

30 NOVEMBER 2009

**DRAFT POLICY: THE DESIGNATION AND
OVERSIGHT OF DESIGNATED SETTLEMENT
SYSTEMS**

CONSULTATION DOCUMENT

Introduction

On 18 November 2009 the Minister of Commerce announced the passing of a bill that extended the scope of the systems that can be designated to systems that clear and settle products (notably securities) as well as payments. The Reserve Bank of New Zealand Amendment Act 2009 creates a new Part 5C of the Reserve Bank of New Zealand Act 1989. Part 5C provides for the designation of settlement systems and gives statutory backing for finality of settlement and netting through a designated settlement system. Part 5C also makes the Securities Commission a joint regulator of designated settlement systems with the Reserve Bank.

Draft policy document

The Reserve Bank and the Securities Commission have prepared a draft policy document for public consultation entitled “The Designation and Oversight of Designated Settlement Systems” (DSS1) (see attachment). This document explains the roles and policies of the Reserve Bank and the Securities Commission in relation to the designation and oversight of designated settlement systems.

The Reserve Bank and the Securities Commission are calling for submissions on the draft policy document. Please forward your submission to either of the following:

Stuart Irvine Reserve Bank of New Zealand PO Box 2498 Wellington 6011 Email: stuart.irvine@rbnz.govt.nz	Peter Nielsen Securities Commission PO Box 1179 Wellington 6011 Email: peter.nielsen@seccom.govt.nz
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Submissions close on Friday, 22 January 2010.

Submissions will be subject to the Official Information Act 1982. The joint regulators may also make submissions available on their respective websites, or draw attention to submissions in any further reports. If you would like the joint regulators to withhold any commercially sensitive, confidential or proprietary information included in your submission please say so in your response. Any request to have information withheld will be considered in accordance with the Official Information Act.

Next steps

Once the submissions have been considered the Reserve Bank and the Securities Commission will finalise DSS1 and release it together with a separate document - *Application Guidelines for Designation under Part 5C of the Reserve Bank of New Zealand Act 1989 (DSS2)*. The Reserve Bank and the Securities Commission will then accept applications from settlement systems seeking designation under Part 5C of the Reserve Bank of New Zealand Act 1989.

Attachment

Draft Policy: The Designation and Oversight of Designated Settlement Systems.

CONSULTATION DRAFT**2. Settlement Systems**

A settlement system is defined in the Act as a system or arrangement for effecting settlements or processing settlement instructions, and includes a payment system.² A settlement is defined as the making of payment or the transfer of the title to, or an interest in, personal property. While these definitions potentially capture the settlement arrangements for a wide range of personal property transfers, the focus of the Reserve Bank and the Securities Commission is on securities settlement systems (including settlement systems for futures and other derivatives) and, in the case of the Reserve Bank, payment systems as well.

Payment and securities settlement systems are a key component of the financial infrastructure. Disruptions in a payment or securities settlement system can have repercussions not only for the market directly served by the system, but for the wider financial system. A payment or securities settlement system may trigger, transmit or amplify shocks across domestic and international financial systems and markets because of:

- The size or nature of the payments or settlements that are processed through the system.
- The aggregate value of the settlements and their importance to the circulation of liquidity within the financial system.
- The number of individuals and institutions who directly or indirectly participate in payment and securities settlement systems or who are otherwise affected by or have an interest in the soundness and efficiency of payment and securities settlement systems.

It is therefore important for investor confidence, the soundness and efficiency of securities markets, and the soundness and efficiency of the financial system as a whole that payment and securities settlement systems operate smoothly and efficiently.

What is a designated settlement system?

A designated settlement system is a settlement system that has been designated under Part 5C of the Act. A settlement system becomes designated by an Order in Council being made, on the recommendation of the joint regulators, declaring that a settlement system is a designated settlement system.

However, it should be noted that while the joint regulators have a role in the designation and ongoing oversight of designated settlement systems, neither the joint regulators nor the Crown are responsible or liable for any losses, damages, costs, or expenses suffered or incurred in connection with a designated settlement system.

² See section 156M.

