15 April 2014

Capital Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

By Email Only: financialmarkets@treasury.gov.au
Copy by email: ASIC, OTC Derivatives Reform - OTCD@asic.gov.au

Implementation of Australia's G-20 over-the-counter derivative commitments – Treasury Proposals Paper – G4 IRD central clearing mandate

The Financial Services Council (**FSC**) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees. The FSC has over 125 members who are responsible for investing more than $2.2 trillion on behalf of 11 million Australians.

1. We welcome the opportunity to make a submission to the *Implementation of Australia's G-20 over-the-counter derivative commitments – Treasury Proposals Paper – G4 IRD central clearing mandate* (February 2014) (the **Proposals Paper**). The FSC supports the broad G-20 agenda in relation to OTC derivatives reform and Australia is well progressed in many respects in relation to the implementation of the G-20 requirements.

2. In relation to the subject matter of the Proposals Paper, the FSC membership covers a broad range of entities, including those forming part of global asset management organisations and others which are predominantly domestic based with activities limited to acting as a trustee or responsible entity with investment management largely outsourced to an investment manager.

3. The Proposals Paper is predominantly directed to the clearing mandate. We provide comments on the clearing mandate.

4. We also provide comments on the trade reporting requirements in relation to Phase 3 Australian Financial Services (**AFS**) Licence holders with a view to the Treasury considering an exemption from trade reporting for certain Phase 3 AFS Licence holders, in addition to not applying trade reporting to end-users. We also make comments seeking re-consideration of the double sided reporting requirements for trade reporting. We acknowledge that ASIC has consulted on the derivative trade reporting requirements (ASIC Consultation Paper 205).

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

However, as the regime is new, we think that an ongoing review and refinement of the trade reporting regime is needed to ensure that any mandated requirement is not disproportionate to the costs or implications of trade reporting recognising the need to capture information of significance in relation to systemic risks.

Difficulties evident overseas with two sided reporting

5. We believe that there have been difficulties apparent with two-sided reporting under EMIR, and we note that the US CFTC adopts single-side reporting. We think there should be re-consideration of the decision to require two sided reporting and consideration of the extent of AFSL entities captured by derivatives trade reporting.

Application to the Buy-side (wealth management/fiduciary account)

6. We note in general that the OTC derivatives reforms are at a more advanced stage of implementation by the "sell side" which are likely to have much of the infrastructure to leverage into the OTC derivatives reforms by virtue of their business as usual activities such as making markets and as market or clearing participants or being part of a group with such entities. We observe that in relation to the "buy-side" (e.g. managing money on fiduciary account, such as responsible entities and superannuation trustees); particularly those not forming part of global asset management firms, they will not be in the same position as the sell-side. For the "buy-side" the OTC reforms are particularly significant, more so than for the sell-side. FSC and similar organisations representing the buy-side are likely to have further comments as these reforms progress. (We do acknowledge that some recognition has been given to the different status and businesses of the "sell-side" and "buy-side" by the implementation tranches of the OTC trade reporting requirements and also the clearing related proposals in the Proposals Paper.)

Mandatory Clearing of G4-IRD

Treasury Question 1: Do you have comments on the benefits and costs of complying with a mandatory central clearing obligation, from the point of view of your business and/or that of your customers:

7. The FSC recognises the need to ensure Australia meets its G-20 commitment in relation to central clearing. It is important this is done as efficiently as possible (that is, with minimal cost and adverse impact to the Australian domestic circumstances).

8. As a general principle, any clearing mandate introduced in Australia should be not be wider or more extensive than foreign clearing mandates. We strongly agree with the proposal to restrict ASIC rulemaking to entities that are considered to be G4 Dealers.

9. We do not support including AFSL holders (other than G4 Dealers) within the scope of the clearing mandate. We do not see the benefit of making the scope any wider until the costs

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

and benefits of clearing are better understood. We observe that AFSL holders (that is, who are not also G4 Dealers) are likely to be required to clear anyway to the extent that their trading counterparties are required to clear, and so AFSL holders will likely indirectly be subject to a clearing mandate. Further, we consider that given market incentives to clear (such as ADI capital charges for non-centrally cleared transactions, and the trend to increased collateralisation of OTC derivatives), we do not consider it appropriate to mandate clearing to AFSL holders which are not a G4 Dealer.

