

# Code of Practice for Clearing and Settlement of Cash Equities in Australia

2016 Internal Review Report

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**Report queries**

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## Introduction

### Overview

In accordance with the “Code of Practice for Clearing and Settlement of Cash Equities in Australia” (the Code) published on 9 August 2013, an internal review of the operation of the Code for the period 1 July 2015 to 30 June 2016 (the review period) has been performed.

This report summarises the findings of the internal review.

### Scope

The requirement for regular reviews is outlined in section 5 of the Code:

“ASX commits to undertake regular reviews in respect of the operation of the Code.

- (a) ASX will conduct an annual internal review regarding the operation of the Code, including with respect to:
- (1) the effectiveness of the Forum in meeting the objectives set out in clause 2.2;
  - (2) ASX’s compliance with the cost allocation principles described in clause 3.2;
  - (3) ASX’s compliance with the access request protocols described in clause 4.3(c) relating to requests for access to clearing and settlement services;
  - (4) ASX’s compliance with the operational standards described in clause 6(c) relating to the protection of competitively sensitive information acquired by ASX Clear and ASX Settlement in the course of providing the TAS and the settlement facilitation service; and
  - (5) ASX’s pricing to verify that there is no discrimination between ASX-affiliated entities and other users of clearing and settlement services.

The internal review will be completed and a written report based on the internal review will be published within 3 months following the end of each financial year. The report will be provided to the Boards of ASX Clear and ASX Settlement and the Forum promptly after the report’s completion. ASX will publish the report on the ASX website.”

The scope of the internal review focused on the clauses outlined in section 5 of the Code, i.e. clauses 2.2, 3.2, 4.3(c), 6(c) and 3.3.



## Review approach

The internal review was performed in accordance with the ASX Internal Audit methodology. This methodology complies with the International Professional Practices Framework (IPPF) issued by the Institute of Internal Auditors.

To perform the internal review, each of the five clauses was assessed to identify the underlying obligations for each clause. Where obligations were identified, ASX Internal Audit developed review procedures to test ASX's compliance with the obligation.

In some instances reliance was placed on the work performed by the external reviewer in the testing of compliance obligations. The report identifies the clauses where reliance has been placed on the external reviewer.

The findings of the internal review were documented using a set of compliance statements that concluded one of the following for each obligation:

- No exceptions noted – ASX complies with the obligation
- Exceptions noted – there were minor instances of non-compliance
- Significant exceptions noted – there were significant instances of non-compliance.

## Conclusion

No significant instances of non-compliance with the requirements of the Code were identified during the internal review. Minor exceptions were noted for Section 2.2 (a) of the Code, which is discussed below:

The Forum meetings are one of the mechanisms by which users may provide input to the Boards of ASX Clear and ASX Settlement. The Forum is required to meet at least three times a year, however for the period under review, the Forum did not meet.

Forum meetings were scheduled for 15 April 2015 and 7 October 2015 but were cancelled in light of the review of competition in clearing cash equities in Australia being undertaken by the Council of Financial Regulators in 2015, and pending a Government decision. This was communicated to members in advance of the meetings and no objections were raised.

While there were no Forum meetings in the review period, the Business Committee met on 17 February 2016, 15 June 2016, and 31 August 2016. A future meeting is scheduled for 30 November 2016.

Refer to the Appendix for the detailed review procedures performed for the sections of the Code identified to be in scope, including the findings and results.

## Appendix

### Internal review procedures and results

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
<b>2 The Forum</b>				
2.2 Objectives				
<p>(a) The objectives of the Forum are:</p> <p>(1) to provide user input to the Boards of ASX Clear and ASX Settlement from a wide range of users in relation to ongoing investment in the design, operation and development of the core clearing and settlement infrastructure for the Australian cash equity market, including CHES</p> <p>(2) to consider any matters of common interest arising under the Code or in the principles set out in the report prepared by the Council of Financial Regulators, and</p>	<p>Performed by Internal Audit</p>	<p>This section outlines the objectives of the Forum. The mechanisms through which the objectives of the forum are achieved are via Forum and Business Committee meetings. These meetings provide a platform to interact with and exchange information between users and the Boards of ASX Clear and ASX Settlement.</p> <p>Section 5(a) (1) of the Code stipulates the internal review will consider “the effectiveness of the Forum in meeting the objectives set out in clause 2.2”. The following was considered during the review:</p> <ul style="list-style-type: none"> <li>- interaction between the Forum and the Boards, including whether the Forum met at least 3 times in the year</li> </ul>	<p>The Forum did not meet in FY16. Forum meetings were scheduled for 15 April 2015 and 7 October 2015 but were cancelled in light of the review of competition in clearing cash equities in Australia, being undertaken by the Council of Financial Regulators (CFR) in 2015, and pending a Government decision. This was communicated to members in advance of the meetings and no objections were raised.</p> <p>At the Forum’s last meeting on 1 October 2014, it was agreed that the timing of the next meetings may be subject to change pending further information in relation to the CFR review and the Government’s decision.</p>	<p>Exception noted – the Forum did not meet during the year under review.</p>

