Corporations and Financial Sector Legislation Amendment Bill 2013

Introduction

1.1 On 21 March 2013, the House of Representatives Selection Committee referred the Corporations and Financial Sector Legislation Amendment Bill 2013 to the Parliamentary Joint Committee on Corporations and Financial Services (the committee) for inquiry and report. The committee agreed to table its report by 15 May 2013.

1.2 The bill would amend the *Corporations Act 2001* (the Corporations Act), the *Payment Systems and Netting Act 1998* (the PSN Act), the *Mutual Assistance in Business Regulations Act 1992* (the MABR Act), the *Australian Securities and Investments Commission Act 2001* (the ASIC Act), the *Reserve Bank Act 1959* (the RB Act), the *Clean Energy Regulator Act 2011* (the CER Act) and the *Carbon Credits (Carbon Farming Initiative) Act 2011* (the CFI Act) to introduce a range of miscellaneous measures relating to the regulation of financial markets and products.

1.3 The key measures are intended to:

- assist central counterparties (CCPs) in managing defaults of clearing participants;
- improve the allocation of resources by the Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia (RBA) in assessing the compliance of Australian market licence (AML) and clearing and settlement facility licence (CSFL) holders with their legal obligations;
- allow certain Australian regulators including the RBA to exchange protected information with other entities in Australia and overseas in the execution of their duties subject to appropriate safeguards; and
- allow ASIC to gather and share protected information with regulatory entities overseas for supervision and enforcement purposes; and require ASIC to report on the use of those powers.[1]

Conduct of the inquiry

1.4 The committee advertised the inquiry on its website, inviting submissions from interested parties by 19 April 2013. The committee also wrote directly to 35

1 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p 3.

stakeholders to invite submissions. In total, five submissions were received, which are listed in Appendix 1.

1.5 The committee conducted a public hearing on 22 April 2013. A list of witnesses can be found in Appendix 2.

1.6 The committee thanks the organisations that provided evidence to this inquiry.

Background

1.7 The 2008 global financial crisis (GFC) prompted calls for financial regulators to review the regulatory framework underpinning domestic and global economies. A central cause of the crisis was the largely unregulated derivatives[2] market, which had grown rapidly. This market was conducted on both public stock exchanges and in private through over-the-counter (OTC) derivative transactions.[3]

1.8 In 2009, the G20 agreed to progress measures to strengthen the international financial regulatory system.[4] As a follow-up to its G20 commitments, the Australian Government asked the Council of Financial Regulators—which comprises the RBA, the Australian Prudential Regulation Authority (APRA), ASIC and Treasury—to undertake a consultation and review of the existing regulatory framework.

1.9 After detailed consultation with interested stakeholders, the Council of Financial Regulators provided a report to the Government on 20 March 2012.[5] It recommended a legislative framework allowing regulators to take a dynamic approach as the market evolves, and allowing for mandated reporting requirements should they be required for financial stability objectives and to meet Australia's international obligations.

---

2 A derivative is a security instrument based on a contract between two or more parties for the sale of one or more underlying assets. The contract confers on the parties the right to exercise the contract at a specified price. Derivatives are generally used as an instrument to hedge risk and the common underlying assets are stocks, bonds, commodities, currencies, interest rates and market indices.

3 Over-the-counter derivatives operate through a dealer network where broker-dealers negotiate directly with one another. A dealer network is often used by small companies that are unable to meet exchange listing requirements.

4 The Group of 20, or G20, is a forum for international collaboration and coordination on matters affecting international financial stability. The G20 includes 19 member countries and the European Union. In September 2009 the G20 endorsed a global transition of derivative products towards recognised exchanges or trading platforms, where appropriate. The G20 also agreed that all standardised OTC derivatives should be cleared through a central counterparty and all OTC derivatives should be reported to trade repositories.

5 Council of Financial Regulators, *OTC Derivatives Market Reform Considerations*, March 2012, http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2012/CFR%20report%20on%20over%20the%20counter%20derivatives/Downloads/PDF/CFR%20Report.ashx (accessed 8 April 2013).

1.10 On 13 September 2012, the House of Representatives Selection Committee referred the Corporations Legislation Amendment (Derivative Transactions) Bill 2012 (the DT bill) to the committee for inquiry and report. The DT bill was intended to implement the Council of Financial Regulator's recommendations and to address Australia's G20 commitments regarding the:

- reporting of OTC derivatives to trade repositories[6];
- clearing of standardised OTC derivatives through CCPs; and
- execution of standardised OTC derivatives on exchanges or electronic platforms, where appropriate'.[7]

1.11 At the public hearing into the DT bill held in Sydney on 5 October 2012, representatives of the electricity sector strongly opposed the application of OTC derivatives regulatory requirements to participants in the national electricity market. The committee found persuasive the view that to expressly exclude any sector or class of derivative would not be best practice and would limit regulators' capacity to respond appropriately to market changes. It recommended that ASIC 'provide regular updates on the development of OTC derivatives rules and the market's response to new regulatory requirements'.[8]

1.12 The *Corporations Legislation Amendment (Derivative Transactions) Act 2012* (the DT Act) was enacted in December 2012. It amended the Corporations Act to implement a legislative framework that allows the operational details of the OTC derivatives scheme to be largely established by subordinate legislation.[9] Under the framework, obligations may be imposed through delegated legislation and regulatory rules.[10] The DT Act was intended to 'provide a high degree of flexibility' to facilitate the adjustment of Australia's OTC derivative requirements in response to international regulatory developments.[11]

---

6 Trade repositories are a special type of facility which collect and store information related to OTC derivatives. These electronic platforms 'play a central role in enhancing the transparency of derivative markets and reducing risks to financial stability', see, European Securities and Markets Authority, *Trade repositories*, http://www.esma.europa.eu/page/Trade-repositories (accessed 2 May 2013).

7 The Hon. Bill Shorten MP, Second Reading Speech, *House of Representatives Hansard*, 12 September 2012, pp 4–6.

8 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Corporations Legislation Amendment (Derivative Transactions) Bill 2012*, October 2012, p. 19.

9 The Hon. Bill Shorten MP, Second Reading Speech, *House of Representatives Hansard*, 12 September 2012, pp 4–6.

10 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.24.

11 The Hon. Bill Shorten MP, Second Reading Speech, *House of Representatives Hansard*, 12 September 2012, pp 4–6.

1.13 The Financial Stability Board (FSB), an international body established after the 2009 G20 London summit,[12] noted in its October 2011 report jurisdictions' progress towards meeting G20 commitments on OTC derivatives:

> The needed laws and regulations are complex and have the potential to result in significant changes in market structure. They must be developed with due care and analysis so as not to compromise the objectives for derivatives market reform set by the G-20 of improving transparency in the derivatives markets, mitigating systemic risk, and protecting against market abuse … it is critical that market participants continue efforts to reform the trading, clearing and reporting of OTC derivatives.[13]

1.14 In a follow-up report in October 2012, the FSB recommended that:

> Jurisdictions should put in place their legislation and regulation promptly and in a form flexible enough to respond to cross-border consistency and other issues that may arise. Regulators need to act by end-2012 to identify conflicts, inconsistencies and gaps in their respective national frameworks, including in the cross-border application of rules.[14]

1.15 On 15 April 2013, the FSB released its fifth progress report on the implementation of OTC derivatives market reforms. The report notes that less than half of the FSB member jurisdictions currently have legislative and regulatory frameworks in place to implement the G20 commitments. The FSB states that 'there remains significant scope for increases in trade reporting, central clearing, and exchange and electronic platform trading in global OTC derivatives markets'.[15] The FSB expects progress in meeting the G20 commitments to accelerate over the course of 2013.

1.16 As noted in the Second Reading Speech to the bill, the Corporations and Financial Sector Legislation Amendment Bill 2013 (the bill) is intended to

---

12 The FSB was 'established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.' http://www.financialstabilityboard.org/about/overview.htm (accessed 12 April 2013).

