3.63. Under the current proposal, to be a payments provider an entity must:

(i) operate in its own name an Exchange Settlement Account (ESA) with the Reserve Bank of Australia,

(ii) be a bank, licensed deposit taking institution or a special service provider regulated under the financial institutions code;

(iii) have the operational capacity to authorise and make payments on behalf of and to CHESS participants, and register entries in the CHESS Payments Provider User Group for the purpose of discharging its net payments to and from the CHESS bank under the Standard Payments Provider Deed;

(iv) meet the technical and performance requirements prescribed by ASTC to ensure that the entity does not affect the integrity or orderly operation of CHESS; and

(v) execute a Standard Payments Provider Deed.

3.64. Under the SPPD, each Payments Provider:

- is required to be a member of APCA, or to have given a non-member undertaking to APCA (recital C);
- undertakes to become and remain a member of the Inter-Bank Payment System and at all times retain the capability to register payment instructions in that system in the manner contemplated by the SPPD (clause 9); and
- undertakes to become and remain a member of the CHESS Payments Provider User Group and at all times retain the capability to register payment instructions in that group in the manner contemplated by the SPPD (clause 9).

3.65. Under the SPPD (clause 10), a payments provider bears the risk of loss to the payments provider in relation to any breach of any regulations, Rules or operating procedures governing the Inter-Bank Payment System by any financial institution (including the payments provider) which acts as a payments provider under CHESS, the Reserve Bank of Australia and any operator in the Inter-Bank Payment System. A payments provider must also indemnify ASTC (and its subsidiaries, servants, agents and assigns) and any CHESS participants involved in settlement under CHESS against any losses, damages, reasonable costs, and expenses that such persons may incur by any breach of the settlement requirements of the SPPD by the payments provider, and any negligence or wilful misconduct of the payments provider (or its officers and employees) in relation to the payments provider's obligations under the settlement requirements of the SPPD.

3.66. ASTC, after consultation with APCA, may suspend a payments provider for a specified period of time (clause 15 of the SPPD). Circumstances that may lead to suspension include: a request for suspension from the financial institution's prudential supervisor; the institution not fulfilling its undertakings under clause 9 (which includes an undertaking to become and remain a member of the Inter-Bank Payment System, Payments Provider User Group, and APCA) in a manner that has a material adverse effect on the ability of the institution to perform under the SPPD; a disabling event or

an insolvency event occurring in respect of the institution; a breach of the SPPD by the institution which results or is likely to result in settlement being cancelled or deferred, or the institution breaches a provision of the SPPD and fails to rectify (or satisfactorily explain) a breach of the SPPD within 10 days of being so requested by ASTC).

3.67. ASTC, after consultation with APCA, may terminate a SPPD with a payments provider if: a suspension event occurs and the financial institution fails to provide a satisfactory explanation to ASTC within 20 days of being so requested; the institution is suspended under clause 15 for periods totalling 15 business days in any 12 month period; or the institution is suspended under certain provisions of clause 15 on three or more occasions in any 12 month period (clause 16 of the SPPD).

3.68. Payments providers can appeal a decision to suspend or terminate a SPPD within ten business days of the event. The appeal will be heard by an independent tribunal appointed by ASTC, after consultation with APCA. The tribunal may: dismiss the appeal; direct ASTC to terminate a suspension; change the period of suspension; vary or revoke any conditions imposed; or, if the appeal is against a termination, direct ASTC and TNSC to enter into a new SPPD with the payments provider in substantially the same terms as in the standard deed (clause 17 of the SPPD).

Takeovers - offer accepted subpositions

3.69. Section 16 of the Rules allows for the electronic acceptance of a takeover offer in relation to securities on the CHESS subregister. SCH must be immediately notified of offers made under a takeover scheme that relate to CHESS approved securities (Rule 16.1).

3.70. Once an electronic acceptance for a takeover offer is received, the relevant securities are reserved in a 'subposition' which prevents the securities from being transferred or converted until the takeover has been resolved (Rule 16.3).

3.71. An offeror for CHESS approved securities under a takeover scheme must have access to CHESS either directly as a participant or through a broker or NBP representative who will then act as the CHESS offeror (Rule 16.2). At the end of the offer period, the CHESS offeror has the capacity to initiate through SCH a transfer into an account controlled by the CHESS offeror of securities for which an acceptance has been received (Rule 16.6).

Holder record lock provision in the event of the death or bankruptcy of a holder

3.72. The old Rules required the recertification, and so removal from CHESS, of a CHESS holding upon the death or bankruptcy of a holder. The new section 11 of the Rules introduces provisions for the creation of a holder record lock mechanism in the event of the death or bankruptcy of a holder. The holder record lock operates to restrict the movement of securities into or out of the holding. This enables the holding to remain in CHESS while ownership of the securities is determined.

3.73. SCH applies a holder record lock upon request from a participant. SCH may request documentation from a participant in support of their request to have the holder record lock applied. Upon request from a participant, SCH can also remove a holder record lock, if the request is supported by adequate documentation. Such

documentation may include, in the case of death, the granting of probate or letters of administration or, in the case of bankruptcy, evidence that the trustee has reached an arrangement with creditors to wind up the affairs of the bankrupt holder or that the bankruptcy has been annulled.

3.74. Under the Rules, it is the participant's responsibility to ensure that the death or bankruptcy is 'bona fide' and the participant indemnifies SCH against any loss if the participant had no authority to request the holder record lock (Rule 11.4.5).

CUFS

3.75. The new arrangements contained in section 3A of the SCH Business Rules enable the transfer and settlement through CHESS of ASX transactions in securities of companies listed on ASX but domiciled in countries that do not recognise uncertificated holdings or the electronic transfer of legal title. The Rules establish a type of depositary receipt known as CUFS (CHESS Units of Foreign Securities).

3.76. CUFS are units of beneficial ownership in foreign securities. Legal title to the securities is held by a depositary entity known as the depositary nominee. The shares are registered in the name of the depositary nominee and held by that nominee on behalf of and for the benefit of the CUFS holder. When buying and selling CUFS, only beneficial ownership is transferred.

Prerequisites for CHESS approval of foreign securities

3.77. The prerequisites for CHESS approval of foreign securities are set out in Rule 3A.2.1. The foreign issuer must apply to ASX for quotation of its shares and have its securities CHESS approved by SCH. SCH must also be satisfied that the foreign issuer is capable of complying with section 3A of the Rules.

3.78. In addition, the foreign issuer must appoint a depositary nominee and give notice to SCH of the identity of the depositary nominee. NBPs that are regulated financial institutions are eligible to act as depositary nominees. These entities are: Australian banks, and their wholly owned subsidiaries that provide nominee, custody and related services; insurance companies authorised under the *Insurance Act 1973* or the *Life Insurance Act 1945;* entities that are approved trustees or that are eligible to be appointed as a custodian of a superannuation entity under the *Superannuation Industry (Supervision) Act 1993;* and, trustee companies.

3.79. ASTC also offers depositary facilities through a wholly owned subsidiary, CHESS Depositary Nominees Pty Ltd.

3.80. The foreign issuer must also make arrangements to the satisfaction of SCH for:

(i) the establishment and maintenance of a CUFS register and a foreign securities register in Australia; and,

(ii) arrange for the safekeeping of any share certificates it issues to the depositary nominee in respect of its shareholding.

3.81. The foreign issuer must also give notice to SCH of the ratio that identifies the number or fraction of CUFS into which a foreign security may be converted and vice versa (the transmutation ratio).

CUFS register and foreign securities register

3.82. The foreign securities register must contain all of the information that would otherwise be required to be kept by the issuer if it maintained an Australian branch register for those securities (Rule 3A.5.1).

