ASIC MARKET INTEGRITY RULES (COMPETITION IN EXCHANGE MARKETS) AMENDMENT 2014 (NO. 2)
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 (Competition in Exchange Markets) Amendment 2014 (No. 2)* (the ***Instrument***) under subsection 798G(1) of the *Corporations Act 2001* (the ***Corporations Act***). Capitalised terms used in this Explanatory Statement (e.g. "Participant") are defined in the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011* (the ***ASIC Market Integrity Rules (Competition)***).

1. Enabling legislation

Subsection 798G(1) of the Corporations Act provides that ASIC may, by legislative instrument, make rules that deal with the activities or conduct of licensed markets, or the activities or conduct of persons in relation to licensed markets or in relation to financial products traded on licensed markets.

The ASIC Market Integrity Rules (Competition) currently deal with the activities and conduct of licensed markets on which certain Financial Products (Equity Market Products, CGS Depository Interests and ASX SPI 200 Futures) are traded. Those Financial Products are currently traded on the licensed markets operated by ASX Limited, Chi-X Australia Pty Ltd and Australian Securities Exchange Limited (**ASX 24**). The ASIC Market Integrity Rules (Competition) apply as specified in the Rules to Participants and Market Operators of those markets.

2. Background

Chapter 2 of the ASIC Market Integrity Rules (Competition) requires Market Operators to implement two types of automated volatility controls: by determining "Anomalous Order Thresholds" and putting in place controls to prevent "Anomalous Orders" from entering the Order Book, and by preventing execution of existing Orders in the Order Book outside of a pre-determined "Extreme Trade Range". These automated controls are applied to higher-risk products, because they are more effective than manual controls requiring human intervention. The controls will apply to ASX SPI 200 futures (currently traded on the ASX 24 market) from 26 May 2014.

Following discussions with ASX 24 regarding the launch of two new sector-based equity index futures, ASIC decided to extend the requirements of Chapter 2 of the ASIC Market Integrity Rules (Competition) to all equity index futures contracts. This is because such contracts pose a significant risk of cross-market contagion between the futures and equities markets.

3. Purpose of the legislative instrument

The Instrument amends Chapter 2 of the ASIC Market Integrity Rules (Competition) to capture all "Equity Index Futures".

Under the rules in the Instrument, the market operator of the ASX 24 market will be required for each Equity Index Future quoted on its market to determine and apply an Anomalous Order Threshold (taking into account historical trading patterns, prevailing market conditions and the relevant index multiplier) and to apply an extreme trade range of 5%.

Details of the Instrument are contained in **Attachment A**.

4. Consultation

ASIC consulted on the amendments in the Instrument through a targeted consultation with the current affected market operator (ASX 24) and industry stakeholders (including the Australian Financial Markets Association and the Stockbrokers Association of Australia) in October 2013. ASIC also circulated a revised proposal for comment in January 2014. Respondents supported the amendments.

5. Penalties

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

Subsection 798G(2) of the Corporations 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. The Instrument does not affect the penalties payable in relation to any Rule.

6. Commencement of the Instrument

The Instrument will commence on on the later of 26 May 2014 and the day on which the 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

A Regulation Impact Statement was not required for this Instrument because it will have a minor impact.

ATTACHMENT A

Paragraph 1 – Enabling Legislation

This paragraph provides that the Instrument is made, with the written consent of the Minister, under subsection 798G(1) of the *Corporations Act 2001.*

Paragraph 2 – Title

This paragraph provides that the title of the Instrument is the *ASIC Market Integrity Rules (Competition in Exchange Markets) Amendment 2014 (No. 2)*.

Paragraph 3 – Commencement

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

Paragraph 4 – Amendments

This paragraph provides that Schedule 1 amends the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011*.

Schedule 1 - Amendments

Item [1] Rule 1.4.3, definition of "Anomalous Order"

Item [1] of Schedule 1 to the Instrument amends the definition of "Anomalous Order" to include reference to Equity Index Futures. This change reflects that Market Operators will now be required to prevent Anomalous Orders in Equity Index Futures from entering the Market.

Item [2] Rule 1.4.3, definition of "Anomalous Order Threshold"

Item [2] of Schedule 1 to the Instrument amends the definition of "Anomalous Order Threshold" to include reference to Equity Index Futures. This change reflects that Market Operators will now be required to determine Anomalous Order Thresholds for Equity Index Futures.

Items [3] to [5] Rule 1.4.3, definition of "Auction", paragraph (b), paragraph (c), and after paragraph (c)

Items [3], [4] and [5] of Schedule 1 to the Instrument amend the definition of "Auction" to insert a new meaning of "Auction" in relation to Equity Index Futures. "Auction" in relation to Equity Index Futures means an auction in the Equity Index Future on the central Order Book of the Responsible Market Operator for Equity Index Futures. Accordingly, the Extreme Trade Range Reference Price for an Equity Index Future will be determined after a Trading Reset by the price established by an auction (if any) on the central Order Book of the Responsible Market Operator for Equity Index Futures.

