



ASIC

Australian Securities & Investments Commission

REPORT 79

**Market assessment report:
Australian Clearing House Pty
Limited / ASX Settlement and
Transfer Corporation Pty
Limited**

July 2006



ASIC

Australian Securities & Investments Commission

Annual assessment (s823C) report

**Australian Clearing House Pty
Limited
ACN 001 314 503**

**ASX Settlement and Transfer
Corporation Pty Limited
ACN 008 504 532**

July 2006

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Executive summary

Section 823C of the *Corporations Act 2001* (Act) requires ASIC to assess how well a licensed clearing and settlement facility operator is complying with certain of its obligations as the holder of an Australian clearing and settlement facility licence. Specifically, ASIC must assess whether a clearing and settlement facility operator has adequate arrangements for supervising the facility it operates.

This report summarises ASIC's fourth assessment of the compliance by Australian Clearing House Pty Limited (ACH) and the compliance by ASX Settlement and Transfer Corporation Pty Limited (ASTC) of its obligations under section 821A(c) of the Act.

This report describes our assessment, conclusions and key recommendations for areas of improvement.

Compliance by ACH and ASTC

We conclude that each of ACH and ASTC continue to have adequate arrangements for supervising their respective clearing and settlement facilities, including arrangements for:

- handling conflicts between the commercial interests of the licensee and the need to ensure that the clearing and settlement facility's services are provided in a fair and effective way; and
- enforcing compliance with the operating rules of the clearing and settlement facility.

Our approach

ASIC uses the formal assessment process to examine whether a clearing and settlement facility 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 the licensee to meet its obligations in the future.

In this assessment we examined the day-to-day supervisory functions carried out by ACH and ASTC.

Generally our assessment report focuses on suggested areas of improvement in ACH and ASTC arrangements rather than on the more positive aspects that support our overall conclusion. It is important to make clear that none of the suggestions for improvement in this report detract from our conclusion that ACH and ASTC arrangements have met and continue to meet their statutory obligations.

The regulatory report ACH and ASTC provided to ASIC and the Minister under section 821E of the Act reviews the supervisory activities the licensees undertook

during the year. Those activities demonstrates the supervisory roles ACH and ASTC have in respect of their clearing and settlement facilities and provides support for our conclusion that ACH and ASTC are complying with their supervisory obligations.

Section 1: Background

1.1 The ASX group (ASX)

Australian Stock Exchange Limited (ASX) currently holds an Australian Market Licence (AML) that permits it to operate a market in the financial products listed on its license. ASIC's assessment of ASX was set out in a separate report dated February 2006. ACH and ASTC each hold an Australian clearing and settlement facility licence and are wholly owned subsidiaries of ASX. ACH provides all clearing services and ASTC provides all settlement services, for transactions entered into on the market operated by ASX.

A copy of ASTC's licence and ACH's licence is available on ASIC's website at www.asic.gov.au.

The infrastructure and services that support the operation of ASTC's and ACH's clearing and settlement facilities are largely provided through ASX Operations Pty Limited (ASXO), another wholly owned subsidiary of ASX. ASXO provides operational resources to ACH and ASTC using common staff and infrastructure.

Pursuant to the merger of ASX and SFE Corporation Limited (SFECL) announced in March 2006, SFECL group companies will become part of the ASX Group. The merger, which will take effect on 25 July has no immediate impact on the conclusions in this report, although ASIC is closely monitoring the integration of both businesses.

1.2 The assessment process

ASIC's role

Section 823C of the Act requires ASIC to assess at least once a year how well a clearing and settlement facility licensee is complying with certain of its obligations as a clearing and settlement facility licensee. The assessment must consider whether the licensee has adequate arrangements for supervising the clearing and settlement facility, including arrangements for handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the facility's services are provided in a fair and effective way.

A clearing and settlement facility 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 use this assessment process to:

- reach conclusions about the adequacy of the arrangements a clearing and settlement facility licensee has in place for supervising its clearing and settlement facility in accordance with its obligations under the Act at the time of the assessment; and

- identify issues that in our view need, or may need, to be addressed to ensure ongoing compliance.

