

# ASIC MARKET INTEGRITY RULES (APX MARKET) AMENDMENT 2013 (NO. 1) EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

*Corporations Act 2001*

The Australian Securities and Investments Commission (**ASIC**) makes the *ASIC Market Integrity Rules (APX Market) Amendment 2013 (No. 1)* (the **Amending Instrument**) under subsection 798G(1) of the *Corporations Act 2001* (the **Act**). Capitalised terms used in this Explanatory Statement (e.g. “Market Participant”) are defined in the *ASIC Market Integrity Rules (APX Market) 2013* (the **APX MIRs**).

## 1. Enabling legislation

Subsection 798G(1) of the Act provides that ASIC may, by legislative instrument, make rules that deal with the following:

- (a) the activities or conduct of licensed markets;
- (b) the activities or conduct of persons in relation to licensed markets;
- (c) the activities or conduct of persons in relation to financial products traded on licensed markets.

## 2. Background

On 29 July 2013, ASIC made the APX MIRs under subsection 798G(1) of the Act. The APX MIRs apply to:

- (a) the activities and conduct of the financial market (the **APX market**) operated by Asia Pacific Exchange Limited (**APX**);
- (b) the activities or conduct of persons in relation to the APX Market;
- (c) the activities or conduct of persons in relation to financial products traded on the APX Market.

The APX MIRs also revoked the *ASIC Market Integrity Rules (APX Market) 2010* (the **2010 APX MIRs**).

APX is the holder of *Australian Market Licence (Asia Pacific Exchange Limited) 2004* authorising it to operate a financial market in securities and managed investment products. APX commenced operation of its market on 20 January 2005. The market ceased operation on 30 June 2008.

On 1 August 2010, as part of the transfer of responsibility for market supervision from Australian market licence holders to ASIC, ASIC made the 2010 APX MIRs. The 2010 APX MIRs were based on a subset of the APX Business Rules that were in existence prior to 1 August 2010. However, at the time the 2010 APX MIRs were made, and to date, the APX market has not been operating. APX now proposes to recommence operating.

When APX recommences operating ASIC must be able to appropriately supervise the activities and conduct of APX, its market participants and the activities or conduct of persons in relation to financial products traded on the APX market. One of ASIC's primary means of supervising this conduct is through market integrity rules that apply to the APX market.

APX will recommence operating with a new trading system (with the capacity for Automated Order Processing being available in the short term), new APX Business Rules and new APX Listing Rules.

APX intends to provide trading services similar to those of ASX Limited (*ASX*) and Chi-X Australia Pty Ltd (*Chi-X*).

The APX MIRs are modelled on the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011 (the Chi-X MIRs)*, which in turn were originally modelled on the *ASIC Market Integrity Rules (ASX Market) 2010 (the ASX MIRs)*. The APX MIRs differ from the Chi-X MIRs only as far as is necessary to reflect the operational differences between Chi-X and APX. That is, unlike Chi-X, APX is a listing market and offers trading services in products listed on its market, and trades executed on the APX market are not subject to central clearing.

The rationale for this approach in developing the APX MIRs is to:

- (a) contribute to a level playing field between APX, ASX and Chi-X in respect of the requirements placed on participants of each of these markets;
- (b) minimise the opportunity for regulatory arbitrage by participants;
- (c) assist participants of the APX, ASX and Chi-X markets to comply with regulatory obligations under the market integrity rules; and
- (d) contribute to efficiency in supervision and enforcement of the market integrity rules by ASIC because the same standards of conduct will be applied.

The APX MIRs impose obligations on participants of the APX Market (*APX participants*) that are also imposed by the Chi-X and ASX MIRs on participants of those markets, in relation to trading in equities, including requirements in relation to Automated Order Processing.

The market integrity rules relating to Automated Order Processing in Chapter 5 of the ASX and Chi-X MIRs will be amended from 26 May 2014 to enhance the controls participants must have in place when using Automated Order Processing, and to make changes to review and notification requirements.<sup>1</sup>

Following consultation with affected stakeholders (see Section 4 below), ASIC believes it is appropriate to apply the enhanced Automated Order Processing rules to APX participants from the same date. This will give sufficient lead time for APX participants to prepare for the changes, and ensure a level playing field between APX, ASX and Chi-X.