3.83. Similarly, the CUFS register must contain all of the information that would be required to be kept under the Corporations Law if the issuer were an Australian listed public company and the CUFS were shares in that company (Rule 3A.5.2).

3.84. The foreign issuer must establish and maintain an issuer sponsored uncertificated subregister and a CHESS subregister (Rule 3A.5.5).

3.85. The relationship between the CHESS subregister and the issuer sponsored subregister in CUFS is for practical purposes the same as under issuer sponsorship for Australian issuers except that the CUFS register records equitable rather than legal ownership.

3.86. The issuer may employ an Australian share registry or custodian to maintain the CUFS register and foreign securities register as its agent (Rule 3A.5.6).

Vesting Arrangements.

3.87. Before settlement of transactions in foreign securities can occur, the foreign issuer must ensure that all foreign securities that are to be held in the form of CUFS are vested in the depositary nominee in a manner that is recognised by Australian law and all applicable foreign laws (Rule 3A.2.3).

3.88. At all times the foreign issuer must ensure that the total number of securities on the CUFS register reconciles with the total number of securities registered in the name of the depositary nominee on the foreign securities register. Equally, the foreign issuer must ensure that it has one or more share certificates registered in the name of the depositary nominee in its possession which represent the same number of securities as are registered in the name of the depositary nominee on the foreign securities register (Rule 3A.5.3).

Corporate Actions

3.89. The Rules ensure that CUFS holders receive the benefit of all corporate actions of a foreign issuer as if they were holders of the corresponding foreign securities, including dividends, bonus issues, rights issues, and benefits that result from mergers and reconstructions (Rule 3A.6).

3.90. However, CUFS holders are unable to attend shareholder meetings and personally vote on a show of hands. The Rules provide for the appointment of proxies by the depositary nominee to represent the wishes of the majority of CUFS holders (Rule 3A.8). The depositary nominee can only accept an offer under a takeover scheme if authorised by CUFS holders (Rule 3A.7).

Transfer and Settlement

3.91. The transfer and settlement arrangement for CUFS are basically the same as for other CHESS approved securities, except that only beneficial ownership is transferred.

The Holdings of CUFS are fully covered under the National Guarantee Fund for losses arising from unauthorised transfer of CUFS by an ASX broker.

Sponsorship

3.92. Participants in CHESS may hold foreign shares directly in the form of CUFS on the CHESS subregister. Others who wish to hold CUFS in CHESS are required to have a sponsorship agreement with a CHESS participant.

3.93. Shareholders who do not wish to be sponsored by a CHESS participant but still wish to hold their foreign securities in an uncertificated form can elect to be issuer sponsored (via the Australian registry).

Transmutation

3.94. Holders of foreign securities that are CHESS approved and approved for quotation on ASX can give notice to the foreign issuer requesting transmutation of a quantity of their foreign securities into CUFS. Provided the notice is accompanied by the corresponding documents of title, the foreign issuer is required to effect the transmutation by vesting title to the securities in the depositary nominee as soon as possible.

3.95. Buyers of CUFS may choose to either leave their holdings in the form of CUFS (so that legal title remains in the name of the depositary entity) or convert the CUFS into shares (so that buyers can hold legal title in their own right).

3.96. Holders of CUFS who wish to convert their CUFS holdings to shares can do so by instructing their sponsoring participant. The sponsoring participant transmits a message through CHESS to the company's registry instructing the registry to transfer the shares from the depositary nominee into the name of the holder and issue a certificate.

Dispute resolution and disciplinary proceedings

3.97. To be approved as the securities clearing house under section 779B of the Corporations Law, ASTC must have in place satisfactory provisions for the disciplining of CHESS participants who contravene the Business Rules. Section 18 of the SCH Business Rules govern disciplinary proceedings.

3.98. Rule 18.2 establishes a disciplinary tribunal and an appeal tribunal. Each tribunal has three members appointed by ASTC's board. Members of these tribunals must be chosen from the disciplinary panel established under Rule 18.1. The disciplinary panel must consist of not less than ten members, with at least one member from each of the following industry groups: natural person members or senior officers of member organisations of ASX; senior officers of an issuer or of a third party provider (such as a commercial share registry); and senior officers of NBPs. In addition to members of an industry group, any person of good reputation and high business integrity may be appointed to the disciplinary panel.

3.99. Generally, an alleged contravention will be dealt with as a proceeding before the disciplinary tribunal. However, in limited circumstances, the Rules provide for an expedited disciplinary procedure conducted before the ASTC board (Rule 18.3). Under the expedited procedure, the ASTC board can impose a penalty on issuers and

participants not exceeding $10,000 in respect of each contravention. If a penalty is imposed, the broker, NBP or issuer may elect that the matter be re-heard before the disciplinary tribunal.

3.100. Disciplinary proceedings may be commenced by the ASTC board by giving notice of the alleged contravention to the CHESS user concerned and also to the president of the disciplinary tribunal (Rule 18.4).

3.101. Any person may lodge a complaint against a CHESS user with the ASTC board which may take whatever action it considers appropriate, including commencing disciplinary proceedings (Rule 1.16).

3.102. If the disciplinary tribunal determines that a participant has contravened a CHESS provision, the tribunal may: censure the participant; publicise details of the contravention and any penalty imposed; impose a fine not exceeding $100,000; direct the participant to institute or upgrade an education and compliance program; impose restrictions on a participant's participation; or suspend the participant's participation in CHESS for up to one year (Rule 18.5.1).

3.103. If the disciplinary tribunal determines that an issuer has contravened a CHESS provision, the tribunal may: censure the issuer; publicise details of the contravention and any direction given; direct the issuer to institute or upgrade an education and compliance program; direct an issuer to pay an amount, not exceeding $100,00 in respect of each contravention, to SCH or a participant for loss or damage suffered (Rule 18.5.2).

3.104. Participants, issuers and the SCH board may appeal determinations of the disciplinary tribunal to the appeal tribunal. The appeal tribunal may affirm, vary or set aside a determination of the disciplinary tribunal (Rule 18.8).

3.105. Rule 18.6 requires that a disciplinary Register be maintained for recording details of contraventions by brokers and NBPs.

3.106. The Rules also establishes a process for resolving minor disputes between CHESS users under Rule 1.15. The board may appoint one or more persons as SCH Governors to hear disputes between any CHESS users in relation to matters regulated by the Articles or the SCH Business Rules. Upon referral of a dispute, the SCH Governors may inquire into all relevant facts and circumstances and make a determination in respect of the dispute. All parties to the dispute shall accept and abide by the determination of the SCH Governors, subject to a person's right to have the dispute determined by a court.

4. Statutory tests

4.1. These applications were made under subsection 88(1) and 88(8) of the Act. Subsection 88(1) enables the Commission to grant authorisations in respect of arrangements that might substantially lessen competition, or that might contain exclusionary provisions. Subsection 88(8) enables the Commission to grant authorisations in respect of exclusive dealing conduct. The Act provides that the Commission shall only grant an authorisation if the applicant satisfies the relevant tests in subsections 90(6), (7) or (8) of the Act.

4.2. Subsections 90(6) and (7) provide that the Commission shall grant authorisation only if it is satisfied in all the circumstances that:

- the provisions of the arrangements would result, or be likely to result, in a benefit to the public; and
- that the benefit to the public would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, from the arrangements.

4.3. Subsection 90(8) provides that the Commission shall grant authorisation in relation to applications under subsections 88(1) or 88(8) only if it is satisfied in all the circumstances, that the exclusionary provision or the exclusive dealing (third line forcing) conduct would result, or be likely to result, in such a benefit to the public that the arrangements should be allowed to be given effect to or the conduct should be allowed to take place.

