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Your Ref: CP 291

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Ms Katie Ryder
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Dear Ms Ryder

Submissions on the Proposed "ASIC Client Money Reporting Rules"

Background

The Australian CFD & FX Association Limited (ACN 608 241 274) (**Association**) makes these submissions on behalf of its members, which are:

1. AxiCorp Financial Services Pty Ltd;
2. BMFN Pty Ltd;
3. EightCap Pty Ltd
4. First Prudential Pty Ltd;
5. Forex Financial Services Pty Ltd;
6. FXOpen AU Pty Ltd;
7. Gleneagle Securities (Aust) Pty Ltd;
8. Go Markets Pty Ltd;
9. Royal Financial Trading Pty Ltd;
10. Synergy Financial Markets Pty Ltd;

(**Members**)

Where there is a reference to the Association throughout these submissions, we are also referring to the individual Members noted above.

The Association, and the Members, thank the Australian Securities and Investments Commission (**ASIC**) for the opportunity to provide submissions on the draft rules set out in Consultation Paper 291 *Reporting rules: Derivative retail client money* (CP 291) (**Draft Rules**).

Summary of Position of the Association on the Draft Rules

Now that the Client Money Reforms are enacted in legislation, the Association agrees with the record keeping, reconciliation and reporting requirements necessary to administer the law efficiently as reflected in the Draft Rules. In this regard, and subject to the specific issues identified below, the Association considers that the Draft Rules:

1. Will improve the transparency of a Licensee's receipt and use of derivative retail client money;

2. Will not significantly impact our members' businesses, create overly burdensome compliance obligations, or impose significant additional costs on members of the Association.

3. Are an appropriate tool to assist ASIC regulate the over-the-counter (**OTC**) retail derivatives sector and assist with the identification of client money anomalies in appropriate cases;

4. Will provide adequate protection for retail clients.

However, the Association has identified the following issues with the Draft Rules which are of significant concern to it and the Members.

1. The requirement to undertake all reconciliations required by the Draft Rules "as at" "7pm" is unnecessarily onerous given members already undertake a similar daily process as at 5pm New York Time (**New York Close**). This time is the global standard for close of trade and should be adopted by ASIC as the time at which reconciliation should occur.

2. The next business day requirement in which to perform accurate reconciliations under Draft Rule 2.2.1(3) should be extended to within 3 business days. . Lengthening the period will enable Licensees to identify anomalies in their figures arising from factors outside their control. For example, anomalies such as bank book errors or the source of client funds not being identifiable (because they are not properly labelled by the client) have the potential to cause balancing issues with the reconciliations. Such issues would ordinarily be "ironed out" in a 3 day period.

3. The $1,000,000 non-compliance civil penalty provisions are extreme and inconsistent with other similar ASIC-regulated reporting regimes. In light of this, administration of the penalties will be difficult – if not impossible – given the potentially higher burdens of proof attaching to serious penalties. Given the penalty's significance, the Association submits that they will only be able to be utilised in the most extreme cases involving fraud and dishonesty (concepts which would amount to contraventions of numerous other sections of the Corporations Act). This undermines the purpose of the Draft Rules in deterring non-compliance with regulatory reporting and record keeping.

These issues are expanded upon as follows:

7pm Reporting Time

The Association submits that ASIC should not adopt 7pm as the time at which "a financial services licensee must perform an accurate reconciliation (refer to Draft Rule 2.2.1 and 2.2.2) (we assume "7pm" means 7pm Australian Eastern Time). Rather, it is submitted, a more appropriate time "as at" which the accurate reconciliation should occur should correlate with the New York close of trade, being 4.59.59pm New York time (**New York Close**).

As ASIC is aware, the Members, and many other well established OTC derivatives brokers, are international businesses, with clients in many jurisdictions throughout the world. A significant portion of the business of Members is generated from the Asian and European markets which are mostly open at 7pm (AEST) (the European markets getting into full swing at this time).

A larger volume of transactions relative to other times of the day are occurring for Members of the Association at this time. As a matter of convenience, and adherence to global business standards, Members (and, as we understand, all well managed OTC derivative brokers throughout Australia)

have an end of day which coincides with the New York Close. This is the global standard time for international financial transactions and occurs at 4.59.59pm New York time (**New York Close**). Trade then re-opens at 5pm New York time. Accordingly, the trading day is defined as the 24 hour period from 5pm New York time to the New York Close (**Trading Day**).

Specifically, for the FX market, the international community (including Australia) agreed, approximately 20 years ago, to define the trading day to finish at the New York Close as part of CLS (Continuous Linked Settlements).