### **3. Purpose of the legislative instrument**

The purpose of the Amending Instrument is to amend the APX MIRs to address regulatory issues resulting from recent market developments in Australia, in particular new risks to market integrity resulting from the growth of automated trading.

#### *Automated Trading*

The Amending Instrument makes amendments to Chapter 5 of the APX MIRs (Trading) to introduce requirements for Market Participants that use their system for Automated Order Processing to:

- (a) have direct control over the automated filters and the filter parameters for that system;
- (b) ensure that the system has in place controls, including automated controls, that enable immediate suspension, limitation or prohibition of the conduct of all Automated Order Processing, Automated Order Processing in respect of Automated Client Order Processing, or Automated Order Processing in respect of one or more Authorised Persons, clients or Products;

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<sup>1</sup> See the *ASIC Market Integrity Rules (ASX Market) Amendment 2012 (No. 3)* and the *ASIC Market Integrity Rules (Chi-X Australia Market) 2012 (No. 3)*.

- (c) ensure that the system has in place controls that enable immediate suspension of, limitation of or prohibition on, the entry into the APX Market of Trading Messages in a series of related Trading Messages where the Market Participant has identified that Trading Messages in the series have entered the APX Market and have interfered with, or are likely to interfere with, the efficiency or integrity of the APX Market;
- (d) ensure that the system has in place controls that enable immediate cancellation of Trading Messages in a series that have already entered the APX Market, where the entry of further Trading Messages in the series have been suspended, limited or prohibited;
- (e) conduct an annual review of Automated Order Processing systems and notification of the Market Participants' compliance with Part 5.6 of the APX MIRs.

The Amending Instrument also removes the transitional arrangement which exempts an APX Market Participant that is also an ASX or Chi-X Market Participant from the APX MIRs relating to certification of Automated Order Processing systems. The transitional arrangement is removed from 26 May 2014.

The purpose of these amendments to Chapter 5 of the APX MIRs is to manage the risk of potential adverse events (and their effects on market integrity) of automated trading.

There are already robust controls in the Australian equity market to mitigate some of the risks from automated trading. However, these controls need to be updated to fully address emerging risks, as well as to align our regime with IOSCO principles and international best practice.

The amendments to Chapter 5 of the APX MIRs made by the Amending Instrument build a more rigorous framework of systems, filters and controls to guard against potential disruptions from aberrant algorithmic activity and will not disrupt the operation of the market in normal conditions. The amendments will ensure that Market Participants have the ability, in real time, to control and prevent aberrant order flow before it disrupts the market. An aberrant algorithm generates not only costs that are borne by the firms using the algorithms, but also negative impacts for all market participants by impairing the fairness and orderliness of the market.

Details of the Amending Instrument are contained in [Attachment A](#).

#### **4. Consultation**

In February 2013, ASIC undertook a targeted consultation on its proposal to revoke the 2010 APX MIRs and replace them with the APX MIRs. The rules in this Amending Instrument formed part of that consultation process. Feedback was sought from relevant stakeholders being APX, ASX, Chi-X, Australian Financial Markets Association (*AFMA*), Stockbrokers Association of Australia (*SAA*), National Stock Exchange of Australia Limited (*NSX*) and SIM Venture Securities Exchange Ltd (*SIMVSE*).

We received written submissions from APX, SAA, and Chi-X, and a combined response from NSX and SIMVSE. Stakeholders have been supportive of the new market integrity rules framework being modelled on the Chi-X MIRs, primarily because this approach minimises duplication of obligations for participants of multiple Australian markets.

In finalising the APX MIRs and Amending Instrument, ASIC has taken into account the feedback received. In particular, in ASIC's targeted consultation letter, ASIC had proposed to apply the enhanced Automated Order Processing rules from commencement of the APX MIRs. In response to feedback received, ASIC will instead amend the APX MIRs (by way of this Amending Instrument) to apply the enhanced Automated Order Processing rules with effect from 26 May 2014. The transitional period to comply with the enhanced Automated Order Processing rules will give greater lead time for APX market participants and ensuring a level playing field for participants of APX, ASX and Chi-X.

