

8 August 2017

Ms Katie Ryder
Senior Lawyer, Market Integrity Group
Australian Securities and Investments Commission
Level 5, 100 Market Street
SYDNEY NSW 2000

Email: policy.submissions@asic.gov.au

Dear Ms Ryder,

Thank you for the opportunity to provide comments and submissions on draft rules set out in Consultation Paper 291 *Reporting rule: Derivative retail client money* ("CP 291") (**Proposed Rules**). Gleneagle Securities (Aust) Pty Ltd (**Gleneagle Securities**) considers that the implementation of the Client Money Rules to be a significant step in ASIC's regulation of the over-the-counter (**OTC**) retail derivatives space and appreciates the opportunity to be involved in this process.

Gleneagle Securities adopts and endorses the submissions made by the Australian CFD & FX Association Limited (**Association**), of which we are a member and which we have had the opportunity to read prior to making this submission. The matters dealt with herein largely mirror the concerns of the Association, however, given the importance of the issues to our business, we have reiterated those concerns in our own terms.

Overview of Gleneagle Securities' Position re: Draft Rules

Gleneagle Securities expresses general agreement with the requirements imposed by the Proposed Rules and considers them to be a necessary step in order administer requirements set out in the new section 981J(1) of the *Corporations Act 2001* (Cth). Subject to the issues raised throughout, Gleneagle Securities does not consider that the Proposed Rules will significantly increase costs of doing business nor will the rules create onerous compliance obligations on us.

That being said, Gleneagle Securities believes that the following issues are of concern to it and other industry members and stakeholders:

1. The period currently set out by ASIC in the Proposed Rule for satisfying the daily reconciliation requirements (24 hours) pursuant to rule 2.2.1 is too short. A longer period would be more suitable as it allows Licensees to review the reconciliation, and identify and rectify any issues within their control before needing to resort to reporting these issues to ASIC. An appropriate time period to satisfy the daily reconciliation requirements would be 72 hours.
2. The time at which Licensees must perform their daily and monthly reconciliations (7 PM) pursuant to rules 2.2.1 and 2.2.2 respectively is inappropriate. This is largely because Gleneagle Securities and most other industry members already undertake a similar daily process as at 5 PM New York Time, at New York Close. Setting the time at which the reconciliations in rule 2.2.1 and 2.2.2 are to be performed in accordance with New York Close is more in line with industry practices and standards.
3. The penalty provisions for contravention of the Proposed Rules are inconsistent with other similar regimes, and further, excessive given the compliance and reporting oriented subject matter that is covered by the Proposed Rules. Gleneagle Securities submits that

the high penalties will undermine the purpose of the rules, and further, will make the rules difficult to enforce unless in the most extreme cases involving fraud and dishonesty. If the purpose of the Proposed Rules, and more specifically their penalties, is to deter non-compliance, then it is submitted that this purpose would be better achieved by a lowering of the penalty levels.

Rule 2.2.1: 24-hour window to perform the reconciliation.

Rule 2.2.1.(3) provides that *"the reconciliations required by [r 2.2.1] must be completed by 7.00 pm on the business day following the business day to which the reconciliation relates"*.

This is read as imposing a 24-hour window after close of business, within which the reconciliation pursuant to r 2.2.1 must be undertaken. There are a number of issues with the chosen 24-hour time frame:

1. 24 hours is insufficient for investigating and rectifying any anomalies which may arise in information received pertaining to client money; and
2. Given any anomalies arising out of unresolved issues relating to client money (arising under 1) will need to be reported to ASIC in accordance with r 3.1.1 – it will create an unnecessary compliance burden on us and other licensees; and
3. For ASIC, this will result in a substantially higher volume of reporting, but the information reported will be of lower quality and prove to be an unnecessary drain on ASIC's resources.

In light of the above, Gleneagle Securities submits that a 72 hour window following New York Close is a more appropriate reporting timeframe. The reasons for this are expanded further below:

1. Occasional anomalies in client money information received

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

- a. 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.
- b. Bank book errors, for example, bank accidentally posts an amount to a Member bank account. This is self-explanatory and the reconciliation issues this would cause are obvious.
- c. Other "black swan" type events, including the ASX crashing (this happened last year) or issues with financial institutions.

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 unnecessarily. Theoretically, larger licensees could be required to lodge reports daily due to the number of unreferenced transactions they receive.

