Computershare

Initial Comments on Discussion Paper:
Competition in the Clearing and Settlement of Australian Cash Equities Market

This note sets out some initial comments from Computershare Limited on the Discussion Paper on competition in the clearing and settlement of the Australian cash equities market. We note that the discussion paper works on the basis that the provision of clearing services will become competitive in Australia but that the provision of settlement services most likely will not be contestable. There are implications for issuers and registrars in either event, but more particularly in the context of settlement becoming contestable.

Where the Discussion Paper addresses what may be the "*appropriate settlement arrangements for non-ASX CCPs"*, it is important that the ensuing developments acknowledge and preserve key features of the Australian securities ownership structure:

- CHESS is not just the settlement system of ASX-listed securities; importantly it is also a sub-register of legal title for those securities, forming a part of the total register of shareholders of each ASX-listed company. Settlement in CHESS thus delivers direct legal title to the securities.
- Australia has a strong reputation for the transparency and efficiency of ownership, with holdings in CHESS being directly visible as part of the register of shareholders and issuers having the right to disclosure of any underlying beneficial owners.

International Background

The discussion paper references the significant regulatory changes underway in the European Union in the areas of clearing and settlement. Computershare is engaged in dialogue with the European Commission and local market regulators on these developments, particularly as it relates to settlement and securities record-keeping aspects. There exist some key drivers of the legislative agenda in the EU that are relevant to contrast to the Australian market:

- The securities markets of the 27 member states of the EU still operate in many ways along national lines. The goal of a single integrated market is a major driver for legislation seeking to open up the national markets among CCPs and CSDs (under the so-called 'EMIR' legislation for clearing and the 'CSD-R' regulation for CSDs). Ultimately, while some new entrants in niche services are likely, the EU developments are expected to result in consolidation particularly amongst the CSDs, with a smaller number of cross-border service providers intended to achieve the goal of a united EU market. One expected benefit for this is to reduce clearing and settlement costs comparative to the US market.
- This is distinct from the Australian position, where the State-driven securities markets were consolidated in the 1980s into an efficient and competitive national market.

- This needs to also be seen in the context of the intended introduction of Target2-Securities ('T2S'), expected in 2015, which will result in most[1] EU CSDs outsourcing their settlement function to T2S to facilitate efficient local and cross-border settlement within the EU. This is expected to reduce the focus between CSDs on the provision of purely settlement services, which is seen as essentially a utility function, and will result in the CSDs focusing on the provision of more value-added services to their clients.
- The CSD-R is intended to achieve common regulation of the activities of the CSDs in relation to the administration of securities, to ensure the integrity of securities issues. In the EU, many providers of settlement services are depositaries, which immobilise title to securities and record and settle beneficial entitlement to the securities. Only a small number of the so-called CSDs provide direct legal title in a manner analogous to CHESS, the most significant of these being the UK system CREST (operated by Euroclear). The fundamental legal differences between the 'direct holding' systems and the depositaries has caused some difficulties in the drafting of the CSD-R.
- The CSD-R is also expected to introduce mandatory full dematerialisation or immobilisation of securities traded on EU markets, and harmonised rules on settlement discipline. These are already well-established and highly efficient features of the Australian market.

In the US, the approach has been to encourage centralisation of both the clearing and settlement functions for equities, with settlement in particular seen as a natural utility service. This drove the formation of the Depositary Trust and Clearing Company ('DTCC') and much of the US regulatory structure in this area. Although some providers have discussed providing a competitive service to DTCC (e.g. NASDAQ explored developing a settlement function in recent years) this has not eventuated.

In those EU markets where the depositary model is used, similar to DTCC in the US, investors do not obtain the benefit of direct legal title to their securities; instead units of beneficial ownership are exchanged and recorded with their systems. This is a key difference between those markets and Australia, where CHESS is a part of the register of shareholders maintained in accordance with the provisions of the Corporations Act. The depositary structure adopted in the US and many EU markets, with limited issuer rights of transparency of ownership, has generated significant complexity, parallel effort and associated cost concerns related to the processes for shareholder communications and shareholder voting, which are necessary to ensure good governance.

