraph of 7.3 should explicitly include those imposed on an international FMI by its home state regulator.

Q8. *Do you have comments on the proposal to extend sanctions for failure to take reasonable steps to ensure compliance by the licensed FMI with a direction or condition onto an outsourced service provider which is a related body corporate, where the service provider is ordinarily (absent the direction) under an obligation to provide critical services to the FMI?*

This question appears to propose that sanctions could be imposed on (non-licensed) affiliates that provide services to the licensed FMI. This is one possible approach to the issue of outsourcing, although it can lead to uncertainty or dispute between the entities as to which is responsible for failure to resolve a particular matter. An alternative approach would be to hold the licensee responsible for all failures, whether caused in-house or by a related or unrelated service provider. Such an approach incentivises the use of robust contracts between the licensee and the service provider.

Q9/10. *Do you have comments on the proposal that penalties for breach of directions or licence conditions be extended to all directions and conditions imposed by ASIC and the Minister on FMI licensees?*
Do you have comments on the proposal that further sanctions be provided for in the Corporations Act for breach of directions and licence conditions?

LCH.Clearnet considers that a consistent and transparent approach to sanctions in relation to breaches of licence conditions, or failure to comply with directions, is desirable.

A set of more graduated sanctions, that can be applied commensurate to the seriousness of a breach, seems a sensible development. The legislation should however continue to contain appropriate mechanisms for consultation and appeal.

Q11. *Do you have comments on the proposal that either ASIC (in the case of and AML) or RBA (in the case of a CSFL) in consultation with the Treasurer could make the appointment of a statutory manager?*

The potential for widespread disruption as the result of a FMI's collapse is recognised. For this reason, international work is under way to consider the appropriate form of recovery and resolution arrangements for systemically-important FMIs. While step-in powers could be one part of such a toolkit, LCH.Clearnet suggests that alignment with the eventual conclusions of such work would promote greater transparency, in terms of ensuring that global authorities' likely actions in such a crisis were consistent and predictable. This would also help FMIs operating in multiple jurisdictions to meet requirements on a consistent basis.

As a separate issue it is not clear how step-in requirements could apply to FMIs located overseas. It would therefore be desirable to clarify in the legislation that FMIs incorporated in foreign jurisdictions would need to be resolved under the laws of that jurisdiction, and would not be subject to step-in powers under Australian law.

Q12. *Do you have comments on the proposal that the relevant appointing agency should be able to appoint itself or a third party entity such as an individual, a professional services firm, or a company, to step in*

and take over the operators of a systemically important FMI?
Subject to the comments above in relation to the use of step-in powers generally, LCH.Clearnet would further note that any such third party, and its directors, would need to meet the proposed test of fitness and propriety. This could be onerous to ensure in a crisis situation.

Q13. *Do you have comments on the proposal that criteria identified in 8.1.3 are appropriate triggers for the appointment of a statutory manager? Are there other criteria that should be considered? If so why?*
Again subject to its general comments, LCH.Clearnet notes that it may be appropriate to apply special regimes such as "step-in" where there is a material risk of FMI insolvency. However, it is not clear that "step-in" would be an appropriate remedy in the remaining three cases; in particular, the final trigger is drafted very broadly. In these circumstances it might be more appropriate for the regulator to issue a statutory direction to management.

Q14/15/16. *Do you have comments on the proposed powers to be exercised by the statutory manager of an FMI and the proposed powers of the appointing regulator in relation to the statutory manager that are set out in section 8.1.4?*
Do you have comments on the proposal that the Banking Act model of interaction with insolvency law, as set out in section 8.1.5, be applied to FMIs?
Do you have comments on the proposal that the statutory manager shuld be obliged to operate in the best interest of overall financial system stability and market integrity?
The proposed powers, the proposed interaction with insolvency law, and the proposed objective could form the basis of an appropriate "special administration regime" for FMIs, but this should be aligned with other jurisdictions so far as possible.

Q17. *Do you have comments on the proposal that all FMIs should be subject to step in unless exempted by regulators?*
LCH.Clearnet considers that it would be helpful to clarify whether the application of step-in powers is fully aligned with the application of the RBA's FSS. In particular, overseas licensees under section 824B(2) of the Corporations Act 2001 benefit from a conditional exemption from the FSS; and given the difficulty of applying step-in provisions to an entity located in another jurisdiction, it would be logical to ensure that the provisions did not apply to such entities.

Q18. *Do you have comments on the proposed criteria for designation of systemically important FMIs in section 9.1.2? Are there other criteria you consider important? If so, why?*
LCH.Clearnet agrees with the criteria proposed in the paper.

Q19. *Do you agree that the insolvency provisions of the Corporations Act should be amended to allow for timely portability of segregated client accounts in the best interests of financial system stability and integrity?*
LCH.Clearnet agrees that such reform would support financial stability.

Q20/21. No comment on these matters.