19 April 2013

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

By email: corporations.joint@aph.gov.au

Dear Dr Grant

Corporation and Financial Sector Legislation Amendment Bill 2013

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment to the Committee on its review of the Corporation and Financial Sector Legislation Amendment Bill 2013 (the Bill).

AFMA is the leading industry association in promoting efficiency, integrity and professionalism in Australia's financial markets and provides leadership in advancing the interests of all market participants. These markets are an integral feature of the economy and perform the vital function of facilitating the efficient use of capital and management of risk. Market participants perform a range of important roles within these markets including those for the over-the-counter (OTC) derivatives.

Support for the Bill

AFMA was consulted during the course of the drafting of the Bill and agrees with its policy objectives. AFMA supports passage of the Bill in its current form.

Part 1 Amendments - Legal Certainty for Portability

The amendment in Part 1 — concerning the payment systems and netting is of particular importance to AFMA members.

Central counterparty clearing houses (CCPs) play an important role in managing risk in financial markets. The requirement for centralised clearing of standardised OTC derivatives is key part of globally coordinated reforms which are being implemented

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domestically under the provisions of the *Corporations Legislation Amendment (Derivative Transactions) Act 2012* passed late last year.

OTC derivatives are traded in a global marketplace and effective regulation can only be achieved through an internationally coordinated comprehensive regulatory effort. International standards therefore play an influential role in how the Australian market regulation is evolving. It is important that rules developed for the Australian market accord with international practice to ensure that Australian market participants and financial market infrastructures have full access to the international market and are regulated in accordance with international principles. Portability is generally recommended as best practice under relevant international principles established by the Financial Stability Board and other international agencies.

The *Payments System and Netting Act 1998* (PS&N Act) is a critical component of the financial system framework. The objective underlying the framing of the PS&N Act was to provide high legal clarity and certainty that the netting arrangements established in relation to transactions and facilities were legally valid and protected, including in situations where one of the participants or parties entered external administration. It was decided in 1998 that enactment of legislation to clarify a number of issues arising in netting financial market transactions was necessary to put them beyond legal doubt. The legislation has served the needs of market by making the financial position of Australian financial institutions certain.

Portability of client positions and related collateral is a valuable technique in the event of a clearing member default or insolvency in a CCP, client positions are not terminated and client positions and collateral can be transferred to one or more non-defaulting clearing members without having to liquidate and re-establish the positions. Portability can mitigate difficulties associated with stressed market conditions, allow clients to maintain continuous clearing access and generally promote efficient financial markets.

Under Australian insolvency law legal problems can arise with the use of porting if the defaulting participant is insolvent. The rights of the defaulting participant can be regarded as its property to a certain extent. As a result dealing with that property, once insolvency proceedings have commenced can run counter to the objectives and operation of insolvency in this country. In the event of a default or insolvency rapid action is of the essence, and it is a particular concern to ensure that a central counterparty clearing house can act without having to obtain consents from external administrators that would otherwise be required under the insolvency provisions in the Corporations Act.

Shielding of porting from insolvency laws is already in place in other important financial centre jurisdictions, such as in the United States and the United Kingdom.

It is important for the legal framework to facilitate portability of collateral in a manner that provides market participants with appropriate protections and legal certainty. The proposed amendment of the PS&N Act would clarify that porting of positions, including associated collateral, in the case of a default or insolvency of a participant is allowed, regardless of provisions in other legislation including the Corporations Act.

The current section 16 of the PS&N Act deals with effectiveness of market netting contracts and is intended to put beyond doubt:

(a) The novation of market-netting contracts where they seek to achieve this.

(b) The efficacy of netting to produce a single settlement amount (either positive or negative) for settlement.

(c) The ability of the netting market to use cash margins and security for margins in accordance with the rules of the netting market to meet the obligations of a broker, without interference by the broker's clients.

The proposed amendments in the Bill extend the existing protection given to the close out netting provisions to the dealing with rights, obligations and property in accordance with netting market rules. This in effect means the operating rules of a CCP which provides for porting. In practice, this protection comes into effect when a CCP with its clearing members decides to implement porting. The intention is that these clearing house arrangements work in accordance with the rules despite other laws, including insolvency laws.

