



ASX
AUSTRALIAN SECURITIES EXCHANGE

ASX Market Rules Guidance Note No. 11

KEY TOPICS

1. Client Order Priority
2. Limit Orders
3. Iceburg Orders
4. Discretionary Trading
5. Allocation

ASX Market Rules

1. 7.5

Guidance Note History

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10 April 2006

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New Rule Introduction

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CLIENT ORDER PRIORITY

Purpose

The purpose of this guidance note is to provide assistance to ASX Market Participant in the interpretation of the ASX Market Rule 7.5 in relation to Client Order Processing.

Background

A Market Participant is in a fiduciary relationship with its client as agent for the client. A fundamental obligation arising from that relationship is that the Market Participant must act in the best interests of the client. It follows from this that the Market Participant must not place itself in a position in which its personal interests and its duty are in conflict with the interests of its client.

The principles in Rule 7.5 provide flexibility to Market Participants in relation to trading of principal orders and orders on behalf of a Prescribed Person provided the over-riding obligation of the Market Participant to act in the best interests of its client is adhered to. In particular the Market Participant must not give unfair preference to itself, to any Prescribed Person or to any client, over another client.

Rule 7.5.1 outlines the meaning of dealing on “own account”. Market Participants should take note of this to ensure that their understanding of “own account” is consistent with the Rules.

Rule 7.5.2 outlines exceptions to the definition of “own account” for Market Participants in exceptional circumstances. Market Participants should make themselves familiar with these also.

Rule 7.5.3 requires a Market Participant to deal fairly and in due turn with:

- (a) clients’ orders; and
- (b) a client order and an order on its own account or on account of a Prescribed Person.

This primary obligation is then placed in context, by reference to a number of relevant factors set out in Rule 7.5.4. Each of these factors is discussed in the paragraphs below.



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“(a) the Market Participant acts in accordance with its instructions”

This factor is self-explanatory. For example, Client A instructs the Market Participant to place a limit buy order. Client B subsequently instructs the Market Participant to place a buy order at market, which is currently at a price above the limit buy order. The Market Participant would not breach its obligations under the Rule if Client B’s order was successfully filled at the higher prevailing market price, since the Market Participant has carried out both clients’ instructions.

The same principle would apply if it were the Market Participant’s own account that had requested the “at market” buy order.

“(b) orders that do not involve the exercise of discretion by the Market Participant in relation to the time or price or quantity of the order are entered in SEATS in a Trading Platform in the sequence in which they are received, and otherwise as expeditiously as practicable”

In cases where the Market Participant has carried out instructions, there is no delay in entering the order (except on instructions), the price/time priority of the Trading Platform determines which orders trade, and allocation is automatic, best execution can be said to have been obtained, even if the Market Participant’s own order is satisfied ahead of a client’s order. This is particularly the case where the Market Participant has no control over the placement of client orders onto the Trading Platform such as when the client uses Automated Client Order Processing (ACOP). Similarly, orders received over the internet are generally placed on the Trading Platform immediately they are received, minimising or eliminating opportunities for delay.

In such cases it remains a matter for the judgement and integrity of the Market Participant as to whether, notwithstanding that the Market Participant’s own account had time priority, it re-allocates its own trade to a client who placed an order later in time via ACOP or the internet. ASX would expect clients (whether retail or wholesale investors) to be advised of the Market Participant’s allocation policy between other clients, the Market Participant’s own account and Prescribed Persons. This is most particularly the case where trades for the Market Participant’s own account or for Prescribed Persons are dealt with and/or allocated on a price/time priority, in the same way as client trades.

“(c) Orders of a client (which is not a Prescribed Person) that involve the exercise of discretion by the Market Participant in relation to the time or price or quantity of the order are given preference over orders of the Market Participants’ own account, unless the client otherwise consents. This means that from the time of receipt of the order until it is fully executed, the Market Participant does not enter into, on its own account, a Market Transaction for the same Products on the same terms unless:



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- (i) *the Products are allocated to the client in accordance with Rule 7.5.6(c); or*
- (ii) *the Products are allocated to the client pursuant to an allocation policy previously disclosed to the client, to which the client consents, under which the Market Participant may buy or sell (and be allocated) the same Products on its own account*

However, a limit order which cannot be executed owing to price differences is not on the same terms”

The provision does not enable a Market Participant to place its own interests ahead of those of its client, as the Market Participant is still subject to the over-riding obligation to deal fairly and in due turn (as specified in Rule 7.5.3 (a)).

