AC
D00/36402

N31039

Form G

Commonwealth of Australia
Trade Practices Act 1974 ---- Sub-section 93(1)
EXCLUSIVE DEALING
NOTIFICATION

To the Australian Competition and Consumer Commission:

Notice is hereby given, in accordance with sub-section 93(1) of the *Trade Practices Act* 1974, of particulars of conduct or of proposed conduct of a kind referred to in sub-section 47(2), (3), (4), (5), (6) or (7), or paragraph 47 (8) (a), (b) or (c) or (9) (a), (b), (c) or (d) of that Act in which the person giving notice engages or proposes to engage.

(PLEASE READ DIRECTIONS AND NOTICES ON BACK OF FORM)

1. (a) Name of person giving notice..... OPTIONS CLEARING HOUSE PTY LTD
ABN 48000 314 503

(*See* Direction 2 on the back of this form)

(b) Short description of business carried on by that person
Financial market clearing services

(c) Address in Australia for service of documents on that person
Options Clearing House Pty Ltd
Level 5, 20 Bridge Street
Sydney NSW 2000

2. (a) Description of the goods or services in relation to the supply or acquisition of which this notice relates
Refer to attached submissions

(b) Description of the conduct or proposed conduct
Refer to attached submissions

(*See* Direction 4 on the back of this Form)

3. (a) Class or classes of persons to which the conduct relates
Trading and clearing participants on the Australian Derivatives Exchange Ltd futures exchange

(b) Number of those persons--
(i) At present time ..... None
(ii) Estimated within the next year..... Approximately 50

(c) Where number of persons stated in item 3 (b) (i) is less than 50, their names and addresses
Not applicable

4. Names and address of person authorised by the person giving this notice to provide additional information in relation to this notice..... ALDO NICOTRA
BLAKE DAWSON WALDON
225 GEORGE ST, SYDNEY
TEL: (02) 9258 6108 FAX: (02) 9258 6999

Dated 13 September 2000

RECEIVED
15 SEP 2000
AUSTRALIAN COMPETITION & CONSUMER COMMISSION
SYDNEY

Signed by/on behalf of the applicant giving notice

(Signature)

Peter Julian FitzGerald
(Full Name)

National Manager, Derivatives
(Description)

SUBMISSIONS IN SUPPORT OF EXCLUSIVE DEALING NOTIFICATION

BY

THE AUSTRALIAN DERIVATIVES EXCHANGE LIMITED

AND

OPTIONS CLEARING HOUSE PTY LIMITED

INTRODUCTION

1. The Australian Derivatives Exchange Limited ("**ADX**") is in the process of establishing a new futures exchange. Currently, the Sydney Futures Exchange Limited ("**SFE**") is the only futures exchange authorised under the Corporations Law. Sydney Futures Exchange Clearing House Pty Limited ("**SFECH**"), a SFE subsidiary, is the only futures clearing house currently approved under the Corporations Law.

2. ADX has applied under Division 1 of Part 8.2 of the Corporations Law for ministerial approval to operate a futures exchange.

3. In order to be approved as a futures exchange under the Corporations Law, ADX will need to satisfy the Minister that there is a clearing house which will clear trades entered into on the ADX exchange. ADX does not have a clearing house capability and has entered into an agreement (the "**Agreement**") with Options Clearing House Pty Limited ("**OCH**"), a wholly owned subsidiary of Australian Stock Exchange Limited ("**ASX**"), pursuant to which OCH will provide clearing services in respect of trades on the ADX futures exchange.

4. The Agreement can be terminated by either party on 1 year's notice, subject to a requirement that it may not be terminated prior to the fifth anniversary of the date on which ADX commences the operation of its markets. The minimum term of the Agreement will therefore be 5 years.

5. Although OCH currently provides clearing services for the exchange-traded options market operated by ASX, it does not clear futures contracts. OCH requires the specific approval of the Minister under section 1131 of the Corporations Law to clear the ADX futures markets. OCH has applied under Division 2 of Part 8.2 of the Corporations Law for ministerial approval to provide clearing house facilities for the ADX futures market.

6. This notification relates to the proposed requirement that market participants who trade in Agreed Contracts (as defined in paragraph 10 of this submission) on the ADX market must clear those trades through OCH. This conduct is similar to the conduct which was the subject of Authorisation No. A30163 in relation to OCH clearing of ASX's options market, discussed in a determination dated 25 October 1995. SFE and SFECH have authorisations for similar conduct (A90569 and A90570).