4.4. Whilst there is some variation in the language between the test in subsection 90(8) and the tests in subsections 90(6) and (7), the Commission adopts the view taken by the Trade Practices Tribunal (the predecessor of the Australian Competition Tribunal) that in practical application the tests are essentially the same.[4]

4.5. In deciding whether it should grant authorisation, the Commission must examine the anti-competitive aspects of the arrangements or conduct, the public benefits arising from the arrangements or conduct, and weigh the two to determine which is the greater. Should the public benefits or expected public benefits outweigh the anti-competitive aspects, the Commission may grant authorisation or grant authorisation subject to conditions.

4.6. If this is not the case, the Commission may refuse authorisation or alternatively, in refusing authorisation, indicate to the applicants how the applications could be constructed to change the balance of detriment and public benefit so that authorisation may be granted.

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[4] *Re Media Council of Australia (No 2)* (1987) ATPR at page 48418.

5. Submissions

5.1. A range of interested parties were invited to comment on the applications and submissions of ASX, ASTC and APCA. Initially, 28 Submissions were received from interested parties. The applicants provided detailed written responses to a number of these submissions in June 1997. On 11 November 1997, the applicants made an additional submission in response to a number of issues raised by the Commission. A further round of 13 submissions from interested parties was received in response to the applicants' additional submission and earlier responses. Attachment D to this determination contains a list of persons and organisations that made submissions. Additional submissions from the applicants were also received in February and March 1998. Copies of all submissions are available on the public register maintained by the Commission.

5.2. The main points of the applicants' submission are outlined below followed by an outline of the key issues raised in the submissions by interested parties and, where appropriate, the responses by the applicants. Following consultation with interested parties, the applicants' proposals concerning the definition of payments provider were substantially altered. The submissions by interested parties on this issue will, therefore, be set out within the outline of the applicants' submission.

Submissions by the Applicants

Public benefits in the form of efficiencies

5.3. The applicants submit that significant public benefits in the form of efficiencies follow from the implementation of the CHESS arrangements. These public benefits include:

- the reduction in the amount of paper handled by the registry and therefore fewer delays and lost transfers;
- elimination of the delay between the settlement of a transfer and the registration of that transfer;
- a reduction in transaction fail rates.
- reductions in the cost of back office operations, which has occurred in an environment of substantially increasing numbers of trades.
- the opportunity to move to a T+3 settlement regime; and
- the containment of risk within the financial system by facilitating the predictable exchange of good title for cleared funds within a short period of time.

5.4. Before the introduction of CHESS, registries were swamped with paper in times of high volume trading. This increased the risk of transfers being lost or misplaced after they were received by the registry. As a result, prolonged delays were experienced.

Holder's could loose the benefit of corporate actions if their transfers were not registered in time. The delays and losses associated with a paper based regime do not occur in an uncertificated regime.

5.5. The elimination of paper settlement and the introduction of DvP settlement through CHESS must be achieved before a T+3 settlement regime can be implemented. The applicants advise that by March 1997, 27 exchanges were already able to settle within three business days and the Hong Kong exchange had achieved a T+2 settlement regime.

5.6. The linking of the securities clearing system with the electronic payments system ensures that the payment obligations of participants always reconcile with the delivery obligations of other participants on a net basis. The provision of DvP settlement is of direct benefit to investors because it enhances confidence that they can be provided with cleared funds on the day of settlement.

5.7. CUFS will extend the benefits of DvP settlement to foreign securities.

5.8. The applicants accept that it is still too early to determine the extent to which cost savings have been passed on to investors. They argue that this is mainly because brokers have undertaken significant expenditure to prepare their systems for CHESS and, as yet, may not have recouped these set up costs. Nevertheless the applicants suggest that there is evidence that some brokers have already cut their costs, particularly at the retail investor end of the market in the form of lower fixed fees for undertaking trades. At the institutional end, the market is very competitive and brokers will be forced to pass on cost savings or face the risk of losing their clients. The applicants argue that the rate of brokerage charged by Australian brokers is comparable with that charged by brokers in overseas markets.

5.9. As a result of the introduction of CHESS, the competitive position of the ASX market relative to other stock exchanges has been enhanced.

5.10. The applicants point out that the success of a stock market is ultimately measured by investor confidence. A high level of confidence is a necessary prerequisite for a highly liquid market. A highly liquid market is of benefit to investors because it ensures the price investors pay for securities more closely represents the true value of those securities.

Effects on competition

5.11. The applicants put forward a number of arguments to highlight what they took to be the limited nature of the effects on competition of the CHESS arrangements.

5.12. The applicants argue that the only way in which the benefits of electronic transfer can be made available to the shareholders of listed companies is by requiring the settlement of broker to broker trades through CHESS. No other form of electronic transfer process is recognised by the Corporations Law as a legitimate transfer of legal title.

5.13. Since the Corporations Law recognises only one securities clearing house, the applicants submit that the SCH Business Rules cannot be regarded as a barrier to market entry as a securities clearing house because this state of affairs is entrenched by the Corporations Law. As a result of this legal framework, the applicants also point out

that the CHESS arrangements have not caused any lessening of competition between providers of electronic transfer and registration systems.

5.14. The applicants note that generally, the SCH Business Rules tend to prescribe what is to happen on the CHESS subregister rather than to regulate services supplied by registries. While some of the Rules do effect registries, the Rules do not preclude registries from continuing to provide a variety of services. The Rules do not, therefore, substantially effect competition between registries.

5.15. They also note that the efficiencies associated with the electronic transfer and registration process will naturally create a preference for taking advantage of those efficiencies. Already some issuers with large numbers of holders have closed their certificated subregisters and instead operate an issuer sponsored subregister, such as the Commonwealth Bank.

5.16. Shareholders have the option of holding on either the certificated register (if the issuer operates one) or the issuer sponsored subregister (if the issuer operates one). they are not, therefore, compelled to enter into a sponsorship agreement with a broker or NBP.

5.17. The applicants submit that the CHESS arrangements do not effect competition between brokers on the market operated by ASX because CHESS only relates to the clearing and settlement of transactions which have already occurred on the market operated by ASX. It also follows that as clearing and settlement is a facility which is generally provided by stock markets, one important way in which ASX can compete with other stock markets is by having an efficient clearing and settlement system. Competition with other stock markets is therefore enhanced by the CHESS arrangements.

5.18. In response to a concern raised in the initial authorisation of phase 1 of CHESS (at paragraph 7.79), the applicants advise that ASTC's audit power has not been used to discriminate against the provision of issuer sponsored subregistry services.

Demutualisation of ASX

5.19. The applicants advise that, under a corporate structure ASX would be operated as a commercial enterprise, focussed on earning an adequate return for its shareholders. ASX would still be required to comply with the obligations in the Corporations Law requiring securities exchanges to have due regard to the public interest and which enable the relevant Minister to disallow any amendments to the Business Rules or Listing Rules of a securities exchange.

5.20. The Corporations Law has been amended by *the Corporations Law Amendment (ASX) Act 1997* to impose continuing obligations on all securities exchanges. These include an obligation to report regularly to the relevant Minister about compliance with the Exchange's obligations under the Law.

5.21. ASX claims that demutualisation is desirable to enable it to meet the competitive challenges of the future, both domestically and internationally.

5.22. In a commercial environment, ASX claims that it would be difficult for it to operate effectively where one of its key operating subsidiaries, ASTC, is unable to distribute any of its profits to ASX.

5.23. Irrespective of whether ASX is to demutualise, ASTC notes that it would seek the removal of Article 86, which states that "no part of profit or income of the company shall be paid or transferred directly or indirectly by way of profit or gain to members". Removal of this Article must be approved by the relevant Minister in the public interest.

