14 February 2013

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Dear Mr McAuliffe

Australia's Financial Market Licensing Regime: Addressing Evolution

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the consultation paper 'Australia's Financial Market Licensing Regime: Addressing Evolution'.

AFMA appreciated the fruitful dialogue we had with you and Ms Havyatt on this discussion paper and we look forward to working with you as policy on the market licensing regime is further developed. Please find attached the AFMA responses to the questions posed in the discussion paper.

Please contact me at dlove@afma.com.au or (02) 9776 7995 if you wish to discuss the matters raised in this submission.

Yours sincerely

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Australia's Financial Market Licensing Regime:

Addressing Evolution

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1. General comments

The current conceptual framework for market licensing is fundamentally sound but it can be improved to recognise and allow for the range of financial markets, including professional financial markets, to be regulated along a consistent continuum, where obligations are determined and applied in a way that is appropriate to the nature and scale of the particular market.

The law should be reformed to recognise the emergence of a new generation of organised trading systems alongside licensed markets which are subject to obligations designed to maintain efficient, fair and orderly financial markets under a proportionate regulatory framework.

There is a strong industry preference for clear rules for licensing markets which should be set out in the Corporations Act with necessary flexibility being achieved by using regulation making powers.

Policy discussion around high frequency trading sits outside the context of market licensing policy and should be dealt with quite separately.

The consultations by Treasury on the discussion paper have revealed a number of consequential issues that will require careful thought before reform proposals can be finalised. One such example relates to intellectual property rights over data that is generated by so-called dark pools. Widening the market licensing requirement to various forms of emerging organised trading facilities affects commercial relationships between investors, participant and principal trading facilities and intellectual property rights with regard to data that need to be thought through.

It is not possible at this time to specify with certainty all the consequential issues that may emerge but room needs to be given for discussions on such issues in future policy consultations.

Market Integrity Rules

Among the consequential issues on which some elaboration can be made is the nature of the current very broad discretionary 'Market Integrity Rules' (MIR) making power in Section 798G of the Corporations Act. The MIR will require a conceptual rethink to clearly separate market operation issues from market misconduct issues.

It is not consistent with the structure of Chapter 7 of the *Corporations Act 2001* (the Act) to deal with issues relating to the regulation of investor behaviour under market licensing related rules. Rules that deal with activities or conduct of licensed markets or

the activities or conduct in relation to the 'fair, orderly and transparent' operation of licensed markets with regard to the matters covered by Part 7.2 of the Act are quite distinct to rules that relate to market conduct by market participants and investors and the two should be clearly distinguished. If evidence justifies regulatory intervention with regard to additional oversight of investor activity then these are market misconduct issues of general application.

It is suggested that a revised Australian Securities and Investments Commission (ASIC) rule making power be directed to rule making for matters covered in Part 7.2 of the Act that covers entities referred to in subsections 798H (a) and (b), namely market operators and participants on licensed markets. With regard to market misconduct issues that ASIC considers should be dealt with as a part of market supervision further policy consultation is required on the question of whether a discretionary rule making power is the most appropriate way to deal with identified problems. Such consultation could encompass classes of persons / entities who should be subject to market supervision by ASIC.

More generally, AFMA reiterates its position that rule making power granted to a regulator should deal with matters relating to the administration and supervision of a regulatory regime set out in the law. It is the role of the Parliament through its acts to set out the framework of the regime and the parameters within which it should operate. Establishing classes of persons and products and the rules which they need to observe when coming within the scope of the regime are properly matters for policy making and Parliamentary decision. Where flexibility is required this can be achieved through regulation making powers. Administration of the law is about how rules set by Parliament of general application are to apply in practice to specific circumstances and persons and then ensure that the law is followed. It is not the role for administrators to creatively expand the scope of the law, even where broad discretions are granted. Discretions are granted by Parliament in order that the law may be applied in a rational, common sense way to particular circumstances in a constantly changing world.

