APX SUBMISSION TO FINANCIAL SYSTEM INQUIRY IN RESPONSE TO THE INTERIM REPORT

August 2014

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1. INTRODUCTION

1.1 Overview

APX welcomes the opportunity to add its voice to the Murray enquiry into the Australian financial system. The 2014 timing of the FSI (the "Inquiry") is particularly apt, given the 1997 Wallis report was pre-GFC. The global landscape has changed dramatically post-GFC, and new entrants have entered the Australian equity capital market space to foster greater competition and flexibility within the financial system.

APX has met with executives assisting the FSI and this submission supplements those discussions.

1.2 Asia Pacific Stock Exchange Limited

APX is an Australian licensed listing market operator having held a market licence since 2004. APX re-commenced operating its equities market in March 2014. APX is wholly owned by the AIMS Financial Group[1]. APX is 100% Australian owned.

APX provides opportunities for growth oriented companies to raise the capital they need for expansion from a diversified range of domestic and international investors, especially from within the Asia-Pacific region. APX is an exporter of Australian financial services IP.

We believe significant capital market development opportunities exist in relation to capital flows between Australia and China. Key market segments upon which APX is focussed are:

- Chinese - based companies seeking capital, market opportunities, or listing in Australia;
- Australian - based companies seeking capital or market opportunities in China; and
- Niche markets for Australian and international companies which are not presently well serviced in the Australian market.

Owing to its strong links with China, APX sees itself as the natural Australian stock exchange for RMB denominated trading in securities in line with Australia's move to create an international RMB hub. APX is planning to introduce dual trading and settlement capabilities in both AUD and RMB for its equities market.

APX provides new competition for the provision of listing and trading services. To develop as a vibrant capital market, Australia needs competition for listing services and it needs competition for clearing and settlement services.

APX has a rare chance to be innovative, and to fundamentally redefine the interactions between, and understanding of, both Australian and Chinese financial markets. We are offering a competitive and innovative alternative to the likes of Australia's ASX and China's Shanghai and Shenzhen stock exchanges. But to promote

[1] www.aims.com.au

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innovation in capital markets, these markets need government and ASIC support. As APX progresses its rethinking of how markets can work in the future, we need others to step out of the mindset of "how it has always been done", in order to embrace "how can it be done". The FSI provides an ideal opportunity to bring this new thinking and attitude to the financial sector.

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2. SUBMISSIONS REGARDING SECTION 1

2.1 Principles for government intervention

APX agrees that there is little need to radically reform the way in which the Government intervenes in or regulates the financial system, but there is scope for refinement.

The Inquiry has suggested some general principles of government intervention to guide the actions of the Government and regulators and that Government and regulators should have regard to those general principles when regulating or considering regulation. Those general principles are set out in Table 1.1 of the Interim Report.

APX agrees with the general principles proposed by the Inquiry. However, having regard to the stated role of Government to remove impediments to the market working more efficiently[2] and to the importance of market forces and competition[3], APX submits that an additional general principle addressing 'timeliness' is required.

In an increasingly competitive national and international environment, speed to market is essential. In sectors of the market in which regulatory approvals are a necessary element of product development, change and competitive positioning, timeliness of regulatory response can be a critical determinant of competitive and commercial viability or success, both nationally and internationally. The circumstances of delays experienced by Chi-X and AXE ECN[4] are examples which are not unfamiliar to those experienced by APX.

Similarly, where regulators are taking enforcement (or similar) actions, those actions should be timely so as to achieve maximum regulatory impact and minimal cost and uncertainty to the regulated community.

In this regard, we submit that a Principle of 'Timeliness' would be to the effect that "The actions of Regulators should be timely. In achieving their objectives Regulators should have clear performance objectives to respond to both industry initiatives and to give effect to regulatory and enforcement responses. Regulators should be held accountable for their timeliness."

2.2 Post-GFC regulatory response

2.2.1 Consumer outcomes and conduct regulation

APX agrees that there should be greater emphasis given to behavioural economics[5], not only in the approach adopted to consumer outcomes and conduct regulation, but in many aspects of markets policy development generally. We submit that equity market behaviour is not assessable or manageable solely on the basis of theories of rational economics and assumptions that consumer behaviours are rational. A substantial component of equity markets dynamics is based upon both emotional and rational behaviours.

[2] Page 1-5 of the FSI Interim Report.
[3] Page 1-6 of the FSI Interim Report.
[4] Page 2-34 of the FSI Interim Report.
[5] Page 1-20 of the FSI Interim Report.

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The arguments relating to short selling and margin lending are a prime example. From a rational economics perspective, short selling is a rational and legitimate investment strategy. However, from an emotional perspective, many investors perceive short selling (borrowing stock to sell in the hope of buying later to make a profit) as an unfair and manipulative strategy. Yet, in a market in which investors may be long or short cash or long or short stock, investors have no such worries in relation to margin lending which, in effect, is "short buying" (borrowing cash to buy in the hope of selling later to make a profit). Both short selling and short buying are rational markets strategies, but with different behavioural responses.

