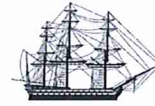


14 June 2012

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Manager, Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
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Dear Sirs

**Submission concerning Consultation Paper dated April 2012: Implementation of a framework for Australia's G20 over-the-counter derivatives commitments**

We attach our submission in respect of the April 2012 Consultation Paper on OTC derivatives.

Generally, we found the paper easy to read and well thought through. The author or authors are to be commended.

We are not commenting on all questions asked in the paper. We are only making submissions on areas that concern our industry—that is, matters that may impact on funds management or managed investment schemes generally.

Our approach to issues raised by the paper can be summed up as follows:

1. We consider that a primary aim of this initiative is to address sources of risk presented in the 2008 global market crisis. Australia has thus far survived the crisis relatively well, but we are nonetheless a small part of the global economy and must embrace key global financial markets initiatives and reforms—as adapted to suit our circumstances;
2. Central reporting of trades will ultimately benefit market participants although in the shorter term, we believe there is a case to be made for data to be gathered by regulators and assessed before public reporting is introduced or key changes made in other areas that will impact on market behaviour. If a phased approach is adopted, information on trade flows, risk concentrations, etc, can be taken into account to assess likely impact on liquidity, for instance, and regulatory change can be tailored accordingly;
3. Margining of trades (both initial and variation) insulates counterparties from the potential loss of market value upon a counterparty default and effectively serves as a limit on trading based on assets available for use as collateral. If the primary goal of these reforms is to reduce systemic risk in the OTC derivatives market, margining could also be considered for uncleared 'unsecured' (e.g. uncollateralised) high-risk OTC derivatives;
4. Generally, clearing of trades should be directed at mitigating overall counterparty risk notwithstanding—but taking into account—the possible disaggregation of netting between uncleared and cleared swaps.

We believe that our industry body, the Financial Services Council, will be making submissions to Federal Treasury in respect of the Consultation Paper. We would generally support submissions made by the FSC on behalf of industry participants.

Thank you for this opportunity to present our submission.

If you have any questions or comments, please do not hesitate to call Marina Dobbyn of our office on (03) 8888 3585, email address: marina.dobbyn@vanguard.com.au

Yours faithfully
**Vanguard Investments Australia Limited**

**Kathryn Watt**
**Director**

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| 1. | Do you have any comments on the general form of the legislative framework? | We believe the general form of the legislative framework is well-considered. It acknowledges the need for stakeholder consultation before decisions are made at either Ministerial or regulator level and is sufficiently flexible to accommodate a broad range of government responses to both domestic and international developments. In terms of detail, however, we would like more clarity on how the Minister's discretion and ASIC's Derivative Transaction Rules or DTRs are intended to interact. Specifically, once the Minister prescribes a class of OTC transactions as being mandated for reporting/clearing/etc, will this class automatically become subject to the mandatory obligation—or will there be a further step (being the making of a DTR that imposes the obligation on all or part of that class) to trigger the operation of the mandatory obligation? We would support the latter (DTR 'triggers' the application of the mandatory obligation once Minister prescribes the relevant class)—and not the former, which has a higher probability of resulting in unintended consequences (i.e. where the prescribing of the relevant class by the Minister automatically imposes the mandatory obligation unless excluded by further regulation or DTR).<br><br>In addition, if the primary goal of these reforms is to reduce systemic risk in the OTC derivatives market, we believe there would be merit in considering whether margining, for instance, should also be instigated for uncleared OTC transactions—specifically, high risk and otherwise 'unsecured' OTC derivatives transactions. While many participants already engage in bilateral risk management through collateralisation for instance (through use of the Credit Support Annex), not all participants do so, nor have alternative risk management processes in place. |
| 2. | Do you have any comments on the definition of 'transaction'? | In referring to the making, modifying or termination of a contract for "derivatives", care would need to be exercised in determining exactly what 'derivatives' are being referred to—e.g. are futures contracts included given they are generally subject to their own clearing regime? Are all FX contracts properly described as 'derivatives'—and is it intended to capture potentially all types of FX contracts, e.g. including Spot FX? What about collateral transfers (or pledges) under the different forms of Credit Support Annexes (**CSA**)—are these 'derivatives'?—and could it cause confusion that, e.g., collateral transfers under English Law CSAs are "transactions" under ISDA Master Agreement terms?<br><br>It is also unclear to us how the 'making, modifying or termination' aspect of the definition is intended to apply across all the mandatory obligations. We can see how it could be applied sensibly in the context of mandatory **reporting**—so that the making, modification (e.g. within sensible de minimis parameters) and termination of every contract is potentially reportable.<br><br>However, making a 'transaction' as defined subject to the **clearing** and **trade execution** mandates will potentially capture each 'making, modifying or termination' afresh. Say a contract is already in the clearing system when modified—the legislation would need to be drafted so that the modification does not give rise to a 'fresh' (second) obligation to clear. And what if the modification leads to a contract falling into a different class/type that isn't subject |

