



D00/38297

A90758

Regulation 7

~~C2000/1202~~

FORM E

COMMONWEALTH OF AUSTRALIA

*Trade Practices Act 1974 - Sub-section 88(8)***EXCLUSIVE DEALING: APPLICATION FOR AUTHORISATION**

To the Australian Competition and Consumer Commission:

Application is hereby made under subsection 88(8) of the *Trade Practices Act 1974* for an authorisation under the subsection to engage in conduct that constitutes or may constitute the practice of exclusive dealing.

1. (a) **Name of applicant:**

Australian Stock Exchange Limited (ASX) ABN 98 008 624 691 and Options Clearing house Pty Limited (OCH) ABN 48 001 314 503.

(b) **Short description of business carried on by applicant:**

ASX and its subsidiaries provide services to the financial community, including trading and clearing services for the ASX derivatives market.

(c) **Address in Australia for service of documents on the applicant:**

c/ - Jason Keady
 Assistant Counsel, Office of General Counsel
 Australian Stock Exchange Limited
 Level 9, 20 Bridge Street
 Sydney NSW 2000

2. (a) **Description of the goods or services in relation to the supply or acquisition of which this application relates:**

See attached submission.

(b) **Description of the conduct that would or may constitute the practice of exclusive dealing:**

See attached submission.

3. (a) **Class or classes of persons to which the conduct relates:**

Persons acquiring or seeking to acquire trading and clearing services in relation to options and share ratio contracts traded on the derivatives market operated by ASX, which will predominantly include stockbrokers and organisations recognised as clearing participants under the ASX Business Rules.

(b) **Number of those persons**

(i) **At present time:**

There are currently 93 active ASX participating organisations. Of that number, 58 participate on the ASX derivatives market.

(ii) **Estimated within the next year:**

- (c) Where number of persons stated in item 3(b)(i) is less than 50, their names and addresses:
Not applicable.
4. (a) Grounds for grant of authorisation:
See attached submissions.
- (b) Facts and contentions relied upon in support of those grounds:
See attached submissions.
5. (a) Does this application deal with a matter relating to a joint venture (*See section 4*) of the Trade Practices Act 1974?
No.
- (b) If so, are any other applications being made simultaneously with this application in relation to that joint venture?
Not applicable.
- (c) If so, by whom or on whose behalf are those other applications being made?
Not applicable.
6. Name and address of person authorised by the applicant to provide additional information in relation to this application:

Jason Keady
Assistant Counsel, Office of General Counsel
Australian Stock Exchange
Level 9, 20 Bridge Street
SYDNEY NSW 2000
Phone: 9227 0939
Fax: 9227 0947

Dated: 10 November 2000

SIGNED on behalf of AUSTRALIAN
STOCK EXCHANGE LIMITED:



Signature of authorised person

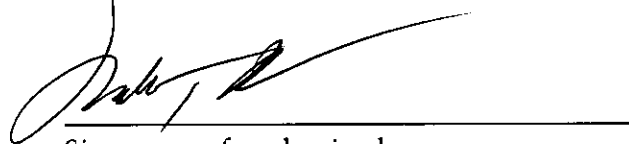
Richard Humphrey

Full Name

MANAGING DIRECTOR

Description

SIGNED on behalf of OPTIONS
CLEARING HOUSE PTY LIMITED:



Signature of authorised person

MARK THOMAS ROBERTS

Full Name

MANAGER DERIVATIVES CLEARING

Description

DIRECTIONS

- 1 If there is insufficient space on this form for the required information, the information is to be shown on separate sheets, numbered consecutively and signed by or on behalf of the person giving the notice.
- 2 If the notice is given by or on behalf of a corporation, the name of the corporation is to be inserted in item 1(a), not the name of the person signing the notice and the notice is to be signed by a person authorised by the corporation to do so.
- 3 In item 1(b), describe that part of the business of the person giving the notice in the course of which the conduct is engaged in.
- 4 If particulars of a condition or of a reason of the type referred to in sub-section 47(2), to (9) (inclusive) of the *Trade Practices Act 1974* have been reduced in whole or in part to writing, a copy of the writing is to be furnished with the application.
- 5 In item 3(a), describe the nature of the business carried on by the persons referred to in therein.
- 6 In item 3(b)(ii), state an estimate of the highest number of persons with whom the applicant is likely to deal in the course of engaging in the conduct at any time during the next year.

