

COMMERCE COMMISSION

DECISION NO 274

Determination pursuant to the Commerce Act 1986 in the matter of an application for authorisation of a restrictive trade practice made by Sydney Futures Exchange Ltd; Sydney Futures Exchange Clearing House Pty Ltd and NZ Futures & Options Exchange Ltd.

**THE COMMISSION:** A E Bollard (Chairman)  
P C Allport  
T G Stapleton

**SUMMARY OF ARRANGEMENT:** In Decision No 271 the Commission authorised certain By-Laws of the Sydney Futures Exchange Clearing House Pty Ltd (SFECH) which:

- set criteria for admission to clearing membership of the SFECH;
- require trades of dealers on the NZ Futures & Options Exchange Ltd who are not clearing members of the SFECH to be cleared through and guaranteed by a SFECH member; and
- provide for disciplinary action against SFECH members.

The authorisation was for a period to 31 October 1995. The parties now seek a further authorisation to continue to give effect to the By-Laws after that date.

The By-Laws are the same as those covered by the current authorisation except that under By-Law 8.2(a) clearing members will be required to have net tangible assets (NTA) of A\$5m. The current NTA requirement is A\$2m. The increased NTA requirement would take effect from 30 September 1995.

**DETERMINATION:** Pursuant to ss 58, 61(6) and 61(7) of the Commerce Act 1986 the Commission determines to grant an authorisation to the arrangements.

**DATE OF DETERMINATION:** 31 July 1995

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A THE APPLICATION

1 Sydney Futures Exchange Ltd (SFE), Sydney Futures Exchange Clearing House Pty Ltd (SFECH) and the NZ Futures & Options Exchange Ltd (NZFOE), collectively called "the applicant", have applied for authorisation, under ss 58(1), 58(2), 58(5) and/or 58(6) of the Commerce Act 1986 (the Act), of arrangements embodied in certain By-Laws and business rules of the SFECH as listed below:

- (a) Arrangement 1 - Tied Membership;
- (b) Arrangement 2 - Admission to Membership;
- (c) Arrangement 3 - Net Tangible Asset (NTA) and Net Liquid Asset (NLA) Requirements;
- (d) Arrangement 4 - Contribution to Commitment;
- (e) Arrangement 5 - Clearing Members to Clear Non-Clearing Members' Trades;
- (f) Arrangement 6 - Non-Clearing Members to be Guaranteed by a Clearing Member; and
- (g) Arrangement 7 - Disciplinary Measures.

2 In its Decision No 271 on 21 December 1993, the Commission authorised these arrangements for the period to 31 October 1995. An application for a further authorisation effective after that date was lodged on 14 March 1995. Before the application was determined it was withdrawn as SFECH was considering a confidential proposal to increase the minimum NTA requirement (arrangement 3).

- 3 The applicant now seeks authorisation for the same arrangements as before except that, as from 30 September 1995, a clearing member will be required to have NTA of A\$5m compared to A\$2m at present.

B COMMISSION PROCEDURES

- 4 The application was registered on 12 June 1995. In accordance with s 60(2)(c), notice of the application was given to 27 persons as listed in Appendix 1. In accordance with s 60(2)(d), the Commission gave public notice of the application on 17 June 1995 in the New Zealand Herald, the Dominion, the Evening Post, The Press and the Otago Daily Times.
- 5 No person notified an interest in response to the public notice and no submissions were made by persons who had been notified of the application. The Commission obtained information and comments from dealers, the NZ Securities Commission, the Department of Justice, the Trade Practices Commission (TPC) and the applicant.
- 6 A draft determination was issued in terms of s 62 on 11 July 1995. No submissions were received on the draft determination and no person has requested that a conference be held. The Commission has determined not to hold a conference on its own motion.
- 7 The Chairman of the Commission's Division, Dr A E Bollard, advised in the draft determination that his wife, Ms Jenny Morel, is a Board member of Trust Bank NZ Ltd (TBNZ). TBNZ is a public broker on the NZFOE but is not a clearing member of the SFECH. The Commission sought views on whether this relationship was seen as a possible conflict of interest in respect of the application. Neither the applicant nor any other interested party has raised any concerns about that possible conflict.

## C BACKGROUND

### **Futures Contracts**

- 8 Complete details on the operation and structure of the futures market were discussed in Decision No 271.
- 9 In brief, a futures contract is similar to a forward contract whereby parties agree on the sale and purchase of a specified commodity, for delivery at a specified future time, at a fixed price. However, for a futures contract there is no delivery of the product. The parties settle on the basis of the difference between the agreed price and the actual market price at the time.
- 10 Other features of futures contracts are that:
- for a particular product all the contracts have identical specifications except for price;
  - they are traded through an exchange; and
  - there is no ongoing contractual relationship between the parties after the deal is made.
- 11 There are three types of activities in which persons may participate on the futures market:
- hedging, which involves persons who are in the physical market for a commodity and use futures to insure against price movements;
  - speculating, which involves persons who seek profits by picking price movements; and

- arbitraging, which involves persons who trade in the physical and futures markets to profit from the price differences between them.
- 12 Speculators and arbitrageurs provide liquidity for hedgers and enable the market to operate efficiently. Speculators also provide an efficient means of predicting future price movements.

### **Options**

- 13 An option is a right acquired for a price to buy (call option) or to sell (put option), a commodity or a right (including a futures contract), at a fixed price at a specified future time.

### **Futures and Options Exchange**

- 14 This provides the mechanism for entering into contracts on futures and options. Members of the exchange may trade on their own account and/or execute orders in their own names on behalf of clients.

### **The Clearing House**

- 15 An integral part of the exchange is the clearing function. Each contract between two dealers is registered with the clearing house. It is then replaced by the clearing house entering into back-to-back contracts with each dealer. Only dealers who are clearing members may register contracts with the clearing house. Others must allocate the contract to a clearing member for registration.
- 16 Neither party to the contract then needs to look to the other for performance under the original contract. That responsibility has been taken over by the clearing house. Payment is guaranteed if either party defaults on its obligations.

- 17 The clearing member is required to lodge a deposit (about 5% of the value of each contract) with the clearing house. As prices vary, the clearing house will call daily margins to cover unrealised losses against each futures contract, ie the amount the party to the contract would lose if it were settled immediately. Conversely, the clearing house pays daily credits for unrealised gains.
- 18 A clearing house can be one of two different types:
- an independent clearing house owned by persons not dealing on the exchange who provide funds to guarantee performance; and
  - a mutually guaranteed clearing house where clearing members dealing on the exchange provide funds to guarantee performance.

#### **Sydney Futures Exchange Ltd (SFE)**

- 19 SFE has operated a futures exchange since 1960. This is currently the only active futures exchange in Australia.

#### **Sydney Futures Exchange Clearing House Pty Ltd (SFECH)**

- 20 Until 1991 the SFE used the London Clearing House (LCH) to clear its market. The LCH is an independent clearing house owned by a consortium of London banks. The SFE then established its own mutually guaranteed clearing house, SFECH, to clear its market in 1991.
- 21 The SFECH has a financial commitment of A\$100m to guarantee the market comprising the capital of the SFECH (A\$10m), insurance (currently A\$24m) and contributions by clearing members (currently a total of A\$66m). Each member contributes a fixed sum of A\$1m and a variable sum based on market share in terms of exposure to the SFECH.

**NZ Futures & Options Exchange Ltd (NZFOE)**

- 22 NZFOE operates the only futures and options exchange in New Zealand. Only members of the NZFOE may operate on the exchange. Products traded on the exchange are listed in Appendix 2.
- 23 NZFOE was established in 1985 as a company owned by its members. In 1992, SFE acquired all the shares in NZFOE and its members are now known as dealers. The Commission had given prior clearance to the acquisition (ref: AUT/BA-A3/2).
- 24 The exchange operates completely on a computer system known as the Automated Trading System (ATS). Members of the NZFOE work from their offices with ready access to their own financial analysis and reporting systems, access to clients by telephone, and are able to watch bids and contracts, and to transact contracts, on an ATS screen. They can enter buy or sell bids on the screen, and when a match (same price) occurs on either side, a contract is automatically struck.
- 25 NZFOE plans to fully integrate its system with an improved SFECH computer trading system in October 1995.

