

Application for Revocation and Substitution

Lodged by

Australian Stock Exchange Limited

and

ASX Settlement and Transfer Corporation Pty Ltd

**in respect of the Clearing House Electronic Subregister System
(CHESS) arrangements**

Date: 25 February 2004

Authorisation No:

A90881
A90882
A90883
A90884

Commissioners:

Samuel
Sylvan
Martin
Willett

Public Register No:

C2003/1040

Executive Summary

The authorisation process

A key objective of the *Trade Practices Act 1974* (the Act) is to prevent anti-competitive arrangements or conduct, thereby encouraging competition and efficiency in business, resulting in greater choice for consumers in price, quality and service.

The Act, however, allows the Commission to grant immunity from legal action for anti-competitive conduct in certain circumstances. One way businesses may obtain immunity is to apply for what is known as an 'authorisation' from the Commission. Broadly, the Commission may 'authorise' businesses to engage in anti-competitive arrangements or conduct where it is satisfied that the public benefit from the arrangements or conduct outweighs any public detriment.

The Commission conducts a comprehensive public consultation process before making a draft decision and ultimately a final decision to grant or deny authorisation.

Previous authorisations

On 27 August 1998, the Commission granted authorisation to applications A90596, A30180, A30181 and A30182 relating to certain rules of the Clearing House Electronic Subregister System (CHESS) after an application by the Australian Stock Exchange (the ASX), the ASX Settlement and Transfer Corporation (the ASTC) and the Australian Payments and Clearing Association (the APCA)¹. Authorisation was granted for a period of five years and was due to expire on 28 August 2003.

Current applications

On 14 August 2003, the ASX and the ASTC applied for the revocation of the authorisations previously granted and the substitution of new applications for authorisation (applications A90881 to A90884).

In lodging these applications the ASX advised that it was in the process of developing new rules in accordance with changes made to the *Corporations Act 2001* under Financial Services Reform. These changes were aimed at increasing competition in financial markets, including clearing and settlement facilities. The ASX advised that it must comply with these legislative changes by March 2004 and requested that the Commission grant interim authorisation to confer continuing immunity to the CHESS arrangements (thereby maintaining the status quo) until such time as the new CHESS rules were in place. The ASX further advised that it did not anticipate seeking authorisation of the new rules but that it would consider this matter further once these rules had been finalised.

The current applications relate to a number of the ASX Listing Rules, ASX Business Rules and the Securities Clearing House (SCH) Business Rules governing the operation of and participation in the CHESS.

When securities are bought or sold in companies listed with the ASX, there is a requirement to transfer or register title to those securities. CHESS is the computer system that transfers the title or legal ownership of securities between sellers and

¹ APCA is not a party to the current applications.

buyers. At the same time this occurs, CHES is facilitating the transfer of money for these securities between the CHES participants. In addition to performing settlement, CHES can electronically register the ownership of securities on its subregister.

On 27 August 2003 the Commission granted interim authorisation to applications A90881 to A90884. In making this decision the Commission considered that maintenance of the existing arrangements is preferable while it considers the merits of the applications for revocation and substitution. The Commission also noted that as the conduct has been operating for some time, denial of interim authorisation may cause marketplace disruption in this instance.

Following this the Commission sought submissions from interested parties and the Applicants in order to assess the public benefits and detriments of the conduct the subject of the applications. On 19 November, the Commission issued a draft determination proposing, subject to any requests for a pre-decision conference, to grant authorisation for a period of six months. No requests for a pre-decision conference were received.

Therefore, having considered the applications and submissions from the Applicants and interested parties, the Commission concludes that in all the circumstances the arrangement is likely to continue to result in benefits to the public and those benefits will outweigh the detriment to the public constituted by any lessening of competition that is likely to result from the arrangements.

The Commission considers that the anti-competitive detriment associated with the CHES arrangements is likely to be small due to the changes made to the CHES Rules by the Applicants since the 1998 authorisations and the implementation of the Financial Services Reform program.

The Commission considers that this low level of anti-competitive detriment is outweighed by the public benefits associated with the operation of the CHES, namely, the efficiency benefits brought about by the continued minimisation of delays in transfer and settlement and the security resulting from Delivery versus Payment settlement. The Commission also considers that there is some public benefit in maintaining the status quo to allow the Applicants to develop new rules in accordance with changes made to the *Corporations Act 2001* under Financial Services Reform.

The Commission therefore revokes authorisations A90596, A30180, A30181 and A30182 and grants substitute authorisations A90881, A90882, A90883 and A90884 as sought by the Applicants.

The Commission notes that the Applicants have advised that they are required to comply with the legislative changes prescribed by the Financial Services Reform program by March 2004 and in these circumstances considers that it is appropriate to grant authorisation to applications A90881, A90882, A90883 and A90884 until 31 March 2004.

List of Abbreviations

APCA	Australian Payments and Clearing Association
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASTC	ASX Settlement and Transfer Corporation
ASX	Australian Stock Exchange
CHESS	Clearing House Electronic Subregister System
CDIs	CHESS Depository Interests
CGS	Commonwealth Government Securities
CIS Act	<i>Commonwealth Inscribed Stock Act 1911</i>
CS Facility	Clearing and Settlement Facility
CUFS	CHESS Units of Foreign Securities
FSR	Financial Services Reform
FSR Act	<i>Financial Services Reform Act 2001</i>
DvP	Delivery versus Payment
NAT	National Adjudicatory Tribunal
RBA	Reserve Bank of Australia
RITS	Reserve Bank Information and Transfer System
SCH	Securities Clearing House
SFE	Sydney Futures Exchange

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1. Introduction

Authorisations

- 1.1. The Australian Competition and Consumer Commission (the Commission) is the Commonwealth agency responsible for administering the *Trade Practices Act 1974* (the Act). A key objective of the Act is to prevent anti-competitive conduct, thereby encouraging competition and efficiency in business, resulting in greater choice for consumers in price, quality and service.
- 1.2. The Act, however, allows the Commission to grant immunity from legal action for anti-competitive conduct in certain circumstances. One way businesses may obtain immunity is to apply for what is known as an ‘authorisation’ from the Commission. Broadly, the Commission may ‘authorise’ businesses to engage in anti-competitive conduct where it is satisfied that the public benefit from the conduct outweighs any public detriment.
- 1.3. The Commission conducts a comprehensive public consultation process before making a decision to grant or deny authorisation.
- 1.4. Upon receiving an application for authorisation, the Commission invites interested parties to lodge submissions outlining whether they support the application or not, and their reasons for this.
- 1.5. The Act requires that the Commission then issue a draft determination in writing proposing to either grant the application (in whole, in part or subject to conditions) or deny the application. In preparing a draft determination, the Commission will take into account submissions received from interested parties.
- 1.6. Once a draft determination is released, the applicant or any interested party may request that the Commission hold a conference. A conference provides interested parties with the opportunity to put oral submissions to the Commission in response to a draft determination. The Commission will also invite interested parties to lodge written submissions on the draft.
- 1.7. The Commission then reconsiders the application, taking into account the comments made at the conference (if one is requested) and any further submissions received, and issues a written final determination.

Current applications

- 1.8. On 14 August 2003 the Australian Stock Exchange (the ASX) and the ASX Settlement and Transfer Corporation (the ASTC) lodged applications for revocation of authorisations A90596, A30180, A30184 and A30182 and the substitution of new authorisations (the applications) under section 91C of the Act.

- 1.9. The applications relate to selected provisions of the ASX Listing Rules, the ASX Business Rules and the Securities Clearing House (SCH) Business Rules. The relevant Rules are listed at **Attachment A**.²
- 1.10. These Rules govern the operation of, and participation in, the Clearing House Electronic Subregister System (CHES) and have previously been authorised by the Commission, most recently in 1998. Essentially, the Rules enable the ASX and the ASTC to exclude individuals and organisations from participating directly in the electronic transfer and settlement of securities transactions through CHES. The Rules require the ASTC to provide its services only in relation to companies admitted to the ASX's official list. The Rules also enable the ASTC to require all CHES participants to acquire services from a recognised payments provider.

Interim authorisations

- 1.11. The ASX is developing new rules for the operation of the CHES as a result of changes made the *Corporations Act 2001*. At the time of lodging the applications for revocation and substitution, the ASX requested that the Commission grant interim authorisation for a period of six months or until such time as the new rules come into force.
- 1.12. On 27 August 2003 the Commission decided to suspend the operation of authorisations A90596, A30180, A30181 and A30182 and to grant interim authorisation in substitution. The Commission granted interim authorisation on condition that the Applicants provide regular updates on the progress of drafting and implementing the new rules. The Commission granted interim authorisation until such time as it issues its draft determination on the substantive applications.
- 1.13. In granting interim authorisation the Commission considered that maintenance of the existing arrangements was preferable while it considered the merits of the applications for revocation and substitution. The Commission also noted that as the conduct has been operating for some time, denial of interim authorisation may cause marketplace disruption in this instance.

