17 June 2010

Ms Sally Palmer
Senior Manager and Legal Counsel
ASX Limited
20 Bridge Street
Sydney NSW 2000

By email: sally.palmer@asx.com.au

Dear Ms Palmer

ASX Operating Rules 21 May 2010

Thank-you for forwarding to the Stockbrokers Association of Australia the ASX Enforcement and Appeals Rulebook and the relevant Procedures, an updated version of the ASX and ASX 24 Operating Rules and the relevant Procedures on 21 May 2010.

We commend ASX on this re-write of the Rules. It is a substantial project to have achieved in the short time available, and has certainly gone a long way to achieving your stated aim of having more streamlined rulebooks.

After the recent market supervision amendments, under the *Corporations Act*[1], a market licensee like ASX must:

> *(a) to the extent that it is reasonably practicable to do so, do all things necessary to ensure that the market is a **fair, orderly and transparent** market; and*
> *(b) comply with the **conditions** on the licence; and*
> *(c) have adequate arrangements (which may involve the appointment of an independent person or related entity) for **operating** the market, including arrangements for:*
> *(i) handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the market operates in the way mentioned in paragraph (a); and*
> *(ii) **monitoring and enforcing compliance** with the market's **operating rules**;*

[1] Section 792A, as amended by the *Corporations Amendment (Financial Market Supervision) Act 2010*

… (emphasis added)

ASX's previous responsibility for '*…monitoring the conduct of participants on or in relation to the market…*'[2] has been removed

In the context of the ASX's new role, we would like to offer the following comments on the ASX rules as provided, particularly in relation to the ASX Operating Rules and Procedures:

a) **Organisational competencies** (new rule 1000 e, f &g): one of the key features of the new market supervision regime is that the bulk of the management and supervision requirements are moving to ASIC. Accordingly, most of the provisions of old ASX Market Rule 3 (supervision arrangements) are to move to the new ASIC Market Integrity Rules (**MI Rules**). Notwithstanding the removal of old Market Rule 3, we are concerned that ASX is imposing excessive management and supervision requirements via new ASX Operating Rules, in particular –
   - Rule 1000e (performance of obligations as market participant),
   - Rule 1000f (fair and orderly market) and
   - Rule 1000g (operational efficiency and proper functioning of trading platform),

   details of which are set out in the accompanying Procedures. Our understanding was that the Operating Rules would only cover the latter two matters, namely fair and orderly market (acknowledging that this is also covered in the MI Rules) and operational efficiency and proper functioning of trading platform. This is consistent with the removal of the obligation for ASX to monitor the conduct of participants in the *Act*, noted above.

   ASIC requirements sufficient: There seems to be little acknowledgement by ASX that both organisational competencies and management and supervision requirements are adequately covered by *Corporations Act* and ASIC Licensing conditions and requirements[3]. There is no reason why the ASIC and *Corporations Act* requirements should <u>not</u> be acknowledged as being the appropriate standards for ASX Market Participants, and should be sufficient for ASX purposes. To maintain detailed management and supervision requirements in parallel would only add to the cost and inconvenience caused by **duplication** between ASX and ASIC requirements.

   At the very least, we would hope that **protocols** between ASIC and ASX would minimize the practical difficulties involved in supervision by the two regulators, for example by designating 'lead regulator' in specific areas.

[2] former section 792A(c)(ii)

[3] See, *Corporations Act* Section 912A, ASIC Regulatory Guide 104 *Licensing: Meeting the general obligations*, ASIC Regulatory Guide 105 *Licensing: Organisational competence*, and the certifications that must be given by a financial services provider prior to obtaining an AFSL – certifications whose breach can have criminal consequences.

b) **Ongoing requirements and the use of Procedures** (Change in details, insurance, etc - new rule 1400e and new procedure 1400f which should probably be renumbered procedure '1400e' for consistency): rule 1400e is very short on detail ('*notify ASX of the matters set out in the Procedures, etc*') then much detail, including substantive requirements not mentioned in the rule, like change in details, insurance (which we thought was going to ASIC?), licence changes, and regulatory action, are spelt out in the Procedure. **Substantive requirements like this should be in the rule, and be part of the Ministerial disallowance process. There is concern ASX will merely change the Procedures as they have in the past (with Procedures <u>not</u> subject to Ministerial disallowance) to introduce substantive requirements.** There is a proper basis to the rule approval process, including the power of the Minister to disallow rules or rule changes. The use of Procedures to introduce or change substantive requirements could be seen as a subversion of the appropriate process. At the very least, ASX should allow the opportunity for **proper consultation** with industry before implementing any new or change to a substantive Procedure. Proper consultation should include a period of at least 4 weeks for consideration and comment on ASX proposals.

