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Dear Tracey,

Thank you for the opportunity to respond to Consultation Paper 86, Competition for market services – trading in listed securities and related data. I am commenting with reference to my experience gained both as a professional fund manager and retail investor. Some of my answers have referenced the CRA International independent expert report.

Executive Summary

The key points from my responses to ASIC's questions are as follows:

- All participants and all investors should have equal and unbiased access to all market liquidity. The current ASX central liquidity model achieves this outcome;
- Internalisation should be disallowed because it would introduce preferencing into liquidity access and trade execution, the stockbrokers would be the controllers of liquidity, and investors would be obliged to become clients of largest stockbrokers if they wanted access to this internal liquidity;
- Liquidity within ASX's on-market central limit order book should not be compromised. Market rule 16.12 ensures ASX central order book liquidity is enhanced, producing systematic efficiency benefits for all investors;
- ASIC should formally distinguish between "on-market" execution (88% of ASX turnover) and "off-market" execution (12% of ASX turnover). ASIC should disallow fragmentation of ASX's "on-market" liquidity;
- The extreme volatility associated with the US sub-prime meltdown confirms the importance of keeping access to all market liquidity in one central pool;
- The independent expert, CRA International, emphasises that liquidity fragmentation would reduce market quality and efficiency, would increase market impact and transactional costs, and would introduce order execution favouritism;
- I request that ASIC not recommend any change in market structure that results in: a reduction of price discovery efficiency, increased market impact costs, increased search costs and latency time, unequal access to liquidity, introduces favouritism into order execution, or reduces transparency;
- I also ask that ASIC not recommend any change in market structure that creates a power base in favour of the stockbrokers at the expense of investors;
- ASX's central liquidity pool model is the most efficient model in terms of price discovery, latency and market transaction costs. Importantly, ASX gives equal and unbiased access to all market liquidity for every investor in the market. The ASX central liquidity model is the most fair and transparent structure for all investors. I request that this model be maintained for the Australian market.

Proposal B1 ASIC's approach to proposed competition for market services involving trading the same securities on more than one market venue rests on three principles:

- (a) Principle 1: competition for market services is, in principle desirable;
- (b) Principle 2: the entry of competitors for market services should not result in a decline in the existing quality and integrity of the market for the securities that trade on more than one licensed market;
- (c) Principle 3: the regulatory regime should set the minimum conditions that will allow competition to develop, where it is efficient and therefore without adverse effects on the market as a whole

B1Q1 Do you agree these are the relevant principles?

My feedback: I agree with these principles, however the following comments should be considered by ASIC for inclusion:

- Competition should only be encouraged if it addresses the principles of “fairness” and “public interest” (I have supplied more information on these proposed principles with my answer to B1Q3);
- CRA International state: “competition between trading venues can generate dynamic efficiencies, in terms of reduced transaction costs or improved services, but the accompanying fragmentation of previous centralised trading can undermine liquidity and transparency, and as a result the quality of price-formation and the efficiency of the market as a whole”¹;
- Competition should only be encouraged if there is no free riding involved.

Therefore ASIC should consider changing Principle 1 to:

“Competition for market services is desirable in principle *as long as the central liquidity pool is not compromised and all investors are treated fairly and equally.*”

B1Q2 Do you agree with ASIC's approach to:

- (a) competition
- (b) the need to maintain existing market integrity and quality
- (c) the role of the regulatory regime

My feedback: With respect to (a) competition, I believe ASIC should consider adjusting its approach, incorporating the following:

- ASIC should make the clear distinction between ‘on-market’ and ‘off-market’ trade execution (88% and 12% of ASX turnover respectively). The ability of competitors to execute trades in ASX listed securities should be considered by ASIC only for ‘off-market’ trading. Fragmentation of ASX’s ‘on-market’ central limit order book should be disallowed (reasons given in paragraphs below). ASIC should also specifically disallow internalisation.
- There are some major pitfalls for investors if execution venues are allowed to compete for order flow in ASX listed securities. For example, internalisation by stockbrokers favours some investors over others, preventing access to those

¹ CRA International ‘Economic assessment of competition for market services’ p 18

investors who are not clients of the broker internalising the trade. Internalisation also harms the efficiency of price discovery. In regards to the internalisation and block trade nature of AXE ECN and Liquidnet, CRA International have stated:

“While transactions of this type could deliver new liquidity, their most immediate effect would be to remove liquidity from ASX and therefore to potentially reduce efficient price discovery and price formation on ASX.”²

- Competition in the Australian exchange market already exists with ASX competing against the National Stock Exchange of Australia, Bendigo Stock Exchange and Australian Pacific Exchange. If ASX did not offer the most efficient place to trade securities, then companies would list their shares elsewhere. There are no restrictions preventing a new exchange from starting in Australia to list and trade securities.

