



G.R. Stevens
GOVERNOR

9 June 2015

The Hon Joe Hockey MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

**COUNCIL OF FINANCIAL REGULATORS: REVIEW OF COMPETITION
IN CLEARING AUSTRALIAN CASH EQUITIES**

On 11 February 2015, the Government asked the Council of Financial Regulators (CFR) and the Australian Competition and Consumer Commission – together, the Agencies – to conduct a review of competition in the clearing of Australian cash equities.

The Agencies previously carried out a review of competition in this market in 2012. In light of stakeholder feedback, the CFR recommended that a decision on any licence application from a competing cash equity central counterparty be deferred for two years. The previous Government endorsed this recommendation in February 2013. In the meantime, ASX was encouraged to develop a *Code of Practice for the Clearing and Settlement of Cash Equities in Australia* (the Code).

Immediately following the announcement of the current review, the Agencies released a consultation paper, seeking feedback on a range of potential policy approaches. Since then, the Agencies have consulted widely and have listened to the views of stakeholders.

I attach for your consideration the CFR's Conclusions Paper, which draws together the key messages from the consultation process and the Agencies' supporting analysis. The Agencies have identified three core conclusions from their review:

- *The policy approach should be one of openness to competition.* This policy stance would recognise the potential benefits of competitive discipline. It would also be consistent with the orientation towards competition in the 2014 Financial

System Inquiry and the prevailing legislative settings in the *Corporations Act 2001* that envisage competition. Indeed, this would reflect the environment in which ASX operated until February 2013. Taking the alternative path of prohibiting competition and establishing a statutory monopoly in cash equity clearing would be unprecedented internationally. To do so would require an unequivocal conviction that a single provider was the optimal market structure for cash equity clearing.

- *Competition, even if permitted, may not emerge for some time, if at all.* There remain strong forces in favour of a single provider of clearing services. A competing central counterparty may therefore never emerge, or at least not for some considerable time. This could weaken the discipline on ASX from contestability of clearing.
- *The regulators should have powers to deal with an ongoing monopoly.* If the moratorium on competition were lifted, ASX could choose to withdraw the Code. Since market forces alone might be unable to discipline ASX's conduct, the regulators should be able to regulate some aspects of ASX's operations if necessary to address industry concerns arising from a continued monopoly.

Reflecting these conclusions, the CFR makes four recommendations. These include recommendations that the Government implement legislative reforms that would give the relevant regulators rule-making and arbitration powers both to facilitate safe and effective competition in clearing, and to deal with the continued monopoly provision of cash equity clearing and settlement services until such time as competition emerged. In particular, the CFR recommends that:

- the Government confirm a policy stance that supports openness to competition in the clearing market for ASX-listed securities, and implement legislative changes to facilitate competition in accordance with a set of 'minimum conditions' for safe and effective competition; these conditions would be set out by the Agencies in a publicly stated policy
- the Agencies develop and publish a set of regulatory expectations for ASX's conduct in operating its cash equity clearing and settlement facilities until such time as a competitor emerged
- the Government implement legislative changes that would allow the relevant regulators to impose requirements on ASX's monopoly cash equity clearing and settlement facilities consistent with the regulatory expectations if these expectations were either not being met or were not delivering the intended outcomes
- the Government implement legislative changes to grant the ACCC an arbitration power to provide for recourse to binding arbitration in disputes about the terms of access to ASX's monopoly cash equity clearing and settlement services.

Importantly, under these recommendations, ASX would not be required to make any operational investments in anticipation of competition, and would not be subject to additional upfront enforceable regulatory obligations as an ongoing monopoly. Nevertheless, the combination of the threat of competition and the threat of possible regulation would be relied upon to encourage appropriate conduct.

In determining an appropriate time for the release of the CFR's Conclusions Paper, you may wish to note that ASX has publicly stated that the level of its clearing fees and the scope of planned investments in its clearing and settlement system depend on the outcome of this review. Accordingly, there is considerable industry interest in the Government's decision on this matter. Ideally, the paper should be released at the same time as any such decision.

You may also wish to note that the CFR's Conclusions Paper, once communicated to ASX, will likely need to be announced to the market immediately given its potential impact on ASX's share price.

Yours sincerely



Encl

cc: The Hon Josh Frydenberg MP, Assistant Treasurer
 Mr Wayne Byres, Chairman,
 Australian Prudential Regulation Authority
 Mr Greg Medcraft, Chairman,
 Australian Securities and Investments Commission
 Mr John Fraser, Secretary to the Treasury
 Mr Rod Sims, Chairman, Australian Competition
 and Consumer Commission
 The Hon Bruce Billson MP, Minister for Small Business