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20 June 2014

Competition Policy Review Secretariat
The Treasury,
Langton Crescent,
Parkes ACT 2600

By email: Contact@CompetitionPolicyReview.gov.au

Dear Sir/Madam

**Chi-X Australia's Submission to the Competition Policy Review**

Chi-X Australia is grateful for the opportunity of providing a submission to the Competition Policy Review (the CPR).

Chi-X Australia is a member of the Chi-X Global group of companies that has successfully launched alternate market platforms in a number of global financial centres. Chi-X Australia is the first Australian stock exchange to genuinely compete with the ASX in the trading of ASX listed securities. Chi-X therefore has a unique mix of Australian and global experience in operating alternate market platforms in competition with incumbent monopoly operators.

Market platforms and stock exchanges are part of the financial market infrastructure that is of critical importance to a national economy. They play a crucial role in determining the success of a financial centre. The CEO of the Singapore Stock Exchange, one of Australia's most significant regional competitors, has remarked:

> "*If we really want to be a [major] financial centre we need to see more exchanges in town*"[1].

In these circumstances, Chi-X is strongly of the view that competition policy in the area of financial market infrastructure is of critical importance to Australia and its aspiration to improve its standing as a financial centre. This submission is therefore made with a view to improving competition policy in a way that enhances Australia as a place to do business. It draws upon the Chi-X experience with respect to capital market infrastructure, but the proposals outlined are applicable to a wide range of financial services and other economic sectors.

[1] See "SGZ and ICE signal hopes for closer ties", retrieved on 12 June 2014 from: http://www.ft.com/intl/cms/s/0/e0d21bdc-cb8f-11e3-8ccf-00144feabdc0.html?siteedition=intl#axzz34O5dijt5

The submission is attached and we hope it assists in your work in this important area.

Please do not hesitate to contact us if you have any queries.

Yours faithfully

Chi-X Australia Pty Ltd

Chi-X Australia

# Chi-X Australia Submission to the Competition Policy Review

## 1. Outline

1.1.1 This submission addresses six key questions listed in the Issues Paper published by the Competition Policy Review (the CPR) and is segmented into the follow topics/key questions:

Section 2: The importance of **requiring the facilitation of competition to be incorporated into industry regulation** and policy development (the key question listed in paragraph 6.2 of the Issues paper);

Section 3: **Unwarranted regulatory impediments to competition** in the financial sector in Australia (key question in paragraph 2.3);

Section 4: **Whether current competition laws promote competitive markets**, given increasing globalisation, changing market and social structures, and technological change (key question in paragraph 5.3);

Section 5: **Whether the definitions of 'market' in the Consumer and Competition Act (CCA) operate effectively**, and work to further the objectives of the CCA (key question in paragraph 5.6);

Section 6: **The way in which misuse of market power should be dealt with under the CCA** (key question in paragraph 5.10);

Section 7: **The experience of Chi-X with respect to the ASX Code of Conduct** on the clearing and settlement of ASX listed securities (key question in paragraph 5.42).

## 2 Requiring Regulation to Facilitate Competition (the key question in paragraph 6.2 of the Issues Paper)

2.1.1 The available evidence across all economic sectors consistently demonstrates that competition between suppliers is an essential ingredient in delivering the best outcomes for consumers and for enhancing Australia as a place to do business. Some of the evidence and statements in support of this in the area of financial market infrastructure include:

(i) Research undertaken by the Goethe University has concluded that market quality is highest in those areas where market competition is greatest[2].

(ii) Analysis undertaken by the Strategic Intelligence Unit at ASIC has concluded that from the commencement of competition in market infrastructure to January 2013, the benefits of competition may have been worth up to $300million per year[3].

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[2] Goethe University House of Finance, Competition among electronic markets and market quality, Peter Gomber, Markus Gsell, Marco Lutat, Discussion Paper 01/2011, retrieved on 26 March 2014 from http://safe-frankfurt.de/uploads/media/Gomber_competition_among_electronic_markets_and_market_quality.pdf .

[3] see page 32 of the Treasury Market Supervision Cost Recovery Impact Statement at http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2013/ASIC%20Market%20Supervision%20Cost%20Recovery/Key%20Documents/PDF/Consultation_draft_CRIS.ashx

(iii) The Capital Markets Cooperative Research Centre conducted an independent study in which it found that in the first year alone, competition in market infrastructure Australia had delivered welfare benefits between $36m-$220m[4].

