



# **BUSINESS RULE GUIDANCE NOTE**

## **TRADING PRACTICES**

**BUSINESS RULE 2.2.4** – Prevention of Manipulative Trading  
**BUSINESS RULE 1.2.1** – Order Records

No: 8/00  
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### **Purpose of this Guidance Note**

This Guidance Note:

- identifies examples of unacceptable trading activity (i.e., which may be manipulative);
- reminds Trading Participants of their obligations in relation to market manipulation; and
- highlights the relationship between manipulative or unacceptable trading and poor order record keeping.

Brokers are also reminded of the fiduciary obligations they owe to clients, including the duty to use reasonable care and skill, to make the best bargain, to give precedence to client Orders and to disclose when acting as principal.

All trading staff of Trading Participants should familiarise themselves with this Guidance Note. If a proper authority holder of a Trading Participant has any question or concern in relation to a particular transaction, he or she should contact the Trading Participant's compliance officer before executing the transaction.

### **Introduction**

A cornerstone of fair and orderly markets is that they reflect the forces of genuine supply and demand. This concept is fundamental. ASX seeks to ensure that its markets are fair and orderly and free of manipulative trading. ASX closely monitors trading activity. There are rules regulating trading activity in ASX's Business Rules and in the Corporations Law. Trading Participants must ensure that their trading is conducted in accordance with the Business Rules and the Corporations Law. Aside from any disciplinary consequences, trading which is manipulative or unacceptable is damaging to ASX's market integrity and the image and reputation of Trading Participants themselves.



Note that unacceptable trading may amount to Prohibited Conduct under the Rules, even if it does not contravene Business Rule 2.2.4, if it is otherwise improper, unprofessional or prejudicial to the interests of ASX, its Participating Organisations or Affiliates. Manipulative or unacceptable trading may also be referred to ASIC, which has responsibility for taking action in respect of a breach of the market offence provisions in the Corporations Law and disciplining licensees and individual proper authority holders.

The primary Business Rule is Rule 2.2.4, which says:

#### **2.2.4 PREVENTION OF MANIPULATIVE TRADING**

- (1) A Trading Participant must not make a Bid or Offer for, or deal in, Securities:
  - (a) as Principal:
    - (i) with the intention; or
    - (ii) if that Bid, Offer or dealing has the effect, or is likely to have the effect, of creating a false or misleading appearance of active trading in any Securities or with respect to the market for, or the price of, any Securities; or
  - (b) on account of any other person where:
    - (i) the Trading Participant intends to create;
    - (ii) the Trading Participant is aware that the person intends to create; or
    - (iii) taking into account the circumstances of the Order, a Trading Participant ought reasonably suspect that the person has placed the Order with the intention of creating,  
  
a false or misleading appearance of active trading in any Securities or with respect to the market for, or the price of, any Securities.
- (2) In considering the circumstances of the Order, the Trading Participant must have regard to the following matters:
  - (a) whether the Order or execution of the Order would be inconsistent with the history of or recent trading in that Security;
  - (b) whether the Order or execution of the Order would materially alter the market for, or the price of, the Securities;
  - (c) the time the Order is entered or any instructions concerning the time of entry of the Order;
  - (d) whether the person on whose behalf the Order is placed, or another person who the Trading Participant knows to be a Related Party of that person, may have an interest in creating a false or misleading appearance of active trading in any Securities or with respect to the market for, or the price of, any Securities;
  - (e) whether the Order is accompanied by settlement, delivery or security arrangements which are unusual;
  - (f) where the Order appears to be part of a series of Orders, whether when put together with the other Orders which appear to make up the series, the Order or the series is unusual having regard to the matters referred to in this Rule 2.2.4(2); and
  - (g) whether there appears to be a legitimate commercial reason for that person placing the Order, unrelated to an intention to create a false or misleading appearance of active trading in or with respect to the market for, or price of, any Securities.



- (3) A Trading Participant must not:
- (a) enter into a transaction on behalf of a client or as Principal which; or
  - (b) make a Bid or Offer for Securities the execution of which, would involve no change of beneficial ownership, unless the Trading Participant can show that:
  - (c) the Trading Participant had no reason to suspect that the transaction would involve no change in the beneficial ownership of the Securities; or
  - (d) the purpose or purposes for which the transaction, or Bid or Offer was made was not, or did not include, creating a false or misleading appearance of active trading in any Securities or with respect to the market for, or the price of, any Securities.
- (4) For the avoidance of doubt, the obligations imposed on a Trading Participant by this Rule 2.2.4 also apply in respect of Orders the subject of Automated Order Processing.

A similar provision exists in relation to the options market (Rule 7.5.4), which also applies, along with 2.2.4, to trading in the warrants market (Rule 8.2.1). Trading Participants should also familiarise themselves with sections 997 and 998 of the Corporations Law (see **Attachment A**) and the case law on market manipulation (see **Attachment B**).

Trading Participants should also be familiar with the requirements in the Business Rules for order record keeping (Rules 1.2.1 and 7.3.2.5). Business Rule 1.2.1 says (relevantly):

#### 1.2.1 RECORDS

Every Participating Organisation shall maintain records in sufficient detail to show particulars of:

- (ii) All orders received for the purchase or sale of Securities shall include details of:
  - (a) identity of person receiving the order;
  - (b) date and time order received;
  - (c) name of natural person placing the order (unless that person is the client);
  - (d) name of client, description and number of Securities to be bought and sold;
  - (e) price limit or price related instructions;
  - (f) time limit on the order (if any); and
  - (g) the request (if any) of a Professional Investor for accumulation and/or price averaging under Rule 3.8A; and
  - (h) any other relevant instructions;

and must be serially numbered and retained for 2 years whether or not the order is executed.