CONSULTATION DRAFT***Benefits of designation to a settlement system***

The rules of a designated settlement system relating to the following matters are valid and enforceable despite any enactment or law to the contrary:³

- The basis on which settlement instructions are given or received.
- The basis on which settlement obligations are determined and calculated (either on a gross basis or using netting).
- The basis on which settlements are effected (either on a gross basis or using netting).
- Any action to be taken if a participant in the designated settlement system is unable, or likely to become unable, to meet the participant's obligations to any or all of the following:
 - the specified operator of the designated settlement system,
 - another participant in the designated settlement system, or
 - any other party to those rules.

Designation also gives legislative backing to the finality of settlements effected, netting done, and personal property transferred in accordance with the rules of the system.⁴

This provides a high degree of legal certainty to participants in a designated settlement system that they can rely on the settlements they receive.⁵ In turn, this contributes to the ongoing flow of liquidity in the financial system, the overall soundness and efficiency of the financial system, and the confidence of investors and other market participants.

Designation may also give the operator of a designated settlement system a super-priority in any personal property held to effect a settlement or mitigate a loss relating to the default of a participant.⁶ This is intended to provide a high degree of legal certainty that the particular designated settlement system will have recourse to the property it holds for those purposes. A designated settlement system will only have this benefit if it is specified in the designation Order in Council.

³ See section 156Q.

⁴ See sections 156R, 156T and 156X.

⁵ Settlement systems, their participants, or other stakeholders should however seek legal advice, as necessary, to take into account their specific circumstances and how Part 5C, or the law more generally, affects them.

⁶ See section 156N(3)(c), and section 103A of the Personal Property Securities Act 1999.

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3. The Joint Regulators of Designated Settlement Systems

Part 5C of the Act makes the Reserve Bank and the Securities Commission joint regulators of designated settlement systems (other than those declared to be pure payment systems). The Reserve Bank alone is the regulator of designated settlement systems that have been declared to be pure payment systems.⁷

The Reserve Bank's purpose is to promote a sound and dynamic monetary and financial system. It must exercise its powers under Part 5C for the purposes of—

- Promoting the maintenance of a sound and efficient financial system.
- Avoiding significant damage to the financial system that could result from the failure of a participant in a settlement system.⁸

The Securities Commission's purpose is to strengthen investor confidence and foster capital investment in New Zealand by promoting the efficiency, integrity, and cost effective regulation of New Zealand's securities markets. It must exercise its powers under Part 5C for the purposes of—

- Promoting the integrity and effectiveness of settlement systems and related markets in New Zealand.
- Enhancing the confidence of investors and other market participants in settlement systems and related markets in New Zealand.⁹

In considering applications for designation, variation, or revocation each of the joint regulators may have regard, or refer, to, and may rely upon, any relevant information, work, or matter held, or produced, by the other joint regulator.¹⁰ This will mean that the joint regulators will work together in their analysis of the various matters they have to consider. The joint regulators will seek to optimise the use of overall regulatory resources in a way that takes into account their respective interests and which makes use of each regulator's comparative advantage and knowledge base.

The joint regulators may also share information obtained under or in connection with Part 5C with each other,¹¹ and each has a statutory obligation to notify the other if it receives an application for designation, variation or revocation, begins a review of a designation, or receives notice of a proposed rule change.¹²

The joint regulators envisage entering into and publishing a Memorandum of Understanding in relation Part 5C of the Act to provide a transparent and readily available record of how the joint regulator framework will operate in practice.

⁷ See section 156P.

⁸ See section 156K(1).

⁹ See section 156K(2).

¹⁰ See sections 156Z(4) and 156ZI(2).

¹¹ See section 156ZM.

¹² See sections 156Y(2), 156ZB(2), 156ZG(2), and 156ZH(2).

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Amongst other things, the MoU will establish communication protocols between the joint regulators and between the joint regulators and designated settlement systems (or applicants for designation).

4. Considering an Application for Designation

The application process and information that should be submitted with an application for designation are set out in the joint regulators' separate *Application Guidelines for Designation under Part 5C of the Reserve Bank of New Zealand Act 1989 (DSS2)*. The Act protects the confidentiality of information required by the joint regulators for the purposes of an application by prescribing the circumstances in which such information may be published or disclosed.¹³

A fee will be charged for an application for designation.¹⁴ Fees will be on a cost recovery basis and will take account of Treasury guidelines.

