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Ms. Dodie Green
Senior Manager, Financial Market Infrastructure
Australian Securities and Investments Commission
Level 5, 100 Market Street
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By email: Competition.Settlement@asic.gov.au

Dear Dodie,

NSX response to CFR consultation paper on Safe and Effective Competition in Cash Equity Settlement in Australia

The National Stock Exchange of Australia "NSX", supports competition in settlement and ancillary settlement services.

NSX is in a unique position in relation to access to settlement, and therefore competition in settlement, because of the forced reliance on, and therefore exposure to, ASX for the provision of essential settlement services to the exchange, whilst being in direct competition with ASX as a listing and trading venue.

We note the following:

- NSX is a direct competitor to ASX as an equity listing market operator;
- NSX is the second largest equity exchange in Australia;
- NSX is the largest user of ASX's DvP Settlement Facilitation Service through CHESS;
- NSX is dependent upon ASX to provide vital settlement and ancillary settlement services; and
- NSX is constrained in its ability to innovate and compete because of the current settlement market structure.

One example of a dependency of NSX on ASX, and ASX's ability to negatively impact its competitor through the manipulation of an ancillary settlement service is the live issue caused by the cessation of CHESS Depository Interest services by CHESS Depository Nominees P/L, a wholly owned subsidiary of ASX Settlement P/L. NSX is vulnerable to a decision by ASX to cease providing services, particularly where a healthy competitive market for services has not been allowed to develop and consequently an equivalent service is not available.

Whilst the topic of this consultation and the questions posed by the paper use DLT as a reference point, it is important to note that the issues and barriers imposed by the current market structure are technology agnostic. There are fundamental market structure issues that must be addressed to allow for proper and effective competition to evolve, and the natural benefits are to be realised.

It is therefore important that one of the outcomes of this process is the development of high-level principles that can be separated from the technology deployed by competing securities settlement facilities "SSFs". These principles should centre around addressing access to data, interoperability, reciprocity rights of records and market IP (e.g. legal, technical and operational recognition of settlement participants' across SSFs).

In this consultation paper, CFR has raised a question around the mandatory imposition of clearing for all markets. NSX is firmly of the view that this suggestion is out of step with the development of new risk management mechanisms and the significant progression towards real-time settlement. Further, that any decision to impose clearing on all markets would in fact be anti-competitive given the products, structure and scale of alternate markets.

Further, in the context of considering market risk through settlement, NSX requests that CFR review access to the National Guarantee Fund for all Licensed Market Operator "LMO". This is a facility that was funded by the participants of all markets, but is restricted to benefit only ASX.

Finally, NSX believe that it is important to highlight the importance of the role of the LMO, in this process. As with the provision of other services to the exchange such as data vendors and order entry interfaces, a LMO will engage with a SSF where it is deemed that the SSF is a suitable service provider to the exchange. The LMO stipulates the rules for settlement in the market and engages the SSF(s) to provide the service, allowing (in multi-SSF scenarios) the market participants a choice of settlement venue.

We have included discussion points around *solution considerations*. NSX would be happy to discuss these further with COFR in the future.

Your sincerely,

Ann Bowering
Managing Director and CEO

NSX's response to CFR consultation paper on Safe and Effective Competition in Cash Equity Settlement in Australia

Rationale

1. Has the emergence of competition in cash equities settlement become more likely than it was considered during the 2015 Review? Please elaborate on your answer.

Yes, competition in cash equities settlement has become more likely since 2015. This has been fuelled by the following reasons:

- ASX's decision to replace CHESS provides a viable window to explore all options.
- ASX's likely choice to use blockchain technology has intensified this opportunity due to the global hype in this technology which is seen as a gamechanger for financial markets. This is especially apparent to deal with the inherent costs and inefficiencies in the post-trade segment.
- The disruptive nature and overall potential of blockchain technology has materialised with the emergence of SETL as a possibly viable competitor to ASX.