Draft Determination

- 1.14. The Commission issued a draft determination on 19 November 2003, proposing to grant authorisation for the CHES arrangements and extending the previously granted interim authorisation until such a time as a final determination comes into force. No pre-decision conference was called.

² For a full copy of the Rules for which authorisation is sought see the Commission's website www.accc.gov.au/adjudication/fs-adjudicate.htm

Chronology

1.15. A chronology of the Commission's assessment of the Applications is below.

Table 1.1 - Chronology of the Commission's assessment of the Application

Date	Action
14 August 2003	The Applicants lodged applications for the revocation and substitution of authorisations A90596, A30180, A30181 and A30182 and requested interim authorisation.
27 August 2003	The Commission granted interim authorisation to the applications, thereby suspending the current applications.
28 August 2003	Existing authorisations were due to expire.
3 September 2003	The Commission provided interested parties with an opportunity to make a submission on the application by 19 September 2003.
25 September 2003	The Commission provided the Applicants with copies of the submissions received from interested parties and invited the Applicants to comment on the submissions.
7 October 2003	The Applicants responded to the submissions from interested parties.
19 November 2003	Draft Determination issued by the Commission.
11 December 2003	Closing date for submissions on Draft Determination
16 December 2003	The Commission requested further information from the Applicants
6 February 2004	The Applicants provided supplementary submission in response to information requested by Commission.
25 February 2004	Final Determination issued by the Commission

2. Background

ASX

- 2.1. The ASX was formed in 1987 to amalgamate the six separate stock exchanges that had previously operated in each state capital. The ASX is the only stock exchange operating in Australia, although it is possible for other corporations to establish a stock exchange if they are approved under the *Corporations Act 2001*.
- 2.2. As at December 2003 there were 1406 domestic companies and 66 foreign companies with equities quoted on the ASX. During the month of December 2003, over 1.2 million equity trades were completed, at an average trade value of \$35 557³.
- 2.3. The ASX holds an Australian market licence and is subject to the conditions set out under section 792(A) of the *Corporations Act* which was introduced in 2002. Under section 792(A) the ASX is required to:
 - ensure an orderly, fair and transparent market;
 - comply with the conditions of its licence;
 - have adequate arrangements for supervising in the market including monitoring the conduct of participants and enforcing compliance; and
 - have sufficient resources to operate the market properly and with required supervisory arrangements.

ASX Demutualisation

- 2.4. The ASX was initially formed as a non-profit organisation limited by guarantee. It was owned collectively or ‘mutually’ by its members with each member of the ASX having an equal interest. Membership of the ASX was limited to brokers and member corporations who had access to the securities-related services provided by the exchange. On 18 October 1996, the members of the ASX passed a special resolution requiring the board to seek the enactment of legislation by the Commonwealth Parliament that would enable the ASX to demutualise and become a company limited by shares. In return for ceding mutual membership, the ASX members were allocated shares in the ASX. Under a corporate structure, the ASX is run as a commercial enterprise, focused on earning an adequate return for its shareholders.
- 2.5. To enable the demutualisation of the ASX, the Commonwealth Parliament passed the *Corporations Law Amendment (ASX) Act 1997*. The ASX demutualised on 13 October 1998.

³ These statistics sourced from the ASX website. www.asx.com.au

- 2.6. Demutualisation broke the nexus between membership of the ASX and access to the ASX trading facilities. Anyone, not just brokers, can hold shares in the ASX and brokers need not hold shares in, or be members of, the ASX to participate as brokers in the ASX market. The ASX's shares can be freely traded, subject to the maximum holding limit of 15%.

CHESS⁴

- 2.7. When securities are bought or sold in companies listed with the ASX, there is a requirement to transfer or register title to those securities. CHESS is the computer system that transfers the title or legal ownership of securities between sellers and buyers. At the same time this occurs, CHESS is facilitating the transfer of money for these securities between the CHESS participants.
- 2.8. The transfer of securities and money is referred to as settlement. Settlement is processed on a Delivery versus Payment (DvP) basis. That is, the transfer of both securities and money is simultaneous and irrevocable once the settlement process begins.
- 2.9. In addition to performing settlement, CHESS can electronically register the ownership of securities on its subregister. This registration is secure and is an efficient means to register holdings if shareholders intend to trade securities.
- 2.10. CHESS performs two major functions:
- it provides a clearing house system to facilitate the settlement or clearing of trades in securities; and
 - it provides a electronic subregister for securities in ASX listed companies.
- 2.11. Whilst the transfer of the securities bought or sold occurs through CHESS, the movement of funds between shareholders and stockbrokers does not currently occur through CHESS.

Financial Services Reform⁵

- 2.12. The Financial Services Reform Act 2001 (the FSR Act) was the result of an extensive reform program examining the regulatory requirements that applied to the financial services industry. In relation to markets and clearing and settlement facilities, the reforms aimed to put in place a flexible and adaptable framework that encouraged innovation and competition.
- 2.13. The new regulatory regime aimed to increase competition in these areas by lowering the barriers to entry and encouraging new participants to operate

⁴ The information contained in this section is sourced from the ASX website www.asx.com.au/about/pdf/CHESSIntro.pdf

⁵ The information contained in this section is sourced from the financial services section of the Treasury website. www.treasury.gov.au

competing markets and facilities. In particular, the new regime ended the distinction between securities exchanges and futures exchanges by introducing a single licensing regime for 'financial markets'. The single licensing regime replaced the seven avenues for authorisation as operators of various financial markets under the Corporations Act. In addition, a suitably qualified market is able to trade in any financial product, and in particular both securities and derivatives.

- 2.14. The FSR Act has also enhanced competition in respect of clearing and settlement facilities by permitting (but not requiring) more than one clearing and settlement facility to handle the clearing and settlement of transactions executed on the one financial market. Furthermore, it has extended the ability to carry out electronic transfers of trades to all prescribed facilities.
- 2.15. The FSR Act also facilitates the participation of overseas markets and facilities in Australia. Licences to operate a market or facility in Australia may be granted to the operator of an overseas market or facility where the operator satisfies certain criteria, such as being subject to a regulatory regime at least equivalent to that in Australia, and undertaking to co-operate with the Australian Securities and Investments Commission (the ASIC). This measure aims to enhance competition by removing barriers to the entry of overseas facilities.

3. Previous Authorisations

1994 Determination

- 3.1. In January 1994 the ASX and the ASTC jointly lodged two applications for the authorisation of ASTC's proposed Securities Clearing House (SCH) Business Rules and proposed changes to the ASX Listing and Business Rules relating to the first phase of the introduction of CHESS. The phase 1 arrangements established the CHESS subregister of securities and enabled the electronic transfer of CHESS approved securities. On 28 June 1994, the Commission's predecessor, the Trade Practices Commission (TPC), granted an authorisation for the phase 1 arrangements. Authorisation was granted subject to the condition that the ASTC's Articles of Association contain provisions that authorise members of the ASTC's board to act in the interests of the securities industry generally, including investors. This authorisation was limited for a period of three years from the time the determination came into force on 20 July 1994.

1995 Determination

- 3.2. In August 1995, two applications were lodged for authorisation to support the second phase of the introduction of CHESS. One was lodged by the ASTC and the other was lodged jointly by the ASTC and the APCA. In October 1995, the ASTC lodged a further application for authorisation in relation to the CHESS phase 2 arrangements. The phase 2 arrangements enabled the electronic settlement of securities transactions to be conducted on a DvP basis. The DvP system enables the ASTC cause the irrevocable transfer and registration of legal title to securities in tandem with the irrevocable transfer of funds between the participants in a CHESS transaction. On 13 December 1995, the Commission authorised the CHESS phase 2 arrangements until 20 July 1997, when the phase 1 authorisations for the CHESS arrangements were due to lapse.

1998 Determination

- 3.3. The most recent authorisations considered by the Commission in relation to the CHESS arrangements are A90596, A30180, A30181 and A30182 granted on 5 August 1998 for a period of five years. These authorisations are the subject of the current applications for revocation and substitution.
- 3.4. The Rules the subject of these authorisations enabled the ASTC and the ASX to exclude individuals and organisations from participating directly in the electronic transfer and settlement of securities transactions through CHESS. These Rules also enabled the ASX to require all brokers and all issuers listed on the ASX to acquire services from the ASTC irrespective of the fees charged by the ASTC for those services. In addition the Rules require the ASTC to provide its services only in relation to companies admitted to the ASX's official list. The Rules enable the ASTC to require all CHESS participants to acquire services from a recognised payments provider to

enable delivery versus payment settlement. These authorisations are outlined in more detail below.