NOTICE

In relation to item 4, your attention is drawn to subsection 90(6) of the *Trade Practices Act 1974* which provides as follows:

- "(6) The Commission shall not make a determination granting an authorisation under subsection 88(1), (5) (8) in respect of a provision (not being a provision that is or may be an exclusionary provision) or a proposed contract, arrangement or understanding, in respect of a proposed covenant, or in respect of proposed conduct, unless it is satisfied in all the circumstances that the provision of the proposed contract, arrangement or understanding, the proposed covenant, or the proposed conduct, as the case may be, would result, or be likely to result, in a benefit to the public and that that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if:
- (a) the proposed contract or arrangement were made, or the proposed understanding were arrived at, and the provision concerned were given effect to;
 - (b) the proposed covenant were given, and the provision concerned were given effect to;
 - (c) the proposed conduct were engaged in,
- as the case may be."

SUBMISSION IN SUPPORT OF EXCLUSIVE DEALING AUTHORISATION BY:
AUSTRALIAN STOCK EXCHANGE LIMITED ("ASX")
AND
OPTIONS CLEARING HOUSE PTY LIMITED ("OCH")

INTRODUCTION

1. ASX operates, among other things, a securities market which is approved under Chapter 7 of the Corporations Law. The securities market incorporates an equities market and a derivatives market (the "ASX Derivatives Market"), both of which are governed by the ASX Business Rules¹.
2. The ASX Derivatives Market facilitates transactions in a range of derivative contracts approved by the exchange from time to time, including options and share ratio contracts².
3. OCH, a wholly owned subsidiary of ASX, currently provides clearing services in respect of trades on the ASX Derivatives Market under arrangements the subject of Authorisation No. A30163 (the "1995 Authorisation"), which expires on 16 November 2000. As the Commission is aware, OCH has recently agreed to provide clearing services to the futures market of The Australian Derivatives Exchange Limited ("ADX") which is scheduled to launch in November this year. OCH is awaiting approval from the Minister to operate an approved futures clearing house under Chapter 8 of the Corporations Law to provide those services.
4. The purpose of this authorisation is to replace the 1995 Authorisation upon its expiry. ASX and OCH request an interim authorisation in the same terms as A30163 be granted, effective from the expiry of A30163 until the final determination of this application.
5. This notification relates to the requirement that Trading Participants on the ASX Derivatives Market must, either directly or indirectly, acquire clearing services from OCH and that, to obtain clearing services from OCH in respect of transactions on the ASX Derivatives Market, organisations must be recognised as ASX Clearing Participants.
6. Copies of the relevant ASX Business Rules are attached for the information and assistance of the Commission.

INTERIM AUTHORISATION

7. ASX and OCH request an interim authorisation in the same terms as the 1995 Authorisation (except as to duration) be granted pursuant to section 91(2) *Trade Practices Act*, effective from the expiry of A30163 until the final determination of the current application.
8. It is submitted that a distinction can be usefully made between applications for interim authorisation where the conduct has already commenced and those where the conduct is proposed. In the former case, a decision by the Commission to grant interim authorisation

¹ Defined terms in the ASX Business Rules have the same meaning when used in this submission.

² Share ratio contracts are no longer traded.

to enable it time to consider the application for authorisation is no more than the Commission maintaining the status quo. If authorisation was ultimately granted, the applicant and other interested parties would not have had their interests disturbed by a decision of the Commission that was not based on a full public hearing of the merits of the application.

9. Although the case dealt with the granting of an interim authorisation pending the outcome of an appeal to the Australian Competition Tribunal, we refer the Commission to the factors listed in *Re Queensland Timber Board* 1975 ATPR 40-005 as relevant to the grant of an interim authorisation. In particular, the Tribunal acknowledged that maintenance of the status quo as a factor often in favour of granting an interim authorisation:

In some cases it may be thought preferable not to disturb the existing position pending a final decision. The good or bad effects of the existing situation will usually be clearer than the possible effects of a change in that situation.

10. It is submitted that given the relevant conduct has already been considered by the Commission pursuant to the application for Authorisation A 30163, it is particularly appropriate in this case for an interim authorisation maintaining the status quo be granted pending the final determination of the current application.

