



Consultation Paper 2/2013 on:

- a market maker regime for Chi-X participants.

21 June 2013

Consultation Closes: Monday 8 July 2013

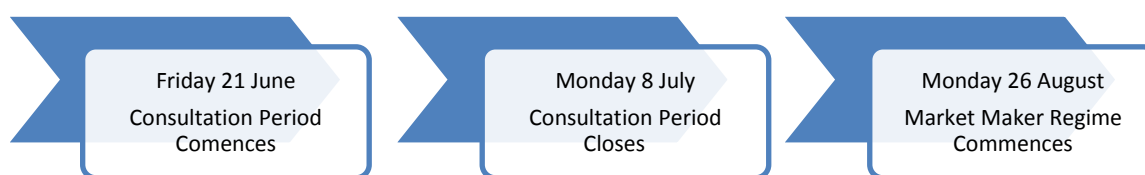
Chi-X Australia Pty Ltd

ABN 47 129 584 667

Consultation on the Proposed Amendment of the Chi-X Operating Rules and Operating Rules: Procedures

1. Introduction

- 1.1.1 Chi-X is proposing to amend the Operating Rules (“Rules”) and Operating Rules: Procedures (“Procedures”) in order to introduce a market maker regime. At present most markets in North America and Europe operate a market maker programme. The UK Government’s Foresight Project on The Future of Computer Trading in Financial Markets has stated that the vast majority of empirical studies on market maker obligations conclude that they improve market quality¹. Chi-X believes it is appropriate, at this stage of its market development, to propose and implement a framework for market makers that will combine clear regulatory standards with appropriate and proportionate benefits.
- 1.1.2 The proposed market maker scheme uses a framework with similar features, including the affirmative obligations imposed on market makers, to those commonly found in the major markets of North America and Europe and which have been found to improve market quality. The obligations will be contained in new Rules and Procedures.
- 1.1.3 The Chi-X market maker scheme may interact with market maker exemptions contained in ASIC and/or Government class orders/regulations/rules and this is briefly discussed in sections 5 and 6 below.
- 1.1.4 The consultation period is open until **Monday 8 July 2013** and participants are invited to provide comments on or before that date on any aspect of the proposals or any related topic. The closing date is set so that any rules can be made prior to the takeover period prior to the national election. All submissions will be treated confidentially unless a submitting entity expressly states otherwise. The basis of each of the proposed amendments is outlined in the following section. Versions of the relevant Rules and Procedures, marked up to indicate the proposed amendments, are at **attachment one** and **attachment two** respectively. It is proposed that the amendments will take effect on **Monday 26 August 2012**. The proposed regime requires regulatory approval prior to implementation.



¹ See page 20 of the working paper “Economic impact assessments on MIFID II policy measures related to computer trading in financial markets” at <http://www.bis.gov.uk/assets/foresight/docs/computer-trading/12-1088-economic-impact-mifid-2-measures-computer-trading.pdf> retrieved 14 June 2012. An Economic Impact Assessment paper published as part of the Foresight Project’s work stated that empirical studies on affirmative obligations for market makers repeatedly conclude that they improve market quality and provide benefits that include lower transaction costs, improved price discovery, increased volumes, lower volatility, greater depth and lower costs of capital.

2. The Proposed Amendments

2.1 The Framework

2.1.1 The proposed amendments are contained in Section 4 of the Rules and related Procedures. The general framework will involve a participant making an undertaking to Chi-X to comply with affirmative obligations that are specified in the Procedures. Chi-X will have a general discretion with respect to considering and then registering a participant as a market maker. The detailed metrics on the affirmative obligations will also be contained in the Procedures. The regime for monitoring and enforcing the affirmative obligations of the market maker will be established in internal policies and procedures developed by Chi-X and will be supplemented by a rule framework that enables action to be taken if a market maker does not fulfil the required obligations. The following sections of the CP set out some more details of the proposed rules and procedures.

2.2.1 Rule 4.9

2.2.1 The primary obligation of Chi-X under the Corporations Act is to operate a fair, orderly and transparent market and this in turn requires Chi-X to ensure that, among other things, it (a) treats all participants equally and (b) provides protection for the wider participant and investing community trading on the Chi-X market. In these circumstances Chi-X is of the view that it is appropriate that the Operating Rules provide a discretion to Chi-X on the granting of market maker status: this discretion obtains the most appropriate balance between the rights of participants and the obligation to ensure that the market is and will continue to be operated a fair, orderly and transparent basis.

