

December 2, 2011

Review of Financial Market Infrastructure Regulation
The Treasury
Langton Crescent
PARKES ACT 2600

**Attention: Manager, Financial Markets Unit
Corporations and Capital Markets Division**

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Dear Sir/Madam,

Reference – Review of Financial Market Infrastructure Regulation

We refer to the Council of Financial Regulators (“CFR”) recent Consultation Paper on the Review of Financial Market Regulation (“Consultation Paper”) and thank you for this opportunity to provide comment. Please find the following submission from the NSX Group (“NSX”), which includes both the SIM Venture Securities Exchange the National Stock Exchange of Australia – the holders of two Australian Market Licences (“AML”) to operate Securities Exchanges trading company issued securities, debt securities and miscellaneous investment scheme securities.

This submission is available for public release.

Contents

Reference – Review of Financial Market Infrastructure Regulation	1
Summary of NSX Position	3
Response to questions 1 to 3 Comments on the location requirements proposal	3
Response to question 6 Power to direct the making of listing rules	4
Response to question 7 Extending power of directions to directors	5
Response to question 8 Applying sanctions against related bodies corporate	5
Response to question 11 Power to appoint a statutory manager	6
Response to question 17 Classification of systemically important FMI's	6
Conclusion and Close	7
Further Information	7

Summary of NSX Position

The NSX supports any efforts that are aimed at enhancing the integrity, robustness and resilience of Australia's financial markets.

However, the NSX has significant concerns about the policy direction described within this Consultation Paper, as the NSX has the view that the implementation of several of the proposals will increase the systemic risk and undermine the role of ASIC as a neutral regulator.

NSX prefers that an appropriate approach by Government would be to implement rules and standards that foster competition and innovation so that no market operator is too big to fail because there are numerous other suppliers ready and capable of offering alternative services. This allows the natural function of western economies to occur, where competition is encouraged. It ensures efficiency, that innovation is common and rapidly delivered, and that those with the best services at the right prices flourish and those that offer substandard, overpriced or undemanded services don't and should not.

In our submission we have sought to address those questions that impact on our current operations, future aspirations and where we believe we have valuable comments to provide.

Response to questions 1 to 3 Comments on the location requirements proposal

NSX is concerned that the discretionary nature of the location requirement will make it difficult for potential new entrants to develop their business case, as the inherent uncertainty created by such a discretionary power will mean cost structures will be difficult, if not impossible, to determine.

Financial services also tend to have a high fixed cost structure with unlimited capacity constraints. As such, it is the ability to use existing infrastructure to service new markets, customers and increased trading volumes that can improve efficiencies, time to market and drive innovation.

Limiting a provider, by requiring the establishment of local infrastructure, will simply result in fewer providers, especially of key services, which will mean less innovation and competition in the Australian market.

It is the submission of the NSX that localisation requirements, whilst aiming to reduce systemic risk, will in fact have the exact reverse impact because the Best of Breed international suppliers will not offer their services in Australia. NSX has already experienced this hesitation in its efforts to utilise international best of breed suppliers due to the government's stance on international operations.

Reduced international competition has and will continue to reduce the pressure for local suppliers to innovate and improve services. These location proposals risk Australia losing the ability to leverage off the best of breed suppliers of international skills, systems and technology that are designed and located overseas which are either unable or not cost effective to relocate or reproduce just in Australia.

Under these proposals Australia will suffer against its more innovative and internationally welcoming competitors throughout Asia and beyond. It will continue to encourage a monopolistic structure that is already too big to fail and will threaten the very market integrity the Rules were designed to prevent in the first place.

Response to question 6 Power to direct the making of listing rules

The proposal to give ASIC the explicit power to direct a licensed market operator to make listing rules with specific content is the proposal that gives NSX extreme concern. It is the submission of the NSX that the current system is in fact working well and provides the right balance between protecting market integrity and enabling product differentiation that fosters competition and innovation between market operators.

The NSX is not only concerned that the proposal is unnecessary but will inevitably lead down a path of “Rules Harmonisation”, not just of Listing Rules (for Issuers), but also ASIC Market Integrity (for Brokers) and Business Rules (for Brokers). The downside of Rules Harmonisation is an assumption that “one size fits all” and the assumption that current ASX Rules are best used as the basis for other AML holders. NSX submits, one size does not fit all and ASX Rules are not appropriate to the full universe of companies that wish to raise capital and be listed on markets operated by NSX. NSX is seeking to offer a differentiated service that is tailored to a growing sector of the Australian economy.

