

9 November 2021

Att: Natalie Boulizos, Senior Manager
Market Supervision
Australian Securities and Investments Commission
email: MIRsubmissions@asic.gov.au

Dear CP 347 Team,

CP 347 Submission—Chi-X Australia

Chi-X Australia is grateful for the opportunity of providing a submission on ASIC Consultation Paper 347: *Proposed amendments to the prohibition on order incentives in the ASIC market integrity rules* ('the CP').

The submission is segmented into this covering letter and **attachment one**, which consists of a table listing the proposals and questions asked in the CP and provides a CXA response to each.

Those markets where payment for order flow (**PFOF**) between market intermediaries is a prevalent and embedded feature can face certain challenges. We note however, that the arrangements between market participants and other intermediaries is separate to the relationship participants have with market operators. Participants are subject to market operator fee structures, and market operators may also establish incentive schemes. In appropriate circumstances, competitive outcomes and benefits for the investor and broader market can be delivered through market operator fee structures and incentive schemes, including through the use of rebates – for example, MiFID and Chi-X Europe.

The Financial Conduct Authority (**FCA**) has clarified its PFOF guidance is not intended to affect the ability of trading venues to operate fee structures (which include maker/taker pricing) or liquidity incentive schemes¹. Instead, these are subject to separate supervision focused on ensuring the proposals are compatible with the venue's regulatory responsibilities².

"It is noted that some forms of fee structure (such as a maker/taker fee structure)³ and incentive schemes are designed to reward certain types of behaviour by market participants, for example liquidity provision. The guidance on PFOF is not intended to affect the ability of a trading venue to operate structures that embed such rewards (e.g. a maker/taker model), where a proposed structure is otherwise compatible with the regulatory responsibilities of the trading venue ... In many cases, the reward serves to reduce the net fee payable to the trading venue and therefore would not constitute PFOF."⁴

¹FCA 2012, Guidance on the practice of 'payment for order flow'. <https://www.fca.org.uk/publication/finalised-guidance/fg12-13.pdf>

² For example, rules and procedures that allow for fair and orderly trading.

³ A structure which applies a charge to aggressive (liquidity taking) orders and pays a rebate to passive (liquidity making) orders.

⁴ FCA 2012, Guidance on the practice of 'payment for order flow'. <https://www.fca.org.uk/publication/finalised-guidance/fg12-13.pdf>

Please do not hesitate to contact Alice Spalding (details below) or Michael Somes (02 8078 1718) if you have any queries.

Yours faithfully



Alice Spalding
Deputy General Counsel
Chi-X Australia Pty Ltd



Attachment One – CXA Answers to CP 347 Proposals and Questions

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
B1	<p>We propose to amend the prohibition on order incentives in Part 5.4B of the Securities Markets Rules to:</p> <p>(a) simplify the concept of ‘negative commission’, which is currently set out in Rule 5.4B.1(2) (and referred to as ‘net cost’);</p> <p>(b) include in the current prohibition, payments that are made to an ‘associate’ (defined in Rule 5.4B.1(2)) of the other person;</p> <p>(c) require a market participant to take reasonable steps, in circumstances where the market participant handles or executes orders as a result of an arrangement with another person, to ensure that the other person has not made a cash payment to a third party (or an ‘associate’ of the third party) for that third party’s orders (or their client’s orders), where the value of that cash payment exceeds any payment made by the third party to the other person for directing those orders to the other person; and</p> <p>(d) prohibit a market participant (or an ‘associate’ of the market participant,</p>	1	Do you agree with our proposal? Please give reasons for your answer.	<p>We note the advantages of principles-based drafting in providing robust and flexible regulatory outcomes.</p> <p>We also note the Australia Financial Services licensee general obligations which include having adequate arrangements in place for managing conflicts of interest and Regulatory Guide 181 Licensing: Managing conflicts of interest (2004).</p>
		2	Do you think there are other ways that entities may seek to circumvent the rules (including the proposed amendments) and engage in payment for order flow? For example, where payment for order flow occurs between two entities that have no direct relationship to the market participant. Do you think we should make further amendments to our rules or take other steps, such as updating our guidance, to address this?	Please see our comments above in response to B1Q1.
		3	Will the proposal result in any changes to your systems and procedures or increased one-off or ongoing compliance or administrative costs?	Not applicable

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
	defined in Rule 5.4B.1(4)) from accepting a cash payment from another person for directing the market participant's orders to that person, where that cash payment exceeds any payment made by the market participant to the other person for directing those orders to the other person. See draft Rule 5.4B.1 in the appendix to this paper.		Please outline the impact and give an estimate of these costs	
C1	We seek your feedback on our current approach to soft dollar incentives in the context of payment for order flow	1	Do you think our current guidance on soft dollar incentives in RG 265 adequately addresses the risks and harms associated with soft dollar incentives for order flow?	Please see our comments above in response to B1Q1.
		2	Do you think we should incorporate the controls on soft dollar incentives (that are currently provided in our guidance in RG 265) expressly within our rule framework? If so, do you think our guidance can be directly transferred into our rules or do you think these controls need to be further revised?	Please see our comments above in response to B1Q1.
		3	Alternatively, do you think we should make further amendments to Part 5.4B to expressly prohibit soft dollar incentives? If so, what forms of soft dollar incentives should be prohibited? Please give reasons for your answer.	Please see our comments above in response to B1Q1.