With respect to (b) the need of maintaining existing market integrity and quality, I agree with most of ASIC’s approach. ASIC should also consider incorporating:

- Ensuring that no fragmentation or disruption occurs to ‘on-market’ liquidity within ASX’s central limit order book (ASX being the primary exchange). It is noted within the CRA International report that “the liquidity of a market is related to its transparency and to the confidence investors can have in the fairness of market processes”³. The report also notes that the business models of AXE ECN and Liquidnet rely, to some extent, on ASX operating an efficient order book.
- With regards to market quality, CRA International state: “market fragmentation can benefit some stakeholders trading in securities, but potentially at the cost of a deterioration overall of the ‘quality’ (in terms of liquidity and resulting pricing outcomes) of the reference exchange”⁴. This assertion supports the need to ensure ‘on-market’ liquidity within ASX’s central liquidity pool is not compromised.
- ASIC especially need to consider the importance of maintaining integrity, quality and confidence through extreme market events when volatility is high, for example the 1987 market crash, 2001 September 11 sell-off, and 2007 sub-prime meltdown. It is especially in volatile times like this that investors need the confidence knowing that all the market liquidity is available in one central pool.

With respect to (c) the role of the regulatory regime, I agree with ASIC’s approach.

B1Q3 Are there other key principles ASIC should take into account? What are they and why are they important?

My feedback: Yes, two other key principles should be considered by ASIC:

- The first one is a “Fairness” principle. This fairness principle should ensure that no single investor is disadvantaged as a result of competition, new parallel platforms, or new regulation or policy;

² CRA International ‘Economic assessment of competition for market services’ p 29

³ CRA International ‘Economic assessment of competition for market services’ p 17

⁴ CRA International ‘Economic assessment of competition for market services’ p 27

- The second one is a “Public Interest” principle. There are minimum standards, conditions and expectations required for platform operators, participants and investors in the public market space. This could be contrasted against the characteristics of over-the-counter markets. There are various aspects of the AXE ECN and Liquidnet proposals that resemble over-the-counter markets, for example internalisation, and this raises questions about whether it is appropriate for the public market space. Any changes to market structure should be benchmarked back to the “public interest” principle whereby the public market structure, and public interest more generally, is considered first and foremost.

Proposal C1 Market quality and integrity – key objectives:

- (a) **Liquidity: preserve or enhance existing liquidity levels by ensuring trading opportunities are widely known and can be acted on by market users depending on their trading preferences;**
- (b) **Price discovery: preserve the integrity of price discovery by ensuring prices are transparent and all participants have access to those prices; and**
- (c) **Integrity: preserve or enhance integrity by effectively protecting against any added risk of market abuse in a multi-venue environment.**

C1Q1 Do you agree these are the key objectives?

My feedback: Yes I agree these should be the key objectives, however further consideration is needed for (a) Liquidity and (b) Price discovery. My suggestions are as follows:

(a) Liquidity. ASIC’s liquidity objective should incorporate the goal of preserving and maintaining ‘on-market’ liquidity within ASX’s central limit order book (CLOB). ASIC should therefore formally distinguish between ‘on-market’ and ‘off-market’ trading, along with the different types of ‘crossings’.

On-market trading occurs within the ASX’s CLOB, representing 88% of ASX execution turnover and off-market trading occurs outside the ASX’s CLOB, representing 12% of ASX execution turnover. Crossings can either be off-market or on-market. Many of the ‘on-market crossings’ add to passive liquidity within ASX’s CLOB and therefore contribute to the on-market liquidity pool. The benefits of increased liquidity within a central liquidity pool are i) to ensure maximum efficiency of price discovery, ii) to achieve the best possible pricing outcome, iii) to maintain low market impact costs (tight bid-ask spreads and low slippage), iv) to ensure optimal transparency, v) to maintain integrity of the market, and vi) to preserve investor confidence (knowing that the investor will have access to all the market volume and price is representative of an efficient market).

