

ASIC CLASS WAIVER [CW 14-1091]

EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

ASIC Market Integrity Rules (ASX Market) 2010

The Australian Securities and Investments Commission (*ASIC*) makes this instrument (*the Class Rule Waiver*) under Rules 1.2.1 and 1.2.3 of the *ASIC Market Integrity Rules (ASX Market) 2010* (*the ASIC Market Integrity Rules (ASX)*).

Under Rule 1.2.1(1), ASIC may relieve any person or class of persons from the obligation to comply with a provision of the ASX Rules either generally or in a particular case or category, and either unconditionally or subject to such conditions as ASIC thinks fit.

Under Rule 1.2.3, ASIC may specify the period or specific event during which any relief from an obligation to comply with a provision of the Competition Rules may apply.

Capitalised terms in this Explanatory Statement refer to defined terms in the ASIC Market Integrity Rules (ASX).

1. Background

The ASIC Market Integrity Rules (ASX) 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 (ASX) 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 (ASX Market) Amendment 2013 (No. 2) (Amending Instrument 1)*).

Amending Instrument 1 makes changes to Rule 3.4.3 of the ASIC Market Integrity Rules (ASX), 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 were 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 (ASX) from 9 May 2014, and Market Participants were to be required to comply with the new notification requirements in the rule from that date. However, Market Participants had advised ASIC that they were experiencing technical challenges in preparing to comply with these requirements from 9 May 2014. Accordingly, on 6 May 2014 ASIC made a new instrument amending 3.4.3 so that a Market Participant would not be required to comply with the new notification requirements in paragraph 1(b) of the Rule, until 28 October 2014 (see the *ASIC Market Integrity Rules (ASX Market) Amendment 2014 (No 2) (Amending Instrument 2)*).

Market Participants have now queried whether it was ASIC's intention for Rule 3.4.3(1)(b) to apply to Derivative Market Contracts, as well as Equity and Cash Market Products. Rule 3.4.3 refers to Market Transactions, which is defined as "*a transaction for one or more Products, entered into on a Trading Platform or reported to the Market Operator under the Market Operating Rules.*" Further, "Product" is defined as "*Cash Market Product or a Derivatives Market Contract, as applicable.*" Rule 3.4.1(1)(b), by virtue of the definition of Product, does apply to Derivatives Markets Contracts.

By contrast, Rule 3.4.3 of the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011 (Chi-X Rules)* which has the same wording as Rule 3.4.3 (ASX), defines Market Transaction as "*a transaction for one or more Equity Market Products, entered into on a Trading Platform or reported to the Market Operator under the Market Operating Rules.*" However, the Chi-X market and therefore Chi-X Rules can be distinguished as Derivatives Market Contracts are not currently traded on that market.

Consultation Paper 202 *Dark Liquidity and high-frequency trading: Proposals (CP 202)*, which had included the proposal to implement new notification requirements for Wholesale Clients, adopted the wording that appears in the current ASIC Market Integrity Rules (ASX). It did not, however, distinguish between Cash Market Products and Derivative Market Contracts. Market Participants subsequently indicated that if Rule 3.4.3(1)(b) (ASX) applies to Derivative Market Contracts, which was not appreciated during the initial consultation, then they would need to implement additional technology changes in order to effectively comply with the new notification requirements in paragraph 1(b) of the Rule.

Accordingly, ASIC is to provide relief from Rule 3.4.3(1)(b) (ASX) in respect of Derivative Market Contracts for a period of 18 months. It is anticipated that during this period ASIC will consult with stakeholders to determine whether the nature of Derivatives Markets Contracts is such that they ought not be included in the

October 2014

notification requirements in Rule 3.4.3(1)(b). It will also allow sufficient time for any necessary IT development.

2. Purpose of the class rule waiver

Paragraph 4 – Reporting to Clients

Rule 3.4.3 provides an alternative reporting regime to Rule 3.4.1, provided certain conditions are met, including that the clients are not Retail Clients.

Paragraph 4 of the Class Rule Waiver relieves the Market Participant of the primary client reporting obligations in Rule 3.4.1.