10. We note our view that clearing should not be mandated for AFSL holders (other than G4 Dealers) is consistent with the most recent finding of the Council of Financial Regulators (**COFR**) in their *Report on the Australian OTC Derivatives Market (April 2014)*. In particular the COFR reached the following conclusion on mandatory central clearing:

> *The Regulators do not believe it is appropriate to mandate central clearing for non-dealers at this time. They will nevertheless continue to monitor the availability of client clearing for OTC interest rate derivatives and the incentives-led migration to central clearing, particularly by non-dealers with access to sufficient liquidity. In addition, the Regulators will review the impact of international regulatory developments*.[1]

Amendment required to Life Insurance and Superannuation related regulations to permit (but not mandate) clearing by life insurance statutory funds and regulated superannuation funds

11. In order for AFSL holders and end users to comply with:

(a) any clearing mandates (although FSC does not support *mandated* clearing to AFSL holders outside of the G4 Dealers);

(b) their own local Australian regulatory obligations (including under life insurance and superannuation legislation and regulations); and

(c) client investment mandate and contractual obligations,

it is important that relevant legislation/regulations are amended and updated to accommodate the compliance obligations in paragraphs (a) to (c) above. An important example of this legislation/regulation is the restriction applying to superannuation funds and statutory funds of a life insurer in relation to security interests and charges over the assets of these types of funds (see section 38(3) of the *Life Insurance Act 1995*, and regulation 13.14 of the *Superannuation Industry (Supervision) Regulations 1994*).

12. Entry into clearing arrangements is essential for many funds seeking access to exchanges and derivatives which they have an obligation to clear centrally by virtue of obligations under investment mandates and contracts set out in paragraphs 11(a) and 11(c) above. Regulation

[1] See Council of Financial Regulators Media Release *Report on the Australian OTC Derivatives Market – April 2014* Media Release Number: 2014-01, 3 April 2014.

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

4.00A and Schedule 7 of the *Life Insurance Regulations 1995* and regulation 13.15A and Schedule 4 of the *Superannuation Industry (Supervision) Regulations 1994* have the intention of providing practical exemptions from the prohibition of charging assets of a life insurance statutory fund or assets of a regulated superannuation fund, in the case of certain regulated derivatives trading for these funds. The exemptions currently only relate to options and futures and are limited only to certain approved bodies/exchanges.

13. The exemptions in the *Life Insurance Regulations* and the *Superannuation Industry (Supervision) Regulations* need to be amended to accommodate the range of products, trading and exchanges contemplated by central clearing mandates. We submit that prompt attention and priority should be given to updating and adapting these regulations to ensure any central clearing undertaken (to meet a contract or client mandate for example) are consistent with the capacity for funds to comply with their legislative and contractual obligations. This can be achieved by widening the exemptions in Regulation 4.00A and Schedule 7 of the *Life Insurance Regulations 1995* and regulation 13.15A and Schedule 4 of the *Superannuation Industry (Supervision) Regulations 1994* so as to include appropriate reference to clearing mandates and by updating the list of approved exchanges under which the exemption can operate. These amendments to life insurance and superannuation regulations should occur even if (as we submit) clearing is not mandated outside G4 Dealers.

Trade Reporting: Exemption for End-users and Non-dealer Phase 3 AFS Licensees

Treasury Question 10: Do you have comments on the proposals relating to:

a) Making the exemption of end users from trade reporting permanent, subject to ensuring that appropriate information on systemically important OTC derivatives trading is available to regulators?

14. The FSC strongly supports the proposal to permanently exempt end users from trade reporting. We also believe that re-consideration should be given to the reach of trade reporting to certain other entities (namely, Non-dealer Phase 3 AFS Licensees as defined in paragraph 15 below). That is, we submit that consideration should be given to exempting Non-dealer Phase 3 AFS Licensees from derivative trade reporting requirements and perhaps this could be implemented by moving from two-sided reporting to single sided reporting by G4 Dealers and the like. Derivative trade reporting should apply to Phase 1 and Phase 2 entities.