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| | | to the clearing mandate? Again, some special drafting will be required. Finally in this context, it is unclear to us why the 'termination' of a contract should bring it within either the clearing or trade execution mandate. We would think a termination should naturally bring a contract (being one already subject to the mandate) outside the scope of either mandate.<br><br>Given the technical nature of these issues, we ask whether the intent of the legislation might be better served by a more intuitive definition of "transaction", e.g. to mean the making of a contract for derivatives. Then any 'modification' or 'termination' of a "transaction" can be made subject to the reporting mandate if the DTRs so require. And any 'modification' within appropriate parameters can be made subject to—or taken outside the scope of—the clearing/execution mandates, as required by the DTRs. |
| 3. | Do you have any comments on the definition of 'party'? | The definition of 'party' is broad enough to capture, for instance, both an Asset Manager (**AM**) and its client/principal where the AM transacts on behalf of its client/principal—yet perhaps not capture the counterparty if the counterparty is a 'foreign person'. It would be appropriate for the legislation to make it clear that a non-'party' may nonetheless **not** object to a 'party' complying with the obligation, potentially extending to situations where the 'party' has voluntarily opted into the obligation.<br><br>In regard to the obligation of a 'party' to clear or execute, the reference to "ensure" (a 'party' must **ensure** that the transaction is cleared or executed in accordance with the DTRs: ref. 3.1 of the Consultation Paper) may be too strong. Depending on how central clearing and mandated execution are ultimately structured, an AM may not actually be able to "ensure" these things, e.g. if it can only access these systems through a broker.<br><br>In addition, care needs to be taken to avoid situations where AMs and principals end up with conflicting obligations in respect of the same 'transaction' to which they are both 'party'—for instance, if certain types of principals are exempted from clearing but AMs are not.<br><br>Ultimately, it is the principal and not the AM on whom the legislation must focus. Risk resides with the principal and given the purpose of these reforms to address systemic risk, it is accordingly appropriate for the legislation to focus on the principal and not target aggregate trading across different principals who are managed by a common AM. |
| 4. | Do you have any comments on the definition of 'eligible facility'? | There may be several eligible facilities in respect of each type of mandatory obligation. **Reporting**: Care would need to be taken so that duplication, overlapping or distortion of data is not an issue. A way to address this would be for the reporting obligation to be borne by one party, e.g. a '**swap dealer**' within the meaning of Dodd-Frank. Also to be avoided is a dual reporting obligation in different jurisdictions in respect of the same transaction, e.g. if reporting is |

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| | | mandated in both Australia and another country or countries—depending on where an AM, its principal and the counterparty reside or operate. In the context of public dissemination/ reporting of trade data, the presence of many eligible facilities (trade repositories) could result in data being fragmented and less useful to participants.<br><br>**Central clearing/trade execution**: Again, consideration will need to be given to how multiple eligible facilities should interact. |
| 5 | Do you agree that non-discriminatory access requirements should be imposed on eligible facilities? | We agree in principle that non-discriminatory access requirements should be imposed on all eligible facilities. However, this could be difficult to apply in practice. By the nature of these reforms, risk is being addressed and of course, participants have different risk profiles. Additionally, 'discrimination' can be a fluid concept, e.g. is it discriminatory against other market participants if only some have the benefit of a threshold before the mandated requirements begin to apply. |
| 6. | Do you have any comments on the rule-making power that will be available to ASIC? | We would expect that appropriate and sufficiently clear parameters are applied to the regulator's rule-making power. Subject to our comment in 1 above and the actual framing of the legislation, the types of matters described in the Consultation Paper seem appropriate to us for rule-making. Finally in this context, the Consultation Paper says that "ASIC will consult with other agencies… and stakeholders in developing DTRs". Will there be a process in place for what happens after consultation, e.g. would ASIC be required to publish its reasons for making a particular decision? |
| 7. | What should be the minimum period of consultation imposed on ASIC in developing DTRs? | We believe this should depend on the likely reach and impact of the relevant DTRs. A suggested rule of thumb would be a minimum 90 days. |
| 8. | What should be the minimum period of notice between when a DTR is made and when any obligation under the DTR commences? | Again, this would depend on the likely reach and impact of the DTRs and whether they have been sufficiently widely disseminated and consulted upon. We suggest the minimum transition period should be 12 to 18 months after the first tranche of DTRs is released. This would apply to all DTRs that effect substantive changes to systems, processes, etc. For other DTRs, we suggest a minimum transition period of 6 months. |
| 9. | Although the possible counterparty scope is set broadly, should minimum thresholds for some or all types of counterparty be set by regulation, so that no rule that is made will ever apply to those counterparties (unless the regulation is subsequently changed)? | We are not certain what is meant by "threshold" in this context. Our response would depend on what these thresholds relate to and, for instance, how/if the mandatory obligation continued to apply in respect of other participants—e.g. if an entity is exempted from central clearing but nonetheless wants to enter into a swap that all other counterparty types are obliged to centrally clear. |

