C L I F F O R D

C H A N C E

Briefing note February 2015

OTC derivatives: Reporting exemption for certain foreign entities in Australia

The latest class exemption published by the Australian Securities and Investment Commission (**ASIC**) may exempt certain foreign entities from reporting trades entered into in Australia but not booked to the profit or loss account of a branch in Australia.

Background

Currently a foreign bank with a branch located in Australia, or a foreign company that is required to be registered as a foreign company in Australia[1] (each a **Relevant Reporting Entity**) are required under Australian trade reporting rules[2] (the **Rules**) to report information about transactions and outstanding positions for certain classes of over the counter derivatives[3] (**OTC Derivatives**) that are either entered into by such entity in Australia or are booked to the profit or loss account of a branch of the entity located in Australia.

ASIC provided guidance that ordinary principles of Australian contract law will apply to determine whether a transaction was entered into by a Relevant Reporting Entity in Australia. This means that a Relevant Reporting Entity has to apply the principles of Australian contract law to each of its OTC Derivative transactions in order to establish whether it is entered into in Australia. This will be expensive, time consuming and complicated as different parties are entering into the transactions across different jurisdictions and making use of different methods of communication.

The International Swaps and Derivative Association **(ISDA)** made an application to ASIC on behalf of Relevant Reporting Entities for relief from the requirement to report reportable transactions and outstanding positions in OTC Derivatives entered into in Australia. Temporary relief previously in place for Phase 2 entities expired on 1 February 2015.[4]

The new class exemption[5]

Following consultation with ISDA, ASIC has now provided relief to Relevant Reporting Entities (the **Class Exemption**) from reporting reportable transactions and outstanding positions for OTC Derivatives which are entered into in Australia and not booked to the profit or loss account of a branch of the Relevant Reporting Entity in Australia. The relief is however subject to the condition that if a reportable transaction has a nexus with Australia (as set out in the Class Exemption and explained below), then the transaction will be known as a nexus transaction **(Nexus Transaction)** and it must be reported as if it were a reportable transaction under the Rules. Outstanding positions must also be reported for Nexus Transactions. These are known as nexus positions under the Class Exemption **(Nexus Positions).**

There is an exception to reporting Nexus Transactions and Nexus Positions. Where a Relevant Reporting Entity is subject to reporting requirements in one or more foreign jurisdictions that are substantially equivalent to the reporting requirements of the Rules, then, provided the Relevant Reporting

Key issues

- ASIC has introduced a new class exemption, excusing certain foreign entities from reporting trades which are entered into in Australia.
- Such entities must still report transactions and outstanding positions with a nexus to Australia, unless these transactions fall within the scope of an alternative reporting exception.
- Eligible entities must opt-in to take advantage of this relief with a deadline of 25 February 2015 for Phase 2 reporting entities to opt-in.

Entity is reporting Nexus Transactions and Nexus Positions in compliance with the alternative reporting requirements in one or more of the foreign jurisdictions and designated (or tagged) the information reported as being reported under the Rules or under the Class Exemption, the Relevant Reporting Entity is not required to report its Nexus Transactions or Nexus Positions.

Eligibility for relief

The Class Exemption only applies to Relevant Reporting Entities who notify ASIC of their decision to opt-in to the relief. It does not apply to a foreign subsidiary of an Australian entity, where the Australian entity is an Australian ADI or AFS licensee.

Once the Relevant Reporting Entity opts-in, the test for whether an OTC Derivative transaction is entered into in Australia will be based on the alternative test set out in the Class Exemption which determines whether a reportable transaction in the opt-in class is a Nexus Transaction or a Nexus Position. The test focuses on the location of persons performing certain functions in relation to OTC Derivatives as opposed to the test based on ordinary principles of Australian contract law.

Opting-in

A Relevant Reporting Entity may submit a written notice (**Opt-In Notice**) to ASIC in order to take advantage of the Class Exemption. The Opt-In Notice **must** include:

- the name of the Relevant Reporting Entity;
- the name of each class or classes of OTC Derivatives (**Opt-In Class**) in relation to which the Relevant Reporting Entity seeks relief; and
- the date (**Effective Date**) from which the Relevant Reporting Entity will rely on the Class Exemption in relation to each Opt-In Class. The Effective Date may not be earlier than the date of the Opt-In Notice.

The Opt-In Notice may be withdrawn at any time by submitting a written withdrawal notice to ASIC which follows similar formal requirements. Notice must be provided at least 30 days before the proposed withdrawal date.