5.24. In addition, the applicants indicated that Article 59A, which authorises directors to "act in the interests of the securities industry generally", would be amended or removed as part of the process of enabling ASTC to operate for profit. Article 59A was included in ASTC's Articles of Association as a condition of the Commission's authorisation of the CHESS phase 1 arrangements. The applicants claim that the interests of ASX and ASTC as commercial enterprises operating in a highly competitive international market are aligned with the interests of the industry as a whole. As such, removal of this Article should not cause concern and in any event other safeguards exist to prevent inappropriate behaviour.

5.25. Accordingly, the applicants request the Commission to remove the condition requiring the retention of Article 59A and to assume the removal of Article 86. Even under these circumstances, the applicants submit that the public benefits arising from the operation of CHESS are such that authorisation should be granted.

Consequence of demutualisation of ASX on CHESS tariffs

5.26. The key assumptions used in setting CHESS tariffs have been based on the need to cover costs and provide for a redevelopment reserve over a seven year market cycle. The estimates were based on an average of 9000 broker trades per day over seven years.

5.27. In their submission, the applicants state that the existing CHESS tariffs still reflect these original assumptions and that the tariffs have been kept as low as possible given the fluctuating nature of the securities industry.

5.28. While ASTC may be presently accumulating funds at a greater rate than originally anticipated, the applicants argue that whether this is excessive can not be determined until the end of the seven year period given the cyclical nature of the securities industry.

5.29. The applicants submit that there is nothing in the concept of ASX and ASTC having the power to operate at a profit that should cause concern either to the Commission or participants in CHESS.

5.30. The applicants also argue that concerns about a conflict between ASTC's shift to a for profit operation and the continuance of its regulatory responsibilities underestimates the commercial value of ASTC's reputation for high market integrity and effective regulation and the responsibilities imposed on ASTC by the Corporations Law.

5.31. Although some of the services offered by ASTC are forced upon CHESS users, other services are optional. The applicants submit that ASTC should be at liberty to set the tariffs for optional services at a level that reflects what the market will bear.

5.32. In terms of the tariffs for services that participants are obliged to obtain from ASTC, the applicants claim that ASTC is constrained in its ability to charge high tariffs and earn disproportionately large profits, as a result of the global competition faced by ASX.

The global market

5.33. The applicants claim that the settlement and transfer services provided by ASTC are inseparable, in competition terms, from the trading services provided by ASX. ASX competes in the global market for the provision of facilities to enable the trading of listed securities and in the global market for the provision of investment services for traders in the securities of listed companies.

5.34. The applicants submit that stock exchanges no longer attract custom exclusively from within their national boundaries. Companies seeking to raise capital do not necessarily list in the country in which they were incorporated, but instead look to the market which offers the best prospects of raising the capital they require. This is illustrated by the Australian company Ozemail listing on NASDAQ instead of ASX. NASDAQ has a reputation for being a market in which technology companies can successfully raise capital. In addition, a number of Australian companies have sought joint listing on Canadian stock exchanges because of their reputation for enabling small to medium sized exploration and mining companies to raise capital.

5.35. The applicants advise that the top 20 listed companies on ASX account for approximately 60 per cent of its turnover. All but two of these companies are listed on other overseas exchanges. Investors, particularly large institutional investors, are therefore able to place orders to buy or sell the securities of these companies on other exchanges in preference to ASX.

5.36. The ability of large institutional investors to choose to invest in the market that will give them the greatest return for the least cost is illustrated by events in both Europe and Asia. In Europe, an increase in the rate of stamp duty in one country will cause the turnover in the market of that country to decline and the turnover in the shares of companies listed on a competing market to rise. This trend is also reflected in Australia and Asia, where within weeks of a decision by the Queensland Government to halve the rate of stamp duty on share transfers, the Malaysian Government reduced its rate to the same level to encourage Malaysian companies to retain their principal listing in Malaysia.

5.37. In addition, ASX is taking initiatives to encourage more foreign companies to list on ASX, for example, by reducing listing fees for foreign companies already listed on a recognised exchange and encouraging the abolition of State Government stamp duties on transfers of shares in foreign companies. At the same time, foreign exchanges are seeking to attract interest from Australian companies, such as American Depository Receipt schemes, which enable Australian companies to gain exposure to the American market.

5.38. The applicants also point to a "value for money" index published by GSCS Benchmarks as evidence of the high level of competition between international exchanges. This index ranks major equities markets. It provides an indication of the market's cost to investors by evaluating the direct costs of the services provided and the indirect costs caused by a market's or an individual's inefficiencies. For the first quarter of 1997, Australia was ranked fourth on the index for settlement. The applicants claim that an important constraint upon tariff increases is their potential to cause Australia to drop down the list, thus becoming less attractive to investors, particularly where Australian shares may be purchased in another market.

5.39. The applicants submit that Australian brokers are in competition with each other as well as brokers in other countries for the business of institutional investors. This competition has, according to the applicants, driven brokerage rates in Australia down to a level which is currently competitive with rates in other countries. Since Australian brokers are obliged to settle ASX market transactions via CHESS, the applicants claim that any significant increase in tariffs for compulsory CHESS services would eventually be reflected in increased brokerage rates charged to investors. This would render the Australian market less competitive, resulting in a loss of business. The resulting reduction in the number of transactions would have a negative effect on ASTC's capacity to raise income by charging fees for CHESS services. It is, therefore, not in ASTC's interests to unreasonably increase CHESS tariffs.

Payments Providers

5.40. The applicants argue that the integrity of the entire electronic payments system rests on the ability of payments providers to fulfil the indemnity obligations imposed under the Standard Payments Provider Deed (SPPD). This requires the payments provider to fund any loss suffered if a settlement is cancelled as a result of a default by that payments provider. The applicants submit that the strict criteria for eligibility as a payments provider stem from this concern. In the past, the only entities that have been able to demonstrate an ability to meet these indemnity obligations have been banks.

5.41. While the strict eligibility criteria may have the effect of excluding particular financial institutions, the applicants consider this necessary to maintain the confidence and integrity of the settlement system.

5.42. Nevertheless, in their initial submission, the applicants advised that they saw no reason why Non-Bank Financial Institutions (NBFIs) should not be admitted as payments providers as long as they can fulfil the eligibility criteria, particularly in regard to the indemnity obligations under the SPPD.

5.43. The applicants note that no NBFI has sought access to the system as a payments provider, however, once the various legal and technical issues have been resolved, a number of NBFIs intend to apply to be payments providers.

5.44. In their initial submission, the applicants pointed out that the original criteria for admission as a payments provider had been expanded to include credit unions and building societies. As they currently stand, to be admitted as a payments provider, an entity must gain approval from either a financial supervisor appointed by SCH or, pending the appointment of a financial supervisor, from SCH in consultation with the Reserve Bank of Australia (RBA), where the entity is a bank, or the Australian Financial Institutions Commission (AFIC), where the entity is not a bank.

5.45. No financial supervisor has been appointed.

5.46. The applicants advise that neither the RBA nor AFIC wish to be formally involved in the process of approving CHESS payments providers. Further, the applicants state that both the Credit Union Services Corporation (Australia) Ltd (CUSCAL) and the Australian Association of Permanent Building Societies (AAPBS) are of the view that a financial supervisor is both inappropriate and impractical.

5.47. Credit unions or building societies are not able to directly enter payments into RITS, and so cannot directly participate in the Inter-Bank Payment System. The applicants proposed that credit unions and building societies could access RITS through their special service provider (SSP). The SSP for most credit unions is their industry body, CUSCAL. The proposal is that CUSCAL will guarantee payment of the obligations of credit unions by meeting any net payment obligations. The risk of default would, therefore, lie with the relevant SSP. CUSCAL has access to sufficient funds to meet any loss as required under the SPPD. The applicants submit that they are still obtaining legal advice in relation to the position of the SSP for building societies. They have had discussions with both CUSCAL and AAPBS in relation to these issues.

