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Mr Laurence White
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Australian Securities and Investments Commission
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Dear Mr White,

OTC derivatives reforms – trade reporting

The Australian Bankers' Association (ABA) appreciates the opportunity to provide comments to ASIC on *Consultation Paper 221: OTC Derivatives reform: Proposed amendments to ASIC Derivatives Transaction Rules (Reporting) 2013*.

Opening remarks

The ABA recognises the proposed changes to the *ASIC Derivative Transaction Rules (Reporting) 2013* are intended to:

- Make a number of technical changes to ensure the reporting regime is more effective and easier to comply with;
- Clarify the rules for delegated reporting to provide a 'safe harbour' from liability if certain conditions are met; and
- Require certain larger overseas subsidiaries of Australian financial entities to report transactions.

ABA member banks are variously captured under the trade reporting rules, including Phase 1 banks, Phase 2 banks and Phase 3 entities. The rules have different implementation, compliance costs and timing implications across different categories. We note that ASIC has provided relief for Phase 1 and Phase 2 entities on particular aspects of the trade reporting rules due to lack of availability of technology, including market infrastructure and vendor software, compliance costs across reporting entities being disproportionate to the regulatory benefit, and uncertainty regarding overseas reporting rules, including lack of agreement about final rules in major markets[1]. We also note that ASIC has announced a delay to the commencement of reporting for Phase 3 entities.

The ABA is concerned that member banks are looking to make changes to their compliance systems and processes, including IT systems, to ensure they comply with the trade reporting rules. However, there have been significant implementation issues, especially the lack of availability of a trade repository in this jurisdiction with functionality for reporting data as stipulated by ASIC.

[1] The ABA and AFMA have recently submitted an application for the extension of relief for Phase 1 and Phase 2 reporting entities to ensure adequate resources and time to implement certain trade reporting rules (noting in certain instances initial relief is due to expire before changes contemplated to be made permanent in this consultation paper can be settled). A number of the matters the subject of the application are contained in this consultation paper.

The DTCC has indicated that necessary functionality will be available later this year, and they are currently seeking a licence with ASIC. There have also been indications from the DTCC that certain required fields will not be available for Australian banks and other financial institutions to meet certain trading rules set by ASIC.

Therefore, improvements to the ASIC trade reporting regime have the potential to make compliance possible for reporting entities and reduce IT system changes and technical challenges as well as reduce compliance costs associated with implementing OTC transaction reporting.

Adjustments and improvements are also consistent with the Government's broader deregulation agenda and Statement of Expectations.

Specific comments – Technical amendments

The ABA mostly supports Option 2 in the consultation paper, however, amendments or adjustments are needed to the proposals ensure the ASIC reporting regime operates efficiently and without imposing additional and unnecessary compliance costs on reporting entities (see comments below). We consider that it is important to make specific amendments to the trade reporting rules to help minimise regulatory burden and compliance costs and ensure that trade reporting data is complete and comprehensive.

We consider that Option 2 without amendments and adjustments may reduce as well as increase the regulatory burden and compliance costs for banks variously. For example, snapshot reporting will reduce compliance costs over lifecycle reporting for all reporting entities. However, the proposed rule change to implement a 'safe harbour' for delegated reporting will potentially increase the expectation that banks, including smaller banks, will provide delegated reporting services to their clients, and therefore, will likely increase compliance costs, not just for larger banks and other financial institutions.

Snapshot reporting

ASIC proposes to amend Rule 2.2.1 to allow reporting entities to meet their reporting obligations in relation to an OTC derivative by either:

- Reporting transaction information separately for each reportable transaction in the OTC derivative ('lifecycle reporting'); or
- Reporting transaction information, or substantially equivalent information, in relation to the OTC derivative on its terms at the end of each business day ('snapshot reporting').

The ABA supports allowing reporting entities to meet their reporting obligations by reporting positions at the end of each business day (end-of-day daily open position reporting). Currently the trade reporting rules require lifecycle reporting with a T+1 delay. Intraday modifications would result in reporting entities incurring additional initial and ongoing compliance costs due to the complexity of the reporting rules and the IT infrastructure needed to facilitate such reporting.

There are operational and technology challenges for reporting entities with regards to lifecycle reporting and reporting errors or corrections identified on a more frequent basis. The DTCC does not allow the correction of a historic record, and therefore, reporting entities are limited to being able to correct the current record of information.

Furthermore, daily open position reporting is simpler to administer than lifecycle reporting and would align better with most foreign trade reporting regimes which the larger banks do significant reporting. Daily open position reporting better enables reconciliations between bank's records and the DTCC's records.