13 Financial Stability Board, *OTC Derivatives Market Reforms: Progress Report on Implementation*, 11 October 2011, p. 1, http://www.financialstabilityboard.org/publications/r_111011b.pdf (accessed 10 April 2013).

14 Financial Stability Board, *OTC Derivatives Market Reforms: Fourth Progress Report on Implementation*, 31 October 2012, pp 1–2, https://www.financialstabilityboard.org/publications/r_121031a.pdf (accessed 12 April 2013).

15 Financial Stability Board, *OTC Derivatives Market Reforms: Fifth Progress Report on Implementation*, 15 April 2013, p. 9, http://www.financialstabilityboard.org/publications/r_130415.pdf (accessed 17 April 2013).

complement the existing legislative framework to implement Australia's core G20 commitments in relation to OTC derivatives reforms.[16]

1.17 In April 2013, the Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, announced the granting of an AML to the Financial and Energy Exchange Global Pty Ltd (FEX), allowing it to operate a new derivatives market in Australia.[17] The Government also granted LCH.Clearnet a licence to clear and settle contracts traded on the FEX market. The licence to LCH.Clearnet is the first non-ASX clearing licence in Australia for a significant market.

1.18 The Government's intention in granting these licences is to:

> … promote greater competition in Australia's derivatives trading markets. By encouraging competition we are promoting Australia as a financial services centre and helping ensure our financial markets are efficient and innovative.[18]

1.19 These announcements highlight the evolving nature of the Australian financial market, particularly increased foreign investment and participation in the provision of market infrastructure such as trading platforms.

Consideration of the bill

1.20 The consultation process for the bill was extensive. Treasury described the drafting process as follows:[19]

- Treasury consulted primarily with the Australian Securities Exchange (the ASX) in preparing the draft bill. This involved the ASX and its legal advisor participating in two conference calls with the drafting officer and being given the opportunity to comment on each draft of the parts of the bill. ASIC and the RBA were also consulted in the drafting process.
- An advanced draft of the bill was sent to the following parties for review and comment, which did not lead to any significant changes:
  - Australian Financial Markets Association (AFMA);

16 The Hon. Bernie Ripoll MP, Second Reading Speech, *House of Representatives Hansard*, 20 March 2012, p. 26.

17 The Hon. Bill Shorten MP, *Government's Approval of the FEX Financial Market and the LCH Clearing and Settlement Arrangement*, Media Release No. 025, 10 April 2013, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/025.htm&pageID=003&min=brs&Year=&DocType (accessed 12 April 2013).

18 The Hon. Bill Shorten MP, *Government's Approval of the FEX Financial Market and the LCH Clearing and Settlement Arrangement*, Media Release No. 025, 10 April 2013, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/025.htm&pageID=003&min=brs&Year=&DocType (accessed 12 April 2013).

19 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

- Australian Bankers' Association;
- Ashurst; and
- Professor John Stumbles, Professor of Finance Law, University of Sydney.

1.21 The Ministerial Council for Corporations[20] was consulted on the amendments to the Corporations Act and approved the changes to the ASIC Act contained in the bill.[21]

1.22 The Office of Best Practice Regulation confirmed that none of the amendments in the bill require a regulation impact statement, as they have a minor impact on businesses.[22]

1.23 The bill does not raise any human rights issues.[23]

Provisions of the bill

1.24 The bill is divided into seven parts:

- Part 1 – Payment systems and netting;
- Part 2 – Review of licences;
- Part 3 – International business regulators;
- Part 4 – Reporting on ASIC's information gathering powers;
- Part 5 – Disclosure of information by the Reserve Bank;
- Part 6 – Consequential amendments relating to derivative trade repositories; and
- Part 7 – Other amendments.

Part 1 – Payment systems and netting

1.25 CCPs are entities providing clearing services for transactions in financial products. CCPs provide a centralised risk management service by inserting themselves as counterparties to each trade transacted on the market. In this process, known as 'novation', the original rights and obligations of the buyer and seller are discharged

20 Now known as the Legislative and Governance Forum for Corporations.

21 The Hon. Bernie Ripoll MP, Second Reading Speech, *House of Representatives Hansard*, 20 March 2012, p. 27.

22 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 4.

23 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, pp 31–32.

and their contracts replaced with two new contracts with the CCP. The CCP acts as a 'matching seller to the original buyer and a matching buyer to the original seller'.[24]

1.26 Professor Wallace C. Turbeville of the Roosevelt Institute notes that derivatives are often structured as swap contracts:

> … on a certain date, one party is required to pay a fixed sum and the other party is required to pay the current price. The fixed payer has sold the risk of price movement and the fixed receiver has bought that risk. Derivatives can be used to hedge existing price risks or to speculate.[25]

1.27 A derivatives trade generates risks between counterparties because:

> … if one party defaults, the other has lost the opportunity to realize that value. The amount of the credit risk is a function of the current value of the derivative. This value changes constantly as the reference price of the derivative changes. Assume A and B enter into a swap at the current market price which is $10. This is the fixed payment and A will be the fixed payer. On a day when the current market price is $11, A is at risk for receiving a net $1 from B at maturity.[26]

1.28 If in this example B goes into default, the longer it takes A to find a replacement and the more prices move before replacement, the worse the consequences are for A. Price moves therefore cause CCP losses.[27] They may cause multiple participants to default, which in turn may lead to cascading effects in the market.

1.29 In the event of default by a participant, a CCP may protect itself against the consequences of the default by moving the client transactions of the failed participant to another, solvent, participant. This process is known as 'porting'.

1.30 Porting can give rise to issues under insolvency laws if the defaulting participant is insolvent. This is because:

---

24 The Hon. Bernie Ripoll MP, Second Reading Speech, *House of Representatives Hansard*, 20 March 2012, p. 26.

25 Wallace C. Turbeville, *Derivatives Clearinghouses in the Era of Financial Reform*, 24 October 2010, p. 1, http://www.rooseveltinstitute.org/sites/all/files/wallace_clearinghouse.pdf (accessed 4 May 2013).

26 Wallace C. Turbeville, *Derivatives Clearinghouses in the Era of Financial Reform*, 24 October 2010, p. 3, http://www.rooseveltinstitute.org/sites/all/files/wallace_clearinghouse.pdf (accessed 4 May 2013).

27 Wallace C. Turbeville, *Derivatives Clearinghouses in the Era of Financial Reform*, 24 October 2010, p. 3, http://www.rooseveltinstitute.org/sites/all/files/wallace_clearinghouse.pdf (accessed 4 May 2013).

> … the rights of the defaulting participant could be regarded as (in part) its property, and dealing with that property, once insolvency proceedings have commenced could run against the provisions and policy of insolvency laws. It is this mismatch which can result in legal uncertainty in the operation of porting.[28]

1.31 The bill proposes to amend the PSN Act to protect portability and security clearing systems under Australian law. In order to provide legal certainty it is:

> … therefore necessary to amend the PSN Act to 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.[29]

1.32 Powerful provisions in the PSN Act may override other laws (such as insolvency laws) and these are included in the PSN Act because:

> … the systems, activities and arrangements it covers are at the heart of the financial system. Ensuring that they have legal validity, including in situations where one of the parties enters insolvency, is considered fundamental to protecting the stability of the financial system.[30]

1.33 These provisions currently apply to netting arrangements covered by market netting contracts,[31] which are a key risk-management tool in financial markets. The proposed amendments would extend the provisions to cover porting arrangements put in place by CCPs:

> The effect of the Bill in this area would be to facilitate, in the case of a default of one of the participants in the clearing facility, the transfer of the obligations of that participant with respect to outstanding transactions to another participant. The transactions would then be completed as if no default had occurred.[32]

---

28 Scott Farrell, King & Wood Mallesons, *Certainty for portability in Australia*, 20 March 2013, http://www.mallesons.com/publications/marketAlerts/2013/Pages/Certainty-for-portability-in-Australia.aspx (accessed 5 April 2013).

29 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 9.

30 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 8.

