



ASIC

Australian Securities & Investments Commission

REPORT 237

Response to submissions on CP 145 Australian equity market structure: Proposals

April 2011

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 145 *Australian equity market structure: Proposals* (CP 145) and details our responses to those issues.

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.

Disclaimer

This report 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.

This report does not contain ASIC policy. Please see Regulatory Guide 223 *Guidance on ASIC market integrity rules for competition in exchange markets* (RG 223).

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A Overview/Consultation process

- 1 On 4 November 2010, ASIC released a consultation package on enhancing the regulation of Australia's equity markets, including the rules necessary to enable the introduction of competition between exchange markets. The consultation package included:
 - (a) Consultation Paper 145 *Australian equity market structure: Proposals* (CP 145);
 - (b) Report 215 *Australian equity market structure* (REP 215); and
 - (c) *Australian equity market structure: Draft market integrity rules*.
- 2 These documents set out our proposals for new market integrity rules for market operators and market participants, and explained our approach in developing these proposed rules.
- 3 The consultation package dealt with, among other things:
 - (a) new controls to curb extreme price movements and to require transparent cancellation arrangements;
 - (b) enhanced controls for direct electronic access and algorithmic trading;
 - (c) formal obligations on market participants to deliver best execution to clients;
 - (d) minimum disclosure about order and trade information;
 - (e) consolidation of market data across all execution venues;
 - (f) market operator cooperation on trading halts and related matters; and
 - (g) better regulatory data on orders and trades.
- 4 On 3 March 2011, we released Media Release (11-38MR) *ASIC announces timetable for the introduction of market competition*, which included a summary of the intended market integrity rule framework that would apply, as well as a preliminary summary of the submissions to CP 145. This report is consistent with that preliminary summary and provides more complete feedback on the key issues that arose out of the submissions and our responses to those issues.
- 5 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 145. We have limited this report to the key issues raised by industry.
- 6 This report should be read in conjunction with Regulatory Guide 223 *Guidance on ASIC market integrity rules for competition in exchange markets* (RG 223). The regulatory guide gives guidance on how market operators and market participants can comply with their obligations under

ASIC market integrity rules common across the relevant markets dealing in equities quoted on the Australian Securities Exchange (ASX): see ASIC Market Integrity Rules (Competition in Exchange Markets) 2011. In this report, we refer to these rules as the ‘competition market integrity rules’.

Responses to consultation

- 7 We received 40 written submissions to CP 145 from a broad range of stakeholders, including market operators, market participants, fund managers, high-frequency trading firms and others from the research, data vendor and technology sectors. We have had over 60 meetings with stakeholders since the consultation paper was published on 4 November 2010 and held information sessions for members of the Australian Financial Markets Association, the Financial Services Council and Stockbrokers Association of Australia. At five meetings of our Market Supervision Advisory Panel (before and after the publication of CP 145), we discussed market structure and the regulatory framework for the commencement of competition.
- 8 For a list of the non-confidential respondents to CP 145, see the appendix. Copies of these submissions are on the ASIC website at www.asic.gov.au/cp under CP 145. We are grateful to respondents for taking the time to send us their comments.

General comments

- 9 Apart from responding to the specific proposals in CP 145, respondents also provided general comments.
- 10 Respondents were generally appreciative of our holistic approach to consulting on the market structure framework. There was widespread support for ASIC to focus on the rules necessary to quickly enable the commencement of competition and allow industry more time to engage with the remaining proposals. However, one respondent suggested that competition should be delayed until all the rules were settled, including those relating to broader market issues.
- 11 Respondents sought certainty via a public timetable to schedule their work, testing and implementation. The vast majority of market participant respondents suggested that they would require six months after the rules were settled to prepare for the commencement of competition.
- 12 Some respondents requested a transitional period to become fully compliant with the rules, suggesting that during this period ASIC should adopt a flexible approach to enforcement focusing on guidance, education and comfort through no-action positions.

- 13 The Australian Competition and Consumer Commission (ACCC) stated in its submission that it is aware of a number of access-related issues including clearing and settlement and market data—in particular, the negotiations between ASX and Chi-X Australia Pty Limited (Chi-X) for access to ASX’s clearing and settlement services. The ACCC has concerns that the success of competition may be threatened by difficulties faced by potential new entrants in accessing certain ‘essential’ services operated by ASX. The ACCC recommended that the Government put in place formal access regulations to limit ASX’s ability to exercise its monopoly powers, noting that otherwise there would be a real risk that the introduction of competition may not achieve its goals.
- 14 One respondent noted current legislative inconsistencies with compensation schemes, and recommended that ASIC support:
- (a) National Guarantee Fund (NGF) coverage against failures to settle and insolvency involving retail clients as the minimum standard required of any market operator; and
 - (b) the Minister making a regulation capping claims against the NGF.
- However, the respondent recognised that legislative change would probably be required.

ASIC’s response

We intend to implement a regulatory framework that reflects the necessary requirements needed for the commencement of competition that harmonises rules across all markets, that will minimise system changes for industry and that will maintain market integrity.

We also intend to provide transitional arrangements for certain competition market integrity rules that are likely to require more resources and capacity (e.g. best execution).

We intend to use the benefit of the feedback from CP 145 to refine some of our proposals that respond to wider market developments (e.g. relating to growth in non-pre-trade transparent pools of liquidity (‘dark pools’) and the impact they are having on the public price formation process, automated electronic trading and volatility controls). We intend as a matter of priority to consult further on these important issues and, subject to the outcomes of this consultation, aim to settle these additional rules in early 2012 (with sufficient lead time for transition and implementation). More details will be provided in coming months.

We do not consider that there is a case (based on market integrity) for delaying competition while we address these broader market developments that are issues in our market today irrespective of the introduction of competition.

We will work with Treasury, the ACCC and industry in considering the development of access arrangements to market operator services.

- 15 We have refined some of the proposed guidance in CP 145 and the draft market integrity rules to take into account the feedback in the submissions we received. Our final guidance is in RG 223.

B Scope of the proposals

Key points

In CP 145, we proposed the scope of products and persons our proposals would apply to, and also proposed penalty amounts for breaches of the market integrity rules.

Respondents were supportive of our approach to the scope of products and persons, with some suggesting that the scope be widened.

Products to which the proposals apply

- 16 In CP 145, we proposed that the proposals in the consultation paper apply to shares, managed investment schemes and CHESS Depository Interests (CDIs) admitted to quotation on the exchange market known as ASX (referred to as 'equity market products').
- 17 Respondents were very supportive that the proposals should apply to equity market products, as defined in CP 145. Some submissions suggested that the scope of products be expanded to cover related equity products, exchange-traded funds, derivatives and debt products. One submission recommended the inclusion of contracts for difference (CFDs) and other over-the-counter (OTC) traded products to limit the possibility of rule avoidance by electing to trade the substitute product rather than the regulated product.

ASIC's response

We have proceeded with our proposed approach to apply the competition market integrity rules to equity market products, as defined in CP 145, but broadened to include a right to acquire, under a rights issue, a share or an interest in a registered scheme.

We will give further consideration to other products to which the proposals in CP 145 could apply. We will consult with industry before making any rule changes.

Persons to whom the proposals apply

- 18 There was general support among market participants to extend the scope of persons that the proposals apply to, including to indirect market participants and fund managers, and there was some support for extending the scope to include CFD providers. One association did not support extending the scope to include fund managers.

- 19 There was also widespread support for the scope of the proposals to be extended so that minimum standards for data consolidation apply to data consolidators under market integrity rules, rather than indirectly, given the desirability of a standardised approach to data consolidation. However, a few submissions expressed concerns about fees for data access and that, if data consolidators were to be formally regulated, the rule framework could discourage firms from applying to be recognised as a consolidator. One submission directly opposed direct or indirect regulatory intervention because it would limit innovation, and argued that market forces would provide a solution.

ASIC's response

We have proceeded with our proposed approach to apply the competition market integrity rules to market operators and market participants, as proposed in CP 145.

A new regulation would need to be made under the *Corporations Act 2001* (Corporations Act) to enable any market integrity rule to apply to persons other than market operators and market participants. We will advise Treasury on extending the potential scope of the rules. It is likely that Treasury would need to consult on broadening the scope of the rules before implementing any new regulation.

In relation to data consolidation, we have provided best practice guidelines for data consolidators (see Section I).

Proposed approach to breaches of the market integrity rules

- 20 In CP 145, we proposed that each market integrity rule include a penalty amount, categorised as Tier 1 (\$20,000), Tier 2 (\$100,000) or Tier 3 (\$1 million), consistent with the existing penalty ranges under the ASIC Market Integrity Rules (ASX Market) 2010. We also proposed to set a maximum penalty for contravention of each market integrity rule and asked for views on an appropriate maximum penalty for each rule.

Note: In this report 'ASIC Market Integrity Rules (ASX)' refers to the ASIC Market Integrity Rules (ASX Market) 2010.

- 21 Submissions did not provide feedback on what the appropriate maximum penalties should be for each rule. However, respondents did generally agree with our proposed approach to penalty tiers, which is consistent with the existing regime.