(iv) Comments in the Johnson Report and by the ASX Chair evidence the positive impact of competition on ASX itself. In 2009, it was stated in the Johnson Report that:

*In the [Australian Financial Centre] Forum's assessment, [the role of ASX as market operator, central counterparty and market supervisor] has been a significant barrier to new competition and innovation. The Forum received a good deal of feedback from industry concerning the lack of equity trading platform development (see Appendix 4) and innovation.*[5]

In 2012, the ASX Chairman stated:

"*ASX's response to competition has been substantial and positive. The company cut its fees, introduced new products and invested in its Technical Services business*"[6].

(v) Within the first twelve months of Chi-X launching competing products, some of the ASX fees charged to ASX participants for those products had decreased from over $500,000 pa to no more than $12,000 pa.

(vi) the CEO of the Singapore Stock Exchange has remarked, in respect of developments concerning the arrival of global market infrastructure providers in Singapore:

"*what are we doing in the face of this intensifying competition? [The] most important thing is that we continue to innovate*"[7];

(vii) The CEO of the United Kingdom's Financial Conduct Authority has stated, in respect of the introduction of a new statutory duty on the FCA to enhance competition:

*"Our new competition duty is the single most significant change in our objectives as a regulator. This is not just because it is new on the face of the Bill, but because of the approach it drives. It means we have to spend more time and effort looking at markets as a whole and whether they function well for consumers. It means we have to look for remedies that help markets work better for consumers.* ***And it means that we don't just wait for problems before we try to promote competition in the markets we regulate. We've started in our own back yard – looking at whether some of our authorisation procedures cause unnecessary barriers to entry.****"*[8] (emphasis added)

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[4] *How beneficial had competition been for the Australian equity marketplace?* Michael Aitken, Haoming Chen and Sean Foley, 24 May 2013 – retrieved on 21 October 2013 from: http://www.cmcrc.com/documents/1372142696hascompetitionbeenbeneficialforaustralianmarketplace.pdf

[5] See page 37 of *Australia as a Financial Centre Building our Strengths*, a report by the Australian Financial Centre Forum, retrieved on 25 March 2014 from http://cache.treasury.gov.au/treasury/afcf/content/final_report/downloads/AFCF_Building_on_Our_Strengths_Report.pdf

[6] See page four of the ASX Chair's address at the 2012 ASX AGM, retrieved on 25 March 2013 from http://www.asx.com.au/documents/investor-relations/Final_Speeches.pdf

[7] See the speech of Mr Bocker at the 14th AGM of SGX, retrieved on 25 March 2014 from http://www.finanznachrichten.de/pdf/20130919_141227_S68_631FE115DC6E26D648257BEB0021DE12.1.pdf

[8] See "100 days of the FCA", a Speech by Martin Wheatley, Chief Executive, the FCA, at the ABI Biennial Conference, London, retrived on 12 June 2014 from http://www.fca.org.uk/news/speeches/100-days-of-the-fca

2.1.2 Notwithstanding the consistent evidence in support of basic competition principles, there are almost equally consistent demands by special interest groups and legacy providers to develop policy settings and a regulatory framework that can have detrimental impacts upon competition. The universal benefits of facilitating competition and the consistent arguments against those principles by those holding vested interests, were succinctly summarised by The Industry Commission in its very first Annual Report:

*Through protection from foreign competition and the establishment and tolerance of public and private monopolies, governments have blunted the rewards and disciplines that competition provides. Effective competition is critical in ensuring that markets convey the right incentives. It is vital to improved productivity performance. Competition not only keeps costs down, it ensures the benefits are passed on to consumers and it provides strong incentives for production to match evolving consumer requirements. It provides rewards for doing things better and discipline for failing to do so.*[9]

2.1.3 In these circumstances, Chi-X is of the view that the tried, tested and proven adoption of competition principles should be a mandatory factor in the policy and regulatory framework for government agencies with an industry focus no matter the economic sector in which they work.

2.1.4 Chi-X accepts that competition is not a panacea or cure all for every industry environment, and that there may be exceptional circumstances when the facilitation of competition is justifiably not an end goal for an agency working with an industry focus. However, the consistency and depth of the available evidence warrants:

(i) a universal principle requiring regulation and policy development to factor the facilitation of competition into related decision making processes;

(ii) a meaningful governance process that ensures more than lip service is paid to the requirement that facilitation of competition is factored into the decision making process.