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
<p>(3) provide a formal mechanism for the Boards of ASX Clear and ASX Settlement to report to users on their strategic plan and investment decisions in relation to the design, operating and development of the core clearing and settlement infrastructure for the Australian cash equity market, including CHES.</p>	<p>Performed by Internal Audit</p>	<ul style="list-style-type: none"> <li>- evidence of Business Committee meetings or discussions with clearing and settlement users</li> <li>- interaction and engagement of the Business Committee in compiling the Forward Work Program.</li> </ul>	<p>While there were no Forum meetings in the review period, the Business Committee did meet on 17 February 2016, 15 June 2016, and 31 August 2016. A future meeting is scheduled for 30 November 2016.</p> <p>The meeting agenda, minutes, papers and the Business Committee Reports to the Forum were noted to be published on the asx.com website.</p> <p>The Forward Work Program is a standing agenda item for the Business Committee meeting. It was presented and spoken to at the meetings and the Business Committee members were invited to nominate any topic they wanted to add. The draft Forward Work Program was sent to members requesting their input and additional items for inclusion. Internal Audit checked the Forward Work Program topics for each scheduled meeting to ensure that the timing for Business Committee consideration of topics was appropriately followed. No exceptions were noted.</p>	
<p>(b) Members of the Forum will not consider or discuss any competitively sensitive information in contravention of the Competition and Consumer Act 2010 (Cth).</p>		<p>No review procedures to be performed. This obligation outlines the confidentiality requirements of the Forum.</p>	<p>Not applicable</p>	<p>Not applicable</p>

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
<b>3 Pricing</b>				
3.2 Published management accounts for cash equities				
(a) ASX will publish management accounts in respect of the clearing and settlement of cash equities in Australia. ASX will publish these accounts on an annual basis, together with ASX's full year financial results, and make them available on the ASX website.	Reliance on PwC	Ensure the annual clearing and settlement cash equities management accounts are published on the ASX website, together with the ASX's full year financial results.	The FY16 management accounts were: (1) published together with ASX's full year financial results, and (2) made available on the ASX website on 18 August 2016.	No exceptions noted.

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
<p>(b) In the management accounts, ASX will allocate directly attributable and common shared costs for cash equity clearing and settlement as between ASX Clear and ASX Settlement. ASX will allocate costs for the clearing and settlement functions on the following basis:</p> <p>(1) The directly attributable expenditure undertaken in respect of relevant clearing and settlement functions will be the increase in total expenditure which results from that function; and</p> <p>(2) The expenditure on shared assets and indirect costs will be allocated on the basis of identified and appropriate drivers of the expenditure related to the respective clearing and settlement functions.</p>	<p>Reliance on PwC</p>	<p>Obtain the management accounts for clearing and settlement of cash equities and ensure the accounting policies for cost allocation are consistent with the Code.</p>	<p>PwC are engaged to provide an audit opinion over the management accounts prepared for clearing and settlement of cash equities.</p> <p>The management accounts include an accounting policy note which outlines the cost allocation methodology used for the allocation of both directly attributable and indirect expenses. As required by the Code, indirect costs are allocated to the activities of clearing and settlement for cash equities based on appropriate drivers for each major expense category. This methodology has remained unchanged from the prior year.</p> <p>PwC assessed the cost allocations performed by ASX in relation to the allocation of expenses to the clearing and settlement entities. From the work performed, PwC noted that ASX has appropriately allocated costs to the ASX clear and ASX settlement business units.</p> <p>Furthermore, the methodology of allocating expenses has remained consistent with prior year, with expenditure being allocated on the basis of relevant drivers and assumptions.</p>	<p>No exceptions noted.</p>



Code obligation	Scope	Requirement/internal review procedure	Findings	Results
(c) ASX will establish a policy which describes the methodology used for apportioning directly attributable and indirect or common shared costs. This policy will be reflected in the published management accounts.	Reliance on PwC	Refer to Section 3.2(b) above	Refer to section 3.2(b) above.	No exceptions noted.
(d) The published management accounts will be subject to review by an external auditor.	Reliance on PwC	Ensure an external auditor has been engaged to perform a review over the management accounts.	PwC has been engaged by ASX to complete an audit over the management accounts for (i) cash equities clearing, and (ii) cash equities settlement operations in Australia for the year ended 30 June 2016.	No exceptions noted.