ASIC's response

We have set the maximum penalties for each competition market integrity rule. We have applied the approach used for the existing penalty ranges under ASIC Market Integrity Rules (ASX), as canvassed in Regulatory Guide 216 *Markets Disciplinary Panel* (RG 216). RG 216 also outlines the policies that the Markets Disciplinary Panel will apply in determining penalties, and other remedial action that may apply.

For example, we have applied the maximum possible penalty (\$1 million) to rules where a serious breach could significantly affect market integrity (e.g. best execution), and the minimum to rules where a breach would have minimal impact (e.g. aggregation of trade confirmations).

C Extreme price movements

Key points

In CP 145, we proposed that market operators have greater controls around extreme price movements.

Submissions generally supported that market operators:

- have order entry controls that prevent anomalous orders from being entered;
- have volatility controls to automatically limit market activity during extreme market movements; and
- provide certainty and transparency around trade cancellations in the event of extreme market movements.

Order entry controls for anomalous orders

- 22 In CP 145, we proposed that market operators must have pre-trade order entry controls to prevent anomalous orders from entering the market.
- 23 There was general support for market operators to have pre-trade order controls to limit the entry of anomalous orders, in addition to market participants' own filters. Submissions stated that these market operator-level order entry controls did not remove the need for market participant-level order entry controls but, rather, that it would provide an extra layer of protection because most market participant controls were likely to be the same or inside the market operator-level controls. However, a few submissions stated that market participants may have to modify their systems, particularly to avoid conflict with market operator-level controls.
- 24 In CP 145, we also asked for views on the implications of order entry controls on market integrity, trade cancellations, liquidity and confidence in the market. Respondents were mixed on whether order entry controls would improve market integrity or limit the number of trade cancellations. However, the majority of respondents submitted that the controls were likely to have no material impact on liquidity but would increase confidence in the market.
- 25 In relation to the thresholds of the controls, the majority of submissions stated that the thresholds should be decided by ASIC in close consultation with market operators and market participants. Respondents suggested a variety of factors to take into account when deciding the thresholds, including:
- (a) the individual profile of each market and its market participants;
 - (b) the impact on volatility and liquidity;

- (c) other mechanisms in place to halt trading in the market;
 - (d) consistency across markets; and
 - (e) ensuring that market operators have the right to impose supplementary and more restrictive limits than ASIC's market-wide controls.
- 26 Respondents submitted that the thresholds of the controls should be made available to the public to increase certainty and to ensure that market participants and clients were aware of the boundaries of the market.
- 27 Some alternatives to ensure anomalous orders are not entered into the market were suggested, including:
- (a) placing a greater emphasis on the use of market-to-limit orders and other order types designed to achieve price certainty;
 - (b) imposing market-wide anomalous order thresholds for every security to be configured into participant order management systems;
 - (c) imposing fines above a certain number of cancellations;
 - (d) having affirmative requirements for market participants not to take advantage of obvious errors; and
 - (e) making market participants responsible for controls that are relevant to their clients and/or particular trading behaviours and rationales.
- 28 Respondents submitted that order entry controls should apply to all financial products traded on exchange markets and to operators of non-equity market product markets, particularly derivatives markets. However, the controls should be specifically tailored to each market and product.

ASIC's response

We have proceeded with making a competition market integrity rule requiring market-level pre-trade order entry controls (set by the market operators and approved by ASIC) to prevent anomalous orders: see Pt 2.1. This should limit the occurrence of anomalous trades.

We will keep our approach to mitigating the negative effects of extreme price movements and the execution risk controls required under review. We will consult on any proposed changes to our approach to execution risk controls. The implementation of any additional controls may require adjustments to the current execution risk controls.

Note: In this report, 'Pt 2.1' (for example) refers to a part of the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011, unless otherwise specified.

Volatility controls for extreme market movements

- 29 There was general support for our proposal for there to be volatility controls for extreme price movements, with preferences divided between a brief halt in trading activity and a limit up/limit down control. Respondents requested more time to engage with stakeholders on volatility controls, given the significant potential impact on the market.
- 30 Concerns were raised that volatility controls may hamper legitimate market activity and disrupt market efficiency if not appropriately designed and implemented. A few respondents preferred anomalous order entry controls and other market participant controls to prevent extreme market movements over the use of volatility controls because of this concern.
- 31 Responses were mixed on whether volatility controls should be market wide, particularly if volatility controls for individual equity market products were implemented. One respondent submitted that ASIC should monitor the effectiveness of order entry controls, volatility controls for individual equity market products and trade cancellation policies before implementing a market-wide volatility control.
- 32 In designing a volatility control, respondents stated that the design should take into account explained volatility (e.g. resulting from a company announcement) without the need to manually override an automated control. Respondents also generally supported consistent volatility controls between equities and derivatives products, provided they are tailored to accommodate the differences between the specific markets and products. Many respondents indicated a preference for the appropriate thresholds to be chosen by ASIC in consultation with industry. A periodic review of thresholds was considered preferable.
- 33 In relation to the mechanism of a volatility control, responses were divided between preferences for a brief halt in trading activity (i.e. between five and ten minutes) and a limit up/limit down control. Respondents generally viewed that the prescribed threshold should be calculated with further consultation, and that the volatility controls should be reviewed regularly to ensure they are relevant to the prevailing market environment.
- 34 While respondents generally had concerns that having different thresholds at different stages of the trading day would create inconsistencies and complexity in the market, some submissions indicated that thresholds should differentiate between auctions and continuous trading.
- 35 There was widespread support for volatility controls to only take into account orders and trades on an order book, and not trades executed off-order book, because the risk of misreported off-order book trades erroneously triggering a halt is very high.

ASIC's response

We intend to consult further with stakeholders on this issue, with the aim of setting relevant competition market integrity rules in early 2012 (with sufficient lead time for transition and implementation). We note that there may be consequential implications for order entry controls and cancellation ranges.

Volatility controls are increasingly important in an environment where automated electronic trading systems are becoming the norm. We will work closely with industry on establishing appropriate volatility bands.

Trade cancellation policies

- 36 There was strong support for our proposal for there to be transparent cancellation policies for clearly erroneous trades, with market participants wanting to retain the ability to cancel erroneous trades by mutual consent. Many respondents stated that implementing order entry controls should substantially reduce the incidence of cancellations required. Some respondents pointed to the possibility of transparent cancellation levels leading to investors 'gaming' the system by attempting to trade closer to the cancellation thresholds.
- 37 Many respondents advocated that ASIC should mandate the extreme price movement cancellation range so that it is transparent and applies to all market operators.
- 38 Consistency of trade cancellation policies across all markets in the event of extreme market movements was supported by the majority of respondents. A few submissions stated that, given the nature of the markets, some flexibility was needed and that ASIC should consult further with derivatives industry representatives.

ASIC's response

We have proceeded with making a competition market integrity rule requiring common trade cancellation processes for extreme price movements: see Pt 2.2. This should ensure that cancellations following extreme price movements are managed consistently if they are needed. We have based our cancellation range for extreme price movements on ASX's preferred model based on the feedback it received to its consultation: Trade Cancellation Policy, October 2010.

We expect that we will need to review our rules on trade cancellations for extreme price movements when we consult on volatility controls for extreme price movements.

On error resolution, we expect that market operators will have transparent policies and operating rules, including the ability for market participants to cancel erroneous trades by mutual consent: see Pt 2.3. We will review our expectations on such policies after future consultation on a regime.

D Electronic trading requirements

Key points

In CP 145, we proposed to build on existing ASIC Market Integrity Rules (ASX) by requiring minimum requirements for direct electronic access and algorithmic trading. We also asked questions about high-frequency trading and its impact on market integrity.

Industry was generally opposed to our proposed requirements for direct electronic access and algorithmic trading, and argued that the existing rule framework was sufficient.

Direct electronic access

Minimum standards for direct electronic access

- 39 In CP 145, we proposed to require market participants to ensure that their direct electronic access (DEA) clients meet specified minimum standards. Industry was generally opposed to our proposal on the basis that it would be too onerous, costly and difficult to implement, as well as potentially making Australia internationally uncompetitive because these requirements were above international requirements for DEA. Respondents considered the existing rule framework to be sufficient.
- 40 Some respondents noted that further detailed guidance on the proposed market integrity rule was necessary, particularly on how to conduct assessments against the criteria and what would be considered to be adequate filters.

Legally binding contract for direct electronic access

- 41 In CP 145, we proposed that a market participant must have a legally binding written contract with the DEA client. Industry was generally opposed to this requirement on the basis that it would involve significant time and cost.
- 42 The majority of market participant respondents indicated that they already have contracts in place with their DEA clients but that ASIC should not assume the same for all market participants. Nevertheless, existing contracts would need to be amended to comply with the proposed market integrity rule. One association noted that some market participants set their contracts at a global level and that amending those contracts to comply with

Australian market integrity rules would be costly and time-consuming and would require a 12-month transitional period. Some respondents were concerned with possible discrimination between automated order processing (AOP) (direct market access users) and DEA, with the proposal forcing an extra level of regulation on DEA clients.

- 43 Most respondents submitted that it should be left to market participants to set the terms for these contracts, rather than the market operator or ASIC. It was noted that market participants are best placed to manage the risks posed by each client, particularly because they carry the liability to the market for all orders placed by their DEA clients. One respondent noted that if ASIC were to set the minimum terms of the contract, then it was likely that a DEA client would only agree to those minimum terms and nothing further. A number of submissions suggested that ASIC should provide additional guidance rather than prescriptive minimum standards.
- 44 While it is clear that at least some DEA clients sub-delegate their access to their own clients, the extent of this is unknown because market participants have no practical way of monitoring this.

