



**Parliamentary Joint Committee on Corporations and Financial Services - Oversight of ASIC,
the Takeovers Panel and the Corporations Legislation - Response to Question on Notice**

Hearing Date: 27 June 2023
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Question:

Chair: You made a few recommendations about things that could improve the ecosystem, Mr Phillips. The committee will make recommendations to ASIC, the government and the parliament about laws and regulations. If you had that opportunity, could you formalise them in some way? Write us a recommendation paper of what you think needs to change in addition to the evidence you have put on the record.

Response:

Please see Cboe's recommendation paper below.



Parliamentary Joint Committee on Corporations and Financial Services:

Oversight of ASIC, the Takeovers Panel, and the Corporations Legislation.

Cboe Australia Recommendations paper for the
identification of barriers to, and opportunities for the
support of, competition within Australia's post-trade
environment

Date: 28 July 2023

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Executive Summary

Cboe Australia thanks the Committee for the opportunity to present its views on the barriers to, and the opportunities for the support of, competition in the Australian securities financial market, particularly the post-trade environment.

The Australian post-trade environment is one that has evolved based on the circumstances of the time. Its historical success has been in large part a result of the exchange, and its member owners, operating in the best interests of the Australian financial system. However, following demutualisation of the ASX, these incentives changed. Since the emergence of Cboe (then Chi-X) as a competing Australian Market Operator, ASX through ASX Clear and ASX Settlement has wielded its significant market power in the post trade environment for the benefit of its vertically integrated business and its shareholders. Case studies demonstrating this are many and transparent, including ASX's approach to the CHES Replacement Project, NSX's application for clearing across its securities through ASX Clear, the delivery of the Trade Acceptance Service "TAS" when Chi-X entered, and its general ongoing approach to stakeholder engagement.

Following the failure of the original CHES Replacement project, Australia's financial market post-trade environment finds itself at a critical juncture. A once in a generation opportunity to redesign the landscape to support the future post-trade environment is available. This opportunity should be taken to ensure that Australia's post-trade environment delivers success for Australia's investors and its financial system now, and well into the future.

To achieve this, the regulatory environment and infrastructure design must be cohesively focused on delivering the greatest benefit to the Australian financial system and Australian investors, rather than retaining or extending market powers for the incumbent operators. They should advance the national interest, treat all users equally, and support innovation and competition.

Cboe Australia strongly supports regulation that actively promotes and facilitates the emergence of competition. This includes having firmly established rules that facilitate competition, a known operating environment, and a robust supervision framework to disincentivise anti-competitive behaviour. The Financial Sector Reform (Competition in Clearing and Settlement) Bill 2023 provides a solid foundation for these

elements, and Cboe Australia considers that further can be done to ensure the right outcomes for Australia's investors and its financial system.

In response to the Committee's request, Cboe makes the following recommendations to support clearing and settlement competition in Australia. References to the relevant section of this paper are provided in parentheses after each recommendation.

1. The regulators and Treasury review the allocation and role of the National Guarantee Fund contribution of \$71.5m, allocated to ASX Clear as "restricted capital reserve", having regard to the benefit of supporting resilience and competition across Australia's financial market. Given their origin, Cboe considers there is a strong argument these funds should be available for the benefit of all CCPs. (1.1)
2. The regulators require ASX Clear and ASX Settlement to be structured in such a way that, at an operations, governance, and technology level, they are incentivised to, and rewarded for, servicing all their customers equally. ASX Group must not be able to continue to use its dominant position through its clearing and settlement functions to diminish competition in areas in which it competes with non-ASX businesses. (1.2 & 1.3)
3. The regulators consider the effects that the failed CHES Replacement program and the requirement for a complete restart of this project have on competition when exercising their supervision functions and any rulemaking powers, noting that these failures have resulted in industry stakeholders needing to commit resources to ASX until up to 2032. (1.4 & 3.1)
4. Following passing of the CICS legislation, ASIC establishes firm rules in key areas that are needed for competition to emerge and be effective. Potential emerging competitors must be assured that:
 - a. Competition will be on a fully interoperable basis. (2.1)
 - b. Competing CCPs will be linked on a peers-to-peer basis. (2.2)
 - c. Access to the CHES settlement batch and the Central Securities Depository will rank equally between CCPs. (2.3)
 - d. Access to key competitor systems will be on an equal access basis. (1.2, 2.4 & 3.1)

