Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

2014 - 2015

Department/Agency: ASIC
Question: BET 93-97
Topic: ASIC Complaints
Reference: written - 03 June 2015
Senator: Lambie, Jacqui

Question:

93. Given your extensive experience can you please detail what role a Financial transaction Tax plays in Europe and if it is good enough for France, why isn't the Government at the very least looking into my Financial Transaction Share Traders Proposal here in Australia.

94. Has the Australian Securities and Investment Commission received any complaints (please provide the number of complaints and the nature of the complaint) about the charges that banks charge people when they withdraw cash from an Automatic teller.

95. Please release any research reports that Australian Securities And Investment Commission has completed on Financial Transaction Tax.

96. Please provide a definition of an insider trader.

97. Please provide the risks that High Speed share trading poses in regards to market melt-down/financial crisis.

98. As offered by the Australian Securities and Investment Commission on the 3 June 2015 in the Senate Economics Committee can we please have a copy of all the companies that are trading within the ASX building?

Answer:

93.

ASIC is not in a position to respond to the specific question which is a question for Government. However, more broadly in relation to a Financial Transactions Tax, ASIC makes the following observations.

The European Commission proposed a financial transaction tax in 2011 (revised in 2013) as a means for the financial sector to pay back what European tax payers have contributed since the global financial crisis. There is ongoing discussion among 11 member states about the shape and implementation of the proposal.

In the meantime, a number of countries have introduced domestic taxes at a local country level, including France and Italy. France introduced its taxes in August 2012 and Italy in

March 2013. Taxes in both countries are between 0.01% and 0.2% of the transaction amount, depending on the product. The taxes apply to transactions in certain French and Italian equities or similar products (e.g. French companies with market capitalisation in excess of EUR 1 billion), certain high-frequency-trading orders and certain over-the-counter transactions.

Economic theory generally suggests that a tax on transactions may adversely impact liquidity, the cost of capital and market efficiency. The research department of the European Commission examined the impact of the French tax on trading volumes, share prices and volatility. It could not confirm that the introduction of the tax had triggered a decline in share prices or that volatility of the taxed market increased after the introduction of the tax. Liquidity (volumes) did decline by around 10% but that coincided with a market-wide decline in trading volumes around the time of the introduction of the tax. It concluded that, overall, "the tax had been absorbed with no effect on the equilibrium" and this is likely due to the "tax “shock” [being] simply too small to trigger such measurable effects".[1]

Findings of third party research are mixed. Some found volatility decreased while others found it increased. Some attribute the fall in trading volumes to the tax (including lower participation by HFTs).

In Australia, the Government recovers the cost of ASIC's market supervision from the industry. This is levied in a number of ways, including fees on order and trade messages. As soon as it was introduced in 2012, there was a significant and sustained reduction in the ratio of order to trade messages from a market average of 11:1 to 7:1 today. The ratio for HFT is currently 12:1 but had been over 50:1. The levy acts as a deterrent to excessive order and trade generation by HFTs in our market.

94.

Please also see ASIC’s answer to BET 76.

ASIC’s records indicate that ASIC has received two reports of alleged misconduct from consumers in the last two financial years (between 1 June 2013 and 30 June 2015) raising concerns about the fees charged for withdrawal from an automatic teller machine (ATM).

There are no express regulatory requirements under the legislation that ASIC administers about the level of fees charged to consumers for withdrawing funds from an ATM.

ASIC is aware that the RBA is responsible for the payments systems, which includes Australia’s ATM system. ASIC understands that the RBA introduced reforms to Australia’s ATM system on 3 March 2009, including the introduction of ‘direct charging’ at ATMs.

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[1] See http://ec.europa.eu/taxation_customs/resources/documents/taxation/other_taxes/financial_sector/effect_french_ftt.pdf

Further information about the ATM Fee Reforms is available on the RBA website at http://www.rba.gov.au/payments-system/reforms/atm-fee-reforms.html.

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ASIC does not have any research reports completed on the Financial Transaction Tax.

96.

