



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 116

Exempt professional financial markets

September 2009

About this paper

This consultation paper sets out when we propose to advise the Minister to exercise the powers under s791C of the *Corporations Act 2001* to exempt from the operation of Part 7.2 specialised financial markets that:

- are accessible exclusively by professional investors; and
- offer products that are not usually traded on public markets used by retail investors (e.g. products other than shares and managed investments).

This paper proposes some additional matters that may need to be addressed in conditions of any exemption.

We have prepared a draft regulatory guide that is attached reflecting the proposals outlined in this paper.

Note: The draft regulatory guide was revised in September 2013.

The Government announced on 24 August 2009 reforms to the supervision of Australia's financial markets. This paper deals with entities exempt from holding a financial market licence so is not affected by those proposals.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 7 September 2009 and is based on the Corporations Act as at 7 September 2009. The draft regulatory guide attached to this paper was revised in September 2013.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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The consultation process

This paper:

- describes how our approach to advising the Minister to exempt a financial market has evolved since we consulted on this issue in 2006;
- proposes new conditions to be imposed on professional financial markets (PFMs) and seeks feedback on other issues stemming from the global financial crisis;
- explores whether our approach to clearing and settlement of transactions effected on a PFM is still appropriate; and
- includes a draft regulatory guide (attached).

You are invited to comment on the proposals in this paper. We also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information.

Your comments will help us develop our policy on exempt PFMs. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Business Cost Calculator Report and/or a Regulation Impact Statement: see Section C, 'Regulatory and financial impact'.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 19 October 2009 to:

Calissa Aldridge
Senior Analyst
Exchange Market Operators
Australian Securities and Investments Commission
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email: calissa.aldridge@asic.gov.au

What will happen next?

Stage 1	7 September 2009	ASIC consultation paper released
Stage 2	19 October 2009	Comments due on the consultation paper
Stage 3	December 2009	Regulatory guide released

A Background to the proposals

Key points

PFMs offer trading services solely to professional investors in a range of financial products.

We consulted in 2006 on the circumstances in which we would recommend that the Minister exempt PFMs from s791C of the *Corporations Act 2001*.

International initiatives in response to the global financial crisis have led us to consider incorporating new standards for PFMs.

Regulatory framework and general approach to market regulation

- 1 A 'financial market' is broadly defined in s767A of the *Corporations Act 2001* (Corporations Act) and includes different types of facilities through which offers to acquire or dispose of financial products are regularly made or accepted. We have given some guidance for assessing whether a person is operating a financial market in Australia in Regulatory Guide 172 *Australian market licences: Australian operators* (RG 172).
- 2 Section 791A of the Corporations Act requires that a person must only operate, or hold out that they operate, a financial market in this jurisdiction if:
 - (a) the person has an Australian market licence (market licence) that authorises the person to operate the market in this jurisdiction; or
 - (b) the market is exempt from the operation of Part 7.2 of the Corporations Act.
- 3 Section 791C gives the Minister the power to exempt a particular financial market or type of financial market from the operation of Part 7.2, as well as the power to impose conditions on the exemption. The Minister has indicated to ASIC particular factors he thinks relevant in considering an application for an exemption. The proposals reflect those factors.
- 4 ASIC's general approach to market regulation is explained in RG 172. It describes the objectives of market regulation as to:
 - (a) protect market participants; and
 - (b) enhance market integrity and financial system stability.
- 5 RG 172 identifies six regulatory outcomes to achieve these objectives. They relate to market information, trading, participant supervision, market supervision, market stability, and clearing and settlement (see Table 1 in the attached draft regulatory guide).

- 6 The guide also describes the circumstances in which we will recommend that the Minister exempt a market from the operation of Part 7.2 on the basis that the regulatory outcomes are not relevant, are achieved without regulation under Part 7.2, or the costs required to achieve the outcomes outweigh the benefits of those outcomes.
- 7 We intend to publish a regulatory guide for exempt professional financial markets (PFMs) and will amend RG 172 to cross-reference the new guide. A draft guide that reflects the proposals in this paper is attached.

Our approach to PFMs

- 8 We consulted in February 2006¹ on circumstances in which we may consider recommending to the Minister that an exemption from Part 7.2 should be granted to PFMs with the following characteristics:
- (a) all market users are professional investors who participate in that market on their own behalf or on behalf of other professional investors;
Note: 'Professional investor' has the meaning given in s9 of the Corporations Act.
 - (b) trading is not anonymous. That is, prior to transactions being entered into, a market user can identify its counterparty or its counterparty can only be one of a limited number of market users known to that user;
 - (c) a limited range of specialised financial products are traded on the facility that are not usually traded on public markets by retail clients (e.g. products other than shares and managed investments); and
 - (d) the operator (or its associated entity) must not operate a clearing and settlement facility for the market.
- 9 The 2006 consultation paper was well accepted by respondents and forms the basis of our current policy.
- 10 Based on our experience with PFMs and our understanding of the regimes in other jurisdictions, we think that the regulatory outcomes of market regulation referred to in paragraph 5 are not always relevant or can be achieved in ways other than requiring a PFM operator to hold a market licence. In addition, regulation under an exemption can more easily be tailored to the characteristics of the specific market.
- 11 As these types of markets have developed, we have recommended allowing market operators to offer multiple products under a single PFM exemption, subject to each type of product being approved. We appreciate that these markets facilitate trading in a wide range of over-the-counter (OTC)

¹ ASIC consultation paper *Regulation of financial markets: Exemptions from Part 7.2 of the Corporations Act*, February 2006.

products and that a single exemption may reduce the compliance cost for PFM operators, as well as reducing ASIC processing time.

- 12 We said that we would oversee these markets by relying on a requirement that the operator hold an Australian financial services (AFS) licence, which would set the minimum standards for operators. In addition, we would recommend imposing conditions relevant to the operation of the financial market. In practice, foreign operators that are exempt from the requirement to hold an AFS licence have been accommodated. This has been done where their overseas regulation is sufficiently equivalent to the AFS licensing obligations in terms of application to market operators, product scope and professional participants.

Note: For example, where there is an ASIC class order for wholesale foreign financial service providers in accordance with Regulatory Guide 176 *Licensing: Discretionary powers—wholesale foreign financial services providers* (RG 176).

- 13 Overseas PFM operators are required to submit to the jurisdiction of an Australian court in any action brought by ASIC in relation to the facility.
- 14 We make each recommendation to the Minister about an exemption on a case-by-case basis. The Minister makes the final decision.

Exempt PFMs operating in Australia

- 15 There are six exempt markets operating in Australia. They deal in foreign exchange (FX), government and corporate bonds, interest rate and credit derivatives. They are listed in Table 1. At the time of publishing, we are reviewing ten new applications and a number of variations to existing facilities. The additional products that these applications address include: precious metal, metal and energy derivatives.
- 16 There are also a number of markets in OTC products that may have similar characteristics to a PFM but that are regulated under a market licence because:
- (a) they chose to be regulated in this way;
 - (b) they do not meet all of the criteria for an exemption; or
 - (c) they applied before the PFM exemption policy was in place.

They are represented in Table 2.

Table 1: Existing exempt PFM operators

Operator	Financial products offered	Date gazetted	AFS licence/exemption
FX Alliance International LLC	FX derivatives and other FX contracts	31/03/2006	AFS licence
GFI Brokers Ltd	FX options and credit default swaps	23/11/2007	ASIC class order exemption
ICAP Brokers Pty Ltd	Bonds	9/03/2004	AFS licence
State Street Bank and Trust Co	FX contracts	10/03/2004	AFS licence
TradeWeb Europe Ltd	Bonds and derivatives on securities, interest rate, credit	18/09/2007	ASIC class order exemption
Tullett Prebon (Singapore) Ltd	FX options	18/09/2007	Exemption under the Corporations Act

Table 2: Market licence holders that offer a market in OTC products

Operator	Financial products offered	Date gazetted
BGC Partners (Australia) Pty Ltd	Bonds	29/09/2006
Bloomberg Tradebook Australia Pty Ltd	Bonds, securities, derivatives, managed investment funds, spot FX	15/11/2006
EBS Service Company Ltd	FX, precious metals	14/03/2005 & varied 21/12/2006
Mercari Pty Ltd	FX and interest rate derivatives	30/05/2005
Yieldbroker Pty Ltd	Bonds and derivatives	3/02/2004
Reuters Transaction Services Ltd	FX, fixed income contracts and derivatives	28/07/2004 & varied 25/10/2005

