KING&WOOD MALLESONS

Level 61
Governor Phillip Tower
1 Farrer Place
Sydney NSW 2000
Australia

T +61 2 9296 2000
F +61 2 9296 3999

www.kwm.com

14 July 2015

Scott Farrell
Partner

Sarah Hickey
Senior Associate

By email
Senior Manager
OTC Derivatives Reform
Financial Market Infrastructure
Australian Securities and Investments Commission
Levels 5, 100 Market Street
Sydney NSW 2000
Email: OTCD@asic.gov.au

Consultation Paper 231: Mandatory central clearing of OTC interest rate derivative transactions

We refer to the request by the Australian Securities and Investments Commission (**ASIC**) for submissions on Consultation Paper 231: Mandatory central clearing of OTC interest rate derivative transactions (**CP 231**) and the Attachment to CP 231, the draft ASIC Derivative Transaction Rules (Clearing) 2015 (**ASIC Rules**). We appreciate the opportunity to make this submission.

We have limited our submission to those aspects of CP 231 and the ASIC Rules that relate directly to Australian law or issues relating to Australian law reform. Accordingly, we make no comments on commercial or operational issues (if any) in connection with CP 231 or the ASIC Rules. Further, we do not comment in this submission on the draft *Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015*.

Our comments on CP 231 and the ASIC Rules are set out below.

1 **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'**

Australian Clearing Entity / Foreign Clearing Entity in representative capacity

1.1 The draft ASIC Rules provide for a scheme or trust to which a Representative Capacity relates to be categorised as either an Australian Clearing Entity or a Foreign Clearing Entity on the basis of where the scheme or trust to which the Representative Capacity relates was incorporated or formed in or outside of Australia.

1.2 However, a trust cannot be formed without a trustee, and as a matter of law, the relevant legal entity will be the trustee. As the trustee or responsible entity (in the case of a scheme) may change a number of times over the course its existence, in our view it would be difficult to ascertain where that entity was "formed" rather than categorising it based on the place of incorporation of the trustee or responsible entity. This would also create a divergence as to how trusts and schemes are treated under the ASIC Derivative Transaction (Reporting) Rules 2013 and how they were treated under the draft ASIC Rules, as the former would turn on whether the entity was an "Australian entity" which would be dependent on the relevant responsible entity or trustee.

1.3 Accordingly, we submit that this be amended so that a scheme or trust is categorised as either an Australian Clearing Entity or a Foreign Clearing Entity based on whether the responsible entity or trustee in respect of that scheme or trust is incorporated or formed in or outside of Australia.

Foreign Clearing Entity

1.4 Paragraph (b) of the definition of Exempt Foreign Licensee, which constitutes paragraph (c) of the definition of Financial Entity, which forms part of the definition of Foreign Clearing Entity, is similar to, but not the same as, the wording used in paragraph (1)(b) of draft regulation 7.5A.62. The Explanatory Guide to draft regulation 7.5A.62 explains that its purpose is to include "overseas-regulated foreign entities that exceed the threshold of $100 billion, provide derivatives-related services to wholesale clients in Australia and are exempt from the licensing requirements in the Corporations Act."

1.5 However, it is submitted that the wording used in the draft regulation and paragraph (b) of the definition of Exempt Foreign Licensee does not fully address this intention. We have addressed draft regulation 7.5A.62 separately in our submission to The Treasury dated 26 June 2015. However, this is because the ASIC Rules (and the regulation) do not require that the wholesale clients are in Australia.[1] Therefore, an entity which satisfies the description of a wholesale client in the Corporations Act, but which is located overseas would still meet the description. If it is intended that this be limited to entities which deal with wholesale clients in Australia then this should be expressed in paragraph (b) of the definition of Exempt Foreign Licensee.

1.6 Further, a considerable reliance is likely to be placed on paragraph (c) of the definition of Exempt Foreign Licensee by a number of overseas entities who otherwise fall within the scope of the definition because they are large overseas entities which deal with institutional (wholesale) clients internationally. Australia's licensing regime may not apply to these entities, not because of a specific exemption, but because of the limits in the application of Chapter 7 of the Corporations Act jurisdictionally. It would be very useful if the Explanatory Statement to the ASIC Rules (once finalised) could evidence the intention that the reference that an entity "is exempt" is meant to refer to an entity which would have been subject to the requirement to hold an Australian financial services licence but for the existence of a specific exemption to that requirement, rather than just that the licensing requirements of the Corporations Act simply don't apply to them in the first place.

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

Related body corporates

[1] See Explanatory Guide to the draft *Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015*, page 10.

2.1 Draft ASIC Rule 1.2.7(1)(b) provides that an entity calculating its gross notional outstanding positions in Derivatives can exclude "a position in a Derivative entered into with a related body corporate of the entity". Table 1 of CP 231 further states that ASIC does not propose to aggregate the clearing threshold across corporate groups. However, it is unclear from the drafting whether ASIC Rule 1.2.7(1)(b) is intended to exclude:

(a) positions entered into by the entity calculating its gross notional outstanding positions with its related body corporates (i.e. transactions to which the entity and a related body corporate are the counterparties); or

(b) positions entered into by related body corporates with third parties.

2.2 Accordingly, if it is ASIC's intention that draft ASIC Rule 1.2.7(1)(b) should expressly provide that entities are not required to aggregate the clearing threshold across corporate groups, we would recommend amending the drafting to state that entities can exclude "any positions in Derivatives entered into by a related body corporate of the entity with a party other than the Reporting Entity".

Entered into in Australia

2.3 Draft ASIC Rule 1.2.7(1)(c) provides that an entity incorporated or formed outside of Australia can exclude, when calculating its gross notional outstanding positions, positions in Derivatives that were not *entered into in Australia.*[2] Whether a Derivative is "entered into in Australia" is a legal question which would turn on the individual facts applicable to each transaction. This could be very difficult to ascertain, would create uncertainty and would be difficult to apply on a consistent basis in modern financial markets.

2.4 Accordingly, we would recommend amending this drafting so that the relevant positions are those "entered into *by the Reporting Entity* in Australia".

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

3.1 Draft ASIC Rule 2.1.1(1) provides that a Clearing Transaction must be cleared through a clearing facility by no later than the end of the first Business Day after the day on which the clearing transaction is entered into (being T + 1). The definition of Business Day under the draft Rules provides that "Business Day means a day that is not a Saturday, a Sunday, or a public holiday or bank holiday in the place concerned". However, this appears to conflict with draft ASIC Rule 1.2.1(b), which provides that a reference to a Business Day is to a Business Day by reference to the time and day in Sydney, Australia.

3.2 Accordingly, we would recommend removing 1.2.1(b) so as to avoid any potential conflict. In addition, this would also address any concerns which may otherwise arise as to the timing of T + 1 if it were based on a Sydney business day only. This is because this timing may not be possible when using a prescribed clearing house subject to different public holidays than those which would otherwise apply in Australia.

[2] Emphasis added.

We welcome the opportunity to discuss these matters, and other issues in connection with the discussion of CP 231 or the ASIC Rules, with you. Please contact Scott Farrell) or Sarah Hickey of our offices if we may be of further assistance.

Yours faithfully