



17 May 2013

Senior Manager, Post-trading and OTC  
Financial Market Infrastructure  
Australian Securities and Investments commission  
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Dear Mr White

### **Derivative Transaction Rules CP 205**

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the draft Derivative Transaction Rules 2013 set out in Consultation Paper 205.

The Australian industry has previously signalled its understanding of the importance of trade reporting though the course of policy development for Australia's legislative framework for OTC derivative regulation. While ASIC's proposed reporting rules are described as being drafted to promote consistency with overseas OTC derivative transaction reporting regimes, at a detail level AFMA considers more work needs to be done to achieve this goal. Authorities around the globe have not fully developed their trade reporting implementation plans with industry in a rationally planned and phased manner. This diminishes the value of the work and effort being put into this exercise by authorities and industry. Overtime we hope that these near term transition problems with implementation will be overcome to produce a data system that is of real value to financial market participants and the community as a whole here and abroad.

The principal concern of AFMA relates to the need for a large amount of localisation required for reporting on the data fields set out in Schedule 2a to the draft rules and the need for precise identification of derivatives products to be reported. The amount of work required to implement the proposed Australian reporting regime is much greater than was envisaged at the policy development stage. In the following comments on the consultation and in the attached spreadsheet we provide views on how these concerns may be addressed.

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## Comments on consultation paper questions

The following are responses to question posed in the consultation paper.

### *B1Q1 Do you support the overall scope of the reporting obligation?*

#### *1. Meaning of “entered into”*

It is proposed that for Australian entities and foreign subsidiaries of Australian entities, all OTC derivatives are reportable transactions, regardless of where they are entered into. For other reporting entities, OTC derivatives either booked to the profit or loss account of an Australian branch of the entity or entered into by the reporting entity are reportable transactions.

The concept of “entered into” will need to be clarified. This is a matter on which regulatory guidance would be welcome. In respect of a foreign ADI branch or foreign registered company the concept of “entered into in this jurisdiction” has caused confusion. The alternative approach of identifying derivatives booked to the profit and loss account of the Australian branch is considered to be workable and the sole preferred test to be relied on.

#### *2. Intra-group exemption*

Intra-group transactions should be not be subject to the reporting obligation as they do not contribute meaningful data for the assessment of systemic risk.

#### *3. Transition time to Trade Repository*

The imposition of reporting obligations is dependent on Licensed Repository or Prescribed Repository (TR) that meets the criteria in Rule 1.2.6 in relation to the Reportable Transaction being in existence. This rule is of great importance. However, as the reporting obligation arises as soon as such a Licensed Repository or Prescribed Repository meets the criteria in Rule 1.2.6 transitional problems arise. A lead time is needed to enable reporting entities to get their connectivity arrangements in place. A minimum 3 month period is required where a new TR comes into operation. This is particularly important if the TR is a new entrant to trade reporting and has no prior trade reporting relationships with reporting entities.

#### *4. CCP reporting exemption*

It has been the industry expectation based on the policy behind the *Corporations Legislation Amendment (Derivative Transactions) Act 2012* that centrally cleared derivatives would be reported through CCP systems and that in line with arrangements in other jurisdictions that CCPs would be trade reporting entities. There should be an exemption on reporting obligations for reporting entities where a reportable transaction goes through central clearing and is reported up though to a TR by a CCP.

*B1Q2 Where both reporting entities entering into a reportable transaction are required to report the details of the transaction to a trade repository, should each reporting entity be required to report, or should only one reporting entity be required to report?*

Previously, AFMA has noted that there are reasonable arguments in favour of both one and two-sided reporting but emphasised that reporting entities should not be under a conformance obligation in respect of two-sided reporting.

In the US, the reporting responsibility is placed in a one-sided hierarchical order where the swap dealers take the majority of the reporting responsibilities. By contrast the European Securities and Markets Authority (ESMA) has adopted a model whereby both sides have the same reporting obligation. Now that members are addressing the practical issues of two-sided reporting implementation under the European rules operational problems are emerging. The trade repositories will face a duplication reporting problem for trade repositories and for those receiving the data. AFMA does not support the ESMA approach which places an obligation on counterparties to ensure that they report contracts “without duplication”.

