26 April 2023

Capital Markets Unit
Financial System Division
Treasury
Langton Cres
Parkes ACT 2600

By email: CICS@treasury.gov.au

Dear Lauren, Christian, Matthew and Darcy,

Cboe Australia welcomes the opportunity to make a submission on the exposure draft of the *Financial Sector Reform (Competition in Clearing and Settlement) Bill 2023* (**CICS Bill**).

Cboe Australia commends the Government and those who have worked on the bill for delivering an innovative and effective regulatory framework for Australia's unique clearing and settlement environment. Most importantly, the bill provides a framework for and is focused on, delivering meaningful benefits for Australia's financial markets for many years to come.

Cboe Australia considers that it is uniquely placed to provide constructive feedback to the bill, noting:

- our history and track record, as one of the rare examples in the Australian marketplace of an entity successfully challenging an ASX monopoly service (secondary market trading); and
- our vision and ambitions, as one of the few entities in the Australian marketplace that could realistically challenge the ASX monopoly in the clearing and settlement of cash equities in the short or medium term.

Our submission covers three key themes:

1. **Support for the CICS Bill** – Cboe Australia is highly supportive of the proposed legislation and is strongly of the view that it is in the interests of investors and the broader financial system. Cboe Australia supports the approach taken by Government to ensure the powers apply to both a monopoly and competitive marketplace. Cboe Australia considers the legislation balances the need to have strong safeguards in relation to the new powers, against the need to ensure that regulators can exercise those powers in a timely manner. Cboe Australia considers the bill and explanatory materials are clear and precise. Cboe Australia thanks Government for its prioritisation of this necessary reform.
2. **Importance of Immediate Action** – For the intent of the reform to be achieved, we think it is important, and possibly critical, that regulators use the tools available to them now to prevent anti-competitive outcomes being embedded into the Australian financial system by the monopoly provider prior to the CICS Bill's passing.

3. **Empowered Regulators** – For the intent of the reform to be achieved, we think it is critical that regulators are willing and empowered to use their new powers to address the root causes that inhibit competition. In our view, an anti-competitive paradigm is entrenched at a fundamental level by the monopoly provider. This includes their extreme vertical integration, inadequate governance, and unique system design. For effective competition to emerge, regulators must be willing to use their new powers to force change at this fundamental level, rather than attempt to build a competitive framework on an unfair foundation.

1. Support for the CICS Bill

Cboe Australia reiterates its strong support of the CICS Bill, and its implementation of the final recommendations of the 2015 Council of Financial Regulators' (**CFR**) Review of Competition in Clearing Australian Cash Equities: Conclusions.

Cboe Australia is strongly of the view that it is in the interests of investors and the broader financial system that there is effective competition in clearing and settlement. In our view, the existing monopoly paradigm has resulted in increased costs to investors, has acted as a handbrake on innovation and has locked the industry into expensive, cumbersome, and proprietary systems.

By giving the regulators powers to enforce the CFR policy statements[1], Cboe Australia is hopeful that these issues can begin to be resolved. In our experience, the inability of the regulators to enforce the policy statements to this point has had clear negative outcomes, including:

1. Cboe Australia, and other customers of monopoly cash equity CS services, having no meaningful input into the strategy setting, operational arrangements, and system design of those services, contrary to expectation 1 of the Conduct Expectations;
2. Cboe Australia having access to monopoly cash equity CS services on terms that are discriminatory, contrary to expectation 3 of the Conduct Expectations; and
3. the monopoly provider, in our view, making investments in the systems and technology that support its cash equity CS services in ways that raise barriers to access, contrary to expectation 3 of the Conduct Expectations.

Cboe Australia is supportive of the new powers applying equally to monopoly and competitive markets. Cboe Australia believes the best outcome for investors is when there is effective competition throughout the financial system. Given the current state of Australia's financial system, to achieve this outcome, it is necessary that the new powers can apply to ensure a monopoly provider of CS services operates in a way that achieves competitive outcomes and to ensure safe and effective competition in clearing and settlement once a competitor emerges.

Given the broadly defined legislation and extensive scope of the powers, Cboe Australia considers there should be strong checks and balances (including consultation) around the making of CS

[1] Minimum Conditions for Safe and Effective Competition in Cash Equity Clearing in Australia (**Minimum Conditions – Clearing**), Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia (**Minimum Conditions – Settlement**), Regulatory Expectations for Conduct in Operating Cash Equity Clearing and Settlement Services in Australia (**Conduct Expectations**)

services rules and the exercise of arbitration powers. This needs to be balanced against the need to ensure that the powers can be exercised in a timely manner to respond to issues in the market. In this regard, while we have noted below our concerns regarding current conduct in the market, we consider the CICS Bill strikes an appropriate balance between these factors.