Each of the joint regulators must consider whether the settlement system should be specified to be a pure payment system. If the joint regulators recommend that a settlement system is to be specified as a pure payment system, then once the system has been designated, the Reserve Bank alone will be the regulator of that system under Part 5C. However, both joint regulators must consider an application for designation, even if the application is from a pure payment system. In practice, once the joint regulators have agreed between themselves that a system applying for designation is a pure payment system then it is likely that in considering the application the Securities Commission would rely on information, work, and matters held, or produced, by the Reserve Bank.¹⁵

In considering an application for designation, each of the joint regulators may have regard to any or all of the matters set out below.¹⁶ The precise relevance and relative importance of each matter is likely to depend on the particular circumstances. Prospective applicants are encouraged to engage with the joint regulators before formally making an application to get an indication of the joint regulators' views on the relevance and relative importance of various matters in the particular circumstances.

The onus is on applicants to demonstrate in writing that particular matters are addressed, cross referencing relevant source material. The intention behind this policy is to ensure that the initial assessment is done by the party who best understands the system (i.e. the operator of the system) which should then expedite the joint regulators' consideration of the application. In some circumstances an applicant may need to provide third party verification in relation to matters of particular importance to support the application. In these circumstances the joint regulators will take into account the third party advice provided, but will nonetheless make their own assessment on the matters at stake.

¹³ See section 156ZN.

¹⁴ See section 156Y(3)(c).

¹⁵ See sections 156P, 156Z(1), and 156Z(3) and (4).

¹⁶ See section 156Z(2).

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The purpose and scope of the settlement system

The system must be a settlement system, which is defined in the Act as a system or arrangement for effecting settlements or processing settlement instructions. A settlement is defined as the making of a payment or the transfer of title to, or an interest in, personal property.¹⁷

The purpose of the settlement system should be consistent with the purposes for which the joint regulators must exercise their powers under Part 5C.

The scope of the settlement system will include the markets it serves or proposes to serve and the basis for membership or participation in the settlement system.

Whether the system is a pure payment system

A pure payment system is a settlement system that provides solely for the transfer of funds.¹⁸

The rules of the settlement system

The rules of the settlement system should:

- Be identifiable, clear, comprehensive, up to date, and readily available to all stakeholders.
- Clearly, effectively, and unambiguously provide for the matters to which designation gives statutory backing.¹⁹
- Enable participants to clearly identify:
 - their rights and obligations in relation to transactions cleared or settled by the settlement system, and
 - the risks and costs associated with using the settlement system.
- Clearly allocate risks to those best placed to manage those risks and otherwise clearly provide for the management of risk.
- Contain mechanisms to deal with the insolvency of a participant in a way that will limit the operational and financial impact on the system and its participants.
- Contain notification requirements which apply to a participant when it, or a participant whose obligations it settles through the settlement system, becomes unable to meet its obligations.

¹⁷ See the definitions of “property”, “settlement”, “settlement instruction”, and “settlement system” in section 156M.

¹⁸ See section 156N.

¹⁹ See sections 156Q, 156R, 156T and 156X of the Reserve Bank Act and section 103A of the Personal Property Securities Act 1999.

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- As applicable, otherwise address matters covered by any relevant international standards.
- Be legal, valid, binding, and enforceable in accordance with their terms in all relevant jurisdictions.
- Include effective mechanisms for monitoring and enforcing compliance with the rules by the operator of the settlement system.

While the joint regulators do not actually approve a system's rules as part of the designation process, the rules may need to be amended to address certain matters before the joint regulators recommend that a system be designated.

Laws and regulatory requirements

The settlement system should have a well-founded legal basis under all relevant jurisdictions. Relevant jurisdictions will include those in which the system and its direct participants are established, domiciled or have their principal office, and any jurisdiction whose laws affect the operation of the system as a result of the contractual choice of law. There may also be other relevant jurisdictions such as a jurisdiction in which a security handled by a settlement system is issued.

If the settlement system is subject to regulatory oversight in another jurisdiction, the joint regulators will need to understand the nature and extent of that oversight and be provided with the name and contact details of the relevant regulatory agencies.