- 3.5. **Application A90596** was lodged by the ASTC in relation to changes to the ASX Listing Rules, the ASX Business Rules and the Securities Clearing House Business Rules (SCH Rules) to accommodate CHESSE Units of Foreign Securities (CUFs) in so far as they may constitute an arrangement that has the purpose or effect of substantially lessening competition within the meaning of s 45 of the Act.
- 3.6. CHESSE cannot be used directly for the transfer and settlement of ASX transactions in securities of companies domiciled in countries that do not recognise uncertificated holdings or electronic transfer of legal title. To overcome this difficulty, the ASX developed a type of depositary receipt, known as CUFS. CUFS enable the holding and transferring of such foreign securities in CHESSE.
- 3.7. **Application A30180** was lodged by the ASX and the ASTC in relation to conduct which may constitute exclusive dealing. The ASX and the ASTC described this conduct as:
- The ASX requiring brokers to acquire clearing, settlement and registration services from the ASTC in respect of transactions between brokers in quoted securities and quoted rights effected through a stock market of the ASX and refusing to deal with them if they do not agree;
 - The ASX requiring issuers to acquire from the ASTC services in relation to the establishment of CHESSE sub registers for issuers' quoted securities and quoted rights or issuers' securities and rights which are the subject of an application for quotation on the ASX and refusing to deal with them if they do not agree; and
 - The ASTC making its services available only to companies on condition that they are admitted to the ASX's official list and refusing to supply its services to those not admitted.
- 3.8. **Authorisation A30181** was lodged by the ASTC for an authorisation to continue to give effect to a contract, arrangement or understanding, a provision of which may be an exclusionary provision within the meaning of s 45 of the Act. The relevant rules were part of the SCH Business Rules and dealt with the suspension of a CHESSE participant if a payment obligation is not authorised by their payment provider, the requirement that all brokers establish a payment facility to facilitate delivery versus payment settlement and the power of the ASTC's board to restrict, suspend or terminate participation in CHESSE.
- 3.9. **Authorisation A30182** was lodged by the ASTC and the Australian Payments and Clearing Association (the APCA)⁶ in relation to exclusive dealing conduct whereby the ASTC would:

⁶ The APCA is not a party to the current applications.

- require all broker participants to establish payment facilities with payments providers in order to be accredited;
 - restrict, terminate or suspend for failure to be accredited;
 - require each payments provider, and the CHESSE Bank, to become and remain a member of the Inter-Bank Payments System, the CHESSE Payments Provider User Group and the APCA; and
 - suspend a payment provider and the CHESSE Bank under circumstances specified in the Standard Payments Provider Deed.⁷
- 3.10. The exclusive dealing conduct for which the APCA sought authorisation for included:
- requiring each payments provider to become and remain a member of the Inter-Bank Payments System;
 - requiring each payments provider to become and remain a member of the CHESSE Payments Providers User Group; and
 - the suspension of a payments provider under circumstances specified in the Standard Payments Provider Deed.

Commission Evaluation

- 3.11. In considering these applications for authorisation the Commission accepted that there were substantial efficiency gains associated with the CHESSE arrangements including:
- the reduction of delays achieved by the removal of paper certificates from the transfer and settlement system;
 - the effective elimination of any delay between settlement and registration;
 - the increased security resulting from the introduction of DvP settlement; and
 - the creation of the capacity to move to a T+3 settlement period.⁸
- 3.12. The Commission noted that the extent to which these efficiency gains resulted in benefits to the public was dependent upon the fees the ASTC charged for CHESSE services. The Commission considered that the existence of adequate checks and balances to protect CHESSE users from the introduction of extortionate compulsory fees was therefore an important factor in its consideration of the authorisations.
- 3.13. In the 1998 authorisation of the CHESSE arrangements, the Commission considered that the ASTC's Articles of Association 59A (which required the ASTC board to operate in the interests of the securities industry generally)

⁷ This agreement enables an electronic link between CHESSE and financial institutions to facilitate delivery versus payment settlement. The agreement sets out the obligations of the payments provider in delivery versus payment settlement and the procedures to be followed for electronic funds transfer.

⁸ The T+3 settlement was the final phase in improving the speed of settlement processes. The T+3 phase was essentially the full implementation of CHESSE.

and 86 (which prohibited the ASTC from paying dividends or otherwise transferring income to its owner, the ASX) were likely to provide adequate safeguards against the introduction of extortionate compulsory fees by the ASTC's board.

- 3.14. However, the ASX requested that the Commission evaluate the applications for authorisation on the basis that the ASX was demutualised and Articles 59A and 86 were removed. The Commission formed the view that if these Articles were removed, the ASTC board would be obliged to adopt a tariff policy that would optimise the profits for the ASX. The Commission considered that the existence of a competitive environment had the potential to provide the most efficient mechanism for ensuring that CHESS tariffs are kept at levels that would enable the public benefits associated with CHESS to be realised.
- 3.15. The Commission was concerned, however, that there was little or no competition in the clearing and settlement of securities transactions. In the 1998 determination, the Commission recognised that the globalisation of the securities industry exposed the ASX to some competition from overseas exchanges. In addition, it was recognised that there was competition between the ASX and the SFE in respect of some products offered on their respective markets.
- 3.16. Despite this, the Commission also acknowledged that in respect of transactions traded on the various financial markets in Australia, there was no competition for the provision of clearing and settlement services and that this lack of competition was supported by the CHESS arrangements. The Commission therefore granted authorisation subject to the following conditions aimed at reducing the barriers to competition in the clearing and settlement of securities transactions:
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 the 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 the ASTC or unreasonably constrain an entity's ability to compete with the 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; and*
 4. *The applicants remove the current exclusion of ASX market transactions in debt securities from clearing and settlement in CHESS.*
- 3.17. In addition, under the CHESS arrangements, access to CHESS delivery versus payment settlement was limited to the ASX market transactions and to transactions that support ASX market transactions. However, the ASTC had discretion to extend access to other classes of transactions. The Commission considered that the discretion of the ASTC to exclude competitors of the

ASX from the efficiencies of CHESSE delivery versus payment settlement was anti-competitive and not justified on public benefit grounds. The Commission therefore imposed further conditions requiring:

5. *The applicants amend SCH Business Rule 7.1 to provide that a transaction is eligible for CHESSE delivery versus payment settlement if the transaction is of a class of transaction determined by ASTC in accordance with objective criteria and that such determination by the ASTC be subject to an appeal mechanism; and*
6. *That such objective criteria and appeal mechanism be formulated to the Commission's satisfaction by the ASTC within three months of the date that the determination came into force.*

3.18. Finally, to ensure that financial institutions were not unreasonably restricted from participating in payments settlement under the CHESSE arrangements the Commission imposed a further condition which provided that:

7. *The payments provider criterion than an entity must maintain an exchange settlement account 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.*

4. Current Applications

- 4.1. On 14 August 2003 the ASX and the ASTC lodged applications A90881, A90882, A90883, A90884 under section 91C of the Act for the revocation of authorisations A90596⁹, A30180¹⁰, A30181¹¹ and A30182¹² and substitution of new authorisations for the ones revoked. The previous authorisations granted by the Commission in 1998 were to expire on 28 August 2003.
- 4.2. The Applicants are currently revising their rules to comply with changes made to the Corporations Act under the Financial Services Reform program and do not consider that the new rules will require authorisation. The ASX has advised that an assessment will be made once the rules are finalised. The ASX has advised that this process will be complete on or before 11 March 2004 and that it is anticipated that the new rules will take effect from this date.
- 4.3. The current applications relate to a number of the ASX Listing Rules, ASX Business Rules and the Securities Clearing House (SCH) Business Rules governing the operation of and participation in CHESS. The applicable rules are listed in **Attachment A**.
- 4.4. The Applicants' supporting submission outlines the changes that have occurred to the rules currently authorised and describes the rules that are submitted for re-authorisation.

Application A90881 – replacing A90596

- 4.5. In 1998 the ASX Listing Rules and SCH Rules which apply to CUFS (referred to as CDIs in the rules), were authorised insofar as any of them may constitute a provision of a contract, arrangement or understanding which provision has the purpose, or has or may have the effect of substantially lessening competition within the meaning of section 45 of the Act.
- 4.6. The applicants submit that they do not consider that the effect of the rules in their current form require authorisation, however they sought authorisation until the new rules come into force.