We submit that greater emphasis should be given to behavioural economics in the development of markets and financial systems policy.

2.2.2 Consumer disclosure

In relation to consumer disclosure, we agree that the current disclosure regime does not produce an optimal outcome. The current disclosure regime was based upon a rationalist argument that investors would read and absorb information set out in a prospectus or product disclosure statement and, in doing so, inform themselves in order to make a rational decision. However, in reality it may be that very few investors read and absorb information set out in a prospectus or product disclosure statement, rather they rely on the advice of either professional advisers, media or peers. We believe this is a result of the complexity and size of such documents. We further submit that the complexity and size is a consequence of the defensive approach to information preparation arising from the liability attaching to the range of parties who have input to the preparation and development of such information/documents. The documents, therefore, are significantly drafted for the protection of the preparer rather than for information purposes. We submit that a comprehensive review of the purpose, design and liability for information set out in a prospectus or product disclosure statement is timely before the next economic upturn.

We also submit that one area which may be considered for immediate improvement would be to introduce the concept of an ASIC 'Reader' for the purposes of prospectus disclosure relating to listed 'financial products'. ASIC is somewhat of an outlier compared to international practice, as it acts formally as the mechanism where a prospectus can be 'filed', rather than 'reviewed'. Other securities regulators (such as the UKLA) actively 'review' such a prospectus, and prescribe (in much greater detail than provided in the Corporations Act or Regulatory Guide 56) what the UKLA requires to be disclosed in a prospectus. Providing certainty (not just guidelines) as to what is required in a prospectus would be a significant improvement to the listed sector, with expected resultant benefits flowing to the wider industry. This would allow ASIC (and market-operators in general) to manage risk more effectively. A change of this nature would also align with the observations regarding greater internationalisation and the concept of a dedicated 'Market Supervision' regulator (discussed below).

2.2.3 Financial advice

In relation to financial advice, we note that there is currently no register of advisers[6]. We submit that the removal of such a register was a major failing of the previous CLERP reforms. We fully support the re-introduction of a

[6] Page 1-21 of the FSI Interim Report.

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comprehensive register of advisers. As submitted by the Stockbrokers Association of Australia[7], we support the introduction of a well-developed obligation and system for reference checking to prevent "bad apples" moving around the industry supported by a publicly accessible register of qualifications, complaints and misconduct. Ideally, such a system would be based upon US style processes (with suitable domestic adaptation) and include legal protections for employers acting in good faith, as without such protections a system will not function effectively. Such a system requires both a compulsion to make enquiries as part of the recruitment process and to report qualifications, complaints and misconduct as well as protection for employers for reporting complaints and misconduct.

[7] *http://fsi.gov.au/files/2014/04/Stockbrokers_Association_of_Australia.pdf*, page 11

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3. SUBMISSIONS REGARDING SECTION 2

3.1 Financial markets

The FSI Interim Report sets out that there is currently a Government moratorium on competition in clearing trades in Australian cash equities[8]. We note that the Government moratorium applies only to ASX quoted cash equities. The Government moratorium does not extend to APX quoted cash equities.

However, the absence of competition currently results in the APX market not having access to a central counterparty clearer (CCP) as LCH is not licensed to clear APX quoted cash equities and ASX does not have the facilities to provide clearing services to a listing market other than its own[9]. Hence, APX is effectively "locked out" of the use of a CCP. The ability of ASX to control which competing listing market operators have equal access to a CCP represents a significant barrier to entry of new equities market operators.

3.2 Financial market licensing

In relation to licensing of financial market operators, we agree strongly with Treasury's observations that the current legislative system has not adapted to market developments, that it is producing a piecemeal approach to regulation and that it is too inflexible to regulate all financial markets appropriately[10]. We agree with the observation that "the piecemeal approach is reflected in the time taken to assess licence applications". We disagree that future market entrants will benefit from regulatory adjustments as APX found no benefit at all (either from ASIC or ASX) as a consequence of the experiences of Chi-X or AXE ECN.

