25 August 2017

Ms Rhonda Luo
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Australian Securities and Investments Commission
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By email: financial.benchmarks@asic.gov.au

Dear Ms Luo

Implementing the financial benchmark regulatory regime

The Australian Financial Markets Association (AFMA) is commenting on ASIC Consultation Paper 292 Implementing the financial benchmark regulatory regime (CP 292).

Broadly we are in support of the proposed rules which are broadly consistent with the other licensing regimes ASIC administers and the intentions of the Government's proposed legislation. AFMA's comments are arranged in the following section as responses to the questions posed in CP 292 with some additional commentary at the end on the Rules.

Comments on Proposals

B1 The proposed administration rules and regulatory guide seek to maintain international and cross-border consistency by being aligned with the IOSCO benchmarks principles, as well as the IOSCO PRA principles and regulatory obligations under key overseas regimes.

B1Q1 Do you agree with our approach to maintaining international and cross-border regulatory consistency?
Yes

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B2 To align with core requirements of other licensing regimes established under the Corporations Act as well as the UK regime, we are proposing to impose five additional requirements that licensees:

- ***(a) have sufficient resources, including financial resources (see Rules 2.1.5–2.1.7);***
- ***(b) have adequate risk management arrangements (see Rule 2.4.2);***
- ***(c) have business continuity plans (see Rule 2.4.3);***
- ***(d) maintain records in a form that is readily converted to English (see Rule 2.5.3); and***
- ***(e) maintain a final stage method for generating and administering the BBSW, if the licensee is the administrator of the BBSW (see Rule 2.2.5)***

B2Q1 Do you have feedback on the five proposed additional requirements set out under proposal B2?
Yes - With regard additional requirements (a) to (d). In relation to to additional requirement (e) the proposal contains a second element in section (2) of Rule 2.2.5, which says that contributors' data "is to be based on the exercise of expert judgment by the Contributors". This refers to the end of the waterfall where contributors are compelled to provide data. The exclusive reliance on 'expert judgment' precludes using more objective means to determine a rate. The circumstances of a crisis which might require compelled contributions could be wide ranging from a systemic collapse to a more idiosyncratic event impacting composite elements of the benchmark. The possibility that a more objective solution than expert judgment might be preferable needs to be left open. In summary, we do not exclude the possibility that in certain circumstances expert judgment may be the only viable option but alternative approaches should not be excluded.

B3 We are proposing to:

- ***(a) make administration rules that can be applied in a way that reflects the nature, complexity and intended use of a licensed benchmark; and***
- ***(b) set out more specific guidance and our regulatory expectations in regulatory guidance, which is also intended to align with the approach taken in international standards and overseas regimes.***

B3Q1 Do you agree with our proposed approach to rulemaking and regulatory guidance?
No

The proposal is worded in such a way as to indicate that ASIC would use regulatory guidance to supplement rules. AFMA has on many occasions voiced the view that regulatory guidance should not be used to impose additional requirements, its role is merely to act as an illuminating commentary. In this case ASIC has extensive administrative discretion and the rules should be drafted with sufficient clarity and precision that the law is understandable on its face without extensive further exposition.

B3Q2 Does the alignment between the proposed administration rules and regulatory guidance, and international or overseas regulatory requirements need to be adjusted? If so, please provide details in your response.
We are only discussing less than a handful of licensed benchmarks so this is not an area of great complexity or variability.

B3Q3 Do you have other feedback on the split between the proposed administration rules and regulatory guidance?
See response to B3Q1

B4 We propose, in general, not to write rules for specific types of benchmarks (for example, index benchmarks). The regulatory guidance distinguishes between different types of benchmarks where needed (see, for example, RG 000.66 which explains the requirements for submissions-based benchmarks to have a code of conduct).

B4Q1 Do you think we need to more clearly distinguish between types of benchmarks? If so, please give your reasons why.
No As noted above there will be so few licensed benchmarks that highly specific rules are not required.

B5 We consider the proposed administration rules are sufficiently flexible to accommodate commodity benchmarks that may be complying with the IOSCO PRA principles. Therefore, no specific rules are needed.

