

**The Australian OTC & Exchange Traded Financial Markets: Summary of
Total Turnover (\$A billion)**

Market	1994	1995	1996	1997	Latest per cent change
Exchange Traded Markets					
Equities	128	118	159	212	34
Futures	6 209	7 151	6 623	8 711	32
OTC Financial Markets					
Foreign Exchange	14 893	15 093	15 207	17 728	17
Currency Options	175	199	222	349	57
Long Dated Securities	1 092	1 557	1 172	1 416	21
Purchase Agreements	870	1 505	1 484	2 413	63
Short Dated Instruments	1 024	980	1 113	1 334	20
Forward Rate Agreements	676	1 025	664	485	(27)
Swaps	273	317	349	410	17
Interest Rate Options	69	60	58	70	21
Total	19 072	20 736	20 269	24 205	19
All Markets	25 409	28 005	27 051	33 128	22

Source: AFMA 1997 Australian Financial Market Report, page 3.

8.7. In respect of the exchange traded markets, ASX operates the securities (primarily equities) market and also conducts markets in derivative products. SFE's futures market facilitates trading in a range of financial and commodity futures including contracts in bank bills, Treasury bonds, the share price index, wool, wheat and electricity.

8.8. OTC markets are made up of transactions negotiated between institutions and professional dealers. There is no central marketplace or facility which matches buyers with sellers. Participants deal bilaterally through telephone and computer systems. The bulk of bond trading takes place on the OTC market, with only a small number of bonds traded on the ASX. The major OTC derivatives markets are in currency options, forward rate agreements, interest rate swaps and interest rate options. Transactions in

foreign exchange, which represents the cash and other claims (such as bonds) held in the currency of another country, are also bilaterally negotiated between institutions.

8.9. There are a number of differences between exchange and OTC markets including:

- exchange markets provide a public price discovery function. Traditionally OTC markets have not provided a public price formation process, however, technological advances are facilitating greater transparency in OTC markets;
- exchanges have an anonymous trading environment supported by appropriate structures designed to reduce the risk of counterparty default including clearing and settlement facilities and resource backing. OTC markets are typically principal to principal negotiations that permit individual assessment of creditworthiness before entering into a transaction; and
- derivative exchanges typically trade standardised contracts while OTC derivative markets involve individually negotiated arrangements which permit counterparties to tailor contracts.

Current regulation

8.10. Market regulation under the Corporations Law draws a distinction between 'securities' and 'futures' contracts. Generally, financial arrangements falling within the definition of 'securities' are traded on a securities exchange, while arrangements within the definition of a 'futures contract' are traded on a futures exchange or an OTC futures market. 'Derivatives' are not recognised as a distinct category by the Corporations Law and are regulated differently depending on whether they are classified as a security or a futures contract.

8.11. Markets in securities and futures products are generally regulated by the Corporations Law through the exchange or exempt market provisions.

8.12. Exchanges must be authorised by the Treasurer and must have rules which satisfy broad criteria relating to the conduct of their business, including the supervision of members. Exchanges are required to submit amendments to their business rules to the Treasurer for consideration and possible disallowance. A co-regulatory structure for the supervision of the market is utilised whereby the exchanges are the front-line regulators of their markets subject to supervision by the ASC.

8.13. The exchanges (ASX and SFE) have comprehensive Articles of Association and Rules which contain provisions relating to membership of the exchange, the supervision and disciplining of members, market conduct and trading arrangements. Both the ASX and SFE have operated for many years with the benefit of authorisation (ie, immunity from court action) under the *Trade Practices Act* in respect of the majority of their regulatory arrangements.

8.14. Some OTC markets fall outside the ambit of the Corporations Law (eg, currency transactions conducted by a bank) while others require an exempt market declaration by the Treasurer. OTC markets are subject to less regulation than exchanges. OTC markets are not generally subject to a co-regulatory structure but sometimes employ trading conventions and documentation promoted by industry associations. (*Trade*

Practices Act authorisations have not been granted in respect of OTC market arrangements.)

CLERP proposals

8.15. CLERP Paper No.6 contains a comprehensive discussion of current regulatory arrangements, and also lists a range of problems with this regulation which include the following:

- the legal distinction between securities and futures inhibits competition between market providers, creates barriers to entry, and leads to uncertainty among market participants;
- OTC markets are subject to substantially less regulation compared to exchanges, and this places exchanges at a competitive disadvantage;
- the traditional distinction between OTC and exchange-traded markets is being challenged by technological developments; and
- the current regulatory structure of exchanges where members have an ownership interest in, and trade directly on, the exchange does not accommodate new market structures, eg, where institutions have direct trading access.