In this regard, we commend the regime put in place by the *Corporations Legislation Amendment (Derivative Transactions) Act 2012* for the licensing of trade repositories which has put in place arrangements which strike an appropriate balance between administrative flexibility and regulatory certainty.

Our comments now turn now to specific questions posed in the discussion paper.

2. Problem identification

1. Do you have any comments on the general form of the current legislative framework for licensing of financial markets in Australia?

The market licensing regime needs to take account of the differing nature of the markets being supervised. It is important for the regulatory framework to accommodate markets that cross the whole spectrum of possibilities.

The increased share of market capitalisation held by institutional investors and their rising participation in trading activity put pressures on the traditional trading system of exchanges that was modelled on retail trading. Institutional investors are interested in a trading environment where they can trade large orders directly with one another, to reduce the market impact of such orders and execute them with high speed.

Electronic trading platforms have enabled more efficient trading of financial instruments such as interest rate products, commodity derivatives and currency by professionals. Wholesale market participants and the professional clients they serve have a similar degree of knowledge. They benefit from more timely execution and lower transaction costs.

Wholesale markets serve to facilitate bilateral contracts between banks, trading houses, commercial enterprises, government authorities and central banks, with market participants providing liquidity and price discovery to these markets. Wholesale financial markets range from pure 'voice broking' via telephone, to managing fully electronic trading platforms, including the hybrid model combining both voice broking alongside an electronic system.

Over the last thirty years technological advances have allowed the introduction of automated trading systems characterised by lower costs per trade, higher speed of execution, and a greater ability to absorb an ever increasing demand for trading services. In addition, barriers to entering the trading business have been lowered, as electronic trading venues are less costly to set up and do not require physical presence of members in a central location. This development is stimulating a growing number of venues, by making markets more contestable as a result of them being cheaper to enter and enabling greater variety of products and specialisation of trading services. The speed of development of the facilitating information network technology reinforces a more rapid pace of change. As a result, a number of proprietary trading systems have emerged seeking to take away market share from traditional exchanges. Moreover, electronic networks of communication provide much more efficient methods of dissemination of trading data and other information to financial intermediaries and investors.

The resulting dynamic environment for financial market operators places consequent demands on the Government and ASIC to provide an appropriate regulatory environment.

2. Do you consider that there are efficiency issues that could be addressed by revising the licensing regime? If so, please provide details.

AFMA has previously stated the view in response to ASIC's Consultation Paper 116 concerning exempt professional markets that there are now real tensions between the conceptual framework in Part 7.2 and real world needs. ASIC is understandably handling this tension through using the exemption power to provide some flexibility to a rigid regulatory framework that does not recognise there is a continuum from traditional exchanges with integrated clearing and settlement facilities, such as the Australian Securities Exchange, to bilateral trading markets with a small number of professional participants.

Electronic systems can also enable linkages to bring together sources of liquidity and to harness efficiencies that contribute to consolidation. In the fixed income market it can be observed that new trading systems are starting to bring together larger groups of users, consolidating sections of the market which formerly relied on bilateral communication.

Equity markets continue to be dominated by centralised exchanges, which serve a wide investor base and have a primary obligation to protect retail investors trading in small parcel transactions. The Australian market is an obvious example of this situation. In order to meet professional investor needs, such as fund managers, large banks and brokers are increasingly working to handle their order flow which creates a demand for alternative trading venues to deal with large volume transactions.

3. 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.

We do not consider that the primary aim of revising the licensing regime should be to address market integrity or investor protection concerns.

AFMA is of the view that it would be preferable for the law to recognise and allow the range of financial markets, including professional financial markets, to be regulated along a consistent continuum, where obligations are determined and applied in a way that is appropriate to the nature and scale of the particular market. The law needs to be reformed to recognise the emergence of a new generation of organised trading systems along side licensed markets which are subject to obligations designed to maintain efficient, fair and orderly financial markets under a proportionate regulatory framework.