⁹ Application A90596 was lodged under sub-section 88(1) of the Act for an authorisation to give effect to, or continue to give effect to a provision of a contract, arrangement or understanding, where the provision has the purpose, or has or may have, the effect of substantially lessening competition within the meaning of section 45 of the Act.

¹⁰ Application A30180 was lodged under sub-section 88(8) of the Act for authorisation to continue to engage in conduct that constitutes or may constitute the practice of exclusive dealing under section 47 of the Act.

¹¹ Application A30181 was lodged under sub-section 88(1) of the Act for authorisation to continue to give effect to a provision of a contract, arrangement or understanding, where the provision is, or may be an exclusionary provision within the meaning of section 45 of the Act.

¹² Application A30182 was lodged under sub-section 88(8) of the Act for authorisation to continue to engage in conduct that constitutes or may constitute the practice of exclusive dealing under section 47 of the Act.

Application A90882 – replacing A30180

4.7. This application relates to conduct which may constitute exclusive dealing. In 1998, authorisation A30180 identified three types of conduct:

- continuing to engage in conduct that constitutes or may constitute the practice of exclusive dealing. The ASX required brokers to acquire clearing settlement and registration services from the ASTC in respect of transactions between brokers in quoted securities and quoted rights effected through the ASX. The Applicants submit that this is no longer relevant, as the rules have been modified such that brokers are able to remove clearing and settlement of trades by way of cancellation from the system to an “Acceptable Clearing and Settlement Service” as defined in the rules. The Applicants have not sought authorisation for this conduct;
- the ASTC making its services available to companies only on condition that they are admitted to ASX’s official list and refusing to supply its services to those not admitted. The Applicants submit that current SCH rules provide that the ASTC may approve a class of an issuer’s financial products which is to be quoted by “an Exchange”. The definition of an Exchange in the SCH Business Rules is broad and allows the ASTC to approve financial products which are quoted on an exchange or market other than the ASX. Accordingly, the Applicants have not sought re-authorisation for this conduct; and
- the ASX requiring issuers to acquire from the ASTC services in relation to the establishment of CHESS sub-registers for issuers’ quoted securities and quoted rights or issuers’ securities and rights which are the subject of an application for quotation on the ASX and refusing to deal with them if they do not agree. From 26 August 2003, the ASX began providing issuers with a blanket waiver in respect of being able to use any approved sub-register. The ASX will be amending the relevant Listing Rules to reflect this change. However, the Applicants have sought authorisation for this requirement until the new rules come into force.

Application A90883 – replacing A30181

4.8. This authorisation relates to conduct that constitutes or may constitute continuing to give effect to a contract, arrangement or understanding, a provision of which may be an exclusionary provision, within the meaning of section 45 of the Act. At the time of the original application, ASTC identified SCH Business Rules 7.33.1, 9.20, 19.2.1 and the definition of Payment Provider in section 21 of the Rules as relevant. These references are the same in the current rules.

4.9. The Rules deal with the suspension of a CHESS Participant if a Payment Obligation is not authorised by their Payment Provider (Rule 7.33.1), the requirement that all brokers establish a Payment Facility to facilitate DvP settlement (Rule 9.20) and the power of ASTC’s Board to restrict, suspend or terminate participation in CHESS (Rule 19.2.1).

- 4.10. The Applicants noted that rule 18.2 establishes an appeals tribunal (discussed further at paragraphs 4.49 to 4.56).
- 4.11. The Applicants sought authorisation for the above rules until the new rules come into force.

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- 4.12. This authorisation relates to conduct that constitutes or may constitute exclusive dealing:
- requiring all broker participants to establish payment facilities with Payments Providers in order to be accredited;
 - restriction termination or suspension by ASTC for failure to be accredited; and
 - requiring the payments provider and the CHESB Bank to become and remain a member of the Interbank payments system and the CHESB Payments Provider User group and the Australian Clearing and Payments Association (APCA) (or to give a non member undertaking to ACPA).
- 4.13. The relevant rules are contained in Chapter 2 of the SCH Rules and the CHESB Payments Interface Standard Client Payment Provider Deed. The Applicants noted that rule 18.2 provides a right of appeal.
- 4.14. The Applicants noted that a number of amendments were made as a result of the 1998 authorisation process. The Applicants submitted that they do not need continued authorisation for this conduct. However, the Applicants sought authorisation for the conduct until such time as the new rules come into force.
- 4.15. An overview of the rules for which re-authorisation is sought is provided below.

ASX Listing Rules

- 4.16. To be admitted to the ‘official list’ and have shares listed and traded on the Australian Stock Exchange, an entity must comply with the ASX Listing Rules. The Listing Rules specify such matters as minimum levels of capitalisation and minimum numbers of shareholders, standards of public disclosure, as well as operational requirements. The Listing Rules also include Rules to support CHESB. A brief outline of the Listing Rules applicable to the applications is provided below (see **Attachment A** for a list of the Listing Rules for which re-authorisation is sought).
- 4.17. To be admitted to the official ASX list, an entity must agree to satisfy the SCH technical and performance requirements and meet any other requirements SCH imposes in connection with CHESB approval of the entity’s securities. The entity must also authorise SCH to establish and administer a CHESB subregister in respect of the securities for which

quotation is sought (Rules 1.1, 1.7 and clause 10 of part 3 of the form set out in Appendix 1A). These requirements are mirrored for admission to the Official List as a debt issuer (Rule 1.9 and Appendix 1B) and for admission as an exempt foreign entity (Rule 1.14 and Appendix 1C).

- 4.18. An entity (except an entity established in a jurisdiction that prevents the entity participating in CHESS) must comply with the CHESS requirements relating to securities for that entity's securities to be quoted (Rules 2.1, 2.2, 2.5).
- 4.19. Listed companies must disclose in their annual report the number of equity securities that are on issue, the number of holders and, if a person holds more than 20% of the equity securities, their name and amount of securities they hold (Rule 4.10).
- 4.20. For an entity's securities to be CHESS approved it must:
 - comply with the SCH Business Rules (Rule 8.1); and
 - provide for, in addition to the CHESS subregister, an issuer sponsored subregister, or a certificated subregister (Rule 8.2).

Rule 8.1 makes the SCH Business Rules part of the Listing Rules.

- 4.21. Except for the limited circumstances listed in Rule 8.10.1, which enable the creation of a 'holding lock' to prevent an SCH transfer, an entity must not prevent, delay or interfere with a proper SCH transfer (Rule 8.10).
- 4.22. Rule 8.14 prevents an entity charging a fee for a range of routine actions such as registering proper SCH transfers, issuing certificates, noting transfer forms, and issuing routine transactions statements. Rule 8.14.1 enables an entity to charge "a reasonable fee" for:
 - issuing a certificate to replace one that is lost or destroyed;
 - marking a transfer form, or marking a renunciation and transfer form, within 2 business days after the form is lodged; and
 - a special transaction statement.

ASX Business Rules

- 4.23. The ASX Business Rules contain ASX procedures and the Rules that govern the behaviour of stockbrokers and their employees. The effect of many of these Rules is to impose a requirement to comply with the SCH Business Rules. A brief outline of the ASX Business Rules applicable to the applications is provided below (a list of these Rules is at **Attachment A**).
- 4.24. All contract notes relating to the sale or purchase of CHESS approved securities must specify that they are issued subject to the SCH Business Rules (Rule 3.8(2A)(ii)).
- 4.25. Contracts relating to the loan of securities under the Securities Lending Service must comply with the SCH Business Rules (Rule 4.43).

SCH Business Rules

- 4.26. The SCH Business Rules provide the basic framework for the operation of CHESSE. The primary function of SCH is to provide facilities for the electronic clearing and settlement of transactions in CHESSE approved securities and to establish and administer electronic CHESSE subregisters of CHESSE approved securities. A brief outline of the SCH Business Rules applicable to the applications is provided below (a list of these Rules is at **Attachment A**).

Participation Criteria

- 4.27. Only CHESSE participants have direct access to the electronic transfer, registration, clearing and settlement facilities of CHESSE. Section 2 of the Rules provides for the admission of two types of participants: broker participants and non-broker participants.
- 4.28. To be admitted to participate in CHESSE, both broker and non-broker participants must:
- (i) meet the technical and performance requirements (Rule 2.6);
 - (ii) meet the stamp duty payment requirements (Rule 2.7); and,
 - (iii) meet the payment facility requirements (Rule 2.12).

