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Corporations and Schemes Unit
Financial Services and System Division
The Treasury
100 Market Street
SYDNEY NSW 2000

Dear Sir/Madam

Consultation Paper: Proposed Industry Funding Model for the Australian Securities and Investments Commission

Chi-X Australia Pty Ltd (Chi-X) is grateful for the opportunity of providing a submission on Treasury's consultation paper on a proposed industry funding model for the Australian Securities and Investments Commission (the CP).

The cost recovery fee to be imposed on Chi-X, which is not stated in the CP but has been bilaterally conveyed by ASIC, will transform the Chi-X cost base and potentially the Chi-X business model. There are a wide range of possible outcomes from this potential transformation and many would have a negative impact of Australia's market infrastructure.

Unfortunately, the CP does not outline a detailed basis on which the cost recovery fees have been determined, nor why the potentially transformative outcomes are justified. For example, it is stated that:

Proxies for supervisory intensity have already been identified for the model outlined in this consultation paper

However the proxies are not outlined anywhere in the paper, nor is the basis on which the level of supervisory intensity has been determined. Chi-X sought advice bilaterally from Treasury and ASIC on both the proxies and the basis on which ASIC/Treasury determined the supervisory intensity for each regulated entity. The responses from ASIC and Treasury have been high level and it is not appropriate to reproduce them here for analysis.

This lack of detail is particularly problematic given that there appear to be different rationales for related regulated sectors: for example, the proxy/supervisory intensity for listed disclosing public

companies is determined by the size of the company and yet on the face of the paper and levy/fee outcomes, this same metrics is irrelevant when determining the cost recovery from the gatekeepers of those companies.

In these circumstances, Chi-X is of the view that a further consultation needs to be undertaken that includes a detailed and transparent analysis of:

- (i) the way in which the aggregate cost figures have been determined for each industry sector and sub-sector;
- (ii) the basis on which supervisory intensity within regulated sectors and sub-sectors has been determined and why they may differ from one sector/sub-sector to another;
- (iii) the proxies for the supervisory intensity and why they may differ from one sector/sub-sector to another;
- (iv) any prima facie anomalies triggered by the outcomes of the allocation of aggregate cost within identified sectors.

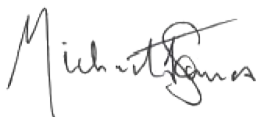
Chi-X is concerned that unless a re-consultation takes place, the current Australian Government Cost Recovery Guidelines may not be satisfied. The checks and balances that are provided by those guidelines may prove invaluable in ensuring that the risks to Australia's markets posed by the cost recovery proposals in the CP, are properly considered in the development of the funding model.

Attachment one to this submission contains the response of Chi-X to selected questions listed in the CP.

We hope this submission is of assistance and remain committed to working with Treasury and ASIC in this important area.

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

Yours faithfully



Chi-X Australia Pty Ltd

Attachment One

Chapter 2: ASIC's Activities

Q1: Do you agree that the exclusion of these activities from cost recovery is appropriate? If not, why not?

A: Chi-X is of the view that the identified activities should be excluded from cost recovery. However, Chi-X is also of the view that there are many functions that ASIC currently undertakes that are not appropriate for industry funding. They include:

(a) an identified portion of the market surveillance, investigation and enforcement function that is allocated to industry for cost recovery purposes but is actually directed solely at individuals who have committed criminal and/or civil offences. It is not industry that creates the need for this ASIC activity any more than Ford or Holden create the need for speed cameras. It is not possible for ASIC to divide industry driven surveillance and that undertaken to identify individual activities and so the ASIC enforcement outcome reports should be used as a proxy metric for allocating what portion of activity has been generated by individuals and what has been generated by firms.

(b) the investigation and enforcement by ASIC of matters that are identifiably non-industry related and are the equivalent of police analysis and prosecutions. The Enforcement Special Account may support the high cost litigation activities undertaken by ASIC, but they do not apply to the initial surveillance, analysis and investigation that has been undertaken in those matters. Many functions are undertaken by ASIC that, in the international jurisdictions examined in chapter 3, are undertaken by publicly funded organisations (eg the SFO in the UK, the Department of Justice in the US).

Q2: Are there any other specific regulatory activities undertaken by ASIC, such as those that support innovation, that should not be cost recovered from industry? If so, please provide examples.

A: Chi-X is of the view that this question is overwhelmed by the size and disproportionate nature of the levies and fees proposed by the CP. The fees and levies are of such a size that they may fundamentally reshape market infrastructure provider (MIP) business models and drive innovation to areas that are not cost recovered. These consequences need to be further explored.