8.16. The CLERP proposals for reform call for uniform regulation of 'financial instruments', which will include all securities, futures and other derivatives as well as foreign exchange, superannuation, general and life insurance and deposit accounts. CLERP notes that the new regulatory regime will provide consistent regulation of functionally similar markets and products.

8.17. Under CLERP's proposed regulatory framework, persons will be prohibited from conducting a market in financial instruments or providing intermediary services unless they hold an appropriately endorsed financial markets licence. The proposed licence will have three categories relating to the operation of market facilities, the operation of clearing and settlement facilities, and the provision of financial intermediary services.

8.18. A market operator's licence will be required where a person proposes to provide a market facility where financial instruments are regularly traded or information is provided about the prices at which persons may expect to trade financial instruments, and which involve multiple buyers and sellers. It is proposed that to obtain a licence the market operator must:

- have adequate arrangements for the supervision of the market;
- have and maintain sufficient resources to conduct the market and carry out supervisory functions;
- have adequate rules or procedures for the operation of the market, including access to market facilities, the recording and disclosure of transactions effected on the market and procedures for dealing with complaints;
- have adequate arrangements for the clearing and settlement of transactions; and
- have adequate protection for retail investors.

8.19. CLERP notes that the Government's response to the Wallis Inquiry recommendations stated that the ACCC will be retained as the economy wide competition regulator for the financial system. The Government agreed with the Wallis Inquiry that the ACCC's competition role is separate from the market integrity role undertaken in the non-disallowance examination of exchange arrangements (under the Corporations Law). CLERP notes, therefore, that market operators who propose to adopt practices inconsistent with the *Trade Practices Act* must seek appropriate authorisations from the ACCC.

Clearing and settlement facilities

8.20. Clearing and settlement facilities play an important role in the efficient functioning and successful operation of financial markets. They may take on major financial risks in guaranteeing the fulfilment of transactions and providing protection against counterparty credit risk.

8.21. Currently there are five principal clearing and settlement facilities that service Australian financial markets:

- SFE Clearing House (SFECH), a subsidiary of the SFE, clears and settles transactions effected on the SFE;
- CHESS which is operated by ASTC, a subsidiary of ASX, records transfers of ASX quoted securities (currently equities only) and determines the resulting settlement obligations which take place through the payments system;
- Options Clearing House (OCH), a subsidiary of ASX, clears all options transactions on ASX's Australian Options Market;
- RITS transfers and provides settlement of Commonwealth Government debt securities transactions; and
- Austraclear which provides a central registry and depository for the money market and debt securities (except Commonwealth debt securities), and operates a system for the electronic transfer of ownership of such debt securities.

8.22. CLERP notes that the nature of clearing and settlement services varies according to the features of the financial product and the way in which the product is traded. For example, derivative products generally involve long term financial commitments and obligations prior to final settlement while equities are settled relatively quickly. An anonymous trading environment for financial instruments requires different clearing and settlement services to systems where counterparties assess credit risk before entering into a transaction.

8.23. The clearing and settlement facilities noted above operate on either a novation clearing or a title transfer clearing basis.

8.24. Novation clearing occurs where a clearing house becomes a party to each registered contract and breaks the link between the original contracting parties. The clearing house enters into substitute contracts with each of the original counterparties (the clearing house members rather than their clients), becoming seller to the buyer and buyer to the seller, with full counterparty risk being transferred to the clearing house. This system permits parties to trade in an anonymous environment by removing the

requirement to assess counterparty credit risk before transacting in the market. SFECH, OCH and CHES operate on a novation clearing basis.

8.25. Title transfer clearing involves the recording, clearance and settlement of transactions, but the clearing house does not become party to the transaction. Austraclear operates on a title transfer clearing basis. The Austraclear system allows members transacting with each other to coordinate with their banks concerning payment obligations on their behalf. Once the banks have notified that they will meet those obligations, any required transfers between the exchange settlement accounts of the banks are notified to the RBA and any related securities elements are settled. The RITS system operates in a similar manner.

8.26. Clearing and settlement of a financial market transaction involves both transfer of ownership of the financial instrument from the seller to the buyer, and payment in respect of the financial instrument by the buyer to the seller. The payment system is thus critically involved in clearing and settlement of financial market transactions. In fact, payment transactions through RITS and Austraclear collectively account for the majority (by value) of high value electronic payments exchanged. As noted in section 7 above, payments in respect of securities transactions cleared and settled through CHES are effected through RITS. CLERP notes that payments to SFECH are settled through Austraclear. Thus, payments in respect of ASX and SFE market transactions as well as payments in respect of OTC transactions are effected through RITS and Austraclear.

