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Manager, Financial Markets Unit
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Dear Sir/Madam

Submission to the Treasury in relation to the draft *Corporations Legislation Amendment (Derivatives Transactions) Bill 2012*

We refer to the draft *Corporations Legislation Amendment (Derivatives Transactions) Bill 2012* (**Draft Bill**) recently released for comment by the Treasury following the receipt of public submissions on the Australian government's Consultation Paper, "*Implementation of a framework for Australia's G20 over-the-counter derivatives commitments*" (**Consultation Paper**). We thank you for the opportunity to make submissions in relation to the Draft Bill.

We note that Norton Rose made a submission to the Treasury in relation to the Consultation Paper on 15 June 2012. Given that the Draft Bill seeks to implement the proposals set out in the Consultation Paper, by proposing to amend the *Corporations Act 2001* (Cth) in order to introduce a legislative framework that will allow the government to require that certain prescribed classes of derivatives be subject to one or more mandatory obligations relating to trade reporting, central clearing and trade execution (each a **mandatory obligation**) and to introduce a new licensing regime for derivatives trade repositories, many of our comments in that submission are also relevant to the Draft Bill. Accordingly, we refer you to our previous submission.

In addition to those set out in our earlier submission in relation to the Consultation Paper, we set out below our specific legal comments on certain aspects of the Draft Bill.

1 Definition of "derivative transaction"

1.1 The definition of "transaction" proposed in the Consultation Paper included the making, modifying or termination of a contract for derivatives. In our submission on the Consultation Paper we commented that consideration should be given to adopting an exhaustive definition, rather than a merely inclusive definition which does not establish the definitional boundaries of the transaction types impacted by the mandatory obligations.

1.2 Whilst the definition of derivative transaction in clause 11 of the Draft Bill is currently drafted to mean only those transactions described in paragraphs (a), (b) and (c) of the definition, the drafting of those paragraphs still results in a large degree of uncertainty regarding the transaction types that may be subject to derivative transaction rules. For example:

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(1) the definition currently refers to the entry into, modification or termination of an "arrangement" that is a derivative, rather than a "contract for a derivative" (as contemplated in the Consultation Paper).

The concept of an "arrangement" appears too broad in this context. It could result in something which is not commonly regarded as an over-the-counter derivative to be caught by the regulations (eg. if a person that was exposed to commodity price risk in its business operations, the physical acquisition of the commodity could be viewed as an arrangement to manage that risk).

(2) the inclusion of paragraph (c), which refers to "any other transaction relating to a derivative", also appears too broad in this context. In our submission on the Consultation Paper, we commented that "making, modifying or terminating a contract for derivatives" should be sufficient to capture all relevant dealings in derivatives for the purposes of the mandatory obligations.

Whilst we understand the desire to maintain flexibility in the proposed legislative framework, we query the need for this paragraph. Is it intended that derivatives counterparties will be required to report other "transactions" related to a derivative to a trade repository beyond the making, modifying or termination of a derivative? In our view greater clarity should be provided regarding the need for paragraph (c) so that market participants can fully understand its potential implications.

Given the broad powers provided to ASIC to make derivative transaction rules in relation to prescribed derivatives transactions, it would appear preferable if the definition of derivative transaction was drafted with a greater degree of precision rather than relying on regulation and rule-making powers. Accordingly, we submit that:

(3) references to "an arrangement" should be replaced with "a contract";

(4) paragraph (c) should be deleted.

2 Exemptions

2.1 The Draft Bill does not provide for specific exemptions from the requirements (eg hedging transactions). We assume that if any exemptions were to be introduced this would be dealt with by way of regulations (eg under section 901C). If the Australian Securities and Investments Commission (**ASIC**) is minded to grant any such exemptions, it would appear prudent for ASIC to issue a statement confirming that it intends to grant or consider certain exemptions or to introduce the relevant regulations before, at the same time as, or soon after, the proposed legislation takes effect.

3 Derivative transaction rules

3.1 Section 901A(3) should be amended to require that derivative transaction rules deal with the matters referred to in this sub-section to the extent relevant to a mandatory obligation, rather than to provide that they "may" deal with those matters. This is because the matters dealt with in this section relate to what and who will be subject to a mandatory obligation, how they will be required to comply and whether there will be any exceptions. These matters are of critical importance to market participants and should be addressed in all derivative transaction rules.

