



# **Options for Amending the ASIC Market Supervision Cost Recovery Arrangements**

ASX Submission

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## Executive Summary

The overall cost of the supervision of Australian equity markets has risen as a result of the introduction of competition in trade execution. The current consultation is not concerned with the overall cost of ASIC's market supervision but asks questions about the distribution of these costs between, and within, different industry segments (ie market operators and market participants).

ASX supports the broad design of the cost allocation methodology. It is consistent with the Government's cost-recovery principles. The levy is designed to recover the costs of regulation from those whose activities are driving the costs of regulatory supervision.

ASX's view is that the proposals in the paper are largely sensible refinements to the existing model. Putting the new arrangements in place for a period of two years provides commercial certainty for that period and enables the gathering of further data to assess their impact.

Of the more significant proposed refinements to the cost recovery arrangements:

- ASX supports a slight reweighting of the activity-based cost recovery between message and trade-based fees on the basis that this means the distribution of fees more closely approximates the ASIC cost of regulating different market activities;
  - ASX notes that the current market licensing review being conducted by the Treasury may lead to dark pools operators needing to meet additional licence obligations. If that occurs it will have flow-through consequences to the cost recovery regime, if ASIC regulatory oversight of these activities is increased;
- ASX believes there is merit in considering the basis upon which supervisory fees could be passed on to end-clients, recognising that this is a matter that particularly concerns the relationship between intermediaries and their clients;
- ASX believes an exemption (or discount) from the supervisory levy for market makers is problematic.
  - The message-based supervision fees are largely a mechanism for recovering ASIC's IT related costs and these are directly related to the number of messages in securities where ASIC regulatory activities are focused. Providing an exemption for any particular trading activity moves those costs to others who have not been responsible for creating the regulatory activity. This would mean that some participants in the market are subsidising the activities of others. This is not consistent with the Government's cost recovery guidelines.
  - Providing an exemption for market makers would be difficult to administer and would be open to gaming, by HFT and others, or to delivering inequitable outcomes.
    - The authorities could try to apply a definition of what constitutes "genuine" market making activity. However, it is likely to be highly complex and ASX would expect it would not be immune from gaming by those seeking to transfer their cost-recovery obligations to others. It would also involve the authorities imposing themselves into commercial market making agreements between market makers and market operators by specifying obligations to be met, when these may differ between markets and products.
    - It may also lead to an unacceptable outcome where a single participant or different participants conducting the same trading activity on different venues, may attract a different treatment under the cost-recovery regime because they are defined as a market-maker on one venue but not the other. This would not be consistent with the cost-recovery principles and may introduce distortions into market place behaviours.
  - The activities of market makers benefit a market operator's market (as distinct from the whole of market). Market making arrangements are, appropriately, the subject of commercial terms between these two parties. The ASIC cost-recovery regime is one factor amongst others (eg exchange pricing, obligations on market makers, etc) that is taken into account in structuring those commercial arrangements; and
- ASX recognises that the current cost recovery framework will be extended to the ASX24 market consistent with the Government's cost recovery principles.

## Appendix 1 – Detailed Responses to Treasury Questions

### Current cost recovery arrangements (1 January 2012 to 30 June 2013)

Consultation Questions	ASX Comments
<p>1. Do you consider that the impact of the current cost recovery approach on overall market quality has been (a) mostly neutral, (b) positive, (c) negative or (d) other? Please provide examples to support your answer.</p>	<ul style="list-style-type: none"> <li>• It is difficult to measure the impact of the current cost recovery approach, given the subdued nature of trading volume (here and overseas) since the measure was introduced.</li> <li>• It is also not possible to isolate the impact of the cost recovery regime from other (general market and/or regulatory) factors that might affect trading. However there has been a noticeable decline in order/trade ratios since the cost recovery arrangements came into effect – this does not appear to have had any negative impacts on market quality.</li> <li>• The overall level of cost-recovery has obviously placed a burden on the industry at a time of generally depressed revenues, more than offsetting fee reductions following the reduction in ASX trading fees. This, as much as the design of the arrangements, may have a general impact on overall trading activity.</li> </ul>
<p>2. Are there any specific segments of our market that you consider have responded to the current cost recovery arrangements in ways inconsistent with government policy or in a manner detrimental to market quality? Please provide examples to support your answer.</p>	<ul style="list-style-type: none"> <li>• ASX is not aware of any market responses which would be inconsistent with government policy or market quality.</li> </ul>

