Baillieu Holst
Since 1889

By Email To: joshua.everson@asx.com.au

4 September 2013

ASX Limited
20 Bridge Street
Sydney NSW 2000

Attn: Mr Joshua Everson

Dear Sirs,

Re: Financial Stability Standards Consultation
Cash Equity Market Account Segregation and Portability, and Rescheduled Settlements

We thank you for the invitation to comment on the above consultation paper and we provide our responses to your questions below.

SECTION B: CASH EQUITY MARKET – ACCOUNT STRUCTURES AND PORTABILITY

Q1: Which method do you prefer and why?

Our preference is for option 1 – to retain the single house account (maintain the status quo).

One of the great efficiencies of the current Australian settlement system for Listed Equities relates to netting of trades. A move away from the existing single house account for settling transactions would reduce the efficiency of the system, and the increased level of transactions to be settled would no doubt delay settlement times.

All investors are protected by the ASX Settlement Operating Rules, which govern the transfer of securities, and bind Issuers, Participants and the ASX Group pursuant to both the rules and section 822B of the Corporations Act (*ASX Settlement Operating Rule 1.2.2*). Clients that are CHESS Sponsored by a Market or Clearing Participant have the benefit of rules related to Client Arrangements including various mandatory notifications (*ASX Settlement Operating Rules* Section 7). With respect to client funds, Participants are required to pay client funds into a designated trust account (*Corporations Act 2001 (Cwth), s981B*) and such funds cannot be withdrawn until such time as the relevant trade is settled. On-market transactions further have the benefit of the protection of the National Guarantee Fund.

Given that Participants can only transfer securities in accordance with the ASX Settlement Operating Rules, these provisions afford investors suitable protection of their securities.

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We support the view of our back office system provider, GBST, that the structure of their systems already provides for segregation of client securities and funds.

We endorse the views of the Stockbrokers Association of Australia in respect of Option 1, regarding the robustness of the existing settlement system.

Our second preference is for option 2 – to introduce a client omnibus account

Option 2 will increase settlement complexity for Participants. Baillieu Holst does not actively trade house positions; however, each of of the three methods detailed in option 2 would require development time, changes to procedures, and additional staff training.

Alternative (a) – designating a trade at the time of order placement, with separate Accumulation and Settlement entrepot accounts to ensure there is no comingling of house and client assets.

To allocate a trade at order placement would require development work by both back office providers and trading system providers. We are unaware at this stage of the cost implications for such changes.

We have some questions about what types of transactions would be designated as "house". We note that "Principal" is defined in the ASIC Market Integrity Rules to include *partners, directors and immediate family members of same* (*ASIC (ASX Markets) Market Integrity Rules*, r3.2.5). We would expect that accounts that belong to a director would be designated as "client" not "house", given that they too are "clients" and should receive the same protection as all other clients. Thus the definition of "house" account will be of particular importance. We also note that errors and suspense accounts should be designated as "house" accounts, however, an error will not (normally) be known at the time of trade. This is also true in the institutional space where allocation of trades will not occur until the end of the day: meaning that at the point of trade, the designation as "house" or "client" may not be known. Some mechanism to reallocate trades would be required.

Alternative (b) – executions not designated as house or client at time of order entry will be classified as house intraday.

This has the effect of "intermingling" potential client trades with house trades and is not in accordance with the desire to segregate client trades from house positions, particularly in the event of an intra-day default.

Alternative (c) – each Clearing Participant operates two IDs (two PIDS).

Again, the issue here is that there would need to be the ability to reallocate trades.

We note that GBST have detailed the complexity of system providers maintaining two separate PIDS and this is not our preference, given the additional messaging requirements.

Option 3 – introduction of an individually segregated client account

We do not consider this option to be viable. The benefits of netting would almost entirely be lost for any Participant that deals with a large number of retail clients, which would likely cause delays in finalising settlement due to the greatly increased number of transactions that would need to be settled with the relevant clearing party.

Implementation costs would be significant as it would require considerable redevelopment of infrastructure relating to settlement and to CHESS.

We consider this option diminishes investor protection and would increase costs to investors, particularly in the retail sector of the market.

Q2: Should any other alternatives be considered?

We note there has been some discussion around the potential for a client to opt in / opt out (choice versus mandatory client protection). This would add considerable complexity to managing our obligations, particularly given the large number of retail clients with whom we deal. If a client opted in / opted out, we would have to manage this in addition to our normal settlement obligations. There would need to be certainty regarding at what point the client would be able to opt in / opt out (e.g. during the settlement cycle / before T+1 /other). Our view is that, whichever option is implemented, it must be mandatory for all clients: there will otherwise be an uneven playing field.

Q3: Are there any other factors that should be taken into account?

Given the aims of the Financial Stability Standards are to promote stability in the financial system, there should be further analysis of whether the increased costs of changing what is, at present, a robust and stable settlement system, are justified.

Q4: Are there any other impacts or benefits of either model on Clearing Participants or their clients that should be taken into consideration?

As noted above, system redevelopment, staff training, and potentially additional staffing requirements would all impact on costs.

Q5: What, if any, would be the implementation impact on Clearing Participants?

Refer our comments above.

Further, depending on the option implemented, there may be a need to amend Client Trading Terms and Conditions, which is an extremely costly exercise – from preparing variations, to informing clients of amended terms.

Q6: Should Clearing Participants be able to offer any of the options outlined to their clients?

We repeat our comments above, that there should be a level playing field: all Participants should be subject to the same requirements, given the stated aims of the Financial Stability Standards.

Q7: Do you believe a gross margin client omnibus structure should be considered in order to facilitate margin pass-through?

We cannot see any benefit in margin pass-through to clients, particularly in the retail client sector. As a Participant, we would still be liable for the margins. The additional administrative work in managing this process would far outweigh any (perceived) benefits.

Q8: Under the ISCA proposal, do you believe that final settlement should occur on a per client account basis or as one single settlement across all clients?

As noted above, we do not consider this option to be viable. We note that, if the final settlement occurred on a per client basis, the delay to settlement times would be considerable and would significantly decrease the existing efficiencies related to netting of obligations.

SECTION B: RESCHEDULED SETTLEMENTS

Q9: Are there any comments on the proposal (to reschedule settlements), especially on the operational impact?

We note that this part of the proposal is aimed at a situation of a major counterparty failure and the circumstances where settlements would be rescheduled under REPO arrangements would be minimal.

Given that the REPO transactions will effectively mean the original trade is closed and a new trade with a matching obligation but a new settlement date will replace same, we question how the messages relating to the rescheduled settlement dates will be notified to us.

We note that there may be some impact on funding or margining arrangements.

Q10: Are there any other changes required to the Clearing Participant/client arrangements to facilitate the operation of the offsetting transaction arrangements?

This would depend on the characterisation of the offsetting transactions, refer our comments above.

Q11: Are there any suggestions for alternatives that achieve the same regulatory requirement, particularly drawing on overseas experience?

No comments.

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Since 1889

CONCLUDING REMARKS

We repeat our view that the existing settlement system is robust, affords strong client protections, and has not had major failures over a long history.

A comprehensive analysis of the real cost and benefit of any changes to our system needs to be considered, along with whether the suggested changes will actually bring about the aim of increased stability of the financial system.

Timing of any changes will be critical – development of systems, testing, changing procedures and training of staff is a time consuming exercise, and we would expect that the timing would be beyond the transitional relief expiry date of 31 March 2014.

We welcome the opportunity to comment further on suggested proposals.

Yours sincerely,

Gavin Powell
Managing Director