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Single sided reporting for OTC derivatives in Australia: Final regulations published

At the end of May 2015, the Government released for industry comment the Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015 (**Regulations**) to, amongst other things, implement the single sided reporting exemption. The final Regulations have recently been published. The part of the Regulations dealing with single-sided reporting will commence on 1 October 2015.

In our briefing of July 2015 (Single-sided reporting for OTC derivatives in Australia: When does it apply?), we discussed the draft Regulations. This is an update of our previous briefing. In this briefing we incorporate the changes that were made in the final Regulations.

Who can make use of the single-sided transaction reporting exemption?

Under the Regulations, the single-sided reporting exemption (the **Exemption**) is available in certain circumstances to phase 3 reporting entities. The Regulations do not refer to a phase 3A or 3B reporting entity, but a phase 3 reporting entity with total gross notional outstanding positions of less than A$5b. This qualifying position must be held for at least two qualifying quarters.

A phase 3 reporting entity is:

- an Australian authorised deposit taking institution (**ADI**) or holder of an Australian financial services licence (**AFS Licensee**) or a credit and settlement facility licensee (**CS Facility Licensee**) or an exempt foreign licensee or a foreign ADI;
- that was not required to report under phase 1 or phase 2; and
- did not opt-in to report during phase 1 or phase 2 by lodging an opt-in notice with the Australian Securities & Investments Commission (**ASIC**).

When can a phase 3 entity rely on the Exemption?

Where a phase 3 reporting entity meets the monetary thresholds (see below), then it will be exempt from complying with the requirements under the ASIC Derivative Transaction Rules (Reporting) 2013 (the **Rules**) to report transaction and position information, **if** the other side to the OTC derivative transaction qualifies as a 'reporting counterparty'.

Key issues

- single-sided reporting relief is available to phase 3 reporting entities with total gross notional outstanding positions of less than A$5b.
- the relief is in the form of an exemption which only applies where the counterparty qualifies as a 'reporting counterparty'.
- the relief does not have a uniform start date for all phase 3 reporting entities.
- a phase 3 reporting entity has to obtain representations from its counterparties and make certain enquiries.
- a phase 3 reporting entity must monitor its own compliance with the A$5b threshold.

Who is a 'reporting counterparty'?

The Regulations prescribe when a counterparty will be a reporting counterparty. A reporting counterparty can be a reporting entity or a foreign entity.

Reporting entity as reporting counterparty

A reporting entity in turn can be a reporting counterparty where it is required to report under the Rules or where it is not required to report under the Rules, it nevertheless voluntarily reports under the Rules.

In short for the counterparty to be a reporting entity, three things must happen. The counterparty must make certain representations, the exempt entity must make certain enquiries and must have no reason to suspect that either the representation is incorrect or, in certain instances, that the counterparty has not been making reports.

A reporting entity must make one of the following representations to the exempt entity:

- it is a reporting entity (but not a phase 3 reporting entity) that is required to report the information under the Rules; or
- if the reporting entity is another phase 3 entity, that it is a phase 3 reporting entity that is required to report such information under the Rules and that the Exemption does not apply (because it does not comply with the monetary thresholds); or
- it is reporting entity and that it will report such information in accordance with the Rules (this will be voluntary reporting as it is not required to report under the Rules).

In addition to obtaining the warranties from the counterparty, the reporting entity will only be a reporting counterparty if the exempt entity makes certain enquiries:

- where the counterparty is required to report under the Rules, the exempt entity must make regular enquiries reasonably designed to determine whether the representation is correct; or
- where the counterparty is voluntarily reporting, the exempt entity must make regular enquiries reasonably designed to determine whether the counterparty has been making reports in accordance with its representation.

Finally, as a last hurdle, the exempt entity must hold a certain belief. Where the counterparty has made a representation that it is required to report under the Rules, the exempt entity must have no reason to suspect that the representation is incorrect. Where the counterparty is voluntarily reporting, the exempt entity must have no reason to suspect that the counterparty has not been making such reports.

