



**ASIC**

Australian Securities & Investments Commission

**REPORT 87**

# **Market assessment report: Yieldbroker Pty Limited**

November 2006



**ASIC**

Australian Securities & Investments Commission

## **Annual assessment (s794C) report**

**Yieldbroker Pty Limited**  
**ACN 092 250 345**

**November 2006**

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# Executive summary

Section 794C of the Corporations Act 2001 (the Act) requires the Australian Securities & Investments Commission (ASIC) to assess whether a licensed market operator has adequate arrangements for supervising the market it operates. ASIC also has the power under section 794C(1) to assess how well the licensee is complying with any of its obligations as a market licensee.

This report summaries ASIC's third assessment of Yieldbroker Pty Limited's (Yieldbroker) compliance by with its obligations under section 792A(c) and Yieldbroker's response to recommendations made in previous assessments.

## Compliance by Yieldbroker

Taking into consideration the current operation of Yieldbroker's market, we conclude Yieldbroker has adequate arrangements for supervising its market, including arrangements for:

- handling conflicts between its commercial interests and the need to ensure that the market operates in a fair, orderly and transparent manner;
- monitoring the conduct of participants in the market; and
- enforcing compliance with its operating rules.

## Our approach

ASIC uses the formal assessment process to examine whether a market licensee has been and is continuing to meet its supervisory obligations. We also use the process to identify areas where improvements may be needed to enable to the licensee to meet its obligations in the future.

In this assessment we focused on the adequacy Yieldbroker's supervisory arrangements and its responses to the recommendations made by ASIC in previous assessments.

# Section 1: Background

## 1.1 Yieldbroker

Yieldbroker is wholly owned by four entities being Citigroup Global Markets Australia Holdings Pty Limited, Deutsche Bank Aktiengesellschaft, Macquarie Bank Limited and ABN AMRO Australia Pty Limited. The Board of Yieldbroker is comprised of employees of these entities.

On 3 February 2004 Yieldbroker was granted a licence to operate two markets, the Dealer-to-Client market and the Interdealer market. During the assessment period Yieldbroker operated only the Dealer-to-Client market. The Dealer-to-Client market allows participants known as clients to request quotes from participants known as dealers. The class of financial product traded on the Dealer-to-Client market is debentures. The participants of Yieldbroker either hold an Australian financial services licence or are professional investors.

A copy of Yieldbroker's licence is available on ASIC's website at [www.asic.gov.au](http://www.asic.gov.au).

## 1.2 The assessment process

### ASIC's role

Section 794C(2) of the Act requires ASIC to assess at least once a year how well a market licensee is complying with particular obligations under its market licence. The assessment must consider whether the licensee has adequate arrangements for supervising the market, including arrangements for handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the market it operates is fair, orderly and transparent.

A market licensee's obligations are ongoing, and whether it is likely to comply with its obligations in the future cannot be judged merely by reference to its past compliance. We therefore used the assessment process to:

- reach conclusions about the adequacy of the arrangements a market licensee has in place for supervising its market in accordance with its obligations under the Act at the time of the assessment; and
- identify issues, which in our view need, or may need, to be addressed to ensure ongoing compliance.

## Assessment process

ASIC's assessment and the views expressed in this report are a combination of processes including the ongoing interaction we have with Yieldbroker in our role as regulator of financial markets and information we gathered for the specific purpose of the assessment.

In conducting our assessment we:

- reviewed the annual regulatory report provided by Yieldbroker to ASIC for the year ending 30 June 2006 as required under section 792F of the Act;
- analysed information we received from and about Yieldbroker in the ordinary course of our dealings with the licensee;
- reviewed material obtained from Yieldbroker using our powers under section 30 of the Australian Securities and Investments Commission Act 2001, including:
  - supervisory policy and procedure documents; and
  - board minutes and reports; and
- visited Yieldbroker offices in Sydney on 20 September 2006 and spoke to Yieldbroker staff.

We have discussed the results of our assessment with Yieldbroker, seeking their comments on both the factual matters set out in this report and our conclusions.