2.1.5 Imposing a requirement on regulators and government agencies to facilitate competition may be seen by some as simply amounting to window dressing, but the cases outlined in sections 3 and 4 below illustrate how imposing competition goals on a regulatory agency would likely have made a real difference in the areas in which Chi-X does business and, in our view, enhanced Australia as a place to do business.

## 3 <u>Unwarranted regulatory impediments to competition (the key question in paragraph 2.3 of the Issues Paper)</u>

3.1.1 Regulation justifiably imposes barriers to entry in the financial services sector, including in the sub-sector of financial market infrastructure. These barriers can exist in rules, polices and formal product/innovation approvals by the regulator. The processes by which this regulation is developed, consulted on, implemented and reviewed, is absolutely essential for ensuring that the barriers to entry it creates, does not stifle competition between service providers in a way that damages outcomes for end users and Australia as a place to do business. Chi-X is concerned that in Australia there are identifiable instances where rules, policies and product/licence approvals have created unwarranted impediments to competition in the financial sector and in

[9] See numbered page 9 of the 1989-1990 Annual Report of the Industry Commission, retrieved on 26 March 2014 from http://www.pc.gov.au/__data/assets/pdf_file/0004/77512/chapters.pdf

particular the provision of financial market infrastructure. The following case histories illustrate how this may be the case:

(i) the time taken, and lack of meaningful statutorily imposed deadlines, for ASIC to grant regulatory approvals (eg licence approvals and/or amendments and the approval of innovative product developments);

(ii) the restrictions on product innovation resulting from ASIC requirements with respect to the real time market data feeds Chi-X/ASX are required to provide to ASIC;

(iii) the discriminatory nature of the ASIC cost recovery mechanisms and the way in which they were developed/implemented;

(iv) the manner in which regulatory reform of financial services has been implemented in Australia, in particular in respect of the regulatory framework for multiple providers of financial market infrastructure, as evidenced by:

(a) the multiple business lines in which ASX retains a monopoly and the manner in which those business lines are subject to competition regulation;

(b) many regulatory measures being based upon an ASX paradigm that inherently favours ASX products;

(c) the vertically integrated business model and staffing pool operated by ASX that inherently favours those ASX businesses subject to competition.

3.1.2 The evidence in support of each of these concerns is outlined below.

3.2 <u>The time taken to grant regulatory approvals</u>

3.2.1 Chi-X is conscious that regulating new financial products and proposals is at times a difficult job. Chi-X respects the leading role that ASIC has played in many regulatory developments and commends its demonstrated expertise in these areas. However, Chi-X is also conscious that the lack of statutorily imposed restrictions on the time ASIC may take to approve licence applications and product developments can result in an unwarranted impediment to competition both internally within Australia and between Australian service providers and those located overseas.

3.2.2 The time taken for regulatory approval can be a significant disadvantage for a competitor seeking to disrupt a local monopoly as:

(i) a cash burn is incurred while regulatory approvals are being obtained;

(ii) the delay in approvals assists a well-resourced monopoly operator to prepare for competition; and

(iii) regulatory delays can make it more difficult to recoup the costs of the investment necessary to bring new technologies and products to market and negatively impact on the success of a new entrant generally.

3.2.3 These outcomes are also significant disincentives for investors considering Australia as a place to commit funding for the development of market infrastructure. These disincentives and the

potential impact on competition locally can be observed by the fact that from the date of the Chi-X licence application in April 2008 to the Chi-X market launch in November 2011, the ASX:

(i) launched a separate market to attract high frequency traders (PureMatch )[10] – 28 November 2011,

(ii) launched a separate market to compete with the Chi-X Delta product that had been successfully launched in Europe (Centre Point[11], one of ASX's most successful equity market products[12]) – June 2010;

(iii) launched a separate market, Volume Match, that provided a large order execution service[13] - 28 June 2010;

(iv) announced a new data centre that it was stated would enable "high speed market data and trade execution with near zero network latency" – 10 June 2010[14].

3.2.4 This period of activity on the part of ASX contrasts with the lack of innovation in the period before competition arrived. As noted above, the Johnson report published in 2009 stated:

*The Forum received a good deal of feedback from industry concerning the lack of equity trading platform development (see Appendix 4) and innovation* [by ASX].[15].

3.2.5 The differences between Australian and global benchmarks in this area can also be highlighted by the regulatory experience of Chi-X and BATS Chi-X Europe and which is outlined in paragraph 1.2.2 to 1.2.5 of the Chi-X submission to the Financial Systems Inquiry[16].

