



20 April 2023

Competition in Clearing and Settlement Team
Markets Group
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By email: CICS@treasury.gov.au

Competition in Clearing and Settlement Draft Bill

The Australian Financial Markets Association (AFMA) is responding to the consultation on the *Financial Sector Reform (Competition in Clearing and Settlement) Bill 2023* (the Bill). While AFMA includes among its membership the affected Financial Market Infrastructure (FMI) providers with Clearing and Settlement (CS) service commercial interests, our membership agreement with FMI members excludes representation about competition related issues. Our comments should therefore be taken in the context that we are looking to the wellbeing of the financial markets in Australia as a whole and its market participants, in particular clearing participants, who are collectively a significant part of our membership.

1. Key points

- AFMA supports the objectives of the Bill to finally put in place the missing legislative powers to complement the already implemented components of the 2015 conclusions of the Council of Financial Regulators (CFR) to give ASIC, the Reserve Bank of Australia and ACCC rulemaking and arbitration powers to manage competition in clearing and/or settlement (CS), and to deal with the possibility of continuing monopoly provision of cash equity CS services.
- We have reviewed the changes being put forward in this consultation and sought views from our members. We have received comment on the arbitration provisions as allowing more discretion to the ACCC and not being subject to merits review, unlike other equivalent arbitration regimes. As a matter of good public policy and rule of law there should be consistency across the ACCC arbitration regimes. We leave it to individual members to raise with you the technical drafting concerns they have with the operation of the arbitration provisions.

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- Other than the above point we have no technical issues with the amendments to make in our comments.
- Given the acceptance of what the Bill will enable, the focus will be on how the regulators use their new powers. It is important that any actions by the regulators following being given the powers proposed in the Bill place the highest priority on the interests of the market participants. CS services exist for the benefit of their clients, the clearing participants acting on behalf of the market participants and investors generally. The most important outcome for market participants and investors is the delivery of safe, efficient and reliable CS services at least cost in the context of the three first attributes.

2. Interest of market participants and investors is paramount

The regulatory environment must deliver safe, efficient and reliable CS services to the clients of the services. The delivery of the services must be at least cost in terms of the CS services being safe, efficient and reliable. All other considerations are subordinate to this end. Regulators considering the use of the powers to be granted by the Bill have to keep this point clearly in mind. Regulatory actions which drive up regulatory costs and compliance burdens are in the end fees that paid by the clearing participants which generally drives up the cost of market participation that investors bear.

AFMA has argued that the constant increase in the cost of regulation for market supervision is a discouragement to competition by increasing barriers to entry. It not only takes away the potential benefits of competition for market participants and investors but adds frictional costs to equities trading which deters participation in the Australian market to the detriment of our market efficiency, international competitiveness and national productivity. The imposition of additional regulatory costs and burden would likely further exacerbate this problem.

The regulators must act in the actual interests of the market and not in terms theoretical policy outcomes and avoid driving up costs to market participants. In reaching their decisions under the new powers regulators must articulate the reasons why their action will deliver safe, efficient and reliable CS services to the clients of the services. If a regulator cannot deliver such an outcome the purpose of regulatory intervention is lost.

3. Transparency outcome

Integration of ownership of listing and trading functions with CS services can allow opaque pricing for clearing and settlement services, if the costs of trading, clearing, and settlement are not clearly distinguished. A core justification for integrated ownership of trading, clearing, and settlement is that it can yield significant efficiencies. While the merits of different CS business models might be debated at the theoretical level in pursuit of devising an optimal FMI model to champion, the realities of dealing with existing infrastructure, ownership interests and costs of change considerations need to be recognised and accepted. This means we are looking to address the shortcomings in the existing arrangements and do not advocate that there should be large scale structural reform to impose a theoretically optimal model which could be both quite disruptive and

impose significant additional costs on the industry at a time when conditions in the market are challenging.

Transparency around the costing of clearing and settlement services would provide benefits for participants regardless of whether there are new entrants to the market. A clear delineation of CS services from trading platform and listing services, even where it is part of an integrated exchange, would be a desirable improvement to market arrangements as it would allow greater transparency resulting in clearing participants have better commercial understanding of the costs of the services they are using. This principle applies generally not just to cash equities CS services, but others as well such as futures clearing.

4. CS Services Competition

The Bill's Explanatory Memorandum speaks of the new powers enabling the regulators to deal with the continued monopoly provision of cash equity CS services until competition emerges.

