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18 April 2013

Dr Richard Grant
Acting Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Dr Grant

Corporations and Financial Sector Legislation Amendment Bill 2013

The ASX Group welcomes the opportunity to make a submission on the amendments proposed to the *Payment Systems and Netting Act 1998 (Cth) (PSNA)* as part of the *Corporations and Financial Sector Legislation Amendment Bill 2013 (the Bill)*.

The ASX Group strongly supports the proposed amendments to the PSNA as the amendments will:

- enhance client protections by giving legal certainty to the ability of a licensed central counterparty (CCP) to transfer (or "port") the client positions and collateral of an insolvent clearing participant to other (solvent) clearing participants;
- facilitate compliance by CCPs with new domestic and international regulatory standards for the operation of "financial market infrastructure", and by authorised deposit taking institutions with new standards for the capitalisation of bank exposures to CCPs, that are in each case predicated on a high degree of legal certainty for portability of client positions and collateral; and
- promote the resilience of CCPs by giving legal certainty to the enforcement of security over non-cash collateral held by a CCP in accordance with its operating rules.

Background

The ASX Group operates two licensed CCPs for the clearance of trades executed on Australia's exchange-based financial markets for ASX-listed financial products, including equities, equity options and interest rate, commodity, index and other futures contracts. The ASX Group is also working closely with market participants and end users to deliver a domestically-located clearing service for over the counter (OTC) A\$ interest rate derivatives this year.

Trades that are cleared through an ASX Group CCP's clearing facility are novated to the CCP (as the "central counterparty") in accordance with the operating rules of the facility. By taking on the trade obligations of trade counterparties to each other through the process of novation, the ASX Group CCPs provide an important counterparty risk mitigation service to their respective clearing participants and contribute to the stability of the cleared markets and the wider Australian financial system.

The ASX Group CCPs' clearing facilities are licensed clearing and settlement facilities under the Corporations Act 2001. The ASX Group CCPs are regulated by the Australian Securities and Investments Commission and, with respect to matters related to financial system stability, the Reserve Bank of Australia.

Portability

On the default of a clearing participant, a key concern of its clients is to preserve open positions held by the participant on their behalf ("client positions") and recourse to the collateral supporting those positions. These objectives are most effectively realised where the CCP is able to transfer, or "port", the defaulting participant's client positions, together with the collateral held by the CCP to support those positions, to another (non-defaulting) participant. Where the CCP is unable to port client positions, it must manage the market risk to which it is exposed, as the counterparty to those market contracts, by "closing out" (that is, terminating) the positions and, where necessary, realising and applying the collateral it holds to meet any loss incurred by the CCP as a result of termination. A key learning of the MF Global default in 2011 is that it is generally preferable, from the point of view of clients of a defaulting clearing participant, for client positions to be ported to another clearing participant rather than to be closed out. An illustration of why that is so is that close out can result in the loss of transactions entered into by clients to hedge market risks to which they are exposed in the course of their business (for example, commodity price fluctuations) and therefore exposes clients to the cost of replacement of those hedges.

However, as highlighted by the Council of Financial Regulators in their Review of Financial Market Infrastructure Regulation in 2011, current Australian insolvency law impedes the timely porting of client positions in the event of a clearing participant default, as legal certainty for porting under Australian law is contingent on the CCP obtaining the prior consent of the court or the external administrator of the defaulting clearing participant. ASX's experience of managing broker defaults is that such consent is unlikely to be forthcoming in a timely way. No consent requirement for porting applies under the laws of the United States or England. The Bill will resolve this issue under Australian law and improve the likelihood of client positions and collateral being successfully ported by a CCP following a clearing participant default.

The proposed amendments to the PSNA are also consistent with the new Financial Stability Standards ("FSS") made by the Reserve Bank, to which ASX Group CCPs must adhere. The FSS require that a CCP's arrangements are structured in such a way that it is 'highly likely' that the positions and collateral of a defaulting participant's clients will be transferred (i.e. ported) to one or more other participants. The amendments to the PSNA proposed by the Bill will provide a firm legal foundation on which CCPs can structure arrangements that meet this 'highly likely' standard.

Enforcement of CCP security interests

The ASX Group also supports the proposed amendments to the PSNA that will give enhanced legal certainty to the enforcement by a CCP of its security interests in non-cash collateral. The Bill removes uncertainty in relation to the perfection and priority of a CCP's security interests in circumstances where a clearing participant or its client is in external administration. This approach is consistent with legislation in the United Kingdom and Hong Kong that specifically authorises the enforcement of CCP security interests notwithstanding the general insolvency moratorium and gives priority to such security interests. Clarification of these matters in the PSNA will better equip CCPs to effectively manage participant default and thereby promote financial system stability.

If you have any queries in relation to any of the matters raised in this submission please contact Nick Wiley, General Manager, Legal or Catherine Eakin, Legal Counsel

Yours sincerely,

Amanda J. Harkness
Group General Counsel & Company Secretary

Copy: Mr Laurence White and Ms Dodie Green, Financial Market Infrastructure, Australian Securities and Investments Commission
Mr Greg Chugg and Ms Jenny Hancock, Payments Policy Department, Reserve Bank of Australia