31 A 'netting market' is a financial marketplace which has been approved (and the rules of which have been approved) by the Australian regulators. Netting allows a positive value and a negative value to set-off and partially or entirely cancel each other out. It often occurs in situations in which one of the participants is experiencing extreme financial difficulty. The current provisions in the PSN Act protect close-out netting, which can occur in the event of participant bankruptcy or default, from Australian insolvency laws.

32 The Hon. Bernie Ripoll MP, Second Reading Speech, *House of Representatives Hansard*, 20 March 2012, p. 26.

1.34 Without the amendments 'insolvency law would allow an external administrator to intervene and stop or unwind' porting transfers.[33] The measures provide legal certainty to these transactions, which will generally be required in crisis situations. The intended result is stability of the financial system through providing protections to clearing facilities 'as one of the key elements in that system'.[34]

1.35 The importance of providing for portability is recognised internationally. In April 2012, the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) published a report titled *Principles for Financial Market Infrastructures* (CPSS–IOSCO Principles). Under these principles, a CCP should have 'segregation and portability arrangements that effectively protect a participant's customers' positions and related collateral from the default or insolvency of that participant'.[35] Furthermore, 'a CCP should structure its portability arrangements in a way that makes it highly likely that the positions and collateral of a defaulting participant's customers will be transferred to one or more other participants'.[36]

1.36 Protection of porting from insolvency laws already exists in other 'clearing' jurisdictions. For instance, in the United Kingdom (UK) the 2013 Regulations to the *Financial Services and Markets Act 2000* made amendments to UK law to make it consistent with the European Market Infrastructure Regulation[37] (EMIR). The EMIR, which entered into force in the European Union on 16 August 2012, introduces a requirement for CCPs to:

> … commit themselves to attempt to port the client accounts on the failure of their clearing member, in order to minimise the systemic disruption caused by clearing member failure.[38]

1.37 This means that the CCP must try to port client positions and an associated margin to a back-up clearing member. The intended benefit is a reduction in counterparty risk and increased market stability. The regulations offer CCPs

---

33 The Hon. Bernie Ripoll MP, Second Reading Speech, *House of Representatives Hansard*, 20 March 2012, p. 26.

34 The Hon. Bernie Ripoll MP, Second Reading Speech, *House of Representatives Hansard*, 20 March 2012, p. 26.

35 CPSS–IOSCO, *Principles for Financial Market Infrastructures*, April 2012, p. 82, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD377.pdf (accessed 24 April 2013).

36 CPSS–IOSCO, *Principles for Financial Market Infrastructures*, April 2012, p. 82, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD377.pdf (accessed 24 April 2013).

37 Regulation (EU) No 648/2012.

38 Explanatory Memorandum, Financial Services and Markets Act 200 (Over the Counter Derivatives, Central Counterparties and Trade Repositories) Regulations 2013, p. 4, http://hb.betterregulation.com/external/SI%202013_504%20UkF%20EM.pdf (accessed 9 April 2013).

'additional certainty that porting can be achieved without the risk of challenge under UK insolvency law'.[39]

1.38 It is important that the Australian legislative framework is consistent with developments in the international regulatory environment. As noted by the Council of Financial Regulators:

> As with many other countries, the Australian OTC derivatives market is highly international in nature. Many Australian-based market participants are active in offshore markets. Similarly, many significant participants in the Australian market are foreign entities. Accordingly, regulatory developments in offshore jurisdictions are very likely to have some spillover effect on the configuration and activity of the domestic market.[40]

1.39 To this end, the RBA's December 2012 Financial Stability Standards[41] (FSS) are aligned with the requirements in the CPSS–IOSCO Principles relating to financial stability. In particular, the FSS require that CCP arrangements be structured in a way that makes porting 'highly likely'.[42]

1.40 As mentioned previously, the framework established by the DT Act was intended to 'provide a high degree of flexibility' to facilitate the adjustment of Australia's OTC derivative requirements in response to international regulatory developments.[43] The bill's proposal to align domestic law with international developments is therefore in keeping with this intention.

Stakeholders' views on Part 1

1.41 All five submitters to this inquiry supported the bill and focused primarily on Part 1 in their submissions. The submitters and those officials who gave evidence at

---

39 Explanatory Memorandum, Financial Services and Markets Act 200 (Over the Counter Derivatives, Central Counterparties and Trade Repositories) Regulations 2013, p. 4, http://hb.betterregulation.com/external/SI%202013_504%20UkF%20EM.pdf (accessed 9 April 2013).

40 Council of Financial Regulators, *OTC Derivatives Market Reform Considerations*, March 2012, http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2012/CFR%20report%20on%20over%20the%20counter%20derivatives/Downloads/PDF/CFR%20Report.ashx (accessed 8 April 2013).

41 Reserve Bank of Australia, *New Financial Stability Standards: Final Standards and Regulation Impact Statement*, December 2012, http://www.rba.gov.au/payments-system/clearing-settlement/standards/201212-new-fss-ris/ (accessed 9 April 2013).

42 Reserve Bank of Australia, *New Financial Stability Standards for Central Counterparties*, December 2012, p. 12, http://www.rba.gov.au/payments-system/clearing-settlement/standards/201212-new-fss-ris/pdf/attachment-2.pdf (accessed 9 April 2013).

43 The Hon Bill Shorten MP, Second Reading Speech, *House of Representatives Hansard*, 12 September 2012, pp 4–6.

the public hearing referred to the following two primary justifications for the proposed amendments to the PSN Act:

- to provide legal certainty and financial stability; and
- to ensure that Australian law is compliant with international developments.

1.42 The ASX Group strongly supported the amendments, arguing that 'the bill will improve the likelihood of client positions and collateral being successfully ported by a CCP following a clearing participant default'.[44] It argued that the proposed amendments to the PSN Act will provide a firm legal foundation on which CCPs can structure arrangements that meet the 'highly likely' standard in the new FSS.

1.43 The ASX Group also suggested that the proposed amendments to the PSN Act will give enhanced legal certainty in the event of a clearing participant or client entering external administration, which will 'better equip CCPs to effectively manage participant default and thereby promote financial system stability'.[45] King & Wood Mallesons took a similar view, arguing that 'for the financial market infrastructure to be effective there needs to be legal certainty around fundamental matters in connection with portability and collateral … The amendments to the [PSN Act] are needed to provide this certainty under Australian law'.[46]

1.44 AFMA noted that it was consulted during the course of the drafting of the bill and agreed with its objectives. It argued that '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'.[47] AFMA agreed with the proposal to amend the PSN Act as the 'preferred vehicle' to ensure that CCPs can enforce security held over all types of assets, because the PSN Act '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'.[48]

1.45 The International Swaps and Derivatives Association (ISDA) argued that the proposed amendments 'are of great importance to the safety, efficiency and stability of the financial markets'.[49] ISDA referred to legal certainty around the enforceability of portability arrangements in connection with the central clearing of OTC derivatives as 'critical to the stability of the market' and accordingly supported the proposed amendments to the PSN Act.[50]

---

44 ASX Group, *Submission 1*, p. 2.

45 ASX Group, *Submission 1*, p. 2.

46 King & Wood Mallesons, *Submission 3*, p. 1.

47 Australian Financial Markets Association, *Submission 4*, p. 2.

48 Australian Financial Markets Association, *Submission 4*, p. 2.

49 International Swaps and Derivatives Association, *Submission 5*, p. 1.

50 International Swaps and Derivatives Association, *Submission 5*, p. 1.

1.46 In verbal evidence to the committee, Treasury referred to the insolvency arrangements set out in the Corporations Act as an impediment to portability.[51] Mr David Woods, General Manager, Corporations and Capital Markets Division, advised that the ability of an external administrator appointed under insolvency arrangements to block or unwind the transfers associated with porting positions and collateral would result in uncertainty and timing delays, which would 'inhibit an effective response to what could be quite a serious financial problem'.[52] Treasury's view is that 'investor confidence will be strengthened by the introduction of arrangements that increase clients' ability to preserve positions notwithstanding broker default'.[53]

1.47 Beyond noting that portability arrangements need to be implemented in 'crisis situations and under extreme time pressure',[54] the EM does not provide practical examples of when these arrangements may need to be put into place. The EM would have benefited from inclusion of examples in order to more effectively communicate the context of what is a highly technical area.

