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Thank you for the opportunity to comment on the April 2012 Consultation paper titled *Implementation of a framework for Australia's G20 over-the-counter derivatives commitments*. We have set out in the below our response to several of the questions raised in the paper. Our comments focus on non-discriminatory access, the exclusion of FX derivatives and the benefits of electronic trading. We also present our thoughts on the segregation and portability of client positions and collateral for your consideration.

State Street is a leading financial services provider serving some of the world's most sophisticated institutions such as pension funds, mutual funds, endowments and sovereign wealth funds. State Street offers a suite of services that spans the investment spectrum, including investment management, research and trading, and investment servicing. As of 31 December 2011, State Street had USD 22 trillion in assets under custody and administration, USD 1.9 trillion in assets under management, operations in 29 countries, and a geographic network that spans more than 100 markets. State Street has a longstanding presence in Australia and is committed to growing our business further through the offer of new products and services.

State Street is one of the world's largest processors of derivatives transactions and as such has been active in policy discussions about central counter party clearing of derivatives in the US, Europe and the Asia Pacific. We support derivatives clearing and execution which we believe will reduce global systemic risk and, properly implemented, benefit our institutional investor customer base. State Street is also well positioned to provide our clients with full-service clearing and other services that can help them realize the benefits of the new derivatives regime, through enhanced transparency, open execution platforms and central clearing. We are planning to become clearing house members for derivatives in several markets. We hope that Australia will include provisions designed to accommodate the particular role of custody banks as a market intermediary on behalf of their clients as in other major markets.

Below are our responses to several of the feedback questions.

Section 3.4.5
Q. Do you agree that non-discriminatory access requirements should be imposed on eligible facilities?

Yes. State Street strongly supports membership criteria for CCPs which are non-discriminatory, transparent and objective so as to ensure fair and open access to CCPs. In recognition of its importance, this principle is being pursued in Section 725 of the US Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and by the European Commission.

In some countries, certain proposed membership rules and criteria appear to be at odds with this principle. Requirements for large Net Capital and for a participant to retain a substantial IRS portfolio and for participants to have a trading desk, seem to favor the existing OTC swap / dealer model. Given the different roles played by market participants in the settlement of OTC derivative transactions we believe that it would be useful for clearing houses to consider different categories of membership, participation and ownership. This includes provisions designed to accommodate the particular role of custody banks as a market intermediary on behalf of their clients.

While we fully support rules that require clearing house members to demonstrate sufficient financial and operational resources to fulfill their obligations, particularly in times of financial stress, we also believe both the clearing houses themselves, swap markets overall and investors will benefit from more diversified clearing house memberships and the emergence of competitive, alternative models for clearing services. If such changes are properly implemented, the result will be more efficient and competitive swaps markets which benefits investors, greater acceptance of the new swaps regulatory regime, and lower levels of systemic risk.

We support membership criteria that are reflective of the character and risk of the positions cleared through a financial institution and the role of the clearing member as a participant in the markets for cleared swaps. As such, we are concerned by membership criteria based on large arbitrary minimum capital requirements and default management requirements based on the use of dealer-affiliated clearing members and swap portfolio or volume size.

Capital Requirements

In State Street's experience, CCP membership rules have often included large minimum arbitrary capital requirements. We are concerned that such requirements may impede the development of a strong marketplace for cleared derivatives. As an alternative to fixed, arbitrary capital requirements, Australia should consider adopting rules requiring risk-based capital requirements, commensurate with the levels of activity and obligations of each clearing member.

While clearing houses should clearly set capital requirements for clearing membership to ensure that members are able to meet their obligations and that

systemic risk is mitigated, a fixed minimum capital requirement is poorly suited to this task. Setting an arbitrary minimum capital requirement that is not clearly correlated to the real potential risk of the member to the clearing house may function as an anti-competitive barrier to entry. An arbitrary minimum capital requirement is also poorly designed to achieve the goal of ensuring that clearing members have sufficient financial resources and operational capacity to meet obligations arising from participation in a clearing house.

We encourage Australia to adopt rules requiring risk-based capital requirements for clearing house members that reflect measures of financial exposure, such as the calculation of members' obligation to a clearing house's guarantee fund (or similar contingent funding obligations). Moving to a purely risk-based requirement will eliminate the need for a fixed minimum capital requirement of any kind, whether excessively high or unsuitably low. An FCM (futures commission merchant or CCP member) with a small client business would have a lower capital requirement than an FCM with a significant client and proprietary position at the same clearing house in the risk based approach.

The benefits of using a guarantee fund calculation as a membership criteria are clear. A member's obligations to a clearing house guarantee fund are based upon the total risk of the clearing house and each member's contribution to that risk, in terms of both its own proprietary positions and those of its customers. A member's actual and potential liability to the clearing house changes over time. A fixed capital requirement as a membership criteria does not take into account the real risk posed by a member to a clearing house. The capital requirement for clearing house membership should reflect these changing risks.