In addition, as there is a phased-in approach with major financial institutions starting out first there will only be in effect one-sided reporting in respect of contracts with end users during the first two phases.

There continues to be industry debate around the merits of the approaches and the reason for this debate revolves around reporting counterparties in a single-sided system bearing too great a compliance burden on behalf of the other counterparty and the onerous nature of conformance obligations where two-sided reporting is used. These problems flow from the incomplete work on internationally agreed identifiers. Settled identifiers provide the obvious technical solution to dealing with data integrity problems, particularly in the case of two-sided reporting.

This issue illustrates the primary industry concern with hurried trade reporting implementation without the basic building blocks being put in place first for the system to work well.

*B1Q3 If only one reporting entity were required to report the details of a reportable transaction to a trade repository, how should it be determined which reporting entity is required to report?*

A single report in respect of a single derivative contract would eliminate the duplicative reporting problem for trade repositories. As noted above the US hierarchical arrangement<sup>1</sup> provides a workable approach to one-sided reporting.

*B1Q4 What is the likely impact of our proposals?*

Favouring solutions which dovetail with systems and requirements that have been implemented for existing US rules reduces the marginal cost to members for implementation of trade reporting in Australia. From a business perspective implementation requires the following processes to be followed:

- Interpreting regulations for business and technical requirements
- Establishing connectivity between market participants and financial market utilities
- Interfacing with Trade Repositories (TR) to meet reporting obligations for reporting entities
- Implementing FpML and SWIFT message protocol for conducting and sharing derivatives trading and message transformation into a standard format
- Identifying derivatives related data, risk and lifecycle events with time value and format bound business rules (including multiple identifiers relates to legal entities, trades and products)
- Record-keeping and data reporting requirements (including an audit trail and daily as well as position reporting records)
- Acquiring data from disparate sources and identifying data fields for regulatory streams

Generally, members in the major financial institutions indicate that they have significant teams working both on the compliance and IT implementation for trade reporting but costs being incurred in current budgets are commercial-in-confidence information which they are not able to share with external organisations.

The greater the degree of localisation in the reporting requirements will mean more resources will have to be found to implement the reporting system. Suitably qualified staff for this work are limited in number, especially when there is keen demand for their services to meet the needs of other jurisdictions.

*B2Q1 Do you agree with the proposed four categories of OTC derivative transaction that are a reportable transaction?*

The categories are considered to provide a workable approach to the identification of a reportable transaction.

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<sup>1</sup> The Commodity Futures Trading Commission rules have a clear structure as to which counterparty has the obligation to report – i.e., if one counterparty is a swap dealer, the swap dealer shall be the reporting counterparty, see Section 45.8, Title 17 of the Code of Federal Regulations.

*B3Q1 Do you agree with the proposal to limit the reporting obligation to OTC derivative transactions?*

Yes. However the reliance of the exclusion definition not on a licensed market being supervised under Part 7.2A is Australian centric. This is considered to be too narrow given the possible extraterritorial operation of the reporting obligation. Given the longer term possibility of mandatory execution requirements which may occur on a trade execution facility in another jurisdiction not supervised under Part 7.2A, such as US 'swap execution facility' further consideration needs to be given to distinguishing OTC transactions from those carried out on a trade execution facility.

*B3Q2 Do you agree with the proposed definition of OTC derivative transaction?*

The comments in response to this question reflect the contents of a letter we wrote to Treasury regarding the Ministerial determination to be under section 901B of the Corporations Act in respect of trade reporting. In essence we have asked the Minister to be specific with regard to derivatives products that are to be subject to the reporting obligation.

We have serious concern in regard to the proposal in CP205 to as define as a reportable OTC derivative transaction as "all derivative transactions other than those where the transaction is executed on, or is reported to the operator of, a Part 7.2A market, in accordance with the operating rules of the relevant Part 7.2A market" based on the expectation the Ministerial determination to require that details of all derivative contracts in the identified asset classes be reported to a trade repository would include:

1. credit derivatives;
2. interest rate derivatives;
3. foreign exchange derivatives;
4. equity derivatives; and
5. commodity derivatives (other than electricity derivatives).

