

ASIC MARKET INTEGRITY RULES (ASX MARKET) AMENDMENT 2012 (NO. 1) EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

Corporations Act 2001

The Australian Securities and Investments Commission (**ASIC**) makes the *ASIC Market Integrity Rules (ASX Market) Amendment 2012 (No. 1)* (the **Instrument**) under subsection 798G(1) of the *Corporations Act 2001* (the **Act**).

1. Enabling legislation

Subsection 798G(1) of the Act provides that ASIC may, by legislative instrument, make rules that deal with the following:

- (a) the activities or conduct of licensed markets;
- (b) the activities or conduct of persons in relation to licensed markets;
- (c) the activities or conduct of persons in relation to financial products traded on licensed markets.

The *ASIC Market Integrity Rules (ASX Market) 2010 (Rules)* were made under subsection 798G(1) of the Act on 1 August 2010. The Rules deal with the activities or conduct of the licensed market operated by ASX Limited (the **ASX Market**).

2. Background

Under Part 7.2A of the Act, ASIC has the function of supervising financial markets the operators of which are licensed under subsection 795B(1) of the Act. ASIC performs this function by, among other things:

- (a) supervising trading activities through market surveillance; and
- (b) supervising conduct of business by participants of those markets.

As part of its responsibility of supervising trading activities, ASIC ensures the integrity of the Australian market by deterring, detecting and disrupting market misconduct—namely, insider trading and market manipulation. This is achieved through both monitoring orders and trades in the market in real time, and analysing orders and trades in the market on a post-trade basis.

Possible market misconduct matters are currently identified from a number of sources:

- (a) a computerised trade surveillance system that alerts ASIC to certain activity, internally developed market monitoring tools, and data feeds from a variety of sources; and

- (b) receive intelligence or referrals from the public, regulated entities (including market operators), and other government organisations including the Australian Transaction Reports and Analysis Centre (*AUSTRAC*).

Under the Rules, participants (*ASX Market Participants*) of the ASX Market, also have responsibilities to assist in ensuring the integrity of the market. These include:

- (a) to ensure that their activities do not result in a market not being both fair and orderly market (Rule 5.9.1);
- (b) to consider the circumstances of an order to prevent the submission of orders that create, or are likely to create, a false or misleading appearance of active trading (Rules 5.7.1 and 5.7.2); and
- (c) to ensure that the systems they use for automated order processing do not interfere with the efficiency and integrity of the market (Rule 5.6.1).

ASX Market Participants that are Australian financial services licensees have additional obligations under section 912A of the Act to, among other things:

- (a) comply with the financial services laws, including the laws prohibiting market misconduct
- (b) take reasonable steps to ensure that its representatives comply with the financial services laws.

3. Purpose of the legislative instrument

The purpose of the Instrument is to amend the *ASIC Market Integrity Rules (ASX Market) 2010* to impose obligations on an ASX Market Participant to notify ASIC where the ASX Market Participant has reasonable grounds to suspect that a matter (“Reportable Matter”) referred to in paragraph (a) or (b) of Rule 5.11.1(1) has arisen (referred to as “Suspicious Activity Reporting”). The purpose of these amendments is to enhance ASIC’s market surveillance capability by providing a further source of intelligence in respect of possible cases of market misconduct and in particular misconduct known in the market as insider trading, front-running or market manipulation. The purpose of the instrument is described in more detail in the Regulation Impact Statement attached to this Explanatory Statement.

Details of the Instrument are contained in [Attachment A](#).

