

Regulatory Expectations for Conduct in Operating Cash Equity Clearing and Settlement Services in Australia

A Policy Statement by the
Council of Financial Regulators

As revised September 2017

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Background

On 30 March 2016, the Government endorsed the conclusions of a review of competition in clearing Australian cash equities carried out by the Council of Financial Regulators (CFR) and the Australian Competition and Consumer Commission (ACCC) – together, the Agencies – in the first half of 2015. These conclusions are set out in the Agencies’ report, *Review of Competition in Clearing Australian Cash Equities: Conclusions* (the Conclusions), published at the time of the Government’s announcement.¹

Among the conclusions arising from the review, the Agencies undertook to publicly set out regulatory expectations for ASX’s conduct in operating its cash equity clearing and settlement (CS) services until such time as a committed competitor emerged. The Conclusions presented the core elements that the Agencies expected to be included in the set of regulatory expectations. The core elements aim to address key governance, pricing and access matters that are dealt with under ASX’s pre-existing *Code of Practice for the Clearing and Settlement of Cash Equities in Australia* (the Code), as well as some of the additional commitments proposed by ASX in its submission to the review and some gaps in the Code identified by stakeholders. Consistent with the Agencies’ commitment and drawing primarily on the core elements proposed in the Conclusions, the Agencies released the *Regulatory Expectations for the Conduct of Cash Equity Clearing and Settlement Services in Australia* (Regulatory Expectations) in October 2016.

In the first half of 2017, the Agencies consulted on the prospect of competition in settlement of cash equities in Australia. The stakeholders’ responses are set out in the Agencies’ report, *Safe and Effective Competition in Cash Equity Settlement in Australia: Response to Consultation*.² The Agencies subsequently identified some aspects of the Regulatory Expectations that required consequential amendments, and have therefore issued these revised Regulatory Expectations in September 2017.

The 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. Users are broadly defined to include participants of the ASX CS facilities; end users; unaffiliated market operators, central counterparties and settlement facilities; technology service providers; and other relevant stakeholders.

ASX is expected to act in accordance with these revised Regulatory Expectations. The Agencies acknowledge that the Regulatory Expectations are not legally enforceable under the existing legislative framework. Accordingly, the Conclusions recommended that legislative changes be implemented to grant the relevant regulators rule-making powers that would enable them to impose enforceable requirements on ASX consistent with the Regulatory Expectations if these expectations were either not being met or were not delivering the intended outcomes. These powers would be held in reserve and would be expected to be used only in the event of a material deviation from the Regulatory Expectations or where ASX’s conduct was generating undesirable outcomes for the market. In addition, the Conclusions recommended that the ACCC be granted an arbitration power that would provide for binding resolution of material disputes, arising where a user was seeking access to any aspect of ASX’s monopoly cash equity CS services, consistent with the Regulatory Expectations. The ACCC may therefore have regard to the Regulatory Expectations when making a binding determination under the proposed arbitration power. The Government has committed to pursue legislative changes in accordance with these recommendations.

Should a committed competitor emerge for any aspect of ASX’s cash equity CS services, the Agencies will review and make any necessary changes to the scope of the Regulatory Expectations. The

1 The Conclusions and the Government’s response are available at <<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Review-of-competition-in-clearing-Australian-cash-equities>>.

2 The Response to Consultation is available at <<https://www.cfr.gov.au/publications/cfr-publications/2017/safe-effective-competition-response/pdf/response-to-consultation.pdf>>.

Agencies also expect to review the Regulatory Expectations periodically, including in the event of material changes to the operating environment for these services. Such reviews may assess the ongoing appropriateness of the Regulatory Expectations and their effectiveness in delivering the intended outcomes, with consideration given to stakeholder feedback.

The Agencies will also establish structured arrangements for engaging with stakeholders in relation to ASX's adherence to the Regulatory Expectations.

Regulatory Expectations

The Regulatory Expectations for the conduct of ASX's monopoly cash equity CS services are intended to support the long-term interests of the Australian market by delivering outcomes that are consistent with those that might be expected in a competitive environment. In particular, the Regulatory Expectations seek to ensure that ASX remains responsive to users' evolving needs and provides access to its monopoly cash equity CS services on a transparent and non-discriminatory basis with terms and conditions, including pricing, that are fair and reasonable.

