Chris Dalton
Chief Executive Officer
cdalton@securitisation.com.au

(t) + 61 2 8243 3900
(f) + 61 2 8243 3939

01 August 2014

Banking and Capital Markets Regulation Unit
Financial Systems and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: financialmarkets@treasury.gov.au

ATTN: Michael Lim

Australian Securitisation Forum response to Treasury Proposals Paper

Central clearing of OTC AUD interest rate derivatives

Dear Mr Lim,

Section 1 – Introduction and executive summary

1. The Australian Securitisation Form (**ASF**) welcomes the opportunity to respond to The Treasury paper entitled *Proposals Paper: Central clearing of OTC AUD interest rate derivatives* (the **Proposals Paper**). In summary, the ASF's submission is that:

   (a) the ASF strongly supports the proposal that the central clearing obligation be confined to internationally active dealers; and

   (b) thresholds should be applied in a manner consistent with that adopted with respect to *ASIC Derivative Transaction Rules (Reporting) 2013* (**DTRs**) – that is, on a trust by trust basis, rather than on a legal entity basis.

2. We have articulated arguments in support of these submissions in Section 2 of our submission.

3. We note that further detail on the securitisation industry's views on central clearing of derivatives was set out in our submission in response to the G4-IRD central clearing mandate (February 2014) (the ***G4-IRD Submission***), a copy of which is attached to this submission. (Annexure A to the G4-IRD Submission contains more details about the ASF.)

Section 2 – Overall comment

The ASF supports the position set out in the Proposals Paper to the effect that the central clearing obligation be confined to internationally active dealers.

However, industry is concerned that the current concepts for application of the mandate – whether Option A or Option B – are not appropriate, on the basis that they would inadvertently capture securitisation SPVs.

This is as a result of the proposal that thresholds be applied under paragraphs (a) of either Option A or Option B on a "legal entity basis" – that is, on a company by company basis - as opposed to being determined on a trust by trust basis (as is the case for the DTRs).

Our concern is as follows: as described in the G4-IRD Submission, in a typical Australian securitisation, a special purpose vehicle (**SPV**) acquires or originates assets, raises finance, and (relevantly) often enters into derivatives. Each SPV is typically a trust – that is, a company acting in its capacity as trustee of a specified pool of assets.

Importantly, under Australian law, a trust is not a legal entity – the company that acts as trustee of the trust is a legal entity, but the trust itself is not.

In the Australian market, each trustee company is typically a member of a group constituting one of a handful of professional trustee companies.

Therefore, each trustee company acts as trustee of a large number of trusts – and therefore, across all of those trust relationships, each relevant legal entity would be party to a large number of derivatives.

The volume of derivatives entered into by some of those trustee companies (each of which is a "legal entity") may currently, or in the future, exceed the thresholds proposed in paragraphs (a) of Option A or Option B (whichever is adopted).

The effect of this would be to inadvertently impose the proposed clearing regime on securitisation SPVs. This would appear to be contrary to the intention set out in Proposals Paper that the regime only apply to a relatively small set of internationally active dealers.

The ASF appreciates that one of the purposes behind the proposed clearing mandate is to promote financial stability. However, importantly, the ASF considers that exclusion of securitisation SPVs does not raise any issues in respect of financial stability because (as noted in Annexure C of the G4-IRD Submission):

(a) **limited recourse** - the recourse of the secured creditors of the securitisation SPV is limited to the assets (i.e. the mortgages or other receivables) of the SPV.

Accordingly, the assets of one trust would not be available to meet the obligations of the same trustee incurred in respect of any other trust.

Therefore, default by one trust of which a trustee company is trustee would not have any direct impact on the ability of any other trust (of which the same trustee company is the trust) to meet its derivative obligations.

(b) **security** – security is granted over the assets of the SPV in favour of a security trustee, who holds the benefit of that security on trust for the secured creditors including the swap counterparty. The swap counterparty would typically rank senior or *pari passu* with the senior financiers.

That is, protection through the provision of security is already built into the securitisation SPV derivatives to protect the swap counterparty. This is therefore different from the inter-dealer derivative market, where each party's position is typically unsecured.

We consider that there are a number of possible ways to address industry's concerns.

Option 1 – align threshold application to the approach adopted under DTRs

We note that under the DTRs, the application of the reporting requirement is determined by application of thresholds which (relevantly) are determined on the basis of the relevant entity acting in its capacity as trustee or responsible entity of each fund – rather than looking at the legal entity itself. That is, ASIC applies the derivative reporting rules on a trust by trust basis, rather than on a legal entity basis.

The ASF requests the application of a similar regime in relation to the determination of the application of the clearing mandate. This would be consistent with Treasury's desire to limit application to internationally active dealers. There would be no adverse impact on the desire to promote financial stability due to the limited recourse and security aspects of the securitisation structures, as outlined above.

ASF considers that this would be the most appropriate way to address this issue, and has the advantage of aligning the regime with that to be applied under the DTRs, thereby decreasing the extent of incremental compliance costs.

Option 2 – define "dealer"

An alternative approach would be to more narrowly define what is meant by a "dealer".

As currently drafted, the Proposal references each "financial entity", which we understand is intended to pick up all those that are required to report under the DTRs. This therefore picks up all holders of an Australian financial services licence.

We consider that this is unintentionally picking up a considerably broader group than is intended. We note, in support of this, the comments in the Proposals Paper to the effect that there is no intention for the mandate to cover smaller financial institutions or end users. Securitisation SPVs are end users – they are not acting on behalf of any other person.

This issue could be addressed by more precisely defining who is a "dealer", in a manner that is sufficient to exclude securitisation SPVs.

Option 3 – specifically exclude securitisation SPVs

A further alternative would be to specifically exclude securitisation SPVs.

The arguments in favour of the exclusion of securitisation swaps from a clearing mandate are set out in Section 2 of the G4-IRD Submission.

Section 3 – Responses on feedback sought

We note that feedback is sought in relation to seven specific questions in respect of the Proposals Paper.

We have not provided a detailed response on these issues, as for the reasons noted in Section 2, it appears clear to the ASF that the intention is that the clearing mandate not apply to securitisation SPVs. ASF's concern is that the current proposed drafting of the regime inadvertently picks up securitisation SPVs. Accordingly, we have only provided detailed input on this issue. (Our responses in Section 2 could however be applied in respect of the issues raised for feedback in items 4 and 5.)

Please do not hesitate to contact me should you wish to discuss this matter further.

Yours sincerely

CHRIS DALTON

Enc. (1)