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

Dear Sir/Madam

Options Paper:- *Australia's Financial Market Licensing Regime: Addressing Market Evolution*

Chi-X Australia Pty Ltd (Chi-X) is grateful for the opportunity to provide a submission on the above options paper (OP) which concerns matters of significant importance to Australia's capital markets.

In May 2011, Chi-X was granted an Australian market licence to operate a secondary market in the trading of ASX listed securities and became the first such exchange to compete with the ASX in the trading of those securities. Chi-X is the Australian subsidiary of a global operator of alternative trading platforms. As such, Chi-X has a unique perspective on the existing Australian market licencing regime.

The benefits to all stakeholders, local and otherwise, of competing platforms in the secondary market trading of securities have been repeatedly demonstrated in overseas jurisdictions. It is therefore important for Australia's financial markets that policy settings and regulation facilitate the development of healthy competition between trading platforms. The regulatory regime

governing trading platforms must be well considered, measured, balanced and applied in an appropriate regulatory context that takes into account competition outcomes. This submission is provided with a view to engaging constructively in the further consideration of the matters raised in the OP as they relate to the development of that regulatory regime.

This submission is divided as follows:

- (i) comments on the overarching key issues that in the view of Chi-X are raised by the OP and which are contained in this covering letter,
- (ii) feedback on the specific questions posed in the OP, which is set out in **attachment one**.

Key Issues

Chi-X is of the view that the following key issues are raised by the OP.

1. The need to address the regulatory gaps identified;
2. The relevance of issues that have been encountered in the existing regime to any proposals that seek to address that regulatory gap;
3. Giving appropriate priority to resolving issues in the existing market licencing regime;
4. Avoiding unintended consequences when reforming the existing regime.

1. Addressing Regulatory Gaps

Chi-X is of the view that dark pools play an important and valuable role in Australia's financial markets. They are able to provide execution and trading opportunities that enhance the operation of our capital markets. However Chi-X agrees that a regulatory gap has been identified in the regulation concerning dark pools and exempt markets and that gap needs to be addressed.

2. The Existing Market Licencing Regime

Chi-X is of the view that there are two aspects of the current market licencing regime that, generally speaking, may be particularly relevant to any proposed reform in the regulation of dark pools and exempt markets:

- a) imbalances in the existing regulation of market operators;

- b) the existing regulatory infrastructure, in particular the governance measures that apply.

a) Imbalances in the Existing Regime

The IMF stated in *Australia: Report on the Observance of Standards and Codes (ROSC)—Summary Assessments*¹ that Australian exchanges are subject to “intensive oversight”² and recommended that ASIC “refine its oversight [of exchanges]”³. Both these conclusions suggest that a more measured and less onerous approach to the regulation of market operators may be warranted. Therefore the options for reforming the relative regulatory standards applied to dark pools may include not only increasing those standards but, in light of ASIC’s new responsibilities for market supervision, also applying relatively less burdensome requirements on existing market operators by reducing unnecessary duplication and overlap. It is notable in this context that the OP contains proposals whereby dark pools may be subject to less onerous monitoring and surveillance obligations than existing market operators (eg those pools would not be required to link to the ASIC surveillance system)⁴.

b) The Existing Market Licencing Regime – Regulatory Infrastructure

Regulatory outcomes are often determined by matters other than the legislation, rules and regulations that may apply. The infrastructure and governance controlling the administration of those written provisions can be as important to achieving the right regulatory outcomes as the provisions themselves. For example, having the right checks and balances on the proposed imposition of licence conditions by a regulator is important to achieving the right regulatory and competition outcomes.

The existing market licencing regime in Australia consists primarily of a one size fits all scheme that is heavily dependent on the application of written provisions in an appropriate context in order to achieve appropriate outcomes. Chi-X is of the view that the infrastructure and governance controlling the administration of the market licencing regime does not always facilitate appropriate regulatory and competition outcomes.

This issue is particularly relevant when considering the reform options outlined on pages 19 and 20 of the OP. Option 1 proposes a flexibility which would be heavily reliant upon the regulatory infrastructure and governance to ensure appropriate checks and balances were part of the processes involved in the exercise of regulatory discretion.

¹ At <http://www.imf.org/external/pubs/ft/scr/2012/cr12307.pdf> retrieved on 24 January 2013

² Ibid 51-52, in comments on Principle 9 of the IOSCO Principles, which deals with the regulatory oversight of regulated exchanges.