ASX should maintain its Code, or should adopt another equivalent mechanism, to give effect to the Regulatory Expectations. ASX has also, in its Code, committed to submitting an annual external audit of its governance, pricing and access arrangements to the Agencies and members of relevant user governance arrangements, benchmarked against the Regulatory Expectations. This audit generally would not be required to form a judgement on the more subjective matters contained in the Regulatory Expectations, such as the promptness and efficiency of investments or the efficiency of prices. Rather, such an audit should develop an evidence base of relevant actions taken by ASX, and in particular provide assurance that it has policies and procedures in place aligned with the Regulatory Expectations and that it has conducted its operations in accordance with these policies and procedures. The outcomes of such audits are expected to be discussed with the ASX Boards, the Agencies and members of relevant user governance arrangements. The findings of such audits may be one input to any decision by the relevant regulators to employ the rule-making or arbitration powers once the supporting legislative framework is in place. The Agencies may additionally periodically request that ASX commission more detailed reviews of how particular aspects of its governance, pricing and access arrangements meet the Regulatory Expectations, or indeed carry out such reviews themselves.

Consistent with its existing arrangements to comply with its broader obligations under the *Corporations Act 2001*, ASX should continue to capture any complaints submitted by users, as well as its corresponding responses, within its complaints-handling system.

The Regulatory Expectations comprise the elements set out below.

1. User input to governance

To ensure responsiveness to users' evolving needs, transparent formal mechanisms should be maintained within ASX's governance framework to give users a strong voice in strategy setting, operational arrangements and system design, and to make ASX's monopoly cash equity CS services directly accountable to users. As part of this:

- (a) ASX should make an explicit public commitment to investing promptly and efficiently in the design, operation and development of the core CS infrastructure for the Australian cash equity market, including the Clearing House Electronic Sub-register System (CHES) and any future replacement system. This commitment should be supported by governance processes that enable users to provide input on the setting of the investment strategy. Investments should ensure that, to the extent reasonably practicable, the performance, resilience, security and

functionality of the core CS infrastructure meet the needs of users, recognising the diversity and differing needs of users. At a minimum, the core CS infrastructure should accommodate internationally accepted communication procedures and standards.

- (b) ASX should ensure that the membership of its user governance arrangements is representative of the user base of its CS services, and that members are able to have a strong input into the agenda and format of meetings or other user governance mechanisms and the setting of priorities.
- (c) ASX should demonstrate that it has had regard to the views of members in setting the terms of reference for the external audits of its governance, pricing and access arrangements carried out in accordance with the Regulatory Expectations. This may take the form of members' non-objection of the proposed terms of reference. These terms of reference may change following any review of the Regulatory Expectations.
- (d) ASX should maintain accountability arrangements that provide for regular public attestations as to the effectiveness of its interactions with users. For example, the following arrangements would be appropriate:
 - (i) ASX's user governance mechanisms operate on a 'comply or explain' basis; that is, the relevant Board would take actions in accordance with recommendations from the user governance mechanisms, or else explain why such actions had not been taken.
 - (ii) ASX report, on at least an annual basis, the service developments and investment projects that it has progressed and how it has taken into consideration the views of users.
- (e) ASX should formally commit to retaining a Board structure for ASX Clear and ASX Settlement that comprises a minimum of 50 per cent of non-executive directors that are also independent of ASX Limited, and where a subset of these independent directors can form a quorum.
- (f) ASX should establish governance structures and reporting lines at the management and operational levels that promote access to its CS services on commercial, transparent and non-discriminatory terms. These arrangements should ensure that the interests of users are upheld in accordance with Regulatory Expectation 3. This may be demonstrated, for example, through the key performance indicators set for relevant management.

