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The Manager, Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
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GETCO

Re: Options for Amending the ASIC Market Supervision Cost Recovery Arrangements

Ladies and Gentlemen:

GETCO appreciates the opportunity to comment on the Australian government's options for amending the ASIC market supervision cost recovery arrangements for the funding provided to the Australian Securities and Investment Commission (ASIC) to perform market supervision functions.

In connection with the Australian government's support for competition among markets for secondary trading of Australian shares, it transferred responsibility for supervision of certain financial markets to ASIC. The recovery of ASIC's costs for cash equities market supervision are allocated between market operators and market participants (the "Current Cost Recovery Approach").

- ASX and Chi-X are each charged a proportion of their allocation as a fixed fee per quarter and a variable fee based on each exchange's share of the trade count and message count in ASX listed securities during the quarter.
- Market participants are proportionally allocated non-IT costs and charged a quarterly variable fee based on each participant's share of the number of transactions during the quarter.
- Market participants are proportionally allocated IT costs and charged a quarterly variable fee based on each participant's share of total messages in ASX listed securities during the quarter.

The Current Cost Recovery Approach will expire on 30 June 2013.

GETCO's comments focus on the Current Cost Recovery Approach's impact on market competition and market quality, as well as ASIC's request for feedback around the possibility of creating an exemption from messaging fee for those market makers who provide beneficial liquidity and take on certain obligations.

I. Introduction

GETCO is a leading electronic market maker, posting two-sided markets to help investors efficiently transfer the risk commonly associated with assets such as stocks, bonds, commodities and options contracts. From offices in Chicago, New York, London, Singapore, Hong Kong, and Palo Alto, the firm transacts business in cash and futures products across four asset classes – equities, fixed income,

currencies, and commodities – on over 50 trading venues around the world. GETCO also hold multiple investments in various trading venues, and in this vein is a minority shareholder of Chi-X Global.
GETCO provides liquidity on the Australian markets through its Australian subsidiary, GETCO Australia Pty Ltd ("GETCO Australia"). GETCO Australia holds an AFSL to engage in market making activities and is a trading participant of ASX, ASX 24 and Chi-X.

II. Discussion

A. *The Current Cost Recovery Approach Has Had the Inadvertent Impact of Discouraging Market Making and Undermining the Government's Stated Goal of Creating a Competitive Market place for Trading Listed Securities)*

The Australian government's support for competition among markets for secondary trading of Australian shares led to the launch of a second Australian equity exchange, Chi-X Australia (Chi-X). Chi-X commenced trading shortly before the introduction of the Current Cost Recovery Approach. GETCO believes that the message-based fee component of the Current Cost Recovery Approach has impeded Chi-X's ability to compete as a new entrant with the incumbent exchange, ASX.

A message-based fee is particularly burdensome on market makers that display quotations on public markets. A market maker's business requires it to send messages to maintain the accuracy of its displayed quotations as market conditions change. These displayed market quotations are accessible, public prices with which other market participants can choose (or choose not) to trade. The cost of maintaining this quotation is incurred by a market maker regardless of whether a market maker executes a trade.

On new markets, which have fewer participants and thus fewer transactions, a market maker must nevertheless update its quotations as frequently as on established markets. A message-based fee, thus, can make it uneconomic to make markets on new markets that have yet to develop significant trading volume. Further, because market makers are critical to the success of any new exchange, the impact of a message-based fee on market maker's ability to provide current, competitive quotations threatens the viability of any new entrant.

When a new exchange, like Chi-X, is launched, market makers' quotations may be the only prices displayed. In actively-traded securities, natural liquidity may develop over time. However, it may take years for an exchange to have sufficient trading interest to support a continuous market without market makers. Moreover, such "natural" liquidity is unlikely to ever develop in less-actively traded instruments. Accordingly, the high cost of the message-based fee on market makers is serving to limit the ability of Chi-X to attract and retain passive liquidity providers, such as market makers, and may undermine Chi-X's long-term viability.

In the Australian government's Cost Recovery Guidelines (July 2005,) the second Principle states that "[c]ost recovery should not be applied where it is not cost effective, where it is inconsistent with government policy objectives or where it would unduly stifle competition or industry innovation." Because of the disparate impact of a message-based fee on the viability of new exchanges, GETCO believes that the Current Cost Recovery Approach has impaired competition and innovation and is thus inconsistent with the Cost Recovery Guidelines.

