



ASIC

Australian Securities & Investments Commission

REPORT 238

Response to submissions on CP 148 Proposed market integrity rules: Chi-X market

April 2011

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 148 *Proposed market integrity rules: Chi-X market* (CP 148) and details our responses in relation 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 224 *Guidance on ASIC market integrity rules for the Chi-X market* (RG 224).

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A Overview/Consultation process

- 1 In Consultation Paper 148 *Proposed market integrity rules: Chi-X market* (CP 148), we sought feedback on our proposals for new market integrity rules specifically for the Chi-X Australia Pty Ltd (Chi-X) market, subject to final approval of Chi-X's Australian market licence application. These proposals are separate from the new market integrity rules for the introduction of market competition: see ASIC Market Integrity Rules (Competition in Exchange Markets) 2011.
- 2 CP 148 set out our approach in developing the market integrity rules for the Chi-X market and how we propose they would apply to market participants who also need to comply with the ASIC Market Integrity Rules (ASX Market) 2010.
- 3 CP 148 dealt with, among other things:
 - (a) minimum presence requirements on foreign market participants who trade on their own behalf;
 - (b) the interpretation of the market integrity rules for the Chi-X market;
 - (c) general guiding principles on how to comply with the market integrity rules for participants of both the ASX market and the Chi-X market where there are duplicate obligations;
 - (d) designated trading representatives (DTRs) for the Chi-X market; and
 - (e) the disciplinary framework for breaches of the market integrity rules for the Chi-X market.
- 4 This report highlights the key issues that arose out of the submissions received to CP 148 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 148. We have limited this report to the key issues.
- 6 This report should be read in conjunction with Regulatory Guide 224 *Guidance on ASIC market integrity rules for the Chi-X market* (RG 224). The regulatory guide gives guidance on how market operators and market participants can comply with their obligations under the ASIC Market Integrity Rules (Chi-X Australia Market) 2011. The operation of the ASIC Market Integrity Rules (Chi-X) is subject to final approval of Chi-X's Australian market licence application and the commencement of the Chi-X market.

For a list of the non-confidential respondents to CP 148, see the Appendix. Copies of the submissions are on the ASIC website at www.asic.gov.au/cp under CP 148.

Responses to consultation

- 7 We received seven written submissions to CP 148 from retail and institutional brokers, industry associations and technology firms. We are grateful to respondents for taking the time to send us their comments.
- 8 The majority of submissions were supportive of our proposal to model the market integrity rules for the Chi-X market on the existing market integrity rules for the ASX market. Respondents also generally agreed with our approach to the interpretation of and requirements for compliance with the market integrity rules for the Chi-X market, aimed at minimising duplication of obligations.
- 9 However, most submissions supported the creation of a harmonised set of market integrity rules to apply to all like markets, rather than maintaining separate rulebooks, as the optimal approach in the medium term.
- 10 A number of submissions also requested that further specific guidance be provided by ASIC on how participants of both the Chi-X market and the ASX market will comply with equivalent market integrity rules for these markets.
- 11 We have refined some of the proposed guidance in CP 148 and draft market integrity rules to take into account the feedback in the submissions we received. Our final guidance on the ASIC Market Integrity Rules (Chi-X) is in RG 224.

Note: Throughout this guide, we use 'ASIC Market Integrity Rules (Chi-X)' to refer to the ASIC Market Integrity Rules (Chi-X Australia Market) 2011 and 'ASIC Market Integrity Rules (ASX)' to refer to the ASIC Market Integrity Rules (ASX Market) 2010.