NSX is a supporter of competition in settlement. But NSX firmly believes that it is important to divorce the principle decision on competition from the technology that may, or may not be used. We believe that this can be supported by a regulatory framework that promotes key principles around data access, sharing and other key concepts such as interoperability, reciprocity rights of records and information (e.g. legal, technical and operational recognition of settlement participants' across SSFs). These higher-level principles can be separated from the technology deployed by competing SSFs. The technology itself could be underpinned by more detailed operating guidelines and procedures.

Current Cash Equity Settlement Arrangements

2. What, if any, are the existing barriers to entry for a competing SSF in Australia?
   For example, are settlement services contestable without the additional provision of ancillary services?
   Are there other factors or particular market features that increase barriers to entry for a competing SSF?

In its purest and simplest form, the settlement of cash market trades can be considered a utility function, delivering finality to an executed trade.

As the second largest cash equity listing exchange, or Approved Market Licensee (AML), NSX is forced to use a number of ancillary products and services within ASX's infrastructure due to the way the cash equities market has evolved over time. Many of these ancillary services occur upstream and downstream from the core settlement function. But as settlement is the glue that binds listed companies with their issued securities and shareholders, all of these ancillary functions are interdependent with settlement, and importantly, the asset registration function through the CHESS and Issuer-sponsored sub-registers, and the investor administration function – predominantly through the CHESS Holder Identification Numbers (HINs) but also the Security Registration Number (SRNs) maintained by the share registry.

The vertical structure of ASX was borne from the merger of the state-based exchanges. ASX cemented this merger with two pieces of critical technology-based market infrastructure. Firstly with electronic trading system SEATS which replaced the open-outcry forum with a screen-based unbiased form of trading in 1987. This was followed in the mid-1990s with CHESS, which initially dematerialised ('digitised' in today's terms) the shareholder register from certificates. This was followed with the introduction of Delivery versus Payment (DvP) Settlement as we know it today. The delivery of both these pieces of core market infrastructure were 'world firsts'. These were delivered at a time when ASX was a mutual entity, driven to unify Australia's securities markets with a 'National Market, National Interest' catchcry being a justifiable motive in the prevailing environment. Under a single vertical market comprising of listing, trading, clearing and settlement, ASX systems were coupled together with interfaces or files of data being transferred to allow ASX departments to operate efficiently, and to provide the best outcomes to market users and customers of a mutual ASX.

The abovementioned context is important as this has now evolved into a monopoly range of ancillary services provided by ASX to AMLs, resulting in barriers to competition in an overall sense to AMLs today - trying to compete with ASX on a level playing field across listing, trading and post-trade functions. The interdependence of these AML ancillary functions with settlement means that, in a truly competitive landscape with multiple SSFs, these functions should not be provided as a monopoly service by one AML that also owns an SSF.

The diagram below demonstrates the interdependence of these ancillary services provided to NSX by ASX today.