The joint regulators will need to be satisfied that:

- The settlement system and its direct participants are each established, domiciled or have their principal office in a jurisdiction with a robust legal system.
- The jurisdiction whose law governs the rules of the settlement system has a robust legal system.
- All relevant jurisdictions have been identified, together with all regulatory requirements in those jurisdictions that specifically relate to the operation of the settlement system.
- The rules of the settlement system are legal, valid, binding, and enforceable in accordance with their terms in all relevant jurisdictions, including in particular in relation to netting and settlements.
- The settlement system complies with the laws and regulations relating to its operation in all relevant jurisdictions. In this regard the joint regulators may consider the settlement system's compliance with anti-money laundering laws that apply to the settlement system and its participants.

Relevant international standards concerning settlement systems

The joint regulators will need to be satisfied with the operator's self-assessment of the settlement system against relevant international standards. Relevant international standards, as may be amended or supplemented from time to time, include:

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For pure payment systems, – the *CPSS Core Principles for Systemically Important Payment Systems* (available on the website of the Bank for International Settlements at <http://www.bis.org/publ/cpss43.htm>)

For securities settlement systems – the *CPSS / IOSCO Recommendations for Securities Settlement Systems* (available on the website of the Bank for International Settlements at <http://www.bis.org/publ/cpss46.htm>)

For central counterparties (in addition to the *CPSS / IOSCO Recommendations for Securities Settlement Systems* or, as applicable, the *CPSS Core Principles for Systemically Important Payment Systems*) – the *CPSS / IOSCO Recommendations for Central Counterparties* (available on the website of the Bank for International Settlements at <http://www.bis.org/publ/cpss64.htm>)

The precise relevance of each matter covered by these standards will depend on circumstances. There is also a degree of overlap with these standards and some of the other matters which the Act allows the joint regulators to take into account. However, central themes across these standards that will generally be relevant include:

- Having a well founded, transparent and enforceable legal framework.
- Clearly identifying and allocating risk, and having an appropriate risk management framework.
- Having appropriate and effective governance arrangements. The Reserve Bank has set out its views on payment system governance in *Payment System Governance* (PS2),²⁰ which is relevant more generally in respect of all systems (i.e. not just to payment systems) seeking designation and to all designated settlement systems. An assessment of governance arrangements should cover, amongst other things, the settlement system's constitution, corporate structure, capital structure, ownership and management, including the constitution, ownership and management of each operator of the settlement system. Where there is more than one operator of a settlement system, the joint regulators will need to understand the relationships and accountabilities between those operators.

The capability and capacity of the operators of the settlement system

The operators of the settlement system must have the capability and capacity to operate the settlement system in accordance with the rules and procedures of the system and in a manner that is consistent with the purposes for which the joint regulators must exercise their powers under Part 5C.

The joint regulators will be interested in the operator's capacity and capability in relation to the monitoring and management of risk. The joint regulators expect the board of the operator of a designated settlement system (or the individual or body with ultimate responsibility for the management of the designated settlement system) to have direct oversight over the risk management framework for the designated settlement system, including approving any policies in relation to risk management

²⁰ Available on the Reserve Bank website at <http://www.rbnz.govt.nz/finstab/payment/2641543.html>

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(such as a financial resources policy), and monitoring performance against those policies.

An applicant may need to provide an independent procedural audit to satisfy the joint regulators that a system performs as intended and with a high degree of operational reliability.

The financial resources of the settlement system

The settlement system must have sufficient financial resources to operate in a sound and efficient manner in the context of the markets it serves.

This consideration is particularly relevant for systemically important settlement systems and significant central counterparties. The joint regulators will have a conservative approach to determining such a system's capacity to withstand extreme but plausible market conditions.

The joint regulators expect a designated settlement system that includes a central counterparty to have a financial resources policy covering at least the following matters, taking into account the systemic significance of the settlement system, and to maintain financial resources in accordance with that policy:

- The performance of regular stress tests using relevant historical data and meaningful scenarios consistent with international best practice. Stress tests should include scenarios not only in relation to market conditions and the failure of participants, but also in relation to liquidity and the quality of collateral held and of the other assets and arrangements that the central counterparty may have recourse to (and the extent to which those matters may be correlated with market conditions and/or the failure of participants).
- The determination of sufficient financial resources (including a minimum level of capital) by reference to the results of stress testing and allowing for further unknown contingencies, and which is consistent with international standards and best practice.
- How further capital will be raised or what other arrangements will be put in place or extended if at any time stress testing indicates that its resources are inadequate.
- A policy in relation to the mix of financial resources and other arrangements which the central counterparty has recourse to in order to meet its settlement obligations.
- An investment policy in relation to cash collateral.
- A policy in relation to eligible non-cash collateral.

