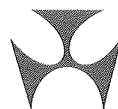


RESERVE BANK OF AUSTRALIA



G.R. Stevens
GOVERNOR

18 December 2012

The Hon. Wayne Swan, MP
Deputy Prime Minister and Treasurer
Parliament House
CANBERRA ACT 2600

Dear Deputy Prime Minister,

**COUNCIL OF FINANCIAL REGULATORS:
COMPETITION IN CLEARING AND SETTLEMENT
OF AUSTRALIAN CASH EQUITIES**

In April 2011, you asked the Council of Financial Regulators (Council) to examine measures which could be introduced to ensure that Australia's regulatory system for financial market infrastructure continued to protect the interests of Australian issuers, investors and market participants, including under a scenario where ASX was part of a foreign-domiciled group. In the course of this work, the Council has identified a number of issues for consideration around competition in clearing and settlement.

On 15 June 2012, you released a Council discussion paper on competition in the clearing and settlement of Australian cash equities. This work was carried out by Council agencies in collaboration with the Australian Competition and Consumer Commission. The particular focus on cash equity clearing reflected interest from potential competing providers that had already emerged.

Since the release of the discussion paper, the Agencies have consulted widely and have listened to the views of stakeholders. I attach for your consideration a copy of the Council's conclusions from this work.

There were mixed views as to whether competition in clearing would deliver net benefits to the Australian financial system. While several stakeholders were strongly in favour of competition, at least in principle, there was a general concern that significant costs could be imposed across the industry. Many respondents were resistant to further changes in the operating environment at the current time, citing difficult market conditions and existing pressures to cut costs.

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Based on stakeholder feedback, the Council recommends a set of 'minimum conditions' for safe and effective competition. Articulating these conditions will allow parties considering entry to clear Australian cash equities to make more informed decisions. It is recognised that making changes in accordance with the minimum conditions to support competition in clearing will involve costs, and that the benefits may not be readily quantifiable.

These uncertainties are not reasons to rule out the prospect of competition for the clearing of cash equities entirely. As a matter of principle, the Council is open to competition and would expect competition to deliver efficient outcomes in terms of pricing, innovation and user responsiveness. However, it is acknowledged that now may not be the appropriate time for changes that will have further cost implications for industry, especially given current market conditions and existing pressures on participants to cut costs. The Council recognises the magnitude of regulatory change already underway, not least in relation to Basel III and OTC derivatives clearing and trade reporting. Taking these factors into account, the Council recommends the following:

- A decision on any licence application from a CCP seeking to compete in the Australian cash equity market should be deferred for two years.
- ASX should work with industry stakeholders to develop a *Code of Practice for Clearing and Settlement of Cash Equities in Australia*, based on a set of 'principles' around user input to governance, transparent and non-discriminatory pricing, and access. ASX would be strongly encouraged to publicly commit to developing and adhering to the Code, potentially via a public exchange of letters between yourself and ASX. Furthermore, it would be strongly preferred that ASX reach agreement on the Code with all relevant stakeholders within six months. ASX would be expected to provide regular updates to the Council and to submit the Code to the Council for approval at the end of the process. Since the recommendation to defer competition would perpetuate ASX's *de facto* monopoly position, a Code is considered necessary to deal with the issues raised by stakeholders that competition might have been expected to address.
- At the end of the two years, it is proposed that the Council carry out a public review of the Code's implementation and effectiveness, and ASX's adherence to it. At the same time, the Council would review the prospect of granting a licence to a competing clearer, or of pursuing other regulatory outcomes. If competition were to be ruled out indefinitely, a regulatory response might be appropriate.

Importantly, it is proposed that these arrangements would apply only to cash equities, and would not apply in relation to clearing and settlement services supporting either exchange-traded or OTC derivative markets or OTC debt markets. The Council reiterates its openness to the provision of OTC derivatives services by one or more domestic or overseas-based CCPs, subject to those CCPs meeting all regulatory requirements. The Council regards the characteristics of the cash equity market and the prevailing competitive dynamics to be very different from those in OTC derivatives markets. In particular, while the OTC derivatives market is wholesale and international

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in orientation, the cash equity market is domestically focussed and exhibits a high level of retail participation. Furthermore, clearing decisions in the cash equity market have implications for the design and operation of other components of the market infrastructure, and in turn the users of such infrastructure.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'John Laker', written in a cursive style.

Encl.

- cc. Dr John Laker, Chairman, Australian Prudential Regulation Authority
Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission
Dr Martin Parkinson, Secretary to the Treasury
Mr Rod Sims, Chairman, Australian Competition and Consumer Commission