



**Australian Government**

**Australian Securities and Investments Commission**

## **COST RECOVERY IMPLEMENTATION STATEMENT**

**ASIC Market Supervision**

**as at 1 July 2016**

**(updated 17 October 2016)**

Cost recovery involves government entities charging individuals or non-government organisations some or all of the efficient costs of a specific government activity. This may include goods, services or regulation, or a combination of them. The Australian Government Charging Framework, which includes the Cost Recovery Guidelines (the CRGs)<sup>1</sup>, sets out the overarching framework under which government entities design, implement and review cost recovered activities.

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<sup>1</sup> the CRGs are available on the Department of Finance website ([www.finance.gov.au](http://www.finance.gov.au))

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## CRIS Version

4.0 17 October 2016



## 1. INTRODUCTION

### 1.1 Purpose of the CRIS

This Market Supervision Cost Recovery Implementation Statement (CRIS) sets out the arrangements for the recovery of costs over the financial year 2016-17 for the Australian Securities and Investments Commission's (ASIC's) market supervision functions. It contains cost recovery forecasts for 2016-17 only, as the Treasurer and Minister for Small Business and Assistant Treasurer announced that the Government will introduce an industry funding model for ASIC's regulatory activities, to commence in the second half of 2017.

Market supervision cost recovery arrangements for ASIC will continue until the commencement of a new industry funding model for ASIC. Once the industry funding model has commenced, the amounts currently cost recovered from industry will cease to be recovered under those arrangements and be replaced with levies or fees on the appropriate sector. As ASIC's market supervision activities are largely consistent with 2015-16, quarterly fees for 2016-17 will remain unchanged (apart from the changes outlined in section 1.1.1).

The following sections of the CRIS have been updated to reflect financial and non-financial performance over 2015-16, and to indicate how this affects market supervision activities in 2016-17:

- Section 1.2.4.2 - FIDA contributions to offset industry cost recovery
- Section 1.4.1 - Cost savings
- Section 1.6 - Historical EMS expenditure will be recovered by 30 June 2020
- Section 1.7 - Operating environment: Changes in 2016-17
- Section 3.2 - Market supervision costs (up to and including Table 6)
- Section 3.3.3 – FEX Global Pty Ltd (FEX) (first paragraph)
- Section 3.4 - Summary of 2016-17 charging arrangements
- Section 5.2 - Industry Funding Model
- Section 6 - Financial Estimates
- Section 7.1 - Summary of the prior two fee charging periods
- Section 7.2 - 1 January 2012 – 30 June 2015: Actual expenditure by key processes

### 1.1.1 Additional update on 17 October 2016 – no FIDA contribution in 2016-17

The Securities Exchanges Guarantee Corporation Ltd (SEGC) Board has determined that no FIDA contribution will be paid by SEGC to ASIC in 2016-17. As noted in version 3.0 of the CRIS, dated 22 June 2016, this decision means that total activity based fees payable by cash equity market participants in 2016-17 will be \$1.465 million more than fees payable in 2015-16. The associated amendments to the CRIS are contained in:

- sections 1.1, 1.2.4.2, 3.3, 3.3.1.6 (deleted), 3.3.1.7, 9 and 10
- Chart 2
- Tables 14(c) (deleted) and 17

## 1.2 Market supervision activities to be cost recovered

### 1.2.1 Background

ASIC is responsible for the supervision of trading on Australia's domestic licensed equity, derivatives and futures markets.

Prior to the transfer of market supervision to ASIC on 1 August 2010, each market operator was responsible for supervising real-time trading on their own markets and the conduct of their participants (for compliance with their market's operating rules, as well as some conduct of their business obligations). Market participants paid for the secondary market supervision function on each domestic licensed financial market they transacted on via fees and charges imposed on market participants by each individual market. The component of those fees and charges relating to markets' secondary market supervision function was typically not transparent to market participants.

Although ASIC still performs the same functions as it did prior to 1 August 2010, ***the pre-transfer functions are Budget funded and are not cost recovered.***

Historical background information about the transfer of the market supervision function to ASIC and the introduction of market competition is provided in Appendix A.

### 1.2.2 Activities being cost recovered

Market Supervision cost recovery encompasses all the new market integrity-related activities post-transfer on 1 August 2010, namely for:

- performing market supervision functions following their transfer from market operators (funded by the Budget measure **Transfer of Market Supervision / Market Supervision**);
- regulating the market after the introduction of market competition for trading and maintaining the supporting regulatory framework (funded by the Budget measure **Market Competition<sup>2</sup>**); and
- continued implementation of the Enhanced Market Supervision (EMS) programme of works (funded by the Budget measure **Enhanced Market Supervision**).

The key aims of the EMS programme are to:

- enhance ASIC's market supervision capabilities, particularly market supervision technology and tools, to a level comparable with international regulatory agency peers, so ASIC can improve its ability to detect and enforce market misconduct / abuse;
- better supervise the increased levels of messaging taking place in the Australian market now and for the foreseeable future; and
- improve interactions and workflow between ASIC and market participants, and within ASIC internally.

The EMS programme is designed to deliver productivity gains to both ASIC and industry. For example, it is anticipated that key elements of EMS will reduce the number of ASIC notices to produce information issued, and that industry will require less time to respond to ASIC notices than is currently the case.

More information about the Budget measures the Government decided should be cost recovered is provided in Table 4 'Government decisions on ASIC market supervision cost recovery' on page 12.

### 1.2.3 What ASIC market supervision sets out to achieve

ASIC's core priority for market supervision is the promotion of investor confidence through fair and efficient markets. This requires market infrastructure that is robust, where the trading, clearing and settlement of transactions is orderly and efficient, and where market misconduct is minimised.

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<sup>2</sup> Funding for the measure referred to as **Implementing Market Competition** terminated on 30 June 2015 and has been replaced by the **Competition for Market Services — continuation** measure. See table 4 on page 12 for more information on all cost-recoverable market supervision Budget measures

## 1.2.4 Who will pay cost recovery charges?

### 1.2.4.1 Domestic licensed financial markets subject to market supervision cost recovery

The domestic licensed financial markets subject to market supervision cost recovery are:

- the domestic licensed financial markets that were part of the transfer of market supervision to ASIC on 1 August 2010;
- Chi-X Australia Pty Ltd; and
- FEX Global Pty Ltd, a new market that was granted a licence by the Government on 4 April 2013, plans to commence operations in 2016-17.

Hereafter, these markets are collectively referred to as 'domestic licensed financial markets'. Table 1 below lists the in-scope domestic licensed financial markets and shows whether costs are recovered directly from the market operator only, or from both the market operator and their participants.

**Table 1: Who will pay cost recovery fees and charges?**

Type of market	Market	Direct cost recovery from Market	
		Operator	Participants
Cash equity (ASX-listed securities)	ASX Limited (ASX) includes TradeMatch, PureMatch and Centre Point electronic order books	Yes	Yes
	Chi-X Australia Pty Ltd (Chi-X)	Yes	Yes
Futures	Australian Securities Exchange Limited <sup>3</sup> (ASX24)	Yes	No
	FEX Global Pty Ltd <sup>4</sup> (FEX)	Yes	No
Small financial markets	National Stock Exchange of Australia Limited (NSX)	Yes	No
	SIM Venture Securities Exchange Ltd (SIM)	Yes	No
	IMB Ltd (IMB)	Yes	No
	Sydney Stock Exchange Limited <sup>5</sup> (SSX)	Yes	No

### 1.2.4.2 FIDA contributions to offset industry cost recovery

A Financial Industry Development Account (FIDA) contribution of \$1.465m was received in 2015-16 to offset EMS costs. This contribution was used to partially offset the cost recovery fees charged to cash equity market participants. Appendix B contains background information about FIDA.

In June 2013 ASIC's responsible Minister approved four annual FIDA contributions for ASIC market supervision to commence in 2013-14<sup>6</sup>. ASIC invoices the Securities Exchanges Guarantee Corporation (SEGC) at the beginning of each financial year for the annual amount approved. SEGC considers and decides whether there are sufficient excess funds in the NGF

<sup>3</sup> formerly Sydney Futures Exchange

<sup>4</sup> FEX is currently preparing to commence operations

<sup>5</sup> Asia Pacific Exchange Limited (APX) has changed its name to Sydney Stock Exchange Limited (SSX)

<sup>6</sup> FIDA contributions of \$1.465m to offset EMS costs were received in 2013-14, 2014-15 and 2015-16 as foreshadowed in past public consultation documents. No FIDA payment for ASIC Market Supervision will be received by ASIC in 2016-17.



to pay the approved amount at its next board meeting.

2016-17 is the last year in which a FIDA contribution might have been received by ASIC. The SEGC board considered the matter at its July 2016 board meeting, and SEGC subsequently advised ASIC that no such contribution will be made in 2016-17. Table 17 includes the amounts that will be charged to cash equity market participants in 2016-17.

Stakeholders were made aware of this issue through prior ASIC market supervision cost recovery documents, consultations and ongoing discussions.

The fee level to apply to cash equity market participants for 2016-17 will be as described in section 3.3.1.7 *"Charges applying to market participants – with no FIDA contribution in 2016-17"* on page 28.

### 1.3 Appropriateness of cost recovery

In accordance with the Australian Government Cost Recovery Guidelines (the CRGs), the Government decided that the costs involved in establishing and running the new market supervision functions at ASIC from 1 August 2010 (and all other market supervision-specific activities thereafter) be cost recovered. ASIC's incremental post-transfer market supervision activities<sup>7</sup> are considered appropriate for cost recovery, consistent with the CRGs.

In the Australian context, the market supervision function is most appropriately provided by Government. Previously, market operators supervised their own markets. With the advent of multiple exchanges trading the same and / or related products, a strong case arose for a single regulator in order to ensure effective and consistent whole-of-market supervision. Failure to do so would have introduced duplication and inconsistency, increasing industry's compliance costs and presenting a barrier to both competition and innovation.

Prior to the transfer of supervision, the supervision of Australia's main cash equity market was carried out and funded by ASX Group. Their clients indirectly bore market supervision costs (though not transparently through separate fees for market supervision). Many other jurisdictions maintain similar arrangements, or Self-Regulatory Organisations supervise markets and market participants (the operating expenses of which are borne by their members; such arrangements are akin to cost recovery).

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<sup>7</sup> Commonwealth Budget market supervision measures subject to cost recovery are listed in Table 4 on page 12

The most direct beneficiaries of well-regulated financial markets are market operators and market participants (intermediaries) and their clients (investors). Imposing cost recovery on market intermediaries is an efficient way to pass costs onto investors who benefit from market supervision (noting that some firms may be both intermediaries and end users, to the extent that they are trading on their own account). Some stakeholders have raised concerns that the competitive environment has limited their ability to pass on supervision costs in part or in full to their clients.

Market supervision also provides significant benefits to the broader Australian community and economy – by assisting markets to carry out their role in the efficient allocation of capital and risk management; thereby contributing to economic growth and employment. As such, in consultations, some stakeholders have asserted that market supervision should be paid for (in part or fully) through general taxation revenue.

It should be noted that only the measures set out in Table 4 on page 12 are cost recovered. ASIC market regulation activities conducted before 1 August 2010 are Budget funded.

Intermediaries generally give effect to the trading behaviour that creates demand for market supervision regulation and have a recognised ‘gate keeper’ role in the Australian regulatory regime. Cost recovery of market supervision can have a positive influence on the behaviour driving regulation.

Cost recovery of market supervision commenced from 1 August 2010 (domestic licensed financial markets only) and expanded to include cash equity market participants from 1 January 2012. There have been very few implementation issues, and cost recovery has been implemented in a streamlined and efficient way. Market operators and cash equity market participants are collectively a relatively small and sophisticated class of stakeholders who are able to efficiently comply with, and bear the costs of, the additional costs of market supervision post 1 August 2010.

Billing takes place quarterly in arrears and, in the case of cash equity market operators and their participants, is based on actual trade and message data. The billing formula recovers quarterly budgeted costs exactly, so billed entities are not over-charged and the Government bears little to no risk of insufficient recovery occurring. Cost recovery of market supervision does not impact any of Australia’s international commitments, nor any access to essential community services or access to government data.

Cost recovery has facilitated the funding of ASIC undertaking and investing in its market supervision functions and developing and implementing a framework to support market structure changes such as implementing market competition. The cost allocation methods used seek to minimise the extent to which intermediaries and operators may pay for the regulation of their competitors.

