

Wednesday 3rd October 2012

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
Canberra ACT 2600
Australia
By email to: corporations.joint@aph.gov.au

Re Corporations Legislation Amendment (Derivatives Transactions) Bill 2012 - Response to Parliament of Australia request for comment by The Finance and Treasury Association.

The Finance and Treasury Association welcomes this opportunity to again consult with the Government on proposed regulation of over-the counter derivatives transactions which have the potential to change the way our members do their vital work of managing financial risk on behalf of Australian corporations.

(To ensure consistency, we again refer to key principles explained in detail in FTA's submission in June 2012 to the Treasury consultation paper on Implementation of a framework for Australia's G20 over-the-counter derivatives commitments. http://finance-treasury.com/files/files/pdf/FTA_submission_to_Treasury_consultation_on_the_G20_derivatives_proposals2_FINAL.pdf

FTA acknowledges that work must continue apace to ensure Australia is able to implement commitments made at the 2009 G-20 Summit in Pittsburgh that over-the-counter (OTC) derivatives will be able to be reported, centrally cleared, and exchange traded. We note the Corporations Legislation Amendment (Derivatives Transactions) Bill 2012 allows regulations and rules to be made to specify the details of these obligations.

In responding to the Treasury consultation, FTA took comfort in its Explanatory Document that Treasury acknowledged a key message from prior consultations which is that "some stakeholders argued their use of derivatives was primarily for the hedging of business risk and questioned the systemic importance of their derivatives trading activities".

However within the same response, FTA noted "**there may be a negative real economy impact from application of these OTC derivative regulations on the corporate sector and FTA asked that that regulators [should] first seek to determine the full cost-benefit equation of the**

proposed reforms". FTA's view is that any extra costs and complications often end up being borne by the end user which ultimately dampens economic activity - so regulators need to be careful what they impose.

FTA members are heartened by Minister Shorten's comment in the second reading speech that "prior to making any decision to mandate reporting, central clearing or use of trading execution venues, the government will engage with stakeholders further and consider any advice from the Council of Australian Regulators."

FTA recognises that Australia is obliged to act quickly to ensure Australian businesses and investors are "able to demonstrate they are subject to an equivalent regulatory regime and so be able to continue to participate in the major derivatives markets of the world while still being primarily regulated in Australia".

FTA also recognises that the key risk of "regulatory arbitrage" between jurisdictions is being addressed by the Government's swift action which will allow Australia's financial regulators "to work with their international counterparts to ensure a unified approach to regulation of the global OTC derivatives markets".

Our members see the establishment of the framework (through amendments to the Act) does not in itself introduce any trade reporting, central clearing or trade execution obligations for OTC derivatives transactions. Rather, the framework creates a mechanism by which such obligations may be implemented by supporting regulations and rules.

FTA notes that under these amendments, The Minister for Financial Services and Superannuation will be empowered by the Corporations Act, 2001 as amended to prescribe a certain class of derivatives. Furthermore we recognise ASIC will be the agency charged with implementation which it will enforce via derivatives transaction rules (DTR) and also by administering carve outs and exceptions.

Corporate Financial Risk Management

FTA members are encouraged that the Minister's intention is to "ensure that Australian businesses can continue to participate in global markets while being primarily regulated in Australia" and "to avoid the unintended consequences of ... [a] ... burden on businesses of duplicated or conflicting rules and the costs of reduced access to international markets."

However FTA is concerned the regulation may be introduced without modelling of the real economic impact. Australian corporate treasurers wish to retain unfettered access to international markets yet fear the impact of the new derivative rules on the basic business of

interest rate and foreign exchange hedging. FTA reiterates that corporations are large users of financial derivatives and these transactions are primarily used to manage financial risk positions created through ongoing business operations or funding activities. FTA is particularly concerned to ensure its Australian corporate treasurer members will continue to be able to use flexible OTC instruments such as forward foreign exchange contracts, interest rate swaps and cross currency swaps and these vital tools not be made prohibitively expensive nor administratively unworkable.

2011 FTA Corporate Treasury Survey revealed that 98% of treasurers surveyed used interest rate swaps, over 80% used forward foreign exchange contracts while 57% (and most larger corporations) use cross currency swaps.

