Stockbrokers
Association of Australia
Incorporating SDIA

27 January, 2011

Ms Calissa Aldridge
Exchange Market Operators
Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2000

By email: marketstructure@asic.gov.au

Dear Ms Aldridge

ASIC CONSULTATION PAPER CP 145 -AUSTRALIAN EQUITY MARKET STRUCTURE - SUBMISSION BY STOCKBROKERS ASSOCIATION OF AUSTRALIA

Introduction

The Stockbrokers Association of Australia Limited ("the Stockbrokers Association"), the peak industry body representing institutional and retail stockbrokers and investment banks in Australia, is pleased to provide this submission to ASIC in relation to Consultation Paper CP 145 – Australian Equity Market Structure.

The Association's members have a strong commitment to maintaining the integrity and high standing of Australia's markets. The Association is also committed to enhancing the efficiency and competitiveness of Australia's financial markets and furthering Australia as a regional financial hub. The ASIC review of Australia's equity market structure is of enormous significance in the context of each of these objectives.

The Stockbrokers Association congratulates ASIC for producing a Consultation Paper of the highest quality. The Paper deals with all of the issues which currently sit at the core of consideration of the future shape of equity markets in an environment of competition and rapid technological change. The decisions reached in relation to the issues in the Consultation Paper (CP) will be highly significant to the future development of our equity markets. The significance will also likely extend into the

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markets for other financial products, where, as we indicate later in our responses, the rationale for many of the proposals in CP 145 logically follows.

The Association appreciates the opportunity to provide feedback, and thanks ASIC for making its senior staff available for meetings with the Association and its members, and being available for member forums. Apart from this written submission, these occasions gave our members the opportunity for valuable feedback and clarification, which is most appreciated.

Framework should suit Australian market conditions

The issues in CP 145 are being considered at the same time as similar regulatory reviews covering the same or similar issues are being conducted in other jurisdictions overseas. The rapid pace of change in markets for financial products is such that the changes are quickly spreading throughout global markets, so that there is not necessarily a significant body of experience in offshore markets which Australia is able to draw upon when making a decision on many of these issues. On the other hand, the opportunity presents itself for Australia to develop its own solutions before entrenched policy settings are put in place in larger offshore markets.

It is important that the solutions adopted are suited to the Australian market conditions and enhance rather than detract from hard-won efficiency. The Australian equities market is highly efficient by regional and world standards. The benefits of market efficiency are critical. Lower transaction costs enable the Australian market to attract trading volumes to our markets in competition with other regional and world markets.

Lower transaction costs also have a documented impact on maximizing the accumulation of wealth, which is of particularly significance to the Superannuation fund balances and managed funds holdings of ordinary Australians. A fundamental submission that the Stockbrokers Association makes in relation to CP 145 generally is that ASIC should be mindful not to erode these benefits and introduce only those changes that are essential to integrity of the markets.

Whilst ASIC has the opportunity to achieve world best practice on the issues explored in CP 145, this should not mean adopting a "Rolls Royce" solution when our own market conditions do not require it. There is currently a likelihood of there being a second competing market operator, but it may be that Australia does not end up with the nine or more competing markets as exist in some other jurisdictions. In fact, trends overseas may be pointing to consolidation of multiple markets rather than further proliferation. Hence, we should favour simpler solutions where possible at this stage of Australia's market evolution.

In this context, as we point out in our Responses below, some of the Proposals are, in our view, unnecessarily over-engineered and/or over-prescriptive. Some of the issues

do not require resolution for Day 1 of the multiple market environment here. Examples of these are:

- *Best Execution*: In the current circumstances in Australia, the proposed Best execution rule is not necessarily a 'Day One' issue

- *Best Execution IT Certification*: In the Australian context, compliance with the Best Execution rule will be heavily reliant on the operation of IT systems. Our members will either develop systems in-house or acquire them from a service provider. Accordingly, in meeting the actual requirement real-time, together with the record-keeping and reporting requirements for best execution, our members will be heavily reliant on the IT system they use. For members who outsource the system to a service provider, it is proposed that a **certification** regime of **accredited order routing service providers** be introduced, so that members know that the use of the relevant system will be sufficient, without the need to test systems on a firm-by-firm basis.

- *Testing Algorithms*: As we set out below, the requirement for Market Participants to test client algorithms is unrealistic, due to client confidentiality and the fact that clients may use a panel of brokers, making it impossible for each broker to know the 'full story' and a duplication for each broker to bear the same testing obligation . If such testing is required, it ought to be a requirement imposed on clients themselves and/or capable of being outsourced to third-parties, while still allowing for the entry of a new market operator(s).

The opportunity can be taken for further time to be devoted to considering those questions and arriving at the optimum result for Australia. Without being a slave to overseas trends, it may be that useful solutions are arrived at in one or more of the overseas reviews of equity market structure that are presently being carried out.

Short Consultation Period

Lastly, we note that the industry consultation on the wide range of important issues in CP 145 is being conducted in a very short time frame and at a time of year that is not optimal for the stockbroking industry. We appreciate the imperatives that ASIC is no doubt under in establishing the regulatory framework for multiple markets. Nevertheless, the amount of time for the industry to consider and debate what are some of the most far-reaching changes to the industry has been brief.

Also, the consultation period has coincided with a period in the calendar year when the stockbroking industry has traditionally operated on "skeleton" staffing, being one of the few windows in the year when the trading climate allows for staff to be away on extended leave with their families. In consulting with our members, we have experienced that many of our members have been away for key parts of the

consultation period, and this has impacted on our ability to consult as fully as desirable on issues of this magnitude. It may be that further feedback continues to be received after this Submission is provided to ASIC, in which case we may provide further submissions at a later date.

We set out below Responses to specific Questions in CP 145. We have not included those questions in relation to which no feedback was received from members.

RESPONSES TO SPECIFIC QUESTIONS

D. SCOPE

D1Q1 Do you agree that the proposals should apply to equity market products as defined?

We support the application of the proposals to equity market products as defined. We assume that the definition extends to ETFs. In addition, where indicated below, we consider that the rationale for many proposals applies equally to other equity linked products and to derivatives.

D1Q2 Which of the proposals in this paper should naturally apply to other products, such as futures, other equity-related products and debt products?

See Answer to D1Q1 above.

D2Q1 Will there be material gaps in the regulatory approach if the proposed rules apply only to market operators and market participants? Should the proposals apply to other persons (e.g. indirect market participants and fund managers)?

Since about 1990, there has been consistent growth in the number of advisers in listed securities and derivatives that are not ASX market participants. This has been influenced by a number of factors, including:

(a) more flexible delivery mechanisms (trading platforms);
(b) technological developments;
(c) improved third party clearing and settlement platforms;
(d) increased ASX capital requirements, and
(e) new business models.

Generally, the trend seems to have been driven by the desire of advisers who previously worked for ASX brokers to operate similar businesses but outside of ASX regulation.

According to some estimates, about 700 AFSL holder firms which are not market participants are advising and dealing in listed securities, but the figure could be as high as 1200. Of these, several hundred firms are of significant size. This compares with around 90 ASX market participants. (These figures are only for AFSL holders; the numbers would be higher if Authorised Representatives and Corporate Authorised Representatives were included.)

Use of the term 'Stockbroker'

The issue of unregulated market participants has also been raised by the Association with ASIC in the context of the use of the term 'stockbroker'. Section 923B of the Corporations Act prohibits a person who is not a market participant (or authorised by one) from referring to themselves as a '…stockbroker or sharebroker, or any other word or expression (whether or not in English) that is of like import to that expression…'.

In recent years, Members have raised concerns about certain non-market participants calling themselves Stockbrokers, or implying that they offer the same services as a stockbroker, without being subject to ASX – or now, ASIC - regulation.

For example, these firm's websites commonly describe themselves as a 'full service share and [other product] brokers'. The products traded by these firms are predominately ASX-listed securities and derivatives, especially derivatives. These firms are therefore holding themselves out to be reputable stockbrokers without proper authorisation and the accompanying regulatory framework, which includes fines for breaches of the Market Integrity Rules of up to $1,000,000.

As we said in our submission to The Commonwealth Parliamentary Joint Committee on Corporations and Financial Services inquiry (aka.Storm inquiry) into financial products and services on 31 July 2009,

> *The term 'Stockbroker' is a professional term. Its misuse can lead to confusion in investors, who may be misled into thinking that they are dealing with someone of a certain standing. In order to call themselves stockbrokers, advisers should be properly qualified to do so. Accordingly, they should have to satisfy professional standards set by the appropriate body in excess of the minimum required by law.*

We would therefore submit that the Market Integrity Rules should apply to:

- AFSL holders (and authorised representatives), whose business is predominantly
- advising and/or dealing
- in listed securities and/or derivatives.

D3Q1 What are your views on an appropriate maximum penalty for each of the proposed market integrity rules in this paper?

Section 798G(2) of the Corporations Act states that the maximum penalty amount for a contravention of the Market Integrity Rules must not exceed $1,000,000. (We were pleased that an earlier proposal in 2009 for a maximum amount of $5,000,000 did not proceed, and that the Act reflects the previous maximum fine able to be levied by ASX for a breach of its operating rules.) The maximum penalty amount under an Infringement Notice given by the ASIC Markets Disciplinary Panel is three-fifths of the maximum amount, or $600,000: s.798K(2). The current version of the Market Integrity Rules which came into effect 1 August 2010, the *ASIC Market Integrity Rules (ASX Market) 2010*, sets out penalties for certain contraventions - for example, $1,000,000 for Manipulative Trading under Rule 5.7.1 - and notes that certain provisions do not have a penalty attached - for example preliminary matters concerning the application of the Rules under Part 1.1.

Generally, the scheme of penalties set out in the present rules resembled those which had been applied under the previous ASX operating rules, but with greater detail. The pre-1 August 2010 ASX rules did not prescribe a particular penalty to a particular rule, but left it to the discretion of the ASX Disciplinary Tribunal. However, over many years, the ASX set out its policy considerations for the penalties it would recommend in submissions to the Tribunal. This developed into formal ASX Disciplinary Tribunal Sanction Guidelines (ASX Disciplinary Processes and Appeals Rulebook Procedures Annexure A) which the Tribunal was bound to apply to pre-1 August 2010 matters before it. The previous ASX Sanction Guidelines were a key influence on the drafting of *ASIC Regulatory Guide 214 Markets Disciplinary Panel*, particularly Tables 2 to 6, which set out the factors to be taken into account in determining penalty amounts.

In 2010, we welcomed the fact that unlike the ASX Sanction Guidelines, ASIC RG214 does not set a minimum amount of penalty for each type of contravention. For many years we had argued that the practice of setting minimum penalties unduly fettered the discretion of the Tribunal. Accordingly, we submit that rather than attaching a maximum penalty to each and every provision, the Markets Disciplinary Panel ought to have the maximum amount of discretion in determining penalties. This may be achieved by following the types of categorisation of contraventions, e.g. as Tier 1, 2, or 3 and the relevant factors set out in RG214, and leaving the Panel to set the appropriate penalties.

E. EXTREME PRICE MOVEMENTS

E1Q1 What implications will this measure have on market integrity? Will it reduce the number of trade cancellations?

It is difficult to make precise comment without more detail as to the nature and setting of the proposed controls at the market operator level.

