



ASIC

Australian Securities & Investments Commission

REPORT 343

Response to submissions on CP 195 Proposed amendments to ASIC market integrity rules: ASX 24 and FEX markets

May 2013

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 195 *Proposed amendments to ASIC market integrity rules: ASX 24 and FEX markets* (CP 195) 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.

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A Overview/consultation process

- 1 In March 2011, we consulted on an application for an Australian market licence by Financial and Energy Exchange Limited to operate an exchange market for energy, commodity and environmental derivatives: see Consultation Paper 149 *Application for an Australian market licence: Financial and Energy Exchange Limited* (CP 149).

Note: Since that time, the applicant for the market licence has changed to FEX Global Pty Ltd.

- 2 In May 2011, we consulted on proposed ASIC market integrity rules for the FEX market in Consultation Paper 157 *Proposed ASIC market integrity rules: FEX market* (CP 157). The proposed rules were modelled on the ASIC Market Integrity Rules (ASX 24 Market) 2010 at that time, with minor amendments to:

- (a) reflect the differences between the proposed FEX market and the ASX 24 market;
- (b) correct drafting anomalies;
- (c) include obligations from operating rules, procedures, determinations and practice notes that applied to the ASX 24 (formerly the Sydney Futures Exchange (SFE)) market prior to the transfer of supervision to ASIC; and
- (d) include a specific obligation on market participants to give priority to their clients' interest if a conflict of interests exists.

Note: In this document, 'ASIC Market Integrity Rules (ASX 24)' refers to the ASIC Market Integrity Rules (ASX 24 Market) 2010.

- 3 In CP 157, we proposed making the same amendments (other than the amendments relating to the differences between the FEX and ASX 24 markets) to the ASIC Market Integrity Rules (ASX 24) at the same time as making the proposed ASIC market integrity rules for the FEX market. We did not receive any substantive comments on the proposals in CP 157.

Note: In this document, 'ASIC Market Integrity Rules (FEX)' refers to the proposed ASIC market integrity rules for the FEX market.

- 4 On 1 August 2011, ASIC amended the ASIC Market Integrity Rules (ASX 24) to include rules on capital and related requirements: see ASIC Market Integrity Rules (ASX 24 Market) Amendment 2011 (No. 1) and Consultation Paper 161 *Proposed ASIC market integrity rules for capital and related requirements: ASX, ASX 24 and Chi-X markets* (CP 161).

- 5 In Consultation Paper 195 *Proposed amendments to the ASIC market integrity rules: ASX 24 and FEX markets* (CP 195), we proposed further amendments relating to rules on:
- (a) risk management obligations for market participants that trade on a house account on the ASX 24 and/or FEX markets;
 - (b) supervision policy and procedure requirements for market participants that trade on the ASX 24 and/or FEX markets;
 - (c) minimum presence requirements for foreign market participants that trade on the ASX 24 and/or FEX markets and that do not hold an Australian financial services (AFS) licence;
 - (d) capital, reporting and margin requirements for market participants that trade on the FEX market, to align the ASIC Market Integrity Rules (FEX) with the current ASIC Market Integrity Rules (ASX 24); and
 - (e) a requirement for market participants that trade on the FEX market to disclose to clients the differences between having their contracts cleared and settled by an overseas clearing and settlement (CS) facility and an Australian-based CS facility.
- 6 We also proposed to make a number of other minor amendments to the ASIC Market Integrity Rules (ASX 24) and the ASIC Market Integrity Rules (FEX) to correct drafting anomalies.
- 7 This report highlights the key issues that arose out of submissions to CP 195 and our responses to those issues.
- 8 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 195. We have limited this report to the key issues.
- 9 For a list of non-confidential respondents to CP 195, see the appendix. Copies of the submissions are on the ASIC website at www.asic.gov.au/cp under CP 195.

Responses to consultation

- 10 We received three responses to CP 195, from a market operator, a market participant and an industry body. We are grateful to respondents for taking the time to send us their comments.
- 11 Generally, respondents supported the proposed amendments. However, some respondents:
- (a) expressed concerns about the proposed amendments relating to the minimum presence requirements and risk management obligations for house accounts;

- (b) had queries about the proposed new market integrity rule for supervisory policies and procedures; and
 - (c) suggested minor amendments, including to the proposed rules for disclosure about clearing arrangements for the FEX market.
- 12 Based on the feedback received, we have amended or made new market integrity rules for the ASX 24 market. We also intend to issue new guidance to address some of the concerns that were raised.
- 13 The proposed ASIC Market Integrity Rules (FEX) will be made subject to Ministerial consent.

