

ASIC CLASS RULE WAIVER [CW 14/0322] EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

ASIC Market Integrity Rules (Competition in Exchange Markets) 2011

The Australian Securities and Investments Commission (**ASIC**) makes this instrument under subrule 1.2.1(1) of the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011* (**ASIC Market Integrity Rules (Competition)**).

Under subrule 1.2.1(1), ASIC may relieve any person or class of persons from the obligation to comply with a provision of the ASIC Market Integrity Rules (Competition).

Unless otherwise indicated, capitalised terms in this Explanatory Statement refer to defined terms in the ASIC Market Integrity Rules (Competition).

1. Background

ASIC Market Integrity Rules (Competition)

On 29 April 2011, ASIC made the ASIC Market Integrity Rules (Competition), which form part of the regulatory framework for competition between exchange markets.

The ASIC Market Integrity Rules (Competition) apply to:

- (a) the activities or conduct of a Market;
- (b) the activities or conduct of person in relation to a Market; and
- (c) the activities or conduct of persons in relation to Financial Products

as specified in each Chapter, Part or Rule

Chapter 4 of the ASIC Market Integrity Rules (Competition) relates to Pre-Trade Transparency. Chapter 4 applies to:

- (a) Equity Market Operators;
- (b) Operators of a Financial Market on or through which offers to acquire or dispose of CGS Depository Interests are made or accepted where those operators are licensed under subsection 795B(1) of the *Corporations Act 2001*;
- (c) Participants of Financial Markets referred to in (a) and (b); and
- (d) Orders and Transactions in Equity Market Products and CGS Depository Interests.

The Financial Markets referred to in (a) and (b) above currently include the financial markets operated by ASX Limited (**ASX**) and Chi-X Australia Pty Ltd (**Chi-X**).

Pre-trade transparency exceptions

Subrule 4.1.1(1) of the ASIC Market Integrity Rules (Competition) provides that, subject to subrule 4.1.1(2), a Participant must not enter into a Transaction unless the Transaction is entered into by matching of a Pre-Trade Transparent Order (being an Order for which

information such as price and volume is made available before execution) on an order book of a Market.

Subrule 4.1.1(1) reflects the importance of pre-trade transparency to the price formation process and to fair and efficient markets.

Subrule 4.1.1(2) of the ASIC Market Integrity Rules (Competition) lists the exceptions to the requirements of subrule 4.1.1(1). A Participant is not required to comply with subrule 4.1.1(1) in relation to:

- (a) Block Trades;
- (b) Large Portfolio Trades;
- (c) Trades With Price Improvement;
- (d) Permitted Trades during the Post-Trading Hours Period;
- (e) Permitted Trades during the Pre-Trading Hours Period; and
- (f) Out of Hours Trades.

ASIC Class Rule Waivers [CW 12/1710] and [CW 13/680]

On 13 December 2012, ASIC made ASIC Class Rule Waiver [CW 12/1710]. Class Rule Waiver [12/1710]:

- (a) withdrew Class Rule Waivers [11/1103] and [12/233];
- (b) provided relief from the Pre-Trade Transparency obligations in Rule 4.1.1(1) of the ASIC Market Integrity Rules (Competition) for
 - (i) “ETF Special Trades”;
 - (ii) “Crossings of a Derivative/Cash Combination” (as respectively referred to in the ASX Operating Rules and ASX Operating Rules Procedures); and
 - (iii) Crossings based on the Best Available Bid or the Best Available Offer.

On 24 May 2013, ASIC made ASIC Class Rule Waiver [CW 13/680] which withdrew [CW 12/1710] but continued, refined and extended the relief previously provided in [CW 12/1710]. In particular, paragraph 7 of [CW 13/680] extended the relief in [CW 12/1710] from Rule 4.1.1(1) of the ASIC Market Integrity Rules (Competition), to certain Transactions on the Market operated by Chi-X arising from:

- (a) Market Pegged Orders;
- (b) Primary Pegged Orders; and
- (c) Mid Point Orders.

This relief applied from 26 May 2013 to 26 September 2013.

2. Purpose of this Class Rule Waiver

This Class Rule Waiver varies [CW 13/680] to create an additional circumstance in which the Pre-Trade transparency obligation in subrule 4.1.1(1) of the ASIC Market Integrity Rules (Competition) is waived. This enables Participants to enter into a transaction in an Equity Market Product as a result of a Derived Order generated to complete certain Orders for a Tailor Made Combination (TMC). TMCs and Derived Orders are described below.

Tailor Made Combinations

A TMC is an existing order type on ASX Trade, the equities trading platform of ASX. It allows Participants to enter into a trading strategy comprised of up to four component “legs” executed at a specified net price. In [CW 13/680], as varied by this Class Rule Waiver, “Tailor Made Combination Order” (**TMC Order**) has the meaning given in Rule 7100 of the ASX Operating Rules. The specifications and procedure for the creation of a TMC Order are outlined in Procedure 4111 of the ASX Operating Rules Procedures.

Each TMC Order represents a specific combination strategy made up of multiple single legs. The combinations may be in the form of a “Derivatives/Cash Combination”, a “Cash Only Combination” or a “Derivatives Only Combination” Each of these combinations has the meaning given by Rule 7100 of ASX Operating Rules.

A TMC Order may trade against an opposing TMC Order or individual Orders which together may satisfy the TMC Order at the same price or at a better price than the net price.