We assume from the wording of this question and the separate questions at E2 below that the controls referred to here are separate controls aimed purely at erroneous orders, and are not intended to double as controls over wider market volatility. We presume that these filters are likely to involve some form of filter to prevent deviations in sale price, and unusually large volumes.

Depending on where these market filters are set, they may minimise or prevent orders which are clearly an error from being transmitted to market and thereby causing market disruption. To this end, they ought to reduce the number of cancellations which arise because of such errors, most notably, "fat finger" errors. Subject to how these controls are structured and operate in practice, measures which would minimise or prevent erroneous orders at the market level would be welcomed.

Human beings will always be liable to make errors, however it has become the trend for increasingly large fines to be imposed on Market Participants for such errors, and not always in cases where any systemic defect or want of supervision is apparent from the public facts of the case. Controls which would minimise such errors would therefore offer the benefit of reducing the increasing level of regulatory risk being faced by Market Participants for basic human error.

Whilst the reductions in events of market distortion arising from errors will obviously also benefit the overall integrity of the market, it is not clear how and whether these controls will offer any benefit to market integrity in other ways. Again, much will depend on what the controls look like, and how, if at all, they will interact with other filters already being used by Participants in DEA/AOP systems.

We would have thought that controls designed to minimise errors would be likely to be set at a wider level than AOP Price and volume filters, so as to eliminate clear errors, otherwise they would have the potential to impede genuine, albeit unusually large orders or price movements.

Likewise, we assume that it is not the intention that these error controls are intended to remove the need for Participants to have their own filters where required. On a day to day level, it is the exercise of discretion and judgment by DTRs in the execution of manual orders, and the operation of appropriate filters in relation to DEA/AOP systems,

that do most to ensure the integrity of the market. Assuming that the proposed controls will assist in the cases of clearly erroneous orders, then they should provide an additional level of assistance in preserving market integrity.

Such controls are unlikely to assist in relation to errors which are not clear errors, such as a Buy instead of an intended Sell, or an order at a price that was incorrect, but not so far away as to trigger a filter, but was nevertheless a mistake. It is unlikely that such an error would now qualify for cancellation under existing trade cancellation policies, so there may not be any corresponding impact on the level of trade cancellations in these instances in any event.

E1Q2 What implications will this measure have on liquidity?

Again, much will depend on the design and setting of these controls. There is a question as to whether the application of the additional control will serve to slow the speed of transmission of all orders to market (increase "latency"), and if so, by how much.

Manual orders that would ordinarily go straight to market without having to pass through any filters would now pass through such a control. The impact of new technology is only now fully being experienced in the Australian market, and it may be that the new ultra-low trading technology being used (such as the new ASX OMX platform) are so fast that any delays from new controls will not be significant.

However, markets, particularly markets between regions, are now competing with each other, and it is important to weigh up any loss of latency which a market level filter could cause to assess whether this could cause Australian markets to become slower market than directly competing regional markets, which could lead to a loss of trading activity and liquidity in certain cases if entities seeking ultra low order latency decide not to trade other markets in preference as a result.

E1Q3 What implications will this measure have on confidence in the market?

We refer to E1Q1 and E1Q2 above. Such controls should, in the absence of other considerations, assist in levels of confidence in the market, at least in relation to market distortions resulting from errors, although they are unlikely to assist in relation to market misconduct generally.

E1Q4 Who should decide the thresholds? What factors should be taken into account when deciding the thresholds?

Thresholds need to be consistent between all markets, otherwise there is a potential for "gaming" between markets based on control levels. There should be either a protocol for agreement between markets as to how these controls are set and monitored. If no

such a protocol can be achieved, then the controls will need to be set and administered centrally by ASIC.

E1Q5 Should the thresholds be made available to the public?

Our basic position is that market controls ought all to be publicly known. There should be no element of surprise as to how the markets function.

E1Q6 What implications will this measure have on market-participant-level order entry controls?

See answer to E1Q1 above. We assume that the market level controls will not dispense with the requirement to have appropriate filters in relation to DEA/AOP systems. The controls would mean that there would at least be a consistent level of control applied in relation to manual orders across all Market Participants to prevent error. This would remove any uncertainty as to where to set a filter such as this, or remove any point of comparison between Participants (if that in fact exists for any reason) as to where each may set such a filter.

E1Q8 Should this obligation apply to all financial products traded on exchange markets and to operators of non-equity market product markets (e.g. derivative markets)?

There is no reason why such controls should apply only to equity products. The nature and setting of such controls may vary between the markets for different products, however the rationale for such controls remains the same. Errors are just as prone to occur in relation to futures as debt products as they do in equity products. However, as a general issue, it is more difficult to apply controls and filters to the more volatile markets, such as derivatives, which are thinly traded.

E2Q1 Do you consider that volatility controls (in single equity market products and market-wide) are necessary or desirable in the Australian market environment? Why?

As a preliminary matter, the questions of whether to adopt volatility controls, and if so, how they should operate, are questions which are not critical to be resolved for the introduction of multiple markets, and so the opportunity is available to move more slowly in considering these issues.

We note also that these issues are being explored in other markets such as the US, which is pursuing controls on an evolutionary basis. The opportunity therefore presents itself for Australia to learn from the experience in these markets whilst it determines the appropriate form of any such controls in our markets. Volatility controls in theory offer the potential to act as a "pressure valve" in the event of a temporary imbalance of

liquidity of a significant degree, and therefore might be considered to be a positive feature.

We note that a market pause functionality that apparently existed in the Chicago Mercantile Exchange is credited in the May 6 Flash Crash Report with having created a sufficient breathing space for liquidity on the Buy side of the E-mini Futures product to be restored after having temporarily evaporated. That would be an instance where a volatility control could be said to have worked to the benefit of the market in that product, and in the overall US markets, in what were otherwise extraordinary events.

It is not clear to us, however, whether the Australian markets have reached a point where measures such as this are needed. Assuming that appropriate filters are in place in DEA/AOP systems, and that error controls are in place as referred to in E1 above, these ought to minimise the trigger for market disruptive events such as the May 6 Flash Crash.

In fact, it is hard to see how the order which is reported to have triggered the May 6 Flash Crash, and many of the single stock orders executed in following trades, could have been executed with such a degree of market impact if they had been executed through an Australian certified AOP system containing the necessary price filters. Therefore, we do not believe that there is any overwhelming urgency to resolve this particular question for Day 1 of the multi-market environment.

E2Q2 Do volatility controls help stabilise markets or do they destabilise markets?

See Answer to E2Q1 above. An essential consideration is that volatility controls must not operate to prevent market movements that occur for good reason.

The most notable cases of market falls in recent memory, such as 9/11 and during the GFC, occurred in response to specific events and therefore could be said to represent the true market. Similarly, any "meteoric" rises as have occurred in recent times have been announcement or sentiment driven. Regulators should be careful in considering any mechanism which would prevent the market from acting when it considers there is good reason. This would do more to destabilise the market, and would also operate unfairly by preventing those who acted swiftly from benefiting from their speed and decisiveness. Volatility controls should therefore only act in cases where there is a clear imbalance or distortion at work, and should be capable if being overridden where they would impact on the proper functioning of the market.

E2Q3 Should there be a market-wide volatility control (with or without volatility controls for individual equity market products)?

It is logical that volatility controls not be applied in one market only, such as the market for equity products. The same logic, if it supports the introduction of a volatility

control, would support its introduction in all markets, although the type of control and the settings of the control may well differ between markets. Applying a market wide volatility control, in the sense of applying the control across all market when the market level of the SPI Index rise/fell by, say, X points in a certain time period, is problematic for a number of reasons. Firstly, there may again be good reason for the movement. Negative news of a serious level in relation to, say, resources, could cause a fall in RIO, BHP and other resource stocks which could, by their combined weight, impact significantly on the SPI Index, and yet the market for all other stocks individually remained unaffected. Secondly, market wide volatility may, as mentioned in E2Q2 above, occur for good reason.

E2Q4 What are your views on this proposal? Please comment on what you consider to be appropriate for the duration of the volatility control, the mechanism for implementing it, the reopening procedure, and whether there should be different requirements for different products.

See Answers to E2Q1-3 above. For the reasons mentioned, we believe it is premature to explore this issue too far at this stage. We note the reference to the market pause in relation to the E-mini futures contract during the May 6 Flash Crash, and how placing the market for that product into a brief single price auction process appeared to work in that instance as a means of restoring the balance of liquidity.

E2Q5 How should a volatility control take into account explained volatility (e.g. caused by a material earnings downgrade)? Should it be possible to manually override an automated volatility control?

See Answers to E2Q1-3 above.

E2Q6 Should volatility controls between equities and derivatives products be consistent? If so, how should this operate?

The approach to volatility controls should be consistent between equities and linked products, although as mentioned above, controls might be different between different products and different markets. If a control is triggered in relation to a product, trading is likely to spread to the linked product e.g. the derivative or ETF over the product or index. There needs to be some judgment factored in to determining whether or at what point trading in respect to a single product will impact on trading in, say, an Index. The issue may be clear in relation to major constituent products, but maybe not so in lesser products.

E2Q7 Should there be specific controls on particular types of orders (e.g. market orders)? What would be the advantages and disadvantages of these?

If appropriate filters exist in relation to DEA/AOP systems, and if appropriate judgment is used by a DTR when manually executing an order (both of which are required, and have for many years been required, under the current MIR framework in Australia), then there is no reason why any further controls should be considered in relation to "at market" orders.

The requirements of the Rules limiting the execution of "at market" orders are, in our view, well understood in the Australian market. The practice documented in the US Flash Crash Report of market orders executing against stub quotes of 0.1 cent or $100,000 would, we would imagine, have the potential to result in regulatory action were they to occur in Australia.

In an increasingly automated and electronic trading environment, the key is to ensure that appropriate filters are in place. If they are, then the instances which would occasion the possible triggering of volatility controls would in our view be significantly reduced.

E2Q8 How regularly should volatility controls be reviewed to ensure they are relevant to the prevailing market environment?

There is no definitive answer to this question, and as already noted, it may be too early at this stage to conclude such a question. A quarterly review would probably be adequate in an ordinary market environment. However, in unusually volatile markets, such as during the last 18-24 months, volatility controls may require more frequent review, and may require continuous monitoring, to ensure that they are set appropriately to protect risk, but not so as to prevent the operation of the real market.

E2Q9 What other practical alternatives are there for stabilising the market?

We do not make any comment on this question.

E2Q11 Should this obligation apply to operators of non-equity market product markets (e.g. derivative markets)?

See answer to E2Q6 above.

E3Q1 Are there any risks in mandating transparent cancellation policies? If so, what are they?

In our submission of 9 November 2010 to ASX on changes to its Trade Cancellation Rules, The Stockbrokers Association's Members expressed a range of opinions in relation to the proposed ASX cancellation policy. On the one hand, it was agreed that the certainty of having set bands outside which trades are cancelled is a good idea. Such a system should be clearer for clients, and their advisers.

On the other hand, members note that Australia is different to the US, and we have not experienced a Flash Crash. The Equities market has some key differences to the futures market, so the SFE approach is not necessarily appropriate. Small Cap and Illiquid stocks also present a particular problem.

There was also concern expressed by some Members that it would seem that the ASX had once again made its decisions without giving proper credence or consideration to market experts and practitioners.