...

The provisions of the Rule shall to the extent to which they are applicable apply not only to records of the Participating Organisation's principal office but also to those of any branch office and to any nominee company beneficially owned and operated by a Participating Organisation for the purpose of conducting the business of the Participating Organisation.

#### Consequences of Breach of the Rules or of the Corporations Law

The possible penalties for a breach of the Rules are set out in Rule 13.5 and include censure, a fine not exceeding \$250,000, and suspension. In the case of Prohibited Conduct, the penalty may also include cancellation of recognition.



ASX may refer to ASIC possible contraventions of sections 997 or 998 of the Corporations Law or related conduct amounting to a failure by a securities dealer or representative to perform their duties efficiently, honestly or fairly. ASIC may take criminal or civil action. ASIC may also take action to revoke, suspend or impose additional conditions on a securities dealer's licence or ban a person from acting as a securities representative permanently or for a specified period.

## Business Rule 2.2.4 – Prevention of Manipulative Trading

Business Rule 2.2.4 was drafted after the enactment of section 998 of the Corporations Law and is expressed in similar terms

Business Rule 2.2.4 is concerned with preventing manipulative trading in three areas:

1. Trading as principal either, (a) with an intention to, or (b) in a manner which does or is likely to, create a false or misleading appearance of active trading in any Securities or with respect to the market for, or price of, Securities (Rule 2.2.4(1)(a)).
2. Trading either, (a) on behalf of clients who have an intention of, or (b) where it is reasonable to suspect the client of having placed the order with the intention of, creating a false or misleading appearance of active trading in any Securities or with respect to the market for, or price of, Securities (Rule 2.2.4(1)(b) and 2.2.4(2)).
3. Trading which does not involve a change in the beneficial ownership of Securities (Rule 2.2.4(3)).

In broad terms, market manipulation has been described as “*the interference with supply and demand in the market for securities and either the inducement of persons to trade in a particular security or the attempt to force a security’s price to an artificial level.*” A Black, “Regulating Market Manipulation: Sections 997-999 of the Corporations Law”. Australian Law Journal, Vol 70, December 1996, p987. Another description is the “*affecting of the market for, or the price of, securities by artificial means i.e., means unrelated to the natural forces of supply and demand.*” **Mobil Corp -v- Marathon Oil Co**, 669 F 2d 366 at p374.

This Guidance Note does not seek to define what is a “false or misleading” appearance as each case will depend on its own circumstances.

To assist participants to understand the application of these obligations at a practical level, examples are given of conduct which is not acceptable. The examples illustrate general principles only and do not affect the operation of the Business Rules.

### **Business Rule 2.2.4(1)(a) –False or misleading appearances when dealing as principal**

This Rule is concerned with both:

- an improper intention on the part of a Trading Participant dealing as principal; and
- the effect, or likely effect, of a Bid, Offer or dealing by a Trading Participant.



It is important to note the distinction between the two areas. The first area concerns the intention of a Trading Participant. The second area is concerned with the effect or likely effect of a Bid, Offer or dealing and involves an objective assessment of whether a false or misleading appearance has been created, irrespective of the intention behind the Bid, Offer or dealing. The Rule does not prevent Trading Participants from carrying out legitimate trading strategies which reflect the forces of genuine supply and demand. However, Trading Participants must do so bearing in mind their obligations to the market and with an appropriate measure of care.

Dealing on a facilitation account for the purpose of filling a client Order is considered to be dealing as principal (trading as 'principal' – see Business Rule 3.1). The definition of “deal” is found in section 9 of the Corporations Law and it applies to Business Rule 2.2.4. The definition includes more than the acquisition or disposal of securities.

### Examples

1. **Index Arbitrage Orders:** A Trading Participant conducting index arbitrage as Principal and entering Orders in an illiquid stock may have a material impact on the price of some stocks, even with small Orders. Index arbitrage Orders are a legitimate commercial reason for trading, but the Trading Participant must have exercised sufficient care to ensure that the Order did not result in a false or misleading appearance with respect to the price of a stock.
2. **Index Replication Orders:** A Trading Participant accepting Orders from a client seeking to replicate an index at a time when one or more of the stocks are being included or excluded from the relevant index or when the size of the portfolio is being increased or decreased, should consider the impact the Orders may have. If the Trading Participant attempts to execute a large proportion of the Order in the Closing Single Price Auction, having ignored opportunities earlier in the day, and this has a material impact on the closing price, this may result in allegations that the Trading Participant created a false or misleading appearance with respect to the price of that stock. (If the Order is executed on the Trading Participant's facilitation account it will have been executed as principal).
3. **Entering or Exiting a Principal Position:** A Trading Participant bidding to accumulate a principal position or facilitate a client Order may not attempt to influence others to sell by entering large or undisclosed offers. A Trading Participant offering to quit a principal position may not attempt to influence others to buy by entering large or undisclosed bids, or attempt to correct any impact its trading may have on the price of the stock, or attempt to restore the price by closing it higher.

A Trading Participant that purchased small quantities of stock compared to its total holding and entered bids in the last 20 minutes of the day at prices sometimes higher than the price of the immediately preceding trade, and where trades resulting from those bids were sometimes the last trades for the day and established the closing price, or sometimes set a new daily high, was held by the National Adjudicatory Tribunal to have created a false or misleading appearance of active trading in, or with respect to the market for or the price of the stock in contravention of Business Rule 2.2.4. It is acceptable when seeking to quit a principal position to buy quantities of stock on the other side of the schedule to meet the market, provided the buying is genuine and done



for the purpose of trading the stock, not for the purpose of restoring any price falls caused when selling.