An insider trader is any party who buys or sells Division 3 Financial Products for example securities and derivatives whilst in possession of information which is not "generally available" and is expected to have a "material effect" on the price or value of the financial product. This is done to obtain trading profits by trading prior to the information being released. Insider traders use the price movement resulting from the release of the information into the public domain to reverse their original trade and lock in profits. There are also related offences for tipping or procuring, which prohibit the provision of inside information to other parties when the insider knows, or ought reasonably suspect, that those parties may engage in insider trading and/or procure others to engage in the act of insider trading. The insider trading prohibitions and related definitions are contained in Division 3 of Part 7.10 of the *Corporations Act 2001*.

97.

One of the most significant recent developments in markets globally has been the dramatic growth in automated electronic trading. These developments have greatly improved the efficiency of trading, but they have also introduced new risks to market integrity.

ASIC's 2012/13 Taskforce on high-frequency trading estimated that around 99.6% of all equity trading messages submitted to a market were sourced from an automated order processing program. Some of this would be direct electronic access flow (clients sending individual orders through a market participant's automated order processing system), but most of the trading messages would have originated from algorithmic programs not only from high-frequency traders but other market participants and asset manager clients.

The Taskforce found that it is not just high-frequency traders that have very fast order entry systems (average order entry speed for HFT was 32 milliseconds compared to 40 milliseconds for others) and rest their orders on the market for short periods (80% of HFT orders rest for less than 1 minute, 78% for others). Therefore, ASIC focuses on the risks of automated trading to the market more generally.

Automated trading can increase the speed, breadth and depth of price movements, as algorithms respond to news and others' orders and trades. System failures, such as feedback loops, can result in unintended and excessive order entry. Unexpected and extreme price movements, as well as system failures, can exacerbate price volatility and losses for investors; undermining their confidence in the market and discouraging participation.

Examples of significant automated trading events outside of Australia in recent years that have damaged market confidence include:

- In May 2010, the 'flash crash' caused prices in some securities in the United States to drop to 1c before quickly rebounding. Many investors lost money. The Securities and Exchanges Commission reported that the trigger was a large mutual fund using an algorithm to work a very large futures order at a time when there was general negative market sentiment and thin liquidity. The interaction of orders generated by the mutual fund and by others' algorithms drove prices down quickly across the futures and equities markets. There were inconsistencies with how market operators responded. It was estimated that 30% of retail investors still had not returned to the market 6 months after the event.[2]
- In August 2012, Knight Capital (a HFT) in the United States launched a new algorithm with a fault. It caused prices in some securities to soar. Knight was unable to shut the algorithm down and was required to fulfil the trades, costing Knight $400 million. The Securities and Exchange Commission fined Knight $12 million.[3]
- In April 2013, a false announcement on Twitter about the White House being bombed sent algorithms into selling mode. Prices plummeted for three-minutes and wiped out over US$100 billion in value before recovering.

In Australia, we have not experienced disruptions of this gravity. ASIC has a world leading real-time market surveillance system with highly qualified staff to ensure we understand our market. We also have robust controls, which were enhanced after the recent international events. They include:

- Access to the public markets must be through regulated market participants;
- For ASX and Chi-X market participant controls include:
    - any system used to place orders and instructions onto a market must go through a certification process and be acknowledged by ASIC;
    - there must be automated filters and controls (i.e. for price and volume anomalies prior to order submission to a market);
    - systems and programs must undergoing adequate testing;
    - there must be the capacity to immediately disable faulty systems;
    - market participants are prohibited from taking advantage of a breakdown or malfunction; giving a false or misleading appearance of active trading; and doing anything to create a market that is not fair and orderly;
- Market operator (e.g. ASX and Chi-X Australia) controls include:
    - automated order entry controls, to prevent obviously anomalous orders from being entered into market trading systems (e.g. mispriced orders);
    - automated controls preventing orders in the trading system from executing at prices a long way from current prices; and
    - transparent policies about when trades will be cancelled if the market is not fair and orderly.

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[2] See SEC and CFTC report at www.sec.gov/news/studies/2010/marketevents-report.pdf

[3] See SEC press release at www.sec.gov/News/PressRelease/Detail/PressRelease/1370539879795

98.

We don’t have that specific information. It is our current understanding that most of the large market participants utilise the co-location facilities offered by the ASX, and, by and large, it is the smaller market participants that do not pay for co-location facilities within the ASX.