3.3 The methods by which ASIC monitors different markets

3.3.1 The method by which ASIC monitors trading on exchanges stifles innovation and impedes competition, both within Australia between competing local providers and between Australian based providers and those located offshore. Under the allocation of regulatory responsibilities between regulators and exchanges in Australia, ASIC is not required to undertake real time market surveillance: that monitoring which falls to ASIC can be adequately undertaken on a non-real time basis and indeed this is the basis employed by some equivalent global regulators. In the United Kingdom for example, there is mix of exchange led monitoring, with the regulator analysing, on a non-real time basis, cross market techniques and industry reporting of suspicious

[10] http://www.asx.com.au/documents/media/PureMatchLaunchandPricingFinal-AustralianSecuritesExchange-ASX.pdf
[11] http://www.asx.com.au/documents/resources/asx_trade_new_order_types.pdf
[12] See "ASX Dark Pool Trades at Record as Bourse Seeks More Rules", retrieved on 12 June 2014 from http://www.businessweek.com/news/2012-09-17/asx-dark-pool-trades-at-record-as-bourse-seeks-more-rules
[13] http://www.asx.com.au/documents/media/20100625_volumematch_to_go_live_28_june_2010.pdf
[14] http://www.asx.com.au/documents/media/20100610_new_data_centre_for_asx.pdf
[15] See page 37 of *Australia as a Financial Centre Building our Strengths*, a report by the Australian Financial Centre Forum, retrieved on 25 March 2014 from http://cache.treasury.gov.au/treasury/afcf/content/final_report/downloads/AFCF_Building_on_Our_Strengths_Report.pdf
[16] See http://cmsau.chi-x.com/Portals/15/Docs/CXA%20submission%20to%20the%20FSI%20310314.pdf

activity[17]. There is no evidence that the real time feed and real time monitoring results in better regulatory outcomes for ASIC than a non-real time approach that does not pose the same impediments to competition in financial market infrastructure.

3.3.2 The local requirement for a real time market data feed to be provided to ASIC has the effect that any market operator innovation must go through an opaque bureaucratic process by which the innovation is integrated into the market data feed for analysis in ASIC's market surveillance systems. Chi-X product development is therefore not subject to an internal or customer driven product cycle, but rather by an ASIC process that is not required to consider innovation or competition outcomes in setting its timelines and deliverables.

3.3.3 Chi-X is also conscious that there are multiple products, based in Australia and offshore, that are not subject to the ASIC imposed requirements on real time monitoring and that therefore operate with a distinct competitive advantage. Some of these instruments can be used just as effectively as Chi-X traded products to effect the market misconduct that the ASIC surveillance is intended to detect (eg insider dealing can be effected through contracts for difference).

3.3.4 The competitive advantage that the ASIC approach to market surveillance delivers to products that are not traded on a lit Australian exchange, also risks handicapping Australia as a place to do business relative to our regional competitors. As global markets become more cross border and products can be migrated between centres more easily (witness the iron ore contract traded on Singapore and the wheat/A$ contracts traded on CME), there is a real risk that this relative competitive disadvantage under which Australia's markets operate may result in a diminishing of Australia's place as a financial centre.

3.3.5 Chi-X is also required to provide ASX with a real time feed so that the ASX can undertake real time market monitoring for continuous disclosure purposes. The duplicative nature of the two real time feeds Chi-X is required to provide to ASX and ASIC, further highlights the unwarranted impediments to competition imposed by the ASIC real time feed requirements.

3.4 The Discriminatory Nature of the ASIC Cost Recovery Mechanisms

3.4.1 The ASIC cost recovery fee imposed upon Chi-X, at approximately A$850,000 a year, is excessive. Nearly fifty percent of the net revenue earned by Chi-X Australia is paid to ASIC in cost recovery fees. An international comparison also evidences the relative impact of the ASIC cost recovery measures: BATs Chi-X Europe is charged approximately A$800,000 a year[18].for the supervision of market activity that is over ten times the volume of that which takes place on Chi-X[19] . BATS Chi-X Europe has a market capitalisation that is a double digit multiple of Chi-X Australia's.