B Risk management

Key points

In CP 195 we proposed amendments to Rule 2.2.1 of the ASIC Market Integrity Rules (ASX 24) and Rule 2.2.1 of the ASIC Market Integrity Rules (FEX) requiring market participants that trade on house accounts to meet certain risk management obligations.

Note: In this document 'Rule 2.2.1 (ASX 24) and (FEX)' refers to a particular rule of the ASIC Market Integrity Rules (ASX 24) and ASIC Market Integrity Rules (FEX).

One respondent identified some concerns with the new rules. We will address these concerns through guidance.

- 14 In CP 195 we proposed to amend Rule 2.2.1 (ASX 24) and (FEX) to require a market participant that trades on a house account to meet certain risk management obligations. These obligations include:
- (a) demonstrating prudent risk management procedures by, among other things, setting and documenting appropriate pre-determined order and/or position limits for each of its house accounts and rejecting orders in excess of those limits;
 - (b) if the market participant has connected to a terminal for the purposes of trading on a house account, being responsible for any orders entered through the terminal, and terminating such a connection in relation to a particular individual, system or device (or class of system or device) when notified by ASIC to do so; and
 - (c) before connecting to a terminal for the purposes of trading on a house account, and at all times while connected:
 - (i) satisfying itself that it has the necessary skills, facilities and procedures to operate, and understand the risks and obligations attached to the use of, such a facility; and
 - (ii) having appropriate controls on the connection, including password and security controls.

Setting and documenting limits

- 15 One respondent submitted that, to date, the risk management obligations have been the responsibility of the market participant that provides its clients and principal traders with access to the exchange. This market participant would generally set trading limits for those clients and principal traders. The

respondent submitted that it may be difficult for a principal trader that accesses the exchange through another market participant to comply with the new rules if the principal trader has no control over the trading limits that are set.

- 16 The respondent suggested that, instead of our proposed amendment to Rule 2.2.1 (ASX 24), we make other amendments requiring a market participant to disclose to the principal trader or client the trading limits it has set. The market participant should obtain a written acknowledgement and acceptance of those limits within five business days and retain this on file. Any changes to trading limits would also need to be acknowledged in writing.
- 17 The respondent also raised concerns about a potential conflict of interest if the person responsible for setting limits may also engage in trading on the house account.

ASIC's response

We have made amendments to Rule 2.2.1 (ASX 24), requiring market participants that trade on house accounts to meet certain risk management obligations.

Under Rule 2.2.1(5) (ASX 24), a market participant that is a market participant on the date the rule is made will have three months to comply with Rule 2.2.1 (ASX 24) in relation to house accounts.

We intend to issue new guidance during the transition period to outline our expectations about the Rule 2.2.1 (ASX 24) risk management obligations for house accounts. We will clarify:

- how we expect principal traders to comply with the risk management rules, depending on the means by which the principal trader accesses the exchange; and
- the person responsible for setting limits.

The proposed amendments to Rule 2.2.1 (FEX) will be made subject to Ministerial consent.

Terminal connections

- 18 One respondent submitted that the existing requirement under Rule 2.2.1(3) (ASX 24) imposes certain obligations on a market participant before the market participant permits a client to connect to a terminal. This client may be a principal trader that is executing trades on a house account.
- 19 The respondent raised concerns that, in circumstances where the market participant's client is a principal trader, the proposed Rule 2.2.1(4) (ASX 24) would transfer responsibility to the principal trader from the market

participant that permits the connection to the terminal. The respondent submitted that, to ensure a level playing field, the proposed Rule 2.2.1(4) (ASX 24) should be rejected or should apply equally to clients, market participants that trade on a house account, and principal traders.

- 20 The respondent also raised concerns about the proposed Rule 2.2.1(4)(c) (ASX 24), which requires that, before connecting and at all times while connected to a terminal for the purposes of trading on a house account, a market participant must ensure that each order placed and any order system complies with the ASIC market integrity rules.
- 21 The respondent submitted that this rule should sit within Chapter 3 of the ASIC Market Integrity Rules (ASX 24) and should apply to all persons that trade on the market, including clients, market participants that trade on a house account, and principal traders. The respondent also submitted that the proposed Rule 2.2.1(4)(c) (ASX 24) would not allow a market participant to make any errors.
- 22 Regarding the proposed Rule 2.2.1(4)(e) (ASX 24), the respondent submitted that more consideration needs to be given to the rule, taking into account common working arrangements employed by market participants (e.g. traders that are given remote access). The respondent submitted that it would be virtually impossible for any market participant that trades on a house account to implement controls that manage the physical access of the market participant and its employees to the systems used for trading.

