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23 March 2018

Dear Oliver,

Re: AUD Forward Rate Agreement (FRA) Mandatory Clearing – Request to the Australian Securities and Investments Commission ("ASIC) for Extension of Relief

The International Swaps and Derivatives Association, Inc. ("**ISDA**") and the Australian Financial Markets Association ("**AFMA**") (the **"Associations**") are submitting a request for the continuation of the relief provided under the *ASIC Derivative Transaction Rules (Clearing) 2015* [1] (the "**Clearing Rules**") on the basis of a minor and technical departure from existing policy.

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 875 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on ISDA's web site: www.isda.org.

ISDA is actively engaged with providing input on regulatory proposals in the United States (the "**US**"), Canada, the European Union (the "**EU**") and Asian jurisdictions. The Associations' comments are derived from this international experience and constant dialogue, and reflect the views of both firms in the Asia-Pacific region and from further afield. As OTC derivatives tend to be cross-border in nature, we wish to highlight the importance of ensuring that regulatory

[1] https://www.legislation.gov.au/Details/F2015L01960

requirements have a consistent domestic and cross-border effect, so as to not disproportionately impact any one sector of what is a global market.

We set out our reasoning for this request below.

Problem

Under Rule 1.2.3(8)(b)(2) of the Clearing Rules, mandatory central clearing of FRAs denominated in AUD will commence on 1 April 2018. The Associations' members believe that mandatory central clearing of these products may not be appropriate, given the very limited volumes of these products now traded in the derivatives market, level of systemic risk they pose and availability of clearing houses available to use to comply with such a mandate.

What are the Facts?

In May 2013, ASIC, the Reserve Bank of Australia ("**RBA**") and the Australian Prudential Regulation Authority ("**APRA**") (collectively, the "**Regulators**") published the *Australian regulators' statement on assessing the case for mandatory clearing obligations* [2] (the "**Regulators' statement**"), which gave details of the analysis the Regulators would apply when assessing the case for mandatory central clearing of particular derivative products. This statement also built on the advice previously provided to the government by the Council of Financial Regulators (the "**CFR**"), which "*favoured an approach whereby central clearing arrangements are given time to evolve in response to economic incentives (including from regulatory requirements) and the commercial considerations of market participants and infrastructure providers*". [3] The Associations review below the current status of the relevant factors which the Regulators stated they would take into account.

Absolute and relative notional outstanding, and metrics for associated risk

The Associations have ascertained from members that the volume of AUD FRAs transacted by entities that would be subject to any potential clearing mandate is very low, giving rise to an insignificant level of systemic risk in the Australian market.

[2] http://www.cfr.gov.au/media-releases/2013/mr-13-02.html

[3] http://www.cfr.gov.au/publications/cfr-publications/australian-auth-statmnt-mandatory-clearing-obligations.html

Magnitude and dispersion of bilateral counterparty exposures

Due to the low volumes described above, the Associations believe that the magnitude and dispersion of bilateral counterparty exposures can also be classified as minimal. Of relevance to this factor is the Regulators' statement, that:

"…the stability benefit of a transition to central clearing is likely to be greatest for products that are traded widely in the Australian OTC derivatives market and which give rise to sizeable counterparty credit exposures between large financial institutions when cleared bilaterally…Conversely, there will be products for which there is limited activity in the Australian OTC derivatives market. For these products the benefit of central clearing would be low." [4]

Profile of participation

The Associations understand that almost no FRAs are currently transacted in the interdealer market, with one major Australian financial institution confirming that it does not trade FRAs at all, and another confirming that it sees average yearly AUD FRA volumes of less than 100. However, some non-financial or buyside participants (who sit outside the scope of the central clearing mandate) may retain a preference to trade FRAs.

Potential impact of central clearing on market functioning

Due to the low volumes and liquidity in FRAs, the Associations would expect the imposition of a clearing mandate to have a negligible effect on market functioning.

The extent to which market participants are already centrally clearing that product

While the Associations understand that one clearing house licensed by ASIC does offer central clearing of AUD FRAs,[5] trading dynamics have shifted over time to a state where market participants now prefer to trade products called Single Period Swaps ("**SPS**"). These products have a similar economic profile to FRAs, save for the fact that settlement occurs at the maturity of the transaction, rather than at commencement. Two major Australian financial institutions noted that their ratio of FRAs to SPS traded is 1:99, while another noted that 70 per cent of new bookings are for SPS (relative to FRAs).

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[4] http://www.cfr.gov.au/publications/cfr-publications/australian-auth-statmnt-mandatory-clearing-obligations.html

[5] Chicago Mercantile Exchange, Inc.

In this context, the Associations note that the Regulators' statement points out that:

"Where no central counterparty has yet been licensed to clear a particular product, or only one central counterparty has been licensed, the issuance of a mandate would constrain Australian participants' choices. In particular, participants would be unable to select clearing arrangements that best fit the scale and scope of their business, operationally and financially, with potential adverse effects for market functioning." [6]

The availability or accessibility of central clearing of that product for different types of Australian market participants

As noted above, at present, only one clearing house licensed or prescribed by ASIC is centrally clearing AUD FRAs.

