SECURITIES & DERIVATIVES INDUSTRY ASSOCIATION

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17 September 2009

Ms Megan Manwaring
Senior Lawyer, Investment Banks
Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2001

By email: policy.submissions@asic.gov.au

Dear Ms Manwaring

Consultation Paper 114 – Client money relating to dealing in OTC derivatives

The Securities & Derivatives Industry Association is the peak industry body representing wholesale and retail stockbrokers and investment banks in Australia.

SDIA supports ASIC's aim to improve the disclosure to retail clients of the arrangements that apply to the holding of their funds by licensees, and of the risks that might attach to those arrangements.

In relation to ASX-traded securities and derivatives, the existence of the Central Counterparty (ACH) is a key investor protection. The handling of client monies is well regulated by the *Corporations Act* client money provisions, supplemented by ASX trust account rules. In particular, due to ACH requirements, the mixing of client funds for derivatives collateral requirements is well controlled and breaches would normally result in serious regulatory action.

However, as well explained in the Consultation Paper, some OTC derivatives issuers and advisers operate outside of the central counterparty environment. Mixing of client funds occurs, and depending on the structure of the transaction, it may be possible for one client's funds to be used to meet the liabilities (e.g. margin requirements) of other clients, or the licensee.

In the area of securities lending, the last 2 years have seen some stark examples of the problems that can occur where client securities are pooled under standard securities lending agreements. Under these arrangements, client securities may be used to meet the funding obligations of the licensee. Issues have arisen as to whether adequate disclosure of these arrangements was made.

In the same way, where client money may be pooled (albeit in segregated accounts), we agree that there needs to be effective disclosure to clients that their money may be used –

a. to meet other clients' obligations, or
b. to meet the licensee's obligations.

Investors need to be clear about the risk that they may lose their money in these circumstances, prior to entering into the transaction or lodging the money. This should be disclosed clearly and prominently in the Product Disclosure Statement. However, as we

have seen in recent cases being considered by a current parliamentary inquiry[1], this particular means may not always be effective, and may be the subject of further review.

Should you require further information, please contact me or Doug Clark, Policy Executive by email: dclark@sdia.org.au.

Yours sincerely,

David W Horsfield
Managing Director/CEO

ABOUT SDIA: The Securities & Derivatives Industry Association is the peak body representing the interests of wholesale and retail market participants in Australia. SDIA was formed in 1999 at the time of the demutualisation of the Australian Stock Exchange. Currently we have 66 member organisations, which account for some $4bn worth of trading daily on the ASX, which is approximately 98% of the market by value. In addition we have over 1300 individual members and are working to build the profession of stockbroking. Our member firms employ in excess of 25,000 people.

[1] Parliamentary Joint Committee on Corporations and Financial Services (Cth) *Inquiry into financial products and services*