ASIC has also consulted on the ASX and Chi-X MIRs on which this Amending Instrument is modelled, through:

- (a) ASIC Consultation Paper *Australian market structure: Draft market integrity rules and guidance* (CP 179), released 28 June 2012, seeking feedback on amendments to the market integrity rules and guidance to address market structure issues arising from recent and anticipated developments in Australia's financial markets;
- (b) ASIC Consultation Paper *Australian market structure: Draft market integrity rules and guidance on automated trading* (CP 184), released 13 August 2012, seeking feedback on amendments to the market integrity rules and guidance to address market structure issues arising from recent and anticipated developments in Australia's financial markets; and
- (c) Meetings with stakeholders and information sessions for members of AFMA, the Financial Services Council (FSC) and the Stockbrokers Association of Australia (SAA).

## **5. Penalties**

Subsection 798G(1) of the Act provides that market integrity rules are legislative instruments for the purposes of the *Legislative Instruments Act 2003*.

Subsection 798G(2) of the Act provides that market integrity rules may include a penalty amount for a rule. A penalty amount must not exceed \$1,000,000. The penalty amount set out below a Rule is the penalty amount for that Rule.

## **6. Commencement of the Amending Instrument**

The Amending Instrument will commence on the later of 26 May 2014, and the day after the Amending Instrument is registered under the *Legislative Instruments Act 2003*.

## **7. Statement of Compatibility with Human Rights**

A Statement of Compatibility with Human Rights is included in this Explanatory Statement at Attachment B.

## **8. Regulation Impact Statement**

The Office of Best Practice Regulation (**OBPR**) has assessed this Amending Instrument as having a minor impact and confirmed that no further analysis, in the form of a Regulatory Impact Statement, is required. The amendments effected by this Amending Instrument were previously part of Regulation Impact Statement (*Australian equity market: Further proposals*) which was prepared in relation to identical amendments that were made to the ASX MIRs and the Chi-X MIRs.

## ATTACHMENT A

Capitalised terms used in this Attachment (e.g. “Market Participant”) are defined in the APX MIRs.

### Paragraph 1 – Enabling Legislation

This paragraph provides that the Amending Instrument is made under subsection 798G(1) of the *Corporations Act 2001*.

### Paragraph 2 – Title

This paragraph provides that the title of the Amending Instrument is the *ASIC Market Integrity Rules (APX Market) Amendment 2013 (No. 1)*.

### Paragraph 3 – Commencement

This paragraph provides that the Amending Instrument commences on the later of 26 May 2014, and the day after the Amending Instrument is registered under the *Legislative Instruments Act 2003*.

### Paragraph 4 – Amendments

This paragraph provides that Schedule 1 amends the *ASIC Market Integrity Rules (APX Market) 2013*.

### Schedule 1 Amendments

#### Item [1] Rule 1.4.3, after the definition of “AFSL”

Item [1] of Schedule 1 to the Amending Instrument amends Rule 1.4.3 to insert, after the definition of “AFSL”, definitions of “AOP Annual Notification”, “AOP Annual Review”, “AOP Annual Review Date”, “AOP Initial Certification” and “AOP Material Change Review”.

These defined terms are used in amended Part 5.6 of the APX MIRs (see items [2] to [32] below).

#### Item [2] Rule 5.6.3

Item [2] amends Rule 5.6.3 by inserting “(1)” before “A Market Participant.” This amendment changes existing Rule 5.6.3 to subrule 5.6.3(1), to accommodate the amendment made by item [7], which introduces a new subrule 5.6.3(2).

#### Item [3] Rule 5.6.3(b)

Item [3] amends Rule 5.6.3(b) by, after “;”, omitting “and”. This amendment is consequential on the insertion of new paragraphs (d) and (e) after paragraph (c) (see items [5] and [6]).

#### Item [4] Rule 5.6.3(c)

Item [4] amends Rule 5.6.3(c) by omitting “markets provided by the Market Participant” and inserting “the APX Market.” This amendment clarifies that Rule 5.6.3(c) applies to the activities or conduct of the Market Participant in relation to the APX Market.

#### Item [5] Rule 5.6.3(c)

Item [5] amends Rule 5.6.3(c) by omitting “.” and substituting “;” This amendment accommodates the amendment made by item [6], to introduce new paragraphs (d) and (e).

#### Item [6] Rule 5.6.3, after paragraph (c)

Item [6] amends Rule 5.6.3, after paragraph (c) by inserting new paragraphs (d) and (e). New paragraph (d) provides that a Market Participant that uses its system for Automated Order Processing must ensure that the system has in place controls, including automated controls, that enable immediate suspension, limitation or prohibition of the conduct of all Automated Order Processing or Automated Order Processing in respect of one or more Authorised Persons or clients, Automated Client Order Processing, or one or more Products.