International developments

- 17 It is generally agreed among securities regulators that the opaqueness of certain OTC products exacerbated the recent global downturn and increased systemic risk. This is because it was difficult for market participants and regulators to ascertain the exposure of participants that defaulted on OTC contracts and the exposure of their counterparties as a consequence of the defaults.
- 18 There has been much discussion in the international regulatory community about the need for higher regulatory standards for trading in OTC financial products in response to the global financial crisis. The Group of Twenty (G20) announced in November that, among other things, national regulators should support exchange and electronic trading of credit default swaps (CDS).² The International Organization of Securities Commissions (IOSCO) taskforce on unregulated financial markets and products has made a number of interim recommendations to enhance transparency of information provided to regulators and the public about CDS transactions and to promote use of central counterparties.³ It has also been suggested that national regulators should examine market supervision.
- 19 Australia is actively engaged in the G20 and IOSCO discussions. We are assessing the recommendations and considering how to give effect to those that are relevant to the Australian market.
- 20 On 11 August 2009, the US administration delivered to Congress a comprehensive package of financial regulatory reform legislation⁴ that proposes sweeping changes to its approach to regulation of OTC derivatives and formalises the proposals in the Financial Regulatory Reform Package (FRRP) announced on 17 June.⁵ There have also been recent enhancements to the US Commodity Futures Trading Commission's (CFTC) regulatory approach for exempt commercial markets (ECMs) in certain contracts (e.g. metal and energy derivatives that play a significant price discovery function).⁶ It is unclear to us at this stage if the FRRP will impact regulation of ECMs or exempt boards of trade (EBOTs). EBOTs offer trading in eligible commodities (e.g. FX, interest rate, debt instruments).

² G20 declaration on *Financial Markets and the World Economy*, 15 November 2008, www.g20.org/Documents/g20_summit_declaration.pdf.

³ IOSCO, Interim consultation report *Unregulated financial markets and products*, 6 May 2009, co-chaired by ASIC and the French Autorité des marchés financiers, www.iosco.org/library/pubdocs/pdf/IOSCOPD290.pdf.

⁴ Financial regulatory reform legislative language, 11 August 2009, www.treas.gov/press/releases/tg261.htm.

⁵ *Financial Regulatory Reform, a New Foundation: Rebuilding Financial Supervision and Regulation*, 17 June 2009 www.financialstability.gov/roadtostability/regulatoryreform.html.

⁶ The *CFTC Reauthorization Act 2008* (US) and 17 CFR 36.3 requires operators of exempt commercial markets to monitor trading on their markets in significant price discovery contracts and to publish daily trade information: www.cftc.gov/newsroom/generalpressreleases/2009/pr5636-09.html.

- 21 The Committee of European Securities Regulators (CESR) has recommended to the European Commission the adoption of a mandatory non-equity trade transparency regime.⁷ The European Commission commented separately on transparency in OTC derivative markets in a recent staff working paper.⁸ IOSCO is also examining transparency of structured finance products.
- 22 We describe these initiatives in more detail in the remainder of this section.
- 23 The current approach to regulating markets with professional participants in the US and Europe is summarised in Table 3 in Appendix 1.

Movement of OTC trades onto electronic platforms

- 24 The G20 declared that regulators should ‘insist that market participants support exchange traded or electronic trading platforms for CDS contracts’. This has been endorsed by the US, which plans to mandate the movement of trades in standardised OTC derivatives onto regulated exchanges and regulated transparent electronic trade execution systems.
- 25 ASIC is indirectly facilitating both the movement of OTC trades onto electronic platforms and enabling Australian professional investors to benefit from access to such trading facilities by recommending the Minister exempt PFMs rather than regulate them under the market licence requirements.

Market transparency

- 26 IOSCO’s taskforce on unregulated financial markets and products noted that the lack of transparency in the CDS market exacerbated the recent market turmoil. It said that a ‘lack of transparency prevent[s] market participants and regulators from accurately assessing ...exposure’ and ‘makes it difficult to detect and deter market misconduct’. The taskforce noted that enhancing transparency and liquidity would lead to more efficient markets and better price discovery. This would in turn reduce volatility and the cost of credit protection.
- 27 IOSCO made an interim recommendation that regulators should facilitate appropriate and timely disclosure of CDS data relating to price, volume and open-interest by market participants, electronic trading platforms, data providers and data warehouses. The same recommendation could be made for OTC derivatives more broadly.

⁷ CESR, *Transparency of corporate bond, structured finance product and credit derivatives markets*, 10 July 2009, www.cesr.eu/data/document/09_348.pdf.

⁸ European Commission, Staff working paper on *Ensuring efficient, safe and sound derivatives markets* (SEC(2009) 905 final), http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/report_en.pdf.

- 28 In the US, it is proposed that all transactions in standardised and non-standardised OTC derivative products must be reported to regulated central counterparties (CCP) and trade repositories, and that aggregated open positions and trading volumes be made publicly available. Details on individual counterparty trades will be made available to the regulators. This is against a background where the Depository Trust and Clearing Corporation (DTCC) had already begun publishing aggregate CDS market data.⁹ Many transactions in OTC traded corporate bonds are already published in real time.¹⁰
- 29 As already mentioned, the CFTC requires ECMs in contracts that have been designated as having a significant price discovery function to publish information daily, such as volume, open contracts and settlement prices.
- 30 CESR has recently recommended to the European Commission the adoption of a mandatory post-trade transparency regime for corporate bonds for which a prospectus has been issued or which are admitted to trading on a multilateral trading facility (MTF). The recommendation also extends to asset-backed securities and collateralised debt obligations that are commonly considered as standardised and to CDSs that are eligible for clearing by a CCP.
- 31 As a minimum, CESR recommends that the price, volume, date and time of execution should be published. Also, the regime should allow for delayed publication for large transactions to minimise any drawbacks on liquidity.

Market surveillance and supervision

- 32 IOSCO has suggested that regulators should have access to transaction and market information to aid in the detection, prevention and enforcement of market misconduct. IOSCO has also suggested that regulators should assess the scope of their regulatory reach and consider if any enhancements are required to regulatory powers to support enhancements to market conduct and information disclosure requirements.
- 33 The US draft legislation intends to give regulators clear and unimpeded authority to deter market manipulation, fraud, insider trading and other abuses in the OTC derivative markets, along with a complete picture of market information.

⁹ In November 2008, DTCC started publishing data on outstanding gross and net notional values and numbers of CDS contracts registered in its Trade Information Warehouse for certain single-name reference entities, all indices and tranches.

¹⁰ Since January 2006, transactions in eligible US dollar denominated corporate bonds are published in real time.

Central clearing of OTC derivatives

- 34 IOSCO has made an interim recommendation that national regulators promote the use of CCPs for CDS transactions by providing ‘sufficient regulatory structure for the establishment of CCPs to clear standardised CDS’. The basis for the recommendation is to improve operational efficiencies, enhance transparency and minimise counterparty default risk.
- 35 The US draft legislation requires all standardised OTC derivative contracts to be centrally cleared through regulated CCPs.
- 36 The International Swaps and Derivatives Association (ISDA) has implemented a protocol to work toward standardising CDS contracts, which will enable the contracts to more easily be centrally cleared.¹¹
- 37 There are several clearing houses that have established, or are considering establishing, CCP clearing of CDSs. They include Intercontinental Exchange (ICE) Trust and CME/Citadel in the US, and ICE Clear, NYSE Euronext, Eurex Clearing and LCH.Clearnet in Europe.

¹¹ The Credit Derivatives Determinations Committees and Auction Settlement CDS Protocol was implemented on 8 April 2009, www.isda.org/press/press040809.html.

B Proposals: conditions on PFM operators

Key points

We propose to recommend that exempt PFM operators be required to:

- have in place rules and procedures to ensure fair and orderly trading and to notify ASIC of disorderly trading conditions and misconduct;
- retain records of transactions and the terms under which participants use the market for a minimum period of five years; and
- require foreign PFM operators to submit to an Australian court in any action taken against the operator in this jurisdiction.

We are seeking views on whether they should be:

- required to make transaction information publicly available on a post-trade basis; and
- allowed to also operate a clearing and settlement facility for the market.

- 38 We propose to recommend that the Minister impose a number of new conditions on exempt PFM operators. We are seeking your views on the proposed conditions, as well as a number of other issues that may result in additional conditions. The proposals and discussion in this section respond to certain risks identified through the global financial crisis and take account of the international developments discussed in Section A. The proposals in this section are reflected in the attached draft guide.