4. Consultation

ASIC has consulted on its proposal to introduce Suspicious Activity Reporting through:

- (a) ASIC Consultation Paper 145 *Australian equity market structure: Proposals* (CP 145), released on 4 November 2010, canvassed at Proposal II the issue of suspicious activity

reporting and proposed for consultation draft market integrity rules to impose a suspicious activity reporting requirement on market participants;

- (b) Discussions with domestic and international market operators, market participants and industry associations, buy-side, sell-side, retail groups, high-frequency traders, research houses, data or technology providers and regulators in the United States, Canada, United Kingdom and Germany to better understand market and technology developments and ways to improve market supervision, held prior to releasing CP 145;
- (c) Discussions with the industry advisory group to the ASIC, made up of representatives from market participants that service both retail and institutional clients, investment management businesses, and the legal profession, on ASIC's intentions to introduce a suspicious activity reporting requirement, since early 2010;
- (d) Active engagement with AUSTRAC throughout the policy development process;
- (e) Meetings with 14 market participants, the Australian Financial Markets Association (AFMA), and the Stockbrokers Association of Australia (SAA), since CP 145 was released.

5. Penalties

Subsection 798G(1) of the Act provides that market integrity rules are legislative instruments for the purposes of the *Legislative Instruments Act 2003*.

Subsection 798G(2) of the Act provides that market integrity rules may include a penalty amount for a rule. A penalty amount must not exceed \$1,000,000. The penalty amount set out below a Rule is the penalty amount for that Rule.

6. Commencement of the Instrument

The Instrument will commence on the day after it is registered under the *Legislative Instruments Act 2003*.

7. Statement of Compatibility with Human Rights

A Statement of Compatibility of Human Rights is included in this Explanatory Statement at [Attachment B](#).

8. Regulation Impact Statement

A Regulation Impact Statement is attached to this Explanatory Statement.

ATTACHMENT A

Paragraph 1 – Enabling Legislation

This paragraph provides that the Instrument is made under subsection 798G(1) of the *Corporations Act 2001*.

Paragraph 2 – Title

This paragraph provides that the title of the Instrument is the *ASIC Market Integrity Rules (ASX Market) Amendment 2012 (No. 1)*.

Paragraph 3 – Commencement

This paragraph provides that the Instrument commences on the day after the instrument is registered under the *Legislative Instruments Act 2003*.

Paragraph 4 – Amendments

This paragraph provides that Schedule 1 amends the *ASIC Market Integrity Rules (ASX Market) 2010*.

Schedule - Amendments

Item [1] – After Part 5.10

Item [1] of Schedule 1 to the Instrument inserts a new Part 5.11 into the Rules.

Suspicious Activity Reporting obligation

Rule 5.11.1(1) is the core Suspicious Activity Reporting obligation. Rule 5.11.1(1) provides that, subject to Rules 5.11.1(2) and (3), if an ASX Market Participant has reasonable grounds to suspect that:

- (a) a person (“the Insider”) has placed an order into or entered into a transaction on the Market in relation to a financial product while in possession of inside information (within the meaning of section 1042A of the Act), whether or not the ASX Market Participant is aware of:
 - (i) the identity of the Insider; or
 - (ii) all of the details of the order or transaction; or
- (b) a transaction or an order transmitted to a Trading Platform has or is likely to have the effect of:
 - (i) creating an artificial price for trading in financial products on the Market;

- (ii) maintaining at a level that is artificial (whether or not it was previously artificial) a price for trading in financial products on the Market;
- (iii) creating, or causing the creation of, a false or misleading appearance of active trading in financial products on the Market; or
- (iv) creating, or causing the creation of, a false or misleading appearance with respect to the market for, or the price for trading in, financial products on the Market,

whether or not the ASX Market Participant is aware of:

- (v) the intention of any party to the transaction or order; or
- (vi) all of the details of the transaction or order,

the ASX Market Participant must, as soon as practicable, notify ASIC in writing of the details of the transaction or order (to the extent known to the ASX Market Participant) and the reasons it suspects the matter set out in paragraphs (a) and/or (b).

Rule 5.11.1(1) requires an ASX Market Participant to notify ASIC in writing as soon as practicable of details of the transaction or order and the reasons for suspecting the matters set out in subparagraph (a) or (b). The matters set out in subparagraphs (a) and (b) ("Reportable Matters") may indicate market misconduct of a kind known in the market as 'insider trading', 'front running' and 'market manipulation'.

