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31 March 2014

Senior Adviser
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

Chi-X Australia's Submission on the Final Recommendations of the Financial System Inquiry

Chi-X Australia Pty Ltd (Chi-X) is grateful to Treasury and the Government for the opportunity of providing a further submission on the final recommendations of the Financial System Inquiry (the Inquiry).

As an overarching comment, Chi-X commends the Inquiry for its impressive work and final recommendations. The work of the Inquiry provides an important template and benchmark for the development of seminal policies in the complex and important area of financial services.

Chi-X has comments on the following recommendations.

Recommendation 44 (ASX Ownership)

Chi-X is of the view that any removal of the cap on the ownership of ASX should not take place without commensurate regulation of the critical infrastructure and public interest responsibilities currently undertaken within or facilitated by the ASX Group. Those responsibilities include clearing, settlement and those associated with the listing function. In particular, it would not be appropriate for the ownership cap to be removed before the CFR finalises its consideration of the regulation of clearing and settlement functions.

Recommendation 30 (Strengthening the focus on competition in the financial system)

Chi-X strongly supports:

- the recommendation for government to commission periodic external reviews of competition in the financial sector every three years, including regulatory barriers to foreign and domestic entrants;
- the comments of the Inquiry on page 254 of the report, in the context of regulatory architecture, that "as an immediate first step, regulators should examine their rules and procedures to assess whether those that create inappropriate barriers to competition can be modified or removed, or whether alternative and more pro-competitive approaches can be identified";
- the statement that "Government should update ASIC's mandate to include a specific requirement to take competition issues into account as part of its core regulatory role".

Chi-X is of the view that minimum implementation times for regulatory approval of commercial measures and the monitoring of post implementation impact of new regulatory requirements would also assist in achieving the goals of the Inquiry in this area.

Recommendation 29 (ASIC funding model)

The Inquiry recommends that ASIC move to a more widespread industry funding model. As outlined in detail in the Chi-X second round submission, and noted by the Inquiry, a cost recovery model can act as a barrier to competition and/or as a measure to discriminate against new entrants. Chi-X supports the views of the Inquiry that any model must be:

- "subject to careful implementation and inclusion of an appropriate transparency and accountability framework";
- "structured to create a close relationship between the incidence of fees and levies and the costs of regulating the relevant activity".

The current cost recovery model to which Chi-X is subject does not satisfy these requirements. In particular Chi-X notes the following issues with the current cost recovery regime:

- (i) The current cost recovery regime is not user pays: it is based upon metrics that do not properly identify the entities creating the need for regulation or accurately measure the appropriate contribution of those entities that are identified. For example, the ASIC reports on the supervision and surveillance of Australia's financial markets confirm that the supervision paid for by cost recovery measures includes disclosure by listed entities¹ and yet ASIC cost recovery does not take into account the "need for regulation" generated by issuer disclosure. This is notwithstanding that income from issuers continues to be the most significant income stream generated by ASX in respect of the trading activities that are subject to ASIC cost recovery².

¹ See paragraph 56 of ASIC Report 405 – accessed on 22 August from [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep405-published-21-August-2014.pdf/\\$file/rep405-published-21-August-2014.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep405-published-21-August-2014.pdf/$file/rep405-published-21-August-2014.pdf)

² See the ASX Full Year Results Annual Report for 2014 retrieved on 25 August 2014 from http://www.asx.com.au/documents/asx-news/ASX_Ltd_Full-Year_Results_Annual_Report_August_2014.pdf

- (ii) The systems used to monitor Australia's markets are also used to monitor and take action concerning trading activity by persons and industry sectors which are not the subject of cost recovery³.
- (iii) Under the current regime, Chi-X currently pays nearly fifty percent of its gross trading revenue to ASIC under a cost recovery regime that commenced at around the same time the Chi-X market was launched. The discriminatory nature of the cost recovery measures is also reflected in the fact that Chi-X's share of the aggregate cost recovery fees paid by market operators (ie ASX and Chi-X) is over twice Chi-X's market share of aggregate trading. The ASIC cost recovery fees charged to Chi-X are also manifestly disproportionate to what alternative market operators pay globally. For example, BATS Chi-X Europe is a listing entity valued at over US\$300m with daily trading volumes that are double digit multiples of that traded on Chi-X and yet it pays lower supervision fees to the FCA than Chi-X pays to ASIC: for the 2013/2014 financial year the respective payments were £450,000 and A\$850,000⁴.

In these circumstances, Chi-X is of the view that it would be fundamentally inappropriate for the Government to roll over the existing cost recovery measures until the issues raised by an ASIC wide funding model are resolved.

The existing ASIC cost recovery measures are unfair and steps should be taken to address this immediately.

Recommendation 14 (Secretariat to promote Australia)

Chi-X is supportive of recommendation 14 (p147) that government should establish a permanent public-private sector collaborative committee, the "Innovation Collaboration", to facilitate financial system innovation and enable timely and co-ordinated policy responses.

Chi-X is of the view that it remains important for an industry led body, possibly consisting of the private sector representatives on the Innovation Collaboration, to:

- (i) act as a co-ordinator for industry-regulator liaison with all the regulators of Australia's financial system;
- (ii) play a leading role in holding regulatory authorities to account on developing Australia's markets;
- (iii) act as an industry representative on the setting of strategies to enhance Australia's financial services and markets; and

³ See for example the following ASIC press releases: *New South Wales man jailed for market manipulation*, retrieved on 25 August 2014 from <http://www.asic.gov.au/asic/asic.nsf/byheadline/14-131MR+New+South+Wales+man+jailed+for+market+manipulation> and *Healthzone directors charged with market manipulation*, retrieved on 25 August 2014 from <http://www.asic.gov.au/asic/asic.nsf/byheadline/14-205MR+Healthzone+directors+charged+with+market+manipulation>

⁴ The amount paid by BATS Chi-X Europe can be obtained on pages 20-21 of the FCA CP 14/6 "FCA Regulated fees and levies: Rates proposals 2-014/15, retrieved on 12 June 2014 from <http://www.fca.org.uk/your-fca/documents/consultation-papers/cp14-6>



- (iv) promote international integration and Australia as a financial centre.

Recommendation 38 (Cyber Security)

Chi-X is supportive of recommendation 38 which is to the effect that government should establish a formal framework for cyber security information sharing and response to cyber threats and the Cyber Security Strategy should be updated.

Chi-X is also of the view that cross border sharing models may also be appropriate within the framework of "vetted" jurisdictions.

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

Yours faithfully

A handwritten signature in black ink, appearing to read "Michael James".

Chi-X Australia