This amendment ensures that a Market Participant has in place controls, including automated controls, that enable the Market Participant to suspend, limit or prohibit Automated Order Processing, where the Market Participant has identified, for example, that Trading Messages from a particular source (such as a particular Authorised Person, account or algorithm) are interfering with the efficiency or integrity of the APX Market. Examples of such controls include controls that terminate the activity of the Automated Order Processing system, shut down the responsible sub-system, force the logout of an Authorised Person or change the parameters of a filter to zero or another level that would prevent further trading.

New paragraph (e) provides that a Market Participant that uses its system for Automated Order Processing must ensure that the system has in place controls that enable immediate:

- suspension of, limitation of, or prohibition on, the entry into the Market of Trading Messages in a series of related Trading Messages where the Market Participant has identified that Trading Messages in the series have entered the APX Market and have interfered with -or are likely to interfere with the efficiency or integrity of the APX Market; and
- cancellation of Trading Messages in a series that have already entered the APX Market where the entry of further Trading Messages in the series has been suspended, limited or prohibited.

This amendment ensures that a Market Participant has in place controls so that once it has identified, through its monitoring arrangements, that a series of Trading Messages (e.g. Trading Messages generated by a common user, account or algorithm that occur in close succession) submitted through its system is having, or is likely to have, an impact on the APX Market, it can suspend, limit or prohibit further Trading Messages in the series from being submitted to the APX Market, and cancel any Trading Messages in the series that have already entered the APX Market.

#### Item [7] Rule 5.6.3

Item [7] amends Rule 5.6.3, by inserting, after (new) subrule (1), a new subrule 5.6.3(2). New subrule 5.6.3(2) provides that a Market Participant that uses its system for Automated Order Processing must have direct control over all automated filters and the filter parameters for those filters.

This amendment ensures that Market Participants that use their system for Automated Order Processing retain direct control over the application of the filters and filter parameters to trading by Authorised Persons through the Market Participant's system. This amendment is designed to ensure that Market Participants are able to prevent aberrant algorithmic activity from interfering with the efficiency and integrity of the APX Market.

#### Item [8] Rule 5.6.4

Item [8] amends Rule 5.6.4 by omitting "Subject to Rule 5.6.6A, before" and substituting "(1) Before". This amendment recognises that the transitional certification provision for participants of APX and ASX or Chi-X in Rule 5.6.6A is omitted by item [22] of the Amending Instrument. This amendment also changes existing Rule 5.6.4 to subrule 5.6.4(1), to accommodate the amendment made by item [9], which introduces a new subrule 5.6.4(2).

#### Item [9] Rule 5.6.4

Item [9] amends Rule 5.6.4 to insert after "these Rules." a new subrule (2) and a note following that new subrule. New subrule 5.6.4(2) provides that a Market Participant that was not required to comply with Rule 5.6.4 in relation to a system for Automated Order Processing because of the operation of Rule 5.6.6A is not required to conduct the review referred to in subrule 5.6.4(1) in relation to that system for Automated Order Processing. Item [9] also inserts a note describing the effect of Rule 5.6.6A and explaining how, and when it is omitted from the APX MIRs.

#### Item [10] Subrule 5.6.5(1)

Item [10] amends subrule 5.6.5(1) by omitting "Subject to Rule 5.6.6A, before" and substituting "Before". This amendment recognises that the transitional certification provision for participants of APX and ASX or Chi-X in Rule 5.6.6A is omitted by item [22] of the Amending Instrument.

#### Item [11] Subrule 5.6.5(1)

Item [11] amends subrule 5.6.5(1) by omitting the words "their Automated Order Processing system meets the requirements of each of paragraphs 5.6.3(a), (b) and (c)" and substituting "the Market Participant has in place organisational and technical resources, arrangements and controls in relation to the system for Automated Order Processing that meet the requirements of Rule 5.6.3."

This amendment recognises that the requirements of paragraphs 5.6.3(a), (b) and (c) have been supplemented by new requirements (see items [6] and [7] above), and those requirements are together more aptly described as "organisational and technical resources, arrangements and controls".

#### Items [12] and [13] Subrule 5.6.5(2) and Paragraph 5.6.5(2)(a)

Item [12] amends subrule 5.6.5(2), by inserting after the words "subrule (1)", the word "must".

