ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 231

Mandatory central clearing of OTC interest rate derivative transactions

May 2015

About this paper

This consultation paper seeks feedback on our proposals to implement mandatory central clearing under Pt 7.5A of the *Corporations Act 2001*.

The draft ASIC Derivative Transaction Rules (Clearing) 2015 (derivative transaction rules (clearing)) attached to this paper set out our proposed requirements for the mandatory central clearing of certain over-the-counter (OTC) interest rate derivative transactions through licensed or prescribed clearing and settlement facilities.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 28 May 2015 and is based on the Corporations Act as at the date of issue.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

Contents

The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy, as well as the draft derivative transaction rules (clearing) attached to this paper and available on our website under CP 231.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs (both one-off and ongoing) of the proposals;
- the likely effect on competition in any financial or services market, or on the efficiency of any such market; and
- other impacts, costs and benefits (including benefits arising from potential substituted compliance or sufficient-equivalence assessments under foreign regulatory regimes).

Where possible, we are seeking both quantitative and qualitative information.

We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on mandatory central clearing. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section H.

Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Please refer to our privacy policy at www.asic.gov.au/privacy for more information about how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by 10 July 2015 to:

Senior Manager, OTC Derivatives Reform
Financial Market Infrastructure
Australian Securities and Investments Commission
Level 5, 100 Market Street
Sydney NSW 2000
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Queries: Rhonda Luo, (02) 9911 5464

What will happen next?

Stage 1	28 May 2015	Release of ASIC consultation paper and draft derivative transaction rules (clearing)
Stage 2	10 July 2015	Comments due on the consultation paper
Stage 3	Second half, 2015	Final derivative transaction rules (clearing) made
Stage 4	4 April 2016	Final derivative transaction rules (clearing) commence

A Background

Key points

In September 2009, the Leaders of the Group of Twenty (G20) nations, including Australia, committed to reforming over-the-counter (OTC) derivatives markets. One of the key commitments made was to require the clearing of all standardised OTC derivative transactions through a central counterparty (CCP). These reforms are expected to improve transparency, mitigate systemic risk and protect against market abuse in OTC derivatives markets.[1]

On 3 January 2013, legislation came into effect that inserted a new Pt 7.5A in the *Corporations Act 2001* (Corporations Act), providing a legislative framework to implement these G20 commitments in Australia.[2] Part 7.5A of the Corporations Act enables the Australian Securities and Investments Commission (ASIC) to issue derivative transaction rules to establish mandatory reporting, central clearing or execution requirements for participants transacting in a class of derivatives prescribed by the Minister.

This consultation paper and the draft ASIC Derivative Transaction Rules (Clearing) 2014 (derivative transaction rules (clearing)) attached to this paper outline our proposed approach to the mandatory central clearing of certain classes of OTC interest rate derivative transactions through licensed clearing and settlement (CS) facilities or prescribed CCPs.

OTC derivatives markets and the global financial crisis

1 Over the past decade, rapid growth in OTC derivatives markets has been accompanied by an increasing awareness of the systemic importance and risks inherent in these markets.

2 The magnitude of these risks was demonstrated during the global financial crisis (GFC) in 2008, particularly at the time of the collapse of Lehman Brothers investment banking group and the threatened collapse of AIG insurance group.

3 As a result of the issues identified during the GFC, in September 2009 the Leaders of the G20 agreed to strengthen the international financial regulatory system. Among other initiatives, they committed to the following reforms to improve practices in OTC derivatives markets:

(a) reporting of all OTC derivative transactions to trade repositories;

(b) clearing of all standardised OTC derivative contracts through CCPs; and

[1] See G20 Leaders, *G20 Leaders Statement: The Pittsburgh Summit*, 24–25 September 2009.
[2] *Corporations Legislation Amendment (Derivative Transactions) Act 2012.*

(c) execution of all standardised OTC derivative contracts on exchanges or electronic trading platforms, where appropriate.

4 The objectives of these reforms are to:

(a) enhance the transparency of transaction information available to relevant authorities and the public;

(b) promote financial stability; and

(c) support the detection and prevention of market abuse.[3]

Australia's response

5 In response to these developments, the Council of Financial Regulators (CFR)—which comprises ASIC, the Reserve Bank of Australia (RBA), Treasury and the Australian Prudential Regulation Authority (APRA)—have developed regulatory reform policy options for OTC derivatives markets and have engaged in extensive stakeholder consultation.

6 Effective from 3 January 2013, the *Corporations Legislation Amendment (Derivative Transactions) Act 2012* amended the Corporations Act by introducing a new Pt 7.5A. This empowers the Minister to, among other things, make a determination allowing ASIC to make rules imposing mandatory central clearing requirements (clearing requirements) on specified classes of OTC derivative transactions. The framework also allows regulations and ASIC rules to be made to specify the details of mandatory central clearing.

7 In May 2013, ASIC, the RBA and APRA (the regulators) published the *Australian regulators' statement on assessing the case for mandatory clearing obligations* (the regulators' statement). The regulators' statement gave details of the analysis the regulators will apply when assessing the case for mandatory central clearing.[4] The regulators' statement addressed the:

(a) preconditions for central clearing;

(b) potential benefits of central clearing for the efficiency, integrity and stability of financial markets;

(c) incremental benefits and costs of a mandated rather than incentives-led transition to central clearing; and

(d) benefits of international consistency.

8 The analytical approach outlined in the regulators' statement was applied in the regulators' *Report on the Australian OTC derivatives market* published in July 2013 (the July 2013 report).[5] In the July 2013 report, the regulators

[3] CPSS–IOSCO, *Principles for financial market infrastructures* (CPSS–IOSCO Principles), April 2012, p. 9.
[4] CFR, *Australian regulators' statement on assessing the case for mandatory clearing obligations*, 8 May 2013.
[5] CFR, *Report on the Australian OTC derivatives market*, July 2013,

recommended, on the grounds of international consistency, that the Australian Government consider imposing a mandatory central clearing mandate for US dollar-, euro-, British pound- and yen-denominated interest rate derivatives (G4 interest rate derivatives). The regulators recommended that the initial focus of the mandate should be on dealers with significant cross-border activity in OTC derivatives.

9 In April 2014, the regulators published another *Report on the Australian OTC derivatives market* (the April 2014 report). The April 2014 report recommended that Australian Government consider imposing a mandatory central clearing mandate for Australian dollar (AUD)-denominated interest rate derivatives (AUD interest rate derivatives). As with the July 2013 report, the regulators recommended that the initial focus of the mandate should be on dealers with significant cross-border activity in OTC derivatives.

The derivative transaction rules (clearing)

10 Under s901A of the Corporations Act, ASIC can make derivative transaction rules that impose requirements for the mandatory central clearing of OTC derivative transactions through licensed CS facilities or prescribed CCPs (together, clearing facilities).

11 Under s901B, clearing requirements can only be imposed by ASIC in relation to a class of derivatives after the Minister has made a determination, by legislative instrument, which specifies that clearing requirements may be imposed in relation to that class of derivatives (Ministerial determination).

12 In February 2014, the Australian Government released a proposals paper, *Implementation of Australia's G20 OTC derivatives commitments: G4-IRD central clearing mandate* (proposals paper), proposing that a Ministerial determination be made:

> … that will allow ASIC to make rules requiring the central clearing of US Dollar-, Euro-, British Pound- and Yen-denominated interest rate derivatives. The obligations would only be applied to large financial institutions with significant cross-border activity in these products...[6]

13 The Australian Government also made a number of proposals in relation to the products subject to the Ministerial determination, the entities subject to mandatory central clearing, the treatment of intra-group derivative transactions and the timetable for implementation.

14 The Australian Government proposed that it would wait for the outcome of future market assessments before considering whether to issue a mandatory

[6] Treasury, *Implementation of Australia's G20 OTC derivatives commitments: G4-IRD central clearing mandate*, proposals paper, February 2014, p. 1.

central clearing mandate for any other derivative transactions. The proposals paper also noted that electricity derivatives would be exempt from mandatory central clearing until the completion of the financial resilience review by the Australian Energy Market Commission.

15 In July 2014, the Australian Government issued a further proposals paper which proposed the adoption of the regulators' recommendation to impose a central clearing mandate for AUD interest rate derivatives, and to combine the mandates for AUD and G4 interest rate derivatives.[7]

16 In this further proposals paper the Australian Government consulted on a number of additional aspects of the proposed mandatory central clearing mandate. In particular, it consulted on a proposed set of criteria for identifying entities considered to be internationally-active dealers in OTC derivatives and, therefore, subject to mandatory central clearing.

17 On 12 December 2014, the former Acting Assistant Treasurer announced that the Australian Government will implement a central clearing mandate for certain AUD and G4 interest rate derivatives. On 28 May 2015, Treasury released a draft Ministerial determination and proposed regulations for public consultation. The proposed regulations define key parameters of the proposed mandate, including the entities that may be subject to the clearing requirements under ASIC's derivative transaction rules (clearing).

18 Under s901A, derivative transaction rules can specify any of the following in respect of the clearing requirements:

(a) the classes of derivative transaction to which particular requirements apply;

(b) the clearing facilities (or the class of clearing facilities) through which derivative transactions in a particular class must be cleared;

(c) the period within which transactions must be cleared;

(d) the persons who are required to comply with requirements imposed by the rules;

(e) the manner and form in which persons must comply with requirements imposed by the rules;

(f) the circumstances in which persons are, or may be, relieved from complying with requirements in the rules that would otherwise apply to them;

(g) the keeping of records, or the provision of records or other information, relating to compliance with (or determining whether there has been compliance with) the rules;

[7] Treasury, *Implementation of Australia's G-20 OTC derivatives commitments: AUD-IRD central clearing mandate*, proposals paper, 8 July 2014.

(h) any other matters that, in accordance with the Corporations Act, may be dealt with in the rules; and

(i) any requirements that are incidental or related to the clearing requirements.

19 The proposals outlined in this paper and the attached draft derivative transaction rules (clearing) seek to implement the proposed Ministerial determination to prescribe AUD and G4 interest rate derivatives as a class of instrument subject to mandatory central clearing.

Who do the proposals apply to?

20 The proposals in this paper apply to dealers that are identified as having significant cross-border activity in OTC derivatives. The proposals will also affect certain clearing facilities (i.e. licensed CS facilities and prescribed CCPs).

21 We seek your feedback on the specific proposals outlined in this paper and the draft derivative transaction rules (clearing) attached to this paper.

B Clearing requirements

Key points

The proposals in this section relate to:

- which entities the clearing requirements apply to;
- how the clearing threshold is calculated;
- the cross-border scope of the clearing requirements;
- the classes of derivative transactions subject to the clearing requirements;
- the obligation to clear derivative transactions subject to the clearing requirements;
- the deadline by which derivative transactions subject to the clearing requirements must be cleared; and
- transactions that extend the maturity date of existing derivatives.

Entities subject to the clearing requirements

22 In-line with the recommendations in the April 2014 report, that the scope of the proposed central clearing mandate be limited to internationally-active dealers, the Australian Government has proposed to limit the entities subject to mandatory central clearing to Australian and foreign clearing entities.