4 Consultation

4.1 The Draft Bill requires ASIC to consult with the public, the Australian Prudential Regulation Authority, the Reserve Bank of Australia and any other person or body as required by regulations before making a derivative transaction rule (section 901J(1)). However a failure to consult will not invalidate a derivative transaction rule (section 901J(3)). Whilst we understand that the intention is that normal practice will involve public consultation, we consider that section 901J(3) should be deleted and a minimum consultation period included in order to afford the public an opportunity to comment upon proposed rules and to reinforce that the public expectation is that consultation will be undertaken

except in unusual circumstances. As we note in paragraph 5.1 below, ASIC would continue to have the ability to issue an emergency rule without consultation under section 901L.

5 Emergency rules

5.1 We note that under section 901L ASIC may make derivative transaction rules in certain circumstances without undertaking any public consultation under section 901J and without obtaining Ministerial consent under section 901K. However, we also note that section 901B provides that derivative transaction rules cannot impose a mandatory obligation unless the derivative is covered by a determination of the Minister by way of legislative instrument.

5.2 We presume the intention is that ASIC is to be prohibited from making any emergency rules under section 901L unless such a determination has first been made (since sections 901J and 901K only apply once such a determination has been made). However, we submit that this should be made more clear in the drafting of section 901L by the inclusion of the following words at the commencement of that section:

"If the Minister has made a determination under section 901B in relation to a particular class of derivatives in relation to which execution requirements, reporting requirements and/or clearing requirements may be imposed,...".

5.3 Whilst not a comment of a legal nature and other market participants might comment separately in relation to the policy impacts of this issue, we query whether the ability of ASIC to impose emergency rules will have any effect in practice, given that the market and participants will need to implement the relevant infrastructure, systems and other processes before a mandatory obligation could operate effectively. The ability for ASIC to issue rules without consultation in unusual circumstances may be a desirable policy objective, but it could also be significantly disruptive, particularly if the Minister has the ability to direct ASIC to amend or revoke an emergency rule.

5.4 We also note that there are no constraints upon the matters to which the Minister may have regard in making a direction to ASIC under section 901L(2)(b). We consider that, in the least, the Minister should be required to consider, when making a direction under that section, the matters listed in 901H(a) as well as any other matters that the Minister may consider relevant.

6 Central counterparties (CCPs)

Mutual recognition

6.1 This comment relates to the broader policy, rather than technical legal aspects, of the Draft Bill. We query whether Foreign CCPs that are sufficiently regulated by equivalent foreign regulators should be subject to the same requirements that apply to new unregulated entities. Requiring strict compliance by foreign CCPs might result in foreign CCPs electing not to operate in the Australian market due to overlap or conflict with local CCP regulatory regime. We suggest that some level of reciprocal regulatory recognition be considered for foreign CCPs that are sufficiently regulated in their home jurisdiction and that they be required to undertake to comply with their home country OTC derivatives regulation. To this end, a core set of provisions could be included in the Draft Bill that sets out the legal and policy considerations that will be taken into account when determining whether the OTC derivatives regulations of another jurisdiction are sufficiently robust to warrant granting mutual recognition to CCPs that are regulated by that jurisdiction.

Recognition of CCPs as licensed derivative trade repositories

6.2 It is important that ASIC consider special recognition of CCPs as derivative trade repositories. Generally, CCPs will be readily equipped to act as the final repositories for regulatory information regarding cleared trades. This is because CCPs, in clearing OTC derivatives transactions, should possess, or at least have access to, most transaction records.

6.3 Other reasons include:

(1) Reducing costs and administrative burdens;

(2) CCPs have already established connections with relevant execution venues and other market participants for cleared trades; and

(3) creating a separate reporting entity housed away from the CCP creates ambiguity as to the true state of a position.

6.4 Prima facie, the Draft Bill does not prohibit CCPs from applying for a derivative trade repository licence. Further, ASIC does not envisage that all licensed trade repositories will carry out only repository functions given the Draft Bill provides that the rules may impose certain requirements on a licensed trade repository including "separation of operational functionality from other services". In our view it would be preferable if ASIC considered adopting a form of "automatic qualification" (either in the licence application stage or expressly in the legislation) for CCPs who apply to be licensed derivative trade repositories.

We would be pleased to discuss further with you any aspects of our above comments. Please do not hesitate to contact Fadi Khoury ((02) 9330 8685), Vittorio Casamento ((02) 9330 8679), Petar Kuessner ((02) 9330 8702) or Tessa Hoser ((02) 9330 8083).

Yours faithfully

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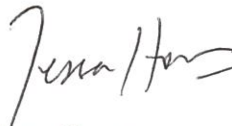

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