5. No Australian Market Operator, or its aligned Clearing and Settlement service, should be able to charge Market or Clearing Participants, investors, or competing Clearing and Settlement infrastructures for the routing of trade executions for clearing and settlement. (4.1)
6. Competing CCPs should transparently agree and maintain operational standards within core functions that deliver to the highest standards of performance and resilience within securities clearing for Australia's investors, Participants, and stakeholders. (4.2)

1. Existing Barriers to competition

1.1 Default funds

CCPs play a critical role in the stability of financial markets. Accordingly, they are held to high prudential standards and are expected to maintain significant capital reserves to deal with defaults by clearing participants. While this is undoubtedly necessary, these resource requirements present a structural barrier to the emergence of competition, particularly in the absence of a global standard Mutualised Default Fund (MDF) in Australia.

ASX Clear currently manages its own default arrangements (including the ASX Clear default waterfall). However, not all the funds that make up the make-up the waterfall originate from ASX. This can be seen in the historical link between the ASX Clear default waterfall and the National Guarantee Fund (NGF), administered by the Securities Exchanges Guarantee Corporation (SEGC).

The NGF was formed in 1987 when the assets of the state exchange fidelity funds were merged, and a national exchange began operating as the ASX. These fidelity funds were historically funded by the Participants and the interest accruing from their trust account balances held with the exchanges. From 1987 these funds were allocated, among other things, to cover losses resulting from a Participant default within the newly formed Central Counterparty clearing house (CCP), now known as ASX Clear.

In 2005, changes were made to the NGF, relieving it of the obligation to provide funding support in the event of a Clearing Participant default. To achieve this, \$71.5 million was re-allocated from the NGF and assigned to ASX Clear for the explicit purpose of managing a Clearing Participant default. These funds within the ASX Clear waterfall structure are termed the "ASX Restricted Capital Reserve" and represent the first tranche of non-defaulting Participant capital accessed in the event of default.

Recommendation

Considering the origin of these funds, which represent mutualised funds from Clearing Participants, Cboe recommends that regulators and Treasury review the allocation and role of the "Restricted Capital Reserve", having regard to the benefit of supporting resilience and competition

across Australia's financial market, and not just ASX Clear's monopoly position.

Cboe considers there is a strong argument that the \$71.5 million should be returned to the SEGC as administrator and manager of this Restricted Capital Reserve for the benefit of all Clearing and Settlement Facility Licensees (CSFL). This would therefore allow access to these funds in the event of a Clearing Participant default by any CSFL.

Rules and procedures guiding usage and access could be established by the SEGC's rules, with the Australian market CCP default waterfall structure supported by the Financial Stability Standards with RBA and ASIC oversight.

Cboe views fair and efficient capital requirements as critical in supporting the emergence of a competing CCP.

1.2 ASX Clear's support of non-ASX AMOs

1.2.1 Non-ASX Listed products

Based on the evidence provided to the Committee by the National Stock Exchange (NSX) regarding its pursuit of CCP clearing for equity products, and Cboe Australia's experience in its request for CCP clearing of Exchange Traded Products in crypto, it is evident that ASX Clear's practices have resulted in outcomes that hinder competition:

- ◆ NSX's application for access to ASX Clear for CCP clearing of its equities took over three years to complete.
- ◆ Cboe crypto products are subject to significantly higher margin requirements than ASX products with similar economic exposures.

These outcomes occurred despite ASX having products of its own with the same or significantly similar risk profiles. Cboe is not in a position to state whether these outcomes were intentional, a consequence of conflicting objectives, or simply bureaucratic inefficiencies. However, the impact to the Australian financial market is clear. The existing processes of ASX Clear are unduly impacting new products being brought to market by non-ASX Australian Market Operators (AMOs).

Recommendation

To ensure consistent treatment of access to clearing, both established and emerging CCPs should adopt a transparent and agreed-upon risk management assessment approach, agnostic to originating AMO. CCPs should have predefined assessment criteria for the various asset classes they clear. Where a new or non-standard product is presented for clearing, there should be a transparent and well-defined process for further assessment, guided by service level agreements. Additionally, CCPs should have channels for escalation and timely discussion when there are differing risk opinions between listing venues and CCPs. Early engagement with regulators is essential to prevent unnecessary delays that could adversely impact Australian listed companies, products, and investors.

1.2.2 Non-ASX AMO access to ASX Clear for clearing

When Chi-X commenced trading ASX listed securities, the Trade Acceptance Service (TAS) was implemented by ASX Clear as a layer between Chi-X and CHESS for the acceptance of Chi-X trade executions.