23 The proposed draft regulations contain definitions for both Australian clearing entities and foreign clearing entities—and also contemplate that the derivative transaction rules (clearing) will set out the circumstances in which a transaction entered into by an entity, acting in the capacity of a trustee of a trust or a responsible entity of a registered managed investment scheme (registered scheme), would be subject to the central clearing requirement.

24 Consistent with the proposed regulations, we propose to adopt the definitions of Australian clearing entity and foreign clearing entity set out in proposal B1, including how these definitions would apply to transactions entered into by an entity in the capacity of trustee or responsible entity.

25 We also propose to set out when an entity may opt-in to become an Australian or foreign clearing entity.

Proposal

B1 We propose that the derivative transaction rules (clearing) include the following definitions:

(a) *Australian clearing entity*: An Australian authorised deposit-taking institution (ADI) or Australian financial services (AFS) licensee that is incorporated or formed in Australia, and whose derivatives

activities meet or exceed the clearing threshold, as it applies to Australian entities.

Note: The draft derivative transaction rules (clearing) specify that some types of derivatives are excluded from this calculation, for example, the calculation does not include derivatives entered into in the capacity of trustee or responsible entity: see proposal B1(c).

(b) *Foreign clearing entity*: A registrable body, as defined under Pt 5B.2 of the Corporations Act, that is an ADI, AFS licensee or exempt foreign licensee, and whose derivatives activities meet or exceed the clearing threshold, as it applies to foreign entities.

Note: The draft derivative transaction rules (clearing) specify that some types of derivatives are excluded from this calculation, for example, the calculation does not include derivatives entered into in the capacity of trustee or responsible entity: see proposal B1(c).

(c) *Application in relation to trusts and registered schemes*: For transactions conducted in relation to a trust or registered scheme (acting in a representative capacity), where the trust or registered scheme exceeds the clearing threshold, the entity acting in the representative capacity would be a clearing entity in relation to that trade. Where the trust or registered scheme is formed in Australia, the trustee or responsible entity would be an Australian clearing entity in relation to that transaction; where the trust or registered scheme is formed outside of Australia, the trustee or responsible entity would be a foreign clearing entity in relation to that transaction.

Note: See proposal B2for more details on the calculation of the clearing threshold for each type of clearing entity.

(d) *Opt-in Australian clearing entity*: An Australian entity whose derivatives activities do not exceed the clearing threshold may opt-in to become an opt-in Australian clearing entity by giving ASIC an opt-in notice. A trustee or responsible entity may give an opt-in notice to ASIC in its representative capacity to a trust or registered scheme formed in Australia.

(e) *Opt-in foreign clearing entity:* A foreign entity whose derivatives activities do not exceed the clearing threshold may opt-in to become an opt-in foreign clearing entity by giving ASIC an opt-in notice. A trustee or responsible entity may give an opt-in notice to ASIC in its representative capacity to a trust or registered scheme formed outside of Australia.

Your feedback

B1Q1 Do you agree with the proposed scope of entities that may be subject to mandatory central clearing?

B1Q2 Do you agree with the proposed definitions of ‘Australian clearing entity’, ‘foreign clearing entity’, ‘opt-in Australian clearing entity’ and ‘opt-in foreign clearing entity’?

B1Q3 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Rationale

26 We consider it appropriate to align the definition of clearing entity in the derivative transaction rules (clearing) with the definition proposed by the Australian Government. That is, the definition will include all financial entities that meet the clearing threshold and are considered to be the most active participants in the Australian OTC derivatives market.

27 In relation to transactions conducted on behalf of trusts and registered schemes, we consider it appropriate to look at whether the entities are acting in a representative capacity. That is, the definition in relation to entities acting in a representative capacity would apply to each fund that has large derivatives exposures, rather than to the total derivatives exposures aggregated across all funds or registered schemes under an entity's management.

28 This approach will ensure that the derivative transaction rules (clearing) are consistent with the draft regulations which will define the scope of our power to make rules in respect of mandatory central clearing—and ensure consistency with the application of the derivative trade reporting regime.

29 The Australian Government is consulting on the making of regulations that define entities as clearing entities in relation to the mandatory clearing threshold—and, for trustees and responsible entities, the regulations contemplate that the derivative transaction rules (clearing) will specify when entities acting in a representative capacity will be clearing entities.

30 Within the scope of these regulations, we propose to further specify the class of entities that will be defined as clearing entities. The expected list of entities that would be covered includes large domestic banks with significant cross-border activity and Australian subsidiaries or branches of large foreign investment banks. These entities are also likely to be subject to mandatory central clearing in other jurisdictions.

Calculation of the clearing threshold

Proposal

B2 We propose to introduce a clearing threshold to determine which entities are clearing entities for the purposes of mandatory central clearing. We propose to take the approach set out in Table 1 to determine if an entity is a clearing entity. The threshold will apply differently depending on whether a clearing entity is an Australian financial entity or a foreign financial entity, and whether the entity is acting in a representative capacity.

Table 1: Proposals for the calculation of the clearing threshold

Proposal		Details of the proposal
B2(a)	Clearing threshold for Australian financial entities	The clearing requirements: • will apply to an Australian ADI or AFS licensee whose gross notional outstanding of OTC derivatives positions meets or exceeds the clearing threshold of $100 billion; Note: See Proposal B4 for details of the derivative transactions that are considered to be OTC derivative transactions for the purpose of calculating the clearing threshold. • will be calculated for each legal entity (i.e. we do not propose to aggregate the clearing threshold across corporate groups); and • for entities acting in a representative capacity for a registered scheme or trust that is formed in Australia, will be calculated for each scheme or trust. Note: Derivatives entered into on behalf of a trust or registered scheme would not be included in the calculation of the clearing threshold for the entity acting in its personal capacity.
B2(b)	Clearing threshold for foreign financial entities	The clearing requirements: • will apply to a foreign ADI, foreign AFS licensee or exempt foreign AFS licensee, whose total gross notional outstanding of OTC derivative positions that are entered into in Australia, or booked to the profit-and-loss account of a branch in Australia, meets or exceeds the clearing threshold of $100 billion; Note: See Proposal B4 for details of the derivative transactions that are considered to be OTC derivative transactions for the purpose of calculating the clearing threshold. • will be calculated for each legal entity (i.e. we do not propose to aggregate the clearing threshold across corporate groups); and • for entities acting in a representative capacity for a registered scheme or trust formed outside of Australia, will be calculated for each scheme or trust. Note: Derivatives entered into on behalf of a trust or registered scheme would not be included in the calculation of the clearing threshold for the entity acting in its personal capacity.
B2(c)	Calculation of the clearing threshold	The clearing threshold calculation will include all derivatives that are subject to the clearing requirements, and all other derivatives that are not traded on a financial market (as defined under Part 7.2A of the Corporations Act) or a regulated foreign market (we will adopt the same definition as in Rule 1.2.4 of the ASIC Derivative Transaction Rules (Reporting) 2013). An entity will become a clearing entity if it is at or above the clearing threshold as at the end of the last day of the quarter for two consecutive quarters. Note: The last day of the quarter, for the purposes of calculating the clearing threshold, is 31 March, 30 June, 30 September and 31 December of each year. The entity will become a clearing entity on the first Monday three months on or after the last day of the second consecutive quarter (second calculation date) (i.e. at least 90 days). Note: For example, if an entity is at or above the clearing threshold as at 30 September 2015 and 31 December 2015, it will become a clearing entity on Monday, 4 April 2016. See proposal G1 for details of the implementation dates for the clearing requirements. A clearing entity that falls below the clearing threshold on the last day of the quarter for two consecutive quarters will cease to be a clearing entity on the day after the last day of the second consecutive quarter (second calculation date).

Your feedback

B2Q1 Do you agree with our proposal to adopt the clearing threshold set by the Australian Government of $100 billion gross notional outstanding in OTC derivatives, for entities other than those acting in a representative capacity?

B2Q2 Do you agree with the proposed application of the clearing threshold in relation to transactions entered into on behalf of a trust or registered scheme?

B2Q3 Do you agree with the proposed derivatives that must be included when calculating the clearing threshold?

B2Q4 Do you agree with our proposals for determining whether an Australian financial entity or foreign financial entity is a clearing entity, and when a clearing entity ceases to be a clearing entity?

B2Q5 Do you agree with our proposal to apply the clearing requirements on the first Monday three months on or after the second calculation date?

B2Q6 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Rationale

31 We believe that the proposed clearing threshold of $100 billion gross notional outstanding in OTC derivatives is an appropriate threshold for determining whether an entity should be considered to be an internationally-active dealer. These entities will have substantial OTC derivatives exposures and—consistent with the analysis in the July 2013 and April 2014 reports—we believe that the greatest systemic risk reduction will come from including these entities in mandatory central clearing.

32 The proposed threshold is consistent with the $100 billion threshold that is prescribed under the draft regulations (which will also define our power to make the derivative transaction rules (clearing)). Therefore, by applying this threshold, we will ensure that the rules we implement are within our rulemaking power.

33 For entities acting in a representative capacity, we propose to adopt an approach that is consistent with the derivative trade reporting regime, and require the clearing threshold to be calculated for each trust and registered scheme. Under this approach, derivatives entered into by an entity in its representative capacity would not be included in the calculation of the entity's clearing threshold when it is acting in its personal capacity.

34 We believe that only OTC derivatives should be included in the calculation of the clearing threshold and subject to mandatory central clearing. The focus of the G20 commitments is OTC derivatives, so it is appropriate to limit mandatory central clearing to OTC derivatives. This proposal also recognises that transactions executed on, or reported to the operator of, a

Pt 7.2A market (or equivalent) are generally subject to existing requirements to clear those derivative transactions.

35 To determine which derivatives are OTC derivatives for the purpose of calculating the clearing threshold, we propose to take an approach that is broadly consistent with the definition of 'OTC derivative' found in the derivative transaction rules (reporting)). This includes all derivatives that are not traded on a financial market (as defined in Pt 7.2A of the Corporations Act) or a regulated foreign market (we will adopt the same definition as in Rule 1.2.4 of the derivative transaction rules (reporting)).

36 Our proposal for using two quarter-end calculation dates against the clearing threshold is designed to ensure that entities whose total gross notional outstanding positions in OTC derivatives fluctuate above or below the clearing threshold do not become or cease to be clearing entities on a quarterly basis. If an entity comes into and out of the clearing requirements on a quarter-by-quarter basis, it may incur transitional or compliance costs (e.g. on-boarding costs), for a relatively short compliance period.

37 Instead, an entity will only become or cease to be a clearing entity if it is above or below the clearing threshold at the end of two consecutive quarters. This means that an entity that experiences an unusual rise above the clearing threshold in one quarter will not immediately trigger the clearing requirements. However, based on the July 2013 and April 2014 reports, we expect that over time most entities will reasonably consistently be above or below the clearing threshold.

38 We consider it appropriate to apply the clearing threshold to each legal entity, and not at group level. This is consistent with the approach taken in the derivative transaction rules (reporting), and will be the simplest approach for entities to implement.

39 We also propose that the clearing requirements only apply to a legal entity that is above the clearing threshold—and not to its subsidiaries or related entities. Again, we consider this to be the simplest approach for entities to implement, allowing for clear identification of those entities which are clearing entities and those which are not, without needing to determine whether a counterparty is part of a group of entities where the parent entity is at or above the clearing threshold.

