

## Chapter 2

### Overview of the bill

2.1 As noted in the Second Reading Speech to the bill, the Corporations Legislation Amendment (Derivative Transactions) Bill 2012 is intended to address Australia's G20 commitments regarding 'the reporting of OTC derivatives to trade repositories; the clearing of standardised OTC derivatives through central counterparties; and the execution of standardised OTC derivatives on exchanges or electronic trading platforms, where appropriate'.<sup>1</sup> The legislative amendments are intended to 'provide a high degree of flexibility' to facilitate the adjustment of Australia's OTC derivative requirements in response to international regulatory developments.<sup>2</sup>

2.2 The bill would amend the *Corporations Act 2001* to implement a legislative framework that would allow the operational details of the new OTC derivatives scheme to be largely established by subordinate legislation.<sup>3</sup> That is, the bill would not introduce new requirements for OTC derivatives transactions. Rather, the bill would introduce a framework under which obligations may be imposed through subordinate legislation and regulatory rules.<sup>4</sup>

#### *The proposed legislative framework of the bill*

2.3 Schedule 1 would amend the Corporations Act to introduce a legislative scheme that would promote 'graduated measures to respond proportionately in managing risks in Australian OTC derivatives markets'.<sup>5</sup> The bill would delegate regulation and rule-making powers to the responsible minister and ASIC. Accordingly, the Minister and ASIC would determine the nature and extent of the regulatory framework governing OTC derivatives transactions.

2.4 The Minister would determine which classes of derivatives would be subject to OTC derivative rules. The Minister's determinations would be subordinate legislative instruments, subject to the Parliamentary disallowance process.<sup>6</sup> In

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1 The Hon Bill Shorten MP, *House of Representatives Hansard*, 12 September 2012, pp 4–6.

2 The Hon Bill Shorten MP, *House of Representatives Hansard*, 12 September 2012, pp 4–6.

3 The Hon Bill Shorten MP, *House of Representatives Hansard*, 12 September 2012, pp 4–6.

4 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.24.

5 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.23.

6 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.108.

exercising the delegated authority, the Minister would be required to consider the determination's likely regulatory impact, the effect on the Australian economy and the integrity of the financial system, and any other matters the Minister considers relevant. In finalising a determination, the Minister would be required to consult with ASIC, APRA, and the RBA. However, failure to consult would not invalidate the determination.<sup>7</sup> Accordingly, the requirement to consult would not necessarily circumscribe the Minister's exercise of the delegated authority or the validity of the subordinate legislation affecting the prescribed class of derivatives.

2.5 Following the Minister's determination, proposed Part 7.5A of the Corporations Act would authorise ASIC to make rules to govern the prescribed classes of OTC derivatives. The rules would establish execution requirements, reporting requirements and clearing requirements.<sup>8</sup> While the rules would be determined by ASIC, the Commission's authority would not be unfettered but would be subject to two avenues of ministerial and parliamentary oversight. First, the rules would be legislative instruments subject to parliamentary disallowance.<sup>9</sup> Second, the bill includes a regulation making power that would authorise regulations to limit the requirements that could be imposed on certain classes of derivative transactions or persons.<sup>10</sup>

2.6 Additionally, the bill would impose restrictions on the requirements that the rules may impose. Proposed subsection 901A(8) would effectively prevent derivative transaction rules from applying retrospectively. As noted in the Explanatory Memorandum (EM) '[t]he derivative transaction rules do not impose requirements retrospectively [and] are limited in the obligations they can impose prospectively in relation to transactions entered into prior to their creation'.<sup>11</sup> Proposed subsection 827D(2A) would also limit the operation of the rules, providing that the RBA financial stability standards would prevail to the extent of any inconsistency with the derivative transaction rules.<sup>12</sup>

2.7 It is expected that ASIC will provide rules of sufficient detail to allow the new OTC derivatives requirements to be effectively implemented. For example, the EM advises that '[t]he rules would be expected to contain precise details specifying who in

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7 Proposed Section 901B, Corporations Act 2001.

8 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.95.

9 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.95.

10 Proposed Sections 901C-901D, Corporations Act 2001.

11 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.107.

12 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.79.

relation to the given transaction must (or may) comply with a requirement'.<sup>13</sup> ASIC would be responsible for determining execution requirements, reporting requirements, clearing requirements, and any incidental or related requirements. In addition, ASIC may specify in the rules classes of transactions subject to particular requirements, the persons to whom the rules apply, and exemptions from compliance requirements.<sup>14</sup>

2.8 Failure to comply with the rules would attract a civil penalty.<sup>15</sup> The EM advises that the new OTC derivative transactions regime would utilise the existing civil penalty regime under the Corporations Act.<sup>16</sup> In addition, the bill would allow regulations to establish alternatives to civil penalty proceedings. Alternatives may include fines, remedial measures, such as education programs, sanctions other than the payment of a fine, and enforceable undertakings.<sup>17</sup>

