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TO:

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13 September, 2016

Re: Treatment of Securities Conversion Transactions under the ASIC Corporations (Derivative Transaction Reporting Exemption) Instrument 2015/844

Dear Sir/Madam,

As a result of the expiry of the relief on 30 September, 2016 afforded to FX Security Conversion Transactions, Exemption 9, contained in the *ASIC Corporations (Derivative Transaction Reporting Exemption) Instrument 2015/844* that came into force on 29th January, 2016, the GFXD wishes to apply, on behalf of its members, for a temporary time-bound exemption regarding the reporting of these transactions.

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial

Markets Association (ASIFMA). Our members comprise 24 global foreign exchange (FX) market participants,[1] collectively representing approximately 85% of the FX inter-dealer market.[2].

1. What are the Facts?

Many of our members act as custodian for their customers who are asset managers. Due to increased access to and investor interest in foreign financial markets, growing numbers of these customers are invested in foreign securities. To facilitate the purchase or sale of these foreign securities, these custodians, as part of their service offering, often enter into an FX transaction that is incidental to and for the purpose of effecting their customer's foreign security transaction. For example, when a non-US customer wishes to purchase a US dollar-denominated security, its broker-dealer or bank custodian will enter into a corresponding FX transaction so that the customer has US dollars available to meet the cash currency requirements necessary to complete purchase or sale of the security. These FX transactions are, therefore, integral to the settlement of the security.

Typically, the settlement cycle for most non-EUR denominated securities is trade date plus three days (T+3). Accordingly, the bank custodian or broker-dealer would enter into a FX transaction with its customer on a T+3 basis as well. In some securities markets, for example in South Africa, the settlement cycle can take up to seven days (T+7).

2. What is the impact of legislative provisions or existing ASIC policy?

Under Section 761D(1)(b) of the Corporations Act 2001 and the corresponding Corporations Regulation 7.1.04(1)(a), foreign exchange contracts with a tenor of more than 3 business days are classified as "derivatives" and are subject to the Reporting Rules.

However, a number of global regulators deem FX Security Conversion Transactions to be 'spot' transactions and therefore out of scope for reporting and other G20 market regulations.

3. What is the relief sought?

This application requests that a further 2 year exemption, until September 2018, be granted to the reporting of FX Security Conversion Transactions relief as set out in the *ASIC Corporations (Derivative Transaction Reporting Exemption) Instrument 2015/844*.

This application is a minor and technical application in accordance with Regulatory Guide 51 as it involves the application of existing policy to existing situations.

The length of the exemption is designed to coincide with the publication of work asked of the CPMI/IOSCO by the FSB to develop global guidance on the harmonisation of data elements reported to trade repositories. Once the CPMI/IOSCO guidance has been issued, we would recommend that the *ASIC Derivative Transaction Rules (Reporting) 2013* are amended to reflect the guidance provided on FX Security

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[1] Bank of America Merrill Lynch, Bank of New York Mellon, Bank of Tokyo Mitsubishi, Barclays Capital, BNP Paribas, Citi, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds, Mizuho, Morgan Stanley, Nomura, RBC, RBS, Société Générale, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac.

[2] According to the 2016 Euromoney league tables.

Conversion Transactions. This will ensure the harmonised treatment for these transactions across all jurisdictions that have implemented derivatives transaction reporting regulation.

4. Why should the relief be granted?

This relief continues to remain relevant for the same reasons as set out in our letter dated 29th August, 2014 issued in response to the *Proposed amendments to ASIC Derivative Transaction Rules (Reporting) 2013*.

At that time, in the United States, the CFTC considered that transactions for the sale or purchase of an amount of foreign currency to effect the actual delivery of a security by the relevant securities deadline to be a bona fide spot FX transaction, and therefore outside of the definition of a "swap"[3].