Note: The proposed regulatory guidance specifically provides that administrators of commodity benchmarks may comply with the IOSCO PRA principles in relation to the oversight of submitters: see RG 000.67.

B5Q1 Are there specific issues or rules that need to be refined to reflect the IOSCO PRA principles?
No issues have been identified by AFMA.

C1 Initially and consistent with CFR advice, we consider that the following five benchmarks are likely to meet the criteria for significant benchmarks set out in s908AC(2) of the proposed legislation:

- ***(a) the BBSW;***
- ***(b) Standard & Poor's (S&P)/ASX 200 index;***
- ***(c) the ASX bond futures settlement price;***
- ***(d) the cash rate (including the total return index derived from the cash rate); and***
- ***(e) the consumer price index.***

C1Q1 Do you have feedback on the list of potential significant benchmarks based on the criteria in the draft legislation?
With regard to the follow reference rates – (b) The S&P/ASX 200 equity index is an equity benchmark calculated from regulated data so it is unclear what value licensing would bring to users. (c) The rationale for identifying the ASX bond futures settlement as a 'significant benchmark' is not understood by industry. While ASX futures are an important benchmark pricing input for a quite a number of transactions for market participants, the ASX futures settlement price itself is a much less important reference rate. Given the cash settlement of ASX bond futures, by the time the settlement process occurs the open interest in the maturing contract has dropped dramatically (i.e. by >90%) and the reference futures contract for pricing input into transactions (such as EFP) would have moved to the next futures contract 24 to 36 hours beforehand. Accordingly, the settlement price itself is not a 'significant benchmark' in the view of AFMA.

(d) With regard to the cash rate, does the Government intend to for ASIC treat the RBA as a regulated entity? This may raise some interesting administrative law issues.

(e) With regard to the consumer price index our query is firstly, the same as in (d) above with regard to the ABS and secondly, why has this rate amongst a number of others prepared by the ABS which are systemically important to economic forecasting has been singled out.

AFMA notes that the defining features of a significant financial benchmark set out in s908AC(2) of the proposed legislation are ones that would not eventuate overnight but would ordinarily accrue over a significant period of time through the use of the relevant financial benchmark in the market.

Nevertheless, we acknowledge the possibility that the significance of a financial benchmark may not be realised until it is on the brink of failure, and Treasury has provided for that by allowing ASIC to make a declaration on short notice without prior Ministerial consent. As noted in the Explanatory Memorandum to the bill, this would deal with an emergency situation.

ASIC states, in para 31 of CP292, that "we will undertake consultation, as appropriate, before declaring any other benchmarks as significant".

AFMA considers that ASIC must consult prior to declaring a new significant financial benchmark, except where ASIC is entitled to declare, and has declared, a significant financial benchmark without prior Ministerial consent. In such a case, there should be more flexibility in the time provided to an administrator to become licensed and to organise their business and operations to properly manage their new responsibilities.

C2 We propose to consider granting exemptions to align with relevant international principles. We think exemptions from the requirement to hold a licence would be rare.

C2Q1 Do you have feedback on our proposed approach to licensing and exemptions?
This is a sensible proposal.

C3 Before deciding to grant a licence to an administrator of a non-significant benchmark, we propose to consider whether the benchmark has some connection to Australia.

C3Q1 Do you agree with the proposal that we consider whether a benchmark has some connection to Australia before granting a licence to an administrator of a non-significant benchmark?
Yes

C4 We propose to consider whether we can place reliance on an overseas regime if we assess that:

- ***(a) the administrator is complying with the overseas regime; and***
- ***(b) the regime is sufficiently equivalent to the Australian regime, which could include an assessment of whether the overseas regime has implemented the IOSCO benchmarks principles or (where applicable) the IOSCO PRA principles.***

C4Q1 Do you agree with our proposed approach to assessing overseas regulatory regimes?
AFMA supports the proposed approach to assessing overseas regimes. The 'sufficiently equivalent' proposal allows market participants to use a large number of benchmarks (e.g. LIBOR) administered and often licensed in other jurisdictions without specific, individual licensing by ASIC. This will greatly simplify the compliance obligations for market participants and minimise duplication of effort across jurisdictions which have implemented IOSCO or IOSCO PRA principles. It is also noted the significant efforts by the Government, which has been highly cognisant of the importance of providing a regulatory regime in Australia which can be recognised as equivalent to other jurisdictions. This will allow market participants to deal effectively with counterparties in other jurisdictions that recognise Australia's regulatory regime for benchmarks such as BBSW without costly offshore licensing obligations.

