Stockbrokers
Association of Australia
Incorporating SDIA

Consultation Paper 222: Reducing red tape - Proposed amendments to the market integrity rules

Submission

9 October 2014

The Stockbrokers Association of Australia would like to make the following comments on the proposals contained in ASIC Consultation Paper 222 *Reducing red tape - Proposed amendments to the market integrity rules* **(CP222)**.

Firstly, we would like to emphasise that our Members welcome the removal of red tape and streamlining of rules, especially where such rules serve no meaningful purpose.

In this Submission, after commenting on the background to the proposals (**Part A**) we address the specific areas for reform of the market integrity rules set out in the Consultation Paper, namely those rules which cover professional indemnity insurance (**Part B**), business connections (**Part C**) and trading prohibitions during takeovers, schemes of arrangement, and buybacks (**Part D**).

As you will see, in summary there is unqualified support for the first two proposals (Parts B&C), and qualified support for the removal of trading restrictions (Part D).

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Part A. Background to the Proposals

We have previously commended ASIC for its management of the transfer of market supervision from ASX to ASIC in 2010. Part of the transition involved transferring rules from *ASX Market Rules* to *ASIC Market Integrity Rules (ASX Market)* ('**MIRs**'), with as few changes as possible, sometimes only as to numbering. While this certainly made for a smooth transition, it meant that certain archaic and unnecessary ASX rules became ASIC market integrity rules. Most of these 'legacy' issues remain.

The Association has previously completed a project to identify rules which a) could be removed or streamlined; and b) instances of duplication where the ASIC rule could be removed if it were adequately handled through other provisions, like those in the *Corporations Act*.

As we noted in submissions to Treasury and ASIC in the lead-up to the transfer of market supervision in 2010, duplication and/or inconsistency had existed between the *Corporations Act* and ASX rules for many years[1]. We note that ASIC has commenced a project to achieve harmonisation of similar requirements under the *Corporations Act* and the market integrity rules. We also note the need for harmonisation in areas such as –

Subject	**Corporations Act**	**MIR**
Client Order Priority	s991B	Pt 5.1
Confirmations	s1017F	Pt 3.4
Financial Records & Audit	Pt 7.8 Div 6	Rule 4.2.1 etc.
Insurance/compensation	s912B	Rule 2.2
Managed Discretionary Accounts	ASIC CO04/194; PS179	Rule 3.3.2
Principal Trading	s991E; Regs 7.8.20, 7.9.63B(4)	Pt 3.2
Responsible Manager/Executive		Pt 2.1
Staff Trading	s991F	Pt 5.4
Trading Records	s988E; Reg 7.8.11	Pt 4.1
Trust Accounts	s981C; Reg 7.8.01&02	Pt 3.5

We are pleased to see that, while it was delayed by work on the market structure changes of 2013, the ASIC harmonisation project is now proceeding.

Part B. Professional Indemnity Insurance (MIR Pt.2.2)

In CP222, ASIC proposes to remove the market integrity rules for participants of the various markets which require participants to notify details of their professional indemnity insurance and to lodge a copy of the certificate of currency of the insurance on an annual basis.

[1] For example, our Submissions to Treasury on the *Corporate and Financial Services Regulation Review* dated 18 May 2006 and the *Market Supervision Changes Consultation Paper and Bill* dated 23 December 2009

Under ASIC's proposal, the requirement to maintain professional indemnity insurance that is adequate - having regard to the nature, extent and risks of their business – will continue, as will the requirement to lodge details of claims.

The substantive obligations to maintain adequate insurance and notify claims or possible claims will therefore remain. The only change will be to remove the lodgment of details and renewal of insurance cover.

These matters are merely administrative in nature, and their removal would have no threat to investor protection. Moreover, their removal will mean that the time and expense of notifying ASIC of the initial cover, and thereafter ensuring that every year a cover note (or equivalent) is sent to ASIC, will be saved. While only a modest amount, our Members support any removal of regulation that will save them time and expense, especially where there is no risk to clients in so doing.

We therefore support this proposal.

Note re ASX Rules: We note that Members that are ASX clearing participants would still be required to make the notifications to ASX Clear that ASIC is now proposing to remove[2]. It would be positive for the industry if **ASX** were to consider a consequential amendment to its rules along the lines of the ASIC proposals.

Part C. Business Connection Rules (MIR Pt.5.2)

Our Members support the changes proposed in Part C, which would remove the need to obtain ASIC consent for the establishment of business connections between market participants.

The rules serve no meaningful purpose. Since 1 January 2005, all AFS Licensees have had a statutory obligation to manage conflicts of interest[3]. For retail clients, business connections are also disclosed in the Financial Services Guide. With the addition of new market integrity rules from 2013 which require disclosure of trading venues, crossing systems and principal transactions, the positive obligation to obtain ASIC approval for business connections could be said to be redundant and of no benefit to any party.

