



**ASIC**

Australian Securities & Investments Commission

## REPORT 453

# Response to submissions on CP 235 Proposed amendments to ASIC market integrity rules for the Chi-X investment product market

October 2015

### **About this report**

This report highlights the key issues that arose in the submissions received on Consultation Paper 235 *Proposed amendments to ASIC market integrity rules for the Chi-X investment product market* (CP 235) 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.

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## A Overview/Consultation process

1 In Consultation paper 235 *Proposed amendments to ASIC market integrity rules for the Chi-X investment product market* (CP 235), we consulted on proposals to amend ASIC market integrity rules and instruments that are considered necessary to enable Chi-X Australia Pty Ltd (Chi-X) to admit warrants and exchange traded funds (ETFs) to quotation on its market.

2 CP 235 followed the release of a consultation paper by Chi-X which sets out proposals to quote and trade warrants and ETFs on its market, commencing with warrants in November 2015 and ETFs in February 2016.

Note: Chi-X was granted an Australian market licence on 4 May 2011, authorising it to operate a financial market in securities and managed investment scheme interests. To date, it has only offered trading services in securities and listed managed investment products that are admitted to quotation on the ASX market, including ETFs.

3 In CP 235, we consulted on:

- (a) whether, and to what extent, our proposed amendments to the ASIC Market Integrity Rules (Chi-X Market) 2011 and ASIC Market Integrity Rules (ASX Market) 2010 would affect market participants' compliance settings, systems, client on-boarding processes, and client notifications regarding third-party execution and clearing arrangements;
- (b) the effect of our proposals to extend the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011, that apply to the quotation and trading of warrants and ETFs to the Chi-X market, on market participants and market operators' technology and compliance settings; and
- (c) our proposal to extend existing relief in ASIC class orders and a class waiver to the quotation and trading of warrants and ETFs on the Chi-X market.

Note: In this document 'ASIC Market Integrity Rules (ASX)' refers to the ASIC Market Integrity Rules (ASX Market) 2010, 'ASIC Market Integrity Rules (Chi-X)' refers to the ASIC Market Integrity Rules (Chi-X Market) 2011 and 'ASIC Market Integrity Rules (Competition)' refers to the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011.

4 As part of our proposals in CP 235, we also sought feedback from industry on our proposals to:

- (a) amend the definitions of 'ETF' and 'managed fund' in the ASIC Market Integrity Rules (ASX) to ensure they reflect recent changes to the ASX Operating Rules; and
- (b) extend the relief from s1017B of the *Corporations Act 2001* (Corporations Act), currently available to ETFs under Class Order [CO 13/721] *Relief to facilitate quotation of exchange traded funds on the AQUA market*, to managed fund products quoted on the ASX market.

- 5 Our proposals sought to ensure existing market integrity and investor protections relevant to the admission, quotation and trading of warrants and ETFs on the ASX market apply to the Chi-X market. In formulating our proposals, we focused on striking a balance between protecting retail investors, encouraging market competition and minimising the impact on industry.
- 6 This report highlights the key issues that were raised in the submissions to CP 235 and details our responses to those issues.
- 7 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 235. We have limited this report to the key issues.
- 8 For a list of the non-confidential respondents to CP 235, see the appendix. Copies of these submissions are currently on [our website](#).

## Responses to consultation

- 9 We received seven written and oral responses to CP 235 from market participants, market operators and an industry association. In the lead up to and during the consultation, a number of discussions were held with various domestic stakeholders. We are grateful to respondents for taking the time to provide us with their comments.
- 10 Respondents were generally supportive of our proposals and our rationale for ensuring the same conduct in relation to similar financial products are treated in the same manner for both the Chi-X and ASX markets.
- 11 In addition to responding to specific proposals in CP 235, respondents also provided general comments. The main issues raised by respondents related to:
- (a) requiring accredited derivatives advisers (ADAs) to obtain further accreditation to demonstrate they understand the differences between the operating rules of, and products on, the ASX and Chi-X markets;
  - (b) the extent to which ADA accreditation under the ASIC Market Integrity Rules (Chi-X) would apply to the ASX market;
  - (c) a preference for a joint explanatory booklet for the Chi-X and ASX warrants markets;
  - (d) requiring Chi-X's explanatory booklet to explain any differences in the operating rules and warrants on the Chi-X market and client acknowledgement that they are aware of any differences;
  - (e) the costs market participants may incur for issuing Chi-X's explanatory booklet to existing retail clients that trade warrants; and
  - (f) the need for a harmonised set of market integrity rules to apply to all similar markets and products.

## Timing for implementation

- 12            The operation of the amended ASIC Market Integrity Rules (Chi-X), ASIC Market Integrity Rules (ASX) and ASIC Market Integrity Rules (Competition) will commence on the day after registration on the Federal Register of Legislative Instruments.