1.48 Treasury provided a detailed example in response to a question on notice.[55] In the example, a client has entered into a number of exchange-traded futures transactions via a broker on the ASX24 futures market, which are cleared by the ASX. The broker becomes insolvent and an administrator is appointed. As the clearing house for the transactions, the ASX may manage its exposure to the broker's default by either:

- 'closing out' the client's portfolio by executing transactions in the market that are equal and opposite to those in the portfolio, thus extinguishing the transactions entered into by the broker on behalf of the client; or
- 'porting' the portfolio to a new broker on behalf of the client.[56]

1.49 Treasury noted that in this example, the preferred and least disruptive solution for the client is that the transactions are ported to a new broker.[57] The client would retain the benefit of the value of the margin held by the ASX in respect of the client's

51 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 2.

52 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 2.

53 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

54 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p 7.

55 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

56 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

57 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

portfolio and would not have to wait until the administrator is in a position to release funds held as margin on trust by the broker.

1.50 Treasury drew the committee's attention to the collapse of MG Global, which was a major global financial derivatives broker, as an example of a successful use of porting arrangements in the United States:

> Arrangements for porting client positions were made by many U.S. clearing houses following the default of MF Global; these included CME Group, ICE Futures US, ICE Clear US, NYSE Liffe US and others.[58]

1.51 Treasury confirmed that, due to the existing legal framework, porting has not taken place in Australia before.[59] Treasury noted, however, that should the bill be enacted, administrators would not need to provide permission for porting, which 'would ensure that the option to port would be available going forward, to the benefit of the end user market participants'.[60] Treasury clarified that the client's portfolio, as client property, is held on trust and accordingly the transfer (porting) of the transaction would not disadvantage the broker's creditors.[61]

1.52 At the inquiry's public hearing, the RBA gave the particularly important example of large wholesale participants, which may have significant exposure in the financial system.[62] Mr Manning, the Deputy Head of the Payments Policy Department, argued that 'exposing those sorts of participants to potential loss or potentially lengthy insolvency proceedings may be an undesirable outcome for the financial system more broadly'.[63]

1.53 The RBA supported the changes proposed in the bill and noted that the changes will 'bring Australia's legal protections for clients of CCP participants into line with international standards'.[64] The RBA argued that 'this will in turn help to ensure that Australia's regime achieves a favourable assessment in peer reviews by various international bodies and in equivalence assessments by overseas regulators'.[65]

---

58 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

59 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

60 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

61 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

62 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 3.

63 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 3.

64 Reserve Bank of Australia, *Submission 2*, p. 1.

65 Reserve Bank of Australia, *Submission 2*, p. 2.

1.54 In verbal evidence to the committee, Mr Oliver Harvey, Senior Executive Leader of Financial Market Infrastructure at ASIC, referred to efforts in the context of the Government's G20 commitments to:

> establish an arrangement which is broadly called substituted compliance, which basically means that the risk framework under which our financial market infrastructure operates is considered to be sufficiently robust for it to be recognised as an alternative means for foreign entities to operate in this jurisdiction. In other words, they would not have to comply with the other jurisdiction; they could comply with the jurisdiction domestically and be recognised as having complied with the foreign jurisdiction requirements in doing so.[66]

1.55 Treasury expanded on the importance of Australia having a system that is deemed compliant with other jurisdictions, including Europe.[67] Mr Woods referred to the work being undertaken by G20 countries to minimise the amount of regulatory overlap so that:

> financial institutions regulated in one jurisdiction can receive the benefit of that when they are operating in another jurisdiction. Clearly, for a country such as Australia with banks who are active in the global financial markets this is quite an important thing for our financial system.[68]

1.56 While the clearing of standardised OTC derivatives through CCPs is one of the pillars of the G20 commitments, it is important to note that central clearing does not eliminate risk.[69] Professor Turbeville argues that it in fact 'concentrates the credit risk inherent in derivatives transactions'.[70] It does, however, facilitate the reallocation of risk to other clearing participants in the event of default or insolvency.

1.57 Similarly, the RBA noted that the result of the proposed amendments will not be a guarantee that porting will always occur.[71] AFMA suggested in its submission

---

66 Mr Oliver Harvey, Senior Executive Leader, Financial Market Infrastructure, ASIC, *Committee Hansard*, 22 April 2013, p. 3.

67 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 3.

68 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 3.

69 Wallace C. Turbeville, *Derivatives Clearinghouses in the Era of Financial Reform*, 24 October 2010, p. 2, http://www.rooseveltinstitute.org/sites/all/files/wallace_clearinghouse.pdf (accessed 4 May 2013).

70 Wallace C. Turbeville, *Derivatives Clearinghouses in the Era of Financial Reform*, 24 October 2010, p. 2, http://www.rooseveltinstitute.org/sites/all/files/wallace_clearinghouse.pdf (accessed 4 May 2013).

71 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 4.

that 'CCPs will not necessarily decide that porting is always the best way to deal with a default'.[72] Instead, the RBA described the legislative amendments as a 'necessary but not sufficient condition for porting to take place' and suggested that they aim for high probability.[73] Treasury noted that the amendments are therefore in keeping with the CPSS–IOSCO Principles.[74] It described the amendments as an additional tool for managing insolvency in what is an important part of the financial system.[75]

Part 2 – Review of licences

1.58 ASIC and the RBA are both currently required to conduct annual reviews of certain licence holders. ASIC is required to conduct an assessment each year of all domestic and foreign AML and CSFL holders. The RBA must also assess at least once a year each CSFL holder for compliance with the FSS determined by the RBA. The bill is intended to provide discretion to ASIC and the RBA in determining the timing of these assessments.

1.59 The Government has indicated that the current arrangements may not be a proper use of scarce resources.[76] For example, 'ASIC is currently obliged every year to formally assess well-run, specialised markets catering mainly to professional investors'.[77] The amendments would enable ASIC to:

> … focus on reviewing some aspect of a licensee's operations each year, with the full review taking place over a number of years. Reviewing licensees in this way may allow for a more comprehensive examination of their operations.[78]

---

72 Australian Financial Markets Association, *Submission 4*, p. 3.

73 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, p. 4.

74 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 1.

75 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 3.

76 The Hon. Bernie Ripoll, *Improving International Regulatory Cooperation*, Press Release No. 1, 24 January 2013, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/001.htm&pageID=003&min=bfr&Year=&DocType=0 (accessed 8 April 2013).

77 The Hon. Bernie Ripoll, *Improving International Regulatory Cooperation*, Press Release No. 1, 24 January 2013, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/001.htm&pageID=003&min=bfr&Year=&DocType=0 (accessed 8 April 2013).

78 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 10.

1.60 The EM explains that the amendments would also permit focusing 'more resources and attention on markets and [clearing and settlement] facilities with a significant level of participation by retail investors'.[79]

1.61 The bill includes a new power to prescribe specific market licensees. In these cases, ASIC and the RBA will have to conduct an annual assessment with respect to relevant legal obligations. By allowing the government to require annual reviews of prescribed licence holders, the bill enables the government to 'take appropriate action if it has concerns in relation to a particular licensee'.[80] The bill is intended to ensure that:

> … important markets used by large numbers of retails investors—for example the ASX and its clearing houses—continue to be subject to regular assessment.[81]

1.62 As noted above, the Minister for Financial Services and Superannuation recently announced the granting of licences to new market participants. The CSFL licence granted to LCH.Clearnet is the first non-ASX clearing licence in Australia for a significant market. The amendments in this part of the bill allow regulators to apply resources flexibly in an evolving marketplace.

Stakeholders' views on Part 2

1.63 ASIC referred in verbal evidence to three categories of licenced markets operating in Australia:[82]

(i) retail markets;

(ii) professional trading platforms; and

(iii) overseas market operators.

