

10 May 2013

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Re: ASIC Consultation Paper 202 – Dark liquidity and high-frequency trading: Proposals

Ladies and Gentlemen,

Liquidnet Australia Pty Ltd appreciates the opportunity to comment on Consultation Paper 202 issued by the Australian Securities and Investments Commission (ASIC) on 18 March 2013 (the Consultation Paper).¹

Background on Liquidnet

Liquidnet provides a system used by institutional investors worldwide to negotiate block trades directly with like-minded institutions. Institutions that use Liquidnet reduce their trading costs by avoiding the market impact costs that result when institutional block orders are exposed to high-frequency traders and other short-term traders in the market. Cost savings achieved by institutional investors using Liquidnet are passed on to the hundreds of millions of individual investors globally on whose behalf our clients trade, resulting in reduced trading costs and higher investment returns for these individual investors. These individual investors include beneficiaries of superannuation funds, investment funds, managed accounts and similar pooled investment vehicles. Liquidnet trades only as agent, except in the limited case of an error or accommodation.

Market impact cost savings

The monthly reports from LiquidMetrix, a UK-based firm that specializes in execution cost analysis for European equities, consistently demonstrate the value of Liquidnet for long-term investors. In its March 2013 report, LiquidMetrix computes that Liquidnet provides 213.28 basis

¹ Australian Securities and Investments Commission, "Consultation Paper 202 – Dark liquidity and high-frequency trading: Proposals," March 2013, www.asic.gov.au/cp (accessed 9 May 2013).

points of savings on average relative to execution on an exchange market.² The second best dark pool competitor provides cost savings of 36.60 basis points; and the third best dark pool competitor provides cost savings of 10.70 basis points.

The LiquidMetrix report further shows that Liquidnet Europe's average execution size for March 2013 was €811,163. The second highest dark pool competitor had an average execution size of €16,729; the third highest dark pool competitor had an average execution size of €10,939.

The data from LiquidMetrix demonstrate that, on an average trade, Liquidnet saves each side (the buyer and the seller) €17,300, or the equivalent of A\$22,094.³ These cost savings are passed on directly to the individual long-term investors that are the beneficiaries of the accounts managed by our institutional clients.

The savings of 213.28 basis points on each trade is particularly significant in relation to our commission, which is eight basis points or less for the major European jurisdictions.

While similar data is not as readily available for Australia, we are confident that the cost savings we provide for Australian equities are equal to or greater than the cost savings we provide for European equities.

Price improvement

In addition to reduced market impact, Liquidnet provides an industry-leading level of price improvement. In the U.S., where data on price improvement must be publicly disclosed, Liquidnet provided price improvement of 95.72% for 2012, relative to the industry average of 7.07% over the same period.⁴ This means that for 2012 Liquidnet provided a level of price improvement that was more than 13 times greater than the industry average. Data on price improvement in Europe, Asia and Australia is not publicly disclosed, but we are confident that the data would be comparable.

For Liquidnet Australia, 75% of executions were at the mid for Q1 2013. Counting only our mid-price executions, since our launch in Australia in February 2008 we have provided price improvement of approximately A\$47 million to our institutional customers. This price improvement is passed on directly to the long-term investors who are the beneficiaries of the accounts managed by our institutional customers. As evidenced by the LiquidMetrix data above, price improvement represents a small portion of the cost savings we provide relative to the greater savings provided through market impact cost savings.

² Intelligent Financial Systems Limited, "LiquidMetrix Guide to European Dark Pools," March 2013. The summary page of the report is enclosed with this letter.

³ Based on conversion rate of AUD/EUR = 1.27710 as of 2 May 2013, <http://themoneyconverter.com/EUR/AUD.aspx> (accessed 2 May 2013).

⁴ Rule 605 data compiled by Thomson Transaction Analytics Reports. Data is for calendar year 2012.

Average execution size

Liquidnet's average negotiated execution size for Australian securities is A\$1,389,200 principal value,⁵ which is 229 times larger than the average execution size of A\$6,064 principal value on the Australian Stock Exchange.⁶

Global network

Liquidnet currently operates our block trading system in 42 markets globally on five continents. In 2011 we commenced operation of a facility in conjunction with the SIX Swiss Exchange to facilitate block trading of Swiss securities on-exchange. We are currently in discussions with several other major exchanges to facilitate on-exchange block trading in their markets.

Industry consensus on the value of dark pools for executing large institutional orders

Robert Greifeld, Chief Executive Officer of NASDAQ, stated as follows in response to a question on dark pools during a television interview with Steve Forbes, the owner and editor-in-chief of *Forbes* magazine:

“... a dark pool that's doing a large size, that's clearly a value added, because we know today that if you come into the lit market with larger size, you have a disproportionate impact on the lit market.”⁷

NYSE Euronext agrees that dark pools provide value for executing large orders:

“The trend towards smaller execution sizes in central ‘lit’ order books boosts the demand for alternative trading models. Dark pools respond to this demand by offering the industry a place for trading large orders with minimal impact on prices and allow professional investors to search counterpart[ies]. Therefore, we strongly believe that there are benefits in offering services complementary to order books.”⁸

The London Stock Exchange plc and Borsa Italiana have written similarly on the value of dark pools for executing large orders:

⁵ Liquidnet trading data for calendar year 2013 (through 31 March 2013).

