



Consultation Paper 1/2011 on the proposed amendment of rules and procedures relating to:

- the interpretation of the procedures;
- losses excluded from the compensation arrangements;
- the timing of the Post-Trading Administration phase;
- reference prices for pegged orders;
- the content and recipient of short sale reports.

12 August 2011

Consultation Closes: 2 September 2011

Consultation on Proposed Amendments to the Chi-X Operating Rules and Operating Rules: Procedures

1.1 Introduction

1.1.1 Chi-X is proposing to amend the following provisions in the Operating Rules and Procedures:

- (i) Procedure 1.2 – the amendment will clarify that the rules of interpretation for the Operating Rules also apply to the Procedures (this will ensure it is clear that a reference to time in the Procedures is to the time in Sydney, Australia);
- (ii) The definition of “excluded loss”, a term that appears in rule 11.7 of the Operating Rules and relates to compensation arrangements – the amendment will clarify that any loss excluded from Division 3 of the Corporations Act is also excluded from the Chi-X Compensation Arrangements;
- (iii) Procedure 4.2 on trading phases – the amendment will extend the time during which participants may report off market transactions from the current period of 16:12-17:50 to a new period of 16:12-18:55¹;
- (iv) Procedure 4.5 on pegged orders – the amendment will change the reference price for pegged orders from the national best bid and offer to the bid and offer on the central limit order book of the ASX’s TradeMatch venue;
- (v) Procedure 4.8 on short sales – the amendment will (a) state that participants must provide short sale reports to an agent nominated by Chi-X and (b) clarify that the contents of short sale reports to Chi-X are the same as the reports participants are currently providing to the ASX.

1.1.2 It is proposed that the amendments take effect in time for the launch of the Chi-X market on 31 October 2011. This consultation paper contains an outline of each proposed amendment (in sections 2 to 6) and a marked up version of the relevant provisions to indicate the proposed amendments (**attachment one**).

1.1.3 The consultation period is open until **2 September 2011** and participants are invited to provide comments on or before that date on any aspect of the proposals or any related topic. All submissions will be treated confidentially unless the express prior consent of the submitting entity is obtained.

2.1 Procedure 1.2 – Rules of Interpretation

2.1.1 Chi-X is proposing to make it clear that the rules of interpretation in rule 1.2 also apply to the Procedures. This will ensure that a reference to time in the Procedures is a reference to the time in Sydney, Australia. The proposed amendment to procedure 1.2 is at **attachment one**.

3.1 The definition of “Excluded loss” – rule 11.7 and compensation arrangements

3.1.1 The compensation arrangements for the Chi-X market are contained in section 11 of the Operating Rules and have been approved under Division 3 of Part 7.5 of the Corporations Act. Rule 11.7 outlines the scope of the compensation arrangements and states that a loss will be covered if it meets criteria that is specified in the rule² and is not an “excluded loss”, a term which is defined in the Operating Rules to mean “a loss that under section 885D(2) of the Corporations Act is not a division three loss”.

¹ The new closing time of 16:12 was announced in Compliance Notice 4/2011, which was released on 29 July 2011.

² The criteria are based on those found in section 885C of Division 3 of Part 7.5 of the Corporations Act

- 3.1.2 Chi-X proposes to amend the definition of “excluded loss” to make it clear that the term will also include any loss that, under sections 885D(1) and 885D(3) of the Corporations Act, is not a division 3 loss. Section 885D(1) states that a loss is not a division 3 loss if, among other things, it is connected to two markets that both have compensation arrangements that have been approved under Division 3 of part 7.5 of the Corporations Act. Section 885D(3) states that a loss is not a division 3 loss if, among other things, it is connected to transactions that could have been effected otherwise than through a financial market. Chi-X is of the view that sections 885D(1) and 885D(3) may capture empty sets but believes it is appropriate to expressly align the rules with the scope of Division 3.

4.1 Procedure 4.2 on the trading phases for reporting off market transactions

- 4.1.1 The table in procedure 4.2 currently states that the post-trading administration phase runs from the close of trading, 16:12, until 17:50. Chi-X is proposing to extend the time that this phase runs to 18:55 and a copy of the amended table outlining the change to the phase is at **attachment one**.
- 4.1.2 The supported functions column in the table in procedure 4.2 outlines the functions that participants are able to undertake in post-trading administration phase. The most significant are cancellation of orders and reporting of off market transactions. Participants are reminded that transactions must satisfy the requirements in the Market Integrity Rules (Competition in Exchange Markets) in respect of both the pre-trade transparency criteria and post trade reporting requirements that apply to any off market transactions that they report to Chi-X. Chi-X will shortly issue guidance on the validation process relating to off market transactions that are reported to Chi-X. This will include details on the validation of off market transactions executed after the close of the Chi-X market.