7. This notification also relates to the requirement under the Agreement that OCH provide clearing services for a minimum of 5 years, in return for which OCH is appointed as the sole clearing house for ADX.

8. Copies of the ADX and OCH Rules submitted to the Australian Securities and Investments Commission ("**ASIC**") by ADX and OCH as part of their applications for ministerial approval under the Corporations Law are attached for the information and assistance of the Australian Competition and Consumer Commission ("**ACCC**"). The

ACCC is in particular referred to ADX Rules 2 and 6, and OCH Rules 2, 5.4 and 11. If, as a pre-condition of obtaining ministerial approval, either ADX or OCH is required to effect an amendment to its Rules which is material to this submission, ADX or OCH will inform the ACCC of such amendment.

NOTIFIED CONDUCT

Requirement to clear ADX trades through OCH

9. ADX and OCH give notice of the following conduct which may constitute exclusive dealing in relation to the clearing of futures contracts traded on ADX markets.

   - ADX requiring, as a precondition to participation in ADX markets, its members to acquire clearing services either directly or indirectly from OCH.

   - OCH making its futures clearing services available only to Futures Clearing Participants who are members of an Approved Exchange and only on condition that they abide by the Business Rules of that Exchange in force from time to time. ADX is an Approved Exchange for these purposes.

10. ADX and OCH propose that all futures contracts specified in the Agreement ("**Agreed Contracts**") which are entered into on the ADX exchange be registered with OCH as clearing house.

11. ADX proposes to refuse to permit a person to trade on its exchange unless that person agrees to obtain clearing services in respect of that transaction from OCH. In particular, the ADX Rules provide that each Market Participant of ADX must either be admitted as a Clearing Participant of OCH, or satisfy ADX that there are arrangements in place with a Clearing Participant to clear their trades (see Rules 2.5.2 and 2.6.2 of the ADX Business Rules).

12. OCH will also require under the OCH Rules that Clearing Participants who wish to clear ADX contracts must also be members of ADX. The same rules will apply in relation to any other futures exchange for which OCH provides clearing services (referred to in the OCH Rules as an "Approved Exchange") (see Rules 2.3.2(a), (b) and(c), 5.4.1 and definition of "Approved Exchange" in Rule 19.1 of the OCH Rules).

Appointment of OCH to be sole clearing house for ADX

13. ADX and OCH also give notice of the following conduct which may constitute exclusive dealing (the "**solus term**").

14. The Agreement provides that OCH will provide clearing services for ADX for a minimum of 5 years. In return, ADX has agreed not to clear Agreed Contracts through any clearing house other than OCH during the term of the Agreement without OCH's consent.

15. If during the term of the Agreement ADX proposes to introduce a new contract, and OCH would be able to clear that contract without a change to either its clearing system or the minimum requirements specified by ADX in respect of the provision of clearing services and without taking any further legal or regulatory action, OCH is required under the Agreement to clear that contract. If the new contract would require a change to OCH's clearing system or ADX's minimum requirements, or require any further legal or regulatory action, ADX and OCH will negotiate in good faith the terms on which the

change will be made or the action taken. If, after this process, no agreement can be reached between the parties, OCH is not obligated to clear the contract and ADX will be entitled to use another clearing house to clear the contract. The ADX Rules contemplate that ADX may have different clearing houses clearing different contracts (see ADX Rule 6.3).

16. It is noted that OCH is not limited to supplying clearing house services only to ADX. The regulatory framework contemplates that OCH may, subject to the approval of ASIC and the Minister, be able to provide clearing services to any Approved Exchange. OCH is therefore well placed to compete for the supply of clearing house services to other derivative exchanges.

17. ADX and OCH do not consider that the solus term is likely to have the effect of substantially lessening competition in any market. Rather, the parties believe it should be regarded as enhancing competition, as it provides the certainty as to the provision of and demand for clearing services needed to procure the entry ADX as a futures exchange and the agreement of OCH to provide futures clearing services. For the avoidance of any doubt, however, ADX and OCH provide notice of the term.

BACKGROUND

18. ADX intends operating a futures exchange offering trading in both futures contracts and options on futures contracts. The ADX exchange will be fully electronic. ADX intends offering three products initially, being:

- 3 month interest rate;
- 5 year bond; and
- an equity index product.