Submissions by AFIC, AAPBS, and the RBA

5.48. AFIC was concerned that there was considerable scope to use the current indemnity obligations in the definition of payments provider as a barrier to entry. AFIC believe that the definition of payments provider is unduly restrictive, particularly in light of the Wallis report recommendations which may result in the payments system being opened up to non-financial corporations.

5.49. AFIC suggested a simpler definition may be along the lines of an entity that has established an exchange settlement account (directly or via a special services provider) with the RBA.

5.50. AAPBS expressed concern over the lack of progress made in addressing the issue of the ability of individual building societies or AAPBS to participate in CHESS as payments providers. AAPBS suggested that alternative definitions of payment provider suggested by ASTC retained very strict criteria that were subjective in nature because there was no formal basis with which to measure the indemnity obligations. AAPBS emphasised the importance of developing a ratings scheme to determine the ability of a financial institutions to meet the indemnity obligations. Such a scheme should operate uniformly for both banks and NBFIs. AAPBS also believed there is a need to include a right of appeal in respect of unsuccessful applications for payments providers.

5.51. The RBA supported the amendment to the definition of payments provider to include building societies, credit unions and special service providers. The RBA advised that the system may have to cater for a wider range of non-bank providers in the future and argued that any authorisation should reflect this. The RBA also re-affirmed that it is not their policy to comment on the financial position of individual banks.

Other submissions by interested parties

5.52. American Express (AMEX) considered it an impediment to the development of the financial services industry that participation in APCA, as overseer of the payments clearing system, should continue to exclude non-bank financial institutions as full members. Despite the advent of new entrants to the financial services industry and the development of innovative technology, the participating membership of APCA's payments clearing system has not significantly changed. AMEX submitted that the necessity for strict prudential and fiduciary controls in no way automatically requires nor justifies such an exclusionary system.

5.53. Westpac Banking Corporation strongly supported the requirement that each payments provider become and remain a member of the Inter-Bank Payments System

and the CHESS Payments Provider User Group. They also strongly supported the arrangements whereby a payments provider may be suspended under the SPPD.

Response by the applicants

5.54. A number of alternative mechanisms for establishing an objective indicator of the ability of NBFI to fulfil the indemnity obligations imposed under the SPPD were canvassed. These included having an independent party, such as Standard and Poor's, determine a valuation for the indemnity and the application of a rating in much the same way that banks are rated.

5.55. Throughout February, March and April of this year, the applicants distributed a number of proposed amendments to the definition of payments provider. These proposals retained most of the elements of the previous definition of payments provider authorised by the Commission in December 1995. The primary effect of these proposed amendments is to:

(i) remove the requirement that payments providers be approved by a financial supervisor; and

(ii) include a requirement that payments providers operate an exchange settlement account in their own name with the Reserve Bank of Australia.

The effect of these proposed amendments are set out in Attachment C to this determination.

5.56. The applicants also note that under the CHESS bank deed, the CHESS bank may refuse to settle with a client bank if the CHESS bank has reasonable grounds for believing that a payment made by the CHESS bank would be voidable under section 588FE of the Corporations Law, if the Client Bank were wound up.

5.57. The applicants advise that there is no specific right of appeal in the SCH Business Rules in respect of unsuccessful applications to become a payments provider. However, approval has not been denied in respect of any application. Further, the applicants argue that since the prerequisites for approval are objective, no right of appeal is necessary.

CUSCAL and AAPBS

5.58. CUSCAL lodged two submissions with the Commission in February and April 1998. CUSCAL expressed general agreement with the modification of provision (a) and the removal of provision (e) as proposed by the applicants.

5.59. In addition, however, CUSCAL submitted a number of recommendations to remove institutional bias from the definition of payments provider and to bring the definition of payments provider into line with the process of law reform following the recommendations of the Wallis Report. CUSCAL noted that with the release of the Financial Sector Reform (Amendments and Transitional Provisions) Bill 1998, it is now possible to adopt terms that will be used in the post-Wallis environment. In respect to the definition of payments provider, the most important effect of these amendments is to introduce the generic term "authorised deposit taking institution" which at present will encompass banks, credit unions, building societies and licensed special service providers.

5.60. To bring the definition of payments provider into line with these reforms, CUSCAL suggested that the reference to building societies and credit unions at (a)(iv) of the definition be replace with the term "an authorised deposit taking institution". CUSCAL also suggested the reference to "special service provider" at (a)(v) be deleted since it will be rendered redundant by the new legislation.

5.61. CUSCAL indicated that it would accept the applicants proposals on condition that ASTC adopt a post Wallis amendment to the definition of payments provider once the relevant legislation has been enacted and all parties agree that it is appropriate to move to the new definition.

5.62. In addition, CUSCAL noted that the account held by CUSCAL with the RBA is referred to by the RBA as a 'settlement account'. However, CUSCAL also indicated that it was accepted by the RBA that CUSCAL's settlement account with the RBA was the same as an ESA, the only difference being that CUSCAL is not a bank. This difference between the term exchange settlement account used by banks and settlement account used by CUSCAL will be removed by the Wallis reforms.

5.63. CUSCAL also noted that under section 866 of the Corporations Law and corresponding provisions in the ASX Business Rules, brokers are currently required to operate their trust accounts with a bank. CUSCAL argues that these provisions would need to be changed before non-bank deposit taking institutions can fully participate in CHESS.

5.64. In a submission lodged with the Commission on 22 December 1997, AAPBS also expressed support for the most recent changes to the definition of payments provider proposed by the applicants. However, they noted that until the changes are approved by the ASTC board, the matter must still be considered unresolved. Accordingly, AAPBS requested that the Commission withhold authorisation or else grant it conditionally until the remaining barriers to building society participation as payments providers in the CHESS system are removed.

Brokers and NBPs

5.65. The applicants advise that in September 1994 the number of brokers was 85 and the number of non-broker participants (NBPs) was 46. By March 1997, there were 86 brokers and 70 NBPs. In relation to CHESS, there have been no claims on the performance bond of NBPs or on the National Guarantee Fund (NGF) in relation to brokers.

5.66. The applicants argue that smaller brokers are not significantly disadvantaged by the arrangements or costs involved in the use of CHESS. This is because in addition to certain fixed costs, the costs to brokers for CHESS services involve individual service charges. If small brokers paid a proportionately higher price, the applicants believe such brokers would respond by only taking the minimum number of services required by the SCH Business Rules. This has not been the case.

5.67. One important difference between brokers and NBPs in the provision of sponsorship services is the process of certificate cancellation. Only brokers are entitled to cancel certificates without recourse to the Registry. In practice, this means that it takes longer for NBPs to convert securities from the certificated subregister to the CHESS subregister. The reason given by the applicants for this difference is that NBPs

are not entitled to the benefit of coverage under the NGF and as such these arrangements are needed to reduce the likelihood of fraud, which may not be sufficiently covered by the $250,000 performance bond provided by NBPs. The applicants argue that this difference is in the interests of the securities industry generally. They also noted that it is the Corporations Law, not the SCH Business Rules, that excludes NBPs from being covered by the NGF.

5.68. Not all NBPs are able to establish sponsored holdings on the CHESS subregister. This function is restricted to NBPs that are securities dealers, futures brokers, Australian banks, trustees, custodians and insurance companies. The justification for this limitation lies in ensuring investor protection in the public interest.

5.69. The applicants also note that under the SCH Business Rules, NBPs have more flexibility over the content of sponsorship agreements.

