Stockbrokers
Association of Australia
Incorporating SDIA

13 May, 2013

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Australian Securities and Investments Commission
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By email: marketstructure@asic.gov.au

Dear Sir/Madam

ASIC CONSULTATION PAPER CP 202 – DARK LIQUIDITY AND HIGH FREQUENCY TRADING PROPOSALS
COMMENTS BY STOCKBROKERS ASSOCIATION OF AUSTRALIA

The Stockbrokers Association of Australia Limited ("the Stockbrokers Association") appreciates the opportunity to provide these comments on ASIC's Consultation Paper CP 202 and Report REP 331.

Set out below are some Preliminary Comments which are made before addressing the specific Questions set out in CP 202.

PRELIMINARY COMMENTS

The issues which are addressed in CP 202 include a number of key issues that have been dominating discussion in equities markets globally. They are the subject of review by regulators in multiple jurisdictions at the present time. The Stockbrokers Association acknowledges the complexities of the issues that ASIC has addressed, and that no easy or straightforward solution has so far been identified in any of the jurisdictions where those issues have been considered. Hence, the Association appreciates that ASIC has not faced an easy task in arriving at the proposals which are put forward for discussion

in CP 202. The Association also acknowledges that any solutions invariably involve the balancing of multiple, often directly competing, and considerations.

In October 2012, the Stockbrokers Association Board issued a position statement which, among other things called for more academic study into the issues that were the subject of market debate, including the impact of HFT on the Australian equities market. The Association commends ASIC for advancing the level of analysis of these issues further by carrying out the analysis of market data which forms the basis of the conclusions in REP 331 and CP 202.

The Association is not in a position to replicate the data analysis carried out by ASIC, and has no reason to doubt the accuracy of the analysis. However, the Association's comments and submissions set out below are necessarily based on an acceptance of the analysis at face value and are subject to the data and findings being correct.

On a final note, during the last five years, the stockbroking industry has been subjected to a huge amount of regulatory and structural change. Whilst this change has been driven by rapid developments in technology, by the introduction of competition in exchange services, and by responses to issues identified as a result of the global financial crises, all of which are factors which stockbrokers acknowledge and understand, nevertheless the sustained period of change has resulted in a considerable financial and resource costs burden being borne by stockbrokers, and to a large degree, a feeling of "change fatigue".

For this reason, the stockbroking industry urges ASIC to limit changes to those where the need is clear and the solution broadly agreed upon. Where it is not necessary to introduce a change at the present, we submit that it should be deferred until a more appropriate later point in time.

Similarly, if it is not clear that a solution being proposed is the right one, then we would submit that it should be the subject of further consideration. This is particularly important in the case of those proposals in CP 202 directed at issues which are directly being considered in other jurisdictions at the present time. It would be highly desirable for a common solution to be arrived at across global equities markets so far as is possible on many of these questions, and hence, implementing a decision in Australia prior to knowing the outcomes in other jurisdictions in our view is not ideal. Every new requirement or change carries a financial cost in implementing it, and the cost of implementing changes which might not prove to be the right one or which may need to be reversed or amended later, for whatever reason, will result in wasted costs in terms of time and money.

SPECIFIC QUESTIONS IN CONSULTATION PAPER

Dark Liquidity - Minimum Size Threshold Proposals

Feedback Questions

B1Q1 Do you agree that a safety net proposal like this is necessary?

B1Q2 Do you agree that the proposed triggers in Option B1.1 and Option B1.2 are appropriate indicators that there has been degradation in price formation?

B1Q3 Do you have a preference for either option? Please explain your rationale.
B1Q4 Are there any securities or group of securities for which it would be preferable to implement a minimum size threshold immediately (e.g. securities outside the S&P/ASX 300)? If so, which threshold should apply?

B1Q5 Do you have any views on the proposed implementation timeframe of 40 business days for the thresholds if triggered?

