Australian Government

Implementation of Australia's G-20 over-the-counter derivatives commitments

Proposals Paper

G4-IRD central clearing mandate

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Manager
Communications
The Treasury
Langton Crescent Parkes ACT 2600
Email: medialiaison@treasury.gov.au

CONSULTATION PROCESS

Request for feedback and comments

This paper seeks stakeholder views on a proposed phased central clearing mandate with respect to interest rate derivatives denominated in G4 currencies, as part of ongoing implementation of the Australian Government's G20 commitments in relation to over-the-counter derivatives.

Treasury has published a consultation website that will allow you to post comments for each section of the paper. These comments will be added to the website and made publicly available immediately. Treasury will moderate the comments after they are submitted on the website. Please refer to the moderation policy on the website for more information. The consultation website is available at https://financialmarkets.tspace.gov.au.

The Paper is also available for you to download from the Treasury website (www.treasury.gov.au) and you can still provide your submission via the Treasury website online form or by post.

Submissions should include the name of your organisation (or your name if the submission is made as an individual) and contact details for the submission, including an email address and contact telephone number where available.

While submissions may be lodged electronically or by post, electronic lodgement is strongly preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website, unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment. Any future request made under the *Freedom of Information Act 1982* (Commonwealth) for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Closing date for submissions: 10 April 2014.

Email: financialmarkets@treasury.gov.au

Mail: Capital Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

Enquiries: Enquiries can be initially directed to Michael Lim

Phone: 02 6263 3114

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1. EXECUTIVE SUMMARY

This paper seeks stakeholder views on mandatory central clearing of interest rate derivatives (IRD) denominated in certain international currencies, as part of ongoing implementation of the G20 over-the-counter (OTC) derivatives regulation commitments.

This consultation is conducted specifically in relation to the requirements in section 901B(3) of the *Corporations Act 2001* (the Act) and the *Legislative Instruments Act 2003* that consultation occur prior to the Minister making a determination allowing the Australian Securities and Investments Commission (ASIC) to make rules regarding the central clearing of OTC derivatives.

The proposals set out in this consultation are based on recommendations provided by the Australian Prudential Regulatory Authority (APRA), ASIC and the Reserve Bank of Australia (Reserve Bank) — collectively 'the regulators' — contained in the *Report on the Australian OTC Derivatives Market* (the Report), published in July 2013.[1] It is recommended that these proposals be read in conjunction with the Report.

In summary the proposed approach contains the following:

CENTRAL CLEARING OF G4-IRD

- It is proposed that a determination be made in the second quarter of 2014 that will allow ASIC to make rules requiring the central clearing of US Dollar-, Euro-, British Pound- and Yen-denominated interest rate derivatives (G4-IRD).
- The obligations would only be applied to large financial institutions with significant cross-border activity in these products, referred to in this paper as G4 Dealers. An indicative list of firms that would be included in the central clearing mandate is published at Appendix A.

OTHER FEEDBACK SOUGHT

Central clearing of other derivatives

- The Government will wait for the recommendation from future market assessments before considering central clearing mandates for any other derivatives.
- In addition, electricity derivatives will not be considered for inclusion in the central clearing mandate until the completion of the review of the sector currently underway.[2]
- The paper seeks preliminary views on the mandatory central clearing of other derivatives in order to ensure that future consultations are best targeted and the

1 Report on the Australian OTC Derivatives Market, July 2013, available at: http://www.cfr.gov.au/publications/cfr-publications/2013/report-on-the-australian-otc-derivatives-market-july/index.html.

2 The AEMC NEM Financial Resilience Review. Further information is available here: http://www.aemc.gov.au/market-reviews/open/nem-financial-market-resilience.html.

Government can provide clear direction to the market following any recommendation from the regulators.

Mandatory platform trading

- For trading platforms no decision will be taken until subsequent reviews by the regulators.

- In addition, the Government is reviewing the licensing arrangements for financial markets. This review will consider whether the framework is adequate to deal with derivatives trading platforms that would be suitable for mandatory trade execution.

Exemption of end-users from trade reporting obligations

- The paper also seeks views on modification of the regulations relating to trade reporting to provide a permanent exemption to end-users for trade reporting following analysis by the regulators to ensure that systemically important information is being captured.

Next steps

The Government seeks feedback on these proposals and, following assessment of stakeholder views, the approach may be modified.

Following this consultation, and subject to stakeholder feedback, the Minister will make a determination identifying classes of derivatives that would be subject to the central clearing mandate. The Minister will also expose for comment draft regulations limiting the scope of ASIC rulemaking under the framework, as appropriate.

2. LEGISLATIVE BASIS

MINISTERIAL DETERMINATIONS IDENTIFYING PARTICULAR DERIVATIVES FOR ONE OR MORE OF THE MANDATES

Under section 901B of the Act the Minister may determine the classes of derivatives that may be subject to ASIC rule-making; specifying whether any rules may relate to requiring either trade reporting, central clearing or use of trading platforms. Determinations are legislative instruments and are therefore subject to review by Parliament and, potentially, disallowance. Classes of derivatives may be defined with reference to any matter, including the underlying asset, or the time when the derivatives were issued.

In making a determination, the Minister must consider certain matters (such as the impact on the stability, integrity and efficiency of the Australian financial system) and consult the regulators. The Minister may amend or revoke a determination.

Prior to making a determination mandating any obligations with respect to a commodity derivative the Minister is required in subparagraph 901B(3)(a)(iii) of the Act to consider the likely impact on any Australian market or markets on which the commodities concerned may be traded. As part of the process of fulfilling the requirement, the Minister will seek the written agreement of the Minister for Industry in relation to any decision to impose a mandate in relation to electricity derivatives.

Under section 901A of the Act, ASIC may, by legislative instrument, make rules imposing requirements for trade reporting, central clearing or use of trading platforms. Central clearing requirements are requirements for derivative transactions to be cleared through a licensed clearing and settlement (CS) facility or a CS facility that has been prescribed in the regulations. ASIC is subject to legislative requirements to consult on any rules; and rules will only come into force upon receiving the consent of the Minister.

REGULATIONS LIMITING ASIC'S RULEMAKING

Under section 901C of the Act regulations can be made that limit the scope of ASIC rulemaking with respect to certain classes of derivative transactions. Regulations may also provide that requirements may only be imposed on certain classes of derivative transactions in certain circumstances.

There is an additional provision in section 901D that allows for regulations to be made limiting requirements that can be imposed by ASIC on certain classes of persons. Regulations may also provide that requirements may only be imposed on certain classes of persons in certain circumstances.

These regulations provide a mechanism by which certain persons and transactions can be carved out of the potential reach of the derivative transaction rules. For example, they may specify thresholds of activity that must be met before a person might become subject to one or other requirements. Likewise, they may provide that certain transactions for certain purposes cannot be made subject to a certain requirement.