3.4.2 This excessive disparity in regulatory fees places Australia at a competitive disadvantage as a potential destination for innovative providers of financial market infrastructure. It may partially

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[17] "So, essentially what we have now in the UK, is a mix of exchange-led monitoring, with the regulator analysing risks such as cross-market techniques on the one hand. On the other, industry itself reporting suspicious activity – so the challenge here becomes a shared one." Martin Wheatley at http://www.fca.org.uk/news/regulating-high-frequency-trading

[18] See pages 20-21 of the FCA CP 14/6 "FCA Regulated fees and levies: Rates proposals 2-014/15, retrieved on 12 June 2014 from http://www.fca.org.uk/your-fca/documents/consultation-papers/cp14-6

[19] Compare http://www.batstrading.co.uk/cxe/market_data/volume/day/ with the daily reports accessible at www.chi-x.com.au

explain Singapore's greater attraction relative to Australia as a destination for infrastructure providers and Australia's relative performance as a financial centre.

3.4.3 The ASIC cost recovery mechanisms have further discriminated against new entrants seeking to bring about innovation and competition to Australia's capital markets, in the following ways:

(i) the successful introduction of competition in cash equities trading has commonly been achieved in other global markets through the introduction of trading on an alternate platform that has a higher message ratio than that which occurs on an incumbent monopoly platform – the ASIC tax imposes a higher cost on those higher message ratio trading strategies relative to other strategies notwithstanding the singular lack of evidence that the high message trading strategies on alternate platforms create a greater need for the ASIC regulation being funded by cost recovery (in fact there is evidence is to the contrary);

(ii) an incumbent monopoly market often generates multiple fees from trading that are simply not accessible to an alternate platform and hence it has many more products that create the need for the ASIC regulation that is being funded by cost recovery (eg listing markets, derivative markets, clearing products) and yet these activities are not subject to cost recovery by ASIC, either at all or to the same extent;

(iii) the ASIC cost recovery mechanism contravenes the fundamental principle of being paid for by those who generate the need for the regulation being subject to cost recovery (eg the regulation of continuous disclosure and insider dealing appear to be covered by the systems and resources funded by cost recovery and yet the cost recovery fee is paid by firms that do not generate the need for this regulation)[20];

(iv) Chi-X pays nearly double the rate of cost recovery fees paid by ASX, based on market share statistics.

3.4.4 ASIC has an approach that any competition in the trading of products may result in cost recovery being sought. Chi-X accepts that market surveillance is an essential task and that cost recovery is a fundamentally sound principle, but nonetheless it needs to be emphasised that the way in which cost recovery is imposed impedes innovation and competition in financial markets in Australia.

3.5 The Manner in which Competition has been Introduced in Australia – The ASX Monopoly

3.5.1 As the CPR will be aware, from the mid-1990s, financial market infrastructure providers commenced a process of demutualisation that ended up with many operating as for profit shareholder owned enterprises. In many jurisdictions this has been followed by a series of policy and regulatory initiatives intended to address the issues raised by the inherent monopoly power exercised by those for profit entities.

3.5.2 The process by which competition in financial market infrastructure has been introduced into Australia has resulted in the ASX retaining monopoly power in many of the areas in which it operates. As far as Chi-X is able to ascertain, the operation in these monopoly areas is not

[20] See for example table two on page 9 of Report 386, "ASIC Supervision of markets and participants: July to December 2013", retrieved on 12 June from http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep386-published-19-March-2014-1.pdf/$file/rep386-published-19-March-2014-1.pdf

subject to any ongoing monitoring or price regulation. As a consequence there are areas where ASX pricing is among the most expensive the world. For example, Morgan Stanley has compiled the following table in respect of ASX listing fees[21]:

| Mkt cap (A$m) | Min | Max | Avg ex ASX | ASX | ASX vs avg |
|---|---|---|---|---|---|
| 1 | 5,118 | 47,006 | 21,206 | 12,500 | -41% |
| 10 | 5,118 | 47,006 | 21,757 | 23,779 | 9% |
| 100 | 10,974 | 76,665 | 34,959 | 40,569 | 16% |
| 500 | 17,973 | 129,563 | 55,593 | 55,377 | 0% |
| 1,000 | 27,542 | 171,405 | 73,541 | 73,889 | 0% |
| 5,000 | 60,431 | 520,425 | 161,373 | 123,169 | -24% |
| 10,000 | 60,431 | 559,597 | 166,269 | 184,774 | 11% |
| 50,000 | 60,431 | 559,597 | 166,269 | 307,974 | 85% |
| 100,000 | 60,431 | 559,597 | 166,269 | 358,750 | 116% |
| 500,000 | 60,431 | 559,597 | 166,269 | 358,750 | 116% |

Assumes A$10 share price. Source: Company Data, Morgan Stanley Research

3.5.3 This feature of the Australian market has predictable consequences with respect to pricing in those areas where Chi-X has brought competition: within the first twelve months of Chi-X Australia launching competing products, some of the ASX fees charged to ASX participants for those products had decreased from over $500,000 pa to not more than $12,000 pa.