## 1.2 Focus of this assessment report

In this assessment we reviewed Yieldbroker's supervisory arrangements and Yieldbroker's responses to recommendations made in previous assessments.

# Section 2: Observations and Recommendations

## 2.1 Yieldbroker is meeting its obligations

After making our assessment, ASIC concludes that Yieldbroker has adequate arrangements for the supervision of its market in accordance with its obligations under section 792A(c) of the Act.

This conclusion is based on information gathered during the assessment process, our observations on the basis of our ongoing correspondence with Yieldbroker and the present operating conditions, and the following observations:

1. Yieldbroker has an adequate framework of operating rules and procedures in place to supervise the market;
2. Yieldbroker has responded adequately to recommendations made in previous assessments;
3. Yieldbroker staff displayed a good understanding of Yieldbroker's supervisory obligations; and
4. no serious market failures or disruptions came to our attention.

## 2.2 Other observations

### Response to recommendations

As part of our previous assessments we made recommendations to Yieldbroker regarding aspects of Yieldbroker's supervisory arrangements. As part of this assessment we reviewed Yieldbroker's response to our recommendations.

### *Conflicts of interest*

Yieldbroker has made changes to its conflicts handling arrangements in response to recommendations made in the June 2005 assessment report. The recommendations were made in response to two areas of concern ASIC held about Yieldbroker's conflicts of interest arrangements - the seemingly limited understanding Yieldbroker staff had about conflicts of interest and how it applied to their duties, and the composition of the Compliance Committee. In this assessment we reviewed the responses made by Yieldbroker to these recommendations.

The first recommendation was that Yieldbroker should develop procedures and provide appropriate training to ensure its staff are able to identify conflicts of interest between the supervisory and commercial

objectives of Yieldbroker and know how to appropriately manage such conflicts of interest.

As part of last year's assessment we reviewed Yieldbroker's conflicts of interest procedure and found it to be adequate. In the current assessment year the Compliance Officer conducted training with Yieldbroker staff about conflicts of interest. We note that Yieldbroker staff now seem to have an adequate understanding of conflicts of interest, how conflicts of interest can be identified and how they should be managed.

We believe Yieldbroker has adequately addressed the first recommendation.

The second recommendation stated Yieldbroker should review its operating rules and procedures in regard to conflicts of interest to ensure that they are consistent with the Act and ASIC Policy Statement 172.

In 2005 Yieldbroker amended its operating rules and procedures to ensure they are in line with the Corporations Act 2001 and ASIC Policy Statement 172.

We believe that Yieldbroker has adequately addressed the second recommendation.

The third recommendation was that Yieldbroker should ensure that the Compliance Committee has an appropriate composition in order to deal with all matters brought before it for its consideration. The fourth recommendation stated Yieldbroker should consider the inclusion of an appropriately qualified independent person on the Compliance Committee.

The Compliance Committee is comprised of representatives of each of the shareholders who are also participants on the market. Yieldbroker stated that it had considered the possible appointment of an independent member to the Compliance Committee and other alternatives to ensure a quorum could be achieved when two members are conflicted because they are the appointed representatives of each participant involved in the matter being considered by the committee. However, Yieldbroker decided to appoint Yieldbroker's general manager to the Compliance Committee when a quorum cannot otherwise be formed. Yieldbroker has stated that in the unlikely event that the general manager had to serve on the Compliance Committee, Yieldbroker has policies and procedures in place to ensure the general manager's conflicts of interest are adequately managed.

We note the general manager is paid a fixed salary and is neither remunerated on nor commercially motivated in the short term by market-related factors such as volume/turnover or number of participants on the market. Further, the commercial interests of Yieldbroker are generally

aligned with its obligation to ensure that the market is fair, orderly and transparent. It is therefore in the interests of the general manager to ensure that this continues to be the case.

Under General Operating Rule 12.4, the Compliance Committee must reach a decision regarding their recommendation without bias and shall give the participant(s) concerned a fair hearing and otherwise shall observe the rule of natural justice.