Foreign entity as reporting counterparty

A foreign entity can be a reporting counterparty if it makes one of the following representations:

- that the foreign entity is subject to reporting requirements in a foreign jurisdiction that are substantially equivalent to the requirements under the Rules **and** reports information about the transaction or position to a prescribed repository **and** designates (or tags) the information reported as information reported under the Rules; or
- that the foreign entity will report such information to a licensed derivative trade repository in accordance with the Rules and designates (or tags) the information as reported under the Rules.

In addition the exempt entity must make regular enquiries reasonably designed to determine that the foreign entity has been making reports in accordance with its representation, or that the entity has been making reports, as the case may be. The exempt entity must have no reason to suspect that the other entity has not been making such reports.

When will a counterparty be required to report under the Rules?

A counterparty will be required to report under the Rules if they qualify as a reporting entity under the Rules. For example, an end user is not a reporting entity and is not obliged to report under the Rules. Where a phase 3 entity enters into a transaction with an end-user, the phase 3 entity will have to report the transaction.

Additionally, reporting entities are only obliged to report those trades covered under the scope of their reporting obligation set out under rule 1.2.5 (*Reporting Entities and Reportable Transactions*) of the Rules.

Where a counterparty is an Australian entity, then all their trades fall within the scope of their reporting obligation and they are required to report all transactions and positions.

Where a counterparty is a foreign entity (not being a foreign subsidiary of an Australian ADI or AFS Licensee), then only their trades booked to the

profit or loss account of a branch of that entity in Australia or entered into in Australia (or with a nexus to Australia if they opted-in to make use of the nexus derivative exemption) will fall within the scope of their reporting obligation and they are only required to report transactions and positions relating to those trades.

Such a foreign entity is likely to be subject to reporting requirements outside of Australia and may well be reporting that trade under foreign reporting rules applicable to it. Such a report will however not necessarily be designated or tagged as being a transaction reportable under the Rules and as such will not be able to make the necessary representation and will not qualify as a reporting counterparty for the purposes of the Regulations.

It may potentially not be tagged for the following reasons. Firstly some entities experience practical difficulties with tagging and in some instances cannot designate or tag on a practical level. Secondly, a foreign entity is only required to designate or tag a trade if it is making use of the alternative reporting exemption under the Rules and reports transactions initially reportable under the Rules to a foreign prescribed trade repository. In those instances where it is not required to report the trade under the Rules and it reports under different rules of another jurisdictions, those trades are not usually designated or tagged as being reportable in Australia.

What if the counterparty is not required to report under the Rules?

Where the counterparty is not reporting the trade or is not obliged to report the trade as explained above, then it will not be able to make the required representations and will not qualify as a reporting counterparty for the purposes of the Regulations. In those instances, the phase 3 reporting entity will have to report transaction and position information.

The phase 3 reporting entity may delegate its reporting obligation to a third party (which could include its counterparty). There are requirements under the Rules for delegating a reporting obligation. There are also safe harbour provisions available to a phase 3 entity that chooses to rely on delegated reporting.

It is also possible that the counterparty may agree to report, despite it not being obliged to report under the Rules. In this instance the counterparty will be able to make one of the required representations and could potentially qualify as a reporting counterparty for the purposes of the Regulations. This is different to delegated reporting as the counterparty is voluntarily reporting and not reporting as a delegate of the phase 3 entity.

It remains to be seen whether counterparties will be prepared to accept the risk of voluntarily reporting in instances where they are not required to do so.

When should the threshold be calculated?

The threshold of less than A$5b of total gross notional outstanding positions should be tested at the end of each quarter day. A quarter day is defined as 31 March, 30 June, 30 September and 31 December.