40 We consider that when calculating the clearing threshold for an entity located outside of Australia, or a trust or registered scheme formed outside of Australia, the entity should only be required to include derivative transactions that were entered into in Australia, or booked to the profit-and-loss account of a branch in Australia. This is generally consistent with the approach taken for the calculation of the threshold for Phase 2 entities under the derivative transaction rules (reporting). This approach achieves the policy objective of only requiring

foreign entities with a significant amount of activity in Australia to be captured by the derivative transaction rules (clearing).

41 For entities acting in a representative capacity, we propose to apply the clearing threshold to each trust and registered scheme. If a trust or registered scheme is established in Australia and it exceeds the mandatory clearing threshold, the trustee or responsible entity would be treated as an Australian clearing entity when acting in the capacity of trustee or responsible entity for that trust or registered scheme. If a trust or registered scheme is established outside of Australia and it exceeds the mandatory clearing threshold, the trustee or responsible entity would be treated as a foreign clearing entity when acting in that capacity.

Cross-border scope of the clearing requirements

Proposal

B3 We propose to:

(a) apply the clearing requirements to derivative transactions entered into between:

(i) two Australian clearing entities;

(ii) an Australian clearing entity and a foreign clearing entity;

(iii) two foreign clearing entities, where a branch of a foreign clearing entity has booked the trade in Australia, entered into the trade in Australia or, if it has opted-in to the nexus test, conducted a nexus derivative;

Note 1: A 'nexus derivative' is an OTC derivative to which a clearing entity is a counterparty that meets the nexus test.

Note 2: The 'nexus test' is the test in ASIC Instrument [15/0067] *ASIC Derivative Transaction Rules (Nexus Derivatives) Class Exemption 2015* based on the location of salespersons or traders performing particular functions in relation to an OTC derivative.

(iv) an Australian clearing entity and a foreign internationally-active dealer; and

(v) a foreign clearing entity and a foreign internationally-active dealer, where the foreign clearing entity has booked the trade in Australia, entered into the trade in Australia or, if it has opted-in to the nexus test, conducted a nexus derivative;

Note: See proposal F1 for details of our proposal for ASIC to publish a list of entities that are an Australian or foreign clearing entity.

(b) consistent with the draft regulations, define a 'foreign internationally-active dealer' as an entity that is registered or provisionally registered as a swap dealer with the US Commodity Futures Trading Commission (CFTC) or as a security-based swap dealer with the US Securities Exchange Commission under the *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US) (Dodd-Frank Act); and

(c) define 'nexus derivative' in a way that is consistent with Instrument [15/0067], and allow foreign clearing entities to opt-in to centrally clear nexus derivatives instead of transactions 'entered into in Australia' under the clearing requirements.

Your feedback

B3Q1 Do you agree with the proposal to apply the clearing requirements in each of the circumstances listed in proposals B3(a)(i)–B3(a)(v)?

B3Q2 Do you agree with our proposed definition of 'foreign internationally-active dealer'?

B3Q3 Do you agree with our proposed approach to defining 'nexus derivative', and to allow foreign clearing entities to opt-in to centrally clear nexus derivatives?

B3Q4 Do you see any practical challenges for clearing entities trying to determine whether they are trading with an entity that is subject to the clearing requirements in each of the circumstances listed in proposals B3(a)(i)–B3(a)(v)?

B3Q5 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Rationale

42 We believe the proposed cross-border scope of the clearing requirements is consistent with the aim of ensuring that derivative transactions between dealers with significant cross-border activity are centrally cleared. By applying the clearing requirements to transactions between clearing entities and foreign internationally-active dealers, we will assist clearing entities to seek equivalence or substituted compliance for these transactions under foreign regimes.

43 Proposals B3(a)(i)–B3(a)(ii) cover transactions involving at least one Australian clearing entity and another clearing entity (Australian or foreign). Where an Australian clearing entity transacts with another Australian clearing entity or a foreign clearing entity, there is a financial stability benefit to clearing the transaction—this proposal is consistent with the recommendations of the regulators.

44 Proposal B3(a)(iii) covers transactions entered into by two foreign clearing entities, where one of the entities books the trade in Australia, enters the trade in Australia or, if it has opted-in to the nexus test, conducts a nexus derivative. In these circumstances both clearing entities would ordinarily have substantial Australian operations (i.e. they would meet the clearing threshold of more than $100 billion gross notional outstanding in OTC derivatives booked or entered into in Australia), and the transaction would also be conducted in Australia. We have proposed to allow clearing entities to opt-in to the nexus test so that the application of the clearing requirements is broadly consistent with the application of the derivative trade reporting regime.

45 We believe it is appropriate that these derivative transactions are subject to mandatory central clearing because they are conducted by entities with material derivatives activities in Australia and the transactions have a clear nexus to the Australian derivatives market.

46 Proposals B3(a)(iv)–(a)(v) covers transactions entered into by an Australian or foreign clearing entity with a foreign internationally-active dealer, which we propose to define as an entity that is registered or provisionally-registered under the Dodd-Frank Act.

47 The scope of these proposals is consistent with the policy objective of providing legal certainty in relation to the cross-border scope of the mandatory central requirement. In addition, transactions with foreign internationally-active dealers are also subject to mandatory central clearing in some other jurisdictions, therefore, proposals B3(a)(v) are designed to ensure consistency with foreign mandatory central clearing requirements (foreign clearing requirements) and increase the likelihood that Australian clearing entities will be able to obtain substituted compliance or equivalence with foreign clearing requirements.

48 In each case, the foreign internationally-active dealer will not be subject to any clearing requirements under the derivative transaction rules (clearing)—only the Australian or foreign clearing entity will be directly subject to the clearing requirements.

49 We propose to make alternative clearing available to both Australian and foreign clearing entities for derivative transactions that are subject to equivalent clearing requirements in a foreign jurisdiction: see proposal D1. This means that in most circumstances where transactions are subject to mandatory central clearing in a foreign jurisdiction, and the Australian or foreign clearing entity is complying with the requirements of the foreign jurisdiction, it will not be required to comply with the Australian clearing requirements.

Transactions and asset classes subject to mandatory central clearing

Proposal

B4 We propose:

(a) to specify that four types of ‘swaps’ may be subject to the clearing requirement, these are ‘fixed-to-floating swaps’, ‘basis swaps’, ‘forward rate agreements’ and ‘overnight index swaps’.

Note: See the draft derivative transaction rules (clearing) attached to this consultation paper for each of the proposed definitions of ‘swap’ ‘fixed-to-floating swap’, ‘basis swap’, ‘forward rate agreement’ and ‘overnight index swap’.

(b) to impose the clearing requirements on swaps that are fixed-to-floating swaps, basis swaps, forward rate agreements and overnight index swaps denominated in AUD and G4 currencies, if they meet

the asset class specifications in Table 2 and do not contain one or more of the following features:

(i) *Optionality*: Where either counterparty is granted an option that, if exercised, would affect the amount, timing or form of the consideration.

(ii) *Multi-currency*: Where the notional principal amount and payments are not denominated in the same currency.

(iii) *Conditional notional principal amount*: Where the notional principal amount would change upon the occurrence of a future event, and the occurrence of the future event is uncertain at the time of entering into the derivative.

(c) to limit the application of mandatory central clearing to the entry, after the commencement date, of an arrangement that is a derivative transaction; and

(d) that mandatory central clearing will not apply where an existing derivative is modified or assigned after the commencement date (other than in the circumstances in proposal B7, which relates to derivative transactions that extend the maturity of existing derivatives by more than 12 months).

Table 2: Asset class specifications for AUD and G4 interest rate derivatives subject to mandatory central clearing

Asset class	Currency	Floating rate index	Termination date range
Fixed-to-floating swaps	US dollar	London Interbank Offered Rate (LIBOR)	28 days to 50 years
	Euro	Euro Interbank Offered Rate (EURIBOR)	28 days to 50 years
	British pound	LIBOR	28 days to 50 years
	Japanese yen	LIBOR	28 days to 30 years
	Australian dollar	Australian Bank Bill Swap Rate (BBSW)	28 days to 30 years
Basis swaps	US dollar	London Interbank Offered Rate (LIBOR)	28 days to 50 years
	Euro	Euro Interbank Offered Rate (EURIBOR)	28 days to 50 years
	British pound	LIBOR	28 days to 50 years
	Japanese yen	LIBOR	28 days to 30 years
	Australian dollar	Australian Bank Bill Swap Rate (BBSW)	28 days to 30 years
Forward rate agreements	US dollar	LIBOR	3 days to 3 years
	Euro	EURIBOR	3 days to 3 years
	British pound	LIBOR	3 days to 3 years

Asset class	Currency	Floating rate index	Termination date range
	Japanese yen	LIBOR	3 days to 3 years
	Australian dollar	BBSW	3 days to 3 years
Overnight index swaps	US dollar	Effective Federal Funds Rate (FedFunds)	7 days to 2 years
	Euro	Euro Overnight Index Average (EONIA)	7 days to 2 years
	British pound	Sterling Overnight Interbank Average Rate (SONIA)	7 days to 2 years
	Australian dollar	RBA Interbank Overnight Cash Rate (IBOC)	7 days to 2 years

Your feedback

B4Q1 Do you agree with the proposed definitions for 'swap', 'fixed-to-floating swap', 'basis swap', 'forward rate agreement' and 'overnight index swap' in the draft derivative transaction rules (clearing) attached to this paper?

B4Q2 Do you agree with the proposed asset class specifications in proposal B4(a)and Table 2?

B4Q3 Do you agree with our proposal that mandatory central clearing should only apply to the entry of an arrangement that is a derivative (other than in the circumstances outlined in proposal B7)?

B4Q4 Do you agree with our proposal to mandate central clearing of AUD-denominated forward rate agreements? If not, why not?

B4Q5 We have proposed mandating central clearing of AUD-denominated overnight index swaps with termination dates of between seven days and two years. Do you consider termination dates of between seven days to three years would be more appropriate for AUD overnight index swaps?

B4Q6 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Rationale

50 In determining which derivatives should be subject to mandatory central clearing we have considered the regulators' statement—which assessed the case for mandatory central clearing—and the recommendations made by the regulators in the July 2013 and April 2014 reports.

51 In relation to the G4 interest rate derivatives mandate, we have considered the regimes in other jurisdictions that have, or are in the process of implementing, mandatory central clearing. We note that the proposed G4 interest rate derivatives mandate would be consistent with the product scope of the CFTC's interest rate derivatives central clearing mandate, and

broadly consistent with the European Securities and Markets Authority (ESMA)'s proposed interest rate derivatives central clearing mandate.

52 In relation to the AUD interest rate derivatives mandate, the April 2014 report noted that there would be a substantial financial stability benefit from increased central clearing of AUD interest rate derivatives, and that the incremental cost of mandatory central clearing of AUD interest rate derivatives would be very low for trades between internationally-active dealers in the Australian market. There are currently three licensed CS facilities authorised to centrally clear classes of AUD interest rate derivatives, providing entities with a choice of venue for direct central clearing.

53 To maintain overall consistency with the G4 interest rate derivatives mandate, we also propose to apply the clearing requirements to the following four classes of AUD interest rate derivatives:

(a) fixed-to-floating interest rate swaps;

(b) basis swaps;

(c) forward rate agreements; and

(d) overnight index swaps.