For most firms, expenditure on cost recovery fees is relatively small (compared to their overall operating costs), though for some firms this is not the case. The potential impacts on viability and competition have been taken into account in determining whether cost recovery is appropriate.

Implementation of cost recovery of market supervision has served to increase stakeholders' engagement on how ASIC utilises its regulatory resources and whether industry obtains 'value for money' for the fees it pays. Transparency and engagement with Government and ASIC about these matters has also improved.

## **1.4 Treatment of cost savings and excess costs**

### **1.4.1 Cost savings**

ASIC assesses whether refunds are required, and if so, how and when they will be remitted to entities in the financial year after any applicable Fees Regulations cease. If savings are made in relation to costs incurred during 2016-17, they will be reflected in either a future fee reduction and / or refunds issued to all impacted entities. This may be done as part of the industry funding model.

ASIC makes every effort to achieve cost savings when delivering market supervision activities. Early in the life of the EMS programme, ASIC achieved significant savings against the maximum allowance approved by the Government when procuring the Market Surveillance System (MSS) upgrade. ASIC determined that it would not require approximately \$5 million of the budgeted MSS upgrade cost (or just over 10% of the entire EMS measure). ASIC has therefore never needed to recover this amount from industry.

Refunds to industry for the period 1 January 2012 – 30 June 2013 totalling \$3.168 million were processed in 2013-14 (see section 7.3 for further information regarding these refunds). As detailed in section 7.1, no refunds were required for the two financial years 2013-14 and 2014-15.

### **1.4.2 Excess costs**

If ASIC expends more than has been agreed by Government and stakeholders on market supervision activities, ASIC cannot cost recover any amounts in excess of such agreements from industry.

## 1.5 The Market Supervision Cost Recovery Stakeholder Panel

In late 2011 ASIC's responsible Minister established the Market Supervision Cost Recovery Stakeholder Panel (MSCRSP) to provide stakeholder perspectives to the Government on financial market supervision proposals and approaches for cost recovery. Treasury chair this Panel and ASIC also attends MSCRSP meetings.

Representatives from ASX Group, Chi-X, the FEX market, market participant and industry representative bodies (e.g. the Australian Financial Markets Association (AFMA), the Stockbrokers Association of Australia (SAA), the Financial Services Council (FSC) and the Australian Shareholders Association (ASA)), some market participants and a financial markets academic sit on the MSCRSP. The Panel first met in early 2012 to gather important early feedback for the Government on the overall cost of the EMS programme, and on the general operation of the post-competition cost recovery arrangements.

In response to feedback from the MSCRSP and industry's comments in general, the Government has taken several steps to ensure that market supervision cost recovery levels remain reasonable. These steps include:

- extending recovery of EMS costs over a longer period of time (seven years) rather than the forward estimates of the Commonwealth Budget (four years); and
- seeking FIDA contributions to partially offset the level of cost recovery revenue required, thus reducing market supervision charges on industry.

Sections 1.2.4.2 '*FIDA contributions to offset industry cost recovery*' on page 4 (regarding FIDA) and 1.6 '*Historical EMS expenditure will be recovered by 30 June 2020*' commencing immediately below contain further discussion on each of these points.

## 1.6 Historical EMS expenditure will be recovered by 30 June 2020

At the outset of the initial transfer of market supervision, ASIC decided not to commit to a long-term contract for its initial market supervision system (MSS). ASIC's strategy was to initially implement proven, low-risk technology, then go back to the market for a more sophisticated, higher capacity solution that could better handle what ASIC expected would be a rapidly changing trading environment.

ASIC's initial MSS contract expired in mid-2013 and ASIC replaced its core market surveillance technology with a new, advanced system. The new MSS is now established and all other key elements of the EMS programme are due to be implemented by 31 December 2016. Ongoing EMS funding has reduced to approximately \$4.3 million p.a.

Other key EMS deliverables are shown in the table below, with the total amount ASIC was funded for each to 30 June 2016 (capital expenditure vs. operating expenditure and implementation vs. ongoing costs shown). The total reflects the maximum EMS funding approved by the Government (\$43.7 million from 2012-13 to 2015-16) less the 'locked in' savings relating to the MSS upgrade<sup>8</sup> and efficiency dividend-related net funding reductions.

**Table 2: Forecast expenditure profile of the EMS measure (\$m)**

EMS Work stream	Capex	Opex	Total
Market Surveillance System	1.91	6.30	8.21
Market Entity Compliance System (MECS <sup>9</sup> )	4.41	1.50	5.91
Market Integrity Workflow	1.49	0.60	2.09
Advanced analytics	6.72	1.28	8.00
Other (including programme management & governance)	0.83	5.78	6.61
Ongoing cost components of the work streams	0.00	7.62	7.62
IT overheads	0.00	0.27	0.27
<b>Total<sup>(a)</sup></b>	<b>15.37</b>	<b>23.35</b>	<b>38.72</b>

<sup>(a)</sup> total cost shown is not the exact sum of the component parts (due to rounding)

Approximately \$20.9 million of the \$38.7 million was recovered during the three year period from 1 July 2013 to 30 June 2016. A further amount of around \$6.7 million will be recovered in 2016-17. The balance will be recovered after 30 June 2017, as part of the industry funding model. The charts further below show the expected expenditure to 30 June 2021. They also show the expected cost recovery profile of all market supervision activities covered by this CRIS and previous CRISes, as of June 2016 when this CRIS was updated. No cost recovery forecasts have been included after 2016-17, as it is expected that the industry funding model will replace the current cost recovery arrangements after that.

The EMS measure was approved in the 2012-13 Budget<sup>12</sup> with the following strategies also approved regarding cost recovery revenue collection to mitigate the impact of high upfront EMS expenditure on stakeholders:

- the permitted timeframe to recover EMS costs was extended to 30 June 2020 rather than within the forward estimates of the 2012-13 Budget (to 30 June 2016); and
- FIDA contributions were to be sought to partially offset the level of cost recovery revenue required from industry.

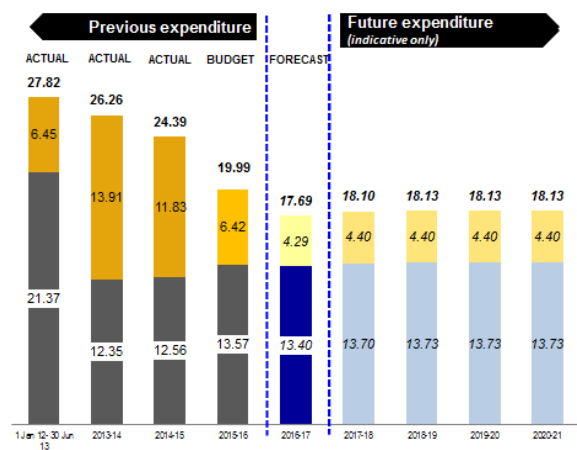
These strategies were necessary as no EMS expenditure in 2012-13 was able to be recovered contemporaneously as the Fees Regulations in effect at that time only allowed ASIC to recover costs approved as part of the **Market supervision** and **Implementing market competition** budget measures, and EMS implementation costs are high relative to projected ongoing expenditure, as shown in the first of the two charts below.

<sup>8</sup> discussed in section 1.4.1 'Cost savings' on page 7

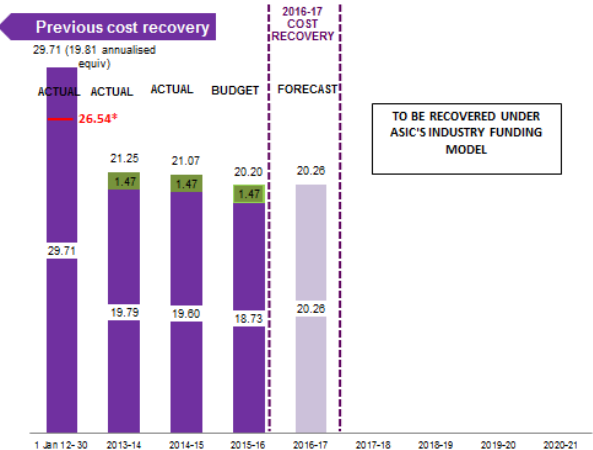
<sup>9</sup> this work stream was previously known as 'Register and Portal'. No MECS costs are to be cost recovered during 2016-17. The scope of MECS includes stakeholders other than market participants, and these costs will be recovered under the industry funding model, following consultation with stakeholders.

Chart 1 (left panel) below shows forecast ASIC market supervision expenditure until 30 June 2021. Chart 2 (right panel) below shows forecast cost recovery until 30 June 2017. It is anticipated that the remaining EMS costs, totalling approximately \$11.2 million, will be recovered under the industry funding model.

**Chart 1: Expenditure 1 Jan 2012 – 30 Jun 2021 (\$m)**



**Chart 2: Cost recovery 1 Jan 2012 – 30 Jun 2021 (\$m)**



- K** 2016-17: Initial transfer & market competition
- E** Forecast 2017-18+ for the above
- Y** Prior periods for the above
- 2016-17: EMS (ongoing and implementation)
- Forecast 2017-18+ for the above
- Prior periods for the above
- 2016-17 industry cost recovery
- Prior periods for FIDA (for EMS cost recovery)
- Prior cost recovery (\$26.54m over 1 Jan 12 – 30 Jun 13 after \$3.17m refunds issued<sup>5</sup>)

**Note to Chart 2 above:**

\* the \$29.71m initially recovered over 1 Jan 2012 – 30 Jun 2013 reduced to \$26.54m after refunds for the period totalling \$3.17m were processed in 2013-14. See section 7.3 for further information about these refunds.

EMS expenditure was greater than amounts cost recovered for EMS in 2012-13, 2013-14 and 2014-15. Expenditure and cost recovery are *roughly* equivalent in 2015-16 (budget), with the cost recovery budget just \$270,000 higher than budgeted expenditure (\$20.86 million c.f. \$19.99 million).

For 2016-17, cost recovery from industry is forecast to be \$2.6 million greater than expenditure. The remaining high upfront costs of EMS are to be recovered by 30 June 2020, under the industry funding model.

## 1.7 Operating environment: Changes in 2016-17

In April 2016, the Treasurer and Minister for Small Business and Assistant Treasurer announced that the Government will introduce an industry funding model for ASIC, to commence in the second half of 2017.

Market supervision cost recovery arrangements for ASIC will continue until the commencement of a new industry funding model for ASIC. Once the industry funding model has commenced, the amounts currently cost recovered from industry will cease to be recovered under those arrangements and be replaced with levies or fees on the appropriate sector.

As ASIC's market supervision activities are largely consistent with those in 2015-16, quarterly fees for 2016-17 will remain unchanged.

ASIC and Treasury have agreed on the cost recovery model outlined in this Market Supervision CRIS. This CRIS has been reviewed by the Department of Finance (DoF) for compliance with the CRGs. ASIC is responsible for preparing this CRIS as it is the entity undertaking the cost recovered activity. Treasury's role is to consult on the cost recovery arrangements (which it does jointly with ASIC) and recommend any changes to the Corporations (Fees) Regulations 2001 (Fees Regulations) to the Assistant Treasurer.