TAS was a materially inferior service imposed on Chi-X that is not consistent with how CHESS accepts trade executions from ASX. This differentiated service continues to this day and is exemplified by the TAS legal terms stating that ASX Clear and ASX Settlement are only required to provide ‘a service of a comparable quality’ [to what is provided to the ASX]. This is a significantly lower standard than providing *equivalent* service or, as we contend should be the case, *equal* service. The existing regulatory expectations, that refer to *non-discriminatory terms* [of access] and *materially equivalent* [service levels], are not enforceable against ASX and would be insufficient to ensure the equal service necessary for effective competition even if they were.

This differentiated service delivery had real world impacts through the elevated trade levels of COVID, most notably on Friday 13 March 2020. Chi-X’s sub-optimal access to CHESS resulted in a disproportionate share of its executions being delayed or rejected by CHESS while ASX trades received preferential treatment for novation, as CHESS struggled to manage the elevated transaction volumes.

Recommendation

The experiences outlined in 1.2.1 and 1.2.2 demonstrate that ASX Clear offers its parent AMO different standards of service to non-ASX AMOs. This is not conducive to supporting a competitive Australian financial market.

Cboe Australia expects that in a well-functioning competitive market, ASX Clear should operate with a guiding principle of delivering for the benefit of the entire Australian financial market and its investors and should not favour its parent AMO over other AMOs. ASX Clear, its Board, and staff should be incentivised to, and rewarded for, the servicing of all its customers equally, non-ASX AMOs included.

To achieve this, Cboe Australia recommends the regulators require ASX Clear to be structured to achieve these outcomes. There are various means by which this could occur, such as divestment, structural separation, logical separation from the commercial influence of ASX and its related companies, and others. The onus should be on ASX to transparently review the available options, critically assess them, and then identify and implement the best option so that the best outcomes for the clearing function are aligned with the best outcomes for the Australian financial market. This should be supported by requirements on ASX Clear to regularly report to regulators and provide transparency to users on how this is being achieved.

Such structuring would ensure that the Committee, regulators, competitors, and the public can have confidence in ASX Clear's actions and decisions in the delivery of its systemically important service.

Recommendations relating to comparable vs. equal access can be found in section 2.4.

1.3 ASX Settlement's critical functions operations support and further ASX's overall market power

In addition to the monopoly position ASX Clear holds in CCP clearing, ASX Settlement similarly holds a monopoly position in securities settlement facilities and Central Securities Depository (CSD) services. The unique operation of the CHESS Settlement batch, the CSD, and the end investor

legal title HIN structure are at the heart of the Australian financial market and a source of extreme market power for ASX Group. These enable ASX Settlement's expansion into other areas including Issuer Services, ISIN creation and management, and Reference Data.

This structure and these services represent barriers to competition for non-ASX AMOs, as competing AMOs are a wholly dependent on their largest competitor to deliver these key services for the efficient functioning of their business.

Supporting competition requires regulators to consider these downstream services, their access, and performance to ensure they:

- ◆ Do not disincentivise competition.
- ◆ Are operated for the benefit of investors, listed issuers, and the broader Australian financial markets.
- ◆ Are not used to re-allocate revenues if competition emerges within clearing or another contestable market.

1.3.1. ASX Settlement as a Central Securities Depository

The operation of a dual register with end investor legal title registration is unique to the Australian financial market. Essentially investors can hold securities through either:

- ◆ The registries, via Share Holder Reference Numbers (SRN), and/or
- ◆ The Central Securities Depository (CSD), via the Holder Identification Number (HIN) system,

The ASX Settlement HIN structure has provided Australian shareholders significant benefits and protections through legal title, name on register holdings, in what was an 'offline' world. These have not been delivered without cost however and as financial markets progress towards a more digitally delivered eco-system, these costs should be addressed.

The HIN system provides ASX significant market power as its function has become the de facto accumulation 'account' for local investors security holdings. Therefore, to ensure representation within the HIN account, non-ASX AMOs and listed issuers must negotiate access with ASX Settlement for representation within the investor's portfolio. Access to HINs is essential for the performance of any listed issuers product.

Note: For comparison, the more common model globally is the operation of omnibus holding structures where investor assets are registered with beneficial ownership, and legal title is registered within accounts at the CSD in the name of a bare trustee (broker or custodian). Such a system allows for highly efficient post-trade settlement and securities holding but does not have some of the protections afforded by the HIN structure.