As a preliminary matter, Stockbrokers Association members have consistently expressed the view that not all dark trading should be considered in the same light. There are a number of forms of off-market trades that have been used for many years, are well understood by the market and do not pose any problems for market quality. These include block special crossings, portfolio special crossings, after-hours trades and overseas trades reported to an exchange in accordance pursuant to market rules.

In addition, on-exchange priority crossings were also long standing and well understood, and did not pose concerns to the market, in the view of our members, although it is noted that these crossings will soon disappear as a result of the introduction of the requirement for meaningful price improvement. The concerns of our members centre on the growth in volume of dark trading outside of these well understood categories, such as the growth of internalized crossings occurring within dark venues. Our members believe that regulatory measures should be directed to address this growth.

In the previous consultations conducted by ASIC on Equity Market Structure reform, the Stockbrokers Association has supported steps being taken to prevent excessive amounts of liquidity migrating from the lit markets to dark venues to the detriment of the quality of the lit exchanges. We note that ASIC's conclusions in REP 331 verify that price formation in the lit market is harmed where dark liquidity (outside of block trades) exceeds 10%, which is consistent with the Association's concerns.

The Association has also supported proposals to better regulate crossings networks than is currently the case. In a number of cases, such dark venues display the hallmarks of a market, particularly where a number of dark venues are "hooked up" and effectively operate in a

multilateral way. In cases such as these, there would be sound policy reasons to impose additional obligations which are relevant to the manner of operation of such venues in the same way as they are imposed on operators of licensed markets

We note ASIC's findings in respect of Dark Liquidity set out in ASIC REP 331 Section B1. We note ASIC has found that dark trading excluding block special crossings in the September quarter 2012 represented 14.5% of market turnover by value. However, we note that of this volume of turnover, 8.4% was due to priority crossings, and 2.6% was due to ASX Centre Point trades. We note at paragraph [94] that trading on broker crossing systems was found to be about 4% of turnover.

On the basis of these findings, the level of dark trading activity in venues that are "problematic" has probably not yet reached the point were it is a serious concern. We agree that a continuation of the growth of problematic dark trading will cause a concern at some point, however we note also that, based on recent developments in Canada, the likelihood is that the imminent introduction of the requirement for meaningful price improvement will most probably lead to a reduction in the volume of dark trading in the near term.

For these reasons, our members are of the view that it is not critical that the design of a dark pool trigger needs to be resolved at this point in time. We believe that this is one issue that can be deferred for the time being, having regard to our submissions in the Preliminary Comments above regarding the volume and cost of change that has been introduced in recent years, and limiting changes to those for which there is a clear and present need. Deferring the issue until after meaningful price improvement has been in operation will enable a better understanding of the impact of that change and of the resulting level of danger to the quality of the lit market, and may assist in deciding on what is the right regulatory solution.

We also note that there is a real potential for dark trading venues to be impacted by the outcome of the new requirements being proposed in Section D of CP 202, if they are proceeded with, and also by the outcome of the review of Australia's Market License Regime currently being conducted by Treasury. Depending on the outcome from these two fronts, there is the potential for the number of dark venues to decline, which could lead to a fall in the volume of dark trading (although on the other hand, it could also be that the same volume might be transacted but on fewer venues). This uncertainty is another reason why our members favour deferring the question of a dark trading trigger for the time being.

Subject to the above, as regards the two options proposed, members did not express any clear preference for either Option B1.1 or B1.2. We commend ASIC for endeavouring to come up with a tailored solution that is more focused on real measures of declining liquidity. Both Options proposed have the benefit of being targeted at securities that can be shown to have been adversely affected by dark activity on an objective measure only.

However, there was a general view that both Options involved measures that quite probably will be very complex to apply, and which may lead to difficulties in implementation. Option B1.2 attracted some support for being targeted only at those stocks impacted by dark liquidity according to the measures in the model. However, there were concerns about the complexity of keeping abreast of which stocks were subject to the threshold and which were not. For that reason, others preferred Option B1.1, given the familiarity with Categories for determining Block

Special Crossing thresholds. However, some concerns were expressed about stocks that were the subject of the threshold ceasing to be subject to a threshold, because they moved from one Category to another, and keeping track of all such movements.