FTA considers deals done by non-financials (particularly corporations) are a tiny part of the derivatives markets here and abroad, and are not material in their impact on systemic risk and hence should be exempted from the proposed rules.

As corporations are not the only-users of these instruments, FTA proposes to work with Government and financial regulators to develop an approach, perhaps requiring “carve-outs”, which work best for non-financial corporations while retaining the spirit and systemic impact of the proposed rules. (Meanwhile FTA will run a discussion at its *Annual Congress in Melbourne on November 2nd* on this same issue.)

Specific concerns

FTA sees the core of the draft bill concerns a new licencing regime to be introduced for a new kind of entity, trade repositories. We note the draft bill provides protections of trade data through imposing restrictions on the use and disclosure of reported data. In such regulations often “the devil is in the detail” so FTA will monitor how these rules are administered by ASIC.

FTA considers OTC trade repository information on corporate hedging should only become publicly available with a significant lag and on a basis where names could not be determined by the nature of data released. And FTA considers that there is a risk of breaching of commercial-in-confidence arrangements.

Clearly for the data to have any utility, there is a need for various parties to be able to use the data i.e. analyse and research it. However as stated in our prior submissions, we question how domestic and global regulators will make any use of so much of the data and would like to see an **exposition of planned use of the data.**

We also seek more confirmation that **ownership of a data depository** should not confer property rights to the trade information and as discussed above we propose the business of these entities be conducted on a mutual not-for-profit basis.

We note the new DTRs will oblige a person to utilise the services of a trade repository, clearing facility or trading platform, so FTA accepts that there is provision for rules which impose a duty upon the relevant facility to provide non-discriminatory access a trade repository, as basically it is “only data”. It will be up to the designers of trade repository databases and researchers to ensure that the data makes sense and that there is sufficient homogeneity in the datasets being analysed.

However, we consider the same **non-discriminatory access principle should not be applied without further consultation to the other two forms of mandated financial infrastructure entities**, central clearing and exchange platforms.

To provide non-discriminatory access to central clearing and exchange platforms may be to put at risk the very purpose of creating them as a way reducing aggregate systematic risk. While it is desirable that like instruments and counter-parties be grouped together, the OTC derivative industry is characterised by a high degree of heterogeneity of instruments and differing credit risks among banks and other types of counter-parties. Incompatible risks and agents should be capable of being excluded. The design of such systems, standards and protocols must involve experts within industry and representative bodies rather than regulators operating in isolation.

Conclusion

- Corporations are large users of financial derivatives in Australia. These transactions are primarily used to manage financial risk positions created through their ongoing business operations or their funding activities.
- FTA is particularly concerned to ensure its Australian corporate treasurer members will continue to be able to use flexible OTC instruments such as forward foreign exchange contracts, interest rate swaps, and cross currency swaps.
- FTA’s primary concern is for such prudent corporate risk management tools to not be made prohibitively expensive nor administratively unworkable.
- Given the potential negative real economic impact, FTA recommends if regulators are considering imposing these OTC derivative regulations on the corporate sector, that they first seek to determine the full cost-benefit equation of the proposed reforms. Any extra costs and complications end up being borne by the end user and dampen economic activity, so regulators need to be careful what they impose.

- FTA considers deals done by non-financials are a tiny part of the derivatives markets here and abroad, and therefore not material in their impact on systemic risk and should be exempted from the proposed rules.
- FTA considers OTC trade repository information on corporate hedging should only become publicly available with a significant lag and on a basis where names could not be determined by the nature of data released.
- FTA considers that to provide non-discriminatory access to central clearing and exchange platforms may be to put at risk the very purpose of creating them as a way reducing aggregate system risk.

FTA continues to seek for Australian entities an appropriate exemption for derivatives being used by corporations for risk management purposes which would protect the non-standardised way they manage risk and in turn avoid unintended consequences to real economy activity.

We look forward to working with the Government and financial regulators on the next stages of the consultations and the design of the institutional framework.

Yours faithfully,

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About FTA

The Finance & Treasury Association (FTA) is a professional association for executives working across all aspects of treasury and financial risk management. The FTA provides training and skills development and access to current information, facilitates networking and builds a community in this specialised area of business. It seeks to increase recognition of the skills of members and to convey the views of members on key technical issues facing the profession to government, other associations and the wider community.