APX SUBMISSION TO THE COUNCIL OF FINANCIAL REGULATORS REVIEW OF COMPETITION IN CLEARING AUSTRALIAN CASH EQUITIES

2 April 2015

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1. Introduction

Asia Pacific Stock Exchange Limited ("APX") welcomes the opportunity to make a submission in relation to the Council of Financial Regulators (the "Council") review of Competition in Clearing. APX also thanks the Council for the opportunity to have made verbal representations during the meeting on 16 March 2015.

By way of introduction it is worth noting that the Council's first review in 2012 examined "*Competition in the Clearing and Settlement of the Australian Cash Equity Market*". The Council's analysis assumed that ASX would remain the sole provider of core securities settlement services. The most recent consultation paper published by the Council in February 2015 is entitled "*Review of Competition in Clearing Australian Cash Equities*" presumably based on this underlying assumption about ASX continuing as the sole provider of settlement services.

ASX's Code of Practice is framed by reference to the Clearing and Settlement of cash equities. For the purposes of clarity, APX submits that the Council's review should examine both clearing and settlement of cash equities in the Australian market and make formal recommendations concerning both in terms of policy and regulatory responses necessary to ensure that the Australian market provides fair and equitable access to both clearing and settlement services. APX formally addresses both clearing and settlement in this submission.

2. Summary

This review raises important policy issues that have the potential to improve the efficiency of Australia's financial markets, to promote innovation and, importantly, to promote Australia's competitiveness among the highly competitive markets of Asia. Conversely, a failure to act and the absence of new policy to facilitate a competitive environment will stagnate the market and actively reduce Australian competitiveness.

The APX Policy Position

At a high level, APX submits the following policy recommendations in respect of clearing and settlement:

- **Settlement:**
  - It is not in the public interest at the present time for ASX's settlement function in respect of cash equities to be contestable. On that basis, APX submits that the Council could recommend a 5 year moratorium on competition in respect of the settlement of cash equities. However, given that competition in the market for settlement services is unlikely to emerge there may be no need to implement any formal moratorium but the question should be formally considered.
  - As a natural monopoly, regulatory intervention is required to ensure fair and transparent access is available to the settlement facility and that pricing does not extract monopoly rents from the industry.
- **Clearing:**
  - Clearing of cash equities is and should be contestable. APX submits that the Council should not recommend extending the moratorium on competition in clearing in respect of cash equities. In the face of potential clearing competition, the best way for ASX to make it unattractive for a new entrant to be interested in clearing Australian cash equities is to keep clearing fees and ease of access at a highly competitive level, which is a win for the industry.
  - For competition in clearing to work in a cost effective way in a market of this size it is essential that it is implemented on the basis of clearing house interoperability, thus enabling self-directed clearing – i.e. an environment in which clearing participants evaluate the service offering of competitive clearing houses and send all their trades to the nominated clearing house of their choice.

Impact of APX Policy Recommendations

The following consequences flow from the APX policy positions:

Settlement

- Any CHESS replacement system should be based on industry standard technology protocols to keep costs low. It is also essential that the project goals include an overarching objective to reduce settlement fees. The market cannot continue to bear the costs of ASX systems without some independent scrutiny of the reasonableness of the project scope, solution design and project cost. This also becomes relevant in the context of regulated pricing, and returns on investment. If the cost of the new system is too high, it will flow through to inefficient and expensive pricing.
- As an entrenched monopoly service provider, ASX Settlement should be subject to Government regulation in respect of pricing and access. This should be done in conjunction with structural separation of ASX Settlement and its systems from ASX and ASX Clear[1]. The ASX Settlement facility will be essential infrastructure used by ASX customers and its competitors and it must be managed in a competitively neutral way, while also delivering efficient and cost effective solutions for the benefit of the industry and its competitiveness in the region.
- The redesign and system replacement for CHESS should factor in this structural separation so that any ASX systems that need to connect to CHESS (or its replacement) connect via a publicly available industry and market neutral technical interface that is also used by other industry participants and any new clearing houses that may seek to enter the market. Such an approach will ensure that ASX cannot discriminate against its customers and is seen to be receiving the same service as all other industry participants.

Clearing:

- If, as it seems, there is no new entrant ready to provide alternative clearing services in the cash equities market, it will be necessary for Government to regulate ASX Clear on an interim basis in respect of pricing and access arrangements.
- It is essential that the regulatory framework also address access to essential infrastructure, such as the ASX settlement facility and impose obligations on ASX as the current monopoly provider of clearing services to ensure that ASX Clear has positive obligations to connect with new entrants into the clearing market; independent processes to review applications from such entities, how they will connect, how interoperability will work (including how the clearing houses will margin positions across the clearing houses). Absent this rule framework (referred to as "**Clearing Integrity Rules"** for convenience), ASX will have scope to delay and frustrate any potential new entrant into the market for clearing services. Having Clearing Integrity Rules in place provides industry certainty and certainty for any new entrant that is interested in the Australian market.
- The alternative unsatisfactory outcome is for Government to wait until a new entrant makes enquiries. This would no doubt result in further delay and analysis, which would reflect poorly on Australia and such uncertainty more than likely fail to elicit any new entrants. The Government and regulators have had first-hand experience implementing a competitive framework for trading. While that took longer than Chi-X and the industry anticipated, that experience should now see Government and regulators well placed to proactively facilitate a competitive framework for clearing that leads the world. The timing for this framework should recognize that the process of reviewing competition in this industry sector already dates back to 2012.

[1] It is acknowledged that structural separation can occur in many different ways. APX submits this goal should be to achieve complete structural and physical separation with an end date in the future recognizing that time will be required but have a clear roadmap of steps that can be taken to improve arrangements over time with clear interim milestones or deliverables.

Current Situation – What is the problem?

Elsewhere in this submission APX has documented at length many of its grievances with the way ASX deals with its competitors. At a higher level, the following seeks to summarise the key problems with ASX's clearing and settlement services:

- Expensive – the report published by Market Structure Partners, *International Transaction Cost Benchmarking Review*, October 2014, demonstrated that ASX clearing and settlement fees are expensive when compared to other comparable clearing and settlement services globally. The report also highlighted a curious capital structure recently implemented that raises many unanswered questions.
- Lack of innovation and investment.
- Lack of transparency.
- Access arrangements for competitors are opaque and often anticompetitive.
- Confidentiality of competitively sensitive information – ASX competitors such as APX are forced to deal with ASX in relation to issuing security codes, ISINs and many of the rules are driven by an ASX view of the world. If APX seeks to offer new products, it is forced to go to its competitor for review and approval. Without structural separation of ASX Clear and ASX Settlement from ASX (in its capacity as market operator), any Information Handling Standard is going to be inadequate to manage confidential and competitively sensitive information.

APX also highlights another example of ASX's predisposition to act unilaterally and not facilitate open access to its services – it recently tendered contractual terms to APX for what has been named the *Multi Market Clearing Acceptance Service (MMCAS)*. These terms include provision for ASX to charge an amount for development costs of the service plus another catch all provision enabling ASX to charge a fee for the MMCAS. ASX had previously said in numerous meetings that the development costs were not significant or complex and ASX would not seek to pass on any charges and yet the legal terms continue to provide provisions for them to charge multiple fees. More troubling is the fact that the legal terms include a provision that the MMCAS will operate until 31 October 2016 or "*the date that the Code of Practice and the related policy decision to defer consideration of a licence application from any other CS facility for the clearing of cash equities cease to be in force, whichever is the earlier*." This provision evidences a clear anti-competitive intent that is designed to place APX in a precarious position if it does not support ASX's monopolistic ambitions in the market for clearing Australian cash equities.

What is an appropriate response to the problem?

Self-regulation under the Code has been a failure so more is required.

Fundamentally, structural reform and regulation is required. On the basis of APX's recommended policy positions, the following are suggested responses to the problem:

Settlement:
On the basis that ASX Settlement is granted a monopoly moratorium to operate the settlement facility in respect of cash equities, the following is required:

- Structural separation of the business and technology systems from ASX. Structural separation should be mandated by licence conditions.
- CHESS and any new settlement system built to replace CHESS must be built with open access at its core and ASX systems accessing ASX Settlement via the same technical interface as all other market operators, industry participants and potential new clearing houses.

- The CHESS replacement project should have industry representation as part of the project governance to ensure system design and budgets for implementation are appropriate to be in a position to reduce settlement fees.
- Government regulation of ASX Settlement pricing as an industry utility.
- Strengthened governance arrangements: this should include more industry representatives on ASX Settlement board and independent directors.

It is acknowledged that structural separation comes with some complexity and may take time, so it would be desirable for a plan (including milestones) to be developed that sees immediate progress on change with a roadmap for the broader change to be implemented over time.

Clearing

On the basis that ASX Clear is not granted an extension of its monopoly in clearing cash equities, the following is required:

- Interim regulation of ASX Clear to ensure that it is providing access to clearing on fair and equivalent terms and that pricing is reasonable.
- Structural separation of ASX Clear and its systems from ASX (in its capacity as market operator) should also be imposed as a licence obligation.
- Current information handling standards are not working, so structural separation and better governance structures are required to ensure that ASX Clear operates more independently of ASX.

ASX media commentary

In the press ASX has been reported to be seeking a 5 year moratorium in the clearing market and has offered discounted fees for clearing if the moratorium is granted. It has also reportedly said that if the moratorium is not granted it will not proceed with the CHESS replacement project.

APX submits that this ASX position linking reinvestment in CHESS with an extension of the moratorium on competition in clearing is flawed.

Firstly, CHESS is a settlement system operated by ASX Settlement Pty Ltd, which has no bearing on any decision to extend the moratorium on competition in the market for clearing cash equities (refer to the ASX marketing brochure published by ASX Settlement Corporation entitled *CHESS Clearing House Electronic Sub register System*[2] that makes it clear CHESS is a settlement system).

Secondly, as a licensed operator of clearing and settlement facilities, ASX has obligations to, among other things, have and maintain robust operating procedures and technical systems to provide fair, efficient and cost effective clearing and settlement services and those obligations should require ASX to redevelop CHESS irrespective of whether there is any moratorium granted in respect of clearing or settlement competition. The Council's Report noted that there is a general sense in the industry that there had over the years been insufficient investment in the core CHESS architecture.

Third, linking the current considerations regarding competition in clearing to the CHESS replacement project is akin to comparing apples with oranges. CHESS is a facility for the Australian dollar settlement and registry of equity securities transactions. The CHESS replacement project has been proposed by ASX as a facility for multi-market, multi-currency, multi-product settlement and registration of equity and derivative transactions.

[2] Also available at http://www.asx.com.au/documents/research/chess_brochure.pdf

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3. Background on APX

APX is an Australian licensed listing market operator having held a market licence since 2004. APX was given approval by ASIC to re-commence operating its equities market in November 2013. APX is wholly owned by the AIMS financial group[3] and is 100% Australian owned.

APX provides opportunities for Asian and Australian companies to raise the capital they need for expansion from a diversified range of domestic and international investors, especially from the Asia-Pacific region. APX is an exporter of Australian financial services IP.