Fair and orderly trading

- 39 It is our policy currently to recommend that the Minister impose a condition on PFMs to notify ASIC of conflicts of interests or if they suspect an Australian participant has or will contravene the Corporations Act or the market's rules. However, unlike market licence holders, exempt PFM operators do not currently have an explicit obligation to ensure markets operate fairly and orderly, to monitor participant conduct or to enforce compliance with the market's rules.
- 40 The approaches currently applied in overseas jurisdictions are varied depending largely on the sensitivities of the contracts traded. There appear to be higher standards for market surveillance and supervision where there is the possibility of the contract playing a significant price discovery function or where trading could manipulate prices on an exchange. Where these risks are less relevant, there are lower standards.
- 41 There appears to be a shift toward enhanced market supervision. For example, the US CFTC recently increased its standards for operators of

ECMs. As already mentioned, IOSCO has suggested that regulators should assess the scope of their regulatory reach and consider if any adjustments are required to support enhancements to market conduct in relation to CDSs. The US FRRP proposes to enhance regulators' powers relating to market manipulation, fraud and other market abuses in relation to OTC derivatives, which may result in further adjustments to the standards for operators.

Proposal

- B1** We propose that PFM operators be required to have rules and procedures to ensure fair and orderly trading. This includes the regular monitoring of users for compliance with market rules.

Your feedback

- B1Q1** Do you agree that PFM operators should have rules and procedures for fair and orderly trading? Please provide reasons to support your view.

- B2** We propose that PFM operators be required to report to ASIC without delay disorderly trading conditions and any conduct that constitutes, or may constitute, misconduct within the meaning of Part 7.10 of the Corporations Act.

Your feedback

- B2Q1** Do you agree that PFM operators should report such incidences to ASIC? What are the costs associated with establishing procedures for reporting to ASIC?
- B2Q2** Should PFM operators have an active obligation to monitor their markets for misconduct within the meaning of Part 7.10? What are the costs and benefits to market operators, participants and the Australian market more generally of such an obligation?
- B2Q3** Should PFM operators have an obligation to discipline users for breaches of market rules and general misconduct? Please provide reasons to support your view.
- B2Q4** Do your answers to these questions vary depending on the nature of the products? Note that PFMs can not offer trading in equities and other financial products usually traded on public markets used by retail investors.

Rationale

- 42 The purpose of these proposals is to ensure the integrity of the specific market and to contribute to the integrity of the overall Australian market.
- 43 We appreciate that the methods of surveilling and supervising a market may vary depending on the nature of the market, participants and the products traded. We would expect the rules and procedures of all PFMs to include monitoring for user compliance with PFM rules, to ensure there is equitable

treatment of users, to detect erroneous trade entry and, where disorderly trading and misconduct within the meaning of Part 7.10 are detected, to report them to ASIC.

Record keeping

Proposal

- B3** We propose that PFM operators be required to retain records relating to the terms under which participants use the market (e.g. user agreements) and the orders and transactions effected on the market. In order to achieve this, operators should retain:
- (a) the date and time that the order was received;
 - (b) the identity of the participant placing the order;
 - (c) the name and quantity of the financial product to which the order applies;
 - (d) the designation of the order as a buy or a sell order;
 - (e) any limit or stop price prescribed by the order;
 - (f) the date and time on which the order expires;
 - (g) details of any modification or cancellation of the order;
 - (h) the price, quantity, date and time of execution of the order; and
 - (i) the identities of the counterparties to the transaction.

Your feedback

B3Q1 Do you agree that these data elements are sufficient to reconstruct trading on a PFM at a given point in time? If you believe that any of the data elements are not relevant or that they are onerous to retain please indicate your reasons.

B3Q2 Are there any other data elements that should be considered? Please provide your reasons.

Proposal

- B4** The records referred to in proposal B3 should be readily accessible for a minimum period of five years. Corrections and other amendments to the records should be easily identifiable and it must not be possible for the records to be otherwise manipulated or altered.

Your feedback

B4Q1 Is five years a suitable retention period? Please give reasons to support your view.

Rationale

- 44 It is important that records are retained and available to support the efficient operation of the market, to manage disputes and assist ASIC to investigate participant misconduct. Terms of business and user agreements typically define the basis on which users agree to trade on a PFM. Order and transaction records are necessary to enable the market operator or ASIC to reconstruct trading at any particular point in time.
- 45 Until recently, we have relied on the record-keeping requirements imposed on AFS licensees or the overseas equivalent standards for PFM operators. However, the AFS standards were drafted with the client-broker relationship in mind, focusing on instructions to deal (see Corporations Regulations 2001, reg 7.8.19), rather than the market operator–user relationship. As a result, there are gaps when compared with the records we expect market operators to retain.
- 46 To address this gap, we have recently started recommending to the Minister that a specific record-keeping condition with the data elements referred to in proposal B3 be imposed.

Submission to Australian court in action against overseas PFM operator

- 47 As discussed in paragraph 12, a PFM operator is usually required to hold an AFS licence unless they are exempt from the requirement to hold an AFS licence. A PFM operator has been able to rely on the AFS licence exemption where we have assessed that the overseas regulation is sufficiently equivalent to the AFS licensing obligations. In these circumstances, the PFM operator is required to submit to an Australian court in any action brought by ASIC in relation to the facility.
- 48 We are considering whether this obligation should be extended to require PFM operators to submit to an Australian court in any action brought against an operator in this jurisdiction (and not just action by ASIC). This would include action taken by market participants.

Proposal

- B5** We propose that an overseas PFM operator be required to submit to the jurisdiction of an Australian court in any action brought against the operator in relation to the facility in this jurisdiction.

Your feedback

B5Q1 Do you agree that market participants and other persons involved with an overseas PFM operating in this jurisdiction should be able to take action against the PFM in this jurisdiction?

Rationale

49 Holders of AFS licences are bound by Australian courts in any action taken against them in this jurisdiction. Our proposed condition would create a level playing field between PFMs that hold an AFS licence and those that are exempt from the requirement to hold a licence.

Post-trade transparency

50 Transparency has been a priority for international securities regulators in assessing responses to the global financial crisis. As discussed in Section A, the US is proposing that aggregated open position and trading volume data in relation to OTC derivatives will be made publicly available on a post-trade basis. IOSCO is considering whether post-trade information about structured finance transactions should be made publicly available. CESR has recommended that this information, as well as corporate bond transactions, should be transparent. It is not current practice for us to recommend that the Minister impose a condition on PFMs to make public details of transactions.

Issue

B6 We are considering whether we should recommend that a post-trade publication condition apply to PFMs.

Your feedback

B6Q1 Should PFM operators make transaction information available to the public? If yes, what information and in what timeframe? Should it be aggregated or transaction based?

B6Q2 What are the implications for market operators in making transaction information available to the market?

B6Q3 Are there persons other than PFM operators that are better placed to publish post-trade information?

B6Q4 Do the answers to these questions vary depending on the nature of the products (e.g. OTC derivatives versus bonds)? Please provide reasons to support your view.

Rationale

51 While we recognise the positive role market information can play in price discovery and facilitating the detection of misconduct, we also recognise the

impact it may have on the willingness of dealers to commit capital. We also recognise that the impact may vary by product type. We are seeking your comments and intend to assess international developments further before forming a view on whether to recommend that the Minister impose post-trade publication obligations on PFMs.

Clearing and settlement of transactions effected on PFMs

- 52 One of the characteristics that currently determine whether we will recommend that the Minister exempt a market is that the market operator or its associated entities ‘must not operate a clearing and settlement facility for the market’. The basis for this condition was that OTC transactions were not typically centrally cleared, and to limit the extent to which a PFM can perform activities typical of a traditional exchange.
- 53 This condition enables a transaction done on a PFM to be centrally cleared by a third-party clearing facility or by a clearing facility that is not operated solely for the PFM. We do not currently permit PFM operators (or an associated entity) from offering a clearing facility exclusively for the market, because the service would look very much like a market for which the market licence regime was intended, with inherent operational and counterparty risk.
- 54 We are minded to retain this as a defining characteristic of PFMs. However, we would like to take this opportunity to explore if it is still appropriate. There is a preference emerging among international regulatory authorities for OTC derivatives to be centrally cleared. We are interested in your views on whether our approach conflicts with that objective.

Issue

- B7** We are considering whether it is still appropriate to require that market operators (and associated entities) do not operate a clearing and settlement facility for the market.

Your feedback

- B7Q1 Is this condition still appropriate in light of the recent international regulatory shift toward central clearing of OTC derivatives?
- B7Q2 Should we consider enabling PFMs and their associated entities to offer a CCP service for the market? What are your reasons?
- B7Q3 Do the answers to these questions vary depending on the nature of the products (e.g. CDSs versus bonds)?

Rationale

- 55 While we recognise the merits of central clearing of OTC derivative transactions, it is questionable whether a PFM operator should be permitted to also offer such a service. This is because the PFM regulatory approach was developed with the aim of enabling the shift from traditional bilateral/phone trading to electronic facilities, which historically did not include central clearing. It was not intended to create an alternative regime to the market licence regime for PFMs that involves all the elements that would ordinarily be regulated under Part 7.2.