Dual reporting

Rule 5.11.1(2) provides that an ASX Market Participant is not required to notify ASIC under Rule 5.11.1(1) if the ASX Market Participant has reported the information that would otherwise be required to be contained in the notification to ASIC under Rule 5.11.1(1) to the Australian Transaction Reports and Analysis Centre ('AUSTRAC') under section 41 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* or under section 16 of the *Financial Transaction Reports Act 1988* ('AML Reporting Legislation').

An ASX Market Participant may have an obligation under AML Reporting Legislation to submit a suspicious matter report ('SMR') to AUSTRAC in certain circumstances. Many of these circumstances may also give rise to reasonable grounds to suspect that there is a Reportable Matter that must be notified to ASIC under Rule 5.11.1(1). ASIC has access to SMRs lodged with AUSTRAC. To avoid double-reporting, Rule 5.11.1(2) provides that, where an ASX Market Participant has reported information to AUSTRAC under AML Reporting Legislation, it is not required to notify ASIC of the same information under Rule 5.11.1(1).

Confidentiality

Rule 5.11.2 provides that an ASX Market Participant who notifies ASIC under Rule 5.11.1(1) must not disclose that the notification was made, or the information contained in the notification,

to any person other than for the purposes of seeking legal advice or as required by law. This Rule does not preclude an ASX Market Participant from communicating that it has obligations under Rule 5.11.1, generally, or from communicating to a client or trader that it has concerns about the conduct of that person, which may constitute an offence under the law or which may expose the ASX Market Participant to risk.

Commencement

Rule 5.11.1(3) provides that an ASX Market Participant is not required to comply with subrule 5.11.1(1) until 1 November 2012. This date will be extended to 20 January 2013 by an ASIC waiver. This will give ASX Market Participants time to implement any new systems they require to comply with the Rule.

ATTACHMENT B

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

ASIC Market Integrity Rules (ASX Market) Amendment 2012 (No. 1)

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

The Legislative Instrument amends the *ASIC Market Integrity Rules (ASX Market) 2010* to impose obligations on an ASX Market Participant to notify ASIC where the ASX Market Participant has reasonable grounds to suspect that a matter (“Reportable Matter”) referred to in paragraph Rule 5.11.1(1)(a) or (b) has arisen (referred to as “Suspicious Activity Reporting”). The purpose of these amendments is to enhance ASIC’s market surveillance capability by providing a further source of intelligence in respect of possible cases of market misconduct and in particular misconduct known in the market as insider trading, front-running or market manipulation. These amendments will bring ASIC further into line with international regulatory practice particularly in the UK, US, Germany and Canada.

Human rights implications

The Legislative Instrument engages the right to privacy and reputation in Article 17 of the International Covenant on Civil and Political Rights (“Article 17”). Article 17 prohibits unlawful or arbitrary interferences with a person's privacy, family, home (which the UN Human Rights Committee has interpreted as including a person’s workplace) and correspondence. It also prohibits unlawful attacks on a person’s reputation. It provides that persons have the right to the protection of the law against such interference or attacks. The UN Human Rights Committee has not defined ‘privacy’. The Commonwealth Attorney-General’s Department has provided guidance that privacy should be understood to comprise freedom from unwarranted and unreasonable intrusion into activities that society recognises as falling into the individual sphere of autonomy. To avoid being considered arbitrary, any interference with privacy must be in accordance with the provisions, aims and objectives of the ICCPR and should be reasonable in the particular circumstances.¹

A Suspicious Activity Report may contain ‘personal information’ as defined in the *Privacy Act 1988*, being information or an opinion (including information or an opinion forming part of a database), whether true or not, and whether recorded in a material form or not, about an

¹ Australian Government Attorney-General’s Department : *Privacy and Reputation*
<http://www.ag.gov.au/Humanrightsandantidiscrimination/Humanrightsandthepublicsector/Humanrightsguidancesheets/Pages/Privacyandreputation.aspx>

individual whose identity is apparent, or can reasonably be ascertained, from the information or opinion.