ASIC's response

We have made amendments to Rule 2.2.1 (ASX 24), requiring market participants that trade on a house account to meet certain risk management obligations.

Rule 2.2.1(4)(c) (ASX 24) is intended to operate to ensure that a market participant's house account orders comply with the rules. It mirrors the obligation imposed in Rule 2.2.1(3)(c) (ASX 24) in relation to a market participant's client orders, and takes into account the operation of Rule 2.2.1(2)(a) (ASX 24).

We intend to issue new guidance during the transition period to outline our expectations about Rule 2.2.1(4) (ASX 24), including the security arrangements that a market participant should have in place. The proposed amendments to Rule 2.2.1 (FEX) will be made subject to Ministerial consent.

C Supervision policies and procedures

Key points

In CP 195 we proposed to make a new market integrity rule requiring market participants to have appropriate supervisory policies and procedures in place.

Respondents raised no objections to this proposal; however, some queries were raised that we will address through guidance.

23 In CP 195, we proposed to make a new market integrity rule requiring market participants of the ASX 24 and/or FEX markets to have appropriate supervisory policies and procedures to ensure compliance by the market participant, and each person involved in its business as a market participant, with the market integrity rules, market operating rules and the *Corporations Act 2001* (Corporations Act).

24 The proposed rule is modelled on market integrity rules that apply to market participants of the ASX and Chi-X markets: see Rule 2.1.3 of the ASIC Market Integrity Rules (ASX Market) 2010 and Rule 2.1.3 of the ASIC Market Integrity Rules (Chi-X Australia Market) 2011.

Note: In this document 'Rule 2.2.1 (ASX) and (Chi-X)' refers to a particular rule of the ASIC Market Integrity Rules (ASX Market) 2010 and ASIC Market Integrity Rules (Chi-X Market) 2011.

25 In CP 195 we proposed a transition period of three months to comply with the new market integrity rule for those market participants of the ASX 24 market that are market participants on the date the rule is made.

26 Respondents raised no objections to the proposal; however, one respondent suggested that we provide a six-month transition period. The respondent submitted that many market participants operate complex global models with much of their trading activity comprising offshore direct market access flow, and it will take more time for market participants to comply with the new rule.

27 One respondent suggested that informal policies and procedures should be acceptable for principal traders where the directors are the only traders, rather than documented policies and procedures. The respondent submitted that in these circumstances there would be no benefit to the principal trader having documented policies and procedures given that there are no staff to supervise.

ASIC's response

We have made Rule 2.2.8 (ASX 24), requiring market participants to have appropriate supervisory policies and procedures to ensure compliance by the market participant, and each person involved in its business as a market participant, with the market integrity rules, market operating rules and the Corporations Act.

Under Rule 2.2.8(2) (ASX 24), we have retained the transition period of three months for those market participants of the ASX 24 market that are market participants on the date that the rule is made. Market participants should already have policies and procedures in place, and the transition period is given to allow those market participants the opportunity to ensure that their documentation is in order.

Under Rule 2.2.8 (ASX 24), a market participant should be able to demonstrate that it has established, maintained and continues to enforce supervisory policies and procedures that are tailored to the nature, size and complexity of their business. We intend to issue new guidance during the transition period to outline our expectations about Rule 2.2.8 (ASX 24).

The proposed Rule 2.2.8 (FEX) will be made subject to Ministerial consent.

D Minimum presence requirements

Key points

In CP 195, we proposed to impose minimum presence requirements on foreign market participants that do not hold an AFS licence.

Respondents raised no objections to this proposal; however, one respondent identified concerns with some of the proposed terms of the deed.

- 28 In CP 195, we proposed to impose minimum presence requirements on foreign market participants that do not hold an AFS licence, to facilitate enforcement actions in Australia for breaches of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the Corporations Act and the *Corporations (Fees) Act 2001* (Fees Act).
- 29 The proposed rules are modelled on market integrity rules relating to minimum presence requirements for foreign market participants of the ASX and Chi-X markets that do not hold an AFS licence: see Rule 2.6.1 (ASX) and (Chi-X) and Consultation Paper 166 *Market integrity rules for non-AFS licensee foreign participants and consequential amendments* (CP 166).
- 30 Respondents did not raise objections to the proposed minimum presence requirements for foreign market participants; however, one respondent raised concerns with some of the proposed terms of the deed.
- 31 The respondent had no objections with entering into a deed with ASIC, but they thought that the deed should be revoked once the foreign market participant ceased to be a market participant on the relevant market. The respondent was also concerned that Rule 2.4.1(2)(f) (ASX 24) gave ASIC the ability to implement further changes without consultation with foreign market participants and that this would hinder the equality of the foreign market participants to that of Australian market participants.

