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ASIC CONSULTATION PAPER CP 277 – PROPOSALS TO CONSOLIDATE THE ASIC MARKET INTEGRITY RULES
SUBMISSION FROM STOCKBROKERS AND FINANCIAL ADVISERS ASSOCIATION

We refer to ASIC Consultation Paper CP 277 issued in January 2017 ("CP 277") relating to the Proposals to Consolidate the ASIC Market Integrity Rules. The Stockbrokers and Financial Advisers Association (SAFAA) appreciates the opportunity to provide the comments below in relation to the Consultation Paper.

SAFAA acknowledges the task that the harmonization of the Market Integrity Rules (MIRs) will have entailed. SAFAA is broadly supportive of the collapsing of market specific Rule Books into a set of Rule Books which are applicable across markets, subject to such modifications and exceptions which make sense and are practical.

As a preliminary matter, we note that the draft ASIC Market Integrity (Securities Market) Rules is a substantial Rule book. The time allowed for comment has not enabled a close examination to identify all of the drafting that differs from the existing Market Integrity Rules, and whether any issues arise from the wording used. There may be issues that emerge over time as particular paragraphs in the new Rule Book are given closer attention or are implemented in practice.

Our comments on the Proposals in CP 277 are set out below.

ASIC Market Integrity Rules for securities markets

B1. Scope of the draft ASIC Market Integrity Rules (Securities Markets)

SAFAA supports the proposal to consolidate the ASIC Market Integrity Rules (APX), ASIC Market Integrity Rules (ASX), ASIC Market Integrity Rules (Chi-X), ASIC Market Integrity Rules (SIM VSE) and ASIC Market Integrity Rules (Competition) into a single rule book.

Market-specific Rule Books were a sensible interim measure to implement the transfer of market supervision to ASIC in a multi-market environment as quickly as possible. However, harmonization of the rules into one Securities Rule books is a logical step to now take.

It makes sense as far as possible to have a level playing field and to apply standardised rules across all markets, subject to any modifications and exceptions that may be appropriate and sensible.

We do not seen any reason why the rules that derive from ASIC Market Integrity Rules (Competition) should not also be applied to SSX, IR Plus and their participants.

We do not have a view as to whether there are reasons to support a waiver of the requirement for SSX, IR Plus and their participants to comply with obligations in the ASIC Market Integrity Rules (Securities Markets) that derive from the ASIC Market Integrity Rules (Competition), until a specified date in the future. This is subject to our fundamental view that the starting point should be that Rules ought to be the same across all markets unless there are good reasons for this not to happen.

We are not in a position to quantify the benefits and/or costs of ASIC proceed with its proposals. From a general standpoint, SAFAA submits that it is self-evident that operating with a standardized Rule book would simplify operational and compliance management within firms.

B2. Application of the ASIC Market Integrity Rules (Securities Markets) to NSXA

SAFAA supports the proposal to apply the ASIC Market Integrity Rules (Securities Markets) to NSXA and participants of NSXA, for the same reasons as are given under B1 above.

We are not aware of any reasons why any specific Rules should not apply to NSXA or to Participants of NSXA.

B3. Definitions in the ASIC Market Integrity Rules (Securities Markets)

SAFAA does not express any view on the Proposal in B3.

ASIC Market Integrity Rules for futures markets

B4. Scope of the draft ASIC Market Integrity Rules (Futures Markets)

SAFAA supports the proposal to consolidate the ASIC Market Integrity Rules (ASX24) and ASIC Market Integrity Rules (FEX) into a single set of ASIC market integrity rules for the same reasons as are given in B1 above.

B5. Definitions in the ASIC Market Integrity Rules (Securities Markets)

SAFAA does not express any view on the Proposal in B5.

ASIC Market Integrity Rules for capital requirements

B6.

SAFAA supports the proposal to consolidate the various capital Market Integrity Rules relating to Capital requirements into two MIR Capital Rule Books.

