

Australian Custodial Services Association
Level 29, 44 Market Street
Sydney, NSW, 2000

6 September 2024

CS Submissions,
Payments Policy Department,
Reserve Bank of Australia,
GPO Box 3947,
Sydney,
NSW,
2001
CSSubmissions@rba.gov.au

Dear CS Submissions,

Australian Custodial Services Association Response to the Council of Financial Regulators *“Reassessing the Case for Central Clearing of Bonds and Repos in Australia A Consultation Paper by the Council of Financial Regulators – July 2024.”*

The Australian Custodial Services Association (**ACSA**) is the peak industry body representing members of Australia's custodial and investment administration sector. Our mission is to promote efficiency and international best practice for members, our clients, and the market. Members of ACSA include NAB Asset Servicing, J.P. Morgan, HSBC, State Street, BNP Paribas Securities Services, BNY, Citi, Clearstream, and The Northern Trust Company.

Collectively, the members of ACSA hold securities and investments in excess of AUD \$5 trillion¹ in value in custody and under administration for Australian clients comprising institutional investors such as the trustees of major industry, retail and corporate superannuation fund, life insurance companies, responsible entities and trustees of wholesale and retail investment funds, and various forms of international investors into Australia.

ACSA welcomes the opportunity to respond and provide input into the consultation process regarding the Central Clearing of Bond and Repurchase trades in Australia. We welcome further input and engagement on this topic.

Costs and benefits

1. Have the potential benefits of central clearing the Australian bond and repo markets increased in recent years? What costs/benefits do you view as being the most relevant for consideration of central clearing in the Australian bond and repo markets?

Debt trades executed in Australia currently settle bilaterally on a negotiated non-enforced T+2 basis, being the AFMA market standard for settlement. Trades may be instructed to settle in the Austraclear

¹ As at 30 June 2024, <https://acsa.com.au/page/IndustryStatistics>

system with any settlement date (T+0 is supported) on a real-time gross settlement basis with cash and securities being simultaneously transferred between participants. Therefore, the counterparty risk is significantly lower than in the Australian equity market.

Custodians provide services to both onshore and offshore clients investing into Australia. Activity may vary across ACSA members but generally there has been an increase in volumes in the bond and repo markets over the last 5 years, at the same time there has been growth in other market instruments as well. ACSA members do not believe that the recent growth necessitates a need in the market, especially from a custody perspective, to move into a central clearing model.

The introduction of such a model would be costly to all participants in the value chain to implement. This would potentially occur at a time when the Australian market is also working on significant projects to deliver change for the equities and payment markets so resourcing could also be seen as an additional challenge.

It should also be noted that in 2021 the market implemented changes to support the mandated use of the Austraclear Repo module to instruct the settlement of Repo and Reverse Repo trades. This created significant challenges for participants and investors who had to change trading & settlement processes, and which created questionable outcomes. ACSA welcomes further discussions about the potential impact and challenges that the introduction of a CCP to the Australian market would bring.

Participation and viability

2. What do you consider to be the minimum product scope and participation necessary to support effective central clearing in Australian bond and repo markets? Do you envisage any issues arising if a prospective CCP was to clear for a single segment of the market (e.g. bonds only or repos only)?

As a minimum, should such an approach be adopted, it should be based on global standards which may help deliver expected outcomes. There could be considerable issues should the market be split based on the underlying debt instrument I.E. government vs corporate bonds or transaction types I.E. Repo vs fixed income and best practice should be adopted for all flows whether it is cleared or not. Not adopting this approach may see fixed income trades settle in one manner and repo settled in another leading to confusion and inconsistency. With trade instructions received from offshore investors it is critical not to confuse investment in such a manner and have a consistent model to support all types of fixed income trades.

3. Under what conditions would you participate in a bond and repo CCP if there was one servicing the Australian market?

Whilst ACSA does not yet see the viability in the proposal each custodian would participate based on underlying client demands and market regulations.

4. In your experience, including with bond and repo CCPs in other jurisdictions, are there likely to be material challenges faced by the Australian market in transitioning to a centrally cleared.

environment and how might these be overcome?

Yes. From a custodian view point the custody community is servicing both on and offshore investors including those in markets where bond and repo CCP's are present. As a general statement there are markets of a greater magnitude than Australia to which the concept of clearing on debt instruments makes more sense due to the market size and appetite to reduce settlement risk.

To implement a new CCP in Australia would come at a significant cost and time for implementation. This also comes at a time when organisations have mandated market changes that are currently a priority. As we have seen with the T+1 implementation in North America, communication with all investors is critical for the success of any major market change. Whilst ACSA members are not supportive of the introduction of a CCP for debt trades, if one were implemented we would expect a minimum of 24 months between the finalization of any technical requirements and a go-live date. Any solution should focus on using international best practice messaging standards and should be aligned to those being introduced in the CHES Replacement system. Ideally this would result in debt securities being held in the CHES Replacement system and a single operating model be used for all securities held in the Australian market.