### Introduction of a fixed component of cost recovery for cash equity market participants

Consultation Questions	ASX Comments
<p>3. Do you consider that a fixed fee on direct market participants reflecting the proportion of cost-recovered participant supervision that is attributable to direct market participants better aligns the fee model with ASIC's regulatory costs?</p>	<ul style="list-style-type: none"> <li>• The use of fixed fees, where appropriate, is an effective way of capturing the costs of some of ASIC's regulatory activities such as general reviews of participants' activities that are not directly related to trading activity.</li> <li>• ASX notes that Treasury is currently reviewing the market licensing regime to ensure that it is appropriately applied across different trading, for example those participants who operate dark execution venues. We note that one impact of licensing such trading venues under the market license regime rather than the current approach (regulating through an AFSL) would be that such venues would also have an additional cost impost under the cost recovery arrangements.</li> </ul>

	<ul style="list-style-type: none"> <li>ASX believes that regardless of whether the market licensing regime is amended as a consequence of the Treasury review there is a strong case that, if ASIC incurs specific supervision costs for activity in such off-market venues, those venues should be charged an additional cost recovery fee (fixed or variable) to fund those costs.</li> </ul>
4. Do you consider that the proposed fixed fee in the order of \$1,800 per quarter is reasonable? Please explain your answer. If you do not view this proposal favourably, please explain your preferred alternative/s.	<ul style="list-style-type: none"> <li>A fixed fee of \$1,800 per quarter (\$7,200 per year) does not seem a particularly high barrier to participation. It would, however, act as an effective minimum regulatory charge for those participants that have low levels of trading activity, including those who use the services of another broker to execute trades.</li> <li>While the fixed charge is relatively high for small participants, they are unlikely to pay significant activity related charges.</li> <li>The introduction of a fixed fee would seem to be a sensible refinement to the cost-recovery model.</li> </ul>
5. What impact does the proposed approach have on your business model? Can you provide examples of how the proposed approach would affect your business in dollar terms?	<ul style="list-style-type: none"> <li>Not applicable to ASX</li> </ul>

### Changes to variable fee components

Consultation Questions	ASX Comments
6. Do you consider that the cost recovery arrangement for equities market supervision costs (for ASX listed securities) should be amended so that some non-IT costs should be recovered through fees on messages? If not, please explain your preferred alternative.	<ul style="list-style-type: none"> <li>ASIC notes it is devoting increasing amounts of supervisory resources to the impacts of specific types of activity with relatively high order/trade ratios and/or high cancellation rates, such as HFT.</li> <li>If the proposal to increase the proportion of supervisory costs recovered from message traffic better aligns overall fees collected from participants with the costs of supervising their activities then it would seem reasonable. However, if the costs are being driven by specific regulatory actions, such as the need to better analyse the impact of certain types of activity (eg HFT) on market integrity then it may be fairer and more efficient to examine if there are other means of limiting the additional fees to those groups (eg, the use of fixed fees) rather than spreading the burden to other participants engaged in activities that do not raise the same concerns.</li> <li>ASX assumes these parameters will continue to be monitored by ASIC in determining the mix of message and trade based fees as the nature of their supervision activities changes and that this mix would change as the policy priorities shift.</li> </ul>
7. What impact does the proposed approach have on your business model? Can you provide examples of how the proposed approach would affect your business?	<ul style="list-style-type: none"> <li>Not applicable to ASX</li> </ul>

<p>8. In your view, have market makers responded to the current cost recovery arrangements in a manner detrimental to market quality? Please provide examples to support your answer.</p>	<ul style="list-style-type: none"> <li>• ASX is not aware of any firm data that would indicate the cost recovery arrangements have had a significant impact on market quality.</li> <li>• However, one market maker in exchange-traded funds (ETFs) resigned citing the supervisory levy as a key contributing factor. Other potential market makers also identified the impact of the levy to ASX as a reason they ultimately decided not to become market makers in these products.</li> <li>• Order/trade ratios have certainly declined since the arrangements were put in place – but that has not translated into deterioration in overall market quality. That said, it has been pointed out to ASX that spreads in ETFs traded in Australia have not tightened to the same extent as they have in many other overseas markets, with the cost recovery arrangements being identified as a possible driver of that difference.</li> </ul>
<p>9. Do you consider that the cost recovery arrangements for equities market supervision costs (for ASX listed securities) should be amended so that beneficial market making activity (subject to strict eligibility criteria) is subject to a reduced cost recovery levy for message based charges? If not, is there an alternative method to prevent the cost recovery arrangements creating a disincentive to undertaking beneficial market making activity?</p>	<ul style="list-style-type: none"> <li>• ASX believes that market operators contract with participants to provide a continuous two-way market making service for specific products (subject to clearly defined quote obligations) to deliver benefits to their market. Those arrangements are subject, appropriately, to negotiated commercial terms between the two parties based on a range of factors including fees charged and the market quality outcomes being sought.</li> <li>• If financial incentives were provided directly through the cost recovery regime then it would fall to ASIC to monitor that the obligations entered into by the contracted market makers have been met and to separate out what part of the business' trading relates to their market making activities and what relates to other trading.</li> </ul>
<p>10. Do you believe we should recognise beneficial market making in the fees regulations and if so, how do you believe we should set the criteria and conduct the process to define beneficial market making activity?</p>	<ul style="list-style-type: none"> <li>• Market making arrangements are, appropriately, the subject of commercial terms between the market maker and the market operator whose market benefits from that activity. They are not arrangements where regulatory authorities should interpose themselves, unless market integrity issues arise.</li> <li>• The activities of market makers in products such as derivatives and structured products are designed to ensure the price of the product remains aligned with the underlying asset values and to provide important liquidity for retail customers seeking to sell. They do not raise the same potential market integrity issues that rapidly changing orders in an order driven market do. This is reflected in the nature of the surveillance activities ASIC undertakes and the data it requires to conduct those market monitoring functions. It should also ensure that the cost recovery arrangements produce an outcome reflecting the costs associated with regulating those specialist product markets consistent with the Government's cost-recovery principles.</li> <li>• However, if in the future, the cost-recovery model had the practical effect of imposing costs on users that were disproportionate to the costs of regulating that activity then it would require reform of those parameters to bring the model into line with the Government's cost-recovery principles.</li> </ul>