1.64 The legislation currently requires ASIC and the RBA to conduct an annual assessment for the licence holders in these three categories. The licensed financial markets operating in Australia are listed in the tables below.

1.65 ASIC referred to retail markets as a fundamental focus for the commission.[83] However, under the proposed amendments ASIC anticipates conducting reviews into

---

79 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 10.

80 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 11.

81 The Hon. Bernie Ripoll MP, Second Reading Speech, *House of Representatives Hansard*, 20 March 2012, p. 27.

82 Mr Oliver Harvey, Senior Executive Leader, Financial Market Infrastructure, ASIC, *Committee Hansard*, 22 April 2013, pp 5–6.

83 Mr Oliver Harvey, Senior Executive Leader, Financial Market Infrastructure, ASIC, *Committee Hansard*, 22 April 2013, pp 5–6.

professional markets less frequently. Mr Harvey noted that the second category will still be required to complete annual self-assessments, which will provide information to ASIC for ongoing identification of risk areas. Finally, ASIC proposes to conduct periodic assessments of overseas market operators.[84]

Table 1: Licensed domestic financial markets operating in Australia

Name of market	*Type of market*
Asia Pacific Exchange Ltd	Retail
ASX Ltd	Retail
Australian Securities Exchange Ltd (also known as the SFE)	Retail
BGC Partners (Australia) Pty Ltd	Professional investors only
Bloomberg Tradebook Australia Pty Limited	Professional investors only
Chi-X Australia Pty Ltd	Retail
FEX Global Pty Ltd	Retail
Mercari Pty Ltd	Professional investors only
National Stock Exchange of Australia Ltd	Retail
IMB Ltd	Retail
SIM Venture Securities Exchange Ltd	Retail
Yieldbroker Pty Ltd	Professional investors only

Source: Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

Table 2: Licensed overseas financial markets operating in Australia

Name of market	*Primary regulator*
Board of Trade of the City of Chicago	US Commodity Futures Trading Commission
Chicago Mercantile Exchange Inc	US Commodity Futures Trading Commission
Eurex Frankfurt AG	Germany Exchange Supervisory Authority
ICE Futures Europe	UK Financial Services Authority
London Metal Exchange	UK Financial Services Authority
Reuters Transaction Services Limited	UK Financial Services Authority

Source: Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

1.66 ASIC argued that requiring it to conduct annual reviews of all licence holders diverts resources away from ASIC's ideal area of focus, being the large retail markets.[85]

1.67 Similarly, the RBA submitted that the proposed amendments would allow ASIC and the RBA to 'better prioritise resources according to the nature and scope' of

84 Mr Oliver Harvey, Senior Executive Leader, Financial Market Infrastructure, ASIC, *Committee Hansard*, 22 April 2013, pp 5–6.

85 Mr Oliver Harvey, Senior Executive Leader, Financial Market Infrastructure, ASIC, *Committee Hansard*, 22 April 2013, p. 6.

market, clearing and settlement facility licensees.[86] The RBA suggested that prescribing facilities of most relevance to the Australian financial system will ensure that they remain subject to a high level of regulatory oversight. The RBA also referred to the flexibility afforded to ASIC and the RBA by the amendments to review the licences of overseas-based facilities operating in Australia. The RBA suggested that this flexibility may allow the regulators to 'better align with the assessment cycles of the facility's home regulator, as long as to do so would not compromise domestic policy objectives'.[87] AFMA referred to the proposals as 'reasonable extensions of the law'.[88]

1.68 Treasury stated in an answer to a question on notice that the Government included in the proposed amendments:

> a regulation-making power to prescribe annual reviews for specified markets, with a view to ensure that the frequency of reviews appropriately reflected factors such as the importance of licensees with respect to financial system stability; the number of retail investors they serve and the risk of harm to those investors; and the efficient use of regulators' resources. A regulation-making power also provides flexibility in adapting the annual review requirements as and when circumstances change.[89]

Part 3 – International business regulators

1.69 Information-sharing with international business regulators is valuable to Australian business regulators (ASIC, the Australian Competition and Consumer Commission and APRA) because it promotes better enforcement outcomes in Australia and abroad.[90] It aligns with the G20 commitments, which require countries to adopt harmonised and cooperative arrangements to ensure transparency and manage risk.

1.70 Recent amendments to the MABR Act regulations allow ASIC to share information for general supervisory purposes and were intended to 'improve the speed and scope of cross-border cooperation and information-sharing, in accordance with recent developments in international regulatory cooperation'.[91]

---

86 Reserve Bank of Australia, *Submission 2*, p. 2.

87 Reserve Bank of Australia, *Submission 2*, p. 2.

88 Australian Financial Markets Association, *Submission 4*, p. 4.

89 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

90 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 11.

91 The Hon. Bernie Ripoll, *Improving International Regulatory Cooperation*, Press Release No. 1, 24 January 2013, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/001.htm&pageID=003&min=bfr&Year=&DocType=0 (accessed 8 April 2013).

1.71 ASIC is, however, unable to share information with pan-European regulators (such as the European Securities Market Authority (ESMA) and the European Systemic Risk Board (ESRB)), as they do not fall within the definition of 'foreign regulator' under the MABR Act or the ASIC Act.

1.72 The bill would amend the MABR Act and the ASIC Act to bring pan-European regulators such as ESMA and ESRB into the definition of foreign regulator. This would 'put beyond doubt' the ability of ASIC to render assistance to pan-European regulators in their administration and enforcement of foreign business laws.[92]

1.73 The Government has explained that the amendments are important for the Australian sector because, for example, 'Australian managed investment schemes may face difficulties in marketing their products in Europe' if the changes to the definitions in the MABR Act and the ASIC Act are not made.[93]

Broadening of the committee's powers

1.74 Part 3 of the bill also amends subparagraph 243(a)(ii) of the Corporations Act. The EM describes the purpose of this amendment as to enable this committee to enquire into the activities of any foreign business law that may significantly affect the operation of the corporations law.[94] Mr Michael Lim, a Treasury Analyst, clarified that these amendments are consequential changes to ensure that the committee can exercise its duties with respect to the proposed new provisions.[95] In effect, the scope of the committee's oversight of ASIC would be broadened in the legislation to reflect the proposed definition of 'foreign business law'.

Stakeholders' views on Part 3

1.75 Treasury advised the committee that the proposed amendments in Part 3 are:

> designed to ensure that the power that ASIC currently enjoys in terms of sharing information with foreign regulators is not limited, as it currently is, by simple drafting of the legislation to regulators of a single foreign jurisdiction but encompasses information sharing with a regulator of multiple jurisdictions. This is clearly the case for ESMA, the European

92 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 11.

93 The Hon Bernie Ripoll MP, Second Reading Speech, *House of Representatives Hansard,* 20 March 2012, p. 27.

94 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 26.

95 Mr Michael Lim, Analyst, Corporations and Capital Markets Division, Treasury, *Committee Hansard,* 22 April 2013, p. 4.

> Securities and Markets Authority, who obviously cover multiple jurisdictions in Europe.[96]

1.76 Mr Woods expanded on an earlier reference to substituted compliance by describing ESMA's detailed assessment of Australia's regulatory framework:

> [ESMA] is looking at that with a view to providing recommendations and advice to the European Commission by the middle of this year on whether Australian financial supervision is a framework which they would see as achieving what they set out to achieve in their regulation and, hence, provide reporting and regulatory relief to Australian banks who are raising capital in the European markets. It is in that context that part of what would give ESMA comfort to reach that judgement would be the knowledge that they would be able to have information sharing with the Australian regulator, notably with ASIC.[97]

1.77 When asked about community concern regarding information-sharing across jurisdictions, ASIC stated that it takes its responsibility in relation to the retention and use of information very seriously.[98] Treasury, in an answer to a question on notice, suggested that:

> The principles and rules that govern the authorised disclosure of confidential and protected information are critical to ASIC's ability to discharge its regulatory obligations as a corporations and financial markets regulator effectively and efficiently. The framework is central to the integrity of ASIC's regulatory objectives and operations – and provides important assurance to the market that information, given to ASIC under compulsion, or voluntarily (for example the contents of complaints given to ASIC) are accorded appropriate protection.[99]

1.78 In relation to subparagraph 243(a)(ii), Treasury further clarified that the term 'affect significantly':

> is not a term of art and has its ordinary meaning. As such it is designed to confer on the Committee a broad flexibility in the matters that the Committee might consider would fall within that term to merit the Committee's inquiry and report.[100]

---

96 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 5.

