



# FAIR, ORDERLY AND TRANSPARENT MARKETS

The purpose of this document is to articulate how the ASX group interprets its obligation under section 792A(a) of the Corporations Act 2001 (Cth)<sup>1</sup> to do all things necessary, to the extent that it is reasonably practicable to do so, to ensure that each of its licensed markets is **fair, orderly and transparent**.<sup>2</sup>

In summary, ASX considers:

An operator of a market generally can be expected to satisfy its obligation under section 792A(a) to do all things necessary, to the extent that it is reasonably practicable to do so, to ensure that it is **fair, orderly and transparent** if:

- The rules governing the operation of the market clearly set out:
  - the criteria and process for someone to become a participant in the market;
  - the rights and obligations of participants under the rules;
  - when a participant can have their participation in the market suspended or terminated; and
  - if the market provides listing services:
    - the criteria and process for an entity to be admitted to its official list and for the entity's securities to be admitted to quotation;
    - the rights and obligations of listed entities and other product issuers under the rules; and
    - when a listed entity or other product issuer may have its admission to the official list terminated or trading in its securities halted, suspended or terminated,

and those rules are applied by the operator of the market consistently and without inappropriate bias.

- The market has clear rules or processes governing:
  - how and when buy and sell orders will be matched;
  - the application of trading halts;
  - the correction or cancellation of trading errors; and
  - the ability of the market operator to suspend trading, correct or cancel trades, or take other corrective action to help avoid or rectify a disorderly market,and its trading systems are secure, reliable and have sufficient capacity to handle reasonably foreseeable peak levels of trading.
- In the case of a market operator that sets the specifications for derivative contracts traded on its market, reasonable steps are taken to ensure that there is nothing built into those specifications that is inherently likely to lead to a disorderly market.
- Participants know with an appropriate degree of certainty whether, and at what prices and in what volumes, they can deal when they choose to use the order book of a facility and have timely access to information about the prices and volumes of all individual transactions concluded on the market.
- In the case of a market operator that sets the specifications for derivative contracts traded on its market, those specifications are readily accessible to market participants.

FAIR

ORDERLY

TRANSPARENT

## Context

In interpreting the scope of its obligation under section 792A(a) to operate a fair, orderly and transparent market, ASX considers it both appropriate and important to have regard to the statutory context in which that obligation appears and also to the commercial context in which ASX's licensed markets operate.

The statutory context includes the definition of "financial market" in section 767A(1), that is, a facility<sup>3</sup> through which:

- offers to acquire or dispose of financial products are regularly made or accepted; or
- offers or invitations are regularly made to acquire or dispose of financial products that are intended to result or may reasonably be expected to result, directly or indirectly, in the making of offers to acquire or dispose of financial products or the acceptance of such offers.

By defining a market as, in effect, a facility through which orders to buy and sell financial products are matched, section 767A suggests that it is that facility (and, in particular, the process within that facility by which such orders are matched) which must be fair, orderly and transparent.<sup>4</sup>

The statutory context also includes the framework within which the operating rules<sup>5</sup> of a licensed market are made, which:

- requires the Minister, before he or she can grant a licence to operate a market, to be satisfied that the operator has adequate rules for the market to ensure, as far as is reasonably practicable, that the market will operate in a fair, orderly and transparent manner;<sup>6</sup> and
- empowers the Minister to disallow any change to the operating rules of a licensed market,<sup>7</sup> having regard to whether the change is consistent with the licensee's obligations under the Corporations Act, including in particular its obligation to ensure, as far as is reasonably practicable, that the market is fair, orderly and transparent.<sup>8</sup>

Once an operating rule of a licensed market comes into effect, the licensee and each participant in the market comes under a statutory obligation to comply with the rule.<sup>9</sup>