2. *Unnecessary compliance burden under rule 3.1.1.*

Rule 3.1.1(1) provides that:

"[a] financial services licensee must give ASIC a written report that complies with sub rule (2) if:

- (a) The licensee fails to perform a reconciliation [...], or*
- (b) The 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, or*
- (c) The reconciliation [...] identifies a difference between the amount held in Client Money Accounts for all persons and the amount recorded in the licensee's records.*

Rule 3.1.1(4) requires this written report to be given to ASIC within 5 business days after the licensee becomes aware of the failure or difference, if applicable.

Differences in client money account reconciliations are not uncommon. It is possible for these differences to occur on a daily basis for a business such as Gleneagle. But these differences are, as mentioned above, caused by factors completely outside the control of Gleneagle.

Nevertheless, Gleneagle will be forced to report to ASIC on a potentially daily basis. This is a heavy compliance obligation and would be completely remedied by the extension of the 24-hour timeframe to allow Gleneagle to investigate and rectify any differences which have arisen due to these factors.

Moreover, failure to furnish ASIC with this potentially near daily report carries a \$1,000,000 penalty - this will be discussed in further detail below.

3. *Lower quality and higher volume of reporting for ASIC*

Should ASIC insist on the 24-hour time frame, then as mentioned above, Gleneagle (and likely many other industry members) may be forced to submit reports to ASIC on a near daily frequency. These reports will detail differences between client money accounts and our records, but they will not expose any real issues but rather give details about anomalies, book errors, inaccurately-provided client information and other minor issues.

ASIC will be inundated with reports of this kind, which will eat away at ASIC's resources and will completely defeat the purpose of the reporting regime. It is submitted that as a result, ASIC will be prevented from identifying the existence of any real issues regarding client money.

4. *In Summary*

The preparation of reports in accordance with rule 3.1.1 detailing these anomalies would be of no utility for ASIC and create an unnecessary compliance burden and cost on otherwise complying licensees. The real concern, however, is that the reports detailing these unresolved issues (due to the short reconciliation window) would simply make it harder for ASIC to discover where real issues regarding client moneys exist.

It is submitted that a 72 hour reconciliation window will provide licensees adequate opportunity to solve 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.

7pm Reporting Time

Rules 2.2.1(1)-(2) and 2.2.2 provide that “A financial services licensee must perform an accurate reconciliation, as at 7.00 pm [...]”

ASIC should not use 7pm as the time at which “a financial services licensee must perform an accurate reconciliation”.

A more appropriate time “as at” which the accurate reconciliation should occur should correlate with the New York close of trade, being 4:59:59 PM New York time. No doubt all brokers that have chosen to make submissions in respect of the Proposed Rules have identified this as an issue.

7PM AEST is a critical time for Gleneagle Securities and other OTC derivative brokers, as they experience a large volume of their transactions from European and Asian markets at this time. It is around this time that performing a reconciliation of Client Moneys may prove to be particularly onerous.

Furthermore, Gleneagle Securities (and many other well established OTC derivatives brokers) are international businesses. A large amount of our business is generated from clients in overseas jurisdictions, and these clients, as well as other key international stakeholders, all coordinate by reference to New York Close. This is the global standard time for international financial transactions, and Gleneagle Securities coordinates its end-of-day with this time. By setting the time as at which reconciliation must occur to 7PM, ASIC is indicating that it intends for the reconciliation as per the Proposed Rules to occur at the end of business for a given day. If this is indeed ASIC’s aim, then it is respectfully submitted that the correct time to define the end of business for a large amount of industry members is with reference to New York Close, not AEST.

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).

Further still, Gleneagle Securities, like most other industry members, already engages in a reconciliation of client money similar to the kind prescribed by the proposed rules. However, this reconciliation occurs at New York Close. The compliance obligations would, therefore, be quite minimal if the information and results yielded from this process could be applied to satisfy the reconciliation requirements in the Proposed Rules. However, this would only be possible if the Proposed Rules required reconciliation at New York Close. We believe that our current processes and systems could be easily adjusted to undertake the reconciliation required by the Draft Rules, provided that it occurs at New York Close.

Should ASIC insist on a 7pm Reporting time, however, Gleneagle Securities anticipates that significant costs will be incurred due to the necessity of implementing new systems to reconcile the information required by the Draft Rules at the stipulated time.

