ISDA Safe, Efficient Markets

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The Australian Securities and Investments Commission's Consultation Paper 186 on Clearing and Settlement Facilities: International Principles and Cross-Border Policy (Update to RG 211)

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] welcomes the opportunity to provide comments on the Australian Securities and Investments Commission's ("**ASIC**") consultation paper on Clearing and Settlement Facilities: International Principles and Cross-border Policy (Update to RG 211) ("**Consultation Paper**") released on 11 September 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 Consultation Paper 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 Consultation Paper, and may provide their comments to ASIC independently.

ISDA commends ASIC for aligning of the Australian regime with the Committee on Payments and Settlement Systems ("**CPSS**") and the Technical Committee of the International Organization of Securities Commission ("**IOSCO**") Principles for Financial Market Infrastructures ("**FMIs**") ("**Principles**")[2] for clearing and settlement ("**CS**") facilities. The Principles promotes effective risk management and a stronger global financial infrastructure that is transparent to participants. The Principles will assist in articulating a formal structure for risk management and key operational aspects of FMIs; establish a means to make these structures transparent; and create a consistent international standards to assess compliance. We believe a harmonized and single international standard would provide greater consistency in oversight and regulation of FMIs worldwide.

[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.

[2] Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, *Principles for Financial Market Infrastructures*, April 2012.

As part of the G20 commitments regarding central clearing, this would align Australia with the other G20 countries, particularly the US and EU and meet the Basel Committee on Banking Supervision ("**BCBS**") requirements for bank exposures to CCPs.

In this paper, we will limit the definition of CS facilities to central counterparties ("**CCPs**") clearing Over-the-Counter ("**OTC**") derivatives transactions only.

General observations

Before we address the questions posed in the Consultation Paper, we would like to make a few general observations.

Recognition of cross-border CS facilities

We commend ASIC for allowing overseas clearing and settlement facilities ("**CSF**") to apply for a CSF license in Australia without imposing a location requirement. However, we note with some concern that ASIC may advise the Minister, under RG 211.154 and RG 211.155, to impose conditions on a particular CSF license, such as the requiring a CS facility to establish a domestic operational presence[3] or the requirement to have a "domestic legal presence" under the proposed amendments to RG 211.148 or to allow regulatory participation in risk management processes for systemically important CSFs. We commend and support RG 211.159[4] which enables ASIC and an overseas CSF to have a dialogue on the conditions that may be imposed prior to advising the Minister. This dialogue should allow an existing or potential overseas CSF licensee greater opportunity to determine whether to take the necessary steps to comply with conditions such as the locational requirements or to restructure its business to avoid such requirements. Before conditions are imposed we believe due consideration should also be given to the overseas CS facility's clearing members and their clients, all of whom may have to comply with divergent national regulations, and who may face operational or regulatory issues as a result of any change in the structure of the CS facility's operations which may include establishment of a domestic legal presence. In particular, care should be taken in considering the impact a locational requirement may have on the existing transactions for clearing members ("**CMs**") and their clients and any unforeseen consequences that may flow from this. We would encourage ASIC to include all stakeholders, such as CMs of the overseas CS facility, in the consultation process.

As you know, a significant percentage of Australian dollar interest rate swaps ("**AUD IRS**") are currently cleared by London Clearing House ("**LCH**") and other foreign CCPs in a well-

[3] ASIC's 'Regulatory Guide 211, Clearing and settlement facilities: Australian and overseas operators', page 45, RG 211.155(h): "requiring your CS facility to establish a domestic operational presence, either with respect to human resources or other aspects of their operations, for either all or part of their function; and"

[4] ASIC's 'Regulatory Guide 211, Clearing and settlement facilities: Australian and overseas operators', page 45, RG 211.159: "We will consult with you about the type of conditions we may recommend before we give our advice to the Minister."

