

ASIC MARKET INTEGRITY RULES (ASX MARKET) AMENDMENT 2015 (NO. 1)

EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

Corporations Act 2001

Summary

This Instrument repeals the following provisions of the ASIC Market Integrity Rules (ASX Market) 2010 (ASIC Market Integrity Rules (ASX)):

- a) Rule 2.2.3 which imposes obligations upon Market Participants to notify the Australian Securities and Investments Commission (ASIC) of details of the Market Participant's professional indemnity (PI) insurance. Other obligations in relation to PI insurance will remain;*
- b) Part 5.2 which prohibits a Market Participant from entering into certain business connections with another Market Participant without ASIC's prior written consent; and*
- c) Parts 6.4, 6.5 and 6.6 which prohibit certain Market Transactions during Takeover Bids, Schemes and buy-backs.*

A Participant will no longer be required to comply with these market integrity rules.

ASIC is repealing these rules because it considers that they pose an unnecessary regulatory burden. ASIC considers that these rules no longer provide a commensurate regulatory benefit.

Capitalised terms used in this Explanatory Statement (e.g. "Trading Participant") are defined in the ASIC Market Integrity Rules (ASX).

1. Operation of this instrument

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

(a) Repeal of Rule 2.2.3 of the ASIC Market Integrity Rules (ASX)

Rule 2.2.3 requires a Market Participant of the ASX Market to notify ASIC in writing of the following details of its PI insurance:

- the amount and nature of the cover;
- the date on which the cover became effective; and
- the date on which the cover will expire.

The details must be provided to ASIC in writing within 10 Business Days following the issue of a new PI insurance policy (or equivalent) or the renewal of an existing PI insurance policy (or equivalent).

Breach of Rule 2.2.3 carries a maximum penalty of \$20,000.

We consider the requirement for Market Participants to notify ASIC of these details of their PI insurance cover to be an unnecessary administrative burden on Market Participants. Market Participants continue to be required to take out, and maintain at all times, a PI insurance policy (or equivalent). This PI insurance policy must be one that the Market Participant determines (acting reasonably) to be adequate having regard to the nature and extent of the business carried on by the Market Participant in connection with its business as a Market Participant and the responsibilities and risks assumed (or which may be assumed) by the Market Participant in connection with that business. Failure to comply with that obligation carries a maximum penalty of \$100,000.

Market Participants are also required to immediately notify ASIC of any notification to its insurer of any claim, potential claim or circumstances that might give rise to a claim under its PI insurance policy.

ASIC does not consider that there is a need for an additional notification requirement to confirm a Market Participant's ongoing compliance with the requirement to hold PI insurance.

It is not our practice to assess the adequacy of PI insurance and, as such, there is no utility for ASIC to collect these details of PI insurance cover with respect to all Market Participants.

(b) Repeal of Part 5.2 of the ASIC Market Integrity Rules (ASX)

Part 5.2 of the ASIC Market Integrity Rules (ASX) prohibits Market Participants from doing any of the following without obtaining prior written consent from ASIC:

- being a Related Body Corporate of another Market Participant;
- allowing a Controller or Employee to be a Controller of another Market Participant;
- having an Employee who is an Employee of another Market Participant or a Related Body Corporate of another Market Participant;
- sharing common computer facilities with, or allowing its computer facilities to be linked with another Market Participant; and
- sharing common premises with or allowing its premises to be accessed by another Market Participant or its Employees.

Breach of this prohibition carries a maximum penalty of \$100,000

Since Part 5.2 of the ASIC Market Integrity Rules (ASX) was made, ASIC has made additional market integrity rules which more effectively fulfil the policy purpose of Part 5.2. The original rationale for Part 5.2 of the ASIC Market Integrity Rules (ASX) was to protect the confidentiality of Order information and particularly pre-trade client Order information. Where a Market Participant has access to the pre-trade client Order information of a second Market

Participant, there is a risk that the first Market Participant may misuse or take advantage of that information.

Since the making of Part 5.2 of the ASIC Market Integrity Rules (ASX), ASIC has made Rule 7.4.1(1) of the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011 (ASIC Market Integrity Rules (Competition))*. Rule 7.4.1(1) requires a Participant to take reasonable steps to ensure its officers and employees do not use or disclose information it receives about orders, or transactions resulting from these orders, unless the use or disclosure is permitted or required under the market integrity rules or the law.