**Dealers on the NZFOE**

- 26 Only those dealers with a trading permit may enter into trades directly on the exchange. Other persons must deal through permit holders. There are three classes of dealers:

(1) Public Brokers who:

- may deal in futures contracts on their own account and/or on behalf of other persons;
- may accept and hold client funds; and
- may be a Trading Permit Holder.

(2) Introducing Brokers who:

- may deal in futures contracts on their own account and/or on behalf of other persons;
- cannot accept and hold client funds; and
- cannot hold a trading permit.

(3) Principal Traders who:

- may deal in futures contracts on their own account;
- may hold a trading permit; and
- if they do, they may deal in futures contracts on behalf of public brokers or principal traders on a give up basis, but must not accept or hold client funds on behalf of any such person.  
[NB: give up means the trade is immediately allocated to that other party].

27 There are currently 20 New Zealand based dealers on the NZFOE comprising:

|  |   |
|--|---|
| Public brokers/trading permit holders/clearing members | 1 |
| Public brokers/trading permit holders                  | 9 |
| Principal traders/trading permit holders               | 3 |
| Principal traders without trading permits              | 3 |
| Introducing brokers                                    | 4 |

28 Since Decision No. 271, a number of the members of the SFE have also become dealers on the NZFOE. They trade from Sydney on the computerised system. There are currently 25 such members comprising:

|  |    |
|--|----|
| Public brokers/trading permit holders/clearing members | 12 |
| Public brokers/clearing members                        | 6  |
| Public brokers/trading permit holders                  | 7  |

29 Full details of the membership of the NZFOE are set out in Appendix 3. A diagram illustrating the relationship between the exchange, the clearing house and dealers is at Appendix 4.

#### **Clearing of the NZFOE**

30 Prior to 28 February 1994, the NZFOE market was cleared by the LCH. All dealers except introducing brokers on the NZFOE were clearing members.

31 In 1993 the LCH advised that it intended to withdraw from clearing the NZFOE. It was then agreed by SFE and NZFOE that SFECH would clear the market from early 1994. The SFECH Rules and By-Laws would then take effect in New Zealand.

**Commission Decision No 271**

32 Accordingly, authorisation was sought for certain of the By-Laws and this was granted in Decision No 271 on 21 December 1993. The authorisation was for the period to 31 October 1995 (to coincide with an existing TPC authorisation, and thus minimise compliance costs) and was granted on condition that the SFE, the SFECH, and the NZFOE report annually, on 4 November, to the Commission on:

- the application of admission and disciplinary provisions of the By-Laws;
- the extent of sanctions imposed under the By-Laws;
- the operation of the guarantee and clearing system for non-clearing members' trades; and
- changes in volumes of trades by NZFOE dealers.

**Implementation of SFECH Clearing of the NZFOE**

33 SFECH took over the clearing of the NZFOE on 28 February 1994. One New Zealand broker, BT Futures New Zealand Ltd (BTF), has become a clearing member of the SFECH. An associate company of BTF in Australia is also a clearing member. However, BTF chose to become a clearing member in its own right.

34 SFECH clearing membership is only open to SFE members. BTF obtained an associate membership of the SFE by acquiring a redundant membership from another party. The SFE rules allow for new memberships (ie there is no fixed limit to the numbers). However, there are a number of redundant memberships which are available for sale for a nominal fee.

35 Seven other NZFOE members (5 public brokers and 2 principal traders) have associate companies in Australia who are clearing members of the SFE and use these to clear their trades.

36 Eighteen of the Sydney brokers now trading on the NZFOE are also clearing members of SFECH and can clear NZFOE trades.

#### **1994 Report to the Commission**

37 On 28 October 1994, the Commission received a report from the SFE. The report provided information on:

- admission and disciplinary provisions - there had only been one application for membership (BT (New Zealand) Futures Ltd) which was accepted. (Since then another Australian broker has been admitted and an application from another Australian broker is under consideration);
- the extent of sanctions imposed - there were no defaults or sanctions;
- the guaranteeing and clearing of non member trades - all non-clearing members have obtained these services from clearers. There have been no complaints to the NZFOE on the operation of this system; and
- changes in volumes of trades on the NZFOE - trades increased from 673,922 for the year ending 30 September 1993 to 833,716 for the year ending 30 September 1994.

### **Growth in the NZFOE Market**

- 38 The applicant has updated the growth in the NZFOE market by stating that volumes have increased from 674,291 for the year ending 31 December 1993, to 919,182 for the year ending 31 December 1994. This represents a 36.3% increase in trades and reflects, among other things, the introduction of Sydney based traders to the NZFOE's computerised market.

### **Application for Further Authorisation**

- 39 In March 1995 the applicant sought a further authorisation to continue to give effect to the same By-Laws after 31 October 1995 when the current authorisation expires. The Commission issued a draft determination on 13 April 1995 proposing to grant an authorisation after 31 October 1995 with no time limit.
- 40 On 4 May 1995 SFECH advised the Commission that it was considering increasing the minimum NTA level required in order to be a clearing member. At that stage the proposal was confidential and the amount of the increase (if any) was not specified. The Commission was unable to seek the views of interested parties. Accordingly, the application was withdrawn.

## **D STATUTORY CONTROLS**

### **Securities Commission**

- 41 Prior to 1988, the New Zealand futures market was not controlled other than by self-regulation by the NZFOE through its Rules. Part III of the Securities Amendment Act 1988 established a broad regime for supervision by the Securities Commission, with day-to-day regulation by the NZFOE. The 1988 Act provides that:

- dealing (buying or selling on behalf of other persons) in futures contracts by any person who is not a member of an authorised exchange or has not been declared by the Securities Commission to be an authorised dealer is prohibited;
- the Securities Commission may declare a body corporate that conducts, or proposes to conduct, a market or exchange in New Zealand for trading in futures contracts to be an authorised exchange; and
- the Governor-General may make regulations on the recommendation of the Securities Commission for:
  - (a) regulating the business and operations of an exchange and its dealers; and
  - (b) setting requirements relating to the receipt and handling of clients' funds.

42 Very detailed regulations have been promulgated in respect of handling clients' funds, because of the impact on third party rights.

#### **Securities Commission Authorisation**

- 43 The only authorised exchange is the NZFOE. The authorisation is conditional on:
- the NZFOE Rules and changes to the Rules being subject to approval by the Securities Commission; and
  - the Securities Commission being consulted when disciplinary powers are invoked.

44 Those conditions also require the NZFOE to consult with the Securities Commission on any proposed changes in its clearing arrangements. These currently are embodied in the SFECH By-Laws. The Securities Commission approved the SFECH Rules and By-Laws in 1993. There was no time limit on this.

45 The Securities Commission has been consulted on the proposed increase in the NTA requirements for clearing membership and has endorsed the increase as contributing to greater integrity and stability of the market.

#### **Sharebrokers Act 1908**

46 The Sharebrokers Act 1908 requires stock exchanges to be registered with the Secretary of Justice and sharebrokers to be licensed. When the NZFOE started trading in share options in December 1990, it and its members arguably became subject to these requirements. This meant that the NZFOE was subject to the supervision of both the Securities Commission and the Department of Justice. The Sharebrokers Amendment Act 1994 removed the supervision over the NZFOE by the Department of Justice.

#### **E TRADE PRACTICES COMMISSION (TPC) DETERMINATIONS**

47 The TPC has made two earlier determinations in respect of the same SFECH By-Laws for which authorisation is currently sought.

