

17 April 2014

Capital Markets Unit
Corporations and Capital Markets Division
The Treasury
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Dear Sirs,

G4-IRD Central Clearing Mandate

The International Swaps and Derivatives Association, Inc. (**ISDA**)¹ is grateful for the opportunity to respond to the proposals paper on the “G4-IRD Central Clearing Mandate” issued by the Australian Treasury (the **Treasury**) in February 2014 (the **Proposals Paper**). The industry supports Australia’s commitment to implement mandatory clearing as part of the G20 over-the-counter (**OTC**) derivatives regulation and support the proposed central clearing of US Dollar-, Euro-, British Pound-, and Yen denominated interest rate derivatives (**G4-IRD**) by large financial institutions such as those large financial institutions above the AUD 50 billion notional outstanding threshold with significant cross-border activity in G4-IRD (referred to as **G4 Dealers**).

Entities subject to the clearing mandate and phased-in approach

As an overarching comment, it is of utmost importance that the clearing mandate is clear and clearly identifies a specified group of entities as an initial phase. The clearing mandate should also allow this specified group of entities the choice of which CCP they will use to clear their transactions and the list of prescribed CCPs should include CCPs located both inside and outside of Australia.

As you may be aware, in March 2013, the United States (**US**) Commodity Futures Trading Commission (**CFTC**) introduced its first clearing mandate for four classes of interest rate swaps and two classes of credit default swaps (**CDS**) under the Dodd-Frank Wall Street reform and

¹ Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

Consumer Protection Act (**Dodd-Frank Act**)². The clearing mandate does not apply to market participants who are eligible to elect an exception from clearing because they are non-financial entities hedging commercial risk. The clearing mandate was phased-in³ beginning with Category 1 Entities which included swap dealers (**SDs**); major swap participants (**MSPs**); major security-based swap participants; and private funds active in the swaps market/ active funds. Category 2 Entities followed including commodity pools, certain private funds; certain employee benefits plans; or persons predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, provided that the entity is not a third-party sub-account. The last phase was Category 3 Entities including third-party subaccounts and those not exempted from the mandatory clearing requirement. Similarly, if the intent in Australia is to extend the clearing mandate beyond the G4 Dealers, we believe the implementation process should be phased-in by product and entity type. For example: the first phase for the clearing mandate should be the G4 Dealers above the threshold, possibly followed by financial institutions below the threshold and non-financial institutions..

In Europe, the European Union (**EU**) has mandated clearing under the Regulation (EC) No. 648/2012 of the European Parliament and the Council on OTC derivatives, central counterparties (**CCPs**) and trade repositories (**TRs**)⁴ (also known as **EMIR**). The determination of products subject to a clearing mandate has yet to be determined. The European Securities and Markets Authority (**ESMA**) has been tasked with providing technical advice on third country regulatory equivalence under EMIR to the European Commission (**EC**) to enable the EC to prepare possible implementation acts concerning equivalence between the legal and supervisory framework of other jurisdictions and the EU. It is fundamentally important that any clearing mandate that will be implemented should not conflict or be duplicative with another jurisdiction's clearing requirements. As a transaction cannot be cleared through two CCPs at the same time, it is important that a non-Australian G4 Dealer that is already clearing elsewhere can benefit from equivalence or substituted compliance as that will allow the non-Australian based G4 Dealer to meet its clearing obligation in Australia by clearing under the regulations of its home jurisdiction. Substituted compliance should look at the equivalence of the clearing regime in the non-Australian jurisdiction and, in accordance with the approach adopted under the foreign entity exemption provided for in the Australian trade reporting rules, recognize any exemptions provided for under the regulations of the non-Australian regime as also exempt under the Australian regime. Similarly, for an Australian-based G4 Dealer, equivalence or substituted compliance would allow it to apply the Australian clearing mandate instead of another jurisdiction's clearing requirements.

² <http://www.cftc.gov/PressRoom/PressReleases/pr6529-13>, Commodity Futures Trading Commission, Press Release, *CFTC Announces that Mandatory Clearing Begins Today*, 11 March 2013.