Q3: Do you support cost recovery arrangements for ASIC's regulatory activities being consolidated within a single ASIC industry funding model? If not, why not?

A: A single model makes sense on a theoretical level: it should assist in delivering a coherent model for cost recovery.

Q7: If the Government decided to introduce an industry funding model for ASIC, would you support not proceeding with the planned review of ASIC's market supervision and competition cost recovery arrangements? Why or why not?

A7: Chi-X is of the view that the existing market supervision and competition cost recovery arrangements should be reviewed to provide competitively neutral outcomes, particularly in light of the outcomes listed in ASIC's own market integrity reports.

Chapter 3: International funding models

Q8: Are there any approaches to industry funding adopted by other regulators that you believe should be applied to an industry funding model for ASIC? If so, please describe and provide reasons why.

A8: Chi-X is of the view that the following models should be considered:

- (a) a cost recovery model that is based upon transactions and can, for example, include a pass through fee on contract notes – the model has worked to recover costs for the SFC in Hong Kong and has similarities with the model that has been successful in funding the SEC;
- (b) a cost recovery model that provides greater equity in allocating costs to those entities that generate revenues and profits from the activities that are regulated;
- (c) a cost recovery model that is more accurately aligned with the risks posed to the Australian market place by competition from regional financial centres competing with Australia for business;
- (d) a model that transparently analyses the impact of the cost recovery proposals on:
 - (i) efficiency and economy;
 - (ii) the proportionality between the cost/burden of regulation and the benefits delivered by that regulation to consumers, with the analysis being either independent of those persons within ASIC that benefit from the costs being recovered, or with the analysis being sufficiently detailed and transparent and presented within a framework that enables those ASIC persons to be held to account;
 - (iii) innovation;
 - (iv) Australia's markets and their position relative to other global centres;
 - (v) competition, including with respect to barriers to entry, the proportional allocation of costs within industry sectors and sub-sectors and the

facilitation of competition between members of the regulated community, both within and across industry sectors and sub-sectors.

Chapter 4: The proposed industry funding model

- Q9: Is the proposed methodology for determining the levy mechanisms appropriate? If not, why not?
- A9: Chi-X is of the view that the relative lack of detail in the CP on the basis for the levy inhibits meaningful consideration of the proposed methodology and feedback on whether it is appropriate.
- Q10: Are there any activities proposed to be recovered through fees that you believe should be collected through annual levies? If so, which activity or activities and why?
- A10: Chi-X is of the view that an alternative model of transaction based fee recovery should be fully explored as an alternative to the model that is proposed. The transaction based levy should be explored as a holistic alternative to the current levy and fee based model for MIPs as transactions provide a viable proxy for determining an appropriate level of supervisory intensity. More particularly it would place some of the risk of allocation of resources on to ASIC: ASIC would have to allocate resources to MIP activity based on the number of transactions it expected to be generated by that activity. This is a method of ensuring that the cost of regulation is aligned with the benefits the regulation (as opposed to the benefits delivered by the regulated activity being undertaken by the commercial provider) delivers to consumers.
- Q11: Is the proposed approach for calculating fees-for-service appropriate? If not, why not?
- A11: The fees for MIPs are set at a one size fits all level, when it may be that this is not appropriate and generates anti-competitive, anti-innovation outcomes. For example, the licences of the legacy monopoly operators contain far less prescriptive detail than those of MIPs that are introducing competition and innovation to the Australian market place. Therefore the non-legacy MIPs may have greater cause to amend the details in their licence than those MIPs who have principles based licences.
- Q12: Do you have any suggestions for how the proposed methodology for calculating fees-for-service could be modified? If so, please provide details.
- A12: See above, where Chi-X outlines that a transaction based fee may be applied on a holistic basis to generate more equitable outcomes.

Chapter 5: Determining ASIC's annual funding and levies

- Q13: Do you support the proposed process for determining funding for ASIC's regulatory activities under an industry funding model for ASIC? If not, why not?

A13: Chi-X is of the view that if ASIC is to move to an industry model then it should move to commensurate governance model that entrenches independence and transparent formalised industry committees within its decision making structure. The FCA governance model may provide a useful model: see <http://www.fca.org.uk/your-fca/documents/corporate-governance>

The FCA governance model may provide particular assistance on remuneration, where an independent sub-committee of the FCA board plays a key role.

Q14: Do you think this process will provide industry with certainty as to the fees and levies to be charged? If not, why not?