8.27. In view of the significance of payments effected through RITS and Austraclear (which accounted for about a third by value of all payments exchanged through the payments system in 1997), a relevant development is the Real Time Gross Settlement (RTGS) system which was introduced by the RBA on 22 June 1998. Both RITS and Austraclear payments are settled on a RTGS basis. RTGS essentially means that payments between participants in the relevant payments systems are settled across exchange settlement accounts held with the RBA prior to the delivery of the payment to the recipient. The intended effect is that where a payment is settled on a RTGS basis the recipient of the payment is assured of receiving value for it, even in the event of failure of the financial institution which sent the payment. Payments system settlement and systemic risks are eliminated under real time gross settlement systems.

Current regulation

8.28. SFECH, OCH and CHES, the clearing and settlement facilities for SFE and ASX markets are regulated under the Corporations Law. Securities and futures exchange clearing and settlement facilities must be authorised by the Treasurer and must have rules that satisfy broad criteria relating to the conduct of their business, including the proper registration of securities transfers and futures contracts and the supervision and disciplining of members. These clearing and settlement facilities are also required to submit amendments to their rules to the Treasurer for consideration and possible disallowance.

8.29. SFECH, OCH and CHES rules have also been considered under the authorisation provisions of the *Trade Practices Act*. The SFECH arrangements relating to membership, supervision and disciplining of members and clearing procedures were granted authorisation by the TPC in October 1995 for a period of five years. In

December 1997 the Commission granted authorisation to ASX and OCH, for a period of five years, in respect of ASX rules relating to participation in the options and share ratios markets, supervision and disciplining of participants and trading arrangements. The CHESSE arrangements, which were initially granted authorisation in June 1994 (Phase 1) and December 1995 (Phase 2) until July 1997, are the subject of this authorisation determination.

8.30. RITS and Austraclear are not subject to formal regulation. RITS is operated by the RBA and does not have any additional independent regulatory oversight. Austraclear is owned by various banks and other participants in the money market, and operates as a private and non-regulated venture. Neither the RITS nor Austraclear arrangements (including their participation and conduct requirements) have been considered under the authorisation provisions of the *Trade Practices Act*.

CLERP proposals

8.31. CLERP notes that systemic risk concerns about market clearing facilities arise from their possible role as the counterparty and guarantor. It is vital that persons who offer clearing and settlement facilities are able to meet their obligations as well as effectively manage risk. CLERP considers that in order to promote efficiency and investor confidence in the effective clearing and settlement of financial market products and payment obligations, clearing and settlement facilities must be licensed to ensure they meet minimum criteria.

8.32. CLERP proposes that all clearing and settlement operators be required to be licensed, unless the facility has already been authorised as part of a licence to operate a market. The criteria to be satisfied to obtain a licence to operate a clearing and settlement facility will be that the facility provider must:

- have adequate rules or procedures for the operation of the facility;
- have adequate arrangements for the supervision of the facility; and
- have and maintain sufficient resources to conduct the facility and perform supervisory functions.

8.33. CLERP notes that under its proposals, the nature of the activities conducted by the market operator will impact on the types of clearing and settlement arrangements which must be provided in conjunction with the market. For example, 'anonymous' trading environments, where parties do not know the identity of counterparties before contracting on the market, will require a system which provides protection against counterparty credit risk (some form of novation clearing and credit capping). CLERP also notes, however, that some markets may not offer clearing and settlement services, with the market operator merely providing information about the price of financial products or simply matching buyers and sellers who settle through private negotiation. In these circumstances, the market operator would be required to disclose that settlement is the responsibility of the individual parties.

Competition in financial markets - some CLERP observations

8.34. CLERP observes that in light of the dynamic nature of financial markets, it is imperative that the regulatory regime is sufficiently flexible to permit Australian markets and investors to fully participate in the benefits of innovation and competition.

It notes that the Wallis Report highlighted the forces for change operating on the financial system, which have had a profound effect on financial markets, including:

- technology - the advent of cost efficient computers and telecommunications technology has radically changed the way markets and intermediaries operate. Technology has facilitated the development of new market structures and products which are not confined to traditional institutional or geographic boundaries;
- globalisation - Australian financial markets are becoming increasingly integrated with other world markets;
- innovation - one of the most striking features of financial innovation during the last decade has been the growth in the use and diversity of financial instruments including derivative products; and
- competition - traditional market structures like financial exchanges are facing unprecedented competition from international exchanges and innovative market facilities.

