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Dear Dior

**CONSULTATION PAPER 235: PROPOSED AMENDMENTS TO ASIC MARKET INTEGRITY RULES AND INSTRUMENTS FOR THE CHI-X INVESTMENT PRODUCT MARKET**

Chi-X is grateful for the opportunity of providing a submission to ASIC on the above Consultation Paper (the CP).

Chi-X has outlined its feedback on each of the consultation questions in the attachment to this submission. This letter outlines the view of Chi-X on four important overarching issues raised by the proposals in the CP:

- (i) the impressive work that has been completed to lay the foundations for the transformation of the market in Australia for investment products;
- (ii) the importance of incorporating the aggregate benefits of competition when analysing the proposals;
- (iii) the impact of a holistic regulatory strategy, that incorporates competition outcomes, on the drafting of the relief proposals and proposed definitions in sections D2 and E of the CP;
- (iv) the existing fragmented regulatory framework for investment products.

**1. Laying the Foundation for the Transformation of the Market for Investment Products**

Chi-X is grateful to ASIC for the impressive work it has completed in laying the regulatory foundation for Chi-X to grant quotation to investment products traded on the Chi-X market. The proposals outlined in sections B, C and D1 of the CP provide the foundation of a regulatory framework that will enable Australian markets to harness the benefits of competition between market infrastructure providers.

## 2. The Benefits of Competition

The proposals outlined in sections B, C and D1 of the CP will, if implemented, assist in Australian markets benefitting from competition between market infrastructure providers. The warrants market operated by ASX has experienced year on year declines since 2012<sup>1</sup>. In the brief time that Chi-X has been engaged with issuers and wider stakeholders in investment products, Chi-X has already harnessed the benefits of having an additional infrastructure provider by working with ASX to deliver an automated process for the initial issue and trading of certain investment products. By bringing competition to the area of product issuance, Chi-X has also brought competitive pressure to bear on the ASX pricing of its issuing, clearing and settlement services. In the words of the Governor of the Reserve Bank of Australia:

*".....For most products, competitive markets will deliver the greatest choice at the lowest price to informed consumers.*

*Granted, there are various exceptions to the generalisation above. Where markets are 'natural monopolies' or externalities exist, for example, regulation is called for. Good outcomes won't occur if consumers are not well informed. And so on.*

*Nonetheless, I would venture that the biggest gains to prosperity over the past 25 years have come from more competition..... Competition lowers prices and costs. It promotes the drive to do better, which spurs innovation."<sup>2</sup>*

Further evidence on the benefits of competition between infrastructure providers includes:

- (i) Research undertaken by the Goethe University has concluded that market quality is highest in those areas where market competition is greatest<sup>3</sup>.
- (ii) Analysis undertaken by the Strategic Intelligence Unit at ASIC has concluded that from the commencement of competition in market infrastructure to January 2013, the benefits of competition may have been worth up to \$300million per year<sup>4</sup>.
- (iii) The Capital Markets Cooperative Research Centre conducted an independent study in which it found that in the first year alone, competition in market infrastructure Australia had delivered welfare benefits between \$36m-\$220m<sup>5</sup>.
- (iv) Comments in the Johnson Report and by the ASX Chair evidence the positive impact of competition on ASX itself. In 2009, it was stated in the Johnson Report that:

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<sup>1</sup> See slide 30 the ASX Analyst Presentation for 2015, retrieved on 14 September 2015 from <http://www.asx.com.au/documents/investor-relations/FY15AnalystPresentationFINAL.pdf>

<sup>2</sup> See " 'Reform' and Economic Growth", Remarks to the National Reform Summit, Hosted by The Australian and The Australian Financial Review, Sydney, 25 August 2015, retrieved on 14 September 2015 from <http://www.rba.gov.au/speeches/2015/sp-gov-2015-08-26.html>

<sup>3</sup> Goethe University House of Finance, Competition among electronic markets and market quality, Peter Gomber, Markus Gsell, Marco Lutat, Discussion Paper 01/2011, retrieved on 14 September 2015 from [http://safe-frankfurt.de/uploads/media/Gomber\\_competition\\_among\\_electronic\\_markets\\_and\\_market\\_quality.pdf](http://safe-frankfurt.de/uploads/media/Gomber_competition_among_electronic_markets_and_market_quality.pdf).