We therefore support this proposal.

Note re ASX Rules: This rule was formerly an ASX rule[4] which became an ASIC market integrity rule in 2010. We note that there remain other ASX rules which still require ASX permission in certain situations. For example, the settlement rules for the bulk transfer of Holder Identification Numbers still require ASX permission before the relevant consent letter is sent to

[2] see *ASX Clear Rule* 4.3.1(c) & 4.3.1(d)
[3] *Corporations Act* s912A(1)(aa); ASIC Regulatory Guide 181: *Licensing: Managing conflicts of interest*
[4] *ASX Market Rule* 4.7

clients[5]. As noted above in relation to the PI Insurance rules, it is hoped that in the same spirit of deregulation and red tape removal, **ASX** may also consider examining its rules for potential improvements as ASIC is now doing.

Part D. Prohibition on certain transactions during takeovers, schemes of arrangement and buy-backs

We are pleased that ASIC considering the appropriateness of market integrity rules covering trading in stocks subject to takeovers, schemes or buy-backs. Since the primary source for regulation of these areas is Chapter 6 the *Corporations Act*, not the market integrity rules, it is useful to ask: *should the market integrity rules apply at all*?

There remains great uncertainty in several areas, especially since the advent of multiple markets in ASX-listed securities, and the further changes in market structure since May 2013. Apparently, the ASIC Market Supervision Department receives many queries from brokers in relation to the proper conduct of trading during takeovers and other corporate transactions. Queries and uncertainty have increased since the May 13 changes which have reduced the thresholds for Special Crossings and effectively mean that NBBO (e.g. Centrepoint) crossings are treated like Specials Crossings. This has led to varying approaches to trading by market participants. ASIC Market Supervision sees this as an anomaly and would like to remove the uncertainty and inconsistency. Reverting to the *Corporations Act* would to a great extent achieve this, but the full impact needs to be assessed.

This is a difficult and technical area and it is difficult to present an 'industry consensus' view. We gather that even within the Commission opinions vary as to whether the proposals in Part D ought to proceed.

Similarly, there is some divergence of opinion in the industry as to the proposals. There is a view among Operators (DTRs) who face the practical implications of the rules every day, that where control of a company may change, as much trading as possible ought to be conducted in the 'lit market' i.e. with pre-trade transparency. According to this view, trading should only be possible in normal trading hours with no late or after hours trading permitted. There are also some who would prefer to retain the additional protections offered by the market integrity rules. However, there are those who see the benefit of removing the market integrity rules in this area as proposed by ASIC.

Obviously, the changes would mostly affect the larger firms which are most active in takeovers and changes of control, especially those which operate overnight desks.

Problems arise particularly where brokers deal for **overseas clients**. If such a client wants to deal their stock after hours in accordance with normal practice and the stock is under takeover

[5] *ASX Settlement Rule* 5.8

the trade often gets caught by the special crossing definition and the client effectively cannot trade in an efficient manner. Clarification either way on the rules would be much appreciated by the industry. Some of our Members have noted that it is obvious that some firms are reporting such transactions in 'inventive ways' (such as breaking the trade up into several small reports) to get around the restrictive rules. The current situation is undesirable and may reflect badly on the market as a whole.

Members agree with the Commission's view of the intention of the prohibitions on trading during a takeover bid or scheme:

> 72 *The effect of Parts 6.4 and 6.5 (ASX), (Chi-X) and (APX) is that market participants that do not act on behalf of the bidder or associate are prevented from transacting in large crossings of stock. This has caused disruption to market participants in their day-to-day business. We do not believe the original policy considerations for this prohibition extend to market participants that are not acting on behalf of the bidder or an associate.* (CP222.72)

It is understandable that the prohibitions on certain off-market transactions like Special Crossings should be targeted at those brokers who are acting for the takeover bidder or an associate. However, the question has also been raised as to whether this may give an advantage to **non-associated bidders**, who can accumulate significant holdings without prior disclosure to the market.

On balance, Members prefer the removal of regulation, provided it does not have adverse consequences for the Market.

Indeed, if areas of Commission's market regulation could be reduced, with a corresponding reduction in demand for its resources, then it could be expected that a **reduction in market supervision fees** for our Members could follow, without sacrificing market integrity.

Thank-you for the opportunity to comment on the proposed changes to the market integrity rules. Thank-you also for making senior officers available to meet with us and our Members to discuss the proposals on several occasions, which is very much appreciated.

We would be happy to discuss these matters further at your convenience. Should you require any further information, please contact me, or Doug Clark, Policy Executive on dclark@stockbrokers.org.au .

Yours sincerely,

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