Derived Orders

In order to complete a TMC Order, ASX’s equities trading platform, ASX Trade, may generate a Derived Order. “Derived Order” is defined in [CW 13/680], as varied by this Class Rule Waiver, to mean “*an Order generated by ASX Trade for a component leg of a Derivative/Cash Combination or Cash Only Combination traded as a Tailor Made Combination Order, whenever the best price and quantity available on the opposite side of the remaining legs is sufficient to satisfy the Tailor Made Combination Order.*”

Accordingly, where all but one leg of the TMC Order can be matched on the Order book (including partially), a Derived Order is generated for that leg for the required volume and price in order to complete the TMC match.

Due to the technical process for executing TMCs, millions of Derived Orders are generated by ASX Trade each day. Relatively few Transactions result from these Orders.

Reasons for granting an exception from the Pre-Trade Transparency obligation

A TMC Order is visible to the Market both as a combination and as individual legs. However, a Derived Order is not Pre-Trade Transparent on an order book of the ASX Market. A Participant that enters into a Transaction in an Equity Market Product as a result of a Derived Order may therefore breach subrule 4.1.1(1) of the ASIC Market Integrity Rules (Competition).

ASIC is granting this Class Rule Waiver on the basis that:

- (a) Derivatives/Cash Combinations and Cash Only Combinations provide benefits to investors, including retail investors, by allowing those investors to execute trading strategies for which the net price is guaranteed; and
- (b) TMC Orders are sufficiently transparent as both the combination and individual legs. Accordingly, there would be no net regulatory benefit in requiring Derived Orders to be made Pre-Trade Transparent.

ASIC intends that this relief will apply an indefinite period of time.

3. Operation of this Class Rule Waiver

Paragraph 4 of the Class Rule Waiver amends [CW13/680] to provide relief to Participants from the obligation to comply with subrule 4.1.1(1) of the ASIC Market Integrity Rules (Competition).

The relief only applies to a Derived Order generated as part of a TMC Order that is a Derivatives/Cash Combination or Cash Only Combination.

4. Consultation

ASIC did not formally consult on making this class rule waiver. However, the decision to grant it was based on discussions with stakeholders including ASX and potential users of TMCs.

5. Statement of Compatibility with Human Rights

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

ATTACHMENT A – Statement of Compatibility with Human Rights

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

ASIC CLASS RULE WAIVER [CW 14/0322]

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*.

Unless otherwise indicated, capitalised terms in this Statement refer to defined terms in the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011 (the ASIC Market Integrity Rules (Competition))*.

1. Overview of the Legislative Instrument

This Legislative Instrument amends ASIC Class Rule Waiver [CW 13/680] to provide relief to Participants of the Financial Market operated by ASX Limited (**ASX**) from subrule 4.1.1(1) of the ASIC Market Integrity Rules (Competition) in the case where the Participant enters into a Derived Order generated to complete certain Orders for a Tailor Made Combination (**TMC**). TMCs and Derived Orders are described below.

Subrule 4.1.1(1) of the ASIC Market Integrity Rules (Competition) provides that, subject to subrule 4.1.1(2), a Participant must not enter into a Transaction unless the Transaction is entered into by matching of a Pre-Trade Transparent Order (being an Order for which information such as price and volume is made available before execution) on an order book of a Market. Subrule 4.1.1(1) reflects the importance of pre-trade transparency to the price formation process and fair and efficient markets.

A TMC is an existing order type on ASX Trade, the equities trading platform of ASX. It allows Participants to enter into a trading strategy comprised of up to four component “legs” executed at a specified net price. It may trade against an opposing TMC Order, or individual legs that together are able to satisfy the TMC Order at the same price or at a better price than the net price.

A partially traded TMC Order can be completed by creating a Derived Order, which is generated by ASX Trade. "Derived Order" is defined in [CW 13-680], as varied by this Class Rule Waiver, to mean “*an Order generated by ASX Trade for a component leg of a Derivative/Cash Combination or Cash Only Combination traded as a Tailor Made Combination Order, whenever the best price and quantity available on the opposite side of the remaining legs is sufficient to satisfy the Tailor Made Combination Order.*”

Accordingly, where all but one leg of the TMC Order can be matched on the Order book (including partially), a Derived Order is generated for that leg for the required volume and price in order to complete the TMC match. A TMC Order is visible to the Market both as a combination and as individual legs. However, a Derived Order is not Pre-Trade Transparent on an order book of the ASX Market. A Participant that enters into a Derived Order may therefore breach subrule 4.1.1(1) of the ASIC Market Integrity Rules (Competition).

This Legislative Instrument varies [CW 13/680] to waive the Pre-Trade transparency obligation in subrule 4.1.1(1) of the ASIC Market Integrity Rules (Competition) to enable a Participant to enter into a Transaction involving a Derived Order that has been generated as part of a TMC Order that is a Derivative/Cash Combination or Cash Only Combination

ASIC is granting this Class Rule Waiver on the basis that:

- (a) Derivatives/Cash Combination and Cash Only Combination provide benefits to investors, including retail investors, by allowing those investors to execute trading strategies for which the net price is guaranteed; and
- (b) TMC Orders are sufficiently transparent as both the combination and as individual legs. Accordingly, there would be no net regulatory benefit in requiring Derived Orders to be made Pre-Trade Transparent.

2. Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.