Applying these conditions to new and existing exempt PFMs

Proposal

- B8** We will recommend that the Minister impose on all new PFM operators, as a minimum, the conditions identified in the attached draft regulatory guide and those agreed through this consultation process.

Your feedback

- B8Q1 Are there any reasons that new PFM operators can not comply with the proposed conditions?

- B9** We will recommend that the Minister use his powers under s791C(2)(a) to vary or revoke the conditions on exemptions in order to bring all existing PFM operators into line with these same standards.

Your feedback

- B9Q1 Do you agree that the proposed conditions should apply equally to existing and new PFMs?
- B9Q2 Are there any reasons that existing PFM operators can not comply with the proposed conditions?

Rationale

- 56 The conditions discussed in this consultation paper and represented in the draft regulatory guide set the standard that we think should form the basis for all PFMs operating in Australia.
- 57 As discussed, our overarching approach is to assess each market on a case-by-case basis. Where a market raises specific issues, we may recommend that the Minister impose additional conditions to address those issues.
- 58 We note that the Minister always makes the final decision about whether to exempt a PFM and the conditions that should apply to the exemption.

C Regulatory and financial impact

59 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:

- (a) maintaining market integrity and investor protection; and
- (b) facilitating greater transparency and oversight in accordance with the IOSCO interim recommendations and G20 declaration.

60 Before settling on a final policy, we will comply with the requirements of the Office of Best Practice Regulation (OBPR) by:

- (a) considering all feasible options;
- (b) if regulatory options are under consideration, undertaking a preliminary assessment of the impacts of the options on business and individuals or the economy;
- (c) if our proposed option has more than low impact on business and individuals or the economy, consulting with OBPR to determine the appropriate level of regulatory analysis; and
- (d) conducting the appropriate level of regulatory analysis.

61 To ensure that we are in a position to properly complete this process, we ask you to provide us with as much information as you can about:

- (a) the likely compliance costs;
- (b) the likely effect on competition; and
- (c) other impacts, costs and benefits,

of our proposals or any alternative approaches: see 'The consultation process', p. 4.

Appendix 1: International comparison

Table 3: Comparison of current regulatory approaches for firms operating electronic trading platforms in Australia, the US and Europe

Issue	Australia – PFM	US SEC – ATS	US CFTC – ECM/EBOT	Europe – MTF
Approach to regulation	AFS licence plus conditions relating to the operation of a market.	'Broker dealer' plus obligations under Regulation ATS.	ECM/EBOT exempt from regulation, but certain specific rules apply.	'Investment firm' plus rules relating to MTFs.
Product coverage	Financial products as defined in Part 7.1 of the Corporations Act (excluding all products offered on a public market).	Securities. Broadly equity and debt (excluding government debt that is exempt from the ATS regime).	ECM: exempt commodities (e.g. energy & metals). EBOT: excluded commodities (e.g. FX, interest rate).	Any financial instrument. Similar to financial products in Australia except spot & forward FX.
Participants	Professionals acting on own behalf or that of other professionals.	Professionals with no look through to underlying client.	Professionals with no look through to underlying client.	Professionals with no look through to underlying client.
Transparency (trade publication)	Case-by-case assessment. Typically to participants only.	None for low-volume products. ATSS with >5% of total US volume, real-time pre- & post-trade transparency.	Aggregated price & volume on T+1 basis for products with significant price discovery function (SPDC).	Real-time pre- & post-trade shares & products admitted to trading on an EEA exchange if done on MTF.
Surveillance/supervision	Currently must report suspected breaches of market rules & the Corporations Act to ASIC. Proposing that PFM have rules for fair & orderly trading.	Surveil for compliance with market rules. Member of an SRO that monitors for compliance with law. Quarterly transaction report to SEC.	As of 22 April 2009, ECMs must have an SRO to monitor trading in SPDCs. ECM/ EBOT T+1/ weekly transaction reports to CFTC.	Fair & orderly trading. Surveil for compliance with rules. Notify regulator of market abuse. Certain trades reported to regulator on T+1 basis.
Central clearing	Operators (or associated entities) must not operate a clearing and settlement facility for the market.	No specific requirements. Central clearing is possible.	If offered, clearer must comply with relevant CFTC rules. Several offer clearing e.g. CME, AM and ICE.	Must have arrangements to facilitate efficient settlement. Several MTFs offer clearing option.
Record keeping	Currently via AFS licence. Propose market orders & transactions.	Market orders & transactions applied through Regulation ATS.	Aggregated trades. ECM transactions in liquid contracts.	Client orders & transactions applied via investment firm obligations.
Regulatory cooperation	Cooperative agreement with ASIC. Bi-annual report similar to market licence.	Cooperate with SEC or SRO examinations. Periodic reporting.	Cooperate with CFTC special calls. Quarterly reports on contract terms.	Provide full assistance to regulator. No ongoing reporting obligations.

Appendix 2: List of proposals and questions

Proposal/Issue	Your feedback
<p>B1. We propose that PFM operators be required to have rules and procedures to ensure fair and orderly trading. This includes the regular monitoring of users for compliance with market rules.</p>	<p>B1Q1. Do you agree that PFM operators should have rules and procedures for fair and orderly trading? Please provide reasons to support your view.</p>
<p>B2. We propose that PFM operators be required to report to ASIC without delay disorderly trading conditions and any conduct that constitutes, or may constitute, misconduct within the meaning of Part 7.10 of the Corporations Act.</p>	<p>B2Q1. Do you agree that PFM operators should report such incidences to ASIC? What are the costs associated with establishing procedures for reporting to ASIC?</p> <p>B2Q2. Should PFM operators have an active obligation to monitor their markets for misconduct within the meaning of Part 7.10? What are the costs and benefits to market operators, participants and the Australian market more generally of such an obligation?</p> <p>B2Q3. Should PFM operators have an obligation to discipline users for breaches of market rules and general misconduct? Please provide reasons to support your view.</p> <p>B2Q4. Do your answers to these questions vary depending on the nature of the products? Note that PFM operators can not offer trading in equities and other financial products usually traded on public markets used by retail investors.</p>
<p>B3. We propose that PFM operators be required to retain records relating to the terms under which participants use the market (e.g. user agreements) and the orders and transactions effected on the market. In order to achieve this, operators should retain:</p> <ul style="list-style-type: none"> (a) the date and time that the order was received; (b) the identity of the participant placing the order; (c) the name and quantity of the financial product to which the order applies; (d) the designation of the order as a buy or a sell order; (e) any limit or stop price prescribed by the order; (f) the date and time on which the order expires; (g) details of any modification or cancellation of the order; (h) the price, quantity, date and time of execution of the order; and (i) the identities of the counterparties to the transaction. 	<p>B3Q1. Do you agree that these data elements are sufficient to reconstruct trading on a PFM at a given point in time? If you believe that any of the data elements are not relevant or that they are onerous to retain please indicate your reasons.</p> <p>B3Q2. Are there any other data elements that should be considered? Please provide your reasons.</p>

Proposal/Issue	Your feedback
<p>B4. The records referred to in proposal B3 should be readily accessible for a minimum period of five years. Corrections and other amendments to the records should be easily identifiable and it must not be possible for the records to be otherwise manipulated or altered.</p>	<p>B4Q1. Is five years a suitable retention period? Please give reasons to support your view.</p>
<p>B5. We propose that an overseas PFM operator be required to submit to the jurisdiction of an Australian court in any action brought against the operator in relation to the facility in this jurisdiction.</p>	<p>B5Q1. Do you agree that market participants and other persons involved with an overseas PFM operating in this jurisdiction should be able to take action against the PFM in this jurisdiction?</p>
<p>B6. We are considering whether we should recommend that a post-trade publication condition apply to PFMs.</p>	<p>B6Q1. Should PFM operators make transaction information available to the market? If yes, what information and in what timeframe? Should it be aggregated or transaction based?</p> <p>B6Q2. What are the implications for market operators in making transaction information available to the market?</p> <p>B6Q3. Are there persons other than PFM operators that are better placed to publish post-trade information?</p> <p>B6Q4. Do the answers to these questions vary depending on the nature of the products (e.g. OTC derivatives versus bonds)? Please provide reasons to support your view.</p>
<p>B7. We are considering whether it is still appropriate to require that market operators (and associated entities) do not operate a clearing and settlement facility for the market.</p>	<p>B7Q1. Is this condition still appropriate in light of the recent international regulatory shift toward central clearing of OTC derivatives?</p> <p>B7Q2. Should we consider enabling PFMs and their associated entities to offer a CCP service for the market? What are your reasons?</p> <p>B7Q3. Do the answers to these questions vary depending on the nature of the products (e.g. CDSs versus bonds)?</p>
<p>B8. We will recommend that the Minister impose on all new PFM operators, as a minimum, the conditions identified in the attached draft regulatory guide and those agreed through this consultation process.</p>	<p>B8Q1. Are there any reasons that new PFM operators can not comply with the proposed conditions?</p>
<p>B9. We will recommend that the Minister use his powers under s791C(2)(a) to vary or revoke the conditions on exemptions in order to bring all existing PFM operators into line with these same standards.</p>	<p>B9Q1. Do you agree that the proposed conditions should apply equally to existing and new PFMs?</p> <p>B9Q2. Are there any reasons that existing PFM operators can not comply with the proposed conditions?</p>



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 000

Exempt professional financial markets

[September 2013](#)~~September 2009~~

About this guide

This guide is for operators of financial markets for professional investors.

