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***Council of Financial Regulators Consultation paper: Review of
Competition in Clearing Australian Cash Equities
February 2015***

The Stockbrokers Association of Australia is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. Our membership includes stockbroking firms across the spectrum, ranging from the largest wholesale stockbroking firms to medium-sized firms, and down to the smallest firms, having mainly a retail client base.

The Stockbrokers Association is pleased to provide this Submission to the Council of Financial Regulators regarding its Consultation Paper: *Review of Competition in Clearing Australian Cash Equities of February 2015*.

We note that the Government's 2-year moratorium on allowing a competing Clearing House (Central Counterparty, or **CCP**) entering the market expired in February this year.

The Association has a strong commitment to the growth of Australia's markets, particularly the Cash Equities Market, and to fostering Australia's role as a regional financial centre. In this regard, it is critical in our view that a robust regulatory

framework is maintained that maintains the balance between fostering innovation and competition whilst at the same time maintaining the integrity and high standing of Australia's securities market.

The Association believes that the CFR has identified the correct issues for consideration in relation to potential competition in clearing and settlement in the cash equities market.

The Association has for some time, and in particular, in previous submissions to Treasury in relation to the Review of Financial Market Infrastructure, registered in-principle support for competition, and for the potential for financial benefits, including efficiencies and innovation, that the market stands to gain from competition. In the Association's view, it is important that the regulatory framework does not shut Australia out from these potential benefits.

As regards the potential introduction of competition in clearing, there are three key objectives that must be satisfied before a decision is made to go down this path.

First, the benefits of introducing competition must clearly exceed the costs that would be involved. We have recently seen the introduction of competition in exchange services generating a level of costs which may ultimately prove to outweigh the benefits of market competition. There is little benefit to be gained from introducing competition in clearing if a similar outcome were to arise in this area as well.

It is vital that the regulatory framework which is settled on does not saddle the industry with compliance costs and other cost recovery levies that render the benefits of competition nugatory.

Secondly, introducing clearing competition should assist in furthering the competitive ability of Australia's cash equities market in the region. It is a key government policy objective to further Australia's position as a regional financial centre, and it must be closely evaluated whether this is best done by introducing clearing competition, or alternatively, whether there might be a case that retaining a single clearing facility maybe a better springboard for achieving that outcome.

Thirdly, financial stability and investor confidence are of utmost importance. It is critical that this confidence not be further undermined by any perception that competing clearing facilities will increase systemic risk, or a perception that investors will not be as well protected, or even a perception that operations of the market will simply become too complicated to understand.

Most of which we wish to state was contained in our Submission to the original review by the Council in 2012. However, compared to 2012, the situation has changed substantially, especially in relation to the following:

- a. to our knowledge, there is no foreign CCP eager, ready and/or willing to move into the market;
- b. we have 2 years' experience of the ASX Forum, which was established by ASX at the start of the initial moratorium; and
- c. the ASX has indicated that if the moratorium were to be extended for at least 5 years, it would discount its clearing fees to Clearing Participants by around 14%.

Set out below are some specific comments addressing Questions in the Discussion Paper. We have not sought to address all of the specific questions, as much would depend on the detail of the competition model being proposed.

FEEDBACK QUESTIONS

Policy Approaches

1. Which policy approach would you prefer, and why?
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.
3. Are there any other overarching issues that should be taken into consideration?

Comment: we agree with the approaches taken by the Agencies and do not propose any alternatives.

Competition

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.

Comment: those in favour of competition often cite the example of Europe, where headline clearing fees charged by CCP's reduced by up to 90%. However, others with European experience have noted that the actual cost to participants in terms of new systems, staff and administration have meant that much of these savings have been negated. In any event, it is very difficult to provide any

meaningful detail of costs or likely benefits of competition.

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?

Comment: please see 4. above

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.

Comment: we have nothing to add to the Agencies’ analysis.

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)?

Comment: like the transfer of market supervision to ASIC in 2010, obviously in a multi-CCP environment ASX (through ASX Clear) could not continue to oversee clearing in its totality. However, unlike the transfer of market supervision, it would not be as simple as handing oversight of CCP’s to ASIC like it oversees Exchanges. This is because of the financial and capital factors involved. For example, the ‘Supervising CCP’ would have a role in the case of default of one of the CCPs which would make it necessary to be much closer to the market. Therefore, an industry-based supervisory body may have to be considered. However, for the foreseeable future, there would appear to be little appetite for industry to fund and/or adequately capitalize such a vehicle.