(b) Price discovery. ASIC should change the objective to:

“Price discovery: preserve the integrity of price discovery by ensuring prices are transparent and all participants *and investors* have *equal and unbiased* access to those prices *and volumes*.”

ASIC should consider the consequences of fragmenting ASX’s liquidity pool and the ability of investors to access multiple trading venues. Not all investors will have access to these multiple venues, and not all investors will be clients of these multiple

venues. This infers that if liquidity is split from the central pool, there will always be some investors who are disadvantaged because they don't have access to the pricing or volume on an alternative platform. This is especially relevant for internalisation. Internalisation creates a power base that shifts from the investor to the stockbroker because the brokers will control liquidity. Investors will be obliged to become clients of the largest stockbrokers if they want access to this internal liquidity.

Under a fragmented model, intermediary vendors could act as liquidity aggregators to pool this fragmented liquidity together (to give the appearance of one big pool). Indeed, this is one of the main ideas AXE ECN have for facilitating execution between liquidity pools. However their reasoning is questionable – inefficiencies will ultimately exist under their fragmented model. Latency will increase due to the time taken to scan multiple markets and facilitate the best execution. Costs to the industry will increase because the aggregation vendor will require a fee, or return on capital, for performing this liquidity search function. To achieve 'best execution' it will essentially require every liquidity pool to link into an aggregator and for every investor to transact through an aggregator. Adding a "middle-man" to the system to counteract liquidity fragmentation will only add to execution transaction costs and create execution uncertainty for investors.

ASX's central liquidity pool model is the most efficient model in terms of price discovery, latency and market transaction costs. Importantly, ASX gives equal and unbiased access to all market liquidity for every investor in the market. For the benefit of all investors and the Australian economy, the efficiency of this central pool is paramount and should not be fragmented.

CIQ2 Are there other objectives ASIC should take into account? What are they and why are they important?

My feedback: Yes, another key objective should be "Costs: keeping transaction costs to the investor as low as possible". This is important so as to promote confident investing and increased liquidity. Changes to the regulatory environment could potentially increase costs to the investor. The transaction cost to the investor incorporates brokerage commission paid to stockbrokers as well as market impact costs, for example bid-offer spread cost and slippage cost.

In relation to competing trading venues and costs, CRA International maintains:

"The advent of a competing trading venue can introduce a number of additional costs:

- The duplication of costs, including 'search' costs (by reducing the visibility of pre-trade information), operating costs and regulatory costs;
- The diffusion of liquidity into separate liquidity pools, which may in turn make price discovery less reliable as well as less stable and undermine efficient price formation overall; and
- The introduction of trading methods and business practices that may also diminish the efficiency of the market as a whole (for example if it becomes more difficult to ensure market integrity)."⁵

⁵ CRA International 'Economic assessment of competition for market services' p 19

Proposal C2 Minimum Conditions – high level statement:

- (a) Post-trade transparency: effective and timely post trade transparency is essential to maintain the existing level of efficiency of price discovery and price formation;
- (b) Pre-trade transparency: full pre-trade transparency might not be essential at the time competing markets commence, but will become essential if a new market starts to account for a significant amount of the trading in a security;
- (c) Integrity: overall integrity of the market as a whole must be maintained through:
 - i. effective working arrangements for whole-of-market supervision; and
 - ii. ensuring the emergence of multiple market venues does not detract from intermediaries best execution obligations to their clients.

C2Q1 Do you agree with this statement of minimum conditions under which competing markets should be permitted to operate?

My feedback: I agree with most of your statement of minimum conditions, however further information is required in each condition. I have outlined the additional information I believe ASIC should consider:

For (a) post-trade transparency and (b) pre-trade transparency, the same requirements should exist for both the incumbent exchange and potential new competitors. Otherwise you are effectively providing a subsidy to the potential new competitor at the expense of the incumbent. Furthermore, full and timely pre & post-trade transparency should exist otherwise the market takes on characteristics of an over-the-counter market.