2. Transparent, non-discriminatory, and fair and reasonable pricing of CS services

ASX should publicly commit to an appropriate minimum level of transparency of pricing across its range of monopoly cash equity CS services (including the provision of data). The pricing of these services should not discriminate in favour of ASX-affiliated entities (except to the extent that the efficient cost of providing the same service to another party was higher). Other than where pricing is anti-competitive or gives rise to financial stability or market functioning issues, the fees charged by ASX are a commercial matter for ASX and its customers. Nevertheless, to ensure that the fees charged by ASX for its cash equity CS services are transparent, non-discriminatory, and fair and reasonable:

- (a) ASX should ensure that all prices of individually unbundled CS services, including rebates, revenue-sharing arrangements and discounts applicable to the use of these services:
 - (i) are transparent to all users of the services
 - (ii) do not discriminate in favour of ASX-affiliated entities, except to the extent that the efficient cost of providing the same service to another party was higher

- (iii) are made available to stakeholders in a form such that the impact of pricing changes can be readily understood.
- (b) ASX should maintain an appropriate method for determining the prices of its CS services so as to generate expected revenue that reflects the efficient costs of providing those services, including a return on investment commensurate with the commercial risks involved.
- (c) ASX should make an explicit public commitment that any changes in the prices of its CS services will not be implemented in a way that would materially shift revenue streams between aspects of its trading, clearing and settlement services.
- (d) ASX should publish any increases in its CS fee schedules along with an attestation justifying their reasonableness. For the most material such increases, this attestation would be expected to refer to relevant metrics and other evidence, such as the calculated return on equity, benchmarked price lists, or an independent review of how ASX's cash equity CS fees compare with those of CS facilities in other markets.
- (e) ASX should maintain an appropriate model for the internal allocation of costs, including the cost of allocated capital, as well as policies to govern the transfer of prices between the relevant ASX Group entities. Compliance with the model and policies would be expected to be subject to internal audit review. The model and policies should be based on reasonable cost allocation principles. For example:
 - (i) where possible, costs should be directly allocated to the service(s) which give rise to those costs
 - (ii) shared costs should be allocated based on appropriate and transparent metrics.
- (f) ASX should negotiate commercially and in good faith with unaffiliated market operators and CS facilities regarding fees and other financial contributions charged for any extensions to its monopoly CS services, and in particular those provided under the existing Trade Acceptance Service and the Settlement Facilitation Service.

3. Commercial, transparent and non-discriminatory access to CS services – service levels, information handling and confidentiality

ASX should facilitate access to its cash equity CS services (including data) on commercial, transparent and non-discriminatory terms. Non-discriminatory terms in this context are terms that do not discriminate in favour of ASX-affiliated entities (except to the extent that the cost of providing the same service to another party is higher). As part of this:

- (a) ASX should have objectives for its CS services that include an explicit public overarching commitment to supporting access to its CS services on commercial, transparent and non-discriminatory terms. ASX should maintain standard user terms and conditions that are consistent with these objectives, taking into account the legitimate business interests of ASX and any parties seeking access to its CS services.
- (b) Service level agreements should commit ASX to providing access to its CS services for unaffiliated market operators and CS facilities on operational and commercial terms and service levels that are materially equivalent to those that apply to ASX as a market operator or CS facility.

- (c) ASX should publish and adhere to protocols for dealing fairly and in a timely manner with requests for access. These protocols should include reasonable timeframes for responding to enquiries and arrangements for dealing with disputes. Nothing in the protocols should affect either party's right to refer a dispute to arbitration by the ACCC once the arbitration regime is implemented.
- (d) ASX should make an explicit commitment to ensuring that any investments in the systems and technology that support its cash equity CS services do not raise barriers to access from unaffiliated market operators or CS facilities. Announcements of any material investments in the systems and technology that support ASX's cash equity CS services should be accompanied by a public attestation that those investments will be designed in a way that does not raise such barriers.
- (e) ASX should retain, and periodically review, its standards for the handling of sensitive or confidential information. Consistent with governance arrangements that promote access on commercial, transparent and non-discriminatory terms (see Regulatory Expectation 1(e)), these arrangements should ensure that conflict sensitive information pertaining to the strategic plans of unaffiliated market operators or CS facilities is handled sensitively and confidentially, and cannot be used to advance the interests of ASX as a market operator or CS facility.