Requirement to have adequate systems and controls

- 45 In CP 145, building on Rule 5.6 of the ASIC Market Integrity Rules (ASX), we proposed that a market participant must have adequate systems and controls in place.
- 46 Market participants submitted that current market participant controls and the existing rule framework were sufficient and reasonable. One association noted that it would be preferable to provide further guidance rather than overhauling the existing rules.
- 47 A number of respondents did not support the proposition that the role of market participant controls is to detect algorithms or erroneous or otherwise disorderly trades, and that it is practically impossible to detect bad algorithms in real time. The buy-side submitted that they test their own algorithms before they deploy them but considered that other market participants may not be as thorough.
- 48 Most market participants submitted that they currently employ filters on DEA systems that are not systematically overridden. However, one respondent noted that, where order flow is directed to algorithms, they expected it would be common practice for market participants to suspend or override DEA filters and rely on built-in protections within the algorithm strategy logic. One association noted that such filters may have to be systematically overridden if market operator-level controls were introduced.

- 49 Respondents did not consider that other controls on DEA, such as ‘go slow’ or ‘reduce volume’ controls, were necessary or even justified. In particular, they stated that if controls were too restrictive, it could potentially impede genuine market activity.
- 50 In relation to whether our DEA proposal should apply to trading in non-equity market products (e.g. derivative markets), the limited responses we received generally agreed with this proposition to ensure overall consistency. One respondent noted that this should be evaluated as part of an ongoing review over the next 12–18 months.

ASIC’s response

We consider the proposed additional controls relating to DEA are a very important addition to existing requirements to further promote the integrity of the market.

As part of our current supervisory work, we are actively engaging with market participants to assess their controls for DEA in compliance with existing market integrity rules.

We intend to consult further with industry on this issue, with the aim of settling additional competition market integrity rules about DEA in early 2012 (with sufficient lead time for transition and implementation).

Algorithmic trading minimum requirements

Testing

- 51 Industry was generally opposed to our proposal to require market participants to test and document all order algorithms that they or their clients use, particularly for client algorithms. For their own order algorithms, market participants submitted that they are extensively tested before use, but the precise nature of that testing is largely unclear.
- 52 Market participants argued that it would not be practical for them to test client algorithms, given their sensitive and commercial nature and that they constitute intellectual property. Some respondents considered the existing requirements to be satisfactory and requested further stakeholder consultation before implementing any change.
- 53 Respondents also noted that the proposed market integrity rule was unclear with respect to ASIC’s expectations about:
- (a) the frequency of testing algorithms;
 - (b) monitoring any changes in algorithms;
 - (c) how market participants would conduct reviews; and
 - (d) the granularity of testing and documentation.

Adequate systems and controls and documentation

- 54 In CP 145, we proposed that market participants that use a trading algorithm to generate orders, or permit DEA clients to use such an algorithm, must have adequate systems and controls and documentation.
- 55 Respondents generally opposed our proposal on the basis that the existing rule framework was sufficient and that additional reporting was unnecessary or unjustified. One respondent submitted that ASIC should focus instead on updating the existing AOP framework to take account of developments in technology. Another respondent noted that, while they did not support additional obligations, they supported further guidance on the issue.
- 56 Most market participants submitted that they regularly, if not continually, review and monitor their order algorithms, particularly for performance. Respondents were opposed to any requirement for order algorithms to have an inbuilt circuit breaker, requiring them to automatically stop if they moved too far from specified parameters, because they preferred controls at the market operator level.
- 57 Respondents were not aware of shortcomings of information technology infrastructure or IT security leading to the intentional misuse of order algorithms or other sensitive information. One respondent submitted that the requirement for adequate IT security arrangements is covered under the existing AOP certification process.
- 58 Respondents generally supported that the algorithmic trading proposals should also apply to trading in non-equity market products (particularly derivative markets), subject to further consultation.

ASIC's response

As part of our current supervisory role, we are actively engaging with market participants on their controls for algorithms in compliance with existing market integrity rules.

We intend to consult further with industry on this issue, with the aim of settling additional competition market integrity rules and guidance in early 2012 (with sufficient lead time for transition and implementation) that take into consideration algorithmic trading and the promotion of market integrity.

High-frequency trading

- 59 In CP 145, we asked for feedback on the impact of high-frequency trading (HFT) and other high-speed trading activity on equity market functioning and market integrity.
- 60 We were provided with information on a range of HFT strategies. Submissions demonstrated the mixed and differing views of stakeholders on the issue, including that HFT:
- (a) benefits liquidity and price formation, tightens spreads and does not pose problems for the Australian market;
 - (b) does not support price formation and increases intraday volatility, particularly for less liquid products;
 - (c) increases volume but not liquidity in the market (the buy-side view); and
 - (d) is not a strategy in itself but rather an IT infrastructure set-up (the HFT firms' view).
- 61 A few respondents considered that it was too early to judge the impact of HFT on price formation and the depth and quality of trading interest in the market, and that further discussion on this issue was necessary.
- 62 In CP 145, we also asked for views on whether electronic liquidity providers (ELPs) should:
- (a) have formal obligations to help maintain orderly trading conditions; and
 - (b) be exempt from the naked short selling ban.
- 63 The majority of respondents submitted that ELPs should not have formal obligations to help maintain orderly trading conditions because there is inadequate justification to impose such obligations and, in any case, it would not be a practical solution. Formal obligations would force ELPs to take unacceptable risks and restrict their ability to operate efficiently, honestly and fairly. In addition, it was noted that a two-sided quote would not benefit the market if quotes were at unrealistic levels. Some respondents also noted that there are already requirements for market makers. However, a few respondents submitted that ELPs should have formal obligations if they benefit from rebates.
- 64 Submissions were mixed on whether ELPs should be exempt from the naked short selling ban. Some respondents did not support an ELPs as a category but noted that the existing class order relief for market makers may apply to certain activities of ELPs.

ASIC's response

We did not propose any new market integrity rules on HFT in the consultation paper. The feedback we received will be taken into account as part of our ongoing consideration of market structure.

We note the existing rule framework that affects HFT, which:

- prohibits unfiltered direct access to the market;
- requires AOP systems to meet minimum standards and be certified;
- prohibits manipulative trading that may create a false or misleading appearance and consider the circumstances of orders;
- bans naked short selling; and
- imposes tick sizes that limit trading opportunities for HFT.

We have proceeded with making a supplementary competition market integrity rule requiring market operators to have order entry controls to further mitigate against erroneous order entry: see Pt 2.1.

We will continue to monitor the effect of HFT on the marketplace and may consult further with industry on this issue, should the need arise.

Maker–taker pricing

- 65 In CP 145, we asked for views on the impact of maker–taker pricing on the integrity of markets and whether maker–taker rebates should be capped.
- 66 The majority of submissions did not oppose maker–taker pricing and a few referred to the benefit experienced overseas of narrower spreads quoted by liquidity providers. One submission stated that maker–taker pricing was no different from ASX having differential charging models for access to various liquidity pools. One association noted that rebates can affect trading behaviour and suggested that further stakeholder discussion is required to understand the potential consequences of maker–taker pricing for the Australian market. However, a few respondents submitted that a clearly defined best execution obligation would effectively address this issue.
- 67 One respondent in particular claimed that maker–taker pricing creates pricing inefficiencies and distortions because the model provides incentives irrespective of the order size, and the financial incentive is targeted at one side of a trade only. The respondent asserted that, unless ASIC prohibits this pricing model, it will be adopted by all market operators due to competitive pressures.
- 68 The limited responses that we received about whether maker–taker rebates should be capped were against the proposition.

ASIC's response

The best execution rule is intended to minimise situations where client orders are routed to markets based on rebates rather than the best interests of the client. However, we would be concerned if pricing incentives influence behaviour in a way that is not in the best interests of clients and wider market integrity.

While we do not intend at present to make a competition market integrity rule on any pricing model, market operators should take into account the potential implications for market integrity when setting fees or rebates. We will discuss with market operators the nature and potential impact of any intended rebates, and we will continue to monitor the impact of pricing models domestically and abroad. If it becomes apparent that a pricing model is having a material impact on market integrity, we may reconsider whether a rule is needed. We have also created a rule (Rule 6.5.1) requiring material changes to a market operator's procedures to be notified to ASIC to enable us to consider the impact on market integrity.

This will include notification of material changes to pricing models.

Note: In this report, 'Rule 6.5.1' (for example) refers to a rule of the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011, unless otherwise specified.

E Best execution

Key points

In CP 145, we proposed a best execution obligation that requires market participants to take reasonable steps to obtain the best total consideration for their clients.

Submissions broadly supported our proposals to apply best execution at the broker level, and that market participants should have adequate policies and procedures in place, but suggested a distinction between 'wholesale' and 'retail' clients.

While there was support that the best execution disclosure obligation should apply to all clients, there was a strong preference for this to only be a one-way notification.

In relation to the proposed order routing and execution quality reporting, there were questions raised about its relevance in an Australian context.

