EXPLANATORY STATEMENT

Issued by authority of the Minister for Revenue and Financial Services

Corporations Act 2001
Life Insurance Act 1995
Superannuation Industry (Supervision) Act 1993

Financial Services Legislation Amendment (Wholesale Margining) Regulation 2016

Section 1364 of the *Corporations Act 2001* (the Corporations Act), section 253 of the *Life Insurance Act 1995* (the Life Insurance Act), and section 353 of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) each provide that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act. Subsections 981A(4) and 984A(2) of the Corporations Act allow the regulations to provide exemptions or modify the provisions relating to holding of client moneys and property that are contained in subdivision 2A (client moneys) and Division 3 (property) of Part 7.8 of that Act. Paragraph 38(3)(c) of the Life Insurance Act allows a life company to mortgage or charge the assets of a statutory fund for purposes prescribed by the regulations. Subsections 31(1) and 32(1) of the SIS Act provide that regulations may prescribe standards applicable to the operation of regulated superannuation funds and approved deposit funds, and to trustees and Registrable Superannuation Entity (RSE) licensees of those funds.

The *Financial Services Legislation Amendment (Wholesale Margining) Regulation 2016* (the Regulation), implements the Government's commitment, contained in its 2015 response to the Financial System Inquiry that was chaired by Mr David Murray AO, to 'develop legislation to facilitate participation of Australian entities in international derivative markets'.

Specifically, the Regulation:

- allows wholesale clients of Australian Financial Services Licensees (AFSLs) to make an agreement with their AFSL that their client money (as defined by section 981A of the Corporations Act) and property (as defined by section 984A of the Corporations Act) may be dealt with other than in accordance with the client money and property regimes contained in the Corporations Act if it is used to facilitate trade in non-centrally cleared derivatives (for example, to meet domestic and international security-based margining requirements); and

- updates the list of approved bodies (being domestic and foreign exchanges and clearing houses) to whom trustees of superannuation funds and life companies may grant security.

The Regulation enables wholesale (institutional) entities to manage their risks more effectively and access optimal pricing and products. It also facilitates compliance with the Group of Twenty (G20) post-global financial crisis reform agenda to improve transparency in derivatives markets, mitigate systemic risk and protect against market abuse.

Details of the Regulation are set out in Attachment A.

The Government undertook extensive consultation on legislative amendments to facilitate compliance with domestic and international margining agreements for non-centrally cleared derivatives from 22 December 2015 to 25 March 2016.

As part of this consultation, the Government released a policy paper on 22 December 2015 which set out its intentions with regard to client money reform. These proposals were put forward in exposure drafts of a Bill and associated Regulation, which were released together with an Explanatory Memorandum and Explanatory Statement on 29 February 2016.

In the consultation versions, the amendments relating to wholesale client money (now in the Regulation) were included in the Bill. They have since been transposed into the Regulation, so that they may be implemented ahead of the commencement of international and domestic non-centrally cleared derivative margining requirements of Australian entities. The updates to the Approved Bodies lists in the SIS and Life Insurance Regulations respectively are minor technical changes, and as such have not been specifically consulted on.

The call for public submissions closed on 25 March 2016. Forty-nine submissions were received, from 42 parties. Government officials also met with a range of stakeholders to better understand their positions.

Stakeholders (including key industry representatives and regulators) indicated support for the amendments in the proposed Regulation. To the extent that concerns were raised, there was no consensus view. Concerns typically related to the administrative cost of having to differentiate between wholesale and retail clients, and a perceived need to offer various types of wholesale client more or less protection. Some stakeholders also offered suggestions to improve other aspects of the Corporations Act. In light of the broad stakeholder support for the reform, and the need for Australian entities to meet margining requirements, the Government determined that the amendments should proceed as drafted.

A Regulation Impact Statement (RIS) titled ‘Impediments to Margining’ was prepared and consulted on in respect of the suite of changes that the Government proposed in order to facilitate Australian compliance with international non-centrally cleared derivatives margining requirements in 2015 and early 2016. This RIS is part of the Explanatory Memorandum for the *Financial System Legislation Amendment (Resilience and Collateral Protection) Act 2016*. The Office of Best Practice Regulation has confirmed that a further RIS specifically for the Regulation is not required. A statement of the Regulation’s compatibility with human rights is set out at Attachment B.

The relevant Acts do not specify any conditions that need to be satisfied before the power to make the Regulation may be exercised.

The Regulation is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The Regulation commences on the day after it is registered.

ATTACHMENT A

Details of the Financial Services Legislation Amendment (Wholesale Margining) Regulation 2016

Section 1 – Name of Regulation

Section 1 provides that the name of the Regulation is the *Financial Services Legislation Amendment (Wholesale Margining) Regulation 2016*.