We believe significant capital market development opportunities exist in relation to capital flows between Australia and China. Key market segments upon which APX is focused are:

- Chinese - based companies seeking capital, market opportunities, or a listing in Australia;
- Australian - based companies seeking capital or market opportunities in China; and
- Markets for Australian and international companies which are not presently well serviced in the Australian market.

Owing to its strong links with China, APX sees itself as the natural Australian stock exchange for RMB denominated trading in securities in line with Australia's move to create an international RMB hub. APX is planning to introduce dual trading and settlement capabilities in both AUD and RMB for its equities market.

APX provides new competition for the provision of listing and trading services. To develop as a vibrant capital market Australia needs competition for listing services, as it needs competition for clearing and settlement services.

APX has a rare chance to be innovative and to fundamentally redefine the interactions between, and understanding of, both Australian and Chinese financial markets. We are offering a competitive and innovative alternative to the likes of Australia's ASX and China's Shanghai and Shenzhen stock exchanges. But to promote innovation in markets, markets need government and ASIC support for innovation. As APX progresses its rethinking of how markets can work in the future, we need others to step out of the mindset of "how it has always been done", in order to embrace "how it can be done".

The APX market currently provides both listing and trading services. The market is currently settled by means of the Settlement Facilitation Service (the "SFS") provided by ASX Settlement Pty Limited ("ASX Settlement"). Settlement obligations are direct broker – broker counterparty obligations utilising the ASX Settlement DvP services.

APX is currently seeking access to the ASX Clearing services to enable central counterparty clearing ("CCP") of APX transactions. Hence, as a listing and trading service provider competing with ASX (in its capacity as a listing market operator), APX has gained first-hand experience of the extent to which current arrangements for managing competition in respect of clearing and settlement access do not work.

This APX submission is from the perspective of a listing market operator seeking access to clearing and settlement services for its market.

[3] www.aims.com.au

4. Current Situation – Settlement Facilitation Service

Competition in clearing of ASX quoted equity products is currently subject of a moratorium. As such, the moratorium applies to the clearing of the ASX and Chi-X markets. It does not apply to the clearing of products listed and traded on the APX market. It is therefore open to APX to seek to clear and settle its quoted products through a clearing facility other than ASX. However, ASX is the only provider in Australia for clearing and settlement of equity products. Given the scale of APX's business and the size of the Australian market it is commercially unattractive to try and build alternative clearing and settlement systems, making ASX the only natural supplier of these essential services. Competition in clearing, if it is likely to emerge, will more than likely come from a global firm seeking to leverage its capital and systems in other markets into the Australian market to keep the costs low enough to overcome the scale difficulties found in Australia.

As outlined above, as alternative clearing facilities are not currently available, the APX market is settled by means of the SFS. Settlement obligations are direct broker – broker counterparty obligations utilising the ASX Settlement DvP services. At the time when APX commenced operation in 2014 ASX did not offer clearing for non-ASX quoted securities, so APX was left with no alternative but to accept the SFS.

APX transactions are settled via the CHESS system. We believe it is relevant to the current considerations to highlight that CHESS was developed and implemented as a settlement and depository/registry system. Indeed, ASX's own marketing materials and website in relation to CHESS make it clear that ASX Settlement operates the system and it is a settlement system.

The current environment is represented in Figure 1 below.

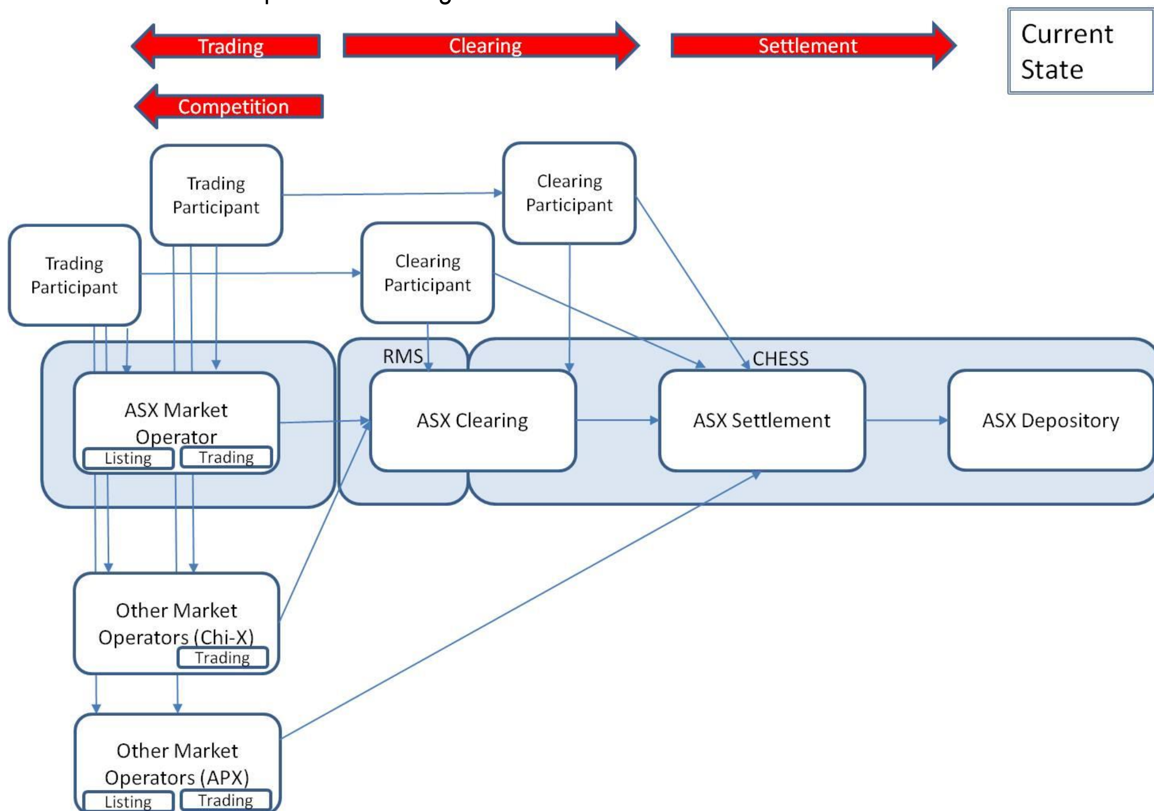

Figure 1 - Current State

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4.1. ASX Code of Practice

ASX established a Code of Practice (the "Code") to manage its behaviours in the absence of an environment conducive to clearing and settlement competition.

APX submits that the Code is not an adequate alternative to competition and, in the absence of competition, Government regulation. Based on its experience, APX submits that the option of self-regulation referred to in the consultation paper is not an appropriate option.

ASX recently invited feedback on proposed operational improvements to the Code. A copy of the APX submission is attached.

The Code is skewed towards the services provided to users such as clearing participants, settlement participants, listed entities and registries. It has little consideration for the needs and perspectives of market operators competing with ASX in its capacity as market operator and how these services can be accessed in a fair and equivalent basis that does not provide commercial advantage to ASX. This is a substantial flaw in the Code.

Whilst ASX publications and service level agreements may address equality of access issues such as pricing and responsiveness to requests, they do not extend to key operational factors such as, for example, decision-making processes for prioritisation of resources or changes for Alternate Market Operator ("AMO") and Alternate Listing Market Operator ("ALMO") initiated requests vis-à-vis prioritisation of resources or changes for ASX initiated requests. There is also no process for communicating to an AMO or ALMO how a prioritisation decision has been objectively arrived at and, in particular, if the AMO or ALMO request directly conflicts with the interests of ASX (as a listing market operator in its own right). If decisions are made on a "commercial-to-ASX Clear" or "commercial-to-ASX Settlement" criteria (or business case), the criteria for the business case is not communicated to market operators (for example, does the change need to meet a certain IRR or NPV?). There is no clear and transparent process to ensure that the ASX decision-making processes, or prioritisation of resources or changes, are objective and no more favourable to ASX in its capacity as market operator than those applied to, or adopted for, AMOs and ALMOs.

ASX advises that it has an agreed timeline for responses to AMO/ALMOs. However, APX observes that:

- these timelines have not been adhered to; and
- they do not take into consideration urgency or needs of the ALMOs, who are the customers of this service.

The Code only partly addresses competitive sensitivities experienced by market operators, especially ALMOs. We acknowledge that ASX has put in place confidential information handling arrangements. However, this does little to dispel the perception that a competing ALMO must obtain approvals from, or developments by, its competitor (being ASX). We do not believe that confidentiality is, or can be, maintained within ASX at the operational level without some sort of structural separation to reinforce information barriers.

The perception of an uneven playing field is not dispelled in the broader market by the information handling arrangements and does little to address the competitive disadvantage.

4.2. Settlement not in public interest to be contestable

APX submits that it is not in the public interest for the settlement and depository (SD) function for cash equities within Australia to be contestable at this point in time. The establishment of competitive SD facilities for multiple market operators within Australia would create significant inefficiencies in market infrastructure.

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APX submits that ASX behaviours in this regard have demonstrated an awareness that this is not contestable, with a resultant consequential diminution in service and monopolistic pricing.

4.2.1. Pricing

A group of industry participants commissioned a report by Market Structure Partners (MSP) to examine pricing by providers of clearing and settlement services globally: *International Transaction Cost Benchmarking Review*, October 2014. This report found that ASX charges are higher than in markets where there is either competition or a utility model in clearing and settlement when compared to larger markets such as Europe and US. The report goes on to say that ASX costs are still higher even when compared to similar sized and smaller markets that similarly lack scale. MSP was also critical of ASX's risk management approach, describing it as "unusual" with it allocating a large and inefficient amount of capital to its default fund, which is used by ASX to justify its return on capital from fees as reasonable.

In response to the two year moratorium on competition in clearing, ASX discontinued certain fees for market operators accessing the clearing service for ASX quoted securities known as the Trade Acceptance Service (the "TAS") whilst ever the moratorium remained in place. The rationale stated for the conditional discontinuation of fees was that the removal of the annual service fee is "consistent with ASX's commitment in the Code of Practice to make the service level agreements consistent with the outcomes of a competitive market (and ASX Clear and ASX Settlement's [emphasis added] licence obligations)".

This conditional discontinuation was to the benefit of Chi-X.

As stated above, APX currently utilises the SFS. APX submitted that the ASX rationale for conditional discontinuation of fees for the TAS applied equally to access to APX's access to the SFS consistent with the outcomes of a competitive market and ASX Settlement's licence obligations. APX sought a discontinuation of the SFS fees on that basis, a request that ASX Settlement refused.

APX accepts that once the clearing moratorium concludes, if competition emerges for the clearing of cash equities, then pricing should also be competitive. However, we are concerned that, once the clearing moratorium concludes if there is no competing CCP's for the clearing of cash equities, then the annual TAS service fee will be re-introduced with no assurance as to pricing or control over pricing. More importantly, the draft legal terms for the new MMCAS clearing service make it clear that ASX is proposing to refuse access if the moratorium on competitive clearing is not extended.

In relation to the ASX Settlement Licence Compliance fee, we submit that the compliance costs of operating a commercial clearing and settlement facility in a competitive environment would ordinarily be a cost of ASX doing business, not an itemised cost incurred by clients such as APX and other market operators.