Now that market participants are examining the detailed implementation of Part 7.5A of the Corporations Act the generic nature of the reference to broad asset groups of derivatives such as 'foreign exchange derivatives' is considered too vague for regulatory implementation purposes. They cause confusion because the generic descriptions do not go to base product classes of derivatives that are familiar to the market.

While the broad principles based definition of 'derivative' works well to ensure coverage by the Corporations Act at a high level, as was recently confirmed by CAMAC in its report<sup>2</sup>, it does not provide sufficient precision and clarity when it comes to imposing regulatory obligations around derivative products. This is recognised in the

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<sup>2</sup> Corporations and Markets Advisory Committee, Final Report 'Derivatives', December 2011.

Corporations Act where the general definition of 'derivate' under section 761D is supplemented by Regulation 7.1.04. Other financial product definitions are supplemented by clarifications under the Corporations Regulations, such as under regulations 7.1.04B, 7.1.04C and 7.1.04F concerning classes of financial products.

Under section 901B of the Corporations Act the Minister may determine the classes of derivatives that will be subject to ASIC rule making. Classes of derivatives may be defined with reference to any matter, including the underlying asset, or the time when the derivatives were issued. The determination mechanism proves a flexible tool for determining 'classes of derivatives' which can readily updated as circumstances and products develop.

In our submission of August 2012 to Treasury we noted that the coverage of derivatives should be done in a way which is comprehensible and usable by the market. Note 2 to s901B says that a class of derivatives can be described by reference to any matter, including (for example):

- the kind of asset, rate, index or commodity to which the derivatives relate; or
- the time when the derivatives were issued, or their date of maturity.

Harmonisation with international developments needs also to be borne in mind. The US Dodd-Frank Act requirements have led to ISDA developing an implementation plan to define a standardised taxonomy for OTC derivatives and develop Unique Product Identifiers (UPI). The taxonomies and UPI are designed to support regulatory mandates around the world to increase transparency through regulatory reporting. The taxonomies will be included in the FpML data standard to facilitate the reporting process. Coordination with other international standards such as ISO International Standards to align with the ISDA taxonomies is ongoing in this area.

AFMA has proposed to Treasury that the Determination follow Note 2 by describing the kind of asset by reference to a base product description used in the market. This approach fits in with market practice. For Australia market purposes, AFMA developed in 2012 a set of RAVA Conventions which identifies OTC derivative products, amongst others, and provides descriptive definitions in way which is compatible with the taxonomies developed by ISDA.

Subsequent discussion with the Treasury indicates that the Minister may list derivatives at the high asset class level and ask ASIC to specify what derivatives products should be subject to the reporting obligations. In this event, AFMA looks to ASIC to clearly identify what OTC derivatives products are reportable.

AFMA proposes that the following list of OTC derivatives as a starting point in identifying OTC derivatives products which will be reportable. The following list identifies derivatives to the base product level but it is possible to go to the sub-product level in this identification process. In addition, the AFMA RAVA Conventions provide additional descriptive information on products which may be of value in giving guidance to the market. AFMA stands by to assist ASIC with this work.

1. Credit - Single Name
2. Credit - Index Tranche
3. Credit - Index
4. Credit - Total Return Swap
5. Credit - Swaption
6. Credit - Exotic
7. Interest Rate - Interest Rate Swap
8. Interest Rate - Non-deliverable Interest Rate Swap
9. Interest Rate - Forward Rate Agreement
10. Interest Rate - Cap, Floor
11. Interest Rate - Swaption
12. Interest Rate - Cross Currency Swap
13. Interest Rate - Non-deliverable Cross Currency Swap
14. Interest Rate - Options
15. Interest Rate - Exotic Options
16. Interest Rate - Basis Swaps
17. Interest Rate - Exchange-for-Physical
18. Interest Rate - Inflation-linked (Zero Coupon) Swap
19. Interest Rate - Inflation-linked (Indexed Annuity) Swap
20. Interest Rate - Inflation-linked (Capital Indexed) Swap
21. Foreign Exchange - Swap
22. Foreign Exchange - Forward
23. Foreign Exchange - Non-deliverable Forward
24. Foreign Exchange - Non-deliverable Option
25. Foreign Exchange - Options
26. Foreign Exchange - Exotic Options
27. Foreign Exchange - Precious Metals Swap
28. Equity - Swap
29. Equity - Index Swap
30. Equity - Options

