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Mr Tim Grimwade
General Manager
Mergers and Asset Sales Branch
Australian Competition and Consumer Commission
PO Box 1199
Dickson ACT 2602

Dear Mr Grimwade

PROPOSED MERGER BETWEEN ASX AND SFE

Thank you for the opportunity to comment on the proposed merger between ASX and SFE. Our comments focus on the roles of their central counterparties and securities settlement systems for which we have responsibilities under the *Corporations Act 2001*.

Efficiency Issues

It is generally accepted that operations of central counterparties and settlement systems are characterised by high fixed costs and low marginal transaction costs. As such, there can be efficiency benefits from horizontal integration.

Currently Australian markets are serviced by two central counterparties and two securities settlement systems – one of each operated by ASX and SFE, respectively. These systems are costly to establish, requiring sophisticated IT, communications and risk management systems, reliable back-up arrangements and links to payment systems. The resource costs of operating duplicate systems are relatively high. Costs are also increased for any participants that need to use systems operated by both organisations. They may need to pay two sets of membership fees, adhere to two different sets of rules and membership requirements, connect to different networks and accommodate differing messaging requirements.

In addition to reducing the costs of duplication, consolidation of central counterparty and securities settlement activities would permit netting of obligations that would not be possible for participants operating in the two separate systems. This additional netting could reduce risk and reduce the liquidity costs of participants operating in both systems. Similarly, consolidated systems would simplify the pledging of collateral relative to separate systems.

The search for these efficiencies has led to consolidation of central counterparties and securities settlement systems overseas, both within countries and across borders. These same motivations lay behind the decision by the Reserve Bank to transfer its securities settlement system for Commonwealth Government securities to Austraclear in 2002. We would expect the proposed merger to provide similar opportunities for efficiency gains.

The central counterparties and securities settlement systems operated by the ASX and the SFE all comply with the Bank's Financial Stability Standards. Should the merger proceed and the new entity move to consolidate these facilities, we would work closely with it to ensure that the resulting facilities continue to meet the Standards.

Competition issues.

Despite the easing of restrictions on the activities of the ASX and SFE in 2001 there is only limited competition between them on the basis of central counterparty or securities settlement services. This reflects the fact that central counterparty and securities settlement system operated by ASX largely clear and settle securities and derivatives trades related to equities and the ASX market, while the SFE's systems clear and settle SFE derivatives trades and settle OTC debt trades. The only instances where the ASX and SFE facilities clear and settle similar products is where their markets offer similar products (equity index derivatives and individual share futures/LEPOs). However, when these instruments are traded on the ASX they are cleared using ASX's central counterparty and similarly for the SFE.

Over time, overseas central counterparties and securities settlement systems, some of which operate on a scale much larger than is possible in the Australian market alone, are the most likely sources of competition to any Australian central counterparty or securities settlement system.

Yours sincerely

John Veale
Head of Payments Policy Department