Due to some of these complexities, there was a feeling that neither of the two alternative proposals represented the right solution. A number of members indicated that they would prefer the simplicity of simply imposing the dark liquidity threshold ($50000/$20000 for Category 1/2/3 stocks) straight away across all stocks (subject to an appropriate period of notice for implementation). That would at least remove any uncertainty as to whether a threshold did or did not apply or no longer applied.

Dark Liquidity - Proposals for Crossing System Providers

Feedback Questions

C1Q1 Are there any reasons that the proposed information should not be made public?
C1Q2 Is a website an appropriate publication means?
C1Q3 Is there additional information that market users should understand, or be informed of, about the handling and execution of orders through a crossing system?
C1Q4 An alternative to crossing system operators publishing the monthly aggregate turnover statistics in proposal C1 (h) is for ASIC to publish these statistics based on the reports we receive under Rule 4.3.2 (Competition). Do you have a preference for whether ASIC or crossing system operators should publish the statistics?
C1Q5 Would there be benefit in ASIC maintaining a register on our website of all crossing system operators with a link to each crossing system's website where the information in this proposal is disclosed?

Other than regarding the proposed requirement for monthly turnover statistics under C1(h), the Stockbrokers Association does not have any concerns about these proposals, nor any preference for any particular alternatives over others.

In relation to C1(h), members who operated crossing systems questioned the need for this requirement given that all trades were already required to be reported to an exchange, and that as a result, the information was readily identifiable on a broker by broker basis after T+3 through data vendors, such as IRESS. As the information was therefore already available to those investors likely to be interested in it, we question whether there is sufficient benefit in the additional requirement that would justify the expense of introducing it.

C2Q1 Do you have any comments on our proposed approach including whether this information should be made available only to a crossing system's users, or to wider market users?

We do not have any comments on this question.

C3Q1 If a market participant routes client orders to another market participant's crossing system (e.g. through an 'aggregator'), it is important for the market participant's client to also receive the information on the crossing systems its orders may be routed to. We have proposed a new rule to require this. Are there any alternative means to achieve this? One alternative is to require that all the matters in proposal C2 be made publicly available

The proposed new rule is a sensible one in our view.

C3Q2 Is six months sufficient time to amend disclosures for existing and new clients?

We do not have any comments on this question.

Feedback Questions

C4Q1 Do you agree that a client should be made aware when a market participant trades with the client as principal and when trades are executed on the crossing system?

C5Q1 Do you have any comments on our proposed approach?

C6Q1 Is there demand from clients to opt out of trading in a crossing system?
C6Q2 Should clients have the option to opt out of all forms of dark liquidity, including principal trading?
C6Q3 What is involved for crossing system operators to build the capacity for clients to opt out in this way?

C7Q1 What is involved for crossing system operators to undertake the proposed monitoring?
C7Q2 Is six months sufficient time to implement the changes?

C8Q1 Do you agree with our approach to capturing orders that rest or transit through a crossing system?
C8Q2 Will the proposed requirements for record keeping successfully enable the replay of orders in a crossing system at any point in time?

C9Q1 What processes do crossing system operators currently have in place to inform clients of system issues?
C9Q2 Is 60 minutes an appropriate time period to require a crossing system operator to inform its users and ASIC that there is an issue that may materially interfere with the execution of orders in the crossing system?

Other than as set out below, the Stockbrokers Association generally supports the proposal for additional requirements for operators of crossing systems. Appropriate additional safeguards and transparency may assist many investors in obtaining a level of comfort about the way in which crossing systems are operated.

As noted earlier, this area is subject to the outcome of Treasury's review of the Market License regime. It is therefore yet to be determined how crossings systems will be treated under any revision of that regime, or the extent to which additional obligations will flow if crossing systems are regulated under a licensing category within that regime. Therefore, to some extent, these proposals could be overtaken by developments on that front.