³ http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/90111tcl_factsheet.pdf, Commodity Futures Trading Commission, *Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution requirements under Section 2(h) of the CEA*, Page 2.

⁴ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF>, *Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade repositories*, 27 July 2012.

Response to specific questions

The remainder of this letter sets out our comments in relation to the specific questions posed in the Proposal Paper. The headings used below correspond to the headings used in the Proposal Paper.

QUESTIONS

Question 1: Do you have comments on the benefits and costs of complying with a mandatory clearing obligation, from the point of view of your business and/or that of your customers?

We believe the implementation cost would be low if a G4 Dealer (a) only needs to clear transactions with another G4 Dealer that are booked in Australia; (b) is allowed to clear this transaction via a prescribed CCP that it is already clearing through, even if such a CCP is located outside Australia; and (c) if possible, it is able to rely on substituted compliance or equivalence such that it will be able to meet its obligations under the Australian clearing mandate by complying with the clearing mandate in their home jurisdictions. We believe this would enable a smooth adoption of the clearing mandate in Australia without causing any major market disruptions. This process will be facilitated by the readiness of the CCPs to accept and clear the G4-IRD, the G4 Dealers' connectivity to the prescribed CCPs and the operation hours of the CCP which may need to be extended to include the Australian time zone, particularly for a CCP based in another jurisdiction. If the clearing mandate is to be extended beyond the G4 Dealers, it would be necessary to ensure that the prescribed CCPs provide client clearing services as some entities may only have the ability to clear their transactions as a client of a clearing member. In order to provide a view on the benefits and costs of complying with a mandatory clearing obligation from the point of view of our customers, more clarity on the scope of the mandate would be required.

Question 2: Do you have comments on the proposal to mandate central clearing in respect to G4-IRD? Please also consider the costs and benefits of a wider or narrower scope. Could you comment on the incremental costs and benefits of a broader or narrower scope? For example, including only USD IRDs or alternately including all IRDs.

Experience from the CFTC mandatory clearing has demonstrated a need for sufficient product granularity to avoid any confusion regarding the types of products that are in and out of scope of the clearing mandate and/or any exemptions that may apply. Sufficient granularity to product type will give certainty to the market on the application of the clearing mandate to each individual transaction. This may be achieved by reference to a definitive list of products that are subject to the clearing mandate which may be maintained and published by the relevant Australian regulator.

We would like to propose that new G4-IRD contracts created as a result of portfolio compression exercises should not be subject to the clearing mandate. As you may be aware, portfolio compression is the process whereby participating firms are able to eliminate transactions among themselves where the risks of those transactions offset one another according to the tolerances set by each participating firm. The transactions are subject to a compression algorithm to produce an unwind proposal that meets the tolerance limits specified by each participating firm.

The unwind proposals will identify transactions that will be completely or partially terminated to produce the compression results. Portfolio compression reduces counterparty credit exposure, operational risk and cost as well as the reduction in capital costs and leverage ratio. As G4 Dealers do participate in trade compression cycles, we believe the resulting new transactions that result from portfolio compression should not be subject to the clearing mandate, although it is a G4-IRD, subject to the clearing mandate.

Question 3: Do you agree with the proposal to restrict ASIC rulemaking to entities that are considered to be G4 Dealers, and to exempt intra-group trades? Could you comment on the incremental costs and benefits of including or exempting other types of entities or transactions? For example including all AFSL holders and ADIs or alternately setting a high threshold of activity.

We believe the clearing mandate should be phased-in, starting with the G4 Dealers and for transactions that are booked in Australia with another G4 Dealer only. Unlike trade reporting which aims to provide regulators with a surveillance mechanism over the market so as to promote transparency, the aim of mandatory clearing is to reduce systemic risk. As such, we do not think that there is a need to include transactions entered into in Australia but booked offshore, within the scope of mandatory clearing as these do not increase the systemic risk in the Australian market.

