

ASIC MARKET INTEGRITY RULES (CHI-X AUSTRALIA MARKET) AMENDMENT 2014 (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 (Chi-X Australia Market) Amendment 2014 (No. 2)* (the **Instrument**) under subsection 798G(1) of the *Corporations Act 2001* (the **Corporations Act**). Capitalised terms used in this Explanatory Statement (e.g. “Market Participant”) are defined in the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011* (the **ASIC Market Integrity Rules (Chi-X)**).

1. Enabling legislation

Subsection 798G(1) of the Corporations Act provides that ASIC may, by legislative instrument, make rules that deal with the activities or conduct of licensed markets, or the activities or conduct of persons in relation to licensed markets or in relation to financial products traded on licensed markets.

The ASIC Market Integrity Rules (Chi-X) deal with the activities and conduct of the licensed market (the **Chi-X Market**) operated by Chi-X Australia Pty Ltd (ACN 129 584 667) (**Chi-X**). The Market Operator and Market Participants of the Chi-X Market are required to comply with the ASIC Market Integrity Rules (Chi-X).

2. Background

The ASIC Market Integrity Rules (Chi-X) govern dealings by Market Participants with their clients. Among other requirements, a Market Participant must give a client a confirmation in respect of a Market Transaction entered into for the client (Rule 3.4.1). However, a Market Participant is not required to give a confirmation to a client that is not a Retail Client (i.e. a Wholesale Client), provided the Market Participant notifies the client of certain matters before entering into the Market Transaction (Rule 3.4.3).

On 5 August 2013, ASIC amended the ASIC Market Integrity Rules (Chi-X) to address regulatory issues arising from recent market developments, including the growing number of Market Participants establishing and operating automated services (referred to as 'Crossing Systems') that match or execute orders of their clients otherwise than on an Order Book of an exchange market (see the *ASIC Market Integrity Rules (Chi-X Australia Market) Amendment 2013 (No. 1) (Amending Instrument)*).

The Amending Instrument makes changes to Rule 3.4.3 of the ASIC Market Integrity Rules (Chi-X), to require a Market Participant to notify their Wholesale Clients of the following additional matters in relation to Market Transactions entered into for the Client:

- (a) if the Market Participant entered into the client's Market Transaction as Principal, that the Market Participant entered into the Market Transaction as Principal; and
- (b) if the client's Market Transaction was executed as a Crossing, the execution code of the execution venue for the Crossing.

These changes are designed to address a lack of disclosure to Wholesale Clients about these matters. Market Participants are already required to notify their Retail Clients of these matters under Rule 3.4.1.

Revised Rule 3.4.3 was to be inserted into the ASIC Market Integrity Rules (Chi-X) from 9 May 2014, and Market Participants were to be required to comply with the new notification requirements in the rule from that date. Market Participants have advised ASIC that they are experiencing technical challenges in preparing to comply with these requirements from 9 May 2014.

Market Participants are also in the process of implementing the systems required to comply with new obligations to 'tag' their short sales and orders, and to provide regulatory data to Market Operators from (see Part 5.12 of the ASIC Market Integrity Rules (Chi-X) and Chapter 5A of the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011*). The commencement dates for the new short-sale tagging and regulatory data obligations were recently extended from 10 March 2014 to 28 July 2014.

Market Participants have indicated that there are information technology efficiencies to be gained if the system changes relating to regulatory data obligations are implemented before the system changes required to comply with revised Rule 3.4.3. Accordingly, Market Participants have requested that ASIC delay the commencement of the revised Rule 3.4.3 until a reasonable period after the commencement of the new regulatory data obligations.

ASIC's FRLI lodgement costs

ASIC is also looking at ways in which it can manage its costs of lodging compilations of the ASIC Market Integrity Rules (Chi-X) for registration on the Federal Register of Legislative Instruments (**FRLI**). A new FRLI fee structure was introduced in July 2013, to recognise the whole-of-life cost of making material available to agencies and the public. Under the new fee structure, which includes a 'per page' fee for lodging compilations, ASIC's costs for lodging compilations of the ASIC Market Integrity Rules (Chi-X) have increased significantly.