The PS&N Act is also being amended ensure that CCPs can enforce security held over all types of assets, including dematerialised securities through the addition of explicit powers for a clearing facility to enforce security held over all types of assets by means of the amendment set out in Schedule 1, item 5, after paragraph 16(2)(f), paragraph (fa) of the Bill.

AFMA agrees with the proposition that the PS&N Act is the preferred vehicle to make the proposed amendment because it covers the widest possible range of external administration proceedings conducted under Australian or foreign law and has the required authority to override provisions in any other legislation.

CCPs will not necessarily decide that porting is always the best way to deal with a default. The porting of large market positions from a less credit-worthy clearing member is problematic in practice and so faces practical implementation hurdles. Accordingly, CCPs may still rely on netting and close-out rather than porting. In such a case there would be crystallisation of a loss for the CCP and the CCP would need to resort to its default funding arrangements.

In the event of a member default as defined in the CCP rules (e.g., fail to settle, fail to post margin, fail to pay fees), the CCP can declared the member to be in a non-conforming or default status. It then follows its default rules and procedures. For instance, the CCP may take hold of the default member's assets, and then either transfers the assets to another member or auctions the portfolio to other members. To cover the loss from the default member, the CCP's first recourse is to the collateral the defaulting member has committed for margins. Under section 440JA of the Corporations Act an operator of a CCP clearing and settlement facility is allowed to enforce security it holds over a defaulting participant's property if the relevant property is cash, negotiable instruments, securities or derivatives and is subject to a 'possessory security interest'. There is some legal uncertainty as to whether security held over

certain types of frequently used collateral satisfies this definition, such as 'dematerialised securities' like shares held in a share settlement subregister like CHESS.

The amendments to the PS&n Act are complex and difficult to grasp from a reading of the legislation alone. Accordingly, the Explanatory Memorandum is of particular importance in this case to an understanding of the Bill and how the amended law is intended to be applied in the future. The Explanatory Memorandum is drafted with sufficient clarity, contextual information and exposition to allow the amended law to be effectively understood.

Part 5 — Disclosure of information by the Reserve Bank

The Bill will allow the RBA to share protected information with other persons in the execution of its duties in an appropriate manner and subject to adequate controls. A power is provided for a person disclosing protected information or documents under section 79A to impose conditions in writing on the person receiving the information or documents. This power is provided in order to assist the RBA in ensuring that protected information provided to it by regulated entities is treated with the appropriate care and respect.

The need to extend the sharing of protected information beyond the limitations of the currently nominated international institutions is understood. In previous consultations with the Australian regulators regarding sharing of datasets relating to particular financial institutions, which by their nature are commercially sensitive, AFMA has expressed the following policy position. The release of unmasked user datasets to other jurisdiction regulators and international authorities is accepted in support of their official responsibilities. However, release to the public, which would include academics and researchers, of Australian user datasets should only be on a masked basis unless consent has been given by the provider of the dataset. This position is based on the fundamental principle of public reporting; that it should not be possible, from the information provided, for any party to calculate or imply any positional or trade related information pertaining to a particular market participant, either directly or indirectly.

In summary AFMA's position is to support the dissemination through confidential channels of unmasked datasets to third parties such as central banks, monetary authorities and international organisations to conduct more detailed analysis for official purposes without user consent. However, contributor consent should be required for release for unofficial uses and public release of commercially confidential datasets.

Other amendments

AFMA has no specific comment with regard to the other parts of the Bill dealing with compliance and information exchange measures other than that are reasonable extensions of the law that will:

- Allow ASIC and the RBA to determine on a case-by-case basis how often they need to assess compliance by particular AML and CSFL holders with their legal obligations.

- Allow ASIC to share information with foreign business regulators both in response to requests from individual business regulators or groups of multi-jurisdictional business regulators, such as pan-European regulators.

- Allow the Clean Energy Regulator to share protected information with licensed and prescribed trade repositories, subject to conditions set out in its legislation.

Please contact me at if further clarification or elaboration is desired.

Yours sincerely

David Love
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