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?

Comment: it continues to be the case (as it was during the earlier review in 2012)

that there has not been any support that our members have identified for competition in the area of settlement. Our members recognise the effectiveness of Australia's settlement system, and we also agree that there are merits in having a single system for establishing and transferring title. Hence, unless compelling reasons can be identified for the introduction of competition in settlement, which we do not presently see, then we agree with the focus of the Discussion Paper on questions relating to competition in **clearing**. While there appears to be no appetite for competition with ASX in settlement services, many of the larger and international brokers in particular are keen to see ASX replace or refresh the CHESSE settlement system. Although the funding model for the new CHESSE system is not known, it is important that there be a meaningful cost reduction for participants.

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?
 - (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?

Comment: as identified by the Agencies, Interoperability encompasses some complex operational issues. It would be simplest for our Members if they were able to choose their CCP on a standing instructions basis. This is to be contrasted with the 'best execution' obligations of the trading platforms, where the price of the security, as well as Exchange fees, may come into the equation. Best (trading) execution is facilitated by facilities like smart order routers that seek out – at additional cost to the participant - the best price across markets. If there were a 'best clearing obligation' as well, it is difficult to see how it could be achieved on a cost-effective basis.

- (d) What are your views on the stability and effectiveness of interoperability between CCPs in other jurisdictions?

Comment: as mentioned above, there are varying views on interoperability in other jurisdictions. Accordingly, it is difficult to draw any conclusions from experience overseas.

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?

Comment: as per our Preliminary Comments, the commercial reality is that it is most unlikely that a competing CCP will seek entry.

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)?

Comment: Code compliance in a competitive environment would be a matter for ASX, and the Agencies. We make no comment on the likelihood of compliance by ASX in those circumstances.

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?

Comment: in the absence of another entrant offering substantial cost savings, most of our Members are tending to express the view that the discussion of competition is largely hypothetical. With an offer on the table from ASX which includes a discount in clearing fees, even though it is hoped that the discount could be increased, most Members are of the view that ASX should be granted another 5 years moratorium.

Monopoly

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?

Comment: if competition were deferred indefinitely, some strengthening of the Code and governance arrangements around it may be justified. For example, consideration could be given to an independent clearing board with a majority

of independent directors.

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.

Comment: the Association has been a member of the Forum since its inception and has found it effective in raising and ventilating issues of concern to industry in relation to its dealings with ASX.

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.

Comment: we have no comment to make on this issue.

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?

Comment: as stated previously, we have found the Forum and Code effective in the context of the monopoly environment operating under the moratorium to date.

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.

Comment: please see 13., 14. and 16. above.

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?

Comment: please see 13., 14. and 16. above.

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?

Comment: please see 13., 14. and 16. above.

Concluding Remarks

Generally, people favour competition. We saw its impact on trading fees when (and even before) Chi-X entered the market in 2011. Therefore, while there is no imminent threat of competition in clearing, the threat of competition is still important. However, in the absence of another deal on the table, there is little incentive to open the floodgates in the short to medium term if ASX can offer a meaningful reduction in clearing fees.

As mentioned several times in this Submission there is a real lack of data available on the costs and benefits of possible clearing competition in order to put a compelling case either way. It would be of benefit to all parties if some feasible independent research could be undertaken, which takes into account internal costs to participants as well as headline clearing costs charged by CCPs.

Assuming a further moratorium is granted, for say, 5 years, the question will then be, *What happens at the end of the 5 years?* Hopefully the Agencies can coordinate work during any further moratorium so that the consultation process does **not** have to start all over again to address the same issues afresh at the end of the period.

Thank you for the opportunity to comment as part of the Council's Review. Thank-you also for the opportunity to meet and discuss these issues with Senior Officers of the Council members in Sydney recently.

We would be happy to discuss any issues relating to this matter at your convenience. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3207 or email pstepek@stockbrokers.org.au .

Yours sincerely,



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