3.5.4 The introduction of competition in this manner enables a monopoly operator to continue extracting monopoly rents in those areas where it is not subject to competition while pricing aggressively in those area where competition exists to disincentivise the existing and prospective providers with which it competes. It does not effectively promote competitive markets. In many of the areas in which ASX and Chi-X compete, ASX has lowered its fees significantly and these results could also be expected if competition was allowed in the areas where ASX currently enjoys a monopoly.

3.6 The Manner in which Competition has been Introduced in Australia – The ASX paradigm

3.6.1 There are many ways on which the regulation of financial market infrastructure in Australia is founded on an ASX paradigm that does not effectively promote competition and some are outlined below.

(a) An ASX Rule Book becomes an ASIC Rule Book

3.6.2 When competition was introduced into Australia, a deliberate decision was made to copy existing ASX rules into the ASIC rule book. This has resulted in ASX products having an initial advantage over some Chi-X products given that they were developed "hand in glove" with the regulatory requirements that participants had to meet when using those products. For example, a participant of Chi-X and ASX is not allowed to execute particular types of transactions when the market is in a particular state and ASX is currently the sole operator responsible for determining that state. Hence the ASX product has a head start over Chi-X products when it comes to providing validation of whether the participant is complying with the prohibitions on executing particular types of transactions during certain trading states. This advantage is further

[21] http://www.businessinsider.com.au/morgan-stanley-the-asx-will-keep-raising-fees-thanks-to-its-quasi-monopoly-status-2014-2

entrenched by the way in which ASX manages the data feed it provides to Chi-X and which conveys the market state and which has no transparent consistency, rigour or reliability.

(b) Chi-X hidden orders

3.6.3 Chi-X has encountered a regulatory reluctance to allow innovative alternate products intended to compete with legacy ASX products. For example, at its market launch Chi-X proposed offering a hidden mid-point order intended to compete with the ASX Centre Point hidden order product but was required by ASIC to impose a $20,000 minimum order value upon the Chi-X hidden orders, notwithstanding that the ASX hidden order product had no such minimum value. During the six month period during which Chi-X was required to impose this minimum value, it did not receive one valid order. Since the minimum value has been removed there have been no market events to indicate that the minimum value was justified. As outlined elsewhere in this submission, the Centre Point product remains one of the ASX's most successful equity market products.

3.7 The Manner in which Competition has been Introduced in Australia – ASX staffing and vertically integrated business model

3.7.1 ASX staff are engaged internally by a service company located within the ASX group and ASX claims that its vertical integration is a significant advantage of its business model[22]. Some of the business operations undertaken within the ASX Group are the providers of critically important services to Chi-X (eg clearing) and it is necessary to engage ASX persons at these businesses in respect of Chi-X product proposals. While Chi-X enjoys mutually respectful and productive relationships with ASX employees, the actual structure of the ASX is problematic in the way that ASX employees receiving confidential information on Chi-X product proposals may report and/or be engaged at a future time by the ASX business units with which Chi-X directly competes. The ASX model creates "no win" situations for those entities competing with the ASX but which also must rely on one or more of the many critically important business lines operated by ASX (eg ASX Clear). A competing entity must either work with:

(i) ASX Clear staff who will also work with the ASX entities with which Chi-X competes; or

(ii) ASX Clear staff who are Chinese walled in a way that will result in Chi-X not receiving the same standard of service as that provided to the ASX entities with which Chi-X competes.

## 4 Whether Current Competition Laws Promote Competitive markets (the key question in paragraph 5.3 of the Issues Paper)

4.1 The lack of clarity on how competition and sectoral regulation interacts

4.1.1 The way in which sectoral and competition regulation interacts is not clear and this is a significant way in which the current competition law does not promote effective markets. The development of sector specific policies to facilitate competition requires an expertise in both the sector being regulated and the regulation of competition. This required combination of expertise creates

[22] For example, Mr Funke Kupper has stated: "*As a fully integrated exchange group, ASX has a broad range of businesses and diversity in our revenues. This compensates, to some degree, for the absolute scale our market lacks compared to the US and Europe. Importantly, it is the difference that makes the difference – we derive scale from our business model and this makes us competitive*." see the address to the ASIC Annual Forum, retrieved on 12 June 2014 from http://www.asx.com.au/documents/investor-relations/ASIC_Annual_Forum_-_ASX_CEO_Speech_-_Text_and_Slides_FINAL.pdf .

special challenges in policy development, rule-making and the monitoring/enforcement of anti-competitive conduct. Chi-X is of the view that those challenges can most effectively be met if:

(i) statutory mandates require sectoral regulators (eg ASIC) to consider the facilitation of competition when developing policy, making rules or monitoring/enforcing the law; and/or

(ii) a statutory mandate for the competition regulator to be involved in and have input to the development of sectoral policies, in particular any significant framework regime.