We believe there should be an exemption for intra-group trades. As you are aware, under Article 11 of EMIR, financial counterparties are granted an intra-group exemption under certain conditions⁵. Under Regulation 50.52 as adopted by the CFTC, there are certain exemptions from the clearing obligation for certain inter-affiliate swaps⁶.

As some of the G4 Dealers will be subject to their home jurisdiction's clearing mandate, the need for equivalence or substituted compliance between the Australian regime and their home regime will be important. Equivalence or substituted compliance will enable these G4 Dealers to comply with the clearing mandate in their home jurisdiction as well as meet their clearing obligations under the Australian regime. As you are aware, under the DFA, the clearing mandate applies to all entities dealing in a swap other than end-users with a hedging exemption under the DFA. Under EMIR, the clearing mandate applies to all financial counterparties (FCs) and non-financial counterparties above a clearing threshold (also known as NFCs+). Accordingly, we think that the Australian mandatory clearing regime should similarly seek to exempt end users and be restricted to dealers with a high number of OTC derivatives transactions outstanding that were not entered into for the purposes of hedging.

We note that the Australian clearing mandate may be deemed different when compared to other jurisdictions with a clearing mandate. In such an instance, will Australia be able to attain

⁵ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF>, *Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade repositories*, Article 11, L201/22 – L201/24, 27 July 2012.

⁶ <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-07970a.pdf>, Federal Register, Commodity Futures Trading Commission, *Clearing Exemption for Swaps Between Certain Affiliated Entities; Final Rules*, 17 CFR Part 50, Vol. 78, No. 70, Page 21783 – 21784, 11 Apr 2013.

equivalence or substituted with foreign jurisdictions and will Australia recognize jurisdictions such as the US or EU as equivalent to the Australian regime? To attain harmonization of regulations on a global level, it is important for each jurisdiction to work together, to recognize each other's supervisory authority and grant equivalence or substituted compliance on an outcomes-based approach as opposed to a rules-based approach.

Also, we seek clarification if the intent is to extend the clearing mandate beyond the G4 Dealers to include other ADIs and certain AFSL holders, subject to a lower outstanding notional threshold. We recognize that not all AFSL holders or ADIs of a certain size should be subject to a clearing mandate, particularly if they are not heavy users of derivatives. Consequently, in addition to the lower outstanding threshold, another factor that may form part of the threshold calculation would be the ADIs or AFSL holders' derivatives trading volume. We believe the proper use of derivatives allows a firm to hedge or mitigate its risks and contributes to better risk management. In order to promote good risk management practices and enable firms to continue using derivatives as a hedging or risk mitigation tool, we believe there should be a separate threshold applied to the ADIs other than the G4 Dealers or AFSL holders. For AFSL holders, the clearing mandate should apply to a smaller segment of the AFSL holders and should be limited to AFSL holders that are authorized to deal in derivatives. If the clearing mandate will be extended to include more entities, the implementation of the clearing mandate should be phased-in. A pre-requisite condition for extending the clearing mandate to other ADIs and AFSL holders would be the establishment of a client clearing framework prior to the commencement of the clearing mandate. As it is unlikely all ADIs or AFSL holders will become clearing members of a CCP, it will be necessary for them to be clients of a clearing member and to clear their transactions through a clearing broker. Their ability to access a CCP indirectly will also be a factor in meeting the Australian clearing mandate.

Question 4: Do you have comments on the calculation methodology used for determining the proposed threshold of activity and the appropriate level of the threshold? Do you have views on whether notional OTC derivatives or notional OTC IRDs is more appropriate basis for calculating the threshold? Or would you prefer a different methodology and if so, why?