In relation to the current ASIC proposals, The Stockbrokers Association supports transparent cancellation policies that are consistent across licensed markets. These policies should limit uncertainty about whether or not a trade will be cancelled. The Association supports with one exception the type of cancellation policy recently adopted by the ASX.

The exception that we refer to is that we believe there should continue to be the ability to permit cancellation of a trade where both parties agree, even if the trade falls within the "no cancellation" range. If both parties agree to cancel a trade, then there is no reason why the trade should be compelled to remain on foot.

E3Q2 What benefits will the market derive from transparent cancellation policies? Consider interconnected, multi-leg trades.

See the answer to E3Q above. Cancellation of other legs of an interconnected trade remains an issue fraught with difficulty, as this may result in an unfair impact to the other party to that leg, who may likewise have entered into interconnected legs that will not be cancelled. This does provide some support for the argument that there should remain scope to seek the agreement of that other party to cancel the interconnected leg, as they may be prepared to do so.

E3Q3 Should trade cancellation policies be consistent across all markets (equity and derivative)? Should ASIC set this policy?

Cancellation policies should be consistent across all market in terms of the principles applied. It may be that the detail of the policy will differ because of the nature of the markets., but the basic principles should be consistent. The Stockbrokers Association does not have a preference as to whether the policies are set by the market operators themselves, so long as there is a protocol to achieve satisfactory consistency, however if this cannot be achieved, then the policies should be determined centrally.

E3Q4 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate

whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

Stockbrokers Association members have already factored in compliance with the Trade Cancellation Policy introduced recently by ASX. Hence, there will be no changes that would be needed if this policy remained the same, and if the policies of other markets licensed to commence operation were consistent.

The introduction of inconsistent policies would create the potential to require multiple processes and procedures, and hence may result in additional costs, but it is premature to speculate on the potential cost impact of that event.

E3Q5 Do you have views on whether this proposal is likely to impose any other additional costs or burdens on any class of stakeholder? Where possible, please identify the nature of the likely costs/burdens, quantify the estimated costs (including any assumptions and relevant data) and indicate whether such costs/burdens will be one-off or ongoing.

We do not make any comment on the potential impact on other parties.

F. DIRECT ELECTRONIC ACCESS

F1Q1 Are these standards adequate, or should others be included? Please elaborate.

The Stockbrokers Association submits that the existing AOP/DMA framework set out in the ASIC Market Integrity Rules, adopted from the previous ASX Market Rule framework, is thorough and has essentially stood the test of time. In particular, the phenomenon of naked and unfiltered direct client access does not exist under the current rule framework, nor is it envisaged that it will be allowed.

The Australian market has not witnessed any market failure of the nature of the May 6 Flash Crash. Much of what is proposed in Proposal F1 already exists under the current Rule framework. Therefore, we believe that the existing framework requires little if any modification.

Feedback which has commonly been given by Market Participants about the existing rule framework is that there is insufficient guidance on what is required to comply with the requirements, most particularly, the nature of the filters required for AOP systems, and filter parameters or settings. The Proposal as worded does however suggest some additional levels of obligation on Market Participants that should be reconsidered or clarified.

The steps required of a Market Participant by way of due diligence to satisfy F1 (b) and (c) should not exceed the existing obligations. It should be suitable compliance for a Participant to obtain undertakings from the client as to the existence of these matters. Prior experience with these requirements has established that requiring some form of examination or assessment to be administered by a Participant of client representatives, in order for the Participant to satisfy itself that it has met this obligation, is not feasible. Apart from determining the content of the examination, and how it would be practicably administered, clients who used multiple brokers would face the situation that their representatives would be undergoing a separate assessment by each broker used. It is also not practical for a Participant to independently ensure that a client has tested its order entry systems.

F1Q2 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

We refer to the answer to F1Q1 above. If the approach which we suggest is adopted, then there should be no or minimal changes required to systems and procedures of Market Participants presently offering AOP/DMA to clients.

If on the other hand additional due diligence steps are required as to any of the matters in Proposal F1, considerable changes will be needed. If steps need to be taken by a Market Participant to independently assess the client's representatives have adequate knowledge and proficiency of regulatory requirements, and the use of each DEA order entry systems, (of which there would be a number) then a mechanism for testing each staff member as to their level of knowledge will need to be developed and administered.

In addition, in the case of institutional clients, as clients will usually use a number of brokers, each of client representative would be facing testing by each of those Market Participants in order that they would all be in a position to satisfy their requirements, which would result in wastage through duplication. The likely result would be that many offshore clients would regard Australian markets as too complicated, and decline to trade here. It is our understanding that this is not a requirement of trading in other jurisdictions.

F1Q3 Do you have views on whether this proposal is likely to impose any other additional costs or burdens on any class of stakeholder? Where possible, please identify the nature of the likely costs/burdens, quantify the estimated costs (including any assumptions and relevant data) and indicate whether such costs/burdens will be one-off or ongoing.

See Answer to F1Q2 above.

F2Q1 To what extent do market participants already have contracts in place with their DEA clients?

The term "contract" is not commonly used in connection with clients of Market Participants generally, including clients DEA clients. The most common terms are Client Agreement and Terms of Business. These agreements will be contractually binding by operation of the document and/or operation of law. The proposal should be in less prescriptive language to permit a variety of means of establishing terms of business used by Market Participants.

F2Q2 Should the market operator or ASIC set minimum terms for these contracts or should this be left to the market participant?

The terms of client agreements should be left to Market Participants to determine. From an Operational Risk perspective, Participants will want to ensure that their relations with clients are defined by adequate terms of business. However, the level of documentation that will be needed for satisfactory risk management purposes will vary considerably between different types of clients, and this ought to be left to Participants to determine.

F2Q4 Are transitional arrangements necessary? Should implementation timeframes differ for disclosure to existing and new clients? What are your views on what the transitional time period and arrangements should be?

If it is accepted that the existing AOP /DMA arrangements set out in the ASIC MIR are adequate, then the question of transitional arrangements should not arise.

F2Q5 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

See the answer to F2Q4 above.

F3Q1 Are current market participant controls sufficient in detecting bad algorithms or erroneous or otherwise disorderly trades?

The proposed MIR should be confined to orders which are clearly erroneous, or which are, or are likely to be, manipulative or create a disorderly market. Monitoring and preventing clients from exceeding pre-determined limits on the client's trading or

financial exposure should be left to a Participant's risk management systems, and should not be dealt with in this MIR.

Secondly, the Rule should require systems to prevent orders which are clearly an error. There may be many errors which are not apparent, such as a Buy instead of a Sell, or Order volume of 10000 instead of 1000. It would be impossible to construct systems or controls to prevent errors such as these. As regards the specific question posed by F3Q1, we believe that market participant controls currently applied to DEA systems ordinarily prevent disorderly or erroneous trades placed through those systems.

There have been instances which have been the subject of Regulatory action by ASX in situations where DEA systems have malfunctioned, and it would appear (although the precise detail of those cases has not been made public) that the controls within those systems have also failed to function such that orders were not prevented from being released into the market. However, the number of these instances is not large, particularly having regard to the volume of orders being transacted by means of DEA systems.

Where orders are being transacted other than by electronic means, i.e. manually, then Market Participants will be reliant on the judgment of sales staff and ultimately of DTR's, rather than other control mechanisms, to prevent erroneous or disorderly trades from occurring. This is effective on an ongoing basis, although it has not prevented human errors such as fat finger errors, or poor judgment in order execution, in a small number of instances.

Lastly, detecting whether an algorithm has gone "bad" may or may not be something which can realistically be expected of a system or control. If the malfunctioning algorithm generates orders which are clearly erroneous, then our comments above apply, and existing filters should prevent such orders being transmitted to market. However, if an algorithm is malfunctioning in a way which does not lead to orders which are disorderly or clearly erroneous e.g. by generating trades which no longer capture profits identified by the algorithm, then this is not the type of malfunction that the Participant's systems could be expected to detect and prevent.

F3Q2 Do market participants currently employ filters on DEA systems that are not systematically overridden? How effective are they?

We are not aware of Market Participants systematically overriding filters that form part of DEA systems. Participants would be aware that switching off a filter in a DEA system has the potential to result in regulatory action.

Given the volume of orders being transacted by means of DEA, the limited number of instances of regulatory action in relation to such orders over the last 10 years would suggest that the current filters being employed are operating adequately. Market

Participants have expressed the view on a number of occasions that they would appreciate more guidance from Regulators on the types of filters that should be employed, and the settings for those filters. As a result of the flexibility in the Guidelines, there is the potential for there to be a variation between filters, and filter settings, used by different Participants in their DEA systems.

Whilst the lack of prescription in the Rules affords Participants with flexibility, there is concern that Participants are carrying a high degree of regulatory risk should their judgment on filter questions prove in hindsight to have been incorrect. There does not appear to be any clear evidence to suggest that any differences that might exist in the filters and filter settings has reduced the effectiveness of filters in practice.

F3Q3 Should we consider other controls on DEA, such as a 'go slow' or 'reduce volume' controls?

More detail is needed to explain what is meant by these forms of controls.

F3Q4 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

Assuming that the existing requirements in relation to systems and controls are considered to be adequate, and that the requirements are not added to as mentioned above, then there should not be any significant changes required or additional resource implications arising from this rule.

F3Q5 Are there any other practical implications associated with complying with this proposal?

See Answer to F3Q4 above.

F3Q6 Do you have views on whether this proposal is likely to impose any other additional costs or burdens on any class of stakeholder? Where possible, please identify the nature of the likely costs/burdens, quantify the estimated costs (including any assumptions and relevant data) and indicate whether such costs/burdens will be one-off or ongoing.

See Answer to F3Q4 above.

F3Q7 Are transitional arrangements necessary? What are your views on what the transitional time period and arrangements should be?

See Answer to F3Q4 above.

F3Q8 Should the DEA proposals apply to trading in non-equity market products (e.g. derivative markets)?

The Association does not see any reason why the controls required for DEA systems should not apply to similar systems for trading in non-equity markets.

F4Q1 To what extent are order algorithms currently tested before use?

The existing requirements in the ASIC MIR, based on the previous ASX Rules, impose requirements for adequate testing and certification of all automated trading systems prior to their first use, and prior to any material change.

Whilst it is not mandatory for algorithmic trading to be carried out by means of an AOP/DEA system, for all practical purposes, it is now the case in the current market environment that algorithmic trading needs to be by way of DEA systems. Hence, Market Participants must ensure that these systems are adequately tested in order to comply with their MIR obligations. Prudent management of operational risk also dictates that algorithms be properly tested prior to their use. The MIR obligations do not however apply to clients of a Market Participant. Therefore, whilst a client would also no doubt be anxious for reasons of its own operational risk management to properly test algorithms prior to use, there is no regulatory obligation to do so.

It is going too far to impose an obligation on a Market Participant, as Proposed Rule F4(2) seeks to do, to ensure that the algorithms of a client are tested and documented. Market Participants are simply not in a position to satisfy such an obligation. Clients will not permit a Market Participant, or anyone else for that matter, have any access to their algorithms.

The Participant will not be in a position to test the client's algorithms or document the logic, as required by the proposed Rule. The likely result of a Rule expressed in this way is that many clients will simply decline to trade in the Australian market, and choose to trade other markets, with the resulting loss of liquidity. The preferred alternatives that should be considered are either imposing direct obligations on clients to carry out testing of algorithms, etc, or alternatively, limiting the obligations on the Market Participant to not permitting clients to engage in algorithmic trading without first obtaining from the client an agreement that the client has tested its algorithms etc.

