



AUSTRALIAN BANKERS' ASSOCIATION INC.

David Bell
Chief Executive Officer

Level 3, 56 Pitt Street
Sydney NSW 2000
Telephone: (02) 8298 0401
Facsimile: (02) 8298 0402

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Ms Michele Bullock
Head of Payments Policy
Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
SYDNEY NSW 2001
pysubmissions@rba.gov.au

Dear Ms Bullock,

Disclosure of Equities Securities Lending

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments on the Reserve Bank of Australia's consultation paper on the *Variation of the Financial Stability Standard for Securities Settlement Facilities: Disclosure of Equities Securities Lending*.

1. General observations

Australia's financial and capital markets are well regarded for the strength of our regulatory regime and banking and finance sector. Sound practices increase investor confidence, promote market efficiency and enhance the competitiveness of Australia's banking and finance sector and economy as a whole. It is, therefore, important for Australia's markets to ensure it preserves a regulatory and governance framework that maintains the highest levels of market integrity and investor confidence, without compromising opportunities for adoption of new technologies, innovation in trading strategies and settlement processes, and international competitiveness.

It is the ABA's view that any changes to laws, regulations or market rules regarding securities lending should seek to contribute to promoting financial stability without imposing unnecessarily burdensome obligations on participants. Regulation should not unnecessarily restrict securities lending arrangements, but rather address uncertainty regarding securities lending and concerns with potential settlement risk. In addition, regulation needs to be cognisant of regulatory standards and approaches being adopted in overseas markets.

The ABA has been liaising with ASIC with regards to the banking sector's views about short selling and the Government on the *Corporations Amendment (Short Selling) Bill 2008*. We believe any new rules must be streamlined to avoid unnecessary multiple data collection points and reporting systems, as such an approach would be inefficient, costly and potentially counter productive. For example, the law should not require real time tagging

of orders that are short sales and simultaneously require reporting of stock lending transactions seeking to capture data for the same purpose¹, as this approach will unnecessarily increase the regulatory burden on business for no additional benefit. However, if existing systems and processes can be modified so that data is captured and reported for discrete purposes, and with minimal additional compliance burden, the ABA would support enhanced disclosure of short selling activities and enhanced disclosure of securities lending activities.

2. Specific comments

Short selling and securities lending contributes to market efficiency, market liquidity, lower transaction costs (i.e. bid-offer spreads) and price discovery. In addition, securities lending assists in managing settlement risk by ensuring trades settle on time, even at times when the market experiences disruption or when market participants experience operational problems.

The ABA supports improving transparency of securities lending arrangements and enhancing disclosure of securities lending activities by publishing aggregate data on accumulated outstanding on-loan positions in individual stocks. We believe that improved disclosure will enhance financial stability and enable more effective supervision of the settlement process. In addition, it will promote a better understanding of market functionality and ensure that all participants have access to data on the volume and value of securities lending.

The ABA recognises that securities lending is often motivated by the need to cover short sales, whether these short sales be directional trades, hedging transactions, market maker transactions or arbitrage transactions. However, securities lending can occur for reasons unrelated to short selling, including borrowing to cover potential failed trades, financing trades or dividend-driven transactions.

A disclosure requirement for securities lending arrangements should seek to make available consistent and reliable data to the market. It will, therefore, be important to ensure that the disclosure requirement results in the capture and reporting of data that is meaningful and contributes to a fully informed market.

2.1 Disclosure requirement—precise wording of amendment

The ABA generally supports the proposal to vary the Financial Stability Standard and associated guidance and adopt a principles-based approach to disclosure of securities lending data. This approach will allow participants to design and implement systems and processes that leverage existing systems and processes, thereby minimising unnecessary compliance costs. However, while a principles-based approach is preferred, it should be clear that the reporting requirement should be limited to information necessary to assess the potential implications for settlement risk.

The ABA raises a number of issues for further consideration, including:

- *Purpose of the transaction:* The ABA notes that securities lending data will be limited to data provided by users of CHES, however, in many cases participants will not have information about whether the underlying transaction relates to a

¹ The ABA notes that the explanatory memorandum to the exposure draft *Corporations Amendment (Short Selling) Bill 2008* included an option of using securities lending data as a proxy for short sales data.

securities lending transaction. Will a custodian or market participant be required to inquire every transaction that is processed? Could this potentially delay and exacerbate the potential for settlement risk and settlement failures as transactions are checked? It is unclear how the disclosure requirement will operate in practice.