Section 2 – Commencement

Section 2 provides that the Regulation commences on the day after registration.

Section 3 – Authority

Section 3 provides that the Regulation is made under the *Corporations Act 2001*, *Life Insurance Act 1995* and the *Superannuation and Industry (Supervision) Act 1993*.

Section 4 – Schedules

Section 4 provides that each instrument specified in the Schedule is amended or repealed as set out in the applicable items in the Schedule.

Schedule 1 Corporations Regulations 2001 - *Wholesale client money and property*

Items [1], [2] and [3]

The Corporations Act, together with the Corporations Regulations, defines acceptable treatment of client money and property held by authorised intermediaries.

This schedule provides that money paid or property given to AFSLs as mentioned in subsections 981A(1) and 984A(1) of the Act is exempt from the regulation of client money and property (as set out in Subdivision A of Division 2, and Division 3 of Part 7.8 of the Act) if the money or property is:

- paid or given in connection with a financial service or product that *relates to derivatives*;
- the entry into the derivative is *not cleared through a clearing and settlement facility*;
- the financial service or product would *be provided to the client as a wholesale client* (for the purposes of the Regulation, sophisticated investors as defined by 761GA of the Act, are not to be treated as wholesale clients) if the service or product were provided to the client when the money is paid; and
- the *licensee has obtained the client's written agreement* to the money or property being dealt with other than in accordance with the relevant Subdivision or Division.

To make use of these provisions, wholesale clients and their AFSL need only agree the manner in which the money will be held or property should be dealt with (e.g. in a security agreement).

In making this agreement, they do not need to explicitly refer to Subdivision A of Division 2 or Division 3 of Part 7.8 of the Act, or to set out their agreement in a separate document.

The exemption provided for by the Regulation is intentionally narrow. It is intended only to facilitate compliance with regulatory reform in respect of non-centrally cleared derivatives. It should not otherwise affect the integrity of protections afforded to wholesale clients in respect of their client money or property. *[Schedule 1 – Corporations Regulations 2001, item 1 (Before regulation 7.8.01 – wholesale client money) and item 2 (After regulation 7.8.06A – wholesale client property)]*

Schedules 2 and 3 – Life Insurance Regulations 1995 and Superannuation Industry (Supervision) Regulations 1993

Items [1] to [22] of Schedule 2

Items [1] to [22] of Schedule 3

Amended list of approved bodies - Schedule 7 of the Life Insurance Regulations and Schedule 4 of the SIS Regulations

The *Life Insurance Regulations 1995* and *SIS Regulations 1994* each include a schedule of 'approved bodies' to whom trustees of statutory funds may grant charges over, or in relation to, fund assets in certain circumstances. This allows trustees of Superannuation Funds and life companies to trade in cleared and uncleared OTC derivatives markets.

The list of approved bodies in each of Schedule 7 of the Life Insurance Regulations and Schedule 4 of the SIS Regulations has been updated to reflect recent changes in financial markets, and to make minor technical corrections. For example, new exchanges and clearing houses which are important in international OTC derivatives markets have been included and entities which no longer exist (due to mergers or otherwise) have been removed from the list. *[Schedule 2 – Life Insurance Regulations 1995 and Schedule 3 – Superannuation Industry (Supervision) Regulations 1994]*

In some cases, the list sets out the name of the actual exchange or clearing house service provided by the entity (rather than a distinct platform operated by the same entity).

Where the rules or other governing documents of the exchange or clearing house indicate there is an operator which is a legal entity that operates two or more facilities (or a facility with a slightly different name), an attempt has been made to specify, where possible, the facility (for example, "[*facility*] operated by [*operator*]").

In other cases, where a distinction does not appear to be drawn between the operator and the facility (and the entity only operates one facility), the legal entity has been specified.

Care has been taken to specify the correct legal name of the facility and operator to the extent possible.

Each schedule also specifies as an approved body a body that performs clearing house functions, in relation to an approved body that does not itself perform those functions, in accordance with the rules of the approved body or a law of the country where the second body is situated.

ATTACHMENT B

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Financial Services Legislation Amendment (Wholesale Margining) Regulation 2016

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

The *Financial Services Legislation Amendment (Wholesale Margining) Regulation 2016* (the Regulation), fulfils the Government's commitment in response to the 2014 Murray Financial System Inquiry to 'develop legislation to facilitate participation of Australian entities in international derivative markets'.

Specifically, the Regulation:

- allows wholesale clients of Australian Financial Services Licensees (AFSLs) to agree that their client money may be dealt with other than in accordance with the client money regime, if it is used to facilitate trade in non-centrally cleared derivatives (e.g. to meet domestic and international security-based margining requirements); and
- updates the list of approved bodies (being domestic and foreign exchanges and clearing houses) to whom trustees of superannuation funds and life companies may grant security.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.