97 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 5.

98 Mr Oliver Harvey, Senior Executive Leader, Financial Market Infrastructure, ASIC, *Committee Hansard*, 22 April 2013, p. 7.

99 Treasury, answers to questions on notice, 22 April 2013 (received 3 May 2013).

100 Treasury, answers to questions on notice, 22 April 2013 (received 3 May 2013).

1.79 While Treasury did not provide a specific example of a foreign business law or a law of a foreign country that could 'affect significantly the operation of the corporation legislation', it noted that this means laws that impose requirements 'that conflict with requirements imposed under the corporations legislation'.[101]

Part 4 – Reporting on ASIC's information gathering powers

1.80 ASIC has considerable information-gathering powers under a range of legislation.[102] These powers:

- enable ASIC to obtain the relevant information it needs to make regulatory and enforcement decisions;
- ensure that people providing assistance to ASIC are protected;
- clearly set out the terms upon which documents and information are to be provided to ASIC; and
- enable ASIC to obtain evidence in a form that can be used in court proceedings.[103]

1.81 ASIC must use its powers for a 'proper purpose', whereby the use of a power must be designed to advance ASIC's inquiry. ASIC recognises that it 'must use these powers responsibly and that it is important that there are safeguards in place to ensure these powers are not misused'.[104] ASIC also acknowledges that it must be accountable and transparent in the use of its powers.[105]

1.82 In 2010, the Senate Economics Legislation Committee (the Economics Committee) raised concerns during a Senate Estimates hearing about the lack of reporting by ASIC in relation to the use of its information-gathering powers. The Economics Committee referred to the objectives of transparency and community confidence in the appropriate use of powers by ASIC.[106] At another hearing of the Economics Committee in 2010, Mr Malcolm Stewart, Vice President of the Rule of Law Institute, criticised ASIC for a lack of accountability in relation to reporting on

---

101 Treasury, answers to questions on notice, 22 April 2013 (received 3 May 2013).

102 Specifically, ASIC has information-gathering powers under the ASIC Act, the Corporations Act, the Crimes Act, the *National Consumer Credit Protection Act 2009* and the MABR Act.

103 Australian Securities & Investments Commission, Information Sheet 145: *ASIC's compulsory information-gathering powers*, September 2011, p. 1.

104 Australian Securities & Investments Commission, Information Sheet 145: *ASIC's compulsory information-gathering powers*, September 2011, p. 2.

105 Australian Securities & Investments Commission, Information Sheet 145: *ASIC's compulsory information-gathering powers*, September 2011, p. 8.

106 Economics Legislation Committee, Estimates, *Senate Hansard*, 1 June 2010, E 171; Economics Legislation Committee, Estimates, *Senate Hansard*, 21 October 2010, E 39.

its use of information-gathering powers.[107] Mr Stewart pointed to the omission of search warrants, wire taps, telephone logs and bank records obtained by ASIC in the preceding three years from the figures provided by ASIC to the Economics Committee. Similar concerns were also raised with this committee at an ASIC oversight hearing in 2011.[108]

1.83 In response to these concerns, ASIC:

> … undertook to conduct an internal review of its procedures and policies relating to its use of such powers. As a result of this review, ASIC undertook to report annually to Parliament on the number, general nature and use of its information gathering powers.[109]

1.84 ASIC reported on the use of its information-gathering powers for the first time in its 2010–11 annual report.[110]

1.85 The amendments in the bill formalise ASIC's reporting commitments by requiring ASIC to report annually on its use of information-gathering powers. The amendments also include a provision for Treasury Ministers to request in writing that ASIC report additional information if required.

1.86 The amendments to subsection 136(2) of the ASIC Act are intended to broadly align ASIC's reporting obligations with those of other regulators, such as the ACCC and to provide a flexible legislative vehicle to mandate additional reporting as appropriate for Parliamentary scrutiny and greater transparency.[111]

Stakeholders' views on Part 4

1.87 At the inquiry's public hearing, it was noted that ASIC possesses significant information-gathering powers and that 'the bill therefore introduces a measure to increase in statute the arrangements to provide transparency around how ASIC uses those powers'.[112]

---

107 Senate Economics Legislation Committee, Corporations Amendment (No. 1) Bill 2010, *Committee Hansard*, E 23.

108 Parliamentary Joint Committee on Corporations and Financial Services, Oversight of the Australian Securities and Investments Commission, *Committee Hansard*, 15 June 2011, pp 1–6.

109 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 12.

110 Australian Securities & Investments Commission, *Annual Report 2010–11*, October 2011, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/annual-report-2010-11.pdf/$file/annual-report-2010-11.pdf (accessed 9 April 2013).

111 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 12.

112 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 6.

1.88 Treasury, in an answer to a question on notice, considered that mandating that ASIC report annually on the use of these powers to be appropriate given the importance attached to the issue by the Senate Economics Legislation Committee.[113] Irrespective of this view, as noted previously, Mr Harvey of ASIC stated at the public hearing that ASIC takes its responsibility in relation to the retention and use of information very seriously.[114]

1.89 Treasury further clarified that it is intended to prescribe by regulation the matters that are the subject of ASIC's currently voluntary annual reporting, as well as the use of ASIC's information-sharing powers under the MABR Act in response to requests from foreign regulators.[115]

1.90 Treasury also confirmed, in response to a question regarding concerns raised by the Rule of Law Institute in 2010, that ASIC already reports on the use of search warrants and access to bank records.[116] It also clarified that ASIC is not an 'interception agency' and is therefore unable to apply for warrants to intercept telephone calls or otherwise access intercepted telecommunications. Treasury noted that ASIC does, however, annually report in writing to the Attorney-General on its use of telecommunications data obtained under the *Telecommunications (Interception and Access) Act 1979* in its capacity as an 'enforcement agency'.[117]

Part 5 – Disclosure of information by the Reserve Bank

1.91 The powers of the RBA in relation to disclosing information have historically been weaker than those given to ASIC and APRA.[118] Sharing of information for regulatory purposes has, however, become an important part of the RBA's work, particularly in collaborating with domestic and international regulators.[119] This is evident in the RBA's role in regulating clearing facilities. The bill would make a number of amendments to assist the RBA in its work. These proposals are modelled on the provisions available to APRA in its legislation.

1.92 The proposed amendments to the RB Act complement those already made by the DT Act. The bill is intended to:

---

113 Treasury, answers to questions on notice, 22 April 2013 (received 3 May 2013).

114 Mr Oliver Harvey, Senior Executive Leader, Financial Market Infrastructure, ASIC, *Committee Hansard*, 22 April 2013, p. 7.

115 Treasury, answers to questions on notice, 22 April 2013 (received 3 May 2013).

116 Treasury, answers to questions on notice, 22 April 2013 (received 3 May 2013).

117 Treasury, answers to questions on notice, 22 April 2013 (received 3 May 2013).

118 The Hon. Bernie Ripoll MP, Second Reading Speech, *House of Representatives Hansard*, 20 March 2012, p. 27.

119 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 12.

