ISDA Safe, Efficient Markets

20 August 2012

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Dear Sir

Corporations Legislation Amendment (Derivative Transactions) Bill 2012 - Exposure Draft

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] welcomes the opportunity to provide comment on the exposure draft of the Corporations Legislation Amendment (Derivative Transactions) Bill 2012 ("**Draft Legislation**") released on 25 July 2012.

ISDA is actively engaged with providing input on regulatory proposals in the United States ("**US**"), Canada, the European Union ("**EU**") and in Asia. Our response to the Draft Legislation is derived from these efforts and from consultation with ISDA members operating in Australia and Asia. Our response is drawn from this experience and dialogue. Individual members will have their own views on different aspects of the Draft Legislation, and may provide their comments to the Australian Government independently.

ISDA commends the Australian Government for its careful consideration of issues which would facilitate Australia meeting its G20 recommendations regarding central clearing and trade reporting of OTC derivative transactions in line with other G20 countries, particularly the US and EU. We also appreciate and support the objectives to reduce counterparty risk, improve overall transparency, protect against market abuse and ultimately reduce systematic risk in the OTC derivatives market.

We are pleased to see that the Draft Legislation addresses many of our concerns expressed in our letter of 15 June 2012 ("**June Letter**") in response to the Australian Government's Consultation Paper entitled "Implementation of a framework for Australia's G20 over-the-counter derivatives commitments" ("**Consultation Paper**").

[1] ISDA's mission is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products. ISDA has more than 800 members from 58 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. For more information, visit www.isda.org.

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We have set out our submission below on the following topics:

- Inclusion of exceptions in the legislative framework
- Scope of the definition of "derivative transaction"
- Extraterritorial reach of the legislation
- Clarity of certain references
- Retrospective effect of clearing requirements
- Retrospective effect of reporting requirements
- Public consultation by ASIC and the Minister
- Issues to be considered by ASIC and the Minister
- Access to data in a licensed derivative trade repository

1) Inclusion of exceptions in the legislative framework

Whilst we appreciate that the Draft Legislation only contains the mechanism by which obligations may be implemented by supporting regulations and rules, we are of the view that it is appropriate to include certain exceptions in the legislative framework. This is particularly the case given the broad definition of "party" in the Draft Legislation. Providing appropriate exemptions in the legislative framework would provide market participants with greater certainty in respect of the policy settings of the regime.

We envisage such exceptions would be appropriate for certain transaction types and parties. We refer to the examples we have previously provided of the types of transactions that we consider are appropriate to be excluded from this regime from a policy perspective[2].

If these could not be drafted into the legislation, we request that they be outlined in the explanatory memorandum for the Draft Legislation so the Government's intention could be made clear.

2) Scope of the definition of "derivative transaction"

Under section 761A, "derivative transaction" is defined as:

(a) the entry into of an arrangement that is a derivative; or
(b) the modification or termination of such an arrangement; or
(c) any other transaction relating to a derivative.

We submit that this definition should be amended for the reasons set out below.

the "modification or termination of" an arrangement that is a derivative

Whilst paragraph (b) of the definition of 'derivative transaction" may be appropriate in the context of the reporting mandate, we are strongly of the view that it is not appropriate in relation to the clearing mandate. This is because it suggests that a derivative that has been

[2] We refer to our response to question 9 in our June Letter.

terminated may be subject to the clearing requirements, which is tantamount to back loading such transactions for clearing. Please refer to our response below in section 5 in respect of back loading.

Accordingly, we submit that the enabling legislation should clarify that the clearing requirements do not apply to terminated derivative transactions. If this is not possible, and the limitation is to be contained only in the supporting regulations or rules, then we request that this be set out in the explanatory memorandum for the Draft Legislation.

"any other transaction relating to a derivative"

We submit that paragraph (c) should be omitted because it is unclear which transactions are intended to be caught by this. Furthermore, it is quite possible that it could have unintended consequences. For example, presumably it is not intended to include financing transactions which are being hedged by the relevant derivative. Accordingly, some thought should be given as to whether paragraph (c) is needed.

3) Extraterritorial reach of the legislation

Section 900A provides that:

> *this Part applies, on the basis specified in section 3, to derivatives, derivative transactions, facilities, persons, bodies and other matters located in or otherwise connected with:*
>
> *(a) a referring State; or*
> *(b) the Northern Territory or the Capital Territory; or*
> *(c) a place outside Australia.*

We submit that if a global reach of the Draft Legislation is intended then there is a concern that this could compromise the achievement of cross-border harmonization of regulatory regimes around the globe. The potential for the Australian regulations and rules to have extraterritorial effect would have significant consequences for compliance by market participants. It would be best if clarity of this issue was achieved in the enabling legislation.

However, we understand that some extra-territorial reach of the Draft Legislation is thought necessary in order to enable regulations and rules to be passed which take into account the impact of foreign legislative requirements on Australian market participants. If this is the case, we submit that the proposed jurisdictional reach be outlined in the explanatory memorandum for the Draft Legislation.

We also submit that the inclusion of "derivatives" in this section is redundant and liable to cause confusion given that "derivative transactions" itself references "derivatives".