Item [13] amends paragraph 5.6.5(2)(a) by omitting the word "must."

These amendments together clarify the intended operation of subrule 5.6.5(2) – that is, that the representations referred to in subrule 5.6.5(1) must meet all of the requirements of paragraphs 5.6.5(2)(a) to (d).

#### Item [14] Paragraph 5.6.5(2)(a)

Item [14] amends paragraph 5.6.5(2)(a), by inserting, after the word "the" (first occurring), the words "organisational and technical resources, arrangements and".

This amendment complements the amendments made by items [6] and [7] (see above), recognising the requirements of Rule 5.6.3 are together more aptly described as "organisational and technical resources, arrangements and controls".

#### Item [15] After subrule 5.6.5(2)

Item [15] inserts, after subrule 5.6.5(2), a new subrule 5.6.5(3). New subrule 5.6.5(3) provides that a Market Participant that was not required to comply with Rule 5.6.5 in relation to a system for Automated Order Processing because of the operation of Rule 5.6.6A is not required to obtain the representations referred to in subrule 5.6.5(1) in relation to that system for Automated Order Processing. Item [15] also inserts a note describing the effect of Rule 5.6.6A and explaining how, and when it is omitted from the APX MIRs.

#### Item [16] Subrule 5.6.6(1)

Item [16] amends subrule 5.6.6(1) by omitting "Subject to Rule 5.6.6A, before" and substituting "Before". This amendment recognises that the transitional certification provision for participants of APX and ASX or Chi-X in Rule 5.6.6A is omitted by item [22] of the Amending Instrument.

#### Items [17], [18] and [19] Rule 5.6.6

Item [17] amends paragraph 5.6.6(1)(a) by adding the words “(**AOP Initial Certification**)” after the word “certification”.

This amendment introduces the defined term “AOP Initial Certification” for ease of reference in the APX MIRs.

Item [18] amends paragraph 5.6.6(1)(b) by omitting the word “certification” and substituting the words “AOP Initial Certification”.

Item [19] amends subrule 5.6.6(2) by omitting the words “written certification” and substituting the words “AOP Initial Certification”

These amendments recognise the new defined term inserted by item [17] into subrule 5.6.6(1).

#### Item [20] Subparagraph 5.6.6(2)(d)(iii)

Item [20] amends subparagraph 5.6.6(2)(d)(iii), by inserting after word “the” (third occurring), the words “organisational and technical resources, arrangements and”.

This amendment complements the amendments made by items [6] and [7] (see above), recognising the requirements of Rule 5.6.3 are together more aptly described as “organisational and technical resources, arrangements and controls”.

#### Item [21] Rule 5.6.6

Item [21] amends Rule 5.6.6, after subrule 5.6.6(3), by inserting a new subrule 5.6.6(4). New subrule 5.6.6(4) provides that a Market Participant that was not required to comply with Rule 5.6.6 in relation to a system for Automated Order Processing because of the operation of Rule 5.6.6A is not required to give the certification referred to in subrule 5.6.6(1) in relation to that system for Automated Order Processing. Item [21] also inserts a note describing the effect of Rule 5.6.6A and explaining how, and when it is omitted from the APX MIRs.

#### Item [22] Rule 5.6.6A

Item [22] omits Rule 5.6.6A.

This amendment removes the transitional arrangement which exempted an APX Market Participant that is also an ASX or Chi-X Market Participant from the APX MIRs relating to certification of AOP systems.

#### Item [23] Rule 5.6.7

Item [23] omits Rule 5.6.7. This amendment complements the amendments made by items [31] and [32] (see below), by recognising that Rules 5.6.9 and 5.6.10 (the requirement to provide ASIC with a confirmation or further certification in relation to a “material change”) will be removed.

#### Item [24] Rule 5.6.8



Item [24] amends the heading of Rule 5.6.8 by omitting “Material change review” and substituting “AOP Material Change Review.” This amendment recognises the new defined term “AOP Material Change Review” which is used for ease of reference in the APX MIRs.

#### Item [25] Rule 5.6.8

Item [25] amends Rule 5.6.8 by inserting, before the word “Before”, the number “(1)”. This amendment changes existing Rule 5.6.8 to subrule 5.6.8(1), to accommodate the amendment made by item [29], which introduces a new subrules 5.6.8(2) and (3).