It sets out when we propose to advise the Minister to exercise the powers under s791C of the *Corporations Act 2001* to exempt from the operation of Part 7.2 specialised financial markets that:

- are accessible exclusively to professional investors; and
- offer products that are not ~~usually traded~~ [available for trading](#) on public markets ~~used by retail investors (e.g. products other than shares and managed investments).~~

This guide does not deal with the requirements for other types of financial markets contemplated under Part 7.2, such as Australian market licences for domestic and overseas operators, and low volume markets.

[Note: This draft regulatory guide was first issued in September 2009. It was updated in September 2013 to:](#)

- [clarify the products that are able to be traded on a professional financial market \(see RG 000.8\(b\)\); and](#)
- [remove the 'non-anonymity' requirement in RG 000.8\(c\).](#)

[The reasons for these changes are explained in the appendix to this guide. Changes made in the September 2013 update are shown as tracked changes.](#)

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About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This draft guide was first issued on 7 September 2009 and is based on legislation and regulations as at the date of issue.

[This draft guide was reissued in September 2013 to reflect the policy updates explained in the appendix.](#)

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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A Overview

Key points

A person must only operate a financial market in this jurisdiction if they have an Australian market licence or the Minister has exempted the market from the requirement to hold such a licence.

We may recommend that the Minister exempt certain financial markets for professional investors from Part 7.2 of the *Corporations Act 2001* where it is justified that the market should not be regulated under Part 7.2.

Regulatory framework

RG 000.1 A ‘financial market’ is broadly defined under s767A of the *Corporations Act 2001* (Corporations Act) and covers different types of facilities through which offers to acquire or dispose of financial products are regularly made or accepted. We have given some guidance for assessing whether a person is operating a financial market in Australia in Regulatory Guide 172 *Australian market licences: Australian operators* (RG 172). RG 172 also explains our general approach to market regulation.

Note: This regulatory guide complements RG 172 and should be read in conjunction with RG 172.

RG 000.2 Section 791A of the Corporations Act requires that a person must only operate, or hold out that they operate, a financial market in this jurisdiction if:

- (a) the person has an Australian market licence (market licence) that authorises the person to operate the market in this jurisdiction; or
- (b) the market is exempt from the operation of Part 7.2 of the Corporations Act.

RG 000.3 Section 795B authorise the Minister to grant market licences to operators of financial markets. Market licence holders are required to comply with all of Part 7.2. There is no power for the Minister or ASIC to relieve licensees from elements of Part 7.2.

RG 000.4 Alternatively, it is possible for the Minister to exempt a particular financial market or type of financial market from the entire operation of Part 7.2. Section 791C gives the Minister this power, along with the power to impose conditions on the exemption.

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Market evolution

- RG 000.5 In recent years, we have seen the development of a number of specialised facilities used exclusively by professional investors for trading in over-the-counter (OTC) products. The business models of foreign voice brokers, for example, have evolved to include electronic trading facilities. These facilities can constitute a ‘financial market’ under the Corporations Act, and accordingly, are subject to Part 7.2.
- RG 000.6 Part 7.2 imposes specific obligations on operators of financial markets, including the requirement to have operating rules. However, the facilities mentioned in RG 000.5 typically operate through bilateral agreements for the provision of service between the broker and the client rather than rules which apply to each and every user of the facility. In addition, many of these types of facilities are not regulated as financial markets overseas.
- RG 000.7 The purpose of this guide is to facilitate the evolution of such trading arrangements for professional investors. The approach is based on recognising that the brokers providing these services are regulated under the Australian financial services (AFS) licensing regime and that the regulatory outcomes referred to in RG 172 and outlined in Table 1 of this guide are achieved through means other than the operation of Part 7.2, or that the outcomes are not relevant.

Exemption from Part 7.2

- RG 000.8 The Minister can grant an exemption from Part 7.2. When deciding whether to recommend that the Minister exempt a professional financial market (PFM), ASIC will usually look for the following market characteristics:
- (a) market users are professional investors who participate in the market on their own behalf or on behalf of other professional investors;

Note: ‘Professional investor’ has the meaning given to the term under s9 of the Corporations Act.
 - (b) only financial products that are not ~~usually traded~~ available for trading on public markets ~~by retail investors~~ are traded on the facility ~~(e.g. products other than shares and managed investment schemes); and~~ and ~~(e) trading is not anonymous. That is, before transactions are entered into, a market user can identify its counterparty or its counterparty can only be one of a limited number of market users known to that user; and~~ (c) the operator (or its associated entity) must not operate a clearing and settlement facility for the market.

Note: For an explanation of the policy updates to draft RG 000.8, see the appendix.

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- RG 000.9 Our approach to PFMs does not affect the approach that we have stated we will take in RG 172 in relation to recommending exemptions for other types of financial markets.

Who is involved in granting exemptions?

Minister

- RG 000.10 The Minister, with the advice and assistance of ASIC, has the power to licence and exempt financial markets operating in Australia.

Department of Treasury

- RG 000.11 The Department of Treasury:
- (a) advises the Minister on financial market policy;
 - (b) briefs the Minister on applications for market licences and exemptions from the licensing provisions; and
 - (c) arranges for market licences and exemptions to be drafted by the Office of Legislative Drafting and Publishing (OLDP).

ASIC

- RG 000.12 ASIC regulates financial markets by:
- (a) advising the Minister about applications for market licences and exemptions;
 - (b) assessing and enforcing market operators' compliance with their obligations; and
 - (c) enforcing the prohibition on a person operating, or holding out that they operate, a financial market in Australia, if the person does not hold a market licence or an exemption.

Applying for an exemption from Part 7.2

- RG 000.13 If you consider that you might come within our policy for exempt professional financial markets, you can make an application to us in accordance with Section D. If you are granted an exemption you must comply with the conditions applied to the exemption.

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B Our approach to exempting professional financial markets

Key points

The Minister decides whether to exempt a market from Part 7.2.

We assess applications on a case-by-case basis.

We will advise the Minister to exempt a PFM if:

- the market operates exclusively for professional investors; and
- the regulatory risks can be managed without regulation under Part 7.2.

The regulatory approach we take for these markets is to ensure the operators meet the requirements for an AFS licence plus certain conditions relevant to the operation of a financial market.

Regulating financial markets

Our general approach

RG 000.14 Our general approach to regulating financial markets in Australia is outlined in RG 172 (for Australian operators) and Regulatory Guide 177 *Australian market licences: Overseas operators* (RG 177). The purposes of market regulation (as set out RG 172 at RG 172.7) are to:

- (a) protect market participants; and
- (b) enhance market integrity and financial system stability.

RG 000.15 Market regulation achieves these purposes primarily by requiring market operators to be licensed, or exempted from the requirement to hold a licence, and to comply with the associated obligations and conditions.

RG 000.16 The Minister has the power to authorise financial markets to operate in Australia and to set the terms under which they may operate. We advise the Minister on appropriate action based on an assessment of the regulatory risks and public interest benefits posed by the market.

Our approach to professional financial markets

RG 000.17 There are six broad regulatory outcomes that we aim to achieve in regulating all financial markets in Australia. These are set out in Table A of RG 172 and summarised in the first column of Table 1 in this guide. We have examined these regulatory outcomes in relation to PFMs and we take the view that usually:

- (a) the regulatory outcomes are not relevant to these markets;
- (b) the regulatory outcomes can be achieved without regulation under Part 7.2; or
- (c) the cost of regulation required to achieve the regulatory outcomes significantly outweighs the benefits of those outcomes.

RG 000.18 The reasons that the regulatory outcomes of Part 7.2 are not relevant to PFMs or are otherwise achieved are explained in column two of Table 1. A fundamental element is that there is no retail involvement so many of the investor protections of Part 7.2 are less relevant. The outcomes that are relevant to PFMs can be achieved more efficiently by using the AFS licensing regime, without lessening the market integrity or system stability goals referred to in RG 000.14. The AFS licensee obligations in the Corporations Act that are relevant to market regulation objectives are set out in column three of Table 1.