It should be noted that Market Participants already carry responsibility for orders which are transmitted through their systems, and carry the risk of client trading on their balance sheets. Participants will therefore already take steps to actively manage trading on behalf of their clients, which will include clients who may be using an algorithm to generate orders.

F4Q2 What instances have been observed of faulty order algorithms? Please provide examples.

There are a few examples of instances where ASX has taken Disciplinary action in cases which appear to have involved faulty algorithms. However, the level of detail in the relevant ASX Circulars was not sufficient for it to be clear as to the extent that an algorithm generated the trading pattern concerned.

F4Q3 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

If the requirements referred to in the Answer to F4Q1 above, namely, that Market Participants must test and document client algorithms, are not proceeded with, then the Rule would largely reflect existing requirements, and hence little change to systems and procedures would be required. If the requirements mentioned are insisted on, then considerable changes to procedures would be needed in order to endeavour to comply with the requirements to test and document client algorithms.

F4Q4 Do you have views on whether this proposal is likely to impose any other additional costs or burdens on any class of stakeholder? Where possible, please identify the nature of the likely costs/burdens, quantify the estimated costs (including any assumptions and relevant data) and indicate whether such costs/burdens will be one-off or ongoing.

See Answer to F4Q1 and F4Q3 above.

F4Q5 Are there any other practical implications associated with complying with this proposal?

See Answer to F4Q1 above.

F4Q6 Are transitional arrangements necessary? What are your views on what the transitional time period and arrangements should be?

We make no comment on this question.

F5Q1 Do you consider that there is an adequate level of understanding in the market of algorithms used? What do you consider is necessary to ensure that market participants adequately understand their execution algorithms? Should there be

additional obligations on market participants (e.g. additional reporting to ASIC)? Please provide details.

Market Participants have a clear understanding of the algorithms that they use to execute orders. Market Participants who provide algorithmic trading systems to clients for their use will explain those systems to their clients in making them available.

One would imagine that a client would not use an algorithmic trading engine if they did not understand how it worked. For algorithmic systems outside the most straightforward types e.g. VWAP, TWAP engines, Market Participants will be expected to keep details of the capabilities and strategies inherent in those systems a closely held secret, given the competitive advantage that those systems may confer, and costs of developing those systems. Hence, the broader market may not have a detailed level of understanding of many of these algorithms.

However, this is no different to any complex trading strategy which likewise may not be widely understood, and there is no danger in this to the market in our view. It is not clear what is meant in F5Q1 by "additional obligations". We do not see the need for any additional obligations on market participants. If DEA systems are appropriately tested and contain adequate filters, then there should be little risk of damage to the markets through their use.

F5Q2 How often do market participants review their order algorithms? What degree of post-trade analysis is conducted on algorithmic trading and order book conduct?

As to the first part of the question, this will vary considerably based on a range of factors such as the type of algorithm its degree of simplicity/complexity, how frequently it is used, any issues identified with execution outcomes, and so on. There is no useful answer to give on a general level.

As regards post-trade analysis, larger market participants all use vendor trade surveillance systems (and universally, as far as we are aware, the SMARTS Broker system) to conduct trade surveillance of all of their trading, including manual as well as AOP trading. This will cover all of the firm's trading, client as well as principal. Therefore, to the best of our understanding, all firms employing algorithmic trading have programs for trade surveillance of such trading.

F5Q3 Should order algorithms be required to have an inbuilt circuit breaker requiring them to automatically stop if they move too far from specified parameters? If so, what parameters should ASIC consider?

Questions such as this should be left to the relevant Market Participant or client as to whether there should be such an automatic pause mechanism built into the algorithm.

So long as the relevant filters operate within the system, it is a matter for the user of the system whether there should also be such pause mechanisms.

It would seem that the existence of such pause mechanisms in many US algorithms may actually have been a major factor in removing liquidity from the US markets on May 6 during the "flash crash", and hence might be considered to have done more to contribute to the liquidity imbalance that generated the Flash Crash than prevent it. It would seem, however, that such inbuilt circuit breakers are preferred by many traders for risk management purposes. The purpose is to prevent losses occurring from "bad" or "suspect" data, whenever significant changes in trade data are identified, and hence are based on a sound business rationale.

F5Q4 We are seeking comment on any incidences where automated or algorithmic trading has resulted in inappropriate and/or undesirable effects on a market. In particular, what trading strategies do you believe have resulted in these effects? Examples of what may be considered inappropriate or undesirable include:

(a) layering of the order book, which creates a false impression of liquidity;
(b) pinging or sniffing algorithms that have intent other than execution;
(c) cascading or looping algorithms that cause volatility or price support;
(d) algorithms that flood the market with orders that are intended to be cancelled, in order to distract or confuse rival traders (i.e. 'quote-stuffing'); and
(e) algorithms that purposely use up bandwidth, making it progressively more difficult for slower market participants to get time–price priority.

The Association is not aware of such instances.

F5Q5 Are there concerns about the shortcomings of IT infrastructure or IT security leading to the intentional misuse of order algorithms or other sensitive information? If so, would an obligation on the market participant to have in place adequate IT security measures be appropriate?

We have not been made aware of any such concerns by our members. The existing obligations in the ASIC MIR to devote adequate resources to AOP systems would appear to already make provision for the type of obligation being suggested in the question.

F5Q6 How effective are pre-trade and post-trade filters (at the market-participant level) in preventing order book and trading misconduct by algorithms?

See the Answer to F3Q2 above.

F5Q7 Should ASIC Market Integrity Rules (ASX Market) Rule 5.7.2 on circumstances of orders be clarified or amended to extend beyond the immediate impact of an order to take account of recent trades beyond the immediately preceding trade?

MIR 5.7.2 already specifies that a Market Participant is required to take into account, among other things, whether the order or execution of the order would be inconsistent with the history or recent trading of the product. The terms "history" and "recent trading" would appear to extend beyond the immediately preceding trade, and therefore, this requirement would already appear to exist. The current wording is in our view appropriate. Further amendment or clarification of the type indicated is not necessary.

F5Q8 Should the algorithmic trading proposals apply to trading in non-equity market products (e.g. derivative markets)?

The Association does not see any reason why the requirement regarding algorithmic trading should not be equally applicable to similar systems for trading in non-equity markets.

F5Q9 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

On the basis of previous Answers in F5, our view is that the existing requirements relating to algorithmic trading are appropriate and do not require further enhancement. In that event, no changes to systems or procedures would be needed.

F5Q10 Do you have views on whether this proposal is likely to impose any other additional costs or burdens on any class of stakeholder? Where possible, please identify the nature of the likely costs/burdens, quantify the estimated costs (including any assumptions and relevant data) and indicate whether such costs/burdens will be one-off or ongoing.

See Answer to F5Q9 above.

F5Q11 Are there any other practical implications associated with complying with this proposal?

See F5Q1 and F5Q3 above.

F6Q1 What HFT strategies are prevalent in Australia? In your view, do they affect the operation of the market or pose risks to market integrity?

There is no absolute definition of what constitutes HFT, although there are some fairly consistent elements of the term emerging in overseas references to the concept.

Responses from members vary on this question. Many do not say they have seen evidence of trading satisfying the description of this term. Some say they have seen some evidence of orders being rapidly placed and cancelled. Whether or not this is due to HFT or some other reason cannot be said with any certainty.

Another practice referred to in the US, that of "quote stuffing" of high volumes of orders in a product in an extremely short time, has not been apparent in this market.

One of the important pre-conditions for HFT, ultra-low latency trading platforms, has not existed prior to the introduction of the ASX OMX platform in recent months. In addition, another factor, co-location, whilst it has existed, has been limited, but is scheduled for a significant expansion in capacity in the near future.

Finally, there is still only one significant equity market operator in this country, ASX, and hence, trading between multiple markets does not yet exist here. It is therefore logical to expect that HFT is likely to increase significantly in the near future as conducive trading conditions are made available.

F6Q2 Do you consider that the above conduct is inappropriate or undesirable? What other examples of conduct should we be focusing on?

It would appear that regulators in other jurisdictions, such as the SEC in the US, are still in the process of coming to terms with all of the details relating to HFT, and are in the process of considering this same question of whether the conduct is appropriate or otherwise.

In the Stockbrokers Association's view, it is important to focus precisely on the conduct that is to be considered, rather than talk generically about "HFT", as there is likely to be a wide variety of practices that are presently all being labelled with the one badge.

Secondly, it is important to approach the conduct in question from the standpoint of the traditional indicia of what constitutes genuine trading a opposed to false or misleading trading under Australian law, namely, ordinary forces of supply and demand and a genuine intention to trade as opposed intentions such as deliberately setting a price, seeking to avoid trading, or seeking to create turnover which is not genuine.

To the extent that any of the practices which are identified as being carried out under the umbrella of HFT do not satisfy this test, then they are contrary to existing law. They should be considered inappropriate and undesirable, unless some good grounds can be made out to illustrate why they should be considered acceptable under the new market environment, and that they should therefore be allowed and the law updated to cater for changing circumstances.

We do not consider that faster order transmission speeds necessarily mean that trading is illegal or unacceptable. In general, trading is becoming increasingly fast due to technological advances, and this is a benefit of modern technology. If market makers can update quotes at ever increasing speed due to technology, this will minimise potentially stale quotes and will reduce the risk of loss. Placing and amending offers in microseconds ought to be acceptable so long as there is a genuine reason for doing so.

There must however be a question mark over placing an order and cancelling it so quickly that no other participant is able to trade with it, as this would have to raise the question as to whether the placer had any genuine intention to trade.

F6Q3 Should there be a minimum order size to discourage traders from placing orders that are of an economically insignificant amount? What should the order size be?

There are concerns expressed by many market observers, including some Market Participants, that the distinct trend of reduction in order size that has been evident on the ASX for at least the last 3 years is an indicator of market misconduct. The ASX noted this trend in its 2010 *Review of Algorithmic Trading and Market Access*, and also noted these concerns, but concluded that there was no evidence to suggest that the pattern reflected market misconduct.

Stockbrokers Association members have raised the issue that as trade sizes fall, business costs rise as back office settlement charges are higher where multiple lines need to be processed for each trade, even if Exchange costs themselves are not based on the number of lines per trade. Having said this, there would be likely to be some results which would flow from imposing a minimum order size.

Imposing a minimum order size could subvert the operation of legitimate automated systems which break orders up into subsidiary orders, such as VWAP engines. There would be potential loss in execution quality by those using such systems for proper purposes. Arbitrage, market making and hedging may all require immediate trades which may sometimes be in small parcels. The fact that an order may be for only one or a handful of shares does not of itself mean that the order is manipulative or misleading as to the market for a product.

The ability to place an order for small number of shares may not be of interest to a retail client, however if some of the claimed benefits of algorithmic and High Frequency trading are increased liquidity and narrower spreads, then all clients will benefit from better liquidity and pricing when they seek to trade. Hence, there is the potential for detriment to market users across the board if a minimum order size led to a negative impact on pricing and liquidity.

F6Q4 The SEC has identified that 90% or more of the orders that HFTs submit to markets are cancelled, citing this as an area of concern. The SEC and other regulators

are assessing whether this practice is fraudulent or improper. What reasons may certain market participants have for high cancellation rates? Do you consider that these reasons are legitimate? Do you consider high rates of order cancellation are a concern? What controls, if any, are necessary to address this? For example, should there be a minimum order to trade ratio?

