J.P.Morgan

Banking and Capital Markets Regulation Unit
Financial System and Services Division
The Treasury
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10 July 2015

Attention: Michael Lim

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Copy to:
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Dear Sirs,

Over-the-counter ("OTC") derivatives central clearing and single-sided trade reporting

JPMorgan Chase Bank, N.A. ("**J.P. Morgan**") is grateful for the opportunity to respond to the proposed amendments to the Corporations Regulations implementing a central clearing mandate for OTC interest rate derivatives and single-sided reporting for Phase 3 entities (defined in the trade reporting derivative transaction rules made by the Australian Securities and Investments Commission ("**ASIC**")) as incorporated in the *Corporations (Derivatives) Amendment Determination 2015 (No.1)* and the *Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015* ("**Corporations Regulations**").

Central Clearing

We note the latest draft of ISDA's submission on ASIC's Consultation Paper 231 on Mandatory central clearing of OTC interest rate derivative transactions circulated 8 July (and to be submitted in final form on 10 July) and AFMA's submission on the Corporations Regulations dated 3 July. In addition to those submissions, we provide our views as set out below.

General observations

J.P.Morgan reiterates the views expressed in its submission dated 14 September 2014 on the Treasury Proposals Paper on the proposed central clearing mandate (see **Appendix**). The G20 commitment in respect of central clearing, namely clearing of all standardized OTC

derivatives through central counterparties seeks to mitigate systemic risk to the financial system, improve transparency and protect against market abuse in OTC derivatives markets.[1]

For the reasons set out in our submission, and in view of the G20 commitments and objectives, we think it prudent that the Government and the Regulators should consider a clearing mandate framework that extends beyond the largest financial institutions. We therefore believe ASIC's rulemaking powers should not be restricted in the Corporations Regulations in relation to the size/types of entities who can be subject to the clearing rules and the circumstances in which clearing requirements can be imposed.

As stated in our previous submission: "*..the potential to bring risk into the financial system is not limited to just dealers. In the absence of broadly harmonized requirements with overseas jurisdictions and by restricting ASIC's rulemaking powers, regulatory oversight may be compromised.*"

Key insights

Under the Corporations Regulations and ASIC's draft rules on mandatory central clearing of OTC interest rate derivative transactions ("**Draft Clearing Rules**"), we believe that the threshold should be reduced from AUD 100 billion to a lower amount so as to capture a wider cross section of the OTC interest rate derivatives market.[2] Such a high threshold would operate too narrowly and potentially result in a build up of systemic risk arising from large volumes of outstanding bilateral transactions (particularly if there is insufficient incentive to clear in the absence of a mandatory requirement (this is discussed further below)).

We think that the method for determining whether or not an entity exceeds the clearing threshold may be subject to distortion (consistent with the discussions in ISDA's submission to ASIC on central clearing).[3]

Distortions can arise based on the profile of derivatives exposure for an entity making up and exceeding the threshold. For instance, larger entities may have smaller derivatives exposure to products mandated for clearing compared to smaller entities who may proportionally have a much larger exposure and yet be excluded from clearing by not exceeding the clearing threshold.

Therefore, calculating (and lowering) the threshold using only in-scope clearable products should be considered: the clearing mandate would more effectively capture those entities (on

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[1] Also described in ASIC's consultation paper 231 on Draft Clearing Rules, page 6

[2] Indeed, as discussed in our previous submission, jurisdictions such as the EU and US have implemented a clearing mandate on a phased basis not just limited to dealers with the large outstanding exposures. For instance, in the EU, non-financial counterparties with OTC positions of EUR 1 billion in credit and equity derivatives and EUR 3 billion in interest rate and foreign exchange derivatives are subject to the clearing mandate.

[3] ISDA Submission on *The Australian Securities and Investments Commission's Consultation Paper 231 on Mandatory central clearing of OTC interest rate derivative transactions*, July 2015, pages 5- 7

a representative basis) who have a significant proportion of derivatives activity in products mandated for clearing.