54 While we note there is not yet a licensed CS facility clearing AUD-denominated forward rate agreements, we are specifically seeking industry feedback on whether it would be appropriate to mandate central clearing of these products. We also note that an exemption from the clearing requirements applies if there is no clearing facility that provides clearing services in respect of the derivatives subject to the mandatory requirement: see proposal C1.

55 We have also proposed to mandate central clearing of AUD-denominated overnight index swaps with termination dates of between seven days and two years—for consistency with the CFTC's mandate for G4 interest rate derivatives. However, we note that ESMA has proposed mandating central clearing of overnight index swap products with termination dates of between seven days and three years. As such, we are seeking feedback on whether it would be more appropriate to mandate central clearing for AUD-denominated overnight index swap products with termination dates between seven days and three years.

56 Subject to these questions, we consider the products listed in proposal B4 meet the criteria in the regulators' statement and are consistent with the recommendations in the July 2013 and April 2014 reports.

No 'backloading' requirement

57 We believe that mandatory central clearing should only apply to new derivative transactions and there should not be a 'backloading' requirement. In other words, clearing entities should not generally be required to centrally

clear OTC derivative transactions that were entered into before the commencement date of the clearing requirements.

58 We also consider that mandatory central clearing should not apply to modifications or assignments of existing derivative transactions that were entered into before the clearing requirements took effect. We are therefore proposing that the clearing requirements only apply to the entry of an arrangement that is a derivative, except where a derivative is modified to extend the maturity beyond a certain period: see proposal B7.

Fulfilling the clearing requirements

Proposal

B5 We propose that:

(a) a clearing entity must clear each derivative transaction subject to the clearing requirements (clearing transaction) through a clearing facility (a licensed CS facility or a prescribed CCP);

(b) a clearing transaction will be 'cleared through' a clearing facility if, broadly speaking, each side of the clearing transaction is replaced by a contract between the operator of the clearing facility and a participant by novation, and the counterparties to the clearing transaction will have no, or substantially no, further rights or obligations arising under the derivative after it has been cleared. The proposed definition of 'cleared through' in the draft derivative transaction rules (clearing) attached to this consultation paper also specifies the clearing arrangements that may be used; and

Note: A clearing transaction can be cleared under direct clearing arrangements (i.e. by clearing the transaction directly as a clearing member) or indirect clearing arrangements (including through another person that is a participant in the clearing facility or which has a clearing relationship with such a participant).

(c) where a clearing entity does not comply with the clearing requirements, the clearing entity will be in breach of the derivative transaction rules (clearing), and may be subject to penalty provisions under the Corporations Act and/or the derivative transaction rules (clearing).

Your feedback

B5Q1 Do you agree with our proposal to require clearing entities to clear each clearing transaction through a clearing facility?

B5Q2 Do you agree with the proposed definition of 'cleared through' a clearing facility in the draft derivative transaction rules (clearing) attached to this consultation paper. Do you agree with our proposal to allow direct, indirect or client clearing arrangements to be used?

B5Q3 Should the clearing requirements be subject to exceptions? For example, are there any circumstances where a derivative transaction cannot be centrally cleared and should, therefore, be exempt from the clearing requirements?

B5Q4 Should the derivative transaction rules (clearing) impose a prohibition on derivative transactions being de-cleared after they have been centrally cleared? If so, are there any circumstances where a mandatorily-centrally cleared derivative transaction should be permitted to be de-cleared?

B5Q5 Do you agree with our proposal to that counterparties must have substantially no further rights and obligations arising under the derivative contract after it has been cleared through the clearing facility? Will there be circumstances in which the counterparties will have subsisting rights or obligations?

B5Q6 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Rationale

59 We propose to require a clearing entity to ensure all derivative transactions that are subject to the clearing requirements are 'cleared through' a clearing facility. This is consistent with the clearing requirements implemented in other jurisdictions, including the United States and the European Union.

60 The proposed term 'cleared through' a clearing facility is defined in the draft derivative transaction rules (clearing) attached to this paper. Broadly speaking, it requires each side of a clearing transaction to be replaced by a contract between the operator of the clearing facility and a participant through novation, and that the counterparties to the clearing transaction have no, or substantially no, further rights or obligations to each other under the derivative after it has been cleared.

61 The proposed definition in the draft derivative transaction rules (clearing) attached to this consultation paper also specifies the clearing arrangements that may be used so that a clearing transaction is considered to be 'cleared through' a clearing facility, which is intended to allow clearing transactions to be cleared using direct, indirect or client clearing arrangements. For example, for a counterparty to a clearing transaction, the clearing transaction will be 'cleared through' a clearing facility if a direct participant acting on behalf of the counterparty is substituted by novation as one party to the derivative, and the operator of the clearing facility is substituted by novation as the other party to the derivative. This includes where the direct participant and the operator of the clearing facility enter into a transaction that has a substantially-equivalent legal and economic effect as a novation of the clearing transaction.

62 We consider that setting out these requirements will provide certainty to clearing entities about whether the clearing arrangements they use will

satisfy the clearing requirements, while also permitting a range of clearing arrangements to be used.

63 We are seeking your feedback on whether these proposals and, in particular, the definition of when a clearing transaction is 'cleared through' a clearing facility, are appropriate. We are also seeking your feedback on whether there should be any exemptions from the clearing requirements because we are aware that a clearing entity may be unable to clear a derivative transaction due to factors outside of its control, for example, if the counterparty does not have sufficient credit with the CCP.

64 We consider that, in general, where a derivative transaction cannot be cleared in these circumstances, then the transaction should still be cleared within the specified period (see proposal B6), or terminated before the end of the specified period, in order to comply with the clearing requirements.

65 The failure to clear or terminate a derivative transaction that is subject to the clearing requirements would be a breach of the derivative transaction rules (clearing) and s901E of the Corporations Act.[8] However, the failure to comply with the clearing requirements would not invalidate a derivative transaction or affect any rights or obligations arising under, or relating to, the derivative transaction: s901G of the Corporations Act.

Deadline for mandatory central clearing (generally, T+1)

Proposal

B6 We propose that:

(a) a clearing entity must centrally clear a clearing transaction as soon as practicable after entry into the arrangement and by no later than the end of the business day following the day on which the clearing transaction was entered into (commonly known as T+1);

(b) the deadline for clearing by the end of the business day is calculated according to time and day in Sydney, Australia. Time and day is to be determined by reference to Australian Eastern Standard Time (AEST) or Australian Eastern Daylight Time (AEDT), as applicable in Sydney, Australia; and

(c) where a clearing entity enters into a clearing transaction, and the transaction is not cleared and is terminated by no later than T+1, then the clearing entity is not considered to have breached the clearing requirements.

[8] Alternatives to civil proceedings are available under s901F and regs 7.5A.101 and 7.5A.102 of the Corporations Regulations 2001 (Corporations Regulations).

Your feedback

B6Q1 Do you agree with our proposed deadline of T+1 for the clearing of clearing transactions?

B6Q2 Do you agree with our proposal that the deadline for clearing be calculated according to business days and AEST or AEDT, as applicable in Sydney, Australia?

B6Q3 If you believe the deadline should be based on the time the derivative transaction was entered into (e.g. 24 hours after the derivative transaction was entered into), how should the deadline for clearing be determined if the derivative transaction is entered into on a cross-border basis by two counterparties located in different time zones?

B6Q4 Do you agree with our proposal that the clearing requirements will not be breached if a clearing transaction is not cleared and is terminated before T+1?

B6Q5 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Rationale

66 When considering the appropriate deadline for clearing derivative transactions, we took into account the fact that some of the clearing facilities used to clear derivative transactions may not be open for clearing during Australian business hours. Requiring clearing transactions to be cleared by the end of the business day on which the transaction was entered into (T+0) could result in the deadline for clearing expiring before a clearing facility is open and available to clear the derivative transaction. We propose a longer deadline to avoid this situation.

67 Derivative transactions may be entered into by counterparties located in two different time zones—for this reason we believe a deadline based on a fixed time is more appropriate than a deadline based on the time zone in the place where the counterparties are located when the transaction was entered into, or some other feature of the transaction. By setting a deadline of T+1, AEST/AEDT (as applicable), we will ensure that a clearing facility is likely to be open to accept a trade before the deadline is reached, and that both clearing entities will be able to easily determine the deadline for clearing the transaction.

68 Our alternative clearing proposal allows for longer timelines where relevant foreign clearing obligations are complied with and other conditions for alternative clearing are met: see Section D.

69 We propose that where a clearing transaction is not cleared and is terminated by T+1 after entry into the transaction, then there is no breach of the clearing requirements. This will ensure that where a clearing entity enters into a transaction in the expectation that it will be cleared, but is unable to clear the transaction, the entity may terminate the transaction within the specified time period without breaching the clearing requirements.

70 This will provide clearing entities with certainty about the period of time given to clear a derivative transaction and how they can comply with the clearing requirements if the transaction cannot be cleared, including for reasons beyond their control.

Transactions that extend the maturity date of existing derivatives

Proposal

B7 We propose that where:

(a) a clearing entity enters into a non-centrally cleared derivative transaction before the entity became a clearing entity (and, therefore, before the commencement of mandatory central clearing for that clearing entity); and

(b) the derivative transaction would have been subject to the clearing requirements if it were entered into after the entity became a clearing entity; and

(c) after the commencement date of mandatory central clearing for that clearing entity, there is a modification (or series of modifications) to the derivative transaction that extends the maturity of the derivative transaction 12 months or more beyond the maturity date of the derivative transaction at the time the derivative transaction was entered into,

then the derivative transaction will become subject to the clearing requirements from the time of the last modification that results in the extension of the maturity of the derivative transaction for 12 months or more beyond the initial maturity date.

Your feedback

B7Q1 Do you agree with our proposal that mandatory central clearing be applied in the circumstances outlined above?

B7Q2 Do you agree with our proposal that a derivative transaction that is extended for 12 months (or more) should become subject to the clearing requirements? If you believe the period should be longer, please give reasons why a derivative transaction would need to be extended for a period of 12 months or more.

B7Q3 What is the likely impact of our proposals? (Please see page 4 for information required.)

Rationale

71 We propose that derivative transactions entered into before the commencement date for a clearing entity will generally not be subject to the clearing requirements. However, we want to prevent clearing entities avoiding mandatory central clearing by entering into modifications of non-centrally cleared derivative transactions that have the effect of substantially

extending the maturity of the derivative transaction, where that same derivative transaction would be required to be cleared if it were entered into as a new derivative transaction.

72 We consider 12 months to be an appropriate period of time for this requirement to apply. If a non-centrally cleared derivative transaction is extended for 12 months (or more) in the circumstances listed in the proposal, then we consider it is likely that the extension is being made wholly or partly to avoid the clearing requirements.

C Clearing through clearing facilities

Key points

We propose to allow clearing entities to use a clearing facility (i.e. a licensed CS facility or a prescribed CCP) to comply with the clearing requirements.

Prescription of clearing facilities

Proposal

C1 We propose:

(a) to allow a clearing entity to use a licensed CS facility or prescribed CCP to comply with mandatory central clearing, whether clearing directly or indirectly; and

(b) that where there is no licensed CS facility or prescribed CCP that can clear the derivative transaction that is subject to the clearing requirements, then the clearing requirements do not apply.