Best execution obligation

- 69 Our approach of applying best execution at the broker level was broadly supported in preference to the North American-style approach of mandating market operator connectivity. Some respondents suggested the obligation should be a more holistic concept, based on the 'best outcome' for the client, with cost being the key factor for retail clients (rather than total consideration being the only factor for wholesale clients). This is in line with obligations in Europe.
- 70 Many respondents suggested that the area where additional flexibility is needed is in the distinction between 'retail' client and 'wholesale' client, as defined in the Corporations Act (as opposed to 'non-professional' and 'professional' client). This is on the basis that systems and processes for categorising clients in this way are already established. One association questioned the application of the best execution obligation to wholesale clients, arguing that these clients are able to use their own means to hold their broker accountable—effectively self-policing the quality of their execution.
- 71 Some respondents noted that retail clients should be entitled to provide a specific instruction (e.g. to nominate a trading venue), even if this results in an outcome other than best overall price.
- 72 There was general support for transitional arrangements to explicitly limit the best execution obligation so that entities that choose to be a participant of a single market can do so for a transitional period without immediate pressure to connect to new markets.

- 73 Some respondents also raised concerns about the current practice of bundling payments for research and trading and suggested that ASIC should seek to address this issue further.
- 74 There was support for our proposed 12-month transitional period, within which participants may meet their best execution obligations solely on ASX.
- 75 Respondents also generally supported that the best execution proposals extend to trading in non-equity market products, particularly derivative markets. However, further consultation on this issue was recommended.

ASIC's response

Market participants currently transact on the order book of a licensed market or as permitted by the limited exceptions to pre-trade transparency under the rules of the licensed market. We intend to continue this broad approach by implementing a formal best execution obligation under the competition market integrity rules, subject to the outcomes of the review by Treasury of the market licensing regime. The outcome of this review may have implications for the application of best execution requirements.

We have taken many of the comments on board and have proceeded with making a competition market integrity rule requiring market participants that deal with clients to take a more holistic approach to best execution by obtaining the 'best outcome' for their clients: see Rule 3.1.1.

We distinguish between 'wholesale and retail' clients, rather than 'professional and non-professional' clients.

For wholesale clients, market participants may take into account a range of outcomes, in addition to 'total consideration'. Wholesale clients may also elect to provide clear standing instructions to 'opt out' of the best execution rules, subject to periodic review. For example, a high-frequency DEA client may elect to opt out where the market participant is not involved in the execution decision.

For retail clients, best outcome is best total consideration, unless the client specifically instructs otherwise on a case-by-case basis. Market participants may interpret this as best price while there are not material differences in transaction costs between licensed markets. Market participants have indicated that price will be simpler to implement, execute and evidence.

As proposed in CP 145, for a period of 12 months, market participants will be able to meet their best execution obligation solely on ASX: see Section C of RG 223.

We intend to consult further during 2011 on pre-trade transparency exceptions, with the aim of settling additional rules in early 2012. Accordingly, best execution will need to be obtained either on an order book of a licensed market or subject to any revised limited pre-trade transparency exceptions set out in the competition market integrity rules.

Policies and procedures

- 76 In CP 145, we proposed to require market participants to have adequate internal policies and procedures, and to review them when there is a material change in circumstances, and, in any event, at least once a year.
- 77 The majority of respondents supported the proposal for market participants to have policies and procedures in place and to review these to take account of material changes, such as new market entrants. Respondents generally did not support a mandated annual review of the arrangements.
- 78 It was suggested that ASIC provide additional guidance on this rather than making highly prescriptive rules.

ASIC's response

We have proceeded with making competition market integrity rules requiring market participants to have policies and procedures in place and to review these when there is a material change: see Pt 3.2.

Disclosure to clients of best execution obligation

- 79 In CP 145, we proposed to require a market participant to disclose to clients that it has a best execution obligation and what this means.
- 80 Respondents generally considered it appropriate that the best execution disclosure obligation apply to all clients. Many respondents requested flexibility with the disclosure mechanism, including electronic notification to clients.
- 81 There was also a strong preference for this to be a one-way notification, rather than requiring express written consent of the disclosure.

ASIC's response

We have proceeded with making competition market integrity rules requiring market participants to make disclosures to all clients: see Pt 3.3. In light of the feedback we have received, we have clarified that:

- the disclosure can be made in printed or electronic form (see Rule 3.3.1(4)); and
- there is no requirement for clients to acknowledge or consent to the disclosure (see Section C of RG 223).

Evidencing execution performance

- 82 In CP 145, we proposed to require:
- (a) market participants to demonstrate compliance with their execution arrangements, including by publishing reports on order routing; and
 - (b) market operators to publish reports on execution quality.
- 83 There were questions about the relevance of these requirements in an Australian context, the expected ultimate beneficiaries of the data and the likely costs of implementation.

ASIC's response

We intend to introduce the order routing and execution quality periodic reporting after further consultation with industry.

We aim to settle the relevant competition market integrity rules in early 2012 and will provide sufficient lead time for implementation.

F Pre-trade transparency and price formation

Key points

In CP 145, we proposed market integrity rules to harmonise minimum pre-trade transparency requirements across markets and to address our concerns about the impact of the growing use of dark pools of liquidity on the price formation process on public markets.

Submissions generally supported our proposals for a tiered block trade regime and for pre-trade transparent orders taking time priority over fully disclosed orders.

While the majority of respondents acknowledged our concerns about balancing 'lit' and 'dark' liquidity, there were discordant views on the appropriate approach. Respondents urged ASIC to consult further on the mechanism to promote pre-trade transparency.

Exception for block trades, large portfolio trades and out-of-hours trading

- 84 In CP 145, we proposed to change the existing \$1 million block threshold for exceptions to pre-trade transparency to a tiered block trade regime.
- 85 Submissions generally supported the proposed tiered block trade regime, with at least a \$1 million threshold for highly liquid equity market products and \$500,000 for all other equity market products. Some respondents also endorsed a \$200,000 threshold for the least liquid products, while one respondent endorsed a top tier of \$2.5 million. One submission, however, stated that the existing single \$1 million threshold works effectively, while another stated that the single threshold should be set at \$100,000 instead. Another respondent submitted that, while the tiered approach made sense, implementation would be difficult. Other respondents questioned the timing of this proposal, suggesting it was not necessary for competition.
- 86 Respondents did not object to the other exceptions for large portfolio trades and out-of-hours trading.

ASIC's response

Although respondents generally supported the change to the existing block threshold, we intend to reassess all exceptions to the pre-trade transparency obligation as a package.

We intend to consult further during 2011 on exceptions to pre-trade transparency with the aim of settling revised rules in early 2012. Market participants should anticipate changes to the exceptions to pre-trade transparency and factor these changes into their business models. We note that compliance with the best execution obligation will need to adapt to any revised limited pre-trade transparency exceptions set out in ASIC's market integrity rules.

In the interim, we have harmonised some existing ASX pre-trade transparency exceptions to ensure consistent requirements across markets: see Rule 4.1.1 and Pt 4.2.

Treasury is planning a review of the legislation relating to market licensing to assess whether changes are necessary, including to the regulatory status of matching mechanisms other than licensed markets. The outcome of this review may have implications for the application of pre-trade transparency requirements.

Price improvement and undisclosed orders—\$20,000 threshold

- 87 In CP 145, we proposed a \$20,000 threshold, below which market participants must display orders and quotes on a pre-trade transparent market, and above which there must be price improvement. While the majority of respondents acknowledged our concerns about balancing 'lit' and 'dark' liquidity, a small number of respondents challenged the policy basis for the proposal. Others also commented on the impact this would have on business models.
- 88 Some respondents agreed with our threshold approach but submitted that the threshold should be set at another level—that is, higher (either \$40,000 or \$100,000) or lower (\$10,000). In addition to the \$20,000 threshold, one submission supported another threshold at \$50,000 for the largest listed entities.
- 89 Some submissions disagreed with our threshold approach for various reasons, including that:
- (a) it would increase trading costs and adversely affect execution quality and efficiency, and the operation of execution algorithms;
 - (b) it would limit choice and disadvantage retail investors who would lose potential price improvement by being denied the opportunity to interact with dark venues;
 - (c) it would conflict with best execution obligations;
 - (d) there was already a strong post-trade transparency regime; and
 - (e) the threshold would stifle technology and discourage HFTs.

- 90 The respondents that challenged the policy basis for our proposals referred to research to demonstrate that dark trading and dark pools are not detrimental to market integrity or price discovery. Many respondents suggested alternative methods to address our objectives:
- (a) applying the threshold to only passive orders (e.g. limit orders);
 - (b) setting the threshold to \$0 to monitor and reassess the issue at a later date;
 - (c) requiring dark pool operators to hold an Australian market licence once they reach a certain volume of total market turnover (e.g. 2.5%);
 - (d) requiring enhanced reporting on dark trades and dark pools;
 - (e) implementing a minimum exposure time for crossed trades;
 - (f) adopting commercial disincentives to trade in dark venues (e.g. removal of the fee differential between crossed and market trades); and
 - (g) an order protection rule that would ensure price–time priority across all pre-trade transparent markets (i.e. a trade-through rule).
- 91 The majority of respondents submitted that ‘stubs’ should be exempt from the \$20,000 threshold if their residual size is below the threshold.
- 92 Respondents did not consider pegged orders to have a negative impact on market integrity. The majority of respondents submitted that these orders should reference the consolidated best bid or offer.
- 93 We asked whether price improvement for trades over \$20,000 should be meaningful and how ‘meaningful’ should be interpreted. Feedback varied from suggesting that no price improvement should be necessary, to views that it should be anywhere between the consolidated best bid and offer to the midpoint.
- 94 Respondents urged ASIC to consult further on the mechanism for promoting pre-trade transparency, particularly after further analysis of the impact of dark pools on price formation in the Australian marketplace. We also intend to review the post-trade transparency deferred publication regime.