ASIC's response

We have made Rule 2.4.1 (ASX 24), requiring foreign entities that do not hold an AFS licence to provide ASIC with a deed before entering into a market transaction. The deed must provide that, among other things, the foreign market participant agrees to comply with Australian court orders and maintain an agent in this jurisdiction authorised to accept service of process.

The purpose of Rule 2.4.1 (ASX 24) is to facilitate enforcement action in Australia for breaches by foreign market participants of relevant market integrity rules, the ASIC Act, the Corporations Act and the Fees Act. ASIC may become aware of such conduct at a point in time when the foreign market participant is no longer a market participant of the relevant market. The deed must therefore remain in place (unless ASIC gives prior written consent to its revocation) irrespective of a foreign market participant ceasing to be a market participant of the relevant market, to facilitate ASIC's ability to take enforcement action in all circumstances.

Under Rule 2.4.1(2)(f) (ASX 24), the deed entered into by a foreign market participant must provide such additional terms as notified by ASIC to the foreign market participant. ASIC will not make further amendments without prior consultation with the foreign market participant.

The proposed Rule 2.4.1 (FEX) will be made subject to Ministerial consent.

E Disclosure about clearing arrangements

Key points

In CP 195 we proposed making a new market integrity rule requiring market participants of the FEX market to make certain disclosures to clients about clearing arrangements.

One respondent submitted that this rule was insufficient and, in response, we have made some amendments.

- 32 In CP 195, we proposed to make a new market integrity rule requiring market participants of the FEX market to disclose to clients the differences between having their contracts cleared and settled by LCH.Clearnet Limited (an overseas CS facility) and an Australian-based CS facility.
- 33 We received one submission that commented on the proposed market integrity rules for the FEX market. The respondent suggested that the disclosure should clearly set out the potentially different outcomes investors may face in the event of an insolvency of the market participant or the overseas CS facility. The respondent also suggested that the proposed rule include an obligation on the market participant to obtain written confirmation from the client that they have received and understood the arrangements.

ASIC's response

We intend to amend proposed Rule 2.2.9 (FEX) to include a requirement that the market participant obtain a written confirmation from the client that the differences between having contracts cleared and settled by LCH.Clearnet and an Australian-based CS facility have been disclosed to the client.

The proposed market integrity rules for the FEX market will be made subject to Ministerial consent.

F Other amendments

Key points

In CP 195 we proposed making other minor amendments to market integrity rules for the ASX 24 and FEX markets, including Rules 3.3.1A and 3.4.2 (ASX 24) and (FEX), which we consulted on in CP 157.

In response to the submissions we received, we have made some amendments to our changes to the ASIC Market Integrity Rules (ASX 24) and our proposed changes to the ASIC Market Integrity Rules (FEX).

Entry of orders

- 34 In CP 195, we proposed Rule 3.3.1A (ASX 24) and (FEX) (which we consulted on in CP 157), which deals with the entry of orders when counterparties have been solicited by the market participant, under Rule 3.3.1(1)(a) (ASX 24) and (FEX), concerning pre-negotiated business. Proposed Rule 3.3.1A (ASX 24) and (FEX) provided that the period of time the market participant must wait between entering the enquiry and entering the order is the time specified by the relevant market operator in its market operating rules or procedures or, if no time is specified, 60 seconds.
- 35 One respondent commented that the majority of times specified in the ASX 24 Operating Rules are 30 seconds, with the exception of a few illiquid contracts. The respondent suggested that the default time for the purposes of the proposed Rule 3.3.1A (ASX 24) should also be 30 seconds.

ASIC's response

We have made Rule 3.3.1A (ASX 24) with a default time of 30 seconds.

The proposed Rule 3.3.1A (FEX) will be made subject to Ministerial consent, and the default time in that rule will also be 30 seconds.

Prohibitions on use of block trade facilities for roll business

- 36 In CP 157, we consulted on an amendment to Rule 3.4.2 (ASX 24) and (FEX) to clarify that market participants are prohibited from executing roll business using a block trade facility. In CP 195 we stated that we will take

into account recent ASX consultation before proceeding with our proposed amendments to Rule 3.4.2 (ASX 24) and (FEX).

ASIC's response

We have made amendments to Rule 3.4.2 (ASX 24). If we receive further information from ASX regarding their outcome of the consultation process, we will take this into account when deciding whether to take any further action on market integrity rules for block trades.

The proposed Rule 3.4.2 (FEX) will be made subject to Ministerial consent.

Appendix: List of non-confidential respondents

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- Australian Financial Markets Association (AFMA)
 - ASX Limited
-