4.1.2 Chi-X notes and commends ASIC for recently emphasising its willingness to incorporate the facilitation of competition into its regulatory charter and would commend the CPR to recommend a statutory mandate for ASIC in keeping with ASIC's recent comments that:

*"[A mandated] competition objective would require and enable ASIC to select the most 'competition-friendly' option from a range of potential regulatory responses, provided that this option was also capable of achieving ASIC's other regulatory objectives.*

*Having such an objective would also mean that ASIC would be better placed to engage with other securities regulators on international policy initiatives addressing competition issues in global financial markets[23].*

4.1.3 While ASIC's views in this regard are commendable, it is the view of Chi-X that the competition law also needs to clarify the way in which competition and sectoral regulation will interact to facilitate competition and enhance Australia as a place to do business. This is borne out by the fact that in drafting this submission, it was drawn to the attention of Chi-X that many of the matters raised were properly for the Financial System Inquiry. However, it has also been drawn to our attention that many of these issues are properly matters for the Competition Policy Review.

## 5 Whether the definitions of 'market' in the CCA operate effectively (key question from paragraph 5.6 of the Issues Paper)

5.1.1 Chi-X is conscious that the "market" for financial market infrastructure can be difficult to define: what products are substitutable and what is the field of activity? Chi-X is of the view that the answers to these questions should properly evolve to meet the demands of the different innovations that are a feature of financial market infrastructure. However, it is important that the difficulty in arriving at a definition should not allow the definition to be hijacked by those seeking to spruik a national champion competing in a global market. It is important for Australia that the definition of "market" for financial market infrastructure continues to factor in competition in Australia between providers wherever they may be based.

5.1.2 Chi-X is also conscious that financial market infrastructure is very much a global market. As stated elsewhere, if Australian regulatory settings are anti-competitive then offshore providers of financial market infrastructure stand to benefit.

5.1.3 This feature of financial markets serves to illustrate how a flexible regime that is able to respond to innovation and the challenging demands of facilitating competition, is an essential aspect of a fit for purpose regulatory framework.

[23] See paragraphs 62 and 63 of the ASIC Submission to the Financial System Inquiry, retrieved on 12 June 2014 from http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-submission-to-the-Financial-System-Inquiry-4-April-2014-1.pdf/$file/ASIC-submission-to-the-Financial-System-Inquiry-4-April-2014-1.pdf

## 6 The way in which misuse of market power should be dealt with under the CCA (the key question in paragraph 5.10 of the Issues Paper)

6.1.1 The importance of an effective regulatory regime for managing the misuse of market power is essential for an economy of Australia's nature, with its geographical isolation, small population and market capacity. It is essential that Australia has a vigilant and effective regime for monitoring and taking action in respect of the misuse of market power. The experience of Chi-X calls into question whether this is the case, particularly when Australia's competition laws are benchmarked against global standards.

6.1.2 Chi-X is of the view that there are areas where the existing regime can be improved to have an immediate impact on the areas in which Chi-X operates and they include the following.

6.2 An effects based test for section 46

6.2.1 Section 46 of the Competition and Consumer Act prohibits a company with substantial market power form taking advantage of that power for the purpose of (a) eliminating/substantially damaging a competitor; (b) preventing entry into a market or (c) competitive conduct. The current approach to enforcement of this provision requires a "smoking gun" email or something similar to prove that the purpose of the conduct was one of the prohibited outcomes. This is well known as a difficult outcome to achieve and one which significantly favours the dominant company. It is not what applies in Europe or the United States. In circumstances where competition provides the significant advantages outlined in section 2 of this submission, it is not clear why Australia should adopt a legislative approach that, relative to other leading jurisdictions, favours a dominant company at the expense of protecting and facilitating competition. The US and Europe have effects based tests for market abuse provisions in their competition law because they work to facilitate competition and the benefits competition provides to end users.