#### **Determination Dated 30 October 1991**

48 The TPC concluded that the arrangements would yield sufficient public benefit to outweigh any anti-competitive detriments resulting from the conduct, and that there were adequate safeguards against the potential anti-competitive effects. The arrangements were authorised for a four year period (to

31 October 1995), subject to the SFE and SFECH reporting annually to the TPC on the matters specified in paragraph 32 above.

#### **Determination Dated 4 November 1993**

- 49 This determination followed the proposal of the SFECH to increase the variable component of the clearing member commitment to its A\$100m guarantee fund, in anticipation of a decrease in insurance cover. The TPC considered this to be a material change of circumstances. On 4 November 1993 the TPC revoked the earlier authorisation and granted an amended authorisation with the same conditions as before.

#### **Current Application**

- 50 The TPC authorisation expires on 31 October 1995. The SFE and SFECH have applied for a further authorisation for the same arrangements with an amended NTA requirement. The TPC is currently considering several applications for authorisation.

#### **F THE MARKETS**

- 51 The SFECH By-Laws regulate the provision of clearing services. These services are provided to dealers and are essential for the efficient functioning of the futures market. A dealer must be able to have contracts registered with SFECH either directly by being a clearing member, or by using the services of a clearing member. Accordingly the markets relevant to this application are for the provision of:

- clearing services; and
- broking services on the exchange.

G THE ARRANGEMENTS FOR WHICH AUTHORISATION IS SOUGHT

52 Authorisation is sought for seven specific arrangements embodied in the SFECH By-Laws which would, or might, substantially lessen competition (s 27), or be exclusionary (s 29). The Commission can only consider granting authorisation to those arrangements. Other arrangements in the By-Laws remain at risk of action if they substantially lessen competition, or are exclusionary. The arrangements for which authorisation is sought are set out below.

**Arrangement 1 - Tied Membership**

53 An applicant for clearing membership of the SFECH must be a current or prospective floor member or associate member of the SFE and, in particular, a clearing member shall not be entitled to clear trades made on the NZFOE unless it is an NZFOE dealer (By-Laws 3.2 and 4.1).

**Arrangement 2 - Admission to Membership**

54 Applicants for clearing membership of the SFECH must meet criteria set out in By-Law 4.4(a)-(h), relating to standing, character, and integrity; having managerial, operational and financial arrangements in place to meet ongoing obligations (including the ability to make an immediate transfer of funds); satisfying legal requirements to operate as a clearer; and being otherwise a "fit and proper person". A corporate applicant must be incorporated in Australia or registered there as a foreign company. Having considered those criteria, the SFECH Board has an absolute discretion as to whether to admit the applicant to membership.

### **Arrangement 3 - Net Tangible Asset (NTA) and Net Liquid Asset (NLA) Requirements**

55 The Board of SFECH may from time to time prescribe the minimum level of net tangible assets of each clearing member. The current minimum NTA level is A\$2m (By-Law 8.1). The Board has resolved, under By-Law 8.2(a), from 30 September 1995, to provide for a minimum NTA requirement of A\$5m. Authorisation is sought for that increase.

56 The Board may also prescribe the amount of net liquid assets to be held by each clearing member (By-Law 8.2(b)). At present no NLA amount is prescribed.

57 A clearing member's right to clear trades may be automatically suspended without right of appeal if it is in breach of the NTA requirement (By-Law 10.3(b)).

### **Arrangement 4 - Contribution to Commitment**

58 Clearing members are required to contribute to the financial commitment of the clearing house to guarantee the market (By-Law 5.1). Each member must provide a minimum fixed contribution of A\$1m to support the obligations of the SFECH and a variable contribution based on the clearing member's share of open positions, or aggregate initial margins, or such other similar basis as the Board may determine (By-Law 5.6).

59 Members are required to contribute a total of A\$60-90m (By-Law 5.6). The actual amount depends on the level of insurance available on acceptable terms and is adjusted accordingly, by changing the variable contributions by members. At present SFECH has financial backing of A\$100m comprising:

|                                   | \$Am      |
|-----------------------------------|-----------|
| Capital of SFECH                  | 10        |
| Insurance                         | 24        |
| Contributions by Clearing Members |           |
| Fixed (29 members at A\$1m each)  | 29        |
| Variable                          | <u>37</u> |
|                                   | <u>66</u> |
|                                   | 100       |

- 60 In the event of a call on the member contributions to cover a default, the Board may require members to make a further contribution “ in such amount as [it] believes necessary to provide continuing financial support to the financial obligations of the clearing house” (By-Law 7.6).

**Arrangement 5 - Clearing Members to Clear Non-Clearing Members' Trades**

- 61 Trading permit holders on the NZFOE who are not clearing members must have their trades ultimately registered with the SFECH by a clearing member (By-Law 31.1).

**Arrangement 6 - Non-Clearing Members to be Guaranteed by a Clearing Member**

- 62 Dealers on the NZFOE who are not clearing members must be guaranteed by a clearing member who is also a NZFOE dealer (By-Law 31.1).

### **Arrangement 7 - Disciplinary Measures**

63 A clearing member may be fined or have its membership of the SFECH suspended or terminated if it:

- has been found guilty of any breach of the By-Laws or futures legislation (including the Securities Amendment Act 1988);
- has notified the Board of a substantial change in control and the change has not been approved;
- has failed to notify a change in control;
- no longer meets admission requirements; or
- is in default (By-Law 10.1).

### **H APPLICATION OF THE ACT**

#### **Existing Arrangement Under Section 59 of the Act**

64 Section 59 prohibits the Commission from granting authorisation to a contract, arrangement or understanding that has been entered into before the Commission makes a determination in respect of the application for that authorisation, unless (pursuant to s 35) the contract, arrangement or understanding is conditional on authorisation.

65 Decision No 271 authorised the parties to enter into and give effect to certain By-Laws of SFECH. The authorisation was granted subject to the condition, pursuant to s 61(2), that it had force and effect until 31 October 1995.

66 The parties have, by making the application, indicated that they wish to enter into an arrangement whereby they give continue to give effect to the By-Laws from 1 November 1995 and give effect to an amended NTA requirement under By-Law 8.2(a) as from 30 September 1995. The new arrangement is an agreement to enter into and give effect to the By-Laws at, and from, those dates. That agreement has been notified to the Commission. The Commission is of the view that the current application is for authorisation of the new arrangement.

### **Authorisation Process**

67 Any person who wishes to enter into, and give effect to, a contract, arrangement or understanding which that person considers would, or might, substantially lessen competition (in contravention of s 27), or constitute an exclusionary provision (in contravention of s 29), may apply for an authorisation to do so.

68 In terms of an arrangement considered under s 27 of the Act, for the Commission to grant an authorisation there must be:

- a lessening of competition, which need not be substantial; and
- if there is a lessening, there must be sufficient public benefit to outweigh that lessening, such that the arrangement should be permitted.

69 In terms of an arrangement considered under s 29 of the Act, the Commission may grant an authorisation if it is satisfied that:

- there is an exclusionary provision; and

- there is such public benefit that, in all the circumstances, it should be permitted.

#### **Initial Assessment Under s 27 of the Act**

- 70 The SFECH By-Laws are arrangements or understandings between the SFECH and all its members. Arrangements 2, 3, 4 and 7 might lessen competition. Arrangements whereby market incumbents determine entry conditions at the least might have that effect.

#### **Initial Assessment Under s 29 of the Act**

- 71 Arrangements 1, 5 and 6 might be exclusionary. The effect of these provisions is that a non-clearing member NZFOE dealer is only able to clear through a SFECH clearer, who must also be a SFE and a NZFOE member.
- 72 Is this exclusionary in terms of s 29? The arrangements involve persons of whom any two or more are in competition with each other, ie SFECH clearers who compete on the clearing services market and some also who compete on the broking market. The terms of s 29(1)(a) are met.
- 73 The provisions exclude a dealer acquiring clearing services from any person who is not a SFE and a NZFOE member. Is that a particular person or class of person as required by s 29(1)(b)? Some clearers may chose to specialise in clearing only and so do not have a need to become a member of the SFE and the NZFOE. There is no incentive for them to do so. Exchange membership has placed greater surveillance and control over activities than SFECH membership alone.
- 74 Such a person is, or would be, but for the relevant provisions, in competition with at least one of the parties to the arrangement (ss 29(1)(a) and 29(2)).