#### Item [26] Rule 5.6.8

Item [26] amends Rule 5.6.8 by inserting, after the word “resources”, the words “arrangements or controls.” This amendment complements the amendments made by items [6] and [7] (see above), recognising the requirements of Rule 5.6.3 are together more aptly described as “organisational and technical resources, arrangements and controls”.

#### Item [27] Rule 5.6.8

Item [27] amends Rule 5.6.8 by omitting the words “, for the purposes of providing the confirmation referred to in Rule 5.6.9 or the further certification referred to in Rule 5.6.10,”. This amendment complements the amendments made by items [31] and [32] (see below), by recognising that Rules 5.6.9 and 5.6.10 (the requirement to provide ASIC with a confirmation or further certification in relation to a “material change”) will be removed.

#### Item [28] Rule 5.6.8

Item [28] amends Rule 5.6.8 by inserting, after the word “review”, the words “(“**AOP Material Change Review**”)”. This amendment introduces a new defined term “AOP Material Change Review” for ease of reference in the APX MIRs.

#### Item [29] Rule 5.6.8

Item [29] amends Rule 5.6.8 by inserting, after the words “these Rules.” (i.e. at the end of (new) subrule 5.6.8(1)), new subrules 5.6.8(2) and (3).

New subrule 5.6.8(2) provides that, before implementing a material change the subject of an AOP Material Change Review the Market Participant must, for the purposes of providing the AOP Annual Notification, obtain written representations from the person who performed the AOP Material Change Review that nothing came to the attention of the person during the course of the AOP Material Change Review that would indicate that the Market Participant is unable to comply with Part 5.6 of the APX MIRs.

New subrule 5.6.8(3) provides that the representations referred to in subrule 5.6.8(2) must include the name of the person making the representation and be signed and dated by the person making the representation. These amendments replace the previous requirements in Rules 5.6.7, 5.6.9 and 5.6.10 (omitted by items [23], [31] and [32]) to provide ASIC with a confirmation or further certification in relation to a “material change” (and receive a written response from ASIC) with a requirement to conduct an internal review, and obtain written representations in relation to the outcome of that review, before making a material change.

#### Item [30] After Rule 5.6.8

Item [30] inserts, after Rule 5.6.8, a new Rule 5.6.8A and Rule 5.6.8B.

### AOP Annual Review

New subrule 5.6.8A(1) sets out the requirement for a Market Participant to ensure that an appropriately qualified person performs a review (“**AOP Annual Review**”) of Automated Order Processing systems. The AOP Annual Review must include a review of the Market Participant’s policies, procedures, system design documentation, including the Market Participant’s procedures for implementation of changes to Automated Order Processing software, filters and filter parameters and other relevant documentation concerning the Market Participant’s compliance with Part 5.6 of the APX MIRs. A Market Participant is not required to perform an AOP Annual Review if it has performed an AOP Material Change Review in the 12 months before the AOP Annual Review Date (defined in Rule 1.4.3 as 1 November each calendar year).

New subrule 5.6.8A(2) provides that the Market Participant must, for the purposes of providing the AOP Annual Notification obtain written representations from the person who performed the AOP Annual Review that nothing came to the attention of the person during the course of the AOP Annual Review that would indicate that the Market Participant is unable to comply with Part 5.6 of the APX MIRs. Those representations must include the name of the person making the representation and be signed and dated by that person (new subrule 5.6.8A(3)).

The AOP Annual Review must be performed, and representations obtained, for the purposes of providing the AOP Annual Notification.

### AOP Annual Notification

New Rule 5.6.8B provides that a Market Participant must, within 10 Business Days of each AOP Annual Review Date (defined in Rule 1.4.3 as 1 November each calendar year), give a written notice to ASIC (the “AOP Annual Notification”), signed and dated by two directors of the Market Participant that includes the following information:

- the name of the Market Participant; and
- the version number and name of the Market Participant’s Automated Order Processing system; and
- a confirmation by the Market Participant that nothing came to the attention of the Market Participant during the 12 months before the AOP Annual Review date that would indicate that the Market Participant is unable to comply with Part 5.6 of the APX MIRs; and
- the name of the two directors of the Market Participant that signed and dated the AOP Annual Notification.

### Items [31] and [32] Rules 5.6.9 and 5.6.10

Items [31] and [32] amend the APX MIRs by omitting Rules 5.6.9 and 5.6.10.