⁶ ASX trading data for calendar year 2013 (through 31 March 2013). “ASX Group Monthly Activity Report – March 2013”, 5 April 2013, <http://www.asxgroup.com.au/media-releases.htm> (accessed 9 May 2013).

⁷ “Interview with Robert Greifeld, Intelligent Investing with Steve Forbes,” December 3, 2010, http://www.forbes.com/2010/12/03/greifeld-nasdaq-psx-intelligent-investing-video.html?partner=daily_newsletter (accessed 9 May 2013).

⁸ “Comments from NYSE Euronext in Response to CESR’s Call for Evidence on the Impact of MiFID on Secondary Markets Functioning (CESR/08-872),” January 2009, <http://www.esma.europa.eu/system/files/NyseEnxtFinal.pdf> (accessed 9 May 2013), p. 6.

“Whilst participants want and need sufficient transparency to create market confidence, this should not undermine their ability to deliver an investment return to end customers or to achieve execution certainty for larger orders without adverse market impact. Therefore, allowing non-displayed trading to take place within the parameters of the appropriate waivers is essential to provide choice and flexibility for end investors, without undermining the execution certainty of displayed orders and at the same time preserving the competitiveness of public order books.”⁹

Elmer Funke Kupper, head of the Australian Stock Exchange, also supports the use of dark pools for trading large orders:

“Fragmentation is ultimately the enemy of efficient markets, so you need a good reason to not transact in a single market. Block trades, where institutions try to find each other with large orders in an efficient way with minimum market impact costs, is such a good reason.”¹⁰

Response to specific ASIC proposals

We now respond to the specific questions posed in the Consultation Paper.

B Dark liquidity: Proposal for a minimum size threshold for dark orders

Proposal B1: Proposed trigger and threshold

We propose to:

- (a) seek feedback on two (alternative) triggers which may indicate that dark liquidity has impaired price formation for a security or group of securities (see Option B1.1 and Option B1.2 in Table 3);**
- (b) consider the feedback and:**
 - (i) confirm to the market which trigger we intend to treat as indicative of impaired price formation;**
 - (ii) monitor the relevant trigger on a quarterly basis by comparing the trigger each quarter to a static six-month reference period between April and September 2011;**

⁹ “LSEG Response to CESR MiFID Consultation Paper 10-394 – Equity Markets,” 28 May 2010, <http://www.londonstockexchange.com/about-the-exchange/regulatory/lsegresponsetocesrmifidconsultationpaper10-394-equitymarkets.htm> (accessed 9 May 2013), p. 2.

¹⁰ Nichola Saminather, “Dark Pools Hamper Market Efficiency, Should Be Avoided, ASX Says,” March 25, 2013, <http://www.bloomberg.com/news/2013-03-26/dark-pools-hamper-market-efficiency-should-be-avoided-asx-says.html> (accessed 9 May 2013).

- (iii) if the confirmed trigger is met, announce that this is the case, and amend Rules 4.1.5 and 4.2.3 (Competition), subject to the Minister’s consent at the time; and
- (iv) apply the amended rules 40 business days from the date they are made;
- (c) not permit the aggregation of orders to meet the minimum size threshold (however, if a dark order that meets the threshold receives a partial fill, which results in the remaining balance being less than the threshold, that order may continue to remain dark); and
- (d) periodically review the categories and thresholds in consultation with industry.

This proposal applies to equity market products.

Table 3: Proposed options for minimum size threshold for equity market products

	Trigger	Minimum size threshold
Option B1.1: Threshold applies to a group of securities	<p>The minimum size threshold would apply if:</p> <ul style="list-style-type: none"> • dark liquidity (excluding block size trades) for a security exceeds 10%; • there is a 4% increase in the pre-trade transparent quoted spreads for that security; and • there is a 15% decrease in the depth at the top five price points for that security. 	<p>The following minimum size threshold would apply to one or more categories of securities when one third of the securities in the category meet the trigger:</p> <ul style="list-style-type: none"> • <i>Category 1:</i> \$50,000, for all equity market products in the S&P/ASX 50; • <i>Category 2:</i> \$20,000, for all equity market products in the ASX 51–300; and • <i>Category 3:</i> \$20,000, for all equity market products in the ASX 300+. <p>If a security moves from one category to another, it would be treated like other securities in the new category.</p>
Option B1.2: Threshold applies on a tiered security-by-security basis	<p>The minimum size threshold would apply if:</p> <ul style="list-style-type: none"> • dark liquidity (excluding block size trades) for a security exceeds 10%; • there is a 20% increase in 	<p>The following minimum size threshold would apply to any security in the category that meets the trigger:</p> <ul style="list-style-type: none"> • \$50,000, for Tier 1 equity market products¹¹ as defined

¹¹ Tier 1 refers to equity market products with 2.5% of their average daily volume greater than \$1 million, Tier 2 refers to equity market products with an average daily volume of greater than \$500,000 but less than \$1 million, and Tier 3 refers to all other equity market products. The list of Tier 1 and Tier 2 equity market products is updated quarterly by ASIC and published online at <http://www.asic.gov.au/block-trade-tiers>.