5.1 Procedure 4.5 on Pegged Orders

- 5.1.1 Paragraph 1.1 of procedure 4.5 states that the reference price for pegged orders is the national best bid and offer. Chi-X is proposing to amend this so that the reference price is the best bid and offer on the ASX Central Limit Order book. A copy of the amended paragraph 1.1 is at **attachment one**.

6.1 Procedure 4.8 on Short Sales

- 6.1.1 Chi-X is proposing to amend procedure 4.8 on reporting of short sales to:
- (a) require participants to provide report short sale reports to an agent nominated by Chi-X - this will allow Chi-X to nominate ASX as its agent so that Chi-X participants can report all their short sale reports to one location irrespective of the market on which those transactions have been executed;
 - (b) make it clear that it is only the reported gross short sales that are required to be reported by participants (ie participants are only required to report that data they are currently reporting to the ASX).

6.2 Procedure 4.8 on Short Sales – reporting to an agent nominated by Chi-X

- 6.2.1 At present paragraph 1.1 of procedure 4.8 states that participants must report short sale transactions to Market Operations at Chi-X. Chi-X believes that this may pose an undue burden on some participants and so is exploring with ASX the possibility of nominating the ASX as the agent of Chi-X so that participants must report short sale transactions, executed on Chi-X, to the ASX instead. This would mean participants could report all short sale transaction information to one market operator. Participants would be required to report to the agent nominated by Chi-X and while full details of the agency arrangement are not yet finalised this agent is likely to be the ASX. This would enable short sale transactions

executed by Participants on Chi-X to be reported in the same format, with the same content and to the same recipient, as is currently the case. The proposed changes to the procedure also specify that Chi-X could not change the agent nominated by Chi-X without consulting on, and providing participants with reasonable notice of, any proposed change.

6.2.2 Chi-X is particularly interested in receiving the feedback of participants on its proposal to require reporting to the ASX of the short sale transactions executed on Chi-X. It is in response to participant feedback that this amendment is being proposed and so all participants are strongly encouraged to provide Chi-X with their views.

6.2.3 Chi-X is also proposing to clarify the deadline for reporting so that it is clearly aligned with that specified in the Corporations Regulations.

6.3 Procedure 4.8 on Short Sales – clarifying the content of short sale reports

6.3.1 Paragraph 1.2 of procedure 4.8 currently states that reports by participants of short sales must disclose, among other things, (i) the total number of each financial product that was sold and (ii) the reported gross short sales. The requirements in (i) and (ii) are duplicative as paragraph 1.2 is subject to rule 4.8, which only requires the report to be provided in respect of short sales. Hence “the total number of each financial product that was sold” and the “reported gross short sales” will be the same figure.

6.3.2 Our proposed amendment on this matter will make it clear that participants are only required to report the following information, which is required to be reported under regulation 7.9.100 of the Corporations Regulations:

- (i) the number of financial products that the seller will vest in the buyer under the securities lending arrangement;
- (ii) a description of the product;
- (iii) the name of the entity that issued the product.

6.3.3 Participants should therefore be clear that they will only be required to be report to Chi-X that information that they are currently reporting to the ASX.

Attachment One

In the following text, strikethrough indicates current text that it is proposed be deleted and underlining indicates new text that it is proposed be inserted.

PROPOSED AMENDMENT TO PROCEDURE 1.2 ON RULES OF INTERPRETATION

P1.2: Rules of Interpretation

1.1 These **procedures** are segmented according to the **rule** to which each **procedure** relates. So, for example, the procedure headed “**P5.4 Market-related disputes**” (referred to in these **procedures** as “**procedure 5.4**”) contains the **procedure(s)** for **rule 5.4**. Each **procedure** is further segmented into parts and/or numbered paragraphs. This layout is for convenience only and does not affect interpretation.

1.2 For the sake of clarity, the rules of interpretation in **rule 1.2** also apply to the **procedures**.

PROPOSED AMENDMENTS TO THE COMPENSATION ARRANGEMENTS

1 INTERPRETATION AND APPLICATION OF RULES

1.1 Definitions

In these rules, the following words have the following meanings, unless the context requires otherwise.

.....

Excluded loss A loss that under section 885D(2) of the **Corporations Act** is not a Division 3 loss.

[Rule 11.7 is not being amended but is included here for ease of reference to the amended definition of “excluded loss”.

