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Banking and Capital Markets Regulation Unit  
Financial System and Services Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Submitted by email to: [financialmarkets@treasury.gov.au](mailto:financialmarkets@treasury.gov.au)

Yieldbroker welcomes the opportunity to comment on Treasury's Proposals Paper *Implementation for Australia's G-20 over-the-counter derivatives commitments*. Yieldbroker has a long history of working collaboratively and effectively with the regulators and is pleased to provide comment on what is a fundamentally important regulation for the Australian financial market.

We support an Australian Dollar (AUD) Interest Rate Derivative (IRD) clearing mandate and see it as a further critical step in the adoption of Australia's G-20 commitments.

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#### About Yieldbroker

Yieldbroker plays an important role in this market by operating the established electronic exchange for Australian Over-the-Counter (OTC) interest rate securities and derivatives. Founded in 1999 by leading banks in local debt markets, Yieldbroker holds an Australian Markets Licence and is regulated by the Australian Securities and Investments Commission (ASIC). Today, more than 100 major financial institutions, including 21 banks, access over 800 debt securities and interest rate derivatives on our exchange, trading approximately \$130 billion each month.

Yieldbroker has a long history of innovating to deliver new depth, transparency and efficiency to Australia's financial system. Yieldbroker is an integral part of the Australian financial market, providing price discovery and execution of OTC IRDs, which is the subject of this consultation paper and proposed clearing mandate. This includes AUD Interest Rate Swaps, Overnight Indexed Swaps and Forward Rate Agreements for the Interdealer market.

Our platform links into the LCH.Clearnet (LCH) and ASX Clear (Futures) clearing houses, providing straight through processing of OTC Derivatives for the market. We have witnessed first-hand the growth in clearing in the Australian market and are in constant daily dialogue with our participants to understand their needs and changing trading and clearing patterns.

Yieldbroker is directly affected by the G-20 OTC Derivatives reform, in particular the U.S. Dodd-Frank regulations, where we are currently operating under a no-action letter from the Commodity Futures Trading Commission (CFTC) with the current intent to move to a Swap Execution Facility (SEF) exemption in the near future. Yieldbroker plays a central role in this market and is well placed to provide comment to Treasury on its consultation paper.

## General Comments

AUD IRDs play a critical role to the financial market and wider Australian economy. In particular, the interest rate swap curve is an important benchmark for pricing and trading of virtually all interest-bearing financial products including corporate bonds, loans and, of critical importance, fixed and variable mortgages.

Yieldbroker is in favour of regulation that supports an “efficient, competitive and flexible financial system”, which is also the objective of the current Financial System Inquiry<sup>1</sup>. The goals of the reform should at a minimum achieve the following objectives:

- Foster a deep, liquid and transparent interest rate market;
- Support the competitiveness of Australia and Australian businesses;
- Improve the attractiveness of Australia as a place to do business and invest; and
- Ensure we maintain a fair, flexible and stable financial system by mitigating systemic risk and protecting against market imbalances.

Yieldbroker strongly believes that clearing assists the market in achieving these goals.

## Fostering Liquidity

Clearing fosters liquidity by removing bilateral counterparty credit risk and centralising it in a well-regulated, sufficiently collateralised and prudently risk managed entity. Central clearing plays a particularly important role in maintaining liquidity during times of financial stress when confidence amongst market participants can erode precipitously. A powerful example of this role was generated during the Lehman’s crisis, when the bilateral uncleared market essentially came to a standstill while the cleared LCH market continued to function.

The implementation of a clearing mandate will help inoculate Australian participants from any future crises of confidence.

The other major variable that influences liquidity is transparency. Transparency provides users with a clear indication of key market metrics to enable participants to make better and more informed trading decisions. While clearing has a role to play in providing centralised trade valuation and risk management services, centralised exchanges or electronic trading platforms provide the pre-trade transparency which drives liquidity.

Other benefits of electronic execution include:

- Improvements in efficiency through straight-through-processing to back-office and clearing and settlement systems;
- Comprehensive data capture and audit trails of the trading process which enhances compliance and regulatory oversight;
- More competitive pricing; and
- Reducing the incremental cost of trading through improved transactional efficiencies.

## Competitiveness of Australia and Australian businesses

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<sup>1</sup> Financial System Inquiry website, Terms of Reference, visited 25 July 2014 <<http://fsi.gov.au/terms-of-reference/>>

As a member of the G-20, Australia made a commitment to implement all three OTC Derivatives reform agenda items:

- Reporting of all OTC derivatives transactions to trade repositories;
- Clearing of all standardised OTC derivatives through central counterparties; and
- Execution of all standardised OTC derivatives on exchanges or electronic trading platforms.

With many of the G-20 member countries already making significant inroads into implementing all three of these reforms, it is important that Australia does not fall behind. Australian businesses already offer, or have plans to offer, services to offshore counterparties or offshore markets. Those jurisdictions require either direct registration or require proof of regulatory equivalence (substituted compliance).

