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Senior Adviser
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email to ASICIFMReview@treasury.gov.au

SUBMISSION TO ASIC INDUSTRY FUNDING MODEL REVIEW

ASX welcomes the opportunity to contribute to the review of the ASIC Industry Funding Model ("IFM"). As a market operator, ASX believes it is appropriate for a regulator to be appropriately resourced.

ASX makes comment on the IFM both from the perspective of a regulated entity liable to contribute to ASIC's regulatory costs, and as the operator of a significant part of the infrastructure that supports Australia's financial markets. From the latter perspective, ASX can bring insight into the impact of the operation of the IFM on participants in these markets, as well as the operation of the market as a whole. Our submission is structured in two parts along this delineation.

In summary, while ASX supports principles underpinning the cost recovery model, we consider there are aspects in which the calculation of the levy could be simplified, primarily in regard to the methodology for large securities and futures exchange participants.

1. General comments

ASX has made numerous submissions to Treasury on various aspects of the IFM in the past. As a general comment, and with regard to the scope of the terms of reference and current budgetary pressures, ASX reiterates a point made in our 2016 submission: there is a strong case for ASIC to be partially funded by tax revenue as core Government activities.

Funding of regulators from general tax revenue is in and of itself an accountability mechanism. While the Government retains control of ASIC's annual budget allocation, and hence the total amount to be funded by industry, in a full cost recovery model, there is limited incentive to restrain ASIC's costs or drive efficiencies. In addition, ASIC's regulatory role has benefits to society as a whole, and therefore it would be appropriate for general tax revenue to fund at least part of ASIC's functions.

2. Issues impacting ASX customers

As mentioned, ASX's position as the operator of a significant part of Australia's financial markets infrastructure provides unique insight into how the IFM affects our customers and the operation of markets.

2.1. Impact of levy calculation for large securities and futures exchange participants

ASX previously made representations to Treasury in 2018 on the levy methodology, prior to the IFM being extended to large futures markets participants. In that submission, ASX noted that the previous methodology for large securities exchange participants of distributing costs based on each firm's share of messages and trades (which in practice meant that roughly half the cost recovery is based on messages and half on transactions) had the benefit of moderating growth in certain trade strategies (for example, high frequency trading). In moving to the methodology where around

90 per cent of firms' cost based on transactions and 10 per cent based on messages in pursuit of simplification, ASX cautioned against unintended consequences on market structure by encouraging the re-emergence of some of these trading strategies.

With the new methodology having been in place for a number of years now, there has been no observable increase in such trading strategies as a result of the change. As such, we see an opportunity for further simplification of the methodology by removing the message-based component completely, and calculating the levy entirely on transaction volumes for both large securities and futures exchange participants. Messages account for a relatively small amount of the levy recovered but create a significant degree of complexity for our participants. This change would have the added benefit of making it easier for firms to estimate the amount of levy payable on a more regular basis given ASX publicly releases total trading volumes but not message counts.

In the 2018 submission, ASX also noted that the IFM should be tailored to the particular market structure and reflect how the market operates in practice. That is, recognising any differences between how the equities and futures markets operate, including how trading is undertaken. For example, in the futures market the levy should apply on a per-lot rather than per-transaction basis to better align with market practice. ASX submits the levy for large futures exchange participants should continue to apply on a per-lot basis.

In addition to simplifying the methodology, there are compelling arguments for moving to a volume based (or per-lot) only basis for large futures exchange participants due to the structure of the futures market. Less liquid futures products are supported by market makers, and there are no specific message types for these market makers. These market makers provide a critical service that reduce transaction costs for end-investors and underpin the health of the futures market.

The ETF, warrant and equity options markets provide an extreme example of this due to the high frequency of updates. Market makers perform a service for these markets, and it is desirable for the market makers to continuously update their quotes to provide tight two-way markets in the markets they cover. Because these quotes are 'messages' for the purposes of the IFM, these market makers are disincentivised from trading in a manner that improves market quality.

Removing the message-based aspect of the IFM for large securities and futures markets participants would not only benefit contracted market makers but would ensure that it remains attractive for counterparties to provide liquidity in our futures markets, which is important for the overall quality of Australia's financial markets.