We consider that Rule 7.4.1 of the ASIC Market Integrity Rules (Competition) addresses the misuse of confidential order information more effectively and efficiently than Part 5.2 of the ASIC Market Integrity Rules (ASX).

Business connection consent applications that ASIC receives under Rule 5.2.1 of the ASIC Market Integrity Rules (ASX) increasingly relate to technology-related connections. For example, we have received an increasing number of applications from Market Participants that link their computer facilities by sharing access to a trading algorithm.

Algorithm access arrangements pose a risk of misuse of confidential order information. As noted above, this is addressed by Rule 7.4.1 of the ASIC Market Integrity Rules (Competition). However, algorithm access arrangements also give rise to an additional risk of errors or issues with the algorithm that can interfere with the efficiency and integrity of the market. These risks are exacerbated where the algorithm is shared by multiple Market Participants.

Algorithm access arrangements are subject to the obligations in Part 5.6 of the ASIC Market Integrity Rules (ASX Market). Part 5.6 regulates automated order processing (*AOP*). The obligations in Part 5.6 include the requirements to have appropriate automated filters in place and to ensure that the use of an AOP system does not interfere with the efficiency and integrity of the market as well as obligations to provide certification of specified matters to ASIC.

When reviewing a certification provided by a Market Participant under Part 5.6, ASIC will consider whether that Market Participant complies with the requirements under Part 5.6. In circumstances where erroneous orders resulting from an algorithm are submitted through an AOP system, ASIC can take enforcement action under Part 5.6, and other relevant provisions in the market integrity rules.

Accordingly, ASIC considers that Part 5.6 of the ASIC Market Integrity Rules (ASX) adequately and appropriately manages the risk, or increased risk, to the market that may arise from technological connections between Market Participants. We do not consider that Part 5.2 of the ASIC Market Integrity Rules (ASX) provides any additional regulatory benefit.

(c) Repeal of Parts 6.4, 6.5 and 6.6 of the ASIC Market Integrity Rules (ASX)

Part 6.4 of the ASIC Market Integrity Rules (ASX) prohibits a Trading Participant from effecting the following Crossings (other than Special Crossings) in the Offer Period under a Takeover Bid or Scheme for relevant Cash Market Products:

- (i) Crossings effected outside of Trading Hours in Cash Market Products at a price that is at or below the offer price for that product (Rule 6.4.1) ;
- (ii) Crossings in Derivatives Market Contracts over the relevant Cash Market Product that are effected during the Late Trading Session State (Rule 6.4.2);
- (iii) Crossings in a Derivatives Combination that includes the relevant Cash Market Product (or a Derivative or Warrant over that product) where the Crossing is effected during Late Trading Session State (Rule 6.4.3); and
- (iv) for a Takeover Bid only, Crossings in a Cash-Only Combination that includes the relevant Cash Market Product (or a Derivative or Warrant over that product) where the price is at or below the offer price and the Crossing is effected outside of Trading Hours (Rule 6.4.3).

Part 6.5 of the ASIC Market Integrity Rules (ASX) prohibits a Trading Participant from effecting a Special Crossing during the Bid Period (or, in some instances, the Offer Period) for a Takeover Bid or Scheme in the relevant Cash Market Products. In particular:

- (i) Rule 6.5.1 prohibits a Special Crossing in Cash Market Products during the Bid Period;
- (ii) Rule 6.5.2 prohibits a Special Crossing in Warrants over a Cash Market Product during the Bid Period;
- (iii) Rule 6.5.3 prohibits a Special Crossing in Derivative Market Contracts over the relevant Cash Market Product during the Offer Period; and
- (iv) Rule 6.5.4 prohibits a Special Crossing in Combinations that include the relevant Cash Market Product (or a Derivative or Warrant over that product) during the Offer Period.

Part 6.6 of the ASIC Market Integrity Rules (ASX) prohibits a Trading Participant from effecting the following Crossings on behalf of an Issuer during the term of a buy-back offer conducted On-Market by that Issuer:

- (i) a Special Crossing in Cash Market Products of the Issuer (Rule 6.6.1);
- (ii) a Special Crossing or Crossing during Late Trading Session State in Derivatives Market Contracts over Cash Market Products of that Issuer (Rule 6.6.2); and
- (iii) a Special Crossing or Crossing during Late Trading Session State in a Combination that includes a Cash Market Product of the Issuer (or a Derivative or Warrant over that product) (Rule 6.6.3).