8.35. On the development of alternative markets CLERP notes that, worldwide, market participants are harnessing technological developments to produce innovative systems which provide cost-effective trading opportunities for professional investors. For example, the Reuters owned Instinet system, which does not currently operate in Australia, provides a computer based platform which permits the real time trading of securities listed on 16 exchanges. Posit, another alternative trading system which permits confidential matching of securities transactions at the midpoint of the bid-offer spread, provides pools of liquidity at certain times throughout the trading day.

8.36. CLERP observes that the economic functions of securities and derivatives markets are similar, notwithstanding the varying characteristics of particular instruments. The traditional view is that there is a fundamental distinction between fundraising (securities) and risk management (futures/derivatives) agreements. That is, there is a fundamental difference between the role of stock exchanges in transferring title to securities and the role of futures/derivatives exchanges in transferring price risks through contractual agreements. CLERP notes, however, that the traditional view that there is a fundamental distinction between the role of securities and derivatives markets is under challenge from a number of perspectives including that:

- derivatives are traded on both the ASX and the SFE;
- substantially similar products are traded on the ASX as securities and the SFE as futures contracts (eg, ASX LEPOs and SFE deliverable share futures contracts);
- some derivatives give rise to a transfer of title to a physical asset if held until expiry (eg, equity options, deliverable futures contracts);
- new financial arrangements have been developed which exhibit traditional characteristics of both 'securities' and 'futures' - eg, endowment warrants which permit holders of a derivative instrument to benefit from dividends paid on the underlying security.

8.37. CLERP also notes that commercial practice does not accord with the traditional view that securities are investment products while derivatives are risk management

tools. Currently, investors use related derivatives and securities products as alternatives to achieving a particular investment strategy. For example, an investor wishing to risk capital for future profit based on movements in the price of shares has a number of choices available - to purchase the share, take an option over it, take out a warrant or buy an individual share future. In order to diversify the investment to reduce risk, the same investor may purchase a share portfolio or a share price index futures contract.

8.38. CLERP also observes that exchange and OTC markets are economically interdependent and to some extent, compete with each other. For example, participants in OTC derivative markets may hedge their exposures through exchange-traded contracts.

8.39. As noted, clearing and settlement arrangements associated with financial markets contribute to the efficient operation of the markets and promote investor confidence. CLERP's proposed criteria for a market operator's licence include the requirement that an operator must have adequate arrangements for the clearing and settlement of transactions effected on its market. CLERP notes, however, that clearing and settlement services may be conducted by the market operator or an associate, or be undertaken by an independent clearing and settlement facility. Under CLERP's proposals, clearing and settlement services conducted by the market operator or associate will be assessed as part of the application to conduct a market, whereas independent facilities will require a clearing and settlement licence.

8.40. It is also noted that CLERP considers that increased competition may result in third party providers competing with existing exchange facilities to clear and settle identical financial instruments.

Competition for clearing and settlement services

8.41. It follows from CLERP's observations that due to technological advances and innovation in the development of financial products, there is an increasing level of competition between the exchanges operated by ASX and SFE, as well as between those exchanges, international exchanges and innovative OTC market facilities. Such developments are providing alternative trading products and opportunities for at least professional investors.

8.42. The Commission recognises (see paragraphs 7.58 to 7.66 above) that the globalisation of the securities industry has exposed ASX to some competition from overseas exchanges. The Commission also recognises that there is competition between ASX and SFE at least in respect of some products offered on their respective markets. In addition, the Commission welcomes the CLERP initiatives to promote competition by removing unnecessary legislative distinctions between financial products and providing a more competitively neutral regime for the regulation of markets and intermediaries.

8.43. However, in respect of transactions traded on the various financial markets in Australia, there is currently no competition for the provision of clearing and settlement services. As a competition authority the Commission is concerned to ensure that, should this lack of competition be the result of current regulation, such regulation is otherwise justified in the public interest. The Commission therefore supports the CLERP proposals aimed at ensuring that legislative requirements do not inhibit the development of competition for the provision of clearing and settlement services. It

notes with approval CLERP's view that increased competition may result in third party providers competing with existing exchange facilities to clear and settle identical financial instruments.

8.44. The self-regulatory rules of a provider of a financial market and/or a clearing and settlement facility may also inhibit competition in the provision of clearing and settlement services. As already noted, the regulatory arrangements of SFECH, OCH and CHESSE have all been the subject of applications for authorisation under the *Trade Practices Act*. Requirements that all transactions on SFE's market must be cleared and settled through SFECH, and all transactions of ASX's derivatives markets must be cleared and settled through OCH, are currently authorised (on net public benefit grounds) under the Act. Both of these authorisations expire in November 2000. The Commission may, however, review these authorisations prior to that date if there has been a material change of circumstances since the authorisations were granted (eg, perhaps as a consequence of changes to the Corporations Law under the CLERP proposals).