1.3.2. Issuer Services

ASX's market position as monopoly CSD, through the HIN structure, imposes additional costs on listed issuers to the detriment of the listed product environment. Many ASX Issuer Services fees are a duplication of services the listing issuers have otherwise negotiated with registries to perform.

As per the evidence provided by NSX, in addition to unnecessary expense for issuers, ASX Settlement has also used this as an opportunity to 'market' ASX to both investors and issuers. This undermines the position of the AMO as the listing venue and the operation of an efficient and competitive marketplace.

1.3.3. ISIN creation

ASX's historic position as the incumbent listing venue and CSD meant it has been the entity tasked with the creation and maintenance of the International Securities Identification Numbering system (ISIN), defined by ISO 6166. ISINs are the global ISO standard for unique identification of financial and referential instruments, including equity, debt, derivatives, and indices and are necessary for the establishment of any listed issuance. This awards ASX significant market advantage as gatekeeper to the ISIN system.

1.3.4 Reference Data

Through its role as Australian ISIN administrator, CSD and HIN operator, the provider of Issuer Services to listed issuers, and its own listings business, ASX has created a significant repository of valuable market reference data. By owning all the necessary inputs to the data ASX has positioned itself as the "Golden Source" for listed issuance product, corporate action data, and a sizeable portion of the investor register. This

information is highly valuable for the purpose of efficient administration across the listed issuer eco-system.

To be clear, ASX should be able to commercialise the data it collects, and adds value to through its validation, verification, and consolidation. However, it should not be able to rely on its monopoly market position to enforce and charge for usage of its services, then use the data collected for further commercial gain.

Recommendations

While there is no single model for CSD's globally, they tend to be operated as market infrastructure utilities for the efficient management of security holdings. They are commonly unaligned with market operators and CCPs and operated at the institutional/omnibus level (not retail).

Consistent with Cboe's comments in section 1.2 and its evidence before the Committee, we recommend that ASX Settlement should operate with a guiding principle of delivering for the benefit of the entire Australian financial market and its investors and should not favour its parent AMO and related entities over non-affiliated entities. ASX Settlement, its Board, and staff should be incentivised to, and rewarded for, the servicing of all its customers equally, non-ASX AMOs included.

To achieve this, Cboe Australia recommends the regulators require ASX Settlement to be structured to achieve these outcomes. There are various means by which this could occur, such as divestment, structural separation, logical separation from the commercial influence of ASX and its related companies, and others. The onus should be on ASX to transparently review the available options, critically assess them, and then identify and implement the best option so that the best outcomes for the settlement function are aligned with the best outcomes for the Australian financial market. This requirement should be supported by requirements on ASX Settlement to regularly report to regulators and provide transparency to users on how this is being achieved.

Such structuring ensures the Committee, regulators, competitors, and the public can have confidence ASX Settlement's operations, processes, actions, and decisions are appropriately considered in its delivery of the systemically important settlement and CSD service.

Further, ACCC should consider the commercial structure that ASX Settlement imposes on non-ASX listed securities and consider whether the broader benefits ASX Settlement gains from admitting product to its CSD fairly compensates ASX for the required effort.

1.4 Current CHESs capability

1.4.1 CHESs Replacement Project (CRP) Status

ASX's failures in the original CRP place it in a precarious position. It is still to complete the original core project deliverables of updating CHESs and is arguably starting from the beginning again. Additionally, ASX is now burdened with the additional development overhead resulting from deferred/postponed maintenance and enhancements to both clearing and market infrastructure. Furthermore, ASX is tasked with supporting the industry in transitioning to T+1 settlement.

These factors collectively raise significant concerns and potential barriers to ASX's ability to support a competitive clearing environment prior to the completion of its revised CRP. The emergence of a competitor within the clearing industry necessitates that ASX has sufficient capacity across various business functions, as well as in technology and development disciplines, to provide adequate support.

The Australian market could be left in the unfortunate position whereby ASX's previous failures further strengthen its monopoly position and serve to postpone competition.

1.4.2 Current CHESs lacks global standard messaging interfaces

The existing CHESs system lacks a globally standardized messaging interface and instead relies on a proprietary messaging specification called the CHESs External Interface Specification (EIS), rather than the more commonly used ISO 15022 (legacy) or ISO 20022 (new) standards. This represents a significant obstacle to the emergence of a committed competitor in the market as they are unlikely to see commercial value in developing to the retiring EIS spec.