Having said that, the Association has supported an appropriate level of regulation to be applied to venues which demonstrate market-like behaviour. In general, the proposals put forward in this section are appropriate in the view of our members.

In regard to C4Q1 above, the existing rules contain disclosure obligations by a licensee to a client prior to dealing with the client as principal, together with disclosure requirements in contract notes. These obligations ought to be sufficient to deal with this issue.

The additional requirement to notify clients in a contract note as to which trades are executed in a crossing system would logistically be a problem of a very tall order. Contract notes are generated by back office systems such as GBST, which will not have the information required to be able to satisfy such a requirement. Stock bought or sold in transactions whether on market or through crossings will frequently be allocated between clients according to a broker's allocation policy, and it would be extremely complex task to be required to dissect trades and trace fills in order to be able to make such a statement in a contract.

As regards C6, clients are free to specify how their orders are transacted, and we would have no objection to clients having the option to opt out of their orders being dealt with in a crossing system.

We question whether there should be any formalized rules regarding clients having the option to opt out of "…**all** forms of dark liquidity, including principal trading…" as suggested in the proposal.

Firstly, as we have mentioned previously, there are forms of dark trading, such as late trading and on-market crossings, which are well understood and do not warrant being the subject of formal rules as foreshadowed. In the same vein, the rules governing Centre Point are well understood, and we have not detected a level of concern about this venue.

These areas can safely be left to be dealt with as between broker and client as is currently the case, without the need for additional regulation to support any "opt-out" requirements to be put in place in relation to them.
Secondly, principal trading is not one and the same thing as dark liquidity, and trades as principal may be transacted in the lit market. The two issues should not be confused, and there are already rules relating to market participants trading with clients as principal.

In our submission, any formal rule should be limited to dealing with having the right to "opt out" from orders being transacted on crossing networks if they so choose.

Dark Liquidity - Other Proposals

Tick Sizes

Feedback Questions

D1Q1 Do you agree that tick sizes are constraining some security prices and that this may be leading to more trading shifting to the dark?
D1Q2 Do you agree that we should target the most affected securities rather than a complete overhaul of the tick size regime?
D1Q3 Do you have a preference for Option D1.1 or Option D1.2? Is there an alternative model we should consider?
D1Q4 Is a pilot desirable and is six months sufficient time to introduce it?

The Association agrees that there are a number of securities that are "tick constrained" as defined in CP 202. Members were not prepared to form conclusions about whether this had the tendency to lead to more trading shifting to dark venues. There were many other factors at play which determined the migration of trading to dark venues which are unconnected with tick sizes.

It may be that there is a tendency for more trading to occur in the Centre Point market where securities are tick constrained, which by definition is dark trading, however as mentioned earlier, our members understood the rules governing this market and did not have a concern about that form of dark trading.

Members felt that reducing tick sizes might be a worthwhile step if it increased liquidity in the lit markets. It was generally felt that narrowing tick sizes should lead to in increase in activity. However, there was not any strong feeling that the proposed changes needed to be made at this point. In view of our submissions under the Preliminary Comments above, there was a mood that such changes should be deferred to a later time.

There were mixed views expressed as to whether changes to tick sizes might have an undesired effect of generating an increase in HFT trading. Some members were of the opinion that reducing tick sizes would lead to more HFT activity, which is not an objective to be encouraged in view of the current market debate about the subject. Some members on the other hand were of the view that narrowing the tick size could reduce the size of HFT profit opportunities across the trading spread, and hence would lead to a reduction in HFT activity.

Members were of the view that the purpose of changing tick sizes should be in order to encourage liquidity and price formation in the lit markets, and not for ulterior motives

of impacting on the level of HFT activity. However the uncertainty about the potential for such changes to lead to more HFT in the current environment did not help in reaching consensus that there was a need to introduce changes at this time.

Consistent with the lack of a pressing need for making the change, there was no strong preference expressed by members overall for either Option D1.1 or Option D1.2. Some members supported D1.1 on the basis that it was far more straightforward and less complex to introduce one tick size for all stocks in the category, rather than for participants to have to constantly familiarise themselves as to which stocks had a reduced tick size and which did not.