The criteria for determining which bank will be classified as a G4 Dealer and therefore subject to the clearing mandate should be very clear so as to avoid confusion and uncertainty in the market. The AUD 50 billion threshold as described in the ASIC Derivative Transaction Rules (Reporting) 2013⁷ for Phase 2 reporting entities may be considered as an appropriate threshold in determining which bank will be classified as a G4 Dealer. This threshold should be limited to banks with cross border activities only and should not include any foreign subsidiaries of a G4 Dealer nor an AFSL holder. The clearing mandate should be applicable to inter-dealer transactions only, i.e., only transactions between two G4 Dealers will be subject to the clearing mandate. If a G4 Dealer trades with a non-G4 Dealer, that transaction is not subject to the clearing mandate. The clearing mandate should also only apply to transactions that are booked in Australia only as the aim of the mandatory clearing mandate is to reduce systemic risk in the Australian market. Transactions that are executed in Australia but booked to the US or the EU

⁷ <http://www.comlaw.gov.au/Details/F2013L01345>, ASIC Derivative Transaction Rules (Reporting) 2013, 9 July 2013.

would be subject to a clearing mandate in those jurisdictions⁸. It should be noted that all the foreign financial institutions in Table 1 of the Appendix A⁹ are, or would be, subject to a clearing mandate in their respective home jurisdictions. Further consideration should be given if the clearing mandate is expanded to include other financial institutions as there may be some jurisdictions which have no clearing mandate or are in the process of consulting on the clearing mandate.

While we recognize the advantages and disadvantages in applying a single threshold, we believe it will be simpler to implement this threshold as the calculation of the AUD 50 billion threshold has been calculated by financial institutions subject to the second phase of the Australian reporting obligations. If different clearing thresholds are applied depending on the asset class, a financial institution would be required to continuously monitor each threshold for each asset class to determine when it may be subject to the clearing mandate and when it may fall below the threshold and therefore not be subject to the clearing mandate. For simplicity, a single threshold across all asset classes would be easier to monitor on a continuous basis. However, there may be possible unintended consequences, such as a change in behavior of a financial institution to avoid crossing over the clearing threshold. To minimize any possible unintended consequences, further discussions between the industry and the Australian regulators would be needed to identify a workable qualifying criteria, if and when, the clearing mandate is to be extended beyond the G4 Dealers.

It is important that any G4 Dealer subject to the clearing mandate will not be subject to two conflicting or differing clearing mandates, particularly for banks not incorporated in Australia. In order to avoid any conflicting or differing clearing mandates between two jurisdictions, it will be necessary for equivalence or substituted compliance to be granted by Australia in respect of a foreign jurisdiction such as the US or the EU. It is also key that in determining which CCPs should be prescribed, to the Australian government factors in the requirements placed on banks subject to their home jurisdictions' clearing requirements and does not mandate clearing through a prescribed CCP that is not recognized by ESMA as an equivalent third country CCP.

Question 5: Do you have comments on the proposed timetable for implementing the central clearing obligation? Could you comment on the incremental costs and benefits of an earlier or later start date than what is proposed?

We do not have any major issues with the proposed timetable for implementing the central clearing obligation. However, a G4 Dealer's ability to comply with the proposed timetable will be dependent on its ability to clear on foreign CCPs which it is already clearing on; equivalence or substituted compliance granted in respect of both the US and EU clearing obligations and the readiness of the G4 Dealers to meet the clearing mandate.

⁸ It should be noted that transactions executed in Australia but booked to a jurisdiction with no clearing mandate will not be required to be cleared.

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<http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Consultations/2014/G20%20over%20the%20counter%20derivatives%20commitments/Key%20Documents/PDF/Proposals-Paper-Central-clearing-G4-IRD.ashx>, Australian Treasury, Proposals Paper, *Implementation of Australia's G-20 over-the-counter derivatives commitments-G4-IRD central clearing mandate*, Appendix A, Table 1, Page 34, 27 Feb 2014.

As implementing a mandatory clearing mandate is a long, complex and costly process, the industry would like to respectfully request as much time as possible to operationalize this process. This lead time will allow the G4 Dealers time to conduct the necessary due diligence on any new CCPs and to put in place the necessary operational systems, processes and legal documentation required to connect to a CCP. It should be noted that mandatory clearing under EMIR is expected to become effective at the end of the 2014 or early 2015. We request consideration be given to the implementation date, to ensure it does not coincide with EMIR's mandatory clearing start date as firms may lack the resources to prepare and implement two clearing mandates in different jurisdictions at the same time.

