9 October 2014

Ms Hema Raman
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Dear Ms Raman

Reducing red tape:
Proposed amendments to the market integrity rules (CP 222)

The Australian Financial Markets Associations (AFMA) welcomes the opportunity to comment on consultation paper 'Reducing red tape: Proposed amendments to the market integrity' rules (CP 221).

AFMA agrees with the objective of reducing business costs and administer the law effectively with a minimum of procedural requirements. While we continue to engage with ASIC on a range of substantive issues relating to Market Integrity Rules (MIR) affecting business costs and procedural requirements not dealt with in CP 222 we agree that is desirable to pursue incremental improvements on a case by case and not hold up changes which can made at an early opportunity rather than waiting to bundle up a large number of changes into a large reform package at a later stage associated with other projects such as rule harmonisation.

As a result of this consultation, much wider commentary has been received from AFMA members going beyond the narrow scope of CP 222 which we have raised with ASIC as part of our ongoing dialogue. AFMA will further document this commentary in writing to ASIC in the near future and restrict this response to the scope of the questions posed in CP 222.

PI Insurance notification

Requiring ASX, Chi-X, APX, SIM VSE and NSXA market participants to notify ASIC of the amount and period of their professional indemnity (PI) insurance cover.

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B1Q1

Do you agree with our proposal to remove the requirement for market participants of ASX, Chi-X and APX to notify ASIC of the amount, nature and period of PI insurance cover? Please give reasons for your view.

Yes. AFMA supports the proposal to remove the requirement for market participants of ASX, Chi-X and APX to notify ASIC of the amount, nature and period of PI insurance cover.

The Corporations Act has a general requirement for financial services licensees to have compensation arrangements in place when dealing with retail clients. Regulation 7.6.02AAA of the Corporations Regulations 2001 have been in place since 1 July 2008 set out that compensation arrangements based on professional indemnity insurance are the default arrangement to meet the section 912B requirement.

Subject to some exemptions, Regulation 7.6.02AAA requires licensees to meet the requirement to have compensation arrangements by holding professional indemnity insurance (PII) cover. The regulation requires the cover be adequate having regard to a number of considerations, including:

- the licensee's membership of an EDR scheme, taking into account the maximum liability that has some potential to arise under that scheme; and
- the financial services business carried on by the licensees, including the volume of business, the number and type of clients and the number of representatives of the licensee.

ASIC sets out guidance in Regulatory Guide 126: Compensation and Insurance Arrangements for AFS Licensees (RG 126) on how to assess whether their PII is adequate.

Importantly, failure to maintain a PII policy is a serious breach which would require licensees to self-identify the breach and to report this to ASIC in a timely manner. The onus is on the licensee to ensure they comply with the obligation to hold adequate PII on an ongoing basis, by self-assessing the adequacy of their PII cover taking into account their business needs and the minimum requirements in RG 126.

The notification requirement imposed on market participants is additional to that on other financial services licensees and this distinction does not appear to have a policy rationale.

B1Q2

Do you agree with our proposal to remove the requirement for market participants of NSXA to lodge with ASIC a copy of a certificate evidencing their PI insurance policy? Please give reasons for your view.

Yes. Consistent with our reasons above that notification is additional to obligations on other financial services licensees and this distinction does not

appear to have a policy rationale, the additional requirement to lodge a broker's certificate in relation NSXA has no policy rationale.

B1Q3

Do you agree with our proposal to remove the requirement for market participants of SIM VSE to provide ASIC with a copy of the certificate of currency for each PI insurance policy? Please give reasons for your view.

Yes. For the same reason as given in answer to B1Q2.

B1Q4

Do you think the removal of these market integrity rules will result in cost savings for market participants of the ASX, Chi-X, APX, NSXA and SIM VSE markets? If so, please quantify the estimated cost savings from the removal of these notification requirements (e.g. the length of time it takes to notify ASIC and the dollar value of staffing resources required to comply with this obligation). If we proceed with the proposals to repeal these notification requirements (proposals B1(a)–B1(c)) we may be required to provide details of this information in a RIS.

The administrative cost for licensees associated with providing ASIC with the notification involves compliance staff and administrative time. Cumulatively, this would involve about an hour of staff time, relating to monitoring timing of notifications and alerting to take action, making inquiry of corporate records and check with insurance broker, preparing notifications and checking and lodgement. Average staffing costs associated with this task are estimated to be $350 per licensee.

In the case of NSXA and SIM VSE markets the additional requirement to obtain a certificate of currency of the licensee's PII policy would add some additional cost to comply with the requirement

B1Q5

Do you see any benefit in retaining these market integrity rules? If so, please give reasons for your view.

No. There has been no identification of a public benefit at any time associated with this requirement.