	<p>the pre-trade transparent quoted spread for that security; and</p> <ul style="list-style-type: none"> • there is a 20% decrease in the depth at the top five price points for that security. 	<p>in draft Rule 4.2.3 (Competition) (approximately 205 products); and</p> <ul style="list-style-type: none"> • \$20,000, for Tier 2 and 3 equity market products as defined in draft Rule 4.2.3 (Competition) (all other products). <p>Securities would be allocated to tiers based on average daily volume on the same basis as Rule 4.2.1 (Competition) on block size trades, which takes effect on 26 May 2013 (quarterly).</p> <p>If a security moves from one category to another, it would be treated like other securities in the new category.</p>
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B1Q1 Do you agree that a safety net proposal like this is necessary?

For the reasons set forth in this section, we disagree with this proposal.

No other market prohibits trading at a materially better price

As noted above, Liquidnet currently trades in 42 markets. Not one of these markets makes it illegal to trade at a materially better price relative to the NBBO. If the proposals above are implemented, the Australian regulators would be the first regulators in the world to make it illegal to trade at a materially better price.

The primary beneficiary of a mid-point execution is the long-term investor

The primary beneficiary of a mid-point execution is the long-term investor. Typically, the market intermediary profits by capturing the spread. The market intermediary is more likely to post buy liquidity at the bid, and sell liquidity at the offer, while the long term investor is more likely to sell at the bid and buy at the offer. Providing the opportunity for a mid-point execution typically benefits the long-term investor by reducing the spread cost to the long-term investor.

Regulations should not require that individuals trade at a materially worse price

As an analogy, a liter of milk in Australia costs A\$1.50. Would it be beneficial to consumers to require that all stores charge A\$1.55 or more for milk? We would disagree with this proposal.

In the same way, we disagree with the proposal to make it illegal for long-term investors to trade at a materially better price.

Discrimination against self-directed retail investors

This proposal is discriminatory against the class of self-directed retail investors. Under the proposal, individuals that invest through collective investment vehicles would have the ability to achieve the best price for their orders, but self-directed retail investors would not have this ability. This proposal also hurts individuals that invest through collective investment vehicles because they lose the opportunity to execute mid-point trades against self-directed retail investors.

ASIC should take time to review the impact of the recently adopted rule changes before imposing further restrictions

A taskforce created by ASIC has conducted research and determined that off-exchange trading above a specific level can have an adverse impact on overall market quality.¹² We have not independently reviewed this research, so we cannot comment on whether we agree with the conclusions.

However, ASIC has previously adopted a rule proposal to address the potential concerns identified by the taskforce. The rule proposal set to take effect later this month most likely will reduce the level of trading in crossing systems by crossing system operators because the potential for profiting from the spread is reduced. The previously-adopted rule proposal, which takes effect later this month, also is less drastic than the current proposal, because the previously-adopted rule proposal will not prohibit firms from obtaining the best price for their customer orders.

We would recommend that ASIC evaluate the impact of the recently adopted rule change for a period of six months, and then determine whether additional steps are required.

Over a rolling period of two to three years, even if overall spreads are flat during the period, 100% of stocks could become subject to the trigger

We have some potential concerns with how the proposed triggers would be implemented. For example, there could be a situation where spreads in the overall market are flat over a period of time, yet over that same period of time 100% of stocks could become subject to the trigger. As an analogy, if we roll two dice, the odds of rolling eight or higher on the first roll are less than 50%. But if we roll two dice ten times, the odds of rolling an eight or higher on at least one roll are close to 100%. In the same way, even if spreads in the overall market were flat over a

¹² Australian Securities and Investments Commission, "Report 331 – Dark liquidity and high-frequency trading," March 2013, <http://www.asic.gov.au/asic/asic.nsf/byheadline/Reports?openDocument> (accessed 9 May 2013).

period of time, it is likely that after a number of measurement periods, close to 100% of stocks would trigger the new restrictions. One way to address this concern would be to clarify that previously-applied restrictions on a stock would be removed if the conditions for the trigger were not met for a subsequent measurement period.

The benefits of 100% price improvement should be taken into account when considering how to address the potential concern of a 4% increase in spread

Under the proposal, if spreads widen by 4% and certain other conditions are met, it would become illegal for a long-term investor to achieve 100% price improvement. We believe, in this instance, that the benefit of 100% price improvement would outweigh the 4% increase in the spread.

Provision relating to stubs

We support ASIC's proposal relating to stubs, as this will help us to continue to reduce trading costs for long-term investors, as discussed in our introduction.

Applicability to exchange crossing at the mid

We would request that ASIC confirm that if these restrictions are implemented, they would also apply to exchange crossing at the mid.

B1Q2 Do you agree that the proposed triggers in Option B1.1 and Option B1.2 are appropriate indicators that there has been degradation in price formation?

Please see our response to Question B1Q1.

B1Q3 Do you have a preference for either option? Please explain your rationale.

We do not support either option.

B1Q4 Are there any securities or group of securities for which it would be preferable to implement a minimum size threshold immediately (e.g. securities outside the S&P/ASX 300)? If so, which threshold should apply?

No.

B1Q5 Do you have any views on the proposed implementation timeframe of 40 business days for the thresholds if triggered?

Please see our response to Question B1Q1.