A Trading Participant should not make large disclosed or undisclosed entries above or below the prevailing spread, particularly during Pre-Open or Adjust, to facilitate filling an Order on the other side of the market. Doing so may create a false and misleading appearance that the entry is on behalf of a genuine buyer or seller. The National Adjudicatory Tribunal has held that a Trading Participant doing so contravened Business Rule 2.2.4(1)(a). The Tribunal found that at the time that each bid was made, the Trading Participant did not intend to buy, intended that the bid would not trade, and intended that the bid would be cancelled, before the Pre-Open Phase ended.

4. **Hedging:** A Trading Participant trading as principal to hedge an exposure to warrants or options, or under an equity performance swap, should be alert to the impact its trading may have on the market for, or price of, a stock.

#### **Business Rule 2.2.4(1)(b) –False or misleading appearances when dealing for clients**

This Rule is concerned with client Orders that are placed with the intention of creating one of the prohibited appearances. It also prohibits Trading Participants using client Orders to create a false or misleading appearance for their own purposes. And it extends to prohibiting Orders or transactions if the circumstances are such that a Trading Participant ought reasonably suspect the prohibited intention.

The Rule does not prevent a Trading Participant from executing an Order simply because it will have an impact on the market for, or price of, a Security. Rather, the Rule requires a Trading Participant to consider whether the Order may be intended to create a false or misleading appearance. Trading Participants are not permitted to accept a client's instructions blindly; they must think about, or ensure they have filters to catch, those Orders which may be manipulative. This is consistent with their obligations to the market (see Rule 2.2.1).

The obligation to the market has been clearly expressed by the National Adjudicatory Tribunal (12 December 1996):

*“People who have dealings with ASX's market do so on the basis of the reputation of the Exchange and its Members, and in particular, on the assumption that Members comply with the Rules and Articles, the law and good broking practice and that when brokers participate in or are a party to, manipulative practices, the reputation of the Exchange and the integrity of its market is adversely affected....A broker has an obligation to follow his client's instructions where such instructions are lawful and reasonable in the circumstances.... It is not correct to say that a broker should slavishly follow every instruction that he is given; he must exercise judgment in each case, given the circumstances surrounding the transaction.”*

Rule 2.2.4(2) identifies matters that a Trading Participant must have regard to. These are discussed below. The list is not exhaustive and the items are not intended to be considered by the Trading Participant in isolation from each other. One way of ensuring that dealers and advisers are constantly reminded of the matters is to set them out on order records.

*Business Rule 2.2.4(2)(a): Whether the Order or execution of the Order would be inconsistent with the history of or recent trading in that Security.*



This aspect of the Rule requires a Trading Participant to exercise judgment based on its experience and its knowledge of trading in the stock. Trading Participants will generally be familiar with the patterns of trading in each stock.

*Business Rule 2.2.4(2)(b): Whether the Order or execution of the Order would materially alter the market for, or the price of, the Securities.*

In the absence of a good reason to buy or sell quickly, clients generally want to obtain the best price. The price is influenced by many factors, particularly the liquidity in the security. Trading Participants have knowledge and expertise in relation to liquidity and the execution of Orders and can judge whether the Order would materially alter the market for, or the price of, the Securities. If the Order would, it is incumbent on the Trading Participant to assess the purpose of the Order (i.e., whether it is genuine or manipulative).

Repetitive Orders to buy or sell the precise volume at the priority bid or offer, or which would trade with the entire priority bid or offer volume and part of the bid or offer at the next price step, should at least be queried.

#### Examples

1. A Trading Participant which receives instructions to buy up, or sell down, to a specified price should query the client before executing the Order to satisfy itself that the client does not intend to create a false or misleading appearance.
2. A Trading Participant which receives instructions to sell stock but also receives instructions to enter large disclosed or undisclosed bids just below the priority bid should query the client before entering the bid to satisfy itself that the client does not intend to create a false or misleading appearance. Whilst this applies during Normal Trading, Trading Participants should be particularly alert to instructions to enter bids during the Pre-Open and then withdraw them prior to the commencement of Normal Trading.
3. A Trading Participant that receives an Order which would result in a material price movement, should consider the terms of the Order and whether it should be executed. What is 'material' will depend on the circumstances surrounding the Order, the stock, and current market conditions. Naturally, some Orders will have an impact on the market, but they will not be prohibited if there is a legitimate commercial reason for them unrelated to an intention to create a false or misleading appearance. If a Trading Participant has satisfied itself as to the legitimate commercial reason and there is no prohibited intention present, there is no reason why the Order should not be processed.

*Business Rule 2.2.4(2)(c): The time the Order is entered or any instructions concerning the time of entry of the Order.*

A Trading Participant should consider carefully any Orders placed with instructions to execute them at or near the close of trading, particularly if a price target is set. A Trading Participant which receives an Order well before the close with instructions to execute it at or near the



close of trading should establish why the client wants the Order executed this way. This is important if the Order is to buy or sell a small volume of the stock and is likely to move the price and possibly fix the closing price. ASX expects that all Trading Participants should be able to recognise Orders which appear intended to fix the closing price.

The expiry of futures contracts may require a timed unwind of the countervailing stock position. In these circumstances, price impact in some stocks may be inevitable, particularly in less liquid stocks. However, a Trading Participant should be alert to a client seeking to cause unnecessary price impact to improperly generate a profit. A Trading Participant which has alternatives, but chooses to unwind at the close, will be scrutinized closely by ASX.

A Trading Participant should also be alert to Orders placed near the close on the last trading day of the month, quarter or year, or on option and warrant expiry dates, which will move the price when executed. A Trading Participant which receives such Orders should consider whether the client is seeking to fix the closing price for that day.