This dynamic environment driven by technology, and now the desire of authorities around the world to move from bilateral trading to electronic trading platforms and exchanges, creates opportunities for new entrants and an increased number of trading facilities. However, this effect is countered by normal business pressures as not all new

entrants may be able to attract sufficient business to operate profitably. The attraction of liquidity is crucial to the success of a financial market. It is reasonable to expect that there will be a tendency to consolidation over time. In any particular market the extent to which electronic trading is currently motivating a phase of fragmentation or consolidation is very dependent on existing structures.

The broad definition of what constitutes a financial market is anticipates the possibility of market innovation and evolution and is able to provide regulatory coverage as market infrastructure changes. It provides a suitable, clear, and robust regulatory coverage of all different types of trading facilities, technological applications, and methods of execution which exist today or may emerge in the foreseeable future.

AFMA notes that the revision of the market licencing regime presents a significant opportunity to address the constraint on remote membership that has previously been identified as a restriction on the integration of Australia's financial markets within the region.

While it is appropriate that foreign exchanges offering remote membership in Australia should conform to the standards of domestic exchanges, it is not appropriate that ASIC should require the same direct level of control of foreign exchanges where there are equivalent oversights by the relevant and equivalent foreign regulator.

There are a number of firms that operate their Asian regional trading businesses from Sydney and reform of remote membership would be important to the continuing relevance of Sydney as a financial hub.

4. Do you agree that regulatory change would be desirable in order to better align Australia's market regulatory regime with overseas regimes?

This is not an important factor in relation to the current proposals.

At the fundamental level AFMA believes that the conceptual framework for the Australian market licensing (AML) regime is basically sound. Beyond the need to provide some flexibility to allow the spectrum of new trading facilities to be efficiently regulated, recognition also needs to be given to international standards where applicable.

In relation to market licensing and approval there are no current international standards directly relevant to trading facilities in contrast to other components of financial market infrastructure (FMI) which may be related to trading facilities that are subject to the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) CPSS-IOSCO Principles for financial market infrastructures. The standards cover systemically important payment systems, central securities depositories, securities settlement systems, central

counterparties and trade repositories and underpin the concurrent policy deliberations flowing from last year's Council of Financial Regulators proposals coming out of its Review of Financial Market Infrastructure Regulation.

5. 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?

Yes.

The September 2009 G-20 commitments are a major impetus for the push to move derivatives trading onto organised trading facilities. Leading reforms around the globe include the relevant requirements in the US Dodd-Frank Act and the EU Markets in Financial Instruments Regulation (MiFIR) directive which deals with the obligation to trade all standardised over-the-counter (OTC) derivative contracts on trading venues.

There is a question of whether OTC derivatives contracts subject to the MiFIR trading obligation may be traded through third country trading venues. There is also a question of whether the trading obligation may apply to persons or transactions outside the EU. In relation to the recognition of third country trading venues, EU law provides that third country central counterparties (CCPs) can be used where the third country CCP is recognised by the European Securities and Markets Authority (ESMA). For the recognition of third country trading venues, the European Commission has proposed in MiFIR that, in order for a third country trading venue to be recognised, the third country must provide an equivalent reciprocal recognition of trading venues authorised under the EU directive.

3. Overview of reform options

6. Do you consider that more flexibility in the AML regime is warranted, so that a greater number of facilities may be covered?

It is now over a decade since the current policy framework for licensing financial markets was devised and first articulated in the Corporate Law Economic Reform Program (CLERP) 6 proposals. In that time there has been a significant transformation in the way professional financial markets operate.

ASIC has justifiably sought to adapt the current regulatory framework to the changing commercial environment.

The fundamental starting point on the operation of the exemption policy is the legislative policy underlying licensing of a market facility. A facility does not constitute a 'financial market' where transactions involve direct negotiation in the way described in

paragraph 767A(2)(a). The effect of this is that a financial market does not arise where there is the making or accepting of offers or invitations to acquire or dispose of financial products in circumstances that involve direct negotiation between the parties who each accept the counterparty credit risk. The starting point to what constitutes a 'financial market' is the involvement of multiple buyers and sellers using the facility.