Cboe Australia also appreciates the clarity and readability of the CICS Bill and is supportive of legislative drafting that avoids unnecessary complexity and overly legalistic language.

Cboe Australia has a small number of suggestions to the CICS Bill and Explanatory Materials that we consider will improve their ability to deliver competitive markets. We request Government consider:

1. Ensuring that open access to interfaces and full interoperability are given prominence at the legislative level, as these are both essential to forming a marketplace where multiple CS service providers can compete on a level playing field;
2. Ensuring the regulators' powers may extend to mandating the same access to CS Services, as the current language of the Policy Statements (for example 'materially equivalent service levels' or 'non-discriminatory access') have proven to be insufficient to receive a service that is to the same standard as what the monopoly provider provides its related entities;
3. Ensuring regulators have regard to the effect that rules and arbitrations in respect of CS services will have on financial markets;
4. Ensuring that the carve-outs permitting a vertically integrated provider to charge higher access fees to non-group entities are limited in scope.

Each of these suggestions are detailed in the table in **Appendix One.** We also consider the CFR policy statements should be updated for consistency with these suggestions.

2. Importance of Immediate Action

Cboe Australia is conscious there are several significant legislative and other processes that must be completed before ASIC is able to use its rule making power. Even if a straightforward parliamentary process for the passage of the CICS Bill is assumed, the appropriate checks and balances on ASIC's rule making power mean there may be a significant period before there are enforceable rules.

Cboe Australia's concern is that the current monopoly provider, through the CHESS replacement project, will take steps ahead of the CICS Bill to build a technology architecture and framework that may lock the Australian financial system into systems and processes that will inhibit the emergence of competition in 'CS services', as that term is defined in the bill.

Cboe Australia is of the view that it is critical that regulators use the tools available to them now to prevent anti-competitive outcomes being embedded into the Australian financial system.

In the context of the CHESS replacement project, specific examples of our concerns include:

1. *Lack of transparency and input* – for both the failed initial CHESS replacement project and the subsequent ongoing project, Cboe Australia considers there has been minimal effort by

the monopoly provider to genuinely consult with its users regarding the strategy setting, operational arrangements, and system design of the new CS services.

2. *Open Interfaces not in scope* – while we are hampered by the monopoly provider's lack of transparency, it appears to Cboe Australia that the monopoly provider is proceeding with a CHESS Replacement model that will not allow open access to interfaces that are essential to providing effective competition. As an example of this issue, Cboe Australia is currently unable to compete on a level on a level playing field against the vertically integrated monopoly provider in the listing and quoting of products due to a requirement imposed on Cboe Australia by the monopoly CS provider to use their issuer management services for Cboe Australia listed and quoted products. In an effective, fully competitive marketplace, this should not occur as each market operator should have the same open access to the necessary interfaces to deal with issuer management of their respective products.
3. *Interoperability not in scope* – while we are hampered by the monopoly provider's lack of transparency, it appears to Cboe Australia that the monopoly provider is proceeding with a CHESS Replacement model that does not have any regard for ensuring there can be interoperability with any future CS Facility that emerges. This is despite the clear intent of Government, through this legislation, and the regulators, through the CFR Policy Statements, that interoperability is the ideal model for a competitive marketplace in clearing.

We consider regulators should use the powers available to them now, when the CHESS replacement project is still in its scoping stages, to direct the monopoly provider to ensure that its project will deliver outcomes that are consistent with the CFR policy statements and a competitive marketplace.

3. Empowered Regulators

The effectiveness of this legislation will be dependent on how regulators use their new powers to challenge the anti-competitive paradigm that is entrenched at a fundamental level by the monopoly provider.

For effective competition to emerge, regulators must be empowered and willing to use their new powers to their full extent to force change at this fundamental level, rather than attempt to build a competitive framework on an unfair foundation.

In our view, this must include addressing:

1. The extreme vertical integration of the monopoly provider, particularly in how it integrates 'core' CS services with other services in ways that frustrate competition (see the issuer management services example above). Regulators must be willing to direct the monopoly provider to undo such integrations if it is necessary for effective competition.
2. The inadequate governance of the monopoly provider. Cboe Australia is of the view that the most effective way for this to be achieved is by regulators being willing to enforce a structural separation of monopoly CS services from the rest of the integrated group. This does not mean separating the shareholding of the clearing and settlement business from the shareholding of the remainder of the integrated group. It does mean implementing a structure that at a basic governance, operational, and systems level, seeks to ensure there

would be no privileges for group members against non-group members. There are several models used for structural separation around the world, including in Canada and at the Cboe group itself (which operates a market and a CCP in Europe).