<p>11. Should firms that benefit from such a discount or exemption be subject to strict, enforceable obligations? If so, what obligations would be appropriate and how should they be enforced?</p>	<ul style="list-style-type: none"> <li>• While ASX believes such discounts may be problematic, if they were to be contemplated than ASX believes the obligations associated with any market maker incentives should be clearly defined and measurable and transparent to the market. The measures should include minimum requirements for posting two-way prices for a specific period of time and within appropriately tight, transparent pricing parameters.</li> <li>• For example, a requirement to maintain continuous two-way quotes for at a minimum period (eg 80%) of the time at a specified maximum spread (eg two price ticks) and minimum quantity (eg 100 shares).</li> <li>• We believe that it would be difficult to achieve these objectives without opening the opportunity for gaming of the arrangements.</li> </ul>
<p>12. What impact would the approach referred to in question (9) have on your business model? Can you provide examples of how the proposed approach would affect your business in dollar terms?</p>	<ul style="list-style-type: none"> <li>• Not applicable</li> </ul>
<p>13. Do you consider that the cost recovery arrangements should be changed so that fees are fixed by ASIC prior to the start of each billing period? Why/why not?</p>	<ul style="list-style-type: none"> <li>• ASX see that there may be benefits from providing greater certainty to stakeholders through advance publication of fee per message/fee per trade for a period. However we appreciate this certainty comes at the expense of potential over/under charging by ASIC for a period. Without any specific historical data on the quarterly volatility of the per message/trade charges it is difficult to make an assessment of whether the costs of the change would outweigh the benefits.</li> <li>• That said, we believe that the existing arrangements seem to work reasonably well so, on balance, we would support continuing with that system unless specific problems are identified.</li> </ul>
<p>14. If you agree with the approach referred to in question (13) what, if any, oversight or safeguard arrangements, including notice periods, would you consider appropriate in relation to this process? If you disagree with the approach referred to in question (13), what alternatives do you believe would be appropriate?</p>	<ul style="list-style-type: none"> <li>• Not applicable</li> </ul>
<p>15. If you agree with the changes referred to in question (13), do you agree that ASIC should set the fixed fees on a quarterly basis. If not, what other arrangement would be appropriate?</p>	<ul style="list-style-type: none"> <li>• Not applicable</li> </ul>

<p>16. Do you agree that participants should be made to pass trade and message fees on to their clients? If so, why is such an arrangement preferable to voluntary pass through of costs?</p>	<ul style="list-style-type: none"> <li>ASX believes that a cost recovery regime should, as closely as possible, impose fees (and recover costs) from those undertaking the market activity that requires regulators to build systems and allocate resources to perform the required regulatory oversight. This will provide effective price signals to those undertaking these activities and ensure the regulatory costs are fairly apportioned.</li> <li>ASX believes there would be merit in considering pass-through requirements – although we recognise that these are matters directly relevant to intermediaries and their customers rather than market operators.</li> </ul>
<p>17. What changes would be necessary in order for your business to implement the approach referred to in question (16)? Can you provide estimates of the costs of those changes?</p>	<ul style="list-style-type: none"> <li>Not applicable</li> </ul>
<p>18. What impact would the approach referred to in question (16) have on your business model? Can you provide examples of how the proposed approach would affect your business in dollar terms?</p>	<ul style="list-style-type: none"> <li>Not applicable</li> </ul>