AUTHORISATION

11. ASX and OCH seek authorisation of the following conduct which may constitute exclusive dealing in relation to the clearing of option and share ratio contracts traded on the ASX Derivatives Market:
- ASX requiring, as a precondition of participation in the ASX Derivatives Market, Trading Participants to acquire clearing services either directly or indirectly from OCH;
 - to obtain clearing services from OCH in respect of transactions on the ASX Derivatives Market, organisations must be ASX Clearing Participants and such clearing services are provided on condition that Clearing Participants agree to abide by the ASX Business Rules and procedures in force from time to time.
12. The ASX Business Rules only permit Trading Participants to enter Options Transactions on the ASX Derivatives Market (Rule 7.2.1.1). A derivatives Trading Participant must be either:
- an ASX Participating Organisation, in which case they must also be a Clearing Participant or obtain services from a Clearing Participant (Rule 7.2.1.2); or
 - a Registered Independent Options Trader (or RIOT), in which case they must obtain clearing services from a Clearing Participant (Rule 7.13.1.6(f)).
13. ASX requires Clearing Participants to agree to comply with the ASX Business Rules and Procedures and any directions from either ASX or OCH (Rule 10.2.1.3(b)). An organisation wishing to obtain clearing services directly from OCH in respect of transactions on the ASX Derivatives Market must be recognised as a Clearing Participant. Importantly, this does not mean that OCH is limited to providing clearing house services in respect of the ASX Derivatives Market.

BACKGROUND

14. The Commission previously considered arrangements similar to the above conduct in the 1995 Authorisation. The Commission's final determination, dated 25 October 1995, authorised the following conduct for a period of 5 years:
- a requirement that ASX Clearing Members, as a condition of trading on ASX markets, acquire clearing house services from OCH; and
 - a requirement that OCH will only make its clearing house services available to persons who are Clearing Members of ASX.

Developments since the 1995 Authorisation

Derivatives Automation

15. In February 1998, the ASX Derivatives Market moved from a "trading floor" to a fully electronic trading system operating on a basis similar to ASX's equities market. To facilitate conversion to an automated derivatives market, the relevant sections of the ASX Business Rules were redrafted during 1997. Those rules were authorised by the Commission under Authorisation No. A90599.

ASX demutualisation

16. ASX demutualised in October 1998 which resulted in changes to the corporate status of trading and clearing participants on ASX's markets. Upon demutualisation, previous concepts such as Member Organisations and Clearing Members were replaced with Participating Organisations and Clearing Participants. Importantly, OCH's role in relation to the ASX Derivatives Market has not changed since the 1995 authorisation. It still plays a central role as the risk manager in relation to the clearing and settlement of derivatives contracts entered into on the ASX Derivatives Market. All trades are registered with OCH by Clearing Participants and OCH manages the lodgement of collateral, management of margins and margin calls and settlement of transactions when options are exercised.

New Derivatives Clearing System

17. In June 1999, ASX and OCH implemented a new derivatives clearing system ("DCS"). DCS is capable of being tailored to meet the needs of a variety of markets. At present it is being used as a platform to provide clearing services to the ASX Derivatives Market and it will also be used to provide clearing services to ADX's futures market when it commences operation.

Third Party Clearing

18. In 1999, third party clearing was introduced to the ASX Business Rules. This removed the requirement that all participants in ASX markets must also be Clearing Participants. The new approach means that those organisations which only wish to trade on the ASX Derivatives Market (ie. Trading Participants) can enter into a clearing arrangement with a Clearing Participant, rather than become recognised as a Clearing Participant themselves. This framework affords greater flexibility and provides a wider range of choices to market participants. It also lowers the barrier to entry for participation and has resulted in a new level of competition for clearing services provided by Clearing Participants to Trading

Participants.

COMPETITION ANALYSIS

19. The conduct the subject of this authorisation application has the effect of restricting the ability of other clearing houses to compete with OCH to clear trades entered into on the ASX Derivatives Market, and to that extent the conduct could be regarded as having an anti-competitive effect. The better view, it is submitted, is that the conduct both enhances competition and serves an important regulatory purpose.
20. The conduct forms part of a regulatory framework necessary to ensure the financial integrity and efficiency of the ASX Derivatives Market as well as facilitating the effective prudential supervision of those participating in the trading and clearing of options and share ratio contract transactions entered into on that market.