C Dark liquidity: Proposals for crossing system operators

Proposal C1: Transparency for the wider market

We propose to make new and amended rules requiring crossing system operators to make publicly available on a website, enough information so that market users can understand how their orders may be handled and executed. This information would include:

- (a) the identity of the operator of the crossing system;
- (b) the date the crossing system commenced operation in Australia;
- (c) the types of financial products traded on the crossing system;
- (d) the order types available on the crossing system;
- (e) the access criteria to the crossing system (i.e. the types of users and the criteria applied to access the crossing system);
- (f) which, if any, other crossing systems' orders may be matched with their orders, and on what basis (e.g. whether client orders may be sent to other crossing systems or whether orders from other crossing systems come into the crossing system);
- (g) the fees for using the crossing system where they differ to standard broking fees and commissions;
- (h) monthly aggregate turnover statistics for each financial product, including when trading as principal (similar to the transaction elements of the crossing system reporting information currently provided to ASIC under Part 4.3 (Competition)), which should remain public for at least two years; and
- (i) any material changes that may be made to the above information.

See draft Rules 4A.2.1 and 4.3.3 (Competition).

The proposed new and amended rules would apply one month from the commencement of the rules.

C1Q1 Are there any reasons that the proposed information should not be made public?

We have no objection to making this information public.

C1Q2 Is a website an appropriate publication means?

Yes.

C1Q3 Is there additional information that market users should understand, or be informed of, about the handling and execution of orders through a crossing system?

We believe that the items proposed by ASIC are sufficient.

C1Q4 An alternative to crossing system operators publishing the monthly aggregate turnover statistics in proposal C1(h) is for ASIC to publish these statistics based on the reports we receive under Rule 4.3.2 (Competition). Do you have a preference for whether ASIC or crossing system operators should publish the statistics?

Either alternative is acceptable to us.

C1Q5 Would there be benefit in ASIC maintaining a register on our website of all crossing system operators with a link to each crossing system's website where the information in this proposal is disclosed?

This would be acceptable to us.

Proposal C2: Disclosure to users

We propose to make a new rule requiring a crossing system operator to provide written disclosure to their existing users and ASIC, to new users before accepting an order for the first time, and when there is a material change, about all the matters listed in proposal C1, as well as:

- (a) any obligations imposed on users;**
- (b) execution risk distinguished from any risks on an exchange market, including settlement risks;**
- (c) details about the operation of the crossing system, including but not limited to:**
 - (i) how orders are managed (e.g. how price is determined and cancellations are managed);**
 - (ii) details about any different treatment or arrangements for certain users or order types;**
 - (iii) the level of anonymity given to orders, including whether indications of interest are allowed and the types of information contained in the indication of interest;**
 - (iv) whether related bodies corporate use the crossing system, and if so, how conflicts of interest are managed;**
 - (v) how any other conflicts of interest that may arise in the use of the crossing system are managed;**
 - (vi) if there are liquidity providers or market makers in the crossing system, what commitments (if any) they have (e.g. quoting obligations) or any benefits they receive (e.g. fee discounts); and**
 - (vii) the circumstances in which principal orders may interact with user orders and the nature of the principal orders (e.g. proprietary desk, facilitation, market maker).**

See draft Rule 4A.2.2 (Competition).

The proposed new rule would apply six months from the commencement of the rule.

C2Q1 Do you have any comments on our proposed approach including whether this information should be made available only to a crossing system's users, or to wider market users?

Liquidnet supports this proposal. Liquidnet currently provides all of these disclosures to our clients, apart from the specific disclosure comparing on-exchange and off-exchange execution and settlement risk. We do not object to providing this additional disclosure.

Liquidnet is committed to providing the highest level of transparency to our clients. A well-informed buy-side institution is in the best position to make trading decisions that benefit the beneficiaries of the accounts that it manages. At recent meetings with our clients, a number of them have advised us that we provide a level of transparency regarding our system and processes that goes beyond the level of disclosure provided by any of our competitors.

Proposal C3:

We propose to:

- (a) make a new rule requiring a crossing system operator (Operator A) that sends a client's orders to a crossing system operated by a different entity (Operator B) to provide sufficient information relating to the matters in proposal C2 about Operator B's crossing system to its client; and**
- (b) amend Rule 4.3.1 (Competition) to clarify, for the avoidance of doubt, that crossing system operators must disclose to ASIC whether the crossing system receives orders from other crossing systems.**

See draft Rules 4A.2.2 and 4.3.1 (Competition).

The proposed new Rule 4A.2.2 (Competition) would apply six months from the commencement of the rule. The proposed amended Rule 4.3.1 (Competition) would have immediate effect.

C3Q1 If a market participant routes client orders to another market participant's crossing system (e.g. through an 'aggregator'), it is important for the market participant's client to also receive the information on the crossing systems its orders may be routed to. We have proposed a new rule to require this. Are there any alternative means to achieve this? One alternative is to require that all the matters in proposal C2 be made publicly available.

We agree with this proposal in concept. We would support further consideration of how best to implement this in practice.

C3Q2 Is six months sufficient time to amend disclosures for existing and new clients?

Yes.

Proposal C4:

We propose to amend the following rules:

- (a) Rule 3.4.1(f) (ASX) and (Chi-X) to include that where a trade confirmation includes a statement that a transaction involved a crossing, it also identifies which crossing system the transaction took place on; and**
- (b) Rule 3.4.3 (ASX) and (Chi-X) to have the effect of requiring market participants, when confirming a trade to their wholesale clients, to:**
 - (i) confirm when a market participant entered into the trade as principal (this includes the extended meaning of dealing as principal as set out in Rule 3.2.5 (ASX) and (Chi-X), and is already required for retail clients); and**
 - (ii) identify the crossing system as the venue where the trade was executed.**

See draft Rules 3.4.1 and 3.4.3 (ASX) and (Chi-X).