At New York Close, Members' liquidity providers generate statements which show all open and closed trades of Members' clients for the Trading Day. At this time, Members' MT4 systems generate an automated report setting out details of all client liabilities (i.e. client equity) and accordingly already undertake a reconciliation of sorts as part of their existing processes. It would not be a large step from this to undertaking the reconciliation process as at this time as all relevant data and information of Members' operations are generated at this point in time. That is, adjustments to the current systems of Members (and no doubt other well established brokers) can relatively easily be made to seamlessly undertake the reconciliation required by the Draft Rules, provided that it occurs at New York Close.

Should ASIC insist on a 7pm Reporting time, rather than New York Close, the Association anticipates that Members (and other industry participants) will have to unnecessarily incur significant costs in building new systems to reconcile the information required by the Draft Rules. Given that any new systems would be new and untested, there would be, it is anticipated, be a longer "teething period" in implementing the changes than would otherwise take place under a New York Close reconciliation standard.

Daily Reconciliation by 7pm the following business day
At B3Q4 / Q5 (page 13) of CP 291 you ask stakeholders for feedback on the following issue:

> *Will it be possible for your business to perform a daily reconciliation by 7 pm on the following business day.*

The answer to whether a daily reconciliation is possible is a definitive "yes".

That being said, there are a number of issues with the 24 hour reconciliation timeframe which, if not extended, will create problems:

1. For ASIC – in the volume and quality of information that it is reported to it under Chapter 3 of the Draft Rules; and

2. For industry participants – in the frequency with which it is required to report to ASIC under Chapter 3 and the associated compliance burden that will create.

The Association submits that there should be a 72 hour window following New York Close in which the daily reconciliations occur for the following reasons:

Occasional anomalies in client money information received

From time to time anomalies occur in respect of the transactions of brokers, including the Members. Such anomalies can and will create difficulties in reconciliation processes. Examples include:

1. Clients making deposits of funds for trading purposes where the deposit does not accurately identify who the client is (for example, unreferenced transactions and deposits). In such cases, the licensee will not immediately be able to undertake an accurate reconciliation of the amount of Reportable Client Money held in a Client Money Account for that client because they do not know who the funds belong to. For larger brokers, this can occur as frequently as daily and take up to a number of days to resolve.

2. Bank book errors, for example, bank accidently posts an amount to a Member bank account. This is self explanatory and the reconciliation issues this would cause are obvious.

3. Other “black swan” type events, including the ASX outage (this happened last year) or issues with members’ financial institutions.

Reconciliation issues arising as a result of the above will typically be resolved within the 24-hour reconciliation window available in most cases, subject to weekends and public holidays. However, from time to time, it may take Members and other stakeholders longer to resolve.

The reason why this is of concern is due to the Reporting Requirements set out in Rule 3.1.1. In particular the requirement that a financial services licensee give ASIC a written report if a reconciliation identifies a “difference between the amount held in a Client Money Account for a person and the amount recorded in the licensee’s records…” Failure to provide the “Chapter 3 Report” carries a potential penalty of $1,000,000 (discussed further below).

In theory each of the above scenarios could cause reconciliation differences in amounts held in a Client Money Account for reasons completely beyond the control of the licensee. The licensee is then required to prepare a report to ASIC setting this out, when if more time was provided, the issue could be resolved without the need to report. Theoretically, larger licensees could be required to lodge reports daily due to the number of unreferenced transactions they receive.

It goes without saying that the preparation of Chapter 3 Reports in these situations would be of no utility for ASIC and create an unnecessary compliance burden and cost on licensees otherwise complying licensees. The real concern, however, is that Chapter 3 Reports detailing these unresolved issues (due to the short “reconciliation window”) would simply make it harder for ASIC to discover where the real issues in respect of client moneys are.

It is submitted that a 3 business day “reconciliation window” will provide licensees adequate opportunity to “iron out” any issues. The benefit to ASIC (as well as the licensee are clear). There is no obvious reason why it is important to limit the window to 24 hours, particularly in light of these issues.

Penalties

Whilst Members of the Association are confident that they will not act in contravention to Client Money obligations, they consider a $1,000,000 non-compliance civil penalty provisions to be extreme and inconsistent with other similar ASIC regulated reporting regimes for reasons set out below. The Association submits that a 1,000 penalty unit penalty achieves the right balance, is consistent with the Derivative Transaction Rules and will be easier for ASIC to administer for reasons discussed.