Board composition

5.70. In the initial authorisation, concern was expressed that as a wholly owned subsidiary of ASX, ASTC would represent the interests of brokers ahead of the interests of the securities industry generally. In response, the applicants claim this has not been the case. In particular, the applicants argue that evidence of this is provided by the board not suspending brokers who were not ready for phase 2 of CHESS, even though the SCH Business Rules justified suspension. The board did not suspend the brokers because this would have been detrimental to the operation of the securities industry in general.

5.71. The applicants advise that membership of the ASTC board is cross-representative of industry groups, and includes brokers, institutional investors, custodians, issuers and ASX board members. An advantage of wide industry representation is that the board is able to pass resolutions knowing the likely effect of their decisions on the industry generally.

5.72. Further, the CHESS Business Advisory Committee (CBAC) has been established to review changes to Business Rules, CHESS procedures and system changes. The CBAC comprises some 20 representatives from various sectors of the securities industry. There is also a Rule Review Group composed of persons from a wide cross section of the industry.

Complaints and discipline

5.73. The applicants argue that the SCH Business Rules act in a number of ways to promote the independence and fairness of appeal arrangements. For example:

(i) membership of the disciplinary panel is constituted to promote its independence;

(ii) members of the appeal tribunal cannot all be drawn from the same industry group (Rule 18.7.7);

(iii) a member may not sit on the appeal tribunal in relation to a matter they heard while sitting on the disciplinary tribunal (Rule 18.1.6);

(iv) a member of the panel must decline to serve on the disciplinary panel or appeal tribunal if they have a material interest in the subject matter of proceedings before that tribunal (Rule 18.1.5).

5.74. The applicants advise that as of 31 December 1997, four matters had been dealt with by the disciplinary tribunal. The penalty imposed in all four of these cases was that details of the contravention were published to the securities industry. In one of these cases a fine of $1,000 was also imposed. Two more matters are pending before the disciplinary tribunal. To date, there have been no cases brought before the appeal tribunal.

5.75. The applicants note that the small number of proceedings is attributable to the relatively small number of breaches rather than any lack of compliance work by ASTC. It also reflects ASTC's advisory and coaching approach to regulation, rather than a 'black letter law' approach.

Time limit

5.76. The applicants argue that there should be no time limit on any authorisation granted by the Commission. They claim it is inappropriate that arrangements which have cost over $35 million and required significant investment by participants should be subject to the uncertainty of a time limit. They suggest that the Commission's power to revoke the authorisation if circumstances change provides a sufficient safeguard.

Report by PA Consulting Group

5.77. Attachment J of the applicants' submission consisted of a report by PA Consulting Group. The report was based on responses to a questionnaire from 7 brokers, 2 issuers, 1 registry, 3 custodians and 2 institutional investors. The report concluded that the introduction of CHESS had resulted in substantial improvements in levels of efficiency and productivity in the industry. However, PA Consulting also found that there was little evidence of these efficiency savings being passed on to customers. They also found little evidence of the respondents taking advantage of the new technology to develop new services and products. PA Consulting noted that this could be a result of the substantial establishment costs incurred by CHESS participants.

5.78. The report noted that respondents were generally positive about all aspects of CHESS, in particular the reduction in settlement risk. Respondents were less positive, however, about CHESS tariff structures and levels. Brokers in particular felt that the services did not provide good value for money. Brokers were keen to see lower fees generally, and lower fail fees in particular.

Feedback from users attached to the applicants submission

5.79. The applicants attached over 35 letters to their submission (Attachment M) by way of feedback from CHESS users. This feedback was generally positive, although many noted that it was too early to determine whether there were any cost savings associated with the introduction of CHESS. A number of those who provided feedback to ASTC suggested that the costs of maintaining a share registry had increased with the introduction of CHESS. Many also stated that the CHESS arrangements had enabled them to reduce staff numbers.

Submissions by interested parties and applicants' responses

5.80. Almost all the submissions by interested parties expressed support for the applications for re-authorisation of the CHESS arrangements and for the authorisation of changes to the SCH Business Rule to accommodate CUFS. A number of the submissions affirmed the importance of both CHESS and CUFS for ensuring that the Australian market remains competitive with major overseas markets where automated settlement occurs.

5.81. Submissions that specifically supported the efficiency benefits claimed by the applicants included:

- BZW Australia Limited (BZW) indicated that the introduction of CHESS has reduced their overheads, increased efficiency and has enabled them to pass on cost savings to clients. Further, DvP settlement has assisted their credit control and capital management as a result of its added security and certainty.
- ANZ Nominees reported a substantial reduction in staff levels despite handling increased transaction volumes.
- AMP Society (AMP) advised they have derived considerable commercial savings as a result of CHESS.
- BHP Share Department (BHP) submitted that there have been many examples of efficiency gains in share registry practices as a result of CHESS, although they found participation in CHESS cost neutral. BHP advised that the biggest single impact of CHESS has been the ability by BHP to handle large volumes within statutory turnaround times.
- Ernst & Young Registry Services stated that the efficiencies produced by the introduction of CHESS have enabled it to improve the standard of service they provide to clients.
- John Lawson, a director of Westpac Custodian Nominees Ltd (Westpac Custodian), stated that following the introduction of CHESS they have been able to significantly reduce the number of staff processing settlement transaction while significantly increasing the number of transactions settled.

5.82. However, almost all of the submissions also expressed concern about specific aspects of the applications. By far the most commonly raised issues were:

(i) the effect on the level of CHESS tariffs of ASX demutualisation and the proposed removal of Articles 59A and 86 from the ASTC Articles of Association;

(ii) the ability of NBFIs to be admitted as payments providers (the relevant submissions have already been outlined above at paragraphs 5.40 to 5.64);

(iii) the effect of brokers' sponsorship agreements, particularly on small investors;

(iv) the limited nature of consultation about changes to the SCH Business Rules; and,

(v) the effectiveness of the complaints and disciplinary procedures.

A number of other issues of concern to particular parties were also canvassed.

5.83. In the following summary of the submissions, it should be kept in mind that in most cases specific critical remarks were prefaced by broad statements of support for the CHESS arrangements.

Demutualisation and tariff levels

Submission by the Australian Securities Commission

5.84. The Australian Securities Commission (ASC) argued that, in the absence of the proposal to remove Articles 59A and 86, the re-authorisation of CHESS would be of public benefit. The ASC noted, however, that Articles 59A and 86 were part of the legal and regulatory framework required to support the CHESS arrangements. Removal of these Articles would raise a range of issues about the appropriate regulatory framework needed to ensure investor protection and market integrity in relation to the clearing and settlement of securities in Australia.

5.85. The timing of the re-authorisation process means that the Commission's determination will be made before the ASC's own consideration of the public interest issues arising from the proposed removal of Articles 59A and 86. The ASC stated that it would be concerned if any authorisation granted by the Commission supported the removal of Articles 59A and 86 without taking into account the demutualisation of ASX. The ASC also noted that, as part of its own regulatory responsibilities, both it and Treasury will need to ensure that mechanisms are put in place to safeguard the regulatory functions of SCH without compromise and also ensure that the interests of issuers, participants and investors are protected.

5.86. The ASC noted that in the original authorisation, reliance was placed on the internal governance of the ASTC board to protect the interests of the securities industry generally. If ASTC moves to a 'for profit' operation, however, the board would be legally bound to seek to optimise profit for ASTC and its shareholder, ASX, and to set CHESS tariffs accordingly. The ASC also noted that the effect of the applicants' proposal was to remove the protection afforded to investors by these Articles while at the same time permitting ASTC to retain the advantages conferred by the Corporations Law on ASTC as the approved securities clearing house. In the view of the ASC, these advantages are considerable.

