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By email

Treasury
Langton Crescent
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Email: FMIConsultation@treasury.gov.au
Attention: Matt Zaunmayr, Assistant Director

To whom it may concern

Financial market infrastructure regulatory reforms

We refer to Treasury's consultation on the package of exposure draft legislation and regulations to implement the proposed financial market infrastructure (**FMI**) regulatory reforms.

Thank you for inviting us to make a written submission.

As Treasury is aware, Ashurst has for many years been regarded as the leading legal adviser in the FMI sector in Australia, advising a large number of exchanges, venue operators, clearing houses, settlement facilities, and their participants. Notably, we advised Chi-X (now Cboe) on its launch in Australia, and LCH in respect of its authorisation as a CS facility for OTC derivatives. We also advise many private market operators on their licensing requirements. Presently, we are advising FCX on its applications for market and clearing and settlement facility licences.

Ashurst, globally, is also a leading adviser on FMI regulation, with partners specialising in this field in London, Paris, Frankfurt and Hong Kong. It means that we commonly are asked to consider cross-border FMI offerings, including the question as to whether offshore providers need to be licensed in Australia.

In this regard, it is pleasing to see the FMI reform package introducing provisions which assist to clarify when an offshore provider would be expected to obtain a licence, together with a process for ASIC to confirm the position. It is appropriate that a licence is only required where there is a material connection to Australia.

We are generally supportive of the policy which underpins the reforms, with their focus on market integrity, confidence in the financial system, financial stability, operational effectiveness. It is appropriate that there is a robust framework for licensing FMI, and for resolving licensed entities where required.

Given the level of detail contained in the reform package, we do not propose to provide detailed comments on the drafting. Rather, we make some observations on the principles which underpin the proposals. These are set out in the annexure to this letter.

We would be happy to discuss any aspect of our submission with Treasury.

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ANNEXURE

OBSERVATIONS ON PROPOSED FINANCIAL MARKET INFRASTRUCTURE REFORMS

1. Application of FMI resolution provisions

1.1 General comment

The draft explanatory materials recognise that resolution powers may apply differently as between a domestic CS facility licensee and an overseas CS facility licensee. This reflects the position that an overseas CS facility is regulated by its home regulator (and potentially regulators in other jurisdictions).

However, these distinctions are not always clear on the face of the draft legislation. Consideration should be given to clarifying which provisions do not apply to overseas CS facilities. We comment on this further below.

1.2 Crisis resolution regime

It is clear in the explanatory materials that key aspects of the crisis resolution regime such as statutory management and compulsory transfer of shares processes are intended to apply only to a domestic CS facility licensee. The explanatory materials suggest that the intention is that the RBA be able to exercise certain limited crisis resolution powers with respect to an overseas CS facility in the limited circumstance where assistance is sought from the RBA by an overseas regulator exercising similar resolution powers (EM, paragraph 1.71).

If this is the intention, then consideration should be given to making this clear in the legislation. Section 848A(1) provides that the RBA may take action with respect to an overseas CS facility (other than under the excluded provisions in section 848A(6)), upon the RBA recognising by instrument a request from the overseas regulatory authority. However, section 848A(1), as drafted, does not specify that these powers may *only* be exercised in these circumstances.

As drafted, proposed Part 7.3B refers generally to the RBA's ability to take action in respect of a "CS facility licensee". For example, draft section 832A empowers the RBA to take control of the business of the licensee as statutory manager or appoint a statutory manager. There is no provision which limits the application of that power to a domestic CS facility licensee.

Although statutory management under Division 3 is excluded by draft section 848A(6) for the purposes of the cross-border crisis resolution framework under Division 9, it is not clear whether the statutory management powers under Division 3 can be invoked outside of the circumstances contemplated by Division 9 (i.e. where there is no request from an offshore regulatory authority as contemplated by section 848A(2)).

If the intention of the legislation is that the RBA may *only* exercise certain specific crisis resolution powers (other than the excluded provisions identified in section 848A(6)) in respect of an overseas CS facility licensee in a cross-border crisis resolution scenario under Division 9, then this should be clarified. Also, if the intention is that the excluded provisions would *never* be invoked with respect to an overseas CS facility licensee in any circumstances, then this should be clarified.