## B Amending ASIC market integrity rules

### Key points

In CP 235 we proposed to amend the:

- ASIC Market Integrity Rules (Chi-X) to introduce existing market integrity and investor protections relevant to the admission, quotation and trading of ETFs and warrants to the Chi-X market;
- ASIC Market Integrity Rules (Competition) that apply to the quotation and trading of warrants and ETFs on the ASX market to include the quotation and trading of warrants and ETFs on the Chi-X market; and
- ASIC Market Integrity Rules (ASX) to introduce mutual recognition of the accreditation and client agreement (warrants) across the ASIC Market Integrity Rules (ASX) and ASIC Market Integrity Rules (Chi-X).

### ASIC Market Integrity Rules (Chi-X)

#### Cash market products

- 13 In CP 235, we proposed to amend the existing ASIC Market Integrity Rules (Chi-X) to introduce the term ‘cash market product’ to reflect the expanded suite of products (which include warrants and ETFs) that may be quoted and traded on the Chi-X market. Respondents were supportive of this proposal.

#### *ASIC’s response*

We have decided to proceed as proposed.

The introduction of the term ‘cash market product’, which will include the existing ‘equity market product’ (as defined) and two new Chi-X investment products (i.e. ‘investment product (MIS)’ and ‘investment product (warrant)’), ensures the ASIC Market Integrity Rules (Chi-X) reflect the financial products that may be available for trading on the Chi-X market.

It also ensures the same regulatory settings that apply to the trading of these products on the ASX market also apply to the trading of these products on the Chi-X market.

#### Accredited derivatives adviser

- 14 In CP 235, we proposed to insert a new Part 2.4 into the existing ASIC Market Integrity Rules (Chi-X) to ensure representatives of market participants providing advice to retail clients on warrants quoted and traded on the Chi-X market are accredited as either a level one or level two ADA.

- 15 Respondents were supportive of this proposal. One respondent suggested ADAs should be required to undertake further accreditation to ensure they could demonstrate an understanding of any differences between rules and products on the ASX and Chi-X markets.

*ASIC's response*

We have decided to proceed with our proposal.

The accreditation requirements in the ASIC Market Integrity Rules (ASX) are supplementary to a market participant's general obligations as an Australian financial services (AFS) licensee to ensure that its representatives are competent to give financial product advice for warrants traded on the ASX market. We believe introducing these requirements to the ASIC Market Integrity Rules (Chi-X) will ensure sufficient market integrity and investor protections are in place for the trading of warrants on the Chi-X market.

Our proposal minimises regulatory duplication by not requiring advisers who are already accredited under the ASIC Market Integrity Rules (ASX) to obtain further accreditation for warrants quoted and traded on Chi-X.

We have considered industry feedback but have decided not to introduce further accreditation requirements because the differences in rules and products on the ASX and Chi-X markets should not be material.

## **Explanatory booklet for warrants and written agreements**

### **Explanatory booklet for warrants**

- 16 In CP 235, we proposed to require market participants to provide retail clients a copy of any Chi-X explanatory booklet for warrants (including any published updates), before clients purchase warrants on the Chi-X market for the first time. Respondents were generally supportive of this proposal.
- 17 Two submissions advised that there would be minimal impact to client onboarding processes because the proposed requirements mirrored those that already apply to the ASX warrants market.
- 18 Some submissions indicated a preference for a joint explanatory booklet for the Chi-X and ASX warrants markets. One respondent suggested that a Chi-X warrants explanatory booklet should highlight any differences between the Chi-X and ASX operating rules and products because existing clients would already be familiar with the ASX warrants market.
- 19 There were two submissions regarding the cost implications of issuing a Chi-X explanatory booklet to existing retail clients that trade warrants. One respondent stated there were costs associated with issuing a booklet to their clients, although they did not provide any further details regarding the nature



and level of the costs in their submission. The second respondent considered the costs to be minimal.

### Client agreements

20 In CP 235, we also proposed to require market participants to enter into a written agreement (forming part of the client agreement) with a retail client, where the client acknowledges the features of warrants and that they have read and understood the explanatory booklet. Market participants would be exempt from the requirement in our proposal if they already have an agreement with a client in accordance with the ASIC Market Integrity Rules (ASX).

21 One respondent indicated that the current structure of Rule 3.1.8 (ASX) would not allow market participants to confirm that clients had received the Chi-X explanatory booklet—but noted it would be sufficient for clients to acknowledge their understanding of the general features of warrants. In addition to clients acknowledging the general features of warrants, they submitted that:

- (a) market participants should be required to obtain written acknowledgements from clients regarding their understanding of the differences between ASX and Chi-X operating rules and products; and
- (b) stand-alone client agreements would be preferable for Chi-X warrants, because they may be required if market operators seek recognition or approval of their products with global regulators in the future.

