

ASIC MARKET INTEGRITY RULES (ASX MARKET) AMENDMENT 2013 (NO. 2) 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 2013 (No. 2)* (the **Instrument**) under subsection 798G(1) of the *Corporations Act 2001* (the **Corporations Act**).

1. Enabling legislation

Subsection 798G(1) of the Corporations 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* (**the ASIC Market Integrity Rules (ASX)**) were made under subsection 798G(1) of the Corporations Act on 1 August 2010. The ASIC Market Integrity Rules (ASX) deal with the activities or conduct of the licensed market operated by ASX Limited (the **ASX Market**). Capitalised terms in this Explanatory Statement refer to defined terms in the ASIC Market Integrity Rules (ASX).

2. Purpose of the legislative instrument

Since the ASIC Market Integrity Rules (ASX) were adapted by ASIC into market integrity rules from the ASX Operating Rules on 1 August 2010, there have been market structure developments including growth in automation and innovation in electronic trading in domestic markets. This has included many Market Participants establishing and operating ‘Crossing Systems’ which are automated services that match or execute client orders otherwise than on a lit market order book with orders of: the participant, other clients or any other person whose orders may access the crossing system.

The purpose of the Instrument is to amend the ASIC Market Integrity Rules (ASX) to address regulatory issues resulting from these recent market developments, including:

- (a) an ambiguity in Rule 3.2.4 with respect to a Market Participant’s ability to charge a Retail Client brokerage, commission or any other fee in respect of a Market Transaction when one of its Related Bodies Corporate enters into a transaction with the Client;
- (b) a lack of disclosure by Market Participants to wholesale clients of the execution venue of

a transaction, and when the Market Participant traded as Principal;

- (c) potentially unfair interposing of a Market Participant's Orders between Orders of its clients that could otherwise have Crossed;
- (d) the efficiency and robustness of a Market Participant's Crossing System; and
- (e) manipulative trading practices that may be effected using trading algorithms.

In response to these regulatory issues, the Instrument introduces the following amendments to the ASIC Market Integrity Rules (ASX):

- (a) an amended rule to clarify that a Market Participant cannot charge a Retail Client brokerage, commission or any other fee in respect of a Market Transaction when trading as Principal;
- (b) new rules for the operation of Crossing Systems to reflect their more 'market like' nature, particularly to ensure their robustness and efficiency in relation to how these systems interact with a Market Participant's Automated Order Processing System and the lit markets;
- (c) new rules requiring disclosure to clients (other than Retail Clients) to ensure that they are made aware of where their Orders are being executed (in the form of disclosure of execution venue), and when a Market Participant has executed their Order on their own account (as Principal);
- (d) enhanced rules about the fairness of dealing with client orders; and
- (e) enhanced rules to address manipulative trading practices that may be effected through trading algorithms.

Details of the Instrument are contained in **Attachment A**.

These amendments are required for ASIC to continue to effectively carry out its responsibility for market supervision in the context of a changing market environment.

3. Consultation

ASIC has consulted on the amendments effected by the Instrument. We have taken the results of the consultation process into account in preparing this Instrument, in which we have aimed to strike an appropriate balance between:

- (a) maintaining and facilitating fair and efficient markets;
- (b) promoting confident and informed investors and financial consumers; and

- (c) facilitating activity in the financial services industry, including not unreasonably burdening financial services providers and facilitating the international competitiveness of the Australian financial services industry.

Our consultation process included:

- (a) *Consultation Paper 202: Dark liquidity and high-frequency trading: Proposals (CP 202)* was released in March 2013 and proposed market integrity rules for the ASIC Market Integrity Rules (ASX). Submissions to CP 202 were received from: market operators, market participants including Market Participants that operate a Crossing System, high-frequency traders, fund managers and retail investors. In addition we received submissions from various associations including Australian Financial Markets Association (AFMA), the Financial Services Council (FSC), the Stockbrokers Association of Australia (SAA), and the Australian Shareholders' Association (ASA) (25 written submissions all together).

We received some substantive comments on the proposals in CP 202 particularly relating to the following areas specific to the ASX Market:

- ensuring Market Participants preference client orders over principal orders at the same price;
- minimum resting times for small orders; and
- removal of 'materiality' from the market manipulation rules.

Based upon these comments, we have not proceeded to make rules in these areas at this stage. Submissions were generally receptive to the remainder of ASIC's proposals in CP 202 that we have proceeded with in relation to the ASX Market.

- (b) We also held meetings with industry stakeholders and information sessions for members of the AFMA, FSC and the SAA.

4. Penalties

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

Subsection 798G(2) of the Corporations 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.