Penalties

Gleneagle Securities would like to reinforce the observations made by the Australian CFD & FX Association in respect of the quantum of the penalties in the Proposed Rules. Gleneagle Securities joins the Australian CFD & FX Association in submitting that a 1,000 penalty unit penalty:

- a) In most instances, is more proportional to the rule that the penalty is attempting to enforce, and
- b) Is largely more consistent with other ASIC-regulated rule regimes such as the Derivative Transaction Rules or the ASX 24 Market, *Market Integrity Rules*, and

- c) Will be easier for ASIC to administer, thereby better serving the purpose of the rules than a \$1,000,000 penalty

Proportionality

ASIC should use the power given to it to set the maximum penalties for a breach of a rule as a means of communicating to the Court the perceived seriousness of the offence. Gleneagle Securities is of the view that the majority of the rules within the Proposed Rules do not lend themselves to the imposition of \$1,000,000 penalties. Given that nearly every rule is capable of contravention in a technical, minor and accidental way, and further that most rules deal with reporting and compliance in a strict liability manner, it is submitted that \$1,000,000 penalties are not appropriate for the rules as they currently stand.

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.

Consistency

Ideally, there ought to be a level of consistency between the Proposed Rules and their penalties and other similar ASIC-regulated regimes, as well as other comparable provisions of the *Corporations Act*.

The Proposed Rules as they currently stand fail to achieve this end. For example, the imposition of a \$1,000,000 penalty for the failure to keep adequate records by r 2.1.1 can be contrasted to the 1000 penalty unit (\$210,000) penalty for essentially the same conduct under Chapter 2 of the *ASIC Derivative Transaction Rules (Reporting)* 2013.

Further, CP 291 at paras. 12-13 seems to suggest that the Proposed Rules (and associated penalties) have been designed with the goal of consistency with the *ASIC Market Integrity Rules (ASX 24 Market)* 2010. One such instance where ASIC has failed to attain this goal is clear when comparing r 3.1.1 of the Proposed Rules with r 2.3.4 of the *ASIC Market Integrity Rules (ASX 24 Market)* 2010.

Rule 2.3.4 provides that:

- "[a] market participant must notify ASIC in writing, within 2 business days if:*
- a) a reconciliation has not been performed, or*
 - b) according to a reconciliation [...] Total Deposits is less than Total Third Party Client Monies; or*
 - c) if it is unable to reconcile its clients' segregated accounts."*

This rule is directly comparable to r 3.1.1 in the Proposed Rules (extracted above), save for one aspect: r 2.3.4 carries with it a \$100,000 penalty, whereas r 3.1.1, for essentially the same conduct, carries with it a \$1,000,000 penalty. It is questioned whether a ten-fold increase in the quantum of the penalty is justified solely on the basis of market in which they are used and the type of business dealing with them.

Ease of administration

Gleneagle Securities submits that the case that ASIC may be required to meet when attempting to secure a civil penalty order in Court will be made all the more difficult by ASIC's decision to impose \$1,000,000 penalties for contraventions.

It is first difficult to imagine the type of conduct that would be necessary for a Court to be willing to impose a \$1,000,000 penalty for a contravention of these rules. Such conduct, it is submitted, would likely require extreme recklessness, fraud or dishonesty - meaning it will attract the operation of other *Corporations Act* provisions, which will likely be better suited to that form of conduct.

It is also submitted that the standard of proof required of ASIC is heightened by the penalty level. Courts applying the *Briginshaw* standard may require more convincing and conclusive evidence in circumstances where a declaration of contravention may result in severe consequences against the contravening party.

The alternative to this is to set the penalty levels at more reasonable amounts, which accord more closely with the seriousness of the conduct proscribed. This will allow ASIC to confidently bring cases against a large number of contravening parties without a great deal of resistance from the Courts, or indeed from the contravening parties themselves.

This is not to say that the penalty levels should be set so low as to be insignificant. The quantum proposed: \$210,000, is sufficient enough to act as a deterrent, will not cause unnecessary obstacles in its administration, and furthermore, is still a significant enough penalty in, especially in circumstances of repeated contravention.

The alternative to what has been proposed above, in our respectful submission, is that ASIC will only be able to pursue matters which are clear-cut breaches easily established on evidence, and even then, ASIC will struggle to ever make a case for the imposition of a \$1,000,000 penalty.

We also agree with the Association that the penalties attaching to the Proposed Rules may attract:

- a) Penalty privilege – leading to enforcement obstacles; and
- b) May be punitive rather than deterrent in character. The consequences to ASIC of this are well known.

Once again, Gleneagle Securities thanks ASIC for the opportunity to prepare these submissions.

Kind regards,

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