Consistent with the outcomes of a competitive market (and ASX Clear and ASX Settlement's licence obligations) we submit that ASX should remove all annual fees for access to the SFS. To retain the fees is inconsistent with ASX's stated position in relation to the annual service fee for the use of the TAS and, by ASX's own analysis, potentially inconsistent with ASX Clear and ASX Settlement's licence obligations.

ASX responded that the *"annual Settlement Facilitation Service DvP Development fee is charged to recover costs associated with the development of a DvP settlement facilitation service for ALMOs. The Settlement Facilitation*

Service CHESS Operations and Support fee reflects the ongoing costs of providing CHESS operations and support to ALMOs. ASX is not waiving the annual Settlement Facilitation Service DvP Development fee." The basis of charging of the annual fees for the TAS, which were waived and refunded by ASX, was the same as the basis of charging of the annual fees for the SFS, which were not waived by ASX.

The ASX response and fee retention was clearly influenced by the non-contestability of its settlement function. There was no competitive or regulatory impetus to drive a reduction in fees.

4.2.2. Restraints on market and service design

On 9 December 2014 ASX unilaterally purported to advise APX of controls it had introduced in relation to the allocation of trading identifiers ("trading codes") to listed companies. The trading codes are the key trading identifiers of a listed company. They primarily relate to the listing process, not the settlement process. For the settlement process the key identifier is the ISIN Code.

Owing to system constraints within ASX, APX is constrained to certain trading code formats (for example, three character company identifier followed by up to 3 character security identifier).

However, the purported controls introduced in relation to the allocation of trading sought to unreasonably restrict the nature of the trading codes allocated by APX. Further, it was unclear in what capacity ASX was purporting to impose the controls upon APX. When asked which entity in the ASX Group was publishing the controls, ASX was initially unable to identify the relevant entity. ASX subsequently advised the controls were published by ASX Operations Pty Limited (ASXO). The document itself identifies ASX Limited (ASXL) as the publisher of the document. APX does not have a contractual relationship with ASXO or with ASXL (the market operator).

On 13 January 2015 APX formally advised ASX that it did not recognise the purported controls on trading codes. On 27 March 2015 ASX eventually acknowledged APX's position and amended the purported controls to not apply to the APX market.

APX submits that, under the auspices of the SFS Agreement, being the only contractual relationship between APX and the ASX group, ASX (in its capacity as a listing market operator) had sought to impose restraints upon APX as an ALMO.

4.2.3. Service levels

In addition to the Forum and Business Committee established by ASX pursuant to the Code, ASX Settlement has established a quarterly client management meeting relating to the SFS.

Whilst these meetings have taken place regularly over the last 2 years, the outcomes from the meetings are of little commercial or practical value.

For example, ASX released a Consultation Paper for ISIN algorithm changes in 2014. In its submission APX raised a number of questions for ASX which were relevant to the operation of the APX market. In January 2015, ASX advised APX at the quarterly meeting that the new ISIN algorithm will be operational from mid-2015. ASX representatives were unaware of why ASX had not responded to APX raised questions before releasing an implementation schedule.

ASX also advised APX that an account manager has been appointed to look after APX needs. This account manager is responsible for settlement needs as well as any other questions relating to ASX products or services. However, APX's finding is that the account manager is neither across any issues or needs of APX, nor has proactively sought to find solutions to satisfy APX needs.

4.2.4. Absence of other competitive behaviours

We have noted recent reports of ASX proposing cuts in its clearing fees at the time of the CoFR review being conducted. It is notable that, in the absence of the CofR review, there were no moves by ASX to reduce its clearing fees. This suggests that the introduction of an environment for potential competition can have an effect on the incumbent's behaviour.

We have also noted reports that ASX Clear has proposed to reduce its fees in order to drive increased clearing volumes from market participants. In that context we note that, as a commercial clearing house operator, there would be two sources of increased volumes – increased volumes from market participants trading through ASX and increased volumes from clearing for other market operators. In this regard we note that ASX Clear has made no endeavours to encourage additional volumes from other market operators. The reason is clear, as to do so would be to encourage competition with its own listing and trading functions. Hence, the behaviour of ASX Clear in this regard, being a reflection of the inherent conflict that exists in the current monopoly environment, are not those that would be associated with a truly commercial clearing house operation.

5. APX seeking access to clearing as ALMO

APX is currently seeking access to ASX clearing services as an ALMO. Whilst Chi-X currently has access to ASX clearing services as an AMO for the clearing of ASX listed and traded products, the access sought by APX as an ALMO relates to APX listed and traded products. ASX is proposing to implement a Multi-Market Clearing Acceptance Service (MMCAS) to support this request. Legal Terms governing this service were recently tabled and include scope for ASX to charge fees that are not yet disclosed. In addition, the contract expressly says that the MMCAS will cease on that date that any decision is taken not to extend the moratorium on competition in clearing for cash equities.

5.1. The importance of competitive access for competition in listing services

Restraint of access to clearing services is a key competitive barrier to an ALMO seeking to compete with ASX in its capacity as a listing market operator.

In order to develop a competitive business, an ALMO needs to generate liquidity and channels for access to capital. The magnitude of liquidity and access to capital is directly related to the ALMO being able to attract large participants to its market (for example, large domestic and institutional investment banks and large on-line brokers). As a general principle, with the increased focus upon counterparty risk globally, these larger market participants will not enter a market which does not utilise a recognised CCP, such as ASX Clear or LCH.Clearnet ("LCH"). A number of potential larger market participants have directly advised APX of this position. Hence, delaying, restraining or over-pricing access to clearing services by an ALMO can significantly reduce the competitiveness and commercial viability of that ALMO and protect the wider commercial and competitive operations of ASX (in its capacity as a listing market operator).

There have been delays, and an absence of appropriate responsibility and drive taken by ASX in its treatment of the APX endeavour to access ASX clearing services. This has clearly hampered, and will continue to hamper, if unchanged, APX's ability to develop its listing and trading services to compete with ASX, and to compete within the Australian market. These are discussed further below.

5.2. The efficiencies of competitive access to clearing services

The environment in which APX would have access to ASX clearing services is represented in Figure 2 below.

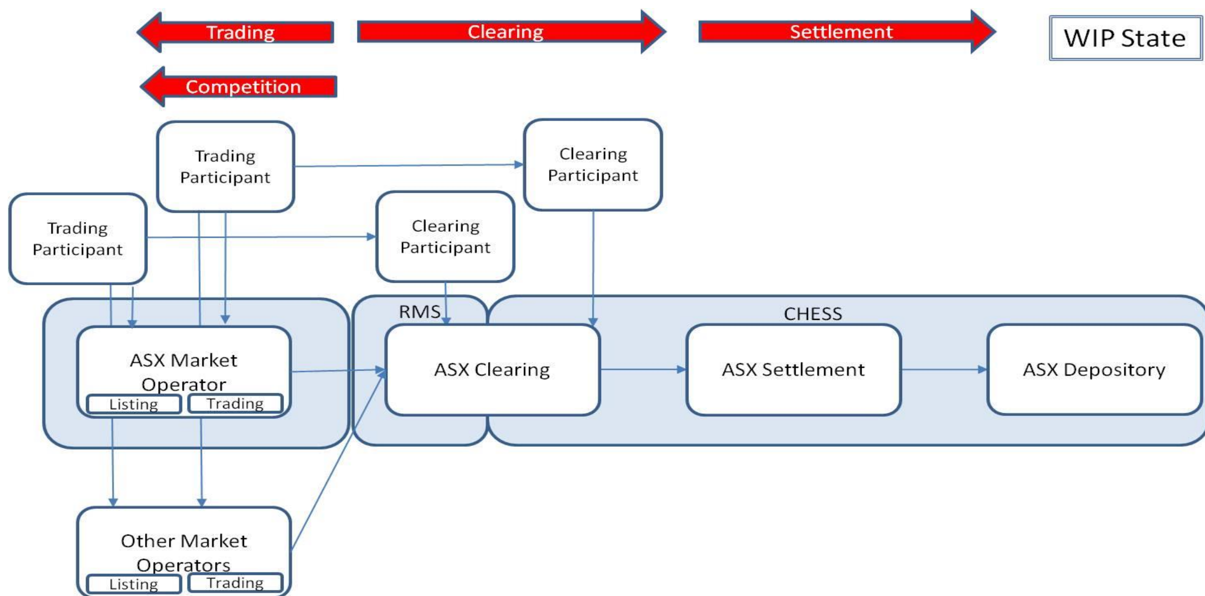

Figure 2 - Proposed APX access to clearing services

As APX utilises the SFS, APX market (or settlement) participants are required to adopt different and manual processes to settle APX transactions as compared to the processes utilised to clear ASX and Chi-X transactions. Further, as APX transactions represent direct broker-broker counterparty exposures, risk is increased in the settlement process.

The provision of access to ASX clearing services for the purpose of clearing and settlement of APX transactions would allow APX market (or settlement) participants to adopt the same processes to settle APX transactions as those utilised to clear ASX and Chi-X transactions. This reduces cost, operational risk and counterparty risk and increases the competitive attractiveness of participating in the APX market. It also ensures appropriate competitive alignment amongst each of the ASX, Chi-X and APX markets.

5.3. ASX failure to comply with the Code regarding access to clearing

APX's experience, so far, in relation to obtaining access to ASX clearing services for non-ASX quoted products indicates that ASX Clear has not delivered on its obligation to provide access in a transparent or non-discriminatory manner or to respond to users' requests for access in a fair and timely manner under section 4 of the Code.

In January 2014 ASX released a consultation paper entitled "Clearing and Settlement Services for Approved Market Operators and Approved Listing Market Operators enhanced service levels and information handing standards" (the "January Consultation Paper").

In the January Consultation Paper, under the heading "Expressions of interest in a Trade Acceptance Service for ALMO-listed and approved financial products", ASX stated that based *"on the feedback received through this consultation on the interest in using the TAS for trading in securities listed on the markets of ALMOs and the requirements of any interested party, ASX will undertake an assessment of the operational requirements and impacts for the TAS."*

In February 2014, prior to responding to the January Consultation Paper, APX met with ASX to discuss the technical documentation for the TAS.

In March 2014 APX submitted to ASX a written response to the January Consultation Paper (the "APX Submission"). In the APX Submission, APX stated that it *"is interested in the utilisation of clearing and settlement arrangements as an "ALMO" whereby ASX provides a Trade Acceptance Service. APX is interested in a post-trade service all along the value chain of centralized counterparty clearing, settlement, and custody".*

On 1 July 2014 ASX published its outcome from the January Consultation Paper. Notwithstanding APX's clear and express interest in the utilisation of clearing and settlement arrangements as an ALMO whereby ASX provides a TAS in both the February 2014 meeting and the APX Submission, ASX stated in its outcome paper that *"There have not been any formal expressions of interest by an ALMO for clearing and settlement arrangements through a 'trade acceptance service'. ASX has proactively sought early engagement with potential ALMO users to assess the modifications to the Trade Acceptance Service required to facilitate such a service".*

It is submitted that the published ASX outcome paper was not an accurate reflection of the facts.