Shortly after commencement of the market, ADX intends to offer options over these products.

ADX intends to expand this product range over time in line with market demand. ADX also intends becoming a member of the international Globex Alliance shortly after opening. Membership of the alliance will greatly increase the range of products available to market participants of ADX, as well as increasing the number of potential participants.

ADX has established its Business Rules which form part of its application for ministerial approval. The Rules contain the regulatory framework necessary for the proper management and control of an electronic futures exchange. The following are some of the issues addressed by the rules:

(a) membership of the exchange as a market participant;

(b) business conduct;

(c) trading and market conduct;

(d) settlement and clearing of transactions;

(e) market emergencies and intervention rules;

(f) disciplinary rules and powers;

(g) dispute resolution; and

(h) fidelity fund provisions.

19. Section 1137 of the Corporations Law imposes an obligation on each of the futures exchange and clearing house to do, to the extent reasonably practicable, all things and take all steps necessary to ensure an orderly and fair market for dealings in futures contracts on a futures market of a futures exchange. Even apart from this statutory obligation, maintaining the financial integrity of a derivatives market and its clearing participants is fundamental to the reputation of any futures exchange and its ongoing success.

20. The function of a futures clearing house is to clear and settle futures contracts entered into on the exchange. Trades entered into on the exchange are reported to the clearing house for registration. On registration, the central clearing house becomes the buyer to each seller and the seller to each buyer. For example, when two ADX market participants enter into a trade (referred to in the OCH Rules as a "Market Contract"), as buyer and seller, that Market Contract is then reported to OCH. On registration the Market Contract is split into two contracts (referred to in the OCH Rules as "Open Contracts"), one between OCH and the buyer and another between OCH and the seller. By performing this role, by a process of novation, the clearing house makes it possible for one party to a contract to be substituted, at any time, for another. It thus facilitates entry and exit from the market as well as enabling the central management of market risk.

21. As counterparty to every Open Contract, OCH becomes responsible for the performance of all of those contracts and is exposed to the risk of each Clearing Participant as its counterparty. OCH therefore needs to manage that risk and does so through a process of marking contracts to market on a daily basis and calling margins from the Clearing Participants which operate as security for future performance. This process is consistent with the process adopted by SFECH and all other leading international derivative clearing houses. Clearing Participants may cover their margin obligations to OCH through cash and, potentially, other collateral security.

22. OCH is also responsible for performing futures contracts when they mature. ADX currently proposes that all Agreed Contracts will be cash settled. On maturity of the contracts, OCH will be obliged to pay and entitled to receive the required settlement amount for each Open Contract. As a result of the novation principle described above, OCH will have back-to-back positions so that where OCH is entitled to receive an amount on maturity in respect of an Open Contract, OCH will have a corresponding obligation to make an equal payment under an opposite Open Contract.

23. OCH monitors the exposure of all Clearing Participants to OCH on a daily basis and has extensive powers under the OCH Rules to protect the clearing system from default by a Clearing Participant or where circumstances exist which may require OCH to act to maintain a fair and orderly market. In order to enforce its Rules, OCH also has powers to take disciplinary and other action in certain circumstances.

COMPETITION ANALYSIS AND PUBLIC BENEFITS OF THE NOTIFIED CONDUCT

Requirement to clear ADX trades through OCH

24. One effect of the notified conduct is to restrict the ability of other clearing houses to compete with OCH to clear trades made on the ADX exchange, and to that extent the

conduct could be regarded as anti-competitive. The better view, it is submitted, is that the conduct both enhances competition and serves a regulatory purpose. In the absence of conduct of the type notified, ADX could not enter as a new futures exchange, and OCH would not be willing to act as its clearing house. The conduct therefore increases competition by facilitating the entry of a new futures exchange. It also forms part of the framework necessary to ensure the integrity and efficiency of the futures market.

25. In the absence of a clearing services provider, ADX would not receive approval to operate as a futures exchange. ADX will need to maximise efficiency and offer low transaction costs to ensure that it succeeds in a competitive global market. It is more cost effective for ADX to obtain external clearing services than to establish its own clearing house. In OCH, ADX believes that it has secured the services of an efficient clearing house with integrity and international recognition.