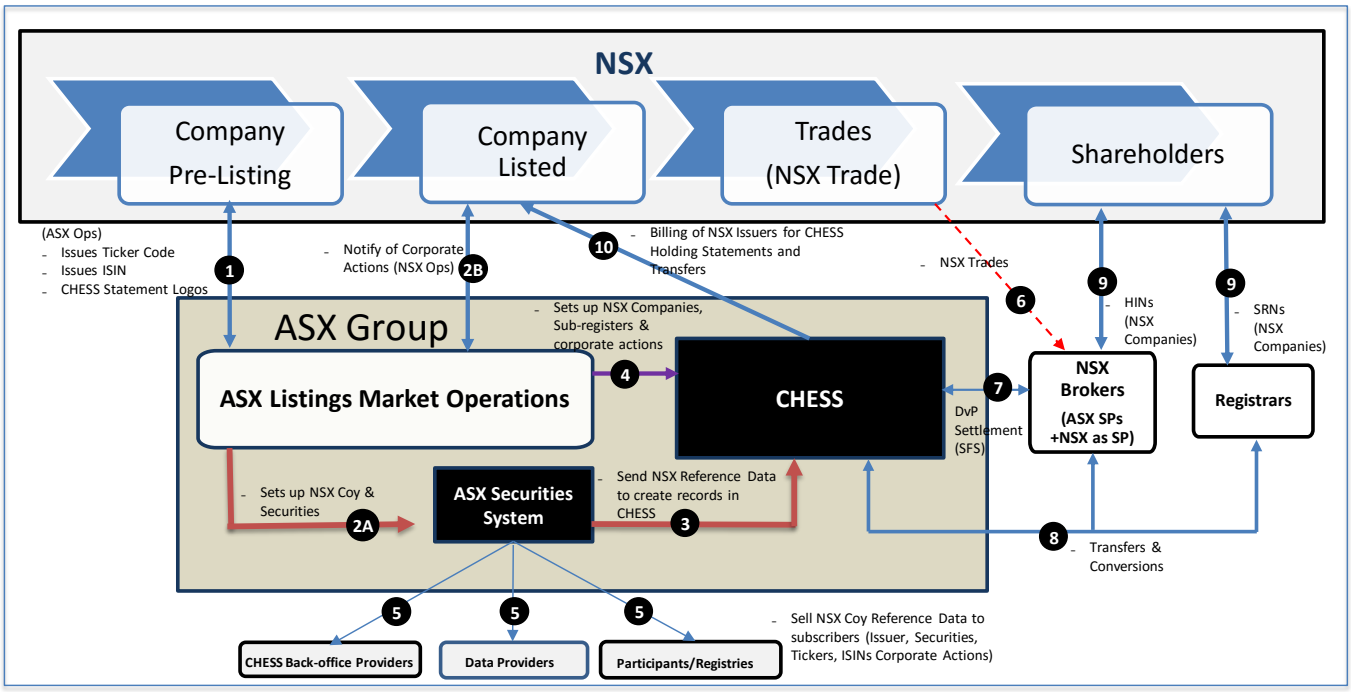

Diagram 1: NSX's Dependencies on ASX Market Infrastructure

Diagram 1 Description

1. As part of the set-up of a new NSX company for settlement through CHESS, NSX emails a request to ASX Operations to reserve an issuer ticker code and ISIN. This may take more than a single attempt if the original ticker code has been reserved by ASX for one of its own issuers (or by another AML).

2. Upon successful application of a code and an ISIN, the logo of the NSX issuer is also sent to ASX to set up the CHESS Statements. Through this process, ASX receives an early insight into upcoming NSX listings and establishes a commercial relationship with the issuer through the ticker, ISIN and logo set-up process for future billing. Further a deed poll is required to be signed by the Issuer and given to ASX stating, among other things, that the Issuer will abide by ASX Settlement rules at all times.

2A ASX Operations then sends the NSX company and securities' information to set-up the company details in the central ASX Securities System.

2B This step is to show that once an NSX company has been established, NSX sends corporate action details that get announced at any time in the future to ASX Operations.

3. The NSX issuer and securities' attributes are sent from the ASX Securities System to CHESS to create these records.

4. ASX Operations then create the sub-registers for the NSX securities in CHESS so that the securities can settle. Any corporate action details that subsequently occur are also created for the NSX securities to ensure that settlement carries the appropriate attributes (e.g. cum and ex periods).

5. ASX then on sells the NSX securities reference data along with ASX securities to subscribers through its Reference Point product.

6. Trades relating to NSX securities are reported to NSX Brokers who must also be ASX Settlement Participants. Where this is not the case, NSX (as an ASX Settlement Participant) acts as a settlement agent on their behalf.

7. NSX is a subscriber to ASX's Settlement Facilitation Service (SFS), (paying monopoly rents) which allows NSX's trades to settle DvP by counterparties matching CHESS ('101') messages.

8. Transfers and conversions relating to NSX securities are then actioned through CHESS messages between the participants, CHESS and the registrars.
9. NSX shareholder HINs are maintained by the NSX brokers and SRNs are maintained by the registrars.

10. ASX then sends monthly invoices directly to the NSX issuers for CHESS holding statements, transfers and conversions and the use of the CHESS Primary Market Facility (not shown in diagram) for any DvP capital raisings each month. This allows ASX to maintain an ongoing commercial relationship with NSX issuers, in many cases causing confusion with these issuers.