The Code sets out a number of relevant statements in relation to the ASX Group's intention and access to clearing and settlement facilities:

- ASX Clear and ASX Settlement operate the <u>sole</u> [emphasis added] licensed clearing and settlement facilities providing clearing and settlement systems and services for the Australian cash equity market. ASX Clear provides central counterparty clearing services for a range of financial products including cash equities and equity options. ASX Settlement provides services for the settlement of equities and other deliverable products. Clearing and settlement of cash equities is conducted through a shared operating system CHESS;
- ASX is <u>committed to sharing</u> [emphasis added] with users of its services benefits and efficiencies arising out of the ASX group structure;
- ASX Clear and ASX Settlement will continue to publish on the ASX website transparent standard terms and conditions:
    - to become an ASX Clear or ASX Settlement participant pursuant to the ASX Clear and ASX Settlement operating rules;

  - for AMOs seeking access to TAS in order to facilitate the clearing and settlement for transactions effected through that AMO pursuant to the TAS Legal Terms; and
  - for ALMOs to apply for the provision of settlement facilitation services, pursuant to the SFS Agreement;
- Access for clearing and settlement services will be provided on a non-discriminatory basis [emphasis added]. ASX Clear and ASX Settlement will not unreasonably prohibit, condition or limit, directly or indirectly, access [emphasis added] by a person or company to clearing and settlement services; and
- ASX Clear and ASX Settlement will consider any request for clearing and settlement services [emphasis added] by AMOs and ALMOs including requests for changes to clearing and settlement services.

APX had to further reiterate its desire to access the clearing and settlement services of the ASX Group before ASX responded. Eight months had then elapsed since the February 2014 meeting and ASX had still not provided the abovementioned solution nor indicated a timeframe for its provision.

A number of meetings have been held since December 2014 to progress APX access to clearing services. However, in a number of instances agreed deliverables have not been met by ASX within agreed timeframes.

We submit that this is hardly "proactively seeking early engagement" nor is it consistent with the Code.

6. The competitive clearing environment

Having had the benefit of practical experience in an environment which does not facilitate competition for clearing competition, APX strongly believes that an environment conducive to competition with client or self-directed clearing and clearing house inter-operability should be created in a defined timeframe. Such an environment may not immediately result in a competitive equities clearing house entering the market, but it will generate a more competitive and responsive service from ASX in response to the threat of competition. This has already been evident in the recent proposals by ASX to reduce its clearing fees. In the interim, until a competitive equities clearing house does enter the market a higher degree of regulation should be adopted than the current self-regulatory framework.

Further, there must be greater separation of the wider ASX Group (in its capacity of listing market operator) from its clearing operations. As a general comment, APX does not believe the Code effectively addresses the monopoly or competition issues which gave rise to its adoption in the first place. It does not adequately address the competition issues faced by other listing market operators. ASX's commercial position is that the integrated value chain of trading, clearing and settlement allows it to provide efficiencies. However, it is this very position which highlights the issues faced by other market operators who are reliant upon access to the monopoly ASX clearing and settlement facilities. Other market operators cannot leverage the efficiencies which ASX can obtain as the only integrated market operator within Australia. Further, the Code does not address a range of issues, including those outlined elsewhere in this submission, or the ongoing perception of conflict and inherent competitive advantage.

APX believes that long-term structural solutions to enhance the competitiveness and efficiency of the market from the perspective of other listing market operators are required. Further, as APX has submitted that it is not in the public interest for settlement and depository services to be contestable at this point in time, these services must be regulated as an industry utility.

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The environment in which competitive access to, and provision of, clearing services would operate is represented in Figure 3 below.

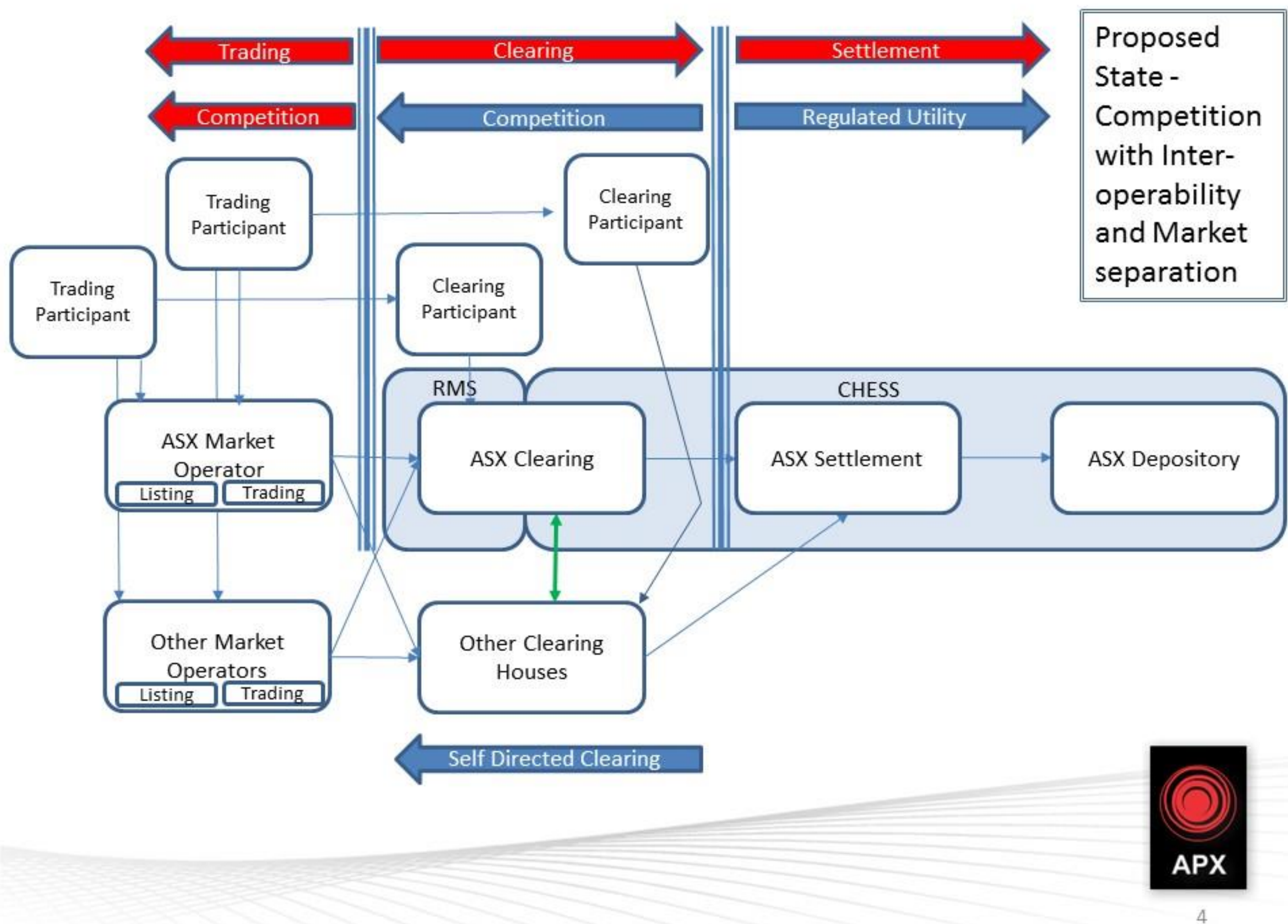

Figure 3 - Competitive clearing environment

6.1. Self-Directed Clearing

APX submits that the optimal environment in which to foster competition, or competitive pressure, is one in which self-directed clearing operates.

In a self-directed clearing environment each clearing participant chooses which clearing house it wishes to utilise for the purpose of clearing its trades. Clearing participants are not forced to connect to each and every clearing house. Hence the decision whether to remain with ASX Clear or to adopt a new clearing house is a commercial decision for that clearing participant.

In many respects it is analogous to the third party clearing environment in which a trading participant chooses whether to self-clear or to utilise the services of one or more third party clearers. The decision is a commercial matter for the trading participant. In the self-directed clearing environment a clearing participant chooses whether to utilise the services of one or more clearing houses.

On this basis there is minimal enforced cost impact upon industry. A clearing participant may chose to remain with ASX Clear.

The timing of the Council's review represents an ideal opportunity to introduce a framework to support a competitive clearing environment with self-directed clearing. ASX is considering replacing its clearing infrastructure over the next 2 to 5 years. In this monopolistic environment the industry must incur the costs of change according to the systems requirements and timeframes established by ASX. Introducing a competitive environment and self-directed clearing at this point in time would allow a potential competing clearing house to pitch for business as an alternative to the ASX CHESS system. As the industry wishes to move to international industry communication protocols, the ease of adopting a new clearing house provider is minimised compared to an imposed adoption of ASX Clear standards and the subsequent move to a new clearing house.

A significant portion of the costs of self-directed clearing would be borne by the market operators as they would be required to implement connectivity to multiple clearing houses in order to facilitate the clearing requirements of their market participants.

6.2. Clearing house inter-operability

As referred to in the Council's Consultation Paper, in a competitive clearing house environment inter-operability between the clearing houses would be required.

We note that the RBA FSS establish the minimal risk management conditions to operate in this environment.

As above, we submit that now is the ideal time for introducing an inter-operable environment, as ASX is proposing to replace its clearing infrastructure and adopt international messaging protocols. The adoption of international messaging protocols should reduce the timeframes and set-up costs for inter-operability. We recognise that there may be little incentive for an incumbent to implement inter-operability. For this reason we propose the introduction of Clearing Integrity Rules to manage timeframes and implementation obligations.

Government and ASIC have first-hand experience implementing Market Integrity Rules (MIRs) to support competition in the market for trading services. Those MIRs are broad in their application and included a shift of market supervision responsibilities from ASX to ASIC. The proposed CIRs would be much narrower in their application and thus less complex and quicker to implement.

6.3. Settlement connectivity

As stated above, we submit that Australian settlement and depository services should be non-contestable in the public interest, at least for now. Hence we recognise that the introduction of an environment for competitive clearing would require the clearing house(s) to connect to the ASX settlement facility. Again, there may be little incentive for an incumbent settlement facility to implement connectivity, especially as the existing CHESS system is bespoke and interfaces would require considerable development. For this reason, it is essential that ASX factor competition in clearing into the design of its CHESS replacement system so that the new settlement system is independent of ASX and provides a standard interface to be used by ASX, other market operators and industry participants on a standardized basis. Also, we propose that licence conditions on ASX Settlement and the Clearing Integrity Rules be utilised to manage timeframes and implementation obligations in relation to settlement access.

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6.4. Separation of listing and trading from clearing

The introduction of competing clearing houses does not mitigate the fundamental conflict of interest issue for AMOs and ALMOs, due to the integration of ASX as a market operator and as a clearing house operator.

We firmly believe that, as discussed above, the conflicts between the interests of ASX (as market operator) and those of AMOs and ALMOs are not manageable and there needs to be forced structural separation of the clearing and settlement functions from ASX. We firmly believe that in an environment for listing and trading competition the clearing house, its Board and its management should be structurally separated from ASX. This is the only way to ensure that all listing and trading market operators are treated as equal customers of the relevant clearing house(s). This should be implemented by way of licence conditions upon the clearing house.

The fully vertically integrated listing - trading – clearing – settlement – depository model works in a monopolistic environment for each of those services. It is unsustainable in an environment in which there is competition for listing and trading services.

