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ASX Limited
20 Bridge Street
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Attention: Ms Diane Lewis, Senior Policy Analyst

Dear Diane

ASX Consultation Paper on a draft Code of Practice for Clearing and Settlement of Cash Equities in Australia

Thank you for the opportunity of commenting on the above Consultation Paper (CP).

In the following, Chi-X has sought to provide constructive comments based upon common global standards for central counterparty (CCP) services and the Principles ("**Principles**") set out in the Report by the Council of Financial Regulators dated December 2012 ("**the Report**").

The comments are segmented as follows:

1. Matters not currently covered by the proposed draft Code:
 - (a) the composition of the Board of ASX Clear;
 - (b) the lack of commercial reasonableness in the TAS (and in particular, Chi-X notes the absence of any equivalent and standard service agreements between ASX Clear and market operators, including those located within the ASX Group);
 - (c) the structural and physical separation of ASX Clear staff and operations from the other business units (including Settlement) within ASX that compete with ASX Clear users so as to give practical effect to the non-discrimination and confidentiality elements in the Principles.
2. Matters currently covered by the draft Code:
 - (a) access to clearing services;
 - (b) the structure of the Forum and user input to governance;

- (c) transparent pricing and cost allocation;
- (d) protection of confidential information;
- (e) independent reporting;
- (f) dispute resolution.

1. Matters Not Currently Covered by the draft Code

(a) The Board of ASX Clear

The Council of Financial Regulators noted in its advice to the Treasurer that Canadian regulators imposed conditions on the Maple Group to ensure that the Group, which includes the Toronto Stock Exchange and CDS Ltd (the sole CCP for Canada cash equities trading), operates its facilities with regard to the public interest. There are significant gaps between the governance and operational conditions imposed by the Canadian regulators to achieve that goal, in respect of the clearing services provided by CDS Ltd, and what is contained in the draft Code. In particular, Chi-X notes that there is no requirement for the ASX Clear Board to have participant representation, market operator representation or clearing and settlement expertise¹.

In this context, Chi-X also notes the remarks of the UK's Office for Fair Trading, on clearing the LSE acquisition of LCH, when it stated that:

*The OFT notes that any attempt to engage in foreclosure [of LCH services to competitors of the LSE] would be transparent to many customers in particular those who are also shareholders. These customers, who are sophisticated financial institutions, **are represented on the LCH.Cleernet board, on its risk committees and on its product advisory groups**. This governance arrangement further limits the likelihood that the parties would engage in activities that would harm customers.²*

[emphasis added]

The Principles require the Code to establish formal mechanisms for accountability of the ASX Clearing and Settlement Boards to users (defined on page 32 of the Report to include not only clearing and settlement participants, but also end-users, alternative market operators, technology service providers and other relevant stakeholders).

In these circumstances, Chi-X is of the view that ASX should amend the draft Code to include a process for appointing clearing and settlement experts, that are also representatives of non-ASX entities (see section 2(b) below), to the board of ASX Clear.

(b) The lack of commercial reasonableness in the TAS

The TAS was not negotiated in a competitive environment and this is indicated by the imbalance of obligations, the nature of the standards specified and the pricing provisions. Chi-X is of the view that ASX

¹ See clause 4.2(b) of Schedule B, Terms and Conditions to the CDS Recognition Order, which is accessible at http://www.osc.gov.on.ca/en/SecuritiesLaw_ord_20130104_224_cds.htm

² see <http://www.of.gov.uk/news-and-updates/press/2012/118-12>

should adhere to the common global standard of enabling market operators to engage with ASX Clear according to a standard contract for the provision of CCP services and that is applicable to **all** market operators, including those within the ASX Group.

In these circumstances, Chi-X is of the view that the TAS does not provide fair and transparent terms of access to the clearing services provided by ASX Clear. Further, neither the draft Code nor the TAS provide any protocol for dealing fairly and in a timely manner for requests for access, including timeframes for responding to requests for access as is required by Principle C. The Principles require access to the CHES infrastructure on non-discriminatory and transparent terms. The Report noted that:

"In particular, ASX should adhere to a protocol for dealing fairly and in a timely manner with requests for access, including timeframes for responding to enquiries."

In these circumstances, Chi-X is of the view that the draft Code should be amended, to ensure consistency with the Principles, by including a statement that ASX Clear services will be provided on an equivalent basis pursuant to the same standard service agreement applicable to all market operators, irrespective of whether they are located within the ASX Group.

(c) Structural and physical separation of ASX Clear staff and operations from the other business units (including Settlement) within ASX

Customers of ASX Clear compete with other ASX entities and business units within the ASX Group. It is not reasonable or realistic to expect staff engaged by ASX Clear to service those customers in a way consistent with the aspirations in the CP and draft Code if they are also engaged by, or are remunerated based on the performance of, those other ASX entities and business units. Chi-X also notes that the separation of the clearing and settlement functions would assist in providing transparency on those functions, including as to pricing. It is also difficult to understand how, practically, confidentiality could be maintained between the two divisions of the ASX without this separation.

Chi-X notes that in many places throughout the draft Code, the term "ASX" is used in a way where it is not clear which entities within the ASX Group are covered. This is problematic as in some circumstances it appears to be used in a way that would be fundamentally inappropriate if the reference were to include entities that compete with Chi-X. It is a basic requirement of transparency that the Code correctly identify which entities within the ASX Group are caught by the terminology being used.

In these circumstances, Chi-X is of the view that the draft Code:

- (i) should be amended by stating that persons engaged by ASX Clear will not simultaneously be engaged by or have remuneration linked to either ASX entities that compete with ASX Clear customers or ASX Settlement;
- (ii) must specify the actual entities within the ASX group to which it is referring and not use a generic label of "ASX".



