



16 September 2011

Ms Anastasia Zafeirakopoulos
Exchange Market Operators
Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2001

By email: marketstructure@asic.gov.au

Dear Ms Zafeirakoulos

Consultation Paper 166: Market integrity rules for non-AFS licensee foreign participants and consequential amendments

The Australian Financial Markets Association (AFMA) welcomes the opportunity to provide comments to the Commission in response to *Consultation Paper 166: Market integrity rules for non-AFS licensee foreign participants and consequential amendments* (CP166).

Consultation Paper 166 continues the important work of introducing market operator competition in the Australian financial markets.

In relation to the consequential amendments to the market integrity rules for ASX and the Chi-X markets we are concerned that, as drafted, ASIC's policy objectives of only minor consequential changes may not be achieved.

Instead, in the context of the changes associated with the evolution of the market towards competition we believe substantive and undesirable changes may result. We propose some changes to address these issues.

AFMA understands that ASIC does not intend in CP166 to undertake a review and refresh of the relevant provisions and rather intends to preserve the status quo while making minimal alterations with the consequential amendments to accommodate a multi-market operator environment. We also understand that a fuller review will be taking place with the project to unify the MIRs in the medium term.

While noting this background we do seek to draw ASIC's attention to a number of matters that may be amenable to minor changes or guidance in the short term and a more substantial redraft in the longer term.

MIR 6.4.1

There is some ambiguity in relation to whether the word 'Scheme' in MIR 6.4.1(1) is referring to a 'Market' Scheme or whether it is intended to apply to all 'Schemes'. We also note that the phrase "At or Within the Spread" is unclear when referring to a closed market. Our understanding is that MIR 6.4.1 applies or is intended to apply to:

- (a) Market bids under the Corporations Act (see s.616) – which are necessarily offers for cash consideration only and which are made through a prescribed financial market (see s.621 (2)); and
- (b) Schemes of arrangement which involve, as part of the scheme proposal, unconditional offers for cash consideration made through a prescribed financial market.

Our understanding is that MIR 6.4.1 does not apply, or is not intended to apply, to schemes of arrangement that do not involve, as part of the scheme proposal, unconditional offers for cash consideration made through a prescribed financial market (that is MIR 6.4.1 does not apply, or is not meant to apply, to schemes of arrangement that are effected 'off-market').

The purpose, or a purpose, of the rule may be to ensure that shareholders who have received an unconditional on-market bid are not disadvantaged by selling their shares after the market closes below the offer price which would be immediately available to those shareholders again when the market re-opens. We note, however, that there appears to be no guidance available with respect to the purpose of ASIC MIR 6.4.1 or the mischief that rule is intended to address.

The ability under an on-market takeover bid or scheme to immediately sell shares at the offer price is not available under wholly off-market schemes of arrangement (nor typically for off-market takeover bids), where the offer is subject to conditions, including 75% of voted shares being voted in favour of the scheme and court approval of the scheme. If the conditions are not met, the shareholders may never secure a sale for the consideration proposed under the scheme. Accordingly, the buying and selling of shares – both during market hours and after the market closes – in corporations that are the subject of off-market scheme of arrangement proposals, at prices which may be at or below the value of the consideration proposed under the scheme, is commonplace and does not disadvantage investors. Rather it reflects the fact that the market perceives there is a possibility that the conditions applying to the off-market takeover bid or scheme of arrangement may not be fulfilled. Moreover, we note that the price for securities of corporations that are subject to schemes of arrangement proposals usually trade at a discount to the offer price under the scheme.

MIR 6.4.1(1) prohibits Crossings at prices which are at or below "the offer price". As is the case for an Off-Market Bid, in a scheme of arrangement which is conducted entirely off-market, the proposed consideration may not involve an "offer price" as referred to in MIR 6.4.1(1), in instances where the consideration offered is wholly or partly shares in the acquiring entity. This supports the view that MIR 6.4.1 is concerned only with prohibiting Crossings at a price at or below the on-market price being offered by an

acquirer under an on-market unconditional takeover bid or under a scheme which involves an unconditional on-market offer for shares for cash consideration.

Exchange for Physicals

Where an Exchange for Physical (EFP) is effected late in the day (where the reporting of the basket may occur later than the Closing Single Price Auction (CSPA) due to logistical reasons), the ambiguity in the interpretation of MIR 6.4.1 has an adverse impact on Participants where securities in the physical basket are the subject of a 'Scheme'. Given the issues highlighted above and the fact that the securities that are the subject of a Scheme are not usually executed at prices above the 'offer price', Participants are essentially left with the following choices:

- remove the securities that are the subject of a Scheme from the physical basket – this is likely to result in a tracking error and undermines the efficiency and integrity of the EFP transaction, which is a legitimate and widely used means of exchanging futures positions and physical holdings of stock. In addition, if a Participant requests that the securities are removed from the basket, the EFP intermediary may find another Participant that will effect the EFP in its entirety without regard for a conservative reading of MIR 6.4.1;
- report the securities in the physical basket that are the subject of a Scheme to ASX at prices above the offer prices to satisfy the requirement in MIR 6.4.1 and then cash adjust the price to the market price – this is problematic as it involves reporting trades to ASX that do not reflect the actual price involved in the transaction. This may also attract regulatory scrutiny where the price reported to ASX is significantly higher than the prevailing market price;
- do not transact the EFP – which may place Participants at a commercial disadvantage *vis a vis* other Participants that may take a less conservative view of their regulatory obligations; or
- effect the EFP, but not report the securities in the physical basket that are the subject of a Scheme to ASX, however this may be a breach of ASX Operating Rule 3500.

To give Participants certainty around acceptable market practice ASIC should:

- clarify the position for all Participants by way of immediate guidance;
- redraft MIR 6.4.1 to ensure that 'Schemes' are limited to Market Schemes only and not all Schemes; or
- advise Participants of the mischief that is being avoided and how the integrity of the market is being maintained by retaining the status quo and leaving MIR 6.4.1 in its current form.

MIR 6.5.1

This rule currently prohibits Special Crossings during a Bid Period for a Takeover Bid or Scheme, it does not prohibit "Priority Crossings" which are treated as on-market under the current market structure.

ASIC have indicated it is not their intention to alter the current arrangements or generate changes to the underlying market structure. We note also that ASIC has indicated an intention to consult on these issues in a more wide ranging consultation in the near future.

We understand that one of the changes to the market structure associated with the commencement of competition is the move to a Trade Report within the National Best Bid and Offer to eventually replace the ASX "Priority Crossing" functionality. This Trade Report type is a simple evolution of the "Priority Crossing" functionality in the multi-market operator environment.

However, as this NBBO Trade Report is currently not treated as an on-market transaction (as is the "Priority Crossing") it would be caught by the proposed changes and disallowed in takeover stocks during the Bid Period and as such a substantive alteration to long-standing practice would ensue without any apparent justification.

MIR 6.6.1

Similarly for buy-back offers the proposed changes to 6.5.1 would not recognise the structural position of the NBBO Trade Reports as the evolution of the "Priority Crossing" in a multi-market environment.

We propose that alterations be made to ensure that NBBO Trade Report be specifically allowed for the purposes of crossings in takeover stocks and during buy-backs to address the issues identified.

Further we would propose some minor redrafting be considered to improve clarity of the relevant sections. As ASIC moves in the medium term to a more substantial review we stand ready to be involved and assist with that process.

AFMA appreciates ASIC's continued commitment to industry engagement including on matters such as those considered in CP 166. Please do not hesitate to contact me at djeffree@afma.com.au or (02) 9776 7993 for further information on AFMA's response.

Yours sincerely



Damian Jeffree
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