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Ms Diane Lewis
Senior Policy Analyst
ASX Limited
20 Bridge Street
Sydney NSW 2000

Dear Diane

ASX Consultation Paper: Clearing and Settlement Services for Approved Market Operators and Approved Listing Market Operators (the CP)

Chi-X Australia Pty Ltd (Chi-X) is grateful to ASX for the opportunity of providing a submission on the CP.

Chi-X also commends ASX for many aspects of the CP, including:

- (i) the initial steps taken to align the prices charged by ASX to market operators with those found in markets where competition exists for clearing services;
- (ii) the general review of the pricing, legal terms, operational/information handling standards, performance and customer focus of the Trade Acceptance Service (TAS);
- (iii) the greater transparency it provides on the clearing and settlement services provided to Chi-X.

Each of these issues received prominence in the Chi-X submission, of 14 May 2013, on the draft Code of Practice for Clearing and Settlement of Cash Equities in Australia and Chi-X is grateful for the steps taken by the ASX in these important areas.

When Chi-X first negotiated with ASX on a clearing and settlement service, it was the perception of Chi-X that ASX saw Chi-X not as client or customer of ASX Clear and/or ASX Settlement, but rather as a competitor to ASX trading venues and therefore as a threat to ASX's trading platforms and associated revenues (eg trading fees and other significant revenues from



market data and connectivity related charges¹). From a Chi-X perspective, and that of our participants, there was little if any differentiation in the staffing, service and operations of the different ASX businesses. The persons who represented ASX Clear, a critical service provider for the Chi-X business, were the same persons responsible for promoting and supporting ASX businesses competing with Chi-X. This was a dominant feature of the ASX-Chi-X relationship at this seminal stage and was reflected in the pricing, service levels and standards imposed on Chi-X in the original standards and legal terms governing ASX's clearing and settlement arrangements.

Chi-X is therefore grateful for some of the developments that ASX has outlined and is hopeful they will provide a platform for continued progress. **Attachment One** contains further comments on the CP that will hopefully assist in this regard and we look forward to engaging with ASX on the areas covered.

While the CP references clearing and settlement arrangements, the comments in this submission primarily concern clearing arrangements. Settlement arrangements require special consideration, particularly given that CHESSE subregisters provide evidence of legal title. Chi-X is strongly of the view that the ASX Settlement business should operate as an industry utility and that steps should be taken to facilitate this as soon as possible. Doing so may be an important step for ASX to take in enabling it to compete on a level playing field when seeking a merger with or acquisition of/by an offshore operator.

Please do not hesitate to contact us if you have any queries.

Yours sincerely

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

Chi-X Australia Pty Ltd

¹ Within the first twelve months of Chi-X launching competing products, some of the ASX fees charged to ASX participants for those products had decreased from over \$500,000 pa to no more than \$12,000 pa.



Attachment One

Chi-X Australia Comments on the ASX Consultation Paper: Clearing and Settlement Services for AMOs and ALMOs (the CP)

1. Introduction

1.1.1 This submission contains comments on the following aspects of the CP.

- (i) Pricing;
- (ii) Enhanced Services;
- (iii) Enhanced/Streamlined Standards;
- (iv) Updated Information Handling Standards;
- (v) The Technical Review;
- (vi) Aligning ASX Clear outcomes with those in a competitive environment.

2. Pricing

2.1.1 The following section addresses the commentary on pricing contained in the CP.

2.1.2 It is stated on page 3 of the CP that:

ASX is proposing to remove the annual service fee effective from 1 July 2014 to provide a pricing outcome consistent with a competitive market for trade execution venues accessing clearing and settlement arrangements.

2.1.3 Chi-X agrees that ASX should waive the remaining payments due under the pricing schedule that was imposed on Chi-X prior to its market launch. However, this will provide an outcome that is only partially consistent with competition as:

- (i) the total costs incurred by ASX in developing the TAS, according to the statement at http://www.asx.com.au/cs/documents/TAS_term_and_review.pdf, provide the basis for the TAS service fee that Chi-X has paid;
- (ii) Chi-X has already paid a significant portion of this service fee to ASX Clear;
- (iii) any other market operators applying to use the TAS will have a competitive advantage as they may be able to use the TAS, paid for by Chi-X, without having to pay a commensurate amount;

- (iv) Chi-X may not be able to avail itself of the cost sharing measures outlined in the legal terms if all TAS fees are waived.

2.1.4 In these circumstances, a pricing outcome consistent with a competitive market for trade execution venues accessing clearing and settlement arrangements must involve the reimbursement of the sums already paid by Chi-X. This arrangement would:

- (i) properly align ASX Clear with global standards;
- (ii) acknowledge the revenue generated by ASX Clear from trading on Chi-X²;
- (iii) acknowledge that Chi-X had no practical option other than entering the TAS agreement and paying the fee;
- (iv) recognise the capital expenditure recouped by ASX from Chi-X; and
- (v) redress the potential price discrimination suffered by Chi-X if additional AMO's apply to use the TAS.

2.1.5 Chi-X is also concerned that the waiver of the fee should not be connected to the continuation of the Code of Practice and the related policy decision to defer consideration of any licence application by a competing central counterparty for the clearing of cash equities. This condition is ambiguous from a legal perspective and defeats the very aim of the waiver that is expressed in the CP: it will result in pricing arrangements that, given they include this condition, are no longer aligning outcomes in Australia with what would be delivered in a competitive environment.

2.1.6 It is also not clear to Chi-X why, given that Chi-X is subject to a TAS service fee of \$1.375 million, most of which has been paid, it was not invited to participate in the revenue sharing initiatives of ASX Clear pursuant to which volume based rebates have been offered to ASX Clear participants who trade on Chi-X.