We note that changes to bank's records are timestamped in the source systems in which the transactions are recorded. Therefore, for most systems, audit histories of the individual transactions are recorded, providing details of any amendments to the transaction with dates and times. This would provide ASIC will sufficient information to facilitate an investigation.

We also note this approach is consistent with the approach adopted in the relief provided to Phase 1 and Phase 2 entities, and therefore, we consider this approach should be made permanent for all reporting entities. End-of-day position data provides ASIC with a full view of systemic risk, in line with G20 objectives. Furthermore, this approach would align with the errors and corrections arrangements that have been applied in practice for reporting obligations adopted in other jurisdictions, such as the United States regime (CFTC) and European Union regime (EMIR).

Therefore, the ABA believes that it is important this approach removes the need for reporting entities to submit intraday modifications to transactions and makes the IT systems more efficient and related initial and ongoing compliance costs more manageable where the requirement allows a reporting entity to report a single end-of-day position. Where there is more than one update or change to the data fields during a business day, the reporting entity should be required to report the data that is current at the end of that business day. In practice, this approach will allow reporting entities to report to a trade repository in batch cycles (generally the following morning of the relevant business day). Therefore, we support clarifying the obligation under Rule 2.2.1(1)(c) by eliminating the need to report transaction modification, termination and assignments.

The ABA does not support an exception for intraday trades. Variations from end-of-day reporting will increase the regulatory burden and compliance costs as the IT solutions required to include/exclude transaction events needs to be developed, tested and supported initially and on an ongoing basis. Banks maintain adequate records to facilitate regulatory investigations.

The ABA believes certain transaction reporting requirements, including execution and confirmation timestamps, result in disproportionate compliance costs, especially where execution and confirmation matching is a manual process.

Importantly, the ABA believes that clarity and certainty with regards to the reporting obligation is needed so that commercial decisions can be made about how reporting entities will ensure they comply with the reporting rules and whether new IT systems need to be built to facilitate end-of-day reporting. We do not support a reversion to transaction-by-transaction reporting, unless there is a clear case for improving system efficiency for industry and ASIC and reducing systemic risk to the market.

Alternative reporting to prescribed trade repositories by foreign reporting entities

ASIC proposes to amend Rule 2.2.1(3) to allow foreign reporting entities that use alternative reporting under that rule to report to prescribed trade repositories in jurisdictions other than the jurisdiction in which the foreign reporting entity is incorporated or formed.

The ABA supports exempting foreign reporting entities from the requirement to report under the trade reporting rules where these entities have already reported a transaction under a sufficiently equivalent reporting regime or where the transaction is exempt from being reported under that regime. This approach is consistent with ASIC's approach to equivalent jurisdictions and is important to ensure harmonisation of trade reporting rules across jusridcitions and to reduce compliance costs associated with reporting entities having to build IT systems and report the same transaction to another trade repository/regulatory authorities.

Tagging of derivative trade data under alternative reporting

ASIC proposes to amend Rule 2.2.1(3) to require foreign reporting entities that use alternative reporting under that rule to designate (or 'tag') the transactions as being reported under the trade reporting rules.

The ABA does not support tagging a transaction as reported where the transaction has been reported to a sufficiently equivalent reporting regime. This functionality is not supported by the DTCC and technical complications mean that such a requirement could result in the trade failing the DTCC jurisdictional validation process. Furthermore, where a foreign subsidiary is required to tag trades, these entities would be required to obtain consent from their clients to be able to report such clients' identifying information to ASIC, which would add significant cost and administrative burden to the foreign subsidiaries. This is likely to put these banks and financial institutions at a competitive disadvantage to local institutions.

Therefore, to enable alternative reporting of the reportable fields required under the foreign jurisdiction and for ASIC to receive these reports by tagging ASIC in the messages, infrastructure changes would need to be made by the DTCC and new IT systems and administration processes would need to be implemented by reporting entities. We note that new infrastructure to respond to this ASIC-specific requirement is likely to increase compliance costs for banks due to the development work needed to be conducted by the DTCC.

Alternatively, the ABA believes that regulatory authorities should cooperate internationally by sharing data captured in trade repositories.

Amended definition of 'regulated foreign market'

ASIC proposes to amend the definition of 'regulated foreign market' in Rule 1.2.4(3) and proposes new Rule 1.2.4(2A) so that any market that is a 'designated contract market' in the United States, or a 'regulated market' in the European Union, is deemed to be a 'regulated foreign market'. ASIC may also determine that a foreign market, or a market within a particular class of foreign markets, is a 'regulated foreign market' where it determines that the market is subject to regulation that is sufficiently equivalent to a market regulated under Part 7.2A of the Corporations Act and a market of a type described.