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| 10. | From the point of view of your business and/or of your clients, do you have concerns around any 'back loading' requirements? For example, are there any problems with obligations applying to transactions that are outstanding at the time the rule is made? | We are not generally in favour of retrospective rulemaking. If 'back loading' is implemented, would it only apply to the reporting obligation—e.g. to capture only transactions that meet certain parameters that were outstanding at the time the rule is made? We expect that information may have to be gathered and reported manually and account needs to be taken of the likely high compliance costs associated with back loading.<br><br>As a possible alternative to 'back loading', a phased approach could be considered. If the purpose of back loading is to gather information, it seems less disruptive to us if an obligation to report (initially, without public disclosure) is mandated—and only when a sufficiently complete data set is obtained, the Council of Financial Regulators may consider implementing the next stage. Please see our comments in relation to Question 16 below. Obtaining information from market participants—not only in respect of new transactions but also, existing—would help the regulator to make an informed decision on back loading and what it may apply to (e.g. even beyond the reporting obligation, whether it could appropriately extend to margining e.g. for long term existing swaps). |
| 11. | Do you agree with the option of prescribing a broad range of derivative classes to be subject to the mandate for trade reporting? If not, what other option do you prefer? | We would support this. We believe that the financial markets generally would ultimately benefit from a broader catchment of information resulting in higher transparency on volume, price, maturity, etc, at the appropriate time—as to which, please see our comments in 25.4 below. In terms of what type of information should be reported, we believe the appropriate measures should focus on reducing or mitigating systemic risk, e.g. relatively low volume derivatives may have higher market risk, e.g. options. |
| 12. | Do you agree with the option of including a broad range of entities in the mandate to report trades? If not what option do you prefer? | We do not support this. We believe that the risk of corruption to market data (e.g. due to double-counting) is higher with each additional entity that is required to report the trade. In addition, compliance costs will generally be higher for lower-volume trading participants. Our view is that 'swap dealers' (within the meaning of Dodd-Frank) should have the sole reporting obligation. Typically, swap dealers have the volume of trades and existing infrastructure to make reporting a lower cost option as compared with other participants. We would submit that other parties should only have the obligation to report if a swap dealer is not a party to the trade.<br><br>However, should Council be inclined to include all parties in the mandate to report, we would submit that a phased implementation or rollout is appropriate given the potentially deep and broad impact of these reforms—beginning with swap dealers and assessing how effective this is and whether the mandate should be extended to other entities—then extending it to AMs if required and finally, end-users, if required. |
| 13. | Are there specific classes of entity that should be excluded from the potential reach of trade reporting DTRs? | We are unable to think of any classes of entity that should be excluded from the potential reach of trade reporting DTRs. From a collection of trade data perspective, please see our comments in 11 above. As to who should report, please see our comments in 12 above. |