3. What, if any, are the existing barriers to competition in the provision of ancillary services?
How would competition in settlement impact upon the provision of ancillary services?
For example, would you expect this to increase the prospect of competition in ancillary services?

Further to our response to the previous question, as an AML, NSX is of the opinion that all the current ancillary services provided should not be exclusively provided by one AML who also owns an SSF to service the entire market. These include:

- allocation of ticker codes and ISINs;
- holding statement set-up;
- central set-up of issuer records and security codes;
- creation of sub-registers;
- collation and sale of all reference data; and
- collation and sale of all corporate actions data

Solution Considerations

Ideally, each AML or a central single utility would be responsible for establishing these details and sending the required information to each SSF. This would reduce the barriers to entry and provide consistency as all SSFs would be receiving the information they require to set-up records from each AML (or the central utility) simultaneously and in the same (agreed) standard format.

The other key ancillary services that create current barriers to entry for SSFs in particular centre on the access rights to the CHESS and Issuer-sponsored sub-registers (asset register), holder records covering HINs and SRNs (investor administration). These are co-dependent as you can't have one without the other. ASX has control rights over CHESS, i.e. the CHESS sub-register and HINs. Although (sponsoring) settlement participants have rights over HINs, ASX Operations as 'master administrator' has overarching rights to both investor administration (HINs) and the CHESS sub-register (asset administration) functions. Similarly, registrars have sole access to Issuer-sponsored sub-registers and holder records (SRNs).

To compete on equal terms, each SSF should have equal accessibility to the CHESS and Issuer-sponsored sub-registers, HINs and SRNs.

Australia's current name-on-register structure is arguably the envy of other foreign markets due to the transparency of ownership and the buy-in it has created with investors to their assets directly. It has laid the foundation for one of the highest direct (per capita) share ownership markets in the world which has been boosted by superannuation and the internet through online broking.

It positions Australia to meet more onerous global and local compliance reporting requirements such as FATCA, Common Reporting Standards and the ATO's trade data capture requirements. Furthermore, as innovative solutions continue to emerge through the Fintech community, end investors will continue to benefit from better, cheaper and faster offerings. As such, NSX is a firm supporter of maintaining the name-on-register structure.

Solution Suggestions

In an ideal scenario, there would be a single Universal Register supporting both retail (name-on register) ownership and institutional ownership through a nominee structure, but with more 'look through' to levels of underlying ownership to promote more transparency to issuers of their shareholder base. This would incorporate open, equal access to SSFs through a standards-based rule framework with more choice for investors and issuers to access their information.

However, fundamental to this model is its independence - the management of the Universal Register in a competitive environment should not be owned and operated by a single SSF or a AML that owns an SSF as is currently the case with the CHESS sub-register.

Key principles this should embody are:

- Accessibility equally by SSFs as well as access by participants, registrars and investors;
- Interoperability between SSFs;
- Reciprocity by SSFs, AMLs and CCPs for consensus on sharing of information, e.g. Participant status; and
- Controls through a standards-based rule framework encompassing the previously listed principles above.

4. Would the entry of a competing SSF have an impact on Australia's electronic sub-register system (i.e. the broker-sponsored and issuer-sponsored model)?

As per our response to Question 3, NSX does believe that there would be an impact on the electronic sub-register system. The core sub-register function of asset registration and maintenance is tied with accurate up-to-date registration and maintenance of investor administration (HINs and SRNs), which makes them interdependent with the settlement process as it functions today.

Competition in Settlement

- Without competition in clearing

5. Do you agree with the risks highlighted in the discussion of this model?
   What other risks, related to links or otherwise, or to the broader efficiency, stability or functioning of the Australian cash equities market, could arise from the model of competition in settlement described in Figure 2?

Yes. NSX agrees with the risks highlighted.

NSX believes it must be the AML who makes the decision on the rules for its market and which SSF(s) it approves to settle its trades. For example, if NSX decides its whole market will settle T+0 and not all SSFs can meet this standard, NSX will choose the one(s) that can. Assuming more than one SSF has been approved, then it would be up to the settlement participants to determine which SSF it settles with.