At this stage we propose that classes of commodity derivatives not be listed. This is on the basis that electricity derivatives will require further work and consultation before they can be subjected to trade reporting. Electricity derivatives come under the class 'Commodity – Energy' which also includes oil and gas. The other commodity classes are:

- Commodity - Agricultural
- Commodity – Metals
- Commodity – Environmental
- Commodity -Freight

Trading in these classes is negligible from an Australian perspective. Reporting on commodity derivatives requires significant additional preparatory work and is not a priority area for G-20 commitment purposes.

*B3Q3 Do you agree that both centrally cleared and non-centrally cleared OTC derivative transactions should be required to be reported?*

We agree that both centrally cleared and non-centrally cleared OTC derivative transactions should be reported in line with the agreed policy underlying the *Corporations Legislation Amendment (Derivative Transactions) Act 2012*. As noted above, there should be an exemption on reporting obligations for reporting entities where a reportable transaction goes through central clearing and is reported up through to a TR by a CCP.

*B4Q1 Do you agree with the proposed timing of reporting?*

Meeting the obligation on T+1 reporting is an operational challenge particularly if two-sided reporting is introduced in circumstances where counterparties report in different time zones.

On the basis that T+1 is consistent with requirements being introduced in other jurisdictions we consider T+1 to be appropriate timing.

The proposed rules appear to capture “back to back” transactions (ie where a party to an OTC derivative transaction may transfer the risk of a derivative transaction to an affiliate either on shore or offshore through an OTC derivative contract such as a swap). Given that these transactions occur intraday and are reportable on a T+1 basis under the proposed rules, the reporting of these transactions represents an additional burden that does not go toward the intention of the proposed rules of identifying risks and ensuring financial stability.

*B4Q2 Should a shorter reporting deadline be set for those reporting entities that are subject to a shorter deadline for reporting to a trade repository under an overseas reporting obligation, or for particular types of reportable transaction (e.g. modifications or cancellations)?*

Differentiated deadlines introduce operational complexity and should be avoided. Such differences do nothing to enhance the value of the collected data and therefore this idea does not serve any regulatory purpose.

*B4Q3 Do you think a longer deadline is needed for reportable transactions executed outside Australia?*

No. Implementing sub classes of reporting obligation based on geography will increase complexity involving additional cost and time required to implement reporting obligations.



*C1Q1 Do you consider an alternative reporting regime would assist in allowing reporting entities to meet their reporting obligation?*

While AFMA supports the alternative reporting regime it would only assist reporting entities where the reporting obligations were identical. For example, for entities reporting under the US rules to the DTCC additional reporting fields or different requirements like two-sided reporting will create difficulties both for reporting dealer and for the DTCC in accepting reporting of trades that did not comply with the CFTC's Dodd-Frank Act reporting obligations.

It is important that existing reporting infrastructure is leveraged. An alternative reporting regime that allows reporting entities that are already reporting their transactions to their home regulators to utilise the same reporting regime in their home jurisdiction is supported. This would reduce time taken for compliance, implementation costs and technological builds. It will also promote international coordination and cooperation among trade reporting regimes through recognition of another jurisdiction's trade reporting regime.

*C1Q2 Do you agree with the scope of entities that should be able to access alternative reporting, or do you consider it should be broader or narrower? (In responding to this question, please include any cost-benefit analysis of your suggested approach.)*

We have commented above on the implementation problems being faced by firms in transitioning to trade reporting under divergent and incomplete local rules. Arbitrary artificial deadlines are prioritised over logically sequenced good reform process. There will be little value in the data to be collected in particular jurisdictions in the near term. Excessive emphasis on the near term integrity of the derivatives trade reporting system and myopia is therefore misplaced. The creation of a globally coherent and efficient data collection system is the long term goal which serves the policy objective G-20 to monitor systemic risk. We are collaboratively embarked on the creation of a market data collection system whose benefits come in the long term when trends and movements can be detected.