C5 We also propose to consider whether there are direct information access arrangements with the administrator.

C5Q1 Do you agree with our proposal to consider direct information access arrangements with an overseas benchmark administrator?
No comment

D1 We propose to write compelled rules conferring on ASIC the power to give notices compelling administration, generation and contributions to significant benchmarks, which may be applied by ASIC in extreme circumstances, including where market-based incentives for benchmark administration or contribution have failed.

D1Q1 Do you have feedback on the circumstances and related policy considerations about when we may issue notices under the compelled rules?
While AFMA notes that contributors who are compelled to provide data and information to Administrators under the compelled rules are protected under section 908CJ of the proposed amendments to the Corporations Act from liability if they act in good faith in accordance with the compelled rules, it is imperative that the final stage method is reasonable, unambiguous and fair and that the contributing bank and its employees have complete protection from legal liability for any steps taken to comply with the compelled rules. AFMA is concerned that it is difficult to assess the impact and practicality of being compelled to provide data or information under the compelled rules without having seen the final stage method. For example, whether (on very short notice) a contributor would have staff with the appropriate expertise who do not have a pre-existing conflict of interest. Put another way, a contributor should not be required to have in place special arrangements outside its normal operating model to enable it to deal with the compelled rules: this would be unreasonably costly and inefficient. It should be made clear that acting in good faith includes providing a contribution with the available resources at the time and within the required timeframe, and allow the contributor to qualify the contribution if necessary (eg if there could be a perceived conflict of interest). AFMA supports the proposals in paragraph 47 to ensure the market continues functioning thereby avoiding serious systemic contractual implications of non-publication of BBSW. The data to be provided to the BBSW administrator is further covered in question D1Q3. It should also be clear that the BBSW calculated from submissions (whether by the BBSW administrator or ASIC) should be published on the page 'BBSW' to avoid contractual confusion.

It is noted that the current BBSW administrator does not give a specific time limits for applying the fall back calculation waterfall stages 1 to 4. ASIC should give consideration to some time limit restrictions for using such fall backs in order to fulfil the public interest test outlined in paragraph 48(a). For example, should the fall back process continue beyond several days it is highly probable the calculated BBSW would diverge from one which would have been set by either VWAP or NBBO. As such, the compelled submissions process would need to be invoked after a few days before markets lost confidence in BBSW.

Experience has demonstrated to AFMA that a submissions based system needs to be based on a sufficient number of contributors to reduce vulnerabilities. If there is only a very limited number of contributors with the same characteristics the quality of the benchmark as a reflection of the market is acutely vulnerable to loss of contributors.

ASIC is asked to give policy consideration to further consultation with market participants about the nature and number of market participants that might be subject to the group to be included in the compulsion rules.

D1Q2 Do you agree with our proposal to write rules conferring the power to give notices? Please provide detailed reasons.

AFMA agrees that the writing of specific rules about when notice may be given to the BBSW administrator and/or BBSW submitters would be difficult and overly restrictive.

In many cases, the exact nature of the event is impossible to predict and if the rules did not include a particular future event then ASIC and RBA may not be able to issue relevant notices in a timely manner. The public interest test appears to be appropriate and sufficiently flexible to allow for potential, unexpected situations.

However, ASIC may consider being more explicit about a potential requirements for an individual market participant to be appointed. If the number of eligible participants is increased (see D1Q1 response) then there may be some benefit to ASIC informing potential contributors that they would be considered in the last stage methodology. This would give additional certainty to potential contributors to ensure adequate preparations are made ahead of time and allow ASIC more flexibility under difficult market conditions.