Brokers

- 4.29. Member organisations of ASX are automatically admitted as broker participants in CHESSE upon fulfilment of the above three requirements (Rule 2.1.1). Brokers are also required to establish a payment facility under Rule 9.20.

Non-Broker Participants

- 4.30. To be admitted to participate in CHESSE, non-broker participants (NBPs) must meet additional requirements (Rule 2.3). For a limited class of NBPs, the only significant additional requirement concerns the lodgement of a performance bond. This limited class includes holders of an Australian financial services licence under the Corporations Act or holders of a futures brokers licence under the old Corporations Act; 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*; trustee companies; building societies or credit unions regulated by APRA; and, a body corporate that provides financial services and is either regulated by APRA or an overseas regulatory authority, or is approved under the Corporations Act (Rule 2.3.1). Only NBPs that belong to this class of regulated entities may maintain sponsored holdings.

- 4.31. Under Rule 2.3.2, any other entity seeking to be admitted as an NBP in CHESS must, in addition to the performance bond and payment facility requirements, also satisfy:
- capacity requirements (for example, its Principals are not under insolvency administration, or, if natural persons, under the age of 18, Rule 2.9);
 - business integrity requirements (for example, its Principles have not been convicted of serious fraud, see 2.10); and,
 - local establishment requirements (the entity is formed in Australia and carries on business in Australia, see 2.11).
- 4.32. SCH may not reject an application to be admitted as an NBP unless notice is given to the applicant of the reasons why it is proposed to reject the application, and the applicant is given 10 business days to address the reasons stated in the notice. An applicant may appeal to the appeal tribunal against a decision to reject its application (Rule 2.13).
- 4.33. NBP's are required to establish at least one payment facility to facilitate DvP settlement (Rule 10.21).

CHESS Units of Foreign Securities (CUFS)

- 4.34. The 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.
- 4.35. 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

- 4.36. The prerequisites for CHESS approval of foreign securities are set out in Rule 3A.2.1. The foreign issuer must have its financial products CHESS approved. SCH must also be satisfied that the foreign issuer is capable of complying with section 3A of the Rules. In addition, the foreign issuer must appoint a depositary nominee and give notice to SCH of the identity of the depositary nominee.
- 4.37. 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).

Vesting Arrangements

- 4.38. 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).

Registers and processing of transfers and transmutations

- 4.39. 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).
- 4.40. Similarly, the CUFS register must contain all of the information that would be required to be kept under the Corporations Act if the issuer were an Australian listed public company and the CUFS were financial products in that company (Rule 3A.5.2).
- 4.41. The foreign issuer must establish and maintain an issuer sponsored subregister and a CHESS subregister (Rule 3A.5.5).

Corporate Actions

- 4.42. 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 (Rule 3A.6).
- 4.43. However, CUFS holders are unable to attend shareholder meetings and personally vote. 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).

Settlement Transfers

- 4.44. Section 7 of the SCH Business Rules governs settlement transfers.
- 4.45. If a broker wishes remove a transaction from DvP Net Settlement, settle a transaction on a Real Time Gross Settlement basis (according to the rules in section 7A), or use an Acceptable Clearing and Settlement Service other than CHESS, the broker must obtain the consent of the counterparty to the transaction and comply with the rules relating to removal of transactions from DvP Net Settlement or Scheduled Settlement.
- 4.46. A participant can be suspended for a period not exceeding 10 business days if their payments provider does not authorise a net obligation to make a payment from their payment facility identified in a DvP settlement instruction (Rule 7.33.1).

Principal registers and CHES subregisters

- 4.47. When a class of an issuer's financial products becomes CHES approved, the issuer irrevocably authorises SCH to establish and administer a CHES subregister for that class of financial products on behalf of the issuer (Rule 8.2.1).
- 4.48. The CHES subregister is the register of legal ownership of financial products held on that subregister. Unless otherwise agreed between the issuer and SCH, in addition to the CHES subregister, the issuer must maintain a certificated subregister and/or an issuer sponsored subregister for each class of CHES approved financial products (Rules 8.2.2, 8.2.3). Thus, the legal record of holding balances for CHES approved financial products must be recorded on at least two of the following subregisters:
- CHES subregister (uncertificated);
 - Issuer sponsored subregister (uncertificated); or,
 - Issuer certificated subregister.

Dispute resolution and disciplinary proceedings

- 4.49. Section 18 of the SCH Business Rules governs disciplinary proceedings.
- 4.50. Rule 18.2 establishes a disciplinary tribunal and an appeal tribunal. Each tribunal is appointed by ASTC's board. Members of these tribunals must be chosen from the disciplinary panel established under Rule 18.1. Rule 18.1 provides that a disciplinary panel must consist of not less than six members, with at least one member from each of the following industry groups: participating organisations; 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.
- 4.51. 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.
- 4.52. Disciplinary proceedings may be commenced by the ASTC board by giving notice of the alleged contravention to the CHES user concerned and also to the president of the disciplinary tribunal (Rule 18.4).
- 4.53. If the disciplinary tribunal determines that a participant has contravened a CHES 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). In addition to the above penalties the disciplinary tribunal may terminate the participant's participation in CHESS (Rule 18.5.4).

- 4.54. 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 \$100,000 in respect of each contravention, to SCH or a participant for loss or damage suffered (Rule 18.5.2).
- 4.55. CHESS users, 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).
- 4.56. Rule 18.6 requires that a disciplinary Register be maintained for recording details of contraventions by participants.

Non-compliance with participation requirements

- 4.57. The ASTC board may impose restrictions on, suspend or terminate participation, if it is satisfied that the participant (broker or NBP) has not continued to comply with the CHESS participation requirements (Rule 19.2).

5. Submissions prior to the Draft Determination

Applicants' submission

- 5.1. The ASX is currently reviewing its operating rules to comply with the terms of its licence and the March 2002 amendments to the Corporations Act that were made under the Financial Services Reform program. The ASX must ensure that it complies with legislative requirements regarding operating rules and written procedures by March 2004.
- 5.2. The ASTC holds a Clearing and Settlement (CS) Facility Licence in accordance with Section 1425(2)¹³ of the Corporations Act. The ASTC has undertaken the process of reviewing its operating rules to comply with the March 2002 amendments to the Corporations Act. The new ASTC rules have been informally lodged with the ASIC, together with an application to vary its licence as a CS Facility.

Public benefits

- 5.3. The Applicants submit that as no material changes have been made to the Business Rules, Listing Rules and SCH Rules since the Commission's 1998 authorisation, the public benefits flowing from the efficiency gains in the clearing and settling of securities transactions as found by the Commission in its 1998 authorisation continue to exist and continue to be a basis for authorisation.

Anti-competitive detriment

- 5.4. The Applicants submit that the Rules are pro-competitive.
- 5.5. The Applicants also note that a number of adjustments were made to the Rules in response to the Commission's concerns at the time of the CHES 1994 Phase 1 Authorisation and the 1998 Authorisation.
- 5.6. The Applicants submit that if the Commission identified any lessening of competition flowing from the relevant rules, the likely benefits clearly outweigh any anti-competitive detriment.

Submissions from interested parties

- 5.7. The Commission sought submissions from a wide range of interested parties in relation to the applications for re-authorisation and received two public submissions, from Burrell Stockbroking (Burrell) and Zurich Financial Services (Zurich). A copy of each submission is held on the Commission's public register.
- 5.8. In summary, Burrell submitted that:

¹³ Section 1425(2) provides that the Minister must grant the operator of each clearing and settlement facility a licence and impose conditions, including specifying the classes of financial products in respect of which the facility can provide services.

- the ASX Business Rules and CHES Rules should be reviewed for unnecessary and overly prescriptive rules which have the impact of raising costs or impeding competition and are not necessary for the conduct of the business of the ASX; and,
 - where the Corporations Law and ASIC have already legislated and have responsibility for a matter, it is not appropriate for the ASX to impose additional costs on broking firms by way of duplicate provisions.
- 5.9. Burrell cited its dispute with the ASX in relation to Business Rule 5.6 as an example of its concerns. Business Rule 5.6 provided that firms may only appoint an authorised representative where the authorised representative is carrying on a branch office.
- 5.10. In summary, Zurich submitted that it has no concerns with the issuing of new authorisations in relation to the applications.