Your feedback

C1Q1 Do you agree with our proposal to allow clearing entities to be cleared through licensed CS facilities or prescribed CCPs?

C1Q2 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Rationale

73 Under s901A(7) of the Corporations Act, where the clearing requirements are in place, the clearing entity subject to the requirements must ensure that a clearing transaction is cleared through either a:

(a) licensed CS facility; or

(b) facility prescribed by the Corporations Regulations.

74 Under s901A(3)(d)(i), ASIC may make rules that specify the licensed CS facility or prescribed CCP (or the class of licensed CS facilities or prescribed CCPs) through which derivative transactions in a particular class must be cleared.

75 We are also not proposing to restrict the licensed CS facilities or prescribed CCPs that can be used to comply with mandatory central clearing. In particular, we are not proposing to restrict Australian clearing entities to clear only through licensed CS facilities. This means that any clearing entity will be able to comply with mandatory central clearing by clearing through a licensed CS facility or prescribed CCP.

76 The Australian Government is consulting on a regulation to prescribe CCPs to ensure clearing entities have appropriate access to clearing facilities to comply with mandatory central clearing. For example, it intends to prescribe foreign CCPs that offer services to Australian clearing entities but which are not required to hold a CS facility licence or an exemption from licensing, in order to preserve clearing entities' access to these CCPs for mandatory central clearing purposes. The Australian Government is also proposing to give ASIC the ability to prescribe additional facilities.

77 This proposal does not change the application of the CS facility licence regime to foreign CS facilities. We have set out the factors that we take into consideration when assessing whether a CS facility is required to be licensed in Regulatory Guide 211 *Clearing and settlement facilities: Australian and overseas operators* (RG 211).

78 Where there is no licensed CS facility or prescribed CCP that is authorised or permitted to clear the derivative transaction that is subject to the clearing requirements, the clearing requirements will not apply.

D Clearing in accordance with foreign clearing requirements (alternative clearing)

Key points

We propose to allow Australian and foreign clearing entities to comply with their clearing requirements by clearing in accordance with clearing requirements in a foreign jurisdiction (alternative clearing).

This section outlines the circumstances where clearing entities will be able to use alternative clearing to comply with their clearing requirements in Australia.

Who can access alternative clearing?

Proposal

D1 We propose that alternative clearing be available to any Australian or foreign clearing entity that is subject to mandatory central clearing.

Your feedback

D1Q1 Do you agree with our proposal to allow any clearing entity to comply with mandatory central clearing by using alternative clearing? If not, do you think the scope of our proposal should be narrower (e.g. restricted to foreign clearing entities)?

D1Q2 Do you believe that access to alternative clearing would assist clearing entities to meet their clearing requirements?

D1Q3 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Rationale

79 We propose to allow any Australian or foreign clearing entity subject to the clearing requirements under the derivative transaction rules (clearing) to meet the requirement using alternative clearing.

80 We believe that alternative clearing offers significant cost-reduction benefits to clearing entities with derivative transactions already subject to mandatory central clearing in another jurisdiction.

81 Furthermore, due to the cross-border nature of derivatives markets, and the need for counterparties to a derivative transaction to use the same clearing facility when clearing a transaction, we believe there is no material regulatory benefit to be gained by requiring clearing in accordance with the derivative transaction rules (clearing) where the derivative transaction is already subject to mandatory central clearing in another jurisdiction.

82 This proposal is consistent with the agreement made in April 2013 by the principals of the OTC Derivatives Regulators Group (ODRG), of which ASIC is a participant.[9] In particular, the principals agreed that clearing requirements should generally not apply to derivative transactions already subject to mandatory central clearing in another jurisdiction, except where:

(a) a category of counterparties or products are exempt *ex ante* from mandatory central clearing in one jurisdiction but not in another; or

(b) a product is subject to mandatory central clearing in one jurisdiction but not in another.

83 We expect that alternative clearing will be beneficial for foreign clearing entities that are subject to mandatory central clearing in the jurisdiction in which they are located. We also expect alternative clearing to be of benefit to Australian clearing entities that must comply with clearing requirements in another jurisdiction.

84 Consistent with this approach, we consider it appropriate to extend alternative clearing—subject to the conditions in proposal D2—to all clearing entities subject to mandatory central clearing.

85 We consider that restricting alternative clearing to foreign clearing entities would be unduly restrictive because many Australian clearing entities may also be subject to mandatory central clearing in another jurisdiction, and each transaction can only be cleared once (unlike trade reporting, which can take place multiple times).

Conditions for access to alternative clearing

Proposal

D2 We propose to require a clearing entity to meet the following conditions to be able to access alternative clearing:

(a) in relation to a transaction that is subject to the Australian clearing requirements, the clearing entity or its counterparty must be subject to clearing requirements in another jurisdiction;

(b) the foreign clearing requirements must require the relevant derivative transaction to be cleared no later than three business days (as counted in that jurisdiction) after the date on which the derivative transaction was entered into (commonly known as T+3);

(c) a clearing entity must ensure the derivative transaction is cleared no later than three business days (as counted in that jurisdiction) after the date on which the derivative transaction was entered into; and

[9] ODRG, *Report to the G20 meeting of finance ministers and central bank governors of 18–19 April 2013*, April 2013.

(d) a clearing facility used to comply with foreign clearing requirements must be a licensed CS facility or prescribed CCP (as described under proposal C1).

Your feedback

D2Q1 Do you agree with the proposed conditions for determining whether alternative clearing can be used to comply with the Australian clearing requirements? If not, should particular criteria be added or removed?

D2Q2 Do you agree with our proposal that derivative transactions using alternative clearing must be cleared through a licensed CS facility or prescribed CCP?

D2Q3 Do you expect to be able to use alternative clearing for all or some of your derivative transactions?

D2Q4 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Rationale

86 We propose four conditions that clearing entities will need to comply with in order to be able to access alternative clearing: see Table 3 for the rationale for each of these proposed conditions. In general terms, these proposed conditions are designed to ensure that clearing entities that are clearing derivative transactions in accordance with foreign clearing requirements will generally be compliant with the requirement under the derivative transaction rules (clearing).

Table 3: Rationale for conditions for access to alternative clearing

Proposal	Condition	Rationale
D2(a)	In relation to a transaction that is subject to the Australian clearing requirements, the clearing entity or its counterparty must be subject to clearing requirements in another jurisdiction.	This proposed condition will ensure that either the clearing entity or its counterparty (or both) is required to clear the derivative transaction. Without this requirement, there would be no certainty that a transaction would actually be cleared.
D2(b)	The foreign clearing requirements must require the relevant derivative transaction to be cleared no later than three business days (as counted in that jurisdiction) after the date on which the derivative transaction was entered into (commonly known as T+3).	This proposed condition will ensure that alternative clearing can only be accessed if the foreign clearing requirements require the derivative transaction be cleared in a timely manner. We consider that clearing a transaction within three business days is an adequate and reasonable 'backstop' deadline.
D2(c)	A clearing entity must ensure the derivative transaction is cleared no later than three business days (as counted in that jurisdiction) after the date on which the derivative transaction was entered into.	This proposed condition will ensure that a clearing entity will clear a derivative transaction in accordance with the clearing requirements of a foreign jurisdiction.

Proposal	Condition	Rationale
D2(d)	A clearing facility used to comply with foreign clearing requirements must be a licensed CS facility or prescribed CCP.	It is important that alternative clearing only occur in clearing facilities that have been licensed or prescribed for the relevant class of derivatives in Australia. This condition ensures the Australian regulators have oversight of the facility (for a licensed CS facility) or can be satisfied that the facility is licensed in a jurisdiction that adequately meets the relevant international standards. We expect the Australian Government to consult on the criteria for prescribed CCPs and initially prescribe a small number of CCPs.

87 These conditions are designed to ensure that clearing entities will be able to access alternative clearing if a clearing facility is appropriately recognised under the Australian regime, through licensing or prescription, and the derivative transaction is cleared in a timely manner under foreign mandatory requirements.

88 In order to minimise cross-border conflicts, inconsistencies and the duplication of requirements in multiple jurisdictions, we have deliberately only proposed that timing requirements of foreign clearing requirements are relevant to determining whether foreign clearing requirements are considered equivalent to the clearing requirements under the derivative transaction rules (clearing). We have not otherwise sought to be prescriptive as to the details of the clearing requirements applicable in the foreign jurisdiction.

E Exemptions from mandatory central clearing

Key points

We propose to provide an exemption from the clearing requirements in the derivative transaction rules (clearing) for derivative transactions:

- between two entities in the same corporate group (the intra-group exemption); and
- that result from an Australian or foreign clearing entity's participation in multilateral trade compression offered by a third party (the multilateral compression exemption).

Intra-group exemption

89 An intra-group derivative transaction is a derivative transaction that occurs between two clearing entities that are in the same corporate group at the time the transaction is entered into.

Proposal

E1 We propose to:

(a) provide an exemption from mandatory central clearing for derivative transactions between two clearing entities that are in the same corporate group at the time the transaction is entered into; and

Note: Two clearing entities are in the same corporate group when they are both a related body corporate of each other, as defined in s9 of the Corporations Act.

(b) require clearing entities to provide notice in writing to ASIC at least one business day before the intra-group exemption is applied to one or more derivative transactions that would otherwise be subject to the clearing requirements. The notice can apply to all future transactions between a clearing entity and one or more related bodies corporate, and must include:

(i) a statement by the clearing entity that it intends to rely on the exemption;

(ii) the name of the clearing entity and its Legal Entity Identifier (LEI) or interim entity identifier;

(iii) the name of the counterparty or counterparties; and

(iv) details of the relationship between the clearing entity and the counterparty or counterparties that explains how they are a related body corporate of the clearing entity.

If there are two or more clearing entities in a corporate group, a single notice can be given on behalf of all clearing entities, as long as the notice is authorised by each clearing entity and provides the names of the counterparties that each clearing entity will transact with under this exemption.

Your feedback

E1Q1 Do you agree with our proposal to allow an exemption from the clearing requirements for intra-group derivative transactions?

E1Q2 Do you have any feedback on the notification requirements?

E1Q3 What is the likely impact of our proposals? (Please see page 4 for information required.)

Rationale

90 We believe that there is little risk-reduction benefit gained from requiring intra-group derivative transactions to be subject to the clearing requirements. The reduction in systemic risk that occurs when derivative transactions are entered into between different corporate groups does not apply to the same extent where derivative transactions are entered into within the same corporate group.

91 In making this proposal, we have taken into consideration the fact that most overseas jurisdictions that have implemented mandatory central clearing have included an exemption for intra-group derivative transactions. For example, the rules made by the CFTC in the United States, [10] the technical standards made under the European Market Infrastructure Regulation (EMIR) in the European Union,[11] the proposals made by the Canadian Securities Administrators (CSA),[12] and the requirement imposed under the *Financial Instruments and Exchange Act (Act No. 25 of 1948)* (Japan), all of which include an exemption from the clearing of intra-group or inter-affiliate derivative transactions.