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| | 13.1. What metrics should be used to determine any thresholds? | We do not believe that a threshold should apply in the first place in the context of trade reporting. Hypothetically, if a threshold amount had to be met (e.g. for net exposure, gross amounts, etc) before the reporting obligation arose, Council would also have to consider implementing preventative measures, e.g. to stop entities from entering into a lot of smaller transactions that do not have to be reported. Also, please see our comments in respect of Question 11. |
| | 13.2. What should be the thresholds of these metrics that trigger when an entity may be subject to trade reporting rules? Should this threshold vary depending upon the nature of the entity? | Please see our comment in 13.1 above. If the reporting obligation is only imposed on 'swap dealers', this would largely cut across the debate concerning whether different thresholds for trade reporting purposes could be considered for different entity types. |
| | 13.3. What is an appropriate threshold to exempt end users from the mandatory obligation to report OTC derivatives transactions to a trade repository or regulator? | In this context, perhaps the appropriate determinant could be (instead of a threshold) whether that transaction had already been reported. |
| 14. | Do you agree with the option of including a broad range of transactions in the mandate to report trades? If not what option do you prefer? | Yes. Our comments on Question 11 apply equally here. |
| | 14.1. Are there specific classes of transaction that should be excluded from the potential reach of trade reporting DTRs? | We believe that the reporting obligation should extend to all classes of transactions that impact materially on systemic market risk—whether risk is increased due to the nature of the transaction (e.g. options), volumes traded (e.g. FX, swaps, FRAs), maturities (long term derivatives), complexity (highly structured derivatives), etc. Although data on lower risk trades (e.g. repos) would be of interest, if the primary parameter is enhanced systemic market risk, these types of trades may be discounted. Spot FX trades may also be too short term (and of relatively low risk) to include in the catchment for reporting purposes. |
| 15. | Do you agree with the option of using a wide definition for what would constitute a transaction in this jurisdiction for the purposes of mandating trade reporting? If not, what definition do you prefer? | Please see our comments in 2 above. We believe it is appropriate for the trade reporting mandate to capture the making of a contract, modifications (but only of reportable parameters under the DTRs) and terminations. We also believe a simpler reporting mechanism for 'roll-overs' could be considered. Consideration could also be given to whether the reporting of certain 'transactions' under the umbrella of ISDA Master Agreements (e.g. 'transactions' constituted by CSA transfers (see 2 above)) would distort market data. |
| 16. | Do you agree with the option of relying upon market forces and a range of other | This is a difficult question to answer as there are many moving parts. |

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|  | mechanisms, such as capital incentives, while monitoring the impact of such mechanisms in systemically important derivative classes and providing for possible future mandating, to ensure that central clearing becomes standard industry practice in Australia within a timeframe that is consistent with international implementation of the G20 commitments? If not, is there another option you prefer? | We consider that there is a logical sequence for implementation of these reforms in order to minimise market uncertainty/disruption and to maximise effectiveness and, if applicable, voluntary take-up:<br>• In order for clearing and trading mandates to be imposed on an informed basis, central reporting must first apply so that gathered data can be analysed to assess the potential liquidity impact of the proposals;<br>• Due to the likely impact on liquidity, following the assessment of trade data, mandatory clearing should precede consideration of mandatory exchange trading; and<br>• Due to the need for significant infrastructure enhancements, implementation of each new mandate (reporting, clearing and trading) should begin first with 'swap dealers', followed by AMs where appropriate, then finally, by end-users.<br><br>As to whether market forces, capital incentives, etc should be relied on to encourage timely take-up, it is difficult to answer this question without knowing how the central clearing system will actually operate. E.g. will there be one central pool (there are potentially many CCPs) for different types of transactions with different risk profiles? What, if anything, will be done to protect participants from 'fellow customer risk'? Will there be adequate liquidity?<br><br>Another question worth considering in this context is whether the central clearing model offers a sufficiently attractive alternative to encourage take-up by participants (as compared with the existing bilateral model with its attendant risk management tools). The existing bilateral model offers the benefit of one pool—and one net amount—for all such transactions between two parties. Introducing a parallel central clearing system for some of these derivatives effectively splits the pool and creates two smaller pools with two net amounts on insolvency. This could have the anomalous effect (given the purpose of central clearing to decrease risk) of actually increasing overall risk. Central clearing could also expose participants to new risks, e.g. 'fellow customer risk'—which would be alleviated if Council were to adopt an effective 'legal segregation of funds' model in the central clearing system.<br><br>Also, in the context of comparing central clearing with bilateral clearing under an English Law CSA, an interest amount is payable under the English Law CSA on cash collateral transferred (cash collateral being equivalent to margin paid to a broker in the central clearing model). Yet it seems unlikely that interest would be payable on margin paid across to a broker or 'swap dealer'—or by the broker into the clearinghouse—in a central clearing system. Nonetheless, if central clearing is set up to apply at the member level only (analogously to futures exchanges), this could result in an effective redistribution of interest amounts to brokers that would otherwise have been payable by the broker to their client counterparties under the existing available bilateral model. To illustrate—and this depends on what central clearing model is ultimately adopted: If margin is assessed at 'member'/broker level, the broker would have a net zero position if Client A is out of the money by the same amount as Client B is in the money. The swap dealer would not therefore have to pay any variation margin to the clearinghouse. However, as between the broker and Client A, Client A (being |