Question 6: Do you have comments on the proposal that some CCPs may be prescribed in order to ensure Australian market participants have appropriate access to CCPs? Or is there another option you prefer? If so, why?

We support the proposal that some CCPs may be prescribed in and outside of Australia, in addition to CCPs that are licensed in Australia. We seek clarity if the prescribed CCPs will need to apply for a license in Australia and if there will be a time limit placed on the prescribed CCP to apply for a license. We believe there should be no time limit placed on a prescribed CCP as some financial institutions are voluntarily clearing through certain foreign CCPs, such as LCH Swapclear. The existing access to clearing will aid in reducing the need for a G4 Dealer to assess and evaluate the risk management practices of a new CCP. If the prescribed CCPs are limited to one CCP or a small number of CCPs, it is possible that this would break up the netting sets and create collateral inefficiencies for financial institutions that may be using a CCP that is not a prescribed CCP.

When determining the prescribed CCPs, it is extremely important that the prescribed CCPs are considered to have the capacity and capability of effectively managing default and resolution scenarios. Additionally, the prescribed CCPs should have appropriate arrangements in place to offer clearing services for the relevant mandated G4 IRD products prior to the implementation of the clearing mandate. The ability of the CCP to meet this requirement is critical in ensuring that any product mandated for clearing will not introduce systemic risk to the financial system. The CCP should also have the capability to run a successful default management process, whereby it is able to close out the defaulted clearing member's positions, cover these losses without exhausting the pre-funded resources available to the CCP as part of its default management rules. There must also be a sufficiently high number of clearing member entities which participate in the default management process of the prescribed CCP. This will ensure a minimum level of risk mutualisation, in the event of a default and will ensure a sufficient number of clearing members are able to participate in the default management process.

Another factor to consider would be the G4 Dealers' existing access to the prescribed CCP. For a "new" CCP, i.e., a CCP that a G4 Dealer has no existing clearing access, a G4 Dealer will require sufficient time to evaluate and gain comfort with the risk management practices employed by the CCP to ensure the assumed risk are within the G4 Dealer's tolerable level. The G4 Dealer would need to assess the adequacy of the initial margin and the default fund, the robustness of the default management practices including any loss allocation/ recovery

mechanisms. As the G4 Dealers will most likely be clearing members of a CCP, they will effectively be underwriting the CCP and any mutualized credit risk of the other clearing members. As such, they should be given the choice of more than one CCP to clear through as they will need to be comfortable with a particular CCP, its risk management, membership criteria, number and concentration of members.

Question 7: From the point of view of your business and/or that of your customers, what is your preliminary view on the costs and benefits of mandatory central clearing of:

- (a) AUD-IRD?**
- (b) North American and European referenced CDS?**
- (c) Any other derivatives?**

When assessing if a product should be cleared, it is important to consider the liquidity of that particular product, together with, the degree of standardization of the product. Liquidity and standardization of the product will impact a CCP's ability to effectively process and risk manage the product. A product that is very illiquid should not be subject to the clearing mandate. This is because in the event of a clearing member's default, it will be difficult for the CCP to close out the defaulted position because of its illiquid nature. Standardized products tend to be more liquid as standardization increases the product's fungibility, thereby resulting in increased benefits to clearing. We believe that any product that is subject to a clearing mandate should be a product that can be cleared on multiple CCPs as opposed to a single CCP. If there is only one CCP that is able to clear a particular product, we are concerned that this would increase systemic risk as the entire market risk of that particular product would be centrally cleared in one location. Additionally, if there are multiple CCPs and the quality of one CCP deteriorates, the firms would have the possibility of transferring their business to a second, potentially more stable CCP, thereby reducing any possible systemic risk.

