FSC FINANCIAL SERVICES COUNCIL

Percy Bell
Manager
Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

25 February 2013

Dear Mr Bell

Re: Implementation of Australia's G20 over the counter derivatives commitments

Thank you for the opportunity to provide a submission.

The Financial Services Council (FSC) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, private and public trustees. The FSC has over 130 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please find our submission enclosed. We look forward to discussing the contents with you. I can be contacted on 02 9299 3022.

Yours sincerely

ANDREW BRAGG
SENIOR POLICY MANAGER

FSC SUBMISSION –
Implementation of Australia's G20 over the counter derivatives commitments

INDEX

This submission contains comments on:

1. Context
2. Ministerial determinations / ASIC rule making
3. Trade reporting
4. Specific feedback on trade reporting

Context

The FSC appreciates the opportunity to provide a submission on this proposals paper. We provided a response to the April 2012 discussion paper on the implementation of a framework for meeting our G20 obligations.

This consultation occurs at a time where the Australian Government is reviewing the adequacy of the Australian Financial Market Licensing regime and the Government is considering Council of Financial Regulators' advice on competition in clearing and settlement in the cash equities market.

It also occurs when a number of G20 member nations are bedding down similar legislative arrangements arising from the 2009 Pittsburgh summit:

> All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the [Financial Stability Board] and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse.

As noted in the proposals paper, no single jurisdiction has yet fully implemented this 2009 agreement from Pittsburgh.

The Corporations Legislation Amendment (Derivative Transactions) Act 2012 prescribes the legislative framework to deliver the following requirements, should they become appropriate:

- 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.

Rather than achieving this by prescribing the requirements immediately in legislation, the Act empowers the Minister to make these decisions at certain times in the future. ASIC then makes rules for prescribed participants.

The legislation also provides a licensing regime for trade repositories.

Ministerial determinations / ASIC rule making

As the legislative framework is now in place, the regulatory environment can be completed by Ministerial determinations identifying particular derivatives for a mandate and ASIC rules determining necessary actions for those derivative types.

FSC believes it is important that Australia's regime has:
- Global comparability;
- Capacity for global equivalence and mutual recognition; and
- Contains integrity, cost-effectiveness and efficiency, maintaining sufficient liquidity.

The proposals paper canvasses:
1. Trade reporting;
2. Central clearing; and

3. Trading platforms.

This submission canvasses the major issues outlined in the discussion paper – recommendations are boxed throughout.

The proposals paper indicates that the Government is likely to initially require trade reporting but not central clearing or trading. Accordingly, the FSC's comments are focussed on the proposals for trade reporting. At this stage we do not have any comments on the new licensing regime for trade repositories.

However if there is a longer-term move to require central clearing, fund managers using offshore clearing houses may become subject to interest withholding tax issues.

FSC supports the position on the withholding tax outlined in the ABA/AFMA submission.

International coordination

It is important that regulators in Australia engage fully with foreign regulators that are also moving to implement G20 commitments on OTC derivative reform. This will help ensure harmonisation and avoid unnecessary duplication.

The costs will initially be in ensuring existing systems support the requirements and secondly, connectivity costs.

It is extremely important that the RBA, along with other G20 central banks, consider what exactly they want to achieve from the information which they want to be mandated. Once that has been established, they need to define what information satisfies that regulatory need. This should then form the basis of a consistent global standard on what needs to be reported.

For example, hundreds of reportable data fields in the US to the DTCC would be burdensome and complicated. A focussed set of data fields would simplify the reporting and be potentially easier for a regulator to monitor. Trade repositories should then have to consistently apply the standard in devising their reporting systems. This would help drive global harmonisation and remove inconsistency.

RECOMMENDATION: Australian regulators should report to the industry the status of agreed global harmonisation on a regular basis.

Trade reporting

It is suggested in the proposals paper that reporting to a trade repository will be the first step in the new regime and the first derivative types to be determined by the Minister will be interest rate, foreign exchange, equity, credit and commodities. This is slated to occur in stages between 2013 and 2015 based on the type of the institution.

The proposals paper notes that of the global $639 trillion OTC derivatives market, Australia counts for around 5 per cent and that trade reporting is uncommon in our jurisdiction.

Accordingly a relatively new regime will be created in Australia over the next two to three years.

FSC considers that a major challenge of implementing the new regime will be to improve market regulation and transparency without long-term adverse impacts on market efficiency and liquidity.

In particular, FSC would be interested to see if trade data reporting will result in immediate disclosure of all trades. FSC would support delayed public disclosure of large trades that have the ability to move the market[1].

If these trades are publicly disclosed before the 'laying off' or 'closing out' occurs, the disclosure will affect market pricing to the ultimate disadvantage of the original trader, with little discernible benefit for the market or investors.

For this reason, FSC is of the view that a one hour delay in public disclosure (or reporting, if reporting results in immediate disclosure) of these trades is appropriate to enable an orderly lay off to occur, while still achieving the policy intent behind increased trade reporting and disclosure.