B Significant issues

Key points

Respondents to CP 148 were generally supportive of our proposals to:

- create a separate set of market integrity rules specifically for the Chi-X market in the short term, and then to create a harmonised set of market integrity rules in the medium term to apply to all like markets;
- set minimum presence requirements for foreign market participants;
- consistently apply guidelines across the market integrity rules for both the Chi-X market and the ASX market;
- apply guiding principles for market participants of both the Chi-X market and the ASX market, although a number of respondents asked that more specific and detailed guidance be provided;
- model the market integrity rules on designated trading representatives (DTRs) for the Chi-X market on the relevant market integrity rules for the ASX market; and
- apply the same disciplinary framework to breaches of the market integrity rules for the Chi-X market as the Markets Disciplinary Panel (MDP) does to breaches of the market integrity rules for the ASX market; however, some respondents submitted that, where breaches of two equivalent rules occur as a result of a single course of conduct, the maximum penalty payable should not exceed the maximum payable for a single breach.

Our approach to making market integrity rules for the Chi-X market

- 12 In CP 148 we proposed an approach to making market integrity rules for the Chi-X market based on modelling the rules, as far as possible, on the ASIC Market Integrity Rules (ASX), which were in turn adopted from the long-standing ASX Market Rules (now superseded). The main consideration underlying this approach was that the same conduct in relation to the same equity market products should be treated in the same manner in both sets of market integrity rules.
- 13 The majority of respondents agreed with our approach of creating a set of market integrity rules specifically for the Chi-X market. In taking this view, respondents took into consideration our timetable for the introduction of market competition. However, most supported the creation of a harmonised set of market integrity rules to apply to all like markets as the optimal approach in the medium term.

- 14 In the meantime, respondents agree that the market integrity rules for the Chi-X market and the ASX market should be as consistent as possible in their drafting and interpretation.

ASIC's response

Consistent with previous statements in Consultation Paper 131 *Proposed ASIC market integrity rules: ASX and SFE markets* (CP 131), our intention remains to review at a later time the market integrity rules for the ASX market and the Chi-X market with a view to conducting a harmonisation exercise so that only one set of ASIC market integrity rules applies to all like markets. This harmonisation exercise will be the subject of further consultation.

Minimum presence of foreign market participants

- 15 In CP 148, we discussed the inclusion of market integrity rules of minimum requirements of presence to apply to foreign market participants who only trade on their own account (and are not required to hold an Australian financial services (AFS) licence) to facilitate enforcement actions in Australia.
- 16 We described a number of potential requirements and also indicated our expectation that similar proposed standards would need to be included in the market integrity rules for the ASX market.
- 17 Submissions suggested that, in setting those requirements, we should aim at ensuring a level playing field for market participants, while not precluding potential foreign market participants from entering the Australian market. Respondents also suggested that we should consider the reach of these requirements in relation to ASIC disciplinary decisions and the obligations of foreign market participants to other participants.

ASIC's response

As stated in CP 148, our intention is that market integrity rules setting minimum presence requirements will be consistent with our current minimum presence requirements for foreign wholesale financial services providers.

We will continue to consult with industry on this subject during 2011 with a view to settling rules consistent across equity markets later in 2011.

Interpretation of the market integrity rules for the Chi-X market

- 18 In CP 148, we proposed to interpret the market integrity rules for the Chi-X market in a manner that is consistent with our guidance for the equivalent market integrity rules for the ASX market. We also indicated our intention that this approach be reflected in specific guidance on market integrity rules for the Chi-X market.
- 19 This means that, to the extent that the market integrity rules for the ASX market have been reflected in an equivalent market integrity rule for the Chi-X market, RG 214 and the pre-existing ASX guidance notes will also serve as guidance on how to comply with the ASIC market integrity rules for the Chi-X market.
- 20 There was general support among respondents for the consistent application of guidelines across the market integrity rules for both the Chi-X market and the ASX market.

ASIC's response

In RG 224, we have provided guidance on how market participants can comply with their obligations under the ASIC Market Integrity Rules (Chi-X). We have aimed to ensure there is consistency across the market integrity framework.

We have recently issued Consultation Paper 152 *ASIC's conversion of ASX and SFE guidance: General operational obligations* (CP 152), which explains our process for converting pre-existing ASX guidance, where relevant, into ASIC guidance.