8.45. As noted, the Commission proposes to require changes to the CHESSE arrangements, as conditions or authorisation of the arrangements, to enable competition in the clearing and settlement of ASX market transactions in equity and debt securities.

8.46. The Commission proposes to require that ASTC remove the current exclusion of ASX market transactions in debt securities from clearing and settlement through CHESSE (see paragraph 7.93 above). As noted, this exclusion ensures that CHESSE does not compete with either RITS (in respect of Commonwealth debt securities) or Austraclear (in respect of other debt securities); although an amendment to the *Commonwealth Inscribed Stock Act 1911* would be required before government debt securities could be cleared and settled through CHESSE. The Commission urges that the relevant provisions of the *Inscribed Stock Act* be reviewed as part of the CLERP proposals to ensure that legislative requirements do not inhibit the development of competition.

8.47. The Commission also proposes that ASX and ASTC amend their Rules to explicitly permit brokers to use the services of a facility other than CHESSE to clear and settle ASX market transactions. As noted in section 7 above, the retention of ASTC Article 59A and 86 would allay many of the Commission's concerns in respect of the need for adequate checks on ASTC's power to charge extortionate compulsory fees. However, should these ASTC Articles be removed as proposed by ASX and ASTC, the Commission considers that the existence of a competitive environment for the clearing and settlement of ASX market transactions has the potential to provide the most efficient mechanism for ensuring that CHESSE tariffs are kept at levels that will enable the public benefits associated with CHESSE to be realised.

8.48. In respect of the possibility of a clearing and settlement facility competing with CHESSE under the current requirements of the Corporations Law, ASIC is of the view that while there may be a case for transfer of beneficial title by a facility other than ASTC (which is the recognised "securities clearing house" under the Law), such a facility could not transfer legal title in a dematerialised system. ASIC also notes that section 779J confers advantages upon the "approved securities clearing house" by not requiring it to comply with the Law's requirements for the conduct of a securities business, the

offer of securities by subscription or purchase or the invitation to subscribe for or buy securities. It is the ASC's view that any entity that wished to offer services of a securities clearing house in competition with ASTC would under the current Law need to be approved as a securities dealer or an exchange and implement indemnity arrangements of the kind envisaged by Part 7.9 before it could operate in competition with ASTC.

8.49. Treasury's submission on the approval and conduct of the securities clearing house (SCH) under the Corporations Law has been noted at paragraphs 6.27 to 6.29 above. Briefly, Treasury advised that approval as the SCH under Part 7.2A of the Law does not confer any exclusive rights on the ASTC in relation to the settlement of transactions involving ASX quoted securities or quoted rights or the registration of quoted securities or quoted rights. While ASTC is therefore not a statutory monopoly in relation to securities clearing, its approval as the SCH does clearly have significance and legal consequences. Treasury notes that the provisions of Part 7.13 of the Corporations Law, which relate to the concept of non-certificated holdings and paperless transfers of "SCH-regulated transfers", are also relevant. The Law leaves to the SCH rules to determine what is an "SCH-regulated transfer" and to identify how and when a proper SCH transfer is effected to pass legal title by electronic means. Thus, if another clearing and settlement service provider such as Austraclear wished to provide a facility for the electronic transfer and registration of legal title to securities, similar amendments to those afforded SCH-regulated transfers in Part 7.13 may be necessary.

8.50. As noted in the submissions of ASIC and Treasury, the Corporations Law currently confers unintended market advantages on ASTC as the SCH under the Law. ASTC has advised the Commission that it is willing to progress modifications of the Corporations Law which ensure that the Law recognises more than one securities clearing house. ASTC indicated that it was to discuss possible changes to the Law with the ASC. The Commission supports this initiative by ASTC, and considers that a review of the relevant provisions of the Law in respect of the transfer of legal title to securities is appropriate in view of the CLERP proposals to provide a more competitively neutral regime for the regulation of financial markets. The current Corporation Law requirements for an entity wishing to clear and settle ASX quoted securities through the transfer of beneficial title should also be reviewed to ensure the requirements are justified in the public interest.

Clearing and settlement facilities in the US and UK markets

8.51. Differences in the regulation, conduct, size and structure of financial markets in the US and UK, and in the clearing and settlement facilities servicing those markets, make comparisons with the Australian market and its clearing and settlement facilities difficult. Nevertheless, it is interesting to note the clearing and settlement facilities servicing the US and UK financial markets, which are outlined briefly below.

USA

8.52. In the United States, equities settlement of market transactions is effected through a depository style of system, which supports transfers of beneficial ownership rather than transfers of legal title (as with CHES).