A potential move to T+1 in Australia would also add complexity and challenges to the introduction of a CCP and may warrant additional changes to trading, matching and settlement processes which are not currently in scope. Again, this additional complexity may result in higher rates of failed trades and higher costs for investors. ACSA members believe that any implementation of a CCP, should it occur, should take place after a move to T+1.

Efficiency and resilience

5. What do you view as being material impediments, if any, to the safe and efficient operation of a bond and repo CCP in Australia? Please consider the effects of an extended disruption on your business (such as liquidity and risk management), as well as broader effects such as those related to financial stability and market confidence.

The most significant impact for custodians would be around technology change, potential liquidity impacts and ability to budget and resource for additional funding for an item that does not bring any return.

It should also be noted that via the custodian value chain the number of failed trades in these instruments today is minimal with effective controls in place today to monitor and deal with counterparts on any trades facing possible failure.

In addition, it should be noted that around 15% of the current settlement volume traded through Austraclear by ACSA members is on a T+0 basis where discount securities (money market instruments) are issued, traded and settled on the same day. The introduction of a CCP would serve no purpose for these trades and bifurcating the process based on certain security types could easily create confusion for investors and lead to failed trades, manual processes and additional costs for investors.

6. How material are issues with settlement chains on the safety and efficiency of the Australian bond and repo markets? In your experience, what are the factors behind these issues? What

steps, if any, should a prospective bond and repo CCP or its participants take to mitigate the risk of issues associated with settlement chains?

From a custody viewpoint trades can run into difficulty when instructions are received late or a counterparty is waiting upon stock to deliver a transaction. Whilst the later statement aligns with that the CCP concept would resolve, the volumes of such transactions are much smaller than those that settle with no issues and are a fraction of those seen in equity markets.

7. Are there any aspects of the bond and repo markets that in your view are not functioning efficiently? For example, would enhanced transparency in bond and repo markets improve the efficiency of these markets?

From a custodial view point the bilateral settlement functionality today gives enough visibility on transactions to enable efficient and timely settlement.

COUNCIL OF FINANCIAL REGULATORS

8. What actions could regulators or industry take to improve the efficiency and/or resilience of the bond and repo markets, including to reduce information asymmetry and improve price and liquidity discovery?

ACSA has no view on this given transactions are entered into by our clients with custodians just acting upon the instructions to enable settlement.

Location

9. Some other major jurisdictions have CCPs operating bond and repo clearing services in their domestic markets. What are your views on an overseas operator providing clearing services for the Australian bond and repo markets?

ACSA members do not see a reason why there could not be a foreign owned institution that the local regulators approve to be licensed to provide a CCP service.

10. Based on your experience, including in other jurisdictions and markets, what features of an overseas-based CCP could present difficulties or introduce risks in the Australian context? How are these challenges managed in other jurisdictions and are they managed successfully?

A risk for an implementation in Australia would be that a CCP is not based on global best practice and standards. Challenges in other markets will often be tabled in appropriate industry working groups and work with the CCP to understand the demands of change and the ability to implement to improve overall market efficiency.

11. With the increasing internationalisation of Australian bond and repo markets, do you consider it desirable for a potential bond and repo service to have effective links to trading and settlement services, including international central securities depositories(ICSDs)?

Yes, having the ability to settle in different depositories/locations (i.e. different ICSDs and global custodians) is useful for participants to consolidate settlement services and ensure that the settlement services create operational efficiencies, enable collateral mobility, facilitate broader access and support end to end risk management. Where issuers determine to list/issue in multiple jurisdictions, it enables centralisation of efficient collateral management for both Australian participants as well as international participants who connect to ICSDs or global custodians.

Critically, considerations also needs to factored in as to what the impacts are to local providers and markets should any of this change from today's transactional flow.

If you have any questions in relation to this submission please contact me.

Yours sincerely

David Travers
Chief Executive office
Australian Custodial Services Association
Email: david.travers@acsa.com.au
Phone: 0466576471

About ACSA

About the Australian Custodial Services Association (ACSA)

The Australian Custodial Services Association (ACSA) is the peak industry body representing members of Australia's custodial and investment administration sector. Our mission is to promote efficiency and international best practice for members, our clients and the market. ACSA works with peer associations, governments, regulators and other market participants on a pre-competitive basis to encourage standards, process consistency, market reform and operating efficiency. Established in 1994, ACSA members currently hold assets in excess of \$4.5 trillion in custody and under administration for Australian institutions.

The key sectors supported by ACSA members include large superannuation funds and investment managers, as well as other domestic and international institutions. Custodians provide a range of institutional services to clients including traditional custody and safekeeping, investment administration, foreign exchange, securities lending, transfer agency, tax and financial reporting, investment analytics (risk, compliance and performance reporting), investment operations middle office outsourcing and ancillary banking services.

www.acsa.com.au

Important Note

ACSA works with peer associations, regulators and other market participants on a pre-competitive basis to encourage standards, promote consistency, market reform and operating efficiency. The views expressed in this letter are prepared by ACSA and should not be regarded as the views of any particular member of ACSA.

The comments in this letter do not comprise financial, legal or taxation advice.