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| | | out of the money) could be obliged to pay the variation margin to the broker—and the broker would likely have no obligation to pay interest to Client A. Contrast: if the 'variation margin' paid by Client A were cash collateral instead (i.e. governed by a bilateral CSA arrangement between the broker and Client A), the broker would be obliged to pay an 'interest amount' to Client A. In this way, it is conceivable that a centralised clearing regime could result in a redistribution of interest amounts (as compared with the bilateral model) among market participants.<br><br>Overall, we can see how take-up of a non-compulsory central clearing system might be quite slow as participants try to come to grips with which option (cleared or non-cleared) gives rise to the best economic and lowest risk outcome.<br><br>Overall, we can see the benefits of not legislating a mandatory take-up. It will give the market time to assess the pros and cons and provide feedback to the regulator. In the shorter term, however, this uncertainty could promote higher costs, arbitrage and market imperfections which are not desirable in times of global financial stress. For these reasons, we consider that a phased implementation—beginning with mandatory central non-public reporting (i.e. no public disclosure as yet)—would at least potentially arm the regulator with sufficient information to decide on the next steps. |
| 17. | Are there specific entities that should be excluded from the potential reach of central clearing rules? | If we have a central clearing system, Council may consider exempting entities from central clearing that are typically asset-rich-but-cash-poor. Otherwise, they would be forced to liquidate assets to realise margin. Examples include many funds in the asset management industry. Council may consider, for instance, exempting these entities if they already have an effective risk management system in place (e.g. bilateral clearing through the use of the English Law CSA) or if they do not engage in speculative high risk trades. Without alternative acceptable risk-management systems in place, however, 'exempting' any entity from central clearing could pose its own risk to how the market operates. They could become a natural vehicle for instigating non-collateralised/margined trades and if their numbers are sufficiently high, could in aggregate present an issue for the system.<br><br>As to whether any entities ought to be 'excluded' (as opposed to 'exempted') from central clearing, an exclusion may create issues if, for instance, all banks are obliged to centrally clear. 'Excluded' entities may thereby be unable to find a counterparty for bilateral uncleared trades and thus, may wish to have the flexibility to 'opt in' to the central clearing regime. For this and other reasons, we suggest that if some market participants will be 'exempted' from complying, they should nonetheless be permitted to voluntarily engage in any mandated activity. |
| | 17.1. What metrics should be used to determine any thresholds? | If this question concerns thresholds in the context of margins to be paid to the clearinghouse, we believe that initial margin levels for cleared trades should reflect no more than a 3 day volatility risk. We think it would be suitable for thresholds to apply not only for de minimis and cost-efficiency type reasons but also, to particular types of entities, e.g. relatively illiquid funds in the funds management industry.<br><br>Given the relative sophistication of existing available risk management mechanisms in the OTC derivatives market, we |

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| | | also submit that care needs to be taken to ensure that the central clearing model does not potentially worsen the risk profile of these products (e.g. by introducing 'fellow customer risk' without significantly mitigating other risks).<br><br>Overall, we consider that the clearing mandate should only apply to swaps that are able to be standardised for which there is adequate liquidity to enable a clearing house to value the risk, e.g. vanilla interest rate swaps of appropriate maximum duration. |
| | 17.2. What should be the thresholds of these metrics that trigger when an entity may be subject to trade clearing rules? Should this threshold vary depending upon the nature of the entity? | See above. |
| | 17.3. What is an appropriate threshold to exempt end users from the mandatory obligation to clear OTC derivatives classes? | See above |
| 18. | Are there specific classes of transaction that should be excluded from the potential reach of trade clearing DTRs? | We consider that the clearing mandate should only apply to standardised swaps for which there is adequate liquidity to enable a clearing house to value the risk.<br><br>We agree that intra-group trades should be excluded from the need to centrally clear. |
| | 18.1. In particular, should some transactions entered into for certain purposes (for example, hedging, commercial risk mitigation) be outside the potential reach of the rule-making power? | It isn't always easy to determine whether / when a transaction falls within the description of a 'hedging or commercial risk mitigation' transaction. There may be some general rules, e.g. hedging or commercial risk mitigation, as a commercial rationale, would more easily apply to buyer of a swap, for instance, as opposed to a seller. However, in a case where both buyer and seller are banks, it may be more difficult to determine who is hedging/ mitigating and who isn't. Ultimately, if these transaction are to be carved out of the potential reach of the rule-making power, sufficiently certain guidelines would be appropriate as to what may constitute a 'hedging/commercial risk mitigation' purpose, e.g. is the term used in contrast to a speculative purpose, for instance, or does it only apply to transactions that actually hedge exposure to an underlying thing, e.g. a USD/AUD FX forward as a hedge against movement of USD at a future time when US Dollars are to be paid or received.<br><br>If such transactions are excluded from the need to centrally clear, we think there needs to be careful consideration and independent verification of what is or isn't a hedge. For instance, most recently, what started off as a hedging strategy by a major US bank culminated in a two billion dollar loss. |