Further, the development of, and discussions on, the Australian rules on margin for non-centrally cleared derivatives by the Regulators should have regard to the scope of the final Corporations Regulations and Draft Clearing Rules. Potential regulatory arbitrage (and lack of commercial incentive) can arise because entities are not subject to either the rules on margin or clearing. The interaction of the two sets of rules should incentivize those entities (who are not subject to mandatory clearing (based on the current narrow scope of the Corporations Regulations and Draft Clearing Rules)) to clear on a voluntary basis. For example, this may be achieved by capturing such entities under the rules on margin thereby making voluntary clearing more appealing from a commercial perspective.

We note the Regulators' view (as stated in our previous submission) that in the long term commercial incentives- from relative pricing of centrally cleared and non-centrally cleared trades – are expected to encourage a range of non-dealers to adopt central clearing, especially those with the scale and liquidity to support it.[4] We believe that expected commercial incentives should not be relied upon as a default position to set the parameters of the clearing mandate framework. If they are, consideration should be given to the overall scope and application of the rules on margin.

Indeed, if the long term view stipulated is to favour commercial incentives to achieve the regulatory outcome, then arguably a consistent set of mandatory clearing requirements applying across a range of non-dealers and implemented on a phased basis should not adversely impact those non-dealers (since they choose and intend to clear).

In the 2014 Report, the Regulators stated they would be concerned if the absence of mandatory clearing requirements for non-dealers encouraged regulatory arbitrage. They would also review the case for extending mandatory clearing requirements if this was likely to materially affect the outcome of equivalence or comparability assessments of overseas jurisdictions with material implications for Australian market participants' costs and international market access. [5]

Closing remarks

Limiting ASIC's rule making powers to the largest market participants (namely, those having gross notional OTC exposures of AUD 100 billion or more) who are already clearing (and who would likely continue to do so irrespective of any obligation) but relying on commercial incentives for the remainder of market participants who may in certain circumstances choose

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[4] http://www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/pdf/report.pdf Australian Prudential Regulation Authority, Australian Securities and Investments Commission and Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market April 2014*, Pages 2 and 47

[5] http://www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/pdf/report.pdf Australian Prudential Regulation Authority, Australian Securities and Investments Commission and Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market April 2014*, Page 47

not to clear due to insufficient commercial incentives (for instance not being subject to the rules on margin)), gives rise to the potential build up of systemic risk and regulatory arbitrage. In this regard (including from an equivalency perspective), the Corporations Regulations should not limit ASIC's rule making powers to the largest market participants and should provide scope for the imposition of a broader clearing mandate.

Further, promoting and facilitating access to centralized clearing structures through a clearing mandate will over time with widespread use reduce the costs of clearing and enhance regulatory governance.

Phase 3 reporting entities: exemption from OTC derivative reporting requirements

We note the ISDA and AFMA submissions (each dated 3 July) and are in broad agreement with the views expressed in those submissions (unless otherwise stated in this letter) regarding the Corporations Regulations on Phase 3 reporting.

General Observations

In December 2014, the Government announced that financial services organisations that engage in small amounts of OTC derivative activity will benefit from 'single-sided' reporting relief, provided they conclude their derivatives transactions with counterparties that are already required to report the trade. [6]

In May 2015, the Government announced that it would provide relief from the trade reporting requirements by allowing 'single-sided reporting' for entities with low levels of OTC derivatives transactions, provided they conclude the transactions with counterparties that are already required to report the trade *or have agreed to report the trade.*[7]

The conditionality of the exemption based on counterparty status referenced to a requirement to report trades, or, as recently extended in May 2015, agreeing to report trades has implications for foreign counterparties in particular from a competitive and legal liability perspective. Some of these concerns have been highlighted in ISDA and AFMA's submissions.

Key insights

The basis upon which reporting relief is achieved under the Corporations Regulations will arguably result in liquidity moving along trade reporting lines which should not be the intention nor effect of the legislation. Trading patterns and behaviour could be directly impacted by the operation of the Corporations Regulations.

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[6] http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/OTC-derivatives

[7] We note that the latter part of the statement "or have agreed to report the trade" was not included in the Government announcement of December 2014: http://mhc.ministers.treasury.gov.au/media-release/058-2014/

Phase 3B entities who are unable to self-report may consider revising mandates and investment instructions to deal only with domestic Australian reporting entities. Indeed, as ISDA highlighted in its submission, "*Feedback received indicates that some phase 3 reporting entities, particularly domestically-domiciled funds, are amending (or actively considering amending) their mandates such that their investment managers will only [be] permitted to deal with counterparties that have Australian reporting obligations under the Australian trade reporting rules.*"[8]

By facing a domestic Australian reporting entity as opposed to a foreign reporting entity, the Phase 3B entity will bring itself within the exemption in the Corporations Regulations on a continuous basis (assuming it does not exceed the AUD 5 billion threshold) and therefore never have to build a system to self-report or consider delegated reporting arrangements (and associated obligations and risks).