Breaches of the prohibitions in Parts 6.4, 6.5 and 6.6 of the ASIC Market Integrity Rules (ASX) carry a maximum penalty of \$100,000.

ASIC considers that conduct during takeovers, buybacks and Schemes is appropriately regulated by the Corporations Act 2001 (*Corporations Act*) and does not require additional regulation under the market integrity rules.

Parts 6.4, 6.5 and 6.6 of the ASIC Market Integrity Rules (ASX) are outdated, highly technical and, in at least some cases, easily circumvented. Although they are not ambiguous in their operation, Trading Participants find some of these prohibitions counter-intuitive and this has led to confusion. This has resulted in inconsistent market practices.

Parts 6.4 and 6.5 of the ASIC Market Integrity Rules (ASX) are broader in scope than the equivalent provisions in the Corporations Act. We do not consider that the policy rationale for the prohibitions supports the breadth of Parts 6.4 and 6.5.

Specifically, Parts 6.4 and 6.5 of the ASIC Market Integrity Rules (ASX) prohibit all Trading Participants from conducting certain trades during a Takeover Bid or Scheme. The provisions in Ch 6 of the Corporations Act relating to ‘on-market’ trades only prohibit acquisitions on behalf of the bidder or an associate through trades that are not ‘on market’: see s623(1) and (3) and items 2–3 of s611 of the Corporations Act.

The effect of Parts 6.4 and 6.5 of the ASIC Market Integrity Rules (ASX) is that Trading Participants that do not act on behalf of the bidder or associate are prevented from transacting in large crossings of stock. This has caused disruption to Trading Participants in their day-to-day business. We do not consider that the original policy rationale for this prohibition extends to Trading Participants that are not acting on behalf of the bidder or an associate.

Rules 6.5.1 and 6.5.2 of the ASIC Market Integrity Rules (ASX) prohibit Special Crossings during the Bid Period of a Takeover Bid or Scheme. In the case of an Off-Market Bid, this differs from s623(1) of the Corporations Act which only operate during the offer period. The Bid Period is broader than the offer period.

2. Consultation

ASIC consulted on the amendments made by this Instrument in Consultation Paper 222 *Reducing red tape: Proposed amendments to the market integrity rules* (CP 222). In CP 222 we consulted on proposals to repeal Rule 2.2.3 and Part 5.2 of the ASIC Market Integrity Rules (ASX) and sought feedback on two alternative options in relation to Parts 6.4, 6.5 and 6.6:

- (a) amend Parts 6.4 and 6.5 to apply only to a Market Participant acting on behalf of the bidder or their associate rather than to all Market Participants; and restrict Special Crossings in the Offer Period and not the Bid Period (Option One);
- (b) repeal Parts 6.4, 6.5 and 6.6 of the ASIC Market Integrity Rules (ASX) and rely on the existing provisions in the Corporations Act to regulate activity during takeovers, Schemes and buy-backs (Option Two).

Submissions to CP 222 were received from a variety of stakeholders, including market operators, market participants and industry associations such as the Australian Financial Markets Association, Law Council of Australia and Stockbrokers Association of Australia.

There was unanimous support for the proposals to repeal the requirements for market participants to:

- (a) notify ASIC of details of their PI insurance cover (Rule 2.2.3); and
- (b) obtain ASIC's consent before sharing business connections (Part 5.2).

Of the two alternate proposals concerning Parts 6.4, 6.5 and 6.6, all respondents who provided feedback on this issue preferred Option 2 - the proposal to repeal Parts 6.4, 6.5 and 6.6 in their entirety.

3. Background

Enabling legislation

ASIC makes this Instrument under subsection 798G(1) of the Corporations Act. The Instrument amends the ASIC Market Integrity Rules (ASX).

The ASIC Market Integrity Rules (ASX) apply to:

- (a) the activities or conduct of the financial market operated by ASX Limited (ACN 008 624 691) (*ASX*);
- (b) the activities or conduct of persons in relation to the ASX Market; and
- (c) the activities or conduct of persons in relation to Financial Products traded on the ASX Market.

