

26 August 2014

Financial System Inquiry  
GPO Box 89  
Sydney NSW 2001  
**fsi@fsi.gov.au**

Dear Sir/Madam

### **Financial System Inquiry Interim Report**

The International Swaps and Derivatives Association (**ISDA**)<sup>1</sup> is grateful for this opportunity to make a submission in response to the Interim Report of the Financial System Inquiry released in July 2014 (**Interim Report**).

ISDA is also grateful for your consideration of our submission on the Terms of Reference. We note that the risks of market fragmentation referred to in our previous submission are relevant to your discussion in the Interim Report of the cross-border operation of financial market infrastructure and international integration. Additionally, we understand that the Australian Government is pursuing steps to ensure certainty of netting which are consistent with the comments in our earlier submission relating to clarity on Australian netting.

This submission is made in response to issues raised in the Interim Report on matters related to the implementation of derivatives reform, resolution powers for financial institutions and impediments to international integration in derivatives markets.

#### *Implementation of derivatives reform*

The Interim Report seeks views on the regulatory burden in Australia when considered against comparable jurisdictions and international integration.

ISDA acknowledges the efforts which have been made by the Australian Treasury and the Australian financial regulators in facilitating compliance by Australian participants with multiple international regulatory regimes as a result of the G20 derivative reforms. A focus on pro-active

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<sup>1</sup> Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: [www.isda.org](http://www.isda.org).

regulation which facilitates international business is critical for the integration of the Australian financial markets with the rest of the world. Accordingly, the Australian regulators' efforts to promote cross-border consistency and implement regulation consistent with international standards should continue, both as a matter of policy implementation as well as in the detail of regulation.

### *Regulators' resolution powers for financial institutions*

The Interim Report seeks views on the costs, benefits and trade-offs of making changes to Australia's current regulatory framework to strengthen the regulators' resolution powers for financial institutions.

ISDA agrees that there are benefits in crisis management powers which enable the resolution of a financial institution without systemic disruption and without exposing the taxpayer to the risk of loss. However, it is critical that these enhancements do not have adverse implications for the integration with the international markets which provides the risk management tools necessary for systemic stability. Such adverse implications could arise if crisis-management enhancements result in legal uncertainty around the enforceability of netting and collateral arrangements in connection with derivatives, ring-fencing of local assets of a foreign ADI in the event of its local branch being made subject to resolution in the host country or discrimination against foreign creditors in the host country. Particular care needs to be taken in implementing any resolution regime which prevails over the existing legal and market structure. Amongst other things, we consider that a priority should be placed on achieving international cooperation and recognition where possible of aspects of a resolution regime that relate to foreign financial institutions. For more information on these issues, please refer to our submission to the Australian Treasury's Consultation Paper "Strengthening APRA's Crisis Management Powers" issued in September 2002.

### *Impediment to international integration*

The Interim Report seeks further information on the potential impediments to international integration. We submit that there are some "legacy" Australian regulatory impediments which reflect earlier regulatory landscapes and a less global marketplace. Removing these impediments would promote international integration without compromising the original policy sought to be achieved by this regulation.

An example of this can be found in regulation which prevents Australian superannuation and life insurance entities from accessing cleared derivatives markets in the United States (a critical marketplace for the management for financial risks). This impediment arises in the appointment of "clearing brokers". Under United States law and regulation this appointment requires that security be granted to the clearing broker over the client's margin which is required to clear the transactions. However, this can be contrary to restrictions on granting security to which a life company or superannuation entity is subject under the *Superannuation Industry (Supervision) Regulations 1994* and the *Life Insurance Regulations 1995*. Although these regulations do have some exceptions for certain transactions on specific exchanges, these exceptions are out-of-date

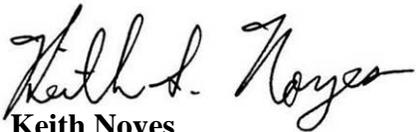
and do not cover all of the requirements for OTC clearing in G20 countries, such as Australia. This could be simply fixed and does not seem at all inconsistent with the policy of the underlying regulation. However, until it is addressed, these entities face restrictions in dealing in an international marketplace in a manner consistent with the G20 reforms designed to make that marketplace safer.

Similar issues are likely to arise when the G20 reforms on margining of non-centrally cleared derivatives are implemented. International standards will require that initial margin to be provided by way of security rather than by absolute transfer (which is the customary manner of derivatives collateralisation in the Australian market). This will give rise to concerns for entities which have restrictions on granting security (such as superannuation entities and life companies) and also Australian banks (due to priority provisions in the Australian *Banking Act 1959*). It is important to the ability of these entities to participate in international markets that these local regulatory impediments are addressed in a timely manner.

ISDA welcomes the opportunity to discuss these matters, and other issues in connection with this submission, with you. Please contact Cindy Leiw ([cleiw@isda.org](mailto:cleiw@isda.org)) if we may be of further assistance. Thank you for your consideration.

Yours faithfully

**For the International Swaps and Derivatives Association, Inc.**

  
**Keith Noyes**  
**Regional Director, Asia Pacific**

  
**Cindy Leiw**  
**Director of Policy**