



Elmer Funke Kupper
Managing Director and CEO

ASX Limited
Exchange Centre
20 Bridge Street
Sydney NSW 2000

Telephone +61 2 9227 0501
Email elmer.funkekupper@asx.com.au
www.asx.com.au

17 December 2012

Ms Deb O'Neill
Chair
Joint Committee for Corporations and Financial Services
PO Box 6022
House of Representatives
Parliament House
CANBERRA ACT 2600

Dear Chair,

Thank you for the opportunity to address the Parliamentary Joint Committee for Corporations and Financial Services on Monday 3 December.

From ASX's perspective, I believe it is important to engage with the joint committee to give it an insight into the exchange and our understanding of the issues impacting on Australia's financial markets. I hope that the committee found our evidence useful and we are, of course, happy to discuss any of these issues or new ones with the committee at its convenience.

During the hearing, committee members asked for further information on a few issues. I have attached the questions and answers to this letter. Please contact me if additional material is needed.

Yours sincerely,

Elmer Funke Kupper

c.c. Dr Richard Grant, Acting Secretary

ASX Further Response to Questions from the PJC

Question 1

"Would it be possible to get, on notice – I do not necessarily want to know the days – the meetings and the topic that is discussed at those meetings?"

Answer 1

Regular monthly meetings are held between ASX and ASIC representatives on:

- a) Business Development, Operations and Technology matters:
 - ASX Business initiatives
 - ASIC initiatives and regulatory issues
 - Matters relating to the operation of the markets and clearing and settlement facilities
 - ASX participants
 - ASX and ASIC technology
 - Changes to the operating rules and
 - Consultations and submissions
- b) Compliance related matters:
 - Run off case management
 - Information requests
 - Rule overlap or other rule issues
 - Referrals
 - Participant co-ordination and
 - Participant capital monitoring

Question 2

"The MOU with ASIC – has it got a term to it? Does it have to be renegotiated?"

Answer 2

There is no term. The MOU is ongoing.

Question 3

"The memorandum of understanding that you have reached indicates that ASIC has capacity to advise the Australian Securities Exchange of a potential breach of the ASX operating rules, but it is limited by the Privacy Act and section 127 of the ASIC Act. Does the ASX receive from ASIC sufficient information to address breaches of its operating rules? Given the transfer of responsibility for supervision of the stock market from ASX to ASIC, should section 127 of the ASIC Act be reviewed to consider the ASX among entities which ASIC may provide confidential information to?"

Answer 3

The regular meetings outlined in Question 1 (above) together with daily discussions between ASX Compliance and ASIC staff and specific meetings/discussions relating to particular incidents/events/issues provide forums for ASX to obtain any relevant information from ASIC that ASX does not otherwise obtain itself through its operational or compliance activities. Also, ASIC has this year released information to ASX pursuant to section 127 to enable ASX to pursue enforcement action against ASX participants.

In relation to the question about section 127 of the ASIC Act being reviewed, we believe this is not necessary for ASX Group licensees. However, it could be helpful if the Securities Exchanges Guarantee Corporation (the trustee of the National Guarantee Fund) was included in the list of bodies corporate in Part 1 of Schedule 3. SEGC has statutory powers under section 892D to require production of documents or statements to assist it in determining a claim for compensation in respect of a broker, but these powers do not apply to ASIC. The inclusion of SEGC in the list in Part

1 of Schedule 3 will facilitate cooperation between SEGC and ASIC in relation to the sharing of information. This is particularly important now that broker supervision functions have been transferred to ASIC.

Question 4

"Could you provide on notice some examples from the US market where the level of high frequency trading and dark pools activity has had very negative outcomes of the kind we are seeking to prevent?"

Answer 4

Below are reports/extracts of high frequency trading and dark pool activity:

The US flash crash date and summary of what occurred

On May 6, 2010, the prices of many U.S.-based equity products experienced an extraordinarily rapid decline and recovery. That afternoon, major equity indices in both the futures and securities markets, each already down over 4% from their prior-day close, suddenly plummeted a further 5-6% in a matter of minutes before rebounding almost as quickly.

Many of the almost 8,000 individual equity securities and exchange traded funds ("ETFs") traded that day suffered similar price declines and reversals within a short period of time, falling 5%, 10% or even 15% before recovering most, if not all, of their losses. However, some equities experienced even more severe price moves, both up and down. Over 20,000 trades across more than 300 securities were executed at prices more than 60% away from their values just moments before. Moreover, many of these trades were executed at prices of a penny or less, or as high as \$100,000, before prices of those securities returned to their "pre-crash" levels.

By the end of the day, major futures and equities indices "recovered" to close at losses of about 3% from the prior day.

<http://www.sec.gov/news/studies/2010/marketevents-report.pdf>

The BATs and Facebook IPOs dates and summary of what occurred

BATS experienced a serious technical failure on Friday, March 23, 2012 which caused it to withdraw its own IPO.

BATS experienced a system problem in our attempt to open the BATS ticker symbol for the first time on Friday morning. We failed to roll into continuous trading with our new BATS ticker immediately following the opening auction. In effect, our newly issued stock did not begin trading as it should and was halted before it ever started trading.

Technology implementations are prone to failures and unexpected outcomes, even after going through rigorous testing. Every market center and every trading participant has experienced technical issues in their history. Our historical reliability has been very strong, with 99.9% uptime on our primary BATS BZX Exchange over the last 3+ years. On Friday we were under the brightest spotlight imaginable ... opening our own stock on our own exchange for the first time ever. It doesn't get much more public than that.