Applicants' response to submissions

- 5.11. The ASX provided a response in relation to the submission from Burrell.
- 5.12. The ASX noted that ASX Business Rule 5.6(2) is not current and is not a rule relevant to CHES or the CHES Authorisation.
- 5.13. In relation to Burrell's broader comments, the ASX stated that its Business Rules and other aspects of its supervisory structure are developed in response to both legislative requirements and the understanding that adequate supervision of the ASX's markets creates confidence in Australian capital markets to the benefit of Australian companies, Australian investors, the Australian economy as a whole, as well as to the ASX itself.
- 5.14. The ASX stated that its rules, before coming into operation, undergo a process of review and industry consultation and cannot come into force unless the appropriate lodgement process is followed which involves the ASIC and Treasury, and leads to the non-disallowance of the rules. When the time for non-disallowance has expired the rules will then come into force.
- 5.15. The ASX also described its disciplinary process. The National Adjudicatory Tribunal (NAT) is established under the ASX Business Rules and is comprised of non-ASX industry members. Decisions by the NAT are also appellable to the appeal tribunal, which is chaired by a Senior Counsel of the Sydney bar, with members also comprised of non-ASX industry members.

6. Draft Determination and Submissions

- 6.1. Before determining an application for authorisation the Commission is required to prepare a draft determination stating whether or not it proposes to grant authorisation to the applications and summarising its reasons. On 19 November 2003, the Commission released a draft determination proposing to grant authorisation to applications A90881, A90882, A90883 and A90884 for a period of six months.
- 6.2. The Commission considered that any potential anti-competitive detriment associated with the CHES arrangements is outweighed by continuing public efficiency and security benefits flowing from the arrangements.
- 6.3. The Commission proposed that authorisation be granted for six months to allow the Applicants to develop new rules in response to changes made to the Corporations Act 2001 under Financial Services Reform. The Applicants are required to comply with these changes by March 2004.

Summary of submissions received following the draft determination

- 6.4. Following the draft determination, the Commission received two submissions, one from the Applicants and one from the ASIC. No pre-decision conference was called. A copy of each submission is held on the Commission's public register.
- 6.5. The Applicants provided a submission in relation to the impact of the amendments made to the *Commonwealth Inscribed Stock Act 1911* (the CIS Act) by the *Commonwealth Inscribed Stock Amendment Act 2002* (the Amendments). The Applicants note that the likely intention of the Amendments is to provide for the electronic creation, issue and recording of Commonwealth Government Securities (CGS) and to facilitate competition in the clearing and settlement of CGS by allowing the appointment of non-government bodies as Registrars under the CIS Act, in addition to, or instead of, the Reserve Bank. In particular, Section 14(3) of the CIS Act allows the operator of a licensed clearing and settlement facility (under Part 7 of the Corporations Act 2001) to be appointed as a Registrar.
- 6.6. The Applicants submit that they welcome the amendments as they provide opportunities for competition not previously available to clearing and settlement facilities, in particular the ability to provide greater access by the retail sector to government instruments.
- 6.7. The Applicants submit that they have explored possibilities with Treasury, however, entry has not been feasible to date, due to a number of reasons including technological infrastructure. The ASTC has not yet been appointed as a Registrar under section 14(3) of the CIS Act.
- 6.8. However, the Applicants submit that in accordance with condition 6 of the Commission's 1998 authorisation, ASX market transactions in debt securities are not excluded from clearing and settlement in CHES.

- 6.9. In its submission, the ASIC stated that authorisation will promote certainty in relation to the operation of the rules of ASX and of ASTC and therefore assists ASX and ASTC in meeting their respective obligations as licensees under the Corporations Act.
- 6.10. The ASIC noted that the ASX's licence requires the ASX to obtain the consent of the Minister before using a clearing and settlement facility other than that operated by ASTC or Options Clearing House Pty Limited. The ASX is seeking to vary the terms of its licence with effect in March 2004.

7. Statutory tests

- 7.1. Under section 91C of the Act, the Commission may make a determination revoking an existing authorisation and granting a substitute authorisation at the request of the party to whom the authorisation has been granted, or another person on behalf of such a party.
- 7.2. In order for the Commission to grant a substitute authorisation, the Commission must consider the substitute authorisation in the same manner as the standard authorisation process.
- 7.3. Under section 91C(7) the Commission must not make a determination revoking an authorisation and substituting another authorisation unless the Commission is satisfied that the relevant statutory tests are met.
- 7.4. In this case the statutory tests which the Commission must apply in considering whether or not it would be prevented from making a determination granting the new authorisation are set out in subsections 90(6), (7) and (8) of the Act.
- 7.5. Section 90(6) provides that the Commission shall not make a determination granting authorisation under subsection 88(1) in respect of a provision of a proposed contract, arrangement or understanding (not being a provision that is or may be an exclusionary provision) unless it is satisfied in all circumstances that:
- the provision of the proposed contract, arrangement or understanding would result, or be likely to result in a benefit to the public; and
 - 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, if the provision concerned were given effect to.
- 7.6. Section 90(7) of the Act provides that the Commission shall not make a determination granting authorisation under subsection 88(1) in respect of a provision of a contract, arrangement or understanding (not being a provision that is or may be an exclusionary provision) unless it is satisfied in all circumstances that:
- the provision of the contract, arrangement or understanding has resulted, or is likely to result in a benefit to the public; and
 - the benefit to the public outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted or is likely to result, from giving effect to the provision.
- 7.7. Section 90(8) of the Act provides that the Commission shall not make a determination granting an authorisation under subsection 88(1) in respect of a provision of a proposed contract, arrangement or understanding that is or may be an exclusionary provision unless it is satisfied in all the circumstances that the provision has resulted, or is likely to result, in such a benefit to the public that the contract, arrangement or understanding should be allowed to be given effect to.

- 7.8. While there is some variation in the language between the tests in subsection 90(6), 90(7) and 90(8), the Commission adopts the view taken by the Trade Practices Tribunal (now the Australian Competition Tribunal) that in practical application the tests are essentially the same.¹⁴ Accordingly, the Commission will assess the likely public benefit and public detriment resulting from the arrangements.

Term of authorisation

- 7.9. Section 91(1) of the Act allows the Commission to grant authorisation for a specific period of time.
- 7.10. The Commission may authorise different aspects of conduct for which authorisation is sought for different periods.

Conditions

- 7.11. Section 91(3) allows the Commission to grant authorisation subject to conditions.

¹⁴ *Re Media Council of Australia (No 2)* (1987) ATPR at 48-418; *Re 7-Eleven Stores Pty Ltd* (1994) ATPR 41-357.

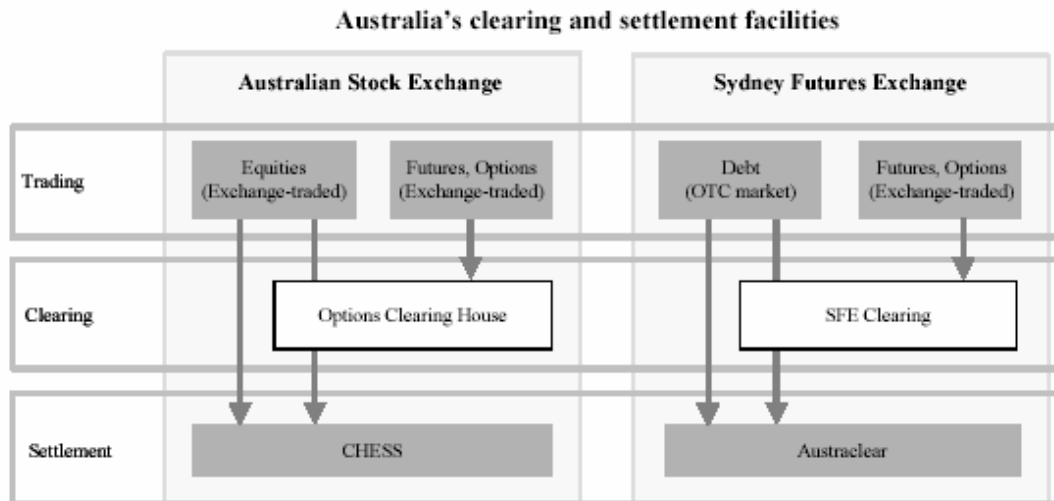
8. Commission evaluation

- 8.1. The Commission's evaluation is in accordance with the statutory test outlined in Part 7 of this final determination.
- 8.2. The Commission notes that the Applicants are currently reviewing and redrafting their rules in order to comply with changes in the Corporations Act brought about by the Financial Service Reform program. Under Financial Services Reform, the Applicants must comply with new the legislative requirements regarding operating rules and procedures by March 2004. The Applicants have advised that they currently do not consider that the new rules will require authorisation, however, they will make a final decision on whether authorisation will be sought in respect of the new rules once they are finalised.

