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Manager, Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600
By email to: financialmarkets@treasury.gov.au

Re Corporations Legislation Amendment (Derivatives Transactions) Bill 2012 - Response to Treasury consultation paper by The Finance and Treasury Association.

Overview

The Finance and Treasury Association welcomes this opportunity to again consult with the Government on proposed regulation of over-the counter derivatives transactions which have the potential to change way our members do their vital work of managing final risk on behalf of Australian corporations.

(To ensure consistency, we refer to key principles explained in detail in FTA's most recent submission on the regulation of OTC Derivatives which was our submission in June 2012 to the Treasury consultation paper on Implementation of a framework for Australia's G20 over-the-counter derivatives commitments.

http://finance-treasury.com/files/files/pdf/FTA_submission_to_Treasury_consultation_on_the_G20_derivative_s_proposals2_FINAL.pdf

FTA recognises that work continues apace toward ensuring that Australia is able to implement commitments made at the 2009 G-20 Summit in Pittsburgh that over-the-counter (OTC) derivatives will be able to be reported, centrally cleared, exchange trading. We note that the Corporations Legislation Amendment (Derivatives Transactions) Bill 2012 will allow regulations and rules to be made to specify the details of these obligations.

FTA takes comfort that in its Explanatory Document that Treasury has acknowledged FTA's key message from prior consultations which is that "some stakeholders argued that their use of derivatives was primarily for the hedging of business risk and questioned the systemic importance of their derivatives trading activities".

We furthermore noted that **there may be a negative real economy impact from application of these OTC derivative regulations on the corporate sector and FTA asked that that regulators first seek to determine the full cost-benefit equation of the proposed reforms.** Any extra costs and complications end up being borne by the end user and dampen economic activity, so regulators need to be careful what they impose.

FTA members are encouraged "the legislative framework will provide the flexibility for consideration of the matters raised before any future decision to mandate reporting, central clearing or on-exchange trading".

FTA recognises that Australia is obliged to act quickly to ensure that Australian businesses and investors are "able to demonstrate that they are subject to an equivalent regulatory regime and so be able to continue to participate in the major derivatives markets of the world while still being primarily regulated in Australia".

We recognise that the establishment of the framework (through amendments to the Act) does not in itself introduce any trade reporting, central clearing or trade execution obligations for OTC derivatives transactions. Rather, the framework creates a mechanism by which such obligations may be implemented by supporting regulations and rules.

FTA notes that under these amendments, The Minister for Financial Services and Superannuation will be empowered by the Corporations Act, 2001 to prescribe a certain class of derivatives. Furthermore we recognise that ASIC will be the agency charged with implementation which it will enforce via derivatives transaction rules (DTR) and also by administering carve outs and exceptions.

FTA reiterates that corporations are large users of financial derivatives and that these transactions are primarily used to manage financial risk positions created through ongoing business operations or funding activities. FTA is particularly concerned to ensure its Australian corporate treasurer members will continue to be able to use flexible OTC instruments such as forward foreign exchange contracts and cross currency swaps and these vital tools not be made prohibitively expensive nor administratively unworkable. **FTA considers that deals done by non-financials are a tiny part of the derivatives markets here and abroad**, and are not material in their impact on systemic risk and hence **should be exempted from the proposed rules**.

We see that the core of the draft bill concerns a new licencing regime to be introduced for a new kind of entity, trade repositories. We note that the draft bill provides protections of trade data through imposing restrictions on the use and disclosure of reported data. In such regulations often “the devil is in the detail” so FTA will monitor how these rules are administered by ASIC.

FTA considers OTC trade repository information on corporate hedging should only become publicly available with a significant lag and on a basis where names could not be determined by the nature of data released. And FTA considers that there is a risk of breaching of commercial-in-confidence arrangements.

Clearly for the data to have any utility, there is a need for various parties to be able to use the data i.e. analyse and research it.

However as stated in our prior submission, we question how domestic and global regulators will make any use of much of the data and would like to see an exposition of planned use of the data.

We also seek more confirmation that ownership of a data depository should not confer property rights to the trade information and as discussed above we propose the business of these entities be conducted on a mutual not-for-profit basis.

We note that the new DTRs will oblige a person to utilise the services of a trade repository, clearing facility or trading platform, so FTA accepts that there is provision for rules which impose a duty upon the relevant facility to provide non-discriminatory access a trade repository, as basically it is “only data”. It will be up to the designers of trade repository databases and researchers to ensure that the data makes sense and that there is sufficient homogeneity in the datasets being analysed.

However, we consider that the same non-discriminatory access principle should not be applied without further consultation to the other two forms of mandated financial infrastructure entities, central clearing and exchange platforms.

To provide non-discriminatory access to central clearing and exchange platforms may be to put at risk the very purpose of creating them as a way reducing aggregate system risk. While it is desirable that like instruments and counter-parties be grouped together, the OTC derivative industry is characterised by a high degree of heterogeneity of instruments and differing credit risks among banks and other types of counter-parties. Incompatible risks and agents should be capable of being excluded. The design of such systems and standards and protocols is best left to experts within industry bodies rather than regulators.

Conclusion

- Corporations are large users of financial derivatives in Australia. These transactions are primarily used to manage financial risk positions created through their ongoing business operations or their funding activities.
- FTA is particularly concerned to ensure its Australian corporate treasurer members will continue to be able to use flexible OTC instruments such as forward foreign exchange contracts and cross currency swaps.
- FTA's primary concern is for such prudent corporate risk management tools to not be made prohibitively expensive nor administratively unworkable.
- Given the potential negative real economy impact, FTA recommends if regulators are considering imposing these OTC derivative regulations on the corporate sector that they first seek to determine the full cost-benefit equation of the proposed reforms. Any extra costs and complications end up being borne by the end user and dampen economic activity, so regulators need to be careful what they impose.
- FTA considers deals done by non-financials are a tiny part of the derivatives markets here and abroad, and therefore not material in their impact on systemic risk and should be exempted from the proposed rules.
- FTA considers OTC trade repository information on corporate hedging should only become publicly available with a significant lag and on a basis where names could not be determined by the nature of data released.
- FTA considers that to provide non-discriminatory access to central clearing and exchange platforms may be to put at risk the very purpose of creating them as a way reducing aggregate system risk.

For Australian entities an appropriate exemption for corporate risk management would protect the non-standardised way corporate entities access OTC derivatives as a primary risk management tool.

We look forward to working with the financial regulators on the next stages of the consultations and the design of the institutional framework.

Yours faithfully,



Paul Travers FFTP

President

Finance and Treasury Association

David Michell CFTP (Snr)

CEO

Finance and Treasury Association

About FTA

The Finance & Treasury Association (FTA) is a professional association for executives working across all aspects of treasury and financial risk management. The FTA provides training and skills development and access to current information, facilitates networking and builds a community in this specialised area of business. It seeks to increase recognition of the skills of members and to convey the views of members on key technical issues facing the profession to government, other associations and the wider community.