Item [6] Rule 1.4.3, after definition of "Employee"

Item [6] of Schedule 1 to the Instrument inserts a definition for "Equity Index Future". "Equity Index Future" means a Futures Market Contract over a market index, where that market index is comprised of more than one Equity Market Product.

Item [7] Rule 1.4.3, definition of "ETR Event"

Item [7] of Schedule 1 to the Instrument amends the definition of "ETR Event" to include references to Equity Index Futures. Accordingly when a Buy Order in an Equity Index Future that is both above the Reference Price and in the Extreme Trade Range for the Equity Index Futures, or a Sell Order in an Equity Index Future that is both below the Reference Price and in the Extreme Trade Range for the Equity Index Future, is received by the Market Operator and not prevented from entering the Market by the controls the Market Operator has in place to comply with Rule 2.1.3, this will constitute an "ETR Event".

Items [8] to [10] of Rule 1.4.3, definition of "Extreme Trade Range", paragraph (b), paragraph (c) and after paragraph (c)

Items [8], [9] and [10] of Schedule 1 to the Instrument amend the definition of "Extreme Trade Range" to insert a new meaning of "Extreme Trade Range" in relation to Equity Index Futures. "Extreme Trade Range", in relation to Equity Index Futures, has the meaning given by new subrule 2.2.1(4). This complements the amendment made by item [23] below to insert a new definition of "Extreme Trade Range".

Item [11] Rule 1.4.3, definition of "Futures Market"

Item [11] of Schedule 1 to the Instrument amends the definition of "Futures Market" to insert a reference to Equity Index Futures. This amendment brings Markets on which Equity Index Futures are traded within scope of the definition of "Futures Market", so that Chapter 2 of the Rules (Extreme Price Movements) will apply that Market.

Item [12] Rule 1.4.3, definition of "Invalid", paragraph (b)

Item [12] of Schedule 1 to the Instrument amends the definition of "Invalid" to insert a reference to Equity Index Futures. Accordingly, where the Responsible Market Operator in relation to a particular Equity Index Future conducts on Auction after a Trading Reset, the Responsible Market Operator will be required to determine whether the Extreme Trade Range Reference Price established by that Auction is "Invalid" having regard to the matters set out in the definition.

Item [13] Rule 1.4.3, definition of "Opening Transaction"

Item [13] of Schedule 1 to the Instrument amends the definition of "Opening Transaction" to insert reference to Equity Index Futures. The "Opening Transaction" for the purposes of setting the Extreme Trade Range Reference Price for Equity Index Futures, is the First Transaction in the Equity Index Future on the relevant Order Book after a Trading Reset.

Items [14] to [16] Rule 1.4.3, definition of "Responsible Market Operator", paragraph (b), paragraph (c) and after paragraph (c)

Items [14], [15] and [16] of Schedule 1 to the Instrument amend the definition of "Responsible Market Operator" to insert a new meaning for "Responsible Market Operator" in relation to Equity Index Futures. "Responsible Market Operator", in relation to Equity Index Futures means the Market Operator determined in accordance with Rule 1.4.5. This amendment complements the amendment made by item [19] to insert new Rule 1.4.5.

Item [17] Rule 1.4.3, definition of "Trading Pause"

Item [17] of Schedule 1 to the Instrument amends the definition of "Trading Pause" to insert references to Equity Index Future. In relation to an Equity Index Future, a "Trading Pause" means a period during which a Market Operator must prevent Orders for the Equity Index Future from being matched or executed on its Market, but during which Bids and Offers for the Equity Index

Futures may be displayed, entered, amended or cancelled. A Market Operator will be required to impose a Trading Pause following an ETR Event.

Item [18] Rule 1.4.3, definition of "Trading Reset"

Item [18] of Schedule 1 to the Instrument amends the definition of "Trading Reset" to insert references to Equity Index Futures. "Trading Reset", in relation to an Equity Index Future, means each of a Trading Pause, Trading Suspension and the end of Trading Hours in relation to the Equity Index Future.

Item [19] After Rule 1.4.4

Item [19] of Schedule 1 to the Instrument amends Rule 1.4.4 to insert a new Rule 1.4.5. New Rule 1.4.5 provides that the Responsible Market Operator in relation to an Equity Index Future is the Futures Market Operator in relation to that Equity Index Future. Where there is more than one Futures Market in relation to that Equity Index Future, the Responsible Market Operator for the Equity Index Future is the Futures Market Operator determined in writing by ASIC and notified on its website.

This amendment allows responsibility for determining the Extreme Trade Range Reference price in relation to an Equity Index Future to fall to the Market Operator of the Market on which the Equity Index Future is traded, or if there is more than one, to the Market Operator nominated by ASIC.