B1Q6

Do you think there is a better alternative to the repeal of these market integrity rules? If so, please provide specific details, including the anticipated cost or cost savings of the alternative.

This is a straightforward removal of a procedural rule with no public detriment. No alternative is contemplated.

Business connections

Requiring ASX, Chi-X and APX market participants to obtain consent from ASIC before sharing business connections.

C1Q1

Do you agree with our proposal to repeal Part 5.2 (ASX), (Chi-X) and (APX)? Please give reasons for your view.

Yes. This rule deals with the handling of confidential information. The law relating to handling confidential information is subject to wider general principles of common law and privacy legislation. Where business connections are shared these are made subject to this body of law. In practice, this rule merely adds redundancy to the system and no enhancement.

More specifically, protection of confidential information has more recently being dealt with through Rule 7.4.1, which requires a market participant to take reasonable steps to ensure that its officers and employees do not use or disclose information about orders received, or transactions resulting from those orders, unless permitted under the competition market integrity rules or the law.

In Regulatory Guide 223 ASIC has set out its expectation in respect of MIR 7.4.1 to the effect that a market participant to restrict the disclosure and use of confidential order information to an 'as needs basis'. ASIC considers it good practice for a market participant to disclose to its clients how, and to whom, it discloses confidential order information.

Rule 7.4.1 deals with the handling of confidential information in a way which better takes account of current trading practices and technology particularly in relation to automated order processing.

C1Q2

If you do not agree with our proposal, is it because you do not consider pre-trade client order information to be adequately protected by the regulatory framework in the absence of Part 5.2 (ASX), (Chi-X) and (APX)? Please give reasons for your view.

AFMA agrees with the proposal.

C1Q3

If our proposal is implemented:

- ***a) do you anticipate any future cost savings? Please provide an estimate of future cost savings (i.e. for costs associated with anticipated reapplications and future consent applications) that will arise from the removal of Part 5.2 (ASX), (Chi-X) and (APX)? Where possible, please itemise the costs;***
- ***b) do you anticipate any future economic cost savings? Please provide an estimate of any economic cost savings (e.g. the opportunity cost of not sharing business connections with participants) that will arise from the repeal of Part 5.2 (ASX), (Chi-X) and (APX). Where possible, please quantify the costs; and***
- ***c) will it affect competition between market participants? For example, could it result in more business connections and industry consolidation?***

Please give reasons for your view.

Costs associated with obtaining consents relate to staff time which can be significant. It is estimated that this would amount to 40 hours per annum per firm amounting to an average staffing cost of $2,400.

C1Q4

If our proposal is not implemented:

- ***a) do you anticipate the number of consent applications you may need to make in the future will increase? Where possible, please give reasons for the anticipated increase (if any) in the number of applications; and***
- ***b) do you have any concerns about retaining Part 5.2 (ASX), (Chi-X) and (APX)?***

Please give reasons for your views.

We restate the view that the rule is redundant and provides no public benefit so its continuing existence would continue to impose an unnecessary administrative burden.

Prohibitions on transactions during takeovers, schemes of arrangements and buy-backs

AFMA members have generally questioned the purpose of the Part 6.5's general prohibition of special crossings of securities during a takeover over a long period. AFMA will address these broader policy issues separately as a part of an ongoing dialogue about the substantive review issues that should be addressed in relation to the MIR and regulatory policy in relation to this part of the law.

Accordingly, while this response is narrowly focused on the specific proposals put forward in CP 222 it does not indicate a general satisfaction with Part 6.5 if the limited current proposal is accepted.

D1Q1

Do you think that Part 6.5 (ASX), (Chi-X) and (APX), in its current form, creates uncertainty about the types of trades that can be executed during takeovers and schemes? If so, please give reasons for your view.

Yes. It is unclear what the underlying policy rationale is for this rule. There is no apparent official record of the policy justification behind this rule. While it may be presumed that since it performs a similar role to section 623 of the Corporations Act which in conjunction to section 602 aims to ensure an equality of opportunity. The balance of judicial authority and Takeovers Panel decisions support a "net benefits" approach to s 623, looking at the commercial balance of advantages flowing to or from the non-bidder from a transaction which is sought to be impugned.

The general policy principle that AFMA has been supporting over the course of the development of the Market Integrity Rules is that where the legislation specifically deals with an issue it should be left to that part of the law that is left to deal with the subject matter. The MIR should not be you as a supplemental

administrative rule-making power that is used to elaborate specific part of the law, such as in this case.

To the extent that Part 6.5 extends the law in a way which goes beyond what the legislature intend then it is reasonable to say that the law is not logically constructed. Such a lack of logic and internal consistency creates an environment of uncertainty as the policy intent for the function of Part 6.5 is not clear.