Basing a clearing member's capital requirement on guarantee fund obligation is also administratively simple and attractive. Clearing houses currently monitor a member's margin and guarantee fund obligations on a continuous basis, each of which is predicated upon the volume and an assessment of the risk of the positions being cleared through that member, and consequently, the risk posed by potential default by the member. The guarantee fund considers the potential exposure of a clearing member both at the clearing house level and at the level of the individual member. The standards that govern the guarantee funds at major clearing houses take into account notional exposure, concentration across membership, stress-testing and collateral, among other factors.

Capital requirements for clearing house membership could be calibrated to a member's anticipated contribution to the risk pool, and calculated as some multiple of the member's guarantee fund contribution. Linking a member's capital requirement to its guarantee fund contribution would ensure consistency and transparency across clearing house members, providing an administratively manageable, easily monitored system for aligning capital requirements with real potential risk.

Risk and Default Management

Membership rules relating to risk management and participation in the default management obligations of clearing members also need to be carefully balanced to achieve both management of systemic risk and a vibrant marketplace. We strongly support clearing house membership rules necessary to ensure that clearing members demonstrate the risk and default management capabilities necessary to ensure they will meet their obligations to the clearing house, especially in times of financial crisis.

For default management, for example, a clearing member must be able to demonstrate it can carry out its obligations under a default scenario to a clearing house. While that demonstration could include having the capacity to trade swaps using experienced swap traders, the ability to execute transactions in the market by having appropriate trading relationships, the ability to take on risk positions the member's balance sheet within the regulatory framework, and the appropriate infrastructure to support such activity are also appropriate methods to achieve default management and should not be excluded in membership rule making.

For risk management, a clearing member must demonstrate ability to monitor positions, calculate potential losses and market risk, perform stress tests, and maintain liquidity, among numerous other requirements. All of these requirements are necessary to protect the integrity of the clearing house, and to minimize systemic risk.

Risk and default management rules, however, should not be used to frustrate fair and open access to a clearing house, or to limit competition from alternative clearing member business models in the marketplace. For example, clearing house default management membership rules typically require the clearing member to demonstrate its ability to participate in an actionable auction process to set prices, and to accept proportional allocations of swap positions in the event of a clearing member default. Typically, existing clearing member firms rely on non-clearing member affiliates (e.g. a swap dealer banking affiliate) to demonstrate this capacity. Potential clearing members with alternative business models, however, may not have such dealer affiliates, but may choose to enter into committed arrangements with non-affiliated firms to perform the same functions as a dealer firm's affiliate. Assuming the legal and financial arrangements between such firms are sufficiently robust to ensure performance when needed, there is no appreciable difference between the default management capacity of the traditional dealer-affiliated clearing member and a non-dealer clearing member outsourcing certain functions to a non-affiliate.

State Street also supports the prohibition of membership requirements that include minimum swap portfolio or transaction volume sizes. These requirements are intended to systematically favor membership for financial institutions that are also substantial dealers in swaps. These requirements do not take into account the risk management capabilities of many clearing house members such as State Street, which are able to closely monitor risk exposures and effectively liquidate exposures through networks of interdealer relationships. Effectively mandating that only large swap dealers may also provide clearing services undercuts the

principles of fair and open access with negative consequences for investors and the market as set out earlier.

Section 4.3.2.16
Q. 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 time frame that is consistent with international implementation of the G20 commitments? If not, is there another option you prefer?

We understand the desire to rely on market forces and other mechanisms initially while collecting more information on the products traded. We would, however, encourage early adoption of mandatory clearing regulations in line with other G20 countries. Unless clearing is mandated, market adoption is likely to be slower and less complete. Implementing regulations to achieve workable processes will also take some time as the details of mandatory clearing are figured out.

4.3.2.18
Q. Are there specific classes of transaction that should be excluded from the potential reach of trade clearing DTRs (Derivative Trading Regulations)?

As the consultation points out it is proposed in some jurisdictions that important classes of foreign exchange (FX) derivatives (such as FX swaps and forwards) initially be exempt from any clearing requirement. State Street strongly believes that some foreign exchange ("FX") transactions, specifically FX forwards and currency swaps, should not be included within the intended framework.

FX markets are not organized in the same manner as OTC derivatives markets, and do not share the same core characteristics. Instead, they are well-organized and provide high-levels of liquidity and transparency. This includes the availability of the Continuous Link Settlement ("CLS") system to address settlement risk, as well as long-established procedures for mitigating counterparty credit exposure. Furthermore, the current FX system has worked well throughout the recent financial crisis, with little evidence of the sort of dislocation encountered in certain segments of the OTC derivatives market and in wholesale funding markets generally. In our view, any potential systemic risk concerns in the FX market have therefore already been properly addressed.

In addition, State Street is concerned that incorporating FX transactions such as FX forwards and currency swaps within CCPs would unnecessarily disrupt the market, with important implications for overall efficiency, stability and costs. Indeed, any presumption in favor of standardization, central clearing, and exchange trading in the highly customized FX market, would greatly reduce its effectiveness as a source of funding and/or hedging for corporations, financial institutions, pension funds and registered or collective funds. Moreover, it would have an especially detrimental impact on funding markets, where FX swaps are a low cost, low risk instrument used extensively by banks, including central banks, for short-term

funding needs, such as currency mismatches. Reducing the availability of customized FX swaps could result in greater reliance on short term placements and/or deposits, thereby creating increased credit risk.