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
<b>3.3 Non-discriminatory and transfer pricing</b>				
(a) Non-discriminatory pricing: ASX is committed to providing non-discriminatory pricing to all customers and potential users. The prices for clearing and settlement services provided by ASX Clear and ASX Settlement, including rebates, revenue-sharing arrangements and discounts applicable to the use of these services, will not discriminate between ASX-affiliated and other customers or potential users of clearing and settlement services.	Performed by Internal Audit	<p>i. Identify the current clearing and settlement customers, including ASX-affiliated customers.</p> <p>ii. Obtain a list of all cash market clearing and settlement billing for two months and ensure that all users have been billed consistently and or differences can be justified.</p>	<p>The list of ASXCL and ASXS participants was obtained from the Participant Transitions team.</p> <p>There are 36 entities that are participants of both ASXCL and ASXS, 29 participants who are participants solely of ASXS, and one participant of ASXS which is also an Approved Listing Market Operator.</p> <p>ASX currently has one Approved Market Operator (AMO) and three Approved Listing Market Operators (ALMOs). There is one ASX-affiliated user of cash market clearing and settlement – ASX Limited, as the holder of the market licence to operate the cash market.</p> <p>A sample of two months billing data was selected from the review period. For the sampled months, for each product code applicable to cash market clearing and settlement fees, the billing rate per unit was reviewed against the corresponding rates in the Clearing, Settlement and Issuer Administration Services Schedule of Fees to ensure all participants were charged the same rate per unit. No exceptions were noted.</p>	No exceptions noted.

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
		<p>iii. Obtain a list of all annual fees for cash market clearing and settlement billing for the period under review and ensure that all users have been billed consistently and/or differences can be justified.</p>	<p>In addition, for the two months selected, the billing data for five participants were reconciled to the invoices issued. No exceptions were noted. The Trade Acceptance Service (TAS) agreement for AMOs and the Settlement Facilitation Service (SFS) agreement for ALMOs only includes annual and one off/ ad-hoc fees. No monthly or ad hoc fees were identified for the AMO, ALMOs or ASX Limited for the period under review.</p> <p>There are no annual fees relevant for the AMO and ASX Limited. Annual fees for the ALMOs were all billed consistently with the fee schedule in the SFS agreement.</p> <p>There are no annual fees relevant for ASXCL and ASXS cash market participants as confirmed by our review of the Clearing, Settlement and Issuer Administration Services Schedule of Fees.</p> <p>There is a revenue sharing scheme for ASXCL and ASXS. Allocation of the revenue share pools has been calculated in accordance with the details of the schemes as disclosed in the original Scheme Notices.</p>	

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
(b) Transfer pricing: ASX Clear and ASX Settlement will charge all users, including ASX-affiliated entities, non-discriminatory prices for materially equivalent services.	Performed by Internal Audit	Refer to section 3.3(a) above.	Refer to section 3.3(a) above.	No exceptions noted.

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
<b>4 Access to clearing and settlement services</b>				
4.3 Responsiveness to Requests				
(c) ASX Clear and ASX Settlement will publish protocols on the ASX website which set out target timeframes for responding to requests for services and dispute resolution processes for AMOs and ALMOs.	Performed by Internal Audit	Review the ASX website for the protocols on:  i. responding to AMO and ALMO service requests	In the "Customer Access" section of the website ( <a href="http://www.asx.com.au/cs/customer-access.htm">http://www.asx.com.au/cs/customer-access.htm</a> ):  (1) the "Services for Approved Market Operators" sub-section has a link to the "Procedures for Access Requests by Approved Market Operators". This document tables the actions and timeframes for new customer enquiries and requests for the enhancement or expansion of the TAS.  (2) the "Services for Approved Listing Market Operators" sub-section has a link to the "Procedures for Access Requests by Approved Listing Market Operators". This document tables the actions and timeframes for new customer enquiries, new service enquiries, enquiries regarding potential enhancement to the Settlement Facilitation Service and operational matters.	No exceptions noted.