B. Fee Based on Messages Have Resulted in Market Makers to Widen Quotes

As described above, the nature of a market maker's business is to provide continuous, two-sided quotations to the market. These quotations are available for execution if other market participants choose to trade. The Current Cost Recovery Approach requires a market maker to pay a fee each time it updates the prices it displays on the public markets. This fee is incorporated into a liquidity provider's quotations, resulting in wider public market spreads.

In addition, a market maker may choose to reduce the costs associated with a fee based on messages by updating its quotations less frequently. To compensate for the greater risk associated with updating quotations less frequently, market makers will be forced to publicly quote wider spreads.

The initial implementation of the Current Cost Recovery Approach resulted in a sharp drop in liquidity on Chi-X from December 2011 as market makers and others reduced their messaging to avoid the fee. While Chi-X volumes had been growing robustly from its October launch, this growth was dramatically curtailed with the introduction of messaging fees (Figure 1). As can be seen from Figure 2, spreads also widened considerably (December was a quiet month for seasonal reasons and so low volumes led to wide spreads).

To support competition in the Australian markets, GETCO took a decision towards the end of March to restart market making activities across 200 stocks on Chi-X regardless of the impact of the messaging fees. GETCO took this step out of concern that, in the absence of support from market makers, Chi-X Australia would fail.

As can be seen in Figures 1 and 2, the impact was immediately noticeable with volumes increasing fivefold and spreads halving. Figure 3 shows how Chi-X volumes have continued to grow based in large part on GETCO's increasing participation.

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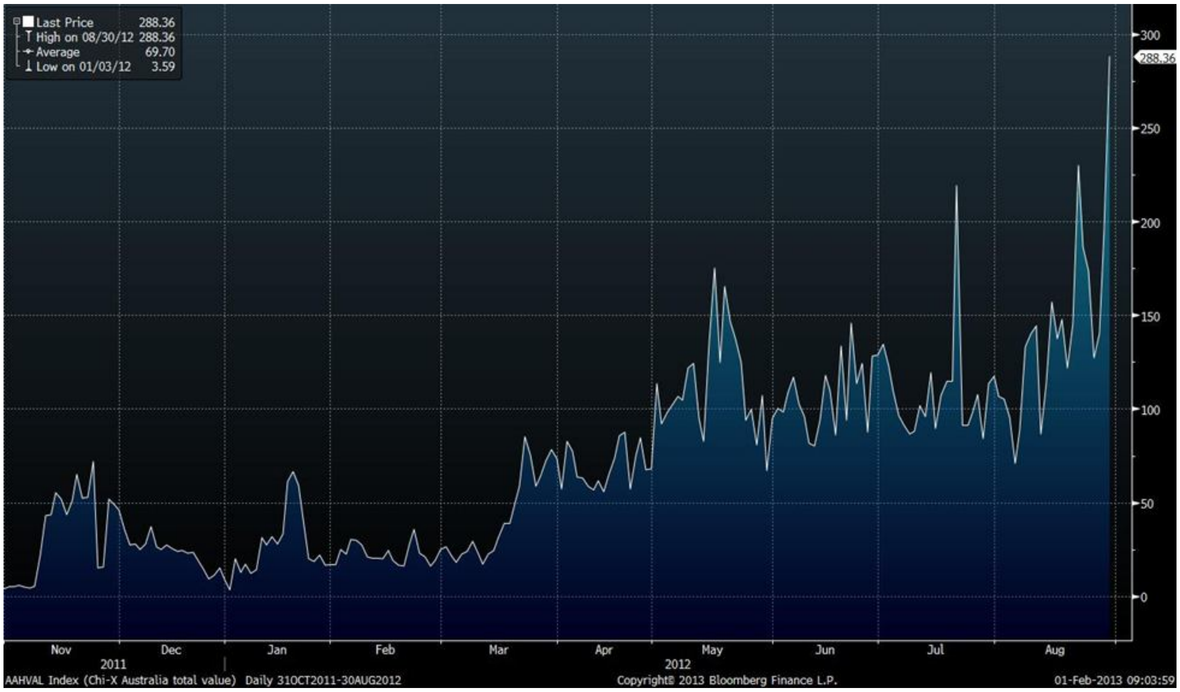