We refer to the Answer to F6Q1 above. As indicated, there are many reasons why one may wish to cancel an order, and being able to do so quickly should not be an issue if the reason is bona fide. On the other hand, the order is likely to be manipulative under existing law if there was no intention to trade.

A more difficult question is whether or not it is legitimate to place and cancel orders as part of "order identification" strategies. It is likely that traders have for years placed orders to try and gauge whether there is any buying or selling interest on the other side. If this can now be done in microseconds, given that the opposing side is able to transmit an order in microseconds in response, is it really any different just because order speeds have become ultra fast (the process sometimes referred to as "pinging"? Much as in the US, where the question is being put for consideration, we are not aware of any clear view being expressed here.

One particular question is that, if it is permissible to allow orders such as iceberg orders to rest in the market concealed as to volume, why should others not be allowed to "ping" to try to ascertain the existence or likely size of such orders?

F6Q5 Should ASIC consider setting controls to manage the volume of messaging traffic (e.g. fee for order cancellations, limits on the speed of messaging or a minimum period of time that orders must stand before they can be cancelled)?

More detail is needed as to the precise control being envisaged in order to comment. Some Participants favour a minimum time for orders to remain in the market, however this view is not held across the board, and other are not in favour. There is a potential the Australian markets could suffer a competitive disadvantage if all of the benefits of high order speed are available in a regional competitor but are limited here.

F6Q6 What impact does HFT have on price formation and the depth and quality of trading interest in the order book?

Again, one needs to be specific about what is meant by HFT. Not all activities carried out by means of HFT will necessarily have the same impact. The clear message from overseas markets is that HFT, together with some other market initiatives, leads to significant narrowing of spreads. HFT enhances the ability of market makers to update quotes for a product and minimise loss, and this enables the quotation of tighter spreads. The maker/taker pricing model will enable market makers to make minimal (or potentially no) profit on a spread, but profit instead from the market rebate for

providing liquidity. As a result, price formation in theory should be significantly enhanced.

F6Q7 Should there be formal obligations on electronic liquidity providers to help maintain orderly trading conditions (e.g. to provide two-sided quotes and to limit their ability to be aggressive liquidity takers during extreme trading conditions)?

This is not in our view a Day 1 issue for the multi-market environment, and the opportunity should be taken for closer thought and analysis to be given to this question.

From our reading of the May 6 Flash Crash report, one of the problems encountered on that day was the problem of "sub quotes" placed in the market at unhistoric levels, in order to satisfy obligations to quote two-way prices, being hit by sellers when liquidity evaporated. A two sided quote will not be of much benefit if the quotes are at unrealistic levels. Some of the blame for the Flash Crash is attributed to the stub quotes, and it may be that the market might not have been so severely impacted if those stub quotes had not existed. Similarly, the initial activity of high frequency traders on May 6, as aggressive liquidity takers, appears to have acted to soak up the initial high volume of selling in the market.

The problem is said to have been exacerbated when the HF Traders quickly turned around to exit the positions, hence adding to the overall selling volume. Whether or not the actions of HFT on that day was helpful or not overall such as to warrant regulatory rule making may not be sufficiently clear at this point.

F6Q8 Should electronic liquidity providers be exempt from the naked short selling ban? If so, why? What criteria should be used for determining whether or not a particular provider or class of providers should be awarded an exemption (see REP 215, paragraph 170)?

The Stockbrokers Association made strong submission to ASIC on behalf of the stockbroking industry culminating in the existing ASIC relief in relation to naked short selling by stockbrokers who act as market makers. Whilst it is ultimately a matter for electronic liquidity providers to make the same argument in their favour, the conditions applying to the existing relief, including the squaring of positions by end of day, could form the basis of similar conditions that may satisfy ASIC as to the level of risk that may be posed by electronic liquidity providers.

F6Q9 What impact does maker–taker pricing have on the integrity of markets? Should maker–taker rebates be capped (see REP 215, paragraphs 163–167)?

We refer to the Answer to F6Q6 above. We understand that in overseas markets, maker taker pricing has allowed market makers to quote narrower spreads. This should

assist price formation and should benefit the integrity of markets. In particular, the impact of trades "crossing the spread" should be lessened where the spread is narrowed. In theory, maker pricing enables market makers to profit from the rebate and not from the trade, and hence quotes can be at little or even no spread. In one sense, trading without intention to profit has been viewed as one indicator of market manipulation, and hence, market making for no profit could on one view be thought to complicate law enforcement in relation to manipulation. However, that view may be overly simplistic.

To the extent that rebates may provide the incentive to provide market making liquidity that would not otherwise be available, or only be available at less attractive prices, the market makers may absorb buying or selling and hence smooth out potential price movements, although query whether that is not simply deferred to a later point as the market maker(s) then exit the position established earlier (as was the case in the May 6 Flash Crash).

G. BEST EXECUTION

G1Q1 What are the practical challenges for market participants to comply with the proposed best execution obligation?

The challenges which have been articulated by members in complying with the proposed best execution obligation are, firstly, determining what is best execution, secondly, managing client expectations in the event that these are artificially raised as a result of the introduction of the obligation, and thirdly, dealing with an administratively burdensome set of requirements relating to the obligation. As to the first matter, there needs to be sufficient guidance or flexibility to know how to calculate best execution where different circumstances come into play e.g. when transaction costs vary between markets, when execution is certain on one market but there may only be 50 shares on the other market, etc.

G1Q2 Do you have any views on whether we should overlay the best execution obligation with a trade-through protection rule similar to that in the US and Canada?

There is no strong voice for a trade through obligation in Australia such as in the US and Canada. The size of the Australian market and the prospect of there being one other competing market to the ASX at this stage are factors in the consideration that a trade through obligation is not warranted at this stage.

As to the second matter, the creation of the best execution obligation could give rise to an expectation by clients of perfection at all times. Orders may be sent to a market based on a valid assessment of best execution considerations, but may rapidly improve

on the other markets. Clients looking at subsequent trade data may conclude that their broker failed in their obligations, and the incidence of complaints and disputes could rise despite the fact that the broker had performed its duties with all due competence.

Thirdly, as noted below, the administrative and reporting obligations that accompany this proposal are very detailed and, in our view, excessively burdensome. This is dealt with in later questions below.

G1Q3 Is it appropriate to allow market participants to meet the best execution obligation based on 'price' rather than 'total consideration' for a transitional period?

We support the transition period to allow brokers to deal with all of the matters required to connect to other approved markets, familiarise themselves with the operation of those markets and implement the best execution obligation.

G1Q4 Do you have any views on the distinction we have made between professional and non-professional investors? Is professional and non-professional investor an appropriate divide?

As a preliminary matter, it needs to be determined whether one group of clients ought to be accorded a higher – or at least different – duty of best execution than another group of clients. Some professional investors may object if they thought that they were not getting the same levels of service in execution as non-professional investors.

Execution of orders is a time-critical activity. A substantial number of our Member firms have both professional and non-professional clients. If these firms had to operate execution services based on a differential duty of best execution, it would at best be unduly onerous, and at worst counterproductive in terms of best execution.

Under Chapter 7 of the *Corporations Act*, it is well established that different duties are owed to professional (wholesale) and non-professional (retail) clients. For example, retail clients are owed higher duties of investor protection in terms of disclosures in advice, complaints handling and compensation. It is a familiar notion. However, in the context of execution of orders on-market, it is difficult to see how such differential standards could easily apply, especially where a firm has both professional and non-professional clients.

More broadly, since the FSR reforms of *Corporations Act* were introduced in 2004, and before that in capital raising, the distinction between wholesale and retail investors has presented problems in practice. These difficulties, and the issues that arose during the Global Financial Crisis, have led the Government to announce a broad-ranging review as part of its *Future of Financial Advice* project of the appropriateness of the distinction

under the *Act*[1]. Accordingly, the finalisation of any rule on best execution based on the category of client should await and take account of the results of the Government's inquiry, otherwise brokers and their clients may be faced with further confusion.

G1Q5 Is it appropriate to have a threshold above which transactions for all clients could take account of a range of factors, and is $500,000 an appropriate threshold?

The product value test of $500,000 may not be an appropriate or relevant threshold for trading in a live equities market since it has no minimum order size. It is more appropriate for some debt and other markets, where a minimum order size of $500,000 or more does apply.

G1Q6 With regard to Option A (i.e. market operator routing):

(a) Would market level routing be of benefit to market participants? What benefits would it provide?

We refer to the answer to G1Q2 above. On one level, requiring the market operator to route orders to better markets might be seen as easier and more straightforward for Market Participants. However, as noted, there is no support at this stage for trade through by market operators.

(b) What are the challenges and costs in implementing such a solution? Where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing.

(c) Should market operator routers be able to take account of undisclosed orders posted on that market when making routing decisions or only pre-trade transparent orders?

G1Q7 With regard to Option B (i.e. best execution on ASX), should we consider explicitly limiting the best execution obligation so that entities that choose to be a participant of a single market can do so for a transitional period without immediate pressure to connect to new markets?

We refer to the answer to G1Q4 above. We support a transition period in view of the level of change facing the market, including Market Participants, in connecting to multiple markets. We note that the availability of a Best Market Router product at affordable price by system vendors may make the best execution obligation easy to satisfy and hence may limit the need for a transition period.

[1] The Hon Bill Shorten MP *Government Releases Options Paper on Investor Protection Threshold* Media Release 018-11 24 January 2011

G1Q8 To what extent do incentives currently determine choice of market participant in which to direct orders? How is this expected to change in the future?

We assume that this question refers to the choice by clients of which market participant to whom to direct their orders.

Clients will select market participants based on a range of factors. The most important factor will be quality of service, principally execution quality, but also including trading ideas and quality of research. Other important factors include the ability to source liquidity in the relevant stock (buy or sell side), client facilitation services (if desired), financing and premium broking services, such as Prime Broking. Quality of systems is an increasingly important consideration, particularly the quality of DEA and algorithmic tools which a broker may have, either to authorise the client to use themselves, or to use to execute the client's orders. Lastly, transaction costs (brokerage and other charges) is a relevant factor in choice of broker.

Institutional clients will often select a panel of brokers, usually reviewed annually, and allocate orders based on panel status. Institutional clients may place orders with a broker, even if not on their panel, as a reward for an outstanding piece of research by an analyst ('tagging" an order). Unless one considers services such as equity research or financing as an "incentive", incentives by a broker to a client in order to place orders would not be a common reason for determining choice of broker.

G1Q9 Should the best execution proposals apply to trading in non-equity market products (e.g. derivative markets)?

There is no rationale for not restricting the best execution obligation only to equity market products.

G1Q10 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

We refer to the answers to G1Q1-9 above. This obligation will clearly involve significant changes to systems, connection to multiple markets, and licensing the use of best market routing software from system vendors. This does not take into account the cost of the related administrative obligations dealt with below. It is difficult to estimate the amount of the costs that will be incurred at this stage, and the level of costs will vary between market participants depending on their businesses.

While the likely cost of becoming a participant of the likely new market operator in 2011 is apparently going to be low, there will be significant other costs for brokers arising

from the increased participation. Updates to trading systems (including order routing), information services and settlement systems will be significant, so one must look further than the mere (low) cost of becoming a participant of the new market.

