CME Group Inc. Submission Regarding the Australian Government's Consultation on the Proposed Resolution Regime for Financial Market Infrastructures

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RE: CME Group Inc. Submission Regarding the Australian Government's Consultation Paper on the Proposed Resolution Regime for Financial Market Infrastructures

On behalf of CME Group Inc. (CME Group) and its wholly-owned subsidiary Chicago Mercantile Exchange Inc. (CME), we thank the Australian Government and the regulators—the Reserve Bank of Australia (Reserve Bank), the Australian Securities and Investments Commission (ASIC), the Australian Prudential Regulation Authority (APRA) and the Australian Treasury—for the opportunity to provide this submission concerning the Australian Government's consultation paper entitled *Resolution Regime for Financial Market Infrastructures* (Consultation Paper).[1]

CME is registered with the U.S. Commodity Futures Trading Commission (CFTC) as a derivatives clearing organization and its clearing house division (CME Clearing) is one of the largest central counterparty (CCP) clearing services for derivatives contracts. CME Clearing offers clearing and settlement services for exchange-traded and over-the-counter (OTC) derivatives transactions, including interest rate swaps (IRS), credit default swaps, agricultural swaps, and other OTC contracts. In October 2014, the Australian Treasury licensed CME as a clearing and settlement facility (CS facility) in Australia for OTC IRS and exchange-traded interest rate contracts eligible for portfolio margining with IRS.[2]

CME Group supports the Australian Government's stated goal of ensuring the timely and effective resolution of a failing financial market infrastructure (FMI) in a manner that maintains financial system stability.[3] We also acknowledge the challenges faced in adopting and implementing a legislative regime to meet this goal. With these considerations in mind, CME Group respectfully submits the following notes for your consideration.

GENERAL OBSERVATIONS

1. We support clarification of circumstances in which the Minister may require a licensed overseas CS facility to transition to a domestic license

CME Group supports legislative amendments to clarify the circumstances in which a licensed overseas CS facility may be required to incorporate domestically and apply for a domestic CS facility license under s 824B(1) of the Corporations Act. CME Group believes that establishing well-defined, quantitative

[1] Australian Government, *Consultation Paper: Resolution Regime for Financial Market Infrastructures* [hereafter *Consultation Paper*] (issued Feb. 2015), *available at* http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Resolution-regime-for-financial-market-infrastructures.
[2] Futures positions and associated collateral may be commingled with cleared swaps positions and associated collateral pursuant to CFTC authorization under Section 4d of the Commodity Exchange Act. *See* 7 U.S.C. § 6d.
[3] *See* Consultation Paper, *supra* note 1, at 5.

triggers[4] for transitioning to a domestic licence would provide certainty to licensed overseas CS facilities and encourage additional CCP participation in the Australian market, thereby facilitating market participants' freer access to global liquidity and optionality in meeting their obligations under the forthcoming clearing mandate. Further, we believe quantitative criteria for determining whether a facility has a particularly strong connection[5] to the domestic financial system should account for the difference between globally traded markets, such as IRS, and those which are primarily onshore, such as local equities or power. We support the Council of Financial Regulators' views on the strength of domestic connections[6] and suggest triggers for this standard focus on markets that are primarily domestic or include significantly higher thresholds for markets that are predominantly offshore.

2. Well-defined thresholds for transitioning to a domestic licence support the PFMIs and the existing mutual recognition framework for CCPs

CME Group has long supported mutual recognition frameworks consistent with the Principles for Financial Market Infrastructures ("PFMIs"), published by the joint work of the then Committee on Payment and Settlement Systems ("CPSS")[7] and the Technical Committee of the International Organization of Securities Commissions ("IOSCO").[8] Global CCPs such as CME, which offer clearing services in numerous foreign jurisdictions, are subject to comprehensive regulation by their home regulators as well as conditions imposed by foreign regulators pursuant to local authorization. Duplicative or conflicting regulatory requirements may impose burdensome economic costs and unnecessary compliance-related risk on a CCP.

The requirement to obtain a domestic license will impose substantial costs on a CCP at a time when its services are relied upon by Australian market participants. An undesirable, but potential outcome under qualitative or indicative standards is an unexpected transition, which could prompt a CCP to withdraw from the Australian market rather than establish an onshore CCP or subject its offshore CCP operations to dual regulatory regimes. We expect that establishing quantitative activity thresholds would provide ex ante certainty to CCPs seeking to operate in Australia and better enable them to weigh potential regulatory costs associated with their Australian activity. Additionally, such quantitative standards would support the existing mutual recognition framework by clearly demarcating levels of clearing activity that will remain subject to the primary oversight of an overseas CCP's home regulator versus levels of activity that may trigger a domestic licence transition.

RESPONSES TO SPECIFIC QUESTIONS IN THE CONSULTATION PAPER

Question 2: *Do you agree with the proposal to introduce enforceable commitments and a new category of licence conditions to support the influence of Australian regulators and resolution authorities over cross-border CS facilities?*

The Consultation Paper provides that "[c]onditions imposed on an overseas licence could include trigger events (such as activity thresholds) linked to the systemic importance or degree of domestic connection of the CS facility."[9] ASIC's Regulatory Guide 211 (RG 211)[10] lists factors for determining whether an

[4] For example, establishing thresholds based on a minimum number of local retail participants (or establishing a greater weight on retail participation than institutional participation), asset classes (not including those that are highly international), or amount of market share in asset classes that are primarily domestic.

