

MEMO# 27600

September 30, 2013

ASIC Releases New Rules on Dark Liquidity and High Frequency Trading

[27600]

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TO: ICI GLOBAL TRADING & MARKET STRUCTURE COMMITTEE No. 2-13
EQUITY MARKETS ADVISORY COMMITTEE No. 21-13 RE: ASIC RELEASES NEW RULES ON
DARK LIQUIDITY AND HIGH FREQUENCY TRADING

On August 12, 2013, the Australian Securities & Investments Commission (“ASIC”) released new market integrity rules on dark liquidity and high frequency trading, as well as guidance on the rules that clarifies ASIC’s expectations of market operators and participants. [\[1\]](#) The rules follow a public consultation on these issues by ASIC, on which ICI and ICI Global commented. [\[2\]](#) ASIC initially adopted market integrity rules that are common to markets trading in equity market products admitted to quotation on ASX to deal with issues relating to the introduction of competition between exchange markets in 2011. To further mitigate issues that arise as a result of multiple exchange markets and crossing systems, ASIC has adopted these new market integrity rules in relation to crossing systems in products able to be traded on the ASX, ASX 24 and Chi-X markets. The rule changes become effective in stages over the following nine months.

Described below are the key changes that were adopted in August 2013.

Dark Liquidity

Crossing System Transparency and Disclosure

Recognizing that the information currently made available by crossing system operators to the market varies greatly in its details and that it is not necessarily provided in a timely or consistent manner, ASIC adopted new requirements regarding transparency and disclosure. In our comment letter, ICI and ICI Global generally expressed support for the proposed disclosure changes, explaining that it is critical for users and prospective users to be informed of how their orders may be handled and executed.

ASIC adopted the following changes:

- From November 10, 2103, crossing system operators must publish on a website information about their crossing system (e.g., products traded, the criteria used to

determine eligibility to use the crossing system, and aggregation and other crossing systems).

- From February 10, 2014, crossing system operators must make disclosures to clients on the operation of the crossing system, including information about user obligations, order types, crossing system operations, and fees.
- Beginning May 9, 2014, crossing system operators must identify in trade information for wholesale clients the crossing system and whether they traded as principal.
- Beginning March 10, 2014, crossing systems will be identified in course of sale reports.

Crossing System Fair Treatment

To ensure that users are treated in a fair and impartial manner and that retail clients are treated fairly compared to wholesale and principal users, ASIC adopted provisions regarding the fair treatment of all users of a crossing system, which ICI and ICI Global support.

Specifically:

- From November 10, 2013, the tick sizes that currently apply to exchange markets will also apply to crossing systems.
- From February 10, 2014, crossing system operators must have a common set of procedures which do not unfairly discriminate between users and, beginning from November 10, 2103, they must allow clients to opt out of using their crossing system.

Crossing System Monitoring

Because ASIC has no visibility of orders resting in or passing through crossing systems and is therefore unable to monitor such activity, ASIC has adopted rules imposing specific obligations on crossing systems operators to monitor activity in their crossing systems and to maintain records of such monitoring, for which ICI and ICI Global expressed support.

In particular:

- Beginning November 10, 2013, crossing system operators must report to ASIC any suspicious activity identified by the crossing system operator.
- From November 10, 2013, crossing system operators must monitor activity on their crossing system; ASIC intends however to put in place a waiver delaying this requirement until May 10, 2014. Crossing system operators must also take action to ensure that any breaches identified as part of its monitoring activities do not recur and maintain records that document its monitoring activities.

Crossing System Controls

To address concerns with the proliferation of crossing systems and their potential systemic importance, ASIC has adopted efficiency and integrity controls for crossing system operators. ICI and ICI Global have expressed support for trading control mechanisms in the United States and Europe and similarly expressed support for ASIC's proposals.

ASIC adopted the following changes:

- Beginning May 26, 2014, existing system and control requirements for automated order processing will extend to crossing systems.
- From February 10, 2104, crossing system operators must notify users and ASIC about system issues as soon as practicable.

Enhanced Conflict of Interest Obligations

To address its concerns that market participants are not adequately identifying or managing all conflicts of interest that arise in their off-market trading, ASIC has supplemented its conflicts of interest rules.

- Beginning February 10, 2014, market participants must protect confidential client information and beginning February 9, 2014, they must deal with client orders fairly and in due turn.
- From February 10, 2014, with respect to order incentives, market participants will be prevented from receiving negative commissions (e.g., where a market participant handles or executes an order as the result of an arrangement with another person to direct orders to the market participant, the market participant must not, directly or indirectly, make a cash payment to the other person for the opportunity to handle or execute those orders if the cash payment leads to the net cost being less than the value of the reported price for the transaction the subject of the order.

High Frequency Trading

In its review of high frequency trading, ASIC noted that some trading practices are of concern and may be predatory (e.g., layering, quote stuffing, latency arbitrage) and proposed certain changes to address manipulative trading practices that may be effected through trading algorithms. While ICI and ICI Global supported ASIC's initiatives to address trading practices that may be considered manipulative or predatory in nature, we expressed reservations about proposals regarding a minimum resting time or order-to-trade ratios. We are pleased that ASIC has not adopted requirements for a minimum resting time or order-to-trade ratios at this time.

ASIC has, however, adopted the changes below:

Manipulative Trading Circumstances of Order

- Beginning February 9, 2014, market participants must consider additional circumstances in considering whether a false or misleading market has been created, including the frequency with which orders are placed, the volume of products that are the subject of each order and the extent to which orders made are cancelled or amended relative to the orders executed.

Manipulative Trading Rules Harmonized

- Beginning February 9, 2014, market participants of the ASX 24 market will be required to comply with new requirements to prevent manipulative trading, the same as currently apply to the ASX and Chi-X markets.

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endnotes

[1] ASIC's press release with link to the various market integrity rules and Regulatory Guide 223 Guidance on ASIC market integrity for competition in exchange markets can be found at:

<http://www.asic.gov.au/asic/asic.nsf/byheadline/13-213MR+ASIC+makes+rules+on+dark+liquidity%2C+high-frequency+trading?openDocument>.

[2] The letter, dated May 10, 2013, is available at http://www.iciglobal.org/pdf/13_ici_icig_asic_hft.pdf.

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