- provide permission for the RBA to share protected information and documents with a person approved by the Governor of the Reserve Bank or prescribed delegates in writing;
- provide a power for the RBA to share protected information and documents on an ongoing basis with other persons or bodies (whether in or outside Australia) prescribed by regulation; and
- allow the RBA to impose confidentiality restrictions on persons to whom protected information is provided, including staff members of contracted service providers.[120]

1.93 The EM provides a limited description of protected information. It states:

> In the course of executing their official duties the financial regulators (that is the RBA, ASIC and APRA) are regularly given information by regulated entities in the private sector that is highly confidential and that could lead to serious damage if it was to become publicly available.[121]

1.94 The Government has explained the need for these amendments in the context that:

> … the [RBA's] current powers are inadequate for its increasingly important role in promoting the stability of financial markets, including its role in regulating clearing facilities, and the cooperative international approach that this requires. The Bill more closely aligns the [RBA's] powers to share information with those of the other regulators.[122]

Stakeholders' views on Part 5

1.95 In an answer to a question on notice, Treasury wrote that section 79A(2) of the RB Act contains a prohibition on disclosure of 'protected information' and 'protected documents' in terms substantially similar to section 56(2) of the APRA Act.[123] Treasury noted, however, that:

> the exceptions to the prohibitions in the two Acts are not the same. In some cases the differences reflect the different functions of the RBA and APRA. However in other respects the differences are not related to, or required because of, different functions and powers and so in those respects there is

120 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, pp 12–14.

121 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 13.

122 The Hon. Bernie Ripoll MP, Second Reading Speech, *House of Representatives Hansard*, 20 March 2012, p. 27.

123 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

> no legitimate reason for the exceptions to the prohibition on disclosure not to be the same, or substantially the same.[124]

1.96 Treasury identified three examples of exceptions in the APRA Act which are not currently replicated in section 79A of the RB Act:

- section 56(5)(a) of the APRA Act to the extent that it permits disclosure to 'any other agency (including foreign agencies) specified in the regulations';
- section 56(5)(b) of the APRA Act which permits disclosure to a person 'approved by APRA by instrument in writing'; and
- sections 56(9) and 56(10) which provide for APRA to impose conditions to be complied with in relation to information disclosed under a permitted exception and provide for a penalty for breach of any such condition.[125]

1.97 Treasury argued that 'consistency between the secrecy provisions in the RB Act and the APRA Act is important given that the RBA and APRA are both members of the Council of Financial Regulators … and co-operate closely with each other in the performance of their respective financial stability mandates'.[126]

1.98 Treasury further argued that the proposed amendments will assist the RBA to fulfil its mandate to promote the stability of the financial system 'by ensuring that protected information may be shared with all other agencies involved with detecting and responding to threats to financial stability'.[127] In Treasury's view it is essential that international financial agencies:

> have access to the data and information needed to carry out this work; this includes institution-specific information, which can reveal concerns such as concentrations of exposures in one or a few institutions. Likewise, departments of Treasury both in Australia and abroad are deeply involved in financial crisis management and other responses to financial sector distress. It could harm effective decision-making if these agencies did not have access to the necessary institution-specific (and hence protected) information.[128]

1.99 The RBA submitted that the proposed amendments to the secrecy provisions in the RB Act are consistent with international best practice as set out by the FSB.[129]

---

124 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

125 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

126 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

127 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

128 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

129 Reserve Bank of Australia, *Submission 2*, p. 2.

In *Key Attributes of Effective Resolution Regimes for Financial Institutions*, the FSB states:

> Jurisdictions should ensure that no legal, regulatory or policy impediments exist that hinder the appropriate exchange of information, including firm-specific information, between supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for guarantee schemes.[130]

1.100 The RBA submitted that 'effective sharing of information needs to be possible both in normal times and during a crisis, and both at a domestic and a cross-border level'.[131] Treasury also endorsed this view.[132]

1.101 At the public hearing, Mr Manning of the RBA gave an example of when the proposed powers may be used:

> One important example here is in the context of an impending financial crisis or in a circumstance in which an internationally active bank is in distress where there may be a need to engage quite strongly in respect of significantly detailed information with overseas regulators in order to understand the implications of a particular bank's activities in the many markets in which it might operate. That may require that the Reserve Bank disclose information that the bank has available on that institution's activities in the domestic markets.[133]

1.102 The RBA also referred to the increasing cross-border nature of the provision of infrastructure services, such as central counterparty services, by noting LCH.Clearnet's interest in providing services for OTC derivatives.[134] According to Mr Manning, the fact that LCH.Clearnet operates its service in 17 different currencies means that a number of overseas regulators are interested in its activities. Given the RBA's role in regulating clearing settlement facilities, the RBA therefore needs to engage with those regulators regarding LCH.Clearnet's activities in Australia and abroad.

---

130 Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October 2011, p. 18, http://www.financialstabilityboard.org/publications/r_111104cc.pdf (accessed 24 April 2013).

131 Reserve Bank of Australia, *Submission 2*, p. 2.

132 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

133 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 10.

134 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 11.

1.103 Mr Manning argued that these examples highlight the increasing globalisation of markets and the need that the RBA has to engage more strongly with overseas regulators, which may involve information-sharing.[135]

1.104 AFMA recognised the need to 'extend the sharing of protected information beyond the limitations of the currently nominated international institutions'.[136] It referred to previous consultation with Australian regulators regarding sharing of commercially sensitive datasets relating to particular financial institutions. 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.[137]

1.105 When asked about community concern regarding information-sharing across jurisdictions, Mr Manning referred to the proposed power to impose confidentiality restrictions on the recipients of information as an essential component.[138] He noted further that the power in question is acknowledged and understood in the international community and is currently the subject of discussion by the CPSS–IOSCO in relation to access of trade repositories to information. While the proposed amendments are not prescriptive in terms of how confidentiality is to be applied, Mr Manning stated that they are sufficient for the RBA's purposes.[139]

Part 6 – Consequential amendments relating to derivative trade repositories

1.106 One of Australia's G20 commitments in relation to OTC reforms relates to the reporting of OTC derivatives to trade repositories. The FSB described the vision of these reforms as follows:

> By providing information to authorities, market participants and the public, trade repositories will be a vital source of increased transparency in the market, and support authorities in carrying out their responsibilities, including (i) assessing systemic risk and financial stability; (ii) conducting

135 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 11.

136 Australian Financial Markets Association, *Submission 4*, p. 4.

137 Australian Financial Markets Association, *Submission 4*, p. 4.

138 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 7.

139 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 7.

> market surveillance and enforcement; (iii) supervising market participants; and (iv) conducting resolution activities.[140]

1.107 In its March 2012 report, the Council of Financial Regulators recommended that Australia introduce a legislative framework to enable the imposition of mandatory reporting requirements for certain products.[141] Internationally, the FSB recommended that trade repository data should be comprehensive, uniform and reliable.[142]

1.108 As noted above, the DT Act provides a legislative framework to implement Australia's G20 commitments in relation to OTC derivatives reforms, including the reporting of OTC derivatives to trade repositories.

1.109 The bill would make minor amendments to the CFI Act, the CER Act and the Corporations Act to allow the Clean Energy Regulator to share protected information, including protected audit information, with trade repositories.

1.110 The EM states that the bill would:

> … add licensed and prescribed trade repositories to the list of entities in the CFI Act and the CER Act with whom the Clean Energy Regulator may share protected information (or to whom the Clean Energy Regulator may authorise CFI project auditors to disclose protected audit information) subject to the conditions set out in those Acts.[143]

1.111 These amendments are intended to assist with the operation of markets on which carbon units and Australian carbon credit units may be traded and to promote transparency.[144]

Part 7 – Other amendments

1.112 The bill would alter the format of subsection 1317E(1) of the Corporations Act without changing its content. The amendment is intended to make the section easier to read and use:

> Subsection 1317E(1) of the Corporations Act lists those provisions in the Act which are subject to the civil penalty provisions in Part 9.4B. Over time additional provisions have been added to the list, and as a result the section has become unwieldy and difficult to read. It is proposed to rewrite the

---

140 Financial Stability Board, *Implementing OTC derivatives market reforms*, 25 October 2010, p. 6.

141 Council of Financial Regulators, *OTC derivatives market reform considerations*, p. 25.

142 Financial Stability Board, *Implementing OTC derivatives market reforms*, 25 October 2010, pp 1–2.

143 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 15.