2.2.2 Accordingly Chi-X is proposing a new rule, 4.9, that will give Chi-X the power to register a participant as a market maker. The rule will also give Chi-X the power to de-register a participant on a permanent or temporary basis and set out a framework for the registration regime, temporary suspension and amendment of the affirmative obligations. The rules enabling Chi-X to register a market maker will be supplemented by procedures that will set out the quoting obligations of market makers with respect to spreads, volumes and times displayed.

2.2.3 The fundamentals of the market maker regime will embody the basic principle that the market maker obligations do not apply on an “opt in, opt out” basis but rather must be adhered to on a sustained basis. This principle will be embodied in the following features of the proposed regime.

- (a) The standalone requirement in the rules that a participant registered as a market maker must comply with the undertaking it has provided to Chi-X market. This has consequences for the contractual obligations of the market maker and the ability of Chi-X to take action under the Rules to ensure that there is compliance with this undertaking or that alternatively appropriate action is taken.
- (b) Temporary relief from the obligation to comply with the market making obligations will be at the discretion of Chi-X.

- (c) Participants will be required to apply to Chi-X to be de-registered, which will not take effect until such time as is specified by Chi-X.
- (d) The detailed obligations with which the market maker must comply and that will be set out in the Procedures.

2.2.4 It will be possible for a participant to apply to review a decision by Chi-X on a participant's registration and de-registration as market maker. This will require minor amendment of existing rules on the review process and the inclusion in rule 4.9 of a sub paragraph on the right to apply for that review.

2.3 Monitoring, Enforcement and Rule 4.10

2.3.1 Chi-X is proposing a new rule, 4.10, that will empower Chi-X to require a market maker to provide information in relation to its activities on the Chi-X market. As market makers may be entitled to receive benefits for fulfilling the affirmative obligations, it is important that Chi-X has in place a robust monitoring and enforcement regime to ensure that the affirmative obligations are being fulfilled and the benefits justifiably received. The proposed rules include a provision that will empower Chi-X to require a participant registered as a market maker to provide information to Chi-X in respect of that market making. This will enable Chi-X to obtain information to monitor compliance with the obligations. Chi-X will monitor compliance with the market maker regime through its compliance and operations departments, with the compliance team having ultimate responsibility for monitoring compliance with the obligations.

2.3.2 As a participant takes on additional obligations with a view to, among other things, enhancing the performance of the market for the wider community trading on the Chi-X market and participating in the benefits of the market maker status, it is appropriate that the immediate focus of any enforcement regime for market makers is the withdrawal of the market maker status of the firm.

2.4 Procedure 4.9

2.4.1 Chi-X is proposing a new procedure, 4.9, that will supplement rule 4.9 with the details on the affirmative obligations that a participant will have to fulfil in order to be eligible for registration as a market maker. A participant would need to ensure that it continued to fulfil those obligations in order to retain its status as a market maker and comply with its obligations under the Rules. A participant that is registered as a market maker will only be released from the requirement to fulfil the affirmative obligations if it is deregistered as a market maker or, at the sole discretion of Chi-X, granted temporary relief. This framework provides a robust form of ensuring participants do not take the advantages of a market maker regime without fulfilling their affirmative obligations.

2.4.2 The affirmative obligations that a participant would have to fulfil to be a market maker would be categorised according to security and include:

- (a) entering and maintaining bid and ask orders that are each in excess of a minimum order value and create a maximum bid-ask spread, the metrics of which will be specified in the Procedures – the current proposals are that the minimum order size

will range between \$5,000 and \$10,000 while the maximum spread will range between 4 and 9 ticks;

- (b) to comply with the requirements in 2.4.2(a) for at least the trading obligation ratio of active continuous trading, which will be specified in the procedures and calculated over a monthly period by: summing the daily time that the participant has submitted orders complying with the requirements in 2.4.2(a) and dividing that figure by the number of trading days in the month;
- (c) to comply with the requirements in 2.4.2(a) and (b) in respect of a subset of the securities traded by Chi-X², the subset having been agreed between Chi-X and the participant prior to the undertaking being made but consisting of not less than 50 of the securities traded on the central limit order book traded on Chi-X;
- (d) to separate market making activities from all other activities in respect of the Chi-X market.