Nexus Transaction

A Nexus Transaction refers to the entry into of an arrangement that is an OTC Derivative (**Nexus Derivative**) to which the Relevant Reporting Entity is a counterparty where one or more of the functions in relation to the Nexus Derivative is or will be performed by a person who is (i) ordinarily resident in or employed in Australia, or (ii) acting as part of a desk, office or branch of the Relevant Reporting Entity or its associate, located in Australia. The reference to an associate is to an 'associate' as defined in the Corporations Act 2001 (Cth)[6] and includes a related body corporate of the Relevant Reporting Entity.

The functions specified in the Class Exemption are intended to capture functions which would typically be performed by a salesperson or trader, including communications between salesperson and client, and include determining the economic terms of the Nexus Derivative, communicating such terms, and offering and agreeing to enter into the Nexus Derivative, along with managing the financial risk arising from the Nexus Derivative.

The test is not intended to capture functions performed by persons sitting in non-sales or trader functions such as management, counterparty risk, operational risk, finance and treasury and the persons' role or job title is not definitive.

A Nexus Transaction also covers Nexus Derivatives executed through an automated electronic trading facility in circumstances where the economic terms are determined by, or consequent financial risk will be managed by, a person who meets the location criteria referred to above. It further includes the modification or termination of an arrangement that is a Nexus Derivative and the assignment, by a party to an arrangement that is a Nexus Derivative, of some or all of that party's rights and obligations under the arrangement if the Relevant Reporting Entity has actual knowledge of the assignment.

Nexus Position

A Relevant Reporting Entity must also by or on the Relevant Reporting Date (as defined below) report information about each outstanding position in a Nexus Derivative outstanding as at the Relevant Reporting Date and that was entered into on or after 25 February 2015 and also before the Relevant Reporting Date.

Alternative Reporting Exception

A Relevant Reporting Entity will not be required to report information on either Nexus Transactions or Nexus Positions if it is subject to reporting requirements (**Alternative Reporting Requirements**) in one or more foreign jurisdictions that are substantially equivalent to the reporting requirements under the Rules[7] and cover OTC Derivatives of the same Opt-In Class.

In addition, the Relevant Reporting Entity (or another entity) must either:

- report information about the Nexus Transaction or Nexus Position to a prescribed repository, in compliance with Alternative Reporting Requirements in at least one foreign jurisdiction, as well as 'tag' such information as information reported under the Rules or under the conditions of this Class Exemption; or
- be exempt from reporting information about a Nexus Transaction or Nexus Position in *all* of the foreign jurisdictions, or no such reporting requirement exists in any of those jurisdictions.

Timing

The new Class Exemption applies to all Relevant Reporting Entities, regardless of whether they have opted-in, from 2 February 2015 to 24 February 2015 (inclusive) and thereafter only if they have opted-in.

Relevant Reporting Entities may opt-in at any stage. However, to take advantage of the Class Exemption, such entities should opt-in before their reporting obligations under the Rules commence.[8]

Eligible Phase 2 reporting entities relying on current ASIC relief[9] should consider opting-in no later than 25 February 2015 with an Effective Date of no later than 25 February 2015. Failure to do so means the Phase 2 entity will be required to report transactions entered into by the Relevant Reporting Entity in Australia from 25 February 2015.

Where a Relevant Reporting Entity has opted-in, it only has to begin reporting Nexus Transactions from the later of (i) 25 May 2015 and (ii) the Effective Date specified in the Opt-In Notice (the **Relevant Reporting Date**).

By or on the Relevant Reporting Date the Relevant Reporting Entity must report a Nexus Position in a Nexus Derivative that is outstanding as at the Relevant Reporting Date and that was entered into by the Relevant Reporting Entity on or after 25 February 2015 and also before the Relevant Reporting Date.

Tagging exemption

Previously, Phase 2 Relevant Reporting Entities could rely on a class order[10] to excuse them from reporting OTC Derivative transactions and outstanding positions entered into in Australia on the conditions that such transactions be reported from 2 February 2015 and outstanding positions as at 2 February 2015 (in an OTC Derivative entered into in Australia on or after 1 October 2014) be reported by or on 1 August 2015, as well as 'tagged' under the Rules during the period from 2 February 2015 to 1 August 2015 (**Phase 2 Class Order Conditions**).