A14: The current proposed model inserts a high degree of arbitrariness into cost recovery calculations: the “urgent and unforeseen policy requirements or market events” may be used to change cost recovery fees. This carve out, and the lack of detailed transparency on the current proxies and supervisory intensity metrics, provide uncertainty on the levies that will be imposed. It is also not currently clear how the fee regime will be applied, to the extent that minor rules changes or licence amendments may be required which do not justify the fee levels to be imposed and it is not clear how this will be managed.

Q15: Are the proposed consultation arrangements on the levy mechanisms and funding appropriate?

A15: Chi-X is of the view that there needs to be greater intensity and frequency of consultation around the initial cost recovery process. The FSA, for example, undertook repeated and extensive consultation during the period leading up to its initial cost recovery proposals (see, for example, <http://www.fsa.gov.uk/pubs/cp/CP111.pdf>)

Q16: Do you support ASIC’s fees-for-service being revised every three years? Alternatively, would you prefer that ASIC’s fees for service be revised more regularly?

A16: Chi-X has a preference for a holistic transaction based cost recovery system for MIPs and stockbroking firms. This regime could involve pass through mechanisms that ensure those genuinely creating the need for regulation are those who meet the cost of that regulation.

Q17: Do you have any further suggestions for enhancements to be made to ASIC’s accountability structure or industry funding model? If so, please provide details.

A17: See the answer to question 13.

Q18: How should the Cost Recovery Stakeholder Panel operate? How should the membership be determined?

A18: If ASIC implements a governance model with independent non-executive representation on the ASIC Commission/Board, then that could be the “control” point for the independent industry committees that provide feedback on cost recovery. It would ensure arm’s length dealing and independence between the industry committees and those persons at ASIC that stand to benefit and/or have an interest in the costs recovery outcomes.

Attachment F – Funding Model for Market Infrastructure Providers (MIPs)

Q52: Are the proposed levy arrangements for MIPs appropriate? Why or why not?

A52: Chi-X is of the view that the proposed levy arrangements are inappropriate. Contrary to the government cost recovery guidelines, the levy arrangements do not:

- (a) provide a sufficient degree of transparency or accountability such that the regulated sector is able to determine the basis on which ASIC’s supervisory intensity is determined or the related proxies used to measure that intensity and arrive at a levy figure (see page 10 of <http://www.finance.gov.au/sites/default/files/australian-government-cost-recovery-guidelines.pdf>);
- (b) consider the impact they may have on competition and innovation (see page 6 of the guidelines), based upon the current proposals outlined in the CP (see also the answer to question 54 below).

Q53: Will the proposed levy arrangements for MIPs be competitively neutral? If not, why not?

A53: The levy arrangements have not been transparently outlined. If the arrangements are based on the view that Chi-X has driven the need for ASIC’s regulation of multiple markets and hence is responsible for a disproportionate portion of the total MIP levy pool, then this analysis needs to be transparently outlined as a reason for the ASIC/government proposals and subject to a transparent and robust debate. To the extent the levy arrangements are driven by this view, they are profoundly anti-competitive.

Q54: Will the proposed levy arrangements for MIPs support innovation? If not, why not?

A54: The proposed levy arrangements are profoundly anti-innovative to the extent:

- (a) they impose a significantly disproportionate fee upon MIPs that are seeking to disrupt the monopoly rent paradigm that has dominated Australian market infrastructure;
- (b) they reward the incumbent legacy monopoly operators for operating an anti-innovation regime, leaving innovation to others who then bear the disproportionate cost of that innovation.

(c) they place Australia at a competitive disadvantage globally: other jurisdictions provide incentives to MIPs to locate in their financial centres which stands in stark contrast to the disincentives that will be posed by the cost recovery proposals.

Q55: Do you prefer an alternative proxy for supervisory intensity on which to determine the levy payable by MIPs? If so, why is this metric more suitable?

A55: Chi-X is of the view that a transaction based fee provides a more equitable and accurate proxy for supervisory intensity relating to MIPs.

Q56: Should the costs of maintaining the AMRF be collected from the entity responsible for making the change or from all MIPs through the annual levies? Please give reasons.

A56: Chi-X is of the view that the transaction based fee should be developed as a model to cover the AMRF costs.

Chi-X is also of the view that the governance surrounding the AMRF needs to be further developed to ensure that the feed is managed on an equitable basis.

Q57: Should operating rule changes be funded by MIPs through annual levies or on a fee-for-service basis? Why or why not?

A57: Chi-X is of the view that a transaction based fee model should be developed to recover the costs relating to the MIP industry sector. This transaction based fee could apply to recover costs currently allocated to both the levy and fee arrangements.