1.3 Resolvability standards

Similarly, the draft legislation provides that the RBA may determine resolvability standards in respect of "all CS facility licensees, and all related bodies corporate of those licensees that are incorporated in Australia" (section 827A).

The explanatory materials indicate that the RBA has the power to set resolvability standards "to ensure that *domestic* CS facility licensees and their related bodies corporate conduct their affairs in a way that would facilitate resolution of the *domestic* CS facility licensee if required. It is also stated that the RBA may assess *domestic* CS facility licensees and related bodies corporate against the standards" (draft EM, paragraph 2.71).

If the intention is that the resolvability standards be limited to *domestic* CS facility licensees, then this should be made clear in section 827A.

1.4 Cross-border crisis resolution

Under proposed Division 9, the RBA may recognise a request by "an authority that is responsible for regulating the operation of a clearing and settlement facility by a CS facility licensee in a foreign jurisdiction", where the authority is exercising their resolution powers.

Consideration should be given to how the RBA might address a situation where it receives requests from more than one offshore regulator. Overseas facilities may be regulated in a number of different jurisdictions. There is also a possibility that the RBA may receive a request from a regulatory authority in a jurisdiction other than the licensee's home jurisdiction; that is, from a regulator who is not the home regulator whose jurisdiction was assessed as the basis for granting the overseas licence under section 824B(2)).

Draft section 848A(2) gives the RBA discretion as to whether it will recognise an offshore regulator's request, and the exercise of the discretion require the RBA to believe that the relevant offshore regulator is exercising or intending to or considering exercising relevant crisis powers. We assume that, in exercising its discretion with respect to a request from a regulator outside the licensee's home jurisdiction, the RBA would likely seek to consult with the home jurisdiction regulator. The RBA may also need to consider how to address competing requests from multiple regulators, including giving primacy to the home jurisdiction

regulator This could be clarified in the legislation, or commented upon in the explanatory materials.

2. Ownership restrictions

2.1 The proposed 15% control limit should be increased

The control limit for widely held market bodies under the current Part 7.4 of the Corporations Act is set at 15%. This reflects the importance of these licensees (such as the ASX) to the financial system.

However, in the context of other FMI licensees, consideration should be given to adopting a higher threshold of 20%. This would be in line with other control thresholds such as those in Chapter 6 of the Corporations Act and the *Financial Sector (Shareholdings) Act 1998* (**FSSA**).

Notably, the FSSA was amended in 2018 to increase the ownership limit from 15% to 20%, "to encourage more participation and great competition in the financial sector market".[1] Further, it was stated in the accompanying explanatory memorandum that this change would remove the misalignment between the ownership cap under the FSSA and the foreign ownership threshold under the *Foreign Acquisitions and Takeover Act 1975*, and that consistency between the thresholds in each Act would simplify investment in Australia's financial system and further encourage new entrants to the sector.

This same underlying policy would support adopting a 20% threshold for FMI licensees. There has been significant focus in the past 12 months on encouraging competition in the FMI sector, particularly in clearing and settlement services (i.e. through the introduction of the "CS services rules" framework). Increasing the threshold to 20% would be consistent with the objective of facilitating investment and competition in this sector.

We appreciate that the Council of Financial Regulators (**CoFR**) response to FMI reforms consultation in July 2020 noted that it did not propose any change to the 15% voting power limit; however this was specifically in the context of a widely held market body.

2.2 Transition for existing licensees

There are a number of FMI licensees which presently have controllers whose voting power exceeds the relevant threshold (whether that is set at 15% or 20%).

We assume the intention behind draft section 852DD is that <u>any</u> increase of voting power of a person with respect to that FMI licensee requires ASIC approval.

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[1] See Explanatory Memorandum to the Treasury Laws Amendment (Financial Sector Regulation) Bill 2018

Consideration could be given to making it clear in the legislation or in the explanatory materials that a person may obtain approval for voting power in excess of 15% (or such other approved percentage) without specifying a particular limit – for example, the approval could contemplate that the person's interest could increase, without the need for further approval. By way of example, the approval could be in terms such as "for an amount exceeding 20%" or "for an amount up to 50%".