Finally, we note the Compliance Committee has not been convened in the two years the market has been operating, and the general manager has not been called upon to join the Compliance Committee.

We believe this to be an adequate response to the third and fourth recommendations.

Yieldbroker has changed its operating rules to reflect these arrangements.

During our assessment we noted that some of the procedures had not been updated to reflect the changes in the operating rules. We suggested Yieldbroker take steps to address this.

In response to our suggestion Yieldbroker has informed us of their intention to undertake a review of the procedures to ensure the procedures reflect the operating rules. Yieldbroker believes that it will complete the review by January 2007.

### ***Monitoring the conduct of participants***

Yieldbroker has responded to the recommendation that the role of the Compliance Committee should be clarified. As noted in the last assessment, that the Compliance Committee does not have a day-to-day role in the supervision of the market; rather the Compliance Committee role is an oversight role. Yieldbroker has changed its operating rules to clarify the role of the Compliance Committee. The changes to the operating rules emphasize that the Compliance Committee supervisory role is an oversight role, whilst the Compliance Officer has the day-to-day supervisory role.

To keep the members of the Compliance Committee informed of participants' compliance with operating rules, the Compliance Officer is sending the members of the Compliance Committee both the monthly and annual compliance reports prepared by the Compliance Officer.

We believe this to be an adequate response to the recommendation.

During our assessment we noted that some of the procedures had not been updated to reflect the changes in the operating rules.

As noted above Yieldbroker has informed us of their intention by to conduct a review of the procedures to ensure the procedures reflect the operating rules.

### ***Enforcing compliance with operating rules***

ASIC noted in June 2005 assessment report that Yieldbroker was not treating breaches of the market performance criteria (MPC) as breaches of operating rules. Yieldbroker's operating rules state that a participant classified as a Dealer must provide price information to Yieldbroker and if a participant requests a quote, to that participant. This price information must be supplied in accordance with the MPC. Breaches of the MPC may occur when Dealers exceed the time limit on responses to requests for quotes for participants or when Dealers do not supply indicative prices to Yieldbroker. ASIC made two recommendations in regard to breaches of MPC by participants, namely that:

- Yieldbroker must ensure that breaches of the MPC are reported to the board as operating rule breaches and if necessary, the appropriate penalties are applied as set out in the operating rules; and
- Yieldbroker should document any consideration of any operating rule breaches.

Yieldbroker has responded to the first recommendation by changing its MPC procedures. The new procedure recognises that not all infractions of the MPC are intentional and thus should not be treated as a breach of the operating rules.

The modified MPC introduced the idea of High Infraction Days (HIDs), days when a dealer incurs infractions in excess of the daily allowable limits. Upon the occurrence of a HID, Yieldbroker notifies the dealer and requests an explanation. A contravention of the MPC occurs if a dealer has five or more HIDs in a month that remain unexplained or may otherwise contravene the operating rules (including unsatisfactory explanations from the relevant dealer). If such a contravention of the MPC occurs, the procedures state that the Compliance Officer must take disciplinary action as outlined in General Operating Rule 11.1.

We believe that Yieldbroker has adequately responded to the recommendation, but we suggest that Yieldbroker review its new MPC procedures to ensure that the MPC procedures are still meeting their goal.

In response to our suggestion Yieldbroker intends to conduct a review of its HID policy in November 2006. Yieldbroker also notes that they have implemented an annual procedure to ensure the relevance of its HID policy is considered on an annual basis.

In response to the second recommendation it was noted in the previous assessment that the Compliance Officer will record consideration of

operating rule breaches in a database. We noted in this assessment that Yieldbroker had set up the database, but as there has been no operating rules breaches or investigations of potential breaches Yieldbroker has not yet had a reason to use the database.

## **Section 3: Recommendations**

Based on this assessment, ASIC has made some suggestions that Yieldbroker may act on but ASIC does not have any recommendations to make in relation to Yieldbroker's current supervisory arrangements.