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| 19. | Do you agree with the option of requiring central clearing for derivatives where at least one side of the contract is booked in Australia and either: (a) both parties to the contract are resident or have presence in Australia and are entities that are subject to the clearing mandate; or (b) one party to the contract is resident or has a presence in Australia and is subject to the clearing mandate, and the other party is an entity that would have been subject to the clearing mandate if it had been resident or had a presence in Australia? If not, what definition do you prefer? | The main difficulty we see with the definitions is: if different currency derivatives come within the central clearing regime at any time in any jurisdiction, there could be an obligation in more than one jurisdiction to centrally clear the transaction. However, this could be mitigated by mutual recognition treaties. Also, please see our comments in 1 above in relation to situations where there might be only one 'party' (as defined). |
| 20. | Do you consider that there are any OTC derivative classes for which an execution on trading platforms mandate would be appropriate at this time? If so, please provide any evidence which supports your view. | No, we do not. We have a concern that mandating trade execution would introduce higher market inefficiency (e.g. by introducing a bottleneck in trade executions) and higher costs. Also, we are not certain that there is sufficient volume in any standardised class of OTC derivative to make a mandated trading platform desirable. We would not be in favour of mandating trade execution at this time. While it could, in the fullness of time, lead to greater price transparency for instance, this would depend on a number of factors—such as the number of available trading platforms and their level of interaction. Trade data could be fragmented and of limited use for pricing purposes.<br><br>Ultimately, we believe is appropriate to give very careful consideration to this issue before any implementation is proposed. The potential for unintended disruptions to liquidity caused by the premature imposition of trading mandates argues for such mandates to be phased in (if at all) very slowly starting with relatively liberal terms.<br><br>If trade execution is nonetheless mandated for electronic platforms, there would need to be some provisioning for circumstances where electronic or other mandatory form of execution is not possible or feasible. Apart from market disruption events, disruption could also occur at the entity level, e.g. due to computer virus or malfunction. |
| 21. | Alternatively, do you agree with the option of applying the same approach to prescribing entities, transactions and derivative classes as has been applied for mandating clearing? | Please see our comments in 20 above. |