SAFAA does not express any view on the merits of waiving the requirement to comply with the capital requirements for participants of NSXA who do not offer AOP services. Our fundamental view is that the starting point should be that there should be a level playing field and the same rules should apply to all unless there is a compelling reason why not.

Clarify Existing Market Integrity Rules

C1. Management Requirements and responsible executives

SAFAA supports the removal of unnecessary duplication of obligations and of unnecessary red tape.

Members also acknowledge that having parallel Responsible Executive and Responsible Manager frameworks under the MIRs and the AFS License regime is a legacy of history, and rationalizing this is a step that needed to be taken.

SAFAA members note that the Responsible Executive framework has served the market extremely well, and is a major factor in the sound management that Market Participants have been required to exhibit up until now. SAFAA cautiously supports the Proposals in

C1 subject to the comments set out below and provided that the positive benefits of the Responsible Executive regime are not lost in the harmonization of requirements.

C1 (a) (i) Notification of appointment or cessation of a Responsible Executives.

We agree that, provided an appropriate management and supervisory structure is in place at all times, the obligations to notify ASIC is an unnecessary requirement

C1 (a) (ii) Specific Competence and continuing education standards for a Responsible Executives

SAFAA members have expressed concerns that, in removing the current specific competence and continuing education standards relating to Responsible Executives, thereby leaving it to the "fuzzy law" standard in section 912A(1) Corporations Act (namely to ensure that representatives are adequately trained and are competent) something valuable will have been lost.

Members have expressed to us that they saw considerable value in having to sit the Responsible Executive Exams, formerly administered by the ASX and in later years by industry, such as the Association's accreditation. The process of studying for and sitting the exam focused their minds on the scope and the detail of their supervisory responsibilities, and made them better managers as a result.

Whilst in general SAFAA welcomes flexibility in the approach to regulatory requirements, especially having regard to the fact that there is a wide variety in the business models from one Market Participant to another, this may be one area where too much flexibility might not lead to a better outcome. The role of management in relation to the business of a Market Participant is something which deserves a high standard, in the views of our Members.

Members have proposed that there should be a requirement in the MIRs that Market Participants must ensure that their Responsible Managers have **demonstrated** the requisite knowledge of the law and regulatory requirements relating to their business, or wording to that effect.

The comment has been made that, at a time when the Government has considered it necessary to introduce a national exam for retail financial advisers because of the need for a standard benchmark to apply to financial advisers, the proposal in CP 277 is to remove the existing benchmarks for those occupying the most important senior roles within a Market Participant.

C1 (a) (iii) The requirement for an annual review of allocated supervisory and control procedures

SAFAA agrees that this formal requirement can be removed without any detriment to the management and supervision of a Market Participant's business. As a practical matter, a Market Participant will review its management and supervisory framework on a routine basis as part of its overall obligation to ensure that it is appropriate. The specific annual obligation applied to Responsible Executives in the Rule does not add anything.

C1 (a) (iv) Ensure that Responsible Executives meet annual CPD requirements

It follows that if the concept of a Responsible Executive is abolished, then specific obligations relating to a Responsible Executive would have no meaning.

As regards annual CPD requirements, SAFAA is strongly in favour of minimum mandatory CPD. This is another example where Members are concerned that in abolishing this Rule, the market is not left with a worse result. SAFAA imposes minimum mandatory CPD on its members, however this will not apply to any Responsible Managers of a Market Participant who are not members of SAFAA.

Similar to the comment in respect of C1(a)(ii) above, in the context where the Government is pursuing an approach where minimum CPD is to be mandated for financial advisers, it would be unusual to remove the existing requirement for annual CPD for Responsible Executives and not replace it with an express obligation elsewhere applying to those responsible for the management and supervision of a Market Participant.

C1 (a) (v) Annual notifications to ASIC regarding Responsible Executive

SAFAA agrees that this annual notification is an unnecessary administrative burden that can be abolished without any negative impact on the effective management and supervision of a Market Participant's business.