The statutory context further includes the capacity of ASIC, under the oversight of the Minister, to make Market Integrity Rules<sup>10</sup> that deal not only with the activities or conduct of licensed markets, but also the activities or conduct of persons in relation to licensed markets or in relation to financial products traded on licensed markets. As the name suggests, ASIC's rule making power is intended to promote "market integrity" in the broadest sense of that phrase. In making such rules, ASIC can address both structural and behavioural issues across all licensed markets. ASIC's Market Integrity Rules therefore effectively set the parameters within which an individual licensed market operator must do all things necessary to ensure that its market operates in a fair, orderly and transparent manner.<sup>11</sup>

The commercial context includes the vital role that the ASX and ASX 24 markets play in the Australian financial system in facilitating the raising, allocation and hedging of capital flows. This suggests that the enquiry as to whether a licensed market is fair, orderly and transparent should be answered at the macro, rather than a micro, level by reference to whether the market is operating in a fair, orderly and transparent manner from the perspective of participants in the market generally rather than from the perspective of an individual participant.<sup>12</sup>

### The meaning of "fair"

The word "fair" can have many different meanings, depending on the context in which it is used.<sup>13</sup>

In ASX's opinion, in the context of section 792A(a), the word "fair" is used in one (or possibly both) of two senses – 'something that conforms to the applicable rules' (as in a *fair* contest) and/or 'free from bias or injustice' (as in a *fair* decision).<sup>14</sup>

As mentioned previously, once an operating rule of a licensed market comes into effect, the market operator and each participant comes under a statutory obligation to comply with the rule. At that point, it is no longer open to a participant to argue that it should not have to comply with the rule because it is unfair. Hence the enquiry as to whether a market is meeting its ongoing obligation to operate in a "fair" manner is not intended to be a value

judgment as to whether its operating rules are fair – that value judgment having already been made by the Minister in deciding to grant a licence to the market operator with its rules as in force at that time and not to disallow any rule change subsequently)<sup>15</sup> – but rather whether the operating rules are being applied in a fair manner (that is, consistently and without inappropriate bias).

ASX considers that a market is likely to meet its obligation to be fair if the rules governing the operation of the market clearly set out:

- the criteria and process for someone to become a participant in the market;
- the rights and obligations of participants under the rules;
- when a participant can have their participation in the market suspended or terminated; and
- if the market provides listing services:
  - the criteria and process for an entity to be admitted to its official list and for the entity’s securities to be admitted to quotation;
  - the rights and obligations of listed entities and other product issuers under the rules; and
  - when a listed entity or other product issuer may have its admission to the official list terminated or trading in its securities halted, suspended or terminated,

and those rules are applied by the operator of the market consistently and without inappropriate bias.

ASX considers that this view of the meaning of “fair” is supported by the decision in *Transmarket Trading Pty Limited v Sydney Futures Exchange Limited*. In that case, Perram J observed that the notion of fairness in section 792A(a):

“relates to a state of affairs in which all market participants are placed in an equal position such that there is level playing field.”<sup>16</sup>

This is not to say that a market must treat all participants equally in all circumstances. Plainly, a market can still meet its obligation of fairness, even though it may provide for different categories of participants with different rights and obligations under the rules, or charge different fees to participants who deal in different products or in different volumes.

Fairness requires a level playing field and that participants in like circumstances are treated in like manner, rather than that all participants in all circumstances are treated equally.

In saying this, ASX acknowledges that different views have been expressed in the past as to what is encompassed within the notion of a market being “fair”. For example, there have been numerous statements in financial and regulatory literature equating the fairness of a market to it being free of manipulation, insider trading and other forms of market misconduct. Indeed, in *Transmarket Trading Pty Limited v Sydney Futures Exchange Limited*, Perram J referred to an SEC order,<sup>17</sup> which he described as informative but not determinative, which defined a fair market as one that is “free from manipulative and deceptive practices, and affords no undue advantage to any participant”.<sup>18</sup>

ASX believes that those statements should mostly be understood as referring to a or the “market” in a broader and more ephemeral sense than that term is used in section 792A(a). Those statements use the term “market” in the sense of the broad interplay of the forces of supply and demand and the conduct of participants in bringing those forces into equilibrium (the market as an economic or behavioural phenomenon) rather than the particular facility on which orders to buy and sell financial products are matched (the market as a functional or physical phenomenon).