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| 22. | If a derivative class is prescribed for mandated use of CCPs should it also be mandated for execution on a trading platform? | We do not believe that mandated clearing should necessarily be linked to mandated execution in this way. While central clearing addresses quite substantive issues relating to systemic market risk, the use of a trading platform is directed more at the mechanics, e.g. if transactions are sufficiently high volume, etc, to warrant it. While use of a mandated trading platform may facilitate ease of execution once certain preconditions are established, it is nonetheless merely a facilitative tool and should not be coupled automatically to the substantive purpose sought to be addressed by mandated clearing. |
| 23. | Do you agree with the option of initially excluding the same entities and transactions from the mandate to execute trades on trading platforms as those for the mandate to clear through a CCP?<br>If not what option do you prefer? | For the reasons set out in 22 above, we do not see any benefit in having mandatory execution platforms/facilities without central clearing. Having said this, we are of the view that margining for uncleared swaps is at least worthy of consideration where no other appropriate risk management mechanism is in place—please see our comments in 1 above. If this could be facilitated somehow in the context of mandated execution facilities, we would be prepared to consider it. |
| 24. | Do you agree with the option of using the same definition of a transaction in Australia for the purposes of mandating executing a trade on a trading platform as for mandating clearing transactions through a CCP? If not, what definition do you prefer? | The proposed definition of 'transaction' includes making, modifying or terminating a derivatives contract. We consider that describing the components of a 'transaction' in this way may lead to confusion in the context of clearing or execution. Potentially, three 'transactions' could arise in the life cycle of one contract that is made, modified and terminated—with even more 'transactions' if modified more than once. We believe it is worth considering whether and how to structure the legislation so that 'transactions' (within the ordinary meaning of the word) that fall within certain standardised parameters are subject to mandatory clearing/execution. If 'transaction' were to retain its ordinary meaning, this need not affect the reporting obligation, e.g. the 'making, modifying or terminating of a transaction' could still give rise to an obligation to report. Generally please see our comments in 2 above. |
| 25. | From the point of view of your business and/or that of your clients, do you have concerns with reporting Australian trades to Australian and/or international trade repositories? | The nature of our business is the management of funds. Traditionally in this industry, maintaining client confidentiality is a key concern. We can see how a reporting requirement could impact negatively on our business. However, we can also see how greater transparency and availability of information would enhance existing services we provide to our clients and investors—provided appropriate delays in public reporting of block transactions, for instance, are built into the system and there are appropriate sanctions to discourage misuse of information by those who receive it ahead of time. |
| | 25.1. What restrictions should there be on the disclosure of reported data by trade repositories?<br>What requirements should be imposed in relation to data protection and privacy? | In terms of what data should be publicly disclosed, we support the disclosure of data that promotes the efficient operation of the market (e.g. price, volume, maturities, fees, etc). In terms of timing of disclosure, immediate disclosure of certain types of trades (such as block trades) would not promote the efficient operation of the market.<br><br>As to data protection, we expect that the legislation will provide for appropriate penalties on untoward disclosure. |

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| | | In relation to privacy, we believe that disclosed information should be sufficiently high level and aggregated that the identities of parties to transactions is not disclosed—including inadvertently by the publication of any information that could identify a party. |
| | 25.2. What restrictions should there be on the use of reported data by trade repositories? | A concern that might arise in this context is conflict and arbitraging. As the first recipient of the market information, the trade repository could potentially use the information to its advantage in its own trading activities. We don't know, for instance, how effective a restriction on entering into the type of trade might be, e.g. no trading in the relevant derivative until the information is made public.<br><br>We also believe it would be worth considering a restriction on who trade repositories should report to—e.g. only to ASIC and no other agency, with the intent that any agency requiring information should obtain it from ASIC, subject to appropriate restrictions and consequences. |
| | 25.3. What restrictions should there be on the sharing of trade repository data between TRLs;<br>and on the sharing of trade repository data between regulators (both domestic and international)? | Sharing of trade repository data between Trade Repository Licence-holders: this may exacerbate the concerns raised in 25.2 above, if information were to be concentrated ahead of time into a small number of hands. In the absence of good reason, we would argue against the sharing of this information between trade repositories.<br><br>If anyone obtains information that isn't made public (whether TRLs or regulators etc): an obligation to keep this information confidential should apply, together with strict liability for disclosure. Also criminal sanctions for reckless or deliberate breach. If information is to be shared with international bodies, there should at least be a connection with that jurisdiction, e.g. an overlapping obligation to report/clear /execute in that jurisdiction. |
| | 25.4. Should the prices and sizes of individual transactions reported to trade repositories be made publicly available? If so, do you have any views on the time frame in which the information should become publicly available? Should there be different time periods for public release of transaction data depending on the size of particular transactions? | We wouldn't object to trade prices and sizes being made publicly available at the appropriate time. To assist the regulator in determining what the appropriate timing should be, we submit that non-public, central reporting should precede any mandate for public reporting of data. This would give the regulator valuable time to gather information to make informed decisions based on a thorough analysis of market data. We expect that based on the review of such data, prompt public reporting will be more appropriate for the most liquid products, with delayed public reporting for less liquid products.<br><br>While we generally support greater price transparency, we emphasize that market liquidity should **not** be sacrificed to achieve transparency—for instance, if details of large-sized block trades are disseminated prematurely. When quoting a price for a block trade, dealers will typically charge a premium to the then current market price for a similar trade of a more liquid size. Once a block trade is completed, the dealer would typically execute one or more liquid-sized mirror trades at current market prices to lay-off its position and to flatten its market exposure. If block trade details are disseminated prematurely, the market will have advance knowledge of the dealer's imminent trading and will move |