*Business Rule 2.2.4(2)(d): Whether the person on whose behalf the Order is placed, or another person who the Trading Participant knows to be a Related Party of that person, may have an interest in creating a false or misleading appearance of active trading in any Securities or with respect to the market for, or price of, any Securities.*

A Trading Participant will not always know of a client's interest in creating a false or misleading appearance, but if a Trading Participant receives an unusual Order from a client, it should attempt to establish whether the client may have an interest in creating the false or misleading appearance.

The National Adjudicatory Tribunal (19 June 2000) has held that a Trading Participant which accepted a buy Order at the end of the month from a fund manager, with instructions to withhold some of the Order until the close, intended to create a false or misleading appearance. The Tribunal found that the Trading Participant knew, or ought reasonably to have known, that its client had intended to create a false or misleading appearance and that, the Trading Participant intended to create the false or misleading appearance.

### Examples

1. Orders placed by a Related Party of a company to buy the company's Securities, when the company is the target of a scrip-based takeover, and the Orders would have the effect of increasing the price of the target's Securities (or Orders to sell the bidder's Securities which have the effect of decreasing the price).
2. Orders placed by a Related Party to buy the Securities of a company, which has company-issued options expiring, preference shares converting, or is attempting to make a placement, which affects the price of those Securities.
3. Orders placed by a large holder of a particular security who may have an interest in inflating the value of that holding (e.g., window dressing for investment performance purposes), or decreasing the price of the security (e.g., as a precursor to a takeover bid or for purposes which include lowering a conversion price).





4. Buying during the period of a rights issue by an underwriter, sub-underwriter or any other party which increases or maintains the price of the underlying security may include as a purpose inducing others to take up their rights entitlements under the issue. Trading under a formal “greenshoe” arrangement is legitimate by virtue of its approval and disclosure.
5. “Put through” Orders which will generate price movements. A client may instruct a Trading Participant to buy up, or sell down, to a certain price and then execute a crossing at that price. The purpose of this strategy may be to generate a capital gain or crystallise a capital loss at an artificial price for taxation purposes (see Rule 2.2.4(3) and “Crossings for Taxation Purposes” below). A further aspect to this trading might involve instructions to reinstate the price to its previous levels.

*Business Rule 2.2.4(2)(e): Whether the Order is accompanied by settlement, delivery or security arrangements which are unusual.*

#### Examples.

1. A Trading Participant which receives an Order for a Forward Delivery Transaction should be alert to any subsequent trading in the security by the buying client. ASX would expect a Trading Participant to question subsequent Orders placed by the buyer or an associate which would generate price increases. The client may be seeking to increase the price of the security prior to settlement of the Forward Delivery Transaction (which may permit the client to sell the Securities into the artificially inflated market).
2. Trading Participants should be alert to trading by a client which does not pay for an initial purchase but settles it with subsequent sales. Sales which are regularly used to settle purchases may be part of an unacceptable trading strategy intended to force the price of the stock higher. The strategy may also result in a false or misleading appearance being created.

*Business Rule 2.2.4(2)(f): Where the Orders appear to be part of a series of Orders, whether when put together with other Orders which appear to make up the series, the Order or the series is unusual having regard to the matters referred to in this Rule 2.2.4(2).*

A Trading Participant may receive an Order near the close of trading which will move the price and establish the closing price. By itself, there may be nothing unusual about such an Order. However, a client that, to the knowledge of the Trading Participant, declines the opportunity to obtain a better price during the day and prefers to pay a higher (lower) price near the close should be queried as to the strategy. And if the Trading Participant receives a series of similar Orders over a number of days each of which generates a price movement near the close of trading, the Trading Participant should query the client and satisfy itself that the client is not attempting to create a false or misleading appearance with respect to the price of the stock.

#### Examples



1. A Trading Participant may receive a large Order with instructions to execute it piecemeal and on an on-going basis. The Trading Participant may be instructed to partially execute the Order in small volumes to restore the price of the stock when it has fallen. ASX expects that the Trading Participant will refuse such Orders.
2. A Trading Participant may receive a series of buy and sell Orders. If the client places a sell Order well above the priority offer and one or more buy Orders which would increase the price towards the client's offer price, the client should be queried as to the strategy. It may be that the buy Orders are intended to get the price running and facilitate the sale at the higher price. Illiquid stocks are particularly susceptible to this type of trading.

*Business Rule 2.2.4(2)(g): Whether there appears to be a legitimate commercial reason for that person placing the Order, unrelated to an intention to create a false or misleading appearance of active trading in or with respect to the market for, or price of, any Securities.*

Many Orders for legitimate commercial reasons can change the market for, or price of, a stock when executed. Such Orders are acceptable despite the price impact, but the Trading Participant must execute the Order in an appropriate way bearing in mind its market obligations. The Trading Participant will also need to be aware of any motive to manipulate the price in addition to the legitimate commercial reason for the Order.

#### Examples

1. A party seeking to add to an existing stake may also intend to increase the price of the stock and improperly inflate the value the existing stake.
2. A Trading Participant instructed by a client to sell a stock down to a particular price before executing a crossing for the same client should consider whether the client is attempting to create an artificial crossing price for taxation purposes, particularly if it is executed around 30 June. Crystallizing a tax loss may be a legitimate commercial reason for an Order. However, it is not legitimate for the client to improperly move the price to an artificial level to facilitate the crossing.

#### Closing Price Orders

ASX notes that an increasing number of institutional Orders require the Trading Participant to obtain the closing price. Individual Trading Participants may have various trading strategies to achieve this. However, if the size of the transaction the Trading Participant intends to execute during the Closing Single Price Auction can reasonably be expected to have an impact on the closing price, ASX believes that the broker should not attempt to buy that volume of stock, related to that Order, during the Closing Single Price Auction. In this situation, Trading Participants which leave large volumes of stock to be purchased near the close or during the Closing Single Price Auction, which are outside the historical volumes during that period of trading, risk contravening Business Rule 2.2.4(1)(a) and section 998 of the Corporations Law. Similar concerns arise with Orders which are submitted late and need to be executed near the close or during the Closing Single Price Auction.