G2Q1 What are some of the practical steps that market participants will need to take to implement internal policies and procedures?

We do not have an issue with a requirement for a Market Participant to have adequate internal policies and procedures, or that these be reviewed as appropriate. We do not agree that there should be a strict requirement for these to be reviewed at least once a year, as there may be little change to circumstances. The frequency should be left to the judgment of the Market Participant.

G3Q1 What are some of the practical steps that market participants will need to take to make the necessary disclosures to clients?

We do not have any issue with communicating best execution obligation and the matters referred to clients. We strongly submit that administrative and cost burden of making disclosures should be contained and the process be as efficient as possible.

Disclosures should be able to be made electronically and by reference to the relevant pages on a web site if desired. This is consistent with disclosures in other financial areas. There should not be any need for hard copy disclosure or for mail out to clients. There should also not be any need for signed acknowledgment of the policies by the client. Negative consent or deemed consent by the continued placement of orders should be adequate, and equates with standards applied to other commercial relationships.

G3Q2 How should disclosure to existing clients be managed?

We refer to our answer to G3Q1 above. Notification by electronic means as set out in the answer above should be sufficient for existing clients. If there is no ability to communicate with the client electronically, then there should not be any requirement for there to be a mail out for the purposes of this disclosure alone. Instead, a reasonable period should be allowed for market participants to include the disclosure in a schedule mail out so as to minimise the extra cost burden of multiple mail-outs.

G3Q3 What are the likely costs involved with this proposed obligation (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to complying with this proposed obligation?

It is difficult to estimate the amount of the costs that will be incurred at this stage, and the level of costs will vary between market participants depending on their businesses.

G3Q5 What controls could ASIC put in place to ensure the order execution policies disclosed to clients are of high quality and contribute to investors' order routing decisions?

We submit that this is not a matter warranting any formal controls by ASIC. ASIC has the opportunity to review disclosures as part of its role as supervisor of market operations and the conduct of holders of AFS Licensees, and has ample powers to deal with any unsatisfactory conduct which it identifies. There is also scope for ASIC to issue Best Practice Guidelines on this subject to assist Market Participants.

G3Q6 Is it appropriate that this disclosure obligation applies to all clients, including professional clients?

If the above submissions regarding electronic disclosure are accepted, then there is no practical reason why disclosures should not be made to all clients, including professional clients.

G3Q7 For retail clients, should there be a requirement for an acknowledgement of the disclosure?

We refer to our answer to G3Q1 above. We do not support the requirement for acknowledgement of the disclosure, and reiterate our submission that negative consent or consent implied from the continued placement of orders should be sufficient.

G3Q8 What are some of the practical steps that market participants will need to take to make these disclosures?

We refer to our answer to G3Q1 above.

G4Q1 Do you have any comments on how ASIC should assess market participant compliance with best execution?

We do not have any issue with a Market Participant being required to demonstrate to its client the matters referred to in G4 (a) and (b). However, we strongly oppose the requirement for the monthly order routing report referred to in G4(c). Such a report serves no useful purpose, and is a bureaucratic exercise that merely adds to cost. It is not apparent who will derive any benefit from its contents.

We submit that a Market Participant should be entitled to rely on the fact that it uses a Best Market Router program that is certified as doing what it purports to do. If the Best Market Router does not in fact achieve best execution, then this should be a matter for certification of the program. ASIC should also consider whether market integrity rules should apply to the BMR vendor to redress any failures to achieve the intended results.

G4Q2 Are there other factors that the order routing report should address?

We refer to the answer to G4Q1 above.

G4Q3 What should be the frequency of reporting (e.g. monthly or quarterly)? We note that the similar reporting obligation in the US is quarterly.

We refer to the answer to G4Q1 above.

G4Q4 Should the order routing report be limited to those transactions below a threshold? The SEC Rule 606 requirement has a US$200,000 threshold, which is the block trade size in the US.

We refer to the answer to G4Q1 above.

G4Q5 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

Any requirement for a Market Participant to demonstrate to clients as to the matters referred to in G4 (a) and (b) would require changes to systems and procedures. It is difficult to estimate the amount of the costs that will be incurred at this stage, and the level of costs will vary between market participants depending on their businesses. However, the extent of the changes should be minimised to the extent that a Market Participant is able to rely on the use of a certified Best Market Router program to achieve best execution.

G5Q1 Are there other factors that the execution quality reports should address?

Assuming that the obligations in G5 relate to market operators and not to market participants who operate an execution venue, we make no comment on this section.

H. PRE TRADE TRANSPARENCY AND PRICE FORMATION

H1Q1 Do you have any views on a tiered block trade regime?

The existing rules for Block Special Crossings have served well for a number of years, but there is recognition that the threshold has remained static despite the passage of

time, and that a single threshold may not reflect the market for all stocks across the entire spectrum of market capitalisation.

The Stockbrokers Association notes the consultation by ASX not long ago as to a $2.5 million threshold for the largest cap stocks. The view of members remains the same, namely, that the amount of $2.5 million is still too high for the largest cap stocks. As regards the less liquid stocks, the reduced threshold of $200, 000 would certainly make it easier to effect a Special Crossing in those stocks, although it would remain true that the liquidity in many of the illiquid names is such that even assembling a block of that size could prove difficult.

As a general observation, making Special Crossings easier at this end of the market might be seen as being at odds with the policy objective elsewhere to restrict the migration of liquidity from the lit market to dark pools, in the very sector where liquidity is needed in the lit market in order to assist in price formation.

H1Q2 Is there value in also having a $2.5 million threshold for the largest 12 equity market products and/or a $200,000 threshold for the less liquid equity market products, as described in paragraphs 283–284? What impact are these additional thresholds likely to have on transparency? What would be the practical impact on market operators and market participants to adapt systems to reflect the new thresholds?

See the answer to H1Q1 above.

H1Q4 What will be the impact on systems and business volumes of imposing a $20,000 threshold and price improvement on dark trades? Should a size limit apply to all equity market products or just the more liquid equity market products (e.g. ASX 200)? Or should the threshold be tiered based on liquidity?

There are a range of opinions amongst Stockbrokers Association members in relation to this proposal. The objective of ensuring that too much liquidity is not diverted away from "lit" markets to dark pools in order to ensure adequate price formation is acknowledged. All members note that the proposal as currently drafted will prevent Participants from internally crossing stocks for less than the $20,000 threshold, and above that threshold if there is no price improvement (which will prevent crossings at the bid or offer). Brokers note that there is likely to be an adverse impact on execution quality, as crossings may in many instances and in relation to many stocks represent the best execution outcome for both parties. Therefore, this proposal may undermine the objective of Best Execution which is foremost at other parts of CP 145. Brokers who operate internal crossings networks highlight that the proposal may adversely impact on the operation of VWAP and other execution algorithms which have become popular with institutional clients.

An order of, say, 500,000 shares might be sliced many times and entered at different times in order to achieve VWAP over the day, but as a result, none of the slices may be eligible to be crossed. This may impact on execution quality, particularly as the proposal is likely to severely limit the ability of brokers to offer client facilitation of the order slices, and potentially a better or more certain execution, by crossing the order internally with the principal book rather than execute the order in the market. We do not believe that this issue is one which needs to be resolved by Day 1 for multiple markets to operate. Internal crossing networks have not deprived the "lit" markets of so much liquidity as to require this issue to be resolved immediately, and the Association submits that the question should be the subject of further deliberation.

H1Q6 'Pegged orders' are discussed in REP 215, paragraphs 253–256. What impact do pegged orders have on market integrity? Should pegged orders reference another market or should they reference market-wide prices? Why?

An order which is pegged to best bid or best offer, as the case may be, can offer effective execution in line with the market, which can be a desired execution outcome. One potential for misuse or market distortion could be where the order is pegged but is sufficiently away from the market such that it does not execute, or does not fully execute. In such cases, depending on the size of the pegged order, it could create the appearance, deliberate or otherwise, or a floor or ceiling for a product (or even both, where there are orders on both sides of the market).

The existing law and market integrity rules should already be sufficient broad to deal with pegged orders which create a false or misleading appearance as to the market for a financial product.

H1Q8 Are there other steps that ASIC could take to minimise the shift of trading into dark pools? For example, should we consider reintroducing a minimum exposure time for crossed trades (i.e. like the 10-second priority crossing rule)?

We refer to the answer to H1Q4 above. There are no immediate alternatives that suggest themselves that do not have their own limitations. However, we do not believe that the question is not one which needs to be addressed in the immediate future.

H1Q9 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

We refer to the answer to H1Q4 above. The proposal would have significant implications for internal crossings networks, which would require amendment to systems and procedures. The proposal would impact on the procedures for carrying on

client facilitation businesses. Estimates of costs are difficult to quantify at this stage, and will vary between Market Participants.

H2Q1 Do you have any views on the data elements that should be publicly disclosed and collected for provision to ASIC?

We do not have any comment on this issue.

H4Q1 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

We do not make any comment on this proposal.

I. MARKET INTEGRITY MEASURES AND REGULATORY REPORTING

I1Q1 What are your views on our proposed approach to requiring suspicious activity reporting? Are there other avenues for obtaining this information?

This Proposal involves an extension of existing reporting obligations. We submit that this extension would result in a substantial over-reporting of unnecessary material to ASIC, which in our view would divert ASIC's focus rather than assist it. Any benefits from this information (which we question) would be significantly outweighed by the cost and administrative burden on market participants of the additional reporting.

Under the Proposed Rule, the obligation to report will arise when the circumstances exist in which a suspicion of insider dealing or market manipulation should reasonably arise. Therefore, a market participant will contravene the Rule if the Participant ought reasonably to have suspected that such an offence had occurred, and did not report this, whether or not the Participant actually formed the suspicion, or did not form the suspicion. This is a significant extension of the existing obligations. Under the AML/CTF Act, the participant must suspect on reasonable grounds, i.e. have the suspicion.

Under section 912D of the Corporations Act, the participant must report actual or likely breaches by the participant as soon as practicable after becoming aware. Stockbrokers Association members have advised that if the Proposal were to come into force, the expanded obligation would result in them reporting a considerable amount of data arising from compliance monitoring programs and systems in order to ensure that they were in compliance with the obligations. It is likely that the bulk of alerts generated by trade monitoring systems, such as SMARTS Broker, would be reported to ASIC on a

daily basis, because of the possibility that they could form reasonable grounds for a suspicion that an offence had occurred. This approach is likely to lead to ASIC being inundated with information that is likely to challenge its resourcing and decision making.

The information would be reported because of the objective test in the proposed rule, notwithstanding that further analysis at the Market Participant end may explain the trading or other action satisfactorily from the market participant's perspective. We do not believe that this result is desirable either from ASIC's perspective or that of market participants.

As an additional consideration, we note the requirement that the party reporting a matter must not disclose that it has notified ASIC to any other person. Whilst the importance of preventing the tipping off of potential suspects is appreciated, then should the obligation be proceeded with despite our concerns, there should be an appropriate carve-out to enable matters to be reported to appropriate entities within the market participant's group. Typical reporting obligations within a group may require the reporting of matters which could involve suspicion of breaches of the law to management, legal and compliance, and risk management channels which may be located in other entities within the group including in offshore jurisdictions where regional and head office management may be located.