8.53. The functions of clearing and settlement are basically divided between two organisations - the National Securities Clearing Corporation (NSCC) and the Depository Trust Company (DTC).

8.54. The NSCC provides centralised clearance, settlement and information services for equities, bonds, mutual funds and annuity transactions executed on the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX) and the NASDAQ markets, as well as some over the counter products. The NSCC system is fully automated and operates on a T+3 settlement cycle. The average daily volume of transactions processed by NSCC in 1997 was 2.6 million with an average daily value of almost US\$134 billion.

8.55. The NSCC is jointly owned by NYSE, AMEX and the National Association of Securities Dealers (NASD). The NSCC has recently absorbed the clearing functions of its regional equivalents, the Midwest Clearing Corporation and the Stock Clearing Corporation of Philadelphia representing the final stage in an industry centralisation process.

8.56. The NSCC has a number of subsidiaries and affiliates that act as specialised clearing agencies, including:

- International Securities Clearing Corporation - provides clearance, settlement and information to US brokers trading in overseas markets.
- Government Securities Clearing Corporation - provides centralised, automated trade comparison, netting and settlement services for US Government securities (such as Treasury bills, bonds and notes) as well as for zero coupon and non-mortgage-backed Agency securities.
- The Options Clearing Corporation - is the largest clearing corporation in the world for financial derivative instruments. It is the common clearing facility for all US exchanges trading negotiable options.

8.57. The operations of NSCC are closely linked to DTC which operates the depository and facilitates post-trade settlement between brokers and institutional counterparties. DTC is owned by its broker/dealer and bank participants.

8.58. The DTC is a major depository of securities, acting as custodian for a large proportion of corporate stocks, bonds and municipal bonds. Specialised depositories exist for Government securities and Mortgage-backed securities.

8.59. The DTC links nearly 600 participants and thousands of investors that serve as transfer agents, paying agents and exchange and redemption agents for securities issuers. DTC has in its custody for participants 82 per cent of the shares of companies represented in the Dow Jones Industrial Average, 78 per cent of shares of all NYSE listed companies, 65 per cent of the shares of issues included in NASDAQ, 61 per cent of the shares of all AMEX listed companies, 92 per cent of the principal amount of outstanding corporate debt listed on NYSE and nearly all the principal amount of outstanding municipal bonds and commercial paper.

8.60. In 1996, DTC participants delivered US\$50 trillion of securities through the depository's book entry system. This is the use of book keeping entries to execute securities transfers from one account holder to another with respect to issues or holdings

which are uncertificated. When a security is bought or sold, the buyer and seller usually through their respective broker and/or bank agents, specify the terms of delivery of the security. The safekeeping institution for the selling client is notified of the transaction by the seller and given the owner's instructions to deliver. The safekeeping institution enters the transaction on its records and informs the depository of the delivery of the security. The new safekeeping institution for the buying client inspects the security transaction against instructions received from its customer, the buyer, for accuracy and authenticity. Upon verification, and payment if DvP is agreed, the security is credited to the new owner's account and recorded on the safekeeping institution's books.

UK

8.61. CREST is the clearing and electronic settlement system for corporate securities in the UK and Ireland. It enables participants to hold securities in uncertificated form and transfer them electronically in real time with effective delivery versus payment settlement.

8.62. CREST operates on a similar principle to CHESSESS in that it incorporates a "name on register" system, which supports electronic transfer of legal title and delivery versus payment settlement of stock exchange transactions, encompassing brokers, institutional investors and custodians. It also has links to share registries.

8.63. CREST is owned and operated by CRESTCo Ltd, a limited company owned by a wide consortium of firms from the securities industry.

8.64. At the end of March 1998 CREST was settling 162 000 transactions daily, with a daily cash value of £30 billion. The value of stock held electronically in CREST is over £1.2 trillion and represents over 80 per cent of the market capitalisation of UK shares.

8.65. In addition to CREST, there are separate systems for the settlement of UK government securities and money market instruments, although there are proposals currently being considered to merge the separate systems to form a single settlement system encompassing the full range of securities.

9. Determination

9.1. For the reasons outlined in section 7 of this determination, and subject to the proposed conditions set out below in paragraph 9.4, the Commission is satisfied that the arrangements and conduct the subject of these applications for authorisation:

- are likely to result in benefit to the public which would outweigh the detriment to the public constituted by any lessening of competition that is likely to result from the arrangements; and
- are likely to result in such a benefit to the public that the arrangements should be allowed to be given effect to, and the conduct should be allowed to take place.