Exemption 2 provides that a Relevant Reporting Entity does not have to comply with the Phase 2 Class Order Conditions provided it complies with the conditions of the Class Exemption.

Timing

Exemption 2 grants Phase 2 Relevant Reporting Entities a grace period from 2 February 2015 to 24 February 2015, during which time these entities will not have to comply with the Phase 2 Class Order Conditions.

If, however, a Phase 2 Relevant Reporting Entity wishes to extend this relief beyond 24 February 2015, it must submit an Opt-In Notice with an Effective Date of no later than 25 February 2015 and comply with the conditions of the Class Exemption.

Regional comparison

The new Class Exemption sets out a definition for Nexus Derivatives based on the location of the salesperson or trader, which more closely reflects the approach taken by regulators in Hong Kong and Singapore to determine whether an OTC Derivatives transaction is reportable in the jurisdiction.

Nevertheless, Relevant Reporting Entities should be aware that the scope of the Australian nexus contained in the Class Exemption is wider than its Singapore or Hong Kong equivalent.

	Australia	Singapore	Hong Kong
Reportable trades	Trades which are: (a) booked to the profit or loss account of a branch located in Australia; or (b) entered into in Australia.	Trades which are: (a) booked on the balance sheet or profit and loss accounts of a person whose place of business is in Singapore; or (b) traded in Singapore.[11]	Trades: (a) to which the reporting entity is a party; or (b) conducted in Hong Kong.
Comparison of tests	"entered into in Australia": The contract will be entered into in Australia if acceptance of the offer to enter into the contract is received in Australia, where an instantaneous form of communication is used to communicate the acceptance.[12] <u>Alternatively</u>, if the Relevant Reporting Entity has opted-in to the Class Exemption, it must show that prescribed salesperson/trader functions are performed by a person who is: ■ ordinarily resident in or employed in Australia; **or** ■ acting as part of a desk, office or branch of the Relevant Reporting Entity or its associate, located in Australia.	"traded in Singapore": The execution of the derivatives contract is performed by a trader;[13] ■ whose place of employment is located in Singapore and who conducts, on behalf of a specified person, activities relating to the execution of derivatives contracts in Singapore; **or** ■ who: (i) for a period of not less than 30 days immediately before the date of the execution of the derivatives contract, conducts or is authorised to conduct, on behalf of a specified person, activities relating to the execution of derivatives contracts in Singapore; and (ii) is physically in Singapore at the time of the execution of the derivatives contract.	"conducted in Hong Kong": The transaction is recorded in the books of its affiliate (which includes any entity in the same group) and the individual through whom the affiliate enters into the transaction: ■ acts in his or her capacity as a trader[14]; **and** ■ performs his or her duty predominantly in Hong Kong.[15]

[1]Under Division 2 of Part 5B.2 of the Corporations Act 2001 (Cth).

[2]Rule 2.2.1 of the ASIC Derivative Transaction Rules (Reporting) 2013.

[3]ASIC's reporting regime currently prescribes the following classes: commodity derivatives (that are not electricity derivatives), credit derivatives, equity derivatives, foreign exchange derivatives and interest rate derivatives.

[4]ASIC Instrument [14/0234].

[5]ASIC Derivative Transaction Rules (Nexus Derivatives) Class Exemption 2013.

[6]Section 9 of the Corporations Act 2001 (Cth).

[7]ASIC currently considers the EU (EMIR), US (CFTC) and Japan to be the only foreign jurisdictions with substantially equivalent reporting requirements.

[8]For example, Phase 3 Reporting Entities are required to commence reporting on 13 April 2015. Phase 3 Relevant Reporting Entities should opt-in to the class waiver on or before this date.

[9] ASIC Class Order [14/0234].

[10]ASIC Class Order [14/0234].

[11]Securities and Futures (Reporting of Derivatives Contracts) Regulations 2013.

[12]ASIC FAQs, available at <http://asic.gov.au/>.

[13]Securities and Futures (Reporting of Derivatives Contracts) Regulations 2013 (as amended by the Second Amendment Regulations).

[14]"Trader" is intended to have its ordinary meaning, so that only persons who make trading decisions are captured by the test. Persons acting solely in their capacity as salespersons are excluded.

[15]The Hong Kong regulators have proposed that any transaction that is executed by a trader who performs his or her duty predominantly in Hong Kong, regardless of the trader's physical location at the time of the transaction, will be considered to have conducted the transaction in.

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