Inconsistency

The Association submits that consistency between the Draft Rules and their associated penalties with comparable contraventions of the *Corporations Act 2001* (Cth) is a desirable goal, the Draft Rules should reflect this end.

We draw your attention to a number of inconsistencies which, in our opinion, arise if the Draft Rules are implemented in the form currently proposed. We provide the following comparison not as an exhaustive list of inconsistencies (as we believe many others arise), but as evidence of the inappropriateness of the penalties in their current form.

Schedule 1 contains examples of the rules and penalties in the Draft Rules. Schedules 2, 3 and 4 contain examples of other rules and their respective penalties. Examples include:

As per Schedule 2, it is a concern that a corporation in peril of a $1,000,000 civil penalty for failure to produce records to ASIC may consider themselves “better off” falsifying the records rather than reporting them, given the lack of consistency between the two provisions. The purpose of the Draft Rule is undermined by its inconsistency with other provisions.
Further, a “Reporting Entity” as per the *ASIC Derivative Transaction Rules (Reporting)* 2013 faces a $210,000 penalty for failure to keep adequate records, whereas the same contravening conduct imposes a $1,000,000 penalty on financial services licensees under the Draft Rules.

If ASIC makes a request for information to a "Reporting entity" under the *ASIC Derivative Transaction Rules (Reporting)* 2013, that entity is afforded a reasonable time to respond to ASIC and failure to do so carries with it a maximum penalty of $210,000. A financial services licensee served with a similar request under the Draft Rules is given a strict two business days to respond, and failure to do so carries a penalty of $1,000,000.

Schedule 3 contains examples of the types of contraventions deemed by ASIC to be serious enough to warrant a $1,000,000 under the *Market Integrity (ASX 24) Rules*. Each of these provisions contains conduct that is intentional, dishonest (or both) or that involves a conflict between the interests of the licensee and their clients. It is submitted that the conduct regulated by the Draft Rules is a completely different, in that it is of a technical record keeping nature (and does not involve concepts of intentionality, conflict or dishonesty). We submit that that comparison of these rules to the compliance and reporting-based regime created by the Draft Rules invites the conclusion that the penalties in the Draft Rules are completely inconsistent and disproportionate with other regimes.

Further still, Schedule 4 contains examples of reporting-based rules in the *Market Integrity (ASX 24) Rules* dealing specifically with record keeping. We note the comparability of these rules to those in the Draft Rules, and we note especially the penalty levels that ASIC has chosen to set for breaches of these rules is 10% of the penalty for a breach of the Draft Rules for almost identical conduct.

Proportionality of Penalty with rule

The quantum of a penalty set by ASIC should reflect the purpose of the rule, the purpose of the penalty, and the seriousness of the proscribed conduct. ASIC has been given the power to set maximum penalties by Parliament in order to indicate to Courts how seriously a contravention ought to be viewed.[1] More generally, it has also been noted that principles of fairness require that there be a degree of proportionality between the seriousness of the contravention and the quantum of the maximum penalty.[2]

It is submitted that the penalty levels selected by ASIC fail in achieving the above mentioned purposes. For example, Draft Rule 2.1.2(a) imposes a penalty of $1,000,000 on a financial services licensee that fails to comply with a request by any person for written records pertaining to Rule 2.1.1 within two business days. It is submitted that a $1,000,000 maximum penalty for a provision which could hypothetically be breached by a single day's delay is grossly disproportionate. We submit that arguably every rule in the Draft Rules is capable of being breached in a trivial, innocent or non-serious way, and this leads us to question ASIC's choice to set maximum penalties at $1,000,000 for these contraventions.

Given that the Rules are technical reporting and compliance rules with minor or trivial consequences for individual breach, we submit that the penalties as currently set at $1,000,000 do not reflect the purpose of the rules, are disproportionate with the seriousness of the conduct, and misleadingly convey a higher level of seriousness of contravention than necessary.

Potential Enforcement Difficulties

Standard of Proof – We note that a Court determining a matter related to a contravention of the client money reporting rules must apply the rules and procedure for civil matters.[3] The standard of proof is "on the balance of probabilities".[4]

However, we submit that a significant hurdle in enforcing the Draft Rules as proposed is the application of the *Briginshaw* standard of proof ("reasonable satisfaction"), which is frequently applied

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[1] The Hon Chief Justice J Spiegelman, *Sentencing Guidelines Judgments*, NSW Supreme Court, <www.adg.nsw.gov.au/sc/sc.nsf/pages/CJ_240699>, 12 December 2001.

[2] Australian Law Reform Commission, *Securing Compliance: Civil and Administrative Penalties in Australian Federal Regulation,* DP 65) 2002), ALRC, Sydney, para 18.15.