ASIC’s response

While we have not proceeded with our proposed \$20,000 threshold, below which orders must be pre-trade transparent, we have proceeded with making competition market integrity rules on exceptions to pre-trade transparency with the threshold set at zero: see Rules 4.1.5 and 4.2.3. This will enable us to quickly respond if there is a shift of liquidity from the pre-trade transparent markets in the short term at a level that would adversely affect the price formation process.

Market participants should anticipate changes to the pre-trade transparency exceptions, which may include a threshold similar to the one we consulted on. In any case, market participants should factor future changes into their business plans.

Despite setting the threshold at zero for the time being, we consider that the quality of price formation on public markets continues to be an important issue. As a matter of priority, we will intend to review the exceptions to pre-trade transparency with the aim of settling revised rules in early 2012. The review will take into account the range of alternative options canvassed in the submissions we received and in particular, will consider whether to increase the threshold for certain exceptions to pre-trade transparency from zero and whether that threshold should apply to all order types.

In the interim, we have made a competition market integrity rule that harmonises across all markets some of the existing ASX pre-trade transparency exceptions: see Rule 4.1.1 and Pt 4.2. These include the block trade and portfolio exceptions, as well as other trades (e.g. priority crossings), and also that pre-existing orders at better prices are satisfied first. This will ensure consistent standards across competing markets from the commencement of competition.

We have also proceeded with making competition market integrity rules to enhance the reporting we consulted on for market participant operators of crossing systems: see Pt 4.3. These rules will take effect from the day after the competition market integrity rules are registered. We have already approached market participants that operate crossing systems, requesting that they commence reporting to ASIC from March 2011. This will facilitate our market analysis and consideration of alternative options.

Content of pre-trade disclosures

- 95 In CP 145, we proposed to require a market operator to make pre-trade information available on a continuous real-time basis during normal trading hours.
- 96 The general feedback was that ASIC should not require any additional data to be disclosed over and above that which is currently disclosed, unless it is of quantifiable positive benefit to investors.

ASIC's response

We have proceeded with making a competition market integrity rule that harmonises the minimum information fields required for publication: see Rules 4.1.2 and 4.1.4. These fields are broadly consistent with those used currently on ASX.

Priority for pre-trade transparent orders

- 97 The majority of respondents supported pre-trade transparent orders taking time priority over fully undisclosed orders (i.e. where both price and volume are undisclosed). Some respondents suggested partly disclosed orders should retain time priority. However, a few respondents asserted that every order should take time priority regardless of whether it is pre-trade transparent.

ASIC's response

We have proceeded with making a competition market integrity rule requiring pre-trade transparent orders to take time priority over fully undisclosed (hidden) orders: see Rule 4.1.7.

Reporting requirements for operators of dark pools of liquidity

- 98 In CP 145, we proposed a market integrity rule requiring operators of dark pools ('crossing systems') to report to ASIC on a monthly basis.
- 99 Market operators and the buy-side generally supported our proposal. One market operator submitted that crossing system operators should be subject to the market licensing regime, given that they essentially provide the same service as a licensed market.
- 100 Two market participants submitted that the requirement to report on a monthly basis was excessive because any information was unlikely to change during that time. Instead, it was suggested that crossing system operators register the information when they establish the crossing system, or report on a half-yearly or quarterly basis. Another respondent opposed the requirement, unless the information was of quantifiable positive benefit.

ASIC's response

Given our concern about the shift away from trading on public pre-trade transparent markets into non-pre-trade transparent markets and the impact on the price formation process, we have proceeded with making a competition market integrity rule requiring non-pre-trade transparent crossing system operators to notify ASIC of the existence and nature of the crossing system: see Rule 4.3.1. Crossing system operators must also report to us on a monthly basis on aggregate daily orders, trades and cancellations per stock: see Rules 4.3.2 and 4.3.3.

The rule will take effect from the day after the competition market integrity rules are registered. We have already approached market participants that operate crossing systems, requesting that they commence reporting to ASIC from March 2011. This will facilitate our market analysis and consideration of alternative options.

For crossing systems operating in the Australian jurisdiction by an entity that is not a participant of a licensed market in Australia, we will look to other means of capturing this data.

We understand Treasury is planning a review of the legislation relating to market licensing to assess whether changes are necessary, including to the regulatory status of matching mechanisms other than order books of licensed markets. The outcome of this review may have implications for the application of pre-trade transparency requirements.

G Market integrity measures and regulatory reporting

Key points

In CP 145, we proposed the provision of suspicious activity notifications and timely access to certain data to enhance our surveillance capabilities.

Respondents generally questioned our approach to require suspicious activity reporting, and there were mixed responses on the identification of short sales.

In relation to the identification of client, origin of orders and off-order book execution venues, while there was in-principle support for enhancing ASIC's surveillance capability, respondents suggested that further consultation should take place before changes were implemented.

Suspicious activity reporting

- 101 In CP 145, we proposed to require a market participant to notify ASIC if it has reasonable grounds to suspect a person is trading with inside information or engaging in manipulative trading.
- 102 Many respondents noted the potential for overlap between our proposed suspicious activity reporting requirement and the reporting requirements under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act).
- 103 Some respondents submitted that the costs of compliance would be significant and that the requirement was unnecessary and unduly burdensome. There were also suggestions that the suspicious activity proposal required more clarity in the market integrity rule and in the guidance.

ASIC's response

We consider that our suspicious activity market integrity rule supplements the AML/CTF Act and is an important market integrity measure against the backdrop of recent market developments (including the introduction of competition). Our rule is substantially similar to the obligation in Europe, and we note that Canada and Singapore as well as Europe supplement their anti-money laundering regime with such a reporting obligation.

We will proceed with making market integrity rules on suspicious activity reporting as early as possible in 2011, with sufficient lead time for implementation (i.e. beyond the date on which the majority of the competition market integrity rules commence). We believe limited changes will be required to systems to comply with our intended rule, although we expect there will be changes to existing processes. We will work with industry on settling the guidance and to develop relevant examples about the application of the rule.

Identification of client, origin of orders and off-order book execution venues

- 104 In CP 145, we proposed to require certain data to be included on order and/or trade messages that would be visible only to ASIC and market operators. We also proposed to require a market participant, when transacting off-order book, to identify on post-trade transparency disclosures (trade reports) the execution venue.
- 105 While there was in-principle support for enhancing ASIC's surveillance capability, respondents suggested the proposed changes should not be linked to the introduction of competition, and further consultation should take place before any changes are implemented. Respondents considered that requirements for additional data would require significant investment in systems. The estimated implementation timeframe varied from three months to two years. Some respondents questioned the utility of the information.

ASIC's response

In terms of enhancements to data fields provided to ASIC, we consider that this is necessary in order to effectively monitor the market and keep pace with international standards.

We will look first at what can be done at minimal cost. We recognise that system and process changes would be required.

We intend to consult further with stakeholders, with the aim of settling these additional competition market integrity rules in early 2012 (with sufficient lead time for transition and implementation).

Identification of short sales

- 106 There was mixed feedback on our proposal to require a market participant to identify short sale orders and trade reports where the sell-side is a reportable short sale. Concerns were raised about implementation difficulties and costs. Several respondents recognised that the obligation to disclose short sales already exists and that the capability for this proposal is already available to the market.

107 Generally, respondents stated that implementation was achievable if sufficient time was provided. One association submitted that the existing short sale requirements were in line with the International Organization of Securities Commissions' principles on short sale reporting and that any changes should be made through amendments to existing regulations, not by introducing new market integrity rules.

ASIC's response

We will proceed with making market integrity rules to require mandatory identification of short sales as early as possible in 2011, as proposed in CP 145, with sufficient lead time for implementation (i.e. beyond the date on which the majority of the competition market integrity rules commence).

Short sale tagging is an important foreshadowed final step from ASIC's 2008–2009 work on short selling to enhance our market analysis and surveillance efficiencies. This proposal reintroduces a requirement that became unworkable at the time of the short selling ban for technical reasons. We have consulted on the reintroduction of the rule extensively since 2008. However, taking into account industry comments, we reached a position to delay its implementation in 2009 to enable the industry to manage the transfer of market supervision and align its system changes with those for the introduction of competition.

At the time of the changes to the short selling requirements, we did not consider that short selling tagging should be included in regulations because the reintroduction was intended to be via market operator rules. Market integrity rules on topics such as this are now our responsibility since the transfer of market supervision to ASIC.

H Post-trade transparency

Key points

There was unanimous support for our proposal to embed the existing post-trade transparency arrangements across markets.

Timing of publication of off-order book trades

108 There was unanimous support for our proposal to embed the existing post-trade transparency arrangements across markets. In relation to the process for modifying the thresholds for block trades, there was general support for an annual review with industry consultation.