The settlement system operator should also have sufficient financial independence to operate, maintain, and develop the settlement system to the expectations of its participants and other stakeholders.

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The joint regulators expect the board of the operator of a designated settlement system (or the individual or body with ultimate responsibility for the management of the designated settlement system) to have direct oversight over the financial resources of the designated settlement system, including approving any policies in relation to financial resources and monitoring performance against those policies.

The importance of the settlement system to the financial system

The joint regulators will need to be satisfied that the system is important in terms of the purposes for which the joint regulators must exercise their powers under Part 5C.

Application of 103A of the Personal Property Securities Act 1999

Section 103A of the PPSA is the provision that gives the operator of a designated settlement system a super-priority in any personal property held to effect a settlement or mitigate a loss relating to the default of a participant. It will apply only if specified in the system's designation Order in Council. As such, this consideration will not always be relevant.

Where this consideration is relevant, the joint regulators will need to be satisfied that the impact of the super-priority on other creditors of participants in the settlement system is proportionate to the risks being managed, and warranted by the system-wide benefits in terms of the purposes for which the joint regulators must exercise their powers under Part 5C.

Other matters the joint regulators may consider**Standing and conduct**

The operators of the settlement system must be of good standing and conduct business in a prudent manner. The joint regulators will be interested in the standing of the operators of a designated settlement system and the suitability of directors of the operators and senior management with responsibility for the operation of the designated settlement system. Matters the joint regulators may take into account include:

- The honesty, integrity, and reputation of directors and relevant senior managers.
- The individual skills and experience of directors and relevant senior managers.
- Whether any operator, or any director or relevant senior manager of any operator, has been subject to any previous regulatory action or been convicted of any relevant offence in New Zealand or elsewhere.
- Whether any operator of the settlement system would be disqualified from being registered as a financial service provider under section 14 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 if that Act applied to that operator.

In the first instance applicants will need to satisfy the joint regulators in relation to those matters. Further requirements, if any, in particular circumstances will be discussed with applicants.

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Electronic securities transfer systems

Part 5C of the Act, together with related provisions in the Securities Act 1978 and the Companies Act 1993, give designated settlement systems the same status in relation to the transfer of securities as electronic securities transfer systems approved under section 7 of the Securities Transfer Act 1991. The following matters, which are considered in deciding whether to recommend that an electronic settlement system be approved under section 7 of the Securities Transfer Act 1991, are therefore relevant in deciding whether to recommend that a securities settlement system be designated under Part 5C of the Act:

- That the risks of unauthorised or mistaken transfer are appropriately allocated and adequately managed.
- That appropriate measures are in place to control automation risk, including:
 - security to prevent unauthorised access and misuse of data,
 - capacity planning to deal with sudden increases in demand,
 - contingency systems to ensure continuous service in the event of system failure, natural disaster or intentional malicious act, and
 - independent technical reviews to confirm that the system performs and continues to perform as intended.
- That there are appropriate controls around the setting and changing of relevant system rules.
- That any system that allows participants to control the transfer of the other people's securities has appropriate measures in place to protect those other people's interests, taking into account the nature of the participants and the nature of the people whose securities may be under the control of participants.

Other matters

The joint regulators may have regard to such other matters as they consider appropriate in the circumstances.²¹ If any other such matters are identified the joint regulators will endeavour to raise these with the particular applicant as early in the process as practicable. For example, the nature or number of the markets served by the settlement system, or the structure of the settlement system may give rise to particular issues.

5. Conditions of Designation

An Order in Council declaring a settlement system to be a designated settlement system may specify conditions to which the designation is subject.²²

²¹ Section 156Z(2)(g).

²² See section 156N(3)(a).