The rigidity arises because the fixed obligations which must be met under section 792A of the Corporations Act are not all appropriate to professional financial markets (PFM). ASIC's approach of advising the Minister to exempt a PFM subject to conditions which would reflect, to the degree appropriate, market license obligations allows inappropriate obligations to be turned off while still allowing an exempt PFM to be supervised and made accountable to investor protection and market integrity regulatory objectives. However, it would be clearly preferable if the law recognised and allowed the range of financial markets, including PFMs, to be regulated along a consistent continuum where obligations are determined and applied in a way that is appropriate to the nature and scale of the particular market.

7. Do you have a preference between Option 1 and Option 2? If so, please provide details.

We have two roads – one is to allow for a more nuanced approach to trading facilities that recognises that they are not necessarily large monolithic institutions; or the alternative to narrow the definition of a market and create a new type of market for specialist trading facilities.

The second alternative is not consistent with the conceptual framework and recent reforms introducing a regime for licensing trade repositories.

8. Is there an alternative option that you think would provide a better outcome than either of those presented? If so, please explain this option.

Australia is not the only jurisdiction where it has been necessary to recognise the emergence of a new generation of organised trading systems alongside licensed markets which are subject to obligations designed to maintain efficient, fair and orderly financial markets under a proportionate regulatory framework.

In parallel, new technological capabilities have led to a rise in the demand for cross-border trading, thus contributing to the overall increase in trading activity. Electronic trading platforms enable efficient and reliable cross-border communication of price information and transaction execution on a global scale. Global trading has been driven by intermediaries expanding internationally, who become market participants on multiple exchanges and trading platforms. As they have grown both through a larger

network of clients and through increased consolidation in the investment banking business they are now the receiving point for a large number of investors' orders.

Electronic trading platforms have encouraged the global trading of financial instruments such as interest rate products, commodity derivatives and currency by professionals. Traders, working closely with innovative technology experts, have changed the way trades are conceptualised and executed. As a result the concept of what is a market operator has evolved and is still evolving.

Overall, these developments have resulted in regulatory responses in the US and Europe that drove the evolution of professional financial markets. Although the frameworks have differed competitive pressures on financial market operators have come from client demands for more cross-border trading and lower transaction costs.

The US National Market System (NMS) covered a market characterised by the dominance of a major exchange, regional exchanges and Alternative Trading Systems (ATS). ATS provided most of the competition, rather than dealers internalising orders. In Europe, exchanges traded primarily in separate sets of stock, mostly originating in each exchange's local jurisdiction, resulting in systematic internalisation of orders by investment firms.

Europe focused on improving competition and removing national barriers within the European Union (EU). This resulted in the Markets in Financial Instruments Directive (MiFID) which provides that entities trading with financial instruments must be organised as either a regulated market or a multilateral trading facility (MTF), with different standards applying to each. Since the implementation of MiFID, the traditional exchanges have had to adapt to a new environment that introduces alternative trading platforms, or MTFs, which have comparable authorisations to exchanges and passports to trade across national borders. This was coupled with the ending of the concentration rule in some European countries. As a result, markets could no longer require orders to be executed at the central national marketplace and monopolies could only be based on market dynamics, rather than on regulation. While competition increased as a result of the reform market fragmentation made the trading environment more complex. Market, product and technology developments outpaced the provisions of the original directive. The response to the financial crisis and the ensuing G-20 commitments required more financial instruments, in particular OTC derivatives, to be traded on facilities. In response the European Commission embarked upon the MiFID II.

When MiFID I was being negotiated, a big question was what a systematic internaliser was. This became the focus for a contentious debate between the old style stock exchanges and brokers over territory for trading securities. The result was very complex provisions about systematic internalisers. As a result there was little take up with only 12 systematic internalisers, representing only two per cent of European equity trading.