**Table 3: Not used**

## 2. POLICY AND STATUTORY AUTHORITY TO COST RECOVER

### 2.1 Government policy approval to cost recover

The sources of policy approval to cost recover ASIC's market supervision functions are listed in the table below:

**Table 4: Government decisions on ASIC market supervision cost recovery**

Budget Measure	When approved	Type of funding	Purpose
<b>1. Transfer of market supervision (aka Market Supervision)</b>	MYEFO 2009-10 <sup>10</sup>	Ongoing	For the additional expenditure incurred by ASIC to undertake its new regulatory functions following the transfer of market supervision (excluding the Markets Disciplinary Panel)
<b>2. Implementing market competition and developing a framework to support competition (aka Market Competition)</b>	2011-12 Budget Measures <sup>11</sup>	Terminates 30 June 2015	To recover ASIC's costs for undertaking its new regulatory functions following the introduction of market competition, and for the development of a framework to support competition in exchange market services. Also provided initial funding for the Markets Disciplinary Panel
<b>3. Enhanced Market Supervision (EMS)</b>	2012-13 Budget Measures <sup>12</sup>	Ongoing	<ul style="list-style-type: none"> <li>Enhancing ASIC's market supervision capabilities, particularly market supervision technology and tools, to a level comparable with international regulatory agency peers, so that ASIC can improve its ability to detect and enforce market misconduct / abuse;</li> <li>Supervising the increased levels of messaging taking place in the market now and for the foreseeable future; and</li> <li>Improving interactions and workflow between ASIC and market participants, and within ASIC internally</li> </ul>
<b>4. Competition for Market Services — continuation (aka Market Competition)</b>	2015-16 Budget Measures <sup>13</sup>	Ongoing from 1 July 2015	To recover the ongoing costs of regulating the market after the introduction of market competition for trading in ASX listed securities and maintaining the supporting regulatory framework. Also provides ongoing funding for the Markets Disciplinary Panel

<sup>10</sup> *Mid-year Economic and Fiscal Outlook 2009-10*, Appendix A: Policy decisions taken since the 2009-10 Budget, Commonwealth of Australia, November 2009, p. 216

<sup>11</sup> *Budget Measures 2011-12*, Budget Paper No. 2 – Part 2: Expense Measures, Commonwealth of Australia, May 2011, p.319

<sup>12</sup> *Budget Measures 2012-13*, Budget Paper No. 2 – Part 2: Expense Measures, Commonwealth of Australia, May 2012, p.277

<sup>13</sup> *Budget Measures 2015-16*, Budget Paper No. 2 – Part 2: Expense Measures, Commonwealth of Australia, May 2015, p.50. This measure replaces measure #2 in this table that terminates on 30 June 2015



Treasury's 'Reforms to the supervision of Australia's financial markets: Exposure draft and consultation paper', also stated that:

*"The Wallis Inquiry, which reported in 1997, made a recommendation that regulatory agencies should collect enough revenue from the financial entities which they regulate to fund themselves. The principle is that for reasons of equity and efficiency, the costs of financial regulation should be borne by those who benefit from it."*

## 2.2 Statutory authority to charge

The legal authority for the charges is set out in the following:

- Section 6A of the Corporations (Fees) Act 2001 (Fees Act)<sup>14</sup> states that the Fees Regulations may prescribe a fee or specify the method for calculating the amount of the fee for the performance by ASIC of its functions under Part 7.2A (Supervision of Financial Markets) of the Corporations Act.
- The Corporations (Fees) Amendment Bill 2011<sup>15</sup> amended the Fees Act to support the recovery of costs from both market operators and market participants. The Bill was passed by the House of Representatives on 2 November 2011 and the Senate on 24 November 2011.
- The Corporations (Fees) Amendment Regulation 2015 (No 1)<sup>16</sup> prescribes the quarterly fee arrangements that apply from 1 July 2015.
  - Cash equity markets: the Fees Regulation prescribes the calculation of the quarterly fee to be paid by each cash equity market operator and direct participants of their markets. Direct cash equity market participants are also prescribed a fixed fee per quarter.
  - ASX24, FEX and small financial markets: the Fees Regulation prescribes the fixed quarterly fees to be paid by each market operator.

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<sup>14</sup> <http://www.comlaw.gov.au/Details/C2012C00692>

<sup>15</sup> <http://www.comlaw.gov.au/Details/C2011A00144>

<sup>16</sup> <https://www.legislation.gov.au/Details/F2015L00970>

### 3. COST RECOVERY MODEL

#### 3.1 Market supervision - Outputs and key business processes

ASIC is committed to preventing inappropriate conduct and improving poor compliance practices before they affect the integrity of markets. This is referred to as achieving 'positive behavioural change'. Engagement with stakeholders (both formal and informal), education, guidance and warning letters are some of the tools ASIC uses to achieve positive behavioural change.

Other Market Integrity-related regulatory tools used by ASIC include:

- surveillance of listed equities, futures and options markets;
- supervision of compliance in those markets with the Corporations Act 2001 (Corporations Act) and ASIC market integrity rules; and
- monitoring market participants and securities dealers' compliance with their Australian financial services (AFS) licence conditions.

When potential market misconduct is detected, ASIC conducts investigations and may take enforcement action—which can result in severe penalties in appropriate cases. The objectives of enforcement action are a combination of one or all of:

- Punishment;
- Improved compliance;
- Protection of the public;
- Compensation for investors; and
- Deterrence.

ASIC releases comprehensive reports on the supervision of markets and overall enforcement outcomes.

- The six monthly ASIC Market Supervision Update has been replaced by the Market Integrity Update, which is a free monthly newsletter.
- The latest enforcement outcome report at the time of updating this CRIS is Report 476 – ASIC enforcement outcomes: July to December 2015, released on 30 March 2016.

These reports provide further information about the processes used and outcomes achieved by ASIC market supervision. Both reports and their predecessors are available at [www.asic.gov.au](http://www.asic.gov.au)

Table 5 below summarises the key processes ASIC employs in market supervision and their intended outcomes. If you are unfamiliar with some of the terms please refer to *ASIC Report 425: ASIC supervision of markets and participants: July to December 2014* for further background information.

Note that some of the outcomes and processes, particularly those relating to contraventions of the Corporations Act, are not subject to cost recovery if they relate to the regulatory responsibilities of ASIC prior to 1 August 2010. However the majority of market supervision / market surveillance processes **are** cost recovered, as ASIC had few staff in this area prior to 1 August 2010 and primarily relied on ASX to refer possible breaches of the law to ASIC. Such matters are now sent to Enforcement teams in cost centres that are not subject to cost recovery. All Market Integrity Rule (MIR) related work is subject to cost recovery and referred to ASIC's cost-recovered MIR Enforcement team. Both MIRs and the MDP were created and implemented specifically for the transfer of market supervision to ASIC and thus all MIR-related and MDP expenditure is cost-recoverable.

**Table 5: ASIC market supervision key outputs and business process**

Key process	Sub processes	Outcomes <i>Punishment - Improved compliance - Protection of the public - Compensation for investors – Deterrence</i>
<b>Market Supervision / Surveillance</b> <i>(incl. real-time market surveillance)</i>	• Monitor alerts; conduct post-trade analysis	Matters proceed to triage, then Investigations & Enforcement  Amended / improved: <ul style="list-style-type: none"> <li>• execution strategies</li> <li>• algorithms for trading</li> <li>• trading filters</li> <li>• trading behaviours and trading system operations</li> <li>• policies and procedures</li> </ul> Better alerts for market surveillance and surveillance process improvement
	• Investigate alerts, issues from breach reports, suspicious activity reports, referrals from other ASIC teams and reports of misconduct from individuals or entities	
	• Liaise with market participants, companies, advisers and investors regarding our enquiries (this may involve use of compulsory information gathering powers)	
	• Engage with industry on trading issues (e.g. DTR <sup>17</sup> behaviour and trading algorithms)	
	• Calibrate alerts and develop / maintain alerts and reports	
<b>Participant Supervision</b>	• General compliance reviews	Matters proceed to triage, then Investigations & Enforcement  Amended / improved: <ul style="list-style-type: none"> <li>• trading behaviours, interactions with clients (e.g. handling client monies)</li> <li>• policies, procedures and compliance frameworks</li> </ul> Participants' increased awareness of their compliance obligations Accurate information lodged about firms' ADA <sup>18</sup> s and firms' management structures Industry presentations and publications
	• Targeted / thematic compliance reviews (e.g. client money handling, managing confidential information)	
	• Risk-based assessment visits	
	• Warning letters, monitoring and remediation activities	
	• Assess and process Applications, Waivers, relief applications, AOP <sup>19</sup> certifications and Notifications	
	• Engagement / liaison with industry on compliance issues	

<sup>17</sup> DTR = Designated Trading Representative

<sup>18</sup> ADA = Accredited Derivatives Adviser

<sup>19</sup> AOP = Automated Order Processing

Key process	Sub processes	Outcomes <i>Punishment - Improved compliance - Protection of the public - Compensation for investors – Deterrence</i>
<b>Regulatory Framework (MIRs) and Market Structure &amp; Analysis</b>	<ul style="list-style-type: none"> <li>Developing and implementing ASIC's MIRs, including FRLI<sup>20</sup> registration</li> </ul>	<ul style="list-style-type: none"> <li>MIRs</li> <li>Quarterly reports published on ASIC's website re market structure and cash equity market statistics</li> <li>Analysis for related ASIC Reports and Consultation documents</li> <li>Related ASIC Reports and Consultation documents</li> </ul>
<b>Investigations and Enforcement &amp; Markets Disciplinary Panel (MDP)</b>	<ul style="list-style-type: none"> <li>Advanced surveillances</li> <li>Preparing briefs (delegates, DPP)</li> <li>Preparing draft and final Statement of Reasons</li> <li>Negotiating / settling matters with Market Participants prior to MDP hearings; Enforcement attend MDP hearings</li> <li>MDP Secretariat (runs MDP hearings, publishes MDP notices)</li> </ul>	<ul style="list-style-type: none"> <li>Bannings</li> <li>Insider trading pleas, verdicts and judgements</li> <li>Market manipulation pleas, verdicts and judgements</li> <li>Continuous disclosure infringement notices</li> <li>Enforceable undertakings</li> <li>Pecuniary penalties</li> <li>MDP-issued infringement notices</li> </ul>

### 3.2 Market supervision costs

Over 2016-17, ASIC's cost recovery budget (for undertaking its post-transfer market supervision functions, including costs associated with regulating of cash equity markets in an environment with competition for trading services and the new EMS systems and processes) is \$20.26m. This cost recovery budget is consistent with 2015-16, and \$2.6 million less than the \$22.88 million shown in Chart 2 of the 2015-16 CRIS.

As shown in the table below, the 2016-17 cost recovery budgets for *Market supervision* and *Market competition* are slightly more than the forecast expenditure for 2016-17. The EMS cost recovery budget is \$2.4 million above forecast EMS expenditure (the reasons for this are explained in section 1.6 'Historical EMS expenditure will be recovered by 30 June 2020' on page 8).

**Table 6: 2016-17 Cost recovery budget and forecast expenditure per cost recovered Budget measure<sup>21</sup>**

\$m	2016-17	
	Cost recovery	Forecast expenditure
<b>Market supervision</b>	10.42	10.26
<b>Market competition</b>	3.17	3.14
<b>Enhanced Market Supervision (EMS)</b>	6.67	4.29
<b>Total</b>	<b>20.26</b>	<b>17.69</b>

<sup>20</sup> FRLI = Federal Register of Legislative Instruments

<sup>21</sup> all tables in this chapter of the CRIS (including Table 6 above) that reconcile to \$20.26m or less and relating in whole or in part to cash equity markets refer to cost recovery budgeted revenue rather than forecast expenditure; see section 1.6 'Historical EMS expenditure will be recovered by 30 June 2020' on page 8

The main cost drivers of the cost recovery budget are staff costs (46.1%) and IT costs (42.6%). Cost drivers are discussed further in the section "Design of cost recovery charges", specifically subsection 3.3.1.2 "Allocation of market supervision cost recovery budget to each cash equity market operator and participant" on page 24 and in Table 13 on page 25.

As stated on page 2 of this CRIS, "the pre-transfer functions are Budget funded and are not cost recovered." This results in a low allocation of ASIC's overheads to market supervision cost recovery; only purely variable and / or post-transfer support staff / support costs are allocated to market supervision cost recovery (with the majority of overhead costs for market supervision being Budget funded; for example, none of the cost of Commission oversight of ASIC market supervision is cost recovered). Less than 5% of the cost recovery budget in 2016-17 relates to shared services costs. The method used to attribute these non-material costs to activities was to add a pro-rated amount to ASX24's direct cost recovery budget based on FTEs and assign the balance of shared costs to cash equity markets and their participants. The rationale of not assigning any shared services costs to FEX or small financial markets is discussed in detail further below in the sections 3.3.3 FEX Global Pty Ltd (FEX) and 3.3.4 *Small financial markets* on pages 30 and 31 respectively.

An average staff cost of \$145,000<sup>22</sup> is consistently used throughout this section to estimate the people-related costs of supervising domestic licensed financial markets. Conducting effective market and participant supervision requires a highly specialised and skilled workforce and ASIC invests in training and developing market and participant supervision staff. Of late, the opportunity for staff in key market supervision teams to both use and develop new tools for ASIC's new real-time surveillance system has involved a great deal of new skill development.