Assessment process

The ASX Group is structured so that the same business units perform functions relating to the operation and supervision of the market operated by ASX and the clearing and settlement facilities operated by ACH and ASTC. The monitoring and enforcement of compliance with each of the ASX Market Rules, the ACH Clearing Rules and the ASTC Settlement Rules is undertaken on an ASX Group basis. That is for instance Compliance Services monitors market, clearing and settlement participant compliance with the market, clearing and settlement rules respectively and Risk Management monitors market and clearing participant compliance with the capital adequacy requirements of the market and clearing rules respectively. ASX Group Compliance has responsibility for the conflict handling arrangements of ASX, ACH and ASTC.

ASIC has reviewed the work and work practices of relevant business units to assess the level of compliance by ACH and ASTC with their obligations under section 821A(c) of the Act. These business units are:

- Compliance Services;
- Clearing and Settlement Operations;
- Investigations and Enforcement;
- Risk Management; and
- ASX Group Compliance

This report only covers the activities of these business units in so far as they relate to the operation of the clearing and settlement facilities.

During the assessment we reviewed operational records and spoke to relevant managers and staff. We served a number of notices that required ACH ASTC and ASX to give ASIC documents relating to their activities. We performed an onsite review in November 2005 of all the business units above apart from Risk Management which we reviewed through a "desk audit" of relevant material, including ACH and ASTC's responses to a self assessment-style letter. ASIC also:

- analysed information available from external sources, including information from international regulatory bodies and ASX Group reports;
- reviewed the annual regulatory reports of ACH and ASTC, given to ASIC as required under s821E of the Act and dated September 2005;
- reviewed the annual report prepared for the ASX Board by ASX Supervisory Review Pty Limited (ASXSR), and given to ASIC dated September 2005;

- analysed information we received from and about ACH and ASTC in the ordinary course of our dealings with each of them as clearing and settlement facility licensees;
- interviewed key staff with operational and supervisory responsibilities;
- reviewed internal ACH and ASTC material, including disciplinary and investigation files, internal reports and information collected by ACH and ASTC on a continuous basis; and
- noted the report prepared by RBA on its assessment under section 823CA(1) of the Act.

ASIC has discussed the results of this review with ACH and ASTC and has sought its comments on both the factual matters and conclusions set out in this report.

1.3 Focus of this assessment report

ASIC made no recommendations concerning the clearing and settlement facilities operated by ACH or ASTC in our last assessment report dated September 2005. The focus of this assessment was to generally review the ongoing supervisory arrangements of ACH and ASTC.

Section 2: Observations and recommendations

2.1 ACH and ASTC are meeting their obligations

After making our assessment of ACH and ASTC, ASIC concludes that each of ACH and ASTC have adequate arrangements for the supervision of its clearing and settlement facility in accordance with its obligations under section 821A(c) of the Act.

This conclusion is based on the following observations drawn from information gathered during the formal part of our assessment process, our observations on the basis of our regular contact with the licensee and the present operating conditions:

- key management and staff responsible for the operation and supervision of the clearing and settlement facilities demonstrate a high level of operational expertise. This view is supported among other things by:
 - the competence, knowledge and expertise of personnel involved in operating the clearing and settlement facilities;
 - the very high operational reliability of the facilities; and
 - the absence of any significant supervisory issues detected;
- ACH and ASTC have good and reliable technology in place that enable them to provide a fair and effective clearing and settlement facility. There were no serious facility failures or disruptions during the period covered by this assessment;
- ACH and ASTC are active and vigilant in financial risk management. Operational personnel and management involved in risk management are knowledgeable and experienced and demonstrate a commitment to sound risk management practices;
- ACH and ASTC operating rules provide an adequate framework for the operation of a fair and effective facility; and
- satisfactory procedures are in place for the key supervisory areas.

2.2 Other observations and recommendations for future action

Restructure of clearing and settlement activities

In the second quarter of 2005 ASX was restructured into five main divisions called Markets, Supervision, Strategy, Shared Services and Technology. Prior to this ACH's and ASTC's operations were mostly carried out functionally within one single division, Clearing and Settlement Division. Clearing and Settlement Division reported to the Executive General Manager, Clearing & Settlement and to the boards of ACH and ASTC (which are ultimately accountable for the compliance of ACH and ASTC with licence obligations). The Clearing and Settlement Division no longer exists and its functions have been diffused within the Markets Division. ASX has assured ASIC that the attention historically given to clearing and settlement will continue, and the restructure will have no adverse effect on supervision of these activities.