As regards D1Q4, a six month introduction period would be sufficient so long as it did not include December-January, which is a customary IT change-freeze period for a large number of market participants. The introductory period should be extended by the length of any period of overlap over those months, if that is the case.

Course of Sales Disclosure (T+3)

Feedback Questions

D2Q1 Should the proposed rule permit market participants to elect for their participant identifiers to be excluded from these reports when those market participants trade exclusively as principal (i.e. not on behalf of clients)?
D2Q2 Do you agree that there is benefit in disclosing the particular crossing system where a trade has been matched?

The Association supports the proposal and agrees with D2Q2 above. The market participant identifier should not be excluded from these reports.

Conflicts of Interest

Feedback Questions

D3Q1 Do you have any comments on the proposed new and amended rules, or the time frame for commencement of these rules?
D3Q2 Are there any other rule amendments or proposals we should consider for conflicts of interest?
D3Q3 Do you have any comments on the proposal to supplement our guidance in RG 181?

The Association considers the drafting of the proposed amendments to be problematic.

The introduction of (h) in the form in which it is drafted raises confusion as to how it interacts with the other paragraphs of 5.1.4. The whole purpose of MIR 5.1.4 was to move away from the previous black letter obligation to give preference to a client order at the same price in every case, and to introduce the concept of "dealing fairly and in due turn", which envisaged certain circumstances and factors where it would be fair and orderly to deal with orders notwithstanding that a client order on the same terms might not be given priority. For example, orders entered without delay and in the sequence in which they are received (parag. (b)), orders entered by the client via DMA without knowledge of the Participant, etc.

In our view, it is not clear whether the intention behind inserting new paragraph (h) was to list this as one factor to take into account in making the assessment, but not necessarily the overwhelming factor. However, the drafting of (h) gives rise to the interpretation, on one reading, that a market participant does not deal fairly and in due turn if it does not give the client order priority in every instance, which negates many of the other existing paragraphs in 5.1.4(1).

Therefore we submit that (h) should be qualified by words such as "unless otherwise permitted" or some such wording.

As regards the proposed paragraph (i), it is not clear how this is relevant to the concept of dealing fairly and in due turn with client orders. If two client orders on opposing sides of the market could have crossed, then interposing a principal order for the market participant on the other side of each client could well raise questions of potential market manipulation, by causing the appearance of increased trading and/or increased turnover for that participant. However, it does not seem to us to be relevant to the question of dealing fairly and in due turn with the two client orders, which are on the opposite sides of the market, except perhaps if there was a significant timing delay between the two legs being executed. Therefore, it seems odd to place (i) in this Rule.

We submit that proposed paragraph (i) might sit better in MIR 5.7.2 dealing with market manipulation and/or in the proposed guidance on market manipulation foreshadowed in CP 202.

Payment for Order Flow

Feedback Questions

D4Q1 Do you agree that direct cash payments and cash rebates should be prohibited?
D4Q2 How would the prohibition of direct cash payments and cash rebates affect commission-based incentives (i.e. commission sharing or commission recapture arrangements) currently used in the industry?

D4Q3 Commission-based incentives may raise similar issues to direct cash payments and cash rebates. How prevalent are commission-based incentives and should they also be specifically prohibited?
D4Q4 Do you agree that soft dollar incentives should be treated differently to direct cash payments?

The Association agrees that cash payments and cash rebates for order flow should be prohibited.

The Association does not support a prohibition that would prevent brokers offering differential brokerage rates according to the volume of business provided by a client. It is a standard aspect of the carrying on of any business to offer discounts for customers who provide more business, and this should not be construed as a "payment". The key consideration is that the lower rate of brokerage results in a lower transaction cost which benefits the end client, and is not a payment of cash to any broker or intermediary directing the order flow.

There are sound reasons for some soft dollar benefits to be provided, for example, trading hardware and software, etc. This is a subject which should be treated separately and in soft dollar benefit policies and guidance generally.