ASIC is not obligated to make rules relating to all entities and derivatives covered in the Minister's determination and regulations. The scope of these obligations can be further limited by the terms of any ASIC-made rules. For example, ASIC trade reporting obligations are being phased in under the rules.

3. MARKET ASSESSMENT AND RECOMMENDATIONS FROM AUSTRALIAN REGULATORS

In July 2013, the regulators released the third *Report on the Australian OTC Derivatives Market* (the Report).[3]

MARKET ASSESSMENT

The Report was compiled following a survey of market participants' OTC derivatives market activities and practices.

The survey considered G4-IRD and AUD-IRD, as well as certain North American and European referenced credit derivatives. In addition, respondents were asked about their level of engagement with central counterparties (CCPs) that clear OTC derivatives, as well as their use of trade execution infrastructure and their risk management practices for non-centrally cleared trades.[4]

To supplement the written survey, the regulators held meetings with a representative sample of dealers and other OTC derivatives market participants. In addition to data from the survey, the assessment has drawn on OTC derivatives markets data collected and published by the Bank for International Settlements (BIS), the Australian Financial Markets Association (AFMA), CME Group and LCH.Clearnet Ltd (LCH.C Ltd).

The Report concluded that there would be benefit to the Australian financial system from adopting an approach that is consistent with that of overseas regulators, who are proceeding with mandatory central clearing across a range of instrument classes, subject to the availability of suitable clearing arrangements.

CENTRAL CLEARING OF G4-IRD

The Report found that international consistency is a key consideration in assessing the case for implementing a domestic central clearing mandate for G4-IRD. Collectively, there is material activity in G4-IRD in the Australian market. Many trades in these products by internationally active participants are already caught by the requirements of other jurisdictions and are therefore already, in effect, subject to mandatory central clearing.

Internationally active participants have established direct or indirect access to at least one CCP offering clearing of these products.

The Report recommends that the Government consider a central clearing mandate for G4-IRD, primarily on international consistency grounds. The initial focus of such a mandate should be dealers with significant cross-border activity in these products.

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3 Report on the Australian OTC Derivatives Market, July 2013, available at: http://www.cfr.gov.au/publications/cfr-publications/2013/report-on-the-australian-otc-derivatives-market-july/index.html.

4 The survey was circulated to 55 institutions, with 30 responses received.

Central clearing of AUD-IRD

The Report reiterates the regulators' earlier conclusion that there would be a substantial benefit from increased central clearing of AUD-IRD.

There is evidence of an increase in central clearing in this market among Australian participants. However, until recently industry progress has been limited by the lack of availability of direct clearing for domestic market participants.

Two CCPs have received regulatory approval to offer clearing of AUD-IRD directly to Australian participants. A number of Australian participants have now established operational arrangements to clear transactions as direct clearing members of these CCPs. Clearing arrangements for non-dealer financial institutions and other smaller users of OTC derivatives remain relatively limited at this stage.

The regulators will continue to monitor progress in implementing appropriate central clearing arrangements for AUD-IRD, before recommending mandatory central clearing for this product class.

Central clearing of North American- and European-referenced credit derivatives

The Report does not recommend mandating central clearing of North American- and European-referenced credit derivatives at this time.

While there is material activity in North American and European referenced credit derivatives in the Australian market, the regulators have observed a relatively low level of activity in these products among domestic participants, including Australian banks. Furthermore, domestic participants are currently unable to directly clear North American and European referenced credit derivatives, and are only clearing to a limited extent through client clearing services.

The regulators are seeking further information about Australian market participants' counterparty exposures in these products and the breadth of central clearing of these products. The regulators will revisit these recommendations in future reports.

Use of trading platforms

The Report notes that there are in-principle benefits in greater utilisation of trading platforms in the Australian OTC derivatives market. However, further consideration needs to be given to what constitutes an acceptable trading venue for these purposes, as principles are still being developed in the major derivatives trading jurisdictions.

The regulators will continue to monitor developments in other jurisdictions and seek more detailed information on activity in the Australian market, with a view to more clearly defining the characteristics of suitable trading platforms. This work will be assisted by the improved market information that will be available as a result of the implementation of trade reporting.

4. RECENT INTERNATIONAL DEVELOPMENTS

Australia has been heavily engaged in international efforts to address conflicting and inconsistent implementation of G20 commitments across jurisdictions.

THE SIXTH FSB PROGRESS REPORT

The implementation of the G20 commitments is being monitored by the Financial Stability Board (FSB). The FSB membership includes the major financial centres around the world and in our region, including: China, Hong Kong, India, Indonesia, Japan, the Republic of Korea, Singapore and Australia.

The sixth FSB Progress Report (FSB Report), published in September 2013, provides an update on international, national and regional progress in finalising standards and implementing reforms to fulfil these commitments. The FSB Report draws on a number of sources to review market participants' readiness to meet the requirements of reforms as they are implemented. In addition, it provides some preliminary consideration of the effectiveness of the reforms in meeting the G20's underlying objectives of increasing transparency, mitigating systemic risk, and protecting against market abuse in the OTC derivatives market.

The FSB Report notes that actual use of centralised infrastructure by market participants is most advanced in trade reporting and central clearing of OTC interest rate and credit derivatives. To date, progress remains slow in the central clearing of products in other asset classes, while the use of organised trading platforms is not widespread in any of the asset classes.

The FSB Report observes that some jurisdictions already have central clearing requirements in place in the largest derivatives markets, with concrete rules already beginning to take effect.

The FSB Report also discusses areas where further work is needed to complete the reforms and achieve the G20 objectives, including:

- increased use of central clearing, and a renewed focus on the commitment to increase the use of exchanges and electronic trading platforms;
- establishment of resolution regimes for FMIs, including CCPs;
- continued work by regulators to cooperate in the application of regulations in cross-border contexts, to enable them to defer to each other's rules where these achieve similar outcomes;
- greater clarity from regulators regarding the detailed rules on the treatment of cross-border transactions and the timetables for implementation; and
- ensuring that authorities can make full use of the data collected by trade repositories in fulfilling their financial stability responsibilities.

ODRG AGREEMENT

The OTC Derivatives Regulators Group (ODRG) was established to find mutually agreed solutions to the problems created by cross-border application of reforms of OTC derivative markets. It consists of regulators from Brazil, the European Union (EU), Hong Kong, Japan, Ontario, Quebec, Singapore, Switzerland, the US and Australia.[5]

On 30 August 2013, the ODRG responded to an April 2013 request by the G20 Finance Ministers and Central Bank Governors, urging key OTC regulators to intensify their efforts to address and resolve remaining cross-border conflicts, inconsistencies, gaps and duplicative requirements by the St Petersburg Summit, which took place in early September 2013.

