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Attn: Leena So-Xu
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ASIC
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SYDNEY NSW 2000

Dear Ms So-Xu

Proposed changes to ASIC's capital requirements for market participants (Non-confidential submission)

NSX is a licensed market operator and is the second largest listing exchange in Australia. As a Tier 1 marketplace, the fundamental purpose of NSX is capital formation; that is, bringing together companies which require capital to fund growth, with investors who have capital and are looking for investment opportunities. Through its role as a securities exchange and as an alternative market providing competition to ASX, NSX sees itself as facilitating innovation, diversification of investment, economic growth and job creation in the Australian economy due to its focus on companies with a sub $50m market-cap. The aims of the NSX are facilitated by a diverse and effective base of market participants who act as the essential intermediaries in matching investors with opportunities. NSX makes this submission against a background and ambition of ensuring the existence and longevity of a viable participant community which is able to cater to the needs of a diverse range of investors and issuers.

NSX's comments focus on the proposal to increase core capital holding requirements for market participants to $500,000 ("the Proposal"). NSX considers that the Proposal, and the consultation document, are flawed and should not be implemented for the following reasons.

There is no evidence to support the case for reform

In making the Proposal ASIC expresses a desire to decrease the risk of a disorderly or non-compliant winding up, yet cites no examples of such events having occurred or at greater risk of occurring than has previously been the case as a basis for justifying the introduction of more onerous requirements.

In imposing regulation ASIC is expected to act in accordance with the Regulator Performance Framework which requires that regulators do not unnecessarily impede the efficient operation of regulated entities and that actions undertaken by regulators are proportionate to the regulatory risk being managed.[1] Whilst ASIC cites, as support for the reform initiative, (i) a need to reconsider existing capital holdings requirements given the status quo has been in place for almost 20 years and (ii) the objective of aligning the relevant requirements of the Market Integrity Rules and the AFS licensing regime, these are not evidence-based justifications for the imposition of more onerous regulation and bear no relation to the risks which ASIC should seek to mitigate in imposing regulation.

ASIC's contention that increased capital requirements are necessary is supported by reference to existing requirements in jurisdictions such as Hong Kong and Singapore, yet ASIC provides no explanation of why jurisdictions such as the UK, US and Canada – all of which have lower or similar capital requirements to Australia – are not appropriate. NSX does not consider that Hong Kong and Singapore are useful or appropriate reference points: these markets have a significantly different risk profile to Australian exchange markets, are characterised by higher concentrations of market participants, less market maturity, lower levels of retail participation and significantly larger issuers. The assessment of risk, and the appropriate measures to mitigate that risk, must be specific to the market in question.

[1] See https://docs.jobs.gov.au/system/files/doc/other/regulator_performance_framework.pdf

The Proposal further fails to address the proportionality of the arrangements given (i) not all market participants present the same level of risk and (ii) the existence of compensation schemes such as the National Guarantee Fund ("NGF") which present a cost to participants yet are seemingly not viewed as appropriate for, or able to provide recourse for, affected investors.

The Proposal will adversely impact on brokers with no corresponding identifiable incremental benefit to investors

NSX is concerned about the competitive impact of the Proposal on market participants. Generally speaking, the more market participants, the greater the competition, innovation and benefits to consumers and industry.

Whilst ASIC's proposal might have no material impact for certain market participants, it undoubtedly compromises the viability and longevity of smaller niche participants. ASIC cites a total of 35 market participants of which three have not consistently held core capital in excess of $500,000 in the 12 months ended 30 April 2018.[2] ASIC has confirmed to NSX that the 35 participants referred to does not include the 11 NSX-only market participants. We therefore wish to highlight that ASIC has failed to take into account the effects of its proposals on a significant proportion – almost 25% - of the affected market.

The reality is that many NSX-only participants are of a significantly smaller scale than the 35 referenced by ASIC. For these participants, meeting a significantly increased capital holding requirement (which increases to $100,000 in May 2019 and then to $500,000 should the Proposal be implemented) means diverting funds away from other business-critical deployment, such as investment. This adversely impacts on those participants' ability to spread risk and generate a return across their business. It also impacts on the cost of trading and the cost of access to capital. The Proposal therefore has the potential to impair smaller participants' business model and make them less competitive. In an extreme scenario this could result in market exit with grave consequences for choice, competition, innovation and capital formation, resulting in a lack of support and engagement for smaller issuers and investors and reduced access to capital for a key segment of the economy which must be supported.

As per our earlier comments, ASIC's approach must be proportionate and focus regulatory effort in areas where it has assessed a commensurate amount of harm. NSX now calls upon ASIC to acknowledge that not all participants present the same level of risk and that the benefits which could (at least in theory) be achieved by increasing existing capital requirements are more than offset by the destabilising impact of the Proposal on a certain class of market participant and the detriment from market exit. ASIC must acknowledge the risk that its Proposal may well result in the very outcome against which it seeks to protect investors as well as a concentration of risk in the "big end of town".

NSX encourages ASIC to reconsider its "one-size-fits-all" approach to capital requirements and instead consider one which is adjusted to reflect differing risk levels taking into account the size of a participant.

Credible alternatives exist to protect investors

NSX notes the existence of the NGF which was established under the Corporations Act 2001 and Corporations Regulations 2001 for the very purpose of compensating investors in the event of certain events including broker insolvency.

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[2] https://download.asic.gov.au/media/4804658/cp302-published-04-july-2018.pdf at paragraph 23.

NSX questions why there is no reference by ASIC in its consultation to the role that the NGF plays in compensating investors when the risk ASIC seeks to ensure against has crystallised. It is curious that ASIC have not mentioned the existence or relevance of the NGF in addressing the harm or risk it has purported to identify, nor – importantly – why it considers that additional measures over and above those which already exist are insufficient to address the risks. The consultation is therefore deficient in that it fails to consider the relevance and impact of existing alternatives to the Proposal.

We look forward to hearing ASIC's further thinking on the important issues raised above.

NSX confirms that no part of this response is confidential and that ASIC may publish it in its entirety.

Yours sincerely