11.7 Losses covered

A loss is a **loss** covered by the **fidelity fund** if it is not an **excluded loss** and:

- (a) a client gave money or other property, or authority over property, to a **participant** (or an entity which was previously a **participant** and which the **client** reasonably believed was a **participant**);
- (b) the money or other property, or the authority, was given to the **participant** in connection with effecting a transaction, or proposed transaction, through the **Chi-X market**;
- (c) the effecting of the transaction through the **Chi-X market** constitutes or would constitute the provision of a financial service to the client as a **retail client**; and
- (d) the client suffers a loss because of the defalcation or fraudulent misuse of the money, other property, or the authority given by the client (as applicable), by the **participant**.

For the avoidance of doubt a **claim** relating to an alleged **loss** caused by defalcation or fraudulent misuse may be allowed even if the person against whom the defalcation or misuse is alleged has not been convicted or prosecuted, or the evidence on which the **claim** is allowed would not be sufficient to establish the guilt of that person on a criminal trial in respect of the defalcation or criminal misuse.]

PROPOSED AMENDMENTS TO PROCEDURE 4.2 ON OPERATING HOURS

P4.2: Hours of Operations

1. Trading phases

1.1 The trading phases for the **Chi-X market** are set out below:

Phase	Time AEST	Supported Functions
Technical Connectivity	06:00	<ul style="list-style-type: none"> • Commencement of technical connectivity to the Chi-X market. • Participants may login to the Chi-X technical infrastructure.
Pre-Market	06:35 until 09:59	<ul style="list-style-type: none"> • Participants may check connectivity and details concerning securities available for trading but will not be able to enter orders into the Chi-X market ; • The Chi-X trading system will not match orders; • Participants may report trades under the rules by the time specified in the Market Integrity Rules (Competition in Exchange Markets).
Continuous Trading	10.00 until 16:12	<ul style="list-style-type: none"> • Participants may enter orders into the Chi-X market; • Orders are matched in accordance with the rules; • Trade reporting is supported in accordance with the rules.
Post-Trading Administration	16:12 until 17:59:59	<ul style="list-style-type: none"> • Participants cannot enter or amend orders but may cancel orders; • The Chi-X trading system does not match orders in this phase; • Participants may report trades under the rules; • All orders remaining in the Chi-X market at the end of this phase will automatically be cancelled.
Technical Connectivity Ends	19:00	<ul style="list-style-type: none"> • All participant connections to Chi-X are closed. • Intraday trade cancellations no longer possible.

PROPOSED AMENDMENTS TO PROCEDURE 4.5 ON PEGGED ORDERS

P4.5: Orders and matching

1. Pegged Orders

1.1 For the purposes of **rule 4.5(a)(ii)**, pegged orders on the **Chi-X market** will reference ~~a national~~ the best bid and offer on the Central Limit Order Book of the **ASX's TradeMatch venue (NBBO)**. ~~The NBBO:~~

(a) ~~will maintain the best bid and offer for each~~ **financial product** ~~sourced from the~~ **listing market and the Chi-X market; and**

(b) ~~will be updated on a continuous basis during such period where the~~ **listing market** ~~and~~ **Chi-X market** ~~are both open for trading.~~

PROPOSED AMENDMENT TO PROCEDURE 4.8 ON SHORT SALE REPORTING

P4.8: Short sale reporting

1.1 For the purposes of **rule 4.8, participants** must submit to an agent nominated by **Chi-X Market Operations** the short sale information required by the **Corporations Act** in respect of **relevant transactions** it has executed on the **Chi-X Market** where the **relevant transaction** involves a short sale or partial short sale. Information required to be submitted under this **procedure** must be submitted by email to operations-cxa@chi-x.com by no later than 9:00 AM Sydney time and on each **business day**:

(a) if the sale occurs after the start of the trading day but before 7pm – on the next trading day after entering into an agreement to sell;

(b) if the sale occurs after 7pm but before the start of the next trading day – on the second trading day after entering the agreement to sell.

~~1.2 Details of the data items and format of the short sale information to be provided is as follows:~~

1.2 Reports provided to the agent nominated by **Chi-X** may be submitted in the format specified by that agent and must contain the following information required by regulation 7.9.100 of the Corporations Regulations:

- ~~• Reports may be received in CSV format;~~
- ASX code;
- Company name;
- ~~• Reports must disclose the total number of each financial product that will vest in the buyer under the arrangement was sold;~~
- ~~Reported gross short sales.~~

1.3 **Chi-X** must not change the agent nominated by it to receive the short sale information required of **participants** under the **Corporations Act** without consulting with and providing reasonable notice to participants on the proposed change.