regulated environment. It is important for market participants to be able to retain the flexibility to continue to clear their transactions through foreign CCPs that have an equivalent regulatory and supervisory regime as the Australian one. Such flexibility will help prevent fragmentation of trading volume between different CCPs and any corresponding reduction of netting benefits and increased in margin costs. Given the global nature of OTC derivatives markets and the relative size of Australia's OTC derivatives market, we urge you to consider the global nature of the markets when implementing the regulations so as not to restrict the ability of Australian market participants to continue participating in and being competitive in the global OTC derivatives market. The imposition of undefined conditions including location requirements on a large CCP may make it impossible for such CCP to continue to undertake Australian related business in the future which may leave Australian and foreign market participants with very little choice as to where to clear their transactions particularly if the market is dependent on a domestic Australian CCP that may not be recognized under any US and EU regulation to which they may be subject.

Regulatory and Financial Impact

We welcome ASIC's compliance with the Australian Government's regulatory impact analysis ("**RIA**") requirements by considering all feasible options, examining the likely impacts of the range of alternative options to meet their policy objectives; notifying the Office of Best Practice Regulation ("**OBPR**"); and preparing a Regulation Impact Statement ("**RIS**") if the proposed option has more than a minor impact on business.

Liaison between national regulators is also important in ensuring the proposed RG 211 amendments will interact positively with other regulatory initiatives impacting FMIs and/or derivatives markets, such as the Dodd-Frank Act ("**DFA**") and the corresponding European regulations. Diverse and inconsistent requirements between different supervisors could increase costs, reduce cross border transaction liquidity, and potentially impede some FMIs from operating in Australia or continuing to handle Australian related business, if faced with conflicting regulatory requirements. One area of potential conflict that may arise is if clearing were mandated in an Australian CCP. For example, if a US customer were to trade an AUD IRS with an Australian Bank and both the US customer and Australian Bank were subject to a mandatory clearing requirement through a national CCP in their respective home jurisdiction, the AUD IRS trade cannot be cleared as it would be impossible to clear a trade through more than one CCP.

Many jurisdictions, including some of the non-G20 jurisdictions have begun to consult and implement the G20 commitment for clearing. Consequently, counterparties will be obligated by law and regulation to clear many of their OTC transactions and, depending on the jurisdiction, may have very limited choices of venues for clearing. As such, it is extremely important to strike a balance between maintaining financial stability; reducing systemic risk; ensuring clearing services are provided in a fair and effect way; avoiding conflicting regulation; not mandating locational requirements; and protecting investors and end users of CS facilities through the RIAs against the cost of compliance and its potential impact on competition, particularly for Australian market participants competing in the global OTC derivatives market. We commend ASIC for

recognizing a foreign regime as 'sufficiently equivalent' if they meet certain conditions[5]. In order to promote international comity, we urge national regulators to recognize foreign regimes as having equivalency to the Australian regime on a holistic level based on observed outcomes and not on a rule-by-rule basis as there will be country-specific differences between the Australian and national regulatory regimes.

Response to specific questions

The remainder of this letter sets out our comments in relation to the specific questions posed in the Consultation Paper. Our response is set out underneath each question. The headings used below correspond to the headings used in the Consultation Paper.

QUESTIONS

Question B1Q1: Do you agree with the approach we intend to take to adopt the Principles in Australia?

In general, we agree with the approach ASIC intends to take in adopting the Principles in Australia.

Question B1Q2: Do you have any comments on how we propose to amend RG 211 to adopt the Principles?

No comments.

Question B1Q3: Are there any practical implications of adopting the Principles by making the proposed amendments to RG211?

No comments.

[5] ASIC's 'Regulatory Guide 211, Clearing and settlement facilities: Australian and overseas operators', page 35, RG 211.113: "We will assess the home regulatory regime, as it applies to the overseas CS facility, as satisfying s824B(2)(c) if it: (a) is clear, transparent and certain; (b) is consistent with the IOSCO Objectives and Principles of Securities Regulation, and achieves the high-level outcomes set out in international recommendations and/or standards relating to CCPs or, if relevant, securities settlement systems published by CPSS-IOSCO from time to time; (c) is comparably enforced in the home jurisdictions; and (d) achieves the systemic risk protection and fair and effective services outcomes that are achieved by the Australian regulatory regime for comparable domestic CS facilities."