In some cases those references can also be understood as arising from a conflation of the different statutory obligations of a licensed market operator. This was particularly the case prior to the enactment of the Corporations Amendment (Financial Market Supervision) Act 2010, when market licensees had an obligation to have adequate arrangements to supervise their market and to monitor the activities of participants on or in relation to their market.<sup>19</sup>

In that context, it was easy to confuse or conflate a licensee's obligation to have adequate supervisory arrangements designed to ensure that participants did not engage in market misconduct with its obligation to operate a fair market.

Since the enactment of the Corporations Amendment (Financial Market Supervision) Act 2010, however, the Corporations Act has drawn a clear distinction between the operation of licensed markets and their supervision. Operational matters unambiguously are within the remit of the market operator,<sup>20</sup> while supervisory matters (including the regulation of the activities or conduct of persons in relation to licensed markets and in relation to financial products traded on such markets via Market Integrity Rules) unambiguously are within the remit of ASIC.<sup>21</sup>

ASX submits that Perram J was therefore right to confine his analysis of fairness under section 792A(a) to whether or not there is a level playing field between market participants, and not to import the SEC's notion that the market must be free of manipulative or deceptive practices in order to satisfy that section. The obligation in section 792A(a) is that the *market* – that is, according to the definition of that term in section 767A(1), the facility through which orders to buy and sell financial products are matched – is fair, not that the participants using that facility behave in a fair or lawful manner.

ASX considers that this interpretation is reinforced by the inclusion in section 792A(a) of the qualification “to the extent that it is reasonably practicable to do so”. In terms of what is both reasonable and practicable, a market operator can plainly exercise a large measure of control over the design and behaviour of its market infrastructure to ensure that it operates fairly; it can exercise much less control over the designs and behaviours of the participants who use that infrastructure.<sup>22</sup>

### **The meaning of “orderly”**

In ASX's opinion, the word “orderly” is used in section 792A(a) in the sense of ‘arranged or disposed in order, in regular sequence, or in a tidy manner’ or ‘according to established order or rule’.<sup>23</sup>

ASX again considers that this view of the meaning of “orderly” is supported by the decision in *Transmarket Trading Pty Limited v Sydney Futures Exchange Limited*. In that case, Perram J observed that the notion of orderliness in section 792A(a) connotes:

“reliable market operations displaying price continuity and depth and in which unreasonable price variations between sales are avoided.”<sup>24</sup>

ASX considers that a market is likely to meet its obligation to be orderly if the market has clear rules or processes governing:

- how and when buy and sell orders will be matched;
- the application of trading halts;
- the correction or cancellation of trading errors; and
- the ability of the market operator to suspend trading, correct or cancel trades, or take other corrective action<sup>25</sup> to help avoid or rectify a disorderly market,

and its trading systems are secure, reliable and have sufficient capacity to handle reasonably foreseeable peak levels of trading.

In the case of a market operator that sets the specifications for derivative contracts traded on its market, the obligation to ensure that the market is orderly would also extend to taking reasonable steps to ensure that there is nothing built into those specifications that is inherently likely to lead to a disorderly market.<sup>26</sup>

ASX notes that in relation to shares, managed investment products and certain other equity market products admitted to quotation on the ASX market, the requirement for orderliness has, to some extent, been codified in Chapter 2 of the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011. That Chapter requires the operators of licensed markets that deal in relevant equity market products to have order entry controls for anomalous orders, to calculate and disseminate an extreme cancellation range and to have transparent trade

cancellation policies that include the mandatory cancellation of trades within the extreme cancellation range which are identified by or to the market operator within 30 minutes from the time of execution and no later than 10 minutes after the close of trading on its market. Those requirements are consistent with the interpretation of the word “orderly” put forward in this document.

### **The meaning of “transparent”**

When read in conjunction with the definition of “financial market” in section 767A(1), ASX considers that the relevant features of a market that must be transparent are the prices and volumes at which orders to buy and sell financial products are matched using that market facility.

