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VIA E-MAIL

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The Treasury  
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**Re: Consultation Paper on *Implementation of a framework for Australia's G20 over-the-counter derivatives commitments.***

Ladies and Gentlemen:

CME Group Inc. (CME Group), on behalf of its subsidiary Chicago Mercantile Exchange Inc. (CME) would like to express appreciation to the Treasury of the Commonwealth of Australia (the "Treasury") for the opportunity to comment on its Consultation Paper on the *Implementation of a framework for Australia's G20 over-the-counter derivatives commitments* issued in April 2012 (the "Consultation Paper"). CME's clearing house division (CME Clearing) offers access to its clearing and settlement services for exchange-traded futures contracts, and for over-the-counter (OTC) derivatives through CME ClearPort. CME is registered with the U.S. Commodity Futures Trading Commission (CFTC) as a derivatives clearing organization (DCO) and as a designated contract market (DCM).

CME Group is also the parent company of the Board of Trade of the City of Chicago, Inc. (CBOT), the New York Mercantile Exchange, Inc. (NYMEX), and the Commodity Exchange, Inc. (COMEX) which are registered with the CFTC as DCMs and/or DCOs. CME and CBOT hold Australian Market Licenses granted by the Parliamentary Secretary to the Treasurer of the Commonwealth of Australia and overseen by the Australian Securities and Investments Commission (ASIC).

The Consultation Paper provides an overview of the legislative framework for the implementation of Australia's G20 OTC derivatives commitments along with options for the regulation and implementation of mandatory obligations related to trade repositories, central clearing and trade execution. This letter primarily focuses on the implementation of central clearing and trade reporting obligations.

*Location Requirements for CCPs*

The Consultation Paper proposes allowing licensed foreign and domestic central counterparties (CCP) to provide clearing services for OTC derivatives in Australia while allowing for the possibility that ASIC and the Reserve Bank of Australia may impose location requirements on CCPs in certain key areas. CME Group strongly supports the proposal to all foreign CCPs to be utilized for purposes of centrally clearing OTC derivatives in Australia. This approach is consistent with the International Organization of Securities Commission's (IOSCO) February 2012 report on *Requirements for Mandatory Clearing* (the IOSCO Report), which states:

Advantages of allowing the use third country CCPs to satisfy mandatory clearing are that it could allow mandatory clearing obligations to apply to a wider range of products or

currencies than is available within any individual jurisdiction as well as increasing consistency between regimes and reducing the potential for regulatory arbitrage. Utilising such CCPs in mandatory clearing regimes would allow authorities to decrease counterparty risk via utilisation of central clearing over and above the use of domestic CCPs. The ability of third country CCPs to provide clearing services under overseas mandatory clearing regimes may also incentivize domestic CCPs to expand the range of products they offer in order to protect and expand their market share.<sup>1</sup>

As observed in CPSS-IOSCO's May 2010 report entitled *Guidance on the application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC derivatives CCPs*, "[g]reater use of CCPs for OTC derivatives will increase their systemic importance."<sup>2</sup> Successful management of systemic risk will require a regulatory regime that incorporates appropriate measures whereby more than one CCP may be utilized for purposes of the mandatory clearing obligation. CME Group believes that this can be best accomplished by allowing central clearing through both domestic and foreign CCPs.

However, CME Group does not believe that imposing location requirements in key areas such as financial, risk management, collateral and operational arrangements for foreign CCPs clearing systemically important products or markets is prudent. Such locational requirements could prevent foreign CCPs from operating in the Australian market due to potential conflicts with their local regulator and, if required in numerous jurisdictions, the potential for prohibitive operating costs due to the placement of redundant capabilities in jurisdictions throughout the world. If foreign CCPs were dissuaded from operating in Australia due to regulatory conflicts and increased costs, or otherwise, Australia may fail to realize the benefits of having multiple CCPs offering OTC derivatives clearing.

The more prudent approach is to ensure that any CCP operating in Australia – whether domestic or foreign – meets international standards for regulation of OTC derivatives CCPs, such as those put forth by CPSS-IOSCO. As explained in the IOSCO Report, the mitigation of concerns regarding use of foreign CCPs for products subject to mandatory clearing may be obtained "if the third country CCPs' supervisors ensure that the risk management of such products is carried out in line with appropriate regulatory standards, such as the CPSS-IOSCO *Principles for Financial Market Infrastructures* and alongside cooperative oversight arrangements"<sup>3</sup> of foreign CCPs between home and local regulators

#### Implementation of Central Clearing

The Treasury is considering using economic incentives and other initiatives to encourage the transition to central clearing while ensuring that Australia retains the authority to implement a central clearing mandate as necessary. CME Group supports the transition to clearing through CCPs and the implementation of prudential capital requirements that are proportionate to the risks assumed by market participants. Due to the decreased counterparty risk of transactions cleared at CCPs, CME Group believes it logical to take an approach where centrally cleared transactions have lower capital requirements than bilaterally executed and settled transactions.