Applicants' response

5.87. The applicants' argued that the ASC's main concerns about the changes to ASTC's Articles of Association relate to the overall regulatory framework needed for investor protection and market integrity. The applicants' suggest that these concerns have to do with the role of ASTC as the securities clearing house approved under the Corporations Law and are of only indirect relevance to the Commission's task of determining whether the benefits of CHESS are outweighed by the costs associated with using CHESS.

Concern about tariff levels

5.88. The submissions from interested parties revealed a high level of concern that ASTC would be able to exploit its position by charging extortionate fees for its clearing and settlement services.

5.89. A number of submissions, including those by the Australian Shareholders' Association, Coopers & Lybrand, Ernst & Young Registry Services, Commonwealth Securities Ltd, Ms Ellen K. Stoddart and Mr Jeremy Davis, argued for the retention of Articles 59A as a safeguard against unreasonable fee increases. Coopers & Lybrand, Commonwealth Securities, Ms Stoddart and Mr Davis also argued for the retention of Article 86.

5.90. Ernst & Young Registry Services noted that, in the absence of Article 59A, the board may be unable to take action in the interests of the securities industry generally if such action imposed costs on ASTC.

5.91. Commonwealth Securities, the Securities Registrars Association of Australia, the Australian Shareholders' Association, BHP Share Department, Ernst & Young Registry Services, National Australia Custodian Services, and Mr John Lawson also submitted that, with the impending demutualisation of ASX (and assuming the removal of Article 86), some regulatory mechanism should be implemented for the ongoing control of tariffs for CHESS services.

5.92. National Australia Custodian Services stated, in its second submission, that while it had no problem with the concept that a demutualised ASX will need to earn profits, for a monopoly to operate without being subjected to a price justification process was simply unacceptable. Commonwealth Securities suggested that the Commission should play a regulatory role to approve price increases for CHESS services.

5.93. The Australian Shareholders' Association (ASA) suggested that after demutualisation, the operations, finances and level of shareholder return of both ASX and ASTC should be scrutinised by an independent body such as the ASC or the proposed Corporations and Financial Services Commission, for as long as ASX or ASTC retain any regulatory function or operate in a non-competitive environment. ASA also noted that there was still concern that the ASTC board represents the interests of ASX and brokers ahead of the interests of the securities industry generally.

5.94. Given that CHESS was originally established using funds from the Securities Industry Development Account (SIDA) on the basis that CHESS would be operated on a non-profit basis with a seven year funding cycle, the Chartered Institute of Company Secretaries in Australia suggested, in their second submission, that ASTC should not be permitted to pay dividends until the expiration of the seven year period and that, at the end of this seven year cycle, the cost structure should be independently reviewed. The Institute also noted that in 1997 ASTC's reserves stood at $42 millions and its operating surplus after tax was $11 million. The Institute suggested that these figures could imply that ASTC is overcharging users.

5.95. GIO Australia (GIO), Commonwealth Securities, and Coopers & Lybrand expressed concern about the forecast of 9,000 transaction per day over a seven year cycle being used as a costing assumption for CHESS. The actual level is currently well over 20,000 transactions per day. Commonwealth Securities argued that the

assumption of 9,000 trades per day is grossly conservative given the recent reduction in stamp duty charges and the massive increase in share ownership following the privatisation of major businesses such as the Commonwealth Bank.

5.96. Ms Stoddart argued that the tariffs should be recalculated without generation of a 'capital reserve'.

5.97. Commonwealth Securities argued for an immediate review by ASTC of the business case assumptions used to determine CHESS tariffs with a general view to lowering the current tariffs.

5.98. Commonwealth Securities also questioned the differential between specific charges, for example, broker to broker settlement is charged at $1.10 while broker to non-broker settlement is charged at $1.60. They also expressed concern that ASTC could impose higher charges on one subset of CHESS users in response to pressure from its shareholders to generate more revenue. National Australia Custodian Services also expressed concern that a cross subsidy could be taking place between different classes of CHESS users. In addition, National Australia Custodian Services emphasised the need to keep fees for NBPs as low as possible in a highly competitive market.

5.99. GIO suggested that the CHESS pricing system should be amended so that the cost of transactions which do not involve a change of beneficial ownership are borne by the parties involved and not the company.

Applicants' response

5.100. In respect of the removal of Article 86, the applicants argued that there is no in principle problem with ASTC paying dividends. The concerns raised in the submissions by interested parties are about the level of tariffs. The Commission should, therefore, have no objection to ASTC paying dividends so long as the benefits of CHESS continue to outweigh any anti-competitive effects.

5.101. In respect of the level of tariffs, the applicants note that a November 1996 study by the International Federation of Stock Exchanges found the average cost of clearing and settlement around the world was US$3.70, while in Australia it was US$1.75.

5.102. The applicants also pointed out that ASTC has no control over the extent to which the lower costs and productivity gains attributable to CHESS are passed on to investors, although competition between participants should ensure that this ultimately occurs once the capital costs of adapting to CHESS have been recouped.

5.103. In addition, the applicants argued that the Commission should be reluctant to play a regulatory role in respect of the setting of ASTC's tariffs unless self-regulation is first shown to fail.

5.104. With respect to the issue of ASTC's use of SIDA funding and the development reserve so far accumulated by ASTC, the applicants affirmed that it is not intended that the development reserve be used other than for the development of CHESS. The applicants specifically stated in their June 1997 response that it was not intended that ASX would have access to the development reserve.

5.105. The applicants also noted that the demutualisation of ASX was driven by the diminishing availability of SIDA funding and by corporate governance concerns arising

from the fact that its interests are diverging from those of its members (whose own interests are increasingly divergent). In the absence of SIDA funding, the applicants suggest that ASX is unlikely to provide capital to ASTC for the development of ancillary services unless ASX can expect a return from ASTC.

5.106. With respect to the issue of price setting between different classes of customers and the possibility of a cross subsidy, the applicants affirmed that ASTC has always had a policy of 'user pays' when determining pricing for CHESS services.

5.107. In response to the Australian Shareholders' Association's concerns about the composition of ASTC's board, the applicants noted that there are only two broker representatives on ASTC's board of nine directors.

Global Competition

5.108. A number of submission questioned the effectiveness of global competition to provide sufficient competitive pressures to ensure that CHESS tariffs do not become unreasonably inflated, especially for small transactions and the majority of issuers.

5.109. Commonwealth Securities argued that the globalisation of the securities industry did not provide a competitive check in relation to retail investors, who do not have the opportunity to shift their business to overseas exchanges should the Australian market become uncompetitive.

5.110. Ernst & Young Registry Services also do not believe that the competition faced by ASX is sufficient to keep tariffs as low as possible. They note that while the largest proportion of trading on ASX involves institutional investors who can choose to deal overseas, a significant segment adding to the liquidity of the market is made up of retail investors who generally do not have a choice to deal overseas.

5.111. Coopers & Lybrand noted that for political and practical reasons, it is not a realistic option for most issuers to seek listing on exchanges in other countries. As such CHESS tariffs for issuers are not influenced by international competition.

5.112. GIO argued that competition will not operate to moderate fees and charges for CHESS services to issuers. Although a broker or NBP can choose to trade shares on ASX or overseas exchanges for at least the major companies, GIO suggests that it is not an option for companies to set up their registry operations off shore.

5.113. Mr Davis claimed that the very nature of CHESS buttressed by the exclusive dealing procedures creates a significant lock-in for certain participants and gives CHESS a very high degree of market power. Listed companies whose market capitalisation lies below the top 50 have no easy or suitable alternative to listing on ASX, unless they have the particular attributes that make a NASDAQ listing attractive. While institutional investors can trade on other markets, most smaller issuers and retail investors have no alternatives, particularly due to the cost of information. Hence a doubling or trebling of CHESS charges on small trades would not be likely to cause a loss of business to the exchange.