2.4.3 The framework of specifying the metrics in relation to the affirmative obligations in the Procedures ensures that they will not ordinarily be changed without providing four weeks notice to the participants impacted (see paragraph 1.1 of Procedures 1.7). The proposed requirements follow standards found in market maker regimes throughout the major markets in Europe and North America.

3. Further details on the Framework

3.1.1 While not specified in the procedures, the decision to register and de-register a participant as market maker will be delegated to the Participant Suitability Committee, the committee within Chi-X that currently has delegated powers with respect to the consideration of applications to become a participant of Chi-X. There will be the possibility of an appeal from decisions of the PSC to the Review Committee.

4. Consequence of market maker registration

4.1.1 A firm that is registered as a market maker may:

- (a) Qualify for a fee regime that is yet to be determined;
- (b) Qualify for short sale relief and other exemptions to ASIC or government imposed requirements and/or fees.

5 The Fee Regime

5.1.1 At present Chi-X imposes a 0.06/0.12 bps maker/taker fee regime. Chi-X will consider an appropriate fee regime for market maker participants that recognises and is proportionate to the benefits they provide. Any new fee regime will be separately developed and implemented in consultation with ASIC.

² A list of the securities will be published on the Chi-X Australia web site.

6. Short Sale Relief and other Exemptions

6.1.1 Participants will be aware that the short sale requirements imposed in the Corporations Act are subject to exemptions mandated by ASIC that concern market makers. The short sale relief that may arise on becoming a market maker is not directly within the gift of Chi-X and is a matter for ASIC to consider. However, it is likely that any such relief and other exemptions from Government mandated fees and requirements will be dependent on Chi-X ensuring that the fulfilment of the affirmative obligations is monitored and enforced.

7. Responses

7.1.1 Emailed submissions and any queries concerning this consultation should be directed to:

Michael Somes
Head of Compliance and Regulatory Counsel
+ 61 2 8078 1718
michael.somes@chi-x.com

7.1.2 Posted submissions should be addressed to:

Michael Somes
Head of Compliance and Regulatory Counsel
Chi-X Australia Pty Ltd
Level 23 Governor Phillip Tower
1 Farrer Place
Sydney NSW 2000

Attachment One

PROPOSED ADDITION OF RULE 4.9 ON CHI-X REGISTRATION OF A MARKET MAKER

It is proposed to insert the following text immediately following the current rule 4.8.

4.9 REGISTRATION AS A MARKET MAKER

- (a) **Chi-X** may register a **participant** as a **market maker**.
- (b) **Chi-X** may, in its absolute discretion:
 - (i) refuse to register a **participant** as a **market maker**; and/or
 - (ii) de-register a **participant** as a **market maker**.
- (c) A **participant** may request a review of a decision by **Chi-X** to refuse to register a **participant** under rule 4.9(b)(i) and/or to de-register a participant as market maker under rule 4.9(b)(ii);
- (d) The process by which **Chi-X** will register a **participant** as a **market maker** is set out in the **procedures**.
- (e) A **participant** that is registered as a **market maker** must comply with the **market maker undertaking** that it has provided to **Chi-X** unless and until:
 - (i) the **participant** has been deregistered as a **market maker**; or
 - (ii) **Chi-X** has agreed, pursuant to a request made under rule 4.9(m), to the **participant** being temporarily relieved for a specified period from the market making obligations, during which period a market maker is not required to comply with the undertaking in respect of those obligations.
- (f) A **participant** may propose to **Chi-X** that the undertaking it has provided be amended but the original undertaking will continue to apply until **Chi-X** has agreed to and specified the date on which the amended **market maker undertaking** will take effect, after which a participant must comply with the **market maker undertaking** as amended.
- (g) A participant that is registered as a market maker but does not comply with the **market maker undertaking** is liable to be de-registered as a **market maker** either totally or partially in respect of a particular subset of the **specified market maker securities** in which it has been registered as a **market maker**.
- (h) A **participant** may, three months or more after it has been registered as a **market maker** under rule 4.9(a), apply to be de-registered as a **market maker** from the beginning of the second month following the date on which **Chi-X** received the application. The application for de-registration may be made in respect of either:

- (i) one or more **securities** on the list of **specified market maker securities** that it has specified in its **market maker undertaking**, so long as deregistering from the listed **securities** does not take the number of **specified market securities** in which it is registered below 50; or
 - (ii) all the **securities** in which it is registered as **market maker**.
- (i) A **participant** may request that it be relieved from its **market making** obligations for a temporary period. In the event Chi-X agrees to the suspension, the failure to fulfil the obligations during that period may not be taken into account by Chi-X in determining whether to de-register the participant as market maker.
 - (j) The register of **market makers** will be published on the **Chi-X** web site. The register shall list each **specified market maker security** in which the **participant** is a **market maker**.

4.10 CHI-X POWERS AND OBLIGATIONS ON PARTICIPANTS THAT ARE REGISTERED

- (a) **Chi-X** may require a **participant** that is registered as **market maker** to provide any information and material in connection with its activities as a **market maker**.
- (b) A **participant** must provide any information and material required by **Chi-X** pursuant to rule 4.10 (a) within the time specified by **Chi-X**.

Attachment Two – Amendments to the Procedures

PROPOSED ADDITION OF PROCEDURES 4.9 AND 4.10 ON MARKET MAKING

It is proposed to insert the following text in the Procedures immediately following the existing Procedure 4.8.

P4.9: Market Making Requirements

1. Process for Registration

1.1 The process for registration as a market maker is as follows:

- (a) A **participant** that wants to be considered by **Chi-X** for registration as a **market maker** must provide **Chi-X** with a completed **market maker undertaking**;
- (b) **Chi-X** will consider each **market maker undertaking** that it receives and then decide whether to exercise its discretion under rule 4.9(a) to register the **participant** as a **market maker**;
- (c) the obligation to comply with the **market maker undertaking** will commence no later than the first day of the month following a participant's registration as a **market maker**;
- (d) **Chi-X** will continuously monitor compliance with the **market maker undertaking** and may request information from a **participant** under rule 4.10 in respect of that **participant's** market making activities;
- (e) **Chi-X** may de-register a **participant** as a **market maker** at any time.

2. Undertaking to Fulfil Affirmative Obligations

- 2.1 In this section of Procedure 4.9, paragraph 2.2 sets out the matters that must be contained in the **market maker undertaking** (eg the obligation to maintain a spread), while paragraph 2.3 specifies the metrics in relation to those matters (eg the required size of that spread).
- 2.2 A **market maker undertaking** submitted to Chi-X may be in the form of the template published on the Chi-X web site and must contain an undertaking:

- (a) to enter and maintain bid and ask orders that are each in excess of the **minimum order value** specified in table 2.2 and that create a bid-ask spread that is not more than the **maximum spread** specified in table 2.2;
 - (b) to comply with the requirements in 2.2(a) for at least the **trading obligation ratio of active continuous trading**, calculated over a monthly period by summing the period of time on each trading day that the participant has submitted orders complying with the requirements in 2.2(a) and dividing that figure by the number of **trading days** in the month;
 - (c) to comply with the requirements in 2.2(a) and (b) in respect of a subset of the **securities** traded by **Chi-X**³, the subset having been agreed between **Chi-X** and the participant prior to the undertaking being made but consisting of not less than 50 of the **securities** traded on the central limit order book traded on **Chi-X**;
 - (d) to separate market making activities from all other activities in respect of the Chi-X market; and
 - (e) to notify Chi-X immediately it becomes aware that it is failing to comply with paragraphs (a) – (d) above and provide a complete explanation for the failure to comply.
- 2.3 Chi-X will allocate each **security** traded on the central limit order book into one of three groups for the purposes of specifying the **minimum order value**, the **maximum spread**, and the **trading obligation ratio** that will apply to market making in each **security**. Table 2.2 contains the value of each of these measures in respect of each security traded on the Chi-X central limit order book.