³ Ibid 59, in comments on a recommended action plan in respect of Principle 9.

⁴ See the last whole paragraph on page 21 of the OP.

Some options that may be worth considering in this area include:

- (i) enabling licensees to expeditiously appeal decisions on licence applications/conditions and the application of ambiguous or broadly worded regulatory provisions;
- (ii) creating a role equivalent to an independent non-executive director within the regulatory infrastructure;
- (iii) focusing senior executive/commissioner responsibility to specific areas, eg policy development, licence approvals, day to supervision, annual review and enforcement.

3. Priorities for Reform

Chi-X is of the view that the issues in the existing market licence regime should be prioritised above the implementation of a new regime for unregulated dark pools. The failure to address existing issues (eg multiple rule books for different platforms) may result in any deficiencies being carried over into a new framework which may in turn frustrate the goals of any proposed reform.

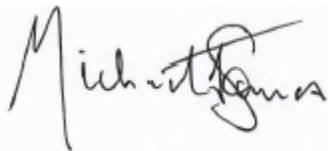
4. Unintended Consequences

The Australian financial market licencing regime covers a broad range of activity and business, not all of which is considered in the OP. Chi-X is conscious that any reforms should be targeted at resolving specific issues that have been identified so that any regulatory reforms do not generate unintended consequences.

We hope this submission assists in your deliberations in this important area.

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

Yours faithfully



Chi-X Australia



Attachment One

| Section | Feedback questions | Chi-X Feedback |
|---------------------------|--|---|
| 3. Problem identification | <p>Q1. Do you have any comments on the general form of the current legislative framework for licensing of financial markets in Australia?</p> <p>Q2. Do you consider that there are efficiency issues that could be addressed by revising the licensing regime? If so, please provide details.</p> <p>Q3. Do you consider that there are market integrity or investor protection concerns that could be addressed by revising the licensing regime? If so, please provide details.</p> | <p>There are issues raised by the current legislative and infrastructure framework for the licencing of financial markets. There is an identified gap in respect of exempt markets and dark pools. However, applying broad and general labels to potential issues and proposed reforms may create a risk that any reform will capture activity that does not raise the problems seeking to be addressed and other unforeseen consequences and excessive costs.</p> <p>Chi-X is of the view that ASIC should consider refining its oversight of licenced exchanges and take steps to address the regulatory gap in respect of dark pools.</p> <p>Regulatory arbitrage should not be permitted in the quality and effectiveness of surveillance and monitoring between different market venues for the trading of the</p> |

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| | <p>Q4. Do you agree that regulatory change would be desirable in order to better align Australia’s market regulatory regime with overseas regimes?</p> <p>Q5. Do you believe that such regulatory alignment could increase the prospects of Australian trading venues and market participants being able to seek regulatory recognition in other jurisdictions?</p> | <p>same or closely related products. Such regulatory arbitrage will result in perverse and unfair outcomes.</p> <p>Regulation of Australia’s financial market must take into account the global nature of the market for financial services and, where possible, must take into account the goal of advancing the interest of Australian markets. Slavishly following global standards is not appropriate but nor is ignoring them.</p> <p>Yes, but this may be of marginal value unless it is part of a holistic approach to placing Australia’s financial markets on a competitive footing with offshore platforms.</p> |

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| 4. Overview of reform options | <p>Q6. Do you consider that more flexibility in the AML regime is warranted, so that a greater number of facilities may be covered?</p> <p>Q7. Do you have a preference between Option 1 and Option 2? If so, please provide details.</p> <p>Q8. Is there an alternative option that you think would provide a better outcome than either of those presented? If so, please explain this option.</p> <p>Q9. Is it appropriate for ASIC to have the power to make rules in respect of licensing obligations as indicated in Option 1? What checks and balances should there be on ASIC's rule-making power? Should it be limited to matters in which default requirements in the legislation are 'switched off' or should they have the ability to make rules relating to all</p> | <p>Chi-X is of the view that flexibility poses risks and that the best option is to start with licence categories that address the immediate problem (eg a specific licence for dark pool operators).</p> <p>Chi-X has a strong preference for Option 2 unless Option 1 is implemented with appropriate checks and balances so that unreasonable decisions can be efficiently and effectively challenged.</p> <p>No</p> <p>No. Chi-X is of the view that it is not appropriate to provide greater extra-legislative discretion/rule making powers when there is not a commensurate introduction of appropriate infrastructure and governance around that discretion.</p> |

