FSC SUBMISSION ON CP 202

The following outlines the Financial Services Council's proposed positions on the proposals outlined in ASIC's Consultation Paper 202. We also refer to the recent consultation undertaken by Treasury on ASIC's Cost Recovery Guidelines.

The positions are based on new research undertaken for the FSC by Capital Markets CRC (CM CRC), former research conducted by Baseline Capital (released in 2012) and consultation with FSC members (including numerous surveys) on these matters.

1. Minimum resting time

We are supportive of the ASIC proposal for a minimum resting time of 500 milliseconds for orders less than $500. While our research shows it will affect only a small proportion of trading activity we believe the proposal represents a reasonable starting position to test the market impact of the proposal.

Should the proposal proceed, we recommend ASIC review its operation following 12 months - with consideration given at that stage to a higher threshold should the measure be found not to be effective at discouraging the relevant trading activity.

2. Call auctions

We believe that further work is needed on assessing whether this change to market structure/operation should be adopted in Australia. The research conducted by CM CRC found that "using call auctions is expected to reduce overall market quality" (page 12) and may prove ineffective if HFT strategies can circumvent the auction process (particularly if the auctions are not randomised).

For this reason, the design of this measure needs further consideration before the FSC is able to support its introduction.

3. Cost recovery

FSC supports recalibration of the cost recovery levy to place a higher cost on orders relative to executed trades (note this is an existing FSC position based on research conducted in December 2012 by Baseline Capital).

We noted in our submission to Treasury on 20 May that we agree that ASIC cost recovery should consist of a mix of fixed charges (reflecting the fixed cost base), charges on messages and charges on trades. We note that ASIC found approximately 10% of its supervisory costs relate to messaging activity and that they now propose to levy fees according to message counts to recover 10% of certain costs. Further, we would support ASIC increasing the 10% message recouping threshold to reflect the increasing supervision costs arising from high message to trade ratios.

The FSC is of the view that "excessive" messaging is generally carried out with a view to extracting information about the intentions of other market participants to their detriment. This has the effect of increasing the friction cost of transactions for investors with a longer-term time horizon.

Increasing the proportion of cost recovery from messages would not only reduce the direct cost of actual transactions, but it would also have the effect of reducing the indirect costs of predatory intra-day traders.

The FSC also supports an further consultation on a market making exemption for providers of genuine liquidity, particularly within the Exchange Traded Fund (ETF) markets.

4. Transaction tax

We have consistently opposed transaction-based taxes. Transaction taxes are inefficient, poorly targeted and give rise to significant unintended consequences. The CM CRC research reinforces our view which is consistent with major domestic and international studies. For example: "In the 2010 Future Tax System (Henry) Review in Australia, transaction taxes on financial instruments were rejected as being inefficient and regressive." (page 20)

5. Minimum size for dark orders

The FSC strongly supports the availability of dark pools to enable large, sophisticated institutional investors to find best execution for their orders.

Importantly and in principle, the FSC does not oppose minimum thresholds in dark pools but we believe they should only be considered following an evaluation of the Meaningful Price Improvement (MPI) framework.

Given MPI rules commence later this month, we believe it is premature to introduce additional size controls on dark liquidity until such time as the efficacy of this measure has been assessed.

6. Other proposals

A) Minimum tick sizes

No position.

B) Broker IDs

FSC supports the status quo on the basis that disclosing broker IDs is likely to increase inappropriate information leakage in the market.

C) Disclosure, conflicts and client equity

FSC supports proposals C1 to C7 in CP 202. These proposals will improve transparency and the quality of market oversight.

D) Soft dollar / payment for order flow prohibition

Support proposal D4 in CP 202. These proposals will enhance market integrity and ensure inappropriate incentives to increase HFT in the market are not permitted.