9.2. The Commission therefore grants authorisation subject to the conditions set out in paragraph 9.4 below, to:

- (i) ASTC and ASX in respect of the exclusive dealing conduct the subject of application A30180;
- (ii) ASTC in respect of the exclusionary provisions the subject of application A30181;
- (iii) ASTC and APCA in respect of the exclusive dealing conduct the subject of application A30182; and
- (iv) ASX and ASTC in respect of the arrangements affecting competition the subject of the amended application A90596.

The substance of the conduct, provisions and arrangements the subject of these applications has been outlined in section 1 of this determination at paragraphs 1.4 and 1.5.

9.3. The authorisation that the Commission grants in respect of the arrangements the subject of applications A30181 and A90596 also applies to or in relation to persons who become parties to the arrangements at a time after the authorisation is granted.

9.4. The authorisation that the Commission grants is subject to the following conditions:

1. The applicants alter their Rules to explicitly permit brokers to use the services of a clearing and settlement facility other than that operated by ASTC to clear and settle ASX market transactions.
2. The applicants not use any power under their Rules to prevent an entity from competing with ASTC or unreasonably constrain an entity's ability to compete with ASTC in the provision of clearing and settlement services.
3. The applicants provide a means through which the counterparties to an ASX market transaction can efficiently communicate their desire to have a transaction cleared and settled through an alternative facility.
4. The applicants amend SCH Business Rule 7.1 to provide that a transaction is eligible for CHES DvP settlement if the transaction is of a class of transactions determined by ASTC in accordance with objective criteria to be

so eligible, and that any such determination by ASTC is subject to an appeal mechanism.

5. The objective criteria and appeal mechanism of condition 4 above are formulated to the Commission's satisfaction by ASTC within three months of the date that this determination comes into force.
6. The applicants remove the current exclusion of ASX market transactions in debt securities from clearing and settlement through CHESSE.
7. The proposed payments provider criterion that an entity must maintain an ESA or similar settlement account with the RBA in its own name not be further qualified so as to exclude particular types of institutions with such settlement facilities.

9.5. The Commission grants authorisation for a period of five years.

9.6. This determination is made on 5 August 1998. If no application for a review of the determination is made to the Australian Competition Tribunal, it will come into force on 27 August 1998. If an application for review is made to the Tribunal, the determination will come into force:

- where the application is not withdrawn - on the day on which the Tribunal makes a determination on the review; or
- where the application is withdrawn - on the day on which the application is withdrawn.

9.7. The interim authorisations currently covering the CHESSE arrangements will continue to operate until such time as this determination comes into force or until such further order by the Australian Competition Tribunal. The interim authorisation relating to the majority of the CHESSE arrangements was granted, in July 1997, on the basis that ASTC's Articles of Association 59A and 86 remain as currently drafted.

Attachment A

ASX Listing Rules submitted for authorisation

1. Rule 1.1 (in particular condition 3 which imposes an obligation on the Issuer to issue an information memorandum that complies with Appendix 1A);
2. Rule 1.7 (as a result of it referring to the necessity for an entity to complete Appendix 1A);
3. Appendix 1A (as a result of part 3 of Appendix 1A which imposes an obligation on the entity to comply with the SCH Business Rules - refer to clause 10);
4. Rule 1.9 (as a result of part 3 of Appendix 1B which imposes an obligation on the debt issuer to comply with the SCH Business Rules);
5. Appendix 1B (As a result of part 3 of Appendix 1B which imposes an obligation on the debt issuer to comply with the SCH Business Rules);
6. Rule 1.14 (as a result of part 3 of Appendix 1C which imposes an obligation on an exempt foreign entity to comply with the SCH Business Rules);
7. Appendix 1C (as a result of part 3 of Appendix 1C which imposes an obligation on an exempt foreign entity to comply with the SCH Business Rules);
8. Rule 2.1 (in particular condition 3);
9. Rule 2.2;
10. Rule 2.5 (in particular condition 9);
11. Rule 2.14;
12. The explanatory note on the first page of Chapter 8
13. Rule 8.1;
14. Rule 8.2;
15. Rule 8.10;
16. Rule 8.11;
17. Rule 8.14
18. Rule 9.17;
19. Rule 9.19;
20. Rule 9.20;
21. Rule 9.21;
22. Rule 9.22;
23. Rule 9.23;
24. Rule 15.11;
25. Appendix 15A
26. Listing Rule 16.5.1 (to the extent that it imposes an obligation on the entity to complete Appendix 16A);

27. Appendix 16A to the extent that the appendix contains an acknowledgment that the entity shall comply with the SCH Business Rules;
28. Rule 17.3 (to the extent of Rule 17.3.1. Rule 8.1 makes the SCH Business Rules part of the definition of Listing Rules so that a breach of an SCH Business Rule could lead to suspension of the Issuer);
29. Rule 17.6 (to the extent that it imposes an obligation to complete Appendix 16A);
30. Rule 17.12 (to the extent that it refers to a breach of a Listing Rule);
31. Rule 17.15 (to the extent that it allows for removal of an entity from the official list where Appendix 16A is not completed);
32. Rule 18.6; and,
33. Chapter 19 (the definitions to the extent that the Listing Rule definitions rely on the definition of the like term in the SCH Business Rules).