The debate under MiFID has moved onto broker crossing systems which differ from systematic internalisers in that if an order to buy a share is put in by a client, the firm crosses that order with another client's holdings rather than trade against the broker's own book. One of the most contentious debates on the MiFID II proposals has surrounded the creation of a fourth trading facility category, that of organised trading facility (OTF), to accommodate broker crossing networks. However, equity exchanges were vehemently opposed to this on the basis of transparency arguments and this has subsequently been removed from the latest draft of MiFID II, although there is talk that it may possibly be re-inserted by the Council of Ministers at the final trialogue process for MiFID II.

It is not AFMA's contention that either the US or EU regulatory frameworks are better or particularly appropriate to Australian circumstances. In fact they illustrate why the Australian regime is a conceptually better framework for accommodating evolving markets. But what they do provide are regimes that enable professional financial markets to be regulated appropriately and which assists in reaching the current regulatory priority of facilitating standardised financial instruments to be traded through organised trading facilities.

9. 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 provisions in Part 7.2?

No. This should be the role of regulation. The rule making power should deal with matters relating to the administration and supervision of the regime. It is the role of the Parliament through its acts to set out the framework of the regime and the parameters within which it should operate. Establishing classes of persons and products and the rules which they need to observe when coming within the scope of the regime are properly matters for policy making and Parliamentary decision. Where flexibility is required this can be achieved through regulation making powers. Administration of the law is about how rules set by Parliament of general application are to apply in practice to specific circumstances and persons and then ensure that the law is followed. It is not the role for administrators to creatively expand the scope of the law, even where broad discretions are granted. Discretions are granted by Parliament in order that the law may be applied in a rational, common sense way to particular circumstances in a constantly changing world.

Application of the law to a class of persons is a matter of considerable commercial importance and consequence to the economy and so is a matter properly for the law. How rules are to apply in detail and matters of timing can be left to administrative discretion.

10. 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.

Market infrastructure providers require regulatory certainty and clarity. Establishing clear parameters under which services can be offered is a desirable objective from an industry stand point. It is also desirable for the law to provide a level play field and to treat comparable infrastructure providers in an equal way. A particular criticism of the current situation is that the exempt market regime and licensing opinions of ASIC do not provide fair and equal treatment in the eyes of some. While legitimate justifications can be made for common sense application of rules by ASIC in the past to fit particular applicant circumstances, looked at from a system perspective, there are anomalies which are perceived as not providing equal treatment in all cases.

While granting the regulator discretion to flexibly apply the law has superficial attractions it can also raise problems when there is interpretive misalignment which allows the regulator to engage in creative policy making as opposed to administering the law as intended by the legislature. ASIC's broad interpretation of its discretion under the Market Integrity Rule making power to engage in policy making and extend the law beyond the intentions of the legislature has been an issue of longstanding concern to AFMA elaborated upon in previous submissions.

There is also a case to be made for taking a graduated approach to approving markets which recognises there is a spectrum of markets, from systemically important market trading infrastructure to very small professional trading facilities and networks. Minor facilities do not necessarily require attention at the ministerial level in the approval process. To distinguish markets which merit ministerial attention from those which do not require the definition of categories of markets.

For these reasons AFMA favours Option 1a.

11. If Option 2 were addressed, how could the limitations to flexibility found in international markets be allowed for in system design?

For the reasons previously discussed we consider Option 2 to be a problematic way to tackle regulation of market infrastructure. This view draws on the observation of the problems that have been encountered in Europe around the MIFID regime and getting definitions to work over time.

The merit of a high level principles based definition of financial market is that it provides flexibility which can be supported by suitable regulations.

12. 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.

In supporting implementation of Option 1a recognition also needs to be given to the challenge it creates because it presumes definition of categories and the selection of appropriate obligations and suitable supervisory arrangements.

The starting point for considering this question is an evaluation of the current obligations and how they have been applied to approved exempt markets though the ASIC application evaluation process. Current conditions imposed on exempt market operators provide the template for how obligations can be applied to different categories of market operators.