2. Matters Currently Covered by the draft Code

(a) Access to clearing services

A pre-condition to providing all market operators with equal access to a CCP is that all operators should use the same method to access the CCP. At present, the access provided to the ASX Clear CCP services is not the same for all market operators³.

There is a significant risk that, under the current proposals, ASX Clear will embed discriminatory access akin to that which existed at NYSE with respect to market data and resulted in a \$5million fine being imposed by the SEC⁴.

In these circumstances, Chi-X is of the view that section 4 of the draft Code should be amended to state that ASX Clear will provide all market operators, including ASX and Chi-X, with the same technical interface specification so that each market operator can build an interface between the trading and clearing systems that ensures genuinely equal access.

(b) The structure of the Forum and user input to Governance

Chi-X is of the view that it is appropriate for ASX Clear Participants to nominate their own representatives to the Forum and that the process of ASX appointment that has been outlined, and which we understand may already have been implemented, sits uneasily with the independence of the Forum. As noted above, benchmarking the user input to governance that is provided by the Forum, against the requirements imposed on the Maple Group, would result in the following enhancements to the draft Code:

- (i) the Code would require clearing and settlement expertise to be present on the Forum;
- (ii) the Forum would be participant led rather than chaired by ASX directors that have fiduciary obligations to ASX business units and entities that are competing with Forum members;
- (iii) the Forum would be guaranteed independent representation on the board of ASX Clear.

In these circumstances, Chi-X is of the view that section 2 of the draft Code should be amended to provide the Forum with direct Board representation, independent of the representatives from the ASX Group Board, which would ensure the Forum had a clearly laid out path for implementing its recommendations and raising its concerns.

(c) Transparent Pricing and Cost Allocation

Chi-X was initially advised that the TAS pricing was based on cost recovery plus an element to cover operational costs. However, transparency on the makeup of the costs recovered has never been

³ In this context, Chi-X notes that the initial ASX draft of the TAS expressly allowed ASX Clear to discriminate between ASX Limited and Chi-X so long as the discrimination was not "unreasonable". Allowable discrimination was determined by taking into account the differences between ASX Limited and Chi-X: - see the Legal Terms for 28 January 2010 at <http://www.asx.com.au/clearing/trade-acceptance-service.htm>. These terms remained in the draft TAS until January 2011, despite repeated objections prior to that date from Chi-X.

⁴ The SEC fined NYSE for failing to ensure fair access to market data. The NYSE failures arose from technological systems that embedded different treatment for different persons seeking access to market data. See <http://www.sec.gov/news/press/2012/2012-189.htm>.

provided. The published clearing and settlement fees for trading that takes place on Chi-X indicates that the fees of ASX Clear and ASX Settlement are significantly more, on a per trade basis, than the trading fees charged by Chi-X. There is no transparency on the impact of revenue generation on the cost recovery of the TAS fee. Chi-X notes that there are no CDS access fees for market operators under the requirements imposed on the Maple Group.

Chi-X notes that the ASX is committing to providing Management Accounts for Clearing and Settlement. Given that the Council of Financial Regulators has considered each of those functions separately, Chi-X believes that it would be appropriate in this context for ASX to publish separate sets of management accounts for ASX Clear and ASX Settlement. This may also address concerns on the risks of cross-subsidisation and align the accounts with the separate client bases.

The Principles on transparent pricing contemplate internal audit and external auditing. For external auditing to be effective in dealing with access and competition issues, as the ACCC has strongly put forward on various matters (see for example, the recent Qantas/Emirates authorisation conditions), such auditing should be undertaken by an independent auditor.

In these circumstances, Chi-X is of the view that ASX should amend section 3 of the draft Code to:

- (i) include statements that there will be transparency on the makeup of the costs of the TAS and the impact on any cost recovery fees of the revenue generated by trading fed to ASX Clear and ASX Settlement through that service;
- (ii) state that separate management accounts will be published for ASX Clear and ASX settlement; and
- (iii) ensure that external auditing is truly independent in accordance with accepted practice on access and competition matters.

(d) Protection of Confidential Information

Chi-X is of the view that the terms on confidential information will be undermined by the lack of any meaningful separation of functions within the ASX Group. For example, persons employed within the ASX Group and currently engaged at ASX Clear may also be simultaneously engaged by, and have remuneration linked to, entities that compete with Chi-X. In these circumstances, confidentiality restrictions in a draft Code or elsewhere will be of limited use at best. The information provisions in the TAS are currently insufficient.

(e) Independent reporting.

Chi-X is of the view that any report to be provided on ASX Clear global benchmarking should be managed by the Forum or an independent body made up of Forum representatives. A report by persons engaged directly by ASX will not be independent in a way that best serves the goals of the benchmarking. In these circumstances, Chi-X is of the view that ASX should amend section 2 of the draft Code to provide that a report on global benchmarking will be undertaken for and at the direction of the Forum so that there is consistency with the governance recommendations in the Principles and greater confidence in the findings.

(f) Dispute Resolution

The draft Code does not deal in any detail with the differences between access to clearing and settlement (pre-access disputes) and disputes in relation to these issues once arrangements are in place (post-



access disputes). These are significant matters and should be addressed more fully including the ability to have arbitration before appropriate regulators such as ASIC and/or the ACCC as appropriate to give confidence in the practical operation of the Code. These provisions are sufficiently important to be addressed upfront.

In these circumstances, Chi-X is of the view that section 4.3 of the draft Code should include more detailed clauses on pre and post-access disputes and dispute resolution.

In keeping with the spirit in which this submission is made, Chi-X is willing to provide further assistance in delivering the changes outlined above so please do not hesitate to contact us if you have any queries.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Michael Jones".

Chi-X Australia Pty Ltd