15. We support the proposals in the Proposals Paper to permanently exempt "end-users" from trade reporting (as proposed in question 10(a) of the Proposals Paper) and have a more tightly targeted AFSL reference in the regulations (as proposed in question 10(b) of the Proposals Paper). We submit that there are sound policy reasons for extending these refinements to exempting the currently described "Phase 3" entities from the trade reporting requirement in ASIC's Derivative Transaction Rules (Reporting) 2013 (**Reporting Rules**) as well. For the

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

purpose of this submission, ***Non-dealer Phase 3 AFS Licensee means*** Phase 3 AFS Licensees (other than ADIs).

16. In summary, we consider the exemption from trade reporting for Non-dealer Phase 3 AFS Licensees is justified since requiring Non-dealer Phase 3 AFS Licensees to comply with the reporting requirements under the Reporting Rules imposes a significant compliance burden on these entities which outweighs any regulatory benefit gained in respect of achieving transparency of those entities' OTC derivatives transactions. In any case, we do not consider that making this adjustment prevents ASIC from fulfilling the objectives of the Reporting Rules.

17. We set out this reasoning in more detail below. Capitalised terms not otherwise defined in this submission have the same meaning as that under the Reporting Rules.

18. We consider that the compliance burden associated with requiring Non-dealer Phase 3 AFS Licensees to comply with reporting obligations under the Reporting Rules greatly outweighs the regulatory benefit of collecting this data, particularly as it is our view that exempting Non-dealer Phase 3 AFS Licensees from reporting would not detract from the regulator's access to information on systemically important derivative trading activity in Australia.

19. There is a substantial amount of work that needs to be done in order for a person to be in a position to provide information in accordance with the ASIC specifications, regardless of whether such persons have established connectivity for reporting in respect of overseas regimes. However, we consider that the regulatory benefit achieved by requiring Non-dealer Phase 3 AFS Licensees to comply with Australia's trade reporting requirements is minimal, particularly since most of this data will already be reported and noting the limited utility of the two-sided reporting data that is being gained under other overseas reporting regimes.

20. For the vast majority of Reportable Transactions involving Non-dealer Phase 3 AFS Licensees, the effect of exempting Non-dealer Phase 3 AFS Licensees from reporting under the Reporting Rules would be that the current reporting regime resembles a one-sided reporting regime. To this end, we note that a large percentage of the volume of OTC derivatives trading executed by Non-dealer Phase 3 AFS Licensees would be done with Phase 1 or Phase 2 entities (rather than with other Phase 3 entities) on the other side of the transaction. These Phase 1 or Phase 2 entities are required to report their side of these transactions in accordance with the Reporting Rules.[2]

21. There are unresolved practical difficulties under the European reporting regime (a key jurisdiction where two sided reporting is implemented) in matching the data relating to the two sides of the same transaction. In our view, these difficulties compromise the regulatory objective of obtaining improved transparency of OTC derivatives trading in the market. We

[2] As a consequence, we do not consider that the regulators would have any substantially less information on systemically important derivative trading in the Australian market.

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

acknowledge the benefits ASIC wishes to obtain from having a two-sided reporting regime.[3] However, given the European experience to date, it appears that the Australian regulators can only expect to obtain very limited benefit (if any at all) from a two-sided reporting requirement. We note that there is no standard practice for having two-sided reporting (for instance, the US reporting regime requires only one-sided reporting).

22. Given the lack of utility we expect regulators to derive from receiving reporting data from Non-dealer Phase 3 AFS Licensees, it is our view that the compliance burden that would be imposed on Non-dealer Phase 3 AFS Licensees in respect of the Reporting Rules would greatly outweigh any regulatory benefit which might be gained by regulators in compelling such entities to comply with the Reporting Rules. Accordingly, we request that the Government exempts Non-dealer Phase 3 AFS Licensees from the Reporting Rules requirements.

23. Our members believe that end users are unlikely to be in a position to report efficiently or effectively, which will result in substantial time and resources being expended for the provision of trade reporting that is likely to be of little incremental value to regulators in assessing broader systemic risks. Any costs associated with the reporting requirements will ultimately be borne by investors. In our view, such costs are unlikely to exceed any benefits from reporting by end users. We consider similar arguments apply in relation to Non-dealer Phase 3 AFS Licensees given trade reporting undertaken by Phase 1 and Phase 2 entities.