26. The provision of clearing services to ADX by OCH is consistent with ASX's strategy to make more efficient use of its fixed cost infrastructure. If the notified conduct were not approved, however, OCH would not be prepared to offer the clearing services because it would not be able to efficiently manage the risks and margining of participants' open positions in respect of market transactions. OCH will be constrained in its fee setting by the presence of SFE as a rival futures exchange. OCH is aware that the success of ADX, and thus of OCH's business as a futures clearing house, depends upon the ability of ADX to provide a competitively priced service to market participants.

27. Apart from allowing the entry of new competitors, requiring all trades in Agreed Contracts to be cleared through a single clearing house will assist ADX and OCH to discharge their statutory duty to take those steps necessary to ensure an orderly and fair market for those futures contracts.

28. The function and responsibility of a clearing house has already been summarised above and largely involves monitoring and ensuring the central financial integrity of the market in trading instruments to be cleared. This is best facilitated by requiring all contracts for such trading instruments to be registered with a central clearing house. The ACCC has previously recognised the significant public benefits of such arrangements. In its 1995 authorisation of an SFE/SFECH application (Authorisations A90569 and A90570) the Trade Practices Commission stated (at paragraphs 6.47 - 6.48):

> The Commission accepted that there is public benefit in arrangements that ensure the financial integrity of the futures market. The financial integrity of SFE's market is provided by SFECH's guarantee of the performance of contracts registered with it (supported by the system of margins, and the mutual backing of the Clearing House). The Commission therefore accepted that there is a public benefit in arrangements which require that all trades on SFE's market be cleared through SFECH.
>
> The requirement that all trades on SFE's market be cleared through SFECH ensures that the Clearing House will not face competition from other clearing houses. However, in the view of the functions performed by a futures exchange clearing house, there may be no other practical alternative. [In a 1986 SFE application], the Commission accepted that the clearing house functions must of necessity be operated by one body and one body only.

Similar expressions of support for these principles were reflected in the authorisation of the ASX/OCH arrangements concerning options (Authorisation A30163) at paragraphs 6.16 - 6.18.

29. ASIC has also recognised the benefits of having a single clearing house. In submissions with respect to ASX Authorisation A30163, ASIC submitted that providing choice of clearing houses to market participants on derivatives markets would be detrimental to the efficiency and regulation of the relevant derivatives exchange.

30. The benefits of having a single clearing house for a derivatives exchange appear to be widely accepted. ADX and OCH are unaware of any example anywhere in the world where a choice of clearing house for a particular contract is made available to derivatives traders.

31. There are also practical considerations and commercial imperatives which make it impractical and detrimental to ADX's market to have a range of clearing houses available for market participants. Liquidity on the ADX market would become illusory if only a portion of the open positions in a given instrument were registered with a particular clearing house, as any market participant seeking to close out a contract would be able to do so only if the other side of the contract was agreeable to or currently had a contract registered with the same clearing house. In other words, choice of clearing house would effectively result in pools of liquidity within the market operated by ADX, the pools being defined by reference to the clearing house holding an open position in respect of each instrument. To trade across these pools of liquidity in an electronic and increasingly automated trading environment would be extremely difficult, particularly in an anonymous market such as that which ADX proposes to offer, and would introduce significant inefficiencies and development costs to the trading process. These costs would ultimately flow through to market and clearing participants and potentially hinder the development of a fledgling market which, to succeed, must provide more efficient trading and clearing systems and lower overall transaction costs.

32. Further, registering contracts with different clearing houses would mean that each clearing participant would have to manage the risk of its positions in isolation, which is inconsistent with the public interest in having a central clearing house to manage market risk in an objective and efficient way. Such an approach would result in increased exposure for the central clearing house to market movements, which would have to be covered by increased margin requirements and thus greater costs to market and clearing participants.

Appointment of OCH to be sole clearing house for ADX

33. The solus term allows OCH to prevent ADX from dealing with any other clearing house for the duration of the Agreement in relation to Agreed Contracts (and restricts such dealings in relation to new contracts) during the term. On one view, this will have the effect of lessening competition in the market for the provision of clearing services. Again, it is submitted that the better view is that the term is in fact pro-competitive, in that it represents the commercial conditions necessary to encourage the entry of ADX and OCH, and thus introduces new competition in the provision of futures exchanges facilities.