ASX again considers that this view of the meaning of “transparent” is supported by the judgment in *Transmarket Trading Pty Limited v Sydney Futures Exchange Limited*. In finding that the market events in that case did not infringe section 792A(a), Perram J commented:

“Nor is there anything which would suggest that the operation of the market was other than transparent. The market log of all trades was available and it was not put, at any point, that there were market events which were concealed or not sufficiently exposed.”<sup>27</sup>

ASX considers that a market is likely to meet its obligation to be transparent if participants know with an appropriate degree of certainty whether, and at what prices and in what volumes, they can deal when they choose to use the market and have timely access to information about the prices and volumes of all individual transactions concluded on the market.

In the case of a market operator that sets the specifications for derivative contracts traded on its market, the obligation to ensure that the market is transparent would also extend to ensuring that those specifications are readily accessible to market participants.

ASX again notes that in relation to shares, managed investment products and certain other equity market products admitted to quotation on the ASX market, the requirements for transparency have been fully codified in Chapters 4 and 5 of the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011. Those Chapters require the operators of licensed markets that deal in relevant equity market products to meet certain pre-trade and post-trade transparency requirements. Those requirements are consistent with the interpretation of the word “transparent” put forward in this document.

### **Balancing fairness, orderliness and transparency**

The phrase “fair, orderly and transparent” is a composite phrase of three potentially conflicting elements. It is conceivable, for example, that something could be fair but not orderly or transparent, orderly but not fair or transparent, or transparent but not fair or orderly. It is also conceivable that something could affect different participants differently – that is, something might be fair to some participants but unfair to others.

The issues at play here are well illustrated by the observations of Young J in *Story v National Companies and Securities Commission*<sup>28</sup> when interpreting another composite phrase – the obligation of financial service licensees<sup>29</sup> to provide their services “efficiently, honestly and fairly”:

“Thus I turn to the phrase “efficiently, honestly and fairly”. In one sense it is impossible to carry out all three tasks concurrently. To illustrate, a police officer may very well be most efficient in control of crime if he just shot every suspected criminal on sight. It would save a lot of time in arresting, preparing for trial, trying and convicting the offender. However, that would hardly be fair. Likewise a judge could get through his list most efficiently by finding for the plaintiff or the defendant as a matter of course, or declining to listen to counsel, but again that would hardly be the most fair way to proceed. Considerations of this nature incline my mind to think that the group of words “efficiently, honestly and fairly” must be read as a compendious indication meaning a person who goes about their duties efficiently having regard to the dictates of honesty and fairness, honestly having regard to the dictates of efficiency and fairness, and fairly having regard to the dictates of efficiency and honesty ... ”

Applying a similar approach to section 792A(a), this would suggest that to meet its obligation under that section, a market must be fair having regard to the dictates of orderliness and transparency, orderly having regard to the dictates of fairness and transparency, and transparent having regard to the dictates of fairness and orderliness.

The limited regulatory guidance as to how to interpret the phrase “fair, orderly and transparent” in section 792A(a) is to similar effect and suggests that if there is a conflict between the elements of the phrase, the licensee is expected to strike an appropriate balance between the demands of each element<sup>30</sup> – in other words, the licensee must strike an appropriate balance between fairness, orderliness and transparency.<sup>31</sup>

ASX believes that the appropriate balance between fairness, orderliness and transparency is one which has regard to the pivotal role that the ASX and ASX 24 markets play in the Australian financial system. ASX considers that the test in section 792A(a) should be biased towards an outcome that achieves fairness from the perspective of most participants and orderliness and transparency from the perspective of the market as a whole rather than an outcome that delivers fairness to an individual participant at the expense of the orderliness and transparency of the market.

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<sup>1</sup> Referred to as the “Corporations Act”. Unless otherwise stated, references to sections are to sections of the Corporations Act.

<sup>2</sup> Operators of licensed markets also have separate obligations under section 792A (among other things):

- to have adequate arrangements for operating the market, including arrangements for:
  - handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the market operates in a fair, orderly and transparent way; and
  - monitoring and enforcing compliance with the market’s operating rules (section 792A(c)); and
- to have sufficient resources (including financial, technological and human resources) to operate the market properly (section 792A(d)).