The proposed amended rules would apply three months from the commencement of the rules.

C4Q1 Do you agree that a client should be made aware when a market participant trades with the client as principal and when trades are executed on the crossing system?

We support this proposal.

Proposal C5: Fairness to all users

We propose to make new rules requiring crossing system operators to ensure that:

- (a) the crossing system is operated by a common set of procedures, which appropriately balances the interests of all users and does not unfairly discriminate between users; and**
- (b) if there are different rules for different types of orders (e.g. market, resting), there is adequate disclosure to clients about the price consequence of the selected order type.**

See draft Rules 4A.3.1 and 4A.2.2 (Competition).

The proposed new Rule 4A.3.1 (Competition) would apply three months from the commencement of the rule. The proposed new Rule 4A.2.2 (Competition) would apply six months from the commencement of the rule.

C5Q1 Do you have any comments on our proposed approach?

We would request that the proposal in clause (a) be further clarified. For example, it should be clarified that a long-term investor has the right to trade with other long-term investors. As demonstrated by the LiquidMetrix data, when institutions are able to protect themselves against HFT and other market intermediaries, they are able to achieve significant cost savings on behalf of their clients.

More generally, it should be clarified that a system can establish categories of participants, as long as those categories are established based on objective criteria and are applied in a non-discriminatory manner.

We support the proposal in clause (b) as it will provide improved disclosure to clients.

Proposal C6: Opting out

We propose to make a new rule requiring crossing system operators to give clients the choice to opt out of their crossing system(s) or any other crossing system that may be accessible through the crossing system at no extra cost and without additional operational or administrative requirements.

See draft Rule 4A.3.2 (Competition).

The proposed new rule would apply three months from the commencement of the rules.

C6Q1 Is there demand from clients to opt out of trading in a crossing system?

This should be the client's choice.

C6Q2 Should clients have the option to opt out of all forms of dark liquidity, including principal trading?

Yes. This should be the client's choice.

C6Q3 What is involved for crossing system operators to build the capacity for clients to opt out in this way?

We currently have this capability, as it is a function of the order type or algo strategy designated by the client.

Proposal C7: Monitoring

We propose to:

- (a) make a new rule requiring crossing system operators to:**
 - (i) monitor orders entered and trades matched through their crossing system(s) for compliance with the crossing system's user obligations and operating procedures;**
 - (ii) report to ASIC any significant non-compliance with these obligations and procedures;**
 - (iii) take action to ensure breaches of the user obligations do not recur; and**
 - (iv) keep records of the monitoring activities, the identified breaches, and the reports to ASIC in accordance with subparagraphs (i) and (ii); and**
- (b) replicate Part 5.11 (ASX) and (Chi-X) on suspicious activity reporting for crossing system operators to ensure that a market participant reports to ASIC suspicious activity that occurs in its crossing system.**

See draft Rules 4A.4.1 and 4A.4.2 (Competition).

The proposed new rules would apply six months from the commencement of the rules.

C7Q1 What is involved for crossing system operators to undertake the proposed monitoring?

While this requirement potentially increases the operation costs for a firm of our size, we believe it is a reasonable requirement and do not object to this proposal. In performing this market monitoring function, we would seek to leverage our expertise in this subject area in other regions, including the US, Europe and Canada.

C7Q2 Is six months sufficient time to implement the changes?

We would contemplate hiring an additional full-time employee to enhance our monitoring capabilities and related responsibilities. We can leverage the expertise we have developed in the US, Europe and Canada, but it could be challenging to complete the hiring and training process and set up appropriate procedures within a six-month period.

Proposal C8: Record keeping

We propose to:

- (a) make a new rule requiring crossing system operators to keep records of the following matters and retain these records for seven years from the date the record was made:**

- (i) all orders, including principal orders, currently in the crossing system; and
 - (ii) any parameters set for an order (e.g. requests to avoid executing with certain other users, minimum executable size, order type, execution venues); and
- (b) issue guidance that records produced in response to a request from ASIC under this rule must be in a particular format (CSV).

See draft Rules 4A.5.1, 4A.5.2, 4A.5.3 and 4A.5.4 (Competition).

The proposed new rules and guidance would apply six months from the commencement of the rules.

C8Q1 Do you agree with our approach to capturing orders that rest or transit through a crossing system?

We currently maintain these records. We support this proposal.

C8Q2 Will the proposed requirements for record keeping successfully enable the replay of orders in a crossing system at any point in time?

We believe this data would be available based on the proposal.

Proposal C9: Systems and controls

We propose to:

- (a) amend Rules 5.6.1 and 5.6.3 (ASX) and (Chi-X) on the responsible use of and system and control requirements for automated order processing, to cover conduct which interferes with the integrity of a crossing system;
- (b) make a new rule requiring crossing system operators to notify all users of the crossing system, and ASIC, as soon as practicable, and at least within 60 minutes, of:
 - (i) any system issues that may materially interfere with the efficiency of the execution of client orders and proper functioning of the crossing system;
 - (ii) how the issues are being managed;
 - (iii) alternative arrangements that have been put in place; and
 - (iv) when the issues have been resolved; and
- (c) issue guidance, in addition to Chapter 5 (ASX) and (Chi-X), to reinforce that crossing system operators, as with all automated order processing, should have adequate resources during stressed market conditions and adequate disaster recovery and capacity management. Depending on the nature and complexity of the crossing system, this may include switching to a back-up facility or bypassing the crossing system and routing to a lit exchange market. Whatever

the case, it must not result in a worse outcome for clients or the lit exchange markets.