The ODRG agreed the following:

- early and comprehensive consultation among relevant authorities when equivalence or substituted compliance assessments are being undertaken is essential;
- a flexible, outcomes-based approach should form the basis of final assessments regarding equivalence or substituted compliance assessments;
- a 'stricter-rule' approach would apply to address gaps in mandatory trading or central clearing obligations;
- authorities should have a framework for consultation on mandatory central clearing determinations;
- jurisdictions should remove barriers to reporting to trade repositories by market participants and to access to trade repository data by authorities; and
- there should be appropriate transitional measures and a reasonable but limited transition period for foreign entities to implement OTC derivatives reforms.[6]

In their previous April report, the ODRG agreed on principles with respect to conflicting and inconsistent implementation, which are outlined below.

ADDRESSING CONFLICTING IMPLEMENTATION

The ODRG recognised that:

- national authorities have ultimate responsibility and authority to protect against all sources of risk to their markets; and
- statutory and regulatory requirements of each jurisdiction are core components of each respective market.

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5 OTC Derivatives Regulators Group — Report to the G20 meeting of Finance Ministers and Central Bank Governors, 16 April, 2013, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/odrgreport.pdf.

6 OTC Derivatives Regulators Group -Report on agreed understandings to resolving cross-border conflicts, inconsistencies, gaps and duplicative requirements, 30 August, 2013, available at http://www.cftc.gov/PressRoom/PressReleases/pr6678-13.

Legal systems and market conditions differ among jurisdictions and due account should be taken of such differences in determining the cross-border application of laws and regulations.

Treatment of regulatory gaps and substituted compliance

The ODRG agreed that substituted compliance, equivalence or recognition would not solve the problem of gaps between the rules of different jurisdictions. For example, a gap would be deemed to occur when:

- a category of counterparties or products are exempt ex ante from central clearing or trading obligations in one jurisdiction but not in another; and
- a product is subject to a central clearing or trading obligation in one jurisdiction but not in another.

In such cases, the group agreed to take a 'stricter rule applies' approach. Under this approach the rules in the jurisdiction that would apply the requirement would prevail. In other words, exemptions would not be imported.

EC AND CFTC AGREEMENT ON CROSS-BORDER REGULATION

On 11 July 2013, the Commodity Futures Trading Commission (CFTC) and the European Commission (EC) announced a path forward regarding their joint understandings on a package of measures for how to approach cross-border derivatives.[7]

The two agencies acknowledged that, notwithstanding the high degree of similarity that already exists between the respective requirements, without coordination, subjecting the global market to the simultaneous application of each other's requirements could lead to conflicts of law, inconsistencies, and legal uncertainty.

CFTC FINAL GUIDANCE AND SUBSTITUTED COMPLIANCE DETERMINATION

On 12 July 2013, the CFTC approved its final interpretive guidance and policy statement regarding the cross-border application of certain swaps provisions, and granted a further exemption from complying with certain requirements for swap dealers or major swap participants established in six jurisdictions, including Australia, out to 21 December 2013 or 30 days following a substituted compliance determination, whichever comes first.[8]

On 20 December 2013 the CFTC announced the outcome of its substituted compliance assessment of six jurisdictions, including Australia, with respect to their regulation of swap dealers and major swap participants. The CFTC determined that Australian swap dealers subject to APRA and ASIC's regulatory regimes can rely on substituted compliance in respect of a number of 'entity-level' requirements under the CFTC's regime.

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7 The European Commission and the CFTC reach a Common Path Forward on Derivatives, 11 July, 2013, available at http://www.cftc.gov/PressRoom/PressReleases/pr6640-13.

8 Exemptive Order Regarding Compliance with Certain Swap Regulations, 16 July, 2013, available at, http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister071213.pdf.

No substituted compliance determination was made by the CFTC in respect of 'transaction-level' requirements, which include mandatory clearing, portfolio reconciliation and compression, and swap relationship documentation. As the Australian Government implements further G20 commitments (such as mandatory clearing requirements), there may be future opportunities to seek additional substituted compliance determinations for some of these requirements.

The CFTC has not concluded substituted compliance assessments of foreign regulatory frameworks with respect to trade reporting and has provided transitional relief from certain trade reporting requirements until 1 December 2014 while it continues to conduct these assessments.

An earlier CFTC regulation governing exemption from the central clearing obligation for certain inter-affiliate swaps extended relief to affiliates in the EU, Japan and Singapore, but not Australia.[9] These jurisdictions were exempted because the CFTC considered that they had 'adopted swap clearing regimes and are currently in the process of implementation'.[10]

ESMA RULES ON NON-EU COUNTERPARTIES DEALING IN OTC DERIVATIVES

On 15 November 2013, the European Securities and Markets Authority (ESMA) finalised its regulatory technical standards (RTS) on the application of European Market Infrastructure Regulation (EMIR) to OTC derivative transactions between non-EU counterparties in certain cases.[11]

These RTS clarify the conditions where EMIR's provisions regarding central clearing or risk mitigation techniques would apply to OTC derivatives by two non-EU counterparties which have a direct, substantial and foreseeable effect in the EU. EMIR would only apply to transactions between two non-EU counterparties if their jurisdictions' rules are not considered equivalent to EMIR, and where one of the following conditions is met:

- one of the two non-EU counterparties to the OTC derivative contract is guaranteed by an EU financial for a total gross notional amount of at least €8 billion, and for an amount of at least 5 per cent of the OTC derivatives exposures of the EU financial guarantor; or
- the two non-EU counterparties execute their transactions via their EU branches and would qualify as financial counterparties if established in the EU.

The Final Report has been submitted to the EC, which has three months to decide whether to endorse the draft RTS.

9 CFTC Approves Final Regulations Governing Exemption from Required Clearing for Inter-Affiliate Swaps, 1 April, 2013, available at, http://www.cftc.gov/PressRoom/PressReleases/pr6553-13.

10 Federal Register, Vol. 78 Thursday, No. 70 April 11, 2013, available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-07970a.pdf.

11 Final Report — Draft technical standards under EMIR on contracts having a direct, substantial and foreseeable effect within the Union and non-evasion of provisions of EMIR, 15 November 2013, available at: http://www.esma.europa.eu/system/files/2013-1657_final_report_on_emir_application_to_third_country_entities_and_non-evasion.pdf.

ESMA ADVICE ON SUFFICIENT EQUIVALENCE OF THE AUSTRALIAN REGULATORY REGIME

Central clearing

ESMA recently published its advice to the EC on its comparison of the Australian regulatory regime with EMIR.[12] The EC is considering whether to adopt implementing Acts in line with ESMA's advice. With respect to central clearing, ESMA recommended that the Australian rules for mandatory central clearing be found equivalent to those under EMIR, if the product is subject to a mandatory central clearing obligation in Australia and the counterparty is not exempt from the obligation. Provided ESMA's advice is implemented, this will mean that any Australian counterparties that are subject to the mandatory central clearing obligation in Australia can comply with EMIR (if they need to do so) by complying with the Australian rules.