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
	Performed by Internal Audit	ii. dispute resolution processes (including pre-access and post-access disputes).	<p>The dispute resolution processes are detailed on the asx.com website in the following sections:</p> <ul style="list-style-type: none"> <li>(1) the "Code of Practice for Clearing and Settlement of Cash Equities in Australia Access Protocols" document (pre-access disputes).</li> <li>(2) the Trade Acceptance Service, Contractual Terms of Service for the provision of a trade acceptance service to Australian financial market licensees in respect of CHESSE-eligible ASX-quoted financial products (in the Dispute Resolution sub-section).</li> <li>(3) the template "Settlement Facilitation Service Agreement" (in the "Dispute Resolution" sub-section).</li> </ul>	No exceptions noted.

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
<b>6 Protection of confidential information</b>				
<p>(c) ASX Clear and ASX Settlement will put in place operational standards for the protection of AMO and ALMO competitively sensitive information acquired by ASX Clear and ASX Settlement in the course of providing the TAS or the Settlement Facilitation Service. ASX will consult with AMOs and ALMOs on the development of Information Handling Standards to implement information barriers within ASX to safeguard AMO and ALMO competitively sensitive information.</p>	<p>Reliance on PwC</p>	<p>i. Ensure that ASXCL and ASXS have put in place operational standards for the protection of AMO and ALMO competitively sensitive information acquired by ASXCL and ASXS.</p>	<p>i. Management confirmed there were no changes during the reporting period FY16 to the processes confirmed as being in place previously.</p> <p>When an AMO or ALMO contacts ASX management with data they wish to be treated as Competitively Sensitive Information (CSI) by ASXCL and ASXS, ASX reviews the information to assess whether it is competitively sensitive. If it is, ASXCL and ASXS request permission to share the data with the relevant management contacts. Once permission is granted, the information is forwarded to the “permissioned” staff for their review. They are required to advise whether they see any issues with the request and/or if they require any further information. For each member of staff receiving CSI, ASX Regulatory Assurance management meets with them and provides training to ensure the permissioned staff understand the requirements of the Information Handling Standards.</p>	<p>No exceptions noted.</p>

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
			<p>The information obtained is ring-fenced and kept in a secure directory where access is limited. Management use hush-mail to correspond internally and externally with the affected parties. Management noted that it is the responsibility of the AMO and ALMO to ensure they send correspondence through to the relevant ASX counterparts and identify that the AMO/ALMO seeks to have the material characterised as conflict sensitive information.</p>	



Code obligation	Scope	Requirement/internal review procedure	Findings	Results
		<p>ii. Obtain correspondence to confirm that ASX has consulted with AMOs and ALMOs (as identified for 4.2(a) above) on the development of Information Handling Standards to implement information barriers within ASX to safeguard AMO and ALMO competitively sensitive information obtained.</p>	<p>ii. A consultation paper dated 23 Jan 2014 has been included on the ASX website (<a href="http://www.asx.com.au/regulation/public-consultations.htm">http://www.asx.com.au/regulation/public-consultations.htm</a>) and has been sent to AMO or ALMOs on - Clearing and Settlement Services for Approved Market Operators and Approved Listing Market Operators: Enhanced service levels and information handling standards.</p> <p>It was noted that the consultation paper includes proposals to enhance the protection of confidential information received from AMOs and ALMOs. Through inquiries with management it was noted that proposed amendments from the consultation process have been completed and came into effect on 1 July 2014.</p> <p>It was noted that submissions from AMO and ALMO to the consultation paper have been included on the ASX website (refer to link listed above). ASX's responses to these submissions have also been published on the website.</p>	<p>No exceptions noted.</p>

Code obligation	Scope	Requirement/internal review procedure	Findings	Results
			<p>Since the release of the above consultation paper, ASX has issued another consultation paper on the Code of Practice for Clearing and Settlement of Cash Equities in Australia – Proposed Operational Improvements dated 3 Dec 2014 on the ASX website.</p> <p>PwC has confirmed with management that ASX has also:</p> <ul style="list-style-type: none"> <li>- expanded the Trade Acceptance Service in 2015 to provide AMOs with non-discriminatory access to clearing and settlement arrangements for trades in CHES-eligible financial products that are admitted to quotation on an AMO's market but are not quoted on ASX's market. The TAS Legal Terms were amended to effect this expansion in service.</li> <li>- issued AMOs with a Feb 2016 review of the TAS Legal Terms.</li> </ul>	