Cboe is of the opinion any potential competitor entering the market is highly likely to adopt a solution based on the ISO 20022 format, supporting movement towards regional and global standards while future proofing development. However, to facilitate the necessary messaging interactions with current CHESSEIS standards, a translation layer would be required. This raises several questions:

- ◆ Who will bear the cost of developing such a service?
- ◆ Does ASX have the capacity to support the development of this service?
- ◆ How long and how much would it take to develop?
- ◆ Can ASX support the establishment of a Co-CCP within current CHESSEIS?
- ◆ What is the Committee's, regulator, industry and marketplaces appetite and prioritization of this work to support a competitive environment?

We understand the original and revised CRP has a stated objective to deliver to the ISO 20022 standard. However, the delivery and access to this is dependent on the project's implementation timeline, whether it is phased or big bang, and if it is phased, the prioritisation of this feature within the timeline. Thus continued CRP delays further delay potential competition emerging.

Recommendations

Given:

- ◆ the status of the CRP,
- ◆ the questions regarding capacity, development, cost and timing, and
- ◆ the stated potential completion timeline of 2032,

Cboe considers ASX has a strong incentive to defer the support for competitive clearing until after its CRP completion. This would result in the continued commitment of resources by the industry into a monopoly provider in what should be a contestable market, meaning that ASX's failures would have the effect of further protecting its monopoly market position in the near to mid-term.

Cboe therefore recommends that regulators consider the effects that the failed CHESSEIS Replacement program and the requirement for a complete restart of this project have on competition when exercising their supervision functions and any rulemaking powers:

Cboe considers that this should include requirements that:

Firstly, within the project, ASX Clear prioritises the delivery of global standards, open access and interoperability, whether a phased or big bang approach is taken. This approach offers market stakeholders surety in the future system to develop for a competitive Australian post-trade environment and/or redeploy its technology otherwise operating elsewhere into the local market.

Secondly, aligned with recommendation 1.2 & 1.3, ASX Clear and ASX Settlement be structured so that they are incentivised to, and rewarded for, the servicing of all their customers equally.

Thirdly, CHES operates as an industry utility until such time as it can support competition.

2. Development of ASIC Rules to support competition

The Financial Sector Reform (Competition in Clearing and Settlement) Bill 2023 (CICS) establishes a framework for ASIC to create rules supporting competition in clearing and settlement. These rules are to be guided by the "Minimum Conditions for Safe and Effective Competition in Cash Equity Clearing in Australia" (MC Clearing), "Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia" (MC Settlement) (collectively the **Minimum Conditions**), and the "Regulatory Expectations for Conduct in Operating Cash Equity Clearing and Settlement Services in Australia" (Regulatory Expectations) set out in Policy Statements by the Council of Financial Regulators (CFR) in 2017.

These Policy Statements are high-level and principles-based approaches which are appropriate to provide scope for adjustment as competitors emerge, and the clearing and settlement landscape changes.

However, they were published prior to the experiences of the current clearing environment and its challenges. Further, there are areas where Cboe Australia considers that greater specificity would promote and encourage the emergence of competition.

For example, the MC Clearing Policy Statement background states: *"...to implement the rules and require that operational changes be made in advance would lead to redundant industry investment and regulatory cost should a competitor fail to emerge. This is particularly important given that the rules will deal with matters such as interoperability and materially equivalent settlement arrangements between the emerging competitor and incumbent CCP, which could be costly to establish."*

Cboe's concern is that potential competitors need to understand the regulators' parameters for competition and timeline for competition to be supported to evaluate whether it is worthwhile to compete. Cboe considers that the ASIC rules should address these areas as early as possible and they should be developed to support the emergence of a committed competitor, not developed ex-ante.

Cboe understands and appreciates the balance that the CFR statements are seeking to strike. This appears to be a 'chicken and egg' scenario. However, Cboe suggests where ASIC can provide specific rules (and/or

guidance) to support the emergence of competition it would be advantageous to this outcome.

2.1 Interoperability is more than open access

Condition 4 of MC Clearing states the need to rely on regulatory measures, such as “open access” provisions to support interoperability. Cboe asserts that operation of an “open access” and fully interoperable competitive clearing environment can differ significantly.

Europe serves as a relevant case study, where the relevant regulatory requirements were based on the principle of open access. The outcome is that some markets operate under a what is referred to as a “preferred clearing” model, while others operate with full interoperability.

In a “preferred clearing” model, both the buyer and seller must nominate the competing CCP for clearing for the trades to be passed to their preferred CCP. If only one party nominates the competing CCP, the incumbent CCP retains both sides of the trade obligation and clears both. This model significantly constrains the potential for the emergence of a competitive environment as it limits the attractiveness of the market for potential competitors, considering Australia’s single securities market. Further it increases costs for Clearing Participants seeking to leverage the benefits of a competitive CCP landscape, as they are essentially mandated to be members of both CCPs.

