ISDA Safe, Efficient Markets

15 February 2013

Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

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Dear Sir/ Madam:

Implementation of Australia's G-20 Over-the-counter Derivatives Commitments

The International Swaps and Derivatives Association ("**ISDA**")[1] is grateful for the opportunity to respond to the proposals paper "Implementation of Australia's G-20 Over-the-counter Derivatives Commitments" issued by the Australian Treasury (the "**Treasury**") in December 2012 (the "**Proposals Paper**").

Consistent with our mission, we support the G20 commitments to bring transparency to the over-the-counter ("**OTC**") derivatives markets and improve risk management practices. As an overarching comment, it is of utmost importance that there is certainty, clarity and transparency in relation to the reporting requirements. These reporting requirements should also consider the methods that are practicable by all industry participants, both Australian and foreign financial institutions alike. We urge the Treasury to take into account international developments on trade reporting and to provide for reporting obligations that are consistent and not more onerous than those being proposed in other jurisdictions. Further, the reporting obligations in Australia will need to be complementary to and work with regulations imposed in other jurisdictions.

A phased-in approach

We support the Treasury's adoption of a phased-in approach by different classes of market participants, i.e., major financial institutions (Phase 1); domestically-focused financial institutions (Phase 2); and end users (Phase 3). In addition to a phased-in approach by different

[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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classes of market participants, we strongly recommend a phased-in approach by product class, starting with the vanilla products in each product class as a first step. As recommended in the Report on the Australian OTC Derivatives Market (the **"Report**")[2], the reporting obligation should consider a phased-in approach across product classes. We support the Report's recommendation as each product class has unique characteristics which will require specific reporting requirements, time and resources to implement. Due to the various product specific requirements, a reporting obligation which requires all product classes to be reported in a single phase is not practicable. In determining the reporting requirements, we urge the Treasury to implement a framework which allows all market participants to easily comply with their reporting obligations.

A consistent trade reporting framework among global regulators

We commend the Australian regulators for working jointly or through such international bodies such as the Financial Stability Board ("**FSB"**) or the International Organization of Securities Commission ("**IOSCO"**) to facilitate the global sharing of trade reporting data amongst regulators; improving clarity; and reducing inconsistencies and conflicts between different regulatory regimes. We also commend the Treasury for recognizing the issue of confidentiality with respect to reporting obligations in Australia and support international cooperation in resolving issues arising from conflicting privacy and confidentiality laws of other jurisdictions.

We urge the Australian regulators to create a consistent trade reporting framework whereby market participants may apply a single set of reporting requirements to fulfill their reporting obligations across various jurisdictions. The reporting requirement should be easy to understand, practicable and use global reporting standards such as the legal entity identifier ("**LEI**"), the product taxonomy, the unique trade identifier (when it has been developed and implemented by the industry) and FpML[3].

As you are aware, due to the cross-border nature of financial activity, market participants are likely to not only be caught by the reporting obligations in Australia, but also reporting requirements under the laws of other jurisdictions which are similarly implementing G20 commitments. We urge the Treasury to take into account various cross-border scenarios and the potential for conflicting reporting requirements by different jurisdictions. To minimize compliance costs and increase efficiency, market participants should be allowed to report to a single "global" trade repository. This would allow data to be retained in a single trade repository thereby allowing national regulations a complete overview of transactions pertaining to their jurisdiction.

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[2] Australian Prudential Regulation Authority, Australian Securities and Investments Commission, Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market*, October 2012.

[3] FpML® (Financial products Markup Language) is the open source XML standard for electronic dealing and processing of OTC derivatives. It establishes the industry protocol for sharing information on, and dealing in, financial derivatives and structured products. For details, please visit http://www.fpml.org.

Response to specific questions

The remainder of this letter sets out our comments in relation to the specific questions posed in the Proposal Paper. The headings used below correspond to the headings used in the Proposal Paper.

QUESTIONS

Question 1: Do you have comments on the costs and benefits of complying with the trade reporting obligation, as outlined above, from the point of view of your business and/or that of your customers?