If at the end of a quarter day the total gross notional outstanding positions held by the phase 3 reporting entity is less than A$5b, then that will be a qualifying quarter day. Conversely, if at the end of a quarter day the gross notional outstanding positions held by that entity exceeds A$5b, then that will be a disqualifying quarter day.

What is the earliest date the Exemption can first apply to a phase 3 reporting entity?

The earliest date the Exemption can apply to a phase 3 reporting entity varies and depends on when that entity became a phase 3 reporting entity.

The Regulations differentiate between a new phase 3 reporting entity and a continuing phase 3 reporting entity.

New phase 3 reporting entity:

A new phase 3 reporting entity is an entity which becomes a phase 3 reporting entity **on or after 1 October 2015**.

For those reporting entities, the Exemption will apply from the date it becomes a phase 3 reporting entity.

Continuing phase 3 reporting entity:

A continuing phase 3 reporting entity is:

- an entity that qualifies as a phase 3 reporting entity **by 30 September 2015** and was not required to report under phase 1 or phase 2; or
- a new phase 3 reporting entity for which the Exemption has ceased to apply after two disqualifying quarter days.

Once it has been established that an entity is a continuing phase 3 reporting entity, then the date of first application of the Exemption will depend on whether the entity was a reporting entity on or before 31 March 2015 or only becomes a phase 3 reporting entity between 1 April 2015 and 30 September 2015.

If the entity was a reporting entity **on or before 31 March 2015**, then:

- if the entity had two disqualifying quarter days calculated as at 31 March 2015 and 30 June 2015, then the Exemption will not apply from 1 October 2015 when the Regulations are proposed to become effective, but will only start to apply on the quarter day that next follows two successive qualifying quarter days on or after 30 September 2015. So the earliest it could apply is 31 March 2016, provided that the phase 3 reporting entity had two qualifying quarter days on 30 September 2015 and 31 December 2015; or
- if the entity did not have two disqualifying quarter days, then the Exemption will apply from 1 October 2015.

If the entity was not a reporting entity on or before 31 March 2015, but became a reporting entity **between 1 April 2015 and 30 September 2015**, then the Exemption will apply from 1 October 2015 regardless of any disqualifying quarters in that period.

How long will the Exemption continue to apply to a phase 3 reporting entity?

Once the Exemption starts to apply, it will apply until the end of the quarter day that next follows two successive disqualifying quarter days in respect of that phase 3 reporting entity. So if the phase 3 reporting entity has disqualifying quarter days on 31 December and 31 March, then the Exemption will cease to apply on 31 March (being the quarter day that next follows two successive disqualifying quarter days).

The Exemption will start to apply again on the day after the quarter day that next follows two successive qualifying quarter days. So if the phase 3 reporting entity had two successive qualifying quarter days on 31 March and 30 June, the Exemption will start to apply again from 1 October (being the day after the quarter day that next follows two successive qualifying quarter days).

Duties of a phase 3 reporting entity

The Exemption only applies to the phase 3 entity's reporting obligations; any other obligations under the Rules remain.

A phase 3 reporting entity has for example record keeping obligations under the Rules. These are not affected by the Exemption. The phase 3 reporting entity must keep records to show that it has complied with its requirements of the Rules and keep these records for at least five years. It must also keep all information that it is required to report. However where it has an arrangement with a licensed or prescribed trade repository to have access to the information that it is required to report, then it does not have to keep this information. Parties should check whether their trade repository keeps the information it is required to report.

Conclusion

The Regulations potentially create a competitive advantage in favour of Australian entities over counterparties that are foreign entities. This has not entirely been dealt with in the final published Regulations.

Contacts

Caroline Jury
Partner
T: +61 2 8922 8035
E: caroline.jury@cliffordchance.com

Nelda Turnbull
Counsel
T: +61 2 8922 8031
E: nelda.turnbull@cliffordchance.com

Meeta Kalaria
Senior Associate
T: +61 2 8922 8000
E: meeta.kalaria@cliffordchance.com