Recommendations

Cboe recommends that ASIC develop rules which clearly outline its expectations for the level of “Open access” required by the incumbent CCP prior to the emergence of any competitor.

Cboe expects that for any potential competitor to emerge, they must have confidence that the environment will be genuinely interoperable.

Furthermore, Condition 4 speaks to the complexity for effective risk management frameworks introduced by competitive clearing and interoperability. While these are undoubtedly genuine issues, Cboe considers the regulators should consider the European model where

these issues have been solved. Cboe considers it is critically important that all key parties, being:

- ◆ Regulators
- ◆ CCPs
- ◆ Clearing Participants
- ◆ Settlement Participants; and
- ◆ Investors,

have a clear understanding regarding regulatory expectations, availability of collateral in the event of default, and the tools that are accessible to any CCP in the event of default by one of its Clearing Participants.

2.2 Rules for the expected CCP linkage model

Assuming ASIC pursues interoperability as a central tenet of its rules, it should provide specific expectations regarding the model for competition formation. In the RBA Bulletin article titled "Central Counterparty Interoperability" from June 2012, two relevant models for CCP linkage are outlined:

- ◆ Participant link, where the competing Co-CCP (Participant CCP) is a participant of the incumbent CCP (Senior CCP), passing collateral through to the incumbent CCP.
- ◆ Peer-to-peer link, where each CCP is a participant of the other with collateral flows moving between each.

Recommendation

Cboe Australia recommends that competition in Australia be firmly established on the peer-to-peer link basis to ensure that ASX Clear does not maintain an unfair dominant position. The establishment of competitive clearing on this basis ensures equal outcomes and requirements for competing CCPs.

If a single linkage model is not prescribed, ASIC and the RBA need to disclose clear criteria for when one model or the other might apply. Otherwise, potential competitors will be unaware of the circumstances and expectations surrounding the competitive and risk management environment in which they are evaluating an opportunity to operate.

2.3 Equal access to CSD (HIN)

ASX Settlement, through its management of Australia's CSD and dual investor register via HINs within the CHESS system, has built itself a walled garden as it relates to legal title transfer and ownership. Access to ASX Settlement's transaction function, which facilitates settlement of cleared positions and transfer to underlying investors' HINs, is essential for the smooth operation of any competing CCP. While the CFR Minimum Conditions and Regulatory Expectations outline the conditions and expectations for ASX to meet in relation to a competitor for clearing, Cboe believes this lacks the environmental context a competing CCP faces in achieving broader marketplace benefits.

Additionally, the Minimum Conditions outline expectations for the continued use of the CHESS settlement batch for ongoing settlement in a multi-CCP environment. Essentially, this obligates a competing CCP to use ASX's settlement infrastructure for service delivery. While this brings significant benefits in terms of operational and liquidity efficiency, it also exposes competing CCPs to ASX's commercial terms.

Recommendation

Any requirement for use of the ASX Clearing and Settlement batch should be covered by explicit rules which state that a cost associated for the settlement of cleared positions by any CCP, ASX Clear or otherwise, shall be on equal terms. Further, any changes to fees charged to CCP participants, ASX Clear or otherwise, are subject to consultation, regulatory oversight, and approval.

2.4 Comparable vs equal access

Section 1.2.2 outlines the effect of ASX being able to provide differentiated service levels to non-ASX AMOs. Even small, technical differences in the provision of clearing and settlement services can have large impacts on the ability of non-ASX entities to effectively compete with ASX. In this context, the existing language of the regulatory expectations – that refer to access on non-discriminatory terms or materially equivalent service levels – are inadequate to foster effective competition. It is not sufficient to make the existing expectations enforceable with rules, rather new rules must reflect the principle of equal access.

Recommendation

To ensure ongoing resilience and integrity of the post-trade environment, it is recommended that ASIC develops rules explicitly stating that services provided within the CHES system are offered on the same basis to competitive service providers as they are to ASX.

If this is not feasible due to the ultimate design of CHES, these services must be functionally equal and equivalent, and operate equally non-functional performance in terms of latency and capacity. Further they must be designed in such a way to be non-discriminatory between the originating sources.

These must be defined within the non-functional specifications of the service, maintained on an ongoing basis and subject to regulatory reporting.