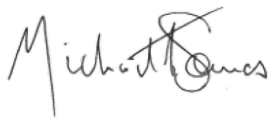
3. The radically integrated and bespoke system design of the monopoly provider's clearing and settlement systems, originally set in place when clearing and settlement was undertaken by a mutually owned entity using a 'public utility' model. The need to address this point becomes increasingly critical if the replacement CHESS system does not provide for open access or interoperability. Regulators must be willing to force the monopoly provider to make changes at a system design level if it is necessary for effective competition.

4. Final Comments

Cboe Australia thanks Treasury for the opportunity to make this submission and is more than willing to provide any assistance that you may require. We believe the CICS Bill will help deliver better outcomes for Australian investors and the Australian financial system.

If you have any questions about our submission, please contact Asika Wickramasinghe (02 8078 1748) or me.

Yours sincerely,



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Appendix 1 – Table of Suggested Changes

Reference	Exposure Draft Wording	Cboe Australia Suggested Change	Justification/Comments
EM paragraph 1.30	Specifically, it is intended that the rules may deal with matters including, but not limited to: […] • the CS facility licensee's provision of services to users (including competitors) including investment in core infrastructure, service levels, transparent, non-discriminatory and fair and reasonable pricing of the CS facility's services, and the provision of access to the CS facility's services (including data) on transparent, non-discriminatory and fair and reasonable terms;	Specifically, it is intended that the rules may deal with matters including, but not limited to: […] • the CS facility licensee's provision of services to users (including competitors) including investment in core infrastructure, open access to CS facility interfaces, providing the same service and service levels to competitors, transparent, non-discriminatory and fair and reasonable pricing of the CS facility's services, and the provision of access to the CS facility's services (including data) on transparent, non-discriminatory and fair and reasonable terms;	Open access to interfaces is not dealt with in the CICS Bill or Explanatory Materials. While is it probable that open access would fall within the scope of ASIC's rule making power under 828A(1)(a), we consider there are clear benefits to explicitly stating this in the Explanatory Materials. For the reasons stated in the body of the submission, we do not consider there can be effective competition while the monopoly provider is able close off access to CS system interfaces to non-group entities in a discriminatory manner. With respect to 'the same service and service levels', we consider this is necessary given our experience of the monopoly provider providing discriminatory service, despite the language of the Conduct Expectations. In our view, until effective competition exists, the onus should be on the monopoly provider to provide the same service and service levels and ASIC's starting approach to rule making should be on this basis. If the same service or service levels are not possible, the onus should be on the monopoly provider, in the course of the consultations required by the CICS Bill, to justify why this is the case and why a lower standard (for example, 'materially equivalent' or 'non-discriminatory') must be used instead. This will also help improve transparency from the monopoly provider to its users. We also consider that the CFR Policy Statements should be updated along these lines.
S828B (and EM 1.22) **and**	(5) In considering whether to make a determination under subsection (2), the Minister: (a) must have regard to: (i) the likely effect on the Australian economy, and on the efficiency, integrity and stability of the Australian financial system, of making the determination; and (ii) the likely regulatory impact of making the determination; and (iii) the likely effect of making the determination on the safety, fairness and effectiveness of competition in the provision of CS services; and […]	(5) In considering whether to make a determination under subsection (2), the Minister: (a) must have regard to: (i) the likely effect on the Australian economy, and on the efficiency, integrity and stability of the Australian financial system, of making the determination; and (ii) the likely regulatory impact of making the determination; and (iii) the likely effect of making the determination on the safety, fairness and effectiveness of competition in the provision of CS services and competition among financial markets; and […]	Rules made in respect of CS services will impact financial markets given their close connection. As a result, we consider regulators must have regard to effects their rules and arbitrations will have on competition among markets, and not just in the provision of CS services. One example of this is relevant is the CHESS capacity constraint issue. When CHESS breached its message capacity limit in March 2020, ASIC's response to protect the market was to implement trade caps on participants (to limit the amount of message they could send to the markets and, by extension, the monopoly CS service provider). Most participants chose to implement the caps by ceasing the submission of messages to Cboe Australia until they were lifted. As a result, Cboe Australia suffered a disproportionate commercial detriment because of how the regulators responded to the monopoly provider's infrastructure failure. We consider the suggested changes are consistent with ASIC and ACCC's competition mandates. We consider the relevant paragraphs of the Explanatory Materials (indicated in brackets) should be updated for consistency with the suggested changes. We also consider that the CFR Policy Statements should be updated along these lines.
s828H (and EM 1.45) **and**	In considering whether to make a CS services rule, ASIC: (a) must have regard to: (i) the likely effect of the proposed rule on the Australian economy, and on the efficiency, integrity and stability of the Australian financial system; and (ii) the likely regulatory impact of the proposed rule; and (iii) the likely effect of the proposed rule on the safety, fairness and effectiveness of	In considering whether to make a CS services rule, ASIC: (a) must have regard to: (i) the likely effect of the proposed rule on the Australian economy, and on the efficiency, integrity and stability of the Australian financial system; and (ii) the likely regulatory impact of the proposed rule; and (iii) the likely effect of the proposed rule on the safety, fairness and effectiveness of competition in the provision of CS	