24. Where end users report themselves (rather than delegate to a third party), there is the likelihood that discrepancies will make it difficult to match transaction details to the report of the corresponding dealer and that the great majority of such discrepancies will be due to data quality issues rather than genuine differences in the actual trade information reported by both parties to the trade. Where end users delegate reporting to their counterparty, which will still involve cost and administrative burden in putting such arrangements in place, data discrepancies should disappear but so too would any value that may come from having double-sided reporting. We consider similar arguments apply in relation to *Non-dealer Phase 3 AFS Licensees*.

25. We would further observe that requiring end users to report could result in end users opting not to engage in derivative transactions, the great majority of which are likely to be to hedge exposures and risk management transactions.

b) Do you have comments on the proposals relating to a more tightly targeted AFSL reference in the regulations?

26. The FSC supports a more tightly targeted AFSL reference in the regulations but believes that a much more effective and productive approach would be to exempt Non-dealer Phase 3 AFS Licensees from the trade reporting regulations (for the reasons set out in this submission).

---

[3] See ASIC Report 357, 'Response to submissions on CP 205 Derivative transaction reporting', July 2013 at [56].

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

Or is there another option you prefer?

27. The FSC submits that all Non-dealer Phase 3 AFS Licensees be permanently exempted from trade reporting.

If so, why?

28. It is recommended that in addition to end-users, Non-dealer Phase 3 AFS Licensees be permanently exempted from trade reporting for the following reasons:

    (a) Non-dealer Phase 3 AFS Licensees are generally end-user purchasers of derivatives and do not make markets in derivatives.

    (b) Non-dealer Phase 3 AFS Licensees trade with derivatives dealers who will already be reporting the trades.

    (c) Any Non-dealer AFS Licensees with *material* derivative exposures will already be reporting as Phase 2 entities.

    (d) If end users are exempted from trade reporting, the perceived benefits of double-sided reporting will be greatly diminished in any case making it more imperative to focus on enforcing effective and efficient single-sided reporting (by Phase 1 and Phase 2 entities).

    (e) To the extent that Non-dealer Phase 3 AFS Licensees delegate reporting to derivatives dealers, only one counterparty will be actively reporting (even though the Non-dealer Phase 3 AFS Licensees will still be responsible for the data reported on its behalf). Preliminary discussions with FSC members indicate that a number of FSC members are considering delegating trade reporting to a third party (particularly brokers or other third party service providers) and as such, any potential benefits of dual sided trade reporting are likely to be minimal.

    (f) If a Non-dealer Phase 3 AFS Licensee does not delegate its reporting obligations, there are likely to be substantial costs associated with reporting to a trade repository, including the substantial investment involved in building the computing infrastructure capability to enable the Non-dealer Phase 3 AFS Licensee to source, capture and collate the data and connect to the reporting repository. (Further, we note there is no licenced trade repository yet, albeit we understand an application for a licence has been made.)

    (g) Whilst some Non-dealer Phase 3 AFS Licensees may seek to delegate their trade reporting obligations to third parties, this will also involve considerable costs. The delegation arrangements that will need to be put in place for this purpose will involve significant challenges for the industry. The agreed delegation arrangements will need

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

to be negotiated, potentially across a number of third parties (such as investment managers, administration service providers and custodians), and it is likely that some data will need to be provided to multiple third parties in any case and that collation arrangements will need to be co-ordinated (such as for example in relation to position reporting).

(h) The additional costs associated with trade reporting are likely to be significant and may be passed on to clients or inhibit new investment activities being established in Australia. Alternatively, the trade reporting obligations might, for some users, disincentivise the use of OTC derivatives to hedge the interest rate or other risks in connection with the investment of client funds if the costs of building and connecting for trade reporting is considered significant. Significant operational and infrastructural compliance costs (both monetary, and from an opportunity cost perspective) are incurred in requiring Non-dealer Phase 3 AFS Licensees to trade report when Phase 1 and Phase 2 entities (essentially the sell-side/market maker/Dealer) are already reporting the same transaction.

(i) Exempting Non-dealer Phase 3 AFS Licensees will reduce costs and increase value by ensuring more consistent reporting from derivative dealers, who are already subject to reporting obligations and so have the required data, systems and processes in place.

(j) This would create greater consistency with the CFTC reporting regulations, which only require one-sided reporting. We observe that the double sided reporting implemented in the EU has been problematic and we expect that there may be the prospect of a shift to single-sided reporting in other jurisdictions.