Attachment B

ASX Business Rules submitted for authorisation

1. Rule 3.8 and in particular Rule 3.8(2A);
2. Rule 3.17 (all);
3. Rule 4.1C (all);
4. Rule 4.43;
5. Rule 4.51 (all);
6. Rule 8.5 (in particular 8.5.2);
7. Appendix 6.16 (in particular clause 24);
8. Rule 8.18 (in particular 8.18.1 and 8.18D);
9. Rule 10.2.1 (in particular 10.2.1.3 and 10.2.1.6)
10. Rule 10.10.1 (in particular 10.10.1(b));
11. Rule 10.10.3; and,
12. Rule 10.13.4 (in particular 10.13.4.4).

Attachment C

Applicant's proposed amendments to the definition of payments provider

Payments Provider means an entity that:

- (a) **is operates an Exchange Settlement Account in its own name with the Reserve Bank of Australia and that is:**
 - (i) a bank as defined in section 5 of the Banking Act 1959 (Cth);
 - (ii) a bank constituted under a law of a State or Territory of Australia;
 - (iii) the Reserve Bank of Australia;
 - (iv) a building society or credit union regulated under the Financial Institutions Code; or
 - (v) a Special Service Provider regulated under the Financial Institutions Code;
- (b) has the operational capacity to:
 - (i) authorise and make payments on behalf of Participants;
 - (ii) make payments to Participants; and,
 - (iii) register entries in the CHESSE Payments Provider User Group ~~(either directly or in the case of a building society or credit union, via its nominated bank or Special Service Provider)~~ for the purpose of discharging its net obligation to make payment to the CHESSE Bank or its net entitlement to receive payment from the CHESSE Bank in accordance with the Standard Payments Provider Deed;
- (c) meets the technical and performance requirements prescribed by SCH to ensure that the entity does not affect the integrity or orderly operation of CHESSE;
- (d) has executed a Standard Payments Provider Deed; and
- ~~(e) is approved as an entity that has:~~
 - ~~(i) the capacity to participate in DvP settlement in a manner that does not affect the integrity or orderly operation of the CHESSE Payments Provider User group; and~~
 - ~~(ii) the financial capacity to meet the indemnities that the entity gives to "Indemnified Persons" under the Standard Payments Provider Deed";~~

such approval to be given by:

 - ~~(iii) a financial supervisor appointed by SCH or a person or body nominated by SCH; or~~
 - ~~(iv) pending the appointing of a financial supervisor SCH, following consultation with the reserve Bank of Australia (where the entity is a bank) or with the Australian Financial Institutions Commission (where the entity is not a bank);~~

Attachment D

List of parties that provided submissions

First round

American Express

AMP Society

Austraclear Ltd

Australia and New Zealand Banking Group Limited (ANZ Nominees)

Australian Association of Permanent Building Societies Inc.

Australian Financial Institutions Commission

Australian Securities Commission

Australian Shareholders' Association Ltd

BHP Share Department

BZW Australia Limited

Chartered Institute of Company Secretaries in Australia Ltd

Colonial State Bank

Commonwealth Bank

Commonwealth Securities Ltd

Coopers & Lybrand Securities Registration Services

Davis, Jeremy G.

Ernst & Young Registry Services Pty Ltd

GIO Australia Holdings Ltd

Jakobi, Horst.

Langford, S Harvey

Lawson, John, (a director of Westpac Financial Services Ltd and a director of ASTC)

National Australia Bank Ltd (National Australia Custodian Services)

Oser, R.A.

Reserve Bank of Australia

Securities Registrars Association of Australia Inc.

Stoddart, Ellen K.

Sydney Futures Exchange Ltd

Westpac Banking Corporation

Second round

Austraclear Ltd

Australia and New Zealand Banking Group Limited (ANZ Nominees)

Australian Association of Permanent Building Societies Inc.

Australian Securities Commission

Chartered Institute of Company Secretaries in Australia Ltd

Credit Union Services Corporation (Australia) Ltd (two submissions)

Davis, Jeremy G.

National Australia Bank Ltd (National Australia Custodian Services) (two submissions)

Reserve Bank of Australia

Stoddart, Ellen K. (two submissions)

Sydney Futures Exchange Ltd