3. Council of Financial Regulators

3.1. Requirement to build-in support for competition

The Council of Financial Regulators' policy statements – MC Clearing, MC Settlement and the Regulatory Expectations – provide an excellent starting point from which to develop a regulatory environment that supports the right outcomes for Australian investors. However, these conditions were formulated before 2017 and do not fully consider the outcomes observed during the original CRP. For example:

“Accordingly, ASX would not be required to make up-front operational changes to accommodate competition until such time as a competing CCP committed to entry. However, at the same time, the technological design of ASX's CS infrastructure should not raise barriers to the potential future implementation of interoperability or access to settlement arrangements by a competing CCP.”

Recommendation

Given the status of the CRP, ASX must be compelled by the regulators to ensure that any new or revised technology solution includes functional and non-functional requirements that allow for competing clearing and/or settlement by a non-ASX entity on an equal access and equivalent basis in terms of functionality, priority, and performance, as per comments in sections 1 and 2.

Given ASX's dominant market position, and its previous approach to competitive threats, failing to do so would likely result in significant delays and costs for a future emerging competitor. Including support for competition within the project at this stage would be the most cost-effective in terms of time, money, and complexity, as they can be implemented without impacting live or legacy processes. It would also support ASX in approaching the project with the guiding principle of open, interoperable, and equal open access.

4. Commercial levers to limit competition

The CFR Regulatory Expectations apply to ASX's engagement with, and provision of services to, users of its monopoly cash equity CS services for both ASX-listed and non-ASX-listed securities. They acknowledge the need for review in the event of a committed competitor.

Recommendation

Cboe Australia recommends that the CFR agencies and ACCC review these expectations now, considering the outcomes observed during the original CRP and the resulting position it has placed the Australian financial market. The purpose of this review should be to manage ASX's incumbent monopoly position and actively inform potential committed competitors of expectations regarding governance, pricing, and access.

4.1 Pricing

Recommendation

From a pricing perspective Cboe recommends that regulators protect the competitive environment by banning additional fees by AMOs to route trade executions to a competing CCP or Securities Settlement Facility (SFF). Explicitly, no AMO should be able to charge Clearing Participants, investors or competing CS infrastructures for the routing of trade executions for clearing and settlement.

This includes:

- ◆ Fees charged to Market Participants or Clearing Participants per-trade, either for execution or routing.
- ◆ Higher costs of membership for Market Participants where not using the AMO's vertically integrated CS infrastructure.
- ◆ Additional charges for connectivity to competing CS infrastructure (pro to rata or otherwise) levied to Market or Clearing participants and/or the competing CCP.
- ◆ Fees charged to the competing CCP, including membership and transaction fees.

Consistent with Cboe's comments in section 2.4, we do not consider it would be sufficient to simply codify the existing language of the CFR Regulatory Expectations, which speak to "transparent, non-

discriminatory, and fair and reasonable pricing for CS services”. New rules are required that explicitly deal with the matters above.

Cboe’s experience, locally and globally, is that where parties with dominant market power have scope to claim ‘incurred’ costs as a lever to justify charges, they will do so to limit competition where possible. To better support competition, it is important to ensure that relevant competing parties manage and maintain their own infrastructure to achieve the highest standards of resilience and efficiency. This should be done so without using costs and system integration as leverage to limit competition. Competition for efficiency and services offered should be the relevant factors for determining which service provider is selected, not direct or indirect fees/costs incurred in support of competition.

4.2 Memorandum of Understanding

Recommendation

In addition to the CFR MC Clearing, MC Settlement, and Regulatory Expectations, whether they are codified in rules or not, competing CCPs should commit to cooperation in core areas that support a high-performing and resilient clearing environment for Australia's investors, Participants, and stakeholders through memorandums of understanding (MoUs).

Precedent for these types of MoUs exist internationally with the Reserve Bank of New Zealand and New Zealand Clearing and Depository Corporation Limited entering into an MoU on the establishment of the NZX post trade infrastructure.

MoUs should cover areas related to:

- ◆ An agreed approach to the risk management controls and postures.
- ◆ Information sharing where it relates to potentially systemic issues and/or macro events impacting the risk profile for the overall Australian financial market and/or its Participants.
- ◆ Use of agreed standards (ISO 20022), alignment of messages content and continued maintenance to ensure efficient development for Australia’s clearing and settlement environment by investors and Participants.
- ◆ Agreement that the costs, maintenance and development overheads associated with enabling full interoperability shall be

each CCPs responsibility and non-transferable to Co-CCPs, AMOs, Participants or investors.