Finally, we note that the approval requirement only applies where a person acquires shares, rather than where a person acquires voting power. There are a number of ways that voting power can increase without an accompanying acquisition of shares (for example, where shares of another shareholder are bought back, or through association with another shareholder). We simply note this point, but appreciate that the acquisition of shares is the relevant trigger in Part 7.4 for widely held bodies. For consistency, the new Division 1A ought adopt the same test.

3. Licensing threshold for an overseas facility – material connection

3.1 Context

The Corporations Act presently requires persons who *operate* financial markets and CS facilities *in Australia* to hold an Australian market licence or a CS facility licence respectively (sections 791A and 820A). There is then a deeming provision which simply provides that an operator incorporated in Australia is taken to operate the facility in Australia, but that is not intended to limit the test (sections 791D and 820D).

As we have noted in the introduction to our submissions, we are commonly asked to advise operators of *offshore* financial markets and CS facilities whether they *operate in Australia*. It is often the case that all of their relevant personnel and infrastructure are located outside of Australia, and they do not have a place of business in Australia. There may be Australian based participants who access their facilities, or that there may be end users (clients) of participants based in Australia who access services of the facilities.

There is no relevant judicial authority on the question as to whether and when an offshore facility operates the facility in Australia. ASIC has published its views on the question, in ASIC Regulatory Guide 172 (**RG 172**) and ASIC Regulatory Guide 211 (**RG 211**). However, this guidance is expressed in very broad terms, with the effect that a facility with even a very limited, and even remote, connection to Australia is considered to be *operated in Australia*. The effect of this is that offshore operators either (a) apply for a licence; (b) restrict any meaningful Australian participation; or (c) ignore the provisions altogether. Obtaining a

licence can take well over 12 months, which means that applying for a licence is unattractive if the level of connection is limited or remote.

We therefore support any proposal to limit the licensing requirement to those financial markets and CS facilities where there is a meaningful or material connection with Australia. This is consistent with the previous CoFR recommendations.

3.2 The process to establish material connection

In line with the CoFR recommendations, the draft legislation introduces a process by which ASIC may make a declaration that an overseas facility has a material connection with Australia and, upon the making of this declaration, the operator is taken to be operated in Australia. We are supportive of legislation which only requires offshore operators to be licensed where the material connection is established. We do, however, consider that two refinements would be appropriate:

(a) It should be made clear that this is the *only* basis on which an overseas facility is considered to be operating in Australia. Otherwise there is the risk that the new sections 791D and 820D could merely be considered to be *deeming provisions*, leaving open the argument that there may be some other basis on which the facility could be considered to be operated in Australia. In the absence of this clarification, the confusion and concern which exists under the present provisions could persist.

(b) In order for ASIC to consider whether a material connection exists, ASIC must necessarily have the information it requires to make the assessment against the relevant matters set out in the draft legislation or under any legislative instrument. Draft sections 791E(5) and 820E(5) contemplate that ASIC may request information from the relevant facility operator. However, there is no obligation on the operator to notify ASIC that a facility has a connection with Australia. Therefore we think there is a potential gap in ASIC's ability to perform the materiality assessment in respect of any such connection and to make a declaration. In the interest of clarity and transparency, the legislation should contemplate a process for ASIC to be notified by a facility operator that has a connection with Australia under the relevant tests (e.g. when the operator becomes aware of the connection).

(c) Consideration should also be given to providing expressly for ASIC to notify an offshore operator that ASIC does not consider there to be a material connection, should that be requested by an offshore operator. This would enable the offshore operator to proceed with confidence that (based on information provided by the operator) it does not require a licence.

(d) Consideration should also be given to allowing time for an offshore operator to obtain a licence following the declaration by ASIC that there is a material connection. For example, a facility may over time attract more Australian participants and users over time. If a declaration is made, the obligation to hold a licence would, in the absence of provisions to the contrary, arise immediately. In our experience it can take a year, and commonly much longer to obtain the licence, so the making of the declaration would (in the absence of other provisions) require the operator to cease its activities which give rise to the connection in Australia, or reduce the activities to reduce the connection in the meantime.