These amendments, along with the omission of Rule 5.6.7 (see item [23] above) reflect that ASIC will no longer require Market Participants to provide ASIC with a material change confirmation, or further certification, each time the Market Participant performs a material change review. However, Market Participants will be required to conduct an internal review, and obtain written representations in relation to the outcome of that review, before making a material change under new subrule 5.6.8(2) (see item [29] above).

## ATTACHMENT B

### Statement of Compatibility with Human Rights

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.*

#### ASIC Market Integrity Rules (APX Market) Amendment 2013 (No.1)

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### A. Overview of the legislative instrument

1. The Australian Securities and Investments Commission (**ASIC**) makes the *ASIC Market Integrity Rules (APX Market) Amendment 2013 (No. 1)* (the **Amending Instrument**) under subsection 798G(1) of the *Corporations Act 2001* (the **Act**).
2. The Amending Instrument amends the market integrity rules (the **APX MIRs**) that apply to:
  - (a) the activities and conduct of the financial market (the **APX market**) operated by Asia Pacific Exchange Limited (**APX**);
  - (b) the activities or conduct of persons in relation to the APX Market;
  - (c) the activities or conduct of persons in relation to financial products traded on the APX Market.
3. APX is the holder of *Australian Market Licence (Asia Pacific Exchange Limited) 2004* authorising it to operate a financial market in securities and managed investment products. APX commenced operation of its market on 20 January 2005. The market ceased operation on 30 June 2008.
4. On 1 August 2010, as part of the transfer of responsibility for market supervision from Australian market licence holders to ASIC, ASIC made the *ASIC Market Integrity Rules (APX Market) 2010* (the **2010 APX MIRs**) that set out the market integrity rules that have applied to the APX market since 1 August 2010.
5. The 2010 APX MIRs were based on a subset of the APX Business Rules that were in existence prior to 1 August 2010. However, at the time the 2010 APX MIRs were made, and to date, the APX market has not been operating. APX now proposes to recommence operating.
6. When APX recommences operating ASIC must be able to appropriately supervise the activities and conduct of APX, its market participants and the activities or conduct of persons in relation to financial products traded on the APX market. One of ASIC's primary means of supervising this conduct is through market integrity rules that apply to the APX market.
7. APX will recommence operating with a new trading system (with the capacity for automated order processing being available in the short term), new APX Business Rules and new APX Listing Rules. APX intends to provide trading services similar to those of ASX Limited (**ASX**) and Chi-X Australia Pty Ltd (**Chi-X**).
8. The APX MIRs are modelled on the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011* (**Chi-X MIRs**), which in turn were modelled on the *ASIC Market Integrity Rules (ASX Market) 2010* (**ASX MIRs**). The APX MIRs differ from the Chi-X MIRs only as far as is necessary to reflect the operational differences between Chi-X and APX. That is, unlike Chi-X, APX is a

listing market and offers trading services in products listed on its market, and trades executed on the APX market are not subject to central clearing.