The ABA supports excluding exchange-traded derivatives, however, the proposed rule wording is unlikely to achieve this result. Defining a 'regulated foreign market' as including a 'designated contract market' (under the United States regime) and a 'regulated market' (under the European Union regime) and a market of a type described or sufficiently equivalent to a market regulated under Part 7.2A of the Corporations Act will address some problems inherent in the ASIC trade reporting regime, but will only partially reduce the potential impact on futures and other exchange-traded derivatives.

We are concerned that the Phase 1 and Phase 2 entities have invested resources and time in working with ASIC in relation to existing relief with regards to exchange-traded derivatives, which seems to be inconsistent with the proposed rule wording. It is not clear whether ETD markets assessed as equivalent are included. If these ETD markets are not included, this will result in industry having to request an extension of these waivers involving unnecessary resources and time from industry and ASIC.

Alternatively, the ABA believes that exchange-traded derivatives should be defined and excluded.

Reporting to prescribed trade repositories

ASIC proposes to amend Tables S1.1 and S1.2 in Schedule 1 to require Australian reporting entities to report to a prescribed trade repository if a licensed trade repository in the relevant asset class is not available and proposes consequential amendments to Rule 2.4.5 to require reporting entities to transfer (or 'port') their derivative transactions and positions to a licensed trade repository within 6 months from the licensing date.

The ABA supports amending the trade reporting rules to ensure that reporting entities are able to comply with the rules with regards to the need to report to a licensed trade repository, where there is no licensed trade repository to report to. The DTCC is currently seeking a licence, however, this is unlikely to be completed prior to 1 October 2014 exposing reporting entities to non-compliance.

Therefore, we agree with ensuring that reporting to a prescribed trade repository is satisfactory in the interim and providing 6 months from licensing date for reporting entities to be complying with the reporting rules. Reporting entities will require sufficient time to ensure vendor systems can be reviewed and IT testing completed. Implementation timing must be contingent on the availability of infrastructure locally (i.e. DTCC).

Furthermore, we note that where an infrastructure provider or service has "captured" the trade data and is unwilling/unable to pass through this data seamlessly, it should be possible to report to a prescribed repository.

ABNs as entity identifiers

ASIC proposes to amend the Tables in Schedule 2 to remove Australian Business Numbers (ABNs) from the hierarchy of entity identifiers that reporting entities must report to trade repositories.

The ABA supports amending the trade reporting rules to remove an ABN from the hierarchy of entity identifiers recognising that not all counterparties that Australian banks and other financial institutions trade with have an ABN, especially globally.

The DTCC does not accept the ABN as an entity identifier. Given the ABN is an Australian-specific identifier, it is unlikely that in the long term, such an identifier will be recognised globally. Additionally, in the shorter term, there are technology challenges for reporting entities because the DTCC cannot accept some prescribed identifiers and for those identifiers that DTCC can accept, it can only populate the name field for ASIC reporting when the counterparty data exists in the DTCC database (and this can only be the case if the counterparty has separately onboarded with the DTCC). A large number of non-reporting counterparties do not have a prescribed identifier and do not onboard with the DTCC.

Therefore, we consider the amendment is needed to ensure international consistency and reporting efficiencies. We note that the ISDA Identifier Waterfall is becoming standardised across jurisdictions and suggest that it would be beneficial to align the ASIC hierarchy components with the ISDA Identifier Waterfall as follows:

- LEI / CICI / pre-LEI
- DTCC / AVID / SWIFT BIC
- Internal identifier.

Reporting obligations for foreign subsidiaries of Australian financial entities

ASIC proposes to amend Table S1.1 in Schedule 1 to require transactions to be reported from 1 October 2015 for all interest rate and credit derivatives, and from 1 April 2016 for all other classes of derivatives, if the reporting entity:

- Is a foreign subsidiary of an Australian ADI or AFS licensee;
- As at 30 June 2015, holds either on its own or in combination with other foreign subsidiaries of the ADI or AFS licensee where these subsidiaries are incorporated or formed in the same jurisdiction, total gross notional outstanding OTC derivative positions of $5 billion or more; or
- Is not required to report under Phase 1, 2 or 3.

ASIC also proposes to amend Table S1.2 in Schedule 1 to require these reporting entities to 'backload' their outstanding positions within 6 months from the transaction reporting date (i.e. by 1 April 2016 for all interest rate and credit derivatives, and by 1 October 2016 for all other classes of derivatives).

