

The Australian Government's G-20 commitment

- 1.1 At the G-20 summit in Pittsburgh in 2009, the Australian Government joined other jurisdictions in committing to substantial reforms to practices in over-the-counter (OTC) derivatives markets.
- 1.2 The Australian Government is now releasing for comment draft legislation that will provide a legislative framework to ensure that Australia can meet its commitments in this area by prescribing the following requirements as each becomes appropriate:
 - the reporting of all OTC derivatives to trade repositories;
 - the clearing of all standardised OTC derivatives through central counterparties; and
 - the execution of all standardised OTC derivatives on exchanges or electronic trading platforms, where appropriate.
- 1.3 The draft legislation will not impose any requirements but will allow for the Minister for Financial Services to make future decisions to prescribe derivatives for reporting, central clearing and exchange trading of derivatives following further consultation with industry and market assessment.

Previous consultation

- 1.4 Earlier this year the Australian Government consulted on the contents of the regulations to be made under the framework, and on the classes of derivatives that might be prescribed as being subject to the framework. Comments were also sought on the proposed legislative framework and licensing arrangements for future trade repositories.
- 1.5 Treasury, in conjunction with the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investment Commission (ASIC) and the Reserve Bank of Australia (RBA) (hereafter the Agencies) conducted 43 face-to-face meetings with stakeholders and received 37 submissions to the consultation paper.

- 1.6 Stakeholders were generally supportive of the proposed legislative framework for the implementation of the G-20 OTC derivatives reforms. A wide range of stakeholders understood the need and supported the flexible approach taken by the Government in implementing the reforms.
- 1.7 A number of stakeholders favoured mandating central clearing rather than relying on market forces to ensure the adoption of reforms occurs in a timely manner.
- 1.8 Some stakeholders argued that their use of derivatives was primarily for the hedging of business risk and questioned the systemic importance of their derivatives trading activities.
- 1.9 The legislative framework will provide the flexibility for consideration of the matters raised before any future decision to mandate reporting, central clearing or on-exchange trading.
- 1.10 The Council of Financial Regulators (the Council) had earlier been considering the implementation of reforms for the Australian OTC derivatives market for some time. In 2009 the Council published a survey of the domestic OTC derivatives market¹, and in June 2011 the Council released a discussion paper on central clearing as the basis for detailed consultation with interested stakeholders.²
- 1.11 Following that consultation, the Council provided a report to the Government on 20 March 2012, setting out advice and recommendations on implementing reforms in the Australian market. This report was released for comment as part of the consultation earlier this year.

International developments

- 1.12 At an international level, in June 2012, the Financial Stability Board (FSB) published its third report on jurisdictions' progress towards meeting G-20 commitments regarding OTC derivatives.³
- 1.13 The report called on all jurisdictions to aggressively push ahead to achieve full implementation of market changes by end-2012 to meet the G-20 commitments in as many reform areas as possible.

1 <http://www.rba.gov.au/payments-system/clearing-settlement/survey-otc-deriv-mkts/index.html>

2 <http://www.rba.gov.au/publications/consultations/201106-otc-derivatives/index.html>

3 http://www.financialstabilityboard.org/publications/r_120615.pdf

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- 1.14 The report noted that all jurisdictions should put legislation and regulations in place promptly, and in a form flexible enough to respond to cross-border consistency and other issues that may arise.
 - 1.15 Major jurisdictions such as the United States and European Union have also recently published guidance on the extra-territorial application of their implementations of the G-20 commitments and their expectations of other jurisdictions, such as Australia.
 - 1.16 The guidance provided from the United States and European Union emphasises the need for Australia to act quickly to ensure that Australian businesses and investors are able to demonstrate that they are subject to an equivalent regulatory regime and so be able to continue to participate in the major derivatives markets of the world while still being primarily regulated in Australia.
 - 1.17 However, the guidance has also highlighted areas of inconsistency and further potential change so it will be important for the Australian regime to remain flexible to ensure that future developments can be accommodated.