Requirement that Trading Participants, directly or indirectly, acquire clearing services from OCH

21. The function and responsibility of a derivatives clearing house is to ensure the central financial integrity of the market in trading instruments to be cleared. This is best facilitated by requiring all contracts for such derivative instruments to be registered with a central clearing house. The Commission has previously recognised the significant public benefits of such arrangements. For example:
 - the authorisation of similar arrangements between SFE/SFECH under Authorisation Numbers A90569 and A90570;
 - the 1995 Authorisation, at paragraphs 6.16 - 6.18; and
 - the Commission's comments concerning a notification in respect of ASX requirements that RIOTs enter into an agreement with a clearing member to participate on the ASX Derivatives Market (see paragraph 7.36 - 7.43 of the Commission's determination dated 3 December 19997 concerning A90599 and N30723).
22. ASIC has also recognised the benefits of having a single derivatives clearing house for each market. In submissions with respect to the 1995 Authorisation, 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.
23. It is submitted that the basis upon which the Commission and ASIC have previously concluded that these arrangements give rise to significant public benefit remains equally applicable to the current application. Further, it is submitted that the developments since the 1995 Authorisation have, among other things, delivered significant efficiencies to market participants and reduced barriers to entry. These developments demonstrate that the authorised conduct has very little, if any, anti-competitive effects and is unlikely to have any detriment to the public.
24. In the absence of the authorisation of the conduct, ASX initiatives to develop new products to be traded on the ASX Derivatives Market would be adversely affected. This is because there may not be a market for those instruments where ASX is able to guarantee appropriate and cost effective risk management and margining procedures which are available through use of a central clearing house.

Requirements that an organisation must be a Clearing Participant to access OCH clearing services in respect of options and share ratio contracts transactions on the ASX Derivatives Market

25. To ensure market participants do not take counterparty risk on each other, options and share ratio contract trades entered into on the ASX Derivatives Market are novated to OCH. OCH requires the counterparties to the novated contracts to be Clearing Participants. This allows OCH to ensure that the counterparties meet certain minimum standards and that such organisations are contractually bound by the regulatory framework constituted by the ASX Business Rules. Under these requirements, it is important for Clearing Participants to demonstrate that they have sufficient financial and organisational resources to meet their contractual obligations to OCH. This protects the financial integrity of the ASX Derivatives Market, it also allows OCH to discharge its obligations to ASX as ASX's clearing house, and enables ASX to satisfy its statutory obligations to maintain fair and orderly markets.

THIRD PARTY SUBMISSIONS IN RELATION TO THE 1995 AUTHORISATION APPLICATION

26. A number of submissions were made to the Commission by third parties concerning the 1995 Authorisation application. Most of those submissions supported the arrangements authorised by the Commission. However, AMP opposed the granting of authorisation and the Commission described the basis of the opposition (at para 5.12) as follows:

AMP Investments Australia Limited opposed the application on the grounds that it could prevent a more efficient clearing structure from evolving, which would allow clearing and registering through one clearing house in respect of both ASX and SFE markets, and investors could choose which clearing house to use.

27. ASX and OCH maintain that the conduct for which authorisation is sought does not preclude rationalisation of clearing houses in the way suggested. In addition, ASX and OCH submit that enabling participants to choose to clear through multiple clearing houses is inefficient, results in higher transaction and operational costs for market participants and, importantly, undermines the capability of a central clearing house to monitor and manage the financial integrity of the market.
28. AMP also submitted that the arrangements would prevent further improvements from evolving in the clearing market, which, it was suggested, would provide efficiencies for market users. It is reasonable to expect AMP, as a significant participant in the financial markets, to be concerned about efficiency and minimising transaction costs. However, it is submitted that these interests have not been adversely affected by the arrangements the subject of the 1995 Authorisation. Indeed, the history of developments in this market since the 1995 Authorisation, which are outlined in paragraphs 11-14 above, indicates that ASX has implemented significant initiatives to improve the clearing market. These developments highlight ASX's and OCH's commitment to innovation and implementation of new technologies and procedures to enhance efficiencies, reduce the costs incurred by market participants and make ASX more competitive in what is now a globalised industry.

29. In light of the above, it is submitted that the public benefit, in the form of the efficient and orderly conduct of the ASX Derivatives Market, which would result from the conduct outweighs any public detriment associated with such conduct.

SIGNED on behalf of AUSTRALIAN STOCK EXCHANGE LIMITED:

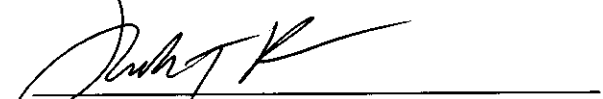


Signature of authorised person

RICHARD HUMPHREY

Name

SIGNED on behalf of OPTIONS CLEARING HOUSE PTY LIMITED:



Signature of authorised person

MARK THOMAS ROBERTS

Name