State Street therefore strongly recommends the exclusion of FX transactions from the scope of the envisioned framework, especially forwards and currency swaps. If Australian regulators nonetheless conclude that it is it important to structure legislation on the basis of an encompassing definition of OTC derivatives, broad discretion should be provided to the appropriate competent authorities to exempt certain categories of FX transactions and/or certain specific regulatory requirements, such as product standardization, centralized clearing and exchange-based trading. This approach has been adopted in the United States where Treasury has the discretion to exempt FX transactions.

4.3.2.19

Q. 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?

We note that the approach being proposed in Australia is similar to that being proposed in other major markets in the Asia Pacific. This approach makes sense from a regulatory perspective. In drafting the regulations we would, however, value early clarity on two points. Firstly, whether the central clearing needs to be done in an Australian CCP or can be done in an overseas CCP. We recommend both options be available. Competing national regulations would make central counter party clearing unworkable. Second, guidance on how a transaction should be managed if it involves an entity in Australia and an entity in another market where domestic central clearing is required. Financial institutions will need to understand how to meet potentially competing obligations. Recognition agreements between regulations to allow clearing in recognized overseas clearing houses would be the best approach.

4.4.20

Q. Do you consider that there are any OTC derivative classes for which an execution on trading platforms mandate would be appropriate at this time? If so, please provide any evidence which supports your view.

We can appreciate the desire to collect more information on the products being traded before mandating execution on an exchange or electronic platform. Execution can, however, be launched relatively easily. As set out in answer to 4.4.22 many existing electronic trading venues could be easily converted to execute derivatives, including for IRS and CDS which regulators are initially planning to put through clearing houses. Participants would benefit from increased price transparency, narrowed spreads and costs reductions. Electronic

execution also gives the buy-side greater access to multiple prices. Clients have expressed interest in voluntary electronic execution in advance of mandated requirements. Regulations should provide for this.

4.4.21
Q. Alternatively, do you agree with the option of applying the same approach to prescribing entities, transactions and derivative classes as has been applied for mandating clearing?

As noted above, we can appreciate the desire to collect more information on the products being traded before mandating execution on an exchange or electronic platform. That said, we firmly believe that execution should occur shortly after clearing for reasons set out below in response to 4.4.22.

4.4.22
Q. If a derivative class is prescribed for mandated use of CCPs should it also be mandated for execution on a trading platform?

Yes. We firmly believe that execution on a trading platform should be mandated if clearing is mandated. Anything that can be cleared can be executed on a trading platform. In the US the proposal is to implement electronic clearing on a 60-day delay to the clearing provisions.

In the present model the volume is spread across numerous big dealers – without transparency. If clearing and execution is not simultaneously required, users could incur additional expenses related to clearing without the benefit of increased transparency, narrowed spreads and cost reductions for transactions that electronic trading would bring by replacing "one-to-one" trading with "one-to many" trading. Introduction of a simultaneous clearing and execution mandate will encourage new entrant market participants, increase competition, and better serve the goal of establishing robust clearing houses.

Concerns about fragmentation and liquidity are sometimes cited as the key reason for deferment of electronic execution. We believe only a small number of platforms will emerge, reducing this risk.

In the US, under Dodd-Frank, clearable trades will be required to be executed electronically through a Swap Execution Facility ("SEF") or exchange where available. Many existing electronic trading venues could be easily converted to execute derivatives. State Street, for example, operates a foreign exchange trading platform, and is planning to operate one or more swap execution facilities ("SEFs").

Segregation and Portability of Client Positions

While not raised in the consultation paper another issue that should be considered is the segregation and portability of client positions. A key aspect of indirect clearing (or client clearing) is to ensure portability and segregation of client positions and collateral. We note that Dodd-Frank requires collateral

segregation and portability to allow investors to move their positions in the case of a clearing broker default. We see benefits in this for clients as their risk will be reduced.

Custodians, such as State Street, may be able to play a role in ensuring collateral segregation and portability. The use of tri-party custody arrangements could provide buy-side counterparties higher levels of protection and greatly increase operational efficiencies compared to an environment where dealers are allowed broad use of comingled customer assets or where customer assets are held separately from the intermediary but comingled with other customers.

State Street recommends requiring the full segregation of all client assets from the proprietary assets of the clearing members, and also by providing clients with the option to choose on a non-discriminatory basis, whether to hold CCP collateral via a third party entity. We would emphasize, in this respect, the important investor protection benefits which this approach to asset segregation provides.

Thank you once again for the opportunity to comment on the paper. Please contact Catherine Simmons, Head of Regulatory, Industry and Government Affairs Asia Pacific on Catherine.simmons@statestreet.com and +852 2230 1577 should you have any questions about the attached or central counter party clearing more broadly. We would like to stay engaged as Australia develops its approach to central counter party clearing and offer the expertise we have gained in the derivatives market and through our participation in similar discussions overseas, particularly the US and Europe.

Yours sincerely

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