75 There is sufficient to conclude that arrangements 1, 5 and 6 may involve exclusionary provisions.

## I ANALYSIS OF THE ARRANGEMENTS

### **Arrangements 2 and 7 - Admission and Discipline**

76 Arrangements 2 and 7 have been considered together as both relate to restrictions of membership.

77 By-Laws 4.4 and 10 set out criteria for admission to, and retention of, clearing membership of the SFECH. After considering a number of specified criteria, the SFECH Board retains an absolute discretion to refuse admission (By-Law 4.4 (a)-(h)). The applicant acknowledges that this may be anti-competitive, but submits that this is overcome by:

- the wide representation on the SFECH Board including independent members (Article 5.7 of the SFECH Articles of Association); and
- a right of appeal to an independent tribunal, as a safeguard against arbitrary or capricious use of that discretion.

78 Aside from the absolute discretion, specified criteria in 4.4 (a)-(h) must be met to the satisfaction of the SFECH Board. Some are matters of fact, but others, e.g. good character (4.4(c)) and “otherwise a fit and proper person” (4.4(g)), are matters of subjective judgement.

79 Article 57 of the SFECH Articles provides for no more than eight directors comprising:

- two members of the SFE Board (at least one of whom is a member of the SFE Board elected by floor members of the SFE) appointed by the Board;
- two elected by clearing members of the SFECH;
- two independent directors appointed by the Boards of the SFE (57(3)) and the SFECH (57(7));
- the Chief Executive of the SFE; and
- the Managing Director of the SFECH.

80 The SFECH By-Law 12 provides that for appeals the Board shall appoint an independent person or persons as an Appeal Tribunal to review the decision. The SFECH has advised that it is subject to the supervision of the Australian Securities Commission (ASC) under the Corporations Act. It is acknowledged that the ASC is not responsible for competition issues. However, the ASC would be in a position to object if the choice of the Appeal Tribunal was clearly not objective. The ASC could not order the Board to change its decision but could be very persuasive. The Board would be most unwise to ignore objections of the ASC. Further, an appellant has the right to seek a review in the Courts, and ASC objections would assist that.

81 The SFECH has also submitted that it reserves the absolute discretion to refuse membership because, having regard to the risk that each member bears, the Board's powers should be expressed in the widest possible terms.

82 In Decision No 231 (re NZ Stock Exchange Rules), the Commission considered ethical rules and stated at paragraph 63 that:

“taking into account the existence and enforcement of these restrictive rules in the past, the very generally worded rule on ethical conduct reinforces the impression that members must conform to an undefined standard of behaviour. Such a vague ground for penalising a member is likely to be anti-competitive.”

83 The SFECH By-Law 10 provides for fines, suspension or termination of clearing membership if the Board is:

“of the opinion that a Clearing Member ... has ceased to satisfy the conditions for admission ... including any conditions imposed by the Board.”

84 In considering By-Law 10, the Commission remains of the view that it is a characteristic of codes of conduct that the text is often broadly worded so as to cover a multitude of behavioural situations which could not be foreseen by the code's author(s) and for which specific provisions could not be written. Such broadly-worded provisions are unlikely to be anti-competitive in themselves, but it depends on the application of them. Any lessening of competition or competitive detriment can arise in the following ways:

- there may be a deterrent effect as market participants may be unwilling to develop strategies or approaches for fear of infringing an oppressive provision; and
- there is no certainty as to how the provision will be interpreted and applied.

#### **Arrangements 3 and 4 - Financial Requirements**

85 Arrangements 3 and 4 are considered together as both relate to the financial requirements for clearing members of SFECH. Each member currently must make a fixed plus variable contribution to the financial backing of SFECH and have net tangible assets (excluding the contribution to SFECH) of at least A\$2m. The NTA minimum is to be raised to A\$5m, an increase of 150%.

- 86 Total contributions by members under By-Law 5.6 remain at A\$60-90m (depending on the level of insurance available). Currently members contribute A\$66m including variable contributions totalling A\$37m. Individual members contribute A\$1m (fixed) plus a variable amount of less than A\$0.5m up to about A\$4m depending on their level of exposure to SFECH.
- 87 The applicant acknowledges that the contribution (A\$1.5-5m) together with the NTA minimum of A\$5m may deter some corporations from becoming clearing members and that, consequently, these financial requirements might lessen competition.
- 88 The SFECH also submits that:
- the financial commitment should be provided by all members and “if an applicant cannot meet this requirement then there are strong prudential arguments in favour of denying it membership”. This is to provide the financial and asset backing commensurate with the risks and funds in the industry;
  - the majority of associate members of the SFE are either themselves, or are associated with, organisations of considerable financial backing. It is unlikely the commitment would act as a deterrent to applicants;
  - by maintaining a minimum commitment of A\$1m and requiring any additional commitment to be in proportion to a clearing member’s share of cleared business, any anti-competitive effect is limited by requiring the financial obligations to be spread in accordance with each member’s open position. The variable commitment falls more heavily on larger members and prevents them growing at the expense of smaller members; and

- the arrangements are not designed to create barriers to entry for entities which may consider becoming a clearing member.

- 89 The NTA minimum is to be raised from A\$2m to A\$5m. The applicant submits that inflation since the original NTA minimum was set in 1991 justifies an increase of A\$2.2m, and growth in market size justifies an increase of \$A2.85m. These figures relate to the SFE market. In the New Zealand context inflation has been much lower and market growth has been around 40% since the Commission authorised a minimum of A\$2m in the existing By-Law in late 1993.
- 90 It is also noted that the increase impacts more heavily on small members. The financial requirements have increased from A\$3.5-7m (contribution plus NTA) to A\$6.5-10m.
- 91 The applicant also submits that the new minimum NTA requirement of A\$5m would be consistent with requirements of other clearing houses internationally. It has provided details of these requirements. In general, independent clearing houses have much higher minimum NTA levels. Mutually guaranteed clearing houses like SFECH have minimum NTA requirements of A\$2-5m.
- 92 While some existing members of the SFECH would not currently meet the new minimum of A\$5m, SFECH says they are able to do so. Most members either have considerable financial resources or have parent or associate companies that do. The latter can readily increase capitalisation if required and SFECH says they are prepared to do so in this case.
- 93 In the New Zealand context, the majority of the public brokers and principal traders have, or are subsidiaries or associates of companies which have, very substantial financial resources. (Introducing brokers do not trade on the NZFOE and have no need for clearing services).

94 The applicant also submits that since the inception of SFECH in 1991 that:

“... (there) has been a general trend for client clearing business away from the less capitalised Members. This recognises the fact that the Clearing House guarantee extends directly only to its Members and therefore clients retain a credit exposure to their Clearing Member in the event of default or insolvency by that Member.”

“The combination of the trend in client clearing business away from the more lowly capitalised Members and the existence of our valuable risk management tool the capital based position limit has resulted in several Members increasing their capitalisation.”

(NB: A clearing member may not take total positions with initial margin liability in excess of 300% of its NTA; refer By-Law 9.1(b) and Additional Prescription 3. Authorisation is not sought for that requirement.)

95 Several clearing members have transferred their clearing business to their parent companies which have a much higher capitalisation. Others have increased their capitalisation to accommodate an increased level of business.