Both direct and indirect<sup>23</sup> post-transfer market supervision staff are placed in different cost centres to pre-transfer (Budget funded) market supervision staff and services that identify both the team they work in and that the cost of performing their role is cost recovered. Purchase orders for post-transfer market supervision related goods and services are coded to different cost centres than those for services that were performed (and continue to be performed) for pre-transfer (Budget funded) market supervision functions. A breakdown of ASIC's market supervision costs by key market supervision processes is provided in Table 7.

Please note that some of the figures in the tables in this chapter may not reconcile to totals due to rounding.

**Table 7: ASIC's market supervision cost recovery budget by key processes**

Key process	Key sub processes, activities and outputs	2016-17	
		\$m	%

<sup>22</sup> based on a sample size larger than twenty that includes market supervision and similar staff in ASIC's Markets cluster; includes estimated salary step increases and other direct employment costs e.g. superannuation, leave entitlements, etc

<sup>23</sup> indirect staff are in 'Shared Services'; all other staff are considered direct

Key process	Key sub processes, activities and outputs	2016-17	
		\$m	%
<b>Market Supervision</b> <i>(incl. real-time surveillance)<sup>(a)</sup></i>	<ul style="list-style-type: none"> <li>• Supervision of trading activities on domestic licensed financial markets</li> <li>• Undertaking real-time market surveillance and post-trade analysis to detect market misconduct (including breaches of MIRs and the Corporations Act on domestic licensed financial markets)</li> <li>• Undertaking whole-of-market monitoring</li> <li>• Managing the increase in market activity and complexity arising from the entry of Chi-X and the move to a multi-market environment, including the ongoing costs of the upgraded ASIC MSS (for next generation whole-of-market surveillance and supervision)</li> </ul>	6.95	34.3%
<b>Participant Supervision,</b>	<ul style="list-style-type: none"> <li>• Building effective regulatory relationships with market participants, including understanding participant business models</li> <li>• Undertaking surveillances and targeted themed compliance reviews on market participants, including referrals from ASIC Case Management</li> <li>• Undertaking Risk Based Surveillance of market participants</li> <li>• Implementing and monitoring required remediation for participants and their representatives</li> <li>• Assessing, recording and managing applications, notifications, certifications and waivers for market participants under the MIRs</li> <li>• Monitoring compliance with MIRs (e.g. best execution)</li> <li>• Monitoring possible new forms of market misconduct arising from the introduction of competition</li> <li>• Monitoring participant compliance with ongoing capital requirements</li> </ul>	2.42	11.9%
<b>Regulatory Framework (MIRs) and Market Structure and Analysis</b>	<ul style="list-style-type: none"> <li>• Developing and implementing ASIC's MIRs, including FRLI registration</li> <li>• Harmonizing MIRs across markets</li> <li>• Undertaking ongoing review and analysis of the market micro and macro structure and the regulatory framework to respond to new issues and market developments</li> <li>• Consulting with stakeholders and creating new MIRs to deal with the changing market environment</li> </ul>	1.18	5.8%
<b>Investigations and Enforcement</b>	<ul style="list-style-type: none"> <li>• Conducting advanced surveillances, investigation and enforcement based on referrals relating to breaches of MIRs and the Corporations Act from the Market Supervision team, including: <ul style="list-style-type: none"> <li>-preparing and serving draft and final Statement of Reasons to market participants</li> <li>-negotiating appropriate outcomes with market participants for prompt settlement of matters, including infringement notices and/or enforceable undertakings</li> <li>-appearing before the MDP as required</li> </ul> </li> <li>• Investigating and taking enforcement actions against new forms of market misconduct arising from competition</li> <li>• Preparing briefs for delegates, DPP</li> </ul>	2.18	10.7%
<b>Markets Disciplinary Panel (MDP)</b>	<ul style="list-style-type: none"> <li>• The MDP functions as an independent peer review body. Its members largely comprise people who currently hold senior roles in the markets</li> <li>• The MDP is responsible for: <ul style="list-style-type: none"> <li>-hearing and determining alleged breaches of the ASIC MIRs</li> <li>-exercising ASIC's powers to issue infringement notices and accept enforceable undertakings relating to breaches of the MIRs</li> <li>-making its decisions, as far as practicable, independently of ASIC</li> </ul> </li> </ul>	0.92	4.5%

Key process	Key sub processes, activities and outputs	2016-17	
		\$m	%
IT <sup>(b) (c)</sup>	<ul style="list-style-type: none"> <li>Cost to implement remaining EMS deliverables such as improved register and portals and advanced analytics and ongoing costs of the EMS deliverables for 2015-16</li> <li>Developing tools to keep pace with market developments</li> <li>Flexible new market MSS connectivity</li> <li>Project management and governance for EMS IT project delivery</li> <li>IT overheads</li> </ul>	5.68	28.0%
ASIC Shared Services	<ul style="list-style-type: none"> <li>Indirect costs, including Finance overheads and other shared services charges (but not IT overheads)</li> </ul>	0.94	4.7%
<b>Total<sup>(d)</sup></b>		<b>20.26</b>	<b>100%</b>

<sup>(a)</sup> the IT costs relate to the operating lease expenses for the ASIC MSS. The lease payments include monthly fees for physical hosting, gateways, and ongoing maintenance.

<sup>(b)</sup> this includes some of ASIC's EMS implementation costs prior to 1 July 2013, some (but not all – see <sup>(c)</sup> below) expected EMS implementation costs over 2016-17 and all cash-equity market related ongoing IT management costs, with the exception of the ongoing costs for the ASIC MSS that are included under "Market Supervision (incl. real-time surveillance)".

<sup>(c)</sup> no MECS costs are to be cost recovered during 2016-17. The scope of MECS includes stakeholders other than market participants, and these costs will be recovered under the industry funding model, following consultation with stakeholders.

<sup>(d)</sup> totals shown are not the exact sum of the component parts (due to rounding)

Table 8 lists ASIC's market supervision key process costs by type of cost.

Table 9 then summarises ASIC's market supervision costs to be recovered from each market segment.

**Table 8: ASIC's market supervision cost recovery budget by key process and type of cost**

Key process	Type of cost	2016-17	
		\$m	%
Market Supervision (incl. real-time market surveillance)	Employees	3.63	17.9%
	Goods and suppliers	0.38	1.9%
	Ongoing MSS related IT costs	2.95	14.6%
	<b>Total</b>	<b>6.95</b>	<b>34.3%</b>
Participant Supervision	Employees	2.24	11.1%
	Goods and suppliers	0.17	0.9%
	<b>Total</b>	<b>2.42</b>	<b>11.9%</b>
Regulatory Framework (MIRs) and Market Structure and Analysis	Employees	1.04	5.2%
	Goods and suppliers	0.13	0.7%
	<b>Total</b>	<b>1.18</b>	<b>5.8%</b>
Investigations and Enforcement	Employees	1.80	8.9%
	Goods and suppliers	0.38	1.9%
	<b>Total</b>	<b>2.18</b>	<b>10.7%</b>
Markets Disciplinary Panel (MDP)	Employees	0.62	3.1%
	Goods and suppliers	0.30	1.5%
	<b>Total</b>	<b>0.92</b>	<b>4.5%</b>
IT	Ongoing IT management costs	3.85	19.0%
	Deferred implementation costs (EMS)	1.83	9.0%
	<b>Total</b>	<b>5.68</b>	<b>28.0%</b>
ASIC Shared Services	Indirect costs	0.94	4.7%
	<b>Total</b>	<b>0.94</b>	<b>4.7%</b>
<b>Total<sup>(a)</sup></b>		<b>20.26</b>	<b>100.0%</b>

<sup>(a)</sup> totals shown are not the exact sum of the component parts (due to rounding)

**Table 9: ASIC's market supervision cost recovery budget by market segment**

Market segment	2016-17 \$m
Cash equity markets (for ASX listed securities) i.e. ASX, Chi-X and their participants	18.61
The ASX24 futures market	1.29
The FEX Derivatives Market operated by FEX Global Pty Ltd	0.21
Small Financial Markets i.e. NSX; SIM; IMB; and SSX	0.15
<b>Total</b>	<b>20.26</b>

### 3.3 Design of cost recovery charges

ASIC's market supervision costs will be recovered through charges on:

- the operators of domestic licensed financial markets that are in operation (or authorised to be in operation) during 1 July 2016 to 30 June 2017; and
- the market participants of domestic licensed financial markets within the cash equity market segment.

No contributions will be available from the FIDA fund in 2016-17 (discussed in section 1.2.4.2 'FIDA contributions to offset industry cost recovery' on page 4).

The cost recovery arrangements for each stakeholder segment are discussed in more detail in sections 3.3.1 to 3.3.4 below.

#### 3.3.1 Cash Equity Markets (for ASX listed securities)

ASX and Chi-X are the only two markets that are currently expected to be operating within this segment during the financial year 2016-17.

In 2016-17, the portion of ASIC's cost recovery budget that applies to the cash equity markets (for ASX listed securities), including part of the deferred costs associated with implementing the EMS programme, is \$18.61 million.

In line with the cost recovery rationale that costs should be recovered from those entities that have created the need for government activity such as regulation, \$18.61 million will be recovered from both market operators and market participants; this will also ensure that the burden of cost recovery is borne equitably across the industry. The method for recovering \$18.61 million is discussed in more detail below.



### 3.3.1.1 Allocation of market supervision costs between market operators and market participants

In 2016-17 cash equity market supervision costs of \$18.61 million will be allocated between market operators and market participants by reference to key ASIC market supervision business processes as follows:

- Costs that are identified as relating to the regulation of market participant activities will be allocated to market participants only (i.e. Participant Supervision, Markets Disciplinary Panel, and Investigations and Enforcement functions).
- Costs that are identified as relating to the regulation of activities of both market operators and market participants will be allocated to both groups based on a proxy that reflects each group's share of overall industry revenue (as per an update to Table 10 below). These include the ongoing costs for the Market Supervision, the Regulatory Framework, and Market Structure and Analysis functions.

The detail provided in columns two and three of Table 10 below was prepared when determining the market supervision fees that applied during 1 July 2013 to 30 June 2015 and it shows that the proxy split used at that time was 12.8% to market operators and 87.2% to market participants.

In determining the market supervision fees to apply in 2015-16 and 2016-17, ASIC has followed the same method as used to determine the fees to apply during 1 July 2013 to 30 June 2015, however ASIC has used more recent data including twelve rather than three months (1 January – 31 December 2014<sup>24</sup>). The updated proxy figures using this data vary little to those used previously, being 12.7% to market operators and 87.3% to market participants. However, for the first time cash equity market revenue information from Chi-X is included in the proxy calculations. As this information is not generally available, ASIC is publishing the proxy outcome only using figures for 1 January – 31 December 2014 (see column 5 of Table 10).

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<sup>24</sup> 84% of ASX's technical services revenue was applied to the cash market (a simplification c.f. the approach for that ASX revenue line in the previous calculations to determine the fees applying 1 July 2013 – 30 June 2015)

**Table 10: Allocation of shared ongoing costs between market operators and market participants based on their share of cash equity market revenue**

	1 Jan – 31 Mar 2012 <i>(used to calculate fees applying from 1 July 2013 to 30 June 2015)</i>			CY2014 <i>(used to calculate fees applying in 2015-16 and 2016-17)</i>	
Group	\$m	%	Comment	%	Comment
<b>Market operators</b>	57.4	12.8%	This includes cash market revenue, a proportion of information services (cash market) revenue, and market connectivity (cash market) revenue <sup>(a),(b)</sup> .  Other cash market related revenue has been included in the calculation of market operators' total revenue to ensure that it is an appropriate comparable to the revenue figure being used for market participants (i.e. given that it includes other revenue streams in addition to trade execution fees).	12.7%	As per the fee period 1 July 2013 – 30 June 2015, with one small change to attribution of ASX technical services revenue <sup>24</sup> . Attributable Chi-X revenue included for the first time.
<b>Market participants</b>	392.4	87.2%	This includes cash market product brokerage only – cash equities, debt and warrants	87.3%	
<b>Total</b>	<b>449.8</b>	<b>100%</b>		<b>100%</b>	

<sup>(a)</sup> ASX has not publicly provided figures regarding the attribution of information and technical services revenue for the cash market c.f. other ASX markets in recent times. ASIC has applied the adjustment used to calculate the fees that applied from 1 June 2013 to 30 June 2015 to determine 'comparable' ASX revenue to brokerage in respect of cash equities, warrants and debt securities in ASIC's analysis. The adjustment is based on information in ASX's 2011 Half Year Report (period ending 31 Dec 2010) on page 16 that states: 'In the first half of 2011, approximately 84% of information services revenue related to cash market and equity option data'. In the case of technical services, ASIC has attributed all the recent growth in technical services revenue to cash market revenue.