We acknowledge that Treasury is currently undertaking a review of the market licencing framework and we look forward to the outcome of that review. APX has engaged with Treasury in that regard. We submit that the review should extend to considering the listing function as a licence category in addition to the existing categories of trading, clearing and settlement. But we also submit that addressing the market licencing framework is only half the issue. The equally significant issue which also needs to be addressed is the market licencing process. For example, the financial obligations contained in new financial market operator licences have not been established as result of broad market consultation nor have they been set out as ASIC policy in a Regulatory Guide. They do not apply to existing market operators. Whilst APX fully understands the desire for financial stability of market operators, the current financial obligations act as a significant disincentive and barrier to investment and growth in those new markets. Hence, the "piecemeal" and, at times, contradictory approach and processes adopted by ASIC serve as much as a barrier to competition as the challenges presented by existing incumbent market operators. In this regard, APX agrees with the Chi-X submission[11] that "policy development at ASIC can take place in opaque processes not subject to a transparent ex ante cost benefit analysis that is part of the consultation process" and "the same person(s) at ASIC can be responsible for making key decisions on the policy development, drafting, implementation, supervision and enforcement of key financial service initiatives – in effect

[8] Page 2-34 of FSI Interim Report.

[9] Chi-X is not a listing market.

[10] Page 2-34 of FSI Interim Report.

[11] http://fsi.gov.au/files/2014/04/Chi-X_Australia.pdf

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ASIC is the lawmaker, policeman, prosecutor, judge, jury and executioner". This is one of the reasons that APX supports the adoption of a new specialised market supervisor referred to elsewhere in the Interim Report[12].

We note in its submission that ASIC has stated that "it has worked over many years to ensure that the ASX Listing Rules reflect the requirements that we think are important to maintaining market integrity"[13]. Yet we note that the standards adopted across listing markets in areas that ASIC thinks are important to maintaining market integrity can vary considerably between ASX and APX (which are very similar in these key areas as noted by ASIC[14]) and NSX and SIM VSE. APX does not necessarily object to being held to high standards within key aspects of the listing rules for specific market segments. In fact, in key aspects of the rules for specific market segments we support this, as it assists with the APX market positioning which is ultimately exported offshore as part of the APX brand. But we are concerned that not all market operators are held to this same requirement for equivalent market segments and, as a corollary, an apparent failure to recognise that different market segments require different listing requirements to meet their specific needs (ie, a one size fits all approach).

This represents a complex and vexing policy issue which must be addressed. On the one hand Government and markets want competition based on differentiated product (ie, listing requirements) and on the other hand ASIC works towards removing that differentiation by requiring the adoption of uniform standards across listing markets. This approach could leave market operators open to legal challenge and potentially anti-competitive outcomes. Yet ASIC has permitted NSX to adopt quite different standards in the same areas. Again, this could be interpreted as being representative of the "piecemeal" approach to regulation.

ASIC quite rightly points out that there is "some scope for market operators to design their own listing requirements"[15]. We strongly believe there should be scope for market operators to design their own listing requirements. This is a basis for competition. Whilst ASIC has promoted consistency across listing markets, feedback APX has received from the market is that there is a desire to do things differently and better – to not be consistent with existing practices which the market believes can be done better. This appears, however, to be contrary to ASIC's position that there is a "need for greater consistency in the listing requirements that apply across these markets". The market wants evolution and development in this regard. The market wants listing requirements which are adaptable to specific sectors of the market, which then better meet the needs of the market.

Whilst we agree that there is scope for deterioration in the listing standards if they are not properly enforced and overseen by ASIC, contrary to ASIC's concern, APX is seeking to raise the standards in many areas in order to promote competition and leverage off the strong international reputation of Australia's financial system. To do otherwise is not in the long-term commercial interests of a market operator, or the wider market in general.

The process of setting operating rule requirements requires review. ASIC correctly points to Canada as an example of where the regulator has more power to approve amendments to existing listing rules. But Canada has also adopted greater flexibility in its processes. We submit that the process can be improved, without resulting in

[12] Page 3-127 of the FSI Interim Report.
[13] http://fsi.gov.au/files/2014/04/ASIC.pdf page 125
[14] http://fsi.gov.au/files/2014/04/ASIC.pdf page 126
[15] http://fsi.gov.au/files/2014/04/ASIC.pdf page 126

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deterioration in the listing standards, by adopting a model similar to that of Canada. That is, there is specific recognition that minor and administrative changes can be "fast tracked" to market thereby reducing the resources required to be committed by ASIC to reviewing such changes. Similarly, there is specific recognition that "substantive" changes require public consultation and publication by the market operator of responses to the consultation prior to changes being submitted to the Minister for disallowance. This public consultation and publication of responses would go some way towards reducing any ASIC perceived risk of deterioration in the listing standards.

We agree that the emergence of multiple listing market operators could conceivably result in investor uncertainty. It is not too long ago (prior to the formation of ASX in 1987) that Australia had in excess of 12 different competing listing markets, being the State exchanges and their second boards. In that regard, given the size of the Australian market, it is probably appropriate that there are no more than 4 listing market operators.