Mandatory central clearing has not come into force yet in the EU. ESMA is currently processing authorisation applications by CCPs. It will also have to formulate RTS setting out the detailed implementation process, including timelines, for specific classes of derivatives, which will be subject to endorsement by the EC. The mandatory central clearing obligation is currently expected to come into force sometime in the second half of 2014.[13]

CCP regulation

ESMA's advice further recommended that the Australian regime for CCPs be assessed as equivalent to that under EMIR. A positive determination of equivalence by the EC is one of the necessary conditions in order for Australian CCPs to provide (or to continue to provide in the case of ASX Clear (Futures)) clearing services to clearing participants established in the EU.

Trade reporting and trade repositories

ESMA also advised that the Australian regimes for trade reporting and Trade Repositories (TRs) were equivalent to that under EMIR. This would mean that market participants subject to reporting requirements in the EU and Australia would be able to satisfy all of these requirements by complying with their Australian obligation. It would also mean that any TRs established in Australia in the future would be able to gain recognition in the EU.

Risk management

ESMA advised that the Australian regime with respect to the risk management obligations applying to non-centrally cleared OTC derivatives was not fully equivalent to that of the EU. Discussions in relation to this assessment are ongoing.

12 For details see: http://www.esma.europa.eu/news/ESMA-delivers-second-set-advice-EMIR-equivalence?t=326&o=home.

13 For details see: http://www.esma.europa.eu/page/European-Market-Infrastructure-Regulation-EMIR.

5. CORE PROPOSAL — MANDATORY CENTRAL CLEARING OF G4-IRD

This section seeks stakeholder views on a Ministerial determination under the legislative framework and related regulations. This determination would allow for ASIC to make rules requiring central clearing of G4-IRD by Australian dealers with significant cross-border activity in G4-IRD (G4 Dealers).

5.1 PROBLEM

Improving the transparency and resilience of OTC derivative markets is one of the four key workstreams on the G20 financial regulation agenda.[14]

The global financial crisis exposed failures in the supervision of derivatives markets. Large volumes of outstanding bilateral transactions had created a complex and deeply interdependent network of exposures that ultimately contributed to a build-up of systemic risk. The stresses of the crisis exposed a number of risks:

- insufficient transparency regarding counterparty exposures;
- inadequate collateralisation practices;
- cumbersome operational processes;
- uncoordinated default management; and
- market misconduct concerns.

In response, the G20 Leaders agreed to reform OTC derivatives markets with the objectives of improving transparency, mitigating systemic risk, and protecting against market abuse.

The G20 has agreed rules requiring OTC derivatives to be traded on exchanges or electronic platforms where appropriate, cleared through central counterparties, for transactions to be reported to trade repositories, and applying higher capital requirements to bilateral derivative contracts.

5.2 OBJECTIVES

Australia has sought to implement the G20 financial regulation workstream in a way that:

- best targets the goals of improved transparency and financial system stability;
- encourages global adoption, so that Australian businesses benefit from consistent global regulation;

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14 The others being:
- strengthening the resilience of financial institutions (including through stronger capital and liquidity buffers and better incentives for risk management);
- addressing the problem of 'too big to fail' (especially through improved arrangements to ensure institutions can be resolved with minimal disruption to the broader financial system); and
- enhancing the regulation and oversight of the shadow banking sector.

- causes the least possible disruption to existing Australian markets practices; and
- leaves room for industry-led initiatives and market forces to encourage adoption.

However, conflicting and inconsistent global implementation has also required that Australia consider small changes to Australian law that can assist Australian businesses to access global markets, while remaining primarily regulated in Australia.

5.3 Impact

Benefits of an Australian mandate on central clearing of G4-IRD

Clearing of OTC derivatives through a CCP reduces counterparty risk through multilateral netting of transactions and mutualisation of losses through a default fund.

Stakeholders have pointed to a number of benefits.

- Many stakeholders see economic value in improved financial stability that can be achieved through the widespread use of central clearing as well as reduced risks and uncertainty for their own business.
- Liquidity in OTC derivatives markets is moving to centrally cleared trades. In practice this has meant that many derivatives contracts are being offered on better commercial terms for centrally cleared trades than for non-centrally cleared trades.
- Under the Basel III reforms introduced by APRA in January 2013, an authorised deposit-taking institution's (ADI's) exposure to trades centrally cleared through a Qualifying CCP (as defined by the BIS) is subject to lower risk weights than in the case of non-centrally cleared trade exposure. This reduces the comparative cost of centrally clearing trades.
- Comparative costs of central clearing have also been reduced through increasing requirements for initial and variation margining of uncleared trades, which have come about in response to requirements for margining and improved industry bilateral risk management practices. It is anticipated that these requirements will continue to increase.

An important consideration for stakeholders has been the international context of an Australian decision to mandate central clearing.

As was noted in the First Proposals Paper, fulfilling Australia's obligations in a globally coordinated way will help to ensure that global markets remain open to Australian business.[15] Companies wishing to purchase or sell a derivative contract will benefit from reduced market impact costs to trading[16] and extra liquidity, which allows them to trade when they wish to trade. This benefits the economy as a whole.

15 Implementation of Australia's G20 over-the-counter derivatives commitments, December 2013, available at http://financialmarkets.tspace.gov.au/implementationG20/.

16 Market impact is the adverse price movement that can occur when a trade is executed; larger, more liquid markets have lower market impact costs.

Participating in global derivatives markets also allows companies to better tailor their derivatives to their risks. This is of value to Australian companies and the economy as a whole.

Global implementation of the G20 commitments also ensures that Australian businesses, investors and corporations have the benefit of improved risk management practices and transparency when they participate in international markets.

Comparability Assessments

The CFTC and European authorities have commenced a process of assessing the comparability or equivalence of the Australian regulatory regime for OTC derivatives, with a number of assessments already completed. Under certain circumstances, positive assessments will allow Australian participants to choose to comply with Australia's domestic regulatory regime instead of the CFTC's or EMIR rules. This will lower the cost of compliance.

The value of substituted compliance to Australian businesses can take a number of forms.

- On balance, it is deregulatory. It allows businesses to avoid the heavy burden of adhering to multiple and often conflicting requirements, for example, employing legal counsel and government liaison representatives around the world to monitor and respond to rules that are covered by similar provisions in Australia.
  - The CFTC's recent decision to grant substituted compliance for its entity-level requirements is an example of such a scenario allowing the main Australian banks registered as swap dealers in the US to avoid the additional costs of complying with the US OTC derivatives regulatory regime in a number of key aspects.
- In some cases a positive assessment is required for Australian businesses to continue to offer services in the US and EU. For example, clarification of Australia's regulatory regime for CCPs issued in August 2013 assisted ESMA's conclusion that this regulatory regime is equivalent, which is a necessary pre-condition for ASX to continue to offer clearing services to EU banks.[17]
- In many cases Australian businesses have reported benefits in the recognition of the Australian regime by overseas regulators and authorities, which can provide a simple means for counterparties to confirm that Australian banks meet their regulator's requirements.
- Five of the eight Asian region banks who have registered as swaps dealers in the US are Australian banks (ANZ, CBA, Macquarie, NAB and Westpac). This illustrates the importance of the US market for Australian banks, and also the fact that they may be the main beneficiaries in this region of the CFTC's substituted compliance determination which only applies to registered swaps dealers.