³ A list of the securities traded will be available on the Chi-X Australia web site: www.chi-x.com.au

TABLE 2.2

Security Group	Minimum Order Value	Maximum Spread: Price: Maximum Spread (in tick size)	Trading Obligation Ratio
Group one (Top 50 by market capitalisation)	\$10,000.00	\$0 < \$20: 4 \$20 < \$40: 5 \$40 < \$50: 6 \$50 < \$60: 7 \$60 < \$70: 8 \$70 < \$80: 8 \$80 < : 9	65%
Group Two (remainder of ASX 200)	\$7,500.00	\$0 < \$20: 4 \$20 < \$30: 5 \$30 ≤ : on a case by case basis (but ≥ 6)	65%
Group Three (remainder)	\$5,000.00	\$0 < \$20: 4 \$20 ≤ : on a case by case basis (but ≥ 5)	50%

3. Consequences of Failing to Comply with a Market Maker Undertaking

- 3.1 A **participant** that fails to comply with a **market maker undertaking** it has provided to **Chi-X** is liable to be deregistered as a **market maker** and/or disciplinary action for a breach of the **rules**.

P4.10: Chi-X powers and obligations on participants that are registered as market makers

- 1.1 It is important that **participants** registered as **market makers** comply with the obligations contained in the **market making undertaking** they have provided to **Chi-X**. Therefore it is also important that **participants** registered as **market makers** respond to requests from **Chi-X** for information in connection with their market making activities within the time specified by **Chi-X** in that request. Failure to comply with a request may amount to a breach of the **Rules**. A **participant** that believes that the time specified for compliance with a request is unreasonably

short must notify **Chi-X** as soon as possible after it receives the request that more time will be needed to provide the information and/or documentation sought.

PROPOSED AMENDMENT OF PROCEDURE 1.6 ON THE RIGHT TO REVIEW A CHI-X DECISION REGISTERING/DEREGISTERING A PARTICIPANT AS A MARKET MAKER

In the text from Procedure 1.6 below:

- (a) double underlining indicates text to be inserted;
- (b) strikethrough indicates text to be deleted; and
- (c) “.....” indicates text in the original which is not relevant to the proposed amendment.

P1.6: Reviews

1. Requesting a Review

1.1 A **participant** can only request a review of a decision if the **rules** state that the decision may be reviewed.

1.2 The following **rules** state that a **participant** may request a review of the decisions that are specified:

(a) rule 4.9(c) states that a **participant** may request a review of a decision by **Chi-X** under rule 4.9(a) to register or de-register a **participant** as a **market maker**;

~~(a)~~(b) rule 5.2 states that a **participant** may request a review of a decision by **Chi-X** under rule 5.1(e) to modify or restrict a **participant's** access to the market in order to ensure a fair, orderly and transparent market;

~~(b)~~(c) rule 5.5 states that a **participant** may request a review of the exercise by **Chi-X** of the powers in rule 5.4(d) in respect of a market-related **dispute**;

~~(e)~~(d) rule 9.1(b) states that a **participant** may request a review of disciplinary action taken by **Chi-X** under rule 9.1(a);

~~(d)~~(e) rule 9.6 states that a **participant** may request a review of a decision by **Chi-X** under the default powers in rule 9.5 to restrict, suspend or terminate a **participant's** access to the **Chi-X market**.

1.3 Notification of a request for a review must comply with **procedure** 13.7 and be given to:

- (a) **Chi-X** Compliance in the case of a notification of a request for a review made under **rules 4.9(c), 5.2, 9.1(b) or 9.6;**
- (b) Market Operations in the case of a notification of a request for a review made under **rule 5.5(a).**

.....

8. **Interim Measures**

- 8.1 Lodging a request for a review pursuant to **rules 4.9(c), 5.2, 5.5, or 9.6** has no impact on the decision in respect of which the request is made. That decision will remain in force unless and until it is changed by the Review Committee.

9. **Review Outcomes**

- 9.1 In the case of a review conducted pursuant to a request made under **rules 4.9(c), 5.2, 5.5, or 9.6**, the **Review Committee** may confirm, vary or quash the decision in respect of which the review is being sought.
- 9.2 In the case of a review conducted pursuant to **participant** objection under **rule 9.1(b)** or a referral from **Chi-X** under **rule 9.1(d)**, a **Review Committee** may impose or utilise one or more of the sanctions in **rule 9.3** and as outlined in **procedure 9.1**.
- 9.3 There is no appeal from a decision of the **Review Committee**.
- 9.4 The decision of the **Review Committee** may be enforced by **Chi-X** as if it were the decision that was reviewed.