<sup>3</sup> ASIC defines a “facility” as any form of infrastructure and says that this definition is consistent with the decision in *Carrageen Currency Corporations Pty Ltd v Corporate Affairs Commission (NSW)* (1986) 11 ACLR 298, 312-3. (see ASIC Regulatory Guide 172 *Australian market licences: Australian operators*, at paragraphs 17 and 30).

<sup>4</sup> ASX therefore would not regard the fact that another market may be affected by circumstances that cause it to be operating in an unfair, disorderly or not transparent manner, or that it has halted trading in response to, or to avoid, that occurring, to be relevant factors in assessing whether an ASX market is fair, orderly and transparent. The latter issue would have to be assessed by reference to the particular circumstances affecting the ASX market.

<sup>5</sup> In this context, the operating rules of a licensed market include not only those rules governing the activities or conduct of the market or of persons in relation to the market, but also any listing rules that are made by the market operator (see the definition of “operating rules” in section 761A).

<sup>6</sup> Section 795B(1)(c).

<sup>7</sup> Before it can change its operating rules, a market operator must lodge written notice of the change with ASIC under section 793D. The Minister can disallow the change within 28 days of that lodgement under section 793E.

<sup>8</sup> Section 793E.

<sup>9</sup> Section 793B and 793C. Although, in the case of the licensee, this is subject to any discretion that the operating rules may afford to the licensee in terms of granting a waiver or exemption from, or not enforcing, a particular rule. Any such discretion is one that would have to be exercised by the licensee “fairly”, as that term is defined later in this Guidance Note.

<sup>10</sup> Section 798G. ASIC’s Market Integrity Rules take primacy over the operating rules of a licensed market (section 793B(2)).

<sup>11</sup> For example, Chapter 2 of the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011 requires a market operator to have in place arrangements for cancellation of erroneous trades. A market operator can determine how it satisfies this obligation within the parameters set by the Market Integrity Rules and having regard to its statutory obligation to ensure, as far as practicable, that its market is fair, orderly and transparent. To date, ASIC has elected to make Market Integrity Rules on a range of matters where the absence of a rule could result in loss of market fairness, orderliness or transparency across financial markets that trade the same financial products if the actions of individual market operators were inconsistent. There may be further instances where ASIC intervention is required, for example to eliminate fee incentives that operate unfairly or that could distort trading activity.

<sup>12</sup> ASX therefore would not regard a short term loss of connectivity to one of its markets by an individual participant or group of participants as rendering the market unfair, disorderly or not transparent.

<sup>13</sup> The Macquarie Dictionary (2006) lists 22, and Dictionary.com lists over 30, different meanings for the word “fair”.

<sup>14</sup> See the Macquarie Dictionary (2006) at page 420.

<sup>15</sup> See the discussion of the Minister’s powers under sections 795B(1)(c) and 793E in the text at notes 6 and 8 above.

<sup>16</sup> [2010] FCA 534, at paragraph 95. This formulation of fairness was accepted and applied by the ASX Disciplinary Tribunal in *ASX Compliance Pty Ltd and Timber Hill Australia Pty Ltd* (15 December 2010) Matter No. 2009018 & 2009026, at paragraph 5.14.1.

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<sup>17</sup> “Order Instituting Administrative and Cease-And-Desist Proceedings”, Exchange Act Release No. 34-49500, 82 SEC Docket 1903 (March 30 2004).

<sup>18</sup> [2010] FCA 534, at paragraph 94.

<sup>19</sup> Section 792A(c).

<sup>20</sup> Section 792A(c).

<sup>21</sup> Section 798F and 798G. Note, however, that this is not to say that market operators have no responsibility in relation to the conduct of market participants. Under section 792B, a licensed market operator must give written notice to ASIC if it has reason to suspect that a person has committed, is committing, or is about to commit, a significant contravention of the market’s operating rules or of the Corporations Act.