We are of the opinion that settlement is in essence a central utility function and that introducing competition in this area would generate unnecessary costs and risks for the Australian market. We are also concerned to ensure that the system in Australia preserves the benefits of direct legal title and transparency of ownership. Our notes below address the potential impact of the introduction of competition in clearing services, which we believe is the most likely outcome for Australia. We have

[1] Not all EU CSDs will outsource their settlement function to T2S. Perhaps the most significant to indicate that they will not participate in T2S is the UK's CREST.

also noted some particular comments related to the impact of competition in settlement services for issuers and registrars, in the event that further consideration is given to this possibility.

If Clearing is Contestable but Settlement is CHESS-only

If only clearing is contestable, the impact for issuers and registrars will largely be driven by the settlement process that is put in place for non-ASX clearers, and the impact of this on the transparency of the share register and the structure of shareholder title. Issuers and their registrars must have the opportunity to review and provide input to such developments. Some issues that were noted in the Discussion Paper of relevance to issuers and registrars are:

1. Settlement Arrangements
   - The Discussion Paper raises the issue of settlement arrangements that the new CCPs must make with ASX, assuming CHESS is a natural monopoly. These arrangements must be 'acceptable' to both parties.
   - As yet, there is no available information about what the possible arrangements may be. It will be important for issuers and registrars to have the opportunity to review the proposed arrangements to address whether there is any impact on the transparency of the register, and whether this changes the delivery of legal title through the settlement process.
   - It would be a retrograde step for the Australian market to move to delivering only beneficial ownership, for example, to participants in a new CCP, where Australia currently operates at the higher standard of direct legal title.

2. Competition & Access to CHESS
   - In the event that rules are introduced to address price transparency and unbundling, it will be relevant that this applies to all users of CHESS and not just to settlement participants. This should avoid the potential for any hidden cross-subsidisation by ASX to counter potentially reduced fees on clearing as a result of competition.

If Settlement is also Contestable

We believe that a utility settlement system, with price transparency, is the most effective approach for the Australian market. In the event that the settlement function becomes contested, any competing settlement system should be subject to requirements that it:

1. So far as possible, operate in a manner equivalent to CHESS, observing the core principles agreed amongst all market stakeholders in the establishment of CHESS; and
2. Not increase the overall costs for users of the markets, especially issuers and retail investors who do not control trading volume or seek mobility in using alternative clearing and settlement infrastructures.

On page 5, the Paper states that the settlement system is also "*the market's central record of securities title"*. It then proceeds to note that an advantage of CHESS as the only settlement system is that the securities record is not held in multiple locations and that this allows *"more accurate whole-of-market record-keeping, as there is no need to aggregate the records held in multiple facilities".* We agree that the role played by the settlement system in recording title is important however it must be noted that CHESS is only part of the central register of title for ASX-listed securities. The total register of shareholders is comprised of two subregisters – the CHESS subregister administered by ASX, and the Issuer Sponsored subregister administered by the issuer or their registrar.

The issuer/registrar receives files from CHESS of CHESS holdings to enable it to compile the total register. Therefore the 'central record' as such is already aggregated from two sources. This allows investor choice in whether to hold their securities directly on the books administered by the issuer or through the use of a sponsoring broker that administers their holdings.

In the event that competition in settlement is pursued, it would be necessary to also consider how the securities holdings would be maintained and updated for settlement. This has not yet been addressed. Any process should not reduce the transparency of the Australian market, make shareholder communications and voting processes more difficult to administer and maintain the efficiency and cost-effectiveness of the current holding structure.

Computershare appreciates the opportunity to present its position to Treasury on these issues, and is keen to continue to participate in the discussions about these important reforms. We would be happy to offer our further insight and assistance to the Council of Financial Regulators where appropriate.