Notwithstanding all the above, the key issue in facilitating competition in listing markets is the risk tolerance of the government and, more particularly, ASIC. Markets are about transference of risk. Markets will evolve. Without competition and the inherent acceptance of risk, Australian markets will stagnate, both nationally and internationally. We submit that, rather than seeking to homogenise listing markets, more work needs to be done on how to better promote competition. There should be a clear understanding both within ASIC, and the market, of the risk tolerance of ASIC and Government in relation to innovation. We suggest that consideration be given to the Ministerial Statement of Expectations[16] more clearly setting out the Government's risk tolerance towards innovation.

3.2.1 Competition in financial market infrastructure

We note that submissions from Chi-X and LCH.Clearnet support introducing competition for clearing ASX-quoted securities[17]. APX similarly supports introducing competition for clearing securities traded on any licenced Australian market.

We note that Chi-X has suggested that a regulator, either ASIC or the ACCC, be given specific legislative responsibility for maintaining and supervising competition in Australia's FMI[18]. We submit that this is implicit in the objectives of ASIC as set out in section 1(2)(a) of the Australian Securities and Investments Commission Act 2001. That is, to "maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy". We agree that it would be beneficial to include a reference to competition in ASIC's broad mandate to the effect of either "maintain, facilitate and improve the performance and competitiveness of the financial system and the entities within that system".

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16 Statement Of Expectations — Australian Securities And Investments Commission, http://www.treasury.gov.au/~/media/Treasury/Policy%20Topics/Public%20Policy%20and%20Government/Statements%20of%20Expectations/Downloads/PDF/ASIC_Statement_of_expectations.ashx

17 Page 2-36 of the FSI Interim Report.

18 Page 2-36 of the FSI Interim Report.

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3.3 The corporate bond market

The Interim Report sets out a number of policy options to improve access for retail investors to the corporate bond market[19]. APX submits that the following combination of options be considered:

- To allow listed entities (that are already admitted to an official list, and therefore subject to comprehensive continuous disclosure obligations) to issue 'vanilla bonds' directly to retail investors without the need for a prospectus. In circumstances whereby a special purpose vehicle (SPV) is utilised as the bond issuer where the SPV is wholly owned by the listed entity and the listed entity is the guarantor of the SPV, the SPV should be permitted to utilise an "abbreviated" prospectus;

- To allow listed entities that are going to be admitted to an official list, and therefore to be subject to comprehensive continuous disclosure obligations, to issue 'vanilla bonds' directly to retail investors by way of the same prospectus utilised for the purposes of the equity capital raising. This would also extend to a special purpose vehicle (SPV) utilized as the bond issuer where the SPV is wholly owned by the listed entity and the listed entity is the guarantor of the SPV; and

- To allow listed entities to issue 'vanilla bonds' without a prospectus to up to 25 people in any 12 months period up to a value of $5 million on the condition that the 'vanilla bonds' not be quoted on a licensed market.

We submit that information memorandums should not be used for issues to retail investors (other than for the offer of tranches within a programme where that programme was initiated by way of a prospectus). Either an offer should require a prospectus or it should not.

In order to further develop the corporate bond market, APX has raised the prospect of creating distinct bond issuance and disclosure guidance with ASIC. Most developed markets globally have such guidance and Australia needs to improve in this area (by providing positive guidance for listed entities in relation to their disclosure obligations).

We also submit that consideration should be given to bringing forward Government incentives towards development of a sharia bond-market (Sukuk Market). Australia is falling significantly behind in relation to the development of this growing international market. In this regard, we note that the UK recently completed a Sovereign sharia issue. APX is considering the implementation of a sharia-market across all its financial product lines.

Government support (particularly in relation to the taxation treatment of sukuk (sharia compliant bonds)) would allow Australia to compete on an even basis with other jurisdictions. APX encourages the Government to further consider this. As sukuk are generally based on multiple transfers of assets into and out of an SPV, they fall foul of capital gains tax and state stamp duty (as well as income tax laws relating to infrastructure funding). The Australian treatment in this regard is not just behind those jurisdictions that are heavily 'sharia compliant' focused

[19] Page 2-90 of the FSI Interim Report.

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(such as the Middle East and Malaysia), but also behind other leading jurisdictions (such as the UK, Germany, Hong Kong and Japan). We note that Australia's Board of Taxation recommended the removal of such tax barriers in 2011, but the Government has yet to respond.

We acknowledge that there are arguments that potential listed entities don't need to wait for tax reform, and that required outcomes may be met by individual rulings from the Australian Taxation Office for these structures. However, APX is of the view that formalised Government taxation arrangements would remove uncertainty and cost thereby allowing Australia to more appropriately compete internationally. APX notes, for example, that Victoria has amended its stamp duty rules to remove barriers to Islamic finance.

3.4 Equity markets

We note that the Inquiry has sought feedback on whether there is a need to introduce differentiated markets to allow greater access to equity markets by smaller companies[20].

