



FINANCIAL
SERVICES
COUNCIL

Treasury Consultation: Competition in the provision of clearing and settlement services

FSC Submission

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1 About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing more than \$3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is one of the largest pool of managed funds in the world.

2 Comments

The FSC welcome the opportunity to comment on the exposure draft legislation 'Review of Competition in Clearing Australian Cash Equities'. Exposure Draft *Financial Sector Reform (Competition in Clearing and Settlement) Bill 2023* (**draft Bill**).

The FSC's fund manager members include large institutional managers who invest in Australian equities which are frequent users, often via their nominated custodians, of the ASX Clearing and Settlement mechanisms.

As a general principle the FSC is supportive of there being competition in financial services and agrees with the benefits that effective competition can provide market participants identified in Report 702 Competition in Funds Management. This includes increased choice, better quality products as well as driving efficiency and innovation.¹

The Explanatory Memorandum to the draft Bill notes that whilst the current regulatory settings for clearing and settlement facilities in the Australian cash equity market reflects an openness to competition they however lack mechanisms to facilitate competitive outcomes. The proposed changes in the draft Bill are designed to provide ASIC and the ACCC with relevant powers to "facilitate competitive outcomes in the provision of CS [Clearing and Settlement] services both prior to and following the introduction of competition."² Under the proposed changes ASIC, with ministerial consent, will be provided with rules to manage matters related to competition such as pricing, access, governance arrangements and interoperability. The ACCC will be provided with arbitration powers that will enable binding arbitration of disputes about the terms of access to CS services, in order to make arbitration available where services are covered by ministerial declaration.

¹ Page 12, ASIC Report 702 Competition in Funds Management prepared by Deloitte Access Economics.

² Page 2, Exposure draft Explanatory Memorandum *Financial Sector Reform (Competition in Clearing and Settlement) Bill 2023*

Consistent with our earlier comments supporting competition in financial services, the FSC is supportive of the regulatory system supporting competitive outcomes in clearing and settlement services and providing ASIC as well as the ACCC with the requisite powers to enable this to occur.

Whilst there is currently only a single cash equity CS provider and CS services in Australia³, having a competitor CS provider could open up a number of benefits to the industry and users of clearing and settlement facilities including:

- Bringing forward new technologies and new ideas in the clearing and settlement area. For example, the USA is moving to T+1 settlement in 2024 which will shorten settlement of trades to one business day after the trade is made, from current practice of T+2 or T+3 (which is two or three business days after trade). This will have implications for Australian ETF fund managers in the way of the settlement cycle of creation orders for ETF units where the ETF is holding US securities and Australian CS facilities currently require trade matching at 11:30am which is only a short time after the US market closes. CS competition in Australia could encourage new ideas, such as allowing later settlement matching or an efficient mechanism to adjust the settlement when the value is not finalised in time for matching.
- Increased efficiencies and potential for cost reductions on an industry wide basis may be possible under competition, which could be used to lower costs for investors. For example, the provision of email addresses from brokers to registry providers and product issuers via CS services could become a standard requirement instead of on a voluntary opt in basis. This would facilitate increased electronic investor communication reducing carbon footprint and the costs associated with mailing paper based communication.

Anecdotal feedback from fund managers operating in markets which have competition in clearing facilities have noted that the competition has generally driven reduction in costs and increased efficiencies where there is interoperability between clearing houses.

Recommendation 1.

The FSC is a supportive of the regulatory settings supporting competitive outcomes in clearing and settlement services and providing ASIC and the ACCC with the requisite powers to enable this to occur.

³ Page 2, Exposure Draft Explanatory Memorandum *Financial Sector Reform (Competition in Clearing and Settlement) Bill 2023*.

3 Facilitating Competitive Outcomes

Legislative interoperability requirements

We are mindful that multiple clearing houses increases complexity. We note that competition does not always result in a better outcome for participants and we should learn from the fixed income trading platform where there are 2 clearing houses; Austraclear and Euroclear.