Table 1: Relevance of financial market regulatory outcomes to professional financial markets

Regulatory outcomes of Part 7.2 (from RG 172)	Relevance of these regulatory outcomes to PFMs	Relevant AFS licensee obligations
<p>1 Market information</p> <p>Market users should use the market on an informed basis.</p>	<p>PFMs rely on user agreements, terms of business and/or other bilateral arrangements to establish the rights and responsibilities of participants and the operator, rather than operating rules that are typical of exchanges. Participants are professional investors who do not need and expect the market operator to provide extensive product information.</p>	<p>s912A(a) services to be provided efficiently, honestly and fairly</p>
<p>2 Trading</p> <p>Users are confident the market operates fairly and that they will be treated fairly.</p>	<p>Users are professional investors who are able to ensure that the terms on which they agree to use the market are fair and are able to assess whether they have been treated fairly. They have non-discriminatory access to the bids and offers.</p>	<p>s912A(a) services to be provided efficiently, honestly and fairly</p>
<p>3 Participant supervision</p> <p>Users are confident about the participants they deal with.</p>	<p>Participation on these markets is limited to professional investors acting on their own behalf or that of another professional investor. PFMs are available to a limited number of investors <u>that are often</u> known to each other through contractual relationships. <u>In some cases,</u> Participants participants are typically able to choose the other participants with whom they wish to deal.</p>	<p>s912A(a) services to be provided efficiently, honestly and fairly</p>

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Regulatory outcomes of Part 7.2 (from RG 172)	Relevance of these regulatory outcomes to PFMs	Relevant AFS licensee obligations
<p>4 Market supervision</p> <p>Listed entities, participants and market users that breach the law or the market rules are likely to be detected and disciplined and supervision is not compromised.</p>	<p>Participants of PFMs do not expect the operator of the market to supervise the market in the same way an exchange is supervised. Professional participants are likely themselves to be able to detect misconduct and breaches of trading practices that disadvantage them and to protect their own interests if they occur.</p> <p>Nonetheless, PFM operators must have rules and procedures for fair and orderly trading (see Section C), which ensures operators have the capability, procedures and processes in place to intervene in transactions where the participants are not acting in accordance with the market's trading terms (including if the operator believes a bid or offer has been entered for an improper purpose) or to manage erroneous entries. PFM operators must report such incidences to ASIC.</p> <p>We also require that PFM operators manage conflicts of interest and report to us, on a periodic basis, the details of significant conflicts and how they were resolved.</p>	<p>s912A(a) services to be provided efficiently, honestly and fairly; s912A(aa) adequate arrangements for managing conflicts of interest; s912A(h) adequate risk management systems</p>
<p>5 Market stability</p> <p>The market operates reliably and is not at risk of failing.</p>	<p>The consequences of financial market instability vary depending on the availability of alternative execution arrangements (and the ease with which users can switch to such arrangements) and the nature of linkages to third party services such as clearing and settlement. It is unlikely that the collapse of a PFM would result in substantial instability in the financial system because:</p> <ul style="list-style-type: none"> • it is relatively easy to switch to an alternative electronic facility or telephone broker; • PFM operators do not have any counterparty risk; and • settlement of transactions is <u>typically</u> managed without the involvement of the operator. <p>In any event, these markets are required to have suitable systems, controls and risk management procedures in place as part of their AFS licence (or equivalent overseas regulatory obligations).</p>	<p>s912A-(d) adequate resources to provide the service; s912A(h) adequate risk management systems; s912A(f) adequately trained staff</p>
<p>6 Clearing and settlement</p> <p>Transactions are cleared and settled promptly, fairly and effectively.</p>	<p>This regulatory outcome is <u>not relevant of limited relevance</u> because participants <u>typically</u> determine themselves how to settle transactions.</p>	

Conditions apply to operators of exempt professional financial markets

- RG 000.19 Exempt PFMs must hold an AFS licence, or be subject to sufficiently equivalent regulation overseas. They must also comply with certain conditions imposed by the Minister which are specific to the operation of the market. The conditions that apply to operators of exempt professional financial markets are set out in Section C.
- RG 000.20 This is the approach applied in some other jurisdictions for markets like PFMs. The operator of a financial market at the very least may be engaging in the financial service of ‘arranging’ and/or ‘dealing’ in the financial products that are traded on that market facility. We consider that the requirement to hold an AFS licence or to be subject to overseas regulation that we have deemed sufficiently equivalent to the AFS licence regime will achieve an appropriate regulatory balance when coupled with the conditions on the exemption applied to a PFM.
- RG 000.21 In the case of overseas operators seeking to operate a PFM in Australia, we may have regard to the regulatory standards of the overseas authority that regulates or oversees the operator. Where we perceive that there is a material difference in the standard of, or approach to, regulation, or that there are significant benefits in us directly regulating an operator, we may recommend that the Minister impose conditions on the exemption to address this gap.

When we will advise the Minister to exempt a professional financial market

- RG 000.22 We will advise the Minister to exempt a PFM that meets the criteria in RG 000.8 on the basis that there is no additional public benefit in regulating the market under Part 7.2.
- RG 000.23 We anticipate recommending that the Minister exempt a market where the regulatory outcomes in Table 1 are fulfilled (if relevant) and that the exemption should be subject to the conditions set out in Section C.
- RG 000.24 This approach allows us to address differences in the business models of PFMs. It also contributes to our objective of ensuring that Australia’s financial markets are fair and transparent by enabling movement of transactions in financial products from bilateral broking to the more transparent electronic trading facilities.
- RG 000.25 In most cases, public consultation about a PFM exemption application will not be necessary because PFMs will generally have an impact on only a limited number of Australian investors. We also note that the Minister is not required to act on our advice when assessing a PFM application.

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Case-by-case assessment

- RG 000.26 We will consider applications by operators of PFMs on a case-by-case basis and make individual recommendations to the Minister. This enables us to consider each application on its merits and to ensure that any advice we provide about an application, and any conditions we recommend, can be tailored to deal with specific issues relevant to the market in question.
- RG 000.27 There are a number of factors pertaining to the operation of the type of facility described in RG 000.8 that will assist us to conclude whether we should recommend that the Minister exempt the PFM. Such factors may include:
- (a) the number of market users;
 - (b) the likely size and volume of trading on the facility;
 - (c) the nature of the financial products traded on the facility;
 - (d) the arrangements adopted to ensure reliable contract formation between market users, and the nature of the contractual framework between market users and the operator;
 - (e) the extent Australian market users will use the facility;
 - (f) the arrangements for ensuring that market users do not participate in the market on behalf of retail investors;
 - (g) the arrangements for the operator to monitor compliance by market users with user agreements and trading obligations, and the action the operator will take in the event of non-compliance;
 - (h) whether the facility has suitable systems, controls and risk management procedures in place;
 - (i) if relevant, how the facility is regulated outside this jurisdiction;
 - (j) whether users of the facility would expect the facility to be regulated under the Australian market licensing regime;
 - (k) the extent to which the integrity and stability of the market depends on:
 - (i) comprehensive supervision by the market operator; and
 - (ii) rules under which the facility operates being subject to ongoing regulatory supervision by the Minister;
 - (l) the likely impact of the operation of the market on the fair, orderly and transparent operation of other financial markets operated in Australia;
 - (m) the likely impact of the failure of the market on the reputation of the Australian financial system generally; and
 - (n) consistency with international regulation, including G20 initiatives for the regulation of trading in OTC derivatives and other financial products.

When we will advise the Minister not to exempt a PFM

- RG 000.28 We do not anticipate recommending an exemption under this policy if the facility offers trading in shares, interests in a managed investment scheme or other financial products that are available [for trading](#) on a public market ~~used by retail investors~~, even if the facility meets the other criteria in RG 000.8.
- RG 000.29 We also do not anticipate recommending an exemption under this policy for a facility that will operate in a similar manner to a licensed market usable by retail investors, but which in practice just limits access to professional investors or limits products to those not referred to in RG 000.28.

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C Conditions applied to exempt professional financial markets

Key points

The Minister may impose conditions when exempting a PFM from Part 7.2.

This section outlines the conditions that we typically recommend the Minister should impose on an exempt PFM.

Conditions typically applied to exempt professional financial markets

- RG 000.30 When we advise the Minister to exempt a PFM from Part 7.2, we will also recommend to the Minister to impose the conditions outlined in this section on the exempt PFM. We may also recommend to the Minister to impose additional conditions if we consider it necessary based on the nature of the relevant market.