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| | <p>provisions in Part 7.2?</p> <p>Q10. If Option 1 were adopted, do you think the discretion should be operated through regulations (Option 1a) or through ASIC guidance (Option 1b)? Please provide details.</p> <p>Q11. If Option 2 were addressed, how could the limitations to flexibility found in international markets be allowed for in system design?</p> <p>Q12. Do you have any general comments in relation to the types of obligations which should or should not apply for particular entities under either option (noting that this will be consulted on in more depth at a later stage)? Please provide details.</p> | <p>Chi-X is of the view that the infrastructure and governance standards applying to the development, finalisation and implementation of regulations and/or ASIC guidance is not commensurate with what should be required of written measures that may have a significant impact on businesses required to comply with those measures.</p> <p>If the principles of the proposed regime are contained in legislation then that should enable platforms to be regulated on a measured basis that takes into account market developments.</p> <p>Chi-X is of the view that any proposals require greater definition before a response can be provided to this question.</p> |

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| 5. Advantages of reform | Q13. Do you have any comments in relation to the perceived advantages of a more flexible market licensing regime? If so, please provide details. | Chi-X is of the view that an appropriate starting point for any licencing reform is to propose the legislative measures and the applicable infrastructure for the administration of those measures. It is difficult to comment on the advantages of a flexible regime without knowing what governance will apply to those administering that regime. As noted elsewhere, Chi-X is of the view that any flexible decision making powers that are granted to a regulator should be accompanied by requirements relating to transparency, case by case review and independent oversight integrated into the operational infrastructure. |
| 6. Potential drawbacks | Q14. Do you have any comments in relation to the potential drawbacks of the proposed licensing reform? Please provide details of any concerns you have. | Chi-X is concerned that issues in the current licence regime need to be addressed to ensure that they do not get carried over into any new regime. |
| 9. Reform issues | Q15. Do you think that making HFTs (including non-market participant HFTs) directly subject to market integrity rules would assist in safeguarding market integrity? Should these | Chi-X is of the view that it is inappropriate to single out one set of indirect market participants in this manner and that doing so will lead to inappropriate prioritisation of |

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| | <p>rules be limited to those which relate specifically to non-market participant HFTs?</p> <p>Q16. Do you have any concerns in relation to making HFTs subject to market integrity rules? If so, please provide comments.</p> <p>Q17. Do you have any comments on how HFT should be</p> | <p>issues based upon emotional rather than evidence based considerations. In recent times, it has become apparent that threats to market integrity are posed by a broader set of persons than those covered by the Market Integrity Rules (see for example the market rumours on Whitehaven and NAB stocks). Chi-X is of the view that there is merit in considering the application of a market conduct regime (narrower in coverage than the current MIRs) to all persons who engage in conduct that may influence the price of or market for publicly traded securities. However, the inappropriate targeting of one section of indirect market participants is costly, will deliver minimal identifiable benefits and potentially damages Australia’s reputation as a financial centre.</p> <p>Chi-X has concerns about inappropriately singling out or targeting one set of market participants - see the response to Q15.</p> <p>Not applicable</p> |

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| | defined and how it should be measured? | |
| 10. Exempt markets | Q18. Do you have any concerns with this proposed option? If so, please provide comments. | Chi-X is strongly of the view that exemptions should apply solely at the market level and certainly not at the operator level; the case for exemptions is difficult to accept if the range of licensing options is reasonably wide and clear. |
| 11. Annual regulatory reports | Q19. Do you have any concerns with this proposed option? If so, please provide comments. | Chi-X is of the view that the deleting the independent Ministerial review of an ASIC report would be a backward step unless some compensating independent oversight, including the right of an expeditious review, became part of the process. |
| 10. Licence fees | <p>Q20. Do you consider the fee for a market licence in Australia needs revision? If so, please provide comments.</p> <p>Q21. Do you see cost recovery as an appropriate approach to levying licence fees? Please provide details.</p> | <p>Any consideration of licence fees should involve a genuine consideration of the total regulatory costs imposed on market operators.</p> <p>The issues raised by the Australian cost recovery regime are extensive and being dealt with elsewhere.</p> |

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| | Q22. Would a change in the fee level have any impact on the decision whether to operate a market in Australia? Does the current rate influence this decision? | The level of regulatory costs, including the licence fee and the cost recovery levies, has a significant influence on the decisions to commence and continue market operations in Australia. |