

CAPITAL MARKETS - RISK MANAGEMENT PRODUCTS (PRACTICALITIES, DEVELOPMENTS AND PROBLEMS)

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INTRODUCTION

I appear to be the non-conformist here. I have little knowledge of law. I would go so far as to say I do not have a legal bone in my body. What I have to contribute today is an insight into the people you need to be able to communicate with, to be of service to the wholesale financial markets.

The issues I intend to cover are:

- Communication with dealers
- Current status of our financial markets
- AFMA's role
- Current AFMA issues.

COMMUNICATION WITH DEALERS

As you saw from the video, the people you need to communicate with are of very few words. They talk in single words, with grunts and expletives. They prefer words of single syllables to aid their comprehension. They usually have a very good ego and high opinion of themselves.

I feel qualified to make all these comments as I have spent 12 years as one of these people. In recent years I have gone through a retraining process to be reinstated as an acceptable member of our community.

Dealers have a short concentration span. Once you can get one to a meeting you will find his concentration will lapse after a short time (say 10-15 minutes). He will look at his watch, the phone, the door, seeking an "out". To understand his behaviour you should be aware that he will probably have a trading position in the market and is wondering what is happening while he is away.

With all this in mind, you can appreciate he has little interest in detail. He will be interested mainly in the basic facts with reference given to supplying more detail on request.

The basic issue you need to address is "does it work or not, what are the risks and how much its going to cost".

The best way to get on the right side of a dealer is to be decisive, direct and to readily take points on notice for future reference or give a quick and direct solution.

My suggestion to lawyers to be of maximum service to a front line dealer is to learn to communicate directly with this person, cutting out the interpreter or middleman.

I understand a brief would rarely come solely from a dealer but direct access to the source will assist you greatly in completing your task.

CURRENT STATUS OF OUR MARKETS

SIZE OF MARKETS

AFMA'S TURNOVER

1991 - 1992

MARKET	MARKET VOLUME
\$A Interest Rate Swaps	\$A 145 billion
\$A Currency Options	\$A 145 billion
\$A Interest Rate Options	\$A 60 billion
\$A FRAs	\$A 515 billion
\$A Bank Bills/CDs	\$A 540 billion
\$A Non-Bank Notes (PNs etc)	\$A 171 billion
\$A Fixed Interest Securities	\$A 1,645 billion
\$A Repurchase Agreements	\$A 650 billion
TOTAL OF THIS MARKET	\$A 4,071 billion

The volumes here are very large which reflect a very large credit exposure between counterparties. It is this exposure that needs to be well protected by the market's documentation.

Since the 1987 crash, there has been a great deal of rationalisation of our markets. Parent companies have closed down subsidiaries, banks have dropped out of some markets and elected to concentrate on specific areas and the market has started playing catch up in areas neglected during the 1980s being documentation, legality of trading practices and costs.

The trends for the future are emerging. The rationalisation is nearly complete and the specialisation we are seeing is forming the base for market growth. I am prepared to

forecast a solid controlled growth in our markets in the coming years. I see the growth to be particularly strong in the derivatives product area.

Australia has a great opportunity to become a well recognised player in the global markets.

Everything I say now is subject to the governments, both State and Federal, picking up the ball and running with it.

We can be an active market in the 24 hour dealing clock.

Say the market starts in Japan, its closing time overlaps with London. New York opens before London closes but Japan does not overlap with new York. The potential is there for Australia to fill the void.

One area people wonder about, is how far we are behind the rest of the world in the area of financial dealing skills, knowledge and products. You may find it interesting to learn we are equal. In many situations, we have taken the initiative and the global markets have learned from us. One such area is netting.

One simple way I like to illustrate the difference between dealing in Australia and dealing in say, the USA. All you need to do is just add a naught. If our average deal is \$10m, theirs is \$100m. Otherwise, the products dealt, the initiative and skills are equal.

AFMA'S ROLE IN THE MARKET

The Australian Financial Markets Association "AFMA" is the self regulatory body of our markets. Its objectives are effective regulation and development of our financial markets.

I refer you to the brochure included in your conference package which summarises the AFMA role, the separate markets and the extent of our membership. In the brochure you will find our organisational chart.

The key element of AFMA is that it is totally run and controlled by market participants. My role is primarily administrative.

All committees of AFMA by definition must comprise market operatives and will only include non-operatives for consultative purposes.

I also refer you to AFMA News of which you have been given our Autumn copy. This newsletter provides the latest in market developments.

Other publications of AFMA are:

- Documentation
- Annual Surveys
- Dealing Conventions
- Contact lists of separate market participants
- Netting
- Code of Conduct

Education forms a major responsibility of AFMA. We run:

- Dealing Diploma
- Documentation workshops
- Netting workshops
- Conference - next one being the Annual AFMA/ISDA Swaps Conference, to be held on September 4, 1992
- Middle Management course - (there is life after dealing).

CURRENT AFMA ISSUES

The major issues facing our markets are primarily of a legal nature. The first of such issues is taxation.

We are being invaded from several areas regarding taxation:

- EDR 45 - Taxation on Swaps
- EDR 68 - Withholding Tax
- EDR 34 - Discount Securities.

In addition, there are probing enquiries on Repurchase Agreements.

We have not yet commenced to be challenged on Options or Netting, but these will come.

In the area of market practices, we have identified several areas where the evolution of markets have come into grey areas of outdated law. Such areas being addressed are:

- **Short Selling**

The convention in our bond markets for example is for dealers to give each other a two-way price on request. This means A rings B and asks for his price in 10 year Bonds. By convention, B must give both a buy price and a sell price. He may not have any 10 year Bonds to sell, but if A takes the sell price, the deal is done and B has shorted the market. This happens every hour of every dealing day.

- **Futures Industry Code**

This code was written prior to Options being a traded market. Are options a futures contract dealt off the exchange?

- **Exempt Markets**

Once again bond dealers making two way prices off the Exchange, are they dealing in a non-exempt market?

- **Insider Trading**

I would prefer not to give too many examples here, just in case, but I can say the markets are paranoid about what is insider trading and what is not. Markets live and survive on rumour and speculation.

- **Code of Conduct**

We have never really established a formal code in Australia. We will be releasing shortly a comprehensive code based upon the Bank of England Code.

- **Accounting**

I am sure all lawyers would love to know about accounting issues. All I can say is that standardisation is the goal or should I say dream!

- **Documentation**

A major goal of AFMA is to see all treasury products dealt under a Standard Master Agreement where banks can net their credit exposure with each counter party across all product lines.

SUMMARY

When performing a role that involves the professional markets, I strongly recommend lawyers learn to bypass the interpreter and communicate directly with the dealer in his language, less the expletives.

Our markets are large and equal to the standard of offshore markets in both knowledge, skill and innovativeness with plenty of potential for future growth.

AFMA is the contact point or window to the markets. It is a body which through market demand, is growing rapidly.

A major goal of AFMA is to produce a Master Agreement which covers all treasury products.

CONCLUSION

What I have attempted to do today is assist in the bridging of the communication gap between the legal profession and the market dealers. I do believe that standardisation of market documentation still allows the lawyer to make a living.

Now I pass you over to someone you may have a better chance of understanding ... a lawyer.