144 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 15.

section and list the provisions in tabular form without making any changes to the substance.[145]

Implementation of Australia's G20 commitments

1.113 In addition to inquiring into the provisions of the bill at the public hearing, the committee also expressed interest in Australia's progress in implementing the framework established by the DT Act. As noted previously, the bill is intended to complement the delegated legislative framework established by the DT Act, which was enacted to address Australia's G20 commitments regarding the:

- reporting of OTC derivatives to trade repositories;
- clearing of standardised OTC derivatives through central counterparties; and
- execution of standardised OTC derivatives on exchanges or electronic platforms, where appropriate'.[146]

1.114 Treasury referred to Australia's approach in implementing the G20 commitments as one designed to take into account developments in overseas jurisdictions. Mr Woods said that the financial sector has been supportive of the approach taken and that the implementation has gone 'relatively smoothly'.[147]

Reporting to trade repositories

1.115 Treasury noted that a decision in relation to the electricity sector has been delayed until a review into the resilience of the sector is completed by the Australian Energy Market Commission (AEMC).[148] ASIC is in the process of finalising a ministerial determination regarding mandating trade reporting and has released two consultation papers, one on the licencing of trade repositories and the other on the rules that require reporting to trade repositories. Mr Harvey of ASIC described the ongoing consultation as 'thorough and extensive' and said that the regulators were 'working extremely closely, extremely well and extremely hard together'.[149]

---

145 Explanatory Memorandum, Corporations and Financial Sector Legislation Amendment Bill 2013, p. 15.

146 The Hon. Bill Shorten MP, Second Reading Speech, *House of Representatives Hansard*, 12 September 2012, pp 4–6.

147 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 8.

148 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 8.

149 Mr Oliver Harvey, Senior Executive Leader, Financial Market Infrastructure, ASIC, *Committee Hansard*, 22 April 2013, p. 9.

Central clearing of OTC derivatives

1.116 In terms of the central clearing of OTC derivatives, Treasury described the approach taken by the regulators and the Government as being to see the impact of other regulatory incentives for banks and the primary users of derivatives in Australia before mandating central clearing.[150] These 'regulatory incentives' include the impact of the Basel III reforms,[151] which 'have imposed greater capital requirements for the use of contracts which are not centrally cleared'.[152] Treasury noted, however, that 'the legislative framework is in place to enable clearing mandates to be imposed if required to ensure that Australia implements its G20 commitments on a timetable consistent with other jurisdictions'.[153]

1.117 The RBA referred to the objective expressed by the Council of Financial Regulators that the process towards central clearing be a smooth transition to enable parties to 'transit at the appropriate pace given the nature of their business and the nature of the clearing options available to them'.[154] Mr Manning noted that while no CCP is currently operating in Australia, the ASX is developing the capacity and at least two overseas CCPs have expressed interest in providing clearing services in Australia. Treasury confirmed in an answer to a question on notice that 'at this time the imposition of any mandatory requirement to trade on a platform is not imminent'.[155]

1.118 At the public hearing Treasury argued that it is important that Australia does not mandate central clearing too soon, in case the unintended consequences are that a party is given a commercial advantage and the choices of the local participants are effectively restricted.[156] Mr Manning noted that this is particularly important in relation to the Australian dollar-denominated interest rate swaps market, which was

---

150 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 8.

151 Basel III is a comprehensive set of voluntary reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the international banking sector. The measures are designed to improve bank capital adequacy, stress testing and market liquidity risk. See, Bank for International Settlements, *Basel III*, http://www.bis.org/bcbs/basel3.htm (accessed 1 May 2013).

152 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 9.

153 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

154 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 9.

155 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

156 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 9.

identified by the Council of Financial Regulators as the most systemically important domestic market.[157]

1.119 Treasury told the committee that while the regulators continue to watch international developments, the implementation of the G20 reforms, particularly in the US, is in a state of flux.[158] The US Commodity Futures Trading Commission (CFTC) 'has yet to issue final guidance on the obligations that will be imposed on Australian banks raising capital within the US under the part of the Dodd-Frank act that gives effect to the G20 commitments'.[159] The *Australian Financial Review* reported recently that:

> Finance ministers from around the world have increased the pressure on the United States to finalise rules for trading derivatives overseas, warning the market was beginning to fragment amid a lack of regulatory co-ordination.[160]

1.120 Treasury noted that it is necessary to look at the instruments mandated in other jurisdictions to avoid the potential for regulatory arbitrage and 'with an eye to the comparability and equivalence assessments that these jurisdictions are currently undertaking and [the] question of substituted compliance'.[161] To this end, ASIC, APRA and the RBA issued a market survey to Australian participants in March 2013, to enquire into the activity of those instruments. A market assessment will then be released mid-year reporting on whether there is a case to consider mandatory clearing requirements for those instruments.

1.121 In a written response Treasury summarised the approach of the Australian regulators going forward as focusing on Australia's progress in implementing the G20 commitments and working 'with international regulators to address any cross-border regulatory issues that arise'.[162]

---

157 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, p. 9.

158 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 9.

159 Mr David Woods, General Manager, Corporations and Capital Markets Division, Treasury, *Committee Hansard*, 22 April 2013, p. 9.

160 Philip Stafford, 'US asked to finalise derivatives rules', *Australian Financial Review*, 22 April 2013, p. 20.

161 Mr Mark Manning, Deputy Head, Payments Policy Department, RBA, *Committee Hansard*, 22 April 2013, pp 9–10.

162 Treasury, answers to questions on notice, 22 April 2013 (received 6 May 2013).

Committee view

1.122 The measures contained in the bill are strongly supported by the committee. They represent practical and prudent steps towards implementing Australia's G20 commitments regarding OTC derivatives.

1.123 The key provision relating to porting arrangements is an important and necessary measure to reflect not only international developments but also to ensure that domestic insolvency laws do not cause uncertainty and inoperability in the derivatives market.

1.124 The committee notes that in the case of participant default or insolvency, price moves and difficulties in finding replacements for transactions can have a cascading effect in the market. This is particularly the case for large wholesale participants. Uncertainty for porting arrangements caused by the operation of insolvency laws could therefore have a significant impact, especially in crisis situations. Legal certainty, which these amendments are intended to provide, is therefore necessary.

1.125 The committee commends the strategic approach that the Australian regulators have taken in implementing the DT Act and the central clearing arrangement. The regulators have been mindful not to give an unintended competitive advantage to one part of the sector over another.

1.126 The committee also commends Australia's engagement on OTC derivatives reforms in international fora to date and notes that this should continue through the G20 process. It recognises that in increasingly global financial markets, such as the OTC derivatives market, there is a need for financial regulators to not only improve the transparency and stability of their own financial systems, but to engage with the international community in these efforts.

1.127 While the committee supports the provisions in the bill regarding ASIC's reporting on the use of its information gathering powers, the committee notes the concerns expressed previously regarding ASIC's use of its powers. The committee will closely monitor the reporting through the ASIC oversight process.

1.128 The committee is particularly interested in the additional scope the proposed amendment to section 243(a)(ii) of the ASIC Act provides to the committee to inquire into foreign business laws. It believes that this is an important broadening of the committee's remit. The committee could envisage the provision being a potentially positive development, as the amendment recognises the increasingly interconnected nature of the global financial system.

Recommendation 1

1.129 The committee recommends that Treasury and ASIC update the committee on Australia's implementation of OTC derivatives market reforms. This could take the form of a report one month after the release of the sixth FSB implementation progress report (which is expected to be released in October 2013). The report could cover:

- **Australia's progress in implementing the framework established by the DT Act;**
- **an assessment of how Australia's progress in implementing OTC derivatives market reforms compares to international efforts; and**
- **advice on any further reforms required to implement Australia's G20 commitments in relation to OTC derivatives.**

Recommendation 2

1.130 The committee recommends that the bill be passed.

Ms Deborah O'Neill MP
Chair