<sup>4</sup> See the page numbered 32 of the Treasury Market Supervision Cost Recovery Impact Statement, retrieved on 14 September 2015 from [http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Consultations/2013/ASIC%20Market%20Supervision%20Cost%20Recovery/Key%20Documents/PDF/Consultation\\_draft\\_CRIS.ashx](http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Consultations/2013/ASIC%20Market%20Supervision%20Cost%20Recovery/Key%20Documents/PDF/Consultation_draft_CRIS.ashx)

<sup>5</sup> How beneficial had competition been for the Australian equity marketplace? Michael Aitken, Haoming Chen and Sean Foley, 24 May 2013 – retrieved on 14 September 2015 from: <http://www.cmrc.com/files/docs/1372142696hascompetitionbeenbeneficialforaustralianmarketplace.pdf>

*In the [Australian Financial Centre] Forum's assessment, [the role of ASX as market operator, central counterparty and market supervisor] has been a significant barrier to new competition and innovation. The Forum received a good deal of feedback from industry concerning the lack of equity trading platform development (see Appendix 4) and innovation.<sup>6</sup>*

In 2012, the ASX Chair stated:

*"ASX's response to competition has been substantial and positive. The company cut its fees, introduced new products and invested in its Technical Services business"<sup>7</sup>.*

- (v) Within the first twelve months of Chi-X Australia launching competing products, some of the ASX fees charged to ASX participants for those products had decreased from over \$500,000 pa to no more than \$12,000 pa.

- (vi) The former CEO of the Singapore Stock Exchange has remarked, in respect of developments concerning the arrival of global market infrastructure providers in Singapore:

*"what are we doing in the face of this intensifying competition? [The] most important thing is that we continue to innovate"<sup>8</sup>;*

- (vii) The former CEO of the United Kingdom's Financial Conduct Authority has stated, in respect of the introduction of a new statutory duty on the FCA to enhance competition:

*"Our new competition duty is the single most significant change in our objectives as a regulator. This is not just because it is new on the face of the Bill, but because of the approach it drives. It means we have to spend more time and effort looking at markets as a whole and whether they function well for consumers. It means we have to look for remedies that help markets work better for consumers. **And it means that we don't just wait for problems before we try to promote competition in the markets we regulate. We've started in our own back yard – looking at whether some of our authorisation procedures cause unnecessary barriers to entry.**"<sup>9</sup>*  
(emphasis added)

There are a number of benefits that competition between market infrastructure providers can bring and it is appropriate that they are considered when deciding upon the proposals outlined in the CP.

### **3. A Regulatory Strategy that Incorporates Competition Outcomes**

Chi-X is grateful for the efforts of ASIC in laying the foundations of a regulatory framework that may facilitate wider stakeholders obtaining the benefits of competition between market infrastructure providers. However, Chi-X queries the current drafting of the proposals in sections D2 and E of the CP on:

- (a) class order 13/721, that provides relief only to managed fund products that are quoted by ASX; and

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<sup>6</sup> See page 37 of *Australia as a Financial Centre Building our Strengths*, a report by the Australian Financial Centre Forum.

