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10 March 2008

Caroline Ramsey
Manager Financial Sector
Competition, Trade & Investment Branch
Ministry of Economic Development
33 Bowen St, PO Box 1473,
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By email: Caroline.Ramsey@med.govt.nz

Dear Caroline

We understand that the New Zealand (NZ) Government has been considering proposals to rationalise and simplify the regulatory framework for futures exchanges and clearing and settlement systems so as to facilitate a more robust legislative framework for licensing futures exchanges, futures dealers and approved clearing and settlement facilities.

A range of groups, including the NZ Securities Commission, Reserve Bank, Treasury and New Zealand Exchange (NZX) were consulted during the preparation of the proposed reforms. We were disappointed that the Australian Securities Exchange (ASX) as the current market operator of futures and options trading and clearing services for the NZ market were not included in these discussions.

We acknowledge that officials have indicated they have been mindful of not legislating for one type of trading platform and that the proposals are not NZX specific, but would apply to any participant who sought to provide such a platform in NZ.

There is no reference in the discussion paper on the status of existing futures market operators such as ASX. We therefore assume there would be no material change to the status of ASX's existing futures and options markets over NZ denominated securities (fixed interest and equity securities). These products are currently traded through the Sydney Futures Exchange and centrally cleared through SFE Clearing Corporation Pty Ltd. Attachment 1 provides more information on ASX and the markets for NZ products that it operates.

General Feedback

ASX is supportive of regulatory reform of the nature proposed. ASX has previously had much input to and experience of regulatory reform of the type contemplated, namely the Australian Corporate Law Economic Reform Process (CLERP). That said, we do not understand why the impetus or major focus of the proposed reform is to ensure the development of robust trading and clearing and settlement infrastructure in relation to emission units. There is nothing within the existing regulatory framework to prohibit or restrict firms in NZ or elsewhere from providing OTC and exchange infrastructure to support the NZ Emissions Trading Scheme (ETS).

Given the short consultation process, our general feedback is as follows:

- the foreign exchange, interest rate and equity markets in NZ are much larger than the likely market for carbon in NZ (see Attachment 2 for specific detail);
- the lack of consultation and benchmarking with other regulatory regimes evident in the discussion and cabinet papers, suggest that not all of the issues have been thought through and may lead to 'regulatory arbitrage'. For example, the papers do not discuss Margin FX and CFDs for which the regulatory and licensing regime in New Zealand is unclear despite clarity being sought by market participants for several years, and a discussion paper being issued by the NZ Securities Commission.
- The changes suggest that a licensed futures exchange can license its own futures dealers, despite this being the purview of the appropriate regulator in all other jurisdictions.

There may also be unintended consequences from the proposed changes which ASX has not had time to assess. Benchmarking the existing regulatory regime and proposed changes against other regulatory regimes where regulatory reform has been undertaken in recent years would identify the appropriate issues for consultation as opposed to the narrow focus in the paper on the subject of emission units.

Specific feedback in relation to emissions trading:

As per our 29 February submission on the Climate Change (Emissions Trading and Renewable Preference) Bill, it is our observation that nothing in the proposed Bill would appear to prevent firms in NZ or elsewhere from providing OTC and exchange infrastructure to support the NZ Emissions Trading Scheme (ETS). Firms with liabilities under the NZ ETS, and the NZ economy more generally, will benefit from competition for the provision of these services.

The Climate Change Response Act appears to be the appropriate place to deal with the nature of emissions units and not the Securities Act or other financial market legislation.

The only workable basis for exchange-based trading in voluntary emission reduction units is where the exchange establishes a legally binding framework between its participants to establish the legal nature of the units. Given this, it does not make sense to define voluntary emission units in the Securities Act or elsewhere.

Moreover, there is no precedence to specifically define mandatory emission units relating to securities and futures trading. Regulation should relate to the trading of 'futures contracts' and not the underlying unit which relies upon other legislation or property rights to define their 'value'.

The flavour of the proposed regulatory reform to support the forthcoming emissions trading seems to be mis-placed given its likely size relative to the existing foreign exchange, interest rate and equity markets that stand to benefit from regulatory reform of the type proposed. The table in the Attachment 2 illustrates the likely size of the NZ ETS relative to the overall financial markets in New Zealand.

Summary

Corporate law reform in NZ is at the heart of not only the credibility of its financial markets, but also competition for the provision of market services at lowest cost.

We would urge the MED to:

- undertake benchmarking of the proposed legislated changes against the Corporations Law in Australia (and other regulatory regimes) to ensure regulatory consistency (and avoid regulatory arbitrage);

- consult more widely, providing more time for meaningful input from ASX, existing futures dealers in New Zealand and others who are likely to be impacted by the changes; and,
- avoid the specific definition of emission units (both mandatory and voluntary) in the Securities Act or anywhere other than the Climate Change Bill or a legally binding framework underpinning any exchange-based voluntary market for carbon offsets.

Given ASX's input and experience of corporate law reform, and the extent to which the markets we operate underpin New Zealand's financial economy, we would appreciate more comprehensive analysis of the proposed changes and in turn the opportunity to make a more detailed submission on the issues identified.