With regards to (c) Integrity, ASIC should establish minimum conditions to ensure that market manipulation of the primary market's central limit order book does not occur (ASX being the primary market). Examples of potential market manipulation, include:

- Participants or clients using the AXE ECN could manipulate prices within ASX's order book to achieve a certain pricing outcome for their trade, given that prices on the ECN will be referenced off the underlying ASX market;
- Participants or clients could enter orders into ASX's order book, only to remove that same order at a later time for internalisation purposes. This scenario would create a 'false' or misleading market within the ASX order book and undermine investor confidence, particularly for retail investors. It would also create an unfair time-price advantage for traders executing via internalisation verses traders executing in ASX's order book;

My overriding view is that internalisation should not be allowed (see answer to next question).

C2Q2 Are there any other conditions ASIC should consider? What are they and why are they important?

My feedback: Yes. The other minimum conditions that ASIC should consider are in relation to liquidity within the primary exchange order book. My suggested minimum conditions for liquidity are as follows:

Liquidity – as a minimum condition, the liquidity within the primary market’s central limit order book should not be compromised by fragmentation (ASX being the primary market). ASIC should consider taking this one step further and declare its minimum condition is to enhance the liquidity of ‘on-market’ trading within ASX’s central limit order book (as distinct from ‘off-market’ transactions, occurring outside the order book).

Further points for ASIC to consider with regards to a minimum condition on liquidity:

- ASIC should formally distinguish between ‘on-market’ and ‘off-market’ transactions, noting that many crossed trades occur on-market in a passive sense due to orders residing within ASX’s central limit order book;
- ASIC should disallow internalisation, as internalisation would directly take ‘on-market’ volume away from ASX’s central limit order book. If liquidity is removed from ASX’s order book then the price discovery process becomes less efficient and market impact costs for investors will increase;
- Internalisation creates an environment where some investors don’t have access to the internal liquidity pools run by stockbrokers. Internalisation also creates a power base that shifts from the investors to the stockbrokers because they will control liquidity;
- Internalisation would be particularly restricting for investors seeking access to the post-IPO secondary market. Most of the trading would be restricted to internalisation by the stockbroker sponsoring and underwriting the IPO. The broader market would miss out on access to this post-IPO liquidity.

The benefits for maintaining high liquidity levels through a central pool are well documented by the independent expert, CRA International, in their economic assessment report (see quotations below). Their analysis supports placing a minimum condition on the potential fragmentation of liquidity.

CRA International propose: “competition between trading venues can generate dynamic efficiencies, in terms of reduced transaction costs or improved services, but the accompanying fragmentation of previous centralised trading can undermine liquidity and transparency, and as a result the quality of price-formation and the efficiency of the market as a whole”⁶.

Furthermore, CRA International state: “market fragmentation can benefit some stakeholders trading in securities, but potentially at the cost of a deterioration overall of the ‘quality’ (in terms of liquidity and resulting pricing outcomes) of the reference exchange”⁷.

CRA International suggest adverse consequences from internalisation and preferencing, including: “these types of trades will directly reduce liquidity in the

⁶ CRA International ‘Economic assessment of competition for market services’ p 18

⁷ CRA International ‘Economic assessment of competition for market services’ p 27

reference market, simply by virtue of the fact that fewer orders will be posted there”⁸ and “the result may be reduced liquidity and wider bid-ask spreads, as well as increased price volatility in the ASX market”⁹.

C2Q3 Are the implications of competition for market services in Australia different from those in other jurisdictions?

My feedback: Yes, the implications of competition for market services in Australia are different from those in other jurisdictions:

The Australian securities market is much smaller than the United States market or the European Union under MiFID. The implications of this are that fragmenting the central liquidity pool in Australia would have a more pronounced effect on efficiency than it would have in the United States or European Union. Making the price discovery process in Australia less efficient may result in corporations seeking listings on other global exchanges in search of the lowest cost of capital. Based on my research, industry participants have suggested that there have been substantial cost increases in terms of compliance, technology and human resources under the implementation of MiFID requirements.