<sup>(b)</sup> 84% of ASX's market connectivity revenue was applied to the cash market. This is consistent with the proportional split applied to the information services revenue used to calculate the fees that applied from 1 July 2013 to 30 June 2015

- Costs associated with implementing the EMS programme will be allocated between market operators and market participants in equal proportion (i.e. 50%:50%). For example, costs associated with implementing the new MSS have been allocated between market operators and market participants in equal proportion (i.e. 50%:50%). The cost of implementing new and improved registers and portals (now known as MECS) was to be an exception to this and was to be allocated 100% to market participants. However, no MECS costs were cost recovered during 2015-16, and none will be recovered in 2016-17, as the scope of MECS has changed to include stakeholders other than market participants. ASIC will consult on MECS cost recovery as part of the industry funding model.

Using calendar year 2014 results as per column 5 of Table 10, namely 12.7% to market operators for shared ongoing costs (87.3% to market participants), the overall result of the functional cost allocation approach outlined above is that market operators will pay just under 13% of the cash equity market supervision costs whilst market participants will pay just over 87% (see Table 11 and Table 12 below).

**Table 11: Cash equity market supervision costs – Overall allocation between operators and participants**

Group	2016-17	
	\$m	%
<b>Market operators</b>	2.35	12.6%
<b>Market participants</b>	16.27	87.4%
<b>Total<sup>(a) (b)</sup></b>	<b>18.61</b>	<b>100.0%</b>

<sup>(a)</sup> this is net of the costs attributed to the ASX24 market (\$1.29 million), FEX (\$0.21 million), small financial markets (\$0.15 million), and inclusive of minimum market participant supervision costs (\$0.61 million). These costs are described in turn in the remaining parts of this chapter of the CRIS

<sup>(b)</sup> total cost shown is not the exact sum of the component parts (due to rounding)

**Table 12: Cash equity market supervision costs by key process – allocation to each stakeholder group**

Key process	Cost allocation	% cost allocation	2016-17	
			\$m	%
<b>Market Supervision (incl. real-time surveillance)<sup>(a)</sup></b>	Market operators	12.7%	0.53	2.9%
	Market participants	87.3%	3.66	19.6%
	<b>Total</b>	<b>100.0%</b>	<b>4.19</b>	<b>22.5%</b>
<b>Participant Supervision</b>	Market operators	0.0%	0.00	0.0%
	Market participants	100.0%	2.42	13.0%
	<b>Total</b>	<b>100.0%</b>	<b>2.42</b>	<b>13.0%</b>
<b>Regulatory Framework (MIRs) and Market Structure and Analysis</b>	Market operators	12.7%	0.15	0.8%
	Market participants	87.3%	1.03	5.5%
	<b>Total</b>	<b>100.0%</b>	<b>1.18</b>	<b>6.3%</b>
<b>Investigations and Enforcement</b>	Market operators	0.0%	0.00	0.0%
	Market participants	100.0%	2.18	11.7%
	<b>Total</b>	<b>100.0%</b>	<b>2.18</b>	<b>11.7%</b>
<b>Markets Disciplinary Panel (MDP)</b>	Market operators	0.0%	0.00	0.0%
	Market participants	100.0%	0.92	4.9%
	<b>Total</b>	<b>100.0%</b>	<b>0.92</b>	<b>4.9%</b>
<b>IT<sup>(b)(c)</sup></b>	Market operators	22.6% <sup>(d)</sup>	1.56	8.4%
	Market participants	77.4% <sup>(d)</sup>	5.34	28.7%
	<b>Total</b>	<b>100.0%</b>	<b>6.90</b>	<b>37.1%</b>
<b>ASIC Shared Services</b>	Market operators	12.7%	0.11	0.6%
	Market participants	87.3%	0.73	3.9%
	<b>Total</b>	<b>100.0%</b>	<b>0.84</b>	<b>4.5%</b>
<b>Total Market Operators</b>		<b>12.6%</b>	<b>2.35</b>	<b>12.6%</b>
<b>Total Market Participants</b>		<b>87.4%</b>	<b>16.27</b>	<b>87.4%</b>
<b>Total<sup>(e)</sup></b>		<b>100.0%</b>	<b>18.61</b>	<b>100.0%</b>

<sup>(a)</sup> this includes the ongoing IT costs for the ASIC MSS.

<sup>(b)</sup> this includes ASIC's deferred IT implementation costs for EMS, some (but not all – see <sup>(c)</sup> below) EMS implementation costs to be recovered over 2016-17 and all cash-equity market related ongoing IT management costs, with the exception of the ongoing costs for the ASIC MSS included under "Market Supervision (incl. real-time surveillance)"

<sup>(c)</sup> no MECS costs are to be cost recovered during 2016-17. The scope of MECS includes stakeholders other than market participants, and these costs will be recovered under the industry funding model, following consultation with stakeholders.

<sup>(d)</sup> the percentages reflect the effect of allocating the ongoing IT costs (excluding ongoing MSS costs) using the revenue proxy i.e. 12.7%:87.3% split between operators and participants, and of allocating deferred EMS implementation costs in equal proportion between market operators and market participants

<sup>(e)</sup> totals shown are not the exact sum of the component parts (due to rounding)

### 3.3.1.2 Allocation of market supervision cost recovery budget to each cash equity market operator and participant

Analysis performed to determine the fees to apply in 2013-14 and 2014-15 found that approximately 10% of ASIC's people-based supervisory costs were attributable to managing surveillance alerts relating to messaging activity.

ASIC believes the growth in algorithmic trading is the main reason driving this change. In dealing with this change, ASIC re-allocated resources and created a team that specifically deals with the supervision of market participants' algorithms to better manage this aspect of market risk. Aspects of investigation and enforcement activity now take much longer than they once did due to order proliferation creating excessive 'noise' around the market activity ASIC is studying. ASIC now undertakes more policy work specifically relating to algorithmic trading and the impact of order proliferation on the Australian market and this trend is expected to continue.

To reflect these market supervision cost drivers, ASIC will recover 10% of ASIC's cash equity:

- market supervision staff costs<sup>25</sup>, and
- non-IT goods and supplier costs

by levying fees according to message counts, with the balance of the two amounts above (90%) recovered from fees on transactions<sup>26</sup>.

ASIC's non-IT and IT cash equity market supervision costs will be proportionally allocated to each market operator and each market participant as follows (also refer to Table 13 below):

- **90% of non-IT costs proportionally allocated using transaction count<sup>27</sup>**

As the number of transactions is the primary driver of ASIC's non-IT cash equity market supervision costs, these costs will be proportionally allocated to each market operator and market participant based on the operator's or participant's share of the total number of transactions in ASX listed securities (as recognised by ASIC's MSS) during each quarter.

90% of all non-IT costs to be recovered from market operators and market participants in 2016-17 are \$0.51 million and \$8.50 million respectively (refer to Table 14b;

Table 14a shows the figures before the 90% adjustment).

<sup>25</sup> i.e. excluding staff allocated to supervising non-cash equity markets (ASX24, FEX and small financial markets)

<sup>26</sup> this is the same method used to determine the fees that applied in 2013-14 and 2014-15

<sup>27</sup> transactions include all transactions that are executed on or reported under the operating rules of the cash equity markets that, after all processing or conversion necessary, are recognised by ASIC's MSS as executed transactions

- o **100% of IT costs and 10% of non-IT costs proportionally allocated using message count**<sup>28</sup>

The number of messages, which is the primary driver of ASIC's IT cash equity market supervision costs, will be used as the basis for allocating ASIC's IT costs and 10% of ASIC's non-IT costs. Specifically, these costs will be proportionally allocated to each market operator and each market participant based on the operator's or participant's share of the overall number of messages for ASX listed securities (as recognised by the ASIC MSS) during each quarter.

**Table 13: Key drivers of ASIC's cash equity market supervision costs**

Core function	Cost drivers
<b>Market Supervision</b>	90% of non-IT costs: Number of transactions IT costs & 10% of non-IT costs: Number of messages (transactions and messages)
<b>Participant Supervision</b>	Of the cost of resources expended: <ul style="list-style-type: none"> <li>• 90% impacted by number of transactions; and</li> <li>• 10% impacted by number of messages</li> </ul>
<b>Investigations and Enforcement</b>	Number of cases reviewed (triggered by transactions and messages using the same proportion as above of 90%:10% transactions:messages)
<b>Markets Disciplinary Panel</b>	Number of cases reviewed (triggered by transactions and messages using the same proportion as above of 90%:10% transactions:messages)
<b>Other</b>	To be allocated by transactions and messages using the same proportion as above of 90%:10% transactions:messages

**Table 14a: Cash equity market cost recovery budget (no % allocation adjustments)**

	Cost allocation	2016-17	
		\$	%
<b>Non-IT costs in cost recovery budget</b>	Market operators	0.57	3.1%
	Market participants	9.44	50.7%
	<b>Total</b>	<b>10.01</b>	<b>53.8%</b>
<b>IT costs<sup>(a)</sup> in cost recovery budget</b>	Market operators	1.77	9.5%
	Market participants	6.82	36.7%
	<b>Total</b>	<b>8.60</b>	<b>46.2%</b>
<b>Total Market Operators<sup>(b)</sup></b>		<b>2.35</b>	<b>12.6%</b>
<b>Total Market Participants<sup>(b)</sup></b>		<b>16.27</b>	<b>87.4%</b>
<b>Total<sup>(b)</sup></b>		<b>18.61</b>	<b>100.0%</b>

<sup>(a)</sup> this reflects all of ASIC's cash equity market IT costs (i.e. it includes deferred IT implementation costs of EMS, ongoing IT management costs, and the ongoing costs of ASIC'S MSS)

<sup>(b)</sup> total cost shown is not the exact sum of the component parts (due to rounding)

<sup>28</sup> messages include trade, order entry, order amend (price and/or volume), and order deletion/cancellation messages that, after all processing or conversion necessary, are recognised by ASIC's MSS as orders or executed transactions. Some processing and conversion may be necessary in ASIC'S MSS because some IT systems generate more than one message for a single order or executed transaction

The costs to be recovered from market operators and market participants using a message count-based allocation in 2016-17 are \$1.83 million and \$7.77 million respectively (refer to Table 14b);

Table 14a above shows the figures before the addition of 10% non-IT costs to the message based allocation pool and the corresponding reduction of the costs in the trade allocation pool).

The main advantage of the proportional cost allocation method based on the level of activity, rather than a fixed fee per transaction and message method, is that it will not result in an over- or under- recovery of ASIC's market supervision costs. The use of an activity-based approach is intended to provide a linkage between the quantum charged and the resources consumed in supervising operators and participants.

**Table 14b: Cash equity market cost recovery budget incl. non-IT and IT cost % allocation adjustments**

	Cost allocation	2016-17	
		\$	%
<b>Allocated based on market share of transaction counts</b> <i>(90% of non-IT costs in cost recovery budget)</i>	Market operators	0.51	2.8%
	Market participants	8.50	45.7%
	<b>Total</b>	<b>9.01</b>	<b>48.4%</b>
<b>Allocated based on market share of message counts</b> <i>(100% of IT costs and 10% of non-IT costs in cost recovery budget)</i>	Market operators	1.83	9.8%
	Market participants	7.77	41.7%
	<b>Total</b>	<b>9.60</b>	<b>51.6%</b>
<b>Total Market Operators<sup>(a)</sup></b>		<b>2.35</b>	<b>12.6%</b>
<b>Total Market Participants<sup>(a)</sup></b>		<b>16.27</b>	<b>87.4%</b>
<b>Total<sup>(a)</sup></b>		<b>18.61</b>	<b>100.0%</b>

<sup>(a)</sup> totals shown are not the exact sum of the component parts (due to rounding)

**Table 14c: Not used**

### 3.3.1.3 Fixed fee for cash equity market participants

ASIC's Market & Participant Supervision team allocates twenty of its staff to conducting compliance reviews of direct and indirect market participants. The aim is for these staff to spend half their time on non-issue specific, general reviews of participants and the other half on more in-depth follow-up reviews and remediation activities.