A New York Stock Exchange Memo to Members (No. 95-28, 10 July 1995) says:



*“What constitutes “near the close” depends upon the degree of risk which can be attributed to the position established by that trade versus the reasonably anticipated impact the trade at the close will have on the closing price. While each situation may be unique, depending upon the size of the transaction and the liquidity of the stock, generally trades executed after 3:40pm would be considered “near the close”. Engaging in such transactions for the firm’s proprietary account would be conduct inconsistent with just and equitable principles of trade. However, [a Trading Participant] would not be precluded from executing the customer’s Order on an agency basis at any time, including at or near the close. It should be recognized, however, that this does not preclude the Exchange from determining that such activity may be a violation of the anti-manipulative provisions of the [Law] or Exchange rules.”*

ASX agrees that care needs to be exercised near the close but would not go as far as to prohibit principal trading near the close.

#### Examples

1. A Trading Participant commits to sell securities to a client at the closing price. To facilitate the transaction, the Trading Participant buys stock throughout the day as principal, assuming market risk. To reduce its principal risk, the Trading Participant leaves a portion of the position to be executed at the close. There is an incentive for the Trading Participant to increase the closing price. The Trading Participant should weight that part of the order to be executed at the close having regard to the volumes which can reasonably be expected to trade at the close. This should ensure that the size of the transaction to be effected at the close does not unreasonably affect the price.
2. An Order to buy securities at the closing price may include a payment to the Trading Participant of a proportion of any gains made by accumulating stock earlier at a lower price. This creates a strong incentive for the Trading Participant to increase the closing price, and the Trading Participant should consider its execution strategy carefully before accepting the instructions. Unreasonably weighting the order for execution at the close and causing unnecessary price impact may result in a contravention of Rule 2.2.4(1) by the Trading Participant.

#### Rule 2.2.4(3) – Transactions involving no change in beneficial ownership

This Rule prohibits transactions in which there is no change in beneficial ownership. However, Trading Participants are permitted to effect such a transaction if either of the following applies:

- a. The Trading Participant can show that it had no reason to suspect that the transaction would not involve a change in beneficial ownership; or
- b. The Trading Participant can show that the purpose of the transaction (or the bid or offer) was not to create a false or misleading appearance of active trading or with respect to the market for, or price of, the stock.

A notation on the Order record that the Trading Participant has satisfied itself of these matters will usually be sufficient evidence of the Trading Participant’s enquiries.



## Examples

1. Where a Trading Participant is instructed by a client to buy up (or sell down) a stock prior to executing a crossing for the same client, ASX expects the Trading Participant to be alert that a possible motive for such trading may be to generate an artificial crossing price. (Trading Participants should refer to Circular 332/2000 for guidance on this issue).
2. Execution of crossings or transactions between the same parties for the same volumes in a warrant series which are later reversed at the same prices may create the impression of turnover, and raises a question about whether the transactions involve a change in beneficial ownership.

## Orders Entered During Pre-Open

ASX notes that some Orders are entered during the Pre-Open phase at prices significantly above or below the prevailing priority bid or offer. The purpose of such entries is often to ensure that they trade during the Opening Phase.

Trading Participants should be familiar with how the opening algorithm works during the Opening Phase. The procedure is described in Business Rule 2.6.3 and chapter six of the SEATS Reference Manual. Trading Participants should be aware that entering Orders during the Pre-Open phase at prices significantly above or below the prevailing priority bid or offer may result in trades which are not at the best possible price and may, therefore, cause the Trading Participant to act contrary to the client's best interests. In some circumstances, the entries may create, or be likely to create, a false or misleading appearance with respect to the price once they trade.

## Evidence of market manipulation

Manipulative trading may be inferred from circumstantial evidence, such as an unusual pattern of trading coupled with a person's interest in affecting trading in the security. Trading Participants may not always know if a client has a particular interest in a stock or what it may be.

However, Business Rule 2.2.4(1)(b) prohibits Orders which a Trading Participant ought reasonably suspect have been placed with the intention of creating a false or misleading appearance. A Trading Participant, therefore, needs to be able to show that, taking into account the circumstances of the Order, it would not have reasonably suspected that the purpose of the trading was to create a false or misleading appearance. It is important that a Trading Participant which receives an unusual Order is able to establish that it has made due inquiries and satisfied itself as to the reason for the trading. As a minimum, appropriate notations should be made on the order record or some other record as to the reason for the trading. The most reliable record of the reason for the trading would be an audio tape of the placement of the Order and the enquiries the dealer or adviser made to satisfy him/herself that a prohibited intention was not present. Such a record may protect a Trading Participant against any allegation of a breach of Rule 2.2.4.



Of course, if a Trading Participant knows of a client's interest in a stock, it cannot close its eyes to that interest.