3.3 Australian connection

Draft sections 791E(2) and 820E(2) contain a list of matters which gives rise to an Australian connection for a financial market or CS facility. This list is largely based on RG 172 and RG 211. There are, however, some notable differences which could have significant implications. The list includes the following:

(a) "*the market/facility provides a market [or providing services for] for financial products based on something else… located or issued in this jurisdiction, including, for example… an asset; a rate (including an interest rate or exchange rate); an index; a commodity*"

In our view, this factor is too broad. There are many products that are traded, cleared or settled which may have a reference asset which is in Australian dollars (e.g. a currency pair with AUD) or a basket of securities which may contain a small number or percentage of Australian equities (e.g. global stock indices). Similarly, a platform may make available an investment fund which comprise Australian assets (e.g. real estate or listed Australian shares). These products which have an Australian-based "something else" may form a very small fraction of products that are able to be traded on the relevant market or subject to clearing and settlement. For these tangentially relevant products to give rise to a connection with Australia is, in our view, too broad.

(b) "*one or more current or expected participants in the market, or users of the market, are resident or based in this jurisdiction…*"

The inclusion of "users of the market" goes beyond RG 172, which only considers whether the market venue has *participants* in Australia. The term "participant" is (relevantly) defined in section 761A as a person who is allowed to directly participate in the market under the operator's operating rules. It also states in RG 172 that where a person's access to the market venue is intermediated, then the person is not a participant. The reference to "users of the market" is therefore vague and could include persons who otherwise could only access the market through a participant (e.g.

investors transmitting orders by means of an automated straight through processing).

The term "users of the facility" in the context of RG 211 is somewhat vague and unclear. CS facilities are used and accessed by participants or members, and any connection with Australia should therefore be considered by reference to Australian participants or members. In all of our previous engagements with ASIC, this has always been ASIC's focus.

(c) "*market targets investors resident or based in this jurisdiction*"

The "targeting" investors element reflects the guidance in RG 172, which states that "all the facts and circumstances need to be assessed in order to determine whether a market venue targets Australian investors" and factors that may indicate the targeting of Australian investors include having direct market access and prices denominated in Australian dollars. Some of these factors are therefore already covered in other paragraphs in the section which gives rise to a domestic connection.

The concept of "targeting" investors in this jurisdiction is not used elsewhere in the Corporations Act. Consideration should be given to using another term which is more commonly used and understood, such as "soliciting" or "inducing" (used elsewhere in Chapter 7).

3.4 Materiality

Draft sections 791E(3) and 820E(3) list matters relevant to ASIC's consideration as to whether a facility has a material connection. These matters are subject to principles that may be determined by ASIC under legislative instrument.

We recognise the benefit in ASIC having a degree of flexibility. However, given the significance of the determination regarding materiality of a connection, it will be very important that these principles set out quantitative measures and objective criteria for assessing materiality. ASIC should have regard to, among other things, the benefits arising from competition, the accessibility of Australian investors to investment products offshore, and whether the investors are professional investors or wholesale or retail clients (which is relevant to the extent of regulatory protections required).

4. Enhancing regulator powers

4.1 Banning order

We support the underlying principle that key individuals involved in the management of an FMI are fit, proper, capable and competent in that role. The draft legislation (draft section 853H) includes the power to make banning orders

which would prevent an individual from controlling an FMI licensee or prohibit them from performing certain functions.

Consideration should be given to the implications for offshore licensees, as the banning of a director or officer could have implications for the offshore licensee in its home jurisdiction and other jurisdictions in which the offshore licensee operates. There is also a question as to whether there might be different conduct standards for directors and officers under the Australian regime, when compared to those applicable in the relevant home jurisdiction. Consideration could be given to including a requirement that ASIC consult the relevant overseas regulatory authority before making any banning order.

4.2 Notification of material changes in circumstances

Draft section 821J requires a CS facility licensee or its Australian related body corporate to notify the RBA immediately after becoming aware of "any material change in the body corporate's circumstances". The relevant circumstances that must be notified "include, but are not limited to" matters such as its solvency, financial position, and corporate structure.

Failure to comply with this obligation is an offence. We consider it would be appropriate for the matters in sub-section (2) to be an *exhaustive list,* such that only material changes in circumstances which impact those matters ought need to be notified to the RBA.