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`VIA E-MAIL TO: financialmarkets@treasury.gov.au

June 15, 2012

Manager, Financial Markets Unit
Corporations and Capital Markets Unit
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sirs,

This paper provides the response of the LCH.Clearnet Group Limited ("LCH.Clearnet") to the Australian Treasury's Consultation Paper on Implementation of a framework for Australia's G20 over-the-counter derivatives commitments.

LCH.Clearnet is the world's leading clearing house group, serving major international exchanges and platforms, as well as a range of OTC markets. It clears a broad range of asset classes including securities, exchange traded derivatives, commodities, energy, freight, interest rate swaps, credit default swaps and bonds and repos; and works closely with market participants and exchanges to identify and develop clearing services for new asset classes.

LCH.Clearnet is pleased to be able to provide the below responses to the Australian Treasury's Consultation Paper. LCH.Clearnet has omitted any questions where no view is being expressed.

**Responses to specific questions raised in the consultation paper**

**3. DISCUSSION OF THE LEGISLATIVE FRAMEWORK**

**3.1 Obligations**

**Q1.** ***Do you have any comments on the general form of the legislative framework?***

LCH.Clearnet welcomes the general form of the legislative framework. It mirrors important G20 commitments and LCH.Clearnet shares the Australian Government's goal in upholding these commitments. It is important that international efforts align to bring greater stability and security to the global OTC derivatives markets.

**3.2 Definition of 'transaction' and 'party'**

**Q2.** ***Do you have any comments on the definition of 'transaction'?***

This definition is appropriate.

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**Q3. *Do you have any comments on the definition of 'party'?***

Generally, LCH.Clearnet believes the definition of 'party' is appropriate. However, there should be clarification on what actions would fall within the definition of '*an action within the Australian jurisdiction*', applicable to a foreign person entity.

## 3.3 Definition of 'eligible facilities'

**Q4. *Do you have any comments on the definition of 'eligible facility'?***

This definition is appropriate.

## 3.4 Non-discriminatory access

**Q5. *Do you agree that non-discriminatory access requirements should be imposed on eligible facilities?***

LCH.Clearnet welcomes the proposal that non-discriminatory access requirements should be imposed on eligible facilities. From a central clearing perspective, LCH.Clearnet respectfully suggests that in the Australian Government's consideration of non-discriminatory access requirements, the Australian Government observes the balance between fair and open access, and the introduction of risk into the financial system. To alleviate such risks, it may be useful to consider imposing financial and operational requirements for clearing participants to ensure stability.

## 3.5 Derivative transaction rules (DTRs)

**Q6. *Do you have any comments on the rule-making power that will be available to ASIC?***

LCH.Clearnet supports the rule-making power that will be available to ASIC.

**Q7. *What should be the minimum period of consultation imposed on ASIC in developing DTRs?***

LCH.Clearnet believes that the minimum period of consultation imposed on ASIC in developing DTRs should be at least 45 days. This consultation period will allow for all stakeholders to sufficiently express their views.

**Q8. *What should be the minimum period of notice between when a DTR is made and when any obligation under the DTR commences?***

LCH.Clearnet believes that the minimum period of notice between when a DTR is made and when any obligation under the DTR commences should be 90 days. LCH.Clearnet would like to highlight that the period of notice should have a graduated approach as some obligations require more implementation time than others. For example, extensive electronic reporting requirements may require a longer period of notice, in order to allow sufficient time for entities to introduce or upgrade internal systems.

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**Q9.** ***Although the possible counterparty scope is set broadly, should minimum thresholds for some or all types of counterparty be set by regulation, so that no rule that is made will ever apply to those counterparties (unless the regulation is subsequently changed)?***

LCH.Clearnet believes this is an area where international consistency is desirable.

## 3.6 'Back loading' of the obligations

**Q10.** ***From the point of view of your business and/or of your clients, do you have concerns around any 'back loading' requirements? For example, are there any problems with obligations applying to transactions that are outstanding at the time the rule is made?***

LCH.Clearnet also believes that this is another area where international consistency is desirable.

In terms of the mandatory obligation to clear, from a central counterparty perspective, back loading of trades is an LCH.Clearnet business as usual event. However, it is desirable that any requirements for mandatory back loading of trades is, if implemented, in relation to the requirement to clear new trades, subject to a longer implementation period. This is necessary as this process is subject to time restraints brought about by legal arrangements and documentation, and portfolio reconciliation.

In terms of back loading trade reporting, a key concern would be the timeframe for the implementation of these requirements. Given the volume of trades involved, the back loading of trades will require more effort than the reporting of new trades. Furthermore, there must be clear guidance on the format and content of reports for back loaded trades, allowing the industry sufficient time to invest in systems to generate the necessary data. Additionally, LCH.Clearnet recommends that as the golden record for cleared transactions, it is preferable that any back loading into trade repositories is managed by clearing houses so that duplication of reporting is avoided together with the industry wide reconciliation this would imply. Again, this is another factor supporting a lengthy implementation period.