<sup>22</sup> Such control is more appropriately exercised by ASIC, whose enforcement powers are grounded in criminal and civil law rather than contract (as ASX’s enforcement powers are under section 793B) and which has the capacity to suspend or cancel the licences of participants to provide financial services (section 915C). ASIC also has the power to supervise the actions of participants and enforce the Corporations Act and the Market Integrity Rules across multiple markets, whereas ASX can only monitor and enforce its operating rules in relation to the markets it operates.

<sup>23</sup> See the Macquarie Dictionary (2006) at page 854.

<sup>24</sup> [2010] FCA 534, at paragraph 95. This formulation of orderliness was accepted and applied by the ASX Disciplinary Tribunal in *ASX Compliance Pty Ltd and Timber Hill Australia Pty Ltd* (15 December 2010) Matter No. 2009018 & 2009026, at paragraph 5.14.2. That decision was affirmed on appeal by the ASX Appeal Tribunal (2 May 2011).

ASX notes that Perram J’s statement quoted in the text above was qualified by an observation ([2010] FCA 534, at paragraphs 95 and 100) that:

“I do not think that the pursuit of orderly markets carries with it the eradication of volatile or unpredictable markets. ... I conclude that the trading behaviour exhibited in [this case] was highly unusual, unprecedented over nearly a decade and inconsistent with an informed response to the data. However, I also accept ... that the actual price fluctuations observed were caused by everyday market phenomena. There is no particular contradiction involved in concluding that the events were highly anomalous but nevertheless caused only by ordinary market events: a once in fifty year market event will eventually occur; someone always wins the lottery. The occurrence of such a market anomaly does not, however, indicate the absence of reliable operations nor the absence of price continuity or depth. Markets, from time to time, exhibit chaotic behaviour but without more that does not, I think, render them disorderly.”

The ASX Appeal Tribunal explained this observation in the *Timber Hill* matter as follows

“... the impact of trading must be considered on a case by case basis. The Appeal Tribunal does not understand Perram J to have laid down an immutable rule concerning the meaning of the phrase ‘fair and orderly’. His Honour was commenting on the facts as they emerged from the evidence before him and, in particular, the evidence that the price fluctuations had been caused by everyday market phenomena. In the present case, there was, as the Disciplinary Tribunal found, an absence of regular and reliable operations with price continuity. There were, in the circumstances, unreasonable price variations and disorderly markets.”

<sup>25</sup> For example, the imposition of position limits or exercise limits on derivative positions.

<sup>26</sup> This might arise, for example, if a derivatives market contract imposed physical delivery requirements that, in practice, were difficult for market participants to meet.

<sup>27</sup> [2010] FCA 534, at paragraph 96. In this regard, ASX construes Perrem J’s reference to market events being sufficiently exposed as a reference to information about the price and volume of trades done on the market being published promptly after they were executed.

<sup>28</sup> (1988) 13 NSWLR 661, at 672.

<sup>29</sup> Section 912(1)(a).

<sup>30</sup> See ASIC Regulatory Guide 172 *Australian market licences: Australian operators* at paragraph 83.

<sup>31</sup> The inclusion in section 792A(a) of the qualification “to the extent that it is reasonably practicable to do so” also lends support to this construction. In this regard, the Explanatory Memorandum for the Financial Services Reform Bill (2002), which enacted section 792A(a), made the following observations (at paragraph 7.38) about that section:

In interpreting the phrase ‘fairness, orderliness and transparency’, it is desirable that all the words in the phrase be considered together. One word taken out of context may lead to a course of action which conflicts with the other words in the phrase. Thus, transparency may on occasions be in conflict with liquidity, yet liquidity is needed for an orderly market. The tensions between the three words need to be resolved sensibly, so that an appropriate balance is struck between the demands of different market participants. This is specifically acknowledged in the clause ‘to the extent that those objectives are consistent with one another’.

The phrase ‘to the extent that those objectives are consistent with one another’ was replaced in the final form of section 792A by the phrase ‘to the extent that it is reasonably practicable to do so’.