Fair and orderly trading

- RG 000.31 The operator must have rules and procedures to ensure fair and orderly trading. This includes the regular monitoring of its users for compliance with its rules.
- RG 000.32 The operator must report to ASIC, without delay, disorderly trading conditions and any conduct that constitutes, or may constitute, misconduct within the meaning of Part 7.10.
- RG 000.33 The purpose of these conditions is to ensure the integrity of the specific market and to contribute to the integrity of the overall Australian market.

Australian financial services (AFS) licence

- RG 000.34 The operator of the PFM must hold an AFS licence that covers the financial services associated with the operation of the market, unless it is exempt as a provider of foreign financial services as outlined in RG 000.35. The basis for this condition is explained in RG 000.20.

Foreign operators

- RG 000.35 Where a foreign operator is exempt from the requirement to hold an AFS licence, whether under the Corporations Act, Corporations Regulations or a class order for wholesale foreign financial service providers, we must be

satisfied that the operator is sufficiently regulated by an overseas regulator. We will rely on the ASIC equivalence assessment undertaken for the class order.

Note: For more information on exemptions for wholesale foreign financial services providers, see Regulatory Guide 176 *Foreign financial services providers* (RG 176).

- RG 000.36 A foreign operator must submit to the jurisdiction of an Australian court in any action brought against the operator in relation to the facility in this jurisdiction.
- RG 000.37 It must register with ASIC as a foreign company if required under the Corporations Act and have a local agent.

Clearing and settlement arrangements

- RG 000.38 The operator (or its associated entity):
- (a) must not operate a clearing and settlement facility for the market; and
 - (b) may provide clearing and settlement arrangements for the market only by providing information and by establishing procedures for the settlement of transactions effected through the market.
- RG 000.39 The purpose of this condition is to limit the nature of the activities that PFM operators may otherwise engage in. If the operator is also operating a clearing and settlement facility for transactions effected through the market, then we may consider this to be an indication that the facility involves a more extensive range of activities than would be appropriate for an exemption from Part 7.2.
- RG 000.40 An independent third party may provide clearing and settlement facilities for the market.

Periodic reporting requirements

- RG 000.41 The operator must provide us with certain information on a biannual basis, including trading volumes and details of Australian participants. The operator must also notify us about certain events as soon as practical, including:
- (a) material changes to the facility, trading processes and control of the operator;
 - (b) misconduct relating to the operator or its key staff; and
 - (c) persons who may commit or have committed a significant contravention of the Corporations Act or the market's rules and any disciplinary action against the user.

- RG 000.42 These conditions are similar to those applied to market licensees. The purpose is to provide us with an ongoing understanding of the nature and extent of activity conducted on the relevant market, as well as information that we consider is relevant in determining the ongoing integrity of the market.

Annual reporting requirements

- RG 000.43 Operators are required to prepare an annual report. The Minister may require an audit report on the annual report. The operator must set out the extent to which it has complied with the conditions applied to the PFM during the reporting period, as well as providing us with other details, including:
- (a) a description of the activities that the operator has undertaken;
 - (b) details of material system outages;
 - (c) details of Australian participants;
 - (d) volume of trading;
 - (e) complaints made to the operator by users and the operator's response;
 - (f) regulatory issues encountered and actions taken to resolve them; and
 - (g) details of significant conflicts of interest and how they were resolved.
- RG 000.44 These conditions are adapted from the obligations applied to market licensees under s792F of the Corporations Act and, along with any others that may be imposed by the Minister, are intended to provide us with an understanding of the nature and extent of the activities that have been conducted on the market during the reporting period.

Record keeping

- RG 000.45 An operator must retain records relating to the orders and transactions undertaken on the market as well as the terms under which participants use the market. These records must be readily accessible to ASIC for at least five years. Corrections and other amendments should be easily identifiable and it must not be possible for the records to be otherwise manipulated or altered. It is important that records are retained and available to support the efficient operation of the market, to manage disputes and assist in investigations of misconduct.

Assistance and cooperation arrangements

- RG 000.46 An operator must give assistance to ASIC, including providing access to information relating to the facility.
- RG 000.47 An operator must also enter into a written agreement with us to facilitate cooperation and information sharing. The agreement will be entered into

prior to the granting of an exemption and will define the scope of cooperation and clarify our expectations about an operator's compliance with the exemption conditions. This is consistent with the obligations imposed on market licensees.

Operate as set out in the application

- RG 000.48 The market must be operated in materially the same way as its operation is described in the PFM application. This condition is intended to ensure that the way that the market is operated is not altered in such a way that an exemption from Part 7.2 may no longer be appropriate.

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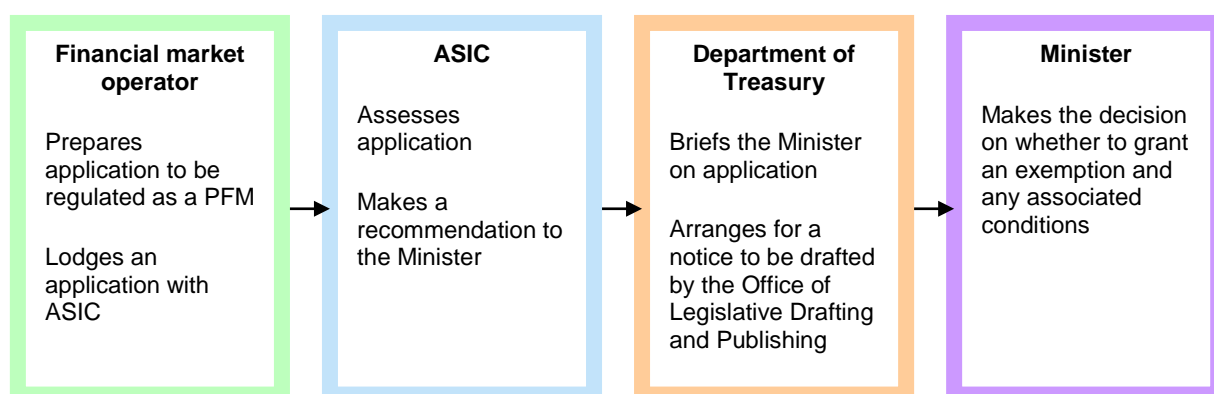
D Applying for an exemption to operate a PFM

Key points

ASIC, the Department of Treasury and the Minister all play a role in the process of applying for an exemption from Part 7.2.

The roles are described in RG 000.10–RG 000.12 and the process is illustrated in Figure 1.

Figure 1: The process for applying for an exemption from Part 7.2



How to apply for an exemption

- RG 000.49 An application for exemption from Part 7.2 should be made to ASIC in writing. The application should fully describe:
- (a) the operation of the particular financial market or type of financial market;
 - (b) why Part 7.2 should not apply. You should make a clear case for why the regulatory outcomes described in column one of Table 1:
 - (i) are not relevant to the market;
 - (ii) are achieved without regulation under Part 7.2; or
 - (iii) will involve costs that significantly outweigh the benefits of those outcomes; and
 - (c) how the operator will comply with the obligations and conditions described in Sections B and C.

Prospective applicants should contact the [Exchange Market Operators/Financial Market Infrastructure](#) team at ASIC prior to lodging an application to discuss the information we require to assess an application.

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How we deal with applications for exemption

- RG 000.50 We aim to advise the Minister about an application within four weeks of receiving it, as long as the application contains all the documents and information needed by us to assess it. The four-week period does not include the time we spend waiting for an applicant to respond to a request for further information, nor the time the Minister takes to consider the application.
- RG 000.51 Occasionally, we may need to consult with the public about a PFM exemption application. In such cases, it will take us longer to provide advice to the Minister. In deciding whether to consult with the public, we will consider:
- (a) whether the application is for a type of financial market or a particular financial market;
 - (b) the features of the market, including:
 - (i) the size of the financial market; and
 - (ii) the market users; and
 - (c) the likely impact of the market on Australian investors and the integrity of Australian markets.
- RG 000.52 Once the Minister decides to exempt a PFM and issues a notice of exemption from Part 7.2, a fee is payable. For the current fee, refer to the Corporations (Fees) Regulations 2001.

Appendix: September 2013 policy updates

RG 000.53 This appendix explains why we have updated our policy to remove the 'non-anonymity' requirement and clarifies the products that can be traded on PFMs, in RG 000.8.

Background

RG 000.54 Consultation Paper 116 *Exempt professional financial markets* (CP 116) and this draft regulatory guide were published in September 2009. Since that time, we have been using the principles in the CP and this draft regulatory guide to guide our approach to advising the Minister on exempting PFMs.