[3] Corporations Act 2001 (Cth) s 1317L.

[4] Ibid s 1332.

by Courts especially in circumstances where an adverse finding results in severe consequences against the contravening party.

We submit that the standard of proof that ASIC may face when attempting to enforce the Draft Rules may, in practice, be much more onerous than anticipated.[5] We further submit that this is due solely to the disproportionality of the penalties. The penalties as they currently stand are set at the maximum of ASIC's competency under the Corporations Act. They impose significant and serious penalties on contravening parties.

We submit that the Draft Rules would be more effective in achieving their purpose (deterring non-compliance) if the penalty levels were lowered (ideally to amounts more reflective of the nature and seriousness of the contraventions). This will mitigate the risk of a Court requiring ASIC to meet what is effectively a higher standard of proof should it wish to bring proceedings against a contravening party. It will ensure that the case that ASIC must meet in order to successfully impose a civil penalty will be easier, and it is submitted that the public interest is better served by ASIC being able to reliably successfully bring cases against a large number of contravening parties for smaller penalties, rather than by infrequently imposing a large penalty in the rare circumstances that ASIC will be able to satisfy the higher standard of proof.

It would be wholly inappropriate if the threat of high penalties to licensees was used by ASIC to drive lesser outcomes, such as infringement notices and Enforceable Undertakings, if in reality there was no intention on the part of ASIC to approach the Court about a potential breach.

Defence – high maximum penalties are often correlated with an increase in defended matters.[6] We question the policy of the imposition of the severe penalties in the Draft Rules on this basis. We note that the fundamental purpose of the penalty regime ought to be to act as a deterrent against non-compliance.[7] We respectfully submit that this purpose would be better achieved with lower penalty levels. Striking the right balance between reasonableness and deterrence to arrive at a figure that both deters contravening conduct, but is not so egregious as to spark heavy litigation, will allow ASIC to effectively enforce the *Client Money Reporting Rules*.

The penalty levels as they currently stand will act as an encouragement for contravening parties to mount cases in defence, which will result in inefficiency and waste of resources, and may even result in judicial reading down or interpretation of the rules.

Penalty Privilege - We note that the operation of the privilege against self incrimination or penalty privilege is a significant burden on the proper enforcement of the *Client Money Reporting Rules*. We note that *Treasure Law Amendment (2016 Measures No. 1) Bill 2016* does not abrogate the privilege with respect to the client money rules. We respectfully submit that Rule 3.1.1 is therefore subject to the application of the privilege, with results mirroring the outcome in *Pyneboard Pty Ltd v Trade Practices Commission* (1983) 152 CLR 528.

In the light of these competing considerations we are not prepared to hold that the privilege is inherently incapable of application in non-judicial proceedings. The issue of its availability in these proceedings therefore falls to be decided by reference to the statute itself. In the consideration of that question it is necessary to bear in mind the general principle that a statute will not be construed to take away a common law right unless the legislative intent to do so clearly emerges, whether by express words or by necessary implication.

We therefore submit that the combination of the *Briginshaw* standard, the fact that the heavy penalties act as a significant encouragement for a contravening party to defend their case, and the availability of the Penalty Privilege (not only to water down the reporting requirements set out in Rule 3.1.1) but also within the curial process, will prove inimical to the proper administration and enforcement of the Draft

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[5] See Vicky Comino, 'Australia's "Company Law Watchdog": The Australian Securities and Investments Commissions and the Civil Penalties Regime [2014] 3 *Journal of Business Law* 228.

[6] See e.g. J Kelly, 'Recent Developments in Environmental Criminal Law in New South Wales'.

[7] See e.g. *Re Trade Practices Commission v CSR Limited* [1990] FCA 521 [40].

Rules. We further submit that all these obstructions may be remedied by a downward adjustment of the penalty levels.

The severity of the civil penalties may indicate that they are punitive

Finally, whilst of a lesser concern, we flag with ASIC that the purpose of the rules viewed in light of the quantum of the penalties may arguably go beyond mere deterrence. The concern that this raises is that the penalties are designed to punish rather than regulate and deter non-compliant behaviour. When penalties are punitive rather than deterrent in nature they can be viewed as criminal and can attract the procedural and substantive elements of the criminal law.

Again, the Association and its Members thanks ASIC for the opportunity to engage with it and make these submissions. Should ASIC wish to talk further about the Draft Rules, the Association and Members would be more than happy to discuss.