<sup>7</sup> See page four of the ASX Chair's address at the 2012 ASX AGM, no longer available on the ASX web site but retrieved on 25 March 2013 from [http://www.asx.com.au/documents/investor-relations/Final\\_Speeches.pdf](http://www.asx.com.au/documents/investor-relations/Final_Speeches.pdf)

<sup>8</sup> See the speech of Mr Bocker at the 14<sup>th</sup> AGM of SGX, retrieved on 25 March 2014 from [http://www.finanznachrichten.de/pdf/20130919\\_141227\\_S68\\_631FE115DC6E26D648257BEB0021DE12.1.pdf](http://www.finanznachrichten.de/pdf/20130919_141227_S68_631FE115DC6E26D648257BEB0021DE12.1.pdf)

<sup>9</sup> See "100 days of the FCA", a Speech by Martin Wheatley, Chief Executive, the FCA, at the ABI Biennial Conference, London, retrieved on 12 June 2014 from <http://www.fca.org.uk/news/speeches/100-days-of-the-fca>



- (b) the definitions of 'ETF' and 'managed fund' in the ASIC Market Integrity Rules (ASX Market) that are bespoke to ASX quoted products.

If ASIC is of the view that Chi-X needs to meet further regulatory requirements before Chi-X quoted products can be subject to the proposals in (a) and (b) above, then it may be more appropriate for:

- (i) those further regulatory requirements to be determined outside the framework provided by those proposals and, for example, in the existing market operator framework and licence conditions;
- (ii) the language in the proposal in (a) and (b) above to be market operator neutral.

The proposed amendment of class order 13/721 and the ETF/managed fund definition in the ASIC Market Integrity Rules (ASX Market), may create barriers to entry that are additional to the existing requirements in the market operator regulatory framework (eg satisfying licence conditions and the approval of Operating Rules), that must be met before an operator can grant quotation to the relevant products. In these circumstances, retaining the proposals as drafted may lead to unintended consequences. For example, they may frustrate any attempt by ASIC or any other stakeholders to harness appropriate competition outcomes over the medium term.

Chi-X is of the view that these two proposals should be re-drafted to remove the potential barriers to entry they may create. Doing so would allow ASIC to fully incorporate competition outcomes in its regulatory strategy and potentially save on resources when Chi-X has fulfilled any requirements to commence the quotation of the relevant products<sup>10</sup>.

#### **4. A Fragmented Framework**

The references to the class order and waiver relief in the CP outline the fragmented nature of regulation in this area. Chi-X has sought to consolidate the requirements relating to investment product in a single Information Pack that outlines the relevant principles and references the applicable detailed requirements. The Information Pack is intended to enable stakeholders in Chi-X quoted products to go to one place in order to locate all relevant material. Chi-X is of the view that ASIC is well placed to make a similar information source available for wider stakeholders in Australia's investment products.

I hope this submission assist in your deliberations. Please do not hesitate to contact us if you have any queries.

Yours sincerely,

Chi-X Australia Pty Ltd

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<sup>10</sup> These issues are also raised in ASIC's Consultation Paper 236: Remaking ASIC class orders on dematerialised securities and CHESS units of foreign securities, which is the subject of a separate submission.