9. The APX MIRs impose obligations on participants of the APX Market (*APX participants*) that are also imposed by the ASX and Chi-X MIRs on participants of those markets, in relation to trading in equities, including requirements in relation to Automated Order Processing.
10. The market integrity rules relating to Automated Order Processing in Chapter 5 of the ASX and Chi-X MIRs will be amended from 26 May 2014 to enhance the controls participants must have in place when using Automated Order Processing, and to make changes to review and notification requirements.<sup>2</sup> The purpose of the Amending Instrument is to amend the APX MIRs, from 26 May 2014, to reflect the impending amendments to the ASX and Chi-X MIRs, and in turn to address regulatory issues resulting from recent market developments in Australia, in particular new risks to market integrity resulting from the growth of automated trading.
11. The Instrument makes amendments to Chapter 5 of the APX MIRs (Trading) to introduce requirements for Market Participants that use their system for Automated Order Processing to:
  - (a) have direct control over the automated filters and the filter parameters for that system;
  - (b) ensure that the system has in place controls, including automated controls, that enable immediate suspension, limitation or prohibition of the conduct of all Automated Order Processing, Automated Order Processing in respect of Automated Client Order Processing, or Automated Order Processing in respect of one or more Authorised Persons, clients or Products;
  - (c) ensure that the system has in place controls that enable immediate suspension of, limitation of or prohibition on, the entry into the APX Market of Trading Messages in a series of related Trading Messages where the Market Participant has identified that Trading Messages in the series have entered the APX Market and have interfered with, or are likely to interfere with, the efficiency or integrity of the APX Market;
  - (d) ensure that the system has in place controls that enable immediate cancellation of Trading Messages in a series that have already entered the APX Market, where the entry of further Trading Messages in the series have been suspended, limited or prohibited; and
  - (e) conduct an annual review of Automated Order Processing systems and notification of the Market Participants' compliance with Part 5.6 of the APX MIRs.
12. The Amending Instrument also removes the transitional arrangement which exempts an APX Market Participant that is also an ASX or Chi-X Market Participant from the APX MIRs relating to certification of AOP systems. The transitional arrangement is removed from 26 May 2014.
13. The purpose of these amendments to Chapter 5 of the APX MIRs is to manage the risk of potential adverse events (and their effects on market integrity) of automated trading.
14. There are already robust controls in the Australian equity market to mitigate some of the risks from automated trading. However, these controls need to be updated to fully address emerging risks, as well as to align our regime with IOSCO principles and international best practice.
15. The amendments to Chapter 5 of the APX MIRs made by the Amending Instrument build a more rigorous framework of systems, filters and controls to guard against potential disruptions from aberrant algorithmic activity and will not disrupt the operation of the market in normal conditions. The amendments will ensure that Market Participants have the ability, in real time, to

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<sup>2</sup> See the *ASIC Market Integrity Rules (ASX Market) Amendment 2012 (No. 3)* and the *ASIC Market Integrity Rules (Chi-X Australia Market) 2012 (No. 3)*.

control and prevent aberrant order flow before it disrupts the market. An aberrant algorithm generates not only costs that are borne by the firms using the algorithms, but also negative impacts for all market participants by impairing the fairness and orderliness of the market.

16. The Office of Best Practice Regulation (**OBPR**) has assessed the Amending Instrument as having a minor impact and confirmed that no further analysis, in the form of a Regulatory Impact Statement, is required.

## **B. Human rights implications**

17. This Instrument does not have any effect on human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* because it does not engage any of the applicable rights or freedoms.

## **C. Consultation**

18. In February 2013, ASIC undertook a targeted consultation on its proposal to revoke the 2010 APX MIRs and replace them with the APX MIRs. This Instrument formed part of that consultation process. Feedback was sought from relevant stakeholders being APX, ASX, Chi-X, Australian Financial Markets Association (*AFMA*), Stockbrokers Association of Australia (*SAA*), National Stock Exchange of Australia Limited (*NSX*) and SIM Venture Securities Exchange Ltd (*SIMVSE*).
19. We received written submissions from APX, SAA, and Chi-X, and a combined response from NSX and SIMVSE. Stakeholders have been supportive of the new market integrity rules framework being modelled on the existing Chi-X MIRs, primarily because this approach minimises duplication of obligations for participants of multiple Australian markets. No human rights issues were raised.
20. In finalising the APX MIRs and Amending Instrument, ASIC has taken into account the feedback received. In particular, in ASIC's targeted consultation letter, ASIC had proposed to apply the enhanced AOP rules from commencement of the APX MIRs. In response to feedback received, ASIC will instead amend the APX MIRs (by way of this Amending Instrument) to apply the enhanced AOP rules with effect from 26 May 2014.
21. The transitional period to comply with the enhanced AOP rules will give greater lead time for APX market participants and ensuring a level playing field for participants of APX, ASX and Chi-X.
22. ASIC has also consulted at length on the Chi-X and ASX MIRs on which the APX MIRs and this Amending Instrument are modelled, through:
  - (a) ASIC Consultation Paper *Australian market structure: Draft market integrity rules and guidance* (CP 179), released 28 June 2012, seeking feedback on amendments to the market integrity rules and guidance to address market structure issues arising from recent and anticipated developments in Australia's financial markets;
  - (b) ASIC Consultation Paper *Australian market structure: Draft market integrity rules and guidance on automated trading* (CP 184), released 13 August 2012, seeking feedback on amendments to the market integrity rules and guidance to address market structure issues arising from recent and anticipated developments in Australia's financial markets; and
  - (c) Meetings with stakeholders and information sessions for members of the Australian Financial Markets Association (AFMA), the Financial Services Council (FSC) and the Stockbrokers Association of Australia (SAA).