<u>Proposal</u>: For large securities and futures exchange participants, the levy should be calculated on a per-transaction or per-lot basis (respectively) only, rather than a combination of transactions and messages.

This would both simplify the methodology, enable participants to accurately anticipate their levy liability and ensure that actions that improve market quality are not penalised.

2.2. Complexity for international participants

ASX notes the discussion by the Review about the trade-off between simplicity and equity in setting the levy.

For our participants, the levy calculation is already significantly complex (particularly for international participants not familiar with the Australian regulatory regime). However, given the IFM has been in place for a number of years now, participants have come to understand the basis on which the levy is calculated. Any changes to the levy that would increase complexity would be likely met with resistance by participants, unless there were significant benefits in moving to a more complex model.

To ensure Australia remains an attractive location to invest, ASX would caution against minor tweaks to the levy in the pursuit of "equity" unless the changes would result in substantially better outcomes for participants (for example, the proposal above). It is important that the IFM does not become a barrier for firms and that Australia remains globally competitive as a financial centre.

<u>Proposal</u>: Changes to methodology for levy calculation should only be made in the pursuit of significant simplification.

2.3. Timing and unpredictability

ASX has also received feedback from our customers regarding the way in which the levy is charged. Customers have reported it is difficult to estimate the amount of levy that will be payable, and difficult to budget for the expense as the bill comes in so late and actual amounts payable can vary vastly from the estimates. Comments about firms' engagement with the Cost Recovery Implementation Statement (CRIS) process are best solicited from individual firms, however based on the feedback we have received from participants ASX encourages Treasury to explore ways to see the levy calculated and charged closer to the actual impact so that firms can allocate appropriately.

ASX notes that removing the message-based aspect of the levy calculation would make the IFM more predictable and easier to calculate for firms.

3. Issues impacting ASX

ASX is broadly comfortable with the settings of the IFM that apply to it as a regulated entity. ASX is highly regulated given its importance in the Australian financial system, and we understand that the levy is broadly proportionate to ASIC's costs in regulating us. We have a number of minor comments to improve the operation of the IFM with respect to ASX.

3.1. Impact on business planning

ASX has observed substantial volatility between the levy amount charged year-on-year, which creates difficulties in the accrual process for our business. While the methodology is transparent and remains similar each year, the amount recovered is based on the costs ASIC incurred in the previous year, and therefore ASX does not have foresight regarding the quantum of the levy recoverable each year. ASX is of the view that further transparency from ASIC regarding the total amount to be recovered would be beneficial.

ASX examines the CRIS in order to estimate the final levy for advanced planning purposes.

3.2. Fees-for-service

ASX is subject to fees when changes to our rulebooks are submitted to ASIC. We continue to have concerns about the duplication in recovery of the costs of ASIC's supervisory activities that are covered by a fee-for-service. We have previously suggested that the IFM should explicitly recognise any revenue generated through fee-for-service charged during the financial year for a particular sub-sector, which would then be subtracted from the total ASIC regulatory costs to be recovered from ASX.

The fees-for-service component of the IFM is designed to recover the cost of regulatory activity completed by ASIC at the request of, and for the benefit of, a specific entity. Rule changes that facilitate new products or services clearly meet these criteria. However, there are a range of other rule changes that: enhance market integrity or rule compliance; reduce regulatory compliance costs for customers (e.g. listed companies, participants); or are required as a result of changes to legislation or other regulatory instruments (i.e. *Corporations Act*, ASIC Market Integrity Rules) or made at the request of a regulator.

ASX proposes that rule changes to enhance market quality and integrity or requested by a regulator should not be subject to a fee-for-service charge. Abolishing fees in these circumstances would remove any possible disincentive to undertake such rule changes.

<u>Proposal</u>: Rule changes to enhance market quality and integrity or requested by a regulator should not be subject to a fee-for-service charge, and rather funded through the annual levy applied to ASX.

If not excluded from the fees-for-service aspect, ASIC should ensure there is no over-recovery for regulatory activities for which a fee-for-service is charged.

4. Further information

Should Treasury have any questions about the matters raised in this submission or require any further information, please contact Grant Lovett on [redacted] or at [redacted]

Kind regards

[redacted]

Grant Lovett
General Manager
Government and Regulatory Affairs