The Relevant Market

- 8.3. Consistent with the statutory test the Commission must assess the public benefits and anti-competitive detriments resulting from the arrangements for which authorisation has been sought. This assessment is conducted within the context of the relevant market(s). However, depending on the circumstances, the Commission may not need to comprehensively define the relevant markets as it may be apparent that a net public benefit will or will not arise regardless of the scope of the defined market.
- 8.4. The Commission did not receive any submissions in relation to the relevant market.
- 8.5. There are currently two major operators of clearing and settlement facilities in Australia: the ASX and the Sydney Futures Exchange (SFE). Both the ASX and the SFE offer a facility that acts as a central counterparty and also a facility that acts as a settlement system. The Options Clearing House (OCH) (soon to be the Australian Clearing House) acts as a central counterparty for some transactions undertaken on markets operated by the ASX, as does the SFE Clearing Corporation (SFECC) for futures, options and some debt transactions conducted on SFE markets. CHES provides settlement and records changes in ownership for equities for the ASX. The Austraclear system, owned by the SFE, does the same for Commonwealth Government Securities, and semi-government and private sector debt securities. The following diagram illustrates these arrangements.¹⁵

¹⁵ RBA, *Regulation Impact Statement for the Financial Stability Standards*, May 2003, pages 1-2.



- 8.6. For the purposes of assessing these applications for revocation and substitution, which relate to the rules governing the clearing and settlement through CHESS of financial products traded on the ASX, the Commission adopts a market for clearing and settlement of financial products traded on the ASX.

Public benefits

- 8.7. The Applicants claim that as no material changes have been made to the Business Rules, Listing Rules and SCH Business Rules since the Commission's 1998 determination, the public benefits flowing from the efficiency gains in the clearing and settling of securities transactions as found by the Commission in 1998 continue to exist and continue to be a basis for authorisation.
- 8.8. In the 1998 determination the Commission recognised that the benefits associated with the CHESS arrangements are primarily in the form of efficiency gains in the clearing and settlement of securities transactions. The Commission noted the following efficiencies in particular:
- the reduction of delays achieved by the removal of paper certificates from the transfer and settlement system;
 - the effective elimination of any delay between settlement and registration;
 - the increased security resulting from the introduction of Delivery versus Payment settlement; and
 - the capacity to move to a T + 3 settlement regime.¹⁶
- 8.9. The Commission continues to accept that a public benefit results in the form of efficiency gains in the clearing and settling of securities transactions from the CHESS arrangements.

¹⁶ T + 3 settlement has now been implemented.

- 8.10. As noted in paragraph 8.2, the Applicants are currently reviewing and redrafting their rules. The Applicants will decide whether authorisation of these revised rules is necessary once the review process is finalised. At this stage it is the Applicants' view that authorisation will not be required in respect of the revised rules. The Commission considers that there is some public benefit in maintaining the status quo until the Applicants implement their new rules. If the Applicants consider that authorisation of these new rules is necessary they will need to lodge a new application for authorisation, or seek revocation and substitution or a minor variation. At this time they will also need to support the application with a submission on the public benefits of the new rules.

Anti-competitive detriment

- 8.11. The Applicants submit that the rules the subject of the applications for revocation and substitution are not anti-competitive given the changes in the environment that have occurred since 1998 and changes to the rules that have been implemented to foster competition. In particular, the Applicants refer to demutualisation of the ASX and the introduction of the Financial Services Reform regime, which have provided a framework for greater competition.

Issues arising from the Commission's 1998 authorisation of the CHES arrangements

- 8.12. In the 1998 determination, the Commission was asked to consider the impact of demutualisation and the removal of ASTC's Articles of Association 59A and 86, which provided safeguards against the introduction of extortionate compulsory fees by ASTC's board.
- 8.13. The Commission noted that the extent to which the efficiency gains from CHES result in benefits to the public is dependent upon the fees the ASTC charges for CHES services. The Commission considered that the existence of a competitive environment had the potential to provide the most efficient mechanism for ensuring that CHES tariffs are kept at levels that will enable the public benefits associated with CHES to be realised. However, at the time the Commission noted that there was little or no competition in the clearing and settlement of securities transactions and that the lack of competition was supported by the CHES arrangements.
- 8.14. The Commission outlined four major concerns in relation to the potential anti-competitive effects of the rules submitted for authorisation:
- the CHES arrangements had the effect of excluding potential competitors from providing clearing and settlement services to brokers trading on ASX's markets;
 - the exclusion by ASTC of debt securities from clearing and settlement through CHES ensured that ASTC did not compete with either the Reserve Bank Information and Transfer System (RITS) or Austraclear in the clearing and settlement of such securities;
 - access to CHES DvP settlement was limited to "on market" transactions as defined by ASTC, with the effect that transactions on trading facilities

that were in competition with ASX were excluded from the efficiencies of such settlement;

- the criteria for recognition as a payments provider should not raise unnecessary barriers to the provision of payment facilities to CHES participants, and in particular should not prevent competition between banks and Non-Bank Financial Institutions for such business.

8.15. As outlined in paragraphs 3.16 to 3.18, the Commission imposed conditions to address these concerns and lessen the potential for anti-competitive detriment as a result of the CHES arrangements. Set out below is a table detailing the conditions imposed by the Commission in its 1998 determination and the response by the ASX and the ASTC to each condition.

Table 8.1

1998 Conditions	Applicants' Response
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 the ASTC to clear and settle ASX market transactions.	SCH Rule 7.4.1A allows that brokers may use a clearing and settlement service which is acceptable to ASIC to settle a transaction if they obtain the consent of the counterparty to the transaction.
2. The Applicants not use any power under their Rules to prevent an entity from competing with the ASTC or unreasonably constrain an entity's ability to compete with the ASTC in the provision of clearing and settlement services.	The Applicants submit that they have been active in considering ways in which competition could be enhanced. The Commission is not aware of any instances in which the Applicants have prevented an entity from competing or unreasonably constrained an entity's ability to compete with the ASTC.
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.	The ASTC has established manual procedures for brokers to use an approved alternative clearing facility. Participants are able to cancel trades prior to netting and direct the trade to an approved alternative clearing and settlement facility.
4. The Applicants amend SCH Business Rule 7.1 to provide that a transaction is eligible for CHES delivery versus payment settlement if the transaction is of a class of transaction determined by ASTC in accordance with objective criteria and that such determination by the ASTC be subject to an appeal mechanism.	SCH Business Rules 7.1.3A and 7.1.3D & F set out these changes.

<p>5. The objective criteria and appeal mechanism in condition 5 were to be formulated to the Commission's satisfaction by the ASTC within three months of the date that the determination came into force.</p>	<p>As outlined above, the required changes in the SCH Business Rules have been implemented by the Applicants.</p>
<p>6. The Applicants remove the current exclusion of ASX market transactions in debt securities from clearing and settlement in CHES.</p>	<p>The Applicants submit that ASX market transactions in debt securities are not excluded from clearing and settlement in CHES. A limited number of debt products are currently cleared and settled through CHES.</p>
<p>7. The payments provider criterion than an entity must maintain an exchange settlement account 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.</p>	<p>The definition of payments provider in Chapter 21 of the SCH Business Rules does place restrictions on institutions, relating to technical and operational capacity. The Applicants submitted that these requirements are necessary to ensure the integrity of the system. The Commission considers that the definition does not exclude particular types of institutions with such settlement facilities.</p>

- 8.16. The Commission considers that the conditions it imposed in 1998 to address concerns regarding potential barriers to competition have been satisfactorily addressed through rule changes made by the Applicants.
- 8.17. The Commission also notes the impact of Financial Services Reform, which has provided a framework for greater competition in markets and clearing and settlement facilities. These changes include the ending of the distinction between securities and futures contracts, the extension of electronic transfer and title provisions to any prescribed clearing and settlement facility, and the greater participation of overseas markets and facilities in Australia.
- 8.18. The Commission notes that the ASX has decided to restructure its clearing and settlement functions to create a single counterparty that will provide contract guarantee support for clearing across all ASX markets. The ASTC's function will be to provide settlement services for equities, warrants and fixed interest products and will be expanded to also include payment and delivery services across all ASX markets. Subject to an application by the ASX to vary the terms of its Australian market licence, Australian Clearing House Pty Ltd (currently known as Options Clearing House Pty Ltd) will be created to provide clearing services with respect to equities, warrants and fixed interest products as well as options and futures. This restructure is consistent with the regulatory requirements under the new FSR Act.
- 8.19. The only interested party submission which raised competition concerns was provided by Burrell Stockbroking (Burrell). In particular, Burrell submit that

the ASX Business Rules and CHES Rules should be reviewed for unnecessary and overly prescriptive rules which have the impact of raising costs or impeding competition and are not necessary for the conduct of the business of the ASX. In addition, Burrell submit that where the Corporations Act and ASIC have already legislated and have responsibility for a matter, it is not appropriate for the ASX to impose additional costs on broking firms by way of duplicate provisions.