ASIC's response

We have proceeded with making a competition market integrity rule requiring a market operator offering trading in equity market products to make public certain information about transactions executed under its rules and during normal trading hours immediately, subject to exceptions, as proposed in CP 145: see Rule 5.1.4.

There are some circumstances where immediate disclosure of executed trades can have negative market impacts, particularly where the transaction relates to only one element of a large portfolio trade or where the market participant executed the transaction as principal and needs to off-load the position it acquired. Taking this into account, we have retained the existing deferred publication delays and thresholds. The equity market product deferred publication categories reflects the existing ASX categories. It is important that the deferred publication regime is harmonised across all markets to prevent the possibility of regulatory arbitrage: see Rules 5.1.1 and 5.2.1.

Content of post-trade disclosures

109 In CP 145, we proposed to prescribe the minimum information that a market participant must report to a market operator, and that the market operator must make public. We sought feedback on requiring certain additional information to be published in post-trade disclosures.

110 General feedback was that ASIC should not require any additional data to be disclosed over and above that which is disclosed currently unless it is of quantifiable benefit to investors.

ASIC's response

We have made a competition market integrity rule that harmonises the minimum information fields required for publication: see Rule 5.1.7. The data fields required are contained in Appendix 1 of RG 223. The fields are consistent with those already used.

We have not mandated the format of the information because we understand that data consolidators already manage differing data formats and harmonisation is not necessary.

We also note that we will keep under review the post-trade information that must be reported to market operators by market participants and the information that must be made available by market operators. We intend to monitor industry developments to determine if additional information should be made public and will consult if any changes are considered necessary. We expect to consult during 2011 on enhancing client information on orders and trades (e.g. category of client as wholesale or retail and distinguishing direct electronic access clients).

Reporting off-order book transactions

- 111 Respondents generally supported our proposal that the executing party is responsible for reporting off-order book post-trade information, with the sellers as the default.

ASIC's response

We have proceeded with making a competition market integrity rule requiring the executing party to report off-order book post-trade information, as proposed in CP 145: see Rules 5.1.1 and 5.1.2.

Activities that do not need to be reported

- 112 In CP 145, we clarified that the following activities are not required to be post-trade reported—the passing of an order, primary market transactions, and stock lending or stock borrowing. Respondents supported this rule.

ASIC's response

We have proceeded with making a competition market integrity rule excluding the passing of an order, primary market transactions, stock lending, stock borrowing and exchange-traded funds special trades from post-trade transparency requirements: see Rule 5.2.2.

I Consolidation of pre-trade and post-trade information

Key points

There was general support for:

- the approach of having multiple providers to consolidate pre-trade and post-trade information;
- an obligation on market operators to provide information to consolidators on a non-discriminatory basis; and
- market operators having the right to charge for their services in providing information to consolidators.

Options to deliver consolidated information

- 113 In CP 145, we put forward two preferred options to consolidate data from all venues—a single provider established by tender process or multiple providers approved by ASIC.
- 114 Respondents acknowledged the importance of ensuring there is a consolidated view of pre-trade and post-trade information in a multimarket environment. Respondents overwhelmingly preferred a multiple consolidator model. This was based on industry expectation that existing data service providers would provide such services and that this would encourage competition and innovation in data services and produce the most efficient outcome for users. However, one respondent did highlight that it was essential for providers to offer the same consolidated information to avoid the data quality problems experienced in European markets.
- 115 Submissions overwhelmingly supported the proposal that market operators should be obligated to provide information to consolidators on a non-discriminatory basis to maintain a level playing field.
- 116 Respondents generally did not object to market operators being consolidators, provided that there was competition and efficiency, and that information was provided on a non-discriminatory basis to other consolidators. However, respondents did not support the outcome of an existing market operator being appointed as the sole provider of consolidated information.
- 117 Most respondents supported the proposal that market operators should have the right to charge for their services in providing information to

consolidators, and that regulation should not distort competitive market forces. However, this was qualified to the extent that market operators do not exploit their monopoly power and that fees were based on cost recovery and sustainability. There were also suggestions of a royalties system, and that ASIC should introduce a 'reasonable cost' provision and ensure that minimum data was readily available.

ASIC's response

We have proceeded with a model where consolidated market data is provided by more than one consolidator. To ensure market data is accurate, accessible and easily consolidated, our new competition market integrity rules require:

- market operators to have adequate controls to prevent anomalous orders from entering their markets (see Rule 2.1.3);
- market participants that transact off-order book in accordance with the permitted pre-trade transparency exceptions to report post-trade information to a market operator (see Rule 5.1.1);
- market participants to take reasonable steps to ensure the post-trade information they report to a market operator is and remains complete, accurate and up-to-date (see Rule 5.1.1(4));
- market participants to take reasonable steps to determine, prior to a transaction being executed, which party will report the transaction to a market operator (see Rule 5.1.2(5));
- market operators to take reasonable steps to ensure the pre-trade and post-trade information is and remains complete, accurate and up-to-date (see Rules 4.1.2(3) and 5.1.4(2)); and
- market operators to make all pre-trade and post-trade information available on reasonable commercial terms and on a non-discriminatory basis to anyone who enters into an arrangement with the market operator (see Rules 4.1.3 and 5.1.5).

We expect data consolidators to comply with our best practice standards. These standards deal with the nature of the service being offered by a consolidator, including:

- delivering on data quality and security;
- offering pre-trade and post-trade information for each data product separately to those users who only wish to purchase specific components; and
- meeting certain operational outcomes (see Section G of RG 223).

We expect that more than one consolidator will emerge in Australia. However, while this is our expectation, if it becomes clear that no industry solution is likely to eventuate to consolidate data from all markets, we may revisit this issue and consider introducing a single consolidator via a public tender process.

Data available free of charge after a certain time period

118 In CP 145, we asked about the appropriate time period after which data should be made available free of charge. Submissions were divided between 15 minutes and 20 minutes (the latter being the current ASX arrangement).

ASIC's response

We have imposed an obligation under Rule 5.1.6 of the competition market integrity rules on market operators to make post-trade information available free of charge on a website that is publicly accessible, on a delayed basis of no more than 20 minutes.

J Market operators: Other obligations

Key points

Given the importance of a high degree of market-wide coordination in an environment with multiple market operators, in CP 145 we proposed cooperation arrangements between market operators.

The main concerns raised by respondents were about a stable testing environment for market participants and the impact of competing markets having different trading hours to ASX.

Respondents generally agreed with our proposals on the assignment of common identifiers, synchronised clocks and tick sizes.

Market operator cooperation

- 119 Submissions generally supported cooperation between market operators, particularly for market operators providing a stable testing environment for market participants. One association submitted that ASIC should control the industry testing itself. A number of respondents suggested that ASIC should require market operators to provide a stable system connectivity testing environment as well as ensuring that market operators limit system changes in the interim.
- 120 The majority of respondents supported the proposal that a market operator must provide information to other market operators, including for the purposes of synchronising trading halts and for the assignment of common symbols and identifiers, particularly where issues of market integrity were concerned.
- 121 In relation to trading hours, some market participants raised concerns about the practical implications of competing markets having different trading hours to ASX for company announcements, trading halts and suspensions, as well as difficulties in determining a stock's closing price and a volume weighted average price (VWAP). However, ASX stated that market operators should be permitted to determine their own opening hours but, where a market operator has longer trading hours than the listing market, they must justify to ASIC how they propose to ensure trading will be conducted in a fair, orderly and transparent manner.
- 122 The majority of responses were opposed to regulatory intervention on the issue of new market operators having or not having opening or closing auctions, because this should be left for market operators to determine. However, two respondents raised concerns about the potential confusion around opening and closing prices.

ASIC's response

We are considering what our role should be in assessing industry readiness and facilitating industry testing. We will engage with industry on our role and determine what steps are necessary to ensure the smooth introduction of competition.

We have made competition market integrity rules on cooperation for market integrity and efficiency purposes (e.g. to share information for regulatory purposes such as on trading halts and suspensions): see Pts 6.1 and 6.2.

Where other areas of cooperation are concerned, subject to our satisfaction, we will allow market operators to agree on arrangements for cooperation among themselves.

We are considering the practical issues raised by differing trading hours between market operators. For trading hours of markets to vary, we note that there will need to be arrangements between market operators in place for managing trading halts and so market operators can comply with their respective market licence obligations (e.g. to have a fair, orderly and transparent market and to monitor compliance with their operating rules). We have also created a rule (Rule 6.5.1) requiring material changes to the procedures of a market operator to be notified to ASIC to enable us to consider the impact on market integrity and our surveillance function. This will include notifications of changes to trading hours.

Assignment of common identifiers

- 123 There is broad support for the use of common market participant identifiers and stock symbols.

ASIC's response

We have proceeded with making competition market integrity rules, as proposed in CP 145, to require market operators to use common market participant identifiers and stock symbols: see Rules 6.2.2 and 6.2.3.

Synchronised clocks

- 124 In CP 145, we proposed a market integrity rule requiring market operators to synchronise the clock of their trading, supervision and reporting systems to the Australian realisation of Coordinated Universal Time, denoted UTC(AUS), as maintained by the National Measurement Institute (NMI).