## Indicators of manipulative trading

1. Marking the close: purchases or sales of small volume at or near the close which fix, or attempt to fix, a higher or lower closing price.
2. Regular purchases on the up-tick, or sales on the down-tick, to generate price movements. If a client regularly buys on the up-tick in the face of consistent selling pressure, the Trading Participant should query whether the client is a bona fide purchaser or has an interest in influencing the price and inducing others to buy.
3. Consistently appearing as the highest bidder, which may be intended to support or increase the price of securities.
4. Layering of Bids: a client placing buy Orders at various price steps below the market to create a false appearance of buying demand. The layering of bids translates into a change in the depth screen which may mislead some retail market participants using depth screens.
5. Entering large disclosed or undisclosed entries just below the best bid or above the best offer (i.e., providing a floor or ceiling). Another feature of this type of trading may be the amendment or cancellation of the entry when it looks like the entry may trade. Note that sections 997 and 998 do not require actual purchases or sales; the entry of a bid or an offer falls within the definition of "transaction" (see sub-sections 997(10) and 998(7)).
6. Entering large disclosed or undisclosed Orders on the opposite side of the market to that in which a genuine Order is to be executed.
7. Domination and control of the market for a stock: purchasing enough volume that one client or dealer may artificially set prices. This might be followed by up-ticking the bid to desired (artificial) levels despite the absence of bona fide investor demand for the stock. Similarly, attempts to reduce a stock's liquidity may suggest a manipulative intent.
8. Executing crossings or transactions between the same parties, which may raise a question whether the transactions involve a change in beneficial ownership and whether the trades are intended to artificially inflate turnover and/or increase the price.

## Pre-arranged Trades Under the Corporations Law

Two particular types of transactions are singled out for special attention in section 998(5) of the Corporations Law. These are:

- wash sales: transactions not involving a change in the beneficial ownership of securities.



- matched orders: where a person makes, or causes to be made, an offer to sell or purchase securities when that person has made, or proposes to make, or knows that an associate (see **Attachment A**) has made or proposes to make, a corresponding offer to purchase or sell the same securities on substantially the same terms.

A person engaging in wash sales or matched orders is deemed to have created a false or misleading appearance of active trading in contravention of section 998(1) of the Corporations Law. Under sub-section 998(6), a defence is available if it is established that the purpose or purposes of the transaction was not, or did not include, creating a false or misleading appearance of active trading. The onus of proving this rests on the defendant.

When a Trading Participant receives instructions from an individual to execute a transaction which also involves an associate, (e.g, from a director of a private company on his or her account to the account of the company), great care should be exercised. These types of transactions (sometimes called a “put through”) may raise a question as to whether there is a change in beneficial ownership and, if not, whether the purpose of the transactions is manipulative.

### **Business Rule 1.2.1 – Order Records**

Business Rule 1.2.1 requires Participating Organisations to maintain appropriate order records. Order records provide an audit trail explaining why the Participant made particular entries on SEATS. ASX expects that a Trading Participant’s order records will accurately reflect clients’ instructions and the Trading Participant’s subsequent activity on SEATS.

Deficiencies in order records may inhibit ASX’s enquiries into possible manipulative trading. It is prudent for Trading Participants to ensure that order records accurately reflect their clients’ instructions to avoid possible disciplinary action for order record breaches and perhaps manipulative trading. In the absence of taped recordings of Orders, written order records may be the only means by which a Trading Participant can check a client’s instructions and whether they were complied with.

Order records which do not accurately reflect a client’s instructions and the other details required by the Rule may be viewed by ASX as circumstantial evidence pointing to manipulative trading by a Trading Participant. Any deficiency in order records will be viewed seriously by ASX.

### **Straight through processing**

Trading Participants offering ‘straight through processing’ should take note of the following additional Business Rules:

- Rule 2.2.4(4), which reinforces the obligations imposed on a Trading Participant by Rule 2.2.4 in respect of Orders the subject of Automated Order Processing.
- Rule 2.2.1(6), which requires a Trading Participant to have arrangements in place so that the Trading Participant can at all times determine the origin of Orders and Trading Messages. The Rule says:



- (6) A Trading Participant must have arrangements in place so that the Trading Participant can at all times determine the origin of all Orders and Trading Messages, including:
- (a) the different stages of processing each Order (regardless of whether a Trading Message is generated) and the time at which each stage occurred;
  - (b) the Order that corresponds to a Trading Message;
  - (c) the identity and capacity of the person placing the Order that corresponds to the Trading Message;
  - (d) whether the Trading Message was the result of Automated Order Processing;
  - (e) the Open Interface Device, or the computer or other device connected to an Open Interface Device of the Trading Participant, through which the Trading Message was submitted into SEATS;
  - (f) the Designated Trading Representative with responsibility for that Open Interface Device or computer or other device connected to the Open Interface Device (unless the Trading Message was the result of Automated Order Processing); and
  - (g) whether the Trading Message was submitted as Principal or for a client.

Appropriate filters should be in place to ensure that Orders which, if executed, will cause a material price movement are referred to a DTR for consideration. Certification of these procedures is required pursuant to Rule 2.2.2(4). Trading Participants should also ensure that Authorised Persons are aware of Rule 2.2.4 and its obligations.

Trading Participants offering 'straight through processing' are subject to the same requirements and obligations as all Trading Participants.

## Training and supervision of staff

Conduct by a staff member of a Trading Participant which contravenes the Business Rules exposes the Trading Participant to disciplinary action. It is in the interests of all Trading Participants to ensure that their staff are adequately trained in respect of the Business Rules and properly supervised. Trading Participants should be particularly attentive in the following areas:-

- Supervision of trading in branch offices;
- Monitoring the use of errors and suspense accounts, in particular intra-day use;
- Adequate and on-going training and supervision of DTRs, especially for on-line and discount brokers;
- Background checks on new employees;
- Monitoring authorisation for staff orders, including those for senior staff;
- Reporting by compliance staff to the chairman; and
- Ensuring that "large order writers" are supervised.

## Reporting Unusual Trading

ASX Surveillance has three main areas of responsibility:



- Identifying trading that may involve non-disclosure of material information by listed entities.
- Detection of market manipulation and other irregular trading.
- Detection of Insider Trading.

Trading Participants which suspect that the market for a stock may be uninformed or that trading in a stock is unusual, are encouraged to raise their concerns with Surveillance. Contacts can be confidential if that is desired.