#### *ASIC's response*

We have decided to proceed as proposed.

Explanatory booklets for warrants are intended to provide a mechanism for assisting market transparency of these products to retail investors. Specific details about individual warrant products are covered in an issuer's disclosure documents.

Chi-X has committed to publishing an explanatory booklet that is relevant to trading warrants on the Chi-X market. We consider the costs for market participants to be relatively minor because they will only need to send a hard copy of the explanatory booklet to clients who cannot receive information electronically.

In developing our policy on client agreements, we sought to minimise regulatory duplication while maintaining investor protection measures for warrants, regardless of the market they trade on.

### Third-party execution and clearing arrangements

22 In CP 235, we proposed to amend the existing ASIC Market Integrity Rules (Chi-X) to ensure that market participants provide information about material changes to third-party execution and/or clearing arrangements to retail clients. Respondents supported this proposal.

*ASIC's response*

We have decided to proceed as proposed. Before a market participant enters into a transaction on behalf of a person for the purchase of an equity market product on Chi-X, they are required to provide their client with a document disclosing any third-party execution and clearing arrangements.

The amendments to Rules 3.1.3 and 3.1.4 (Chi-X) ensure clients are advised about material changes to these arrangements arising from the commencement of quotation and trading of warrants and ETFs on the Chi-X market.

## ASIC Market Integrity Rules (Competition)

- 23 In CP 235, we proposed to extend the existing ASIC Market Integrity Rules (Competition) that apply to the quotation and trading of warrants and ETFs on the ASX market to include the quotation and trading of warrants and ETFs on the Chi-X market. In particular, we proposed to:
- (a) amend the definition of 'equity market product' to include equity market products that may be admitted to quotation on the Chi-X market under the Chi-X Operating Rules; and
  - (b) apply Chapter 5A (Competition) to orders and transactions relating to warrants and ETFs admitted to quotation on the Chi-X market.
- 24 We also proposed to not include any transitional provisions for the application of the ASIC Market Integrity Rules (Competition) to warrants and ETFs admitted to quotation on the Chi-X market under the Chi-X Operating Rules. Respondents were supportive of our approach.
- 25 One respondent indicated the effect of the proposals on their technology settings would be minor because they already had the necessary infrastructure in place for complying with the requirements. They noted that the additional technology costs they would incur were related to testing to ensure a smooth transition to the Chi-X market.

*ASIC's response*

We have decided to proceed as proposed. This means that:

- Chapters 2–5, 6 and 7 (Competition) will apply to ETFs admitted to quotation under the Chi-X Operating Rules and traded on the Chi-X Market; and
- Chapter 5A (Competition) will apply to orders and transactions of warrants and ETFs admitted to quotation under the Chi-X Operating Rules.

Extending the existing rule framework that applies to the quotation and trading of warrants and ETFs on the ASX market to the Chi-X

market will ensure industry can access a new market for warrants and ETFs with minimal additional regulatory burdens and costs.

Transitional provisions were not considered crucial in light of the phased launch of Chi-X's investment product market, and the application of the same regulatory settings to those that already apply for these products on the ASX market.

## ASIC Market Integrity Rules (ASX)

### Mutual recognition of accreditation obligations and client agreements

- 26 In CP 235, we proposed to amend the ASIC Market Integrity Rules (ASX) to recognise that accreditation for providing advice to retail clients on warrants and client agreement (warrants) obligations are the same under the ASIC Market Integrity Rules (ASX) and ASIC Market Integrity Rules (Chi-X).
- 27 Respondents were generally supportive of mutual recognition, with one respondent noting the mutual recognition of accreditation and client agreements between the ASX and Chi-X markets was important to maintaining a level playing field between the markets. However, they also suggested there should be some limits on the extent of mutual recognition to ensure that clients were fully informed of the differences between the operating rules and/or products on the Chi-X and ASX markets.
- 28 One respondent sought to clarify whether ADAs that were accredited under the ASIC Market Integrity Rules (Chi-X) would only be able to give advice on ASX warrants, rather than the broader suite of products available on the ASX.

#### *ASIC's response*

Our approach to the ASIC Market Integrity Rules (ASX) is to minimise any regulatory duplication from the introduction of warrants quoted and traded on the Chi-X market—while ensuring consistent investor protection measures apply to warrants quoted and traded on the Chi-X and ASX markets.

We have decided to proceed with our proposal to not require a market participant to enter into a new written agreement with a retail client if they have an existing written agreement with the client under Rule 3.1.8 of the ASIC Market Integrity Rules (Chi-X) (Rule 3.1.8(4) (ASX).

In response to industry feedback, we have decided to amend the drafting of Rule 2.1.4(3) to clarify that advisers already accredited as a level one or level two ADA under the ASIC Market Integrity Rules (Chi-X) would only be able to give advice to a retail client in relation to warrants on the ASX market.