The authorities in the US and EU markets pushed for competition in execution venues under very different circumstances to those existing in Australia today. In the United States, ECNs were encouraged to operate by authorities because traditional floor based exchanges (e.g. NYSE) did not embrace electronic order execution. In the European market, the EU authorities are breaking down all possible trade barriers for goods and services between EU member countries, and securities trading between countries is an extension of this. Australia is not facing a scenario that resembles the United States or European Union structural situation. If at some point in the future consolidation in exchanges led to a pan-Asian trading market, for instance if ASX had access to Hong Kong listed securities, then Australia may resemble the MiFID situation.

The implications of competition on regulation and supervision could be different in Australia when compared to the Canadian jurisdiction. In Canada, there is an independent regulator and market supervisor known as Market Regulation Services Inc (RS), formed as a result of multiple execution venues. RS operates under a user pays model. “RS is funded by the marketplaces and marketplace participants it regulates through a transparent, user-pay fee structure. The costs for Universal Market Integrity Rules (UMIR) regulation are recovered from brokers/dealers through an allocation model based on the volume of trading activity on the marketplaces RS regulates”¹⁰. Based on the Canadian model, the implications for Australia are that ECNs or internalisers operating in Australia may have to pay ASX for the cost of ASX’s efforts in maintaining market integrity through regulation and supervision. ASX may receive a fee on a pro-rata basis. Alternatively, ASX may negotiate with the Australian Government to spin out its regulation and supervision divisions (the Australian Government could take control of these divisions).

⁸ CRA International ‘Economic assessment of competition for market services’ p 20

⁹ CRA International ‘Economic assessment of competition for market services’ p 31

¹⁰ Market Regulation Services website: <http://www.rs.ca/en/about/faq.asp>

Another implication is that ASX will be left with a clear business disadvantage, without the opportunity to pick up new trading volume. Drawing a comparison with the London Stock Exchange (LSE) under MiFID – any volume LSE loses to exchanges or platforms in other countries, e.g. LSE may lose volume to Deutsche Borse, it has the equal opportunity to pick up new volume by executing trades in securities listed on Deutsche Borse. In Australia, ASX has no such opportunity to pick up volume from other players because it has 100% of the volume. The same holds true in comparison to the United States market, whereby the Nasdaq and AMEX exchanges have the opportunity to trade in NYSE listed stocks, but equally NYSE has the opportunity to trade in Nasdaq and AMEX listed stocks. ASX does not have the same opportunities to pick up volume from other exchanges with listed securities.

In forming an opinion on competition and fragmentation, ASIC should be made aware that the New Zealand Exchange has trading rule D10.1, which requires trades to be reported back through their central platform. This rule is equivalent to ASX's market rule 16.12. As a 50% shareholder in the AXE ECN, New Zealand Exchange appear to be hypocritical in their efforts to abolish ASX market rule 16.12.

C2Q4 Are there any policy reasons why AXE and Liquidnet should not have access to settlement facilities operated by the ASX Group?

My feedback: No, there are no reasons.

C2Q5 What practical issues arise and how might they be addressed?

My feedback: N/A. I am not in a position to answer this question with experience.

C2Q6 Are there policy reasons that support the continuation of rules such as market rule 16.12?

My feedback: Yes there are policy reasons that support the continuation of rules such as market rule 16.12. These reasons are as follows:

- Market rule 16.12 ensures equal and unbiased access to all market liquidity for every investor. Market rule 16.12 prevents “preferencing” over liquidity access and trade execution;
- Market rule 16.12 stops manipulation of ASX's central limit order book;
- Market rule 16.12 ensures that stockbrokers do not control the liquidity pools, nor create their own internal pools. If stockbrokers controlled liquidity investors would be obliged to become clients of the largest stockbrokers (to get access to their internal liquidity). Smaller stockbrokers could be pushed out of the market;
- Market rule 16.12 ensures maximum liquidity is maintained within ASX's central limit order book. The benefits of increased liquidity within a central, on-market liquidity pool are to:
 - Ensure maximum efficiency of price discovery;
 - Achieve the best possible pricing outcome;
 - Maintain low market impact costs (tight bid-ask spreads and low slippage);
 - Preserve investor confidence;

- Maintain integrity of the market.
- Market rule 16.12 ensures latency is kept as low as possible because all the liquidity is available in one central pool. There will be no middlemen or aggregation vendors involved in the process, therefore search time for liquidity and transaction costs are kept to an absolute minimum;
- Market rule 16.12 ensures optimal market transparency and presents an exact and immediate picture to investors for trade reporting;
- Maintaining market rule 16.12 also ensures there is no ‘free-riding’ off the ASX.