Once Australian participants can point to Australian clearing mandates and other G-20 reform implementations, they will be better placed to demonstrate a satisfactory level of equivalence. Such an outcome would reduce the unnecessarily duplicative regulatory burden on participants and reduce costs which are passed on to the end user. It will also make it easier for Australian companies to compete against market heavyweights in what is a global market.

A competitive clearing landscape is vitally important to improving the competitiveness of Australia. A recently published report by Deloitte estimates that the additional cost for centrally cleared OTC derivative transactions as a result of the European Market Infrastructure Regulation (EMIR) directive will be €13.60 per €1 million notional amount traded<sup>2</sup>. Based on the AFMA AFMR 2013 report, Yieldbroker estimates that in 2013 approximately AUD \$15.5 trillion was traded which could currently be cleared by one or both of the clearing houses in operation in Australia<sup>3</sup>. Using the Deloitte estimates as a proxy for the costs incurred by Australian participants, at today's exchange rates the EMIR directive would add an additional AUD \$300 million in transaction costs to the market each year.

The same report estimates the additional costs for uncleared OTC derivative transactions to be €170.50 per €1 million notional traded, primarily due to increased capital charges for non-centrally cleared OTC derivatives as a result of Basel III. Therefore, the cost of not clearing will in most cases significantly outweigh the costs of clearing.

It is critical that Australia encourages a competitive environment and creates a regulatory environment that is conducive to accessing clearing services for Australian participants.

### Attractiveness of Australia

While the Australian market is sophisticated, it is important that Australia's position in the global financial markets is contextualised.

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<sup>2</sup> Deloitte, 2014, OTC Derivatives: The new cost of trading, visited 25 July 2014

<<https://www.deloitte.com/assets/Dcom-UnitedKingdom/Local%20Assets/Documents/Industries/Financial%20Services/uk-fs-OTC-Derivatives.pdf>>

<sup>3</sup> AFMA, Australian Financial Markets Report 2013, 2013

[Fixed AUD: Floating AUD + Floating AUD: Floating AUD + Floating AUD: Non-AUD + Overnight Index Swap + AUD Forward Rate Agreements – removing In-house Transactions]

The Australian OTC IRD market accounts for only 2.4% of the global OTC IRD turnover<sup>4</sup>, and AUD Exchange-Traded Interest Rate Futures account for only 3.7% of all global Interest Rate Futures turnover<sup>5</sup>.

There are distinct advantages for Australia's financial system and the broader economy associated with Australian governments, businesses and banks being able to interact seamlessly and efficiently with counterparties around the world while effectively managing risk.

Due to the size of the Australian market, it is imperative that Australia continues to be successful in attracting global banking participants in the locally-domiciled financial system. The need for participation by banks with a diversified risk exposure is highlighted by Yieldbroker's trading data. Only 9.8% of all fixed to floating interest rate swap trades executed on our market involve an Australian bank facing another Australian bank. This data demonstrates that there is a level of reluctance from Australian banks to trade with counterparties with similar risk profiles, driving a search for offshore counterparties.

A key pre-requisite to attracting global banks to Australia is a positive and clear regulatory environment which encourages best practice without imposing overly burdensome and costly compliance requirements. While we commend the staged and measured approach the regulators are taking to implementing the G-20 commitments, it is imperative that the regulators are clear that their intention is to implement all three pillars of the OTC Derivatives reform, including mandatory platform based trading of standardised instruments.

This is particularly critical during this period of structural market change when global counterparties are assessing and rationalising the locations where they intend to conduct business.

### Financial Stability

The Report makes mention that the availability of two CCPs has been a key determinant to push forward with a central clearing mandate for internationally active dealers. Yieldbroker concurs with this assessment. Competition is a critical element to a robust, mature and internationally competitive financial system. Competition improves the quality and variety of services offered to the market and increases the pace of invention and innovation and lowers prices.

As mentioned above, clearing improves financial stability by removing bilateral counterparty credit risk and centralising it in a well-regulated, sufficiently collateralised and prudently risk managed entity. The financial markets are in period of great structural change. Clearing plays an ever-increasing role in our markets. Yieldbroker therefore sees significant merit in regulators creating a clear, flexible and market-driven regulatory system that can adapt over time.

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Yieldbroker is encouraged by the regulators proposal to include AUD with the G4-IRD clearing mandate.

