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Sydney NSW 2000

14 May 2012

RIA Benchmarking Study  
Productivity Commission  
GPO Box 1428  
Canberra City ACT 2601

Dear Sir/Madam

**Issues Paper - Regulatory Impact Analysis: Benchmarking**

Chi-X Australia (Chi-X) commends the Australian government and the Productivity Commission on the publication of the above Issues Paper and for examining the critical importance of regulatory impact analysis in the development and implementation of Australian regulation.

Chi-X Australia Pty Ltd is the licenced operator of an Australian financial market and is a member of the Chi-X Global group of companies that also operates securities trading venues in Japan and Canada<sup>1</sup>. As such the focus of this submission is on the role of a regulatory impact analysis in the rule making process that applies to the regulation of financial markets. While financial markets may be one industry among many falling within the scope of the Productivity Commission's Issues Paper, a robust rule/regulation making process, that gives appropriate prominence to a regulatory impact analysis, is of a significant and enduring importance to the competitiveness of Australia's financial markets and their place in an increasingly globalised industry<sup>2</sup>.

The overhaul of Australia's regulatory regime was a necessary part of the process by which Chi-X obtained an Australian market licence (on 4 May 2011) and then launched its market (on 31 October 2012). Chi-X is largely supportive of the methods and processes, including those relating to the regulatory impact analysis, employed by the Australian government and regulatory authorities in the development and implementation of the reforms that enabled the Chi-X Australia market to launch. However, the regulatory impact analysis undertaken in other global jurisdictions contain measures that, in

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<sup>1</sup> This response represents the views of Chi-X Australia Pty Ltd only and as such any references to 'Chi-X' are solely to Chi-X Australia Pty Ltd.

<sup>2</sup> It is also attracting increasing attention on a global stage – see for example the US House Subcommittee on TARP, Financial Service, and Bailouts of Public and Private Programs Oversight and Government Reform Committee, and, for example, "Regulation 'pushing up financial firms' costs" at <http://www.ft.com/intl/cms/s/0/03ebb904-9a8f-11e1-83bf-00144feabdc0.html#axzz1uo96xsNs> retrieved 14 May 2013.

the view of Chi-X, could be adopted to improve the regulation/rule making processes in Australia and in turn enhancing Australia's financial markets. This submission is focused upon the following such measures:

1. ex ante cost benefit analysis;
2. requiring rule making bodies to certify that a proposed regulation will:
  - (a) enhance Australia as a place to conduct business;
  - (b) promote competition;
3. The need for governance, independence and transparency in the consideration and legislating of rules and regulations.

### **1. An ex ante cost benefit analysis**

As outlined in the Issues Paper, the OECD has recognised the importance of adopting ex ante impact assessment practices that are proportional to the significance of the regulation and include cost benefit analysis. The Issues Paper seeks instances in which overseas practices highlights improvements that may be made in Australian practices and Chi-X provides the following as potentially helpful cases.

In October 2011, ASIC published Consultation Paper 168 which proposed some substantial reforms across many different areas of equity markets. The CP was 260 pages long with 87 additional pages containing draft rules. The CP devoted one page to the regulatory and financial impact (page 129) of the proposals and no cost benefit analysis. In July 2011, the European Securities and Markets Authority (ESMA) published a consultation paper entitled *Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities*. The CP was 114 pages, including the draft guidelines, and of this 12 pages was devoted to a cost benefit analysis. The role of the cost benefit analysis is transparently enshrined in ESMA processes<sup>3</sup>. It is the view of Chi-X that an ex ante cost benefit analysis that is transparently part of the consultation process, should be legislatively mandated for all Australian rule making authorities. The inclusion of the cost benefit analysis at the consultation stage results in at least the following advantageous outcomes:

- (i) The policy proposals consulted on are at a more considered and advanced stage than if no cost benefit analysis had been undertaken, resulting in a more effective use of industry resources and consultation process generally;
- (ii) there is greater transparency on the rationale for and benefits of the proposals;
- (iii) there is a transparent mechanism of assessing the relative performance of the proposals once they are implemented.

The need for ex ante consultation is also highlighted in comparing the approaches of other regulators to ASIC's approach on its market surveillance responsibilities and the associated cost recovery. In August 2011, Treasury and ASIC issued a joint consultation paper on proposed cost recovery mechanisms in respect of market surveillance. This was the first consultation on ASIC's market surveillance model and did not involve any consideration of alternative surveillance models and associated costs. The Cost Recovery Impact Statement (CRIS) for the market surveillance selected by ASIC without consultation of

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<sup>3</sup> See <http://www.esma.europa.eu/page/Cost-benefit-analysis>



industry was not published until 25 November 2011, which was after the regulations in respect of the consultation had been finalised. An experts group to consider the cost recovery proposals was not established until after the cost recovery measures had been imposed. This contrasts with:

- a) the practice of the FSA with respect to the consultation process on its cost recovery generally and the recovery of costs associated with market monitoring<sup>4</sup>;
- b) the development of the consolidated audit trail proposals by the SEC<sup>5</sup>.