s828L (and EM 1.37)	competition in the provision of CS services; […] (1) ASIC may make a CS services rule without consulting as required by section 828J, and without the consent of the Minister as required by section 828K, if ASIC is of the opinion that it is necessary, or in the public interest, to do so in order to protect: (a) the Australian economy; or (b) the efficiency, integrity and stability of the Australian financial system; or (c) safety, fairness and effective competition in the provision of CS services. […]	services and competition among financial markets; […] (1) ASIC may make a CS services rule without consulting as required by section 828J, and without the consent of the Minister as required by section 828K, if ASIC is of the opinion that it is necessary, or in the public interest, to do so in order to protect: (a) the Australian economy; or (b) the efficiency, integrity and stability of the Australian financial system; or (c) safety, fairness and effective competition in the provision of CS services and competition among financial markets. […]	
s153ZEA	The objects of this Part are to: (a) facilitate access to CS services on terms and conditions, including pricing, that are transparent, non-discriminatory, fair and reasonable; […]	The objects of this Part are to: (a) facilitate access to CS services on the same terms and conditions, including pricing, or, if that is demonstrably impossible, provide access to CS services on terms and conditions that are transparent, non-discriminatory, fair and reasonable; […]	Consistent with the change to EM 1.30 suggested above, we consider the same services and service levels, should be the starting point for the regulators. If this is not possible, the onus should be on the monopoly provider to justify why that is the case.
EM paragraph 1.135	To provide certainty to industry on how access outcomes are determined the Commission must consider various matters. The Commission must consider the following matters when making a final determination, but has discretion on what to consider in making an interim determination: […] • access to CS services is on fair and reasonable terms and conditions (including pricing) that are transparent and non-discriminatory • the long-term interests of the Australian market are supported by delivering outcomes that are consistent with those expected in a competitive market for CS services	To provide certainty to industry on how access outcomes are determined the Commission must consider various matters. The Commission must consider the following matters when making a final determination, but has discretion on what to consider in making an interim determination: […] • access to CS services is on the same terms and conditions (including pricing) or, if the vertically integrated provider legitimately cannot provide the same access, on fair and reasonable terms and conditions that are transparent and non-discriminatory • the long-term interests of the Australian market are supported by delivering outcomes that are consistent with those expected in a competitive market for CS services • a competitive market for CS services is advanced by full interoperability among competing CS facilities and open access to CS facility interfaces	With respect to the same access, this is so that the Explanatory Materials are consistent with the changes suggested above (EM 1.30 and s153ZEA). With respect to interoperability, while the CICS Bill and Explanatory Materials refer to interoperability (by referring to operational and technical requirements), we consider there should be an explicit reference to the desirability of full interoperability for a competitive marketplace for CS services to clearly guide the ACCC when it uses its arbitration powers. In our view, there cannot be an effective competitive environment without full interoperability. We also believe this is the view of the broader industry and is reflected in the consultations carried out by CFR. With respect to open access, this is not dealt with in the CICS Bill or Explanatory Materials but should be included for the reasons set out above (EM 1.30). We also consider that the CFR Policy Statements should be updated along these lines.

s153ZER(3) (and EM 1.137)	(3) For the purposes of paragraph (2)(a), the pricing principles are as follows: […] (b) access price structures should not allow a vertically integrated provider to set terms and conditions that discriminate in favour of its related entities, except to the extent that the cost of providing access to other access seekers is higher;	(3) For the purposes of paragraph (2)(a), the pricing principles are as follows: […] b) access price structures should not allow a vertically integrated provider to set terms and conditions that discriminate in favour of its related entities, except to the extent that the cost of providing access to other access seekers is higher provided that the higher costs are not due to the vertically integrated provider mandating a different form of access to its related entities.	We do not consider that a vertically integrated provider should be allowed to charge higher access prices to unrelated entities, on the basis that the cost to provide access to unrelated entities is higher, if that higher cost is due to a decision by the vertically integrated provider to force the unrelated entities to use different access mechanisms that are, by design, more expensive to operate. Given our concerns around the lack of open access and the same service being provided by the vertically integrated provider to all customers, we are concerned the proposed language could provide a licence to engage in price discrimination, despite the intent of the CICS Bill and Policy Statements. We consider the relevant paragraph of the Explanatory Materials (indicated in brackets) should be updated for consistency with the suggested changes. We also consider that the CFR Policy Statements should be updated along these lines.