## 4.2 Trade repositories

**Q11.** ***Do you agree with the option of prescribing a broad range of derivative classes to be subject to the mandate for trade reporting? If not, what other option do you prefer?***

LCH.Clearnet expresses no strong opinion on the option of prescribing a broad range of derivatives classes to be subject to the mandate for trade reporting but believes that this is an area where international consistency is desirable.

However, if the Australian Government does prescribe a broad range of derivative classes to be subject to the mandate for trade reporting, LCH.Clearnet would respectfully suggest there are graduated phases of implementation, as until compliance dates are confirmed for each derivatives class, entities will be uncertain as to which derivatives' implementation should be prioritised. Therefore, it is essential that compliance dates should be finalised as soon as practicable. As noted in the consultation paper, for certain obligations, such as trade reporting, participants will need to invest in their systems. Uncertainty over which derivatives classes will be implemented first will lead to participants planning simultaneously for all derivatives classes.

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**Q12.** ***Do you agree with the option of including a broad range of entities in the mandate to report trades? If not what option do you prefer?***

LCH.Clearnet supports the option of including a broad range of entities in the mandate to report trades. Mandating a broad range of entities to report trades will allow the Australian Government to have an overview of the risk within the market and will be consistent with other jurisdictions' rules. The range of entities mandated should be communicated to the market as soon as practicable.

**Q15.** ***Do you agree with the option of using a wide definition for what would constitute a transaction in this jurisdiction for the purposes of mandating trade reporting? If not, what definition do you prefer?***

LCH.Clearnet believes the approach is appropriate.

**4.3 Central clearing**

**Q.16.** ***Do you agree with the option of relying upon market forces and a range of other mechanisms, such as capital incentives, while monitoring the impact of such mechanisms in systemically important derivative classes and providing for possible future mandating, to ensure that central clearing becomes standard industry practice in Australia within a timeframe that is consistent with international implementation of the G20 commitments? If not, is there another option you prefer?***

LCH.Clearnet believes that this is another area where international consistency in implementation of the G20 mandate is desirable.

**Q17.** ***Are there specific entities that should be excluded from the potential reach of central clearing rules?***

LCH.Clearnet agrees with the option to exclude public entities, such as central banks, debt offices, supra-national multilateral development banks and entities such as the International Monetary Fund, from central clearing rules. In addition, non-financial institutions, i.e. corporate entities and CCPs themselves should also be exempt.

**Q17.1.** ***What metrics should be used to determine any thresholds?***

LCH.Clearnet recommends that the Australian Government consider using a risk sensitive approach for determining any 'size' threshold when assessing parties' derivative exposures. LCH.Clearnet does not recommend using Notional as a measure of total exposure; the dangers of using notional amounts as an indication of risk, particularly in the case of interest rate derivatives where the notional of swap is not settled, are becoming well known since the Basel Committee's proposals to use a method based on notional amounts as the basis for determining capital requirements for exposures to CCPs. As an example, even within interest rate derivatives, the value sensitivity of a 30yr AUD swap is almost twenty times that for 1yr AUD swap *per unit of notional.*

Each asset class will have its own approach to measuring risk exposures and sensitivities. One approach to consider would be to use a 'Value at Risk' (VaR) measure or specifically in the case of interest rate derivatives, a change induced by a one basis point change in the underlying interest rate curve.

A further measure, which might serve to unify potentially disparate units from different asset classes, could be hypothetical initial margin requirement, since this is a true risk-based measure which, were thresholds to be breached within a cleared environment, would lead to risk-mitigating sanctions. LCH.Clearnet does however see practical difficulties in imposing such a measure.

However, LCH.Clearnet recognises that a significant drawback of these approaches is the relative opacity of 'Value at Risk' and certainly the fact that it is neither a contractual feature nor a constant figure.

**Q18.** ***Are there specific classes of transaction that should be excluded from the potential reach of trade clearing DTRs?***

LCH.Clearnet believes that this is another area where international consistency in implementation of the G20 mandate is desirable.

**Q18.1.** ***In particular, should some transactions entered into for certain purposes (for example, hedging, commercial risk mitigation) be outside the potential reach of the rule making power?***

LCH.Clearnet believes that rules on exemptions for hedging may be appropriate. Rules for these should, as far as possible, be equivalent to those proposed in other major jurisdictions.

**Q19.** ***Do you agree with the option of requiring central clearing for derivatives where at least one side of the contract is booked in Australia and either: (a) both parties to the contract are resident or have presence in Australia and are entities that are subject to the clearing mandate; or (b) one party to the contract is resident or has a presence in Australia and is subject to the clearing mandate, and the other party is an entity that would have been subject to the clearing mandate if it had been resident or had a presence in Australia? If not, what definition do you prefer?***

LCH.Clearnet encourages international consistency with regard to clearing mandates for non resident parties. Each jurisdictional clearing mandate must ensure that there are no conflicts of interest that could restrict parties from different jurisdictions from executing and clearing trades through a CCP and therefore impact the availability of liquidity in the global market.