Item [20] Subrule 2.1A.1(2)

Item [20] of Schedule 1 to the Instrument amends subrule 2.1A.1(2) to insert references to Equity Index Futures. This amendment extends the application of Chapter 2 (Extreme Price Movements) to Equity Index Futures. Accordingly, Market Operators of Markets on which Equity Index Futures are traded will be required to have in place adequate controls to prevent Anomalous Orders in Equity Index Futures from entering their Market, and to prevent a Transaction in Equity Index Futures from executing on an Order Book of their Market in the Extreme Trade Range for the Equity Index Future.

Item [21] Subparagraph 2.1.1(5)(b)(ii)

Item [21] of Schedule 1 to the Instrument amends Subparagraph 2.1.1(5)(b)(ii) to insert reference to Equity Index Futures. This amendment provides that in determining an Anomalous Order Threshold for an Equity Index Future, the Market Operator must take into account, at a minimum, the relevant index multiplier for the Equity Index Future, in addition to historical trading patterns and prevailing market conditions.

Item [22] Subrule 2.2.1(2)

Item [22] of Schedule 1 to the Instrument amends subrule 2.2.1(2) to omit "250 price steps" and substitute "5%". This amendment requires a Market Operator (currently, the market operator of the ASX 24 Market), for each ASX SPI 200 Future quoted on its market, to determine and apply an Extreme Trade Range of 5%. The purpose of this amendment is to harmonise the Extreme Trade Range for ASX SPI 200 Futures with the new Extreme Trade Range for other Equity Index Futures.

Item [23] After subrule 2.2.1(3)

Item [23] of Schedule 1 to the Instrument amends subrule 2.2.1 to insert a new definition of "Extreme Trade Range" for Equity Index Futures. The Extreme Trade Range for an Equity Index

Future means all prices which are greater than 5% away from the Reference Price for the Equity Index Future.

Items [24] to [26] Subrule 2.2.2(4), paragraph (b), paragraph (c)and after paragraph (c)

Items [24]. [25] and [26] of Schedule 1 to the Instrument amend subrule 2.2.2(4) to insert a new paragraph (ca) as follows:

> "(ca) the central Order Book of the Responsible Market Operator for Equity Index Futures (in the case of Equity Index Futures),"

This amendment requires a Market Operator that operates an Order Book for Relevant Products other than the central Order Book of the Responsible Market Operator for Equity Index Futures (in the case of Equity Index Futures) to determine the Reference Price for each Relevant Product for that Order Book after each Trading Reset on that Order Book, as the price of the Opening Transaction or if the price of the Opening Transaction is Invalid, a price determined by the Market Operator acting reasonably not to be invalid, until the Market Operator receives a notification of the Reference Price for the Relevant Product.

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 (Competition in Exchange Markets) Amendment 2014 (No. 2)

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 Instrument

The *ASIC Market Integrity Rules (Competition in Exchange Markets) Amendment 2014 (No. 2)* (the ***Legislative Instrument***) is made under subsection 798G(1) of the *Corporations Act 2001* and amends the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011* ***(ASIC Market Integrity Rules (Competition))***.

Chapter 2 of ASIC Market Integrity Rules (Competition) requires market operators to implement two types of automated volatility controls: by determining "Anomalous Order Thresholds" and putting in place controls to prevent "Anomalous Orders" from entering the Order Book, and by preventing execution of existing Orders in the Order Book outside of a pre-determined "Extreme Trade Range". These automated controls are applied to higher-risk products, because they are more effective than manual controls requiring human intervention. The controls will apply to ASX SPI 200 futures (currently traded on the ASX 24 market) from 26 May 2014.

Following discussions with ASX 24 regarding the launch of two new sector-based equity index futures, ASIC decided to extend the requirements of Chapter 2 of the ASIC Market Integrity Rules (Competition) to all equity index futures contracts. This is because such contracts pose a significant risk of cross-market contagion between the futures and equities markets.

The Instrument amends Chapter 2 of the ASIC Market Integrity Rules (Competition) to capture all equity index futures. Under the rules in the Legislative Instrument, the market operator of a market on which equity index futures are traded will be required for each equity index future to determine and apply an anomalous order threshold (taking into account historical trading patterns, prevailing market conditions and the relevant index multiplier) and to apply an extreme trade range of 5%.

B. Human rights implications

The Legislative Instrument does not engage any of the applicable human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

C. Conclusion

The Legislative Instrument is compatible with human rights as it does not raise any human rights issues.

D. Consultation

ASIC consulted on the amendments in the Instrument through a targeted consultation with the current affected market operator (ASX 24) and industry stakeholders (including the Australian Financial Markets Association and the Stockbrokers Association of Australia) in October 2013. ASIC also circulated a revised proposal for comment in January 2014. Respondents supported the amendments.

Australian Securities and Investments Commission