Failure to fully segregate the ASX listing and trading functions from the clearing function will fail to deliver on Australian government and industry commitments to competition and innovation in listing and trading services.

7. Competition pathway

7.1. Certainty

The industry wants certainty and we submit that the current review must deliver certainty.

For this reason, an extension of the existing moratorium should not be an option. An extension of the moratorium will only serve to delay certainty. An extension of the moratorium for 5 years (as proposed by ASX) will extend the moratorium through the majority of a market cycle, thereby precluding competition during a rising market at the very time when a competitor may enter the market.

ASX has requested a moratorium extension of 5 years to provide a certain environment in which it would like to make investment decisions regarding the replacement of CHESS. As highlighted elsewhere in this submission, CHESS is a settlement system operated by ASX Settlement so linking its replacement to an extension of the moratorium in respect of clearing services is inherently flawed and mischievous. APX submits that ASX has an obligation to invest in CHESS and maintain a system with integrity irrespective of the outcome concerning any moratorium in relation to clearing services.

APX acknowledges that a competitive CCP may not enter the market in the short term, but an environment allowing a competitor to enter sooner rather than later will promote competitive pressures and provide a higher degree of certainty. APX submits that an environment conducive to clearing competition can be created within 18 months. The pathway to a competitive environment is represented in Figure 4 below.

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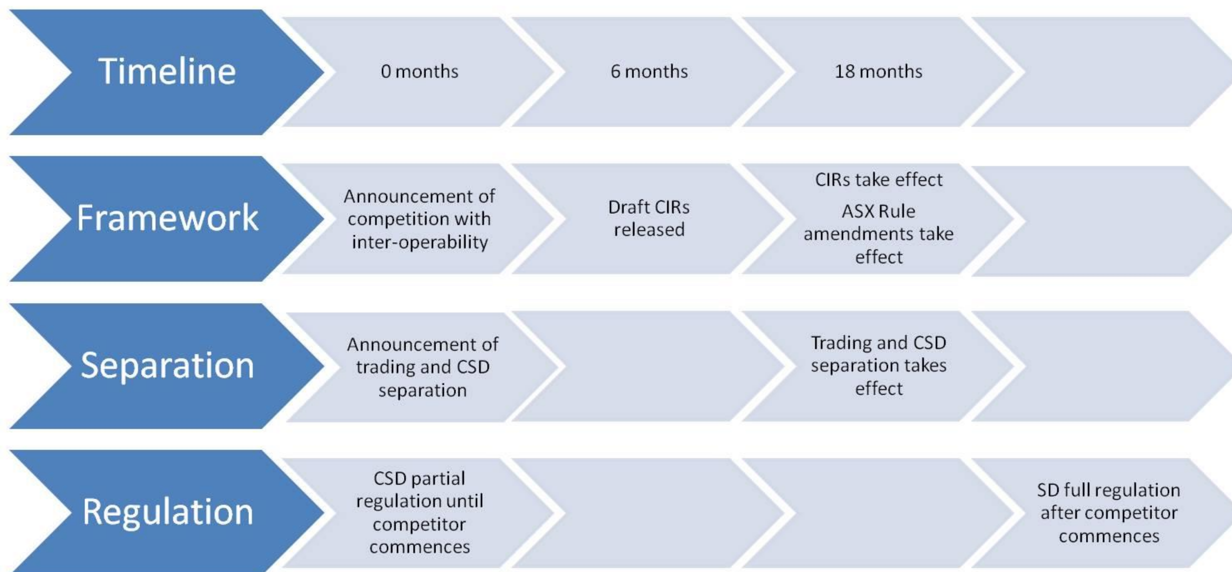

Figure 4 - Pathway to a competitive clearing environment

7.2. Clearing Integrity Rules

A necessary component of any competitive clearing environment will be the introduction of Clearing Integrity Rules ("CIRs"). The CIRs would include, at least, the following:

- Access arrangements and fees;
- inter-operability of the clearing houses;
- capitalisation of the clearing houses;
- settlement facility connectivity; and
- the capital obligations of the clearing participants in the clearing houses.

As discussed above, the introduction of CIRs are necessary to both regulate the competitive environment and to provide a regulatory imperative for the incumbent to implement the necessary environmental changes.
We believe CIRs could be published in draft form within 6 months, with a view to them taking effect in a further 12 months. This provides the market with certainty of implementation timeframes and provides ASX with an 18 month transition period in which to establish the necessary frameworks and structural separation of clearing and settlement.

7.3. Interim arrangements until a competitor emerges

APX submits that an environment for competition in clearing services is essential. That environment can be implemented within 18 months. The establishment of an environment for competition in clearing services does not necessarily mean a competing clearing house will emerge. Hence interim regulatory arrangements will be required until such time as a competitor enters the market.

The Council review suggests three possible forms of interim regulation:

- Self-regulation;
- Partial regulation; and

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- Full regulation.

As discussed above, APX submits:

- the self-regulation model adopted to date, as reflected in the Code, has failed and is not sustainable;
- the clearing function should be subject of partial regulation and structural separation of the listing and trading functions from the clearing and settlement functions; and
- the settlement and depository facility should be regulated as an industry utility for the benefit of brokers and of competing clearing houses.

In the absence of new entrant ready to provide alternative clearing services in the cash equities market, it will be necessary for Government to regulate ASX Clear on an interim basis in respect of pricing and access arrangements. Access can be primarily regulated by means of the Clearing Integrity Rules. Having Clearing Integrity Rules in place provides industry certainty and certainty for any new entrant that is interested in the Australian market. Pricing will require regulation by other means available to Government.

As an entrenched monopoly service provider, ASX Settlement should be subject to Government regulation in respect of both pricing and access. The ASX Settlement facility will be essential infrastructure used by ASX customers and its competitors and it must be managed in a competitively neutral way, while also delivering efficient and cost effective solutions for the benefit of the industry and its competitiveness in the region.

APPENDIX

Responses to specific CoFR questions

Question 1

Which policy approach would you prefer, and why?

Settlement should be regulated as a monopoly and clearing should be open to competition with interim regulation of ASX clearing until such time as a competing CCP seeks to enter the market.

Question 2

Are there alternative policy approaches to those outlined in this paper that you think should be considered by the Agencies? If so, please provide details.

None

Question 3

Are there any other overarching issues that should be taken into consideration?

Please refer to the broader APX submission.

Question 4

What particular benefits would you expect to arise from competition in the clearing of Australian cash equities? What level of fee reduction, or specific innovation in product offerings or service enhancements would you expect to arise? Please share any relevant experiences from overseas or in related markets.

In Europe, clearing fees were reduced by up to 90% in some markets as a result of the introduction of competition in clearing. With clearing interoperability, CCPs continued to innovate and offered fee structures on a per trade and per contract note basis. Clearing fees are also a fixed amount per unit as opposed to ASX's clearing fees that are set on an ad valorem basis linked to the value of the trade. The cost reductions in Europe appear to have been significantly understated in some of the media commentary.

Question 5

What costs or other impediments might you expect that you, and the industry as a whole, may incur if competition in clearing emerged? Please provide a description of the nature of these costs and any relevant estimates?

With ASX poised to redevelop CHESS, APX will need to examine its systems and do a cost assessment for the change management process. If an alternative CCP were to emerge, this could be evaluated at the same time. Given most overseas CCPs support global IT standards such as SWIFT, APX does not anticipate that it will be a substantial cost.

If ASX proceeds to replace the CHESS system, this will create the need for significant IT projects and costs on an industry wide basis to connect to a monopoly supplier. If a competitive framework is implemented it could provide the opportunity for participants to evaluate the cost/benefit of connecting to an alternative provider at the same time without increasing the cost of the project spend. That is, a new

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CCP entering the market could give them choice and the potential to connect to a new system at lower cost.

Question 6

What are your views on the specific risks that competition in clearing could pose to market functioning and financial system stability? Do you think the 'minimum conditions' identified by the Agencies would be appropriate to both promote competition and protect the stability and effective functioning of securities markets? Are there any other conditions that should be considered or other issues that the minimum conditions should seek to address? Please describe these.

APX does not accept that an overseas CCP can provide clearing services for OTC markets in Australia without the need to be incorporated domestically and have operation "on the ground" but that if the same CCP wants to offer clearing services in respect of cash equities that it is somehow special and requiring more domestic regulation. For a market the size of Australia, we need to be able to leverage the scale efficiencies that overseas CCPs have to lower the cost of doing business and make the Australian market more efficient. If this can be done for OTC markets in Australia it can surely be done for cash equities.

APX supports the other proposed arrangements, particularly those concerning access to settlement services and would add the need for CIRs to ensure ASX Clear has obligations to co-operate, among other things, with implementation of the interoperability model.

Question 7

What changes, if any, would be necessary to effectively oversee a multi-CCP environment in the cash equity market (e.g. additional regulatory arrangements)?

Please refer to question 6.

Question 8

Is there likely to remain a single provider of equity settlement services, either in the short or long term? Should competition in clearing emerge, what implications might this have for the design of the equity settlement facility, the cost of equity settlement services, access to equity settlement for the competing CCP, and future investment in the settlement infrastructure? Would the Code be sufficient to achieve access to equity settlement on appropriate terms, or would an alternative regulatory approach be necessary?

Yes, as noted in the APX submission, it is therefore essential that CHESS provides a standardized and transparent technical interface for use by all industry participants, including ASX and any competing CCP's.

Question 9

If competition in clearing emerged, should interoperability between CCPs be encouraged in Australia?
(a) How might competition in clearing affect the organisation and conduct of your operations? In the absence of interoperability, would you expect to establish connections to multiple trading platforms and CCPs? If so, would implications such as this diminish the commercial attraction of competition between CCPs?

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(b) With interoperability in place, would you expect to consolidate clearing in a single CCP? How would this decision be affected by best execution obligations? What effect would interoperability have on the costs that you may expect to incur from competition in clearing?
(c) What actions might the Agencies need to take (in addition to the requirements around management of financial exposures between interoperating CCPs specified in the Bank's FSS) in order to ensure that interoperability did not introduce additional financial stability risks? Would 'open access' obligations need to be imposed to facilitate interoperable links?
(d) What are your views on the stability and effectiveness of interoperability between CCPs in other jurisdictions?

APX supports interoperability as the only viable option. As APX is not a clearing participant we cannot comment on the costs from that perspective. As a market operator APX would need to establish arrangements with both CCPs and it comfortable that this can be done without extensive cost if industry standard protocols are required by CIRs.

Question 10

If the moratorium were lifted, would you expect a competing CCP to seek entry to the Australian market in the near future, noting the 'minimum conditions' set out in the Agencies' 2012 Report (refer to Section 4.3)? If competition were permitted but no competing CCP entered the market, at least for a time, should transitional regulatory measures (such as the existing Code) remain in place until such time as competition did emerge?

APX is not aware that a competing CCP is imminent, particularly given the proposed regulatory regime. APX does not support extension of the moratorium in clearing competition. APX supports an environment which facilitates competition. Given the absence of any new entrant, it will be essential that a regime of interim regulation is put in place. The ASX Code is proven to be manifestly inadequate and we have outlined numerous examples of its failures in this submission. APX therefore submits that a more robust regulatory intervention is required, including structural separation, and regulation of ASX access and pricing regimes.