92 However, we believe it is important that we are notified in advance that the intra-group exemption is going to be applied in respect of each inter-group entity. This will allow us to track use of the exemption for such counterparties, and monitor whether it is being used appropriately. We therefore propose that clearing entities notify ASIC before relying on the exemption to transact with an inter-group entity. Where notification is not provided for a counterparty, a clearing entity would not be entitled to apply the exemption.

Multilateral compression exemption

93 Trade (or portfolio) compression is the practice of reducing or eliminating OTC derivative contracts by simultaneously terminating or replacing them with a smaller, more compact set of contracts, giving rise to economically-equivalent exposures or for a compensating payment. The CFR has recognised that:

[10] CFTC, *Clearing requirement determination under section 2(h) of the Commodity Exchange Act (USA)*, 13 December 2012.
[11] ESMA, *Final Report: Draft technical standards on the clearing obligation—interest rate OTC derivatives*, 1 October 2014.
[12] CSA, *Proposed model provincial rule on mandatory central counterparty clearing of derivatives*, Staff Notice 91-303, 19 December 2013.

> …trade compression can be a particularly effective method for dealers with a large number of trades, but relatively small net exposures, to reduce operational risk.

94 Trade compression can take place:

(a) bilaterally, between two counterparties across a portfolio of contracts they have entered; or

(b) multilaterally, either across a number of counterparties and portfolios or within a CCP.

95 A multilateral compression cycle for non-centrally cleared derivatives involves a service provider providing coordination between the parties in the compression cycle, to analyse the non-centrally cleared derivatives portfolios submitted by the parties and publish the results of the compression cycle. The results may be the reduction in value of non-centrally cleared derivatives, or the termination of non-centrally cleared derivatives and replacement with new derivatives that represent a reduced notional exposure between the relevant counterparties. The counterparties to the amended or new derivatives do not change.

96 The CFR has encouraged wider participation in multilateral compression cycles for AUD interest rate derivatives.

Proposal

E2 We propose:

(a) to provide a limited and specific exemption from the clearing requirements for derivative transactions that are amended or created as part of a multilateral trade compression cycle operated by a third party;

(b) that the exemption only be available if all of the following conditions are satisfied:

(i) the trade compression cycle is conducted in accordance with the rules of a third-party operator for conducting compression;

(ii) the trade compression cycle is conducted in compliance with the counterparty credit risk tolerance levels set by the parties to the multilateral compression cycle;

(iii) the amended or new transactions are entered into between the counterparties to the original trades that were amended or terminated in accordance with the rules of the compression cycle; and

(iv) the original transactions are not themselves subject to the proposed clearing requirements; and

(c) not to provide an exemption from mandatory central clearing for bilateral compression cycles.

Your feedback

E2Q1 Do you agree with our proposal to allow an exemption from the clearing requirements for transactions that are created as part of a multilateral trade compression cycle? Are there any conditions that should be placed on this proposed exemption?

E2Q2 Do you agree with our proposal not to allow an exemption from mandatory central clearing for bilateral compression exercises?

E2Q3 What is the likely impact of our proposals? (Please see page 4 for information required.)

Rationale

97 Multilateral compression cycles can result in the amendment of existing OTC derivatives or the creation of new OTC derivatives. If amended or new OTC derivatives fell within scope of the proposed clearing requirements and were required to be cleared, the clearing requirements could reduce the effectiveness of multilateral compression. This is because mandatory central clearing would change the counterparties to the amended or new derivatives, so that the counterparties would face a CCP instead of the original counterparty. This outcome would change the credit risk profile of the new or amended derivatives, and may make multilateral compression less economically attractive or viable.

98 In recognition of the benefits of multilateral compression, we are proposing a limited exemption from mandatory central clearing for new or amended OTC derivatives—where the transaction occurs as part of a multilateral trade compression cycle. This exemption would also apply to multilateral compression conducted within CCPs.

99 To ensure that this exemption is applied appropriately, we propose to specify that the exemption would only be available if a number of conditions relating to the compression cycle and the resulting amended or new transactions are met.[13] These conditions seek to ensure that only transactions that are required to be amended or terminated as part of the multilateral compression would be eligible for the exemption.

100 We have not proposed to provide an exemption for bilateral trade compressions because we consider multilateral trade compression cycles are likely to result in greater risk-reduction benefits. It may also be more difficult to ensure that an exemption of a bilateral trade compression is applied and utilised appropriately.

[13] The CFTC has provided relief from the requirement to clear swaps resulting from multilateral compression, if the conditions specified in the no-action letter are satisfied: see CFTC Letter 13-01, *No-action relief from required clearing for swaps resulting from multilateral portfolio compression exercises*, 18 March 2013.

F Notification and record-keeping requirements

Key points

We propose to require entities to:

- notify us before they become, or cease to be, a clearing entity;
- maintain records demonstrating compliance with the derivative transaction rules (clearing) for five years; and
- provide those records to ASIC at our request.

Notification of status as a clearing entity

Proposal

F1 We propose:

(a) to require an entity to notify us when it becomes, or ceases to be, a clearing entity. Notification must be provided at least 30 days before the entity becomes subject to mandatory central clearing, and within 30 days after the entity ceases to be subject to mandatory central clearing;

(b) that ASIC may publish these notifications; and

(c) to require a clearing entity, or an entity that will become a clearing entity, to disclose to a counterparty or prospective counterparty, on request, information set out in the draft derivative transaction rules (clearing) attached to this consultation paper relating to its status as a clearing entity.

Your feedback

F1Q1 Do you agree with our proposal to require entities to notify us when they become, or cease to be, a clearing entity? If not, why not?

F1Q2 If proposal F1(a) is implemented, should ASIC publish a list of clearing entities on an ongoing basis, based on the notifications provided to us? Are there any practical benefits in ASIC publishing a list based on notifications from clearing entities (taking into account existing industry mechanisms for providing notifications about an entity's regulatory status)?

F1Q3 Do you agree with our proposal to require existing or prospective clearing entities to disclose to a counterparty or prospective counterparty information relating to its status as a clearing entity?

F1Q4 What is the likely impact of our proposals? (Please see page 4 for information required.)

Rationale

101 It is important for us to be aware of the entities subject to mandatory central clearing. This will allow us to ensure that the clearing requirements are being complied with by clearing entities—as well as to monitor and assess the ongoing effectiveness of the clearing requirements.

102 We are therefore proposing that entities be required to notify ASIC at least 30 days before they become a clearing entity, and within 30 days of ceasing to be a clearing entity. This will ensure that the information we have regarding which entities are clearing entities for the purpose of mandatory central clearing is up to date.

103 We also propose that the derivative transaction rules (clearing) allow ASIC to publish any such notifications if we decide to do so. We are seeking your feedback as to whether it would be helpful to publish the notifications we have received on our website, which may be updated from time-to-time.

104 This proposal recognises that some market participants may not want a list of clearing entities to be publically available for reasons of commercial confidentiality, while others may find that it simplifies compliance with the derivative transaction rules (clearing) and helps facilitate market certainty.

105 To comply with mandatory central clearing a clearing entity will need to know whether each of its counterparties is, or is not, a clearing entity. Therefore, we propose to require clearing entities and entities that will become clearing entities —on the request of a counterparty or a potential counterparty— to disclose in writing information prescribed in the draft derivative transaction rules (clearing) attached to this consultation paper relating to the entity's status as a clearing entity (e.g. whether the entity is an Australian or foreign clearing entity, if the entity will become or cease to be an Australian or foreign clearing entity on a future date, and whether a foreign clearing entity has opted-in to centrally clear nexus derivative transactions). This will assist a clearing entity to comply with mandatory central clearing by being able to determine which of its transactions with certain counterparties are subject to the clearing requirements.

Record-keeping requirements

Proposal

F2 We propose to:

(a) require a clearing entity to maintain records to demonstrate it has complied with the clearing requirements for a period of five years from the date the record is made or amended;

(b) not require a clearing entity to keep the records in F2(a) if the clearing entity has arrangements in place to access those records through another person, for the duration of the five-year period; and

(c) require a clearing entity to provide us with records (or other information) demonstrating compliance with the clearing requirements, upon our request, within the time specified. The request must be made in writing and give the clearing entity reasonable time to comply.

Your feedback

F2Q1 Do you agree with our proposal to require clearing entities to maintain records demonstrating compliance with the clearing requirements for a period of five years?

F2Q2 Do you agree with our proposal to require clearing entities to provide us with these records upon our request? If not, why not?

F2Q3 What is the likely impact of our proposals? (Please see page 4 for information required.)

Rationale

106 It is important that clearing entities maintain records demonstrating compliance with the derivative transaction rules (clearing). We believe these records should be maintained for a period of five years and should demonstrate an entity's compliance with the rules over this period.

107 To ensure compliance with the derivative transaction rules (clearing), we need to be able to obtain access to these records. In the event we seek this information, we will provide a reasonable period of time for the clearing entity to comply with the request.

G Commencement of mandatory central clearing

Key points

We propose a commencement date for mandatory central clearing of 4 April 2016 for those entities at or above the clearing threshold as at the last day of the third and fourth quarters of 2015 (i.e. 30 September 2015 and 31 December 2015).

Derivative transactions entered into before the commencement date will generally not be subject to the clearing requirements. However, the clearing requirements will apply if, after the commencement date, a derivative transaction that would be subject to the clearing requirements if it was entered into after the commencement date is amended so that the maturity of the derivative is extended by more than 12 months.

Calculation and commencement dates

Proposal

G1 We propose the schedule of dates set out in Table 4 to determine which entities will be clearing entities for the purposes of proposal C.

Note: Proposal C gives details of the circumstances in which an entity would become subject to mandatory central clearing.

Table 4: Proposed calculation and commencement schedule

Date	Requirement
30 September 2015	First calculation date
31 December 2015	Second calculation date
4 April 2016	Mandatory central clearing takes effect for those entities that were above the clearing threshold on the first and second calculation dates

Your feedback

G1Q1 Do you agree with the proposed commencement date of 4 April 2016 for mandatory central clearing (for those entities that are at or above the clearing threshold as at 30 September 2015 and 31 December 2015)?

G1Q2 What is the likely impact of our proposals? (Please see page 4 for information required.)

Rationale

108 We propose that mandatory central clearing commence on 4 April 2016 for entities that meet the mandatory clearing threshold. In the proposals paper, it was indicated that approximately 14 entities are expected to qualify as clearing entities. Due to the relatively low number of entities that are likely to be clearing entities at the proposed commencement date, we believe it is appropriate not to adopt phased implementation.

109 Entities that will qualify as clearing entities will generally have, or will be in the process of putting in place, arrangements with CCPs, whether as direct clearing members or as clients of clearing members. Many of these entities will already be subject to mandatory central clearing in other jurisdictions.

110 We consider the proposed commencement date to provide sufficient time for entities to comply with the clearing requirements. It reflects our expectations that entities will be aware from the time of the first calculation date whether they fall above the clearing threshold and, therefore, whether they are likely to be subject to mandatory central clearing from the commencement date. Entities would have three months from the second calculation date to prepare for the commencement of mandatory central clearing.

