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Dior Loveridge and Joseph Barbara
Australian Securities and Investment Commission
Level 5, 100 Market Street
Sydney NSW Australia
Sent via e-mail to: marketstructure@asic.gov.au

Dear Dior and Joseph

ASFA SUBMISSION: CONSULTATION PAPER 202, DARK LIQUIDITY AND HIGH FREQUENCY TRADING: PROPOSALS

Thank you for the opportunity to provide comment in relation to the ASIC's *Consultation Paper 202 Dark Liquidity and High Frequency Trading: Proposals.*

The Association of Superannuation Funds of Australia (ASFA) welcomes the Proposals set out in the Consultation Paper and broadly supports efforts that promote capital market efficiency and quality. This is consistent with ASFA's focus on whole of system issues. ASFA's core strategies are aimed at encouraging industry best practice, advocating for a system that plays a productive role in the Australian economy, and ensuring the industry delivers on its primary purpose of delivering decent retirement incomes.

Historically ASFA's members outsourced investment related activities to asset managers, custodians and asset consultants. More recently, the operating models of several larger Registrable Superannuation Entities (RSEs) have changed and many investment related functions have been insourced, thereby bringing the RSE closer to the actual assets and the trading and valuation activities associated with these assets. Hence ASFA's interest in participating in this consultation process.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds (SMSFs) and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

Overview of the Australian Superannuation Market

After more than a decade of compulsory contributions, Australia's superannuation pool has grown to approximately $1.50 trillion in assets; this ranks Australia fourth in terms of superannuation assets on a global basis. Based on a typical asset allocation of around 40 – 50% of fund assets into Australian equities, then approximately $650 - $750 Billion of the Australian superannuation pool is invested in Australian equities – this represents around 40 – 50% of Australian market capitalisation as at 30 April 2013. Further, it is anticipated that the Australian superannuation pool will grow to around $3.2 trillion by 2022 – fuelled by asset value growth and strong contribution flows underpinned by the increase in the superannuation guarantee levy from 9 – 12 per cent over the next 7 years.

A significant share of the growth described above will flow directly through to the Australian share market - this will provide the market with critical liquidity and underpin a vibrant and efficient capital market.

The Australian superannuation market is witnessing several significant shifts, including:

- *Market consolidation:* regulatory changes, competition and the drive for scale have driven a significant increase in the amount of merger activity in the Australian superannuation industry. ASFA expects that this activity will continue and that several very large players will ultimately emerge in the market place.
- *Increase in-house investment activiti*es: historically, RSE outsourced investment related activities to external parties such as fund managers, custodians and asset consultants. Due to scale and cost, several RSE's have insourced investment activities such as stock selection and research; as a result, these RSE's are evolving into asset managers - this brings the RSE significantly closer to the real assets of the fund – including Australian equities. As a result, the RSE requires a different and appropriate internal skill set.
- *Retail shift to Self Managed Superannuation Funds (SMSF's) and the development of Individually Managed Accounts (IMAs):* the Australian SMSF market has grown significantly over the last 10 years, it now accounts for approximately one third of the total Australian superannuation pool. In response, several RSEs have developed IMAs to provide members with the 'look and feel' of direct share ownership with the fiduciary overlay that an RSE will provide.

The impact of the shifts set out above in combination with the implementation of the Stronger Super regime requires RSEs to have a deeper understanding of capital markets and the downstream effects that Dark Liquidity and High Frequency Trading (HFT) may have on fund performance and ultimately the effect on member valuations.

General Comments

Notwithstanding the shift to insourcing investment related activities as described above, the majority of superannuation funds do not directly engage in either HFT or Dark Pools. Typically there is nothing set out in Investment Management Agreements that precludes external managers from using Dark Pools.

Market practices

The general assessment from our members is that while both HFT and Dark Pools operate to some extent outside normal market trading conventions there is little convincing evidence that they damage the interests of market participants. As major users of capital markets, superannuation funds are keen to ensure markets are efficient, liquid and properly regulated to ensure all participants are able to understand the risks they face and have an ability to protect their interests.

This does not mean that innovation in trading practices should be stifled or restrictions placed to meet the lowest common denominator of market participant. At the end of the day, superannuation funds' responsibilities lie to the members and funds will always seek to minimise transaction costs, through market impact, brokerage and direct fees and charges. Funds will continue to encourage their external managers to take advantage of all opportunities to trade efficiently.

HFT

Based on our feedback from our members HFT is not a relevant feature of external Investment Management Agreements. ASFA believes that the majority of market participants adopt good trading practices but ASFA also recognises that ongoing monitoring is critical to maintaining an even playing field and transparent capital markets.

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Dark Pools

In general, ASFA members see no rationale that would require all trading to be done on "lit" exchanges, however ASFA welcomes further discussion around this issue. This has never been the tradition of securities markets historically. Large market participants, like superannuation funds, will always wish to act in ways that may limit their transactions costs (particularly market impact). This is particularly so for large block trades which at times are necessary.

Based on ASFA's member feedback Dark Pools rely on the lit market for pricing benchmarks and parameters. That means that both dark and lit pools are symbiotic and neither is likely to come to completely dominate sophisticated modern securities markets. It is also true that if all large block trades were forced through a lit market it too would affect true price discovery for other smaller market participants.

ASFA believes that further exploration and discussion on this issue is required and seek to be part of this ongoing process.

Specific Comments

ASFA's view is that the new regulations surrounding Dark Pools are welcome. Operators will have to pay attention to minimum size thresholds where dark liquidity exceeds a percentage that is deemed detrimental to prices.

The proposal to reduce the tick size for lower value stock will take away some incentive to trade in Dark Pools as the spread will not be as large as before on lit exchanges.

Recommendations

- Dark Pools, ASFA recommends that
  - ASIC amend the Market Integrity Rules to implement a minimum size threshold for dark orders for a security or group of securities.
  - ASIC should consider a pilot on reduced tick sizes for constrained equity market products.
- HFT: ASFA recommends that
  - ASIC makes new and amended Market Integrity Rules to address excessive messaging, market noise and manipulative trading.

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Should you have any further queries with respect to this, please do not hesitate to contact Chris Donohoe .

Yours sincerely

Pauline Vamos
Chief Executive Officer