We have no objection to our submission being released.

Yours sincerely

A handwritten signature in cursive script, appearing to read "Anthony Collins", is placed over a rectangular area with a light grey dot grid background.

ANTHONY COLLINS
GENERAL MANAGER – EMERGING MARKETS

Attachment 1 - About ASX

As one of the world's top 10 listed exchange groups, measured by its market capitalization, the ASX group of companies was created through the merger of the Australian Stock Exchange and the Sydney Futures Exchange.

ASX group operates under the brand, Australian Securities Exchange.

The Australian Securities Exchange spans the markets for corporate control, capital formation and price discovery and functions as an operator, supervisor, central counterparty clearer and payments system facilitator.

Of specific relevance to the financial markets in New Zealand:

- ASX provides exchange-traded and over-the-counter financial services to institutions throughout the Asia-Pacific region and globally through its operating subsidiaries Sydney Futures Exchange Limited, SFE Clearing Corporation Pty Ltd and Austraclear Limited.
- Subsequent to its acquisition of the New Zealand Futures and Options Exchange (NZFOE) in 1992, ASX subsidiary companies have operated the only futures and options exchange and clearing house servicing the interest rate, equity, foreign exchange, commodity and energy markets in NZ.
- For the 12 months ending 31 December 2007, the value of trade in the NZ markets operated by ASX averaged NZ\$6.4bn a day – more than 40 times greater than the value of trade in the NZ equity market for the same period.
- The clearing house which supports the NZ futures and options markets, SFE Clearing Corporation (SFECC), facilitated over A\$42 trillion worth of derivatives trades in 2007, largely in Australian fixed interest futures, and at year-end participant margins managed by SFECC totalled A\$4.2bn. To put this in perspective, this annual transaction value is around 42 times Australia's annual GDP and 200 times New Zealand's GDP.
- ASX Participants include all the major investment banks and brokerage houses and OTC brokers servicing the financial markets globally, including the EU Emissions Trading Scheme (ETS).

Attachment 2 – Some Perspective on the Global Carbon Markets

Table 1 illustrates the size of the global carbon market in 2006. From the table it is evident that the mandatory markets, as one would expect, dominate the value of trading. For example, the value of trade in the fledgling New South Wales (NSW) Greenhouse Gas Abatement Certificate Scheme (GGAS) was 8 times larger than the much higher profile Chicago Climate Exchange (CCX) – the latter being the worlds largest legally binding voluntary market. As another basis for comparison, the CO₂-e coverage of the NZ ETS will be approximately 1/40 that of the EU ETS.

Table 1: The Global Carbon Market

	2006 Volume (Million tCO ₂)	2006 Value (US\$ Million)
Voluntary OTC Offset Market	13.4	54.9
Chicago Climate Exchange	10.3	36.1
Total Voluntary Market	23.7	91
Other GHG Trading Schemes:		
EU ETS Trading Scheme	1,101	24,357
Primary Clean Development Mechanism	450	4,813
Secondary Clean Development Mechanism	25	444
Joint Implementation	16	141
NSW GGAS	20	225

Source = World Bank – State and Trends of the Carbon Market – May 2007
 Point Carbon estimates for 2007 are: EU ETS volume (value) = 1,600 Mt (US\$41bn); Primary CDM volume (value) = 947 (US\$17,500m); and, Secondary CDM volume (value) = 350 Mt (US\$8,300m).

Tables 2a and 2b illustrate the value of over-the-counter (OTC) trading in New Zealand's financial markets for the month of April 2007. In summary, the average daily turnover in interest rate derivatives and foreign exchange was US\$2.9 billion and US\$13 billion per day, respectively. Highlighting the significance of the exchange-traded New Zealand 90 bank bill futures market to interest rate price discovery and risk transfer within New Zealand's economy, the average daily value of trade in April 2007 was NZ\$7.6bn or 3 times the value of OTC interest rate derivatives traded. By comparison, the daily value of trade in the New Zealand equity market was NZ\$122m.

Table 2a: OTC Interest Rate Derivatives Traded in New Zealand (April 2007)

Single interest rate derivatives by type	Average daily turnover US\$m	Per cent of total
Forward rate agreement	665	23
Currency swaps	2178	75
OTC options	44	2
Total	2887	100

Table 2b: OTC Currency Trading in New Zealand

Market	Average daily turnover US\$m	Per cent of total
Spot	2,037	16
Forward	765	6
Swap	9,660	74
Derivatives	545	4
Total	13,007	100

Source: RBNZ Survey¹

As evident from Tables 1 and 2, the value of carbon trading in New Zealand, and globally for that matter, relative to the size of currency and interest rate markets is likely to be very small and this fledgling market should not be the driver for which important financial market reform is undertaken.

¹ These results are part of a triennial survey of 54 central banks and monetary authorities co-ordinated by the Bank for International Settlements (BIS) and reported in US dollars. In New Zealand the survey captures the activity of the four major banks participating in the local wholesale financial markets.