When determining the scope of trades to be reported, an easy to understand, clear and practicable reporting criteria should be established. A balance will need to be struck on a plausible implementation schedule, the benefit of having such data reportable and the use of such data. As noted in the Proposals Paper, a large portion of the Australian OTC derivatives market consists of cross-border activity.[4] These cross-border transactions will most likely be subject to two reporting regimes and the scope of which cross-border transactions to be reported needs to be clearly defined. This should be balanced against the benefit of having such data reported, the intended use of such data and the possibility of conflicting reporting requirements.

The Proposals Paper also states "there may be some costs associated with establishing systems that can efficiently capture the necessary information and transmit this to and from trade repositories"[5]. If a bespoke trade reporting regime is implemented, careful consideration should be given to the costs associated with such a framework. Market participants would incur unnecessary compliance costs as a separate Australian-specific trade reporting framework would need to be setup. Market participants would not be able to leverage their existing reporting framework to minimize their compliance costs. This may delay the implementation of trade reporting in Australia as it would require time, resources and costs to create and implement a bespoke reporting solution.

The scope of transactions to be reported will determine a market participant's cost and benefits analysis. We believe greater clarity on the scope of transaction to be reported is needed and encourage the Treasury to consult with the industry prior to determining the scope of transactions to be reported.

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[4] Australian Prudential Regulation Authority, Australian Securities and Investments Commission, Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market*, October 2012, Page 32.

[5] The Treasury, *Implementation of Australia's G-20 Over-the-counter Derivatives Commitments*, Proposals Paper, December 2012, page 10.

Question 2: Do you have comments on the proposal to mandate a broad range of derivatives subject to the phase-in and exceptions outlined below? Or is there another option you prefer? If so, why?

As mentioned above, the phase-in should also take into consideration the industry's capacity to meet the reporting obligation. We believe a "big bang" approach, in which all five derivative classes are required to be reported by a specified deadline, may not be practicable. Some firms, particularly those that are currently not performing any form of reporting may lack the resources and technology capability to achieve this undertaking by the specified timeframe. These firms will need time to build up their resources and technology infrastructure to meet these reporting obligations. Additionally, reporting of more complex and/or bespoke transactions would require more resources due to the lack of marketplace standard for such products and the need for market participants to develop systems to capture these complex and/or bespoke transactions.

The Proposals Paper states that "within each phase, there would be scope for further differentiating between instrument classes, according, for example, to the availability of relevant licensed trade repositories"[6]. The timeline for implementation of the reporting obligation should not be solely based on the availability of a relevant licensed trade repository but should also take into consideration the industry's capacity to meet the reporting requirements for the specific product class. For each product class, there exists a diversification in data standards and booking systems. The trade data fields in each product class are mostly unique. For example: an exercise price of a swap option (also known as a "**swaption**"), is usually quoted as a percentage while the exercise price of a foreign exchange ("**FX**") option is usually quoted in decimal places. Consequently, the data mapping of a swaption exercise price between an in-house system and a trade repository will be completely different from the data mapping of a FX option exercise price.

Further, a firm may have several booking systems to support different product classes. Each booking system may be unique in its information technology ("**IT"**) protocol and standards. As such, the system enhancement required for data extraction from one booking system may not be re-deployed for use in another booking system, even for common data fields such as trade date. Each enhancement design would require significant time and resources from the market participant's technology and operations departments. In a time where many jurisdictions are implementing their G20 commitments, market participants are facing resource constraints in complying with the various reporting obligations globally.

We seek clarification on whether the reporting obligations will be a single sided reporting regime and will support an agency reporting arrangement for clients, given that the Proposals Paper states the following:

> For most OTC derivatives product classes, the vast bulk of transactions will typically involve at least one counterparty from the group of larger market participants. These

[6] The Treasury, *Implementation of Australia's G-20 Over-the-counter Derivatives Commitments*, Proposals Paper, December 2012, page 13.

larger firms may therefore be well positioned, operationally, to act as agents for counterparties using trade repositories[7].