Importantly, the cost/benefit/risk/efficiency of fragmenting a single settlement across two SSFs needs to be modelled and understood. The complexity of 'bridging' securities between SSFs and the impact on failed settlements with corporate action entitlements, increased margining and ready access to securities lending facilities may outweigh any reductions in participants' settlement fees. Participants may have more to say on this point.

As noted consistently through our response, NSX is supportive of competition in settlement services even where, for the reasons outlined above, both sides of a trade must settle through the same SSF. This competition will still allow SSFs to compete on costs and importantly on innovation which will continually improve and evolve the market.

6. How would the risks change with different settlement timing and/or methods in the two SSFs?
   For example, consider situations in which both SSFs settle on a gross trade-by-trade basis (DvP Model 1), or in independent batches (DvP Model 3), or if the SSFs use different settlement methods.

- Where both SSFs settle on a gross trade-by-trade basis, if this was in 'real-time' then there will no time to allow for the movement of securities between SSFs to prime for settlement where legs of trades are split between SSFs. In a real-time scenario, the need for a CCP is diminished.
- If this was to occur at certain times during the day, these settlement times would need to be consistent between SFFs with agreed protocols to allow for a window to move securities across the bridge.
- This would be the same situation under a DvP Model 3 scenario with independent batches by SSFs, i.e. the batch times would need to be the same with agreed windows to move securities prior to each batch run.

- Where different settlement methods are used, securities lending arrangements and securities locking facilities may need to be in place to ensure they are not sold more than once as outlined in the paper, but the cost/benefit needs to be understood.

- Where not all trades are cleared

7. What do you see as the risks, related to links or otherwise, or to the broader efficiency, stability or functioning of the Australian cash equities market, that could arise from the model of competition in settlement described in Figure 3?

There are no knock-on risks or interoperability considerations under this model. It appears to be the most straight forward model to facilitate competition. As stated in our response to Question 5, NSX believes AMLs should choose which SSFs it selects to settle trades for its own market through a service agreement.

8. How would the risks change with different settlement timing/methods in the two SSFs? For example, consider situations in which both SSFs settle on a gross trade-by-trade basis (DvP Model 1), or in independent batches (DvP Model 3), or if the SSFs use different settlement methods.

There is no change in risk as there is no crossover of securities between the two SSFs. Participants will however need to be able to operationally deal with the nuances of both SSFs.

9. Should central clearing of all trades executed on an anonymous basis be mandatory – regardless of where they trade – or should central clearing be optional? That is, should all AML holders be required to link to at least one CCP? Does your response change depending on the settlement method or timing of each of the SSFs?

NSX does not support Mandatory CCP Clearing as it would be a gross over-engineering of its market structure with no foreseeable benefits for its market in the short to medium term.

As the settlement cycle continues to reduce, eventually to T+0, the role and value-add of CCPs will diminish. This may be supported by further innovation and other developments. For example, the introduction of the National Payments Platform (NPP) may allow for overlay services to enable a self-clearing network between the banks on behalf of their (settlement participant) clients.

Currently, the shareholders of NSX's listed companies are mainly retail, who generally are ready and able to settle T+0 now and obtain no real benefit from extended settlement even today. As such, retail investors presently pay for T+2 settlement.

Competition in clearing and settlement

10. What (if any) are the additional risks in a market in which there is competition in clearing as well as settlement, including to the broader efficiency, stability or functioning of the Australian cash equities market? To what extent are these risks addressed by the Minimum Conditions (Clearing)?

There should be no additional market risk. Technically, clearing is a more straightforward function as there is no need for a physical movement of assets and cash like settlement. Exposure, margining and risk assessments of participants and securities are generally based on modelling scenarios or historic patterns.

The real risks and complexity in clearing lies with default management and the robustness of technical solutions where a default scenario plays out. As noted in the consultation paper, the management of this risk may result in additional ongoing costs such as margining, having securities lending facilities in place and interoperability between CCPs and SSFs to manage settlement fails and defaults.

As stated in our response to Question 9, NSX is strongly against any Minimum Condition for Mandatory Clearing in our market for the reasons stated, including the natural contraction of the settlement cycle which will eventually remove clearing risk all together.