RG 000.55 It is worth noting that the Australian Government has been considering possible reforms to the financial market licensing regime, including the regulation of PFMs. In November 2012, the Government issued an options paper *Australia's financial market licensing regime: Addressing market evolution*.¹ If this paper were to lead to reform of the licensing framework, it would result in a commensurate change to our approach to regulating PFMs. We will continue to use the principles in CP 116 and this draft regulatory guide when advising the Minister unless, and until, any changes to the regime are made.

RG 000.56 As explained in RG 000.4, s791C of the Corporations Act gives the Minister the power to exempt a particular financial market or type of financial market from the requirement to hold a market licence, along with the power to impose conditions on the exemption. When deciding whether to recommend to the Minister to exempt a PFM, we will usually look for certain market characteristics. Those characteristics are outlined in CP 116.

RG 000.57 Recent market and regulatory developments have led us to reconsider the characteristics outlined in CP 116. In September 2013, we issued a revised version of this draft guide to reflect these changes.

RG 000.58 The four characteristics of a PFM, as outlined in CP 116, were:

- (a) All market users are professional investors who participate in a market on their own behalf or on behalf of other professional investors.
- (b) Only financial products that are not usually traded on public markets by retail investors are traded on the facility (e.g. products other than shares and managed investment schemes).
- (c) Trading is not anonymous.

¹ The paper is available at: www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2012/Australias%20Financial%20Market%20Regime%20Addressing%20Market%20Evolution/Key%20Documents/PDF/optionspaper.ashx.

(d) The operator (or its associated entity) must not operate a clearing and settlement facility for the market.

RG 000.59 These characteristics were adopted to ensure that the activities that could be undertaken by PFMs were distinct from those that could be undertaken by traditional exchanges (for which we would generally recommend the Minister grant a market licence).

Our policy changes

RG 000.60 The policy changes in RG 000.8 reflect changes to the market characteristics that we will usually look for when advising the Minister to exempt a PFM.

Update to the products able to be traded on a PFM

RG 000.61 The revision of the products that are able to be traded on a PFM (i.e. in RG 000.08(b)) is aimed to reduce ambiguity and clarify our existing policy about the types of financial products that are permitted to be quoted and traded on a PFM before we would be prepared to recommend that the Minister grant an exemption.

RG 000.62 This minor amendment is in response to the increased number of inquiries we have received from existing and prospective PFM operators about this requirement. It clarifies that at the time a PFM seeks to commence offering trading in a particular financial product, the same product is not already available for trading on a public market.

Removal of the 'non-anonymity' requirement

RG 000.63 We have removed the 'non-anonymity' requirement in RG 000.8(c) to better align with international developments and the Government's G20 commitments.

RG 000.64 Historically, transactions on PFMs were conducted on a non-anonymous basis—that is, users of these types of trading platforms would typically only transact with entities with whom they were familiar and had prior arrangements (which typically included a pre-trade credit risk assessment and an underlying agreement—for example, a pre-existing International Swaps and Derivatives Association (ISDA) agreement). Settlement of obligations arising from those transactions would then take place on a bilateral basis, making it crucial that users knew the identity of the trade counterparty before the transaction was entered into.

RG 000.65 More recently, driven by both market forces and by the commitment of the G20 countries (which includes Australia) to have a greater proportion of over-the-counter (OTC) derivative transactions centrally cleared, there is now a global shift towards central clearing to reduce systemic risk. Given many more OTC derivatives transactions will be entered into between a

counterparty and a central counterparty (CCP) clearing provider, it will no longer be necessary for the counterparties to those transactions to be able to identify each other (because each counterparty will be entering into a transaction with the CCP).

RG 000.66 To accommodate this development, we consider it appropriate to remove the 'non-anonymity' requirement.

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Key terms

Term	Meaning in this document
alternative trading system (ATS)	<p>Alternative trading system under US 17 Code of Federal Regulation—Regulation of Exchanges and Alternative Trading Systems means any organisation, association, person, group of persons, or system:</p> <ul style="list-style-type: none"> • that constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange; and • that does not: <ul style="list-style-type: none"> – set rules governing the conduct of subscribers other than the conduct of such subscribers' trading on such organisation, association, person, group of persons, or system; or – discipline subscribers other than by exclusion from trading
ASIC	Australian Securities and Investments Commission
associated entity	An associated entity under s9 of the Corporations Act
Australian financial services (AFS) licence	A licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services
Australian market licence	A licence under s795B of the Corporations Act that authorises a person to operate a financial market in Australia
CDS	Credit default swap
central counterparty (CCP)	An entity that interposes itself between the counterparties to trades, becoming the buyer to every seller and the seller to every buyer
CESR	Committee of European Securities Regulators
clearing and settlement arrangements	Arrangements for the clearing and settlement of transactions effected through a financial market, as defined in s790A of the Corporations Act
clearing and settlement facility	<p>A facility that provides a regular mechanism for parties to transactions relating to financial products to meet obligations to each other that:</p> <ul style="list-style-type: none"> • arise from entering into the transactions; and • are of a kind prescribed by regulation, <p>as defined by s768A of the Corporations Act</p>

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Term	Meaning in this document
Commodity Futures Trading Commission (CFTC)	An independent agency with the mandate to regulate commodity futures and option markets in the United States
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
EEA	European Economic Area
exempt board of trade (EBOT)	A market regulated in the United States by the CFTC that is exempt from the operation of the Commodity Exchange Act and limited to eligible contract participants in a selected limited group of eligible commodities
exempt commercial market (ECM)	A market regulated in the United States by the CFTC that is exempt from the operation of the Commodity Exchange Act and limited to principal-to-principal transactions between eligible commercial entities in exempt commodities
financial market	A facility through which: <ul style="list-style-type: none"> • offers to acquire or dispose of financial products are regularly made or accepted; or • offers or invitations are regularly made to acquire or dispose of financial products that are intended to result or may reasonably be expected to result, directly or indirectly, in: <ul style="list-style-type: none"> – the making of offers to acquire or dispose of financial products; or – the acceptance of such offers, as defined in s767A of the Corporations Act
financial product	A product as defined in Div 3 of Part 7.1 of the Corporations Act
Financial Services Authority (FSA)	An independent non-governmental body, given statutory powers by the <i>Financial Services and Markets Act 2000</i> to regulate the UK financial sector
financial services licensee	A person who holds an AFS licence
G20	Group of Twenty
IOSCO	International Organization of Securities Commissions
multilateral trading facility (MTF)	A multilateral system operating in the European Economic Area that is operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments—in the system and in accordance with non-discretionary rules—in a way that results in a contract in accordance with the provisions of Title II of the European Markets in Financial Instruments Directive

Term	Meaning in this document
operating rules	As defined in s761A of the Corporations Act
participant	As defined in s761A of the Corporations Act
professional financial market (PFM)	For the purposes of this regulatory guide, a financial market meeting the following characteristics: <ul style="list-style-type: none"> market users are professional investors who participate in the market on their own behalf or on behalf of other professional investors; only financial products that are not usually traded available for trading on public markets by retail investors are traded on the facility; and <ul style="list-style-type: none"> trading is not anonymous. That is, before transactions are entered into, a market user can identify its counterparty or its counterparty can only be one of a limited number of market users known to that user; and the operator (or its associated entity) must not operate a clearing and settlement facility for the market
professional investor	As defined in s9 of the Corporations Act
public market	A market accessible by retail investors
<i>Regulation ATS</i>	Section 242.3 of US 17 Code of Federal Regulation. It governs the operation of alternative trading systems in the United States
retail client	A person identified as a retail client in s761G of the Corporations Act
RG 172 (for example)	An ASIC regulatory guide (in this example numbered 172)
s791 (for example)	A section of the Corporations Act (in this example numbered 791), unless otherwise indicated
Securities and Exchange Commission (SEC)	An independent agency of the US Government that holds primary responsibility for enforcing the federal securities laws and regulating the securities industry, the nation's stock exchanges, and other electronic securities markets
self-regulatory organisation (SRO)	A non-government organisation that has responsibility to regulate its own members—for example, the FINRA (the US Financial Industry Regulatory Authority)
SPDC	Significant price discovery contract

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Related information

Headnotes

Australian financial services licence, Australian market licence, clearing and settlement arrangements, clearing and settlement facility, conflicts of interest, conditions, exemption, financial market, financial market regulation, professional financial market, professional investor, regulatory outcomes

Regulatory guides

RG 172 *Australian market licences: Australian operators*

RG 176 *Foreign financial services providers*

RG 177 *Australian market licences: Overseas operators*

Legislation

Corporations Act, Part 7.2, s761, 762, 763, 764, 765, 767, 768, 790, 791, 792, 798, 911, 913

Consultation papers

Regulation of financial markets: Exemptions from Part 7.2 of the Corporations Act (February 2006)

CP 29 *Australian market licences: Australian operators* (November 2001)

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