This general supervision aims to conduct on-site compliance reviews and risk-based surveillance with every participant at least once every three and a half years, process applications, notifications and waivers and perform regular reviews of participants' risk-based capital. The effort spent by ASIC on such supervision is relatively constant and does not depend on the level of transaction and messaging activity of trading market participants.

Allocation of relevant supervisory costs based on the level of trading and order messaging activity of participants results in highly variable individual charges for what is essentially the same level of supervision received by all participants as a group from year to year. In such

circumstances, a fixed fee approach is considered to be a more equitable and administratively efficient method for recovering supervision costs from participants.

The fixed fee will be \$1,905 per quarter per each market participant based on the following calculations (all figures are rounded to the nearest hundred dollars):

- Average staff cost p.a. of \$145,000
- 60 per cent of the salaries and wages of this team are subject to cost recovery (with the remainder Budget funded because the rest of their time is spent on ASIC's market supervision activities that are not subject to cost recovery); and
- 70 per cent of the reviews are conducted on direct market participants, with a current regulated population of c. 80 — 90 market participants.

The workings are as follows:

$$\begin{aligned} \frac{\$145,000 \times 20 \times 50\% \times 60\% \times 70\%}{80} &= \$7,612.50 \text{ p.a.} \\ &= \$1,903.13 \text{ per quarter} \\ &= \$1,905 \text{ per quarter (rounded to the nearest \$5)} \end{aligned}$$

This fee will be collected quarterly in arrears for every cash equity market participant<sup>29</sup>. No goods and supplier or overhead costs are recovered in this fee; rather, recovery of these costs is incorporated into other participant supervision costs that get rolled into the variable, activity-based fees imposed on trading market participants. Assuming 80 market participants are subject to the charge, the expected revenue from this fee in 2016-17 is \$0.61m.

The fixed fee will be payable regardless of the level of trading and messaging activity of the market participant, i.e. even if no activity has occurred during the quarter, the fixed fee will be charged.

#### 3.3.1.4 Variable fees for cash equity market participants

Table 14d below shows how the minimum participant supervision fee impacts the variable fees to be charged to cash equity market participants (total impact of \$0.61<sup>30</sup> million during 2016-17). The amount to be recovered from market participants using trade count-based fees reduces to \$7.95 million, and for message count-based fees the amount reduces to \$7.71 million. The overall cost recovered through variable fees with respect to the cash equity market reduces by \$0.61 million from \$18.61 million to \$18.00 million.

<sup>29</sup> in the case of trading market participants, this fee will be split across each such participants' active Trading PIDs in that quarter (trading PIDs are unique identifiers that tag a trading market participant's identity to every trade side and order on a market)

<sup>30</sup> the reductions to the amounts applying to market participants due to revenue from the minimum participant supervision fees have been applied in the ratio 90:10 to the amount allocated based on market share of transaction counts: amounts allocated based on market share of message counts

**Table 14d: Cash equity market cost recovery budget incl. (1) non-IT and IT cost % allocation adjustments; and (2) net of minimum participant supervision fees**

	Cost allocation	2016-17	
		\$	%
<b>Allocated based on market share of transaction counts</b> <i>(90% of non-IT costs in cost recovery budget)</i>	Market operators	0.51	2.9%
	Market participants	7.95	44.2%
	<b>Total</b>	<b>8.47</b>	<b>47.0%</b>
<b>Allocated based on market share of message counts</b> <i>(100% of IT costs and 10% of non-IT costs in cost recovery budget)</i>	Market operators	1.83	10.2%
	Market participants	7.71	42.8%
	<b>Total</b>	<b>9.54</b>	<b>53.0%</b>
<b>Total Market Operators<sup>(a)</sup></b>		<b>2.35</b>	<b>13.0%</b>
<b>Total Market Participants<sup>(a)</sup></b>		<b>15.66</b>	<b>87.0%</b>
<b>Total<sup>(a)</sup></b>		<b>18.00</b>	<b>100.0%</b>

<sup>(a)</sup> total cost shown is not the exact sum of the component parts (due to rounding)

### 3.3.1.5 Variable fees for cash equity market operators

The quarterly charges that will apply to each cash equity market operator are outlined below. The charges are to be collected quarterly in arrears.

The formula for calculating the activity-based quarterly fee to be paid by each market operator in 2016-17 is as follows:

Operator A's overall quarterly fee	= Fee based on 90% of ASIC's total market operator related non-IT costs	= \$0.51 m ÷ 4 quarters <sup>31</sup>	× No. of transactions executed on or reported under the operating rules of the financial market operated by Operator A during the quarter (as recognised by the ASIC MSS) ÷ Total no. of transactions executed on or reported under the operating rules of all cash equity markets during the quarter (as recognised by the ASIC MSS)
	+ Fee based on Operator A's share of ASIC's total market operator related IT costs + share of 10% of ASIC's total market operator related non-IT costs	= \$1.83 m ÷ 4 quarters <sup>31</sup>	× No. of messages from the financial market operated by Operator A during the quarter (that are recognised by the ASIC MSS as orders or executed transactions) ÷ Total no. of messages from all cash equity markets during the quarter (that are recognised by the ASIC MSS as orders or executed transactions)

### 3.3.1.6 Not used

### 3.3.1.7 Charges applying to market participants – with no FIDA contribution in 2016-17

Market participants will also pay quarterly charges based on their transaction and message activity during each quarter, plus a fixed fee for minimum participant supervision. The formula for calculating the charges to be paid by each market participant in 2016-17 is as follows.

<sup>31</sup> quarterly figure rounded to nearest \$1,000



Amount of Participant A's quarterly fee	=	Fee based on Participant A's share of 90% of ASIC's total market operator related non-IT costs	=	\$7.95 m ÷ 4 quarters	×	No. of transactions executed on or reported to the cash equity markets by Participant A during the quarter (as recognised by the ASIC MSS) ÷ Total no. of transactions executed on or reported to the cash equity markets by all participants during the quarter (as recognised by the ASIC MSS)
	+	Fee on Participant A's share of ASIC's total market operator related IT costs + share of 10% of ASIC's total market operator related non-IT costs	=	\$7.71 m ÷ 4 quarters	×	No. of messages by Participant A in the cash equity markets during the quarter (as recognised by the ASIC MSS) ÷ Total no. of messages by all participants in the cash equity markets during the quarter (as recognised by the ASIC MSS)
	+	Fixed fee for minimum participant supervision	=	\$1,905		See section 3.3.1.3 'Fixed fee for cash equity market participants' on page 26

### 3.3.2 The ASX24 futures market

ASX24 is currently supervised by ASIC on a post-trade basis. ASIC receives ASX24-specific reports every day that are automatically uploaded into ASIC's MSS.

The current cost recovery arrangement for the ASX24 market involves the imposition of a fixed quarterly fee on the market operator only; participants of futures markets do not pay a direct fee to ASIC under this arrangement.

ASIC's supervisory effort for the ASX24 market is approximately equal to the cost of seven full-time employees. The 2016-17 cost recovery budget is based on ASIC's supervisory cost for the ASX24 market. This is approximately \$1.29 million, based on seven full time employees and a share of budgeted goods and supplier and shared services costs. No allowance is made for ASX24-related MSS system changes in 2016-17.

The fixed quarterly fee for the ASX24 market in 2016-17 is \$323,405<sup>32</sup> per quarter. This fee is to be collected quarterly in arrears.

**Table 15: Total cost of ASX24 market supervision**

Type of cost	Cost
Seven ASIC staff members specialising in ASX24 market supervision (including on-costs) <sup>33</sup> p.a.	\$1,015,000
Goods and Suppliers costs (pro-rated share based on seven staff) p.a.	\$146,694
ASIC shared services costs (pro-rated share based on seven staff) p.a.	\$131,920
<b>Total cost 2015-16</b>	<b>\$1,293,614</b>

<sup>32</sup> quarterly figure rounded to the nearest \$5

<sup>33</sup> see average staff cost assumption on page 17

### 3.3.3 FEX Global Pty Ltd (FEX)

Consistent with the cost recovery arrangements currently in place for the ASX24 futures market, FEX will be supervised by ASIC on a post-trade basis in 2016-17 (i.e. no real-time surveillance on ASIC's MSS). ASIC's annual supervisory effort for the FEX market is estimated at \$205,000 (see Table 16 below) and includes the cost of one new employee who will be directly engaged in the FEX market supervision and travel costs for two ASIC employees to undertake four compliance reviews on FEX overseas participants. This figure was determined assuming FEX would commence operations on 1 July 2015, though the date FEX will commence operating is not yet known. FEX plans to commence operations in 2016-17.

Although the travel costs for both ASIC employees will be included in the cost recovery charge, all other costs of the second ASIC employee will be Budget funded and not recovered from the FEX market. Other than the travel costs specified below, ASIC will not allocate a pro-rated share of goods and supplier and overhead costs to FEX during 2016-17, as this market is new and ASIC will need to assess the actual effort required in its supervision.

ASIC and Treasury will consult on changes to charges for all market operators, including FEX, as part of ASIC's industry funding model.

Table 16 below shows that the fixed quarterly fee for the FEX market in 2016-17 is \$51,250<sup>34</sup> per quarter. This fee is to be collected quarterly in arrears, for quarters in which FEX operates.

**Table 16: Total cost of FEX market supervision**

Type of cost	Cost	Rationale for ASIC incurring this cost
One new ASIC staff member specialising in FEX market supervision (including on-costs) <sup>35</sup> p.a.	<b>\$145,000</b>	The FEX market will commence trading with unique and highly differentiated contracts based on underlying asset classes that require ASIC to acquire new skills, expertise and knowledge. Subject to commencement of operations, a new, dedicated ASIC FEX resource is required during 2016-17 and beyond.  If supervising the FEX market requires more than one additional ASIC supervisory resource due to market activity on FEX exceeding current projections, this additional cost will not be passed on to FEX and will be Budget funded until 30 June 2017.
Travel costs for two employees to conduct four compliance reviews per annum on FEX's overseas participants	<b>\$60,000</b>	FEX's target participants are different entities than those currently supervised by ASIC with respect to trading on ASX, ASX24 and small financial markets, and they are expected to be predominantly located offshore. Subject to commencement of operations, the salary cost of the one staff member travelling with the allocated FEX staff member will be Budget funded and will not be cost recovered from the FEX market.
<b>Total cost 2016-17</b>	<b>\$205,000</b>	

<sup>34</sup> rounded to the nearest \$5

<sup>35</sup> an average staff cost of \$145,000 applies throughout this CRIS (see average staff cost assumption on page 17)

FEX market participants will not pay a direct fee to ASIC during 2016-17. The imposition of a fixed quarterly fee on the futures market operator (FEX) only is a cost recovery arrangement that currently applies to futures markets. As part of the industry funding model, Treasury and ASIC will consult with industry on the principles for the recovery of futures markets' (including FEX) supervision costs to ensure that fair and transparent cost recovery arrangements that appropriately reflect the complex nature of futures markets are implemented.

### 3.3.4 Small financial markets (SFM)

The current cost recovery arrangement for the SFM (i.e. NSX, SIM, IMB and SSX) will continue to apply. As ASIC does not currently undertake real-time market surveillance on the SFM, it is more appropriate to continue to recover ASIC's costs for supervising these markets based on the supervisory effort expended by ASIC in terms of full-time employees.

ASIC's total cost for supervising the SFM (and their direct participants<sup>36</sup>) is based on a supervisory effort required equivalent to one full time ASIC employee at a cost of \$145,000 p.a.<sup>35</sup> This is based on the risk profile and trading activity on the four markets that comprise the SFM segment.

The resource allocated for SFM surveillance is based in the Real-time Market Surveillance / Supervision team, as although the SFM are not monitored in real-time, the skills required to conduct effective post-trade market surveillance for the SFM are located in that team<sup>37</sup>.

Apart from employee costs, ASIC does not incur any other significant costs to supervise the four markets within this segment, and will not allocate a pro-rated share of goods and supplier and overhead costs to SFMs' cost recovery charges during 2016-17.

The fixed quarterly fee for each one of the four SFMs is \$9,065 per quarter, with the workings as follows:

$$\begin{array}{rcl} \frac{\$145,000}{4} & = & \$36,250 \text{ p.a. per SFM} \\ \text{then...} & & \\ \frac{\$36,250}{4} & = & \$9,062.50 \text{ per SFM per quarter} \\ & = & \$9,065 \text{ per SFM per quarter (rounded to the nearest \$5)} \end{array}$$

These fees are to be collected quarterly in arrears. Participants of the four SFMs will not pay a direct fee to ASIC in 2016-17.