96 Comments from New Zealand based NZFOE dealers generally support the view that entities with very low capitalisation would not be credible in the market for clearing services. Most local dealers (or their associated companies) have financial resources well in excess of the contribution to SFECH plus the proposed A\$5m NTA minimum. Those dealers account for a high proportion of trading on the NZFOE. They either clear through associated companies or other very substantial clearers who offer very competitive service and fees. The large dealers would be very unlikely to use a small clearer for those services.

97 The financial requirements may prevent or deter some small entities from becoming clearing members and clearing their own trades. It may also prevent

them from endeavouring to establish a market presence, albeit limited, in providing clearing services to other parties. Figures provided in confidence indicate that smaller entities can establish a modest presence in the Australian market. However, the SFE market, with 120 dealers including 29 clearing members is less concentrated than the NZFOE market.

- 98 The applicant also notes that there have been no instances of a potential clearing member being denied entry because of the financial requirements to contribute to the SFECH backing and to meet the NTA minimum. Further, no member has resigned for that reason.
- 99 The number of SFE members who were clearers on the LCH dropped from 120 to 25 when the SFE switched from the LCH to SFECH in 1991. Since then five new clearing members have been admitted (including one New Zealand dealer) and one has resigned for reasons unrelated to the financial requirements.
- 100 Since Decision No 271 in December 1993, the number of New Zealand based NZFOE clearers has reduced from 18 to one clearer only. The sole New Zealand based clearer is currently BTF, who is referred to at paragraph 33. This reduction is a consequence of:
- three resignations from the exchange by principal traders and one by a public broker all for reasons unrelated to financial requirements for clearing;
  - seven members have associate companies in Australia who are clearing members and choose to clear through them;

- other members could meet the criteria but have chosen to clear through other members. They choose not to be involved in the clearing function; and
- previously all dealers were obliged to be clearers on the LCH although they did not contribute to the guarantee. The owners of the LCH did that.

- 101 In the same time, 18 Australian based clearers have joined NZFOE and can clear NZFOE trades. There are thus 19 entities now offering a clearing service for NZFOE dealers.
- 102 It is acknowledged that some NZFOE members have associate companies already in the SFE and the SFECH and see no point in committing extra funds to become clearing members. Others who could meet the requirements similarly were not interested in joining. They see no cost disadvantage in using another party to clear their trades and no point in guaranteeing other people's risks. The choice is between paying clearers' fees, or becoming a member and incurring the opportunity cost and risk of contributing funds to the SFECH guarantee. The latter cost reflects a collective decision of the SFECH clearing members. This might lessen competition.
- 103 Comment was sought from local NZFOE dealers. In general they were not concerned about the substantially increased NTA limit. Several, including large entities not affected by the new limit, said it was or could be restrictive and prevent or deter entry by small operators. It was suggested that new small entrants may be able to offer innovative service and/or competitive fees. Other market comment included:
- the market was competitive in terms of price and service. It was not expected that there would be any significant reduction in the number of clearers sufficient to raise concerns about the level of competition in

the short term, although a further substantial increase in the NTA limit may raise concerns; and

- the A\$5m was reasonable and commensurate with the nature of the market and, in particular, the clearing and guarantee role of the clearers.

- 104 The potentially anti-competitive nature of the financial requirements is reinforced by the discretions contained in By-Law 8.2 which permit the SFECH Board to prescribe financial requirements relating to the minimum level of each clearing member's NTA and the amount of NLA to be held by each clearing member.
- 105 A substantial increase in the NTA minimum in real terms may have a significant effect on the market. All SFECH members either exceed the A\$5m minimum or are prepared to do so. However, there are some who could not meet a minimum NTA limit that was substantially increased beyond \$5m. They may, in some cases, have parent or associate companies who could provide more capital. The issue then would be whether they see the requirement as reasonable. They may chose to exit the clearing market rather than commit more funds to their dealing/broking entity.
- 106 While the Commission accepts the need for By-Laws 8.2(a) and (b), it draws attention to the provisions of s 65 of the Act. If any exercise of the discretions contained in By-Laws 8.2(a) and (b) resulted in a material change of circumstances, then the Commission may consider exercising the powers contained in that section. This issue is discussed further below in paragraphs 158-165.
- 107 There are also discretionary powers in By-Law 7.6. In the event of a call on members contributions to cover a default, the Board may require such further contributions as it believes necessary to support the obligations of SFECH.

The purpose is clearly to enable SFECH to continue to meet its obligations. SFECH has advised that this provision enables it to meet its immediate obligations in the event of a default and to reinstate but not increase the ongoing level of financial contributions. That would require amendment to By-Law 5.6.

### *Conclusion*

- 108 The financial requirements lessen competition but to enter and compete effectively on the market for clearing services an entity would need substantial resources in any event. The requirements may deter or prevent smaller entities from clearing their own trades or establishing a small presence in the clearing services market. The discretion to increase the NTA or impose an NLA requirement enhances any anti-competitive effect.

### **Arrangements 1, 5 and 6 - Tied Membership**

- 109 Arrangements 1, 5 and 6 are considered together as all relate to the requirement that a SFECH clearing member must also be a SFE and a NZFOE member. This is exclusionary to the extent that a clearer must belong to the exchanges.

### *Arrangement 1*

- 110 By-Laws 3.2 and 4.1 require that a SFECH clearing member who is clearing the NZFOE market must be a member of the SFE and the NZFOE. That has the effect of preventing a person who is not a member of both exchanges offering clearing services to NZFOE members.
- 111 It is suggested, for the confidence of the market, that a dealer must have trades executed and cleared through clearing members of good standing. Control is exercised through membership of the SFE and the NZFOE. This affects

competition in that a non-member of both exchanges is excluded from providing clearing services.

*Arrangement 5*

- 112 This arrangement means that an NZFOE dealer who is unable to meet clearing membership requirements is excluded from being able to clear, other than through another party who is an actual or potential competitor. To do so a dealer has to disclose its business and positions to that competitor.
- 113 The TPC considered this point in its 1991 Determination granting authorisation for the SFECH's By-Laws. The TPC stated that, while there is potential for detriment in the conduct, that detriment is minimised by the sanctions embodied in the By-Laws and the ability of non-clearing members to use prudent management practices in choosing clearing members from whom they will acquire clearing services.
- 114 The Commission, after considering the conduct of this arrangement since December 1993 (when it issued Decision No 271), concurs with the TPC view.

*Arrangement 6*

- 115 Arrangement 6 has the same effect as arrangement 5 in that it excludes a NZFOE dealer who is not a clearing member of the SFECH from having trades guaranteed other than through a SFECH clearing member.
- 116 It is impractical for the trade not to be cleared. It is one of the features of a futures contract that two parties can enter into a contract and, through the clearing mechanism, not have to subsequently look to the other for performance.

117 While the clearing member has the potential to breach the confidence of a trade provided by a non-clearing member, there will be a sufficiently wide selection of clearing members of the SFECH through whom trades can be cleared. A dealer may spread trades among several clearers.

118 The Commission is of the view that arrangements 1, 5 and 6 contain exclusionary provisions, in that dealers are prevented from having trades cleared or guaranteed other than through a SFECH clearing member.

## J PUBLIC BENEFIT

### Introduction

119 In assessing public benefit for the purpose of the tests set out in ss 61(6) and 61(7), the Commission is required to consider the public benefit flowing from each provision of the contract, arrangement or understanding.

120 The public benefits claimed by the applicant are virtually identical to those contained in the application of October 1993, which led to the existing authorisation.

121 This section considers the public benefits of each arrangement for which authorisation is sought. The Commission is not aware of any factors which should cause it to assess these benefits less favourably now than in 1993.

### Arrangements 2 and 7 - Admission and Discipline

122 The applicant links the criteria and discretion in relation to admission to the need to maintain confidence and the continuing ability to mutually guarantee one another's activities. Any applicant for membership rejected by the SFECH Board has a right of appeal to an independent Appeal Tribunal which considers the same criteria for admission as the SFECH Board.