### Changes to ASX 24 cost recovery

Consultation Questions	ASX Comments
<p>19. Do you consider that the current proposed cost recovery approach for equities market supervision costs (for ASX listed securities) can be extended to the ASX24 market once ASIC's real-time market surveillance system receives ASX24 data in real-time via the Australian Markets Regulation Feed? If not, please explain your preferred alternative.</p>	<ul style="list-style-type: none"> <li>ASX notes that it is proposed to extend the existing cost-recovery regime for equity markets to ASX24 markets, based on similar principles of seeking to match fee recovery to the cost of supervising particular groups; participants and market operators. In that respect, it is a natural progression of the arrangements to a model that is fully consistent with the Government's cost-recovery principles.</li> <li>The changed fee arrangements are proposed to apply from the 2013-14 FY when ASIC begins real-time market surveillance of ASX24 markets. There would be a need to ensure market operators and participants were fully informed of the proposed changes and the implications for them prior to the new system coming into effect.</li> </ul>
<p>20. What impact does the proposed approach have on your business model? Can you provide examples of how the proposed approach would affect your business in dollar terms?</p>	<ul style="list-style-type: none"> <li>Not applicable</li> </ul>



## Cost recovery and penalties for breaches of market integrity

Consultation Questions	ASX Comments
21. Do you consider it appropriate that pecuniary penalties issued by the MDP be applied to the cost recovery figure? If so, please explain why.	<ul style="list-style-type: none"> <li>The fines levied for breaches of the market integrity rules are directly related to the underlying market surveillance and participant supervision that ASIC undertakes. It is appropriate that these monies be available to defray the costs of the supervision activities for other participants who abide by the rules.</li> </ul>

## Collection and administration of fees

Consultation Questions	ASX Comments
22. Do you consider that the proposed change to late payment fees is more administratively simple and efficient, and easier for billing entities to reconcile? If not, please explain your preferred alternative.	<ul style="list-style-type: none"> <li>Having an effective penalty regime to ensure timely payment of fees is an important integrity measure to ensure that those who do pay on time are not effectively discriminated against.</li> <li>A fixed penalty, based on a sliding scale may be more administratively simpler.</li> </ul>
23. What impact does the proposed change have on your business model? Can you provide examples of how the proposed change would affect your business?	<ul style="list-style-type: none"> <li>None</li> </ul>
24. Do you consider that the sanctions for late payments of cost recovery fees should be expanded? If so, what sanctions do you believe are appropriate?	<ul style="list-style-type: none"> <li>It is important that there is an effective mechanism to ensure collection of fees, particularly for those foreign participants without an AFSL. The nature of those of those sanctions should be proportional to the circumstances and the potential impact on the participant's clients.</li> </ul>
25. Do you consider that granting ASIC the power to suspend or revoke an entity's licence may be appropriate under certain circumstances? If so, how should those circumstances be defined? What safeguards would be appropriate in relation to such a power?	<ul style="list-style-type: none"> <li>The option of temporarily suspending or revoking a licence for consistent non-payment, as noted in the consultation paper would have an extreme impact on clients.</li> <li>If such sanctions are to be introduced it is important that guidance is provided as to what clearly defined circumstances may lead to such a significant response.</li> <li>Consistent late payment of fees suggests that the broker is experience financial stress or has operational deficiencies.</li> </ul>
26. Do you consider that granting ASIC the power to ban an entity from further trading may be appropriate under certain circumstances? If so, how should those circumstances be defined? What safeguards would be appropriate in relation to such a power?	<ul style="list-style-type: none"> <li>The less extreme option of restricting a participant from trading for a period until their account is settled is another option that could be considered. This would be a particularly strong lever where a participant is trading on its own account. Where a participant undertakes both propriety trading and trading on behalf of clients a penalty of restricting the firms proprietary trading – while leaving trading on behalf of clients unaffected would be one possible response.</li> </ul>

<p>27. Do you consider that the Fees Act should be amended to provide for the repayment of recovered fees or the adjustment of future fees when ASIC spends less than its budgeted costs? Should the Act provide for just one of these processes or both? Why?</p>	<ul style="list-style-type: none"><li>• ASX would support the Corporations (Fees) Act be amended to provide for a process for repayment of recovered fees or adjustment of future fees if ASIC underspends its budgeted costs.</li></ul>
<p>28. What process, repayment or adjustment, is most likely to be efficient to administer? Why?</p>	<ul style="list-style-type: none"><li>• ASX believes that the repayment of direct overpaid amounts in a timely manner is the simplest way to make repayments.</li></ul>