<sup>36</sup> e.g. ASIC processes applications, notifications, waivers, etc

<sup>37</sup> dedicated SFM-resource is not included in cash equity markets' Real-time Market Surveillance / Supervision costs

### 3.3.5 Recovery of unforeseen costs occurring during 2016-17

This section of the CRIS outlines the approach ASIC will take regarding cost recovery of any future additional costs unforeseen at the time of preparing this CRIS that ASIC may need to incur in 2016-17 to enhance its market supervision/regulatory capabilities to keep pace with industry innovation, market structure changes, and market developments. It assumes that policy authority for ASIC to cost recover falls within the Government's existing policy approvals for cost recovery of ASIC's market supervision activities (see Table 4 on page 12).

Promoters of market innovations are encouraged to discuss such proposals with ASIC at the earliest possible opportunity so that ASIC can:

- advise as to the proposed structure of recovering such costs in the next Fees Regulations; and
- request quotes from both internal and external suppliers as to the likely quantum of the cost.

Wherever possible, ASIC's approach will be to directly charge the promoter of the market innovation for ASIC's additional costs relating to such a change(s). Such charges would commence from the time the next Fees Regulations are implemented. If a proposal does not fall within existing policy authority for cost recovery, a new authority will need to be sought from Government.

Any changes to policy approvals for cost recovery of ASIC's market supervision activities and / or significant ASIC's market supervision activities themselves will be reflected in an updated CRIS.

### 3.4 Summary of 2016-17 charging arrangements

The table below provides a summary of the total fees for each financial market segment for the financial year 2016-17. Subject to the additional \$1.465 million payable by cash equity market participants due to no FIDA contribution being received in 2016-17, these fees are consistent with 2015-16 as ASIC's market supervision activities are largely unchanged.

**Table 17: Summary of ASIC's cost recovery charges 2016-17**

Market segment	Group	Charging method	Quarterly charges	Total <sup>38</sup>
<b>Cash equity markets (for ASX listed securities) i.e. ASX and Chi-X</b>	Market operators	Activity-based fees	\$587,000 per quarter (to be proportionally recovered from all operators)	<b>2.35</b>
	Market participants	Activity-based fees	\$3,914,250 per quarter (to be proportionally recovered from all trading participants)	<b>15.66</b>
	Market participants	Fixed fee (for minimum participant supervision)	\$1,905 per quarter per cash equity market participant	<b>0.61</b>
<b>ASX24</b>	Market operator	Fixed fee	\$323,405 per quarter	<b>1.29</b>
<b>FEX Global Pty Ltd<sup>39</sup></b>	Market operator	Fixed fee	\$51,250 per quarter	<b>0.21</b>
<b>Small Financial Markets i.e. NSX; SIM; IMB; and SSX</b>	Market operators	Fixed fee	\$9,065 per quarter per small financial market	<b>0.15</b>
<b>Total 2016-17 \$m<sup>(a)</sup></b>				<b>20.26</b>

<sup>(a)</sup> total cost shown is not the exact sum of the component parts (due to rounding)

<sup>38</sup> figures do not include any FIDA contributions in 2016-17

<sup>39</sup> quarterly fees of \$51,250 will not be payable until FEX commences operations

## 4. RISK ASSESSMENT

ASIC considers the proposed 2016-17 ASIC market supervision cost recovery arrangements as medium to low risk as:

- ASIC market supervision cost recovery is not new. Since 1 January 2012 cash equity market operators and their participants have been charged quarterly in arrears, predominantly according to their market share of trade and message counts. They now generally understand and are accustomed to paying these fees and working with a Government entity conducting market supervision.
- There is no change in the complexity or materiality of ASIC market supervision cost recovery:
  - the activities and outputs presented in this CRIS are unchanged save for the progressive implementation of the EMS programme of works;
  - the methods used to calculate fees and charges in this CRIS do not differ from those that applied previously<sup>40</sup>. Whilst it initially took some time for billed entities to understand the methods when they were introduced, they are now generally well understood; and
  - in 2016-17 the cost recovery budget is the same as the 2015-16 budget.
- The key sensitivities listed below have all been mitigated by ASIC to the best of its ability, save for the issues involved in the Government's response to the Financial System Inquiry (FSI) that are outside ASIC's control:
  - Cash equity market participants may be sensitive to a fee change as the result of a FIDA contribution not being received. Further to a decision by the SEGC board, no FIDA contribution will be made in 2016-17. To ensure that cash equity market participants were fully aware of the implications of a FIDA contribution not being received, Table 17 on page 33 and sections 3.3.1.6 '*Charges applying to market participants – net of FIDA contribution*' and 3.3.1.7 '*Charges applying to market participants assuming no FIDA contribution*' in version 3.0 of the CRIS dated 22 June 2016 clearly outlined the fees that would be charged in both cases;
  - Market participants that are heavy users of automated trading technology are typically sensitive to the amounts to be recovered with respect to messaging activity<sup>41</sup>. Apart from the \$1.465 million increase as a result of there being no FIDA contribution, there will be no change to the total to be recovered in 2016-17;
  - A full review of the existing market supervision cost recovery methodology was not undertaken in 2014-15 or 2015-16, in advance of the introduction of an industry funding model for ASIC's regulatory activities .

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<sup>40</sup> the introduction of the fixed fee for cash equity market participants (see section 3.3.1.3 on page 26) has been the only methodology change since 1 January 2012. This fee was introduced on 1 July 2013

<sup>41</sup> several firms who do not trade in a message-intensive fashion actually appreciate this aspect of ASIC's cost recovery model

## 5. STAKEHOLDER ENGAGEMENT

### 5.1 Consultation with the Market Supervision Cost Recovery Stakeholder Panel (MSCRSP)

The key role of the MSCRSP has been previously outlined in section 1.5 on page 8 of this CRIS. Treasury and ASIC regularly meet with the MSCRSP to discuss their views on financial market supervision proposals and approaches for cost recovery.

Formal consultation with the MSCRSP commenced in early 2012, and follow-up meetings were held in May 2012, November 2012, January 2013, May 2013 and September 2014.

In March 2015 Treasury informed MSCRSP members of the Government's decision to use the same method that was applied to calculate fees during 1 July 2013 to 30 June 2015 to determine fees and charges to apply in 2015-16.

The MSCRSP met on 1 June 2015 to discuss the 2015-16 consultation draft CRIS released on 15 May 2015. The key points made by MSCRSP members at that meeting were:

- a full review of the method used to cost recover ASIC Market Supervision should take place as soon as possible, ideally as part of the Government's FSI-related review of ASIC's future funding requirements and possible funding models; and
- any recommendations adopted as part of such a review should be ready for implementation from 1 July 2016.

### 5.2 Industry Funding Model

A full review of the current cost recovery methodology was not undertaken in 2015-16.

ASIC has supported Treasury to consult with industry on the proposed industry funding model for ASIC. The Government will consult extensively with industry to refine and settle this funding model.

## 6. FINANCIAL ESTIMATES

**Table 18: Cost recovery financial estimates**

(\$000)	2015-16 (budget 1 year)	2016-17 (projected 1 year)
<b>Revenue</b>	\$20,201 <sup>42,43</sup>	\$20,256
<b>Expenses (excluding DPICs)</b>	(\$18,370) <sup>42,43,44</sup>	(\$17,692)
<b>Balance – DPICs recovered in period</b>	\$1,831	\$2,564
<b>Balance management strategy</b>	<p>As detailed in section 1.6, Enhanced Market Supervision (EMS) expenditure in previous years has not been fully cost recovered.</p> <p>ASIC therefore plans to recover more revenue than has been expended, in the financial years from 1 July 2015 to 30 June 2020. The difference between revenue and expenditure in these years is due to the deferral of high upfront costs incurred in the early implementation years of the EMS measure, and subsequent cost recovery in later years. These are referred to as deferred project implementation costs (DPICs).</p> <p>As noted in Table 19, some EMS costs were also recovered in the 2013-15 CRIS period.</p> <p>It is anticipated that EMS costs not recovered at the end of the 2016-17 CRIS period will be recovered under the industry funding model.</p>	

## 7. FINANCIAL PERFORMANCE

ASIC closely monitors the costs of undertaking its market supervision functions. To ensure accountability and transparency, ASIC accounts for the expenses relating to its market supervision functions separately by recording them under distinct cost centres that link to ASIC's market supervision budget measures and the ASIC teams incurring the cost (see Table 4 on page 12 for details of ASIC's sources of funds for market supervision that are subject to cost recovery).

Cost recovery revenue is reported in ASIC's Financial Statements<sup>45</sup>.

<sup>42</sup> 2015-16 budgeted revenue and expenses have both been reduced by \$0.205m as FEX Global is yet to commence market operations

<sup>43</sup> \$0.150m was received from ASX24 in 2013-15 for an MSS variation to support real-time data. ASIC did not incur this expenditure in 2013-15, but is expecting to incur similar expenditure in 2015-16. The 2013-15 revenue will be applied to 2015-16 expenditure. \$0.150m has been deducted from actual 2013-15 revenue, and added to budgeted 2015-16 revenue in Tables 18 and 19. \$0.150m has also been added to budgeted 2015-16 expenses in these tables.

<sup>44</sup> ASIC's cost recovery expense budget for MECS and other EMS costs in 2015-16 was \$1.561m less than its internal budget, with the balance to be recovered in later years.

<sup>45</sup> see <http://asic.gov.au/about-asic/corporate-publications/asic-annual-reports/#ar14>



## 7.1 Summary of the prior two fee charging periods

**Table 19: Summary of the financial performance of the prior two fee charging periods**

(\$000)	1 Jul 2013 – 30 Jun 2015 (actual 2 years)	1 Jul 2015 – 30 Jun 2016 (budget 1 year)
Revenue	\$42,322 <sup>43</sup>	\$20,201 <sup>42,43</sup>
Expenses (including budgeted DPICs)	(\$41,250)	(\$20,201) <sup>42,43</sup>
DPICs brought forward to reduce fees in later years	(\$1,072)	\$0
Refunds	\$0	\$0

Historically ASIC has evaluated the financial performance of market supervision cost recovery at the conclusion of each fee charging period.

In line with the new CRIS template introduced on 1 July 2014, ASIC will update the financial performance figures in this CRIS annually after the conclusion of each financial year from 1 July 2015.

## 7.2 1 January 2012 – 30 June 2015: Actual expenditure by key processes

**Table 20: Cost recovery expenses 1 Jan 2012 – 30 Jun 2015 (3.5 years) by key process**

(\$000)	CRIS 1 Jan 2012 – 30 Jun 2013 (actual 18 months)	CRIS 1 Jul 2013 – 30 Jun 2015 (actual 2 years)
Key processes		
Real-time Market Surveillance / Supervision	\$7,444	\$11,793
Participant Supervision	\$4,900	\$4,853
Regulatory Framework (MIRs) & Market Structure Analysis - Ongoing	\$1,733	\$2,212
Regulatory Framework (MIRs) & Market Structure Analysis - Competition DPICs	\$2,064	\$1,950
Investigations & Enforcement	\$2,251	\$3,487
Markets Disciplinary Panel (MDP)	\$941	\$1,645
IT Costs - Ongoing	\$2,885	\$9,434
IT Costs - Competition DPICs	\$2,495	\$1,084
IT Costs - EMS DPICs	\$0	\$3,156
ASIC Shared Services Costs	\$1,832	\$1,636
<b>Total</b>	<b>\$26,544</b>	<b>\$41,250</b>

As noted previously, the costs recovered in 2013-15 include expenditure approved as part of the EMS measure.

### 7.3 1 January 2012 – 30 June 2013: Refunds issued in 2013-14

As detailed in the 2015-16 CRIS, ASIC saved \$3.17 million over the 2012-13 fee charging period relative to the cost recovery revenue collected.

A majority of the amount saved (\$2.72 million) was attributable to cash equity market participants<sup>46</sup>. \$406,601 of the refund per quarter was allocated according to cash equity Market Participants' market share of transaction count, and \$46,855 per quarter was allocated according to participants' market share of message count.

Refund amounts attributable to ASX24, ASX and Chi-X in total were \$447,587 (i.e. \$74,598 per quarter).

In the case of the Small financial markets (SFM), no refunds applied as the resourcing for the SFM was exactly as planned during the period.