See draft Rules 5.6.1 and 5.6.3 (ASX) and (Chi X) and draft Rule 4A.2.3 (Competition).

The proposed amended Rule 5.6.1 (ASX) and (Chi X) and new draft Rule 4A.2.3 (Competition) would apply six months from the commencement of the rules.

The proposed amended Rule 5.6.3 (ASX) and (Chi X) would apply from 26 May 2014 when ASIC Market Integrity Rules (ASX Market) and (Chi-X Market) Amendment 2012 (No. 3) comes into effect.

C9Q1 What processes do crossing system operators currently have in place to inform clients of system issues?

We support this proposal. In clause (b), we would recommend for ASIC to clarify that notification can be limited to impacted users, as certain outages might affect specific categories of users (for examples, users connecting to Liquidnet through a specific internet service provider).

C9Q2 Is 60 minutes an appropriate time period to require a crossing system operator to inform its users and ASIC that there is an issue that may materially interfere with the execution of orders in the crossing system?

Yes.

D Dark liquidity: Other proposals

Proposal D1: Tick sizes

We seek your feedback on two options we are considering to address the issue of tick constraint for equity market products: see Table 4. We would consider initially implementing one of these options on a pilot basis, and periodically update the equity market products on the list (e.g. quarterly with the S&P/ASX index rebalancing).

Table 4: Options to address tick constraint for equity market products

	Description	Result
Option D1.1: Increase middle tick tier	Increase the middle tick tier for equity market products in the S&P/ASX 200 priced from \$2–\$5	Equity market products priced from \$2–\$5 that currently have a tick size of \$0.01 would move to \$0.005.

Option D1.2: Reduce tick size of severely constrained securities	Reduce the tick size of severely tick-constrained equity market products (as listed in Table 9 of REP 331) to the next lowest tier in Part 6.4 (Competition)	A tick-constrained equity market product that currently has a tick size of: <ul style="list-style-type: none"> • \$0.01 would move to \$0.005; and • \$0.005 would move to \$0.001.
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D1Q1 Do you agree that tick sizes are constraining some security prices and that this may be leading to more trading shifting to the dark?

We do not have a position on this proposal, as it is a complicated matter to determine the optimum tick size for a particular stock. In the past, some of our clients have expressed concern that narrowing spread sizes can reduce depth of displayed liquidity, to the detriment of long-term investors.

D1Q2 Do you agree that we should target the most affected securities rather than a complete overhaul of the tick size regime?

Please see our response to Question D1Q1.

D1Q3 Do you have a preference for Option D1.1 or Option D1.2? Is there an alternative model we should consider?

Please see our response to Question D1Q1.

D1Q4 Is a pilot desirable and is six months sufficient time to introduce it?

If this proposal were put forth in isolation, six months might be a sufficient time period for implementation. Because of the number of proposals that ASIC has put forth, firms will be challenged to implement all of these proposals within the proposed timeframes.

Proposal D2: Course-of-sales disclosure (T+3)

We propose to make a new rule requiring market operators to make available (on the same terms as required by Rule 5.1.5 (Competition)) at a minimum the following information on financial products traded on their market, or reported to them, three business days after a trading day and for each transaction:

- (a) the product code;**
- (b) the time of the transaction;**
- (c) the price;**
- (d) the volume;**
- (e) the value;**
- (f) the market participant identifier;**

- (g) the condition code (e.g. type of crossing); and
- (h) the specific market or venue (e.g. ASX's Trade Match, ASX's Centre Point, Chi X, a market participant's crossing system).

See draft Rule 5.1.6A (Competition).

The proposed new rule would apply immediately on commencement of the rule. However, the requirement to identify crossing systems in the venue field would apply from March 2014 when the new ASIC Market Integrity Rules (Competition) on regulatory data take effect.

D2Q1 Should the proposed rule permit market participants to elect for their participant identifiers to be excluded from these reports when those market participants trade exclusively as principal (i.e. not on behalf of clients)?

We do not object to this proposal. Our clients have differing views on this issue. Some clients support immediate identification of the crossing system or other execution venue because it assists them in locating block liquidity. Other clients oppose identification of the crossing system or other execution venue, even after trade date, because of their concern that it provides information to the market if the institution has more shares to trade on the order. We believe that ASIC's proposal for reporting on T+3 is a reasonable compromise.

D2Q2 Do you agree that there is benefit in disclosing the particular crossing system where a trade has been matched?

Please see our response to Question D2Q1.

Proposal D3: Conflicts of interest

We propose to make new and amended rules requiring market participants for all their dealings in all financial products to:

- (a) protect client information, including order routing instructions;
- (b) manage and protect client information when engaging outsourced and third party service providers;
- (c) ensure market participants preference client orders over principal orders at the same price (by amending Rule 5.1.4 (ASX) and (Chi-X) on relevant factors for the obligation on fairness and priority in dealing in Rule 5.1.3 (ASX) and (Chi-X));
- (d) not interpose principal trading between client trades that would otherwise have crossed (by amending Rule 5.1.4 (ASX) and (Chi-X)); and
- (e) not charge retail clients commission when dealing as principal (including on behalf of a related body corporate) (by amending Rule 3.2.4 (ASX) and (Chi-X) on brokerage and commission).