- 123 The applicant argues that any opportunity to impose the membership criteria in an anti-competitive manner is offset by the wide representation on the SFECH Board and the right of appeal to the independent Appeal Tribunal. The Commission considers that the stability and integrity of the market which this practice would bring about is a public benefit, and is of sufficient significance to outweigh any lessening of competition.
- 124 Where a clearing member can no longer meet the financial requirements or other criteria, it is in the interests of other clearing members, the market and clients, that appropriate penalties may be imposed immediately on that member.
- 125 The Commission accepts that there are public benefits arising from the provisions relating to admission and discipline, and that there are sufficient safeguards in place to protect individual clearing members and provide for the integrity of the market. The power for the SFECH to impose effective sanctions is balanced by adequate rights of appeal. Since the By-Laws were authorised in December 1993 there has been no indication that they have been used in a manner which would unreasonably restrict competition.

### **Arrangement 3 - NTA and NLA Requirements**

- 126 The SFECH submits the primary object in setting a minimum NTA level is to:
- ensure clearing members both have, and are perceived to have, sufficient strength to continue operating, even in the event of having to meet their obligations when another member defaults;
  - ensure market security by allowing only those with sufficient financial strength to operate as clearing members; and

- reinforce the mutuality concept of the SFECH in ensuring all its clearing members have a vested interest in the operations of the clearing house and other members.

#### *Improved Financial Backing*

- 127 The SFECH cites one benefit of a mutual clearing house as being that dealers are guaranteed on the same day, compared to an independent clearing house where the guarantee is not effective until the next day.
- 128 The Commission accepts that, by clearing contracts on the same day, dealers are not subject to the same degree of risk if contracts were cleared on the following day. As a result of clearing on the same day, the clearing house accepts that risk, before the margins are paid. In effect, the NTA requirement supports the financial backing and risk of the clearing house.

#### *Financial Standing of Clearing Members*

- 129 The financial probity of clearing members is essential to the confidence and integrity of the mutual financial backing, and the SFECH submits that the NTA requirement is reasonable and prudent for the futures industry in Australasia and provides a strong public benefit.
- 130 As the clearing member is participating in guaranteeing the market, not simply trading in it, there is risk, and potential for abuse, in the futures market.

#### *Comment*

- 131 The Commission accepts that the public benefit arising from the NTA requirement is that the financial standing of clearing members ensures confidence in the security and stability of the market. Comments from dealers and the Securities Commission support this view. This, in turn, flows through

other clearing members and brokers to the public generally. There have been no suggestions that public confidence in the security and stability of the market has been other than high since the authorisation in December 1993.

- 132 Equally there is public benefit in the discretions in By-Law 8.2 to increase the NTA requirement and to impose an NLA requirement as appropriate. However, the Commission cannot determine whether any proposed exercise of either discretion has public benefit without that proposed exercise being scrutinised under the Commerce Act.

#### **Arrangement 4 - Contribution to Commitment**

- 133 Clearing members are required to provide a contribution to the financial commitment which backs the SFECH guarantee. This comprises a fixed component of A\$1m plus a variable component (based on the clearing member's exposure to the clearing house).
- 134 SFECH submits that:
- the mutual financial backing is an incentive to clearing members to be actively concerned with the management policies of the SFECH and creates the circumstances for all members to comply with these for the common good; and
  - the minimum A\$1m fixed commitment (irrespective of a clearing member's size) provides an assured commitment to the clearing house and an interest in seeing that the house and all its members act in a prudential manner.
- 135 The applicant claims that the arrangements allow the SFECH Board flexibility to choose between insurance and members' variable commitments, according

to the state of the credit reinsurance market, and that this enhances confidence in the strength of the clearing house.

- 136 The Commission agrees that there are substantial public benefits for the same reasons as stated in paragraph 131. The fixed amount of A\$1m does not appear onerous given the nature of the market. The Commission considers that the experience since the December 1993 authorisation has confirmed this.
- 137 It also accepts that there are substantial public benefits in By-Law 7.6 enabling SFECH to require further contributions if member contributions are called on (in full or part) to cover a default situation.

#### **Arrangement 1 - Tied Membership**

##### *Responsibilities of Ensuring an Orderly and Fair Market*

- 138 The SFECH states that "it is a well recognised principle of international futures exchanges that persons registering contracts in their own name on an exchange should also be a Member of that exchange". ... The basis "is that in order for an exchange to control its markets, it must have jurisdiction over all persons in whose names are registered on that market".
- 139 The SFECH argues that, otherwise, it is possible for a clearing member who is not an exchange member to be in a position to influence or manipulate the market. Unless a clearing member is subject to exchange control, the exchange cannot direct that a clearing member's position be reduced, or to disclose the beneficial holders of the interest (ie the clients who are the principals behind the contracts). The public benefit of this requirement is in ensuring the integrity of the market.
- 140 The Commission agrees that there is a significant public benefit in a system of self-regulation for the supervision of persons clearing an exchange. The

Commission is not aware of any problems with the system since the December 1993 authorisation.

- 141 The only persons affected by the membership tie are those who would seek to provide a clearing service and avoid the dual supervision of the SFECH and the NZFOE.

*Entrance Requirements of the SFE and the NZFOE*

- 142 The SFECH submits that the tie helps to “ensure that clearing members have the necessary expertise in the futures industry and are involved in that industry on an ongoing basis”. That assumes even greater importance when the clearing house is mutually guaranteed. The Commission accepts that the public benefit of this is the stability of the exchange through sound commercial practice and this has continued to be demonstrated.

**Arrangements 5 and 6 - Non Clearing Members to be Guaranteed by and to have Trades Cleared by Clearing Members of SFECH**

- 143 These provisions are considered jointly. If a clearing member guarantees a non-clearing member, it agrees to accept and clear all trades allocated to, but not accepted by, other clearers, and all trades allocated directly to it. The guarantor provides an automatic assurance of clearing any trade of the non-clearing member. The Commission accepts as a public benefit that all contracts are guaranteed and this has resulted in continued confidence in the NZFOE.

*Development of Specialist Clearers*

- 144 The SFECH submits that it encourages professional clearers to offer specialist clearing services. Many trading permit holders on the NZFOE decline to clear

themselves because of the benefits offered by specialist clearers. The benefits are claimed to be:

- better quality clearing services;
- ancillary benefits developed by specialist clearers;
- avoidance of the risk inherent in being a member of the mutual financial backing; and
- allowing one-shop service as regards overseas markets such as Australian derivatives, eg Over the Counter options and the Australian options market.

145 All dealers consulted were satisfied with these services. The Commission accepts the view that the activities of specialist clearers provide public benefit and considers that this has been demonstrated in a period of expansion since December 1993.

*Registration of all Trades Essential to Maintenance of Integrity of the Market*

146 The SFECH submits it is essential for the integrity and the operation of the futures market that each trade be registered with the clearing house. Further, the SFECH claims it is essential that this be through the SFECH otherwise "the other Trading Permit Holders of the Exchange cannot rely on the mutual financial backing of the clearing house and would be forced to have recourse to the credit-worthiness of the counter party to each trade, thus adding to transaction costs and impairing liquidity".

147 The Commission accepts that the maintenance of integrity of the market is a public benefit. The exchange mechanism provides benefits of reduced transaction costs and liquidity. An essential part is that all trades are cleared

through a single clearing house. The integrity of the market has been maintained, under the rules for which authorisation is sought, in a period of expanding turnover.

## K BALANCING

### **Lessening of Competition**

- 148 The Commission shall not grant an authorisation unless it is satisfied that entry into the arrangement lessens competition; that the lessening is outweighed by the public benefit resulting from the arrangement; and that therefore the arrangement should be permitted. This weighing is considered in the following paragraphs.

#### *Arrangements 2 and 7 - Admission and Discipline*

- 149 In respect of arrangements 2 and 7, the Commission finds a lessening of competition in the admission and disciplinary requirements. However, particularly because of the safeguards in these requirements, it also finds public benefits in terms of sound commercial practices and confidence in the market, which are sufficient to outweigh this lessening. The Commission accepts that arrangements 2 and 7 result in such public benefits that they should be permitted.