6.3 A flexible cease and desist power

6.3.1 Chi-X is of the view that greater flexibility should be provided to regulators in respect of the monitoring and taking action to quickly halt serious anti-competitive behaviour. The nature of a dominant market player is that it is able to price products at a level that inflict serious and immediate damage upon smaller competitors and that the time taken to investigate the activity can threaten the existence of the entities the investigation is seeking to protect.

6.4 Protecting Competition and Protecting Firms

6.4.1 Chi-X is of the view that there is an unhelpful rigidly academic approach in Australia to "protecting competition not firms". The nature of Australia is that in many markets there are only a limited number of competing firms and to rigidly apply a rule disregarding the damage to the only firm in a position to compete with a dominant corporation, is too conservative and risks damaging competition.

6.5 Adopting European approaches to impose a Special Responsibility upon a Dominant Entity.

6.5.1 Chi-X is of the view that, given the importance of competition as highlighted in section 2 above, it is appropriate for Australia to incorporate a special responsibility obligation into the law. It is accepted in Europe competition law that "[a dominant corporation] *has a special responsibility not*

*to allow its conduct to impair genuine undistorted competition on the common market"* (ECJ, 9th November 1983, Michelin[24]). That is, the company in dominant position has to allow a sufficient degree of competition so that other competitors can highlight their merits in terms of consumer well-being according to parameters of prices, quality, diversity and innovation.

## 7 The experience of Chi-X with respect to the Code of Conduct on the clearing and settlement of ASX listed securities (the key question in paragraph 5.42 of the Issues Paper)

7.1.1 In February 2013, the Treasurer put in place a two year moratorium on competition in the clearing of ASX listed cash equities, acting on the advice of the Council of Financial Regulators (CFR). The CFR stated in its report to the Treasurer that during the moratorium "a Code [of Conduct] is considered necessary to deal with the issues raised by stakeholders that competition might have been expected to address"[25]. Clearing is an essential aspect of financial market infrastructure and is subject to competition in many jurisdictions globally.

7.1.2 Chi-X is concerned that there may be a view that the ASX's current Code of Conduct provides a viable alternative to competition when the following is strong evidence that it does not:

(i) the ASX Clear business operates to a reported EBITDA margin of 76% that is consistent with a monopoly business[26];

(ii) there is no alternate market operator representation on the board of the ASX Clear business (compare the representation on the boards of the LCH and Canadian CDS, which respectively include a director representing Nasdaq OMX and Chi-X respectively);

(iii) the pricing of ASX Clear services are comparable to other monopoly operators operating without a Code and well in excess of the rates where competition in clearing exists;

(iv) the price benchmarking that has been undertaken by the ASX of its clearing services is not independent;

(v) Chi-X and other market places receive access to and services from ASX Clear and ASX Settlement that is significantly different to that provided to the ASX businesses with which Chi-X competes;

(vi) many critical ASX Clear functions (eg IT and Operations) are staffed by persons taken from a single pool of employees (see section 3.7 above).

7.1.3 Chi-X is concerned that unless substantive governance changes are made to the operation of the Code it will in operate as a self-serving mechanism for the ASX entities that it covers.

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[24] Retrieved on 12 June 2014 from http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61981CJ0322

[25] See the Council of Financial Regulator's letter to the Treasurer of 18 December 2012, retrieved on 12 June 2014 from http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2013/Council%20of%20Financial%20Regulators%20advice%20on%20competition/Downloads/Letter%20-%20CFR%20to%20DPM.ashx

[26] See slide 17 of the ASX's Full Year 2013 Result Presentation, retrieved on 12 June 2014 from http://www.asx.com.au/documents/investor-relations/ASX_Ltd_Full-Year_Result_Analyst_Presentation_2013.pdf

## 8 CONCLUSIONS

8.1.1 The facilitation of competition is an essential consideration in the development, implementation and application of industry policies and regulation that are crucial to the economic welfare of all Australians. Australia's financial services generally, and market infrastructure specifically, are subject to unwarranted regulatory impediments to competition, not only in those areas where there are regulatory prohibitions and barriers to entry but also those areas where competition has been allowed.

8.1.2 There is a need for genuine reform of the way competition is integrated into the regulatory framework of Australia's financial markets and the way in which dominant market entities are regulated.

8.1.3 Australia's financial markets perform well in meeting the needs of end users, but it is likely that they will have to continue to punch significantly above their weight simply to retain their relative position globally. Chi-X is of the view that in these circumstances it is imperative to introduce reforms that meaningfully incorporate the facilitation of genuine competition into the regulatory landscape if we are to continue to enhance Australia as a place to do business.