Indications of Interest

Feedback Questions

D5Q1 Should market participants be required to disclose whether a proposed order is on behalf of a client or as principal (including for a related body corporate)? What controls should be in place to ensure there is appropriate representation about the nature of liquidity?
D5Q2 If a market participant discloses that a proposed order is a client order, should such disclosure only be permitted when the market participant has received a client order? Or are there instances in which a client would not want to place an order with a market participant, but would want the market participant to send an indication of interest?
D5Q3 Should market participants be required to obtain client consent for: (a) using indications of interest in relation to the client's order(s); and
(b) disclosing in the indication of interest that it is in relation to a client order?

Many Association members felt that abuse of indications of interest was self-limiting to a significant extent. If brokers were considered to have been abusing IOIs, clients would quickly work this out and brokers would be "binned" by the client(s). Hence, it was felt that additional prescriptive regulation dealing with IOIs was not needed, and that the best way to deal with the subject of IOIs was through the issuance of ASIC Guidance. We note that regulators such as FINRA have dealt with IOIs through Guidance Notes.

Some members did believe that there was a real potential for IOIs to be regarded as fictitious by many clients, and therefore some further regulation was called for.

The Association notes the potential for liability under a number of existing Corporations Act provisions dealing with false, misleading or deceptive statements and conduct with respect to securities that may be applicable if a market participant represented that they had potential client flow which was not in fact true. The majority of members therefore considered that there was already some significant enforcement tools available to ASIC to deal with misrepresentation of fact in the area of IOIs, and that the preferable approach at first instance would be to issue better guidance and back this up with greater use of existing tools.

There may be instances where clients may quite legitimately wish to test for potential trading interest on the other side prior to placing an actual order, and provided that the broker was so engaged, this would not be inappropriate.

Members did not see any reason for an additional requirement that a participant disclose whether a proposed order is on behalf of client or as principal. The existing requirements for principal disclosure to clients prior to trading with them were thought to be sufficient regulation in this area.

High Frequency Trading

Feedback Questions

E1Q1 Do you agree that we should discourage small and fleeting orders? If not, why not?
1Q2 Do you agree with the minimum resting time of 500 milliseconds for small orders before any amendment or cancellation can occur? If not, why not?

E1Q3 Do you think the proposed sizes for a 'small order' is appropriate, or too small or too large?

E1Q4 Do you think there is a better way to address excessive small and fleeting order messages and trades in the Australian market?
E1Q5 Do you think any category of market participant should be exempted from this proposal? If so, describe the impact the proposal may have on these market participants.
E1Q6 Does the six-month period for commencement of these rules allow sufficient time to make the appropriate system changes?

Stockbrokers Association members have provided strong feedback that there is a growing and undesirable pattern of orders in small size, and to an unacceptable degree, being placed and cancelled at high speed. This has generated a level of market noise which is very confusing and which in many instances interferes with the ability to fill orders efficiently. Many members have reported that liquidity can be illusory, and can disappear before there is a chance to execute against it.

Having said this, the difficult question is what, if any, effective measure exists that would address market concerns. The general view of Association members is that ASIC's proposed minimum resting period of 500 milliseconds for orders < $500 is not likely to be achieve these objectives, and therefore, does not warrant being adopted at this stage.

We understand why ASIC has put forward the proposal, and we also note that the concept of a minimum resting period of 500 milliseconds has gained some support in the policy debate currently under way in other jurisdictions, particularly in Europe. As mentioned previously, there is merit in regulatory settings on issues such as this being standardised across jurisdictions as far as possible. However, we note that there is increasing commentary in other jurisdictions as well questioning the likely effectiveness of a minimum resting period, which accords with Stockbrokers Association members' views.

Our members felt that ASIC's proposal could easily be circumvented by algorithms being set so as to avoid the limit e.g. order size of $501. Members also believe that the requirement would be difficult and expensive to configure in their systems.