If AUD-IRD is to be mandated, substituted compliance should be granted in respect of other equivalent foreign regimes with similar requirements and dealers should be able to clear AUD-IRD on existing CCPs that they are already clearing on, provided such CCPs are operating under an equivalent regime. As noted in our response above, we are concerned with the potential liquidity fragmentation in the market, the break-up of netting sets and the reduction in capital efficiencies if the choice of which CCP a financial institution may choose to clear its AUD-IRD transactions is limited. Further consideration should be given to the breath of the mandate for AUD-IRD transactions and a financial institutions access to CCPs.

If financial institutions are able to meet this clearing obligation by clearing through an offshore CCP, we have no strong objections. We believe the costs of mandating clearing of North American and European referenced CDS in Australia may outweigh the benefits as these products are subject to clearing obligations in other jurisdictions, such as the US.

Question 8: Do you have views on the appropriate timing of the introduction of such mandatory requirements? Are there any preconditions that should be met before such mandatory requirements are introduced?

As we have mentioned earlier, it is important that the imposition of the clearing mandate considers the capacity of the prescribed or licensed CCPs to effectively manage default and resolution scenarios and the G4 Dealers clearing access to the prescribed or licensed CCPs.

If the policy intent is to extend beyond the G4 Dealers, a precondition would be the need for the client clearing framework to be available in the prescribed CCP(s). As not all entities will be eligible or want to become a clearing member, they will need to be able to clear their transactions through a clearing member as a client.

As this is a mandatory clearing requirement, a precondition would be the avoidance of any duplicative or conflicting clearing regulations that may impede or prevent a foreign financial institution from meeting its Australian clearing obligations due to its home jurisdiction's regulations, such as ESMA's recognition for a third country's CCP. It should be noted, under EMIR, a European financial institution may only clear through a third country CCP that has been recognized by ESMA.

Question 9: What do you view as the characteristics that make a trading platform suitable for mandatory trading of derivatives?

We believe it is not necessary to mandate the use of a trading platform in Australia at this time as we believe the use of trading platforms will grow organically without a need for a mandate. We believe that a voluntary regime should be considered where parties may elect to clear on a registered trading platform and in so doing, be able to benefit from substituted compliance which may be granted by foreign regimes. On the other hand, if and when, the Australian authorities grant substituted compliance for foreign regimes, we would like to suggest that the assessment of these foreign regimes be based on outcomes and objectives rather than rules as it would not be possible for two different jurisdictions to have identical rules. If there is a mandate to use a trading platform, we would like to suggest substituted compliance to the greatest degree possible as well as an implementation date after the trading platform mandate in the US or EU has been established and the implementation issues worked out. This will enable regulators to avoid any implementation issues that have arisen in the US or any potential issues that may arise under the Markets in Financial Instrument Directive II¹⁰ (also known as **MiFID II**) in the EU. It is important to allow sufficient flexibility in trading methods that reflect the differing levels of liquidity that exist across the derivatives market and the differing needs of market participants. At present, unlike the cash equity and futures markets, there is no swaps market that has continuously traded prices and is therefore dependent on dealers to provide liquidity. While there are a number of standardized and liquid swaps that will migrate to a trading platform, it is possible that there will be insufficient liquidity to support the type of order book models common to the cash equity and futures markets. Prior to the trading platform mandate, we support the Government's review of the licensing arrangements for financial markets and the suitability of the licensing regime in dealing with derivatives trading platforms. We believe the licensing review will assist in removing any uncertainty for trading platform operators and participants.

¹⁰ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0656:FIN:EN:PDE>, European Commission, *Proposal for a Directive of the European Parliament and the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council*, 20 Oct 2011.