C2Q7 Which of the approaches mentioned in paragraph 58 is the better one? Are there other approaches? What are they?

My feedback: The better approach is (b) requiring through regulations all licensed markets to introduce a rule requiring participants to trade in accordance with the rules of a licensed market.

My overriding view is that ASX’s central liquidity pool should not be fragmented. However, other approaches to consider include introducing a ‘concentration rule’ or ‘default rule’ to protect liquidity within ASX’s central order book if fragmentation were to occur. The CRA International report identifies a similar approach that France and Germany used prior to MiFID: “Some EU member states (e.g. France) adopted a ‘concentration rule’ that required transactions up to a certain size to be conducted on a regulated market. Other member states (e.g. Germany) applied a ‘default’ rule that required banks/brokers to execute orders on an exchange unless an investor opts-out on a per order basis.”¹¹

Another approach to consider would be to allow alternative platforms to only execute ‘off-market special crossings’ and stipulate that all other transactions must take place through ASX’s central order book.

C2Q8 Do any other current ASX rule raise similar issues?

My feedback: No, not that I am aware of.

C2Q9 What rules about supervisory decision-making might competing market operators need to have?

My feedback: I am not in a position to answer this question with experience. However one would anticipate they might need to have similar rules to the primary exchange.

C2Q10 What are the minimum conditions that should apply to ensure supervisory decisions are not tainted by actual or potential conflict?

My feedback: The minimum conditions would need to ensure that the supervisory and disciplinary functions operate at arms length from the commercial interests of the

¹¹ CRA International ‘Economic assessment of competition for market services’ p 41

business. As the AXE ECN is 50% owned by stockbrokers, these participants should not be involved in any disciplinary or supervision decisions. As such, internalisation by stockbrokers would be tainted with conflicts, therefore should be disallowed. The ASX central liquidity model is completely transparent and independent of all participants.

C2Q11 What are the implications for decision-making structures within a licensed market operator?

My feedback: N/A. I am not in a position to answer this with experience.

C2Q12 Should regulations be made to deal with the broader range of potential conflict?

My feedback: Yes, regulations should be made to deal with the broader range of conflicts. Potential conflicts of interest include:

- Alternative trading platforms can be used as an exclusive inside market to which some investors, including the general public, do not have access. This is in conflict to the principles of “fairness” and “public interest”. Therefore, regulation should be implemented to prohibit internalisation;
- Price and time priority for public orders is potentially jeopardised in a market where alternative trading platforms exist. Orders within the central market’s order book may miss out on execution if exclusive liquidity pools exist elsewhere;
- Alternative platforms owned by the stockbrokers may not necessarily encourage stockbrokers to offer the best price to clients because they have a direct link to the profits generated by the trading platform – i.e. payment for order flow;
- Fund managers may send trade executions through stockbroker owned/operated platforms in return for favourable allocations in corporate floats – an indirect form of payment for order flow;
- Operating a stockbroker owned trading platform in a supervisory and compliance capacity is in direct conflict to being in the business of equity trading, underwriting and distribution;
- A privately owned alternative trading platform does not necessarily have the same level of transparency or self-regulation a public exchange does. Alternative platforms can take on characteristics of an over-the-counter market.

C2Q13 Should ASIC’s role as a substitute decision-maker be expanded to cover a wider range of conflicts? If yes, which ones?

My feedback: ASIC’s role could be expanded to cover a wider range of conflicts. The conflicts for ASIC to consider are outlined in my answer to C2Q12.

D1Q1 Do you agree that trading information from multiple venues should be consolidated?

My feedback: I do agree that trading information from multiple venues should be consolidated. As outlined in my response to C1Q1, AXE ECN and Liquidnet suggest intermediary vendors will exist to consolidate the fragmented liquidity and trading data information together (to give the appearance of one big pool). However, inefficiencies will ultimately exist under this fragmented model. Latency will increase due to the time taken to scan multiple markets and facilitate the best

execution. Costs to the industry will increase because the aggregation vendor will require a fee, or return on capital, for performing this liquidity search function and trade reporting consolidation.