Fig 1 Chi-X Australia volumes from launch. Source: Bloomberg

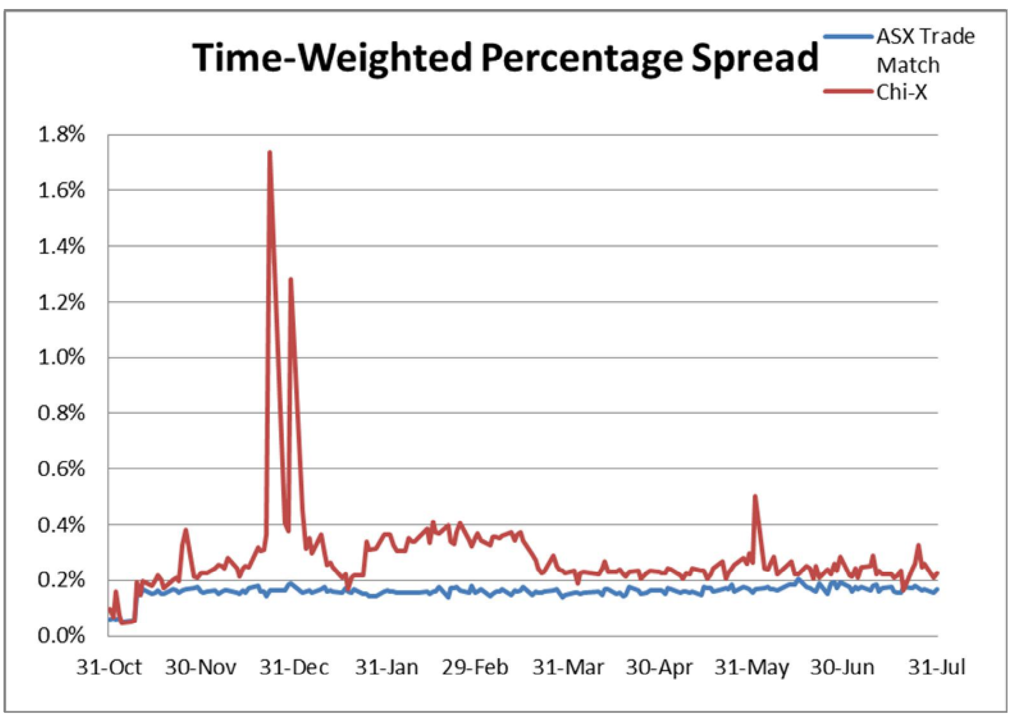

Fig 2. Source: Financial Markets Research Centre

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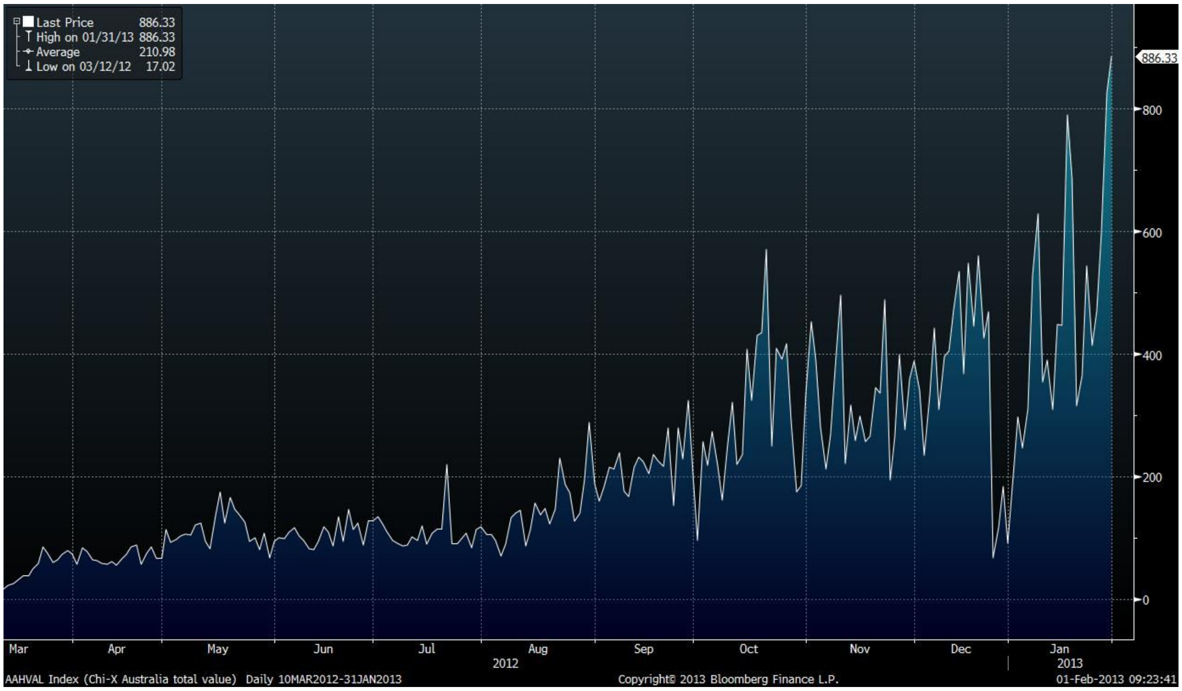