Guidance for participants of both the Chi-X market and ASX market

- 21 In CP 148, we provided general guiding principles for market participants who will participate in trading on both the Chi-X market and the ASX market, and considered 'grandfathering' obligations where market participants have already complied with obligations in the ASIC Market Integrity Rules (ASX).
- 22 While most submissions agreed with the principles in CP 148, a number of respondents pointed out that more detailed and specific guidance could be provided in this area to reduce interpretation risk and give market participants certainty in relation to compliance with equivalent rules applying to both the Chi-X market and the ASX market.

ASIC's response

In RG 224 we have provided a table containing a number of guiding principles on how to comply with equivalent obligations in

the ASIC Market Integrity Rules (Chi-X) and the ASIC Market Integrity Rules (ASX), together with examples where these principles apply and the requirements on market participants, with specific exceptions.

We believe RG 224 contains sufficient guidance in relation to this area. We will continue to liaise with industry on any emerging issues.

Designated trading representatives

- 23 In CP 148, we proposed market integrity rules for the Chi-X market on designated trading representatives (DTRs) modelled on the relevant market integrity rules for the ASX market. Under these rules, all trading by a market participant must be carried out either by DTRs or in accordance with the automated order processing (AOP) requirements.
- 24 We also said that a market participant that has structured its operations so that all trading is conducted under AOP requirements will still need to appoint at least one DTR, who will be in charge of supervising the trading activities of the participant.
- 25 Submissions generally agreed with our approach. However, questions were raised about how participants would comply with the suitability requirement for DTRs in the absence of standardised DTR training and order entry systems.

ASIC's response

While we do not require DTRs to be registered with Chi-X or to pass an examination in order to become a DTR, a market participant is required under the ASIC Market Integrity Rules (Chi-X) to ensure that DTRs are sufficiently trained and have adequate experience, training and competency. If a participant wants to nominate an existing DTR as DTR in relation to the Chi-X market, it will need to ensure that the DTR is sufficiently trained specifically in relation to the Chi-X market, as the rules and operational requirements of the Chi-X market and the ASX market may differ.

In RG 224, we provide further guidance on how market participants should determine how they will meet the DTR requirements.

Disciplinary framework

- 26 In CP 148, we proposed that Regulatory Guide 216 *Markets Disciplinary Panel* (RG 216) would apply to breaches of the market integrity rules for the Chi-X market. We also proposed to make the penalty amounts for breaches of the market integrity rules for the Chi-X market the same as those for breaches of the market integrity rules for the ASX market.
- 27 We proposed that, where breaches of both sets of rules occur as a result of a single course of conduct by the market participant, the MDP would have the ability to have regard to the totality of the conduct and determine a penalty amount that would correspond to a single breach. We also said that, in the same way, the MDP may decide to apply separate penalties for breaches arising from a single course of conduct which, in total, exceed the maximum penalty payable for a single breach of each market integrity rule.
- 28 A number of respondents expressed a view that, where breaches of two equivalent rules occur as a result of a single course of conduct by the market participant, it would not be appropriate for the MDP to decide to apply separate penalties which, in total, exceed the maximum penalty payable for a single breach of each market integrity rule.

ASIC's response

Where breaches of two equivalent rules are the result of a single course of conduct by the market participant, our approach will generally be to seek penalties on the basis that there has been a single breach.

If the MDP finds that there have been two breaches, it may either apply separate penalties for each breach or an overall penalty for both breaches. In either case, the MDP will seek to ensure that the final penalty (whether it is an aggregate of separate amounts or an overall amount) is just and appropriate, and not excessive, having regard to the totality of the conduct. This is consistent with RG 216 in relation to multiple breaches of the same rule: see especially RG 216.125. The penalties that are applied for any particular course of conduct should not generally increase merely because there are multiple applicable rules applicable to that conduct.

Appendix: List of non-confidential respondents

- Australian Financial Markets Association
 - Stockbrokers Association of Australia
 - Chi-X Australia Pty Ltd
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