H Regulatory and financial impact

111 In considering whether to make a derivative transaction rule, we are required by section 901H of the Corporations Act to have regard to:

(a) the likely effect of the proposed rules on the Australian economy, and on the efficiency, integrity and stability of the Australian financial system;

(b) the likely regulatory impact of the proposed rules;

(c) if the transaction to which the proposed rules relate to include transactions relating to commodity derivatives—the likely impact of the proposed rule on any Australian market or markets on which the commodities concerned may be traded; and

(d) any other matters that ASIC considers relevant, including, for example:

(i) any relevant international standards and international commitments; and

(ii) matters raised in consultations.

112 We must also, under s901J, consult with the public about the proposed rules.

113 Before settling on a final policy, we will comply with the Australian Government's better regulation requirements by:

(a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;

(b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and

(c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

114 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

115 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:

(a) the likely compliance costs (both one-off and ongoing) of the proposed derivative transaction rules (clearing);

(b) the likely effect on competition in any financial or services market or on the efficiency of any such market; and

(c) other impacts, costs and benefits (including potential substituted compliance or sufficient equivalence benefits under foreign regulatory regimes).

See 'The consultation process', p. 4.

Key terms

Term	Meaning in this document
ADI	Authorised deposit-taking institution
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A of the Corporations Act.
ASIC	Australian Securities and Investments Commission
AUD interest rate derivatives	OTC interest rate derivatives denominated in Australian dollars
CCP	Central counterparty
clearing entity	An Australian or foreign entity that is subject to the clearing requirements
clearing facility	A licensed CS facility or a prescribed CCP
clearing threshold	The threshold specified in the derivative transaction rules (clearing) used to determine whether an entity will become or cease to be a clearing entity
clearing transaction	An OTC derivative transaction that is required to be centrally cleared in accordance with the derivative transaction rules (clearing)
clearing requirements	The requirements for derivative transactions to be cleared through a licensed CS facility or a prescribed CCP Note: As defined in 901A(7) of the Corporations Act.
Corporations Act	*Corporations Act 2001*, including any regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
CPSS	Committee on Payment and Settlement Systems of the Bank of International Settlement
CPSS–IOSCO Principles	CPSS–IOSCO, Principles for financial market infrastructures, as revised from time to time
CS facility	A clearing and settlement facility as defined by s768A of the Corporations Act

Term	Meaning in this document
CS facility licence	An Australian CS facility licence under s824B of the Corporations Act that authorises a person to operate a CS facility in Australia
CS facility licensee	A person who holds a CS facility licence Note: This is a definition contained in s761A of the Corporations Act.
derivative trade repository rules	ASIC Derivative Trade Repository Rules 2013—rules made by ASIC under s903A of the Corporations Act that deal with the matters as permitted by this section
derivative transaction	Means: • the entry into an arrangement that is a derivative; • the modification or termination of such an arrangement; • the assignment, by a party to such an arrangement, of some or all of the party's rights and obligations under the arrangement; or • any other transaction that relates to a derivative and that is in a class of transactions prescribed by the regulations
derivative transaction rules (clearing)	The proposed ASIC Derivative Transaction Rules (Clearing) 2015
derivative transaction rules (reporting)	ASIC Derivative Transaction Rules (Reporting) 2013—rules made by ASIC under s901A of the Corporations Act that deal with reporting requirements, and requirements that are incidental or related to the reporting obligation
Dodd-Frank Act	*Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US)
G4 interest rate derivatives	OTC interest rate derivatives denominated in the four currencies of US dollar, Euro, British Pound and Japanese Yen
G20	Group of 19 of the world's largest economies, and the European Union
G20 commitments	Commitments made by the leadership of the G20 nations in September 2009 for the operation of OTC derivatives markets
GFC	global financial crisis
foreign internationally-active dealer	An entity that is registered or provisionally registered as a swap dealer under the Dodd-Frank Act
Instrument [15/0067]	Instrument [15/0067] *ASIC Derivative Transaction Rules (Nexus Derivatives) Class Exemption 2015*
IOSCO	International Organization of Securities Commissions
LEI	Legal Entity Identifier

Term	Meaning in this document
Ministerial determination	A determination made by the relevant Minister under section 901B of the Corporations Act, specifying one or more classes of derivatives in relation to which mandatory reporting, clearing or trade execution obligations may be imposed
nexus derivative	An OTC derivative to which a clearing entity is a counterparty that meets the nexus test
nexus test	The test in Instrument [15/0067] based on the location of salespersons or traders performing particular functions in relation to an OTC derivative
OTC	Over the counter
OTC derivative transaction	An arrangement that is an OTC derivative under the derivative transaction rules (reporting)
Pt 7.5A (for example)	A part of the Corporations Act (in this example numbered 7.5A)
Rule 1.2.5 (Reporting)	A rule of the derivative transaction rules (reporting) (in this example numbered 1.2.5)
s903A (for example)	A section of the Corporations Act (in this example numbered 903A)

List of proposals and questions

Proposal	Your feedback
B1 We propose that the derivative transaction rules (clearing) include the following definitions: (a) *Australian clearing entity*: An Australian authorised deposit-taking institution (ADI) or Australian financial services (AFS) licensee that is incorporated or formed in Australia, and whose derivatives activities meet or exceed the clearing threshold, as it applies to Australian entities. (b) *Foreign clearing entity*: A registrable body, as defined under Pt 5B.2 of the Corporations Act, that is an ADI, AFS licensee or exempt foreign licensee, and whose derivatives activities meet or exceed the clearing threshold, as it applies to foreign entities. (c) *Application in relation to trusts and registered schemes*: For transactions conducted in relation to a trust or registered scheme (acting in a representative capacity), where the trust or registered scheme exceeds the clearing threshold, the entity acting in the representative capacity would be a clearing entity in relation to that trade. Where the trust or registered scheme is formed in Australia, the trustee or responsible entity would be an Australian clearing entity in relation to that transaction; where the trust or registered scheme is formed outside of Australia, the trustee or responsible entity would be a foreign clearing entity in relation to that transaction. (d) *Opt-in Australian clearing entity*: An Australian entity whose derivatives activities do not exceed the clearing threshold may opt-in to become an opt-in Australian clearing entity by giving ASIC an opt-in notice. A trustee or responsible entity may give an opt-in notice to ASIC in its representative capacity to a trust or registered scheme formed in Australia. (e) *Opt-in foreign clearing entity*: A foreign entity whose derivatives activities do not exceed the clearing threshold may opt-in to become an opt-in foreign clearing entity by giving ASIC an opt-in notice. A trustee or responsible entity may give an opt-in notice to ASIC in its representative capacity to a trust or registered scheme formed outside of Australia.	B1Q1 Do you agree with the proposed scope of entities that may be subject to mandatory central clearing? B1Q2 Do you agree with the proposed definitions of 'Australian clearing entity', 'foreign clearing entity', 'opt-in Australian clearing entity' and 'opt-in foreign clearing entity'? B1Q3 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Proposal	Your feedback
B2 We propose to introduce a clearing threshold to determine which entities are clearing entities for the purposes of mandatory central clearing. We propose to take the approach set out in Table 1 to determine if an entity is a clearing entity. The threshold will apply differently depending on whether a clearing entity is an Australian financial entity or a foreign financial entity, and whether the entity is acting in a representative capacity.	B2Q1 Do you agree with our proposal to adopt the clearing threshold set by the Australian Government of $100 billion gross notional outstanding in OTC derivatives, for entities other than those acting in a representative capacity? B2Q2 Do you agree with the proposed application of the clearing threshold in relation to transactions entered into on behalf of a trust or registered scheme? B2Q3 Do you agree with the proposed derivatives that must be included when calculating the clearing threshold? B2Q4 Do you agree with our proposals for determining whether an Australian financial entity or foreign financial entity is a clearing entity, and when a clearing entity ceases to be a clearing entity? B2Q5 Do you agree with our proposal to apply the clearing requirements on the first Monday three months on or after the second calculation date? B2Q6 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Proposal	Your feedback
B3 We propose to: (a) apply the clearing requirements to derivative transactions entered into between: (i) two Australian clearing entities; (ii) an Australian clearing entity and a foreign clearing entity; (iii) two foreign clearing entities, where a branch of a foreign clearing entity has booked the trade in Australia, entered into the trade in Australia or, if it has opted-in to the nexus test, conducted a nexus derivative; (iv) an Australian clearing entity and a foreign internationally-active dealer; and (v) a foreign clearing entity and a foreign internationally-active dealer, where the foreign clearing entity has booked the trade in Australia, entered into the trade in Australia or, if it has opted-in to the nexus test, conducted a nexus derivative; (b) consistent with the draft regulations, define a 'foreign internationally-active dealer' as an entity that is registered or provisionally registered as a swap dealer with the US Commodity Futures Trading Commission (CFTC) or as a security-based swap dealer with the US Securities Exchange Commission under the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 (US) (Dodd-Frank Act); and (c) define 'nexus derivative' in a way that is consistent with Instrument [15/0067], and allow foreign clearing entities to opt-in to centrally clear nexus derivatives instead of transactions 'entered into in Australia' under the clearing requirements.	B3Q1 Do you agree with the proposal to apply the clearing requirements in each of the circumstances listed in proposals B3(a)(i)–B3(a)(v)? B3Q2 Do you agree with our proposed definition of 'foreign internationally-active dealer'? B3Q3 Do you agree with our proposed approach to defining 'nexus derivative', and to allow foreign clearing entities to opt-in to centrally clear nexus derivatives? B3Q4 Do you see any practical challenges for clearing entities trying to determine whether they are trading with an entity that is subject to the clearing requirements in each of the circumstances listed in proposals B3(a)(i)–B3(a)(v)? B3Q5 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Proposal	Your feedback
B4 We propose: (a) to specify that four types of 'swaps' may be subject to the clearing requirement, these are 'fixed-to-floating swaps', 'basis swaps', 'forward rate agreements' and 'overnight index swaps'. (b) to impose the clearing requirements on swaps that are fixed-to-floating swaps, basis swaps, forward rate agreements and overnight index swaps denominated in AUD and G4 currencies, if they meet the asset class specifications in Table 2 and do not contain one or more of the following features: (i) *Optionality*: Where either counterparty is granted an option that, if exercised, would affect the amount, timing or form of the consideration. (ii) *Multi-currency*: Where the notional principal amount and payments are not denominated in the same currency. (iii) *Conditional notional principal amount*: Where the notional principal amount would change upon the occurrence of a future event, and the occurrence of the future event is uncertain at the time of entering into the derivative. (c) to limit the application of mandatory central clearing to the entry, after the commencement date, of an arrangement that is a derivative transaction; and (d) that mandatory central clearing will not apply where an existing derivative is modified or assigned after the commencement date (other than in the circumstances in proposal B7, which relates to derivative transactions that extend the maturity of existing derivatives by more than 12 months).	B4Q1 Do you agree with the proposed definitions of 'swap', 'fixed-to-floating swap', 'basis swap', 'forward rate agreement' and 'overnight index swap' in the draft derivative transaction rules (clearing) attached to this paper? B4Q2 Do you agree with the proposed asset class specifications in proposal B4(a)and Table 2? B4Q3 Do you agree with our proposal that mandatory central clearing should only apply to the entry of an arrangement that is a derivative (other than in the circumstances outlined in proposal B7)? B4Q4 Do you agree with our proposal to mandate central clearing of AUD-denominated forward rate agreements? If not, why not? B4Q5 We have proposed mandating central clearing of AUD-denominated overnight index swaps with termination dates of between seven days and two years. Do you consider termination dates of between seven days to three years would be more appropriate for AUD overnight index swaps? B4Q6 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Proposal	Your feedback
B5 We propose that: (a) a clearing entity must clear each derivative transaction subject to the clearing requirements (clearing transaction) through a clearing facility (a licensed CS facility or a prescribed CCP); (b) a clearing transaction will be 'cleared through' a clearing facility if, broadly speaking, each side of the clearing transaction is replaced by a contract between the operator of the clearing facility and a participant by novation, and the counterparties to the clearing transaction will have no, or substantially no, further rights or obligations arising under the derivative after it has been cleared. The proposed definition of 'cleared through' in the draft derivative transaction rules (clearing) attached to this consultation paper also specifies the clearing arrangements that may be used; and (c) where a clearing entity does not comply with the clearing requirements, the clearing entity will be in breach of the derivative transaction rules (clearing), and may be subject to penalty provisions under the Corporations Act and/or the derivative transaction rules (clearing).	B5Q1 Do you agree with our proposal to require clearing entities to clear each clearing transaction through a clearing facility? B5Q2 Do you agree with the proposed definition of 'cleared through' a clearing facility in the draft derivative transaction rules (clearing) attached to this consultation paper. Do you agree with our proposal to allow direct, indirect or client clearing arrangements to be used? B5Q3 Should the clearing requirements be subject to exceptions? For example, are there any circumstances where a derivative transaction cannot be centrally cleared and should, therefore, be exempt from the clearing requirements? B5Q4 Should the derivative transaction rules (clearing) impose a prohibition on derivative transactions being de-cleared after they have been centrally cleared? If so, are there any circumstances where a mandatorily-centrally cleared derivative transaction should be permitted to be de-cleared? B5Q5 Do you agree with our proposal to that counterparties must have substantially no further rights and obligations arising under the derivative contract after it has been cleared through the clearing facility? Will there be circumstances in which the counterparties will have subsisting rights or obligations? B5Q6 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Proposal	Your feedback
B6 We propose that: (a) a clearing entity must centrally clear a clearing transaction as soon as practicable after entry into the arrangement and by no later than the end of the business day following the day on which the clearing transaction was entered into (commonly known as T+1); (b) the deadline for clearing by the end of the business day is calculated according to time and day in Sydney, Australia. Time and day is to be determined by reference to Australian Eastern Standard Time (AEST) or Australian Eastern Daylight Time (AEDT), as applicable in Sydney, Australia; and (c) where a clearing entity enters into a clearing transaction, and the transaction is not cleared and is terminated by no later than T+1, then the clearing entity is not considered to have breached the clearing requirements.	B6Q1 Do you agree with our proposed deadline of T+1 for the clearing of clearing transactions? B6Q2 Do you agree with our proposal that the deadline for clearing be calculated according to business days and AEST or AEDT, as applicable in Sydney, Australia? B6Q3 If you believe the deadline should be based on the time the derivative transaction was entered into (e.g. 24 hours after the derivative transaction was entered into), how should the deadline for clearing be determined if the derivative transaction is entered into on a cross-border basis by two counterparties located in different time zones? B6Q4 Do you agree with our proposal that the clearing requirements will not be breached if a clearing transaction is not cleared and is terminated before T+1? B6Q5 What is the likely impact of our proposals? (Please see page 4 for the information required.)
B7 We propose that where: (a) a clearing entity enters into a non-centrally cleared derivative transaction before the entity became a clearing entity (and, therefore, before the commencement of mandatory central clearing for that clearing entity); and (b) the derivative transaction would have been subject to the clearing requirements if it were entered into after the entity became a clearing entity; and (c) after the commencement date of mandatory central clearing for that clearing entity, there is a modification (or series of modifications) to the derivative transaction that extends the maturity of the derivative transaction 12 months or more beyond the maturity date of the derivative transaction at the time the derivative transaction was entered into, then the derivative transaction will become subject to the clearing requirements from the time of the last modification that results in the extension of the maturity of the derivative transaction for 12 months or more beyond the initial maturity date.	B7Q1 Do you agree with our proposal that mandatory central clearing be applied in the circumstances outlined above? B7Q2 Do you agree with our proposal that a derivative transaction that is extended for 12 months (or more) should become subject to the clearing requirements? If you believe the period should be longer, please give reasons why a derivative transaction would need to be extended for a period of 12 months or more. B7Q3 What is the likely impact of our proposals? (Please see page 4 for information required.)