CHAPTER 2 OVERVIEW OF THE DRAFT BILL

2.1 This draft Bill provides for the implementation of graduated measures to respond proportionally in managing risks in Australian OTC derivatives markets. In outline, the framework will operate as follows:

- The Minister for Financial Services and Superannuation (the Minister) will be empowered by the *Corporations Act, 2001* (the Act) to prescribe a certain class of derivatives (in relation to a mandatory obligation).
- A derivatives transaction rule (DTR) may in turn be issued by ASIC to establish one or more mandatory obligations (reporting, clearing or execution) for participants transacting in this prescribed class of derivatives.
- Any rule must be consented to by the Minister before taking effect. The scope of rules, and other technical features of the scheme, may be further limited by Regulation.
- A new licencing regime will be introduced for a new kind of financial infrastructure entity, trade repositories.

2.2 The establishment of the framework (through amendments to the Act) does not in itself introduce any trade reporting, central clearing or trade execution obligations for OTC derivatives transactions. Rather, the framework creates a mechanism by which such obligations may be implemented by supporting regulations and rules.

2.3 Decisions to prescribe or make rules for a class of derivatives will require public consultation, and will include opportunities for other agencies to provide advice. Rules will require the consent of the Minister and be disallowable legislative instruments. The Bill also contains a regulation-making power to narrow the scope of the mandatory obligations (and therefore the parties who will be required to comply with the obligations under the DTRs). These regulations will provide a means of limiting the classes of persons and transactions to which the rules can be applied. That is, the regulations may provide carve outs and exemptions any trade reporting, clearing or execution mandates.

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- 2.4 It is expected that the Minister will cause such regulations to be made, at the same time as prescribing a class of derivative as being subject to ASIC's trade reporting, clearing or execution rule making power.
- 2.5 Under the rule-making power, ASIC will also be able to specify cases in which certain persons or certain transactions would not be required to report, clear or execute trades in accordance with the DTRs. That is, within the limitations of the rule making power, ASIC may provide for additional carve outs and exceptions.
- 2.6 As there is no existing regulation of trade repositories, trade reporting DTRs will be complemented by a licensing regime for trade repositories. There are no operators of trade repositories (as the term is contemplated by the G-20 commitments) in Australia; therefore no existing operators will be affected. Clearing facilities and trading platforms are already subject to separate licensing regimes.
- 2.7 The trade repository licensing regime is modelled on the current licensing regimes for Australian market licence holders (AMLs, Part 7.2 of the Act) and Australian clearing and settlement facility licence holders (CSFLs, Part 7.3 of the Act). It has a similar structure to Part 7.2 and Part 7.3, however no separate overseas licensing regime is necessary as the requirements for licensing will be limited to those that would be appropriate for either a domestic or overseas based trade repository.
- 2.8 The licensing regime will be established at a high level in the amended Act, with regulations filling in detail (as is the case with the AML and CSFL regimes). ASIC will be given powers to make rules governing the operation of a trade repository in addition to issuing and imposing conditions on individual TR licensees. Similar checks and balances exist in relation to this rule making power to those in relation to the derivative transaction rules set out above.
- 2.9 It is important that the regime established for licensing and supervising any domestic facility is sufficiently equivalent to the regimes in place in major overseas jurisdictions such as the EU and the US to facilitate mutual recognition and therefore Australian facilities' access to intermediaries located in those jurisdictions.
- 2.10 Where the DTRs oblige a person to utilise the services of a trade repository, clearing facility or trading platform, the rules can impose a duty upon the relevant facility to provide non-discriminatory access. Such a requirement is important, given that there may be only one facility offering services for a given derivative class. ASIC will also have power to make additional rules to determine the obligations of trade repositories, clearing facilities or trading platforms in relation to any requirements imposed upon parties to transactions.

- 2.11 The Bill provides for the protection of trade data through imposing restrictions on the use and disclosure of reported data. The derivative trade repository rules may also impose requirements in relation to the integrity and security of a trade repository's systems.
- 2.12 ASIC will be given the function of supervising trade repositories however it will be able to perform this function in respect of overseas licensees by satisfying itself that the home regulator has adequate regulations in place or that adequate arrangements are in place with the home regulator.
- 2.13 Licensing and associated powers will be exercised by ASIC.