D1Q3 Do you believe the rules should be more specific about the circumstances in which we may issue a notice? Please provide detailed reasons.
The specific circumstances may be difficult to predict as stated in D1Q2. However ASIC may consider some being more explicit about some trigger situations such as: 1) The BBSW administrator's fallback waterfall operates for an extended period (eg. more than three days). In this case, the administrator is experiencing significant difficulty in re-activating NBBO or VWAP and may require additional time to allow markets to settle to more normal activity. The compelling requirement would diversify the BBSW rate set methodology during this time and remove a reliance on the particular administrator's algorithm for the setting; 2) The BBSW administrator is insolvent. In this case an alternative administrator would need to be found and using the compelling notice would allow ASIC to replace the administrator in an orderly manner; 3) BBSW process fails due to regulatory intervention or administrator insolvency where no alternate administrator can be found. In this case, BBSW would likely be discontinued and replace in contracts that reference BBSW by other fallback or alternative benchmarks. During the process of discontinuation, ASIC may find the compelling requirements useful to allow for such a transition and avoid disruptive contractual issues; and 4) Following consultation with the RBA.

ASIC Financial Benchmark (Administration) Rules

2.6.2 Fair, reasonable and non-discriminatory access to Licensed Benchmarks

A benchmark administrator licensee must have fair, reasonable, non-discriminatory and objective conditions for access to the Licensed Benchmark specified in its licence, including fair, reasonable and non-discriminatory pricing where charges apply for access to the Licensed Benchmark.

Comment on Rule 2.6.2
In the context of the Background provided below, AFMA supports the proposed requirement for benchmark administrators who have significant market power to conduct their commercial arrangements with users of their benchmark in a manner that complies with the fair, reasonable, non-discriminatory (FRAND) principle. Guidance should be given that the fees charged to users should bear a reasonable relationship to the costs and risks of efficiently producing the benchmark, including a

reasonable return on capital. Moreover, the regulation should provide reasonable protection to the intellectual property of the benchmark administrator.

The application of a FRAND regulatory power should take into account competitive conditions within the relevant market. It should not inhibit benchmark administrators and relevant users being able to negotiate and agree contract terms in competitive markets and in other situations should ensure that this is done within the limits of FRAND requirements.

Background

The Financial Conduct Authority (FCA) in the UK observed that while the possession of market power is not in itself anti-competitive, there is a risk that benchmark administrators could behave in anti-competitive ways and exploit their market power in a way that may adversely affect competition. Therefore, the FCA introduced fair and reasonable and non-discriminatory (FRAND) requirements to limit the ability of benchmark administrators to exploit their market power in a way that might hinder effective competition.[1] The European Union Regulation on financial benchmarks likewise places a FRAND obligation on the administrators of critical benchmarks.[2]

In Australia, the Council of Financial Regulators' has considered a similar issue and principles in the context of ASX's equity clearing and settlement (CS) services. The Council's Regulatory Expectations of ASX seeks to maintain "transparent and non-discriminatory pricing of, and terms of access to, its monopoly cash equity CS services". This includes an expectation that ASX should maintain an appropriate method for determining the prices of its CS services so as to generate expected revenue that reflects the efficient costs of providing those services, including a return on investment commensurate with the commercial risks involved.

2.2.5 BBSW Benchmark administrator licensee to maintain Final Stage Method

(1) A benchmark administrator licensee whose benchmark administrator licence specifies the BBSW must maintain a method (Final Stage Method) for generating and administering the BBSW that is designed, to the extent reasonably practicable, to allow the licensee to generate and administer the BBSW when other methods that the licensee would normally use to generate and administer the BBSW have failed or are likely to fail.

[1] Financial Conduct Authority Handbook - MAR 8.3 Requirements for benchmark administrators.

[2] Regulation (EU) 2016/1011 of the European Parliament and of the Council (Article 22).

Rule 2.2.5 Comment on a rule making timing conundrum
AFMA understands the rationale for the proposed rule and agrees with the industry consensus view that BBSW will become a 'significant financial benchmark'. We note that Rule 2.2.5 specifically presumes that BBSW is declared to be a 'significant financial benchmark' under section 908AC (2) of the proposed amendment to the Corporations Act. As ASIC's declaration under sub (2) is subject to Ministerial consent it will be important that this rule and supporting Regulatory Guide commentary is not made until after Ministerial consent to BBSW being declared a significant financial benchmark occurs, to avoid pre-emption of a ministerial decision.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

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