If the intention is to facilitate reporting by a single market participant, then the reporting obligation should be clear that the agent or other market participants do not incur any responsibility or liability in connection with the reporting of that trade. Otherwise the purpose of allowing single-sided reporting may be defeated. ISDA urges the Treasury to consider how this issue is dealt with in other jurisdictions and to be consistent with international developments.

Question 3: Do you a preference for the timetable being prescribed in regulation or implemented by a phased approach to ASIC rule-making?

We would prefer the option that allows for greatest flexibility and consultation. If the ASIC rule making is more likely to be responsive to market feedback as the phased approach progresses then this is most likely to be preferable. However, there may be a place for regulation to set minimum timeframes for phasing in so that ASIC is not inclined to rush the process.

Question 4: Do you comments on the proposal timetable for implementing the trade reporting obligation? Or is there another option you prefer? If so, why?

A long lead-time is preferred and end-2013 appears reasonable for the start of the phasing-in to be effective. We urge further consultation with the industry on the proposed timetable prior to implementing the reporting obligation.

Question 5: For Phase 1, do you have a preference for referencing legal status, thresholds of activity, or size proxies? For Phases 2 and 3, do you prefer activity thresholds or size proxies?

In addition to the comments above, there are advantages and disadvantages to all the suggested methods for referencing legal status, threshold of activity or size proxies. Ideally, the referencing method should be a bright line test, in which market participants, are able to easily and clearly identify which category an entity falls into. In this instance, a threshold based approach to Phase 1 may be preferable. However, care needs to be taken as to how this is introduced so as to avoid unnecessary uncertainty. For Phases 2 and 3, to be consistent with Phase 1, the preference is for a threshold based approach as well.

[7] The Treasury, *Implementation of Australia's G-20 Over-the-counter Derivatives Commitments*, Proposals Paper, December 2012, page 11.

Question 6: Do you have comments on the proposed regulations at Attachment A? Or is there another option you prefer? If so, why?

No comment.

Question 7: Do you have comments on the proposal to wait until after review processes before making a decision on mandating trade reporting of electricity derivatives? Or is there another option you prefer? If so, why?

No comment.

Question 8: Are there other bodies with responsibility for underlying assets upon which a derivative is based and should be also specified under section 901J?

No comment.

Question 9: Do you have comments on the proposal to implement the trade reporting and trade repository licensing regime expeditiously, but not to impose interim reporting obligations ahead of this? Or is there another option you prefer? If so, why?

We agree that there is no need to impose interim trade reporting obligations and a full and measured consultation process would be necessary. A full and measured consultation process enables both the Australian regulators and market participants to attain the best possible reporting framework than an interim solution that has a shorter and less measured consultation period. The longer consultation process would also allow Australian regulators to observe the reporting issues that arise in other jurisdictions and avoid certain operational and implementation issues that have arisen in those jurisdictions.

As other jurisdictions have yet to finalize and/or clarify some of their regulations, the extra-territoriality impact of those jurisdictions remains uncertain. Without this certainty, it is difficult to ascertain the degree to which the Australian reporting framework needs to be in place before it is recognized under a foreign regime for "substituted compliance". In such a circumstance, we understand the need for urgent recommendations in response to unexpected market developments. However, we urge caution in making any hasty recommendations and urge the Treasury to consult with market participants prior to making a recommendation.

We believe cooperation and dialogue between regulators is necessary to mitigate conflicting and overlapping regulatory regimes and the extra-territorial impact of foreign regimes.

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Question 10: Do you have comments on the proposal to not impose central clearing obligations at this stage? Or is there another option you prefer? If so, why?

We welcome the Treasury's proposal not to impose a central clearing obligation at this stage and for allowing an industry-led migration to central clearing of AUD denominated interest rate swaps (**IRS**).

Question 11: Do you have comments on the proposal to not impose trading obligations at this stage? Or is there another option you prefer? If so, why?

As the G20 recognized, it is not always appropriate for derivatives trading to take place on a trading platforms even if the transactions have become relatively standardized. We strongly support the Treasury's proposal not to impose a trading obligation at this stage.

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

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