4) Clarity of certain references

We submit that there should be clarification of the following references in the Draft Legislation.

a) "Class"

We submit that the Draft Legislation should include a definition of "class" as it applies in the legislation to each of derivatives, derivative transactions, financial products, licensed derivative trade repositories or prescribed derivative trade repositories and licensed CS facilities or prescribed facilities, to provide market participants with more clarity in respect of the legislative framework for the regime. In particular, we submit that a definition of a "class" of derivatives is required in the enabling legislation to enable market participants to appreciate the scope of the Minister's delegated power to make a determination under section 901B(2). We recommend the definition of "class" be based on a product classification system that is aligned with international standards.

b) Entities for reporting and clearing requirements (section 901A(3))

We note that the framework for introducing rules on reporting and clearing requirements refers to a facility prescribed by the regulations for these purposes (subsections 901A(6)(b) and (7)(b)). We assume that these facilities are the same as those referred to as:

(i) for reporting requirements, the "prescribed derivative trade repository" to which information about derivative transactions, or positions in a particular class must be reported under section 901A(3)(c); and

(ii) for clearing requirements, the "prescribed facility" through which derivative transactions in a particular class must be cleared (section 901A(3)(d)).

We request that this be clarified in the Draft Legislation.

5) Retrospective effect of clearing requirements

Section 901A(8)(c) provides that a clearing requirement could apply to a transaction that has been entered into but not cleared by the time the clearing requirement starts to apply.

We disagree with the effect of this subsection, which amounts to back loading. As we indicated in our June Letter, it is worth noting that there is no back loading requirement for clearing in the US and EU and refer to the explanation in our June Letter for our position on back loading[3].

[3] See our response to question 10 in our June Letter.

6) Retrospective effect of reporting requirements

We understand that the intent of the second part of Section 901A(8)(b) is to enable the imposition of a requirement for reporting aggregate position data on transactions that were entered into before the reporting requirement starts to apply. Although this *prima facie* appears to be less onerous than requiring reporting of individual transaction data, members are unsure about the operational and cost impact of such a requirement. This is particularly so if other countries were to impose reporting requirements on legacy transactions that are different from Australia's requirements. We reiterate our request in the June Letter that any reporting requirement in relation to legacy transactions be consistent with international standards[4].

In any case, we believe that the drafting of the second part of Section 901A(8)(b) should be clarified or at the least, its intent outlined in the explanatory memorandum for the Draft Legislation.

7) Public consultation by ASIC and the Minister

a) Ministerial determinations under section 901B(2)

We note that the Minister is not subject to a requirement to engage in public consultation before determining the classes of derivatives to which requirements may apply.

We request that the Minister be required to engage in public consultation under the enabling legislation before making determinations under section 901B(2) as the market will be able to make valuable contributions to the deliberations on these matters.

b) Public consultation by ASIC

i. Timeframe for consultation

We welcome the inclusion of the provisions requiring ASIC to consult with the public before making a derivative transaction rule or derivative trade repository rule under sections 901J(1)(a) and 903G(1)(a) of the Draft Legislation.

We submit that a reasonable time period needs to be provided for this consultation process in order for this to be of maximum utility. We request that this is reflected in the Draft Legislation, and in any case, implemented by ASIC.

ii. Consequences of consultation

Under the Draft Legislation, ASIC is not required to pay due consideration to the result of any public consultation.

[4] See our response to question 10 in our June Letter.

We suggest it is appropriate that ASIC be required to pay due consideration to the result of the consultation with the public (and indeed its fellow regulators), given the potentially broad scope of the powers delegated to ASIC.

8) Issues to be considered by ASIC and the Minister

Sections 901B(3)(a), 901H(a) and 903F(a) of the Draft Legislation describe the two issues which the Minister and ASIC must have regard to before exercising their powers to make a determination and rules respectively, over a class of derivatives.

We reiterate our submission in the June Letter that it would be useful to include a requirement in the section that ASIC and the Minister must also consider international guidance, in forms such as the OICV-IOSCO paper of February 2012 entitled "Requirements for Mandatory Clearing"[5]. This would provide the regulated community with comfort that the Minister and ASIC will have regard to issues affecting the international consistency of OTC derivative regulation, such as the potential for overlap between competing clearing mandates in different jurisdictions.

We refer to the obligations imposed by the Office of Best Practice Regulation in respect of preparing a preparing a Regulation Impact Statement ("**RIS**") in respect of a decision "likely to have a regulatory impact on business". We note the significant impact of the Draft Legislation on our members' business from a costs and compliance perspective and are concerned to see this taken into account in the regulation making process. We believe it will provide some assurance to market participants if the need for a RIS were set out in the explanatory memorandum for the Draft Legislation.

9) Access to data in a licensed derivative trade repository

Section 904B (2) allows a derivative trade repository licensee to request another derivative trade repository licensee to provide it with derivative trade data that is retained in the second-mentioned derivative trade repository licensee's derivative trade repository. Section 904B(5) obliges the second-mentioned derivative trade repository licensee to comply with such request (unless excused or prohibited from doing so by the supporting regulations or rules). Our members do not see why the first-mentioned derivative trade repository licensee should have such access and submit that such access should be given only if there is some systemic purpose to be served and this is a matter for determination by the regulators and not by the first-mentioned derivative trade repository licensee. Thus, we submit that the provision should be amended so that the request cannot be made by the first-mentioned derivative trade repository licensee – but that the relevant regulator upon making a declaration to this effect, can request the second-mentioned derivative trade repository licensee to provide the relevant data to the first-mentioned derivative trade repository licensee.

[5] This paper is referred to in our June Letter.

ISDA

ISDA appreciates the opportunity to provide comments on the Draft Legislation and looks forward to working with the Treasury as it continues the regulatory process. Should you require further information, please do not hesitate to contact the undersigned.

Yours faithfully,
For the International Swaps and Derivatives Association, Inc.

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