Proposal	Your feedback
C1 We propose: (a) to allow a clearing entity to use a licensed CS facility or prescribed CCP to comply with mandatory central clearing, whether clearing directly or indirectly; and (b) that where there is no licensed CS facility or prescribed CCP that can clear the derivative transaction that is subject to the clearing requirements, then the clearing requirements do not apply.	C1Q1 Do you agree with our proposal to allow clearing entities to be cleared through licensed CS facilities or prescribed CCPs? C1Q2 What is the likely impact of our proposals? (Please see page 4 for the information required.)
D1 We propose that alternative clearing be available to any Australian or foreign clearing entity that is subject to mandatory central clearing.	D1Q1 Do you agree with our proposal to allow any clearing entity to comply with mandatory central clearing by using alternative clearing? If not, do you think the scope of our proposal should be narrower (e.g. restricted to foreign clearing entities)? D1Q2 Do you believe that access to alternative clearing would assist clearing entities to meet their clearing requirements? D1Q3 What is the likely impact of our proposals? (Please see page 4 for the information required.)
D2 We propose to require a clearing entity to meet the following conditions to be able to access alternative clearing: (a) in relation to a transaction that is subject to the Australian clearing requirements, the clearing entity or its counterparty must be subject to clearing requirements in another jurisdiction; (b) the foreign clearing requirements must require the relevant derivative transaction to be cleared no later than three business days (as counted in that jurisdiction) after the date on which the derivative transaction was entered into (commonly known as T+3); (c) a clearing entity must ensure the derivative transaction is cleared no later than three business days (as counted in that jurisdiction) after the date on which the derivative transaction was entered into; and (d) a clearing facility used to comply with foreign clearing requirements must be a licensed CS facility or prescribed CCP (as described under proposal C1).	D2Q1 Do you agree with the proposed conditions for determining whether alternative clearing can be used to comply with the Australian clearing requirements? If not, should particular criteria be added or removed? D2Q2 Do you agree with our proposal that derivative transactions using alternative clearing must be cleared through a licensed CS facility or prescribed CCP? D2Q3 Do you expect to be able to use alternative clearing for all or some of your derivative transactions? D2Q4 What is the likely impact of our proposals? (Please see page 4 for the information required.)

Proposal	Your feedback
E1 We propose to: (a) provide an exemption from mandatory central clearing for derivative transactions between two clearing entities that are in the same corporate group at the time the transaction is entered into; and (b) require clearing entities to provide notice in writing to ASIC at least one business day before the intra-group exemption is applied to one or more derivative transactions that would otherwise be subject to the clearing requirements. The notice can apply to all future transactions between a clearing entity and one or more related bodies corporate, and must include: (i) a statement by the clearing entity that it intends to rely on the exemption; (ii) the name of the clearing entity and its Legal Entity Identifier (LEI) or interim entity identifier; (iii) the name of the counterparty or counterparties; and (iv) details of the relationship between the clearing entity and the counterparty or counterparties that explains how they are a related body corporate of the clearing entity. If there are two or more clearing entities in a corporate group, a single notice can be given on behalf of all clearing entities, as long as the notice is authorised by each clearing entity and provides the names of the counterparties that each clearing entity will transact with under this exemption.	E1Q1 Do you agree with our proposal to allow an exemption from the clearing requirements for intra-group derivative transactions? E1Q2 Do you have any feedback on the notification requirements? E1Q3 What is the likely impact of our proposals? (Please see page 4 for information required.)

Proposal	Your feedback
E2 We propose: (a) to provide a limited and specific exemption from the clearing requirements for derivative transactions that are amended or created as part of a multilateral trade compression cycle operated by a third party; (b) that the exemption only be available if all of the following conditions are satisfied: (i) the trade compression cycle is conducted in accordance with the rules of a third-party operator for conducting compression; (ii) the trade compression cycle is conducted in compliance with the counterparty credit risk tolerance levels set by the parties to the multilateral compression cycle; (iii) the amended or new transactions are entered into between the counterparties to the original trades that were amended or terminated in accordance with the rules of the compression cycle; and (iv) the original transactions are not themselves subject to the proposed clearing requirements; and (c) not to provide an exemption from mandatory central clearing for bilateral compression cycles.	E2Q1 Do you agree with our proposal to allow an exemption from the clearing requirements for transactions that are created as part of a multilateral trade compression cycle? Are there any conditions that should be placed on this proposed exemption? E2Q2 Do you agree with our proposal not to allow an exemption from mandatory central clearing for bilateral compression exercises? E2Q3 What is the likely impact of our proposals? (Please see page 4 for information required.)
F1 We propose: (a) to require an entity to notify us when it becomes, or ceases to be, a clearing entity. Notification must be provided at least 30 days before the entity becomes subject to mandatory central clearing, and within 30 days after the entity ceases to be subject to mandatory central clearing; (b) that ASIC may publish these notifications; and (c) to require a clearing entity, or an entity that will become a clearing entity, to disclose to a counterparty or prospective counterparty, on request, information set out in the draft derivative transaction rules (clearing) attached to this consultation paper relating to its status as a clearing entity.	F1Q1 Do you agree with our proposal to require entities to notify us when they become, or cease to be, a clearing entity? If not, why not? F1Q2 If proposal F1(a) is implemented, should ASIC publish a list of clearing entities on an ongoing basis, based on the notifications provided to us? Are there any practical benefits in ASIC publishing a list based on notifications from clearing entities (taking into account existing industry mechanisms for providing notifications about an entity's regulatory status)? F1Q3 Do you agree with our proposal to require existing or prospective clearing entities to disclose to a counterparty or prospective counterparty information relating to its status as a clearing entity? F1Q4 What is the likely impact of our proposals? (Please see page 4 for information required.)

Proposal	Your feedback
F2 We propose to: (a) require a clearing entity to maintain records to demonstrate it has complied with the clearing requirements for a period of five years from the date the record is made or amended; (b) not require a clearing entity to keep the records in F2(a) if the clearing entity has arrangements in place to access those records through another person, for the duration of the five-year period; and (c) require a clearing entity to provide us with records (or other information) demonstrating compliance with the clearing requirements, upon our request, within the time specified. The request must be made in writing and give the clearing entity reasonable time to comply.	F2Q1 Do you agree with our proposal to require clearing entities to maintain records demonstrating compliance with the clearing requirements for a period of five years? F2Q2 Do you agree with our proposal to require clearing entities to provide us with these records upon our request? If not, why not? F2Q3 What is the likely impact of our proposals? (Please see page 4 for information required.)
G1 We propose the schedule of dates set out in Table 4 to determine which entities will be clearing entities for the purposes of proposal C1.	G1Q1 Do you agree with the proposed commencement date of 4 April 2016 for mandatory central clearing (for those entities that are at or above the clearing threshold as at 30 September 2015 and 31 December 2015)? G1Q2 What is the likely impact of our proposals? (Please see page 4 for information required.)