Recently, following the implementation of trade reporting requirements in Australia, ESMA has recommended to the EC that the Australian trade reporting regime be considered equivalent with EU

17 ASX letter, 'RBA interpretation of Financial Stability Standards applies "Cover 2" to ASX Clear (Futures)', 16 August 2013 (http://www.asxgroup.com.au/media/PDFs/RBA_interpretation_of_FSS_applies_to_Cover_2.pdf).

law. This means that Australian businesses face the lowest possible regulatory barriers when dealing in European markets in relation to trade reporting.[18]

Shaping obligations to reflect Australian priorities

A domestic central clearing mandate tailored to the Australian context may mitigate the risk of unintended consequences for Australian participants from foreign regulation.

Where Australian participants are directly subject to overseas regulators' requirements differences in market structure and conditions will result in conflicts of law, inconsistencies, and legal uncertainty for Australian entities. It will be difficult for foreign regulators to foresee or mitigate these problems.

Mandating central clearing of derivatives in Australia allows us to shape obligations to reflect our priorities:

- reflecting the Australian legal system;
- reflecting existing Australian business practices and industry-led solutions; and
- targeting Australian goals of increased transparency and reduced systemic risk.

It is hoped that, in implementing the 'stricter rule applies' approach, overseas jurisdictions will recognise and take into account differences in institutional characteristics and structures across jurisdictions.

Costs of an Australian mandate on central clearing of G4-IRD

Stakeholders have also raised concern that central clearing of OTC derivatives can result in considerable costs. The main costs that have been identified are detailed below.

- Significant changes to market practices and legal arrangements will be required, which will result in costs and burdens, such as:
  - renegotiating contractual arrangements to reflect that risk management will be handled by the CCP rather than bilaterally by the two counterparties to the OTC derivative contract; and
  - administrative and legal changes to contracts to reflect the requirements of CCPs.
- Posting initial margin to CCPs will increase many market participants' collateral needs above levels that are characterised by current bilateral arrangements, particularly where these do not currently require exposures to be collateralised.
  - It is, however, noted that there is an international program under way which will impose collateralisation requirements on non-centrally cleared trades.

18 European Securities and Markets Authority (ESMA) Final report Technical advice on third country regulatory equivalence under EMIR — Australia (http://www.esma.europa.eu/content/ESMA-Technical-advice-equivalence-Australia-OTC-and-TR-Supplement).

- The CCP requirement that participants exchange variation margin introduces liquidity risk, which end-users may have difficulty managing, particularly as currently many end-users are not required to exchange variation margin on bilateral trades. To manage this liquidity risk end-users are likely to be forced to hold more liquid assets that generate lower returns.

- Market participants who join CCPs as direct members are obligated to make a contribution to pooled risk resources, as well as hold capital against their trades and any contingent obligations to the CCP and pay fees to clear trades.

- The capital treatment of exposures to CCP default funds has also emerged as a concern for many banks. In some instances the treatment of these exposures could push up the relative costs of centrally clearing.

- As CCPs tend to focus on a selection of derivatives products, central clearing can lead to increases in some counterparty exposures, particularly where previously offsetting bilateral exposures in different products are 'un-netted'. This could be exacerbated if the various centrally cleared components of a participant's portfolio are cleared through different CCPs.

- While a CCP may pay interest on any collateral held, such interest when paid to a non-resident may be subject to interest withholding tax. Stakeholders have raised concerns that the imposition of withholding tax can add to the cost of central clearing.

Feedback sought

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

We request that, in commenting, you quantify compliance costs as far as possible, including whether costs are likely to change over time, are transitional or projected ongoing costs. For example, costs may include:

- legal costs;
- staff cost — for example number of staff hours and training costs;
- IT costs; and/or
- increased costs of managing risks or funding projects.

Please separate additional costs that would come about as a result of this proposal, as well as other regulatory costs that could be mitigated if you are able to comply with Australian regulation rather than many different countries' regulations.

To assist this analysis it would be useful to know whether your trades, and/or those of your clients, are becoming subject to central clearing obligation from other countries and whether your counterparties prefer central clearing of trades.

5.4 PROPOSAL AND ANALYSIS

It is proposed that a determination be made in the second quarter of 2014 that will allow ASIC to make rules requiring the central clearing of G4-IRD by G4 Dealers.

5.4.1 Products subject to the determination

Commercial and regulatory developments in G4-IRD have resulted in liquidity moving to centrally cleared trades. Stakeholders have said that, in these instances, not only should there be limited regulatory impact from mandatory central clearing, but opportunities for substituted compliance can provide significant benefits.

It is expected that the net effect will be a significant reduction in the regulatory burden as well as improved business opportunities for Australian banks. Australian banks have submitted that:

> *Given the scope of our international operations, we may be subject to reporting, clearing and ultimately trade execution requirements imposed by other jurisdictions, such as the EU, in order to implement their G20 commitments …*
>
> *In that context, we believe that one of the key objectives of the Australian government and agencies in implementing Australia's G20 commitments should be to ensure international co-ordination, in order to minimise regulatory duplication and overlapping regulatory requirements.*[19]

The transition to central clearing of G4-IRD between dealers has accelerated. Australian banks' notional principal outstanding of IRDs cleared at one of the international clearing houses, LCH.C Ltd, which includes these products, had increased to US$1.4 trillion by November 2013.[20]

Dealers operating in the Australian market have reported that most new transactions in G4-IRD are centrally cleared, especially interdealer transactions entered into with overseas-headquartered banks, many of which are either already, or expect soon to be, subject to central clearing mandates in place overseas.

These obligations are reflected in Chart 1, which shows that nearly all G4-Derivatives transactions by Australian banks are with foreign counterparties. These transactions are increasingly subject to foreign central clearing obligations.

In addition, increasing numbers of transactions amongst Australian banks will also need to be centrally cleared. This is because:

- foreign regulators require central clearing; and
- there are reduced commercial opportunities to trade without centrally clearing.