Question 11

If the moratorium on competition were to be lifted, would the threat of competition be sufficiently credible to encourage ASX to retain and adhere to the Code, or would the Code need to be mandated (see Section 5.4)?

Much greater regulation would be required. The ASX Code is proven to be manifestly inadequate and we have outlined numerous examples of its failures in this submission. APX therefore submits that a more robust regulatory intervention is required, including structural separation, and regulation of ASX access and pricing regimes.

Question 12

Would you support an extension to the moratorium on competition in clearing? If so, why? What time period would be appropriate before the industry was ready for competition in clearing to emerge?

APX does not support extension of the moratorium in clearing but does support a 5 year moratorium on competition in settlement.

Question 13

If competition in the clearing of Australian cash equities were to be deferred indefinitely, what form of regulation may be necessary? Would a self-regulatory regime under the Code be sufficient to deliver the benefits of competition in clearing, or would some other form of regulation be necessary?

The Code has been a failure and much more robust regulatory intervention would be required by Government and regulators to ensure that the Australian market is not stifled by expensive and inefficient clearing and settlement services.

Question 14

How effective are the governance arrangements under the Code? For example, please expand upon the following:
(a) the effectiveness of the Forum and Business Committee
(b) the responsiveness of ASX to the issues raised by the Forum and Business Committee
(c) the composition of ASX's Boards.

As noted elsewhere in this submission the Code has been ineffective.

As noted elsewhere, greater independence is required on the Board of ASX Clearing and, as submitted, if ASX Settlement is regulated as an industry utility, greater industry representation is required on the Board of ASX Settlement.

Question 15

How effective are the current pricing arrangements? For example, please expand upon the following:
(a) the level of transparency of pricing, revenues and costs associated with ASX's cash equity clearing and settlement services
(b) the cost allocation policies adopted by ASX
(c) whether pricing is comparable with overseas clearing and settlement services.

Cost allocation policies are something that applies after the fact. If the technical solution and business operations are inherently inefficient or the system costs too high, any cost allocation method is going to allocate costs that are too high and be reflected in pricing that does not compare favourably to other markets. The real questions should be – (a) what does competitive pricing look like, and (b) to provide that same or similar pricing in Australia, how does ASX need to lower its costs to be able to provide the service with a reasonable commercial margin?

Question 16

How effective are the access provisions under the Code? For example, please expand upon the following:
(a) the adequacy of existing access provisions to support competition in trading of ASX-securities
(b) whether the scope of access provisions should be expanded beyond ASX securities
(c) whether the information-handling standards implemented under the Code are sufficient to support innovation, by mitigating potential conflicts of interest for ASX staff and management
(d) whether any further commitments are required to improve necessary access to ASX's clearing and settlement facilities by alternative market, and listing market, operators. If so, what measures are required?

As noted elsewhere in this submission the Code has been ineffective.

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As noted elsewhere, APX has sought expansion of the scope of access provisions beyond ASX securities but the ASX response has been less than appropriate.

The information-handling standards are not sufficient and are seen to be not sufficient. It is totally inappropriate that a market operator should be required to seek the approval of its direct competitor in order to bring innovation to the market.

APX submits that in order to improve necessary access to ASX's clearing and settlement facilities by alternative market, and listing market, operators a more robust regulatory intervention is required, including structural separation, and regulation of ASX access and pricing regimes.

Question 17

In general, how effective do you think the Code has been in addressing the issues identified by stakeholders in the 2012 Review? Do you think a Code of Practice is an effective mechanism for delivering outcomes similar to those that might be expected under competition? Please share your experience in relation to the operation of the Code.

The Code has not been effective. Examples of the experiences of APX in this regard have been set out elsewhere in this submission.

Question 18

Are there any other issues that the Code should seek to address? What steps, if any, should be taken to strengthen the arrangements under the Code in order to realise the benefits of a competitive market? Are formal enforcement mechanisms or extended accountability commitments necessary?

The Code has not been effective. In order to realise the benefits of a competitive market more formal enforcement mechanisms and extended accountability commitments are necessary through a combination of structural reform, Clearing Integrity Rules and licence conditions.

Question 19

If you think that another form of regulation would be necessary:
(a) What would be the appropriate scope of such regulation? Should both ASX Clear and ASX Settlement be regulated?
(b) What aspects of each service should be regulated (e.g. pricing, access, structure, ownership, infrastructure development)?
(c) Would the measures available under the existing legislative and policy framework be sufficient for this purpose? If not, what new regulation or legislation might be necessary?

APX submits that both ASX Clear and ASX Settlement be regulated as set out elsewhere in the submission.

APX submits that all of pricing, access, structure, ownership and infrastructure development are critical to ASX competitors such as APX. In particular, pricing has an overarching impact on the industry and its international competitiveness.

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APX submits that new policy and a combination of new and existing regulatory framework are required, including structural reform, Clearing Integrity Rules and licence conditions.

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ASX

Appendix 3 – Invitation for Feedback

ASX invites you to provide feedback on the proposed operational improvements to the Code set out below.

Consultation question
1. Moving from three Forum meetings per year to bi-annual Forum meetings.
Your feedback: APX has no objections
2. Moving from three Business Committee meetings per year to quarterly Business Committee meetings.
Your feedback: APX has no objections
3. Changing the governance requirements such that Technical Committees established under the Code report to the Business Committee rather than the Forum.
Your feedback: APX has no objections
4. Changing the definition of 'Agencies' so that it refers to the Council of Financial Regulators (CFR).
Your feedback: APX has no objections
5. Changing the requirement for ASX Clear and ASX Settlement to annually commission independent international cost benchmarking to a requirement that they commission updated international cost benchmarking from an independent consulting firm every two years.
Your feedback: APX has no objection to amending the timing from annual to every 2 years. However, APX submits that the further proposed changes are inappropriate for the following reasons: • Clause 3.4(a) changes the nature of the report from a "greenfields" report to an "update" report. • The deletion of clause 3.4(b) removes the industry consultation process in relation to the scope and methodology of the report. • The combination of these changes essentially locks in the scope, methodology and provider of future reports to the scope, methodology and provider of the 2014 report. It removes any scope for industry input into future reports or to facilitate change of scope and methodology to account for industry or other

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changes. For example, the Oxera report was commissioned by ASX (in accordance with Clause 3.4). The MSP report was commissioned by industry. The proposed amendments to clause 3.4 preclude the opportunity for industry to factor the learnings from the scope, methodology and outcomes of both the Oxera and MSP reports into future reports. It also locks in Oxera as the report provider for future reports.

We consider the proposed changes to remove review of, and consultation on, scope, methodology and provider to be a significantly retrograde change.

6. A new requirement for ASX Clear and ASX Settlement to report to the Forum each year that an updated international cost benchmarking report is not produced on any material changes to ASX Clear and ASX Settlement's tariffs structure and fee levels, and the impact of those changes for users.

Your feedback:

APX has no objection to the proposal on condition that the proposed changes regarding scope and methodology referred to above are not adopted.

7. Remove the requirement for an annual review regarding the operation of the Code.

Your feedback:

APX has no objection on the basis that the removal is of "an annual internal review" as proposed in the consultation paper, not removal of "an annual review" as proposed in the question. That is, the external review will remain.

8. Direct the external review of the operation of the Code to the core provisions and commitments relating to ASX's compliance with: the operation of the Forum (clause 2.4); transparent and non-discriminatory pricing (clauses 3.1 to 3.4); transparent and non-discriminatory access (clauses 4.1 to 4.4); and the protection of competitively sensitive information (clause 6(c)).

Your feedback:

APX has no objection to the changes proposed in relation to the references to clauses 2.4 and 4.1 to 4.4 in the new clause 5(a).

It is proposed to delete the current clause 5(b)(4) referring to "ASX's pricing to verify that there is no discrimination between ASX-affiliated entities and other users of clearing and settlement services". We assume this is on the basis that reference to discriminatory pricing is captured within the proposed wording of amended clause 5(b)(1) (proposed 5(a)(2)) which will refer to clauses 3.1 to 3.4 (clause 3.3 addresses price discrimination). By deleting existing clause 5(b)(4) the "verification" process is deleted. APX submits that, if current clause 5(b)(4) is to be deleted then the new clause 5(a)(2) should extend the references to clauses 3.1 to 3.4. The currently proposed wording makes particular reference to "including ASX's compliance with the cost allocation principles described in clause 3.2". Clause 5(a)(2) should be extended to also include "and verification that there has been no discriminatory pricing between ASX-affiliated entities and other users of clearing and settlement services described in clause 3.3." Hence the proposed clause 5(a)(2) would read "including ASX's compliance with the cost allocation principles described in clause 3.2 and verification that there has been no discriminatory pricing between ASX-affiliated entities and other users of clearing and settlement services described in clause 3.3."

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APX submits that the opportunity should be taken to further extend the scope of section 4 and, as a corollary, the scope of the external audit report in section 5, for a number of reasons.

- Whilst clause 4.1(a)(2) addresses access to clearing services via the TAS service and clause 4.1(a)(3) addresses access to settlement services via the SFS service, there is no reference to access to clearing services for the purpose of clearing non-ASX quoted or traded products (referred to here as "multi market clearing services" or "MMCS"). There is no guarantee that the clearing of non-ASX quoted or traded products would be done via the TAS service, it may be done via MMCS. If clearing of non-ASX quoted or traded products would be done via MMCS, the absence of a relevant reference to MMCS may result in ASX publications and processes for the purpose of clearing non-ASX quoted or traded products being excluded from future external audit reports. APX submits that Clause 4.1(a)(2) should be amended to specifically refer to access to TAS for the purpose of clearing and settlement of transactions in ASX quoted or traded products and a new clause 4.1(a)(4) added to specifically refer to access to MMCS for the purpose of clearing and settlement of transactions in non- ASX quoted or traded products.
- The Code is skewed towards the services provided to users such as clearing participants, settlement participants, listed entities and registries. It has little consideration for the needs and perspectives of market operators competing with ASX in its capacity as market operator. This is a substantial flaw in the Code.
    - Whilst ASX publications and service level agreements may address equality of access issues such as pricing and responsiveness to requests, they do not extend to key factors such as, for example, decision-making processes for prioritisation of resources or changes for AMO and ALMO initiated requests vis-à-vis prioritisation of resources or changes for ASX initiated requests. There is also no process for communicating to an AMO or ALMO how a prioritisation decision has been objectively arrived at and, in particular, how that decision has been objectively arrived at if the AMO or ALMO request directly conflicts with the interests of ASX as market operator. If decisions are made on a "commercial-to-ASX Clear" or "commercial-to-ASX Settlement" criteria (or business case), the criteria for the business case is not communicated to market operators (does the change need to meet a certain IRR or NPV, for example?). There is no review by the external auditor to ensure that the decision-making processes or prioritisation of resources or changes are objective and no more favourable to ASX in its capacity as market operator than those applied to, or adopted for, AMOs and ALMOs.
    - ASX advises that they have an agreed timeline for responses to AMO/ALMOs. However, it has been our observation that (1) these timelines have not been adhered to (2) they do not take into consideration urgency or needs of the ALMOs, who are the customers of this service.
    - The Code only partly addresses competitive sensitivities experienced by market operators, especially listing market operators. We acknowledge that ASX has put in place confidential information handling arrangements. However, this does little to dispel the perception that a competing listing market operator must obtain approvals from, or developments by, its competitor (being ASX). The perception of an uneven playing field is not dispelled in the broader market by the information handling arrangements and does little to address the competitive disadvantage.
- Whilst clause 4.2(a) refers to the objective of consistency with the outcomes of a competitive market and, to this end, service level agreements are put in place with AMOs and ALMOs, there is also no indication that an equivalent service level agreement exists between ASX Clear and/or ASX Settlement (on the one hand) and ASX (on the other) and that those service levels are reviewed by the external auditor. Similarly, there is no indication that the process for managing requests for services or change requests by ASX is managed in the equivalent manner to those made by AMOs and ALMOs and that those service levels are reviewed by the external auditor to ensure they are no more favourable than those adopted for AMOs and ALMOs. APX submits that
    - Clause 4.2 should be extended to the following effect

"(b) ASX is committed to providing non-discriminatory decision-making processes and service levels to all customers and potential users. The decision-making processes and service levels provided to customers and potential users will not discriminate between ASX-affiliated and other customers and potential users of clearing and settlement services. ASX will establish and implement decision-making processes and service level agreements with all customers and potential users, including ASX-affiliated users, for materially equivalent services."