10. **Review Fees**

- 10.1 The fees for lodging a request for a review are as follows:

- (a) a review under rule 4.9(c) of a decision under rule 4.9(b) to register or de-register a participant as a market maker - \$5,000.
- ~~(a)(b)~~ a review under **rule 5.2** of a decision under **rule 5.1(e)** to restrict/modify a participant's access to the market for the purpose of maintaining a fair, orderly and transparent market - \$5,000.
- ~~(b)(c)~~ a review under **rule 5.5** of the exercise by **Chi-X** of the powers in **rule 5.4(d)** in respect of a market **dispute** - nil;

~~(c)~~(d) a review under **rule** 9.1(b) of disciplinary action taken by **Chi-X** under **rule** 9.1(a) - \$5,000;

~~(d)~~(e) a review under **rule** 9.6 of a decision by **Chi-X** under the default powers in **rule** 9.5 to restrict suspend or terminate a **participant's** access to the **Chi-X market** - \$5,000. :

10.2 A **Review Committee** has the discretion to order the refund of a fee paid by a **participant** for a review of under rule 9.1(b) of disciplinary action taken by **Chi-X** under **rule** 9.1(a).

PROPOSED AMENDMENT OF PROCEDURE 13.7 ON THE NOTIFICATION REQUIREMENTS FOR A
REQUEST TO REVIEW A CHI-X DECISION REGISTERING/DEREGISTERING
A PARTICIPANT AS A MARKET MAKER

In the text below double underlining indicates text to be inserted and strikethrough indicates text to be deleted, in the current procedure 13.7.

P13.7: Notifications

1. Written notice

1.1 Unless otherwise specified in the exceptions listed in paragraph 1.2 below, notifications to **Chi-X** by a **participant** under the **rules** should be addressed to:

Market Operations
Chi-X Australia
Level 23 Governor Phillip Tower
1 Farrer Place
Sydney NSW 2000

Tel: +61 2 8078 1700
Email: operations-cxa@chi-x.com

1.2 The following exceptions to paragraph 1.1 apply:

- (a) The notice is in relation to a request for a review pursuant to **rules** ~~4.9(c)~~, 5.2, 9.1(b) or 9.6;
- (b) The notice is in respect of actual or contemplated disciplinary proceedings under the **rules**;

- (c) The notice relates to a confidential matter, complaint or allegation of conflict of interest concerning the operation of the **Chi-X market**;
- (d) Specific correspondence with a **participant** directs how notices are to be provided.

1.3 Notifications that fall within the exceptions specified in paragraph 1.2 should be addressed to:

Compliance
Chi-X Australia
Level 23 Governor Phillip Tower
1 Farrer Place
Sydney NSW 2000

Tel: +61 2 8078 1700

Email: compliance-cxa@chi-x.com

Definitions – it is proposed that each of the following definitions will be added to the definitions for the Operating Rules and Operating Rules: Procedures

active continuous trading – the aggregate time in which the **Chi-X market** is in continuous trading for an **equity market product** but excluding:

- (a) the period during which the **equity market product** is in an opening or closing auction or a regulatory halt on the listing market;
- (b) the first fifteen and last ten minutes of the continuous trading phase on the **Chi-X market**.

market maker – a **participant** that has been registered as a market maker by **Chi-X** under rule 4.9

market maker undertaking – an undertaking by a participant made to **Chi-X** to comply with affirmative obligations contained in the **Procedure 4.9**

maximum spread – the number of ticks specified in table 2.2 in procedure 4.9 and that is the maximum allowable number of ticks between the bid and offer that must be maintained by a market maker in order to comply with its **market maker undertaking**.

minimum order value – the minimum order size specified in table 2.2 in procedure 4.9 and that is the minimum order size of the bid and offer orders that must be maintained by a **market maker** in order to comply with its **market maker undertaking**.

security – As defined in section 761A of the Corporations Act

specified market maker securities depending on the context, either the list of **securities** in which a participant may be a **market maker** and which is published by **Chi-X** on its web site or the subset of that list in respect of which a particular participant has undertaken to meet the requirements listed in paragraph 1.1 of procedure 4.9.

trading obligation ratio – the percentage of **active continuous trading** on the Chi-X market specified in table 2.2 and for which a **market maker** must maintain bid and offer orders in order to comply with its **market maker undertaking**.