APX fully supports a differentiated markets approach as a mechanism for both greater competition between listing markets and to thereby provide greater access to suitably structured markets for, not just smaller companies, but specific sectors of the economy. To achieve this requires a more competition focused and adequately resourced regulator to allow and understand differentiated markets. On the contrary, as submitted elsewhere, to continue to require that all markets adopt rules that mirror those of the incumbent ASX listing market clearly reduces competition and innovation substantially.

APX submits that market mechanisms should be allowed to develop which facilitate an equity raising "growth pathway" for small and mid-cap companies which allows them to progress to a "full listing" status in due course. Innovation and differentiated markets can provide such a pathway.

A barrier to such development is the ownership and control of the clearing and settlement infrastructure by ASX. The CHESS system is so tightly entrenched in all aspects of the settlement and registration processes and the broker infrastructure systems that any change to accommodate differentiated markets or differentiated capital raising mechanisms which are not consistent with those adopted by ASX is prohibitive. It is also not in the best interests of ASX. The evolution of differentiated markets would be best served by separation of the settlement and registration systems from ASX.

[20] Page 2-94 of the FSI Interim Report.

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4. SUBMISSIONS REGARDING SECTION 3

4.1 Financial advice

We note that the Inquiry has invited views on the introduction of an enhanced public register of financial advisers (including employee advisers) which includes a record of each adviser's credentials and current status in the industry, managed by either Government or industry[21].

As stated above, we submit that the removal of such a register was a major failing of the previous CLERP reforms. We fully support the re-introduction of a comprehensive register of advisers and, as submitted by the Stockbrokers Association of Australia[22] and ASIC, the introduction of a well-developed obligation and system for reference checking to prevent "bad apples" moving around the industry supported by a publicly accessible register of credentials, complaints and misconduct. Ideally, such a system would be based upon US style processes (with suitable domestic adaptation) and included legal protections for employers acting in good faith, as without such protections a system will not function effectively. To be effective, such a register and reference checking framework requires BOTH an obligation to register advisers and report their misconduct and protection for doing so.

We also submit that ASIC should have the power to ban individuals from managing or controlling a financial services business.

4.2 Compensation arrangements

The Inquiry has invited views on compensation arrangements[23]. Whilst the Inquiry has not particularly addressed the issue of Part 7.5 compensation arrangements for financial markets, we submit that there is considerable scope for review and efficiency in this area.

At present, clients of participants trading on the ASX market are covered by the National Guarantee Fund (NGF) under Part 7.5 Division 4 of the Corporations Act. Clients of participants trading on the Chi-X, APX, NSX and SIM VSE markets are covered by four different compensation arrangements under Part 7.5 Division 3 of the Corporations Act. Yet, many of the participants in these markets trade in one or more of them. However, the compensation arrangements are all different, offering different levels of protection to investors.

We submit that, in the interests of enhanced consumer protection, participants in all markets of a similar character to that of ASX (that is, equities markets) and regulated under similar MIRs to ASX should be covered by the NGF under Part 7.5 Division 4 of the Corporations Act. We also submit that in such circumstances the SEGC, as administrator of the NGF, should be independent of ASX.

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[21] Page 3-69 of the FSI Interim Report.

[22] *http://fsi.gov.au/files/2014/04/Stockbrokers_Association_of_Australia.pdf*, page 11

[23] Page 3-85 of the FSI Interim Report.

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We also submit that, as the primary responsibility for supervising many of the activities of the industry which may give rise to claims on Part 7.5 schemes has moved from market operators to ASIC (for example, the Corporations Act and Market Integrity Rules relating to the handling of client money and property) the law should be amended to allow for greater provision of information by ASIC to the administrators of Part 7.5 schemes to allow them to better assess the risks to which those compensation arrangements may be exposed. At present, the administrators of Part 7.5 schemes have an obligation to assess the adequacy of the schemes without access to key information which may be in the possession of ASIC.

4.3 Regulatory burden

The Inquiry has invited views on aspects of regulatory burden. In particular, the Inquiry has asked whether there are regulatory outcomes which can be improved, without adding to the complexity or volume of existing rules[24]. There are a number of aspects of regulation applicable to listed entities which are similar in both the Corporations Act and the listing rules of market operators such as APX. For example,