D1Q2 Do you think that Part 6.6 (ASX), (Chi-X) and (APX), in its current form, creates uncertainty about the types of trades that can be executed during buy-backs? If so, please give reasons for your view.

Yes. There is a lack of certainty with regard to whether trades on behalf of the issue with price improvement of any size are allowed to occur in a Market Participant's crossing system.

D1Q3 In relation to Option 1:

(a) Do you agree that Parts 6.4 and 6.5 (ASX), (Chi-X) and (APX) should be amended so that they only apply to market participants acting on behalf of the bidder or their associate (proposal D1(a)(i))? Please give reasons for your view. Does your answer differ for takeovers and schemes? If so, please provide your views for both takeovers and schemes.

(b) Do you agree that Rule 6.5.1(ASX), (Chi-X) and (APX) and Rule 6.5.2(ASX) should be amended so that they only restrict special crossings in an off-market bid during the offer period rather than the bid period (proposal D1(a)(ii))? Please give reasons for your view. Does your answer differ for takeovers and schemes? If so, please provide your views for both takeovers and schemes.

(c) Do you agree that Part 6.6 (ASX), (Chi-X) and (APX) should be retained in its current form (proposal D1(a)(iii))? Please give reasons for your view.

(d) What do you consider to be the estimated cost savings (itemise your costs where possible (e.g. staff costs, transaction costs, system costs)) or other benefits to market participants and investors from:

- ***(i) proposal D1(a)(i) (if your answer differs substantially for takeovers and schemes, please give reasons and provide separate estimates for takeovers and schemes); and***
- ***(ii) proposal D1(a)(ii) (if your answer differs substantially for takeovers and schemes, please give reasons and provide separate estimates for takeovers and schemes).***

In relation to the questions in D1Q3 it is AFMA's general position that Option 1 it not desirable and the rules should be deleted.

D1Q4 In relation to Option 2:

(a) Do you agree with the proposal to repeal Part 6.4 (ASX), (Chi-X) and (APX) (proposal D1(b)(i))? Please give reasons for your view. Does your answer differ for takeovers and schemes? If so, please provide your views for both takeovers and schemes.

Yes. AFMA's reasons are set out in response to D1Q1.

(b) Do you agree with the proposal to repeal Part 6.5 (ASX), (Chi-X) and (APX) (proposal D1(b)(ii))? Please give reasons for your view. Does your answer differ for takeovers and schemes? If so, please provide your views for both takeovers and schemes.

Yes. AFMA's reasons are set out in response to D1Q1. Takeovers and schemes of arrangement do not require separate treatment.

(c) Do you agree with the proposal to repeal Part 6.6 (ASX), (Chi-X) and (APX) (proposal D1(b)(iii))? Please give reasons for your view.

(d) What do you consider to be the estimated cost savings (itemise your costs where possible (e.g. staff costs, transaction costs, system costs)) or other benefits to market participants and investors from:

- ***(i) proposal D1(b)(i) (if your answer differs substantially for takeovers and schemes, please give reasons and provide separate estimates for takeovers and schemes); and***
- ***(ii) proposal D1(b)(ii) (if your answer differs substantially for takeovers and schemes, please give reasons and provide separate estimates for takeovers and schemes).***
- ***(iii) proposal D1(b)(iii).***

Members have identified a significant amount of staff time is associated with dealing with the uncertainties created by these rules. It is estimated that this would amount to 112 hours per annum per firm at an average combine staffing cost of $860 per hour, amounting to $96,320. In addition, the loss of value to clients from not being able to execute trades to their best advantage is a significant but hard to quantify cost on the system.

D1Q5

Do you have any concerns about retaining Parts 6.4–6.6 (ASX), (Chi-X) and (ASX), as is. Please give reasons for your view.

Yes. AFMA supports repeal of these rules for the reasons given above. At a principles level if rules do not have an original policy reason that continues to remain valid then there is no basis for justifying the existence of a rule

D1Q6

Can you suggest any alternative approaches to Options 1 and 2 regarding Parts 6.4–6.6 (ASX), (Chi-X) and (APX). If so, please give a detailed explanation of your preferred approach(s) and reasons for your view.

The main issue that arises with reliance on section 623 relates to the practical interpretation of 'associate' from an operational point of view. It would be useful for ASIC to provide guidance on the identification of 'associates' with regard to execution of trades.

I trust that this feedback will prove useful to you, and we look forward to working with you on addressing issues associated with these proposals and wider ones associated with the prohibitions on transactions during takeovers, schemes of arrangements and buy-backs in the MIR. Please contact me on or at if you have any questions.

Yours sincerely

Michael Go
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