See draft Rule 7.4.1 (Competition) and draft Rules 3.2.4 and 5.1.4 (ASX) and (Chi-X).

We would include additional guidance in RG 181 on the management of conflicts of interest that arise in the handling and executing of orders.

The proposed new and amended rules and guidance would apply three months from the commencement of the rules.

D3Q1 Do you have any comments on the proposed new and amended rules, or the time frame for commencement of these rules?

Protecting client information

We support the general obligation for market participants to protect client information. However, this requirement should be interpreted in a manner that allows for use of information that is fully disclosed to the client and reasonably relates to the market operator's conduct of its business.

For example:

- For US equities, Liquidnet reports its daily trade volume in individual stocks to Bloomberg, an information vendor. This information is reported to Bloomberg after the close of trading. Clients elect whether to have their execution data reported to Bloomberg in this manner. This information can be beneficial for institutions because it assists them in locating block liquidity. The client is not identified to Bloomberg.
- For European equities, Liquidity provides client trading data to a third-party to conduct independent transaction costs analysis (TCA) of the client's executions. This is subject to the client's prior consent, and the client is not identified to the third-party. This third-party TCA provides a benefit to our clients by supporting their execution cost analysis.
- Liquidnet reports to its clients through its desktop application trades that it executes through its system. Clients elect whether to have their execution data included within this service. This information can be beneficial for institutions because it assists them in locating block liquidity. The client is not identified.
- Liquidnet reports liquidity and volume on an aggregated basis, including by country, sector, and market cap (e.g., large, mid, small and micro). Liquidnet does not differentiate between or separately identify buy and sell liquidity. This is useful information for institutions in determining the type of order flow that is available through Liquidnet.

- For Asia-Pacific equities, Liquidnet discloses execution data to a third-party that reports on trade settlement performance. No client names are provided to the third-party. This is valuable information for clients in evaluating their settlement performance.

These are examples of uses of information that reasonably relate to the conduct of our business. We believe these uses should continue to be permitted. We would support a requirement that all uses of information (such as the ones described above) be disclosed to clients.

Referencing client orders over principal orders

We do not object to this requirement, but we believe that when a crossing system operator agrees to trade out of a position at the specific request of a client as a result of an error by the client or an alleged error by the crossing system operator, it should be acceptable to trade out of that position on a parallel basis with other client orders outside our own pool.

Inter-positioning

This proposal would not impact Liquidnet.

Charging commissions on principal trades

This proposal would not impact Liquidnet.

D3Q2 Are there any other rule amendments or proposals we should consider for conflicts of interest?

No comment.

D3Q3 Do you have any comments on the proposal to supplement our guidance in RG 181?

No comment.

Proposal D4: Payment for order flow

We propose to make a new rule for all dealings in financial products that:

- (a) expressly prohibits a market participant from paying direct cash payments or cash rebates to other market participants or AFS licensees for the opportunity to handle or execute their orders; and**
- (b) allows soft dollar incentives for arranging the execution of orders in circumstances where:
 - (i) there is no impact on the market participant's best execution obligations;****

- (ii) details of any incentives offered and received are disclosed to the client in a comprehensive, accurate and understandable way before the service is provided; and
- (iii) the incentive enhances the quality of the financial service to the client.

See draft Rule 7.5.1 (Competition).

We would include additional guidance in RG 181 on how the obligations in the proposed rule may affect securities dealers and other AFS licensees.

The proposed new rule and guidance would apply immediately on commencement of the rule.

D4Q1 Do you agree that direct cash payments and cash rebates should be prohibited?

It is not clear to us how this rule would impact traditional commission sharing arrangements. We would request that ASIC clarify that institutions could continue to participate in traditional commission sharing arrangements where they can obtain best execution through one dealer while at the same time satisfying research obligations to a second dealer. These types of arrangements benefit institutions by enabling them to obtain top-level research without satisfying execution quality.

D4Q2 How would the prohibition of direct cash payments and cash rebates affect commission-based incentives (i.e. commission sharing or commission recapture arrangements) currently used in the industry?

Please see our response to Question D4Q1.

D4Q3 Commission-based incentives may raise similar issues to direct cash payments and cash rebates. How prevalent are commission-based incentives and should they also be specifically prohibited?

Please see our response to Question D4Q1.

D4Q4 Do you agree that soft dollar incentives should be treated differently to direct cash payments?

Please see our response to Question D4Q1.

Proposal D5: Indications of interest

Indications of interest raise a number of regulatory concerns. We seek your feedback on these issues in the context of the Australian market.

D5Q1 Should market participants be required to disclose whether a proposed order is on behalf of a client or as principal (including for a related body corporate)? What controls should be in place to ensure there is appropriate representation about the nature of liquidity?

This proposal would not impact Liquidnet.

D5Q2 If a market participant discloses that a proposed order is a client order, should such disclosure only be permitted when the market participant has received a client order? Or are there instances in which a client would not want to place an order with a market participant, but would want the market participant to send an indication of interest?