#### *Arrangements 3 and 4 - Financial Requirements*

- 150 In respect of arrangements 3 and 4, the Commission concludes that the financial requirements result in a lessening of competition. It accepts that such requirements are necessary to ensure confidence and the integrity of the exchange. The Commission considers that the requirements are not onerous, given the volatile nature of the market and market expectations of financial

integrity, and therefore also finds that the stability of the market is a public benefit which outweighs this lessening.

151 However, as discussed at paragraphs 104-106, the discretionary powers in By-Law 8.2 to prescribe NTA and NLA requirements enhance any potentially anti-competitive effects of those requirements. This issue of the application of s 65 to this situation is also discussed below at paragraphs 158-165.

152 There is also a discretionary power in By-Law 7.6 relating to additional contributions if there is a call on member contributions. However, the Commission accepts the need for SFECH to act quickly and restore the financial backing to an appropriate level in such circumstances.

### *Conclusion*

153 The Commission accepts that, in principle, and subject to the discussions at paragraphs 158-165, arrangements 3 and 4 result in public benefits which outweigh any lessening of competition and should be authorised.

### **Exclusionary Provisions**

154 The Commission shall not give an authorisation unless it is satisfied that entering into the arrangement and giving effect to the exclusionary provisions would, or would be likely to, result in such a benefit to the public that this should be permitted. This balancing is undertaken in the following paragraphs.

### *Arrangement 1 - Tied Membership*

155 In respect of arrangement 1, the Commission has found exclusionary provisions exist. It accepts that there is public benefit in maintaining a fair and

orderly market and having clearing members subject to supervision by both the clearing house and the exchange.

*Arrangements 5 and 6 - Non-Clearing Members to be Guaranteed by and have Trades Cleared by Clearing Members of SFECH*

156 In respect of arrangements 5 and 6, clearing members have sufficiently wide options to avoid potential conflicts of interest with competitors, and the detriments to competition are minimal. The Commission accepts that for practical purposes all trades must be registered through a single clearing house and the clearing process provides substantial public benefits in maintaining the efficiencies and integrity of the exchange.

157 The Commission accepts that arrangements 1, 5 and 6 result in such public benefits that they should be permitted.

L BY-LAW 8.2: SECTION 65

158 Section 65(1)(b) of the Act provides that:

“..if at any time after the Commission has granted an authorisation under section 58 of this Act the Commission is satisfied that -

(b) There has been a material change of circumstances since the authorisation was granted;

the Commission may revoke or amend the authorisation or revoke the authorisation and grant an amended authorisation in substitution for it.”

159 In its Decision No 271 the Commission authorised By-Law 8.2 which gives the SFECH Board the discretion to prescribe NTA and NLA requirements. The then requirement was a minimum NTA level of A\$2m (under By-Law 8.1 which was also authorised) and no NLA minimum had been specified.

- 160 In that Decision the Commission took the view that any increase in the NTA level, using the discretion, could be addressed under s 65. If any use of the discretion resulted in a material change in circumstance, the authorisation of By-Laws 8.1 and 8.2 could be revoked. It is noted, that in Decision No 271, the authorisation was for a limited time. In the present case, the Commission intends not to impose a time limit.
- 161 In considering the present application, the Commission has considered the questions, when might a material change of circumstances occur, and what might the Commission wish to do in response to such a change?
- 162 In 1993, market circumstances relating to the availability of insurance cover on acceptable terms led to SFECH changing By-Law 5.6 to increase the contribution by members from A\$45m to A\$60-90m as required. SFECH sought and obtained an amendment (under the equivalent provision to s 65) to the existing authorisation from the TPC.
- 163 SFECH has advised that:
- “we do not seek authorisation beyond the current proposed level of A\$5m. In any event it would have been our intention to seek a further authorisation should the amount significantly increase. We would see it as a matter for the Commission as to whether such a further change is treated as a change of circumstance or the proposed authorisation is specifically limited. In any event we have no objection to the condition that the Commission be notified of any future change.”
- 164 Given the possibility that circumstances in the market might change, and that an increase in the NTA requirement, and/or imposition of the NLA requirement might be necessary, the Commission requires assurance that any such increase and/or imposition would not have an anti-competitive purpose or effect.

165 The Commission proposes to authorise By-Law 8.2, subject to the condition that the applicant notifies the Commission, within 15 working days of any proposal to change the NTA requirement, and/or to impose an NLA requirement. This condition will enable the Commission to consider the proposal.

M CONDITIONS

**Previous Determination**

166 In terms of s 61(2) any authorisation granted pursuant to s 58 may be subject to such conditions, and for such period, as the Commission thinks fit.

167 The current arrangements involved a substantial change in the relationship between dealers and the clearing house. The move to a mutually guaranteed clearing house involved very substantial increases in the financial requirements for membership. In the previous application, the applicant submitted that, with the SFECH guarantee and the increasing links between the SFE and the NZFOE markets, the latter would grow substantially, as the NZFOE moved to its in-house clearing arrangements.

168 So that it might review the conduct of the SFE, the SFECH and the NZFOE, the Commission determined to make an authorisation for those arrangements:

- for a fixed period, from 21 December 1993 until 31 October 1995; and
- requiring the SFE to report annually on developments until 31 October 1995.

**Existing Conditions No Longer Required**

169 From the information provided by the applicant in its annual report and the current application, and from the Commission's own investigation, it is clear that the operation of the arrangements has not raised any substantial concerns.

170 Accordingly, the Commission is of the view that the conditions, relating to annual reporting and the fixed term of the authorisation, as previously made in Decision No 271, in respect of the proposed arrangements for which authorisation is sought by the SFE, the SFECH and the NZFOE, are no longer required.

**New Conditions Imposed**

171 The Commission has determined to authorise the By-Laws and Business Rules of the SFECH, subject to the SFECH notifying the Commission, within 15 working days of entering into any arrangement to, and prior to the implementation of any proposal to:

- change the NTA requirement, and/or
- impose an NLA requirement.

## N DETERMINATION

172 The Commission, pursuant to sections 61(6) and (7) of the Commerce Act 1986, authorises the following By-Laws of the Sydney Futures Exchange Clearing House Pty Ltd:

Clearing By-Law 4.4 (a)-(h)

(Arrangement 2 - Admission to Membership);

Clearing By-Law 10.1

(Arrangement 7 - Disciplinary Measures);

Clearing By-Laws 4.4 (a), 8.1 and 8.2 (a) and (b)

(Arrangement 3 - Net Tangible Asset and Net Liquid Asset Requirements);

Clearing By-Laws 5.1, 5.6 and 7.6

(Arrangement 4 - Contribution to Commitment);

Clearing By-Laws 3.2 and 4.1

(Arrangement 1 - Tied Membership);

Clearing By-Law 31.1

(Arrangement 5 - Clearing Members to Clear Non-clearing Member's Trades); and

Clearing By-Law 31.1

(Arrangement 6 - Non-Clearing Member to be guaranteed by a Clearing Member, who is also a NZFOE dealer).

173 This authorisation shall come into effect on 30 September 1995 and, accordingly, the authorisation granted in Decision No 271 is revoked from that date.

Dated at Wellington this 31<sup>st</sup> day of July 1995.