However in appropriate circumstances, the Market Participant may be dealing fairly and in due turn if with its client’s consent, it shares a trade pro-rata between clients, the Market Participant’s own account or a Prescribed Person. Appropriate circumstances might include one or more of the following:

- appropriate Chinese walls being in place between the Market Participant’s principal trading desk and the client advisory side of the business (Guidance Note No 13 “Prohibition of advice to clients” provides some guidance as to appropriate Chinese wall arrangements);
- where Prescribed Persons are subject to:
 - appropriate trading restrictions such as embargoes on dealing in specified securities where the Market Participant or a related party is underwriting those securities or providing corporate advisory services to the issuer of those securities;
 - “blackout” periods such as where there is a change in the firm’s research recommendation for those securities;
 - the prior written consent of a partner, director in respect of such transactions. Note however that Rule 7.8 confers obligatory requirements in respect of trading by or for a “connected person” as defined in Rule 7.8.1.



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In appropriate circumstances, the Market Participant may be dealing fairly and in due turn if:

- the orders are received at approximately the same time;
- the Market Participant believes on reasonable grounds that without its own participation as principal, it would not be able to effect those orders on such favourable terms or at all.

Similarly, in appropriate circumstances the Market Participant may be dealing fairly and in due turn if it executes a trade for the Market Participant's own account or for a Prescribed Person, prior to a trade for a client. Appropriate circumstances might include one or more of the following:

- appropriate Chinese walls being in place between the Market Participant's principal trading desk and the client advisory side of the business. This should include meaningful restriction of access to electronic records, computer files and screens as well as physical separation;
- Prescribed Persons are subject to appropriate trading restrictions such as embargoes on dealing in specified securities, "blackout" periods and other trading restrictions (as noted above);
- it is clear that the orders of the Market Participant's own account or of the Prescribed Person were placed on the Trading Platform earlier in time than the client orders; or
- the client order was an "iceberg" order which does not maintain time priority for the undisclosed volume of the order over the disclosed volume of a subsequently entered order at the same price for the Market Participant's own account or for a Prescribed Person.

In such circumstances, provided the Market Participant has not given unfair preference to itself or a Prescribed Person, the Rule will not mandate a give up of the trade in favour of the client.

In both cases the client must have been advised in **very clear** terms by the Market Participant as to its procedures for ensuring it deals fairly and in due turn in accordance with Rule 7.5.3 (a). Additionally the client must have consented as to the circumstances the Market Participant may buy or sell the Products on its own account or on the account of a Prescribed Person on the same terms whilst there is an unfilled order of the client.

The Market Participant should keep a record of such disclosure to the client and of such client's consent if it is given. Where retail clients are involved, the Market Participant will need to be particularly careful to ensure that the client's consent is an informed one. The record may be kept electronically, noted on the order record, contained in a client agreement or as part of the account opening procedures employed.



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It would be prudent for Market Participants which do not give up trades done on behalf of the Market Participant's own account or Prescribed Persons, in favour of their clients, to specify their procedures in some written format, such as in the client agreement. The consent may also be recorded in a confirmation, particularly where the client is a retail client. (If it is in a confirmation, a provision along the lines of "Under the ASX Market Rules you have consented not to obtain the benefit of client order precedence" would suffice).

ASX would expect the disclosure by the Market Participant to its client to be comprehensive in that the Market Participant should also disclose to its clients whether orders on behalf of its own account may be placed with other Market Participants, and thus compete with a client's order indirectly.

Limit Orders

Both ASX Market Rule 7.5.4(c)(ii) and 991B(3)(a) the Corporations Act specifically acknowledge that a limit order, which cannot be executed owing to price differences, is not on the same terms.

However deliberate attempts by Market Participants to avoid their obligations under Rule 7.5.4(c)(ii) by placing bids at a higher price or offers at a lower price than those of their client, such that the market moves against their client's order are clearly not in the best interests of their client. Such actions may be considered as Unprofessional Conduct.

Iceberg Orders

The Iceberg Order (if available) prioritises all disclosed volume over all undisclosed volume. Upon execution of the disclosed volume of an Iceberg Order, a further volume (equal to the original disclosed volume or, where the balance of the order is less than the original disclosed volume, then the balance of the order) is automatically disclosed and is ranked ahead of any undisclosed volume at the same price.

Trading Participants need to consider how the use of Iceberg Orders may impact upon their dealing and allocation policies.

