

15 March 2021

Craig McBurnie  
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Market Infrastructure  
Australian Securities and Investments Commission  
Level 5, 100 Market Street, Sydney, NSW 2000

via e-mail: [otcd@asic.gov.au](mailto:otcd@asic.gov.au)

Dear Mr McBurnie,

**Re: Feedback to CP 334 – Proposed changes to simplify the ASIC Derivative Transaction Rules (Reporting)**

Further to ASIC's release of Consultation Paper 334 please find attached Equity Trustees Limited (EQTL) feedback. Specific and detailed response is provided in respect to question H2Q1 as requested in e-mail correspondence of 11 February 2021 with Sheridan Hure, given EQTL's reliance on delegation of reporting activities to investment managers.

However, in commenting on the proposed changes EQTL would make the following wider observations:

1. The stated regulatory objective of the OTC Derivative Transaction Reporting Rules is to assist regulators in identifying systemic vulnerabilities arising from OTC trading positions and counterparty exposures. Further, they are intended to inform market surveillance activities and regulatory policy. With the reporting requirements having been in place for an extended period, global regulators, including ASIC, should now be in a position to comment on how successful the reporting requirements have been and, crucially, the extent to which systemic vulnerability has altered (presumably reduced) since their introduction.

At this stage the premise of the Consultation Paper appears to be on the harmonisation of global data definitions and standards rather than a review of the relative success or otherwise of the reporting regime to date in fulfilling its regulatory objective. The ESMA Final Report is similarly silent on analysis of the fulfilment of the regulatory objective. International harmonisation is of some benefit albeit not cost free to the industry and more particularly investors, who will ultimately bare that cost either through fees to fund the amended regulatory reform or in the increased volatility in their investments if asset managers alter investment strategies to reduce the use of derivatives for hedging purposes. Harmonisation alone is not a particularly useful regulatory objective and therefore the Regulatory Impact Statement and analysis should be attached to reduction of systemic vulnerability and the marginal benefits that will be derived from the alteration of the existing reporting rules.

2. We believe ASIC should consider the desired outcome in amending the reporting requirements. In assessing systemic vulnerability, the question of absolute accuracy of market exposure vs order of magnitude is of relevance given it comes with a very different cost profile to industry. If the regulatory objective is to monitor the exact daily positions of global financial institutions to understand systemic exposure and vulnerability, to enable ASIC and other regulators to step in at a (hitherto undefined) point of concern prior to coming under financial stress, then clearly, international harmonisation of data standards and





attendant linking of reporting and analysis is desirable. Community and investor expectation of timely regulatory action armed with such information should commensurately increase to ensure systemic risk is not allowed to develop and does not threaten the financial system. This is a marked shift for most regulators who typically do not work to a zero-failure regime.

The alternative course is for regulators to be furnished with sufficient information to understand an "order of magnitude," rather than exact, level of exposure for global financial institutions to allow them to adjust regulatory policy in advance and take timely action in relation to individual institutions to avoid catastrophic consequences of individual institutional failures. This would appear, on the face of it, to be a more realistic regulatory goal, and the extent to which alteration of current rules and introduction of ever-increasing complexity, may be somewhat muted.

3. As ASIC is aware, in a small number of instances since the introduction of the existing OTC Reporting Rules, EQTL has breached the requirements. In line with EQTL's breach assessment process they have been assessed and reported to ASIC where deemed material. EQTL understands other market participants have done likewise. In those instances these breaches have been self-identified and reported rather than a result of ASIC's data analysis identifying anomalies. This is not to say that EQTL believes that financial institutions should not hold primary responsibility for identifying and reporting such breaches. However, it does suggest that a reporting regime designed to identify systemic vulnerability is not achieving that objective if it is unable to identify such anomalies. It is assumed (although not explicitly stated) that the international harmonisation of data requirements will better enable ASIC and other regulators to do so. However, it is also notable that such changes will significantly increase regulatory cost and complexity both initially and on an ongoing basis as different regulators re-calibrate their requirements from time to time.

It would appear to EQTL that a much more efficient, and likely more effective, mechanism for ASIC and other global regulators to achieve their regulatory objective would be to impose the OTC derivative reporting requirements on globally systemic financial institutions (G-SIFIs) given they are the target of the regime and are the best placed to report on their own exposures, given they are the point of aggregation of those exposures. These institutions should be readily identifiable from the existing data, albeit are likely already known to regulators even without the substantial data available. This would significantly reduce the complexity and very high cost of compliance for the whole industry with requirements that appear not to be particularly effective. In addition to other existing regulatory settings aimed at G-SIFIs across the globe it also provides a disincentive to becoming a systemically significant institution which presumably aids in the achievement of the regulatory objective.

4. EQTL welcomes the proposal to clarify the approach to Alternative Reporting. EQTL has made enquiries of ASIC in this regard previously and been somewhat confused by the negative response given the provision for it within the rules. In response EQTL put in place appropriate reporting requirements to meet the ASIC rules rather than relying on Alternative Reporting.

EQTL would note however that It is counterintuitive that as the data standards and reporting rules harmonise the provision for Alternative Reporting would appear to be reducing in a number of jurisdictions including Australia. There should be congruence in the altering regulation and provision for Alternative Reporting.