c) **Breach Reporting** (new rule 5000)**:** similarly, the detail of breach reporting under the new rule is left to the Procedures. However, there did not appear to be a 'Procedure 5000' in the version we saw, so there is no detail. (At least here, the substantive requirement is set out in the rule.)

d) **Key risks and internal systems (KRIS) statement** (new Appendix 8510(b)-2: this seems to be a carry-over from the existing ASX requirement in rule 3, but is not supported by a substantive rule. Rule 8510(b) to which it presumably applies only refers to an 'auditor's report'. The KRIS statement is an annual attestation by directors as to the firm's systems and compliance, not an auditor's report. In any case, it should no longer be necessary, with ASIC AFSL audit and other requirements being sufficient.

e) **Appeals – less peer review:** the disciplinary rules provide for a disciplinary mechanism whereby ASX management imposes the penalty, which can then be appealed to the 'Appeal Tribunal'. We are pleased to see that the earlier **threshold** of $20,000 for Appeals has been removed. However, this new system effectively removes a layer of peer review from the old system, where the Disciplinary Tribunal (of peers) decision could be appealed to the Appeal Tribunal (of peers). The new system has only one layer of peer review, where the equivalent of the old Disciplinary Tribunal (renamed the 'Appeal Tribunal') hears appeals from ASX Management decisions. As we have said to ASX previously, this adoption of the SFE system - while simpler and cheaper for ASX - diminishes the efficacy and integrity of 'peer review' which has served the industry well for many years.

f) **Disciplinary Process – governance issues**: following-on from the last point, we would hope that the ASX's new power to levy penalties administratively without the need for independent peer review would be properly exercised. It should for example include arrangements so that the ASX decision maker is as far as possible 'independent' of the

ASX investigators and enforcement personnel who prepare and prosecute the case. (The ASIC 'delegate' model could be useful for this purpose.)

g) **Appeals – more costs**: in order to appeal an ASX management decision to the Appeal Tribunal, the market participant will have to pay a new fee of **$5,500**. While a fee used to apply under the old regime, it only applied for appeals from the Disciplinary Tribunal to the Appeal Tribunal. There was no fee payable for the hearing at first instance before the Disciplinary Tribunal. Under the new regime, the first instance hearing by way of peer review will effectively be before the Appeal Tribunal. It is a therefore a further erosion of peer review to have to pay a substantial fee to achieve a determination independent of ASX management. The comment was made at last week's Annual Stockbrokers Conference that the appeal fee was being introduced to '*stop frivolous claims*'. We do not understand the rationale for this. Courts and tribunals like FOS have long had the discretion to exclude '*frivolous and vexatious claims*'. However, it is entirely different to apply this in the context of merely seeking peer review. If it could be better expressed as an attempt to prevent '*frivolous and vexatious defences*', then this is hardly appropriate, when all that may be being sought is a hearing by independent peers. Notwithstanding these arguments, if the ASX is to pursue this measure, **will the $5500 be refunded** if the broker is successful?

h) **DTR's**: as you would be aware from our earlier submission in April, Members are very interested in the proposal to remove DTR's. Concern has been expressed that the removal of appropriately qualified and independently accredited specialist operators may impact negatively on the integrity of the market. Traditionally, DTR's play an important role. They are the first line of protection for the firm from improper trading. They play a 'gate keeper' quality-control role. Even with AOP orders, DTR's often play an important role in determining appropriate action when a trading message is blocked by a filter. With new trading functions (*Centrepoint* & undisclosed orders) commencing in late June this year, and further facilities (iceberg orders; *VolumeMatch; PureMatch*) to come, it will be even more important that specialist operators are on-hand to manage trading.

In a recent decision of the ASX Disciplinary Tribunal involving erroneous orders being placed into the ASX Trading Platform, the Tribunal took the following matter into account:

> '*The importance of the role of DTRs in reviewing and preventing the entry of orders into the trading platform that could result in a market that is not fair and orderly*'[4]

Our Members would agree with the sentiments expressed by the Tribunal.

We gather that there has been some further development of the approach to this area, and we await details of the new arrangements from ASX and/or ASIC.

[4] ASX Circular 150/10 3 May 2010 *Disciplinary Matters*

i. ***Maximum penalty***: Members were very pleased to hear at last week's Annual Stockbrokers Conference that consistent with our earlier submissions, the maximum fine for breaches of the ASX Operating Rules would be returned from the current $1,000,000 to the pre-2008 level of $250,000.

Thank-you for the opportunity to comment on the rules and procedures as lodged. We look forward to seeing the next version(s) and assisting generally in the transition process.

If you require further information, please contact me, or our Policy Executive, Doug Clark by email dclark@stockbrokers.org.au

Yours sincerely,

David W Horsfield MSAA
Managing Director/CEO