Rules Harmonisation will also stop innovation and product development by Market Operators such as the development of “trading windows” by NSX. It stops competition and the benefits that competition brings to customers. NSX submits that innovation does not equate with increased risk but can actually help to mitigate risk for investors.

There is also an implicit assumption, within the paper, that the ASX is the ideal business model to follow. The assumption does not recognise that ASX is a for-profit business and is no longer a mutual society, operating for the benefit of its members (who were stockbrokers). As a dominant monopolistic like business, ASX has a commercial incentive to push for rules and the harmonisation of those rules that benefit its business model at the detriment of its competitors. By using its monopolistic power a dominant Market Operator would be able to raise barriers to entry by successfully lobbying for regulation change to its advantage.

NSX believes that the current system of submission of rule changes, current powers that ASIC already has at its disposal and the Ministerial approval process, although cumbersome and slow at times, is both effective and provides a suitable balance between the business aspirations of a Market Operator and the Regulators need for market integrity. Operating Rules have to be approved as part of the Australian Market License application process and any changes proposed by an AML holder to its Operating Rules must be acceptable to ASIC, in order to avoid a disallowance direction by the Minister.

From a practical perspective this means that any AML holder seeking changes to their Operating Rules will need to engage in extensive discussions with ASIC, including justification of why the rule changes are desirable and evaluation of the consequences of those rule changes on the operation of the market concerned and its impact on market integrity.

With the overriding legal obligation to ensure an efficient, transparent and orderly market underlying the whole concept of the Australian Market License system, NSX would find it inconceivable for an AML holder to seek to change its Operating Rules if those changes raise concerns with ASIC. Furthermore, we also think it is inconceivable for an AML holder to resist changes that ASIC wishes the AML to apply to the Operating Rules. NSX’s experience in this area is that ASIC has sufficient power pursuant to the Corporations Act to delay acceptance of quotation of financial products by an AML holder. If the AML holder cannot satisfy ASIC concerns then the AML holder’s business suffers. The AML holder has strong incentives to work with ASIC on Operating Rule changes.

To provide ASIC with increased powers to not only approve rule changes but to create and apply new rules removes the well-designed process whereby the creation and review of rules is separate. By providing rule change capabilities to ASIC the natural independent checking of changes is removed. The diversification of an AML holder’s business is stifled because innovation and competition become restrictive.

In addition, the present system has a further powerful mechanism that will drive an AML holder to ensure that its Operating Rules are compatible with the objectives of ensuring an efficient, transparent and orderly market and a high level of market integrity. ASIC is required by the Act to review and report on the operation of a Market Operator. The annual assessment and subsequent report to the Minister, enables ASIC to make recommendations to the Minister, including the ability to impose conditions on the AML Holder. Outside of this process ASIC has the ability to suspend the operation of a class of financial products to preserve market integrity.

NSX would argue that for the purposes of enhancement and/or protection of market integrity the existing process ensures that the Minister has the power to be able to impose conditions on any AML Holder to ensure Market integrity is protected without the introduction of new powers that have the risk of increasing rule uncertainty including Operating Rule harmonisation.

As a final point, if the driver for ASIC is really to control the impact of an overseas operator owning an AML, then any change should be applied to AML holders that are owed by overseas operators. The current system has proved to work for existing operators and any changes risks upsetting a proven system that works.

Response to question 7 Extending power of directions to directors

Whilst in principal NSX supports the concept that ASIC should be able to extend the power of directions to directors and officers, NSX is concerned that this power will leave directors potentially in an irreconcilable conflict between the obligation to satisfy the regulator's direction and their general duties as a director of the relevant company under the Corporations Act.

NSX notes that it is proposed to provide legislative protection for directors and managers who comply with directions that may, without such protection, conflict with other obligations placed upon those officers.

NSX submits that the proposal acknowledges that directors and officers will require legislative protection is evidence that the proposal is unsound and that it introduces a moral hazard. Directors will be operating under the knowledge that should a situation become uncontrolled ASIC will step in and Directors will receive the benefits of the legislative protection.

The legislative protection will also mean that directors will be protected against claims by parties who suffer loss, but for the legislative protection would have been able to pursue a claims against directors. Any potential reduction in rights by aggrieved parties should be carefully considered.

NSX submits that the current situation where directors of the AML Holder carry the obligations remains the preferred position.

Response to question 8 Applying sanctions against related bodies corporate

As a general position the NSX does not support the notion that sanctions should be applied against related bodies corporate.