ISDA's discussion on delegated/voluntary reporting relating to Corporations Regulations 7.5A.71(2)(ii) and 7.5A.71(3) does not draw a distinction based on which entity retains the obligation to report.[9] Strict delegation would be contradictory to the purpose of the Corporations Regulations because delegation relates to the performance of an obligation by another person as opposed to a transfer of the obligation to another person. The Corporations Regulations seek to relieve a Phase 3B entity of the requirement to report (as opposed to retaining the underlying trade reporting obligation under a delegation arrangement).

Whilst some foreign entities may be amenable to offer delegated reporting, the operation of the Corporations Regulations in and of themselves will mean that Phase 3B entities would more often than not prefer an outright relief from reporting.

A Phase 3B entity would therefore take the necessary steps and actions to bring itself within the exemption under the Corporations Regulations. The exemption itself is premised upon the status of the counterparty which has consequences depending on whether the counterparty is Australian or foreign incorporated.

The scope of reportable obligations has been set by ASIC and distinguishes between domestic and foreign reporting entities. The Corporations Regulations expands the scope of potential obligations on foreign entities in order for the relief to operate on the same basis as if the Phase 3B entity was facing an Australian domestic reporting entity. In turn, this creates a level of risk and uncertainty that would be difficult to risk accept by the foreign counterparty (which is likely to be subject to reporting obligations in its home and other jurisdictions).

Indeed, it is highly unlikely that a foreign reporting entity will ever choose to report additional trades that it is not required to report under the ASIC trade reporting rules without

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[8] ISDA Submission on *Exposure Draft of the Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015 – Comments on Single-Sided Reporting*, pages 6-7

[9] ISDA Submission on *Exposure Draft of the Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015 – Comments on Single-Sided Reporting*, paragraphs 2.5 and 3.2, pages 6-7

any negation of legal risk and liability for a breach in reporting of such trades. In contrast, delegation arrangements offer certainty as to where the liability and risk lies between two trading parties.
However, delegation arrangements may be less appealing to Phase 3B entities, but foreign entities would have to offer delegation to address reporting of trades that do not fall within the scope of the exemption (because of the conditionality of the exemption based upon the counterparty (and not the Phase 3B entity's) status and because of the legal uncertainty regarding the liability in assuming the obligation to report additional out-of-scope trades).

Closing remarks

The Government announcement in December 2014 further noted in respect of the exemption:

"This will apply to all Phase 3B entities as defined in the trade reporting rules. This means that the trade reporting compliance burden will mainly fall on larger financial institutions that are systemically important, *while still providing regulators with information they need to effectively supervise over the counter derivatives markets.*"

We note and agree the observations made by ISDA and AFMA that the exemption under the Corporations Regulations should be deemed satisfied where a foreign counterparty reports the trades that it is required to report (and not additional out-of-scope trades).[10] Furthermore, for the reasons that ISDA and AFMA have provided, we do not think that effective OTC market supervision would be adversely impacted.[11]

Thus, consideration will need to be given between the Government's broader de-regulatory policy objective - the key reason for relieving the smallest market participants from trade reporting and foregoing oversight over trades of certain Phase 3B entities that would go unreported to ASIC based on trading with a foreign counterparty.

Indeed, absent the Corporations Regulations, ASIC would not have oversight of the out-of-scope trades of foreign reporting entities. And market surveillance over in-scope trades of the larger financial institutions upon whom the trade reporting compliance burden will mainly fall would not be undermined.

Yours faithfully,

For and on behalf of JPMorgan Chase Bank, N.A.

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[10] See ISDA Submission on *Exposure Draft of the Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015 – Comments on Single-Sided Reporting*, paragraph 4.4, page 9 and AFMA Submission on *OTC derivatives central clearing and single-sided trade reporting - Draft Regulations*, paragraphs 3.16 and 3.17, pages 4 and 5.