29. ASIC will still obtain a view of derivatives transactions in the market under one-sided reporting to enable it to meet its G20 commitments. ASIC's RG 251 (*Derivative transaction reporting*) at 251.3 indicates that the objectives of the derivatives reforms called for by the G20 following the global financial crisis, are to: (a) enhance the transparency of derivative transaction information available to relevant authorities and the public; (b) promote financial stability; and (c) support the detection and prevention of market abuse.

30. One-sided reporting, as implemented successfully in the U.S. under Dodd Frank, will provide ASIC with price and volume transparency of derivatives transactions in the market (under scope). ASIC will still receive under one-sided reporting, the vast collection of prescribed data including the counterparty to the trade and detailed information of the transaction, as set out in ASIC's derivatives reporting rules.

31. On this basis it is difficult to see why two-sided reporting by Non-dealer Phase 3 AFS Licensees, which will cause a significant increase in regulatory and administrative burden, and an as yet unidentifiable but significant financial burden, is necessary from a net regulatory benefit perspective.

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

32. Additionally, from an EMIR perspective, the FSC has been informed that trade repositories have reported that since EMIR reporting has commenced this year, missing trades and identifiers mean that a large percentage of derivatives trades reported under EMIR cannot be matched definitively. It appears then, based on the EMIR experience as reported to FSC, that the two-sided reporting appears to have confused and not enhanced the expected transparency of the derivatives reporting regime in the EU.

33. **In summary, we believe that there are strong reasons for exempting Non-dealer Phase 3 AFS Licensees from trade reporting** (in addition, to not applying trade reporting to end-users) **and that achieving the G20 commitment to transparency can be achieved by single sided reporting by significant dealers in derivatives (namely Phase 1 and Phase 2 entities).** This result would be consistent with the Government's stated objectives of reducing red tape to decrease the cost of doing business in Australia and not undermine Australia's commitment to the G-20.

Trade Reporting timeline – concerns with 1 October 2014 start date, and double sided reporting

34. While we submit that consideration be given to exempting Non-dealer Phase 3 AFS Licensees from trade reporting, below we set out some comments indicating the significant concerns among FSC members in relation to the application, and the October 2014 timeline, of derivative trade reporting to Phase 3 entities when there is currently no Australian licenced derivative trade repository to commence on-boarding with (and even then, there is a lead time, after licencing of any Australian licenced DTR, for any reporting entity to connect with the licenced DTR itself or have its delegate do so.)

35. Given the trade reporting rules are a matter for ASIC, we will provide a copy of this submission to ASIC. We acknowledge ASIC consulted on the trade reporting rules. We intend to also raise these and related matters separately with ASIC who has pro-actively approached wealth management industry bodies (including the FSC) in relation to engaging with the "buy-side"/wealth management industry in respect of the OTC derivatives reforms and in particular the up-coming trade reporting requirements for Phase 3 entities. We recognise and applaud ASIC for this engagement. We have only set out a summary of FSC member concerns with the 1 October 2014 trade reporting start date for Phase 3 entities, and comments on two sided reporting. In any engagement with ASIC we may raise details we felt are not necessary for this submission.

Concerns with 1 October 2014 start date for trade reporting by Phase 3 entities

Implementation issues in relation to the Phase 3 trade reporting start date of 1 October 2014

36. Under the current trade reporting timeframes, responsible entities of registered schemes and trustees of superannuation funds (as AFS licence holders) will need to connect to a licensed derivative trade repository (**DTR**) and set up a large number of accounts by 1 October 2014.

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

There is as yet no licenced DTR and therefore we have concerns that any entity which becomes a licenced DTR may not be in a position to open accounts with the large number of AFS licence holders (Phase 3 entities) currently subject to trade reporting requirements to enable Phase 3 entities to meet the 1 October 2014 start date.

37. It is difficult to foreshadow set up issues as timing of the connection to any licenced DTR is dependent on the resources (including staffing) to support on-boarding processes by any prospective licensed DTR. Given this, we are concerned that set-up delays beyond the control of AFS Licence holders will impact their ability to meet the 1 October 2014 reporting deadline for Phase 3 entities.