Consideration will have to be given to the licensing of operators of multiple markets that may fall under different categories. Like markets should be subject to equivalent obligations. Market operators should not be burdened with a full suite of obligations that would apply to a systemically important market for minor trading facilities that are competing for business in particular market niches.

4. Advantages of reform

13. Do you have any comments in relation to the perceived advantages of a more flexible market licensing regime? If so, please provide details.

Conceptually, the AML regime is predicated largely on markets in shares, in which regulated exchanges have traditionally played a central role. The emergence of alternative trading functionalities, rapid technological developments, and the growing spotlight on OTC trading all challenge this paradigm. The law has an all or nothing approach to obligations imposed on an AML, which is at odds with the principles and broadly based definition of what a financial market is.

14. Do you have any comments in relation to the potential drawbacks of the proposed licensing reform? Please provide details of any concerns you have.

The time required to develop the details needed for implementation of the preferred Option 1a is not a problematic factor. It is important to adequately consult on the details of the changes with stakeholders, particularly around the definition of categories and the matching of appropriate obligations to those categories

The principle concern surrounds the impact on existing market operators, both those with an AML and those operating under the exemption regime and those providing services which may be required to obtain a license. The expectation is that

implementation of a revised regime should not result in disruption to business operations and the provision of market services. This would require transitional arrangements to transfer existing AML and exemption market approvals to licenses under the appropriate categories to new rules without market operators having to go through a new license application or resubmission process with attendant costs and uncertainty that would result.

The basic working assumption is that current market operators are currently meeting appropriate obligations and market integrity objectives of the law. Therefore they should not be required to change how they are operating their current businesses.

5. High Frequency Trading

15. 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 rules be limited to those which relate specifically to non-market participant HFTs?

Consultation by the government on issues relating to High Frequency Trading (HFT) should await the outcome of the work by the ASIC HFT Taskforce in March 2013.

There is a threshold issue of why regulation of automated trading in the guise of high frequency trading is being raised in the context of the financial market licensing regime. This is not a market infrastructure issue but relates to investor behaviour and the obligations of market participants, not one about the provision of a facility on which the trading occurs.

The Consultation Paper suggests that HFT is a new form of automated trading that trades in and out of positions in stocks and futures to earn small but consistent profits. This is in fact a description of longstanding market making and is not a new activity in the market.

AFMA also does not agree with the proposition that "*. . . HFTs arguably increase the risk of market volatility.*" This proposition is not supported by evidence, and definitely not by the example cited in the statement: "*This may occur as an HFT causing volatility, particularly through erroneous trading as was seen by Knight Capital in the US in August 2012. . .*" There is no indication that the erroneous trading by Knight in August caused volatility. In fact, none of the circuit breakers were triggered because prices were not dislocated. The only volatility caused by the Knight event in August was to Knight's own stock.

The official *Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues on Findings Regarding the Market Events of May 6, 2010* did not find that HFT created a domino effect during the Flash Crash.

16. Do you have any concerns in relation to making HFTs subject to market integrity rules? If so, please provide comments.

ASIC has direct supervision powers over the trading activity of investors. Part 7.10 Division 2 of the Corporations Act has a series of criminal offences with very significant penalties that regulate market misconduct which are applicable to persons who may misuse HFT technology to manipulate the market. The persons subject to these provisions are those who engage in the prohibited conduct, not the market participants who provide access to the market.

The role of ASIC's market surveillance is to detect such conduct, investigate and follow up with enforcement action if sufficient evidence exists.

17. Do you have any comments on how HFT should be defined and how it should be measured?

Our comment in relation to Question 15 is repeated.

Market manipulation may be attempted by any type of trader regardless of the technology they use to access the market. Where technology allows novel forms of market manipulation which are found to impact the market, regulation may be appropriate if substantiated by a costs and benefits analysis. At this stage, certainly in the Australian context, these concerns appear theoretical at most. We are not aware of evidence at this stage to suggest these are real concerns warranting regulatory intervention.