3. Purpose of the legislative instrument

The Instrument amends revised Rule 3.4.3 so that a Market Participant will not be required to comply with the new notification requirements in paragraph (1)(b) of the Rule, until 28 October 2014. This change will give Market Participants a three-month period after the implementation of the regulatory data obligations to prepare for compliance with the new notification requirements.

The Instrument also delays the date on which revised Rule 3.4.3 is inserted into the ASIC Market Integrity Rules (Chi-X) until 26 May 2014. As a result ASIC will only be required to create a single compilation of the ASIC Market Integrity Rules (Chi-X) for a number of changes to those rules to be made on the same date. This approach is in accordance with guidance provided by the Office of Parliamentary Counsel that agencies may make savings on their FRLI lodgement fees, and potentially reduce compliance costs for users, by aligning the commencement dates of amendments, to reduce the number of compilations needed.

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

4. Consultation

ASIC consulted on the amendments to Rule 3.4.3 effected by the Amending Instrument through its March 2013 Consultation Paper 202: *Dark liquidity and high-frequency trading: Proposals*, and meetings with industry stakeholders and information sessions for members of the Australian Financial Markets Association (AFMA), the Financial Services Council and the Stockbrokers Association of Australia.

ASIC consulted on implementation issues in relation to revised Rule 3.4.3 at a meeting with six Market Participants on 25 February 2014. ASIC engaged in further consultation with Market Participants on these issues, at a specially-convened meeting of AFMA members on 13 March 2014.

5. 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. The Instrument does not affect the penalties payable in relation to any Rule.

6. Commencement of the Instrument

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

7. Statement of Compatibility with Human Rights

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

8. Regulation Impact Statement

The amendments to Rule 3.4.3 effected by the Amending Instrument, along with other changes made by the Amending Instrument in response to recent market developments, were the subject of Regulation Impact Statement: *Australian market structure: further proposals* in June 2013, which was lodged on FRLI with the *ASIC Market Integrity Rules (Chi-X Australia Market) Amendment 2013 (No. 1)*.

A further Regulation Impact Statement was not required for this Instrument as it is minor or machinery in nature and does not substantially alter the existing requirements for Market Participants.

ATTACHMENT A

Paragraph 1 – Enabling Legislation

This paragraph provides that the Instrument is made, with the written consent of the Minister, 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 (Chi-X Australia Market) Amendment 2014 (No. 2)*.

Paragraph 3 – Commencement

This paragraph provides that the Instrument commences on the day after the day on which 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 (Chi-X Australia Market) Amendment 2013 (No. 1)* (i.e. the Amending Instrument).

Schedule 1 - Amendments

Item [1] Paragraph 3, column 2 of the table (commencement information for Schedule 1, item [4])

Item [1] of Schedule 1 to the Instrument amends the commencement information in column 2 of the table in paragraph 3 of the Amending Instrument, so that item [4] of Schedule 1 of the Amending Instrument will commence on 26 May 2014.

Item [4] of Schedule 1 to the Amending Instrument is the provision that omits existing Rule 3.4.3, and substitutes revised Rule 3.4.3, in the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011* (i.e. the ASIC Market Integrity Rules (Chi-X)).

This change to the commencement information for item [4] of Schedule 1 to the Amending Instrument will align the commencement date of revised Rule 3.4.3 with the commencement date of other changes to the ASIC Market Integrity Rules (Chi-X) that are due to take effect on 26 May 2014 (see, for example, *ASIC Market Integrity Rules (Chi-X Australia Market) Amendment 2012 (No. 3)*).

However, as noted below, the amendments made by item [2] of Schedule 1 to the Instrument will mean that the new obligation in paragraph 3.4.3(1)(b) to provide additional notifications to clients that do not receive confirmations under Rule 3.4.1, will not take effect until 28 October 2014.

Item [2] Schedule 1, item [4]

Item [2] of Schedule 1 to the Instrument amends item [4] of Schedule 1 to the Amending Instrument, by inserting after subrule 3.4.3(4), a new subrule 3.4.3(5).

