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Ms Kristye van de Geer
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By email: Kristye.vandeGeer@asx.com.au

Dear Ms van de Geer

## ASX 24 Bond Futures Roll Consultation

The Australian Financial Markets Association (AFMA) is making comment on the Consultation Paper entitled *ASX 24 Bond Futures Roll Consultation* (the Consultation).

AFMA welcomes the review by ASX of the Bond Futures Roll market structures. We see opportunities for improvements that will support the integrity and growth of the market and create savings for investors.

AFMA also supported the changes to the Bills contracts, and encourages ASX to continue to review its products and rules to find market efficiencies. For example, there may be similar efficiencies to be found in the SPI roll.

On a general level as there is significant uncertainty around how the changes will affect the market that ASX should monitor and review in 12 months (or sooner if required) with a view to further changes to parameters if appropriate.

### ***OPTION 1 -****Tick Size*

AFMA answers the question around tick size a posed, but we note our interest in exploring the potential for decoupling the roll market raised below.

There are a number of arguments in favour of tick size change.

In general, AFMA supports market making as providing increased liquidity, tighter pricing and the more regular provision of two-sided markets across the day.

The risk-reward requires careful calibration in all markets to ensure the right balance is created to incentivise liquidity. Too high a reward in comparison to risk tends to create

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locked markets where natural flow risks being disadvantaged and the market may not gain a net material benefit from an excess of roll market making activities.

Determining which spread is optimal is difficult and can change over time. It is not an exact science.

Some firms that represent a significant proportion of volume under present arrangements favour no change. They are concerned that reducing the tick size while not reducing the exchange transaction cost means a reduction in profit and loss per tick increment, and that this could reduce net incentives to participate.

Some members believe that there is currently an excess of liquidity in the roll market. They expect that with a decreased tick size there will continue to be ample liquidity for the roll market, particularly given the past experience of similar changes, and that the costs to investors of crossing the spread will be significantly reduced.

We do note some risks to liquidity in the outright market as we understand the fully interacting nature of the roll market requires the tick size changes to be reflected in these markets. For some members these liquidity risks to these outrights is of more concern.

AFMA suggests that further consideration be given to a delinking of the calendar spreads from the outright market. The roll markets could still settle as separate legs. We understand there are precedents for this in the US and Japanese markets.

ASX should endeavour to create an optimal mix of risk and reward.

Members indicate that a 6 month transition period is appropriate for any tick changes to be introduced and if this option is adopted, ongoing assessment of post-change impacts be conducted.

***OPTION 2 -****Maximum Allowable Order Size*

There are a range of views on the proposal to increase order size.

As noted in the paper there is the potential benefit to aggregate more client orders into a single larger market order. Such a change will allow firms trading on an agency basis the potential to share a single good queue position, rather than the challenge of sending multiple client orders separately due to the current restricted size.

On the potential negatives, also as noted in the paper it may facilitate further locking up of the book, and increased risks in relation to error trades.

It is difficult to determine in advance what would be the net effect, particularly as the PTRM changes have not yet had their full effect. This could interact with GTC orders and lower order size changes if changes are made to those elements of market structure.

If there are changes made to order size AFMA supports these being carefully monitored.

***OPTION 3 -****Good Till Cancelled Functionality*

AFMA supports Good Till Cancelled functionality as the great majority of members support this position for a period of time. Some of this support is limited to the contracts being valid for a period of 24, 48 hours or 5 days.

There are a range of views on the optimal design of the GTC orders, particularly in terms of the period of time the orders should persist and be available.

The general view is that the current repeated purging of orders in the roll market results in those that provide price discovery being disincentivised, as execution is more likely to go to those that are fastest into the market in each session rather than those first to price.

A view among many is that a longer period of persistence will enable orders to progress in the queue long enough to get executed whereas currently they are more likely to be purged.

Providers of intermediating liquidity are also generally supportive of GTC as it will encourage flow back into the screens.

The exact impact is difficult to estimate particularly in combination with some of the other changes proposed.

If changes are made AFMA supports actively monitoring the net effect of changes.

The algorithm for reinstatement appears appropriate if GTC is to be introduced.

***OPTION 4 -****Pre-Trade Risk Management (PTRM) Changes*

PTRM can provide an important risk management function for market participants, market operators and investors.

By moving the final line of risk checks to the exchange side the potential for firms to compete on the quality of pre-market checks is reduced.

AFMA understands and supports the intention behind the PTRM changes (ASX Notice 0738.19.07), however, we remain concerned that use of the PTRM might not be the most direct or appropriate method of addressing the behaviours of concern.

The changes that have defined usage of PTRM filters above a very low frequency as a rule breach have inadvertently put firms at risk of breach of the licence rules even when using the PTRM filters appropriately as a risk reduction tool. This decreases the utility of these filters as a risk reduction tool for those using them appropriately.

PTRM remains an important tool available for use by Participants alongside their own order management tools, but the increased risk of rule contraventions (related to the PTRM changes via ASX Notice 0738.19.07) may create perverse incentives around the use of PTRM functionality.

AFMA is hopeful that the changes made so far to PTRM will deliver positive improvements to market practice, but in the medium to longer term more direct and appropriate methods should be used, and PTRM usage should be available for genuine risk reduction usage without risking licence condition breaches.

*General Questions*

The tick size change should be managed to carefully balance the risk/reward balance for participating in the roll market.

The rule framework for intention to trade might also be worth revisiting to ensure it is appropriately calibrated. We note that ASIC has raised concerns around some practices in the market and AFMA supports efforts to ensure the rule framework is appropriately designed to address these concerns.

*ASX Block Trades and CentrePoint*

While there is not a strong consensus at present for the introduction of block trades AFMA would support continued consideration of the potential for measures such as block trades and CentrePoint in the roll market.

We note that the MIR prohibiting these is not in and of itself a reason not to consider the change. The MIRs for Futures are overdue for revision and the fact that block trades are excluded from the roll is due to an accident of history in their migration from market rules than any mischief in the practice itself.

AFMA is supportive of the view that block trades and CentrePoint should not be allowed to damage market liquidity. It is important that market quality be maintained and any changes to introduce these types of facilities should be done only with confidence that there will not be adverse market impacts.

We suggest an industry working group be established to consider the evidence and potential for these type of changes within the roll and outright market and look to understand international practice.

*Conclusion*

We thank you again for the opportunity to comment and commend ASX for its continued interest and actions in evolving and improving the market.

Yours sincerely

Damian Jeffree

**Director of Policy and Professionalism**