- the APX and ASX listing rules both include rules relating to transactions involving related parties. Similar obligations apply in Chapter 2E of the Corporations Act. In effect, a listed company must comply with both sets of obligations. History would show that the intent of the introduction of Chapter 2E was to replace the obligations in the listing rules. However, owing to drafting deficiencies and inflexibility in the practical application of Chapter 2E, the relevant listing rules were retained to address the concerns of industry. Ideally, Chapter 2E should be reviewed and redrafted in a manner which facilitates the removal of the relevant listing rules, thereby reducing burden on industry.
- the Corporations Act contains the majority of provisions relating to off-market buy-backs whereas the listing rules contain the majority of provisions relating to on-market buy-backs. History would show that this was a consequence of the inability of legislators to develop appropriate on-market buy-back obligations, thereby leaving the development and implementation to the exchanges. Ideally, as the on-market buy-back provisions have existed in the listing rules in stable format for many years, the legislated buy-back provisions should be reviewed and redrafted in a manner which facilitates the removal of the relevant listing rules.
- the Corporations Act contains certain provisions relating to the disclosure of the holdings of directors of listed companies. Owing to drafting deficiencies and inflexibility in the practical application of those provisions relevant listing rules were developed to address the deficiencies and concerns of industry. Ideally, as the director's disclosure provisions have existed in the listing rules in stable format for many years, the legislated director's disclosure provisions should be reviewed and redrafted in a manner which facilitates the removal of the relevant listing rules, thereby reducing burden on industry.

In these limited circumstances in which legislators have endeavoured to establish obligations in the Corporations Act but have not fully achieved the objective, by including these provisions in legislation it would reduce ASIC's concerns in relation to a potential deterioration in listing standards and be consistent with ASIC's concept of certain listing principles or standards being prescribed by legislation[25]. The reason we suggest that this approach

[24] Page 3-97 of the FSI Interim Report.

[25] http://fsi.gov.au/files/2014/04/ASIC.pdf page 126

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be adopted in these limited circumstances is that if too many obligations are established in legislation it reduces the scope for competition and innovation between listing market operators.

The same concern, exists in relation to the Market Integrity Rules (MIRs). There are circumstances in which legislators have endeavoured to establish obligations upon market participants in the Act but have not fully achieved the objective. As a consequence, operating rules were developed to address the deficiencies and concerns of industry. Those operating rules have now migrated into the MIRs. A number of those MIRs now replicate provisions of the Corporations Act. There is scope to review the MIRs to reduce that regulatory overlap. At the same time, there is a desire by ASIC to harmonise all the various MIRs into a single set of MIRs. Whilst this would be an admirable objective, we caution that harmonising everything could reduce the scope for competition and innovation between trading market operators.

The Inquiry has also asked whether there are circumstances in which the costs of regulation affecting the financial system outweigh the benefits[26].

APX submits that the barriers to mutual recognition and equivalence are such a circumstance. As set out elsewhere, the absence of such capability denies non-Australian entities cost effective access to Australian markets. In doing so, because of the "mutual" nature of such arrangements, Australian entities are denied cost effective access to overseas markets. The opportunity cost of this overly-defensive approach by Australia outweighs the benefits which could be obtained by enabling access to overseas markets. Despite this, we are not promoting a wholesale reduction in Australian standards, but that a realistic and risk-based review be conducted to facilitate greater internationalisation. Similarly, if Australia wants to export financial services and compete overseas, it will increasingly need to allow foreign access to Australian markets.

4.4 Independence and accountability

4.4.1 ASIC

APX fully supports the need for a well-funded ASIC with budgetary certainty. A well-funded and robust ASIC is essential to ongoing confidence in the Australian financial system. However, APX is not convinced that a fully industry funded model is an appropriate model. Based upon the industry funded experience relating to markets supervision in which the funding model has been described as analogous to a "transaction tax" and has had a direct impact upon market behaviour, we are sceptical in relation to the development of an appropriate model. Further, an industry funded model should not serve to dissuade new entrants from entering the markets, as to do so would be detrimental to the markets.

In the event that a more industry funded model is adopted, it should be introduced over a period of time such that over that extended period government funding gradually decreases as industry funding gradually increases. The process of industry funding and the use of those funds must be transparent. A conceivable challenge which may arise from a more industry funded model is the question of accountability. Whilst ASIC will remain accountable to government, there will be an increasing focus on expenditure accountability to those parties who provide the funding (ie industry). This dual accountability will raise new tensions to be considered.

[26] Page 3-97 of the FSI Interim Report.

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In the event that a more industry funded model is adopted, APX submits it should be based upon a rolling 3 year business plan and budget presented by ASIC to Government.

APX is also supportive of the appointment of independent, non-executive Commissioners to ASIC.

4.5 Mandate Execution

4.5.1 Balancing Objectives - Competition

The Inquiry has invited views on alternatives in relation to ASIC's mandate[27].

The Interim Report raises the question of the inclusion of reference to competition in ASIC's mandate[28]. As set out above, we submit that this is implicit in the objectives of ASIC as set out in section 1(2)(a) of the Australian Securities and Investments Commission Act 2001. That is, to "maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy".

ASIC's mandate should include reference to supporting or improving competition, but should not include reference to "promoting" competition. At the very least it should be required to not inhibit competition.

We agree that it would be beneficial to include a reference to competition in ASIC's broad mandate as set out in this section to the effect of either "maintain, facilitate and improve the performance and competitiveness of the financial system and the entities within that system".