[11] See ISDA Submission on *Exposure Draft of the Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015 – Comments on Single-Sided Reporting*, paragraph 4.7, page 10 and AFMA Submission on *OTC derivatives central clearing and single-sided trade reporting - Draft Regulations*, paragraphs 3.16 and 3.17, pages 4 and 5.

Appendix

J.P.Morgan Submission September 2014

J.P.Morgan

Banking and Capital Markets Regulation Unit
Financial System and Services Division
The Treasury
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12 September 2014

Email: financialmarkets@treasury.gov.au

Dear Sirs,

AUD-IRD Central Clearing Mandate

JPMorgan Chase Bank, N.A. ("**J.P. Morgan**") is grateful for the opportunity to respond to the proposals paper on the "AUD-IRD Central Clearing Mandate" issued by the Australian Treasury (the "**Treasury**") in July 2014 (the "**Proposals Paper**"). We are supportive of the introduction of a central clearing mandate for Australian dollar denominated ("**AUD**") (and Japanese Yen-, US dollar-, Euro and British Pound- denominated ("**G4**")) interest rate derivatives ("**IRD**"). Unless otherwise stated in this letter, we agree with the submission made by the International Swaps and Derivatives Association Inc. ("**ISDA**").

General Observations

The Regulators' report on the Australian OTC Derivatives Market in July 2013 ("**2013 Report**") expressed the view 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.[1]

The Regulators' subsequent report on the Australian OTC Derivatives Market in April 2014 ("**2014 Report**") recommended that Government consider a central clearing mandate for trades between internationally active dealers in AUD-IRD (being the largest and most systemically important OTC derivatives market in Australia).[2] The Regulators proposed to keep under review the case for extending mandatory central clearing to non-dealers in light of ongoing market and international regulatory developments.[3]

In that same 2014 Report, the Regulators recognised that the efficiency, integrity and stability of the Australian OTC derivatives market may be enhanced through greater use of centralized infrastructure: trade repositories; central counterparties and trading platforms.[4]

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[1] http://www.cfr.gov.au/publications/cfr-publications/2013/report-on-the-australian-otc-derivatives-market-july/pdf/report.pdf Australian Prudential Regulation Authority, Australian Securities and Investments Commission and Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market July 2013*, Page 2

[2] http://www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/pdf/report.pdf Australian Prudential Regulation Authority, Australian Securities and Investments Commission and Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market April 2014*, Page 2

[3] http://www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/pdf/report.pdf Australian Prudential Regulation Authority, Australian Securities and Investments Commission and Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market April 2014*, Page 47

[4] http://www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/pdf/report.pdf Australian Prudential Regulation Authority, Australian Securities and Investments Commission and Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market April 2014*, Page 1

We are supportive of these conclusions. We would also emphasise the importance of implementing a clearing mandate that is internationally consistent in substance and form with key overseas jurisdictions such as the European Union ("**EU**") and the United States of America ("**US**"). J.P. Morgan, like many other foreign ADIs, considers substituted compliance a necessary feature of Australia's clearing mandate to be able to operate effectively in Australia.

The criteria for determining which entities and transactions are subject to the clearing mandate should be clear and unambiguous. The proposed scope outlined in the Proposals Paper is restrictive in application and in comparison with other jurisdictions (like the EU and the US).

We are concerned that where there is a significant departure with such overseas jurisdictions, deemed equivalence with Australia will be compromised. Taking an approach which differs from other jurisdictions and which is restricted to a concentrated group of dealers, would, we believe, increase the potential for regulatory arbitrage in the market and adversely affect prudential regulation of systemic risk.

To discuss in isolation a clearing mandate comprising of a small group of internationally active dealers without giving consideration to any broader framework could hinder substituted compliance benefits as well as the efficacy of the Australian clearing mandate at a local level. We think it prudent that the Government should consider a clearing mandate framework looking beyond internationally active dealers as part of its general considerations for an Australian clearing mandate.

Response to specific questions

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

QUESTIONS

Question 1: Do you have 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?

- ***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?***

We broadly agree with ISDA's response to this question.