Solution Considerations

Perhaps a consideration is to have a 'AML Market Threshold' before a mandatory CCP clearing requirement kicks in. For example, this could consider trade value and volumes, liquidity of the market and the value of settlements and failed trade statistics. Given the current size of our market, NSX does not expect to reach such a threshold in the mid term.

11. What kind of safeguards in the settlement process would be necessary to minimise financial interdependencies between competing CCPs in the settlement process?
    For example, do you think that interoperating CCPs should be required to settle trades between themselves as quickly as possible? If so, what would be required to allow this to happen?

Settlement default insurance taken out by SSFs may be an option to reduce the financial interdependencies between CCPs. But this may result in higher costs being passed on to Participants.

NSX does not understand the example, as technically CCPs would not be settling any trades. As such NSX would like to clarify this question further with CFR.

12. In each of the three market structures described, at what point do you consider it most likely that the choice of SSF would be made (e.g. at the AML level or by the trading participant)?

As stated in our response to Question 5, NSX believes that the choice of SSF(s) should rest with the AML. The AML is responsible for running its market and would assess each SSF on its suitability to settle its listed securities.

Where an AML has multiple SSFs in place, the Settlement Participants would decide which SSF they want to settle through.

13. Are there other models of competition in settlement, or adaptations of the described models, that the Agencies should consider?
    If so, what are the risks to safe and effective competition in (clearing and) settlement and what kinds of safeguards could be put in place to mitigate them?

CFR should investigate how TARGET2 Securities (T2S) works in Europe to determine whether there are any synergies with interoperability they have achieved, how it manages interdependencies between SSFs and mitigates risks across jurisdictions which may possibly be helpful in this assessment.

Implications for Market Efficiency and Financial Stability

Listed market functioning

14. Would the emergence of a competing SSF, providing differing settlement timeframe(s) and/or settlement models, potentially impact:

    a) price formation, liquidity and fragmentation in the trading of securities settled in this way; and/or
    b) listed entities' obligations regarding the way they conduct corporate actions?

    Please elaborate on your answer.

(a) If a trading security has different settlement time tables, it is unclear at which point this is 'advertised'. Assuming you negotiate the settlement timeframe after it has traded, you would be unaware at trade execution so it shouldn't impact price formation, liquidity and fragmentation in the trading of securities.

However, if the settlement details are advertised pre-trade, then it is more likely that they may be factored into price discovery and formation and impact liquidity possibly fragment trading.

Therefore, if settlement differences are being considered, it would appear to make more sense that these details are 'negotiated' post execution of the trade.

Solution Considerations

Given the potential complexity of splitting legs of a trade to settle across multiple SSFs, it may be that the selling broker, acting for the holder of the securities nominates the settlement SSF which the buyer must accept. A 'flag' next to the Selling Broker on the trading platform could indicate this. Once the trade is executed, the Selling Broker could nominate different settlement options for the trade with the default being the standard settlement regime that applies e.g.T+2.

(b) Regarding corporate actions, assuming that the default settlement date, e.g. T+2 criteria is maintained for ex-periods, record dates, etc then there shouldn't be any impact, as any earlier settlement would still follow the default criteria.

Under a T+0 scenario, corporate actions are simplified with the possible removal of an ex-period with the record date aligning with the trade date.

Solution Considerations

The same issue as is currently the case applies where settlements fail due to securities shortfalls and need to be rescheduled. The current CHESS functionality where the entitlement to the buyer is 'diary adjusted' as part of the settlement calculation should be maintained as a minimum but with possible improvements to remove any need for manual follow up of claims from the buyer against the seller.

Controls for Safe and Effective Competition

Adequate regulatory arrangements

15. Do you agree with the analysis of the regulatory arrangement described in 6.1, and that this is necessary to ensure fair and effective competition in the settlement of cash equities in Australia?
    If not, please explain why not and if you consider there to be other issues, please also include these in your answer.

Yes, NSX believes that these arrangements are absolutely necessary.

ASIC as the issuer of C&S Facility Licences to CCPs and SSFs, along with RBA for financial stability oversight has monitoring and reporting powers over them (like what happens now with ASX Clear and ASX Settlement) which could perhaps be enhanced under a competitive landscape.