38. The implementation aspects of trade reporting for the "buy-side" include delegation of reporting and entering into legal documentation in respect of delegated reporting, as well as the development and implementation of compliance programs by Phase 3 AFS Licensees to monitor the trade reporting submitted by the delegate to any licenced DTR.

Difficulties with the Phase 3 trade reporting start date of 1 October 2014

39. Assuming trade reporting continues to be implemented for Phase 3 AFS Licensees, we would be concerned if the delay of any Australian licenced DTR is sought to be resolved by the interim fix of permitting the use of a prescribed DTR for trade reporting by Phase 3 entities, with a switch from the prescribed DTR to any subsequently Australian licenced DTR. This would involve duplication of costs in setting up with a prescribed DTR (for a limited period) and then an Australian licenced DTR. This is inefficient especially for Phase 3 entities not connected or not otherwise needing to be connected to an (offshore) prescribed DTR.

40. Our members are still determining whether or not to appoint a delegate to report on their behalf or whether to self-report as there has been no 100% definitive commitment from third parties (custodians, brokers or any other third party) in respect of acting as a delegate to undertake trade reporting for responsible entities and superannuation trustees. While the market is considering these aspects, there has not yet to our knowledge been an entity which has absolutely definitively confirmed that it will definitively act as a trade reporting delegate. Of course, many responsible entities and superannuation trustees may be expecting another party (such as an investment manager, custodian or administrative services provider) to act as its delegate for trade reporting. This uncertainty is preventing many Phase 3 AFS Licensees from undertaking a robust costs/value assessment between delegated reporting and system builds required to self-report. Once there is an Australian licenced DTR, we anticipate third party entities offering delegation services may be able to provide terms and costs of acting as a delegate for reporting.

41. Depending on whether a Phase 3 entity decides to delegate reporting or self-report, it will then need to either:

    (a) negotiate the delegation arrangements with the third-party provider and meet any other on-boarding requirements of that party. These activities will be undertaken

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

simultaneously with other fund managers, responsible entities and superannuation funds who are delegating reporting, which may cause a bottle-neck and delays.

and/or

(b) enter into arrangements to source the required data from a third party (e.g. investment manager, Administrator, Broker) and undertake relevant system builds to be able to self-report. Within that timeline Phase 3 entities would need to account for further time for systems testing and any required fixes.

42. Regardless of whether a Phase 3 entity delegates trade reporting or self-reports, it will also need to:

(a) negotiate delegated reporting agreements/investment management agreement amendments with clients; and

(b) On-board funds with an Australian licensed DTR and develop and implement compliance programs to monitor the trade reporting submitted by the delegate to the DTR. This will be undertaken simultaneously with other fund managers, responsible entities and superannuation trustees and is likely to result in a bottle-neck and delays. The on-boarding cannot commence in substance until there is a licenced DTR.

(c) In addition, derivatives reporting commences at about the same time in some other jurisdictions (e.g. Canada) and fund managers, responsible entities of registered schemes and superannuation trustees may be dealing with all of the above issues simultaneously in more than one jurisdiction.

43. Any delegation document would likely need to factor in technical reporting requirements (including data fields, file formats, time requirements etc.) needed to successfully implement the reporting by October 2014. Lead time is needed for any investment management agreement delegation clauses to be negotiated, agreed upon and updated. For some FSC members, this may be in the region of 50 investment management agreements.

44. Given that many investment managers appointed by Non-dealer Phase 3 AFS Licensees are offshore and trade globally and have had to already comply with existing regulatory requirements, there may be resistance from such offshore investment managers to accepting or complying with reporting obligations (as a delegate for reporting) which are inconsistent with other existing global regulatory requirements. Wherever possible, to assist in effective implementation, the current global reporting data fields should be replicated.

45. In addition, for some FSC members, given the large number of sub-delegated arrangements documented in investment management agreements (which include delegation of investment management, operational administration etc.), this initial delegation may require further sub-delegation to additional parties.

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

46. A delegate may not be able to provide all aspects of the reporting (e.g. valuation). This will require multiple entities to facilitate any delegated reporting.