We do not foresee disproportionate costs arising from complying with a mandatory central clearing obligation for AUD-IRD from the point of view of our business or customers. From the customer perspective we do not foresee disproportionate costs arising based on a phased implementation of an Australian clearing mandate not just restricted to dealers (discussed in

Questions 4 and 5 below) and provided that the choice of CCP used by the customer should not be dictated by the clearing mandate.

We support a clearing mandate that covers non-dealers sufficiently large enough in scale and infrastructure to be able to absorb the costs associated with clearing. In addition, on the basis of phased implementation, cost savings would arise over time through economies of scale and associated synergies from wider use of centralized clearing structures.

The costs of entry into new clearing arrangements with dealer counterparties would therefore decrease so that the scope of transactions would not have to be limited to inter-dealer trades only.

Question 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 savings to your firm?

We broadly agree with ISDA's response to this question.

However, we believe that the imposition of a central clearing mandate for AUD-IRD would be likely to lead to substituted compliance benefits *if* AUD-IRD is mandated in the overseas jurisdiction *and* the central clearing mandate is similar in substance and form to that of the overseas jurisdiction.

Therefore the benefits that flow from substituted compliance are conditional on implementing a consistent framework and not just mandating the same product. Such benefits will include significant costs savings in the context of reduced legal, compliance and operational costs as trades would be cleared through existing arrangements and systems without having to incur costs of establishing new systems.

This approach (namely, adopting a phased implementation of a clearing mandate that is not restricted to just dealers) would minimise the gaps in mandatory clearing obligations and positively impact on any comparability assessments with key jurisdictions such as the US and the EU.

By way of example the European Securities Markets Authority's technical advice to the European Commission to consider the Australian regime equivalent with respect to the clearing obligation of the European Market Infrastructure Regulation would be where (i) the product subject to the clearing obligation in the EU is also subject to the clearing obligation in Australia; and (ii) the counterparty in Australia is a non-exempted entity, or if exempted it would benefit from an equivalent exemption if established in the EU.[5]

[5] http://www.esma.europa.eu/system/files/2013-1373_esma_technical_advice_on_equivalence_of_australia_-_otc_and_tr.pdf *European Securities Markets Authority, Supplement to the Final Report, Technical advice on third country regulatory equivalence under EMIR (Australia)* (October 2013), Page 9

Another reason why substituted compliance benefits may be more likely to flow where the Australian clearing mandate is similar in substance and form to that of an overseas jurisdiction (across product class and entity type), is the OTC Derivatives Regulators Group's ("**ODRG**") practical recommendation to the Financial Stability Board (through its published understandings) on applying a stricter rule approach to address gaps in mandatory trading and clearing obligations for resolving cross border conflicts.[6]

The ODRG's subsequent reports of March and September 2014[7] indicate continued work on, and support for, harmonisation and consideration to international standards (where appropriate) on remaining cross-border implementation issues.

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

We broadly agree with ISDA's response to this question.

We further note that the benefits of merging the timing and determination for G4-IRD and AUD-IRD will also provide participants required to clear across product types to have certainty on how to apply the same rule consistently across product types.

Question 4: Do you agree with the proposal to restrict ASIC rulemaking to entities that are considered to be dealers?

We do not agree with the proposal to restrict ASIC rulemaking to entities that are considered to be dealers. ASIC's rulemaking powers should not be restricted to just dealers on the basis of prudential regulation of systemic risk and international consistency considerations.

The significance of the AUD-IRD in the Australian OTC derivatives market has been noted (the Regulators' view that there would be a substantial financial stability benefit from increased central clearing of AUD-IRD and that AUD-IRD account for more than half of notional principal outstanding of all IRD in Australia).[8]

On the basis that prudential regulation of systemic risk is a policy consideration (and we believe it should be), the proposed threshold would not capture, for example, medium sized banks (which are systemically significant).