34. ADX requires a 5-year commitment from OCH to provide clearing services so as to be able to present itself to market participants as a credible and competitive alternative to SFE. In return for making such a commitment, OCH requires assurance that there will be an on-going demand for its clearing services. Without the solus term, OCH would not have the confidence as to its expected returns necessary for it to incur the costs of adapting its systems for the needs of ADX (such costs being partially, but not totally, met by ADX) and to take the risk associated with providing services to a new entrant which, by definition, has no track record of generating revenue. If OCH were not prepared to

provide clearing services, the only alternative at this time for ADX would be to use SFECH which is the only clearing house currently approved to clear futures contracts (although SFECH would also need to seek separate approval to clear ADX markets).

35. Even if the solus term is characterised as lessening competition, it is submitted that it does not substantially lessen competition. After four years, ADX is able to terminate the Agreement on 1 year's notice. The restriction on competition therefore only lasts for a relatively short period while OCH enters the market. Even during this period, the knowledge that ADX will shortly be able to terminate the Agreement and appoint a new clearing house will constrain OCH not to act anti-competitively. Also, ADX/OCH will be in direct competition with SFE/SFECH. OCH knows that a failure by it to act competitively may see market participants abandon ADX markets for SFE markets, with the consequential adverse affects on OCH's returns from its futures clearing.

36. It is submitted that the public benefit from both the greater competition which will result from the introduction of a new futures exchange and clearing house and from the efficient and orderly conduct of the ADX futures market outweighs any public detriment associated with the notified conduct.

SIGNED by **THE AUSTRALIAN DERIVATIVES EXCHANGE LIMITED**:

Signature of authorised person

Name

SIGNED by **OPTIONS CLEARING HOUSE PTY LIMITED**:

Signature of authorised person

Name

D00/36402

N 31039

Form G

Commonwealth of Australia
Trade Practices Act 1974 ---- Sub-section 93(1)
EXCLUSIVE DEALING
NOTIFICATION

To the Australian Competition and Consumer Commission:

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(PLEASE READ DIRECTIONS AND NOTICES ON BACK OF FORM)

1. (a) Name of person giving notice OPTIONS CLEARING HOUSE PTY LTD
ABN 48000 314 503

(*See* Direction 2 on the back of this form)

(b) Short description of business carried on by that person
Financial market clearing services

(c) Address in Australia for service of documents on that person
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2. (a) Description of the goods or services in relation to the supply or acquisition of which this notice relates
Refer to attached submissions

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3. (a) Class or classes of persons to which the conduct relates
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(b) Number of those persons--
(i) At present time None
(ii) Estimated within the next year Approximately 50

(c) Where number of persons stated in item 3 (b) (i) is less than 50, their names and addresses
Not applicable

4. Names and address of person authorised by the person giving this notice to provide additional information in relation to this notice ALDO NICOTRA
BLAKE DAWSON WALDRON
225 GEORGE ST, SYDNEY
TEL: (02) 9258 6108 Fax: (02) 9258 6999

Dated 13 September 2000

Signed by/on behalf of the applicant giving notice

(Signature)

Peter Julian FitzGerald

(Full Name)

National Manager, Derivatives

(Description)

SUBMISSIONS IN SUPPORT OF EXCLUSIVE DEALING NOTIFICATION

BY

THE AUSTRALIAN DERIVATIVES EXCHANGE LIMITED

AND

OPTIONS CLEARING HOUSE PTY LIMITED

INTRODUCTION

1. The Australian Derivatives Exchange Limited ("**ADX**") is in the process of establishing a new futures exchange. Currently, the Sydney Futures Exchange Limited ("**SFE**") is the only futures exchange authorised under the Corporations Law. Sydney Futures Exchange Clearing House Pty Limited ("**SFECH**"), a SFE subsidiary, is the only futures clearing house currently approved under the Corporations Law.

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NOTIFIED CONDUCT

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Appointment of OCH to be sole clearing house for ADX

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BACKGROUND

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(a) membership of the exchange as a market participant;

(b) business conduct;

(c) trading and market conduct;

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19. Section 1137 of the Corporations Law imposes an obligation on each of the futures exchange and clearing house to do, to the extent reasonably practicable, all things and take all steps necessary to ensure an orderly and fair market for dealings in futures contracts on a futures market of a futures exchange. Even apart from this statutory obligation, maintaining the financial integrity of a derivatives market and its clearing participants is fundamental to the reputation of any futures exchange and its ongoing success.