NSX is of the view that where a FMI is reliant on an outsourced service provider, which is a related body corporate, the provision of these ongoing provisions should be an element of the conditions of operating the FMI. The situation could best be dealt with by virtue of contract law rather than creating a system whereby ASIC can look through the veil of incorporation and have powers that can be imposed on the management and board of directors of separate legal entities.

Response to question 11 Power to appoint a statutory manager

NSX is of the view that the existing system of licensing and conditions of the license provides the Minister with the necessary powers. The proposal that an external administrator would be appointed introduces a new moral hazard and potentially transfers the obligation (or at least the public perception) from the directors of the FMI to ASIC.

By creating the situation where the Minister can appoint a statutory manager to prevent market failure, by implication, the responsibility to prevent a market failure shifts from the directors of the AML holder to ASIC as regulator, because the regulator can prevent market failure by imposing a statutory manager.

The current license conditions place an obligation on the AML holder to ensure that it has all the necessary resources in place to operate a fair, transparent and orderly market. Failure to do so places the license at risk and the Minister is able to place conditions on the AML holder to rectify any breaches.

The key asset and hence value of an AML holder is its license, as it is the license that enables it to operate its business. The obligation is therefore presently on the directors of the AML holder to protect that asset. Suspending a license or placing additional conditions is a more effective method of control over the operations of an AML Holder than placing the Minister or ASIC in the position of having to step in and have the management of the AML holder replaced.

Response to question 17 Classification of systemically important FMI's

The introduction of criteria of systemically important FMI's and the concept of “too big to fail” creates a distortion in the economy and competitive markets, as they will enable the pursuit of higher risk strategies in the expectation and knowledge that any cost of failure will be guaranteed by the Government. NSX wishes to draw the attention to the Treasury concerning the issues that had to be contended with by financial service providers that were not a party to the Government guarantees on bank deposits.

The declaration will also tend to entrench the business position of the existing dominant incumbent as customers and investors focus on the knowledge that the dominant incumbent will be the only party protected by Government guarantees.

A more appropriate approach would be to implement rules and standards that foster competition and innovation so that no market operator is too big to fail because there are numerous other suppliers ready and capable of offering alternative services. This allows the natural function of western economies to occur, where competition is encouraged. It ensures efficiency, that innovation is common and rapidly delivered, and that those with the best services at the right prices flourish and those that offer substandard, overpriced or undemanded services don't and should not.

NSX is concerned that the concepts behind the Consultation Paper are aimed at protecting the Australian Financial Markets from failure of the ASX or its business units. This failure could be either due to systematic failure or changes following a takeover of the ASX by a foreign entity.

NSX submits that both these risks can be adequately dealt with under the current regime and system of licensing and conditions attached to licences. Further, that the regulators and regulation should try to foster innovation and competition as the best method of preserving market integrity. This removes the too big to fail monopoly type model from the equation rather than promoting it further under the proposals of the consultation paper.

If there is a view that the current system is cumbersome and would experience difficulties in reacting to a major issue in a timely fashion, then the procedures and legislative power should be reviewed and if necessary amended.

The proposals in the discussion paper go well beyond what is necessary and create a new moral hazard by transferring the burden from the AML to ASIC and ultimately the Minister. The obligation to maintain a fair, orderly and transparent market should at all times rest with the directors of the AML holder. Is it the role of ASIC and the Minister to determine the minimum standards necessary for the health and wellbeing of the Australian capital markets, or is it for ASIC and the Minister to step in and determine what the AML holder is required to do to satisfy that hurdle rate?

NSX submits the role of ASIC and the Government is to set the hurdle rate and it is the role directors to ensure that the hurdle rate has been satisfied.

Conclusion and Close

Thank you again for the opportunity to make comment on this important public policy issue.

NSX wholly supports the Government's intentions to ensure the integrity and resilience of the Australian Financial Services sector, but believes that the proposals within this Consultation Paper do not satisfy this overarching policy objective of improving market integrity in the financial services, and would represent a massive step backwards for competition and innovation.

NSX acknowledges that the current regulatory regime may require modification and updating to reflect the new environment. NSX believes that a review of the regulatory framework governing both financial markets, and clearing and settlement facilities is justified, and would welcome the opportunity to contribute to this process.

Further Information

If you require any further clarification on this submission, please contact Mr Michael Cox on 02 4921 2420 or email at michael.cox@nsxa.com.au.

Yours sincerely,



Michael Cox
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