RECOMMENDATION A one hour delay in public disclosure of trades should be adopted.

Specific feedback on trade reporting

Do you have comments on the costs and benefits of complying with the trade reporting obligation, as outlined in this document, from the point of view of your business and/or that of your customers?

We would be interested in the scope of the trade reporting obligation so far as it will affect Phase 2 and Phase 3 participants. We submit that once a trade is reported (e.g. by a Phase 1 participant), there should be no requirement for the other party (being a Phase 2 or 3 participant) to also report. This will save on duplication and cost, including for regulators.

1. Type of derivatives

Do you have comments on the proposal to mandate a broad range of derivatives subject to the phase-in and exceptions outlined below? Or is there another option you prefer? If so why?

We generally have no material issue to mandate a broad range of derivatives. However, consideration should be given to more complex derivatives (e.g. exotic/multi-leg) should have a longer phase in time for mandatory trade reporting.

2. Timetable

[1] A fund manager, for instance, may transact in large volumes that are capable of moving the market. For some transactions, the counterparty might price the trade on the assumption that it is able to 'close out' or 'lay off' its exposed position (assuming it enters into the transaction with this intention) by entering into smaller trades with other participants. If real time disclosure of the original trade takes place, the market will be fully informed of the position the counterparty is attempting to lay off. The outcome will be that the lay-off risk is increased and the counterparty will charge a higher price that reflects the increased risk.

Do you have a preference for the timetable being prescribed in regulation or implemented by a phased approach to ASIC rule-making?

We would prefer implementation via a phased approach to ASIC rule-making. This allows more flexibility for a proposed implementation date to be moved back if necessary.

Do you have comments on the proposed timetable for implementing the trade reporting obligation? Or is there another option you prefer? If so, why?

As the paper recognises, whether or not the proposal timetable is achievable will depend partly on how much time is allowed for implementation after the details of the reporting regime are sufficiently firmed up and relevant trade repositories have been licensed.

We are comfortable with the timeline proposed save that we feel trade reporting should not begin until March 2014 at the earliest.

It is also important that the rules are in place and understood by industry well before implementation begins. We would suggest at least a 12 month period post finalising rules before trade reporting should begin. The lack of clarity and concurrent finalising of rules alongside implementation in the US of the CFTC swap dealer requirements has caused significant issues not only for Australian swap dealers but entities globally.

RECOMMENDATION
A 12 month transition period which follows the creation of the trade reporting regime should occur prior to reporting commencing

The plethora of rules, implementation dates and subsequent no action relief is also likely to cause a significant burden for the CFTC in attempting to regulate the reforms.
We have witnessed first-hand from the US swap dealer reforms the impact an arbitrary deadline for implementation can have when rules are not finalised and understood properly by industry. This should be avoided in Australia.

Accordingly we believe that a minimum allowance of one year from this time would be appropriate for Phase 1 participants, with additional six month allowances as proposed for Phase 2, then Phase 3 participants.

The timetable would have to allow for appropriate processes and policies to be developed and set up, reasonable questions to be asked including of the regulator, assessing any duplication that may arise (e.g. duplicating reports to overseas repositories), staff training, appropriate software and electronic platforms for trade repository access to be set up and tested.

For Phase 1, do you have a preference for referencing legal status, thresholds of activity, or size proxies? For Phases 2 and 3, do you prefer activity thresholds or size proxies?

We would issue a note of caution against adopting legal status as the trigger for reporting. Such a regime could lead to entities creating alternate entity types to circumvent the requirement to report. For this reason we would be more supportive of a threshold trigger for reporting requirements.

Threshold triggers linked to market activity is more likely to reflect the level of risk and regulatory cost related to the participant. FSC submits that ASIC should consult with the industry on various threshold trigger ranges prior to finalisation.

RECOMMENDATION
Bands of market activity should determine whether a financial institution is subject to phases 1, 2 or 3.
ASIC must consult with the industry prior to finalising bands and thresholds.

Do you have comments on the proposal to implement the trade reporting and trade repository licensing regime expeditiously, but not to impose interim reporting obligations ahead of this? Or is there another option you prefer? If so, why?

We agree that the trade reporting and trade repository licencing regimes should be implemented expeditiously but that the mandatory trade reporting phase-in period should not begin until earliest March 2014 for the reasons outlined above.

However, should the finalising of the regime be delayed beyond that proposed, then industry should be afforded at least 12 months before commencement.

We do not agree that an interim regime should be implemented in lieu of the final regime. This will involve system changes and business process changes that might not be reflected in the final rules. This has the potential to cause duplication of costs by having to comply with a regime which is likely to be changed and require further system amendments etc.

An interim regime may have been an attractive option at the time of drafting the Consultation Paper in light of the then requirement for swap dealers to make arguments for substituted compliance around March 2013.