I1Q2 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

Please see answer to I1Q1 above. Assuming that market participants take the cautious approach to ensuring compliance with the expanded obligation, as envisaged, then significant costs will be incurred on an ongoing basis in reporting the level of data which members predict they will need to be reporting on daily basis.

I1Q4 Are transitional arrangements necessary? What are your views on what the transitional time period and arrangements should be?

Please see the answer to I1Q1 above. It is our submission that the obligation should not be adopted, and therefore that transitional arrangements should not be required.

I1Q5 Should this obligation apply to trading in non-equity market products (e.g. derivative markets)?

Please see the answer to I1Q1 above. It is our submission that he obligation should not be adopted, and therefore that it should not apply to non-equity products either.

I2Q1 Will market participants be able to categorise the originator of orders as proposed?

This proposal is a considerable undertaking which presents a number of logistical difficulties and would be costly to implement. This is not a Day 1 issue for introduction of multiple markets, and we submit that the issue should be delayed for further consideration of its practicality and relative cost benefit.

Changes to order management systems would be required, and data validation programs involving checking of orders against back office systems, where client identity data is largely held, would be required. The whole process of order transmission would be slowed down, all for the sake of assisting the monitoring of the small number of orders that may require regulatory oversight. This will undo some of the benefits of technological advances and high speed trading that are supposed to be the outcome of this process of change.

A mechanism for allocation of one identifier for each client would be required, otherwise, as clients can and routinely do , use multiple brokers, it would be pointless for ASIC's purposes if each broker issued their own identifier to the same entity.

Orders may be amalgamated, and there would need to be the ability for order management systems to capture data for multiple clients in that event. Information about the originator of the order may not necessarily provide adequate information about the person for whom the order was placed. The allocation of orders is sometimes not known at the time of the order and not determined until later in the day, so it may not be able to form part of the order at the time it is placed.

I2Q2 Will market participants be able to identify the IP address associated with the origin of an order?

Not all brokers capture the IP address associated with the origin of an order. For those that do not, there would need to be significant upgrades to systems and procedures, at significant cost to our Members to achieve this, which would again be a considerable undertaking. (see also, our answer to I2Q1)

I2Q3 Will market participants be able to provide an identifier for DEA channels and algorithms? I2Q3 Will market participants be able to provide an identifier for DEA channels and algorithms?

This requirement would add a further level of complexity and cost to the design of order management systems and DEA/algorithmic systems. Whether this information would be meaningful is not clear. For example, a VWAP engine would come within the definition of an algorithm, but whether it is of any relevance to require this to be

identified as part of an order record so as to justify the cost of capturing this information is highly questionable. Whilst a Market Participant might be in a position to attach an identifier to its own systems, it may not be able to do so for systems used by a client. As mentioned elsewhere in answers to CP 145, clients will be reluctant to disclose information relating to their own proprietary systems. Any requirement to attach identifiers would, to be effective, need to be imposed in clients direct.

I2Q4 Will market participants be able to provide a market participant-wide identifier? Is there benefit in providing this as an interim step or would it be preferable to move to a market-wide identifier?

Please see answer to I2Q1 above. It is difficult to envisage a mechanism whereby a range of market participants could coordinate the issue of identifiers to clients in a consistent manner and so that a client only received one identifier, particularly also as clients may not disclose to a market participant whether they are already using other brokers or if so, how many.

I2Q5 Is it appropriate to use the client's HIN or SRN for this purpose?

A HIN or SRN could be used, although this option may not always be available. A client might not necessarily have one at the time an order is placed. In some cases, a Participant may use a single HIN for multiple clients in an omnibus holding, such as in relation to margin lending.

I2Q6 What are your views on having a large trader identifier? What should the thresholds be?

We do not see any benefit in a larger trader identifier, and do not see the cost of designing and implementing such an identifier as justified.

I2Q8 What other additional types of data do you consider should be made available to ASIC to perform our function as a market supervisor?

In our view, the amount of information already accessible by ASIC is sufficient for it to effectively perform its function as market supervisor. The challenge for ASIC is to effectively use the information that it has. We do not believe that additional information is needed (except that which may be subsequently sought by way of further explanation or information gathering in the ordinary course under Notices to produce documents or statements once a suspicion has been formed). In fact, it would be questionable whether increasing the volume of order and trade data, particularly in the context of increasing liquidity and turnover, might not tend to cloud the effective monitoring of market activity.

I2Q9 Considering the additional data to be captured in order and trade reports, what will be the impact on the performance and capacity of your order management and trading systems?

Please see earlier answers in this section I2. The additional data will undoubtedly add to the complexity of systems and impact on their speed and performance.

I3Q1 What are your views on this proposal?

We support this proposal.

I4Q1 What are your views on this proposal?

We believe that the market is not articulating any need for this proposal. The demand for information about the level of short selling in the market appears to have been satisfied by daily net short position reporting regime which has been in operation for some time now. There has been no voice that the information being generated by this is inadequate for the market's needs, or that a measure such as that being proposed is needed to prevent market failure or to satisfy any information deficiency.

Given the comprehensive number and nature of the changes being proposed by CP 145, it is our submission that this Proposal should be deferred for later consideration or shelved completely.

I4Q2 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

The cost of introducing tagging of short sale orders will require IT systems changes in order to implement. System changes of this nature are costly.

I4Q3 Do you have views on whether this proposal is likely to impose any other additional costs or burdens on any class of stakeholder? Where possible, please identify the nature of the likely costs/burdens, quantify the estimated costs (including any assumptions and relevant data) and indicate whether such costs/burdens will be one-off or ongoing.

I4Q4 Are there any other practical implications?

Issues have been raised as to how to flag sell orders that are part short and part long. This is not an uncommon situation. There is the additional complication in the situation of amalgamated orders, where one seller is short and one long. There has been no

suggested method for addressing this other than to manually adjust the information after the event.

I4Q6 We do not expect that any manual adjustments or splitting of orders will be required. Do you agree?

Please see the answer to I4Q4 above. We are not aware of how orders identified in that answer are able to be dealt with other than by manual adjustment.

J. POST TRADE TRANSPARENCY

J2Q1 What will be the impact of requiring transactions done outside normal trading hours to be reported before any market opens?

This requirement reflects existing obligations on market participants to report off market trading, which works well. We support the continuation of these obligations.

J2Q3 Are the existing categories for block exceptions still appropriate? If not, why not? What is the impact of the delays on transparency?

This existing mechanism for facilitated block special crossings has worked well, and represents an appropriate balance between transparency and the benefits to the market overall of enabling facilitation of large orders with minimum price impact. We do not support any changes to the current mechanism or to thresholds for the present. It may be appropriate to schedule the thresholds for review at a later point in time, having regard to any changes to the market that may have occurred in the meantime.

J2Q6 Will compliance with this proposed obligation require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

Please see the answers to J1Q3 above.

J3Q1 Should crossing systems be uniquely identified on post-trade publications, to assist market participants and investors to locate liquidity?

We do not support such a requirement. It is not inconsistent with the rationale for removal of broker IDs to then reimpose a form if identification of the broker.

J3Q2 Is there value in publicly disclosing whether a trade was done on an agency or principal basis?

We do not support such a requirement. Identifying that a trade was done by a market participant as principal does not assist the market in that there is a wide variety of capacities for which the trade may have been executed e.g. hedging, arbitrage, market making, and facilitation. There is little to be gained from knowing this information, but conversely, there is a potential that a market participant may face risk by the market gaining knowledge that the participant might be exposed as a result of the trade. Such a requirement is inconsistent with the rationale behind the deferral of facilitated block special crossings discussed in J2Q3 above.

J3Q3 Is there value in publicly disclosing whether a trade was generated by a dark order?

Whilst it is possible that some may derive some value from such information, there is a high potential for this information to be wrongly interpreted, hence we do not support disclosure of this information.

J3Q4 Is there value in publicly disclosing whether at least one side of a trade was generated by an algorithm?

We do not support such a requirement. Algorithmic programs offer a number of advantages, including the ability to minimise execution costs e.g. VWAP tools, or the ability to close out price distortions e.g. arbitrage tools. In addition, algorithms may assist in being able to effectively identify and capture other profit opportunities in a way that could not be achieved by human action. A result of the operation of these algorithms is the liquidity that they bring to the market that may not otherwise exist. Public disclosure that an order or trade is algorithm-related may benefit parties who will then "game" or front-run the algorithm. This could effectively render the algorithms ineffective, and deprive the market of the benefits referred to. Whilst there is nothing wrong with trying to out-wit an algorithm, it is not a level playing field to require algorithms to identify themselves when other traders in the market may continue to trade anonymously.

J4Q1 Is it appropriate that the executing party be responsible for reporting of off-order book post-trade information, with the sellers as the default?

This is the logical outcome, and we are in support.

J5Q1 Are there any other activities that should not be reported?

There are no matters that we are able to identify at present.

K. CONSOLIDATED TRADE INFORMATION

K1Q1 Do you have views on the best way to implement a consolidated view of pre-trade and post-trade information in Australia?

The availability of consolidated pre-trade and post-trade information for equity market products is critical to the operation of a multi-market environment. The preferred outcome is for the information to be made available on a consolidated basis by multiple data vendors in competition, in order to ensure efficiency of service and price. A single vendor may be attractive in terms of simplicity, however the absence of confirmation would result in their being no competitive pressure to produce the most efficient information outcome for users.

K1Q2 After what time period should data be made available free of charge?

Information should be available on a basis that is not inferior to present arrangements. The current arrangements of information being freely available after approximately 20 minutes and Broker IDs becoming available after 3 days appears to work satisfactorily at present.

K1Q3 Will compliance with either option require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

It is difficult at this early stage to make other than general observations about this issue. Multiple consolidators should in theory provide the benefits of competition as to price, speed service levels which should assist with overall efficiency. It is difficult to quantify at this stage what changes would be needed to Participant systems and their likely cost, to accommodate changes to sources of consolidated market data.

K2Q1 Should market operators be able to profit from providing information to consolidators or should market operators be obligated to provide their most socially valuable information, such as top five best bids and offers, for no fee or at cost?

Widely available market information is central to the effective functioning of a multi market environment. It is critical that information be consolidated and made available as quickly as possible to the wider market, otherwise the market could potentially operate less efficiently than at present. For this reason, barriers to access to information must be kept to a minimum.

As market operators are commercial ventures, then it is difficult to disagree with the proposition that they should obtain a fair return for the sale of information. Information charges however must be fair and not operate to create an inefficient market. There needs to be an adequate mechanism for review of information charges to ensure productivity, competition and market efficiency considerations for the market overall are satisfied.

K2Q2 Should market operators be obligated to provide information to consolidators on an equivalent basis to that they provide to other information users, such as, for example, co-location proprietary traders?

See answer to K2Q1 above. There should not be any anti-competitive aspects to the provision of information to some users as compared to others. Information must be made available by a market operator at the same time to all parties.

K2Q3 Do you consider it would be appropriate for a market operator, either directly or by way of commercial association, to be an ASIC-approved consolidator, or the single provider of consolidated information? If so, what additional protections should be put in place to ensure that competition issues are addressed?

See the answers to K2Q1 and Q2 above. It is not a concern as to who the consolidator of information might be, so long as the competition and efficiency considerations are satisfied.

L. MARKET OPERATORS

L1Q1 Are there other components that we should consider, including in a cooperation protocol between market operators?