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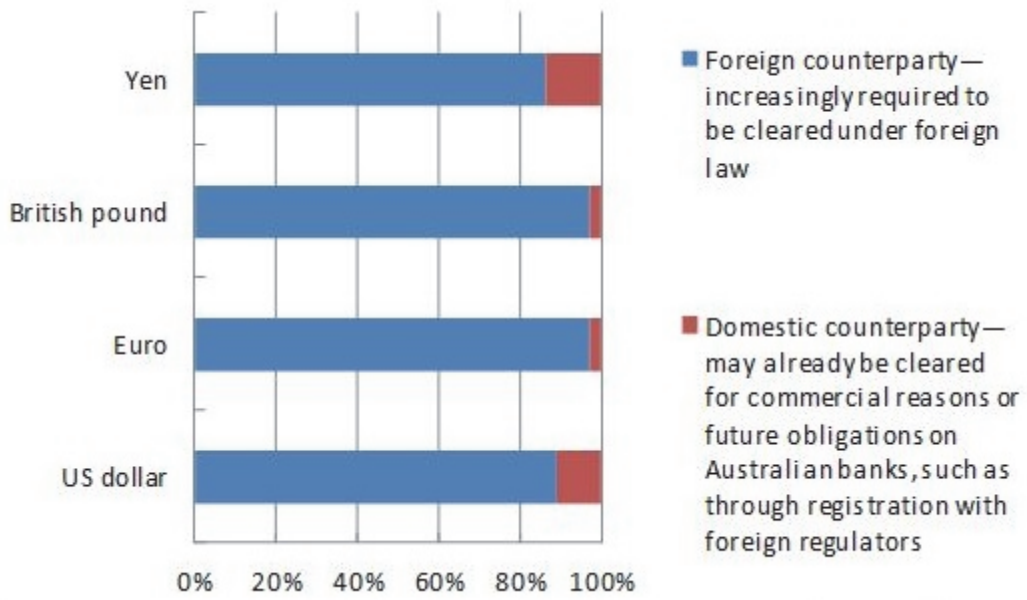
19 ANZ, CBA, Macquarie Bank Limited, NAB, Westpac, *Comments on Australian Treasury's December 2012 Consultation Paper on Implementation of Australia's G20 over-the counter derivatives commitments ('Consultation Paper')* available at http://financialmarkets.tspace.gov.au/implementationg20/submissions/.

20 Information supplied by LCH.C Ltd

Chart 1: Current counterparties to Australian banks(a)



(a) Taken from the Report on the Australian OTC Derivatives Market, July 2013, Australian Prudential Regulation Authority, Australian Securities and Investments Commission and Reserve Bank of Australia (http://www.cfr.gov.au/publications/cfr-publications/2013/report-on-the-australian-otc-derivatives-market-july/pdf/report.pdf).

Feedback sought

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 of coverage? For example, including only USD IRDs or alternately including all IRDs.

5.4.2 Definition of G4 Dealers

The Report recommends that the central clearing obligation should apply to dealers with significant cross-border activity in G4-IRD (G4 Dealers). The regulators have considered options for identifying G4 Dealers. Further detail is at Appendix A.

It is proposed that entities subject to mandatory central clearing would be financial entities who have reached a certain threshold of activity. There are several possibilities for determining how the threshold should be calculated. For example, one possibility would be to align the threshold with that for phase 2 of the trade reporting obligation prescribed in ASIC's trade reporting DTRs regime, being $50 billion or more notional OTC derivatives outstanding held by a financial entity as at an agreed date. Another possibility would be to calculate the threshold based on notional OTC IRDs outstanding. The threshold would be calculated on a legal entity basis, so only the outstanding OTC derivatives entered into by the legal entity would be counted (and would not include outstandings of related entities).

In addition, for the avoidance of doubt, it is the intention that public entities such as central banks, debt offices, supra-national multilateral development banks and entities such as the International Monetary Fund (IMF) would be out of scope of any future central clearing rules.

5.4.3 Exemptions of intragroup trades

The EU and US have both introduced an exemption from the central clearing obligation for intra-group transactions. This is to avoid introducing any requirement to centrally clear derivatives transactions that are not transferring any risk into or out of a single corporate group.

It is proposed that intragroup trades would be exempted from central clearing requirements, subject to appropriate conditions (such as notification requirements).

5.4.4 Comparison with other jurisdictions

Japan

Japan began requiring mandatory central clearing in November 2012, beginning with Japanese index-based credit default swap (CDS) indices referencing Japanese underliers (that is the iTraxx Japan Index Series) and plain-vanilla JPY-denominated interest rate swaps referencing LIBOR.[21]

Mandatory central clearing requirements initially apply to transactions between large domestic financial institutions registered under the Financial Instruments Exchange Act (FIEA) that are members of the CCP, Japan Securities Clearing Corporation (JSCC).

Hong Kong

In Hong Kong, the Hong Kong Monetary Authority (HKMA) and Securities and Futures Commission (SFC) have proposed broadly that Hong Kong entities that are counterparty to a central clearing eligible transaction be required to clear this transaction through a designated CCP if both they and their counterparty have exceeded a specified threshold (clearing threshold) and their counterparty is not exempted from the central clearing obligation.[22]

The Hong Kong regulators have stated they are prepared to consider extending these exemptions in respect of transactions with certain public sector entities, as well as to non-financial entities using OTC derivatives for commercial hedging purposes, intra-group transactions and transactions involving jurisdictions that have a material level of foreign exchange control, and/or other local regulatory restrictions that make it impractical to require central clearing to take place in any jurisdiction other than its own jurisdiction.

European Union

In the EU, EMIR requires transactions be centrally cleared where they involve financial counterparties or non-financial counterparties that exceed a specified central clearing threshold (which has been set at EUR 1 billion in gross notional value for OTC credit and equity derivatives, and EUR 3 billion in gross notional value for OTC interest rate, foreign exchange and commodity derivatives).

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21 Financial Stability Board, *'OTC Derivatives Market Reforms — Fifth Progress Report on Implementation'*, 15 April 2013, http://www.financialstabilityboard.org/publications/r_130415.pdf.

22 Hong Kong Monetary Authority and Securities and Futures Commission, *'Joint consultation conclusions on the proposed regulatory regime for the over-the-counter derivatives market in Hong Kong',* July 2012, http://www.sfc.hk/web/doc/EN/speeches/consult/Conclusions_Paper_120711_final.pdf.

Transactions involving central banks and other public bodies charged with or intervening in the management of public debt can be exempted by way of a delegated act. The current exemption only relates to the US and Japan, but the EC has been asked to consider including Australia. Certain intragroup transactions are also exempted from a central clearing obligation, as well as transactions by non-financial counterparties that are objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity of the counterparty.

The United States

In the US, the CFTC adopted its first mandatory central clearing determination in December 2012 and requires four classes of interest rate swaps and two classes of CDS be cleared. Compliance will be phased in by type of market participant entering into a swap subject to the central clearing requirement, and the first phase commenced on 11 March 2013. Under Dodd-Frank and CFTC rules, an exemption from the central clearing obligation is available for non-financial entities and small financial institutions (those with total assets of $US 10 billion or less) where the relevant swaps are being used to hedge or mitigate commercial risk.

An exemption from the central clearing obligation is also available for transactions between certain affiliated entities. In June 2012, the SEC adopted rules regarding processes for determining whether specific derivatives contracts will be subject to mandatory central clearing requirements. The SEC has similar powers under Dodd-Frank to provide exemptions from central clearing obligations to certain entities, but has not yet finalised the rules that would determine which exemptions would be available.