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The Act expressly provides that the breach of a condition of designation does not affect the application of the provisions in the Act relating to the enforceability of the rules of the system, settlement finality, netting, the transfer of personal property, or section 103A of the Personal Property Securities Act.²³ However, the breach of a condition of designation could ultimately give rise to a review of the designation by the joint regulators.²⁴

It is envisaged that the following standard conditions would apply in most cases:

- That the designated settlement system complies on an on-going basis with all laws and regulations relating to its operation.
- That the contact person will notify the joint regulators of any change to the operator of the designated settlement system or to the contact person.
- That the contact person will notify the joint regulators of any changes to any financial resources policy or risk management framework for the designated settlement system, as soon as is reasonably possible.
- That the contact person will notify the joint regulators of any material non-compliance with laws or the financial resources policy or risk management framework for the designated settlement system, as soon as is reasonably possible.
- That the contact person will notify the joint regulators of any event which materially increases risk to the designated settlement system, as soon as is reasonably possible.

Reporting by designated settlement systems

In recommending that a settlement system be designated, the joint regulators will also recommend, as a standard condition of designation, that the specified operator of the settlement system be required to prepare and publish an annual report on the settlement system, in a form to be agreed with the joint regulators, to be delivered to the joint regulators and published within [3] months of the operator's balance date, and including the following:

- Financial statements for the settlement system for the reporting period.
- A self-assessment against the relevant international standards (updating the self-assessment done when applying for designation).
- An assessment of financial resources of the settlement system over the reporting period and the extent to which financial resources have been maintained in accordance with any financial resources policy.
- An assessment of risk management over the reporting period and the extent to which risks have been managed in accordance with any risk management policy.

²³ See section 156N(6)(b).

²⁴ See section 6 below on the ongoing oversight of designated settlement systems.

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- An assessment of the operational performance of the settlement system over the reporting period.
- An assessment of the governance of the settlement system over the reporting period.
- A statement as to whether there have been any changes to any financial resources policy or risk management policy over the reporting period and the reasons for any such changes.

The purpose of the annual report is to provide a systematic and transparent mechanism for providing relevant information to participants, the joint regulators, and other stakeholders.

The aim in requiring a self assessment against relevant international standards to be part of the annual report is to ensure that the operator is constantly assessing the system against the relevant standards and an up to date assessment is always available. Operators should therefore review at least annually the existing assessment and update it if required. A more fundamental review of the assessment should be carried out at least every three years.

System specific conditions

In addition to standard conditions, additional conditions may be imposed in relation to a specific settlement system to take into account particular issues relating to that system. For example, a designated settlement system that includes a central counterparty may be subject to a condition relating to regular stress testing and providing stress-testing related information to the joint regulators periodically.

6. Ongoing Oversight of Designated Settlement Systems²⁵

Engagement with designated systems

The joint regulators will seek to meet with each designated settlement system regularly (e.g. six monthly). These meetings will be used to discuss the settlement system's most recent annual report to the joint regulators and, more generally, matters relating to the ongoing operation of the settlement system, its designation, and any regulatory developments.

The joint regulators will generally endeavour to get the operators of designated settlement systems to voluntarily address particular concerns identified by the joint regulators. The joint regulators may also require the supply of further information and/or require particular information to be independently verified.²⁶

If the joint regulators have significant concerns that are not voluntarily addressed by the operator of a designated settlement system to their satisfaction, the joint regulators

²⁵ In the case of 'pure payment systems', all references to joint regulators in this section should be read as if they were references to the Reserve Bank of New Zealand.

²⁶ See section 156ZL and the text below on statutory information requests.

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are likely to then consider whether to review the designation with a view to imposing a condition requiring certain actions to be taken in accordance with a specified timetable to address those concerns.²⁷ In this way conditions may be used to escalate concerns and compel remedies.

The joint regulators' powers will be used in proportion to the seriousness of the concern and the likelihood of the concern being resolved without the use of such powers.

Commentary on matters relating to designated settlement systems

The joint regulators may also publish commentary on matters relating to designated settlement systems. For example, the Reserve Bank maintains an ongoing commentary on financial stability issues in its six-monthly Financial Stability Report; and the Securities Commission may publish any report or comment in the course of the exercise or intended exercise of its function of keeping under review the law and practice relating to settlement systems in New Zealand (but excluding pure payment systems).²⁸ Part 5C also anticipates publication of information subject to limitations in relation to information that was supplied pursuant to the Act.²⁹

Statutory information requests and related powers

The joint regulators may require the following persons to supply the joint regulators with any information relating to the designated settlement system:³⁰

- The specified operator of the designated settlement system.
- A participant in the designated settlement system.
- The contact person of the designated settlement system.

