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16 May 2013

Manager
Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

Proposed Amendments: ASIC Market Supervision Cost Recovery Arrangements July 2013 to June 2015

Chi-X Australia Pty Ltd (Chi-X) has comments on the following issues raised by the proposed amendments to the ASIC market supervision cost recovery arrangements for the period July 2013 to June 2015 (“the Proposals”):

- (i) the lack of fairness in the application of the Proposals given what activity is/is not subject to the cost recovery tax;
- (ii) tensions and inconsistencies between the requirements of the Government’s Cost Recovery Guidelines (Guidelines)¹ and the Proposals;
- (iii) the lack of a market maker exemption.

1. Fairness

In its submission dated 6 February 2013, Chi-X expressed concern over the fairness of the cost recovery regime by reference to:

- (i) the objectively identifiable negative impact of the cost recovery tax on market efficiency²;

¹ Accessible at:

http://www.finance.gov.au/publications/finance-circulars/2005/docs/Cost_Recovery_Guidelines.pdf

² See for example Andrew Lepone and Alex Sacco: “The Impact of Message Traffic Regulatory Restrictions on Market Quality: Evidence from Chi-X Canada”, which was referenced in the Chi-X submission of 6 February

- (ii) the number and type of markets excluded from the cost recovery measures on a non-transparent basis notwithstanding that those markets should impose a similar supervisory cost upon ASIC to that imposed by the Chi-X platform³;
- (iii) the lack of any or any sufficiently justified basis for the increased focus on message traffic;
- (iv) the narrow scope of entities liable to the tax given the far broader scope of entities that have benefitted from and gave rise to the need for the ASIC supervision that is funded by the tax⁴.

None of these issues appear to have been addressed in a meaningful way in the CRIS.

2. Identified Gaps with the Cost Recovery Guidelines

In the submission dated 6 February 2013, Chi-X identified the following tensions and inconsistencies between the Proposals and the requirements of Guidelines:

- (i) the potential for the Proposals to stifle innovation given ASIC's discretionary power to recover costs for innovation on exchange markets without reference to or subject to any transparent and objective governance requirements and dispute resolution processes;
- (ii) the threat posed by the Proposals to the government policy of enabling innovation and competition in the trading of ASX listed securities⁵;
- (iii) the massive differences in the commercial impact of the cost recovery tax on the different markets supervised by ASIC;
- (iv) the disproportionate allocation to Chi-X of the cost recovery burden borne by market operators caught by the proposals (ie the Chi-X share of the cost recovery pool allocated to market operators is approximately twice that of the Chi-X market share).

The fairness issues identified in section 1 above also provide evidence that the proposals may not satisfy the cost effectiveness and competition/innovation requirements contained in the Guidelines.

2013 and is accessible at <http://www.cmrc.com/documents/1364384205sacco-lepone-paper-2013-what-have-message-taxes-done-to-the-efficiency-of-markets-1.pdf>.

³ The previous submission identified that the ASX options market was exempt from cost recovery and it is now apparent that the ASX warrants market is also exempt.

⁴ For example, issuers and market operators that generate income directly from issuers are either not subject to a cost recovery tax or are not subject to a tax in respect of that activity notwithstanding that their activity in this area gives rise to and benefits from the ASIC supervision funded by the tax.

⁵ The benefits of the government policy evidenced in the statement on page 32 of the CRIS relating to savings to traders of over \$300million a year are noteworthy in this regard.

Chi-X is of the view that these tensions and/or inconsistencies have not been addressed. Indeed, since its submission in February, Chi-X has since identified further markets that are not subject to the cost recovery measures notwithstanding that their participant profile and nature should impose a supervisory burden on ASIC similar to that of Chi-X.

3. The Market Maker Exemption

It is stated on page 32 of the CRIS that ASIC has observed, during the period from prior to competition commencing to January 2013, a decline in spreads on Australia's cash equities markets. The CRIS notes that this decline in market spreads may be generating savings to traders of over \$300million per year. This decline in spreads can be directly linked to trading by market makers. The Treasury Discussion Paper on Options for amending the ASIC Market Supervision Cost Recovery Arrangements, published in December 2012, acknowledged that a message based cost recovery tax may disincentivise the very trading that generates this benefit⁶. The lack of any market maker exemption in the Proposals will therefore result in cost recovery measures that are biased against, disincentivise and put at risk the Australian operations of, market participants that deliver significant benefits to the Australian market place. This outcome makes no sense.

In these circumstances, Chi-X remains strongly of the view that a measured market maker exemption is important for Australia's market and the fair application of the Proposals.

Please do not hesitate to contact us if you have any queries.

Yours faithfully



Chi-X Australia Pty Ltd

⁶ See page 13 of the Treasury Discussion Paper accessible at <http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2012/Amending%20the%20ASIC%20market%20supervision%20cost%20recovery%20arrangements/Key%20Documents/PDF/Discussion%20Paper.ashx>