We need to be pragmatic in the short term to achieve our long term policy vision. Facilitation needs to be a primary regulatory objective in this transitional period and alternative reporting is a very sensible, pragmatic approach at a time when jurisdictions are not coordinated and consistent in their requirements.

*C2Q1 Do you agree with the criteria we are proposing be used to determine that a trade repository can be used for reporting under an alternative reporting framework?*

Allowing reporting to an alternative trade repository is dependent on ASIC being granted access to that data. Such access would need to be obtained well in advance of the commencement date of the reporting obligations. If access were not granted then

reporting entities would need to implement an alternative reporting infrastructure. Market participants would need ample lead time for alternative reporting if a cooperative agreement cannot be setup prior to the trade reporting commencement date. The question therefore arises how would ASIC arrange access to the data. There are practical issues that need to be explored on this issue and explained to reporting entities.

*D1Q1 Do you have any comments on the proposed data fields in Part S2.1 of Schedule 2 that will need to be reported to trade repositories? Are there any data fields that it will be particularly burdensome to report?*

The analysis contain in the attached spreadsheet compares the proposed ASIC, ESMA and established CFTC data requirements. This analysis reveals that a significant amount of work has to be done locally by the end of this year. The spreadsheet also provides a scale indication of the degree of burden required to do the reporting.

#### *1. Standard categorisation of data fields*

The CPSS/IOSCO Report on OTC Derivatives Data Reporting and Aggregation Requirements identifies the following functional categories of data elements that are of relevant value for the Trade Repositories:

1. Operational data, i.e. data used by a Trade Repository for internal management purposes and such as transaction number, trading and clearing venue.
2. Product information, i.e. information that allows for the classification and/or identification of the instrument.
3. Transaction economics, i.e. the material terms of a transaction, including effective and termination dates, notional amounts, coupon amounts, payment schedules, etc.
4. Valuation data.
5. Counterparty information.
6. Underlyer information, i.e. unique code for identifying underlyers and various attributes of the underlyers.
7. Event data, i.e. information that records the occurrence of an event and includes a time stamp (which indicates precisely when a particular event occurred).

It is therefore useful to think in terms of functional categories of data elements when setting out common data fields to follow this structure:

1. Operational data
2. Product information
3. Transaction economics
4. Valuation data
5. Counterparty information
6. Underlyer information
7. Event data

The difficulty being faced is introducing firm data from a range of financial institutions' systems with different levels of sophistication and formatting. The more characteristics that have to be reported, the more time-consuming the set-up will become. Many organisations have committed substantial resources to constructing and implementing derivative reporting infrastructure to meet equivalent requirements imposed by American and European financial services regulators which in turn are related to implementing G20 commitments to enhancing transparency in the OTC derivatives market.

ASIC should ensure that it defines its data reporting requirements such that they are consistent with similar requirements imposed by US and European regulators in order that reporting entities can leverage of their existing reporting infrastructure.

## *2. Normalisation by design of data fields*

The analysis carried of the proposed data fields indicates that there a significant problems with the structures of the nominated fields and the information to be gathered as well as levels of redundancy in data to be collected. AFMA's comments on the individual fields are set out in the attached spreadsheet. Field nominations should contain normalised data so that the resultant database will be able to efficiently provide the database queries and reports desired and ongoing data maintenance will be as straightforward as possible. This would mean that each field should:

1. Contain the smallest meaningful value.
2. There should be no repeated groups of fields (similar data belongs in the same field).
3. There should be no unnecessarily repeated data values.
4. Where practical, all fields in a table should be relevant to every record.

In its current form it appears that the proposed data fields violate the above principles. Data normalisation supports the efficient organisation of data into a tabular format. A good database design includes normalisation. Without normalisation a database system may slow, be inefficient and might not produce the expected result. Normalisation reduces data redundancy and inconsistent data dependency.

It also needs to be borne in mind when specifying data that for non-standardised low-volume complex derivatives it is difficult to represent transaction economics and the lifecycle event data in a normalised data format.