The global nature of the OTC market enables market participants to attain pricing transparency, liquidity, orderly trading and a diversified range of potential counterparties to reduce systemic risk. The mandate to use a trading platform may pose a risk to these highly integrated markets through market fragmentation, whereby established cross-border trading relationships may be broken as smaller pools of regional liquidity emerges. These smaller pools may be less transparent, subject to price volatility and have a high concentration of market participants and risk. Consequently, when determining the characteristics that make a trading platform suitable for mandatory trading of derivatives, we wish to highlight the development in the CFTC's cross border guidance which has led to uncertainty regarding the scope of the trading mandate for cross border transactions. We hope that any trading mandate issued by the Australian authorities would not be extra-territorial in nature and any substituted compliance granted by the Australian authorities would include the CFTC-regulated swap execution facilities (SEFs) as well as other trading platforms with equivalent regulations such as the EU-regulated multilateral trading facilities (MTFs).

As you may know, in December 2013, ISDA published a survey on the Footnote 88¹¹ and Market Fragmentation: An ISDA Survey¹². The survey findings revealed that (a) 50% of the survey participants believe that liquidity had been fragmented across platform and cross-border lines resulting in separate liquidity pools and prices for similar transactions; (b) 84% of the survey participants believed non-US persons were choosing not to trade on Swap Execution Platforms (SEFs) as a result of the CFTC rules coming into effect; (c) 68% of the survey participants believe that trading activity with US persons has been reduced or has ceased as a result of the CFTC requirement that all SEFs with temporary SEF registration status are required to be fully compliant with all applicable SEF rules beginning on October 2, 2013; and (d) 61% of survey participants believe trading has been redirected from electronic to voice trading as a result of the CFTC rules coming into force. The survey results indicate that the trading platform mandate is expected to provide greater transparency but would result in a negative impact on price and liquidity.

It is unclear how this will impact the OTC derivatives market, although any fragmentation in liquidity would lead to less efficient pricing in certain markets, greater volatility and pricing differences. There is a pressing need for regulators to implement the G20 reforms without creating market fragmentation and less efficient OTC markets.

Question 10: Do you have comments on the proposals relating to:

(a) Making the exemption of end-users from trade reporting permanent, subject to ensuring that appropriate information on systemically important OTC derivatives trading is available to regulators?

(b) A more tightly targeted AFSL reference in the regulations?

Or is there another option you prefer? If so, why?

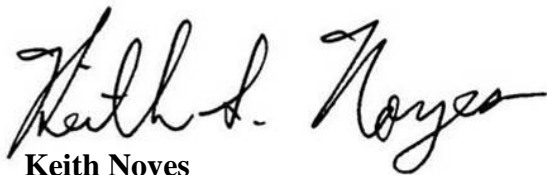
¹¹ <http://www.gpo.gov/fdsys/pkg/FR-2013-06-04/pdf/2013-12242.pdf>, Federal Register, Commodity Futures Trading Commission, *Core Principles and Other Requirements for Swap Execution Facilities; Final Rules*, 17 CFR Part 37, Vol. 78, No. 107, Footnote 88, Page 33481, 4 Jun 2013.

¹² <http://www2.isda.org/functional-areas/research/research-notes/>, *Footnote 88 and Market Fragmentation: An ISDA Survey*, 18 Dec 2013.

We support the permanent exemption of end-users from the trade reporting requirement as the reporting entities such as authorized deposit-taking institutions (**ADIs**) or Australian financial services (**AFS**) Licensees (also known as **AFSL**) will be reporting their side of the transaction to a trade repository (**TR**). As end-users tend to transact with ADIs or AFS Licensees, we believe the majority of their derivatives transactions will be captured by the transaction-level data being submitted by the ADIs and the AFS Licensees meet their Australian reporting obligations¹³. Only in instances in which an end-user trades with another end-user will those transactions not be reported to a TR. We also support a more tightly targeted AFSL reference in the regulations and we support the proposal to limit the AFSL to derivatives authorized under their AFSL for trade reporting purposes. This is predicated on the assumption that an AFSL is not able to trade in a class of derivatives for which it is not authorized under their AFSL.

Yours faithfully

For the International Swaps and Derivatives Association, Inc.



Keith Noyes
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¹³ It should be noted that these transactions will need to be tagged to enable ASIC to view the data in a foreign trade repository.