While there are substantial entry barriers to contesting the market for cash equities clearing services in Australia it is nevertheless open to competition and therefore clearing is potentially contestable. While the *Corporations Act 2001* for the last twenty years has allowed for the possibility of competition the market environment has not been conducive to new entrants offering competing services.

The clearing and settlement business is one dependent upon economies of scale. It is a complex business which demands a high level of resources and expertise. It represents a large long-term investment which needs to be prudently managed. Market participants generally favour those clearers who can offer economies of scale resulting in lower fees as well as broad netting benefits that flow from being in a large pool of transactions with a larger number of counterparties.

It is desirable to provide an environment in which well resourced, competent and experienced CS service providers are attracted to provide their services in Australia so that more financial instruments may be centrally cleared, and competitive discipline may apply. It is difficult to foresee all the circumstances by which variously configured CS service providers may seek to enter the Australian market or interconnect with developing regional infrastructure. The Bill provides the regulatory framework that should give confidence to prospective competitors to assess the viability of entering the Australian market from a purely commercial standpoint without being inhibited by regulatory uncertainty.

5. Technological change

Fintech is also an important new driver of change. The influence of technological innovation, in some quite novel ways, is an increasingly important influence on equity exchange operators. It drives them to improve the efficiency of their businesses which in turn makes them look for greater economies of scale through cross border mergers and acquisitions when we are looking at dominant national exchanges. This creates a dynamic market environment which may permit offshore operators to reassess national markets

and to consider entering them to meet an emerging strategic competitor or to take advantage of opportunities which change brings. These market forces have been at play in major markets and the existing ownership and control of current equities FMI should not be presumed to be immutable. Growing reliance on automated trading is diminishing the importance of geography for financial markets as the pursuit of liquidity and transaction efficiency becomes more important than parochial knowledge of a local environment and social interactions for both issuers and investors. A market which is open to the entry and exit of FMI service providers and allows for easy connectivity with global markets would allow Australian industry to adapt more quickly and efficiently, as infrastructure reconfigures to meet commercial imperatives. It also provides a safeguard from marginalisation of the Australian market through being isolated from changes occurring at a global level.

Regulators must be awake to the changing environment brought about by technological change and look forward and not just back in the rear-view mirror when considering their actions with the new powers.

6. Importance of core CHES function

While there has been much focus in recent time on CHES Replacement and the challenges this project has faced, AFMA wishes to emphasise the importance of the legal framework enabling settlement finality and proof of ownership of the Clearing House Electronic Sub-register System (CHES) over the technology that makes the system function and the ASX Settlement functions as a whole. The protection of this core CHES function is of utmost importance when considering what actions regulators may eventually take once they receive the powers proposed by the Bill.

It is important to bear in mind that there are various functionalities incorporated within ASX Settlement, one of which is CHES but also the DvP payments arrangements. Since full dematerialisation of shares for domestic issuers occurred at the beginning of 1999 domestic shares are held in certificated form. Uncertificated securities held within CHES are recorded on the CHES sub-register which is maintained directly on the clearing system while uncertificated securities which are held outside CHES are registered on the issuer sponsored sub-register. The two sub-registers together form the complete register of securities. CHES maintains an electronic sub-register of CHES-approved securities to enable electronic transfer of ownership. This sub-register forms part of the central register of an issuer's equity holders. CHES is not a depository and it does not acquire title to securities dematerialised in the CHES sub-register. Transfers of uncertificated securities (whether within the CHES sub-register or to and from the CHES sub-register and the issuer sponsored sub-register) are effected electronically and take effect when the name of the transferee is registered on the CHES sub-register or the issuer sponsored sub-register. CHES also offers a name on register facility. Shareholders can hold the securities either in their own names or in the name of a broker nominee. The legal finality given by this system provides major value to the Australian market in terms of transaction efficiency, risk management and legal certainty. Most communications between issuers and shareholders in relation to corporate actions, such as the notification of entitlements or obligations and the lodgement of applications, elections of any monies payable, occur

directly between the issuer's appointed share registrar and the holder without the involvement of CHESS.

In the use their new powers ASIC should be able to fully justify in terms of the interests of market participants and investors any changes they propose to the arrangements for settlement finality and proof of ownership based on clear and real benefits.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au in regard to this letter.

Yours sincerely

A handwritten signature in blue ink that reads "David Love". The signature is written in a cursive, flowing style.

David Love
General Counsel & International Adviser