3. Enhanced service levels and amendments to the legal terms

3.1.1 Chi-X is grateful for the commitment of ASX to improving service standards in the TAS and is of the view that the proposed amendments will improve the services provided to AMOs. However, Chi-X has comments on the following technical aspects of the proposed amendments:

- (i) Chi-X is concerned that a technical enhancement of the TAS may require more notice than the minimum periods specified in the table contained in clause three of Schedule 3 and that in particular:

² The ASX a clearing fee for each transaction on Chi-X that is nearly three times the trading fee paid to Chi-X: 0.18bps is the total Chi-X fee per transaction v 0.50bps for the total ASX Clear fee per transaction.

- (a) technical enhancements involving an external CHES release may require more notice than the three month minimum; and
 - (b) a non-functional enhancement requiring an internal CHES release may require more than one month's notice - Chi-X is of the view two months is an appropriate minimum notice period;
- (ii) notification of a new clearing participant accreditation – Chi-X would be grateful for an opportunity to discuss this bilaterally as it is not clear to Chi-X whether this amendment confirms the practical solution that ASX and Chi-X have previously agreed;
 - (iii) the situation of default or restrictions imposed on a clearing participant should be managed by ensuring Chi-X is kept informed of any developments prior to the events that trigger notification (ie action being taken against a participant).

4. Enhanced/streamlined standards³

4.1.1 The legal terms governing the TAS are counterintuitive in the way they impose many more standards and obligations on Chi-X as a service receiver than they do on ASX as a service provider. This is a stand out feature of the agreement when it is benchmarked globally. Regulation does not justify this outcome as this lack of balance is not representative of market operator-clearing services in other jurisdictions. Chi-X is therefore grateful for the steps taken to address this imbalance by removing standards that duplicate obligations contained elsewhere. The standards are not possibly equivalent to those in place for ASX Trade to the extent standards transparently imposed on one entity (Chi-X) but opaquely imposed on another (ASX) are inherently different in the standard of transparency applied to each.

5. Updated information handling standards

5.1.1 Chi-X is concerned at the principles underpinning the existing and proposed confidentiality arrangements in the Information Handling Standards. Confidential information provided by an AMO to ASX Clear should be subject to “need to know” requirements. The text proposed is not aligned with this basic principle but rather empowers a director to receive “what is reasonably required” to discharge his/her function. Chi-X has previously expressed concern to ASX about the persons to whom confidential information has been disclosed and the “copy catting” by the ASX Group of Chi-X proposals that have previously been the subject of confidential disclosure. Chi-X is of the view that the principles outlined in the proposed standards do not set the standard as high as would exist if ASX Clear treated Chi-X as a genuine customer, in which case information shared by Chi-X with ASX Clear would be disseminated on a need to know basis only.

³ See also paragraph 7.1.1(ii).

6. The Technical Review

- 6.1.1 The Technical Review was conducted without apparent independence and without the involvement of Chi-X. This undermines the report on the review as it has been initiated, conducted, finalised and published without the perspective or input of the sole current user of the service. It is not clear to Chi-X why this is the case and is an outcome fundamentally inconsistent with what would occur if there were competition for clearing services.
- 6.1.2 A public consultation and submission process is not the best forum for progressing discussions on the matters covered by the review but Chi-X notes that the findings are singularly lacking any examination of the impact of differences in the AMO and ASX Trade Processors on the actual business of Chi-X. This is particularly concerning as a single rejected transaction (let alone a trade outage of some hours), can potentially have a crippling effect on the development of a Chi-X product and/or its trading platform.

7. Aligning ASX Clear outcomes with those in a competitive environment

- 7.1.1 Chi-X is grateful for ASX taking steps to align ASX Clear services with those found in a competitive environment. However, Chi-X is of the view that ASX Clear will not, while it is a monopoly provider, deliver outcomes aligned with those achieved in a competitive environment, until the following matters are fully addressed.
- (i) Access - The access provided to ASX Clear systems should be exactly the same for all ASX Clear clients, including those within and outside the ASX group. Chi-X notes and commends ASX for charging ASX trading platforms a fee for using the TAS and would advocate, if it has not happened already, that this arrangement also be implemented architecturally.
 - (ii) Same service/standard levels - The services provided and standards imposed by ASX Clear should be the same, and transparently so, for all platforms, including those outside and within the ASX Group.
 - (iii) Pricing - ASX Clear and ASX Settlement pricing should be independently benchmarked to global norms.
 - (iv) Board representation - There should be market operator and participant representation on the board of ASX Clear.
 - (v) Business separation - ASX Clear should be separated from other ASX business units (including settlement⁴) within ASX that compete with ASX Clear users, and separated in a way that gives practical effect to the non-discrimination and confidentiality elements in the principles set out in the report on clearing and settlement by the Council of Financial Regulators.

⁴ ASX Settlement should operate as an industry utility, particularly given its role in providing evidence of legal title.



- 7.1.2 Chi-X is supportive of the steps taken by ASX to address some of these issues but is of the view that until each is addressed in a transparent and objective manner, there is a real risk that ASX will perpetually be required to undertake some form of independent review to justify arrangements that otherwise appear to inherently treat ASX business differently to non-ASX business.
- 7.1.3 Chi-X would welcome the opportunity to work with ASX to entrench the steps in 7.1.1(i)-(ii) and 7.1.1(v), as part of the reengineering of ASX's clearing and settlement arrangements pursuant to the implementation of ISO20022. Failure to appropriately address these issues as part of the implementation of ISO20022 may undermine any intention within ASX to otherwise align ASX Clear outcomes with those found in a competitive environment.