New subrule 3.4.3(5) provides that a Market Participant is not required to comply with paragraph 3.4.3(1)(b) until 28 October 2014.

Accordingly, while revised Rule 3.4.3 will be inserted into the ASIC Market Integrity Rules (Chi-X) from 26 May 2014, a Market Participant will have until 28 October 2014 before the Market Participant is required to comply with the new requirements in paragraph 3.4.3(1)(b) to notify a client that is not provided with a confirmation under Rule 3.4.1, of the following additional matters:

- (a) if the Market Participant entered into the client's Market Transaction as Principal, that the Market Participant entered into the Market Transaction as Principal; and
- (b) if the client's Market Transaction was executed as a Crossing, the execution code of the execution venue for the Crossing.

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 (Chi-X Australia Market) Amendment 2014 (No. 2)

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*.

A. Overview of the Instrument

1. The *ASIC Market Integrity Rules (Chi-X Australia Market) Amendment 2014 (No. 2)* (the **Legislative Instrument**) is made under subsection 798G(1) of the *Corporations Act 2001* and amends the *ASIC Market Integrity Rules (Chi-X Australia Market) Amendment 2013 (No. 1)* (the **Amending Instrument**).
2. The Amending Instrument in turn amends the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011* (**ASIC Market Integrity Rules (Chi-X)**). The ASIC Market Integrity Rules (Chi-X) apply to the activities and conduct of a financial market (the **Chi-X Market**) operated by Chi-X Australia Pty Ltd (ACN 129 584 667). The Market Operator and Market Participants of the Chi-X Market are required to comply with the ASIC Market Integrity Rules (Chi-X).
3. The ASIC Market Integrity Rules (Chi-X) govern dealings by Market Participants with their clients. Among other requirements, a Market Participant must give a client a confirmation in respect of a Market Transaction entered into for the client (Rule 3.4.1). However, a Market Participant is not required to give a confirmation to a client that is not a Retail Client (i.e. a Wholesale Client), provided the Market Participant notifies the client of certain matters before entering into the Market Transaction (Rule 3.4.3).
4. The Amending Instrument amends Rule 3.4.3 to address regulatory issues resulting from recent market developments, including a growth in the number of Market Participants establishing and operating automated services (referred to as 'Crossing Systems') for matching and execution of their clients' orders other than on an Order Book of an exchange market. The Amending Instrument revises Rule 3.4.3 to require a Market Participant to notify their Wholesale Clients where the Market Participant entered into a Market Transaction with the client as Principal, and of the execution venue code for Market Transactions executed as Crossings.
5. Market Participants have advised ASIC that they need additional time to prepare for compliance with their new notification obligations under revised Rule 3.4.3. The Legislative Instrument therefore amends revised Rule 3.4.3 so that a Market Participant is not required to comply with the new notification obligations in that Rule until 28 October 2014. The Legislative Instrument also changes the date on which revised Rule 3.4.3 is inserted into the ASIC Market Integrity Rules (Chi-X) by the Amending Instrument, to 26 May 2014, to align with the commencement date of other changes to the Rules. This change will reduce the number of compilations required to be prepared for the Federal Register of Legislative Instruments, saving on lodgement fees for ASIC and potentially reducing costs for users of the Rules.

B. Human rights implications

6. The Legislative 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*.

C. Conclusion

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

D. Consultation

8. ASIC consulted on the amendments to Rule 3.4.3 effected by the Amending Instrument through its March 2013 Consultation Paper 202: *Dark liquidity and high-frequency trading: Proposals*, and meetings with industry stakeholders and information sessions for members of the Australian Financial Markets Association (*AFMA*), the Financial Services Council and the Stockbrokers Association of Australia.
9. ASIC consulted on implementation issues in relation to revised Rule 3.4.3 at a meeting with six Market Participants on 25 February 2014. ASIC engaged in further consultation with Market Participants on these issues, at a specially-convened meeting of AFMA members on 13 March 2014.

Australian Securities and Investments Commission