A threshold based on gross notional outstanding OTC derivative positions equivalent to AUD 100 billion operates too narrowly and would result in a build-up of systemic risk arising from large volumes of outstanding bilateral transactions and resultant unaccounted exposures. This

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[6] http://www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/pdf/report.pdf Australian Prudential Regulation Authority, Australian Securities and Investments Commission and Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market April 2014*, Page 13

[7] http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/odrgreport033114.pdf *Report of the OTC Derivatives Regulators Group (ODRG) on Cross-Border Implementation Issues March 2014* and http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/oia_odrgreportg20_0914.pdf *Report of the OTC Derivatives Regulators Group (ODRG) on Cross-Border Implementation Issues September 2014*

[8] *Proposals Paper*, Page 3

is the type of risk that the Government (together with other participating G20 countries) is seeking to prevent through regulatory reform measures. Implementing a threshold to capture a limited number of participants based on an arbitrary value has greater potential for regulatory arbitrage and market distortion (to fall outside of scope) in contrast with, for example, setting a threshold by reference to status as a swap dealer ("**SD**") or major swap participant ("**MSP**") under the US Commodity Futures Trading Commission ("**CFTC**") rules.

Further, the potential to bring risk into the financial system is not limited to just dealers. In the absence of broadly harmonized requirements with overseas jurisdictions and by restricting ASIC's rulemaking powers, regulatory oversight may be compromised.

Indeed, just because a market participant has a smaller amount of notional value outstanding at a particular point in time does not necessarily mean that the market participant is *not* bringing risk into the system. Nor does it preclude the participant from using the market. In order for prudential regulation to operate effectively, we believe all participants in the AUD-IRD market should be subject to the clearing mandate (unless they are end users).

On the basis of international consistency considerations, we note that the clearing mandate for key jurisdictions such as the EU and US (which most foreign ADIs would seek substituted compliance under) is broader in scope covering non-dealer entities such as SDs, MSPs, financial counterparties and non-financial counterparties above a clearing threshold.

The Australian regime should adopt a clearing mandate substantially similar in substance, form and intent to that of these key jurisdictions. That is, mandatory central clearing implemented on a phased basis and not restricted to just dealers.

In that regard, the characteristics of any phased implementation should be consistent with overseas jurisdictions so that Phase 1 captures the largest counterparties, Phase 2, medium sized/high volume market participants and Phase 3, smaller financial counterparties (exempting end users). Crucially, the point being here that such a framework captures all sources of risk that have a potential to adversely impact and disrupt the financial markets.

The above considerations are central to the dialogue on placing any restriction to ASIC's rulemaking powers. Essential to this dialogue is recognising all the sources of risk that can be brought into the system.

Question 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?

We consider Option B to be preferable over Option A.

As discussed under Question 4, a phased implementation of a clearing mandate which is not restricted to dealers should be recommended.

The applicable criteria should include a Phase 1 covering, and consistent with, proposed Option B.

Phase 2 should include entities with gross notional outstanding OTC derivative positions equivalent to AUD 50 billion (consistent with the criteria under the ASIC's Derivative Transaction Rules (Reporting) 2013 ("**ASIC Reporting Rules**")[9]). Phase 3 should capture remaining entities with gross notional outstanding OTC derivative positions equivalent to AUD 10 billion (a higher threshold than under the ASIC Reporting Rules, acknowledging that smaller entities may lack in scale and infrastructure and would face competitive disadvantages to otherwise enter the market).

Defining internationally active dealers using reference to their status as a SD is preferable because the criterion is objectively ascertainable (and therefore less vulnerable to regulatory arbitrage and market distortions). This is in contrast to a definition referable to a set threshold amount only where there is more potential to take actions to fall outside of the scope. Also, calculation of the threshold amount is itself subject to disputed interpretation in the context of "entered into" transactions.[10]

We are supportive of Treasury's view that providing a definition of internationally active dealers based on status as a SD "*is not intended to target US financial institutions, but [to serve] as a proxy to capture global financial institutions with significant cross-border activities, most of which are expected to be regulated as swap dealers in the US.*"[11]

In order to regulate systemic risk of the Australian financial markets, it is not necessary to draw a comparison between the presence of a particular SD in the US compared to in Australia. As noted under Question 4, just because a market participant has a smaller amount of notional value outstanding at a particular point in time does not preclude the market participant from bringing risk into the system.

In practical terms, we believe using SD status as part of the referable criterion is essential to capture all systemically significant internationally active dealers (without the risks associated with using a set threshold amount only for Phase 1). Thereafter the remaining Phases will capture other entities participating in the market but who are not SDs (other than end users).