The right in Article 17 is engaged by the Legislative Instrument by reason that it:

- (a) involves the collection, storage, security, use or disclosure of personal information;
- (b) creates confidentiality or secrecy provisions relating to personal information; and
- (c) provides for mandatory disclosure or reporting of information.

The Legislative Instrument is compatible with the rights recognised in Article 17 of the ICCPR by reason that any interference with a person's privacy or reputation resulting from compliance with the Suspicious Activity Reporting rule will be lawful and not arbitrary. In particular:

- (a) The Suspicious Activity Reporting rule is made in accordance with ASIC's power to make market integrity rules dealing with the activities or conduct of persons in relation to licensed markets and in relation to financial products traded on licensed markets (see subsection 798G(1) of the Act).
- (b) The Suspicious Activity Reporting rule will assist ASIC to perform its function of supervising financial markets, the operators of which are licensed under subsection 795B(1) of the Act (see section 798F of the Act). Supervision of the financial markets must include more than mere observation – it extends to detection and deterrence of misconduct.
- (c) The Suspicious Activity Reporting rule will further the objects of Chapter 7 of the Act, including promoting fair, orderly and transparent markets for financial products (see paragraph 760A(c) of the Act). A fair, orderly and transparent market is one in which market misconduct is minimised. Detection and deterrence of market misconduct contribute to minimising that misconduct, and the Suspicious Activity Reporting rule will assist ASIC in detecting and deterring that misconduct.
- (d) The Suspicious Activity Reporting rule is subject to a number of safeguards, including:
 - (i) The obligation to notify ASIC under the rule is limited to matters that may indicate a person is engaging in, or may have engaged in, market misconduct of a kind known in the market as insider trading, front-running or market manipulation. Before notifying ASIC under the rule, the ASX Market Participant must have "reasonable grounds to suspect" (i.e. facts that would support the truth of the assertion) that a Reportable Matter has arisen;
 - (ii) Information provided to ASIC under the rule will be protected in accordance with ASIC's legislative obligations under s127 of the *Australian Securities and Investments Commission Act 2001*, and to, the extent the information is personal information, under the *Privacy Act 1988*; and

- (iii) ASX Market Participants will be required to maintain the confidentiality of the notification and the information contained in it in accordance with Rule 5.11.2.

If the Legislative Instrument was considered to limit the right in Article 17 of the ICCPR, ASIC considers that the Legislative Instrument is nevertheless compatible with that right. The right in Article 17 is not absolute. As noted, the right has implied limitations ('unlawful' and 'arbitrary') and may be subject to a permissible limitation where that limitation aims to achieve a legitimate objective, there is a rational connection between the limitation and the objective and the limitation is reasonable, necessary and proportionate. Any limitation imposed on the right by the Legislative Instrument has a clear legal basis, in that it:

- (a) *Aims to achieve a legitimate objective.* The rule will assist ASIC to perform its function of supervising financial markets under Part 7.2A of the Act, and to further the statutory objects of Chapter 7 of the Act by promoting fair, orderly and transparent markets for all investors and participants.
- (b) *Has a rational connection with the objective* – By ensuring that suspicious activity is notified to ASIC, the rule will enhance ASIC's ability to detect, pursue and deter misconduct which may have an impact on the fairness, orderliness and transparency of Australia's markets.
- (c) *Is reasonable, necessary and proportionate* – The rule is necessary to achieve the legitimate objective described above because it provides ASIC with a significant additional source of market intelligence, recognised in overseas jurisdictions as imperative to market integrity. The rule contains adequate safeguards by requiring an ASX Market Participant to have reasonable grounds to suspect a matter before a Suspicious Activity Reporting notification is made, and by requiring an ASX Market Participant to maintain the confidentiality of any such notification. Further safeguards are provided by ASIC's statutory obligations to protect confidential and personal information contained in the notification.