5. Commencement of the Instrument

The Instrument will commence in accordance with the Commencement information in the Instrument as follows:

- (a) Items [1], [7] to [10] of Schedule 1 to the Instrument; the day after the day on which this instrument is registered under the *Legislative Instruments Act 2003*;
- (b) Items [2] and [3] of Schedule 1 to the Instrument, the day after the end of the period of 3 months beginning on the day on which this instrument is registered under the *Legislative Instruments Act 2003*;
- (c) Items [5] and [6] and [11] to [13] of Schedule 1 to the Instrument, the day after the end of the period of 6 months beginning on the day on which this instrument is registered under the *Legislative Instruments Act 2003*;
- (d) Item [4] of Schedule 1 to the Instrument, the day after the end of the period of 9 months beginning on the day on which this instrument is registered under the *Legislative Instruments Act 2003*;
- (e) Items [1] to [3] of Schedule 2 to the Instrument, the day after the day on which this instrument is registered under the *Legislative Instruments Act 2003*.

6. Statement of Compatibility with Human Rights

A Statement of Compatibility with Human Rights is included in this Explanatory Statement at **Attachment B**.

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 2013 (No. 2)*.

Paragraph 3 – Commencement

This paragraph provides that the Instrument commences as follows:

- (a) Items [1], [7] to [10] of Schedule 1 to the Instrument; the day after the day on which this instrument is registered under the *Legislative Instruments Act 2003*;
- (b) Items [2] and [3] of Schedule 1 to the Instrument, the day after the end of the period of 3 months beginning on the day on which this instrument is registered under the *Legislative Instruments Act 2003*;
- (c) Items [5] and [6] and [11] to [13] of Schedule 1 to the Instrument, the day after the end of the period of 6 months beginning on the day on which this instrument is registered under the *Legislative Instruments Act 2003*;
- (d) Item [4] of Schedule 1 to the Instrument, the day after the end of the period of 9 months beginning on the day on which this instrument is registered under the *Legislative Instruments Act 2003*;
- (e) Items [1] to [3] of Schedule 2 to the Instrument, the day after the day on which this 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*, and Schedule 2 amends the *ASIC Market Integrity Rules (ASX Market) Amendment 2012 (No. 3)*.

Schedule 1 – Amendments to the *ASIC Market Integrity Rules (ASX Market) 2010*

Item [1] Rule 1.4.3, after the definition of “Cross”

Item [1] of Schedule 1 to the Instrument amends Rule 1.4.3 by inserting a new definition of ‘Crossing System’.

This defined term is used in Rules 5.6.1 and 5.6.3 in relation to Automated Order Processing.

Item [2] Rule 3.2.4(1)

Item [2] of Schedule 1 to the Instrument amends Rule 3.2.4(1) to correct an anomaly in the

existing rule, which refers to a Market Participant acting as "Principal on its own behalf". Item [2] omits the words "on its own behalf". This has the effect of clarifying the operation of the subrule (1) insofar as it applies to a Market Participant who enters into a Market Transaction as Principal and has the effect that the Market Participant cannot charge the brokerage, commission or any other fee in respect of this transaction, except in the circumstances outlined in the rule.

Item [3] Rule 3.2.5, after the words "Market Participant" in paragraph 3.2.5(1)(e)

Item [3] of Schedule 1 to the Instrument amends Rule 3.2.5 by inserting into 3.2.5(1)(e) the following words after "any Related Body Corporate of the Market Participant", "except where that Related Body Corporate is dealing as a trustee of a trust in which it, or the Market Participant, has no direct or indirect beneficial interest." This means that the extended meaning of dealing as Principal does not include instances where a Related Body Corporate of the Market Participant acts in the capacity of a trustee of a trust in which it, or the Market Participant, has no beneficial interest.

Item [4] Rule 3.4.3

Item [4] of Schedule 1 to the Instrument omits Rule 3.4.3 and replaces it with a substantively similar rule for confirmations required to be given to a Wholesale Client, except the amended rule:

Paragraph (b) Rule 3.4.3(1) requires a Market Participant to give notification to a Wholesale Client if that Market Participant enters into a transaction with the Wholesale Client as Principal, and if the Market Transaction was executed as a Crossing, the execution venue for the Crossing.

Rule 3.4.3(2) allows a Market Participant not to give the notifications required in paragraph (b) of subrule (1) where a Wholesale client has agreed that it does not want to receive such notifications.

Rule 3.4.3(4), provides that ASIC may publish on its website relevant codes for the execution venue (being crossing system identifiers) that are to be disclosed by Market Participants in accordance with the new paragraph (1)(b)(ii) of Rule 3.4.3.

Item [5] Rule 5.1.4

Item [5] of Schedule 1 to the Instrument make amendments consequential to the amendment in Item [6] below, to ensure the punctuation of Rule 5.1.4 is appropriate for the amendment made by Item [6].

Item [6] of Schedule 1 to the Instrument amends Rule 5.1.4 by inserting a new paragraph 1(h). New paragraph 1(h) provides that a Market Participant's orders cannot knowingly be interposed between Orders of its clients that would otherwise have Crossed. This amendment ensures that a Market Participant manages any conflicts of interest it may have when trading as Principal by ensuring that it has systems in place to prevent it from knowingly interposing itself between its client's orders.

Items [7] to [9] Rule 5.6.1

Items [7] to [9] of Schedule 1 to the Instrument make amendments consequential to the amendment in Item [10] below, to ensure the punctuation and formatting of Rule 5.6.1 is appropriate for the amendment made by Item [10].