The ABA does not support imposing reporting obligations on foreign subsidiaries. We are concerned the proposed approach:

- Represents an extra-territorial reach by ASIC and is not aligned with the regimes of foreign regulators;
- Presents a barrier to certain offshore investments and will impose significant initial and ongoing costs on the industry and ASIC; and
- Carries practical and technical complexities, and in particular, the manner in which the threshold would apply, including potentially capturing smaller entities, causing difficulties due to AUD currency fluctuations, requiring the development of new IT systems and administration processes to deal with contingencies, etc. (The threshold could be considered low given that it is aggregated across all subsidiaries and that intragroup transactions are included. The threshold could also inadvertently apply continuously where in fact a one-off transaction may trigger the threshold and a permanent reporting obligation (e.g. a business restructure or other non-recurring circumstances.))

We do not believe that the cost outweighs the benefit of ASIC having access to this trade data. Imposing a transaction-by-transaction reporting obligation on foreign subsidiaries is an unreasonable burden and cost and inconsistent with the Government's broader deregulation agenda.

Safe harbour for delegated reporting

ASIC proposes to amend Rules 2.2.6 and 2.2.7 in relation to delegated reporting to provide a 'safe harbour' from enforcement action if certain conditions are met, so that a reporting entity is not responsible for a breach of the relevant rules for a reportable transaction or reportable position, provided that the reporting entity delegates the reporting obligation to another entity (the 'delegate').

The conditions include:

- The terms of the delegate's appointment and any related agreements or arrangements are documented in writing;
- The appointment, agreements and arrangements between the reporting entity and the delegate provide that the delegate will report on behalf of the reporting entity in relation to the reportable transactions and reportable positions in accordance with Rules 2.2.1 to 2.2.5; and take all reasonable steps to ensure that the information, and any changes to the information, reported on behalf of the reporting entity under Rules 2.2.1(1) and 2.2.2(1) in relation to the reportable transactions and reportable positions is and remains complete, accurate and up-to-date; and
- The reporting entity makes regular inquiries that are reasonably designed to determine whether the delegate is discharging its obligations under the terms of its appointment.

The ABA would support an appropach that addresses the liabilities and legal risk concerns with delegated reporting, however, the proposed approach is not supported. Further clarity around the conditions to be met by both parties would be needed to facilitate industry standard contractual agreements.

However, the ABA believes that delegated reporting is not a viable option, even with a 'safe harbour', because:

- Delegated reporting services could be a defining factor in accessing market liquidity;
- Banks, including smaller banks, may have reporting obligations for transactions conducted with smaller ADIs/AFSL holders other than non-reporting counterparties, and therefore, still need to have reporting capabilities; and
- Some counterparties, including REs and trustees, will want to delegate reporting to banks, including smaller banks, and therefore, would need to have delegated reporting services.

We note that clarity regarding reporting obligations, and in particular, what constitutes taking all reasonable steps to ensure accuracy in the context of delegated reporting may address some concerns of smaller reporting entities as to whether the liabilities and legal risk is too great to not implement their own IT systems and reporting. Smaller reporting entities will include smaller banks and other ADIs as well as managed funds and other vehicles caught by the trade reporting rules (noting some of these reporting entities will be part of institutional groups that have a reporting obligation). The implementation costs for smaller reporting entities could be significant and involve internal systems enhancement, potential connectivity linking required with the market infrastructure, and reliance upon vendor solutions, even where comparatively few derivative transactions are conducted.

However, ASIC is to prescribe a part of the industry standard delegation documentation and this is likely to impose responsibility on the delegate to effectively carry the risk of reporting and any associated breach. This is unacceptable and is likely to result in few larger banks and other financial institutions being prepared to provide delegated reporting on behalf of smaller reporting entities. Furthermore, delegated reporting may result in regulatory burden not just falling on larger banks and other financial institutions, but also smaller banks. Therefore, some smaller banks may be facing compliance costs associated with implementing their own reporting capabilities as well as delegated reporting services for some of their counterparties, compounding the compliance impact on these smaller banks.

The ABA believes there are a number of outstanding issues and concerns with doubled sided and delegated reporting. Therefore, we consider that single sided reporting for Phase 3 entities remains the preferred approach to balance the policy intent with managing the regulatory burden and compliance costs for all entities and better enable larger banks and other financial institutions to facilitate trade reporting across the Australian market. Single sided reporting will achieve the policy intent without imposing additional costs and resource burdens and resulting in reduced efficiencies for industry and ASIC. In practice, single sided reporting could be achieved through the end user exemption definition, where the definition includes corporates and some AFSL holders (Phase 3 entities), or through implementing a single side reporting obligation for Phase 3 entities.

Yours sincerely,

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