Paragraphs 5 and 7- Confirmations clients other than Retail Clients

Paragraph 5 restricts the operation of the waiver to circumstances where:

- (a) the client is not a Retail Client: and
- (b) The Market Transaction relates to a Derivatives Market Contract.

Paragraphs 7 and 8 include conditions which build back into the obligations of the Market Participant all obligations which would apply to Derivatives Market Contracts under Rule 3.4.3, save for those in sub-rule 3.4.3(1)(b)

The combined effect of this instrument ensures that a Market Participant is required to notify clients, other than retail clients, that it has entered into the client's Market Transaction as Principal and if a transaction has been entered as a crossing for Cash Market Products only.

The class rule waiver effectively delays the commencement of Rule 3.4.3(1)(b) for a period of 18 months. The waiver has been made on the basis that further consultation is required to determine whether the nature of Derivatives Markets Contracts is such that notification is or is not appropriate and to allow sufficient technology build time if it is appropriate.

Market participants are still be required to comply with Rule 3.4.3(1)(b) in respect of Cash Market Products as of 28 October 2014.

3. Operation of the class rule waiver

Paragraph 4 – Reporting to Clients

Paragraph 4 of the Class Rule Waiver restricts operation of the waiver to circumstance where the client is not a Retail Client and for Market Transactions involving Derivatives Market Contracts only.

Paragraphs 4, 7 and 8 – Confirmations – clients other than Retail Clients

Paragraph 5 of the Class Rule Waiver relieves a Market Participant from the obligation to comply with Rule 3.4.1 in circumstances described in Paragraph 4.

October 2014

Paragraphs 7 and 8 restore the obligations in Rule 3.4.3 save for sub-Rule 3.4.3(1)(b).

The Class Rule Waiver will operate from 28 October 2014 until 30 April 2016 (inclusive).

4. Consultation

Consultation Paper 202 *Dark Liquidity and high-frequency trading: Proposals (CP 202)*, which had included the proposal to implement new notification requirements for Wholesale Clients, adopted the wording that appears in the current ASIC Market Integrity Rules (ASX). At that time, it was not appreciated that Market Transactions for Products included Derivatives Market Contracts.

ASIC did not consult specifically on the making of this Class Rule Waiver. This class rule waiver was made to allow for consultation around the applicability of Rule 3.4.3(1)(b) to Derivatives Markets Contracts. It will also allow sufficient IT build time pending the outcome of the consultation process.

6. Regulatory Impact Statement

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

5. Statement of Compatibility with Human Rights

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

October 2014

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 14/1091]

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*.

1. Overview of the Legislative Instrument

The Australian Securities and Investments Commission (*ASIC*) makes this instrument Legislative Instrument under Rules 1.2.1 and 1.2.3 of the *ASIC Market Integrity Rules (ASX Market) 2010* (the *ASIC Market Integrity Rules (ASX)*).

Under Rule 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 (ASX), either generally or in a particular case or category, and either unconditionally or subject to such conditions as ASIC thinks fit.

Under Rule 1.2.3, ASIC may specify the period or specific event during which any relief from an obligation to comply with a provision of the ASIC Market Integrity Rules (ASX) may apply.

The Legislative Instrument grants relief for a Market Participant from the requirement to notify clients, other than Retail clients, both:

- (a) when it enters into the client's Market Transaction as Principal; and
- (b) the execution code of the execution venue for the Crossing if the Market Transaction was executed as a Crossing.

2. Human rights implications

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

3. Consultation

ASIC did not consult specifically on the Legislative Instrument. Consultation Paper 202 *Dark Liquidity and high-frequency trading: Proposals (CP 202)*, which had included the proposal to implement new notification requirements for Wholesale Clients, adopted the wording that appears in the current ASIC Market Integrity Rules

October 2014

(ASX). At that time, it was not appreciated that Market Transactions for Products included Derivatives Market Contracts.

The Legislative Instrument delays commencement of operation of sub-Rule 3.4.3(1)(b) as it applies to Derivatives Markets Contracts only. This will allow for appropriate consultation to be made as to the applicability of the sub-rule to that class of financial products and for any IT development to take place.