The Associations also understand that other clearing houses licensed or prescribed by ASIC do not have any current plans to offer this service in the foreseeable future. Market participants as well as other clearing houses have noted that AUD FRAs present an operational challenge insofar as AUD FRAs settle and fix on the same day, which creates problems for clearing houses because their end-of-day process will not complete until the start of the next Asia-Pacific trading day.

This limits the availability and accessibility of central clearing for this product.

Whether participants have already established appropriate commercial and operational arrangements with central counterparties

The Associations understand that a sizeable portion of Australian derivatives market participants are currently not members of the clearing house providing AUD FRA clearing services, meaning that commercial and operational arrangements would need to be negotiated and finalised upon the imposition of an AUD FRA central clearing mandate. This process may not be straight forward, and may constrain Australian participants' choices, given that clearing house's position as the only provider of such services.

Therefore, imposition of a central clearing mandate for these products may have a relatively high incremental regulatory cost.

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6 http://www.cfr.gov.au/publications/cfr-publications/australian-auth-statmnt-mandatory-clearing-obligations.html

Evidence of commercial pressure or regulatory incentives to centrally clear that product (which may include regulatory incentives as a result of the cross-border reach of regulation in other jurisdictions)

While the US Commodity Futures Trading Commission (the "**CFTC**") proposed[7] in June 2016 to require AUD FRAs to be centrally cleared as part of the expansion of its interest rate swap clearing requirement, it ultimately decided:

"not to include AUD denominated FRAs…based on several factors. First, the Australian authorities have postponed required clearing of AUD denominated FRAs... Second, ASX commented that it would not be prudent… to finalize a clearing requirement for this product in light of the delay in the Australian clearing requirement for this product. Finally, ASX stated that it has observed a general trend in the Australian domestic market away from FRAs and towards single-period swaps instead…" [8]

AUD FRAs are not currently subject to a central clearing mandate in any other region or jurisdiction globally.

What is the Impact of the Problem?

Compliance with any potential central clearing mandate may have the impact of making compliance relatively difficult and costly for market participants, due to:

- the very limited volumes of AUD FRAs now traded in the derivatives market;
- the low level of systemic risk they pose;
- the high cost of establishing a clearing relationship potentially only to clear this product;
- the availability of only one clearing house to use to comply with any such mandate; and
- the operational challenges associated with centrally clearing this product.

Clearing entities would be required to negotiate, set up and operationalise arrangements and memberships with the clearing house, which may entail system, capital, legal, technological and operational costs. These would not be able to be amortised over a large volume of trades, and any potential cross-margining benefits would be limited due to the lack of volume in other products currently cleared through that facility. Thus, imposition of the mandate would be likely to have a high cost, with little associated benefit.

[7] 81 FR 39506; http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-14035a.pdf.

[8] 81 FR 71202; http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-23983a.pdf.

What is the Impact of Legislative Provisions or ASIC Policy?

The Associations believe it has always been the intention of ASIC (and indeed the Australian regulators) to impose a central clearing mandate where incentives exist to transition from bilateral margining to central clearing, and the associated incremental costs would be low. The Associations do not believe, on an assessment of the costs and benefits of such a mandate, that ASIC would consider it prudent policy making or an efficient use of its resources to impose a market-changing regulatory mandate on a market which is, for all intents and purposes, statistically and economically insignificant.

Relief Sought

The Associations request an extension of the date in Rule 1.2.3(8)(b)(2) of the Clearing Rules, for a minimum of 2 years. However, it is also requested that the Regulators give due consideration to whether a central clearing mandate may ever be appropriate for these products, given the general shift away from transacting in FRAs. Accordingly, and to ensure optimal future use of resources for both regulators and industry, the Associations request that the relief be made permanent, or at least extended until such time (if any) as conditions exist which would overwhelmingly support the Regulators' statement and justify the imposition of a central clearing mandate for this product. This would be the Associations' strong preference.

Why Should Relief be Granted?

Relief should be granted because the Associations believe that the costs of imposing a mandate would significantly outweigh the benefits, for the reasons explained above.

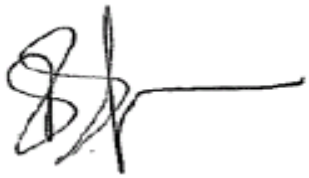
Additionally, there may be some entities which may prefer still to transact FRAs over SPS. To the extent such entities are clearing entities as defined in the Clearing Rules, the Associations recognise the importance of enabling Australian business to continue to offer a choice of trading FRAs or SPS on reasonable and similar economic terms, depending on which product best suits the economic, financial, hedging, risk or other needs of the counterparty. Imposition of a central clearing mandate in respect of AUD FRAs could be expected to make offering these products more costly.

What Conditions Should be Imposed on the Relief?

As noted above, the Associations request that the Regulators ensure the relief is extended in such a way that it does not require revisiting the issue unless and until conditions exist that would justify the imposition of a clearing mandate. The Associations would see little benefit in having to draft and submit a further application to extend the relief at an arbitrary date in the future, without any change in underlying market trading patterns justifying reopening the issue.

Thank you for your consideration of this application. The Associations would be very happy to discuss this request further at your convenience. Please do hesitate to contact Rishi Kapoor, Director, Policy, Asia Pacific, ISDA (at rkapoor@isda.org or +852 2200 5907) or David Love, General Counsel and International Adviser, AFMA (at dlove@afma.com.au or +612 9776 7995).

Yours faithfully,



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