We note that management of the minimum resting period is to be placed on brokers, and not at the exchange level. Hence, compliance will require each participant to make changes potentially to multiple trading systems. The cost impact of such a requirement would be better managed if implementation were to occur once within the trading systems of each exchange/trading venue. In any case, in the absence of a strong case as to the effectiveness of the proposal, we submit that the costs outweigh the benefits and the proposal is not justified.

In addition to the cost impact of this proposal, there was a real risk that a minimum resting period would impact adversely on a number of classes of trader who might have a legitimate need to amend orders within the 500 millisecond time frame. For example market makers, such as in Exchange Traded Options, who had a need to re-price orders according to price moves in the underlying, and arbitrage traders, who similarly would need the ability to rapidly amend orders, could potentially be financially impacted by the proposal. These classes of trading are beneficial to the market.

Whilst a 500 millisecond period sounds extremely short, it is nevertheless long enough to provide other traders with a significant advantage in order to target or to "game" legitimate market makers. If a resting period were to be imposed, then at the very least there would need to be a carve out for market makers in order to provide them with some protection from predatory behaviour.

Stockbrokers Association members believe that a better way to address the issue of small fleeting orders, at least initially, would be through a combination of the following measures:

1. More robust application of the existing market manipulation laws and market misconduct Market Integrity Rules against orders in respect of which there was no genuine intention to trade.

2. More detailed guidance from ASIC in relation to small fleeting orders. In particular, we note that IIROC in Canada has issues guidance in recent times on the topic, and has expressly stated that it regards "pinging" of orders as market misconduct. The Association believes that such Guidance from ASIC would have an impact on market behaviour.

3. Financial disincentives for Order to Trade ratios which are considered excessive would work more effectively than black letter prescriptions. Indeed, the cost recovery levy that has been imposed in Australia may already have had a sufficient desired effect.

In addition to the above measures, there was a view expressed by a number of brokers that the growth in small fleeting orders, predatory orders and other such forms of activity detrimental to market quality and market confidence would be reversed if the market was to re-embrace the publication of broker IDs in the live market.

There was a view that the ability to engage in these forms of order placement has flourished in the anonymous market, and to a large extent, the market would self-police such behaviour if participants ceased to be anonymous. However, unsurprisingly, other brokers did not support a return to the display of broker IDs.

We note that recently, the ASX raised the possibility of a pilot exercise in reintroducing broker IDs for stocks outside the ASX 300 as one means of facilitating liquidity in that sector. A trial of displayed IDs could be used to ascertain the impact on small fleeting orders as well.

Feedback Questions

E2Q1 Do you have any comments on our proposed guidance?
E2Q2 Do you think there is a need to address order-to-trade ratios in the Australian market?

We refer to the Submissions under E1 above.

At this stage, as found by ASIC, order to trade ratios do not appear to have reached the same level as US and Europe, so there is not a pressing need to address them per se. Rather, it is the issue of order placement and cancellation for non-genuine reasons that warrants attention. A high order to trade ratio could be important as a potential indicator of non-genuine order placement, however it could also be consistent with genuine order placement as well. As we mentioned in E1 above, an order to trade ratio could be high for valid reasons not connected to manipulation In addition, market misconduct may also occur in the absence of a high ratio.

Hence any guidance to on order to trade ratios needs to be balanced. Guidance should not be such that the ratio is given elevated significance on its own, leading to participants facing potential regulatory action on the basis merely of a high ratio alone.

The question of order-to-trade ratios could merit consideration in the context of the 3 measures that we put forward in E1 above as an alternative strategy for dealing with small fleeting orders to the minimum resting period proposal. Any guidance would of necessity be kept general, and placed in the context of being one possible contributing factor in assessing market misconduct.

Feedback Questions

E3Q1 Do you consider that removing 'materiality' from circumstance of the order will have a negative or positive impact on compliance and enforcement with the rule? Please explain your rationale.
E3Q2 Do you consider the proposed additional circumstances of order adequately cover those which should be considered by a market participant when assessing whether an order or orders are manipulative? Are there additional circumstances that should be included?