This proposal would not impact Liquidnet.

D5Q3 Should market participants be required to obtain client consent for:
(a) using indications of interest in relation to the client's order(s); and
(b) disclosing in the indication of interest that it is in relation to a client order?

Yes.

Forcing institutions to display block order information when it is not in their economic interest to do so means higher profits for high-frequency traders and other market intermediaries and lower investment returns for millions of Australian citizens. Conversely, providing flexibility for institutional traders to seek the most efficient means for executing their block orders will mean reduced trading costs, and higher investment returns, for millions of Australian citizens.

We appreciate the opportunity to comment on the Consultation Paper.

Very truly yours,



James Chatfield,
Director, Liquidnet Australia Pty Ltd



LiquidMetrix Guide to European Dark Pools – March 2013

Key Points

- This guide contains information on the following dark pools: BATS Europe Dark, BlockMatch™, Chi-Delta, Liquidnet, Nordic@Mid, POSIT, Turquoise Dark, UBS MTF.
- We analyse every trade executed on these venues comparing the price achieved to full depth lit liquidity on European trading venues.
- Based on this analysis we can quantify price improvement, EVBBO outliers and a range of other execution quality statistics for each dark pool.
- For each dark pool we also provide some general information such as market model used, stock coverage.

Overview

During March 2013 a total value of **EUR 32.64bn** was traded on the Dark Pools included in this guide.

Some brief statistics:

- Overall an average price improvement of **14.19 BPS** representing **EUR 46.33m** was achieved by dark pool participants compared to a strategy of sending aggressive orders to the best lit venue.
- Although all venues price off the midpoint of the primary market, well over **99%** of dark pool trades executed were also within consolidated EVBBO.

Trade sizes on some venues were of a size that meant the trades could not have been executed on any lit venue (% illiquid on lit).

	BATS Dark	BlockMatch	Chi-Delta	Liquidnet	Nordic@Mid	POSIT	Turquoise Dark	UBS MTF
% Illiquid on Lit	0.06%	0.32%	0.05%	70.80%	0.36%	18.89%	0.28%	0.06%
% inside EVBBO*	99.62%	99.98%	99.71%	99.98%	99.92%	99.73%	99.62%	99.70%
% outside EVBBO*	0.38%	0.02%	0.29%	0.02%	0.08%	0.27%	0.38%	0.30%
% at EBBO Mid*	52.94%	26.20%	55.36%	69.59%	76.23%	52.97%	48.04%	30.20%
Arbitrage v MTF	0.003 BPS	0.000 BPS	0.002 BPS	0.000 BPS	0.000 BPS	0.001 BPS	0.004 BPS	0.004 BPS
Avg Onbook Spread	8.42 BPS	8.99 BPS	8.83 BPS	213.28 BPS	16.13 BPS	36.60 BPS	10.70 BPS	7.48 BPS
Avg Improvement	4.21 BPS	4.49 BPS	4.41 BPS	106.64 BPS	8.07 BPS	18.30 BPS	5.35 BPS	3.74 BPS
Worst Case Spread Capture ***	30.41%	11.37%	32.38%	40.11%	42.38%	33.28%	24.99%	16.75%
Value Traded	€ 5,251 m	€ 3,245 m	€ 6,128m	€ 2,579 m	€82m	€ 4,245 m	€ 2,923 m	€ 8,186 m
No of trades	780,969	365,531	950,241	3,179	7,497	253,759	415,718	1,001,947
Avg Trade Size	€ 6,724	€ 8,878	€ 6,449	€811,163	€10,939	€ 16,729	€ 7,031	€ 8,170
Instruments Traded	1,289	1,325	1,307	720	210	1,393	1,336	1,505
(Avg p.d)	(853)	(651)	(902)	(86)	(65)	(621)	(865)	(959)
Eff Instruments	71.1	74.8	80.0	52.4	20.4	85.8	83.1	72.6
(Avg p.d)	(52.8)	(45.6)	(59.1)	(13.6)	(7.5)	(32.90)	(50.3)	(48.7)
Fees	0.15 BPS	n/a	0.30 BPS	n/a	n/a	n/a	0.30 BPS	0.10 BPS
	0.05BPS (self cross)		0.15 BPS (non IOC/ FOK)					
Cleared / Counterparty	Yes CCP=Multiple	No Bilateral	Yes CCP=Multiple	Bilateral/ CCP=SIx-clear	CCP/ Bilateral	n/a n/a	Yes CCP=Multiple	Yes CCP=Multiple

**Based on value traded

** Based on midpoint reported trades only, not accounting for maker - taker fee/rebate.

*** For dark pools that include bid/offer matches, this statistic is not relevant, see Methodology.

markit Data for BlockMatch, Liquidnet, POSIT, UBS MTF is supplied by Markit BOAT. Markit BOAT is a MiFID-compliant trade reporting platform which enables MTFs and investment firms to meet their pre- and post-trade transparency obligations for their cash equity trades.
For more information contact: markitboatsales@markit.com

The LiquidMetrix Guide to European Dark Pools and data for Turquoise, BATS Europe and Chi-X Europe is supplied by LiquidMetrix.

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Best Execution, Quantified

LiquidMetrix is the suite of software services focussing on execution quality, transaction cost analysis, SOR analysis, best execution compliance and pre-trade cost prediction offered by Intelligent Financial Systems.

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