- 125 Respondents generally supported that the NMI represents an accurate source for clock synchronisation. One response submitted that brokers rely on their own firm-wide standardised time reference clocks for timestamps.

ASIC's response

We have proceeded with making a competition market integrity rule, as proposed in CP 145, to require market operators to synchronise their clocks to the NMI's clock to a defined level of precision and accuracy: see Rule 6.3.1. Market operators will need to ensure their clocks remain synchronised on an ongoing basis: see Rule 6.3.2.

Tick sizes

- 126 The majority of respondents supported our proposed approach to harmonise ASX's existing tick sizes across markets. However, a small number stated that harmonisation would limit innovation and competition, and suggested that market operators should be permitted to differentiate their tick sizes.

ASIC's response

We have proceeded with making the competition market integrity rule, as proposed in CP 145, to harmonise tick sizes across markets based on the current tick sizes on ASX: see Rule 6.4.1.

We will keep the tick sizes under review.

Fair access to markets

- 127 In CP 145, we asked for feedback on whether we should supplement the rules applying to market operators in the Corporations Act and in Regulatory Guide 172 *Australian market licences: Australian operators* (RG 172) relating to access to their market.
- 128 Respondents generally agreed that market operators should have specific obligations to not unreasonably prohibit, condition or limit access to a person for which the market was established.
- 129 The majority of respondents agreed that market operators should be required to offer all their services on a transparent, fair and non-discriminatory basis.
- 130 Respondents generally agreed that there are issues arising from market operators having vertical pricing structures, based on concerns about pricing, cross-subsidisation and anti-competitive behaviour. It was suggested that clearing and settlement should be separated from trading and fees for each stage of the process, which should be separate and transparent.

ASIC's response

We did not propose any new market integrity rules on this issue in CP 145. We consider the existing rules to be adequate for the time being.

Market operator systems and controls

- 131 In CP 145, we asked for feedback on whether we should supplement the rules applying to market operators in the Corporations Act and in RG 172 relating to their systems and controls.
- 132 Market participants generally agreed that there should be a rule for market operators to have reasonable business continuity and disaster recovery plans, to conduct capacity stress tests and to review the vulnerability of systems to internal and external threats. One market operator stated that they already had such arrangements in place. Another market operator stated that additional rules were not necessary. One association stated that this issue should be part of a broader public policy review of the market licensing provisions of the Corporations Act.

ASIC's response

We did not propose any new market integrity rules on this issue in CP 145. We consider the existing rules to be adequate for the time being.

K Market participants: Other obligations

Key points

In CP 145, we proposed a number of rules for market participants to maintain market integrity.

Respondents generally supported our proposed approach on these market integrity rules, and provided additional comments on the operation of market integrity-related trading halts and suspensions. However, a number of submissions did not support the requirement for written authorisation as consent to aggregate transactions.

Trading to be under the operating rules of a market operator

- 133 Most respondents supported our proposal to prevent a market participant from trading in equity market products by means other than under the operating rules of a market operator, unless the trade is under a primary market auction.

ASIC's response

We have proceeded with making the competition market integrity rule, as proposed in CP 145, to require trading by market participants to occur under the operating rules of a market operator: see Rule 7.1.1. We note however, that no licensed market will be able to have an operating rule requiring the reporting of off-market trades to their market.

Participant not to trade during trading halt

- 134 In CP 145, we proposed a market integrity rule to prevent a market participant from transacting in equity market products during a market integrity-related trading halt and/or suspension.
- 135 Respondents agreed that all trading in equity market products should stop during a market integrity-related trading halt or suspension, irrespective of where the trade is intended to take place.
- 136 Most respondents considered it appropriate that this obligation should also apply to all Australian financial services (AFS) licensees.

ASIC's response

We have proceeded with making the competition market integrity rule, as proposed in CP 145, to require all trading by market participants to stop during a market integrity-related trading halt: see Rule 7.2.1. We may use our waiver power, if required, on a case-by-case basis.

We will liaise with Treasury on the issue of expanding this rule to apply to all AFS licensees.

Participant may produce single trade confirmations

- 137 There was general support for market participants to produce a single trade confirmation for orders executed across multiple markets. Respondents stated that the existing requirements in the Corporations Act, as well as the proposed market integrity rules, are sufficient to ensure that trade confirmations disclose sufficient information to clients in a multimarket environment. Many respondents noted that requiring client authorisation would be onerous where market participants have already received authorisation to accumulate confirmations for retail clients on ASX.
- 138 Several submissions did not support the requirement for written authorisation as consent to accumulate transaction confirmations because it would be a costly and time-consuming process.

ASIC's response

We have proceeded with making the competition market integrity rule, as proposed in CP 145, to allow market participants to accumulate client trade confirmations where a single order is executed across multiple markets: see Rule 7.3.1.

Where market participants have already received client authorisation under Rule 3.4.2 of the ASIC Market Integrity Rules (ASX), market participants need only notify clients about how client confirmations will be accumulated across multiple markets.

Where clients have not already authorised, market participants will need to obtain written authorisation: see Section I of RG 223.

Appendix: List of non-confidential respondents

- Asian Association of Independent Research Providers
 - ASX Limited
 - Australian Competition and Consumer Commission
 - Australian Financial Markets Association
 - Australian Financial Services and Securities Dealers Association
 - Bloomberg
 - Capital Markets CRC Ltd
 - Chi-X Australia Pty Ltd
 - Craig Benson
 - Endace Technology Limited
 - Eugene Clark
 - Financial Services Council
 - Financial Services Institute of Australasia
 - Getco Asia Pte Ltd
 - IMC Financial Markets
 - Instinet Australia Pty Ltd
 - Liquidnet Australia Pty Ltd
 - National Measurement Institute
 - National Stock Exchange of Australia Limited
 - Sirca Limited
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Key terms

Term	Meaning in this document
ACCC	Australian Competition and Consumer Commission
AFS licensee	A person who holds an Australian financial services licence under s913B of the Corporations Act Note: This is a definition contained in s761A of the Corporations Act.
agency	Where a market participant acts on behalf of a client
aggregate consideration	The combined price of a basket (or portfolio) of products acquired and/or sold in a transaction
algorithm/algorithmic trading	Electronic trading activity whose parameters are set by predetermined rules aimed at delivering specific execution outcomes
allowable tolerance	A permitted margin of difference between the time on an entity's clock and the time on the Universal Time Clock
AOP (automated order processing)	Orders generated by an electronic system
arbitrage	The process of seeking to capture pricing inefficiencies between related products or markets
ASIC	Australian Securities and Investments Commission
ASIC Market Integrity Rules (ASX)	ASIC Market Integrity Rules (ASX Market) 2010—rules made by ASIC under s798G of the Corporations Act for trading on ASX
ASIC Market Integrity Rules (Chi-X)	ASIC Market Integrity Rules (Chi-X Australia Market) 2011—rules made by ASIC under s798G of the Corporations Act for trading on Chi-X
ASX	ASX Limited (ACN 008 624 691) or the exchange market operated by ASX Limited
ASX 24	The exchange market formerly known as Sydney Futures Exchange (SFE), operated by Australian Securities Exchange Limited
Australian market licence	Australian market licence under s795B of the Corporations Act that authorises a person to operate a financial market
best available bid and offer	The highest bid (best buying price) and the lowest offer (best selling price) for an equity market product that is available across all pre-trade transparent order books at the time of the transaction. The best bid and best offer may not necessarily be on the same order book. It may be that the best bid is on the order book of Market X and the best offer is on the order book of Market Y

Term	Meaning in this document
best bid or offer	The best available buying price or selling price
best execution	Where a market participant achieves the best trading outcome for its client
bid–ask spread	The difference between the best bid and the best offer
block special crossing	An off-order book crossing which may be agreed at any price, where the consideration is at least \$1 million
block trade	A crossing where the consideration for the transaction is not less than \$1 million (pre-trade transparency exception in competition market integrity rules)
bps	Basis points
bundling	The practice of market participants and other service providers providing other services, such as advice, research and analytical tools, in conjunction with trade execution
buy-side	A term referring to advising institutions typically concerned with buying, rather than selling, assets or products. Private equity funds, mutual funds, unit trusts, hedge funds, pension funds and proprietary trading desks are the most common types of buy-side entities
capital formation	A method for increasing the amount of capital owned or under one's control, or any method in utilising or mobilising capital resources for investment purposes
CDI (CHESS Depository Interest)	An instrument used by non-Australian companies to support electronic registration, transfer and settlement of their products listed on ASX
CentrePoint	An ASX-operated execution venue that references the midpoint of the bid–ask spread on ASX's CLOB
CHESS	Clearing House Electronic Subregister System
Chi-X	Chi-X Australia Pty Limited
circuit breaker	A mechanism that pauses trading in a product if it exhibits extreme price movement in a defined period of time. Circuit breakers can either apply to individual products or can be market-wide, based on an index's movement
clearly erroneous trade	A transaction that deviates so substantially from current market prices that it is considered to be executed in error
CLOB (central limit order book)	A central system of limit orders, where bids and offers are typically matched on price–time priority