## 4.4 Trade execution

**Q22.** ***If a derivative class is prescribed for mandated use of CCPs should it also be mandated for execution on a trading platform?***

LCH.Clearnet does not believe that if a derivatives class is prescribed for mandated use of CCPs, that it should also be mandated for execution on a trading platform. As long as the necessary trade reporting can be performed, LCH.Clearnet sees no need for derivatives classes to be mandated for execution on trading platforms. Utilisation of existing trading infrastructure minimises the burden and incremental cost of change and ensure a higher degree of compliance.

## 5.2 Licensing of trade repositories

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**Q25.** ***From the point of view of your business and/or that of your clients, do you have concerns with reporting Australian trades to Australian and/or international trade repositories?***

LCH.Clearnet has no strong concerns with reporting Australian trades to Australian and/or international trade repositories. LCH.Clearnet urges for international consistency on reporting requirements to trade repositories. Furthermore, in order to ensure consistency in reporting, LCH.Clearnet suggests that parties to a transaction should, where possible, report it only once. This can be achieved by the use of global repositories which are accessed by multiple authorities according to their needs. It will allow market participants to manage the cost of such activity, and will allow for data integrity and minimise the opportunity for double counting.

**Q25.1.** ***What restrictions should there be on the disclosure of reported data by trade repositories? What requirements should be imposed in relation to data protection and privacy?***

The key issue is the extent to which public disclosure interacts with the ability to manage risk. There is no doubt that the speed and details with which transaction and counterparty data is made available will alter the appetite of market participants to conduct business. OTC markets typically operate with transaction sizes above those in other markets, and market-makers may become less willing to commit capital to the execution of large orders faced with the prospect of immediate market-wide knowledge of these transactions.

From the perspective of a central counterparty, LCH.Clearnet would suggest specific consideration of public disclosure requirements immediately following the default of a CCP member. LCH.Clearnet is concerned that a CCP's default management process could be compromised if too great a degree of transparency is given to the actions of a CCP in a stressed market environment. Public disclosure of a defaulting member's positions may move the market against the CCP, as might premature disclosure of individual trade details within a broader risk neutralisation programme. It is important that the CCP, at a time of default, is able to operate without the risk of its actions being open to market manipulation.

In terms of requirements that should be imposed in relation to data protection and privacy, LCH.Clearnet urges for legislation that will require trade repositories and their officers and employees to safeguard the confidentiality of data.

**Q25.2.** ***What restrictions should there be on the use of reported data by trade repositories?***

LCH.Clearnet believes that reported data by trade repositories should only be used for required regulatory reporting.

**Q25.3.** ***What restrictions should there be on the sharing of trade repository data between TRLs; and on the sharing of trade repository data between regulators (both domestic and international)?***

Subject to adequate confidential data policies and procedures, LCH.Clearnet expresses no concern on the sharing of trade repository data between TRLs.

LCH.Clearnet expresses no concerns over the sharing of trade repository data between regulators.

**5.2 Review of financial market infrastructure (FMI)**

**Q31.** ***Do you agree with the factors identified in section 6.2 for ongoing derivatives markets assessments?***

LCH.Clearnet agrees with the factors identified in section 6.2 for ongoing derivative markets assessments.

**Q32.** ***Are there other factors that should also be included?***

LCH.Clearnet does not believe any other factors need to be included.

**Q33.** ***Do you have any comments on the rule-making power that will be available to ASIC?***

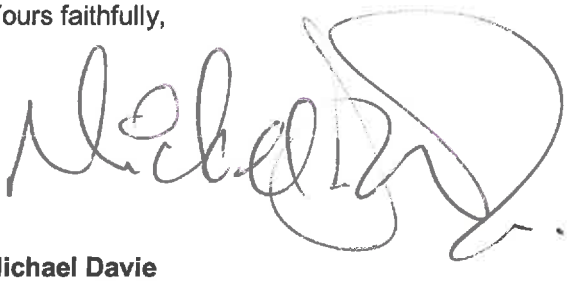
LCH.Clearnet supports the rule-making power that will be available to ASIC. LCH.Clearnet welcomes the point that ASIC will consult with other agencies and stakeholders in developing the DTRs.

**Q34.** ***Do you have any preliminary views on matters to whish DTRs should apply?***

In as far as possible, the DTRs should mirror other foreign regulations that have been brought out to uphold the G20 commitments.

LCH.Clearnet appreciates the opportunity to comment on these important issues and would be pleased to enter into a further dialogue regarding these issues. Please do not hesitate to contact Rory Cunningham at +44 (0)20 7426 7093 regarding any questions raised by this response letter.

Yours faithfully,



**Michael Davie**
On behalf of LCH.Clearnet Group Limited