5.114. Mr Davis was also concerned about the technological lock-in effects of CHESS.

Domestic competition in clearing and settlement services

5.115. To enhance the operation of competitive pressure on ASTC's pricing, the Commonwealth Bank of Australia (CBA) suggested that Austraclear Limited could offer an alternative equities clearing and settlement system. CBA is a major holder of Austraclear shares. CBA noted that Austraclear has already developed a clearing and settlement system in New Zealand. Based on that experience and its current infrastructure in Australia, Austraclear could provide a competitive alternative in Australia, particularly at the wholesale end of the market.

5.116. CBA questioned the need for ASX to establish an exclusive dealing arrangement requiring brokers and issuers to acquire clearing settlement and registration services from ASTC. CBA was also concerned that, as currently framed, the Rules prevented potential competitors such as Austraclear from entering the market.

5.117. CBA was particularly concerned that competitors, such as Austraclear, be able to offer DvP in Real Time Gross Settlement for equity securities so as to fully exploit technological efficiency gains and further the G30 and ASX initiatives in minimising settlement time frames as well as reducing systemic risk in the payments system.

5.118. However, a number of interested parties also expressed concern about the entry of competitors to ASTC. The Chartered Institute of Company Secretaries in Australia argued that the entry of competitors to ASTC should not be taken lightly. In view of the complexity of the securities industry they suggest that the qualifications of new entrants should be strictly appraised. The Institute has serious reservations about having more than one entity responsible for the transfer and registration of legal title to securities.

5.119. In their second submission, ANZ Nominees stated that for efficiency and security reasons, they would not support any change to the existing arrangements that would allow brokers to choose between alternative clearing and settlement service providers. ANZ Nominees strongly argued that there should be a single entity responsible for clearing and settlement facilities in each market segment: CHESS for equities, RITS for Commonwealth bonds, and Austraclear for other debt securities).

5.120. Nevertheless, ANZ Nominees also noted that the current settlement tariff charged by both Austraclear and RITS is $12.50 while the CHESS tariff is $1.60. This price difference helps to explain why some participants who already utilise CHESS to settle equity transactions are keen to be able to settle their debt transactions through CHESS.

5.121. Mr Lawson, a director of Westpac Custodian Nominees Ltd and of ASTC, submitted that the multiplicity of clearing and settlement facilities in Australia, which includes ASTC, Austraclear, and RITS, as well as Futures and Options Clearing Houses, should be consolidated and treated as a legislated monopoly with the appropriate controls in place to ensure they are effectively and equitably servicing the securities industry and all investors.

5.122. Mr Davis argued that it is likely that Austraclear will only compete for large wholesale transactions in the most active and liquid company stocks. In response to the applicants' claim that CHESS must operate as the default clearing and settlement facility for trades on ASX's market, discussed below at paragraph 5.130, Mr Davis

pointed out that the counterparty to a typical ASX trade through SEATS is not known until after the trade has been executed. Mr Davis argued that in these instances the freedom to agree with the counterparty to opt out of CHESS is illusory. Such a freedom is only real, according to Mr Davis, when the parties, usually in large trades, already know each other.

5.123. Austraclear Limited (Austraclear) opposes the CHESS applications to the extent that they prevent or constrain Austraclear's capacity to offer alternative clearing and settlement facilities for equity securities traded on ASX.

5.124. Austraclear operates the central securities depository (CSD) and the electronic clearing and settlement facility for Australian money market securities (debt securities), excluding Australian Government securities. They advise that their system complies with all of the G30 recommendations.

5.125. Securities lodged at the Austraclear CSD by participants are either in paper or registered form and include bills of exchange, certificates of deposit, commercial paper, as well as state government, bank and corporate bond issues. Austraclear currently has in excess of 750 participants including all licensed Australian banks, major securities dealing houses, stockbrokers, life and superannuation companies, fund managers, trust companies, custodians, federal and state governments and large corporations. The total value of securities lodged in the system presently exceed $150 billion and daily turnover is generally in excess of $20 billion and has been as high as $80 billion.

5.126. Austraclear also operates the central securities depositary for the New Zealand money market and facilitates the settlement of equity trades.

5.127. Austraclear advises that it has the capability to settle equity trades between its members, which include all major participants in the securities market in Australia who hold and trade portfolios of both debt and equity securities. Austraclear also advises that it would offer considerable efficiencies in the settlement process if it were able to enter the market.

Applicants' response

5.128. Under the current ASX Business Rules, brokers have no choice but to use CHESS for the clearing and settling of ASX trades, although the applicants' also advised that under the current Rules there is no prohibition against Austraclear providing clearing and settlement services in respect of trades of ASX securities which do not occur on the market operated by ASX.

5.129. In their submission lodged with the Commission in November 1997, ASTC and ASX stated that, if required by the Commission, they are prepared to modify their Business Rules so that the Rules provide brokers with a choice of using an alternative clearing and settlement provider.

5.130. If the Rules were changed to give brokers such a choice, the applicants argue that the only way that settlement could be made certain is to mandate the use of CHESS as the automatic default option for an ASX market transaction. To do otherwise is to run the risk that brokers would be unable to agree on which settlement service to use, with the result that a trade on SEATS may fail to be settled. Under this proposal, brokers' trades on SEATS would still need to be communicated to CHESS and so

brokers would still need to be CHESS participants to trade on an ASX market. Brokers wishing to use a different clearing and settlement service provider for a particular transaction would have to notify CHESS and arrange for the transaction to be removed from the CHESS settlement process.

5.131. The applicants suggest that the additional constraint on ASTC's pricing afforded by the prospect of competition from Austraclear (and possibly others) should allay any residual concerns about ASTC paying dividends to ASX. They also argue that price supervision by the ACCC is unnecessary given the ability of at least one service provider to operate in competition with ASTC.

5.132. In addition, the applicants argue that the removal of Article 86 is essential if competition was to operate effectively. They suggest that there would be no point in Austraclear even contemplating competing against a non-dividend paying ASTC, because ASTC's non-dividend paying status would give it a considerable competitive advantage.

5.133. In its responses to the entry of Austraclear as a competitor, ASTC anticipated that Austraclear's clearing and settlement service for securities quoted on ASX would deliver securities in the form of title to a beneficial, as opposed to legal title. Since the Corporations Law only regulates clearing and settlement services in relation to legal title, the applicants argued that Austraclear could compete with ASTC by providing a service at the level of beneficial ownership without requiring any change to the Corporations Law.

5.134. However, in its second submission, Austraclear emphasised the disadvantages facing a depositary system operating in competition with a system capable of delivering legal title. Austraclear expressed the view that the present provisions of the Corporations Law, which do not allow more than one recognised system of electronic transfer of legal title, imposes a barrier to entry that would prevent Austraclear from providing an alternative clearing and settlement facility for ASX listed equities.

5.135. With respect to Mr Davis' concerns about technological 'lock-in', the applicants note, in their November submission, that the establishment of technological standards is simply unavoidable for the effective operation of CHESS. They also point out that if another service provider adopted the same standards for sending messages as CHESS, there would be nothing to stop participants using the technology they currently use for CHESS to communicate with that other service provider. The applicants advise that there is no requirement imposed by ASX that participants use their technology only for CHESS.

Broker sponsorship, issuer sponsorship and small investors

5.136. Submissions by small investors, including those by Mr S Harvey Langford, Mr Horst Jakobi and Mr R A Oser, indicated concern that the broker sponsorship arrangements would have the effect of tying small investors to one broker. Mr Jakobi was particularly concerned that broker sponsorship prevents him from trading with the broker of his choice without informing his sponsoring broker. These submissions encouraged greater use of issuer sponsored subregisters as an alternative to broker sponsorship. Concern was expressed that ASX was not doing enough to encourage the establishment of issuer sponsored subregisters.