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<sup>4</sup> Bank of International Settlements, 2013, 2013 BIS Triennial Survey - Geographical distribution of global OTC interest rate derivatives market turnover, April 2013

<sup>5</sup> Comparison of 2012 World Federation of Exchanges survey for STIR and LTIR futures to ASX turnover data published on their website

Like clearing, regulatory and commercial incentives will be effective in transitioning the market to electronic trading. Yieldbroker is encouraged by the recent Council of Financial Regulators Report on the Australian OTC Derivatives Market which reports 60% of dealers are already transacting through electronic, hybrid or voice-brokered platforms<sup>6</sup>. This research shows that the market is moving towards electronic execution and that the incremental cost of a trading mandate for Australian dealers will continue to abate.

The market will benefit from a consistent regulation of these platforms. At present most platforms do not hold a full Australian Markets Licence and are operating under an exemption. A number of offshore jurisdictions have tightened their rules and requirements for exemptions. Australia should follow these precedents by implementing a more consistent licencing structure for exchanges and trading platforms. This will ensure that all entities are held up to the same high standard, which should include requirements for operating rules, surveillance systems, compliance functions and annual assessments. Yieldbroker encourages the regulators to continue with their reform of the Australian Market Licence regime which commenced in 2012, but was subsequently paused in light of other regulatory priorities.

Yieldbroker understands that other offshore jurisdictions, including the United States, are considering implementing a clearing mandate for AUD, which will likely be followed by a trading mandate.

Such a development could see a flow of AUD transactions migrating offshore because counterparties are forced to transact part of their business on a platform which is regulated by that jurisdiction. Australia must implement regulatory reform to maximise the prospects that AUD liquidity remains onshore and is regulated in our market.

Yieldbroker has, where applicable, summarised in the Appendix attached its response to the feedback questions raised in the Proposals Paper.

Yours sincerely,

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<sup>6</sup> Council of Financial Regulators, 2014, Report of the Australian OTC Derivatives Market, April 2014

## Appendix

### Feedback Sought

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

Yieldbroker response: Refer to the General Comments above.

### **In particular, do you agree that the additional compliance costs of complying with a central clearing mandate for AUD-IRD would be low for internationally active dealers?**

Yieldbroker response: Yieldbroker agrees with this as currently all trades on Yieldbroker's platform that can be cleared are cleared through either LCH or ASX. Any additional compliance costs should be minimal as most internationally active dealers are already compliant.

In addition, as noted above in reference to the Deloitte's report, the cost of not clearing will in most cases significantly outweigh the costs of clearing.

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

Yieldbroker response: N/A – No comment.

2. **With respect to benefits, do you have views on whether the imposition of a central clearing mandate for AUD-IRD would be likely to lead to substituted compliance benefits for dealers? If so, what would these benefits be, and would you be able to provide an estimate of the benefits or savings to your firm?**

- **If possible, please provide the same details as requested above with respect to the detailed breakdown of benefits and savings estimates.**

Yieldbroker response: As noted in General Comments above, once Australian participants can point to Australian clearing mandates and other G-20 reform implementations, they will be better placed to demonstrate a satisfactory level of equivalence. Such an outcome would reduce the unnecessarily duplicative regulatory burden on participants and reduce costs which are passed on to the end user. It will also make it easier for Australian companies to compete against market heavyweights in what is a global market.

3. **Could you please comment on the incremental costs and benefits of merging the timing and the determinations for G4-IRD and AUD-IRD?**

Yieldbroker response: Refer response to question 2 above.

**4. Do you agree with the proposal to limit ASIC rulemaking to entities that are considered to be dealers?**

Yieldbroker response: Yes. Initially limiting the clearing mandate to dealers will minimise the compliance costs involved (as many dealers are already compliant) and will ensure that only those participants with significant levels of trading in AUD-IRD are subject to the ASIC regime. It is important that ASIC make clear its long-term intentions to enhance regulatory certainty, which is an important element of maintaining and enhancing the attractiveness of Australia to offshore investors as a place to conduct business.

**5. What are your views on the two options presented above to define internationally active dealers? Do you have views on additional criteria that should be used, or do you think that one or more of the suggested criteria should not be used? Or would you prefer a different methodology and if so, which one and why?**

Yieldbroker response: N/A - No comment

**6. Do you have comments on a possible coordination of the AUD-IRD mandate with similar overseas requirements? If so, to which key overseas jurisdictions should an Australian mandate be linked?**

Yieldbroker response: As noted in General Comments above, Yieldbroker is directly affected by the G-20 OTC Derivatives reform, and in particular the U.S. Dodd-Frank regulations, where we are currently operating under a no-action letter from the CFTC with the current intent to move to a SEF exemption in the near future. In addition, given the U.S. is leading the implementation of the G20 OTC commitments, any AUD-IRD mandate should be coordinated with the U.S. Coordination with the European regulations would also be beneficial to participants, as a large percentage of the Australian Interest Rate Derivatives market is transacted out of Europe, specifically London.

**7. Do you have comments on the proposed timetable for implementing the central clearing obligation?**

Yieldbroker response: Yieldbroker considers the proposed timetable to be reasonable and achievable from a participant's perspective.