[5] *See* Council of Financial Regulators: Supplementary Paper to the Review of Financial Market Infrastructure Regulation, *Ensuring Appropriate Influence for Australian Regulators over Cross-border Clearing and Settlement Facilities* § 3 (July 2012), *available at* http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/cross-border-clearing/HTML/Graduated.

[6] *Id.* at § 3.3 (classifying as 'relatively weak' connections those where the "facility may serve a market that is inherently highly international, or it may have only a small number of Australian participants")

[7] Renamed 'Committee on Payments and Market Infrastructures' in September 2014.

[8] Comm. Payment and Settlement Systems & Technical Comm. Int'l. Org. Securities Comms.(CPSS-IOSCO), *Principles for Financial Market Infrastructures* [hereafter *PFMIs*] (April 2012), *available at* http://www.bis.org/publ/cpss101a.pdf.

[9] *See* Consultation Paper, *supra* note 1, at 11.

overseas CS facility is systemically important or has a strong domestic connection;[11] however, such factors are deemed to be indicative only, not determinative.[12] CME Group believes that more determinative standards would result in greater clarity around the proposed resolution regime's application to CS facilities, and support the existing mutual recognition framework as it applies to overseas CS facilities. We further propose that setting the 'strong domestic connections' triggers based on local market activity rather than global market activity reduces the likelihood of regulatory conflict—where multiple regulators may have an interest in one market (such as the globally-traded IRS market)—and mitigates the potential that foreign regulators' policies will be designed to reciprocally impact Australia.

We note the risk that foreign CCPs could be discouraged from seeking an overseas CS facility license due to uncertainty around indicative standards and potential impact on the CCP's operational planning and budgeting of their future operations in Australia. As such, CME Group suggests that the thresholds for 'systemic importance' and 'strong domestic connection' standards be established at a high level both to ensure the mutual recognition framework is not undermined by requiring a transition to a domestic license at a relatively low level of activity in Australia. For example, standards should be set at a sufficiently high level such that an overseas CS facility would be required to transition to a domestic CS facility license only where such a substantial portion of its business in primarily onshore markets creates a risk that the foreign regulator's lack of familiarity with local market conventions could result in less-than-appropriate oversight and potentially material risks to local Australian business.

Question 3: *Do you have any comment on the proposed power for the Minister to require a licensed overseas CS facility that is systemically important with a strong domestic connection to transition to a domestic licence?*

CME Group agrees with the approach cited in the Consultation Paper and the Council of Financial Regulators' policy on cross-border regulatory influence that an overseas CS facility should qualify as both systemically important and having a strong domestic connection before a transition may be required.[13] We reiterate our concern that standards for a strong domestic connection should be drafted in such a way that systemic importance in the global IRS market does not by itself trigger an onshore licencing requirement. Such an outcome could result in market fragmentation due to lack of global participation in a domestic CS facility and lack of overseas CS facilities registered in Australia. This approach, if widely implemented, would result in a cost structure that no longer allowed for global clearing offerings, thereby reducing liquidity and access to competitive clearing offerings in global markets both Australia and abroad.

CME Group's understanding is that the Consultation Paper's proposed domestic licence transition requirement is intended to be consistent with the approach outlined in RG 211.[14] We request confirmation that the legislative amendments proposed in the Consultation Paper are intended to underpin that policy and do not represent a material change in the position of the Australian Government in relation to overseas CS facilities.

In addition, we note that RG 211.158 affirms ASIC's intent to take a graduated and proportionate approach to advising the Minister to impose licence conditions and RG 211.160 provides for consultation with an overseas CS facility licensee prior to ASIC advising the Minister to impose license conditions. While such consultations should offer a licenced CCP some prior notice of conditions and domestic license transition triggers, we believe a minimum period of time for a licence transition ought to be

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[10] *See* Australian Securities and Investments Commission, *Regulatory Guide 211: Clearing and settlement facilities: Australian and overseas operators* [hereafter *RG 211*] (Dec. 2012).
[11] *See id.* at pars. 211.67 & 211.68.
[12] *See id.* at par. 211.69.
[13] *See id.* at 12.
[14] *See e.g.*, RG 211, *supra* note 7, at 20–22 (establishing systemic importance and domestic connection criteria that may trigger a requirement for an overseas CS facility to obtain a domestic operator licence).

prescribed to ensure that preliminary uncertainty around planning and budgeting for future Australian operations does not discourage foreign CCPs from seeking an overseas CS facility license.

CONCLUSION

CME Group supports the Australian Government's efforts to enhance its FMI resolution regime. Our view is that the text of the final legislation should be revised to ensure that overseas CCPs facilities operating or seeking to operate in Australia are not discouraged from such operations due to inappropriately low thresholds for local registration requirements or uncertainty regarding the circumstances in which they may be required to transition to a domestic CS facility licence. CME Group recognizes the Australian Government's interest in having appropriate authority to mitigate significant disruption to the functioning of the Australian financial system due to the default of an overseas FMI. We respectfully suggest that additional clarity around the circumstances in which such authority may be utilized will ultimately benefit the Australian financial market and its participants by encouraging a wider range of participation by overseas CS facilities, thus providing market participants with greater flexibility in fulfilling their obligations under the forthcoming clearing mandate.

CME Group thanks the Australian Government for the opportunity to provide these comments. If you have any comments or questions regarding this submission, please feel free to contact Mr. Sunil Cutinho, President, CME Clearing by telephone at (312) 634-1592 or by e-mail at sunil.cutinho@cmegroup.com.

Sincerely,

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