Surveillance may be contacted by email at [surveillance@asx.com.au](mailto:surveillance@asx.com.au) or on telephone (02) 9227 0521.

The Guidance Note is not a substitute for legal advice. Particular legal obligations and liabilities will depend on the facts in each case.

If a proper authority holder of a Trading Participant has any question or concern in relation to a particular transaction, he/she should refer to the Trading Participant's compliance policy or contact the compliance officer before executing the transaction.

## Enquiries

Enquiries about this Guidance Note can be made to:

Richard Flynn  
Senior Analyst  
Surveillance  
Ph: 9227 0713  
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## ATTACHMENT A

### MARKET MANIPULATION PROVISIONS IN THE LAW

#### 1. Section 997 of the Law – Transactions Which Intend to Induce Others to Buy, Sell or Subscribe

In summary, section 997 prohibits a person entering, either directly or indirectly, into two or more transactions in securities of a body corporate which have the effect of increasing, decreasing, maintaining or stabilising the price of those securities, with the intention of inducing others to purchase, sell or subscribe for securities of that body corporate or a related body corporate.

“Transaction” is defined in sub-section 997(10) to include:

- (a) the making of an offer to sell or buy securities (i.e., entering an offer or a bid); and
- (b) the making of an invitation, however expressed, that expressly or implicitly invites an offer to sell or buy.

#### 2. Section 998 of the Law – Creating False or Misleading Appearances and Fictitious Trading.

##### A. False Trading.

Sub-section 998(1) prohibits a person creating, or doing anything that is intended or likely to create a false or misleading appearance:

- of active trading in securities; or
- with respect to the market for securities; or
- with respect to the price of securities.

##### B. Market Rigging.

Sub-section 998(3) provides that a person shall not maintain, inflate, depress, or cause fluctuations in, the market price of securities by means of:

- transactions in securities that do not involve a change in beneficial ownership; or
- any fictitious transactions or devices.

##### C. Wash Sales and Matched Orders.

Under sub-section 998(5), a person is deemed to have created a false or misleading appearance of active trading in securities who:

- enters into, or carries out, either directly or indirectly, any transaction which does not involve any change in the beneficial ownership of the securities (commonly called “wash sales”); or
- offers to sell (or buy) any securities at a specified price where the same person, or an associate of the person, has offered or proposes to offer to buy (or sell) substantially the same volume of securities at substantially the same price (commonly called “matched orders”).

##### D. No Change in Beneficial Ownership

Under sub-section 998(7), a purchase or sale of securities does not involve a change in beneficial ownership if a person who had an interest in the securities before the transaction, or an associate of



that person, has an interest after the transaction. The interest held need not be the same before and after the transaction.

## RELEVANT DEFINITIONS

### 1. Associates

Section 11 provides that associates of a body corporate include:

- a director or secretary of that body corporate;
- a related body corporate (See section 50);
- a director or secretary of a related body corporate.

Section 15 provides that associate relationships may also relate to:

- persons acting or proposing to act in concert;
- persons prescribed by the Corporations Regulations as an associate under the provision in which the associate relationship arises; and
- persons proposing to become, whether formally or informally, associated in any way.

Section 12 is concerned with various ‘relevant agreements’ (see section 9) in respect of takeover bids and voting rights attached to shares. Relevant agreements relate to voting rights, controlling or influencing the board or the affairs of a body corporate, or disposal of shares.

Section 16 provides that a Trading Participant is not an associate of a client merely by being the client's securities adviser. However, additional facts may give rise to an associate relationship. A Trading Participant will not have a relevant interest in securities it holds on behalf of a client in the ordinary course the Trading Participant's business (section 609).

The purpose of these provisions is to allow for the aggregation of relevant interests. One effect is to catch those devices used to conceal a person's true relevant interest (such as warehousing).

### 2. Related Parties

Section 228 includes the following persons as related parties of a public company:

- an entity that controls a public company;
- directors of the public company;
- directors (if any) of an entity that controls the public company;
- if the public company is controlled by an entity that is not a body corporate – each of the persons making up the controlling entity;
- spouses and de facto spouses of persons referred to above.

A definition of “Related Party” is also found in the Business Rules, and is relevant to Rule 2.2.4(2)(d). The relevant part of the definition says:

“Related Party means:

- (a) in relation to a body corporate:
  - (i) the meaning under section 228 of the Law; or



- (ii) a Substantial holder of the body corporate.”



### 3. Deal

Section 9 of the Corporations Law (relevantly) states that “deal”:

- “(b) in relation to securities – subject to subsection 93(4), means (whether as principal or agent) acquire, dispose of, subscribe for or underwrite the securities, or make or offer to make, or induce or attempt to induce a person to make or offer to make an agreement:
- (i) for or with respect to acquiring, disposing of, subscribing for or underwriting the securities; or
  - (ii) the purpose or purported purpose of which is to secure a profit or gain to a person who acquires, disposes of, subscribes for or underwrites the securities or to any of the parties to the agreement in relation to the securities.”



## ATTACHMENT B

### CASE LAW ON MARKET MANIPULATION

Trading Participants should note the following important cases, extracts of which are below, on section 998 of the Corporations Law and its predecessor, section 70 of the Securities Industry Act (NSW).

***The Queen v Harrold Christensen (WA District Court, 24/11/95, unreported)***

Christensen, a stockbroker, was convicted of creating a false or misleading appearance with respect to the price of Paragon shares. A client had borrowed funds and used its shareholding in Paragon as security. The client would be subject to a margin call if the price of Paragon fell below 70 cents. The client had an interest in maintaining the price, but Christensen, by purchases of Paragon shares by his own private company, was found to have contravened section 70 of the Securities Industry Act.