Question B2Q1: Are there any consequences of ASIC taking into account the CPSS-IOSCO assessment methodology and disclosure framework in our consideration as to whether the CS facility meets the Principles?

We believe the CPSS-IOSCO Disclosure framework for financial market infrastructures ("**Disclosure Framework**") and CPSS-IOSCO Assessment methodology for the principles for FMIs and the responsibilities of authorities ("**Assessment Methodology**") will promote transparency and reduce risk. Counterparties, that are regulated financial institutions, will be able to assess the risks of their clearing arrangements, including the effects of such risks on their regulatory capital.

The Disclosure Framework and Assessment Methodology will allow market participants to obtain sufficient information from CCPs to make appropriate risk assessments and to compare the risks posed by different CCPs through the disclosure of standardized information. In order to allow market participants to make such a comparison, the Disclosure Framework must supply sufficient direction and guidance to FMIs to ensure information is disclosed and prepared in a consistent and comparable form.

Although the purpose of the Assessment Methodology is to promote implementation and ongoing observance of the FMI Principles and not to provide market participants with information about FMIs, we believe the assessment reports will contain information important to market participants. We recognize the inherent tension between ensuring full and frank communication with regulators and external assessors, on one hand, and enhancing transparency by making assessment reports widely available. However, we believe the assessment reports must be provided to participants of a FMI, particularly if those FMI participants are providing guarantees, default funds or other financial support to that FMI. In order to mitigate any concerns regarding inappropriate disclosure or misuse of confidential information, those participants of the FMI should be prohibited from using any information from the assessment report other than to assess and manage the risks in their relationship with the FMI and should establish information walls and procedures that would customarily be used to protect confidential information.

Question B3Q1: Are there any transitional arrangements that are necessary to enable you to comply with expectations outlined in the amended RG211 as proposed in the consultation paper?

As mentioned earlier in this paper, different jurisdictions may be at different stages in their implementation process of meeting the G20 commitment for clearing. As such, the timing and implementation process will be different across jurisdictions and it may simply not be possible for a cooperative arrangement to be put in place between Australia and the national jurisdiction before an overseas CSF licensee applies for an overseas CSF license. A more flexible approach should be adopted to take into account the national jurisdiction's proposed supervisory and FMI regulations and the progress it has made in introducing these regulations.

Question C1Q1: Do you agree with the approach we intend to take to implement the Council's measures under existing legislation?

In general, we agree with ASIC's approach to implement the Council's measures under existing legislation.

Question C1Q2: Do you have any comments on how we propose to amend RG 211 to take into account the Council's measures under existing legislation?

We have some concerns regarding the factors that may indicate if a CS facility is systemically important or has a strong domestic connection. We recognize the need to protect the financial stability of Australia and we commend the Council for outlining relevant factors that may be used in assessing the systemic importance of a facility in Australia. While some of these factors are based on the BCBS rules text for *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*[6], not all the factors may be appropriate for a CS facility as it is not a bank and the calculation methodology for determining a global systemically important banks ("**G-SIBs**") is based on an indicator-based measurement approach.

As the factors for indicating if a CS facility is systemically important with a strong domestic connection are neither exhaustive nor determinative and are indicative only and will be applied on a case by case basis, we believe that greater clarity is needed for a CSF licensee to determine if it requires a domestic CSF license or if an overseas CSF license is acceptable and, crucially, whether it will be required to comply with any related domestic location requirements, domestic legal requirements or provide for greater regulatory participation in its risk management arrangements, amongst other things. Even greater clarity and comfort is needed for an overseas CSF licensee as it may operationally expensive or impossible to switch to a domestic CSF license and comply with the conditions attached thereto, particularly if it is required to establish a domestic operational or legal presence. If ASIC determines an overseas CSF as systemically important with a strong domestic connection, ASIC must allow the overseas CSF sufficient time to comply with the domestic CSF license requirements or to comply with the conditions imposed on its license[7]. Prior to making such a determination, ASIC should weigh the costs and benefits before imposing those conditions on an overseas CSF licensee. Care should be taken that the license conditions do not increase compliance costs so severely that an overseas CSF chooses not to apply for an overseas CSF license in Australia or to restructure its business to exclude Australian products/participants if the costs outweigh the benefits of operating in the Australian market.