  - in the interests of equality and transparency of service, Clause 4.3 should be extended by including reference to ASX where-ever a reference to "AMO or ALMO" occurs in clauses (a), (b) and (c).

- APX experience in relation to obtaining access to ASX Clearing services for non-ASX listed products indicates that ASX Clear has not delivered on its obligation to provide access in a transparent or non-discriminatory manner or to respond to users requests for access in a fair and timely manner under section 4 of the Code.

  In January 2014 ASX released a consultation paper entitled "Clearing and Settlement Services for Approved Market Operators and Approved Listing Market Operators enhanced service levels and information handing standards" (the "January Consultation Paper").

  In the January Consultation Paper, under the heading "Expressions of interest in a Trade Acceptance Service for ALMO-listed and approved financial products", ASX stated that based "on the feedback received through this consultation on the interest in using the Trade Acceptance Service for trading in securities listed on the markets of ALMOs and the requirements of any interested party, ASX will undertake an assessment of the operational requirements and impacts for the Trade Acceptance Service."

  In February 2014, prior to responding to the January Consultation Paper, APX met with ASX to discuss the technical documentation for the Trade Acceptance Service.

  APX provided a response to the January Consultation Paper in March 2014 (the "APX Submission"). In the APX submission we stated "APX is interested in the utilisation of clearing and settlement arrangements as an "ALMO" whereby ASX provides a Trade Acceptance Service. APX is interested in a post-trade service all along the value chain of centralized counterparty clearing, settlement, and custody".

  On 1 July 2014 ASX published its outcome from the January Consultation Paper. Notwithstanding APX's expressed interest in the utilisation of clearing and settlement arrangements as an ALMO whereby ASX provides a Trade Acceptance Service in both the meeting and the APX Submission, in that response ASX stated "There have not been any formal expressions of interest by an ALMO for clearing and settlement arrangements through a 'trade acceptance service'. ASX has proactively sought early engagement with potential ALMO users to assess the modifications to the Trade Acceptance Service required to facilitate such a service".

  We submit that the published ASX response was not an accurate reflection of the situation.

  The ASX Code of Practice for Clearing and Settlement of Cash Equities in Australia ("the Code") sets out a number of relevant statements in relation to the ASX Group's intention and access to clearing and settlement facilities:

  - "ASX Clear and ASX Settlement operate the sole [emphasis added] licensed clearing and settlement facilities providing clearing and settlement systems and services for the Australian cash equity market. ASX Clear provides central counterparty clearing services for a range of financial products including cash equities and equity options. ASX Settlement provides services for the settlement of equities and other deliverable products. Clearing and settlement of cash equities is conducted through a shared operating system CHESS";
  - "ASX is committed to sharing [emphasis added] with users of its services benefits and efficiencies arising out of the ASX group structure";

- "ASX Clear and ASX Settlement will continue to publish on the ASX website transparent standard terms and conditions:
  - (1) to become an ASX Clear or ASX Settlement participant pursuant to the ASX Clear and ASX Settlement operating rules;
  - (2) for AMOs seeking access to TAS in order to facilitate the clearing and settlement for transactions effected through that AMO pursuant to the TAS Legal Terms; and
  - (3) for ALMOs to apply for the provision of settlement facilitation services, pursuant to the Settlement Facilitation Service Agreement";
- "Access for clearing and settlement services will be provided on a non-discriminatory basis [emphasis added]. ASX Clear and ASX Settlement will not unreasonably prohibit, condition or limit, directly or indirectly, access [emphasis added] by a person or company to clearing and settlement services"; and
- "ASX Clear and ASX Settlement will consider any request for clearing and settlement services [emphasis added] by AMOs and ALMOs" including requests for changes to clearing and settlement services.

In order for ASX to progress matters, APX had to reiterate its desire to access the clearing and settlement services of the ASX Group. Eight months had elapsed since the February 2014 meeting and ASX had not provided the abovementioned solution nor indicated a timeframe for its provision. We submit that this is hardly "proactively seeking early engagement" nor is it consistent with the Code.

Finally, APX submits that the scope of the new clause 5(a)(4) referring to clause 6(c) is not broad enough. The opportunity should be taken to amend the scope to refer to all elements of clause 6, not just clause 6(c). The scope of clause 6(c) is to put in place operational standards and to consult on the implementation of information handling standards. As the 2014 external audit report (http://www.asx.com.au/cs/documents/PwC_Code_of_Practice_External_Review_Report.PDF) sets out, both of those have been implemented. Hence, future audit reports will have minimal scope or effect if limited to clause 6(c). We note that the 2014 external audit report included findings regarding clauses 6(a) and (b) hence there should be no objection to future reports being extended accordingly. Hence, the new clause 5(a)(4) should refer to "clause 6", not "clause 6(c)".

9. Change the requirement for 'users of clearing and settlement services' to be consulted as part of the annual external review to Forum and Business Committee Members being consulted as part of that review.

Your feedback:

APX objects to the proposed change.

APX acknowledges that ASX has extended the proposed scope of the amendment from being limited to members of the Forum to being limited to members of the Forum and Business Committee.

We note that, whilst the Code currently refers to "Users of clearing and settlement services" being consulted as part of the review, page 39 of the 2014 external audit discloses that the 2014 review was limited to members of the Forum only. APX submits that "Users of clearing and settlement services" extends beyond members of the Forum (and beyond both members of the Forum and the Business Committee) and is not limited to "a sample of users of clearing and settlement services". APX submits that the 2014 review was not conducted in a manner consistent with the Code.

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We acknowledge that there may be difficulties from an audit perspective interpreting the current wording "Users of clearing and settlement services" and determining who "users" are and whether all or a sample should be consulted.

However, we submit that feedback from a broader sample of direct users of clearing and settlement services is an important source of potential information and intelligence to assist the external auditor to conduct its review. The 2014 external review indicates that the external auditor was substantially reliant upon enquiries made of ASX management. Enquiries of a sample of direct users of clearing and settlement services may (or may not) have identified issues which could have been the subject of a "deeper dive" or more in-depth analysis by the external auditor. Narrowing the scope as proposed would deny the auditor that potentially valuable source of information and diminish the value of the report.

We strongly submit that the scope should be better defined, perhaps to the effect of "a reasonable sample of significant direct users of the clearing and settlement services being market operators, clearing participants, settlement participants, payment providers, listees and share registries" (and there may be more).

We further submit that the circulation of the external audit report should be extended to the Business Committee. We have been unable to identify a record to indicate that the broader industry (including the Business Committee) was made aware that the 2014 reports had been published (prior to the publication of this current consultation paper).

Additional comments

As a general comment, APX does not believe the Code of Practice effectively addresses the monopoly or competition issues which gave rise to its adoption. It does not adequately address the competition issues faced by other listing market operators. ASX's commercial position is that the integrated value chain of trading, clearing and settlement allows it to provide efficiencies. However, it is this very position which highlights the issues faced by other market operators who are reliant upon access to the ASX clearing and settlement facilities. As market operators they cannot leverage the efficiencies which ASX can obtain as an integrated market operator. Further, the Code does not address a range of issues, including those outlined above, or the ongoing perception of conflict and inherent competitive advantage.

APX believes that long-term structural solutions to enhance the competitiveness and efficiency of the market from the perspective of other market operators is required.

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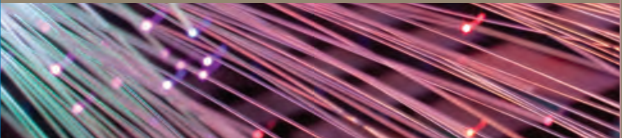
CHESS

Clearing House Electronic Subregister System



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What is CHESS?

If you buy or sell financial products such as shares in a listed company, you must exchange the title or legal ownership of those financial products for money. This exchange is called settlement.

For financial products traded on the Australian Securities Exchange, settlement is effected by a world-class computer system called CHESS, which stands for the Clearing House Electronic Subregister System.

CHESS is operated by the ASX Settlement Pty Limited (ASX Settlement), a wholly owned subsidiary of the ASX. ASX Settlement authorises participants such as brokers, custodians, institutional investors, settlement agents and so on to access CHESS and settle trades made by themselves or on behalf of their clients.

Usually, three business days after a buyer and seller agree to a trade, CHESS effects the settlement of that trade. It does this by transferring the title or legal ownership of the shares while simultaneously facilitating the transfer of money for those shares between participants via their respective banks. This type of settlement is called Delivery versus Payment (DvP). It is irrevocable.

In addition to performing settlement, CHESS electronically registers the title (ownership) of shares on its subregister. This registration is secure and is an efficient means for holders to register title of their shares if they intend to trade them.

In summary, CHESS performs two major functions for ASX.

- It facilitates the clearing and settlement of trades in shares, and
- It provides an electronic subregister for shares in listed companies.

CHESS performs these and other functions for a diverse range of financial products, including shares. To make it easier to read, this brochure talks about shares. However, most of what it says also applies to the other types of financial products approved for settlement via CHESS, including warrants, stapled securities, company issued options and units in trusts.

What benefits does CHESS offer investors?

CHESS benefits investors by providing a means of transferring and registering ownership of shares that is:

- secure
- efficient
- convenient
- seamless, and
- cost effective.

Do I have a choice of where I register title to my shares?

Yes. As a shareholder, you can choose to register the legal title to your shares on either the:

- CHESS subregister, maintained by ASX Settlement, or
- Issuer Sponsored subregister, maintained by the company who issued the shares. Most companies engage a share registry to administer their subregister on their behalf.

Registration in both subregisters is by electronic means. No paper certificates are issued for either subregister. However, a few foreign companies listed on the ASX may still offer paper certificates.

The principal register for any particular company is made up of the combined holdings registered on both the CHESS subregister and Issuer Sponsored subregister.