D1Q2 Are there other options apart from those described at paragraph 69 above?

My feedback: The other option is to keep the status quo in Australian markets. Australia's central liquidity model operated by the ASX is the most cost efficient, transparent and independent model. It promotes investor confidence in price discovery, liquidity access and execution ability. Therefore, I request ASIC keep the current model in place with a central liquidity pool.

D1Q3 Do you agree there should be common reporting requirements for similar types of transactions across different market venues. If not, why not?

My feedback: Yes I agree there should be common reporting requirements across different market venues. ASIC should consider whether special reporting requirements for new competitors would result in an exclusive advantage to them at the expense of the incumbent exchange (ASX).

D1Q4 Is a lack of pre-trade transparency acceptable? Why and in what circumstances?

My feedback: A lack of pre-trade transparency is not acceptable.

CRA International comment on transparency: "greater transparency reduces the market power of brokers, as smaller traders get more of the price benefits arising from large trades. In turn, this reduced broker market power should make for lower transaction costs, both through its direct impact on spreads and indirectly by promoting innovation and cost reduction".¹²

A lack of pre-trade transparency does not create a level playing field between the ECNs and incumbent central exchange. It is effectively the equivalent of giving the ECNs or brokers an economic subsidy. In addition it can undermine investor confidence, especially with retail investors, and creates an unfair advantage for some investors. It can undermine the efficiency of price discovery and you would be bringing over-the-counter market characteristics into the public markets domain.

D1Q5 Should a threshold model be adopted? What thresholds should apply?

My feedback: No, a threshold model should not apply. This would result in an unfair advantage against the incumbent primary exchange. This would not be a level playing field. You would be effectively giving a subsidy to the new entrant.

D1Q6 Are there other market integrity factors that should be considered?

My feedback: The application for internalisation of trade execution by stockbrokers or alternative platforms should be considered very closely – it would directly affect the integrity and quality of the Australian market. The distinction made here is that

¹² CRA International 'Economic assessment of competition for market services' p 17

internalisation is different to ‘off-market crossings’. Internalisation is the internal execution of order flow by brokers or ECNs that would otherwise be executed ‘on-market’ within ASX’s central limit order book. Internalisation creates an exclusive market and fragments liquidity. It favours some investors over others, disadvantaging those investors who are not clients of broker internalising the trade. Internalisation also reduces liquidity in the central liquidity pool and harms the efficiency of price discovery. I request that ASIC disallow internalisation.

CRA International suggest adverse consequences from internalisation and preferencing, including: “these types of trades will directly reduce liquidity in the reference market, simply by virtue of the fact that fewer orders will be posted there”¹³ and “the result may be reduced liquidity and wider bid-ask spreads, as well as increased price volatility in the ASX market”¹⁴.

D1Q7 Do you agree with the above as a proposed minimum framework? If not, why not?

My feedback: Implementing a minimum framework and the effect it will have on investors in terms of fairness, exclusivity, cost (market impact and search costs), efficiency and confidence of execution should be carefully considered. Would the regulators be making an already efficient market less efficient?

In implementing a framework, I agree with ASIC that integrity and quality of the market must not be jeopardised. ASIC should consider elaborating on this further and developing framework to ensure the liquidity of ASX’s central limit order book is not fragmented or compromised.

D1Q8 Do you agree that principles-based regulation should be the preferred approach? If not, why not?

My feedback: Yes I agree that principles-based regulation should be the preferred approach.

D1Q9 What are the relative merits of using regulations or conditions on market licenses to achieve minimum overall market quality and integrity objectives?

My feedback: It stops any ambiguity over who should be responsible for ensuring quality and integrity.

D1Q10 Are there any other mechanisms to ensure the minimum quality and integrity conditions can be met? What are they?

My feedback: There are several other mechanisms to ensure the minimum quality and integrity conditions can be met:

- Do not change the current market structure. Australia has the most efficient, transparent and cost effective model in the world – with ASX operating a central liquidity pool – why change the structure only to potentially jeopardise efficiency, quality and integrity;

¹³ CRA International ‘Economic assessment of competition for market services’ p 20

¹⁴ CRA International ‘Economic assessment of competition for market services’ p 31

- ASX (as an independent, transparent organisation) could be responsible for supervising and monitoring ECNs and their participants. ASX could charge a fee for this service;
- ASX could hand over all its supervisory, regulatory and policy divisions to the Australian Government to operate.