ASIC operates within a robust financial management and budgeting framework. These cost savings were due to:

- Lower than anticipated costs for disciplinary action for alleged breaches of the market integrity rules in part due to a low rate of contested matters. ASIC acknowledges the generally positive and co-operative approach that industry has demonstrated in its dealings with us on disciplinary matters;
- Other supplier cost savings; and
- Lower than expected overheads incurred for market supervision cost recovery.

### 7.4 International benchmarking

ASIC benchmarks the cost of ASIC market supervision cost recovery relative to double-sided cash equity market turnover with comparable regulators FINRA (USA) and IIROC (Canada). ASIC market supervision cost recovery is comparable / in line with costs in Canada, a similar market in terms of size to Australia and even that of the US, a market of far greater size.

In the following analysis ASIC has made several assumptions and adjustment to compare like regulatory functions with like. Exact comparisons are not possible as no two jurisdictions are exactly alike. ASIC has used the following sources to prepare this analysis:

- IIROC and FINRA annual reports;
- SEC Fee rate advisory information;
- past published ASIC market supervision cost recovery documents; and
- IRESS.

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<sup>46</sup> amounts of \$5 or less were not refunded as these were not economically significant amounts

**Table 21: International benchmarking**

Basis points		
<b>1. AUS - ASIC Market Supervision Cost Recovery post-Competition (cash equity markets only)</b>		
<i>Using revenue collected (net of FIDA offset and refunds)</i> <sup>(a)</sup>	<b>0.0739</b>	1 Jan 2012 - 31 Mar 2015 (average over 3.25 yrs)
<b>2. USA - Analysis using comparable FINRA revenue</b>		
Max over CY2007 - CY2013	0.0940	in CY2012
Min over CY2007 - CY2013	0.0518	in CY2008
Average over CY2007 - CY2013	<b>0.0762</b>	
<b>3. Canada<sup>(b)</sup> - Analysis using comparable IIROC costs (includes capital costs)<sup>(c)</sup></b>		
Max over FY2009 - FY2014	0.0873	in FY2012
Min over FY2009 - FY2014	0.0616	in FY2009
Average over FY2009 - FY2014	<b>0.0756</b>	
<b>4. Canada<sup>(b)</sup> - Analysis using comparable IIROC costs (excludes capital costs)</b>		
Max over FY2009 - FY2014	0.0754	in FY2013
Min over FY2009 - FY2014	0.0578	in FY2011
Average over FY2009 - FY2014	<b>0.0670</b>	

<sup>(a)</sup> CRIS refunds for 18m period 1 Jan 2012 - 30 Jun 2013 of \$3.17m have been smoothed over the entire 3.25 year period

<sup>(b)</sup> Canadian fiscal years are to 31 March

<sup>(c)</sup> Money from fines and settlements is contributed to IIROC's restricted fund, which IIROC uses to fund capital expenditures necessary to address emerging regulatory issues, projects relating to investor and industry education, and other uses authorised under IIROC's Recognition Orders

## 8. NON-FINANCIAL PERFORMANCE

ASIC has built on a largely favourable review of its market supervision function by the IMF in November 2012<sup>47</sup> and is generally regarded as an effective markets regulator.

A number of problems other jurisdictions have experienced since introducing market competition are either not evident in Australia, or are far less prevalent, due to the design of the current regulatory framework. This has received praise from influential local and international industry practitioners<sup>48</sup>, including ex-ASX CEO Elmer Funke Kupper who, at the 2014 Stockbroker's Association Conference said, *"in Australia, ASX believes ASIC has done a good job managing the challenges arising from our recently fragmented market structure"*. The same article quotes John Fildes, the Chief Executive of Chi-X Australia (ASX's direct competitor) as saying *"ASIC has taken a very measured, fact-based approach to the dark pool rules – creating a task force, analysing the data and coming to its own conclusions without listening to the media bias. The regulator has managed the dialogue with the market well."*

<sup>47</sup> See International Monetary Fund, "Australia: Financial System Stability Assessment", November 2012 available at <http://www.imf.org/external/pubs/ft/scr/2012/cr12308.pdf>

<sup>48</sup> Another example provided below from [efinancialnews.com story "Australian dark-pool rules mark a test case for Asia"](http://www.efinancialnews.com/story/2013-06-04/australian-dark-pool-rules-asic?ea9c8a2de0ee111045601ab04d673622) 4 June 2013 available at <http://www.efinancialnews.com/story/2013-06-04/australian-dark-pool-rules-asic?ea9c8a2de0ee111045601ab04d673622>:

*"Australia continues to set a sensible trend towards achieving strong and clean equity markets. The EU should consider what ASIC has implemented in the recent past, what it is doing and what it proposes to do and analyse if parts are appropriate for European markets."* – Stuart Baden Powell, head of European electronic trading at RBC Capital Markets

The final report of the Financial System Inquiry noted that *"Australia needs a better mechanism to allow Government to assess the performance of financial regulators... regulators should develop better performance indicators"*<sup>49</sup>.

Like all Commonwealth entities, ASIC is subject to performance reporting requirements under the PGPA Act that came into effect in 2014-15.

In the area of ASIC Market Supervision, ASIC believes the current monthly and half yearly reports it issues on *ASIC enforcement outcomes* and *ASIC supervision of markets and participants* form an excellent basis for future performance indicator development. Monthly Market Integrity Updates and the latest of the six monthly reports, Report 476 – ASIC enforcement outcomes: July to December 2015, released on 30 March 2016, are available at [www.asic.gov.au](http://www.asic.gov.au).

ASIC also uses its regular Market Supervision Updates to notify market stakeholders of any urgent issues we see emerging in the market as quickly as possible.

## 9. KEY FORWARD DATES AND EVENTS

- 17 October 2016: Publication of the updated CRIS re FIDA (*due to 2016-17 FIDA contribution not being made*)

## 10. CRIS CHANGE REGISTER

Date of change	CRIS change	Approver	Basis for change
2/6/2015	Certification of the CRIS	Greg Medcraft, ASIC Chairman	Changes in 2015-16 cost recovery budget
18/6/2015	Agreement to the CRIS	Hon Josh Frydenberg MP, Assistant Treasurer	Changes in 2015-16 cost recovery budget
23/6/2016	Update for 2016-17	Greg Medcraft, ASIC Chairman	Changes in expenses, updates of financial estimates
17/10/2016	Further update for 2016-17	Greg Yanco, ASIC Senior Executive Leader, Market Supervision	Note that no FIDA contribution will be received in 2016-17

<sup>49</sup> see <http://fsi.gov.au/publications/final-report/>

## APPENDIX A: RECENT HISTORY OF ASIC MARKET SUPERVISION

### A.1 Transfer of market supervision to ASIC

On 24 August 2009, the Government announced its decision to transfer the responsibility for supervision of domestic licensed financial markets from market operators to ASIC. The Corporations Amendment (Financial Market Supervision) Act 2010 gave effect to this decision and received Royal Assent on 25 March 2010.

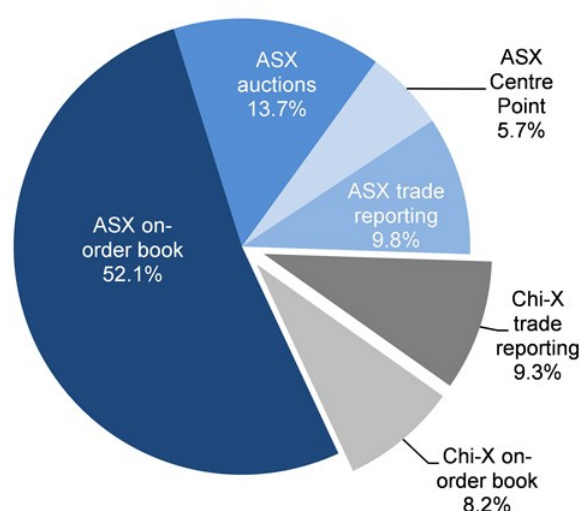
### A.2 Introduction of market competition

On 31 March 2010, the Government announced its support for market competition. On 4 May 2011, the Government granted Chi-X an Australian market licence under section 795B(1) of the Corporations Act 2001 to enable it to operate an alternative exchange for trading in ASX listed securities. Chi-X commenced operations on 31 October 2011.

The figure at right shows the market share according to total dollar turnover of each cash equity market execution venue in the December 2014 quarter<sup>50</sup>. The figure shows that Chi-X has made significant inroads into the Australian market since commencing operations.

ASIC regularly publishes information on market structure and cash equity market statistics. For more information, please see <http://www.asic.gov.au/regulatory-resources/markets/market-structure/>

**Chart A: Cash equities: market share of execution venues 1 Oct – 31 Dec 2014**



### A.3 Enhanced Market Supervision (EMS)

Maintaining the integrity and efficiency of the Australian equity market is essential as Australia has some of the highest levels of share ownership among the general population in the world. This market is the foundation of a majority of Australians' superannuation holdings, and is at the core of Australia's capital markets. It is also important to Australia's competitiveness as a regional financial centre. ASX-listed equities are ranked eighth largest in the world in terms of free float market capitalisation<sup>51</sup>.

Appropriate investment in technological capabilities and systems is critical to facilitate effective surveillance in the future. The financial market landscape has rapidly evolved post-competition with changes in technology, trading techniques and regulation.

<sup>50</sup> see report 'Equity market data for quarter ending December 2014' available at <http://www.asic.gov.au/regulatory-resources/markets/market-structure/equity-market-data/equity-market-data-for-quarter-ending-december-2014/>

<sup>51</sup> source: <http://www.asx.com.au/listings/listing-IPO-on-ASX.htm>

Increased adoption of algorithmic trading techniques by both the buy side and the sell side, and the entry of specialist high frequency trading firms to Australia has resulted in average trade size declining and an increase in the number of orders in the Australian market. A recent study by ASIC's high-frequency trading taskforce found evidence of high order to trade ratios (indicative of order proliferation) in the Australian market that was widespread and not limited to high frequency traders. Order proliferation makes the detection of market misconduct more difficult.

Order proliferation increases the data capacity requirements of the entire industry. ASIC, market operators and market participants must all deal with the cost of investing in greater system capacity to store and manage order records for surveillance and compliance purposes.

In response to the Australian market changing and becoming more complex, the Government agreed to provide ASIC with additional funding on a cost recovery basis via the EMS measure in the 2012-13 Budget so that ASIC can enhance its market supervision capabilities, including:

- providing greater surveillance system capacity and capability (including dealing with greater levels of high frequency trading (HFT) and algorithmic trading);
  - developing superior capabilities to search data records and identify suspicious trading, by connecting patterns and relationships – essential for detecting insider trading relationships;
  - implementing new and improved post-trade surveillance tools to identify market trends, patterns of trading behaviour and repeated/systematic behaviour; and
  - improving ASIC portals and registers, including developing new portals and registers, that are (or will be) accessed by market participants.
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## APPENDIX B: THE FINANCIAL INDUSTRY DEVELOPMENT ACCOUNT (FIDA)

### B.1 About FIDA<sup>52</sup>

The Financial Industry Development Account (FIDA) is an account used to hold certain excess funds from the National Guarantee Fund (the NGF) which may under the Corporations Act 2001 (the Act) and the Corporations Regulations 2001 (the Regulations) be used for specified purposes if approved by the Minister.

The NGF is a fidelity fund established under the Act and allows investors in financial markets to claim for compensation in defined circumstances. The NGF mainly (but not exclusively) covers the Australian Securities Exchange (the ASX).

The NGF was established in 1987 from the amalgamation of state and territory fidelity funds, following a long history of exchanges operating their own fidelity funds. It was formed from contributions by brokers, interest on brokers' moneys which were held by various markets and interest and profits received from the investment of these funds.

The NGF is administered by the Securities Exchanges Guarantee Corporation (the SEGC, a company limited by guarantee whose sole member is the ASX) as trustee in accordance with the Act.

### B.2 Roles of the Minister and SEGC

The Regulations allow the Minister to approve the use of excess NGF funds for certain designated purposes. One of those purposes is to pay for costs and payments made to ASIC in relation to ASIC's responsibilities for market supervision.

While the Minister may approve certain payments to FIDA, it is within the discretion of the SEGC to decide whether there are sufficient excess funds available to pay the amounts approved by the Minister.

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<sup>52</sup> see <http://www.segc.com.au/pdf/segc-annual-report-2014-final.pdf> for more information about FIDA and the NGF