Irrespective of which subregister you use to hold shares, you will need to go through a stockbroker if you want to trade them.

How do I register my shares on the CHESS subregister?

To register your shares on the CHESS subregister, you arrange with an authorised participant (usually your stockbroker or their settlement agent) to sponsor you on CHESS. This 'CHESS Sponsor' will ask you to sign a sponsorship agreement that sets out the terms and conditions under which they can operate your holdings on the CHESS subregister on your behalf. This in no way changes your legal ownership of the shares.

CHESS shareholders are allocated a Holder Identification Number (commonly referred to as a HIN), which is similar in concept to a bank account number. Your HIN uniquely identifies you as the holder of shares on the CHESS subregister. Following your registration, ASX Settlement will send you a notification of your HIN. Keep this notification in a safe place as a record of your sponsor and your HIN. You should protect your HIN in the same way you protect your bank account number and not disclose it to anyone, unless required to do so in the normal course of business or by law.

If you wish, you may enter into a sponsorship agreement with more than one CHESS Sponsor. If you do, you will have a different HIN for each of your CHESS Sponsors.

How do I register my shares on the Issuer Sponsored subregister?

If you do not have a CHESS sponsorship agreement with your stockbroker or have not provided the stockbroker purchasing shares for you with a HIN, your shares will be registered on the Issuer Sponsored subregister by default.

You do not require a formal sponsorship agreement with a company to register your shares on their Issuer Sponsored subregister.

For each Issuer Sponsored holding, you will be allocated a unique Securityholder Reference Number (also known as an SRN) by the relevant issuer. Your SRN uniquely identifies your holding on the Issuer Sponsored subregister. Unlike a HIN, your SRN will not identify any holdings on the CHESS subregister. Also, unlike a HIN, you will have a different SRN for each holding.

Who controls the transfer or movement of shares?

If you hold your shares on the CHESS subregister then your CHESS Sponsor controls the transfer or movement of shares to or from your CHESS Sponsored holdings, but may only do so if following your specific instructions. This is explained in your sponsorship agreement.

If you hold your shares on the Issuer Sponsored subregister and want to sell them, your stockbroker must convert them to the CHESS subregister in order to settle the trade. To facilitate this, you must provide your stockbroker with the relevant details, including the SRN.

In addition to movements initiated by stockbrokers on your instructions, the share registry may, from time to time, adjust your holding on either subregister. These adjustments are usually to effect corporate actions such as a company issuing bonus shares.

You will be notified of any changes to your share holdings by a holding statement mailed to your registered address. For shares on the CHESS subregister, this is done by ASX Settlement. For shares on the Issuer Sponsored subregister, this is done by the share registry of the relevant company.

What are the main differences between the CHESS subregister and the Issuer Sponsored subregister?

On the CHESS subregister you have only one HIN (for each CHESS Sponsor) that identifies all of your holdings in all of the companies you have invested in. As most shareholders have only one CHESS Sponsor, one HIN identifies their entire portfolio.

On the Issuer Sponsored subregisters, you have one SRN for each holding. If you have a portfolio of shares you will have a number of SRNs, one for each company you have invested in.

To hold shares on the CHESS subregister you must have a formal sponsorship agreement with a CHESS Sponsor. No formal agreement is required for you to hold shares on the Issuer Sponsored subregister.

To change your registration name, address, or notification of Tax File Number for your shares on the CHESS subregister, you need to contact only your CHESS Sponsor. For shares on the Issuer Sponsored subregister, you need to notify the share registry of each company in which you hold shares.

Should I hold my shares on the CHESS subregister or the Issuer Sponsored subregister?

If you hold your shares on the Issuer Sponsored subregister and wish to sell them, you must advise your stockbroker of the share registration details, including the SRN, so your stockbroker can convert the shares from the Issuer Sponsored subregister to the CHESS subregister in order to settle the trade. This conversion must be completed in time for settlement or else the stockbroker will incur a fee, which they may pass on to you. Currently the time to settle a trade is 'T+3' or 'trade date plus 3 business days'.

If you hold your shares on the CHESS subregister and you wish to sell them, your CHESS Sponsor can move your shares for settlement without the need of a conversion. This is both easy and efficient.

Taking this into account, some of the factors you might consider when deciding which subregister to hold your shares on include:

- Issuer Sponsored shareholders may be inconvenienced by the need to communicate precise details of their holdings to their stockbrokers and bear the risk of incurring fees if a conversion from the Issuer Sponsored subregister is not completed in time for settlement;
- CHESS Sponsored shareholders enjoy hassle-free settlement and are not exposed to the risk of incurring fees arising from a failed settlement;
- Investors dealing with more than one stockbroker may experience settlement delays and possible fees when securities are transferred between different stockbrokers for settlement. Such investors may consider discussing these aspects further with their stockbrokers.

Are the shares I hold on the CHESS subregister safe?

Yes, your shares are safe for the following reasons:

- Transactions on a CHESS holding can only be effected by the CHESS Sponsor. By law your CHESS Sponsor may access your CHESS holding only when you have given them specific instructions to do so. Your CHESS Sponsor must authenticate your identity when you give them instructions. We suggest that you check that your stockbroker has adequate security measures in place to ensure that when you call they can verify your identity, for example by means of a password or PIN.
- The Corporations Act and the ASX Settlement Operating Rules regulate the actions of all ASX Settlement participants, such as stockbrokers, and what sort of transactions they can perform against the CHESS subregister.
- ASX audits ASX Settlement participants to ensure they comply with ASX Settlement Operating Rules and relevant legislation.

- ASX Settlement notifies you by mail of any change to your holdings on the CHESS subregister. To maximise the security of your holdings, make sure you register them using your direct address rather than an address 'care of' an intermediary, thus ensuring you receive all such notices directly.
- Your CHESS Sponsor must keep an electronic audit trail of all movements in your CHESS holding.
- ASX Settlement has implemented a range of security measures to minimise unauthorised access to CHESS, including message encryption and the limiting of each CHESS user's access to a specific and secure telecommunications line.

Are there protections against loss?

Yes. The National Guarantee Fund (NGF) is a compensation fund that covers losses in certain categories related to activities of ASX Market Participants, such as failure to complete a transaction, the unauthorised transfer of securities or failure to deal with property entrusted to the Market Participant where the Participant becomes insolvent. Compensation is not available for losses arising from normal trading. For more information about the NGF and the specific events it is legislated to cover, see the website of the fund's trustee (**www.segc.com.au**).

When will I receive CHESS Holding Statements?

ASX Settlement issues CHESS Holding Statements at the end of each month in which a transaction has occurred for a particular holding.

A CHESS Holding Statement shows the opening and closing holding balances of the holding for the statement period as well as listing any CHESS transactions that have occurred.

Statements are issued directly by ASX Settlement on behalf of each company. Separate statements are issued for each security. A statement is only issued when there has been a transaction during the month.

ASX Settlement does not issue routine CHESS Holding Statements for holdings of renounceable rights. However, a transaction statement for these securities may be provided if you request it through your CHESS Sponsor or the share registry.

You can request a CHESS Holding Statement at any time through your CHESS Sponsor. Your CHESS Sponsor may charge for this service.

Why are notices sent to me?

ASX Settlement sends you notices to inform you of any changes to your registration details or any change to your holding that is not covered by the routine holding statements. Some of the types of notices you may receive include:

- Change of name and/or address
- Change of sponsor
- Takeover offer acceptance
- Buyback offer acceptance, and
- Collateral reservation.

Can I have a relationship with more than one CHESS Sponsor?

Yes. There are several ways in which you can manage a relationship with more than one CHESS Sponsor:

- Establish a separate sponsorship agreement with separate stockbrokers and operate separate portfolios by always selling shares through the stockbroker who bought them for you. You will need to manage a HIN for each stockbroker.
- Establish sponsorship through one stockbroker (your CHESS Sponsor). If you trade through another stockbroker, advise that stockbroker of your sponsorship arrangements and instruct them to transfer your shares to or from your CHESS Sponsor. You must also instruct your CHESS Sponsor to deliver or receive the shares as a result of the trade. Your CHESS Sponsor may charge a fee for this.

- Appoint a non-broker such as a trustee company or margin lender as your CHESS Sponsor. When you trade with a stockbroker, instruct them to settle into your HIN with your CHESS Sponsor.

Can I move my CHESS holdings between CHESS Sponsors?

Yes. You can move either your entire CHESS holding or part of your CHESS holding from one CHESS Sponsor to another. If you are moving your entire CHESS holding, you should be able to keep the same HIN.

How do I change my name and/or address in CHESS?

To change your registered name and/or address, contact your CHESS Sponsor and provide them with the details and the paperwork necessary to verify the changes. Your CHESS Sponsor makes the changes in CHESS. You cannot change these details through the Share Registries. Once the changes are effected, ASX Settlement will mail you a CHESS notice confirming your new details.

How do I convert shares from the Issuer Sponsored subregister to the CHESS subregister?

To convert shares from the Issuer Sponsored subregister to the CHESS subregister:

- Enter into a sponsorship agreement with your chosen CHESS Sponsor. You will be allocated a HIN.
- Give your CHESS Sponsor the details of your Issuer Sponsored holdings, including the SRNs of the Issuer Sponsored holdings, and instruct them to move these holdings onto the CHESS subregister. Remember, your SRN can be found on your Issuer Sponsored holding statements.

Your CHESS Sponsor will convert your Issuer Sponsored holding to the CHESS subregister. ASX Settlement will confirm the conversion by mailing you a CHESS Holding Statement for each security transferred.

How do I convert a CHESS Sponsored holding to the Issuer Sponsored subregister?

To convert a holding to the Issuer Sponsored subregister, give appropriate instructions to your CHESS Sponsor, who will arrange the conversion. Your sponsor may charge a fee for this service.

How can I affect an 'off-market' transfer?

If you are sponsored in CHESS and wish to transfer your shares to another party 'off-market' (perhaps to gift them to someone), either:

- Instruct your CHESS Sponsor to make an off-market transfer of the shares to the other party; or
- Instruct your CHESS Sponsor to convert the shares to the Issuer Sponsored subregister. When this is done, complete an Australian Standard Transfer form, available from the share registry, to effect the transfer from your Issuer Sponsored holding.

For more information, ask your CHESS Sponsor.

How can I pledge my shares as collateral for a loan?

There are several ways of pledging your shares as collateral:

- If your lender also has access to CHESS, they may act as the CHESS Sponsor of the shares you wish to pledge
- You might transfer the shares into the name of your lender's nominee company, or
- Establish a three-way agreement between yourself, your CHESS Sponsor and the lender whereby the CHESS Sponsor agrees not to transfer the shares without the lender's authority.

If I have a query about my holding, who do I contact?

As a CHESS Sponsored shareholder, your first contact for any enquiry should be your CHESS Sponsor. This includes queries into transactions on your CHESS Holding Statement and any queries regarding your registration name and address on CHESS.

If you have a query related to matters handled by the share registry, for example dividend reinvestment participation, rights acceptance, dividend payment instructions, etc., you may need to contact the relevant share registry. However, your CHESS Sponsor is advised of any changes to your holding initiated by the share registry, so they may be able to answer your query themselves.

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