ASIC market integrity rules modelled on market operator rules

On 24 August 2009, the Australian Government announced its decision to transfer the responsibility for supervising Australia's domestic licensed financial markets from market operators to ASIC. To support this decision, the *Corporations Amendment (Financial Market Supervision) Act 2010* commenced on 1 August 2010. It inserted a new Part 7.2A into the Corporations Act which grants ASIC the power to make market integrity rules dealing with activities and conduct in relation to licensed financial markets, including participants of the relevant market.

During the transfer of responsibility for market supervision, ASIC's public policy was to refrain from making substantive policy changes to the obligations that applied to participants of the various existing financial markets including the ASX market. This facilitated a streamlined transfer of supervision with minimal disruption to industry.

Harmonisation of market integrity rules

ASIC is currently undertaking a project to ‘harmonise’ some or all of the market integrity rulebooks. The amendments in this Instrument form part of this initiative.

4. Commencement of the Instrument

The Instrument will commence on the day after the day on which the Instrument is registered under the *Legislative Instruments Act 2003*.

5. Statement of Compatibility with Human Rights

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

6. Regulation Impact Statement

A Regulation Impact Statement is not required for the Instrument because it will have a minor regulatory impact.

ATTACHMENT A

Paragraph 1 – Enabling Legislation

This paragraph provides that the Instrument is made 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 (ASX Market) Amendment 2015 (No. 1)*.

Paragraph 3 – Commencement

This paragraph provides that the Instrument commences on the day after the day on which this instrument is registered under the *Legislative Instruments Act 2003*.

Paragraph 4 – Amendments

This paragraph provides that Schedule 1 amends the *ASIC Market Integrity Rules (ASX Market) 2010*.

Schedule 1 - Amendments

Item [1] Rule 2.2.3

Item [1] of Schedule 1 to the Instrument repeals Rule 2.2.3.

Item [2] Part 5.2

Item [2] of Schedule 1 to the Instrument repeals Part 5.2.

Item [3] Part 6.4

Item [3] of Schedule 1 to the Instrument repeals Part 6.4.

Item [4] Part 6.5

Item [4] of Schedule 1 to the Instrument repeals Part 6.5.

Item [5] Part 6.6

Item [5] of Schedule 1 to the Instrument repeals Part 6.6.

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 (ASX Market) Amendment 2015 (No. 1)

This 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 this Instrument

1. This Instrument repeals Rule 2.2.3 and Parts 5.2, 6.4, 6.5 and 6.6 of the ASIC Market Integrity Rules (ASX Market) 2010 (**ASIC Market Integrity Rules (ASX)**). A Trading Participant will no longer be required to comply with these market integrity rules.
2. The Australian Securities and Investments Commission (**ASIC**) is repealing these rules because it considers that they pose an unnecessary regulatory burden. ASIC considers that these rules no longer provide a commensurate regulatory benefit.

Rule 2.2.3 of the ASIC Market Integrity Rules (ASX)

3. Rule 2.2.3 imposes obligations upon Market Participants to notify ASIC of details of the Market Participant's professional indemnity (**PI**) insurance.
4. Market Participants will continue to be required to take out, and maintain at all times, a PI insurance policy (or equivalent). ASIC does not consider that there is a need for an additional notification requirement to confirm a Market Participant's ongoing compliance with the requirement to hold PI insurance.
5. It is not our practice to assess the adequacy of PI insurance and, as such, there is no utility for ASIC to collect these details of PI insurance cover with respect to all Market Participants. Accordingly, the provision to ASIC of these details of PI insurance cover serves no regulatory benefit.

Part 5.2 of the ASIC Market Integrity Rules (ASX)

6. Part 5.2 of the ASIC Market Integrity Rules (ASX) prohibits a Market Participant from entering into certain business connections with another Market Participant without ASIC's prior written consent.
7. Since Part 5.2 of the ASIC Market Integrity Rules (ASX) was made, ASIC has made additional market integrity rules which more effectively fulfil the policy purpose of Part 5.2.
8. The original rationale for Part 5.2 of the ASIC Market Integrity Rules (ASX) was to protect

the confidentiality of Order information and particularly pre-trade client Order information. Where a Market Participant has access to the pre-trade client Order information of a second Market Participant, there is a risk that the first Market Participant may misuse or take advantage of that information.

