FSC submission on ASIC's revised cost recovery guidelines

The Government is proposing amendments to the ASIC market supervision cost recovery arrangements for the period from 1 July 2013 to 30 June 2015 which the FSC broadly supports. This will enable the Government to recover over the period:

- costs incurred by ASIC in the performance of its market supervision functions and the implementation of market competition; and
- costs associated with the Enhanced Market Supervision (EMS) measure announced at the 2012-13 Budget to replace ASIC's integrated market surveillance system, enhance its market surveillance and supervision systems and tools and deliver improvements to those ASIC portals and registers accessed by market participants.

As noted in our prior submissions to the Treasury, we agree that ASIC cost recovery should consist of a mix of fixed charges (reflecting the fixed cost base), charges on messages and charges on trades. We note that ASIC found approximately 10% of its supervisory costs relate to messaging activity and that they now propose to levy fees according to message counts to recover 10% of certain costs.

We think that the public interest would be better served by requiring a larger proportion of cost recovery to be based on message counts.

It is actual trading that serves the public good – allowing price formation and the efficient redeployment of capital. In contrast, the excessive use of messaging which is not followed up by actual trading is not in the interest of the Australian capital market.

"Excessive" messaging is generally carried out with a view to extracting information about the intentions of other market participants to their detriment. This has the effect of increasing the friction cost of transactions for investors with a longer-term time horizon. Increasing the proportion of cost recovery from messages would not only reduce the direct cost of actual transactions, but it would also have the effect of reducing the indirect costs of predatory intraday traders.

The proposed amendments to the Regulations implement the following policy decisions:

- The introduction of a fixed fee component of $1,835 per quarter for cash equity market participants;
- Increased messaging fees to shift a portion of ASIC's staff costs from trade activity to messaging activity; and
- Changes to the late payment fees to make them administratively simpler and more efficient.

As noted in our earlier submission to Treasury, we believe there is scope for market makers conducting genuine market making activity to be granted an exemption from messaging fees. This would create a level playing field where currently there is an imbalance as market makers who submit messages to ASX as order type MO 36 are not included in the ASIC message count for purposes of cost recovery.

The FSC believes that the introduction of any market maker exemption should be structured in a way that prevents against entities avoiding cost recovery on messages not associated with genuine market making activity.

To reflect the growth in algorithmic trading (of various types) there is a proposed change on the different drivers of ASIC’s non-IT and IT cash equities market supervision costs. Previously:

- non-IT costs were proportionally allocated based on the number of transactions, and
- IT costs proportionally allocated based on the number of messages.

In the forthcoming period 1 July 2013 to 30 June 2015, it is expected that in addition to 100% IT costs a further cost (to be 10% ASIC non-IT cost) will also be charged to message counts.

<u>Inadvertent negative impact on ETFs</u>

As the ETF is comprised of a portfolio of underlying shares, market makers will tend to adjust the price they quote of an ETF as the underlying securities changes in price. This can result in a new portfolio value for an ETF every few seconds.

If accurate pricing is to be maintained a continuous stream of messaging adjusting previous price levels needs to be updated on the order book. It can therefore be expected that market makers will have a high ratio of messages (both ETF orders and orders for their hedge) as against trades (both ETF fills and fills for their hedge).

ETF market making activity comprises a continuous stream of messaging (orders) to buy and sell at specific levels which reflect a genuine intent to trade. The submission of these price levels (orders) to the visible and transparent order book in a “live” environment helps to preserve the integrity of ETF product pricing, promotes liquidity and thereby protects investors who expect to transact at fair and accurate prices.

Any additional costs placed on this provision of liquidity (such as new charges for the cost recovery based on message count), will likely flow through to end investors in the form of increased execution spreads.

This has the effect of increasing the end user cost of accessing these simple, transparent and low cost investment vehicles. In recognition of the liquidity that genuine ETF market makers provide and the potential impact that a messaging levy may have on this activity, the FSC would support relief from the messaging component being given to genuine market makers. We would welcome an opportunity to meet with you to discuss this further.