***North v Marra Developments Ltd (1981) 148 CLR 42.***

Marra had launched a scrip-based takeover of another company. To enhance the prospects of the takeover succeeding, the broker and Marra arranged for the broker to purchase Marra shares on behalf of the broker and the company's directors at prices well above the prices at which they had traded prior to the takeover. The purpose was to influence target shareholders to accept the takeover offer. When the brokers sued Marra for its fees, the transactions were found to contravene section 70 of the Securities Industry Act. Mason J stated of section 70 (at p59):

*“It seems to me that the object of the section is to protect the market for securities against activities which will result in artificial or managed manipulation. The section seeks to ensure that the market reflects the forces of genuine supply and demand. By ‘genuine supply and demand’ I exclude buyers and sellers whose transactions are undertaken for the sole or primary purpose of setting or maintaining the market price. It is in the interests of the community that the market for securities should be real and genuine, free from manipulation. The section is a legislative measure designed to ensure such a market and it should be interpreted accordingly.*

*“I agree with Hope and Samuels JJA in rejecting the suggestion that the section strikes only at fictitious or colourable transactions. Transactions which are real and genuine but only in the sense that they are intended to operate according to their terms, like fictitious or colourable transactions, are capable of creating quite a false or misleading impression as to the market or the price. This is because they would not have been entered into but for the object on the part of the buyer or of the seller of setting and maintaining the price, yet in the absence of revelation of their true character they are seen as transactions reflecting genuine supply and demand and having as such an impact on the market.*

*“When purchases have been made of shares in a company at or about a particular level for the purpose of setting and maintaining a market price for those shares there is a breach of the statutory prohibition....”*

***Fame Decorator Agencies Pty Ltd v Jeffries Industries Ltd (1998) 28 ASCR 58.***

Fame was a large holder of ordinary shares and preference shares in Jeffries. Preference shareholders were entitled to convert their preference shares into ordinary shares if Jeffries failed to pay a dividend on a particular date. The conversion ratio was based on the weighted average price of



ordinary shares during the twenty trading days immediately prior to the conversion date. Jeffries announced on 28 April 1995 that it would not pay a dividend. During the last 3 minutes of trading in the ordinary shares on that day, Fame sold 170,000 shares causing the price to fall from 35c to 13c. This resulted in Fame receiving a greater number of ordinary shares upon conversion than had these sales not occurred. Gleeson CJ in the NSW Court of Appeal (at p62) said that:

*"[section 998]...aims to preserve the integrity of the share market. Markets, in reflecting the interaction of forces of supply and demand, may suffer from a variety of imperfections, including mismatches of information, without such imperfections destroying their integrity...."*

*"... The conduct of a seller of thinly traded shares, calculated to effect sales at the lowest, rather than the highest, obtainable price, and timed so as to deflect the possibility of some purchasers bidding up the price, had both the purpose and effect of creating, temporarily, an artificial market and price."*

***ASC v Nomura International plc (1998) 17 ACLC 55***

Nomura was a stock index arbitrageur. On 29 March 1996, Nomura held a large short position in the SPI futures contract, hedged by a long stock position. On that day, to unwind its arbitrage position, Nomura placed orders to sell securities worth approximately A\$600 million in the last half-hour of trading. It also allowed its short SPI contracts to go to expiry that day. Nomura used other strategies to unwind its position including placing offers to buy and offers to sell all the stocks in the All Ordinaries Index at the time at prices between 5 and 20% below the previous day's closing price (for Bids) and between 5 and 20% above the previous day's closing price (for Offers). It also placed other sell orders near the close, unrelated to the arbitrage position, to ensure that prices closed on the down-tick and were not up-ticked immediately prior to the close of trading.

Sackville J agreed with the comments made by Mason J and Gleeson CJ above and added (p136):

*"Thus, in order to establish a contravention of s 998(1), it is enough to show that the alleged contravener did something that was intended or was likely to create a false or misleading appearance in one of the three respects specified in the sub-section. If that is established, it is not necessary also to show that the alleged contravener **actually** created a false or misleading appearance...."*

***Donald v ASIC (Federal Court of Australia, Victoria Registr, 10 October 2000, unreported)***

This was an appeal from a decision of the AAT which found a securities representative had contravened section 998(1) in that his conduct was likely to have created a false or misleading appearance with respect to the price of Burswood shares and banned him from acting as a securities representative for two years.

Heerey J had no doubt that it was open to the AAT to find that what the applicant did was likely to create a false and misleading appearance with respect to the price of Burswood shares. His Honour stated: *"I conclude therefore that the Tribunal was not required to find the applicant knew or had in mind at the time of the contravening conduct that a false or misleading appearance were likely to be created...In any event,...he clearly intended a price to be set which would be different from that resulting from the operation of genuine supply and demand."*



## ATTACHMENT C

### RELATED PUBLICATIONS

- Circular to Member Organisations: “Sections 997 and 998 of the Corporations Law”. No. 306/1990. Dated 21 June 1990 (re-issued 1991).
- Circular to Member Organisations: Amendments to Business Rule 2.8: False or Misleading Appearance. No. 262/1997. Dated 27 June 1997.
- Guidance Note: “Participant Organisation Disclosure of Incentive Payments Offered by Warrant Issuers”. No. 2/1997. Dated 1 June 1997 (revised October 1998).
- Guidance Note: Business Rule 7.5.4.1 “Options Market - Trading Activities” No. 6/2000. Dated 8 May 2000.
- Circular to Participating Organisations: “ASX Business Rule 2.2.4 Prevention of Manipulative Trading When Acting on Behalf of Clients”. No. 332/2000. Dated June 2000.
- Circular to Participating Organisations: “Responsibility of Trading Participants For Bids And Offers In SEATS.” No. 600/2000. Dated 23 October 2000.