9. We consider that Rule 7.4.1 of the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011* now addresses the misuse of confidential Order information more effectively and efficiently than Part 5.2 of the ASIC Market Integrity Rules (ASX). Rule 7.4.1(1) requires a Participant to take reasonable steps to ensure its officers and employees do not use or disclose information it receives about orders, or transactions resulting from these orders, unless the use or disclosure is permitted or required under the market integrity rules or the law.
10. Written consents sought from ASIC under Part 5.2 increasingly relate to the sharing of computer facilities, including the sharing of trading algorithms. This gives rise to an additional risk of errors or issues with the algorithm that can interfere with the efficiency and integrity of the market. We consider that this risk is now effectively addressed by Part 5.6 of the ASIC Market Integrity Rules (ASX Market).
11. Part 5.6 establishes a regime for the regulation of automated order processing (*AOP*). The algorithms which may be shared by Market Participants are subject to Part 5.6. The obligations in Part 5.6 include the requirements to have appropriate automated filters in place and to ensure that the use of an AOP system does not interfere with the efficiency and integrity of the market as well as obligations to provide certification of specified matters to ASIC.

Parts 6.4, 6.5 and 6.6 of the ASIC Market Integrity Rules (ASX)

12. Parts 6.4, 6.5 and 6.6 of the *ASIC Market Integrity Rules (ASX)* prohibit certain transactions during takeovers, Schemes and buy-backs
13. ASIC considers that conduct during takeovers, buybacks and Schemes is appropriately regulated by the Corporations Act 2001 (*Corporations Act*) and does not require additional regulation under the market integrity rules.
14. Parts 6.4, 6.5 and 6.6 of the ASIC Market Integrity Rules (ASX) are outdated, highly technical and, in at least some cases, easily circumvented. Although they are not ambiguous in their operation, Trading Participants find some of these prohibitions counter-intuitive and this has led to confusion. This has resulted in inconsistent market practices.
15. Parts 6.4 and 6.5 of the ASIC Market Integrity Rules (ASX) are broader in scope than the equivalent provisions in the Corporations Act. We do not consider that the policy rationale for the prohibitions supports the breadth of Parts 6.4 and 6.5.

Further Background

16. This Instrument is made under subsection 798G(1) of the Corporations Act. This Instrument

amends the ASIC Market Integrity Rules (ASX) which apply to:

- (a) the activities and conduct of the financial market operated by ASX Limited (ACN 008 624 691) (*ASX*);
- (b) the activities or conduct of persons in relation to the ASX Market; and
- (c) the activities or conduct of persons in relation to financial products traded on the ASX Market.

17. This instrument repeals Rule 2.2.3 and Parts 5.2, 6.4, 6.5 and 6.6 of the ASIC Market Integrity Rules (ASX Market). Breaches of Rule 2.2.3 and Parts 5.2, 6.4, 6.5 and 6.6 of the ASIC Market Integrity Rules (ASX Market) all incur a penalty.

B. Human rights implications

18. 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

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

D. Consultation

20. ASIC consulted on the amendments effected by this Instrument in Consultation Paper 222 *Reducing red tape: Proposed amendments to the market integrity rules (CP 222)*. In CP 222 we consulted on proposals to repeal Rule 2.2.3 and Part 5.2 of the ASIC Market Integrity Rules (ASX) and sought feedback on the following alternative options in relation to Parts 6.4, 6.5 and 6.6:

- (a) amend Parts 6.4 and 6.5 to make them more consistent with the equivalent provision in the Corporations Act (Option One);
- (b) repeal Parts 6.4, 6.5 and 6.6 of the ASIC Market Integrity Rules (ASX) and rely on the existing provisions in the Corporations Act to regulate activity during takeovers, Schemes and buy-backs (Option Two).

21. Submissions to CP 222 were received from a variety of stakeholders, including market operators, market participants and industry associations such as the Australian Financial Markets Association, Law Council of Australia and Stockbrokers Association of Australia.

22. There was unanimous support for the proposals to repeal the requirements for market participants to:

- (a) notify ASIC of details of their professional indemnity insurance cover (Rule 2.2.3); and
 - (b) obtain ASIC's consent before sharing business connections (Part 5.2).
23. Of the two alternate proposals concerning Parts 6.4, 6.5 and 6.6, all respondents who provided feedback on this issue preferred Option 2 - the proposal to repeal the Parts 6.4, 6.5 and 6.6 in their entirety.

Australian Securities and Investments Commission