5. EQTL strongly disagrees with the proposal to remove the opportunity for delegated reporting. Specific response to H2Q1 is provided below however EQTL would note that the delegation of derivative reporting to those most proximate to the trade, in EQTL's case the investment manager, is far more desirable to ensure accuracy and timeliness in reporting. Reversion of the reporting activity to EQTL would serve no purpose other than to delay the reporting, compromise the quality of data and impose an enormous compliance cost on Managed Investment Schemes for which EQTL acts as Responsible Entity – a cost that would be passed on to investors, for no discernible benefit to investors. The introduction of such inefficiency would also compromise ASIC's regulatory objective and increase ASIC's own costs in analysis and querying of data.

A more effective mechanism would be to provide further guidance on the monitoring activities expected of delegators following this consultation.

Please do not hesitate to contact me should you have any queries in relation to this response.

Yours sincerely,

  
Qwen Brailsford  
Chief Risk Officer  
Equity Trustees





## Appendix 1 – Equity Trustees response to CP334 Proposal H2Q1

H2Q1 - In this first consultation we seek to gather information about the practices of reporting entities in overseeing their delegates in order to better inform any future proposals we may make in relation to delegated reporting in the second round of consultation. In particular: (a) What are the specific processes and practices that you rely on to determine if the delegate is complying with the terms of the delegation agreement and to ensure that complete, accurate and current reporting is being carried out on your behalf?

Equity Trustees Limited (EQTL) follows an operating model under leading specialist service providers are appointed to provide services to the funds for which we act as responsible entity or trustee, unless we form the view that a particular function is best carried out by EQTL itself. We then undertake monitoring and oversight of these service providers.

Under this operating model, and as contemplated by ASIC Regulatory Guide 251: Derivative transaction reporting (**RG 251**), we delegate to the fund investment managers (each, an **Investment Manager**) the OTC trade repository reporting and monitoring functions that sit with us as reporting entity under RG 251. EQT considers that delegation these functions is the most appropriate approach given following:

- It is the Investment Manager which makes the day to day investment decisions in relation to a fund's portfolio, has the counterparty relationships, executes the OTC transactions, records the transactions in their systems and reports the transactions to the fund custodians and administrators;
- EQTL does not readily have access to this information on a daily basis and hence would be unable to undertake directly the detailed level of reporting involved without a substantial time and financial investment, and a significant change in this operating model;
- If EQTL were to undertake these functions itself, it would still be heavily reliant on Investment Managers (and other service providers) for gathering and collating the required information;
- In EQTL's view, the additional cost of carrying these functions itself is unlikely to deliver a commensurate benefit in terms of consumer protection or market integrity; and
- EQTL has implemented a number of measures (outlined below) designed to [mitigate the risks of outsourcing these functions and to ensure that complete, accurate and current reporting is being carried out on EQTL's behalf].

Set out below is an outline of our processes and practices with respect to the delegation of these functions:

1. **Establishment of new funds** – prior to the establishment of a new fund, information in relation to the intended use of OTC derivatives and proposed trade repository reporting mechanism is obtained from the proposed Investment Manager (and reflected in the term sheet for the proposed new fund). On advantage of this is that it opens the conversation with any Investment Manager who may be unaware of the reporting requirements and enables the establishment of appropriate reporting arrangements. Each new fund must be approved by EQTL's Due





Diligence Committee (DDC) and a new fund proposal cannot be presented to the DDC for approval until the term sheet is complete (including in relation to OTC reporting).

2. **Documentation of reporting obligations** – EQTL's standard investment management agreement (IMA) contains a template delegation clause for OTC derivative reporting - see clause 6 of the IMA attached (**Delegation Clause**), under which:

- a) reporting and monitoring responsibility is delegated to the Investment Manager (generally, the Investment Manager may either report directly or obtain single sided counterparty reporting representations on our behalf);
- b) the Investment Manager's obligations with respect to reporting are clearly spelt out, including the obligation to:
  - i. immediately notify EQTL when it becomes aware of any errors or omissions in the relevant data submitted to the Trade Repository;
  - ii. provide quarterly certifications to EQTL with respect to the discharge of reporting obligations; and
  - iii. provide to EQTL all such assistance as EQTL reasonably requires in relation to its reporting obligations.

All new IMAs contain the Delegation Clause and, where a new fund is being setup for an existing client where the Delegation Clause is not currently in the existing IMA, it will be added by the amending agreement relating to the creation of the new fund (if relevant). There is also an ongoing project to incorporate the Delegation Clause in the IMAs with other relevant Investment Managers.

3. **Compliance and monitoring of delegates** - the monitoring of delegates is undertaken in a number of ways, including as follows:

- a) The monitoring of the reporting obligations in relation to OTC derivative reporting is specifically dealt with the EQTL Master Compliance Plan (the relevant parts of which are incorporated by reference in the plans for other funds), which sets out specific compliance controls and allocates responsibility for them.
- b) Quarterly attestations are obtained from each Investment Manager in relation to meeting their obligations under the OTC reporting delegation, including that they have reported transactions and positions in accordance with RG 251.
- c) There is annual Investment Manager due diligence process, which includes an annual questionnaire containing specific questions in relation to the OTC reporting (including confirmation that the Investment Manager has processes and procedures in place to meet their obligations under the Delegation Clause in the IMA).
- d) EQTL's incident and breach process requires service providers (including Investment Managers) to notify EQTL of any incident or breaches, including in relation to the OTC reporting, within 48 hours of identification. EQTL then manages the incident to ensure appropriate corrective action and/or reporting is undertaken.