## Other minor amendments to the ASIC Market Integrity Rules (ASX)

- 29 In CP 235, we proposed to amend the ASIC Market Integrity Rules (ASX) to introduce amendments to the definitions of 'ETF' and 'managed fund' to reflect recent changes to the ASX Operating Rules. These changes allow a foreign company that has the characteristics of a managed investment scheme (as defined in s9 of the Corporations Act) to be an acceptable legal form for an ETF or managed fund for admission to quotation on the ASX market.
- 30 The feedback received supported this proposal. However, one respondent submitted it would be beneficial if the definitions were market-neutral rather than bespoke to the ASX market.

### *ASIC's response*

We have decided to proceed as proposed.

Updating the definition of 'ETF' and 'managed fund' in Rule 1.4.3 (ASX) ensures that we incorporate recent changes to the ASX Operating Rules, and accurately capture, for market supervision purposes, all ETF and managed funds that are admitted to quotation on the ASX market and traded on both the ASX and Chi-X markets.

As we noted in CP 235, consistent with previous statements in Consultation Paper 131 *Proposed ASIC market integrity rules: ASX and SFE markets* (CP 131) and RG 224 *Guidance on ASIC market integrity rules for Chi-X and APX markets* (RG 224), we intend to review at a later time all market integrity rules with a view to harmonising the rules so that only one set of market integrity rules applies to all like markets.

## C Extending relief in existing ASIC class orders and a class waiver

### Key points

There are a number of existing ASIC class orders and a class waiver that facilitate the trading of warrants and ETFs on the ASX market. In CP 235, we proposed to vary these instruments to extend their application to the Chi-X market.

We also proposed to vary [CO 13/721] so the relief from s1017B of the Corporations Act applies to both ETFs and managed funds admitted to quotation on the ASX market.

### Extending existing ASIC relief to the Chi-X market

- 31 As part of our proposals in CP 235, we proposed to vary class orders and a class waiver to extend application of existing relief to the quotation and trading of warrants and ETFs on the Chi-X market. We also proposed to grant the relief, in all material respects, on the same basis as the existing ASX relief. Respondents agreed with this proposal.
- 32 One respondent indicated that they did not believe ASIC's proposals would result in unintended consequences. They noted that the extension of the class waiver and class orders was necessary to ensure product issuers were subject to the same relief when issuing warrants on the Chi-X market.
- 33 Another respondent commented that extending the ASX relief to the Chi-X market would minimise regulatory burdens and reduce the need for individual relief applications.

#### *ASIC's response*

We have decided to proceed as proposed. This ensures that the same regulatory settings apply to warrants and ETFs irrespective of the market on which they are quoted or traded.

### Extending existing relief in [CO 13/721]

- 34 We proposed to vary [CO 13/721] so the relief from s1017B of the Corporations Act that currently applies to ETFs admitted to quotation on the ASX market also applies to managed funds admitted to quotation on the ASX market.

- 35 We proposed to grant this relief on the condition that responsible entities ensure investors in managed funds receive disclosure about significant changes that affect their product holdings through immediate disclosure to the market, rather than receiving individual significant event notifications.
- 36 Respondents were supportive of this proposal. However, one respondent suggested it would be preferable if the extension of relief to managed funds was granted to any licensed market, rather than being limited to managed funds admitted to quotation on ASX's AQUA market. They submitted that granting the relief to a specific market would not enable market operators that were seeking to admit the same products to quotation and trade on their market in future to benefit from the relief.

*ASIC's response*

We have decided to proceed as proposed.

We previously received approximately ten individual relief applications for managed fund products admitted to quotation under Schedule 10A to the ASX Operating Rules. In all instances, the same relief from s1017B in [CO 13/721] for ETFs admitted to quotation under Schedule 10A to the ASX Operating Rules was applied.

Attaching the condition that responsible entities meet the continuous disclosure requirements in s675 means that investors in managed fund products quoted on ASX (as for investors trading ETFs quoted on either the Chi-X or ASX market) will receive disclosure about significant changes that affect their holdings in the product through immediate disclosure to the market, rather than through individual event notifications within the timeframe required under s1017B. It also minimises the administrative burden on responsible entities.

As we noted in Report 373 *Response to submissions on CP 196: Periodic statements for quoted and listed managed investment products and relief for AQUA products* (REP 373), our approach to [CO 13/721] was to grant relief to financial markets that were licensed to quote ETFs as of the date of the class order (i.e. the AQUA market), and consider extending the relief to other financial markets when they became licensed to quote ETFs. We have adopted the same approach when considering to extend the relief to managed fund products as proposed.

## Appendix: List of non-confidential respondents

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- ASX Limited
  - Chi-X Australia Pty Ltd
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