ASIC Proposal		ASIC Feedback Question		CXA Feedback
B1	<p>We propose to introduce the term 'cash market product' to the ASIC Market Integrity Rules (Chi-X), which will include the existing equity market products (as defined) and two new Chi-X investment products—'investment product (MIS)' and 'investment product (warrant)'. See the draft amended ASIC Market Integrity Rules (Chi-X) in Attachment 1 to this paper.</p> <p>Note: Proposal B1 is subject to the Minister's approval to the variation of Chi-X's Australian market licence and a decision not to disallow the proposed amendments to the Chi-X Operating Rules</p>	B1Q1	<p>Does this proposal raise any issues for trading systems? Please describe the nature of these issues and provide an estimate of the time and costs required to update your trading systems.</p>	<p>Chi-X has designed the system release that will enable warrants to trade in the Chi-X Trading System so that is optional for participants to include the upgrade.</p> <p>Therefore those participants that are not interested in trading warrants are able to avoid the cost of the system changes necessary for trading in those products.</p>
B2	<p>We propose to insert a new Part 2.4, relevant to warrants, into the ASIC Market Integrity Rules (Chi-X): see the draft amended ASIC Market Integrity Rules (Chi-X) in Attachment 1 to this paper.</p> <p>Note: Proposal B2 is subject to the Minister's approval to the variation of Chi-X's Australian market licence and a decision not to disallow the proposed amendments to the Chi-X Operating Rules.</p>	B2Q1	<p>Does this proposal raise any compliance issues for market participants? If so, please provide an estimate of the time and costs required to resolve these issues</p>	<p>Chi-X supports the proposal and is of the view that it is important that Australia's regulatory framework, including that relating to the accreditation of advisers, is not tied to the products of one market infrastructure provider (see remarks of the FCA's former CEO at footnote 9 of the covering letter).</p>
B3	<p>We propose to make specific amendments to the ASIC Market Integrity Rules (Chi-X) in relation to disclosures and acknowledgements in client agreements with retail clients (Rule 3.1.2 (Chi-X)) and the provision of explanatory booklets for warrants (Rule 3.1.8 (Chi-X)): see paragraph 33 and the draft amended ASIC Market Integrity Rules (Chi-X) in Attachment 1 to this paper. Note: Proposal B3 is subject to the Minister's approval to the variation of Chi-X's Australian market licence and a decision not to</p>	B3Q1	<p>Do you agree with our proposal? If not, why not?</p>	<p>Chi-X prioritises the needs of retail investors, in particular with respect to mandated disclosures that seek to ensure investors are aware of the risks posed by particular investments.</p> <p>Therefore Chi-X will produce, prior to the launch of its investment products market, a user focused booklet for use by participants and their clients.</p> <p>In these circumstances, Chi-X supports the proposal.</p>

ASIC Proposal		ASIC Feedback Question		CXA Feedback
	disallow the proposed amendments to the Chi-X Operating Rules.	B3Q2	Will you need to update your client on-boarding processes for providing Chi-X-issued booklets to retail clients that may trade warrants on the Chi-X market? If so, please provide details.	Chi-X will work with its participants to address any issues that may arise in this area.  Chi-X will issue a digital version of the handbook that will be able to be used by participants to notify clients that may trade warrants in the Chi-X market.
		B3Q3	Do you have any alternative proposals?	
B4	We propose to amend Rules 3.1.3 and 3.1.4 (Chi-X) to: (a) apply to transactions in cash market products (i.e. update the current reference to equity market products); and (b) require a participant to provide clients with a disclosure about its third-party execution and clearing arrangements if there are any material changes to these arrangements arising from the commencement of quotation and trading of ETFs and warrants on the Chi-X market. Note 1: See the draft amended ASIC Market Integrity Rules (Chi-X) in Attachment 1 to this paper. Note 2: Proposal B4 is subject to the Minister's approval to the variation of Chi-X's Australian market licence and a decision not to disallow the proposed amendments to the Chi-X Operating Rule	B4Q1	What is the impact of our proposal in terms of notifications to clients? Please provide details.	Chi-X is of the view that the current notification, required to be provided to clients under Procedure 11.11 of the Chi-X Operating Rules: Procedures, satisfies the obligations of a participant under rule 11.11 of the Chi-X Operating Rules in cases where that participant is seeking to trade warrants and ETFs quoted by Chi-X and Chi-X is not a member of the SEGC.
		B4Q2	Do you have any alternative proposals? If so, please provide details	Chi-X has applied to become a member of the SEGC and is hopeful that this application will be finalised in the near future.
C1	We propose to: (a) amend the definition of 'equity market product' in the ASIC Market Integrity Rules (Competition) to include an equity market product that may be admitted to quotation on the Chi-X market under the Chi-X Operating Rules; (b) amend the application of Chapter 5A (Competition) so that it applies to orders and transactions in financial products that	C1Q1	What is the effect of our proposal on your technology and compliance settings? Please provide details. Are transitional provisions necessary? If so, please provide	Chi-X has engaged with participants with a view to facilitating the technology changes required for the introduction of products granted quotation by Chi-X. For example:  (a) CXA has made the Technical Specification for the new Investment Products Platform available to participants in the Client Forum