Feedback sought

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.

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 the more appropriate basis for calculating the threshold? Or would you prefer a different methodology and if so, why?

5.5 Implementation and Review

Timetable for implementation

Stakeholders have expressed concern that they will need sufficient time to conduct due diligence on any new CCPs and put in place the necessary operational systems, processes and legal documentation in order to connect to CCPs. Accordingly, it is proposed that there would be a period of time after the determination is made in respect to G4-IRD before central clearing would become mandatory through ASIC rule making.

Consultation would also be expected to take place with regulatory authorities outside Australia regarding the mandatory central clearing rules proposed to be adopted in accordance with

international agreements and to ensure appropriate harmonisation in the process of implementing mandatory central clearing requirements.

This period would provide market participants the opportunity to prepare to centrally clear transactions without disruption to their use of derivatives for hedging or the risk of noncompliance with the law.

Taking these matters into account, the proposed timetable for giving legal effect to the above proposals is as follows:

- Second Quarter 2014 — The Government would expose for comment a draft Ministerial determination relating to G4-IRD, with relevant accompanying regulations restricting ASIC rule-making.
- Second Quarter 2014 — it is currently expected that, in parallel, ASIC would consult on rules relating to the details of the central clearing obligations.
- Late 2014 - central clearing rules completed.
- Early 2015 — central clearing obligations would commence.

Feedback sought

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?

5.6 Licencing and prescription of CCPs

A key consideration in implementing a mandatory central clearing requirement is the availability of central clearing of that product for different types of Australian market participants, whether as direct participants or as clients.

Prior to any entity being subject to a central clearing mandate it will be necessary to establish that CCPs have appropriate arrangements in place to offer services.

In February 2013, ASIC and the Reserve Bank released a joint statement explaining how the two regulators are implementing the Principles for Financial Market Infrastructures (PFMIs) in Australia (the Statement).[23]

Under the Act, ASIC can only make central clearing rules requiring central clearing through either a licenced or prescribed CCP.

The Government will consider prescribing CCPs to ensure Australian market participants have appropriate access to CCPs. One circumstance in which the Government would consider prescribing a

23 Implementing the CPSS–IOSCO Principles for financial market infrastructures in Australia, February 2013, available at http://www.asic.gov.au/asic/asic.nsf/byheadline/Implementing-the-CPSS%E2%80%93IOSCO-Principles-for-financial-market-infrastructures-in-Australia?openDocument.

CCP would be in order to preserve domestic participants' access to clearing through an overseas CCP that is making available services to Australian entities but has been judged to be not operating in Australia and therefore is not required to have an Australian CS facility licence.[24]

Feedback sought

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?

24 Note that prescribed CCPs would still need to be licensed if they are judged to be operating in Australia. ASIC has set out the factors it considers when assessing whether a CCP is operating in Australia in its Regulatory Guide 211. Available at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg211-published-18-december-2012.pdf/$file/rg211-published-18-december-2012.pdf.

6. OTHER FEEDBACK

6.1 MANDATORY CENTRAL CLEARING OF OTHER PRODUCTS

Central clearing of AUD -IRD

There is an emerging case for mandating central clearing of AUD-IRD.

Industry take-up of central clearing had, until recently, been limited by the lack of availability of direct central clearing for domestic market participants. However two CCPs have received regulatory approval in July 2013 to offer clearing of AUD-IRD directly to Australian participants.

A number of Australian participants have now established operational arrangements to clear transactions as direct clearing members of these CCPs. Clearing arrangements for non-dealer financial institutions and other smaller users of OTC derivatives remain relatively limited at this stage.

APRA, ASIC and the Reserve Bank will conduct a further market assessment in 2014. This will review the case for mandating central clearing of AUD-IRD. To gauge the regulatory impact of such a mandate, the regulators will examine the extent to which domestic participants have established direct clearing arrangements with the two CCPs that have been granted regulatory approval to provide these services.

Central clearing of other derivatives

The regulators will also seek further information about Australian market participants' counterparty exposures in North American and European referenced CDS and the breadth of central clearing of these products. In light of this information, the regulators will review the case for a domestic mandate.

Indirect effects of regulation

Some stakeholders have raised concern that, despite not being subject to direct obligations, the indirect effects of global regulation have significantly increased the costs and complexity of managing their business's risks. These costs are expected to rise as take-up of central clearing by major participants increases.

The regulators are undertaking further work to understand derivatives use by businesses other than the G4-Dealers. This will help to inform the regulators and the Government of the indirect effects of derivatives regulation on these businesses. This analysis will also consider incremental costs and benefits of extending a central clearing mandate to some businesses other than the G4-Dealers at some stage in the future.

Understanding the indirect effects of a clearing mandate on end-users will be a very important precondition prior to any decision to mandate the central clearing of AUD-IRD in particular.

Preliminary views sought

Some stakeholders have raised that there would be benefit to the market from the Government providing a timetable for implementation of AUD-IRD and other derivatives. This would assist market participants and service providers to prepare for the transition to mandatory central clearing.

In order to assist the Government to provide direction as early as possible following any future recommendations from the regulator, this paper seeks preliminary views on the benefits and costs of the mandatory clearing of other derivatives as well as an indicative timetable for implementing these.

This feedback will be used in order to best tailor any future consultation.

Feedback sought

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?

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?

6.2 Mandatory platform trading

For trading platforms it is proposed that no decision be taken on any mandatory requirements until subsequent reviews by the regulators.

The regulators did not make a recommendation regarding a mandatory platform trading obligations in the Report. The regulators will continue to monitor developments in other jurisdictions and seek more detailed information on activity in the Australian market, to more clearly define the characteristics of suitable trading platforms.

The Government is reviewing the licensing arrangements for financial markets. This review will consider whether the framework is adequate to deal with the derivatives trading platforms that would be suitable for mandatory trade execution. As part of this review, the Government is considering the impact of potential foreign registration requirements for Australian markets.

Feedback sought

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

6.3 END-USER EXEMPTION FROM TRADE REPORTING

Permanent exemption of end-users from trade reporting

Regulations exempting end-users from trade reporting are scheduled to expire at the end of 2014.

It is proposed that, rather than being allowed to expire, the end-user exemption from trade reporting be made permanent. This is in order to give certainty to stakeholders and to focus trade reporting implementation on the major market participants in Australia.

The exemption may need to be narrowed to ensure that appropriate information on systemically important OTC derivatives trading is available to regulators. Details of the exemption will be consulted upon following the analysis by ASIC of derivatives use in the Australian market, currently underway. The regulators will also consider the impact of reporting of systemically important OTC derivatives transactions on global efforts to coordinate the reporting framework.

A more tightly targeted AFSL reference in the regulations

Stakeholders who hold an Australian financial services license (AFSL) with authorisations limited to commodity derivatives have also raised concern that the exemption, as it currently stands, could create an obligation with respect to derivatives not covered by their AFSL.