20. The function of a futures clearing house is to clear and settle futures contracts entered into on the exchange. Trades entered into on the exchange are reported to the clearing house for registration. On registration, the central clearing house becomes the buyer to each seller and the seller to each buyer. For example, when two ADX market participants enter into a trade (referred to in the OCH Rules as a "Market Contract"), as buyer and seller, that Market Contract is then reported to OCH. On registration the Market Contract is split into two contracts (referred to in the OCH Rules as "Open Contracts"), one between OCH and the buyer and another between OCH and the seller. By performing this role, by a process of novation, the clearing house makes it possible for one party to a contract to be substituted, at any time, for another. It thus facilitates entry and exit from the market as well as enabling the central management of market risk.

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22. OCH is also responsible for performing futures contracts when they mature. ADX currently proposes that all Agreed Contracts will be cash settled. On maturity of the contracts, OCH will be obliged to pay and entitled to receive the required settlement amount for each Open Contract. As a result of the novation principle described above, OCH will have back-to-back positions so that where OCH is entitled to receive an amount on maturity in respect of an Open Contract, OCH will have a corresponding obligation to make an equal payment under an opposite Open Contract.

23. OCH monitors the exposure of all Clearing Participants to OCH on a daily basis and has extensive powers under the OCH Rules to protect the clearing system from default by a Clearing Participant or where circumstances exist which may require OCH to act to maintain a fair and orderly market. In order to enforce its Rules, OCH also has powers to take disciplinary and other action in certain circumstances.

COMPETITION ANALYSIS AND PUBLIC BENEFITS OF THE NOTIFIED CONDUCT

Requirement to clear ADX trades through OCH

24. One effect of the notified conduct is to restrict the ability of other clearing houses to compete with OCH to clear trades made on the ADX exchange, and to that extent the

conduct could be regarded as anti-competitive. The better view, it is submitted, is that the conduct both enhances competition and serves a regulatory purpose. In the absence of conduct of the type notified, ADX could not enter as a new futures exchange, and OCH would not be willing to act as its clearing house. The conduct therefore increases competition by facilitating the entry of a new futures exchange. It also forms part of the framework necessary to ensure the integrity and efficiency of the futures market.

25. In the absence of a clearing services provider, ADX would not receive approval to operate as a futures exchange. ADX will need to maximise efficiency and offer low transaction costs to ensure that it succeeds in a competitive global market. It is more cost effective for ADX to obtain external clearing services than to establish its own clearing house. In OCH, ADX believes that it has secured the services of an efficient clearing house with integrity and international recognition.

26. The provision of clearing services to ADX by OCH is consistent with ASX's strategy to make more efficient use of its fixed cost infrastructure. If the notified conduct were not approved, however, OCH would not be prepared to offer the clearing services because it would not be able to efficiently manage the risks and margining of participants' open positions in respect of market transactions. OCH will be constrained in its fee setting by the presence of SFE as a rival futures exchange. OCH is aware that the success of ADX, and thus of OCH's business as a futures clearing house, depends upon the ability of ADX to provide a competitively priced service to market participants.

27. Apart from allowing the entry of new competitors, requiring all trades in Agreed Contracts to be cleared through a single clearing house will assist ADX and OCH to discharge their statutory duty to take those steps necessary to ensure an orderly and fair market for those futures contracts.

28. The function and responsibility of a clearing house has already been summarised above and largely involves monitoring and ensuring the central financial integrity of the market in trading instruments to be cleared. This is best facilitated by requiring all contracts for such trading instruments to be registered with a central clearing house. The ACCC has previously recognised the significant public benefits of such arrangements. In its 1995 authorisation of an SFE/SFECH application (Authorisations A90569 and A90570) the Trade Practices Commission stated (at paragraphs 6.47 - 6.48):

> The Commission accepted that there is public benefit in arrangements that ensure the financial integrity of the futures market. The financial integrity of SFE's market is provided by SFECH's guarantee of the performance of contracts registered with it (supported by the system of margins, and the mutual backing of the Clearing House). The Commission therefore accepted that there is a public benefit in arrangements which require that all trades on SFE's market be cleared through SFECH.
>
> The requirement that all trades on SFE's market be cleared through SFECH ensures that the Clearing House will not face competition from other clearing houses. However, in the view of the functions performed by a futures exchange clearing house, there may be no other practical alternative. [In a 1986 SFE application], the Commission accepted that the clearing house functions must of necessity be operated by one body and one body only.