ASIC Proposal	ASIC Feedback Question	CXA Feedback
<p>are admitted to quotation on the Chi-X market under the Chi-X Operating Rules; and (c) not include any transitional provisions for the application of the ASIC Market Integrity Rules (Competition) to ETFs and warrants admitted to quotation on the Chi-X market. Note 1: See the draft amended ASIC Market Integrity Rules (Competition) in Attachment 2 to this paper Note 2: Proposal C1 is subject to the Minister's approval to the variation of Chi-X's Australian market licence and a decision not to disallow the proposed amendments to the Chi-X Operating Rules.</p>	<p>details.</p>	<p>part of the CXA web site (see <a href="http://cmsau.chi-x.com/Portals/15/Docs/Chi-X%20Technical%20Notice%200010-15.pdf">http://cmsau.chi-x.com/Portals/15/Docs/Chi-X%20Technical%20Notice%200010-15.pdf</a> published on 15 July 2015);</p> <p>(b) the system build for the investment product trading system has used the same standards (eg on reference data for warrants) and global protocols that are used in the current CXA Trading systems so participants will be able to use existing methodologies and previous system-build experience to connect to the CXA trading system for investment products if they so desire;</p> <p>(c) the changes to the CTS that are necessary for the trading of investment products are relatively minor – this means that participants and vendors are not required to digest and comprehend a complicated technical specification full of proprietary technology in order to connect to and build their own systems;</p> <p>(d) it will be optional for participants to use the functionality that will enable them to trade in warrants and investment products.</p>
<p>D1 We propose to vary the ASIC class orders and class waiver listed in Table 2 to include references to Chi-X so that, in all material respects: (a) the relief extends to trading in warrants or ETFs quoted on Chi-X; (b) any conditions of the relief will apply to warrants and ETFs quoted on Chi-X; and (c) the beneficiaries of the relief would be of the same type (i.e. products, issuers, market makers, trustees, product holders, authorised participants and</p>	<p>D1Q1 Do you agree with our proposal to vary the class orders and class waiver in Table 2 to extend existing relief for ETFs and warrants quoted on ASX to those quoted on Chi-X? Please give reasons for your view.</p>	<p>Chi-X agrees with the statement in the CP that there is no reason for the application of different regulatory approaches for each of the markets.</p>



ASIC Proposal		ASIC Feedback Question		CXA Feedback
	responsible entities). Note: Proposal D1 is subject to the Minister's approval to the variation of Chi-X's Australian market licence and a decision not to disallow the proposed amendments to the Chi-X Operating Rules.	D1Q2	Would our proposal result in any adverse or unintended consequences? If so, please provide details.	Chi-X is unaware of any adverse or unintended consequences to the proposed variation of the class orders specified.  Chi-X is of the view that the class orders and waivers listed should be located in a central place together with other applicable ASIC and industry guidance. This would facilitate it being located and followed by all stakeholders in a transparent manner.
D2	We propose to vary [CO 13/721] so that the relief from s1017B of the Corporations Act also applies to managed fund products admitted to quotation on the ASX market under Schedule 10A to the ASX Operating Rules.	D2Q1	Do you agree with our proposal? If not, why not?	Chi-X queries this proposal as worded as it potentially discriminates against Chi-X products by restricting the relief to ASX quoted products. This is further discussed in the covering letter for this submission.
E1	We propose to amend: (a) the definitions of 'ETF' and 'managed fund' in the ASIC Market Integrity Rules (ASX) to reflect the products admitted to quotation and trading on the ASX market under Schedule 10A to the ASX Operating Rules; and (b) Rules 2.4.1 and 3.1.8 (ASX). Note: See the draft amended ASIC Market Integrity Rules (ASX) in Attachment 3 to this paper.	E1Q1	Do you agree with our proposal? If not, why not?	Chi-X queries these proposals as currently worded as they potentially discriminate against Chi-X products by restricting the application of the rules to ASX quoted products. This is further discussed in the covering letter for this submission.