Other than as identified, no.

L1Q2 Should a market operator be required to provide information to other market operators for this purpose free of charge?

It is crucial to the operation of a multi-market environment that there be consistency and co-operation between market operators on key matters as to the operation of the markets. To achieve this, there needs to be an adequate protocol governing this cooperation, otherwise matters must be prescribed centrally by ASIC.

Market operators must be prevented from imposing any charge for the exchange of information that is relevant to cooperation between them, as opposed to commercial

information such as trade data, otherwise the integrity of the market overall may suffer.

L1Q3 Will compliance with the proposed protocol require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

This issue is unlikely to impact on market participants or their procedures or costs.

L1Q5 What is the impact, if any, of there being longer trading hours on a market other than the listing market (i.e. ASX)? This issue is discussed in REP 215, paragraphs 272–273.

It is preferable for markets to operate for the same time duration, as this would eliminate potential for misunderstanding by clients as to issues of best execution if only one market was open. These issues could be dealt with by suitable guidance by ASIC on best execution in this event. At some point, the extension of trading hours if sufficiently lengthened could generate the need for shift work, as there is a limit to how effectively staff, especially DTR's, can be expected to function under consistently stressful conditions. This would then occasion a quantum leap in resourcing and cost overheads, which may outweigh the benefits of the increase in trading hours.

Trading data has shown consistently over time that there is a concentration of liquidity around the opening and closing. It could eventuate that longer opening hours may simply move the timing of this, and increasing the length of the quieter periods in between, with little overall benefit.

L1Q6 What is the impact, if any, of new market operators having or not having an opening or closing auction? If new market operators have auctions, should they occur at the same time as those on ASX? This issue is discussed in REP 215, paragraphs 272–273.

The introduction of opening and closing auctions delivered a significant benefit in terms of the orderly setting of the price of products at the opening and closing, thereby managing potential market manipulation and issues of imbalance between supply and demand that could potentially lead to market distortion. For these reasons, we would regard it as important that all markets feature an opening and closing auction mechanism. It would not in our analysis be critical that all markets be open for the same hours, and therefore, the opening and closing auctions may occur at different times as a result.

L2Q1 Are there any practical problems with allowing the relevant market to assign the identifiers for new market participants? If so, would it be preferable to have a single entity responsible for this function? Is this something ASIC should undertake?

It is essential for the efficiency of a multi market system that single identifiers are used so far as is possible. This includes, but is not limited to, participant identifiers, issuers and quoted products. It is hard to see how a multi market environment could operate with any efficiency, and best execution and measured, if common identifiers are not used. At the very least, systems would be more difficult and costly to design, and more susceptible to error, if common identifiers are not used.

It follows that the identifiers must either be set centrally by one entity, or must be set by the relevant market, but if the latter approach is followed, there would need to be a clear and consistent methodology set down and followed by market operators for assigning an identifier, whether it be to a participant or to a traded product.

The Stockbrokers Association does not favour any particular approach, so long as the clarity and consistency is achieved. It follows also that there must be a protocol for cooperation between markets to ascertain that an identifier has not already been allocated by another market, and notifying each other market once identifiers are issued by a market.

L2Q2 Are there any other identifiers that should be standardised?

See answer to L2Q1 above.

L2Q3 Will compliance with the proposed obligations require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

See answer to L2Q1 above. Aside from the costs involved in transitioning to a multi market environment, there would not be any costs associated with this requirement. There would however be potential adverse cost burden if there was universal identifiers were not to be used.

L3Q1 Are there other sources besides the NMI that represent an accurate source from which to synchronise clocks?

The Stockbrokers Association is not in a position to make comment on an issue such as accuracy of time sources or what should be an appropriate unit of time measurement.

On the subject of time synchronisation generally, there is a significant risk of market disruption if markets do not synchronise their time clocks. There was a suggestion that this may have been a contributing factor in the May 6 Flash Crash. Inaccurate time stamps could lead to malfunctioning algorithms, or algorithms functioning properly but being "fooled" by stale or incorrect data. Identifying best execution across markets becomes problematic if consistent time cannot be measured.

L3Q2 What is an appropriate level of precision for the measurement of time? What is an appropriate level of 'allowable tolerance'? Should this be static or dynamic?

See answer to L3Q1 above.

L3Q3 Should market participants using co-location services provided by market operators be required to synchronise their clocks sooner than other participants to facilitate surveillance and investigations?

See answer to L3Q1 above.

L3Q4 What are the practical issues for market participants to synchronise their clocks?

See answer to L3Q1 above. For market participants to synchronise all of their time clocks together would no doubt be a task of considerable technical complexity and coordination, and potentially also cost. We would query why this would be needed, so long as the market operators themselves were synchronised.

L3Q5 Will compliance with the proposal require any changes to your systems or procedures? What are the likely costs of such changes (where possible, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing)? Are there likely to be any significant impediments to making these changes?

See answer to L3Q4 above.

L3Q6 Do you have views on whether the proposal is likely to impose any other additional costs or burdens on any class of stakeholder? Where possible, please identify the nature of the likely costs/burdens, quantify the estimated costs (including any assumptions and relevant data) and indicate whether such costs/burdens will be one-off or ongoing.

See answer to L3Q4 above.

L4Q1 Do you have any views on our proposed approach to harmonising tick sizes?

It is highly desirable that tick sizes be kept uniform across all markets. Uniform tick sizes are considered essential to enable identification of best execution across markets.

It was identified, on the other hand, that not allowing competition between markets as to tick sizes removed the potential for flexibility. One market might be quicker to react to market changes by adjusting tick sizes, and this could be beneficial to the market and also to the operator by attracting liquidity. It was also identified that problems could arise if the markets could not agree on standard quick sized, which highlighted the need for an adequate protocol on this matter.

L4Q2 Should we consider increasing the middle tier from ASX's current $2 to $20, as proposed by ASX?

Stockbrokers Association members have not articulated any strong demand for change to the middle tier of the tick size range. There may be benefits in achieving narrower price spread for this range of stocks, or more opportunity for price improvement trades.

This is an area which is not critical for Day 1 of the multi-market environment, and so could be deferred for further consideration.

L4Q3 Would it be preferable for tick sizes to be a function of price and trading volume? What are some of the practical challenges in implementing such an arrangement?

Please see answer to L4Q1 above.

L4Q4 What approach should we take to reviewing tick sizes?

Please see answer to L4Q1 above.

L5Q1 Should market operators have a specific obligation to not unreasonably prohibit, condition or limit access to a person for which the market was established?

The opening up of the market for exchange services to competition is predicated on principles of free market competition and the economic benefits by way of efficiency and increased services that should flow from such competition. It follows that there should not be any unreasonable restriction on access to services placed by any licensed market operator on any person. We presume that the Australian Trade Practices Act would require that this be the case, although we have not conducted a legal analysis on the question. For abundant clarity, a specific obligation to this effect would be beneficial.

L5Q2 Should market operators be required to offer all of their services on a transparent, fair and non-discriminatory basis by making the services available to all

market participants willing to pay for the services? Should the services also be available to non-participants (e.g. data/system vendors)? If so, on what basis?

The obligation to provide services on a fair and non-discriminatory basis should extend to all services. This particularly applies to market data, which is fundamental to the operation of a multimarket environment. There is a clear need for data to be available to all who require it, which will include data and system vendors, as well as brokers and clients of brokers and institutions as well.

L6Q1 Given the nature of the way markets are evolving to become more electronic, should there be a specific market integrity rule on market operators to have reasonable business continuity and disaster recovery plans, to conduct capacity stress tests, and to review the vulnerability of systems to internal and external threats?

We note that there exist a range of market integrity rules applicable to market participants, and which carry severe potential monetary penalties, which deal with obligations in relation to DEA/AOP trading systems operated by brokers. These include but are not limited to rules dealing with testing, business continuity, disaster recovery and IT security.

There is no logical reason why the obligations on market operators should be any less stringent, given that the whole market relies on these issues being satisfactorily managed. ASIC will no doubt have regard to these issues in considering whether a market operator has carried out its obligations as the holder of a market licence, and whether or not circumstances warrant any action being taken with respect to that licence, hence there already exist grounds on which a market operator will bear consequences for failure to properly manage these issues. Nevertheless, this does not meant that a specific market integrity rule should also not exist with respect to market operators, as it does with respect to market participants.

L6Q2 Should there be a specific market integrity rule on market operators relating to their responsibilities when relying on a third party for the performance of operational functions that are critical for the provision of continuous services?

For the same reasons as are set out in our answer to L6Q1 above, a specific market integrity rule relating to these matters could be justified. Otherwise, the objective of preventing trading during a market suspension is supported.

M. MARKET PARTICIPANTS – OTHER OBLIGATIONS

M1Q1 Do you have views on whether this proposal is likely to impose any additional costs or burdens on any class of stakeholder? Where possible, please identify the nature of the likely costs/burdens, quantify the estimated costs (including any assumptions and relevant data) and indicate whether such costs/burdens will be one-off or ongoing.

The Association supports this proposal. It is difficult to assess the likely additional cost burden, which would be likely to vary from party to party. We would be concerned if any significant cost increases were to result.

M2Q1 Do you agree that all trading in equity market products should stop during a trading market integrity halt or suspension, irrespective of where the trade is intended to take place?

There may be some difficulty in adequately defining what is a "market integrity halt or suspension", and distinguishing these in all cases.

M2Q2 Is it appropriate that this obligation would be limited to market participants or should it apply to all AFS licensees?

If such an obligation were to be introduced, then it would be anomalous to impose a trading halt only on market participants but leave other AFS licensees free to transact.

M3Q1 Do you agree that the existing requirements in the Corporations Act and Corporations Regulations, as well as the proposed market integrity rules, are sufficient to ensure trade confirmations disclose sufficient information to clients in a multimarket environment?

The existing MIR permitting aggregation of transactions into a single contract note has operated well. We are not aware of any criticisms about the operation of the MIR. Extending the operation of the MIR to permit aggregation of transactions across multiple markets is a logical extension of the rule, and we do not foresee that any issues will arise.

If a client wishes to obtain further information as to individual prices, then the proposed rule will enable a client to request it. It is difficult to predict before the event whether there is likely to be a greater frequency of clients requesting further information in the environment of multiple markets. There might be the potential that clients may want further information if there are significant price disparities between markets.

Responding to individual requests by clients wanting further information will have an impact on broker costs. However, if as we anticipate that prices on the main markets will remain close, then we would anticipate that there will not be a large level of requests for further information.

However, we do not support the requirement for there to be written authorisation for the ability to aggregate transactions. Obtaining written authorisation, particularly if client signatures are involved, is a costly process to administer. We strongly argue that this authorisation should be able to be obtained by electronic notification to clients, together with negative consent/implied consent by continuing to place orders.

M3Q2 Do you have views on whether this proposal is likely to impose any other costs or burdens on any class of stakeholder? Where possible, please identify the nature of the likely costs/burdens, quantify the estimated costs (including any assumptions and relevant data) and indicate whether such costs/burdens will be one-off or ongoing.

Please see answer to M3 Q1 above.

Thank-you once again for the opportunity to comment on these proposals, and for your willingness to discuss and clarify matters during the consultation period. We would be happy to discuss any issues relating to this matter at your convenience. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au .

Yours sincerely,

David W Horsfield
Managing Director/CEO