- *Offshore borrowers:* The ABA notes that there is significant securities lending undertaken offshore to Australia, which is unlikely to be captured under the proposed disclosure regime and therefore may result in significant understating to the market of the volume of securities lending being carried out in Australian securities. For example, a borrower and a lender may use the same global custodian. The loan can be arranged directly between the parties under an omnibus arrangement where the securities can be transferred in the global custodian's books without the underlying sub-custodian even being aware of the transaction. There is not always a change in the registered owner of the stock within Australia. Similarly, loans can be made directly between borrowers and lenders and instructions issued to the sub-custodian to deliver stock "free of payment" to a third party with no reason provided as to the purpose of the transaction. It is unclear how the reporting requirement will apply to sub-custodians and offshore borrowers. It is also unclear whether public disclosure of data collected on this basis may mislead the market.
- *Intermediary lending:* The ABA notes that intermediary lending arrangements may result in multiple disclosures relating to the same parcel of securities that are on-lent and therefore may result in overstating to the market of the volume of securities lending being carried out in Australian securities. It is unclear whether data can be reconciled and/or whether this will decrease the quality of data.
- *Commercially sensitive information:* The ABA notes that the disclosure of securities lending arrangements may result in the disclosure of confidential proprietary information.

The ABA believes that any new reporting requirements should impose an obligation on participants that are securities lenders, and not on other participants that may be securities borrowers, to report securities lending activities irrespective of location. If an obligation is placed on both lenders and borrowers this would unnecessarily increase the regulatory burden, and undermine the objective of enhancing transparency of securities lending arrangements.

Given the issues we have raised above, it is pleasing that the RBA and the ASX have indicated that further consultation on operational factors and technical and practical considerations will take place with market participants, custodians and system suppliers. Adequate time should be allowed for consultation with industry representatives to ensure the exact nature of any rule changes and reporting requirements can be assessed.

2.2 Alternative arrangements for disclosure

The ABA supports utilising CHES or another system to facilitate data capture and reporting, i.e. matching field, subject to the continuation of straight-through-processing. A settlement instruction could be entered into the system as related to a securities loan – either a new loan or loan return. It will be essential that data capture and reporting excludes the 'chain of loans', otherwise quality of data will be adversely affected.

The ABA notes that the market operator/ASX would be responsible for capturing tagged data reported by participants, consolidating/aggregating loan data and disseminating aggregate data on accumulated outstanding on-loan positions in individual stocks. Collection of data could be on an end-of-trading day basis and published prior to the next trading day.

The ABA understands that the IT infrastructure to undertake the necessary levels of disclosure between participants and the market operator is generally already in place. However, data fields would need to be modified, and therefore market participants/custodians and system suppliers would need to make changes to current systems and processes to comply. The ASX would also need to make changes to CHES and other systems to consolidate and publish data as well as make changes to ASTC rules to meet the disclosure requirement.

The ABA notes that the Government is looking to introduce new reporting requirements for short selling activities. Given the low rate of settlement failures in Australia, we believe that there should be careful consideration of whether increased scrutiny of securities lending activities and disclosure of securities lending activities (in addition to the collection and dissemination of short selling data) is justified.

2.3 Compliance costs

The ABA notes that it is difficult to make comment about compliance costs with the new reporting requirement until the reporting methodologies are agreed and the system and process implications are identified. However, any reporting requirement will require modifications to "tag" transactions and continue with the current high levels of straight-through-processing achieved. System and process enhancements will be required to comply.

2.4 Implementation issues

The ABA recognises that the RBA believe that there is a strong case for implementing the disclosure requirement as soon as possible, and therefore is proposing the new disclosure requirement take effect by the end of March 2009. We are concerned that this will be not adequate time for market participants, custodians and systems suppliers to make the necessary system and process enhancements.

Any changes should recognise that market participants, custodians and system suppliers will need some time to implement systems and processes and adjust to any new settlement rules, including IT infrastructure required to support data capture and reporting. A system-based solution should be pursued as a manual or direct reporting obligation would unnecessarily increase the burden on business. It will, therefore, be important to ensure sufficient time for implementation of a well constructed, system-based solution².

² The ABA notes that the ASX has indicated that changes to the CHES system to provide a mechanism for facilitating the collection and publication of securities lending information would likely require potentially significant systems changes to both CHES and in ASTC participant IT systems. ASX (2008). *Transparency of Short Selling and Securities Lending*. p10.

Therefore, the ABA believes the implementation period should be accompanied by transitional arrangements. A more feasible implementation period would be for the new disclosure requirement to take effect 1 January 2010. Transitional arrangements should include a "no action" period. This approach will allow system and process changes to be designed and implemented.

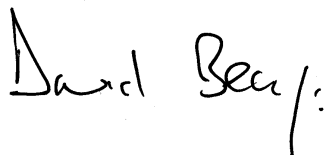
3. Concluding remarks

The ABA believes that improving transparency of securities lending arrangements and enhancing disclosure of securities lending activities will enhance confidence in the fair and orderly functioning of Australia's markets.

However, given the high level of settlement success and high levels of straight-through-processing achieved, it will be important to ensure that the reporting requirement provides meaningful data and any changes do not adversely affect existing systems and processes. We are concerned that a rushed and ill-conceived regulatory approach may lead to unforeseen complications and market disruption.

If you have any queries regarding the issues raised in this submission, please contact me or Diane Tate, Director, Corporate & Consumer Policy on (02) 8298 0410: dtate@bankers.asn.au.

Yours sincerely



David Bell