Interoperability/ open-source technology between the settlement and clearing providers is key to creating an operational efficient workflow and a requirement. Interoperability (which should include mandated sharing of information between clearing houses) will enable different clearing houses to process and settle trades across different exchanges/platforms.

For effective competition to emerge and thrive, the industry will require appropriate legislative and regulatory support to ensure free and fair functioning of multiple entities in security settlement business. This may involve mandating certain requirements in order to achieve competitive outcomes.

The draft Bill recognises the need for interoperability, including in settlement, default management, risk management, recovery and resolution so that there is coordination and cooperation and links between CS facilities, with the intention that the rules may deal with these matters amongst others.⁴ ASIC may make CS services rules, including requiring compliance with CS services rules, where Ministerial consent is provided and the Bill also provides powers to arbitrate disputes for certain clearing and settlement services where there is a genuine inability to agree on terms of access to CS services as well as access and commercial access.

These are sensible measures which will facilitate competition in CS services.

Giving ASIC the power to make rules, including requiring compliance, in relevant areas will assist to support orderly functioning of CS services and competition. To illustrate, following the November 2020 ASX outage, ASIC wrote to market participants asking them to demonstrate business continuity arrangements and the ability to trade via alternative platforms, in the event of a future outage.⁵ This in effect required brokers to invest in technology upgrades that would enable them to trade larger volumes via CBOE make it a more viable alternative to ASX Ltd in the event of a future outage.⁶ Whilst this was an important step to ensure efficient and effective operation of Australia's financial markets infrastructure, which will assist with placemen of future trades (which is distinct from settlement) this is a good example of the regulatory regime also supporting genuine competitive outcomes. New entrants into the Australian market should be encouraged, as this will place competitive pressure on the incumbent and drive innovation in the market. We

⁴ Paragraph 1.30, Exposure Draft Explanatory Memorandum *Financial Sector Reform (Competition in Clearing and Settlement) Bill 2023*.

⁵ [ASIC puts brokers on notice: boost competition or face regulation \(afr.com\)](#)

⁶ Ibid.

acknowledge the level of investment required, relative to the size of the Australian market, being significant barrier to entry.

3.1 Further Consultation with industry encouraged

Further consultation between industry and with regulators is encouraged to ensure potential entrants provide a service that builds and improves on what is currently offered. Prior to issuing any additional CS facility licence feedback should be sought from market participants on the list of requirements that would assess the new entrant's ability to meet the standards required by the market. The following principles should also be considered in relation to provision of CS facility licenses: the need for market stability, the need for improvements to what is currently offered, costs need to be (significantly) lowered and that it doesn't add significant burden on the users to implement change. There is also the need to consider market liquidity. Feedback in relation to multiple clearing and settlement systems in Europe has indicated that this tends to fragment ETF liquidity, as it creates operational overhead for brokers and market makers to trade on different exchanges and use different clearing and settlement systems. Poorly designed systems may lead to fragmented liquidity highlighting the need to consider market liquidity implications.

Future consultation should also seek to understand and examine barriers to commercialising alternative clearing and settlement systems, to determine the best path forward for local market infrastructure.

Recommendation 2.

The FSC recommends further consultation be undertaken to identify requirements and any issues which need to be addressed, including interoperability between providers, prior to the provision of additional CS facility licenses.

3.2 Suitable Transition Period

The entry of a new CS provider is likely to require system, process or data change requirements for other stakeholders in the industry, including the incumbent CS provider, which wish to connect with (for interoperability purposes) or use the services of the new CS provider. This may require sizeable upfront capital investment to implement effective competition in securities clearing services and interoperability. This can potentially result in initial cost escalation in securities clearing and other related services.

The FSC believes many of these issues can be addressed, if carefully managed by appropriate transition periods, access to arbitration of disputes (as envisaged under the draft Bill) and considered regulator response.

The transition period could determine risk management strategies, interoperability and price issues. Consideration would also need to be given to the settlement service and how this would interact with any competition in clearing.

Recommendation 3.

The FSC recommends there be a suitable transition period to determine risk management strategies, interoperability requirements and address implementation issues.