Term	Meaning in this document
compensation scheme	Compensation arrangements in place under the Corporations Act to meet certain claims arising from dealings between investors and market participants
competition market integrity rules	ASIC Market Integrity Rules (Competition in Exchange Markets) 2011—rules made by ASIC under s798G of the Corporations Act that are common to markets dealing in equity market products quoted on ASX
consolidator	See data consolidator
Corporations Act	<i>Corporations Act 2001</i> (Cth), including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
CP 145	ASIC consultation paper <i>Australian equity market structure: Proposals</i> , released 4 November 2010
crossing system	An automated service provided by a market participant to its clients which matches or executes client orders with orders of the market participant (i.e. against the participant's own account) or with other clients of the market participants. These orders are not matched on a pre-trade transparent order book.
crossing/crossed transaction	A type of transaction where the market participant for both the buyer and seller are the same. The market participant may be acting on behalf of buying and selling clients, or acting on behalf of a client on one side of the transaction and as principal on the other side of the transaction
dark liquidity/hidden liquidity	Non-pre-trade transparent orders
dark pool	Non-pre-trade transparent electronically accessible pools of liquidity
dark trading	See off-order book trading
data consolidator	An entity that combines data from various execution venues to produce a consolidated view of order and/or transaction information for use by investors
DEA (direct electronic access)	Electronic access to markets via the electronic infrastructure of a market participant
ELP (electronic liquidity provider)	Typically, HFTs or algorithmic traders who attempt to profit by providing continuous two-sided quotes for liquid securities on an unofficial basis to capture the bid–ask spread of a product
equity market	The market in which shares are issued and traded, either through exchange markets or OTC markets

Term	Meaning in this document
equity market products	Shares, managed investment schemes, the right to acquire by way of issue shares and managed investment schemes, and CDIs admitted to quotation on ASX
exchange market	A market that enables trading in listed products, including via a 'central limit order book'. Note: Not all exchange markets offer primary listings services.
exchange-traded fund special trade (ETF special trade)	Has the meaning given to the term 'ETF Special Trade' by the operating rules of ASX
execution venue	An execution venue is a facility, service or location on or through which transactions in equity market products are executed and includes each individual order book maintained by a market operator, a crossing system and a participant executing a client order against its own inventory otherwise than on or through an order book or crossing system. This includes an order book and other matching mechanisms.
facilitated specified size block special crossing	An existing ASX exception from post-trade reporting permitting a delay for transactions above \$15 million, \$10 million, \$5 million or \$2 million, depending on the product
financial market	As defined in s767A of the Corporations Act. It encompasses facilities through which offers to acquire or dispose of financial products are regularly made or accepted
financial product	Generally a facility through which, or through the acquisition of which, a person does one or more of the following: <ul style="list-style-type: none"> • makes a financial investment (see s763B); • manages financial risk (see s763C); and • makes non-cash payments (see s763D) Note: See Div 3 of Pt 7.1 of the Corporations Act for the exact definition.
FIX protocol	Financial Information eXchange protocol. A messaging standard for communication of financial information
fragmentation	The spread of trading and liquidity across multiple execution venues
FSG	Financial Services Guide
fully hidden order	An order on an order book that is not pre-trade transparent

Term	Meaning in this document
HFT (high-frequency trading)	While there is not a commonly agreed definition of HFT, we characterise it in this document as: <ul style="list-style-type: none"> • the use of high-speed computer programs to generate, route and execute orders; • the generation of large numbers of orders, many of which are cancelled rapidly; and • typically holding positions for very short time horizons and ending the day with a zero position
HFTs	High-frequency traders
high-speed trading	A specialised form of algorithmic trading characterised by the use of high-speed computer programs
indirect market participant	A broker that is not itself a market participant, but that accesses the market through a market participant
internalisation	Where a client order is transacted against a market participant's own account
IOSCO	International Organization of Securities Commissions
IRESS	IRESS Market Technology Limited
issuer	A company that has issued shares
large portfolio trade	A transaction that includes at least 10 purchases or sales, the market participant acts as agent for both the buyer and seller of the portfolio or as principal buys from or sells to the client, and the consideration of each is not less than \$200,000 and the aggregate consideration is not less than \$5 million
latency	An expression of how much time it takes for data to get from one point to another
limit order	An order for a specified quantity of a product at a specified price or better
liquidity	The ability to enter and exit positions with a limited impact on price
managed investment scheme	As defined in s9 of the Corporations Act
market impact	The cost incurred when the price of execution is different from the target price
market integrity rules	Rules made by ASIC, under s798G of the Corporations Act, for trading on domestic licensed markets
market licence	An Australian market licence

Term	Meaning in this document
market maker	An entity that provides a required amount of liquidity to a market, and takes the other side of transactions when there are short-term buy and sell imbalances in customer orders in return for rebates and/or various informational and execution advantages
market manipulation	As defined in Pt 7.10 of the Corporations Act
market operator	A holder of an Australian market licence that is the operator of a financial market on which equity market products are quoted
market order	An order at the best price currently available
market participant	An entity that is a participant of a financial market on which equity market products are quoted
NMI	The National Measurement Institute division of the Commonwealth Department of Innovation, Industry, Science and Research.
non-professional client	A person who is not a professional investor
NTP	Network Time Protocol
off-order book trading	Transactions that take place away from a CLOB and that are not pre-trade transparent. It is often referred to as 'dark liquidity' or 'upstairs trading'. It includes bilateral OTC transactions and transactions resulting from a market participant matching client orders or matching a client order against the participant's own account as principal. When this type of trading is done in an automated way and is part of a pool of liquidity, it is referred to as a 'dark pool'
operating rules	As defined in s761A of the Corporations Act
order book	An electronic list of buy orders and sell orders, maintained by or on behalf of a market operator, on which those orders are matched with other orders in the same list.
origin of order	A type of order category that identifies trading capacity and, if relevant, the type of client
OTC	Over-the-counter
partly disclosed order	An order on an order book that is pre-trade transparent with the exception of either price or volume
pegged order	A specified quantity of a product set to track the best bid or offer on the primary market
post-trade transparency	Information on executed transactions made publicly available after transactions occur

Term	Meaning in this document
pre-trade transparency	Information on bids and offers being made publicly available before transactions occur (i.e. displayed liquidity)
price formation	The process determining price for a listed product through the bid and offer trading process of a market
price sensitive information	Information about a company that will have, or can be expected to have, an impact on the price of that company's products
price step	The difference in price of one tick size
price-time priority	A method for determining how orders are prioritised for execution. Orders are first ranked according to their price; orders of the same price are then ranked depending on when they were entered
priority crossing	A type of crossing on ASX's CLOB that is transacted at or within the spread with time priority
professional client	A professional investor as defined in s9 of the Corporations Act
professional investor	As defined in s9 of the Corporations Act
Reg ATS (Regulation Alternative Trading System)	Section 242.3 of US 17 Code of Federal Regulation. It governs the operation of alternative trading systems in the US
Reg NMS (Regulation National Market System)	New substantive rules designed to modernise and strengthen the regulatory structure of the US equities markets
REP 215	ASIC report <i>Australian equity market structure</i> , released 4 November 2010
RG 214 (for example)	An ASIC regulatory guide (in this example numbered 214)
Rule 2.1.2 (for example)	A rule of the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011 (in this example numbered 2.1.2), unless otherwise specified
S&P/ASX 200 Index	An index of the largest 200 shares listed on ASX by market capitalisation
s912 (for example)	A section of the Corporations Act (in this example numbered 912), unless otherwise specified
sell-side	A term that describes firms that sell investment services to the buy-side, or corporate entities, including broking-dealing, investment banking, advisory functions and investment research
settlement	The exchange of payment and delivery for purchased securities

Term	Meaning in this document
SFE	The market formerly known as Sydney Futures Exchange (now ASX 24)
short sales	The practice of selling financial products that are not owned by the seller, with a view to repurchasing them later at a lower price. Short sales can be naked or covered
SOR (smart order router)	An automated process of scanning various execution venues to determine which venue will deliver the best outcome on the basis of predetermined parameters
spread	The difference between the best bid and offer prices
stub	The residual volume from a partly filled order
synchronised clock	A system time clock that matches a reference source clock
tick size	The minimum increment by which the price for an equity market product may increase or decrease
total consideration	For a buy order, the purchase price paid by a client in respect of performance of a client order, plus transaction costs; or for a sell order, the sale price received by a client in respect of performance of a client order less transaction costs.
trade confirmation	A legal document provided to clients which sets out the terms of an executed transaction
trade report	An electronic message created when a transaction is executed, detailing the terms of the transaction
trade-through	A model and rule that embeds price–time priority across multiple pre-trade transparent venues to protect displayed bids and offers from being bypassed
trading halt or suspension	A temporary pause in the trading of a product for a market-integrity-related reason, such as when an announcement of price sensitive information is pending (does not include a halt or suspension caused by a technical problem (including a power outage) affecting a market operator's trading system.
two-sided quote	A quote to buy and sell
undisclosed order	A non-pre-trade transparent order
Universal Time Clock	A clock that is referenced to UTC(AUS)
UTC(AUS)	The output of the caesium atomic clock designated by the NMI as UTC(AUS)
volatility	Fluctuation in a product's price

Term	Meaning in this document
volatility control/collar	A set price limit whereby a product can only trade at or above (or at or below) that level for a period of time. These controls can limit the disruptive effect of anomalous trades
VolumeMatch	An ASX-operated execution venue that facilitates the matching of anonymous large orders with reference to the last price on ASX's CLOB