Since then, the European Commission published its Delegated Act[4] covering the definition of an FX spot contract on 25th April, 2016. The Delegated Act states that an FX spot contract includes "a contract for the exchange of one currency against another currency….where the contract for the exchange of those currencies is used for the main purpose of the sale or purchase of a transferable security or a unit in a collective investment undertaking, [and delivery is scheduled to be made within] the period generally accepted in the market for the settlement of that transferable security or a unit in a collective investment undertaking is the standard delivery period or 5 trading days, whichever is shorter." By being classified as a spot transaction, these FX Security Conversion transactions are not a "financial instrument" for the purposes of, and therefore are outside the scope of MiFID/MiFIR.

Similarly, the regulatory authority in Singapore has defined transactions used solely to fund the purchase or sale of a foreign security where the settlement period is greater than T+2 days as an FX spot contract and are thus outside the scope of OTC derivatives regulation within its jurisdiction.

Furthermore, in a joint HKMA/SFC Consultation conclusion and further consultation on introducing mandatory clearing and expanding mandatory reporting issued in February 2016, the HKMA recognised that the inclusion of FX Security Conversion transactions under mandatory reporting would be of minimal value. Consequently, FX Security Conversion transactions with a T+7 day cap on the settlement period were excluded from mandatory reporting.

Subjecting these transactions that are incidental to related securities transactions to OTC derivatives regulation would expose bank custodians, broker-dealers and their customers to unnecessary operational, price, credit and other risks. As a result, participants may restrict FX Security Conversions to T+2 FX spot contracts, even when the securities settlement takes longer, thereby exposing the customer to FX risk while exposing the bank to certain operational risks and changing the long-standing and well-functioning settlement processing for systemically relevant securities markets that exist today.

Applying OTC derivatives regulation to this type of incidental transaction does not provide any meaningful protection to participants (in the form of disclosures) or meaningful information to the regulatory authorities (in the form of regulatory reporting).

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[3] https://www.gpo.gov/fdsys/pkg/FR-2012-08-13/pdf/2012-18003.pdf

[4] http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2398-EN-F1-1.PDF

Furthermore, inconsistent treatment of these transactions globally should be avoided to ensure that the lack of exclusion for FX Security Conversions from OTC derivatives regulation in some jurisdictions doesn't create unnecessary disincentives from transacting in securities in those jurisdictions by raising their transactional costs relative to other jurisdictions which have excluded them.

As there is not a requirement to report FX Security Conversion Transactions in other jurisdictions, a system build would be required to identify and report these transactions for entities required to report under the *ASIC Derivative Transaction Rules (Reporting) 2013*. This build would be complex and expensive given the diverse trade capture systems and booking methodologies and methods used by international entities. In addition, any development would be time consuming given the need to resource the definition, development, testing and implementation of a solution for a very small number of trades that are reported globally.

Given the different number of trade capture systems as well as booking methodologies and methods it is extremely difficult to quantify both the number of trades impacted and the cost of such a bespoke development. The situation is further complicated by the fact that some of our members act in the capacity of a custodian bank and so will have a material volume of Security Conversion Transactions, whereas others act in the capacity of an executing dealer servicing the requirements of their clients and so will have a much lower volume. One member has estimated that as much as 50% of their reportable volume, approximately 500 trades per week, to be Security Conversion Transaction related. Another has estimated that their volume is just 1%, or approximately 20 trades per week, of their reportable volume.

Since the introduction of the reporting obligations by the CFTC at the end of 2012, reporting entities have spent considerable amounts of money in developing solutions to meet the multi-jurisdictional obligations. It has been estimated that to introduce this change to their existing reporting infrastructure would cost several hundred thousand USD for each impacted reporting entity. However, this estimate could increase if banks have multiple trade capture systems and/or have implemented solutions to meet their multi-jurisdictional reporting obligations.

5. What conditions should be imposed on the relief?

We do not believe that any conditions should be placed on the relief as there would be no adverse regulatory impact or any impact to third parties.

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Please do not hesitate to contact John Ball on +852 2531 6512, email jball@gfma.org should you wish to discuss any of the above.

Yours faithfully,

James Kemp
Managing Director
Global Foreign Exchange Division, GFMA