4.5.2 Breadth of mandate: ASIC

The Interim Report raises the option of splitting market supervisory activities into a specialised market supervisor[29]. Whilst we note that the Inquiry generally opposes creating new regulatory bodies, we support such an initiative.

As set out above, we agree strongly with the Treasury observation that the current legislative system has not adapted to market developments, that it is producing a piecemeal approach to regulation and that it is too inflexible to regulate all financial markets appropriately[30]. We submit that whilst the current legislative system may be partially accountable for this outcome, the culture within ASIC is equally accountable. In order to change the culture a new start is required.

We caution, however, against the adoption of a new body responsible for solely for listings, similar to the UK Listing Authority. Our experience is that whilst the regulator in the UK was happy to take on the role of listing authority, industry has not been satisfied with the role of the UKLA. Not only does it reduce the scope for

[27] Page 3-120 of the FSI Interim Report.
[28] Page 3-122 of the FSI Interim Report.
[29] Page 3-124 of the FSI Interim Report.
[30] Page 2-34 of the FSI Interim Report.

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competition between listing markets, it runs the significant risk of becoming slow, entrenched and removed from engagement with the market. We believe the listing approval function best remains with the market operators.

4.5.3 Enforcement powers: ASIC

The Inquiry has invited views on enforcement[31].

ASIC has set out the comparison between Australia and other jurisdictions in a number of aspects, as referred to in the Interim Report[32]. However, there are other inconsistencies which should be addressed between the Corporations Act and the Market Integrity Rules. For example, ASIC has set out that the penalty under the Act for market manipulation is $200,000. However, the penalty under the MIRs for market manipulation is $1,000,000. This could invite an enforcement arbitrage situation in which ASIC pursues an action under the MIRs with a lower burden of proof and a higher penalty rather than pursuing an action under the Act. We acknowledge that the $1,000,000 penalty was "inherited' as part of the transfer of supervision from ASX to ASIC, but we submit that penalties under the differing regimes administered by ASIC should be reviewed and harmonised.

4.5.4 Talent management

The Inquiry has identified that to be able to perform their roles effectively regulators need to be able to attract and retain suitably skilled and experienced staff[33].

APX supports the proposal by the Inquiry to review the mechanisms to attract and retain staff. Consideration of the 'actual' cost of appropriate regulation needs to be applied, and it should be done in consideration of the separate functional mandates currently undertaken by ASIC.

APX notes that some European regulators, such as the Dutch AFM, require general movements of their staff in and out over a rolling 4-5 year period. Managing loss of 'corporate know-how' would be important, but it would restrict 'institutionalisation' of staff and foster innovation of thinking within the regulator. It also promotes free movement of qualified staff between industry and the regulator and helps both parties better understand and address the concerns and motivations of the other.

Linked to the discussion on 'competition' existing within ASIC's mandate, having a regulator that is required to consider competition (or actually support innovation – like the FCA's 'Project Innovate' to support start-ups) would assist in attracting better candidates from industry.

In this regard, we believe removing ASIC from the Public Service Act 1999 in a similar fashion to APRA and RBA would be beneficial.

[31] Page 3-124 of the FSI Interim Report.
[32] Page 3-125 of the FSI Interim Report
[33] Page 3-126 of the FSI Interim Report

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5. SUBMISSIONS REGARDING SECTION 4

5.1 Cross-border regulatory settings

5.1.1 Regulatory recognition arrangements

We note that the Inquiry has invited views on domestic regulatory process to have regard to foreign regulatory developments impacting Australia[34]. The Inquiry has identified that domestic regulatory processes could be improved to better consider international standards and foreign regulation, including processes for collaboration and consultation about international standard implementation, and mutual recognition and equivalence assessment processes.

APX submits that, in fact, Australia is significantly behind international moves in relation to mutual recognition and equivalence. Australia needs to understand that it has to give a little, to gain a little. Our experience is that Australia's approach to recognition or equivalence is generally perceived as Australia expecting international regulators to allow Australian standards or processes, but Australia wishing to maintain its own standards without recognising comparable overseas standards. Australian regulators need to recognise that "mutual" is the key component of the mutual recognition concept.

Australia is a long way behind moves towards capital market mutual recognition and equivalence internationally, especially in Europe. Convergence and equivalence are vital to encouraging and growing technical development and capital movement. Only recently, APX has entered into discussions with an overseas regulator (that regulates securities markets to the highest international standards) in order for APX listed companies to use an Australian prospectus in that jurisdiction (on an equivalence basis) but their perception was that Australia had little appetite for mutual recognition or equivalence.

We submit that Australia could learn by examining the access models adopted in Dubai whereby prospectuses from approved jurisdictions are broadly acceptable and foreign brokers are entitled to participate in local markets but remain subject to home jurisdiction regulatory oversight. In this fashion, Dubai has provided a channel to access the European markets.