The primary aim of this approach is to establish and uphold the utmost standards of cooperation, and alignment of, operational, risk management, and technology domains within Australia's clearing and settlement environment. By doing so, the aim is to enable competing CCPs to thrive based on their commercial terms, products, and services while preserving the integrity and resilience of the clearing ecosystem. It is crucial to prevent the creation of unwarranted barriers or competitive friction within their infrastructure, which could impede fair competition and hinder the overall efficiency of the clearing ecosystem.

5. Conclusions

Cboe Australia's view is that ultimately, the best outcome for Australian investors, users of infrastructure, and the financial system is effective competition in the provision of clearing and settlement.

Chi-X Australia, now Cboe Australia has provided a 12-year case study demonstrating the benefits competition delivers within Australia's financial markets. Through our relentless competition for listed securities secondary trading market share with ASX, we have proven that competition generates innovation and delivers cost-efficiencies that benefit all stakeholders. This has been achieved within an environment delivering significant headwinds generated by ASX's dominant market power.

Cboe considers that the lack of effective competition in the provision of clearing and settlement services in Australia has played a significant role in the failure of the CHES replacement project. ASX prioritised the interests of its users, and CHES' public interest purpose, behind its own commercial interests. This failure and the broader issues with ASX's behaviour, are symptomatic of an integrated, monopoly provider that has not been held accountable by an effective competitor and is therefore free to place its interests above all others.

For this to change, competition must be actively supported to thrive. The recommendations included within this paper are consistent with this ideal of actively supporting the emergence of competition and build on the significant work already undertaken by the Committee, the Council of Financial Regulators and Government.

Glossary of Terms

ACCC	Australian Consumer Competition Commission
AMO	Australian Market Operator
ASIC	Australian Securities and Investments Commission
ASX Clear	ASX Group owned operator and licenced CCP for Australian securities
ASX Group	integrated exchange offering listings, trading, clearing, settlement, technical and information services, technology, data and other post-trade services.
ASX Settlement	ASX Group owned operator and licenced SSF and CSD for Australian securities
Cboe	Australian Market Operator, formerly called Chi-X Australia
CCP	Central Counterparty (Clearing House)
CFR	Council of Financial Regulators
CHESS	Clearing House Electronic Subregister System, an ASX owned and operated integrated CCP, SSF and CSD technology
Chi-X	Australian Market Operator, now known as Cboe Australia
CICS	The Financial Sector Reform (Competition in Clearing and Settlement) Bill 2023
Clearing	Post trade activities from trade validation post execution through until completion of clearing position settlement
Co-CCP	Other CCP operating in the same market
Committee	Parliamentary Joint Committee on Corporations and Financial Services: Oversight of ASIC, the Takeovers Panel, and the Corporations Legislation.
CRP	CHESS Replacement Project
CSD	Central Securities Depository
CSFL	Clearing and Settlement Facility Licence (holder)
DVP	Delivery versus Payment
ETP	Exchange Traded Product
FSS	Financial Stability Standards
Golden source	Aggregate market reference data collated to be a single 'source of truth' for all market and issuer related information
HIN	Holder Identification Number, register managed and maintained CHESS, supplied end of day to a companies Registry
Interoperability	Interoperability facilitates novated trades between market participants that maintain clearing arrangements with different CCPs. To achieve this, a link is established between the two CCPs: the original trade contract is novated into three contracts, rather than two as occurs when a trade takes place between participants of the same CCP. The three contracts are between; 1. the buyer and its CCP; 2. the two CCPs; and 3 the seller and its CCP.
ISIN	International Securities Identification Numbering system

MDF	Mutualised Default Fund, where Clearing Participants contribute to pre-fund default capital in the event of any one of their failures to settle.
NGF	National Guarantee Fund
NSX	National Stock Exchange of Australia
NZX	New Zealand's Exchange
RBA	Reserve Bank of Australia
Register	Record of legal title for share ownership held in electronic form
Registry	An organisation that manages a company's list of shareholders (Register), maintaining an accurate record of shareholder transactions, issuing holding statements and managing dividend payments and other corporate actions.
SEGC	Securities Exchanges Guarantee Corporation
Settlement	All activities resulting from the completion of clearing settlement through to the allocation and disbursement required for underlying client contract settlement, and over-the-counter transactions.
SSF	Securities Settlement Facility
SRN	Shareholder Reference Number, register managed and maintained by a company's Registry
TAS	Trade Acceptance Services, technology middleware implemented between Cboe Australia trade executions and ASX's CHES system.