Similar expressions of support for these principles were reflected in the authorisation of the ASX/OCH arrangements concerning options (Authorisation A30163) at paragraphs 6.16 - 6.18.

29. ASIC has also recognised the benefits of having a single clearing house. In submissions with respect to ASX Authorisation A30163, ASIC submitted that providing choice of clearing houses to market participants on derivatives markets would be detrimental to the efficiency and regulation of the relevant derivatives exchange.

30. The benefits of having a single clearing house for a derivatives exchange appear to be widely accepted. ADX and OCH are unaware of any example anywhere in the world where a choice of clearing house for a particular contract is made available to derivatives traders.

31. There are also practical considerations and commercial imperatives which make it impractical and detrimental to ADX's market to have a range of clearing houses available for market participants. Liquidity on the ADX market would become illusory if only a portion of the open positions in a given instrument were registered with a particular clearing house, as any market participant seeking to close out a contract would be able to do so only if the other side of the contract was agreeable to or currently had a contract registered with the same clearing house. In other words, choice of clearing house would effectively result in pools of liquidity within the market operated by ADX, the pools being defined by reference to the clearing house holding an open position in respect of each instrument. To trade across these pools of liquidity in an electronic and increasingly automated trading environment would be extremely difficult, particularly in an anonymous market such as that which ADX proposes to offer, and would introduce significant inefficiencies and development costs to the trading process. These costs would ultimately flow through to market and clearing participants and potentially hinder the development of a fledgling market which, to succeed, must provide more efficient trading and clearing systems and lower overall transaction costs.

32. Further, registering contracts with different clearing houses would mean that each clearing participant would have to manage the risk of its positions in isolation, which is inconsistent with the public interest in having a central clearing house to manage market risk in an objective and efficient way. Such an approach would result in increased exposure for the central clearing house to market movements, which would have to be covered by increased margin requirements and thus greater costs to market and clearing participants.

Appointment of OCH to be sole clearing house for ADX

33. The solus term allows OCH to prevent ADX from dealing with any other clearing house for the duration of the Agreement in relation to Agreed Contracts (and restricts such dealings in relation to new contracts) during the term. On one view, this will have the effect of lessening competition in the market for the provision of clearing services. Again, it is submitted that the better view is that the term is in fact pro-competitive, in that it represents the commercial conditions necessary to encourage the entry of ADX and OCH, and thus introduces new competition in the provision of futures exchanges facilities.

34. ADX requires a 5-year commitment from OCH to provide clearing services so as to be able to present itself to market participants as a credible and competitive alternative to SFE. In return for making such a commitment, OCH requires assurance that there will be an on-going demand for its clearing services. Without the solus term, OCH would not have the confidence as to its expected returns necessary for it to incur the costs of adapting its systems for the needs of ADX (such costs being partially, but not totally, met by ADX) and to take the risk associated with providing services to a new entrant which, by definition, has no track record of generating revenue. If OCH were not prepared to

provide clearing services, the only alternative at this time for ADX would be to use SFECH which is the only clearing house currently approved to clear futures contracts (although SFECH would also need to seek separate approval to clear ADX markets).

35. Even if the solus term is characterised as lessening competition, it is submitted that it does not substantially lessen competition. After four years, ADX is able to terminate the Agreement on 1 year's notice. The restriction on competition therefore only lasts for a relatively short period while OCH enters the market. Even during this period, the knowledge that ADX will shortly be able to terminate the Agreement and appoint a new clearing house will constrain OCH not to act anti-competitively. Also, ADX/OCH will be in direct competition with SFE/SFECH. OCH knows that a failure by it to act competitively may see market participants abandon ADX markets for SFE markets, with the consequential adverse affects on OCH's returns from its futures clearing.

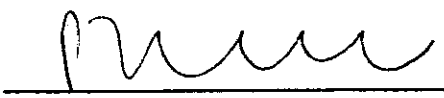
36. It is submitted that the public benefit from both the greater competition which will result from the introduction of a new futures exchange and clearing house and from the efficient and orderly conduct of the ADX futures market outweighs any public detriment associated with the notified conduct.

SIGNED by THE AUSTRALIAN DERIVATIVES EXCHANGE LIMITED:

Signature of authorised person

Name

SIGNED by OPTIONS CLEARING HOUSE PTY LIMITED:



Signature of authorised person

P FitzGerald

Name