



ASIC

Australian Securities & Investments Commission

ASIC's focus relating to markets

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*Speech to the Financial Information Services Division (FISD) of the
Software and Information Industry Association*

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Introduction

ASIC has set its agenda for the coming year, based on three priorities, around which we organise our business:

- confident and informed investors;
- fair and efficient markets; and
- efficient registration and licensing.

ASIC's focus in the markets area is to promote fair and efficient markets in Australia. With this focus, ASIC is concerned with:

- fair, orderly and transparent financial markets;
- efficient capital raising on our markets; and
- the international competitiveness of our markets.

Background to ASIC's market supervision remit

ASIC is responsible for supervision of conduct and trading on Australia's licensed markets. We conduct real-time surveillance of trading on ASX and, since 31 October 2011, Chi-X. We supervise compliance in those markets with the *Corporations Act 2001* (Corporations Act) and ASIC market integrity rules.

We promote Australian financial markets through surveillance of the market and by taking enforcement action for significant breaches. We will also take pre-emptive action to prevent possible market misconduct. In addition to our focus on insider trading and market manipulation, we also look at matters concerning order management, including problematic algorithms.

Recent market developments

The task of supervision of our markets does not get any simpler. Trading can be effected directly through internet capabilities. Trading is increasingly sourced from offshore. The equities and derivatives markets are more closely linked. The products on offer are more complex. We must add to this the anticipated huge increase in superannuation for funds under management, from \$1.3 trillion to \$3 trillion over the next decade. Much of that will go into our markets.

Growth in automated trading

One of the most significant recent developments in Australian and global markets has been the dramatic growth in automated electronic trading. In

2011 approximately 75% of market participants had AOP certification, compared with only 42% in 2006. High-frequency traders (HFTs) are also becoming more prevalent in Australia. With the recent introduction of Chi-X and ASX's new data centre with enhanced co-location facilities, we expect their presence to only increase. We believe high-frequency trading (HFT) presently accounts for about 25% of trading.

Growth in number of execution venues and fragmentation of order flow

The growth of new execution venues and dark trading in North America and Europe has resulted in significant fragmentation of order flow. In Australia, the number of crossing systems has trebled since 2009 to 16 (operated by 13 participants). We are seeing a trend towards more frequent, smaller trades, away from public markets. We saw the market share of trading in these venues double in the six months to the end of December, to 4% (a small amount still).

Market structure reforms

In October 2011, ASIC released Consultation Paper 168 *Australian equity market structure: Further proposals* (CP 168), which proposed a number of rules that we considered to be necessary to keep pace with technological and market developments. The proposals intend to supplement the robust regime already in place and build on the strengths of the Australian market.

CP 168, which closed 10 February 2012, sought views on proposed market integrity rules relating to:

- automated trading, including HFT;
- volatility controls for extreme price movements;
- enhanced data for supervision;
- the product scope of best execution; and
- pre-trade transparency and price formation in the market.

The role of information and market integrity

FISD is market-information centric, so of particular interest to FISD members may be the role of information and market integrity

With competition between market operators and the trend towards trading in 'dark pools', there is a risk that fragmentation of trading data across trading 'venues' may hinder price formation if a consolidated view of pricing is not easily available.

This may hinder the ability of all investors to see all of the information that is relevant to make an informed investment decision. It may also mean that price discrepancies between markets might last longer than they would with complete, accurate, consolidated market data.

We consider that a consolidated source of trade information that is available for a reasonable price to all users is a fundamental element of a fair, orderly and transparent market.

When we began putting together the regulatory framework to support market competition, we looked internationally. We found that the issue of consolidating pre-trade and post-trade information in a fragmented market had been approached in different ways. We considered several different options, including creating a single information consolidator or approving multiple pre-trade and post-trade information venues. Through extensive consultation with industry, we found that your industry overwhelmingly preferred a multiple consolidator model. This was based on the expectation that existing data service providers would provide those services and it would encourage competition and innovation in data services. This should produce the most efficient outcome for users.

With the release of our market integrity rules for competition in April 2011, we introduced a model that allowed for consolidated market data to be provided by more than one source. To ensure that market data was accessible and easily consolidated, we implemented a rule framework that required:

- market operators to ensure that all pre-trade and post-trade information is complete, accurate and up-to-date and to take reasonable steps to identify and correct any errors;
- market operators to make all pre- and post-trade data available on a non-discriminatory reasonable commercial basis to anyone who wants access to it; and
- consolidators to comply with ASIC's best practice standards. These standards aim to ensure, among other things, completeness and quality of information and robustness and reliance of service.

We have found that many market participants and data vendors have sourced data directly from market operators to create their own interpretations of a consolidated view of orders and trades. Many others rely on the consolidated feeds provided by data vendors. We believe that the process for securing consolidated data is working well.

Information and best execution

A consolidated view of market data is also important for best execution. Market participants need a consolidated view of the market at a point in time in order to provide the best outcome for retail clients.

We have built flexibility into our requirements for best execution for professional clients and other clients dealing in large trades. Consolidated and comparable information about orders and executed trades is necessary to facilitate the evidencing of execution performance against the best prices at the time. This will allow clients to evaluate their broker's execution performance. We are aware that some vendors are offering analytical tools for this purpose, as well as more basic execution-quality statistics for retail investors (e.g. Fidessa's Fragulator).