C1 Q2 Cost savings of removing rules in C1(a)

The cost savings of removing the requirements in C1(a) will vary from firm to firm. SAFAA has members ranging from the largest global investment banks to large national retail broking firms down to small firms, so the cost savings will vary considerably.

However, Members have advised that it goes without saying that removing those requirements whose removal is supported will generate a cost benefit worth achieving.

C1 Q3 Any unforeseen consequences of removing rules in C1(a)

These are set out in relation to the discussion of each specific rule in C1(a). We have noted the risk for some of those rules where abolition could lead to the loss of something of value to the market unless the obligation is replicated elsewhere either in the MIRs or in the Corporations Act or Regulations.

C1 Q4 Removal of title of Responsible Executive

SAFAA agrees that, if the parallel Responsible Executive/Responsible Manager frameworks is to be rationalized, then it makes no sense to retain the title "Responsible Executive".

There will as a practical matter be a need to refer to the relevant positions in the management of a Market Participant by some common title, for the purposes of communication, Guidance, correspondence, ASIC notices, and so on. There is no reason why the term Responsible Manager would not suffice.

C2 Q1 Removal of requirement to notify significant changes to management structure

SAFAA agrees with the removal of this requirement. The overall requirement to ensure that a Market Participant is appropriately managed and supervised, and the penalties for failure to satisfy that Rule, should remove the need for ASIC to sign off that the changes do not negatively impact on the management and supervision framework at the Participant.

C3 Q1 Proposal to update Guidance in RG214 and RG 224 regarding management structure

SAFAA strongly supports the review and updating of the ASIC Regulatory Guides.

As previously mentioned, SAFAA Members support flexibility in relation to compliance with the Rule framework, given the wide variety of business models and circumstances between different Market Participants. Except in relation to the specific rules referred to which SAFAA supports retaining in an appropriate form, SAFAA supports the abolition of the Responsible Executive rules identified, and reliance on the general Responsible Manager framework.

However, general obligations can result in increased regulatory risk for firms, and it is important that firms who make a genuine and reasonable call on interpretation of a requirement are not punished because ASIC subsequently takes a different view of the requirement. For this reason, SAFAA supports a review and updating of the RGs to ensure that there is clear guidance to assist Participants in their decision making.

Members also urge that there be the fullest consultation on the content of the RGs to ensure that there is not "regulation by Guidance Note". The Market at present has some say in the content of Market Integrity Rules, through consultation and through the Ministerial disallowance process.

There is no equivalent disallowance process in relation to the content of ASIC Guidance Notes, hence it is important that the consultation process in relation to these (as well as all other) Regulatory Guides be as full and fair as possible.

Carving out certain trustees from the definition of "Principal"

C4Q1 Members have not expressed a strong view on the proposal to remove from the definition of "Principal", in relation to the Rules applying to "dealing as Principal", those trustees who hold a beneficial interest of less than 5% of the trust, and which was acquired in lieu of fees.

Members consider that the proposal makes sense, and do not oppose it.

C5Q1 Members do not have a view one way or another on the Proposal to limit the expanded definition of "Principal" such that it does not apply to the prohibition on front running of client orders.

Applying clarified Rule 3.2.4 to all Securities Markets

C6Q1 Consistent with our approach to a level playing field applying to all markets in the absence of a compelling reason to the contrary, SAFAA Members do not see any reason why the clarified Rule 3.2.4 should not apply to all securities markets that are subject to the ASIC MIR (Securities Markets).

Aggregation of orders for Block Trades and Large Portfolio Trades

Adoption of definition of Block Trade Rule 4.2.1 into the ASIC Market Integrity Rules (Securities Markets)

C7Q1 Support for this is subject to the comments under C9Q1 below.

Adoption of definition of large Portfolio Trade Rule 4.2.1 into the ASIC Market Integrity Rules (Securities Markets)

C8Q1 Support Members support this Proposal.

Aggregation of Client and Principal Orders for Block Trades

C9Q1 Members have indicated a preference for Option 2. There has also been an argument that there is no logical reason why Option 1 should not be acceptable.