Fig. 3 Chi-X Australia volumes from March 2012 to present. Source: Bloomberg

As a consequence of its decision to support Chi-X's business through market making, GETCO now pays 10.325% of all message fees collected, even though GETCO's trading volume is less than 2.597% of all transactions in the Australian markets. This status quo is not sustainable. Moreover, should the current proposal to further increase the burden on messaging fees be implemented without an exemption for market makers, it is unlikely that GETCO and other market makers would be able to continue to make markets.

C. *<u>GETCO Supports A Fixed Component of Cost Recovery For Cash Equity Market Participants.</u>*

GETCO supports a fixed fee on direct market participants. GETCO believes that a fixed fee better aligns the fee model with those who are supervised and therefore generate ASIC's regulatory costs. GETCO, however, submits that the fee should be substantially higher than the AUD 1,800 currently under consideration. AUD 1,800 is not a material sum for most participants, and a higher allocation could and should be borne.

The amount collected through the fixed fee (even at the proposed level) from the fifty percent of participants who currently pay little or nothing towards the costs of ASIC supervision would approximately equal the amount of cost recovery fees that would be forgone by granting an exemption for market makers from the message-based fee.

D. *GETCO Supports an Exemption for Market Makers from the Messaging Fee for "Beneficial" Market Makers Where Market Makers are Subject to Strict Enforceable Obligations.*

As the Government's discussion paper recognizes, market makers play an important role in financial markets. Natural buyers and sellers may not enter the market at the same time or for the same size. Market makers bridge this time gap by providing continuous, two-sided quotations, thus allowing natural buyers and sellers to immediately trade with market makers' quotes.

Because of the important role of market makers, in Australia and other mature markets there is precedent of offering incentives, tied to obligations, for beneficial market making activities, particularly where there is a need to build liquidity. GETCO believes that an exemption for market making in Australia from the messaging fess is both appropriate and necessary, particularly if the government wants to support the continued viability of Chi-X and other competitor markets to ASX. This exemption, however, should not come without obligations. GETCO believes that requiring participants to meet the following obligations would ensure that market makers provide meaningful liquidity:

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- To make a market in over 50 (nominated) securities on any given day and to only receive the fee exemption on those names;
- To be present on both the bid and the offer in excess of 80 percent of the trading day in each of nominated names (dependent upon liquidity of the names); and
- To be within a given range of the last trade on both the bid and the offer at all times;
- To hold an AFSL; and
- To be adequately capitalized.

If, as is proposed, operational costs are also recovered through messaging fees, which would increase as a result, GETCO would potentially become liable for 10.325% of all ASIC's costs. In such an event the resultant increase in fees would make GETCO's market making activities on Chi-X non-viable. If GETCO were to cease such market making activities due to the increase in fees it is likely that Chi-X's volumes would shrink by two-thirds and this would then bring into question Chi-X's ongoing viability.

GETCO appreciates the opportunity to submit these comments. Please do not hesitate to contact me at 65 8288 8455 with any questions.

Sincerely,

Rebecca Weinrauch
General Counsel, GETCO Asia