Information and pre-trade transparency

Pre-trade and post-trade transparency is generally regarded as central to both the fairness and efficiency of a market and, in particular, to its liquidity and quality of price formation.

Information about bids and offers (pre-trade) enables investors to identify trading opportunities, contributing to investor confidence that they will be able to execute a transaction. Investor confidence in a market is an incentive to participate, contributing to liquidity and stimulating more competitive pricing.

It also plays an important role for investor companies in valuing their assets and assessing their ability to raise further funds. The competition market integrity rules already require a high level of trading interest to be immediately pre-trade transparent.

We recently consulted in CP 168 on measures to further promote pre-trade transparency. We have indicated a preliminary intention to make new rules requiring 'dark' orders to provide meaningful price improvement and to tier the block sizes – so the threshold will be \$200,000 for the majority of stocks, down from \$1 million. We will not proceed at this stage with a minimum size threshold for dark orders. However, we will continue to monitor developments, looking particularly at issues of price discovery and widening of spreads. As dark pools grow market share, we will get more concerned. The issue for regulators worldwide is the point at which the market is negatively impacted.

We will also conduct a review of the appropriate regulation of dark pools, as they become more like markets, to ensure protection of overall market integrity.

Market information for better supervision

FIRD is market-information centric, so of particular interest to FIRD members may be our proposals around enhanced data for market surveillance in CP 168

To supervise increasingly complex and technologically advanced markets, ASIC needs to invest in surveillance and data management technology. Our proposals in this area are designed to assist us in fulfilling our surveillance function and thus to promote the ongoing integrity of Australia's markets. The enhancements proposed around data for market supervision can be summarised into three main categories:

- order and trade data;
- clock synchronisation; and
- provision of trading records to ASIC in a standard format.

Data to assist ASIC with surveillance

Origin-of-order information, including a client reference, would allow ASIC to detect and investigate market manipulation and insider trading with greater efficiency and may assist market participants' own risk management.

Proposal

That market participants provide additional regulatory data such as the identification of:

- execution venue;
- the category of client (e.g. principal or agent, retail or wholesale);
- the origin of order (including if indirect market participant/shadow broker); and
- the algorithm that generated the order.

Early position

With a lengthy transitional period, our early position is to require the identification of:

- execution venue;
- whether the order is made as principal or agent;
- origin of order (including a client reference) where that information is readily available (guidance to be provided);
- Australian financial services (AFS) licence number of a client order (where the order originates from shadow broker, and information is readily available); and
- whether the order originates from direct market access.

Synchronised clocks

In today's market, where orders are processed at extraordinary speed, time synchronisation of each market operators' systems is critical to ensuring the accurate consolidation of market data.

Proposal

Enhanced clock synchronisation for market operators (improvement on standards introduced under competition market integrity rules) and the introduction of clock synchronisation for market participants.

Early position

At this stage, ASIC doesn't intend to proceed with the proposed enhancements – however, we will keep this area under review. Feedback from market operators suggested that it was too much too soon, given synchronisation standards were introduced recently under the market integrity rules for competition (October 2011). Market participants suggested that clock synchronisation for a broker participant was currently technically challenging.

Providing records to ASIC and proposing a standard format

ASIC currently receives records in a number of different formats; including documents sent as images, Excel, PDF and CSV files – no formatting standard is currently prescribed. Given the large quantities of data that cannot be easily or consistently analysed, our ability to effectively perform our regulatory functions would be greatly enhanced if the records were to be provided in the same format, and contain standardised information in a specified order.

Proposal

To make a rule to require market participants to use a standard format when sending ASIC transaction-related trading records it requests (CSV or Excel file format (where practicable) and information to be provided in the order prescribed).

Early position

Proposals in CP 168 to be implemented through guidance rather than a rule – with slight revisions to content so information can be easily sourced.

We consider that these changes are important to keep pace with technological and market developments in Australia and global financial market trends, and are increasingly important in an environment with competing exchange markets.

Legal entity identifiers

There have been various initiatives around the world on the data required for market supervision. A coalition of financial services trade associations has started an initiative to develop an international consensus-based system that identifies requirements and standards for a viable, uniform and global legal entity identifier (LEI) solution to aid regulators and industry in monitoring systemic risk. Concurrently, there is also an initiative of the Financial

Stability Board to provide a framework for the development of a global LEI (i.e. to ensure public interests are protected). These initiatives are likely to come together in their delivery, in the relatively near future.

ASIC is supportive of the developments on global LEIs and we do not intend to do anything that is inconsistent with these initiatives. Our requirements for client identification will try to leverage on global LEI initiatives, where possible.

Closing remarks

We recognise that our surveillance capability needs to keep pace with new technology, trading strategies and changing market structure.

We are committed to ensuring that the Australian equity market has effective price formation and provides fair, orderly and transparent trading of financial products for fundamental investors, both small and large. This will, in turn, facilitate efficient capital raising for companies.

Through recently made changes and further proposed changes to the regulatory framework, ASIC aims to ensure:

- prices are available;
- investors receive fair prices (best execution);
- markets operate efficiently and in an orderly way, even where there is volatility; and
- the public market continues to be liquid and efficient.

We will continue to work closely with industry to reach a solution that achieves our regulatory objectives while minimising system changes and costs.