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| | | against the dealer. In anticipation, either dealers will have to raise their block price or counterparties will have to disaggregate their block trades—but incur less efficient and more costly execution. There is also a concern that dealers could be more reluctant to quote on block trades. Block trades aggregated across multiple accounts are not unusual for AMs. Investors would ultimately bear the inflated pricing/costs arising from a more illiquid market for block trades.<br><br>Given the above, we believe it is appropriate to delay the public release of all transaction data for large sized transactions. The delay needs to be long enough to allow a dealer enough time to comfortably hedge its exposure in the market. This will depend on individual transaction types, sizes and market composition. Further, as liquidity levels differ over time, these factors should be reassessed at least quarterly. We would suggest that public reporting of large-sized transactions should be delayed to at least 24 hours (longer if not a business day) after the transaction is executed. |
| 26. | Would Australian market participants support a domestic trade repository as an alternative to an international trade repository, recognising there are likely to be cost implications in establishing and maintaining a domestic trade repository? | Evidently there are competing concerns ranging from set up costs for a domestic trade repository to longer term issues that may arise from using an established international trade repository—such as conflicting laws between the place of its formation and the place(s) of its operation; or the extent to which we become a 'captive' user with little ability to affect price or quality. Other considerations are also relevant, such as how the reporting will be facilitated—whether the TR is required to maintain an Australian office to which trades can be reported, or if it is in a different time zone which may be inconvenient, e.g. if information technology issues were to arise or if the reporting entity made a mistake in its report and wished to correct it before the false data went out into the wider market. |
| 27. | Is it appropriate for ASIC or another regulator to have the power to grant licenses to trade repositories, or should the Minister have this power? What checks and balances should there be on ASIC's power to grant trade repository licenses? | No comment. |
| 28. | Should any requirements be imposed on trade repositories with respect to obligations to provide third parties with access to the information (subject to authorisation from data providers and regulators)? | Point 5.2.2 of the Consultation Paper says: "It may be important for third-party providers of ancillary services to have access to information held by trade repositories, in order to facilitate other risk management and operational improvements in OTC derivatives markets." What types of ancillary services might be involved here (that facilitate other risk management and operational improvements in these markets)? |
| 29. | Do you have any initial views on the property rights in trade information passed to trade repositories? | No. |

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| 30. | Are there any reasons why the location requirements being developed for FMIs should not be applied to trade repositories? If so, are there alternate approaches you prefer? | We are not familiar with the location requirements being developed for FMIs and cannot comment on this. |
| 31. | Do you agree with the factors identified in section 6.2 for ongoing derivatives markets assessments? | Yes |
| 32. | Are there other factors that should also be included? | A further factor that could be considered is the extent to which mandating could add risk (type and extent) or redistribute a benefit (e.g. interest amount payable on cash collateral) as compared with existing available bilateral risk mitigation models. |
| 33. | Do you have any comments on the rule-making power that will be available to ASIC? | We submit it is appropriately within the mandate of a regulatory body (including ASIC) to make rules concerning the minutiae of how broader rules (formulated under Acts or Regulations) should be applied—provided the requirement for appropriate consultation by the regulator (or the Minister, for that matter) is embedded into the legislation.<br><br>Ultimately, parliament and responsible Ministers are more directly accountable to industry and should thus be responsible for the actual making of decisions that could have a broad or deep impact. We believe that our comment in 1 above, while it may appear to cut across this, is nonetheless consistent. In the context of whether it is appropriate for ASIC or the Minister to trigger the application of a mandate to a class of derivatives, the Minister would determine, after due consultation with industry and other relevant bodies, the applicable class or classes of derivatives, thereby setting the boundary. It would then be left to ASIC to determine (again, after due consultation) the degree to which derivatives within that class or those classes can be sufficiently standardised to give rise to a clearing obligation, for instance. |
| 34. | Do you have any preliminary views on matters to whish DTRs should apply? | We believe it is appropriate for legislation to prescribe how risk should be addressed in the central clearing process. For instance, steps to be taken to mitigate 'fellow customer risk', investment risk, operational (fraud) risk. If this is to be done through DTRs, they need to be sufficiently certain to be workable. However, to the extent that such matters concern broader policy issues, these would be more appropriately dealt with at the Ministerial/ regulation level.<br><br>In terms of other legislation, we note that the Payment Systems and Netting Act is relevant in the context of clearing houses generally. |