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<sup>1</sup> IOSCO Report, at 38.

<sup>2</sup> CPSS-IOSCO May 2010 consultative report, at 1.

<sup>3</sup> IOSCO Report, at 39.

### Trade Repositories

CME Group supports the objective of establishing mandatory data reporting regimes in the OTC derivatives markets. Market participants should be subject to a system that requires them to make complete and detailed transaction reports regarding OTC derivatives transactions. Such reports can provide regulatory authorities with a comprehensive audit trail for important regulatory purposes. In addition, we believe that increased public transparency for OTC derivatives transactions also generally benefits all market participants and is a worthy goal. However, in our view it is critically important to design any such mandatory reporting system in the most cost effective and efficient manner possible. Leveraging existing infrastructures where possible rather than building from scratch is prudent and can help manage industry implementation costs. It can also help assure that the best and most effective regulatory access to data is secured.

In the area of cleared trades, the CCP serves as the natural repository of data for the transactions it clears. CCPs necessarily have already established connections with relevant execution venues and other market participants for cleared trades. These existing connections can be leveraged for reporting purposes as well. Requiring entirely redundant reporting channels to non-third party repositories for cleared trades is at best unnecessary and costly and at worst could create unnecessary ambiguity about the true state of a trade or position. We note that the central counterparty clearing model breaks the originating trade and replaces it with positions between the CCP and the original parties. The post-clearing positions are uniquely maintained by the CCP.

There are overwhelming operational reasons why it is critical to ensure that CCPs act as final repositories for regulatory information regarding cleared trades. First, calling on CCPs to play this role would be the lowest cost and least burdensome path available to implement the regulatory reporting requirements for derivatives transactions. This is so because each CCP that clears swap transactions already possesses the majority of transaction records that will be required to be maintained. Any required records that are not currently maintained by a CCP that clears a particular derivatives transaction can easily be reported to such CCP at the time a transaction occurs. Execution venues that are matching standardized OTC derivatives transactions that will be cleared will necessarily be required to establish connectivity with CCPs for the purpose of clearing. These connections could easily be used to facilitate reporting as well. Therefore, industry technology build outs for reporting purposes would be as limited as possible.<sup>4</sup>

Second, any system that would result in the creation of a separate set of trade details housed away from a CCP and at a third party non-CCP repository introduces potential ambiguity about the true state of a position. When a trade is cleared on a CCP, it is unarguable that such CCP must always be the holder of the "gold copy" of the trade. This is required because that CCP must margin the position, must calculate open interest, and must interact with the back office systems of its clearing members. These are the core functions of clearing and cannot be delegated.

The development of mandatory derivatives reporting regimes will also certainly require the development of unique transaction and counterparty identifiers, a significant undertaking. The process for developing these unique identifiers must be coordinated with other regulators to the maximum extent possible. Given that market participants frequently transact in multiple jurisdictions and therefore are subject to multiple regulatory requirements, it makes sense to strive for compatible identification protocols to avoid the need

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<sup>4</sup> Third party repositories would have to establish entirely separate and new connections with all the relevant parties including the CCPs, execution venues, trade counterparties and regulators. Requiring redundant channels of connectivity to allow non-CCP repositories to maintain a separate set of cleared trade information would be expensive and unnecessary. These costs would likely be passed on to end users. Further, such redundant reporting loops would introduce the potential for new points of failure or errors in the reporting chain.

for developing separate systems. In addition to the extent required identification codes are designed to be compatible, regulators would be able to share information more effectively. In our view, any mandatory reporting requirements should not go into effect unless and until industry wide and internationally coordinated standards for product, swap and counterparty identifiers are firmly in place.

CME Group thanks the Treasury for the opportunity to comment on this matter. Should you have any comments or questions regarding this submission, please contact Phupinder Gill at (312) 930-3088 or [Phupinder.Gill@cmegroup.com](mailto:Phupinder.Gill@cmegroup.com) or Sean Downey, Director and Assistant General Counsel at (312) 930-8167 or [Sean.Downey@cmegroup.com](mailto:Sean.Downey@cmegroup.com).

Sincerely,



Phupinder S. Gill  
Chief Executive Officer

SMD/Australia G20 OTC Comment Letter