Our listing Exchange has an obligation to operate and maintain fair and orderly markets. In the ordinary course, when an exchange experiences a technical problem, normal trading in the affected securities resumes once the technical problem is resolved. This situation was unique, however, because the affected security was our own. After fixing the software module that failed, and rolling it back into production, we were faced with how the market would react to a re-opening of our stock after the failed first start. Had the delay been only a few minutes, the restart process would have possibly been manageable. But after 2 ½ hours had transpired, we determined that this was a material event that had eroded investor confidence in our own stock and made the timely resumption of fair and orderly trading unlikely. As a result, we pulled the IPO and unwound all auction executions.

http://www.batstrading.com/resources/newsletters/CEO_Newsletter_25Mar2012.pdf

Facebook

On May 18, 2012, Nasdaq experienced system difficulties during the Nasdaq Halt and Imbalance Cross Process (the "Cross") for the FB IPO. These difficulties delayed the completion of the Cross from 11:05 a.m. until 11:30 a.m...

As a result of the system difficulties, however, certain orders for FB stock that were entered between 11:11:00 a.m. and 11:30:09 a.m. in the expectation of participating in the Cross – and that were not cancelled prior to 11:30:09 – either did not execute or executed after 1:50 p.m. at prices other than the \$42.00 price established by the Cross. (Other orders entered between 11:11:00 a.m. and 11:30:09 a.m., including cancellations, buy orders below \$42.00, and sell orders above \$42.00, were handled without incident.) System issues also delayed the dissemination of Cross transaction reports from 11:30 a.m. until 1:50 p.m. At 1:50 p.m., Nasdaq system difficulties were completely resolved...

As a result of these unique circumstances, Nasdaq is proposing to accommodate members for losses attributable to the system difficulties on May 18, 2012 in an amount not to exceed \$62 million.

<https://www.sec.gov/rules/sro/nasdaq/2012/34-67507.pdf>

Knight Capital malfunction date and summary of what occurred

Knight Capital Group Provides Update Regarding August 1st Disruption To Routing In NYSE-listed Securities

As previously disclosed, Knight experienced a technology issue at the open of trading at the NYSE yesterday, August 1st. This issue was related to Knight's installation of trading software and resulted in Knight sending numerous erroneous orders in NYSE-listed securities into the market. This software has been removed from the company's systems.

Clients were not negatively affected by the erroneous orders, and the software issue was limited to the routing of certain listed stocks to NYSE.

Knight has traded out of its entire erroneous trade position, which has resulted in a realized pre-tax loss of approximately \$440 million. Although the company's capital base has been severely impacted, the company's broker/dealer subsidiaries are in full compliance with their net capital requirements. Knight will continue its trading and market making activities at the commencement of trading today. The company is actively pursuing its strategic and financing alternatives to strengthen its capital base.

<http://www.knight.com/investorRelations/pressReleases.asp?compid=105070&releaseID=1721599>

Other issues or incidents in the US

Flash order controversy at Direct Edge. Direct Edge withdrew the practice of flashing customer orders to their liquidity providers before routing unfilled orders to other venue in 2011.

Number of dark pools operating in the US

According to Mary Schapiro there are 15 public exchanges, more than 30 dark pools, 3 electronic communication networks (ECNs), and more than 200 internalizing broker-dealers.

Proportion of off market trading in the US

According to Fidessa, 32% in FY13.

Category	Venue	Trade Type	Turnover (m USD)	Volume	#Trades	Av.Value	Av.Size	Share
[-] Lit			1,445,753	44,206,071,177	134,896,038	10,718	328	67.61%
	[+] NYSE		393,475	9,714,162,410	13,531,731	29,078	718	18.4%
	[+] NASDAQ		318,901	9,571,351,246	31,570,926	10,101	303	14.91%
	[+] NYSE Arca		209,651	6,811,632,958	22,307,368	9,398	305	9.8%
	[+] BATS		176,397	5,496,586,465	22,087,767	7,986	249	8.25%
	[+] EDGX		132,249	4,455,134,317	13,451,741	9,831	331	6.18%
	[+] BATS Y		71,252	2,483,289,809	11,610,883	6,137	214	3.33%
	[+] NASDAQ BX		49,368	2,104,647,976	8,800,601	5,610	239	2.31%
	[+] EDGA		46,604	1,816,067,134	7,401,899	6,296	249	2.18%
	[+] NASDAQ PSX		22,309	889,379,397	2,016,258	11,065	441	1.04%
	[+] Chicago Stock Exchange		9,416	287,543,634	8,830	1,066,402	32,564	.44%
	[+] CBSX		8,412	300,054,926	1,437,718	5,851	209	.39%
	[+] NSX		5,990	177,551,651	421,865	14,199	421	.28%
	[+] NYSE Amex		1,728	68,669,254	248,451	6,956	276	.08%
[-] OTC			692,736	23,790,111,602	40,823,107	14,189	487	32.39%
	[+] OFF/Q		595,249	20,610,679,054	40,083,949	14,850	514	27.84%
	[+] OFF/N		59,856	1,878,320,732	8,701,693	6,879	216	2.8%
	[+] Boat xoff		36,836	1,215,342,959	37,423	984,303	32,476	1.72%
	[+] Euronext OTC		796	85,768,857	122	6,522,177	703,023	.04%

Proportion of retail flow executed on lit exchanges

Internalisation is also thought to account for almost 100% of all retail marketable order flow. Retail internalization is driven by the purchase of order flow by wholesale OTC market makers from retail brokerage firms. This practice enables broker/dealers to "prefer" those orders that are profitable to arbitrage and route unwanted orders to other market centers

Dark Pools, Internalization, and Equity Market Quality, CFA Institute 2012