



4 November 2011

The Manager
Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: MarketSupervision@treasury.gov.au

Dear Mr White

Corporations (Fees) Amendment Regulations 2011 (No.2) Consultation

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the Corporations (Fees) Amendment Regulations 2011 (No.2).

These comments should be read in the context of our previous strongly voiced concerns with the Government's underlying policy decision on cost recovery made in response to the Consultation Paper on the 'Proposed financial market supervision cost recovery model' and on the *Corporations (Fees) Amendment Act 2011* prior to passage. In our view the policy decision is fundamentally flawed because it ignores existing excess ASIC related cost recovery measures and other contributions to revenue made by and through the financial services sector. The purpose of these comments is not to reiterate our previous strong fundamental reservations with the overall approach to cost recovery but merely to address the regulations as presented.

1. General Observations

As a general observation our members have been shocked by the very substantial participant fees they will have to pay after using the calculation formula based on their own internal data for estimated trades and messages next year.

The regulations continue to reflect incorrect underlying assumptions which the explanatory memorandum fails to address. The proposed regulations incorporate both a simplistic formula of fixed fee amounts and proportional activity-based fees, charged quarterly in arrears. The comment that there was broad agreement on the technical

design of the fees in having a proportional activity-based fee charged quarterly in arrears ignores the need for a more sophisticated methodology to produce a fair outcome.

2. Unexplained Factors

The initial difficulty in commenting upon these regulations is the failure of the explanatory memorandum to provide any explanation for the calculation of the factors contained in the formulae being used for the calculation of the operator and participant fees. This is a most unsatisfactory state of affairs and seriously undermines the quality and value of the explanatory memorandum as a medium of official public record. The actual basis for the calculation of the factors should be set out.

3. Market Supervision Costs

In our previous comments we have noted that ASIC's market supervision costs (budgeted to be \$ 6.11 million in the 18 month period starting from 1 January 2012) directly relate to the operation of the markets and should wholly allocated to the market operator fee calculation rather than using a revenue proxy formula for the calculation operator and participant fees. This approach to allocation is consistent with the distinction drawn between market supervision and participant costs in the cost recovery analysis because it recognises the quantum of ASIC supervision resources devoted to surveillance and supervision of operations on systemically important markets and the greater intensity of supervision resources devoted to them compared to non-systemic markets.

The current Council of Financial Regulators consultation paper on financial market infrastructure (FMI) lends support to our view of the systemic importance of certain FMI services. It confirms the view that any disturbance to the smooth operation of these services can cause systemic disruption, damage market integrity and result in loss of investor confidence. The paper goes on to note that each of the ASX market and clearing and settlement licensees provide crucial FMI services to participants. The ASX market outage of 27 October demonstrated the accuracy of this view and why significant market supervision resources are devoted to market operations.

4. TMR

Although it is logical to apportion costs across trade transactions, that is not the case for messages. The ratio of message to trade count is one of the defining features of some market participants, in particular market makers that utilise high frequency trading technology. As such it cannot follow that any outcome that discriminates on this basis between participants has neutral effect on market behaviour and dynamics. Regulatory administration fees should be neutral in effect and not applied in a way that modifies market behaviour.

The potential risk different messages pose to the market varies widely. As a result they cannot be treated as equal in surveillance value and charged for as if they were the same. Additionally IT processing costs are not the same for all messages.

The formulae for both the operator fee and participant fee include a component for the total number of messages (TMR). A simplistic application of a TMR item based on the total number of messages received by ASIC's Integrated Market Surveillance System fails to take into account the appropriate apportionment of surveillance risk raised by different message types and needs to be developed further.

In order that at least some approximation of the differing risk to the market posed by 'trade' messages - that are a much more likely candidate for investigation - and other less risky messages including 'cancel' messages, 'amend' messages, and 'place order' messages, messages other than trade messages should not be included in message counts for cost allocation purposes

Similarly, messages are more or less of a risk to the market depending on the value of their content. For example an order for \$3 worth of stock will be much less of a substantial risk to the market than an order for \$3,000,000. Accordingly, the supervisory cost to a trade message should be made proportional to the amount of value the trade message.

The primary driver for ASIC's IT costs remains, as for all supervisory costs, the disorderly or fraudulent behaviour of a very small number of people. It is not the great majority of the market that is working within the rules of the market that are driving these costs. As risk to the market should be considered when allocating IT costs, the allocation methodologies should not ignore differences in potential for risk to the market posed by different activities. A message based approach to IT cost apportionment is not the right tool to use. Given that very large numbers of messages to trade ratios are generated by market makers, large brokers and other reputable market participants it is likely the case that the businesses operating well managed fully compliant operations that are less likely to be in breach will be charged proportionately more, while malefactors seeking to manipulate the market with a small number of illegal trades will be charged proportionately less.

The cost for finding the trades and orders of concern should be shared at least proportionally by those responsible if not disproportionately with the rest of the market contributing on a fair and reasonable basis that does not interfere with good market practice.

We recommend that the message count approach needs to be adapted to count only trade messages and to allocate costs on a basis proportional to their value in the case of equities.

Please contact me at dlove@afma.com.au or on (02) 9776 7995 if further clarification or elaboration is desired.

Yours sincerely

A handwritten signature in blue ink that reads "David Love". The signature is written in a cursive style with a large initial 'D'.

David Love

Director – Policy & International Affairs