The joint regulators may exercise the power to request information only if they consider the information is reasonably required to enable them to perform their functions and duties, or exercise their powers, under Part 5C. For example, the joint regulators may need further information to properly understand how market conditions are impacting on a designated system's risk controls, to consider amendments to rules, in relation to applications for variation or revocation of designation, or to properly consider a review of a designation.

The joint regulators can also specify the manner in which the information must be verified.

Failure to supply information formally requested pursuant to the joint regulators' statutory power, without lawful justification or excuse, is an offence.

²⁷ See section 156ZH and the text below on variations or revocation of designation.

²⁸ See sections 10(1)(da) and 28A of the Securities Act 1978.

²⁹ See section 156ZN.

³⁰ See section 156ZL.

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The Act protects the confidentiality of information provided pursuant to a statutory information request by prescribing the circumstances in which such information may be published or disclosed.³¹

The Securities Commission may also exercise its powers under the Securities Act for the purposes of performing its functions and duties under Part 5C of the Act.³² Those powers include:

- Conducting inspections to obtain documents and records.
- Summoning witnesses and receiving evidence in relation to any matter before the Securities Commission.

Rule changes

For the purposes of Part 5C of the Act, the rules of a designated settlement system are the rules contained in documents specified in the designation Order in Council, and include any amendments to those rules that have been notified to and not disallowed by the joint regulators or which have been made pursuant to a variation of the designation.³³

The specified operator of a designated settlement system must, as soon as practicable, notify either of the joint regulators of any amendment that is proposed to be made to the rules of the designated settlement system. The joint regulators may then disallow the proposed rule change within 20 working days.³⁴

The joint regulators encourage the specified operators of designated settlement systems to engage with the joint regulators ahead of formally notifying proposed amendments. This is to reduce the likelihood of proposed rule changes being disallowed as a result of issues that can't be resolved within the prescribed period.

Part 5C is silent on the matters the joint regulators may take into account in considering whether to disallow rule changes. In considering whether to disallow rule changes the joint regulators will consider whether the rules of the designated system continue to adequately provide for the matters to which the Act gives statutory backing. More generally, the joint regulators may take into account any matter which may be relevant to the proposed rule change and which may be or may have been taken into account in considering an application for designation or an application to vary a designation.

In considering proposed amendments, the joint regulators will also consider whether the consultation requirements set out in the system's rules have been complied with and whether there has otherwise been appropriate consultation in the circumstances.

³¹ See section 156ZN.

³² See section 156L.

³³ See section 156M.

³⁴ See sections 156ZB and 156ZC.

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The joint regulators will also consider whether proposed rule changes are such that the system operator should more properly apply for a variation of the designation (for example, if the proposed rule changes would result in the joint regulators needing to review the designation with a view to imposing new conditions of designation).

Variations or revocation of designation³⁵

A variation or revocation of designation is made by Order in Council on the recommendation of the joint regulators. A variation to a designation will be needed if the designation Order in Council needs to be amended, including if a new condition needs to be added.

A recommendation to vary or revoke a designation may be made either following an application for variation or revocation or following an independent review initiated by either of the joint regulators.

In determining whether to make a recommendation that any designation be varied or revoked, each of the joint regulators may have regard to any or all of the following matters:

- Any or all of the matters it may take into account in considering an application for designation.
- Any failure to comply with any condition to which the designation is subject.
- Any failure to comply with the requirements of the Act.
- Any other matters that the joint regulator considers appropriate.

Before making a recommendation to vary or revoke a designation, the joint regulators must notify the contact person specifying the reasons for proposing to vary or revoke the designation, and advising that the contact person may make submissions to the joint regulators. This notice may be given either in writing or orally depending on the circumstances of the particular case. The contact person must be given an opportunity to make submissions within a time period that the joint regulators consider reasonable in the circumstances and they must consider any submissions made by that person during that time period. Although the Act only requires that notice be given to the contact person, the joint regulators may, if they consider it appropriate, advise other persons and give them the opportunity to make submissions.

Fees will be charged for an application to vary or revoke designation. Fees will be on a cost recovery basis and will take account of Treasury guidelines.

³⁵ See sections 156ZD to 156ZJ.