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[6] BCBS, *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

[7] ASIC's 'Regulatory Guide 211, Clearing and settlement facilities: Australian and overseas operators', page 44, RG 211.152: "The Minister may impose any conditions that they consider appropriate for the operation of the CS facility. We will advise the Minister about the conditions we think should apply to your CSF license".

Question C1Q3: Are there any practical implications of implementing the Council's measures by making the proposed amendments to RG 211?

Please refer to C1Q2.

Question C1Q4: Do you suggest any additional amendments to RG 211 to implement the Council's measures under existing legislation?

No comments.

Question C2Q1: Are there any transitional arrangements that are necessary to enable you to comply with expectations outlined in the amended RG211 as proposed by this consultation paper?

As adequate cooperation arrangements must be in place between ASIC, the Reserve Bank of Australia ("**RBA**"), the overseas CSF licensee and the relevant home regulators, before ASIC can advise the Minister to grant an overseas CSF license, an implementation date of end of 2012 may not be workable. Additional time may be needed for these cooperation arrangements to be agreed and put in place, as many jurisdictions are currently in the process of implementing the G20 commitments for clearing and reporting. The pace of implementation varies from jurisdiction to jurisdiction. The Australian regulators may wish to take into account, among other things, the proposed supervisory and FMI regulations, and the progress in introducing these regulations in these jurisdictions when granting an overseas CSF license. If an adequate cooperation arrangement cannot be put in place between ASIC, RBA, the overseas CSF licensee and the home regulators by the implementation date, we would like to suggest a "grandfathering" approach whereby a temporary license is provided to an overseas CSF licensee to enable financial institutions to continue clearing their OTC derivatives on an overseas CCP, such as LCH. We commend RBA and ASIC for looking to put in place cooperative arrangements with the relevant home authorities to facilitate this process.

Question D1Q1: Do you agree with the approach we intend to take to make consequential amendments to RG211 to take into account the RBA's proposed financial stability standards?

Yes, the assessment of an overseas assessment should not be based on a rule-by-rule approach and should look at the substantive regulatory outcome (where appropriate) on a holistic level. Different overseas jurisdictions may need to cater for special characteristics of their local markets. Hence, differences may arise in requirements and supervision between the Australia and the foreign regime. The recognition of 'equivalence regimes' will promote international comity; minimize operational and implementation costs; and harmonization of international standards.

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Question D1Q2: Do you have any comments on how we propose to amend RG211 in this way?

No comments.

Question D1Q3: Are there any practical implications of making these consequential amendments to RG211?

No comments.

Question D1Q4: Do we suggest any additional amendments to RG211 to which are necessary taking into account the proposed revised financial stability standards?

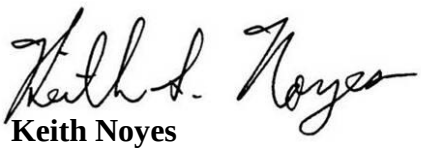
No comments.

Question D2Q1: Are there any transitional arrangements that are necessary to enable you to comply with expectations outlined in the amended RG211 as proposed by this consultation paper?

As different national jurisdictions are at different stages of implementing the G20 commitment for clearing, not all national jurisdictions may be able to have a regulatory framework in place as compared to Australia. ASIC may wish to take into account, among other things, the proposed regulations, and the progress in introducing these regulations in the national jurisdictions.

Yours sincerely,

For the International Swaps and Derivatives Association, Inc.



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