Developing a normalised representation for OTC derivatives is a two-step process:

1. The development of an industry standard representation. This requires the definition of the appropriate contractual language at the marketplace level, followed by the development of an algorithmic representation of those terms. US experience shows that it typically takes between 3 to 6 months to develop this process depending on existing forms and familiarity with the product.

2. Once this industry standard is in place, the respective participants then need to integrate this new data representation into their respective systems. Here also, the experience shows that it typically takes 3 to 6 months to do so.

### 3. Collateral data demands too onerous

Collateral data requirements are more extensive than for the CFTC regime, which only requires an indication of collateralisation. Under the CP205 proposal the additional collateral data is required, which is not part of current reporting information gathering systems. As no existing systems currently exist for collateral reporting this is a particularly onerous requirement. This is an area which well demonstrates why it is desirable for various regulators to get their thinking organised in a coherent form before industry is asked to implement incomplete proposals.

*D2Q1 Do you agree with the data formats we are proposing to specify, and agree that the other data formats should not be specified in the derivative transaction rules (reporting)?*

AFMA agrees with the approach on not specifying technical data formats in the derivative transaction rules. As noted in our comments on the data fields, development of global data format standards is a matter of priority and should precede implementation.

*D3Q1 Do you agree with the mechanism by which we are proposing to obtain information about mark-to-market valuations and collateral?*

Provision of this requirement will require implementation of new, third-party enterprise collateral management systems. Typically this would involve the input of seven key data feeds from the front and back office, including trading positions and foreign exchange rates, interest rates and bond market data. For larger banks with more diverse operations, the number of data sources can be much higher, including the reference data associated with the assets – the maturity and next coupon date of bonds, the eligibility criteria of the CCPs or the credit support annexes used to govern collateral posting in bilateral deals, and the ranking of assets. It also requires trading contextual indicators, securities lending rates, concentration ratios and limits.

*E1Q1 Do you have any comments on the proposed timetable for the implementation of the reporting obligation for different categories of reporting entity?*

The 31<sup>st</sup> of December is not a workable date for the implementation of regulatory changes in Australia and is generally avoided for practical reasons as being in the midst of a holiday period when staffing levels are minimal and IT system change freezes are in

place. It is normal practice in Australia to set implementation dates beyond Australia Day on 26<sup>th</sup> January during the month of February.

Consideration should also be given to reporting implementation deadlines in other jurisdictions such as Hong Kong and Singapore. The same dates should be avoided. A minimum two week gap is requested with deadlines in other jurisdictions.

*E1Q2 Do you believe the interim reporting phase will be helpful to your entity, and are you likely to opt in to this phase?*

Current deadlines are considered ambitious. Opt-in may be useful in particular circumstances but is unlikely to have broad take up.

*E1Q3 In the event your entity is considering opting in to the interim reporting phase, do you support the approach of applying a reporting obligation to these entities, or do you consider more legal certainty would be provided through a broad reporting obligation combined with a class order exemption?*

There is not a settled view on this matter at present as it depends on the attitude taken in other jurisdictions as to whether a statutory rule is required to demonstrate equivalence of the Australian regime when seeking substituted compliance.

*E1Q4 Do you agree with the proposed phased implementation by asset class?*

Our proposal to more clearly define which OTC derivatives products will be subject to a reporting obligation emphasises the idea of an asset class as not being a sufficiently precise when considering practical implementation issues. There is a need to look at implementation at a sub-product level. Reporting on commodity related derivatives present particular challenges from an Australian perspective and this is one area where much more preparatory work is required before implementation can be considered.

*E2Q1 Do you agree with the proposed requirements for derivative position information?*

The reference in the accompanying text to reporting of “historical swaps” has caused confusion as this term has specific meaning under CFTC rules where it refers to transactions that existed prior to a particular date and not open positions.

*E2Q2 Are there particular challenges in reporting derivative position information as at the date the reporting obligation takes effect for a particular counterparty in a particular asset class?*

This requires historical client data the submission of which may require client consent's to be obtained. Such consent may not be given in all circumstances, particularly where past clients are concerned.

Please contact me  
elaboration is desired.

if further clarification or

Yours sincerely

A handwritten signature in blue ink that reads "David Love". The signature is written in a cursive, flowing style.

**David Love**  
**Director – Policy & International Affairs**