Some members have expressed the view that aggregating principal and client orders on one side of a transaction would be too complicated from an operational standpoint, and they would not seek to do this. Therefore, regardless of whether Option 1 or Option 2 were adopted, those firms would not avail themselves of it.

Feedback from members generally was that if the Block Trade threshold is reached on the basis of client orders, then there could be no objection on any policy grounds to allowing Principal orders to be aggregated with the client orders on one side of the trade. On this basis, there was general support for Option 2.

As regards Option 1, it is worth going back to the ASX Market Rules as in force prior to 2004. MR 2.8.3 was worded as follows

> "(1) A Block Special Crossing in Equity Securities may be effected by a Trading Participant if:
>
> .....
>
> (c) either the Equity Securities are:
>
> (i) bought by the Trading Participant as Principal, or as agent on behalf of one or more clients of the Trading Participant or in both capacities; and
>
> (ii) sold by the Trading Participant as a Principal or as agent on behalf of one client of the Trading Participant. That client may be a Funds Manager acting on behalf of more than one client account;"

It is quite clear that prior to 2004, the ASX MRs allowed aggregation of principal and client orders in order to achieve the Block threshold. The words "in both capacities" make this clear.

The MR was later amended, it would appear in order to clarify that Principal orders could not be on both sides of the Block trade. This was arguably not necessary, due to the Corporations Act prohibition on wash trading. However, the amendments that were made to the ASX MRs appear to have created uncertainty in the Rule. The ASIC MIRs have now continued the restriction on Principal orders being aggregated, which was not originally in the MRs.

As a matter of principle, it does not make sense to be concerned about trades occurring as Block Trades when the threshold would not have been reached without the Principal

order, when the same could be said about a Block Trade when the Principal order comprises the entire (unaggregated) side. The latter trades would not have occurred either but for the Principal Order. There is no difference between a Principal facilitation order whether it is the entire side of a Block or whether it is one order in the aggregated side (so long of course as Principal is not on both sides). In both cases, the position is taken on at risk by the firm.

There is also arguably no logic in exposing a large order that meets the Block threshold to the lit market, and the risks to execution that would result, when it could have been executed as a Block Trade but for not permitting the Principal Order to make up the block threshold.

If one accepts this reasoning, then there is no reason why the ASIC MIRs should not reflect the pre-2004 ASX Rule (i.e. Option 1).

Derivative Market Contracts and Wholesale Client Disclosure

Proposal to remove Class Waiver and apply Rule 3.4.3(1)(b) disclosures to Derivatives Market Contracts

C10Q1 As mentioned previously, the starting point that the Association adopts is that there should be a level playing field and standardised rules across all markets and products, unless there is logic to justify modifications or exceptions to apply.

As regards this Proposal, there has been a strong argument expressed that the Rule 3.4.3(1)(b) disclosures are not needed in the Derivatives Market, and that removing the Class Waiver will just result in unnecessary administrative burden and extra cost.

This argument is based on the fact that the Derivatives Market is, and is known to be, a market with a heavy presence of market makers. A large proportion of liquidity is provided by market participants.

In addition, a significant reason for the requirement, understandably, is the growth of dark pools, and the expressed preference of many institutional investors to know when their orders are being crossed with Principal orders. However, dark pools are not a feature of the Derivatives Market, so therefore this issue is really more a feature of the cash market.

For this reason, there is a strong view that there is no reason why the Class Waiver should not continue. In fact, there is a view that the original disclosure requirement was originally only intended for the Cash market, and that rather than extend (or remove) the Class Waiver, the Rule should be amended to make clear that it **only** applies to the cash market.

Record Keeping for Market Operators

SAFAA members do not express any views on the proposals in relation to Market Operators.

CONCLUSION

SAFAA appreciates the opportunity to comment on the Proposals in CP277. We would be happy to discuss any issues arising these comments, or to provide any further material that may assist. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au.

Yours sincerely,

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