The ASIC cost recovery measures have had a significant impact on the Chi-X business and imposed a disproportionate cost on Chi-X and other members of the broking community. It is not clear to Chi-X why the cost recovery consultation proceeded without:

- I. a fuller exploration of the alternatives to the proposed surveillance system and cost recovery models;
- II. a transparent cost benefit analysis of the regulatory measures in respect of which the cost recovery was sought;
- III. an ex ante cost recovery impact statement.

## **2(a) Enhancement of Australia's markets**

Australia's financial markets are subject to relentless global competition. It is not automatic that an Australian company will raise capital through an Australian market nor that a derivative contract focused on largely Australian underlying physical products will be traded on an Australian exchange. Indeed there is a school of thought that in the future these outcomes will become less likely<sup>6</sup>. In these circumstances, Chi-X is of the view that it is important that legislation expressly and transparently incorporate into every rule making process the consideration and analysis of how a proposed regulation will enhance Australia's markets and competitiveness. The experience of Chi-X and anecdotal evidence from our participants is overwhelmingly to the effect that Australia is one the most expensive jurisdictions in which to operate or participate in a financial market. This places our market place, its participants, investors and the Australian economy at a competitive disadvantage. Accordingly Chi-X is of the view that an important part of any regulatory impact analysis is the transparent consideration of how the proposed regulation will enhance Australia's financial markets. Such a measure would be of significant long term benefit for our markets and the broader economy. This measure is one of the seven principles of good regulation that are enshrined in the United Kingdom's Financial Services and Markets Act and is part of the legislative framework that governs SEC rule making<sup>7</sup>.

Chi-X is of the view that an express requirement to consider how a proposed regulation impacting on Australia's financial markets would enhance those markets would provide a clear and unambiguous policy requirement for rule making authorities. It would complement section 1(2) of the Australian Securities and Investments Commission Act 2001, which states that in the performance of its functions ASIC "must strive" to "maintain, facilitate and improve the performance of the financial system and the entities within [it]".

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<sup>4</sup> See the annual FSA consultations on Fees and the consultation on and development of the All reference data model, including cost recovery, for the FSA's market monitoring system.

<sup>5</sup> See [www.sec.gov/rules/proposed/2010/34-62174.pdf](http://www.sec.gov/rules/proposed/2010/34-62174.pdf)

<sup>6</sup> See for example "Biota boss talks up Big Apple" Australian Financial Review 28 April

<sup>7</sup> See, for example, section 2(b) Securities Act, s3(f) Exchange Act, S 2(C) Investment Act, s202(c) Advisers Act.



## **2(b) Competition as a required consideration**

In North America and the United Kingdom, the rule making governance processes contain express recognition of the importance of competition outcomes in the rule making process<sup>8</sup>. The potential impact of such a policy requirement is highlighted by the fact that as part of the chosen method of introducing competition to Australia and enabling the Chi-X market to launch, ASIC harmonised market wide Market Integrity Rules around existing ASX Operating Rules. This had the predictable result of favouring ASX products in key areas<sup>9</sup>. Further, Chi-X is of the view that the cost recovery mechanism implemented by ASIC has imposed a disproportionate cost on Chi-X and its participants in a way that significantly disadvantages new market operators seeking to compete with legacy monopoly providers.

Chi-X is of the view that it is important that any rule making process and regulatory impact analysis be required to consider the competition outcomes of the rules being proposed. Chi-X is of the view that this could be appropriately achieved by requiring competition outcomes to be part of the consultation process and either mandating the involvement of competition authorities in the rule making process or in the annual audit of rules and regulations from a competition perspective.

## **3. Independence and Governance in the Rule Making Process**

Chi-X is of the view that, in those cases where one body may be responsible for all the stages in the rule making process<sup>10</sup>, it is important to have transparent independent checks enshrined in the rule making process generally and the regulatory impact analysis in particular. There are good reasons why the regulated community is often subject to governance processes that require independent oversight of key functions, whether by way of audit, independent board members or internal compliance processes. The underlying policy basis for applying these governance standards to the regulated community are equally (if not more so) applicable to those bodies that undertake regulation, in particular if a single entity is responsible for all steps in the regulation making and enforcement process.

The FSA is subject to legislatively enshrined independent checks on its rulemaking processes and has independent representation at the board level. The SEC is subject to judicial review, government oversight and transparent Commission deliberations where confidentiality is not required. Chi-X is of the view that appropriate adoption of these measures would benefit the regulatory impact analysis and wider rule making processes in Australia.

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<sup>8</sup> See, for example, section 23(a) of the Exchange Act in the US and Chapter III of Part X of the Financial Services and Markets Act in the United Kingdom

<sup>9</sup> For example, pre trade transparency rules are built around existing ASX products.

<sup>10</sup> For example, each and all of the initiating/developing/finalising policy, rulemaking, supervision and enforcement functions.



I hope this assists in your deliberations in this important area. Please do not hesitate to contact me if you have any queries.

Yours faithfully

Michael Somes  
**Head of Compliance and Regulatory Affairs**