AMLs do not have any control over the viability of SSFs but perhaps can provide 'service level and service breach' reporting and a scorecard against the AMLs market rules to the Regulators to assist with their monitoring and oversight – similar to the capital adequacy for AFSL/market participants.

16. Would there be a need for coordination of default management arrangements across competing SSFs in the event of a participant default?
    Who should be responsible for such arrangements?

Yes, NSX believes that these arrangements are absolutely necessary.

Technically, the CCP is the first point of call for trade default, but this does not extend to unrelated positions held in client accounts which, in the case of the BBY default allowed the appointed Administrator to freeze all client HIN assets. This should be addressed in the context of a competitive environment – especially to protect unrelated holdings of retail investors.

Solution Considerations

Further to our response to Question15, NSX believes that ASIC and RBA should have a more active role – especially on the rule framework around the cooperation and coordination requirements between competing SSFs in general, but especially around default management. Arguably, there should be more accountability on the SSFs themselves – perhaps as Central Settlement Counterparties as the value of CCPs potentially diminishes with the evolution to a T+0 settlement cycle and possibly self-clearing as per the NPP example stated in our response to Question 9.

Access on fair, transparent and non-discriminatory terms

17. Do you agree with the scope of the access considerations described in 6.2?
    If not, please explain why not and if you consider there to be other issues, please also include these in your answer.

Yes, NSX believes that these arrangements are absolutely necessary.

As a current user of ASX's monopoly infrastructure, encompassing the ancillary services outlined in our response to Questions 2-4, NSX is also the largest user of ASX's DvP Settlement Facilitation Service (SFS). For this, NSX pays monopoly rents to ASX Settlement. It is unclear whether ASX Ltd as an AML pays similar monopoly rents to ASX Settlement.

NSX is of the opinion that access on fair, transparent and non-discriminatory terms should not be left in the hands of ASX to introduce and administer. This should be supported by a clear internal transfer-pricing model where ASX can transparently and on non-discriminatory terms demonstrate the fairness of its pricing as it applies to itself (as an AML user) and other users

of all its monopoly services (i.e. including ancillary services). Furthermore, these prices should be regulated to ensure ongoing fairness to external users.

Appropriate links between competing SSFs

18. Do you agree that the controls and safeguards described above, in combination with the Minimum Conditions (Clearing), are adequate to mitigate the risks that may emerge with competition in settlement, and to ensure such competition is safe and effective?

    a) If not, please describe any additional controls or safeguards that you believe are necessary and explain why?

    b) Are any of the proposed controls unnecessary? If so, please explain.

(a) Yes - NSX agrees with the controls and safeguards.
(b) Yes - NSX reiterates its strong view that a Minimum Condition which imposes Mandatory Clearing on its market is a grossly unnecessary requirement with no apparent benefit to its market. As we have suggested in our response to Question 9 and 10 a possible consideration is a threshold where a Minimum Condition may kick-in for Mandatory Clearing. Given our current market size, NSX would not expect to reach such a threshold in the mid term, which can only improve with the removal of competitive barriers.

19. Do you agree that securities should be able to be moved between competing SSFs (e.g. via a link or a bridge between the SSFs, or possibly at the registry level) or do you envisage other ways for efficient settlement to be achieved?

NSX is a firm supporter of competition in settlement. In simple terms, this can be achieved by the model presented in Figure 3 of the consultation paper which could deliver some benefits simply from the presence of an alternative provider.

Solution Considerations

NSX agrees that should a model emerge similar to the one presented in Figure 2 or, from NSX's perspective a hybrid of this model, where AML 2 could use either SSF but by bypassing the CCP as NSX's market does not meet a Minimum Condition Threshold.

NSX believes that it should be the decision of the AML to determine which SSF(s) it has an agreement with to settle trades for its market. That is, the AML determines whether or not the SSF is a suitable service provider to the exchange, stipulates the rules for settlement and engages the SSF(s) to provide the service and allowing the participants the choice of SSFs to then settle their trades.