An emerging equivalent in our region is the development of the ASEAN Trading Link[35] to develop an integrated ASEAN capital market. The ASEAN Trading Link is a gateway to the full range of investment opportunities provided by the ASEAN Exchanges. It provides a single entry-point to three of the largest stock markets of the ASEAN Exchanges collaboration – Bursa Malaysia, Singapore Exchange and Stock Exchange of Thailand. Jointly these three markets offer nearly 2,200 listed companies with a market capitalisation of USD1.4 trillion. Together, they account for some 70% of the total market capitalisation of ASEAN. Brokers of participating exchanges can now seamlessly trade shares on other participating markets. Investors can now buy and sell shares across the ASEAN region through their broker as easily as they would on their home-country stock

[34] Page 4-98 of the FSI Interim Report

[35] www.aseanexchanges.org

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exchange. These three markets serve as the foundation of the ASEAN Trading Link and Vietnam, the Philippines and Indonesia are expected to join in the near future.

In other regional developments to facilitate internationalisation and cross border capital flows, on 1 April 2013 the securities regulators in Malaysia, Singapore and Thailand have implemented the ASEAN Disclosure Standards Scheme (Scheme) for multi-jurisdiction offerings of equity and plain debt securities in ASEAN. The Scheme aims to facilitate fund raising activities as well as to enhance the investment opportunities within ASEAN capital markets. Issuers offering equity and plain debt securities in multiple jurisdictions within ASEAN will only need to comply with one single set of disclosure standards for prospectuses, known as the ASEAN Disclosure Standards, bringing about greater efficiency and cost savings to issuers[36].

In November 2013 The Singapore Exchange announced that it would create a framework in cooperation with China Securities Regulatory Commission to allow Chinese companies to directly list on the Exchange[37]. Chinese companies have been allowed to list in Singapore before, but they had to be incorporated outside mainland China. Currently, Chinese companies listing on APX have to be similarly be incorporated outside mainland China.

More recently, on 26 August 2014 the Monetary Authority of Singapore (MAS), SC Malaysia, and, SEC Thailand launched the ASEAN CIS Framework to facilitate cross-border offers of CIS to retail investors[38].

Equivalence and mutual recognition in listing standards, prospectus, broker recognition and exchange regulation are going to be vital steps needing to be taken if Australia wishes to develop its international competitiveness.

We believe that Australia can, and should, be the financial hub for the Asian region. Australia's strengths lie in its stable and open political system; its strong and well regulated financial system; its breadth of investment opportunity; its financial sophistication and innovation; and its liveability. Working closely with our Asian trading partners to find new and better ways of integrating with Asian economies, especially through mechanisms of mutual recognition and equivalence is essential to the future of the Australian economy. As the Interim Report sets out, as China continues to free up capital controls, a significant proportion of the resultant increase in both portfolio and direct investment flows are likely to be within this region[39]. Further, by 2030, ASEAN is projected to be the equivalent of the fourth largest economy[40] which puts the importance of international integration into developments such as the ASEAN Trading Link and ASEAN Disclosure Standards Scheme into perspective.

Owing to its strong links with China, APX is ideally positioned to develop the equity market capital flows between Australia and Asia, particularly China. We are working towards bridging the gap between Australia and China. APX has a rare chance to be innovative, and to fundamentally redefine the interactions between, and understanding of, both Australian and Chinese financial markets. APX parent company, AIMS, has actively introduced a number of international investors into the Australian markets and to date has also attracted over A$1.0 billion of investments into Australia from overseas investors. To continue to develop the markets between

[36] http://www.theacmf.org/ACMF/upload/asean_standards_1_apr_2013.pdf
[37] http://blogs.wsj.com/moneybeat/2013/11/27/singapore-to-allow-mainland-chinese-listings/
[38] http://www.theacmf.org/ACMF/webcontent.php?content_id=00067
[39] Page 4-78 of the FSI Interim Report
[40] Page 4-79 of the FSI Interim Report

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Australia and Asia, particularly China, requires ongoing support to integrate Australia into Asian capital flows and attract equity investment into Australia, the removal or reduction (to the same level as interest withholding tax) of dividend withholding tax for foreign investors, greater regulatory co-operation between Australian regulators and their Chinese counterparts; and enhanced currency flow (both wholesale and retail) between Australia and China.

APX agrees with the Inquiry that increased government to government dialogue is required in the region and that industry integration efforts continue to require Government support[41]. We would support the proposition that a senior Treasury Minister be given explicit responsibility to champion Australia's financial services[42] nationally and internationally and to co-ordinate and champion change to enhance Australia's international competitiveness.

[41] Page 4-85 of the FSI Interim Report

[42] Page 4-99 of the FSI Interim Report

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