47. Where the AFS Licensee (such as a responsible entity, superannuation trustee, or even a fund manager) delegates the reporting responsibility, the AFS Licensee would need to establish appropriate monitoring and reporting and ongoing due diligence designed to ensure that the delegate complies with the reporting requirements. FSC Members are concerned with the current expected implementation date of October 2014 for Phase 3 entities given the time needed to finalise arrangements with delegates and sub-delegates and to ensure that systems can be established, and connection and appropriate testing can be implemented with the appointed delegate as well as the (not yet) licenced Australian DTR.

48. There is some reticence to finalise connectivity to any *prospective* Australian licenced DTR without the certainty that the Australian DTR licence has been granted. If Non-dealer Phase 3 AFS Licensees are not exempted from trade reporting, there should be a delay to the commencement of Phase 3 trade reporting to accommodate the above factors and particularly the fact there is still no Australian licenced DTR to connect to for Phase 3 trade reporting.

49. If the final reporting specifications for any prospective licenced Australian DTR is not available until May/June 2014 this reduces the lead time for Phase 3 entities to develop system requirements.

50. If trade reporting is to continue to apply on a two-sided basis, and to Phase 3 entities, then it does not make sense in our view to hard-code a start date (1 October 2014) for Phase 3 entities when there is yet no Australian licenced DTR to report to. While engagement can commence with a *prospective* (anticipated) Australian licenced DTR, and this work has commenced by many FSC members, there can not be certainty on systems and linkages and reporting formats, and related matters until the prospective licensee has been granted an Australian DTR licence.

51. IT and operational resources cannot be sufficiently allocated until there is a known and licenced DTR to commence the negotiations with.

52. For the above reasons and assuming trade reporting continues to apply to Phase 3 entities, it seems more appropriate to link the Phase 3 trade reporting start date to a period (say 6 months) after a licence is granted to an Australian licenced DTR. This would make preparation for implementation of Phase 3 trade reporting more efficient and cost effective.

53. Accordingly, if Non-dealer Phase 3 AFS Licensees are not exempted from trade reporting, there should be a delay to the commencement of Phase 3 trade reporting to accommodate the above factors and particularly the fact there is still no Australian licenced DTR to connect to for Phase 3 trade reporting.

YOUR FUTURE FIRST

Financial Services Council Ltd
ABN 82 080 744 163

Level 24, 44 Market St
Sydney NSW 2000

T. +61 2 9299 3022
F. +61 2 9299 3198

E. info@fsc.org.au
W. fsc.org.au

54. *Offshore exchanges*: Our members report that the list of exempted foreign regulated markets (that is for which trade reporting is not required) is insufficiently wide and does not cover foreign exchanges which are traded regularly by AFSL entities. Ideally, a general definition of exchanged traded derivatives should be put in place rather than having a specified exchange-based definition. Requiring trade reporting of some exchanged traded derivatives only, particularly if there is the potential for the list of exchanges to change over time, adds significant operational complexity to the trade reporting process.

Trade Reporting should be single-sided not two-sided, and the "Dealer" should be the party required to report

55. Below we set out our concerns with two-sided reporting. We acknowledge ASIC has already consulted on the trade reporting requirements. However, as the trade reporting regime is new and particularly as such matters relate to the "buy-side", we think that an ongoing review and refinement of the trade reporting regime is needed to ensure that any mandated requirement is not disproportionate to the costs or implications of trade reporting recognising the need to capture information of significance in relation to systemic risks.

56. We believe that one-sided reporting would be appropriate (and for the reporting to be completed by the sell-side). Again, this would be consistent with the US reporting requirements (although noting that the European regulations require two-sided reporting). Two sided reporting leads to the unnecessary duplication of reporting for OTC derivatives transactions and also imposes mandatory trade reporting on a significantly greater number of entities. The costs of implementation are likely to be significant for each entity, and as a result, the initial and ongoing compliance costs that will be imposed on the industry as a whole will be far greater than if one-sided reporting obligations were to be introduced as is the case in the United States. In terms of which party should be required to report, in the buy-side context, if an ADI, bank or swap dealer is involved in the trade (a "**Dealer**"), we consider the Dealer to be the most appropriate counterparty to report. Dealers are better positioned to undertake the reporting and many will likely have to build far less additional infrastructure to comply with the obligation compared with buy-side firms (such as FSC's members).

Thank you for the opportunity to make this submission. If you have any questions on our submission, please contact Stephen Judge on (02) 9299 3022.

Yours sincerely

STEPHEN JUDGE
General Counsel

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au