Regards,

Christain Dove

Lance Rosenberg

Joel Murphy

Matt Murphie

On behalf the Australian CFD & FX Association Limited

Schedule 1

Select *Client Money Reporting Rules* and their maximum penalties.

Client Money Reporting Rules 2017	
Contravention	***Maximum Penalty***
Failure to keep accurate records at all times of the amount of Reportable Client Money held in a Client Money Account for clients: r 2.1.1(1)-(2).	$1,000,000
Failure to retain records for the purposes of the above rule for 7 years: r 2.1.1(3)	$1,000,000
Failure to perform an accurate account reconciliation of each Client Money Account and licensee records as at 7.00PM each business day: r 2.2.1(1)	$1,000,000
Failure to perform an accurate account reconciliation of total Client Money Account and licensee records as at 7.00PM each business day: r 2.2.1(2)	$1,000,000
Failure to keep records for the purposes of the above two rules for at least 7 years: r 2.2.1.(4)	$1,000,000
Failure to comply with a written request within two business days by any person for a record kept under subrule 2.1.1: r 2.1.2(a)	$1,000,000
Failure to comply with a written request within two business days by ASIC for a record kept under subrule 2.1.1: r 2.1.2(b)	$1,000,000

Schedule 2

Comparable penalties

Other Comparable Provisions	
Contravention	***Maximum Penalty***
Engaging in conduct that results in the concealment, destruction, mutilation or falsification of any securities of or belonging to the company or any books affecting or relating to affairs of the company is guilty of an offence: s 1307(1).	100 Penalty Units ($21,000) or two years imprisonment, or both:
Failure by a Reporting Entity (within the meaning of r 1.2.5) to keep records demonstrating compliance with the Derivative Transaction Rules: r 2.3.1(1) *ASIC Derivative Transaction Rules (Reporting)* 2013	1,000 penalty units ($210,000)
Failure to comply with a request by ASIC for such information within a reasonable time: r 2.3.2 *ASIC Derivative Transaction Rules (Reporting)* 2013	1,000 penalty units ($210,000)

Schedule 3

Rules in the *ASIC Market Integrity Rules (ASX 24 Market) 2010* which carry $1,000,000 penalties.

ASIC Market Integrity Rules (ASX 24 Market) 2010	
1. Examples of rules which hold $1,000,000 penalties	
Rule Summary	**Maximum Penalty**
3.1.2.(1)(a) A market participant must not offer to purchase or sell or deal in any contract as Principal with the intent, or if it has the effect, of creating a false or misleading appearance of active trading in any Contract or with respect to the market for, or the price of, any Contract.	$1,000,000
3.1.2.(1)(b) A market participant must not offer to purchase or sell or deal in any contract on account of any other person with: the intent, or awareness that the person placing the order has the intent, or in circumstances where the market participant ought reasonably to have suspected that the person placing the order has the intent, To create a false or misleading appearance of active trading in any Contract or with respect to the market for, or the price of, any Contract.	$1,000,000

3.1.3.(1) A market participant must not enter orders without the intent to trade	$1,000,000
3.1.8(1) A market participant must not withhold an Order with an intent of obtaining a counterparty or counterparties.	$1,000,000
3.1.8(2) A market participant must not withhold two or more orders with the intent of avoiding trading in the market.	$1,000,000
3.1.17 A market participant must not offer and/or allocate trades to a client unless those trades have been obtained under instructions previously obtained by that client.	$1,000,000

Schedule 4

Comparable Reporting Rules in the *ASIC Market Integrity Rules (ASX 24 Market) 2010*

ASIC Market Integrity Rules (ASX 24 Market) 2010	
2. Comparable Recording Keeping and Reporting Rules	
Rule Summary	**Maximum Penalty**
Rule 2.2.4(1) A market participant must maintain internal records of instructions received from clients for a period of not less than 5 years from the date of the trade.	$100,000
Rule 2.2.4(2) A market participant must maintain records of its Representative's Trading for a House Account for a period of not less than 5 years from the date of the trade.	$100,000
Rule 2.2.4.(3) A market participant must keep a separate record of all error trades for a period of not less than 5 years from the date of the trade	$100,000

Rule 2.2.4.(4)(a) A Market Participant must maintain such accounting records as correctly record and explain the transactions of the Market Participant and the financial position of the Market Participant.	$100,000
Rule 2.3.4 A market participant must notify ASIC in writing within two business days if: (a) a reconciliation is not performed in accordance with rule 2.3.2 (b) according to a reconciliation under 2.3.2, Total Deposits is less than Total Third Party Client Moneys, or (c) if it is unable to reconcile its clients segregated accounts	$100,000