Our members believe that replacing the term "materiality" with "impact" is not a positive step. The latter term is not particularly clear or well understood. Every bid or offer or trade will have an impact on the market - the market is the culmination of all such events, and of the price signals created by each such event. Hence, to be required under the rule to consider the "impact" of the order does not in our view assist or make clearer the test of what is or is not an order which can be safely accepted for execution. In our view, there is nothing wrong with the existing wording, which has stood the test of time.

In our view, there is nothing wrong with the Corporations Act Market Manipulation provisions or with MIR 5.7.1. In our view, MIR 5.7.1 (formerly ASX MR 13.4.1) should be the substantive offence. MR 13.4.2 (which is now ASIC MIR 5.7.2) originated more as an explanation or an amplification of the list of circumstances that needed to be considered by a broker in determining whether or not they satisfied MR 13.4.1.

What now appears to be happening is that the ASIC MIRs are in the process of elevating the facilitative provision (5.7.2) into being of more importance than the main provision, especially as there is now a $1 million fine specified at the end of MIR 5.7.2 for breach of that sub-Rule, the same fine as is imposed for breach of MIR 5.7.1. By adding further paragraphs to 5.7.2, which is now being proposed by CP 202, this in our view is simply creating a series of extra sources of potential regulatory action against brokers, with a low threshold for proving liability, even in the absence of any market misconduct.

We submit that MIRs 5.7.1 and 5.7.2 should be reviewed so that the latter operates in conjunction with the former, and not as a regulatory sword on its own. Only in that event would it be a fair thing to add additional matters for order takers to give consideration to in assessing the appropriateness of an order.

E3Q3 Do you think it is appropriate to align the rules on market manipulation for the futures and equities markets? Do you consider that one or more aspects of the current Part 5.7 (ASX) and (Chi-X) on manipulative trading do not apply to the derivatives markets and trading? Are there other circumstances that should be included that specifically apply to the futures market?

The Corporations Act provisions dealing with market manipulation were harmonized some years ago so that they now apply to all financial products, including but not limited to securities, futures and other derivatives.

The fact that the corresponding Market Integrity Rules for the equities exchanges are not aligned with those of the ASX 24 market on this subject is entirely a historical anomaly, and there is good reason to harmonise those rules now as far as possible.

The rules of the ASX 24 market are generally more brief and limited in their drafting than the equities MIRs, and therefore using the equities MIRs as the model for new provisions in the ASX 24 market is the logical course in our view.

It is not clear from the Draft Amendments to the ASX 24 Market Integrity Rule in the Attachments to CP 202 whether existing MIR 3.1.3 is to be deleted. This is the rule prohibiting the placing of an order for a futures contract where there is no intention to trade. Whilst such an order would in our view amount to manipulative conduct in any event, even in the absence of an express rule to that effect, it is an anomaly that there is no equivalent rule expressly set out in the equities MIRs. There is no reason in our view for the harmonization of the rules between the equities and ASX24 markets to not result in the inclusion of such a rule in the ASX and Chi-X MIRs as well. It would certainly be in keeping with, and greatly strengthen, the guidance we have suggested above in relation to issues such as “pinging”.

E3Q4 Do you agree with our proposal to issue guidance on the trading behaviour considered to be market misconduct? If not, why not? What other examples, if any, should be included in our guidance, and why?

We refer to our submissions under E1 above. As mentioned there, the issue of "pinging" is one where Guidance from ASIC along the lines of that issued by IIROC would be beneficial. Previous Guidance Notes by ASX were regarded as being helpful, and the updating of this Guidance by ASIC would be appropriate.

Guidance is always subject to the fact that the offences in the Corporations Act are matters of legal construction, and ultimately ones for the Courts to determine. Hence, ASIC Guidance is simply that.

Nevertheless, Guidance on such issues is viewed with great importance by the market, and could, assuming it is soundly reasoned, contribute towards certainty and also provide leadership to the market in terms of what may be regarded as appropriate behaviour as regards the placement of orders generally.

We would be happy to discuss any issues arising from our submissions on this issue. 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