The seal of the Commerce Commission was affixed hereto in the presence of:



*A E Bollard*

Dr A E Bollard  
Chairman

## Appendix 1

In accordance with s 60(2)(c) notice of the application was given to:

### **New Zealand based NZFOE Members**

AMP Investments (NZ) Ltd  
ANZ Banking Group (NZ) Ltd  
Bank of New Zealand Ltd  
BT Futures New Zealand Ltd  
Mr Weston Bell  
Buttle Wilson Futures Ltd  
Citibank NA  
Clark Wycherley Investments Ltd  
CS First Boston NZ Futures Ltd  
Egden Wignall & Co Futures Ltd  
Electricity Corporation of New Zealand  
Fixed Interest Brokers (NZ) Ltd  
Holroyd Capital Management Ltd  
New Zealand Dairy Board  
Ord Minnett Jardine Fleming Futures NZ Ltd  
Strategic Futures & Options Ltd  
The Hong Kong & Shanghai Banking Corporation Ltd  
The National Bank of New Zealand  
Trust Bank New Zealand Ltd  
Westpac Banking Corporation

### **Other Persons**

The Insurance Council of New Zealand Inc  
NZ Bankers Association  
Department of Justice  
Investment Funds Association of New Zealand Inc  
Securities Commission  
Australian Trade Practices Commission  
Fay Richwhite Futures Ltd (ex-Member of NZFOE)

## Appendix 2

### PRODUCTS TRADED ON THE NZFOE

#### **Futures and Options on Futures**

90 Day Bank Bills

NZ 3 Year Government Stock

NZ 10 Year Government Stock

#### **Futures and Options on the Index**

NZSE-10 Share Index

#### **Futures**

US Dollar

NZ Wool

#### **Share Options**

Brierley Investments Ltd

Carter Holt Harvey Ltd

Fletcher Challenge Ltd Ordinary Division

Fletcher Challenge Ltd Forestry Division

Goodman Fielder Ltd

Lion Nathan Ltd

Telecom Corporation Ltd of NZ Ltd

## Appendix 3

### NEW ZEALAND DEALERS ON THE NZFOE

#### **Public Brokers/Trading Permit Holders/Clearing Members**

BT Futures New Zealand Ltd

#### **Public Brokers/Trading Permit Holders**

ANZ Banking Group (NZ) Ltd

Bank of New Zealand Ltd

Buttle Wilson Futures Ltd

CS First Boston NZ Futures Ltd

Egden Wignall & Co Futures Ltd

Fixed Interest Brokers (NZ) Ltd

Ord Minnett Jardine Fleming Futures NZ Ltd

The National Bank of New Zealand

Trust Bank New Zealand Ltd

#### **Principal Brokers/Trading Permit Holders**

Citibank NA

The Hong Kong and Shanghai Banking Corporation Ltd

Westpac Banking Corporation

#### **Principal Traders Without Trading Permits**

AMP Investments (NZ) Ltd

Electricity Corporation of New Zealand Ltd

New Zealand Dairy Board

#### **Introducing Brokers**

Mr Weston Bell

Clark Wycherley Investments Ltd

Holroyd Capital Management Ltd

Strategic Futures & Options Ltd

**AUSTRALIAN DEALERS ON NZFOE****Public Brokers/Trading Permit Holders/Clearing Members**

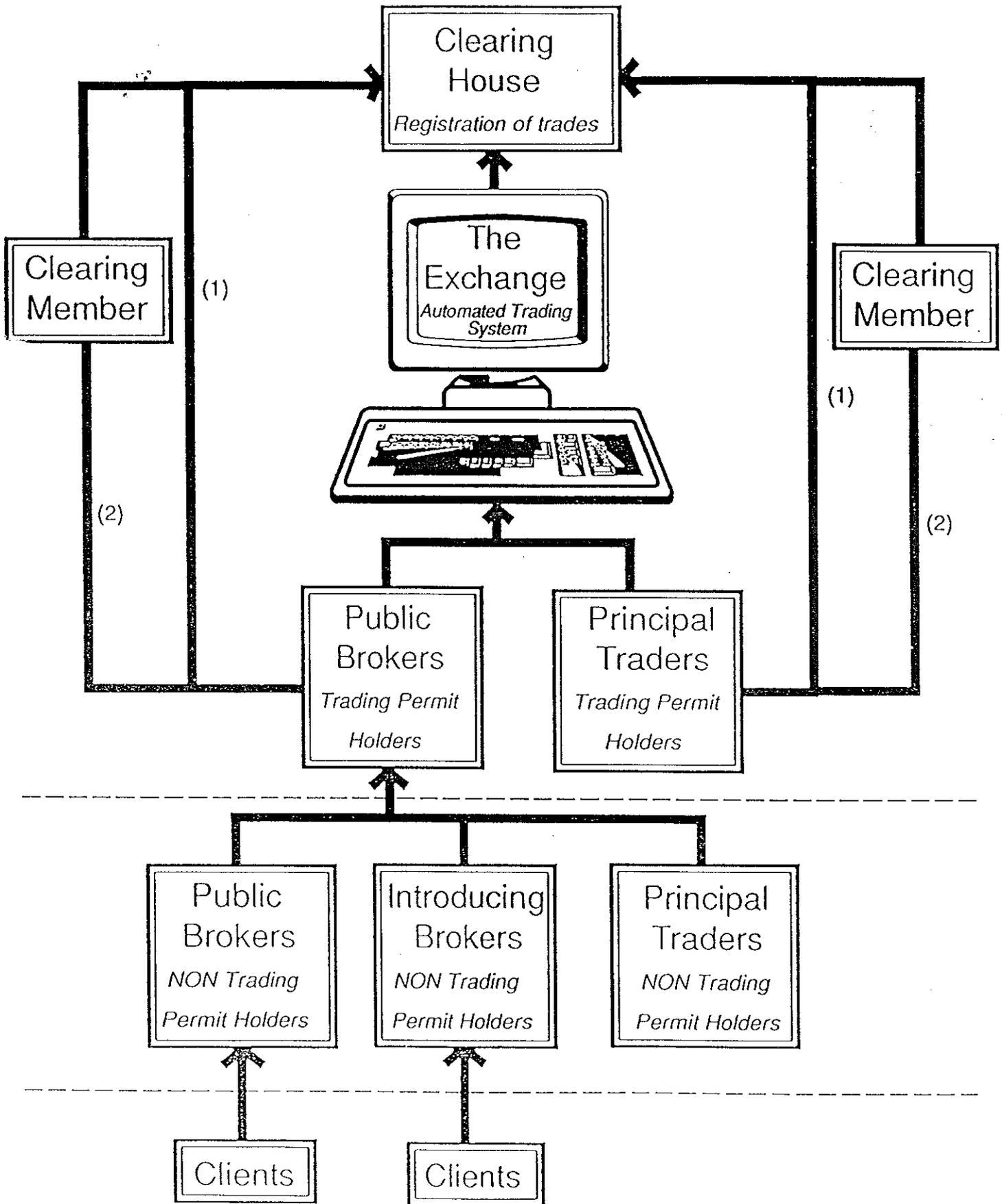
Australian Gilt Futures Ltd  
Barclays Bank plc  
Bankers Trust Australia Ltd  
Commonwealth Bank of Australia  
CS First Boston Australian Securities Ltd  
FIMAT Australia Pty Ltd  
McIntosh Futures Ltd  
Macquarie Bank Ltd  
Merrill Lynch (Australia) Futures Ltd  
J P Morgan Australia Ltd  
Ord Minnett Jardine Fleming Futures Ltd  
SBC Australia Ltd

**Public Brokers/Clearing Members Without Trading Permit**

ANZ Capel Court Limited  
Citifutures Ltd  
Deutsche Bank AG  
Midland Bank plc  
National Australia Bank Ltd  
Potter Warburg Clearing Pty Ltd

**Public Brokers With Trading Permits**

ANZ McCaughan Futures Ltd  
Bain Refco Commodities Ltd  
C, A & L Bell Commodities Corporation Pty Ltd  
HSBC Futures Australia Ltd  
L Quay Futures Brokers Pty Ltd  
Potter Warburg Securities Pty Ltd  
Tullett & Tokyo (Australia) Pty Ltd



- (1) Public Broker/Principal Trader may become clearing member and deal direct with clearing house; or
- (2) They will use another party who is a clearing member.