### ***Trade repositories***

2.9 The Second Reading Speech notes that the bill would introduce a new licensing regime for trade repositories.<sup>18</sup> Consistent with ASIC's role as the corporate, markets, and financial regulator, the new licensing regime would fall within ASIC's regulatory responsibilities. ASIC would be authorised to disqualify persons from obtaining, or retaining, an Australian derivative trade repository licensee where ASIC has declared the individual to be unfit or otherwise disqualified from involvement in a corporation.<sup>19</sup> The bill would provide procedural fairness in the disqualification process, through requiring, among other matters, ASIC to notify licensees or applicants of the intended disqualification and provide an opportunity to respond. The EM notes that the procedures are modelled on existing disqualification procedures in the Corporations Act.<sup>20</sup> It is evident that the new licensing system is drawn from existing licensing regimes but modified to address 'the different roles of this new form of market infrastructure entity will play'.<sup>21</sup>

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13 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.98.

14 Proposed Section 901A, Corporations Act 2001.

15 Proposed subdivision B, Part 7.5A, Corporations Act 2001.

16 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.114.

17 Proposed Section 901A, Schedule 1, Corporations Act 2001.

18 The Hon Bill Shorten MP, *House of Representatives Hansard*, 12 September 2012, pp 4-6.

19 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.82.

20 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.83.

21 The Hon Bill Shorten MP, *House of Representatives Hansard*, 12 September 2012, pp 4-6.

2.10 The bill would confer on ASIC responsibility to determine rules to regulate the operation of trade repositories. The rules may canvass issues including the manner in which licensed derivative trade repositories provide their services, the handling or use of derivative trade data, the governance, management and resources of licensed review trade repositories. Additionally, ASIC would have authority to monitor the integrity of the electronic platforms operated by licensed derivative trade repositories. Rules may include requirements concerning the integrity and security of computer systems, operational reliability, business continuity planning, operational separation of functions, and the outsourcing of functions to other entities.<sup>22</sup>

2.11 The bill recognises that Australia's OTC derivatives markets include cross-border transactions. Accordingly, the bill would authorise ASIC to inquire into the regulatory regime applying in the foreign market and the adequacy of the supervision the regulations provide.<sup>23</sup> The EM advises that the rules 'can be tailored to operate in a coordinated and consistent way to varying overseas requirements'.<sup>24</sup>

### ***Application of the Legislative Instruments 2003***

2.12 The bill would authorise the responsible Minister and ASIC to amend determinations, regulations, derivative transaction rules and derivative trade repository rules to incorporate written instruments or any matter contained in writing. An instrument or matter contained in writing may be incorporated if in force or existing at a particular time or from time to time.<sup>25</sup> This is contrary to the general prohibition in the *Legislative Instruments Act 2003* against incorporating documents that may exist after the legislative instrument has commenced and documents with a limited lifespan. Accordingly, the bill would effectively modify the Legislative Instruments Act's application to the OTC derivatives regulatory framework.

2.13 The EM argues that this is necessary to ensure that regulations applying to transactions conducted on Australian exchange platforms can take account of international developments and thereby promote international coordination and open markets.<sup>26</sup>

### ***Consequential amendments***

2.14 The bill contains consequential amendments to the *Australian Prudential Regulation Authority Act 1998*, the *Australian Securities and Investments Commission*

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22 Proposed Section 903A, Corporations Act 2001.

23 Proposed Section 902A, Corporations Act 2001.

24 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.136.

25 Proposed Section 907B, Corporations Act 2001.

26 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.230.

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*Act 2001*, the *Mutual Assistance in Business Regulation Act 1992*, and the *Reserve Bank Act 1959*. The amendments would extend information sharing protocols between relevant domestic regulators to allow a coordinated regulatory approach for the proposed OTC derivative transaction requirements.<sup>27</sup>

2.15 The proposed amendments are also intended to further Australia's commitment to international regulatory cohesion, with amendments to the Mutual Assistance in Business Regulation Act designed to permit Australian regulators to respond to requests by foreign regulators for information, documents and evidence from persons in Australia.<sup>28</sup>

### **Consideration of the bill by the Senate Standing Committee for the Scrutiny of Bills**

2.16 The Senate Standing Committee for the Scrutiny of Bills has considered the bill and raised two key concerns:

- First, the Scrutiny of Bills Committee expressed concern with the general framework of the bill that would effectively delegate overall regulatory authority to the responsible Minister and to ASIC (Part 7.5A). In particular, the committee highlighted proposed sections 901A-D and 903A-903C, which would authorise ASIC to establish derivative transaction rules and derivative trade repository rules.
- Second, the proposed modification of the application of the Legislative Instruments Act (clause 907B).<sup>29</sup>

2.17 While drawing the Senate's attention these matters, the Scrutiny of Bills Committee did not seek the Minister's advice regarding the appropriateness of the proposed regulatory framework. Rather, the Scrutiny of Bills Committee referred to the Senate the question of whether the proposed delegation of legislative power is inappropriate.<sup>30</sup>

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27 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraphs 1.263-1.264.

28 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraphs 1.277-1.279.

29 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest 11/12*, 19 September 2012, pp 34.

30 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest 11/12*, p. 4.