- 8.20. The Applicant's response stated that the rules, before coming into operation, undergo a process of review and industry consultation and cannot come into force unless the appropriate lodgement process is followed, which involves ASIC and Treasury and leads to the non-disallowance of the rules.
- 8.21. The ASX also described its disciplinary process, in which the National Adjudicatory Tribunal (NAT) is established under the ASX Business Rules and is comprised of non-ASX industry members. Decisions by the NAT are also appealable to the appeal tribunal, which is chaired by a Senior Counsel of the Sydney bar, with members also comprised of non-ASX industry members.
- 8.22. The Commission notes that a review of the rules has recently been completed by the Applicants in the context of the stated Financial Services Reform aims to increase competition in markets and clearing and settlement facilities. The Rules have been lodged with the ASIC for non-disallowance. Once this process is finalised, the Applicants will decide whether authorisation is necessary. The Commission also notes that the only other submission received in relation to the applications supported the re-authorisation of the CHES Rules.

Conclusion

- 8.23. In light of the amendments made to the CHES Rules in response to the Commission's 1998 authorisations and changes brought about by the Financial Services Reform regime, the Commission considers that the CHES Rules for which authorisation is sought are likely to result in small, if any, anti-competitive detriment.

The balance of benefit and detriment

- 8.24. The Commission may only revoke and grant a substitute authorisation if it is satisfied that, in all the circumstances, the proposed arrangements will result in a public benefit that will outweigh any anti-competitive detriment.
- 8.25. The Commission considers that the anti-competitive detriment associated with the CHES arrangements is likely to be small due to the changes made by the Applicants since the 1998 authorisations and the implementation of the Financial Services Reform program. In particular, FSR included the ending of the distinction between securities and futures contracts, the extension of electronic transfer and title provisions to any prescribed clearing and settlement facility, and the greater participation of overseas markets and facilities in Australia.

- 8.26. The Commission also considers that the CHES Rules are likely to continue to result in a benefit to the public through efficiency gains brought about by the continuing minimisation of delays in transfer and settlement and the security resulting from Delivery versus Payment settlement. In addition, the Commission acknowledges that there is some public benefit in maintaining the status quo to allow the Applicants to develop new rules in accordance with the changes made to the Corporations Act under Financial Services Reform.
- 8.27. Overall, the Commission considers that the public benefits flowing from the relevant CHES Rules are likely to outweigh the anti-competitive detriment.
- 8.28. Therefore, the Commission revokes authorisations A90596, A30180, A30181 and A30182 and to grants authorisations to the ASX and the ASTC in respect of the applications A90881, A90882, A90883 and A90884 relating to the ASX Listing Rules, the ASX Business Rules and the SCH Business Rules (listed at **Attachment A**).¹⁷

Timing of re-authorisation

- 8.29. In lodging the applications for revocation and substitution, the Applicants requested that interim authorisation be granted for six months, or until such time as the new rules come into force. Interim authorisation was granted to the applications for revocation and substitution on 27 August 2003, pending the Commission's consideration of the applications. The Commission issued a draft determination on 19 November 2003, proposing to grant authorisation for the CHES arrangements and extending the previously granted interim authorisation until such a time as a final determination comes into force.
- 8.30. The Commission considers that, in granting authorisation until 31 March 2004, the applicants will be provided with sufficient time to allow them to adhere to the legislative requirements resulting from the March 2002 amendments to the Corporations Act. In particular, the Commission noted that the Applicants must redraft the CHES Rules by March 2004 in order to comply with these changes. The Applicants have advised the Commission that this process will be complete on or before 11 March 2004 and that it is anticipated that the new rules will take effect from this date.
- 8.31. The Commission notes that the Applicants have stated that once the new rules governing CHES have been finalised, an assessment will be made as to whether or not they will require authorisation.
- 8.32. In issuing its final determination the Commission does not revoke the interim authorisation that was granted by the Commission on 27 August 2003. Accordingly, interim authorisation will continue to protect the CHES rules listed at **Attachment A** from action under the Act until the Commission's final determination comes into effect.

¹⁷ For a full copy of the Rules for which authorisation is sought see the Commission's website www.accc.gov.au/adjudication/fs-adjudicate.htm

9. Determination

The Applications

- 9.1. On 27 August 1998, the Commission granted authorisation to applications A90596, A30180, A30181, and A30182 relating to certain rules of the Clearing House Electronic Subregister System (CHESS) following applications from the Australian Stock Exchange (the ASX), the ASX Settlement and Transfer Corporation (the ASTC) and the Australian Payments and Clearing Association. Authorisation was granted until 28 August 2003.
- 9.2. On 14 August 2003, the ASX and the ASTC (the Applicants) lodged four applications for the revocation of authorisations A90596, A30180, A30181, and A30182 and their substitution by new authorisations A90881, A90882, A90883 and A90884.
- 9.3. The substitute authorisations sought are in relation to certain of the ASX Listing Rules, the ASX Business Rules and the SCH Business Rules, which govern the operation of CHESS. The rules for which authorisation is sought are listed at **Attachment A** and are provided in full on the Commission's website at www.accc.gov.au/adjudication/fs-adjudicate.htm.
- 9.4. Interim authorisation was granted to applications A90881, A90882, A90883 and A90884 on 27 August 2003, pending the Commission's consideration of the substantive applications.

The Statutory Test

- 9.5. Pursuant to section 91C(7) of the Act, and for the reasons outlined in Part 7 of this determination, the Commission is satisfied that the revocation of Authorisations A90596, A30180, A30181 and A30182 and the substitution of applications A90881, A90882, A90883 and A90884 is likely to result in public benefits that outweigh the public detriment constituted by any lessening of competition that would be likely to result from giving effect to the arrangements.

Conduct Authorised

- 9.6. Accordingly, the Commission revokes authorisations A90596, A30180, A30181 and A30182 and grants substitute authorisations A90881, A90882, A90883 and A90884.
- 9.7. The substitute authorisations provide the Applicants with immunity from the application of sections 45 and 47 of the Act to the extent that the rules listed in **Attachment A** may be an exclusionary provision, may have the effect of substantially lessening competition, or may constitute the practice of exclusive dealing.

9.8. In issuing its final determination the Commission does not revoke the interim authorisation that was granted by the Commission on 27 August 2003. Accordingly, interim authorisation will continue to protect the CHES Rules listed at **Attachment A** from action under the Act:

- where no application is made to the Tribunal for review of the Commission's determination, until the date that the Commission's final determination comes into effect;
- where an application is made to the Tribunal for review of the Commission's determination, until the day on which the Tribunal makes a determination on the review; or
- until the Commission, or the Tribunal in the event of an application for review of the Commission's determination, decides to revoke interim authorisation.

9.9. The Commission grants the substitute authorisations until 31 March 2004.

Attachment A

ASX Listing Rules submitted for authorisation

- Chapter 1: Admission – 1.1 (Conditions 3 & 7), 1.7, 1.9, 1.14
- Chapter 2: Quotation – 2.1, 2.2, 2.5, 2.16
- Chapter 4: Periodic Disclosure – 4.10.16
- Chapter 8: Transfers and Registrations – Explanatory Note, 8.1, 8.2, 8.5, 8.6, 8.10, 8.11, 8.14
- Chapter 12: On-going Requirements – 12.4
- Chapter 14: Meetings – 14.2A
- Chapter 19: Interpretation and Definitions
- Appendix 1A
- Appendix 1B
- Appendix 1C

ASX Business Rules submitted for authorisation

- Section 3 Client Relations: 3.8 – Confirmations
- Section 4 Delivery and Settlement: 4.43 – Securities Lending Service

SCH Business Rules submitted for authorisation

- Section 2: Applications for Participation and Participation Criteria
- Section 3A: CHESSE Depository Interests (CDIs)
- Section 3B: Foreign Depository Interests (FDIs)
- Section 7: Settlement Transfers – 7.1, 7.1.3, 7.13A.1, 7.1.3E, 7.1.3F, 7.33.1
- Section 7A: Real Time Gross Settlement
- Section 8: Issuers
- Section 9: Brokers – 9.20
- Section 10: Non Broker Participants
- Section 18: Disciplinary Proceedings
- Section 19: Restriction, Suspension or Termination of Suspension
- Section 21: Interpretation and Definitions