The approach being canvassed in the Consultation Paper is similar to that in MiFID II. MiFID II proposals have suggested that HFT firms might be required to register with an EU Competent Authority or a third country with a recognised comparable regulatory regime. The conceptual structure of the EU regulatory framework, and for that matter US dealer rules, is quite different to that of Chapter 7 and the route and means to achieving regulatory objectives is quite distinct. Therefore, it is not appropriate to consider implementing similar solutions.

Again we reiterate that it is not consistent with the structure of Chapter 7 of the Corporations Act to deal with issues relating to the regulation of investor behaviour under either the market licensing or market supervision market integrity rules. If evidence justifies regulatory intervention with regard to additional oversight of investor activity then these are market misconduct issues of general application.

6. Exempt markets

18. Do you have any concerns with this proposed option? If so, please provide comments.

Consistent with our support for Option 1a, AFMA considers that it is conceptually correct to license the market operator and not individual facilities.

We note our comments with regard to transitional arrangements to smooth the transfer of exemption approvals to a market operator license with consistent obligations in relation to a category of trading facility being provided.

Such an approach is also conceptually consistent with the new trade repository licensing regime under s 905E of the Corporations Act.

7. Annual regulatory reports

19. Do you have any concerns with this proposed option? If so, please provide comments.

No.

However, AFMA does see merit in proposing that the annual regulatory report should be made a public document available through the ASIC website in the interests of transparency. Annual regulatory reports contain information that is important to market participants' ability to evaluate market operators and their ability to meet market integrity requirements.

8. Licence fees

20. Do you consider the fee for a market licence in Australia needs revision? If so, please provide comments.

The current licence fee of $ 1,340 is appropriate.

Regulatory costs relating to market supervision have spiraled since ASIC took over responsibility. The proposals in the Consultation Paper should not result in increased administrative costs and the greater clarity in the law envisaged by the adoption of Option 1a should result in more efficient administration of the law as it reduces subjectivity in the decision-making process.

21. Do you see cost recovery as an appropriate approach to levying licence fees? Please provide details.

AFMA reiterates comments it has previously made on cost recovery policy to the Government. AFMA views with concern the increasing number of fees and charges imposed by the Government and their substantial distorting effects. In relation to market surveillance, the initial cost recovery regime risked the viability of the newly established market operator competition. While this is being addressed by adding further complexity to the already complex regime, this is not an optimal outcome. Particularly given the quantum of recovery there is a case to be made that the scheme should be rolled back.

AFMA supports a reduction in the number of fees, taxes and charges in favour of a reduced number of efficient taxes.

Industry recognises that when viewed in isolation most regulation is reasonable; however the cumulative effect of all regulatory measures builds into a burden which exerts a drag on the economy. As a wide array of new rules are implemented – both here and internationally – it is critically important for the sake of our economic growth, investor returns, and the global competitiveness of the Australian financial services industry that the cumulative weight of new rules and measures, such as cost recovery is understood. The aggregate burden of such measures is not readily apparent, as government does not have a coherent mechanism for monitoring and reporting on the totality of measures from a regulatory burden perspective.

The current activity-by-activity approach makes the cumulative impact of regulation difficult for the public and policy makers to measure when working within the confines of their own portfolio responsibilities. Attention also needs to be paid to the general policy concern that without effective checks and balances in the design of the system, the ability to cost recover can make it easier for agencies to justify inefficient practices, because by virtue of making no net call on the budget they do not face the same level of official scrutiny. The ability to raise revenue that is deemed to be partly sheltered from budgetary and Parliamentary scrutiny because of its dedicated sourcing and application reduces incentives to be cost effective.

22. 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?

New government costs and charges are an impost on business that will affect how the competitive environment and the relative attractiveness of doing business in Australia compared to other jurisdictions are viewed.

Most charges associated with government activities, particularly those related to regulatory activities, are paid by firms rather than individuals. To the extent that they are then passed on to counterparties (including investors), increased prices or a

reduction in the range of products or services available will result. Australia is viewed as a high cost business environment by overseas investors and further increases in regulatory costs and imposts reinforce this view.

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