“(d) if the sequence of entry of orders into a Trading Platform is not clearly established by the time the orders were received, and one of the orders is for the Market Participant's own account, the Market Participant gives preference to the order of a client over any order for the Market Participant's own account”



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Where the sequence of entry of orders to the relevant Trading Platform is not clearly established, it may be necessary to give the client the benefit of favourable trades at the expense of the Market Participant's own account, or Prescribed Persons. This should be the case regardless of whether or not the client's order involves discretion by the Market Participant in relation to the time, price or quantity of the order.

Discretionary Accounts

Discretionary accounts and managed funds, which are operated by a Market Participant on behalf of a client, require special consideration. Such clients are much more reliant on the Market Participant to do the right thing by them (because of the extent of the discretion given to the Market Participant) and therefore must be even more diligent in carrying out its obligation to act in the best interests of the client.

Accordingly, the most prudent approach for Market Participants, which trade as principal, while operating discretionary accounts and managed funds, is to give up all its own trades on the same terms in favour of the client.

If any other procedure is to apply other than the strict client order precedence in such circumstances, then the Market Participant must ensure that it fully discloses that procedure to its client in a meaningful way, and the client gives an informed consent to that procedure being applied to the client's discretionary account or managed fund.

“(e) if the Market Participant has acted in accordance with its procedures to ensure that a person initiating, transmitting or executing an order who is aware of instructions of a client (which is not a Prescribed Person) to deal in the relevant Products that has not been entered in a Trading Platform does not use that information to the disadvantage of that client”

This provision is intended to prohibit front running either by the Market Participant, a Prescribed Person or other clients of the Market Participant.

“(f) the Market Participant buys or sells for a Wholesale Client”

For some time there has been a carve out from the ASX Market Rules for Wholesale Clients (as defined in the Market Rules) where a Market Participant confines its clients to Wholesale Clients and executes each transaction to the best advantage of the Wholesale Clients.

This has been in recognition of the ability of Wholesale Clients to make their own trading decisions independently of the Market Participant. It is also in recognition of the fact that many Wholesale Clients benefit from Market Participant's trading on their own account, in that Market Participants are able to offer principal facilitation (i.e. take



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the other side of a trade with a Wholesale Client so as to provide liquidity for that Investor, in the knowledge that they are able to unwind the principal position they have taken on in the market). Many of the principles outlined in the above paragraphs dealing with Chinese walls will therefore not apply to principal facilitation business, where interaction between the client advisory and the principal facilitation areas of the business is necessary and required by the Wholesale client.

While Market Rule 7.5.4 does not differentiate between categories of investor if a Market Participant has different client order precedence procedures for Wholesale Clients, as opposed to retail investors, then clearly this must be disclosed to the Wholesale Clients.

- “(g) *allocation of Market Transactions occurs in accordance with Rule 7.5.5; and*
- (h) *a Market Participant keeps a record of a client’s consent under Rule 7.5.4(c).”*

ALLOCATION

(RULE 7.5.5)

Purpose

ASX Market Rule 7.5.5 has been written to provide a broad obligation to allocate purchases and sales fairly. Rule 7.5.6 sets out relevant factors in determining whether the obligation has been met. Rule 7.5.5 links into Rule 7.5.4.

Background

The Rule recognises that a “first in, first served” allocation policy, particularly between clients, may not always be the fairest way to deal with competition between clients for priority to trade. The Rule allows the Market Participant flexibility, provided the Market Participant has disclosed to its clients its allocation policy in a clear and meaningful way, prior to trading.

Disclosure of Principal Dealing

Under Market Rule 7.3.2, if a Market Participant acts as principal, they must disclose that fact to a client prior to entering into a transaction with that client. As such, Market Participants must ensure that where a client order is received electronically and the Market Participant will take the other side of an ensuing trade as principal, the client is contacted and the fact that the Market Participant is acting as principal and not as an agent, is effectively disclosed. Care must be taken in such circumstances inasmuch as a client might challenge the effectiveness of a disclosure transmitted to the client’s e-mail address if the client has not actually read the e-mail message. Whatever arrangements a Market Participant adopts in this regard, they should be effectively communicated to clients prior to processing any electronic orders on their behalf.



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Qualification

ASX has published this note to promote commercial certainty and to assist Participants. Nothing in this note necessarily binds ASX in the application of the Rules in a particular case. In issuing this note, ASX is not providing legal advice and market participants should obtain their own advice from a qualified professional person in respect of their obligations. ASX may replace this Guidance Note at any time without further express notice to any particular person. Readers may contact ASX to ensure they have the latest version.