Item [10] Rule 5.6.1

Item [11] of Schedule 1 to the Instrument amends Rule 5.6.1 by introducing a new sub-subparagraph (1)(b)(iii) and subrule (2). New sub-subparagraph 1(b)(iii) provides that a Trading Participant which uses its system for Automated Order Processing must at all times ensure that such use does not interfere with the efficiency and integrity of any Crossing System operated by the Trading Participant. New subrule (2) provides that a Trading Participant has six months to ensure that its Automated Order Processing system meets the requirement in new paragraph 1(b)(iii).

These amendments ensure that a Trading Participant that operates a Crossing System uses its Automated Order Processing system in a manner that does not interfere with the efficiency and robustness of the Crossing System.

Items [11] and [12] Rule 5.7.2

Items [11] and [12] of Schedule 1 to the Instrument make amendments consequential to the amendment in Item [13] below, to ensure the punctuation and formatting of Rule 5.7.2 is appropriate for the amendment made by Item [13]

Items [13] Rule 5.7.2

Item [13] of Schedule 1 to the Instrument amends Rule 5.7.2 by inserting three new paragraphs (i) (j) and (k) into Rule 5.7.2. Rule 5.7.2 sets out the matters are relevant to a Market Participant's consideration of the circumstances of an order for that may give rise to a false or misleading appearance of active trading. The three new paragraphs amend the rule to refer to the following circumstances:

- (i) the frequency with which Orders are placed by a person;
- (j) the volume of the Products the subject of each Order placed by a person; and
- (k) the extent to which a person amends or cancels an instruction to purchase or sell a Product relative to the number of Transactions executed for that person.

These amendments to Rule 5.7.2 ensure a Market Participant considers additional circumstances of an Order that may be indicative of manipulative trading.

Items [1] to [3] of Schedule 2 to the Instrument

Items [1] to [3] of Schedule 2 to the Instrument amend the *ASIC Market Integrity Rules (ASX*

Market) Amendment 2012 (No 3) (Amendment 3 of 2012).

Amendment 3 of 2012 amended Rule 5.6.3 (Automated Order Processing system requirements) by introducing new paragraphs 1(d) and (e) to that Rule, which take effect on 26 May 2014. The amendments in Items [1] to [3] of Schedule 2 to the Instrument further amend Rule 5.6.3(1)(e) by adding subparagraphs (iii) and (iv). New paragraphs 1(e)(iii) and (iv) of Rule 5.6.3 extend a Trading Participant's obligation regarding its system requirements for Automated Order Processing to apply to a Crossing System operated by the Trading Participant. This will ensure that a Trading Participant has controls that enable the immediate cancellation of, suspension of, limitation of, or prohibition on the entry into a Crossing System of Orders in a series that interfere with, or are likely to interfere with, the efficiency or integrity of the Crossing System.

These amendments will ensure that a Trading Participant operates an orderly Crossing System that has robust controls in place, and align Crossing System controls with those already applicable to a Trading Participant's systems that enter messages into a Trading Platform of a Market.

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 2013 (No.2)

This 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*.

1. Overview of the Instrument

Background

This Instrument amends the *ASIC Market Integrity Rules (ASX Market) 2010* to:

- (a) introduce a new definition, being ‘Crossing System’ (see Rule 1.4.3);
- (b) clarify an existing prohibition on Market Participants charging Clients brokerage, commissions or any other fee in respect of a Market Transaction when they enter into a Market Transaction with a Client as Principal (see Rule 3.2.4);
- (c) impose a specific requirement on Market Participants to disclose to a Wholesale Client in respect of a Market Transaction, the execution venue if a Crossing occurred and when the Market Participant transacted as Principal (see Rule 3.4.3);
- (d) enables ASIC to determine and publish on its website details of the codes identifying particular execution venues in which Market Transactions can take place (see Rule 3.4.3);
- (e) impose a specific obligation on Market Participants not to knowingly interpose orders on its Own Account between orders of its clients that would otherwise have Crossed (see Rule 5.1.4(1)(h));
- (f) impose a specific requirement that a Trading Participant which uses its system for Automated Order Processing to ensure that it does not interfere with the efficiency and integrity of any Crossing System operated by the Trading Participant (see Rule 5.6.1); and
- (g) impose a specific requirement that a Trading Participant which uses its system for Automated Order Processing to ensure that the system has in place controls that enable:
 - immediate suspension or limitation of, or prohibition on, the entry into any Crossing System operated by them of Orders in a series of related Orders where the Trading Participant has identified that Orders in the series have entered the Crossing System operated by the Trading Participant and have

interfered with or are likely to interfere with the efficiency or integrity of the Crossing System (see Rule 5.6.3);

cancellation of Orders in a series that have already entered a Crossing System operated by them where the entry of further Orders in the series has been suspended, limited or prohibited in accordance with the above (see Rule 5.6.3).

- (h) impose a requirement on a Market Participant to consider additional circumstances of the Order to address any manipulative trading practices that may be effected using trading algorithms (see Rule 5.7.2)

2. Human rights implications

This Instrument does not engage any of the applicable human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.