E1Q1 Do you agree with this analysis?

My feedback: Yes I agree with ASIC's analysis.

E1Q2 Are there free riding issues associated with using ASX prices as a reference point?

My feedback: Yes, there are free riding issues associated with using ASX prices as a reference point. These are summarised as follows:

- ASIC should examine the intention of use for ASX pricing data. Under the current market structure model, the participants (stockbrokers) are working in commercial partnership with ASX under joint outcomes. ASX charges the participants trading fees, infrastructure fees and data fees. The participants charge their clients (investors) brokerage fees (bearing in mind that brokerage fees are disproportionately more than exchange fees). ASX charges their fees to participants with a view that the participants are working in commercial partnership. However, under the new market structure being considered by ASIC, if the participants are working in competition with ASX then the basis for commercial outcomes has changed. ASX will have the right to charge more for its data and infrastructure fees because the participants are now using ASX's data and infrastructure with the aim of taking business away from ASX;
- ASX prices are formed as a direct consequence of the price discovery process occurring within ASX's central limit order book. The efficiency of price discovery relates directly to the liquidity within ASX's central order book. ASX is in business of encouraging liquidity through this order book – ASX spends money on marketing, technology, distribution and supervision trying to make the order book as liquid and efficient as possible. If ASX did not operate its order book efficiently then competing platforms like AXE and Liquidnet would not have an efficient reference point. AXE and Liquidnet are relying on ASX's efficient pricing. Therefore AXE and Liquidnet are profiting off ASX's efforts and should provide compensation to ASX if they wish to reference ASX data.

E1Q3 How should these issues be dealt with?

My feedback: These issues can be addresses in two ways:

- The ECNs, alternative platforms and stockbrokers can form a commercial arrangement with ASX; or
- By not changing the current market structure model – i.e. leave as is.

E1Q4 Are there other competition issues that might need to be addressed? What are they?

My feedback: Yes, there are other competition issues that might need to be addressed. These are outlined as follows:

- Does the client agreement between an investor and stockbroker permit execution to occur on alternative platforms? The same issue might arise for investors who have read and signed a prospectus with a fund manager - investors have signed a prospectus under the belief that trades will be executed through the ASX's central liquidity pool;
- Does the listing agreement between ASX and a company (e.g. BHP) permit trading in their securities on alternative exchange platforms without an agreement at the alternative platform (i.e. breach of contract)?
- Competition should be examined with the effect that fragmentation would have on the cost of capital for companies listing on the ASX. Some directors of companies may not wish to have their shares traded on alternative platforms because of the funding risk associated with an increased cost of capital;
- The ASX spends a significant amount of money on market supervision, compliance and policy formation to maintain the integrity and reputation of the Australian equity market in a global market context. Based on the latest public information, ASX has 91 Australian staff members working in its Market Supervision division – monitoring & enforcing its operating rules, processing company announcements, applying trading halts, referring matters to ASIC and disciplining participants where necessary. In addition, the ASX also operates a Regulatory Policy unit. If another company is going to directly or indirectly profit off ASX's supervision and regulatory efforts then ASX should be financially compensated by the ECNs and participants involved;
- Is ASX obliged to work with alternative venues in a combined supervisory effort? Who will pay for the extra costs and time involved for ASX?
- AXE ECN said it would replicate every market action event from ASX, e.g. trading halts and suspensions. Many of these actions ASX implement are due to suspicious trading patterns. What if a suspicious trading pattern occurs at an ECN, should ASX be forced to stop trading in a particular stock?

Many thanks for your time taken to read my submission.

Disclaimer: I am a portfolio manager and equity analyst at Platypus Asset Management, helping to manage \$1.5 billion in Australian Equities. We manage a diversified portfolio of investments, which include positions in Macquarie Bank, ASX Limited and Commonwealth Bank, companies which all have an economic interest in the outcome of Consultation Paper 86. Independently of Platypus, my family stock portfolio has positions in the same three stocks.

Yours sincerely,

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