We note that our recommendations for Phase 2 and Phase 3 are based on definitions referable to gross notional outstanding positions which carry risks of potential regulatory arbitrage. We are supportive of incorporating an objective element in to each of those Phases (for example,

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[9] http://www.comlaw.gov.au/Details/F2013L01345 Australian Securities & Investments Commission, *ASIC Derivative Transaction Rules (Reporting) 2013, 9 July 2013*

[10] See ISDA's discussion on "entered into" transactions in *ISDA's Submission* generally and Pages 2-3 and 8

[11] *Proposals Paper*, Footnote 5, Page 8

under the CFTC rules, the concept of MSPs) to minimise the potential for regulatory arbitrage across all entity levels.

We agree with ISDA that interpreting "entered into transactions" creates irresolvable practical difficulties and welcome guidance on this point. These transactions should only be included (contemplated in the Proposals Paper[12]) as clearable transactions if a revised, practical interpretation can be provided without incurring disproportionately significant costs as suggested by ISDA. [13]

The calculation of gross notional outstanding positions should be calculated on an aggregate basis - of swaps transacted by an entity/fund manager (including all its related entities/funds)- rather than at the entity/fund level to prevent market distortion. If transacted on an entity basis this could result in regulatory arbitrage.

We recommend a revised criteria that is internationally consistent and which aligns with the regulators' and Government's considerations of fulfilling Australia's international obligations – to implement a clearing mandate that operates effectively on a global level whilst preventing a build-up of local systemic risk from resultant unaccounted exposures.

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

We broadly agree with ISDA's response to this question.

An AUD-IRD mandate should be introduced in Australia prior to any similar mandate in any other jurisdiction; this is particularly so given that central clearing of AUD-IRD has already been underway for some time now.

Otherwise, at the very least, the AUD-IRD mandate should be introduced at the same time as such a mandate is first implemented in an overseas jurisdiction. The mandate is directly connected to the Australian market so that the Regulators should lead the way in implementing such a mandate first and foremost.

Question 7: Do you have comments on the proposed timetable for implementing the central clearing obligation?

We have no particular issues with the proposed timetable other than recommending implementation of an AUD-IRD mandate should be in place prior to the introduction of a similar mandate in any other jurisdiction (as discussed under Question 6).

We also recommend a central clearing mandate that is not restricted to dealers only and is implemented in phases for which the rules specify an outline of the commencement dates for

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[12] *Proposals Paper*, see Pages 7-8

[13] See ISDA's discussion on "entered into" transactions in *ISDA's Submission* generally and Pages 2-3 and 8

the phases for the reasons set out above. This will allow market participants (clearing members and clearing vendors alike) to prepare systems and policies. In turn this will help to reduce the burden and costs of compliance without undermining regulatory obligations and overall enhance regulatory governance.

Closing statements

As discussed above, we think it prudent that the Government consider (i) defining internationally active dealers referable by an objective standard of status as a SD regulated entity (as proposed under Option B) and (ii) implementing an internationally consistent clearing framework on a phased basis that is not restricted to just dealers (excluding end users).

We note the Regulators' view that in the long term commercial incentives- from relative pricing of centrally cleared and non-centrally cleared trades – are expected to encourage a range of non-dealers to adopt central clearing, especially those with the scale and liquidity to support it.[14] We believe that commercial incentives should not be relied upon as a default position to set the parameters of the clearing mandate framework. Promoting and opening access to centralized clearing structures through a clearing mandate will over time with widespread use reduce the costs of clearing and enhance regulatory governance.

In the 2014 Report, the Regulators stated they would be concerned if the absence of mandatory clearing requirements for non-dealers encouraged regulatory arbitrage. They would also review the case for extending mandatory clearing requirements if this was likely to materially affect the outcome of equivalence or comparability assessments of overseas jurisdictions with material implications for Australian market participants' costs and international market access. [15]

In that regard, adopting a clearing mandate framework that is consistent in substance and form with key overseas jurisdictions such as the US and the EU is essential.

Yours faithfully,

For and on behalf of JPMorgan Chase Bank, N.A.

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[14] http://www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/pdf/report.pdf Australian Prudential Regulation Authority, Australian Securities and Investments Commission and Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market April 2014*, Pages 2 and 47

[15] http://www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/pdf/report.pdf Australian Prudential Regulation Authority, Australian Securities and Investments Commission and Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market April 2014*, Page 47