14 May 2018

Manager, Corporations Unit
Consumer and Corporations Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email to ASICFunding@treasury.gov.au

Re: ASIC Industry Funding Levies Regulation Enhancements

Thank you for the opportunity to comment on the draft regulations and related explanatory material to amend elements of the ASIC Supervisory Cost Recovery Levy.

Subject to ASX receiving a benchmark administration licence, we note that the industry funding regime is being extended to apply to this subsector. The proposal to share the costs between benchmark administrators based on the number of benchmarks they administer appears reasonable.

Large Securities Exchange Participants

The new regulations propose amending the existing mechanism for recovering the regulatory costs associated with large security exchange participants. The explanatory material states that the change is designed to 'simplify' the mechanism for allocating costs amongst these market participants.

The existing methodology distributes these costs amongst participants based of each firm's share of messages and trades. The amount collected under each element is currently determined using a split of ASIC's IT and non-IT costs, with the former recovered based on messages and the latter largely based on transactions (with a small message-based component). In practice, this has meant that roughly half the cost recovery is based on messages and half on transactions.

ASX notes that the current design enables costs to be broadly allocated in line with ASIC's regulatory activities and no subset of the regulated population avoids paying their fair share of ASIC costs. ASIC's IT related costs are driven in large part by the need to accommodate an increasing number of smaller orders being routed to exchanges so a message-based element to the levy was an important design feature.

The current design has the added benefit of moderating the rapid growth of some undesirable trading strategies that involved high order-trade ratios. In this regard, it was successful in ensuring that the very rapid growth in high frequency trading (HFT) experienced in a number of overseas jurisdictions was not repeated here. However, the design also recognised the importance of market making in some products by excluding from the levy certain specific messages types used by market makers.

Going forward, this methodology is to be replaced by a formula whereby around 90 per cent of the total cost will be based on transactions and 10 per cent based on messages. While the paper explains that the change is justified on the basis of simplifying the model it is not clear whether the resulting split aligns more closely with the costs of the specific regulatory activity being undertaken by ASIC.

It is also important that any change to the methodology for determining how ASIC's costs are shared amongst participants does not have any unintended consequences on market structure by encouraging the re-emergence of some of the undesirable trading strategies.

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It is hard to assess the impact of the proposed change, including whether the cost burden will be appropriately shared between participants in a manner that reflects ASIC's underlying regulatory costs. There is also no indication in the explanatory material that the impact on market operation has been considered when designing the proposed changes.

Large Futures Exchange Participants

While not explicitly addressed in the proposed regulatory amendments, ASX observes that there has been very little transparency and understanding of how a similar methodology will be applied to distribute the new charge on large futures exchange participants. While this also involves a transaction and message based charging regime, it is not clear how this will work in practice, including whether there will be a similar split (e.g. 90/10) between the two elements.

It is important that the authorities consider carefully the impact of the approach taken to allocate the funding obligation amongst futures market participants to ensure it is both fair and efficient. It is not necessarily the case, for example, that the model used for equity markets should be the same as that applied to futures market.

The model should be tailored to the particular market structure and reflect how the market operates in practice. That is, recognising any differences between how the equities and futures markets operate, including how trading is undertaken. For example, in the futures market the levy should be applied on a per-lot rather than per-transaction basis to better align with market practice and to avoid the need for costly changes to participants' systems.

There should be lower reliance on message-based charges to recover these regulatory costs as less liquid futures products are supported by market makers, and there are no specific message types for these market makers. These market makers provide a critical service that reduce transaction costs for end-investors and underpin the health of the futures market.

The imposition of the new charge for futures participants should reflect the nature of ASIC's costs in monitoring and regulating these entities and be shared fairly amongst them. It is particularly important that the authorities analyse the impact of the chosen model on market participants and specific futures products and ensure the outcomes do not unnecessarily impact on the efficient operation of the futures market.

ASX would be happy to provide any assistance to facilitate such detailed analysis (including supplying any necessary additional data) to ensure the imposition of the ASIC levy on these participants in both fair and efficient.

Yours sincerely

Kind regards

Gary Hobourn.

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