It is proposed that the regulation be amended so that obligations would only be imposed on AFSL holders with respect to derivatives authorised under their AFSL. So for example, if an entity holds an AFSL with authorisation only for electricity derivatives, ASIC could not make rules requiring reporting of AUD-IRD trades by that entity.

Aside from this change, the application of trade reporting rules to other AFSL holders would remain a decision for ASIC, as is currently the case.

Feedback sought

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?

7. NEXT STEPS

Following this consultation, and subject to stakeholder feedback, the Minister will make a determination identifying derivatives that will be subject to the central clearing mandate. The Minister will also expose for comment draft regulations clarifying the scope of ASIC rule making under the framework as appropriate.

The regulators will conduct a third market assessment in 2014. The Government will consider any further recommendations following that assessment.

The regulators are also continuing to monitor developments in participants' risk management practices for non-centrally cleared trades.

8. FEEDBACK SOUGHT

In commenting on the consultation questions below, you are encouraged to read the proposals in conjunction with the *Report on the Australian OTC Derivatives Market*, by APRA, ASIC and the Reserve Bank, published in July 2013 and available at this web address http://www.cfr.gov.au/media-releases/2013/mr-13-03.html.

Feedback questions		Page
1.	Do you have comments on the benefits and costs of complying with a mandatory central clearing obligation, from the point of view of your business and/or that of your customers? We request that, in commenting, you quantify compliance costs as far as possible, including whether costs are likely to change over time, are transitional or projected ongoing costs. For example, costs may include: • legal costs; • staff cost — for example number of staff hours and training costs; • IT costs; and/or • increased costs of managing risks or funding projects. Please separate additional costs that would come about as a result of this proposal, as well as other regulatory costs that could be mitigated if you are able to comply with Australian regulation rather than many different countries' regulations. To assist this analysis it would be useful to know whether your trades, and/or those of your clients, are becoming subject to central clearing obligation from other countries and whether your counterparties prefer central clearing of trades.	17
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 of coverage? For example, including only USD IRDs or alternately including all IRDs.	19
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.	21

APPENDIX A –FIRMS POTENTIALLY SUBJECT TO AN AUSTRALIAN G4-IRD CENTRAL CLEARING MANDATE

As noted in the Proposals Paper, the recommendation made by the regulators in the Report is that the Government should consider a central clearing mandate for G4-IRD, with an initial focus on dealers with significant cross-border activity in these products. The Proposals Paper further suggests that a threshold be used to limit the scope of the clearing mandate to such entities, and mentions some possible methodologies for calculating the threshold.

One possibility is to use gross notional OTC derivatives positions outstanding to determine which entities will be included in ASIC rule making. This is the measure used in the trade reporting DTRs, where a financial entity[25] will be included in the Phase 2 reporting obligation if it holds $50 billion or more notional OTC derivatives outstanding as at 31 December 2013. It is also a measure used in other jurisdictions (though with differing thresholds) such as the EU and the US for similar purposes.

An alternative approach would be to calculate the threshold based on notional outstanding IRD. The threshold may then need to be adjusted down given that notional IRD is only a subset of all OTC derivatives outstanding.

It is proposed that only Australian financial entities and Australian branches of foreign financial entities at or above the threshold would be within scope. Financial entities would be defined in the same way as under the reporting DTRs, and would include ADIs, AFSLs and wholesale foreign exempt financial services providers. Where a foreign entity is included through its Australian branch coming within one of these categories, the threshold would only include transactions entered into in Australia or booked to the profit and loss account of the branch in Australia. Where a G4 Dealer falls below the threshold in the future, the central clearing obligation would no longer apply.

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25 In the trade reporting DTRs, a financial entity was relevantly considered to include Australian and Foreign ADIs, AFSLs and Exempt Foreign Licensees (foreign firms providing services to wholesale clients and acting under an exemption from the requirements to hold an AFSL).

Table 1 provides an indicative list of entities that are primarily being considered for inclusion in ASIC rule-making. The table also provides information on those firms that are already registered as Swap Dealers with the CFTC and whether they may be subject to clearing obligations under EMIR (noting that the detailed rules on the application of this obligation are yet to be finalised).

Table 1: Indicative list[26] of firms subject to future central clearing requirements under the proposals in this paper

Proposed to be included in the Australian G4 Dealer definition	Registered as a Swap Dealer with the CFTC	Subject to clearing requirements under EMIR[27]
Australia and New Zealand Banking Group Limited	Yes	Yes
Bank of America N.A.	Yes	Yes
Commonwealth Bank of Australia	Yes	Yes
Citibank N.A	Yes	Yes
Deutsche Bank AG	Yes	Yes
JPMorgan Chase Bank — London	Yes	Yes
Lloyds Bank PLC Australia	Yes	Yes
Macquarie Bank Ltd	Yes	Yes
National Australia Bank Limited	Yes	Yes
Royal Bank of Scotland PLC	Yes	Yes
Westpac Banking Corporation	Yes	Yes

26 Please note — not all firms identified are included, the total number of firms identified is 13.

27 Indicative answers based on information currently available, noting that important technical rules on how the clearing obligation under EMIR will apply have not been finalised yet.

GLOSSARY

The Act	*Corporations Act 2001*
ADI	Authorised Deposit-taking Institution
AFMA	Australian Financial Markets Association
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
AUD	Australian dollar
BIS	Bank for International Settlements
CCP	Central counterparty
CDS	Credit default swap
CFTC	Commodity Futures Trading Commission
EMIR	European Market Infrastructure Regulation
ESMA	European Securities and Markets Authority
EU	European Union
FIEA	Financial Instruments Exchange Act (Japan)
First Proposals Paper	Implementation of Australia's G20 over-the-counter derivatives commitments, December 2012
2012 Report	Report on the Australian OTC Derivatives Market, APRA, ASIC and RBA, October 2012
FSB	Financial Stability Board
FSB Report	The sixth FSB Progress Report, published in September 2013
G4-IRD	US dollar-, euro-, British pound- and yen-denominated interest rate derivatives
G4 Dealer	Australian entity with significant cross-border activity in G4- IRD, an indicative list is at Appendix A
G20	Group of Twenty
HKMA	Hong Kong Monetary Authority
IRD	Interest rate derivative
JSCC	Japan Securities Clearing Corporation
ODRG	OTC Derivatives Regulators Group
OTC	Over-the-counter
PFMIs	Principles for Financial Market Infrastructures

Proposals Paper	This paper
RTS	Regulatory Technical Standards
Report	Report on the Australian OTC Derivatives Market, July 2013
Reserve Bank	Reserve Bank of Australia
SEF	Swap execution facility
SFC	Securities And Futures Commission (Hong Kong)
Statement	Implementing the CPSS–IOSCO Principles for financial market infrastructures in Australia, February 2013
TR	Trade Repository
US	United States of America