



**ASIC**

Australian Securities & Investments Commission

**REPORT 94**

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

May 2007



**ASIC**

Australian Securities & Investments Commission

# **Annual assessment report**

**ASX Limited**  
**ACN 008 624 691**

# **Annual assessment report**

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

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

**May 2007**

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# Executive summary

Section 794C of the *Corporations Act 2001* (Act) requires ASIC to assess how well a licensed market operator is complying with its obligations as the holder of a market licence.

Section 823C of the 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.

More specifically, ASIC must assess whether a market operator has adequate arrangements for supervising the market(s) it operates and whether a clearing and settlement facility operator has adequate arrangements for supervising the facility it operates.

This report summarises ASIC's fifth assessment of compliance by ASX Limited (ASX) with its obligations under s792A(c) and compliance by Australian Clearing House Pty Limited (ACH) and ASX Settlement and Transfer Corporation Pty Limited (ASTC) with section 823C of the Act.

Our last report about ASX was publicly released in March 2006. ASIC's report on ACH and ASTC was released in July 2006.

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

Generally our assessment reports focus on suggested areas of improvement in a licensee's 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 ASX, ACH and ASTC's arrangements have met and continue to meet their statutory obligations.**

## Compliance by ASX, ACH and ASTC

1. We conclude that ASX continues to have 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 listing rules and market rules.
2. 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.
3. During the assessment period a number of significant organisational and structural

changes occurred including the establishment of ASX Markets Supervision Pty Ltd (ASXMS), a merger with SFE Corporation Limited (SFE Corp) and the dissolution of ASX Supervisory Review Pty Limited (ASXSR). These changes and in particular the merger with SFE Corp occurred without any significant disruption to ASX or SFE's markets. The establishment of ASXMS with its own board is a positive development, because it further delineates between ASX group's commercial and supervisory activity, creates a platform for board level focus on ASX group's supervisory obligations and allows for a more transparent funding basis for supervisory activity.

4. The key recommendations in this report relate to the resources ASXMS has at its disposal and how ASXMS plans for its future staffing needs. We have found no evidence to suggest that there has been any significant impact on ASX group's current supervisory performance. ASX is cognisant of the potential risk to the ASX group's ability to adequately supervise activity on its market. ASX has decided to increase the level of resources in ASXMS effective from 1 July 2007. ASIC fully supports this decision.
5. Another key recommendation concerns the effectiveness of the governance arrangements in place to oversee supervisory activity conducted by business units that are not part of ASXMS. In our view a consolidation of these various functions with ASXMS would be an advantage. Alternatively this could be addressed through a revision of the terms of the Supervision Charter.

# Section 1: Background

## 1.1 The ASX group

During the period of the assessment, ASX held an Australian market licence that permits it to operate a market in the financial products described on its licence. Two ASX group entities, ACH and ASTC, hold licences to operate clearing & settlement facilities. Copies of ASX, ACH and ASTC licences are 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 of the Act requires ASIC to assess at least once a year how well a market licensee is complying with its obligations as a market licensee. 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 operates in a fair, orderly and transparent way.

Section 823C of the Act also requires ASIC to assess at least once a year how well a clearing and settlement facility licensee is complying with 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 market licensee's and a clearing and settlement facility licensee's obligations are ongoing. Whether a licensee is likely to comply with its obligations in the future cannot be judged merely by reference to its past compliance. We therefore use the assessment process to:

- reach conclusions about the adequacy of the arrangements a licensee has in place for supervising its market and 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.

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. For instance Compliance Services in ASXMS monitors market, clearing and settlement participant compliance with the market, clearing and settlement rules respectively and Prudential Risk Management unit monitors market and clearing participant

compliance with the capital adequacy requirements of the market and clearing rules respectively. ASX Licence Compliance has responsibility for the conflict handling arrangements of ASX, ACH and ASTC.

Our assessment of each licensee in ASX group (i.e. ASX, ACH and ASTC) is conducted in one integrated review process.

ASIC's assessment and the views expressed in this report are a combination of processes - the ongoing interaction we have with ASX group in our role as regulator of companies and financial markets, an on-site inspection of books and records and interviews with ASX group personnel, and the discussions we have with ASX group about the issues that have arisen from our previous assessment processes.

In conducting our assessment we have particularly considered:

- the annual regulatory report given to ASIC by ASX dated September 2006 as required under s792F of the Act;
- the annual regulatory reports of ACH and ASTC, given to ASIC as required under s821E of the Act and dated September 2006;
- the annual report prepared for the ASX Board by ASXSR dated September 2006, a copy of which was given to ASIC;
- information we received from and about ASX group in the ordinary course of our dealings with ASX and ACH / ASTC as a market licensee and clearing and settlement facility licensees respectively, including:
  - information received as part of the rule amendment process;
  - interaction with ASX, ACH and ASTC on a range of operational issues;
  - referrals of serious contraventions;
  - the register of rule waivers; and
  - ASX group's most recent annual report;
- information from external sources, including media commentary and reports published by ASX group;
- the operation of the market throughout the period, in particular in relation to issues of disclosure and trading;
- internal ASX, ACH and ASTC material, including disciplinary and investigation files, internal reports and information collected by ASX group on a continuous basis;
- discussions with senior ASX group management; and
- comments made in interviews or discussions with a range of ASX group personnel; and
- the report prepared by the Reserve Bank of Australia on its assessment under section 823CA(1) of the Act dated May 2006.

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

This assessment involved two onsite reviews. The first was conducted in August 2006 soon after the establishment of ASXMS, and the second in November 2006. Three sets of notices for production of books were issued, along with supplementary notices during the November onsite.

Following the August and before the November onsite review, we wrote to ASXMS seeking a reconciliation of its funding and staffing numbers. This was to assist ASIC to consider the adequacy of resources, in particular staffing levels in ASXMS and whether they are sufficient.

After our onsite visit was completed we provided written findings to ASX group and had discussions about a number of issues. Where appropriate, our report reflects ASX group's responses.

### **1.3 Focus of this assessment report**

The main focus of this assessment was to review the operation of ASXMS following its establishment in July 2006. In particular we looked at the resources of ASXMS and how it will continue to be resourced in the future. We also looked at its management and reporting structures including the role of the ASXMS board.

We considered ASX group's arrangements for handling conflicts of interest following the establishment of ASXMS and the dissolution of ASXSR. In particular we considered the practical changes in ASX group's conflict handling arrangements to ensure that there would be no retreat from the clearer division of commercial and supervisory functions put in place over the previous few years and that no gaps had emerged from the change in arrangements.

We reviewed the performance of those units that carry out key supervisory activity in relation to the market and clearing and settlement operations. These units included all of the units now within ASXMS being: Participants (comprising Compliance Services, Surveillance and Investigations); Issuers; Enforcement; and Prudential Risk Management, as well as units in ASX group's Operations Division including Companies Announcement Office (CAO); Clearing Risk Management; and Market Control . We looked at the quality and consistency of their activities as well as the sufficiency of resources, in particular staff, at their disposal.

We also considered specific events that occurred during the relevant period and considered emerging issues for and the risks faced by key supervisory units.

We also reviewed how ASX, ACH & ASTC had responded to the recommendations set out in last period's annual assessment.



# **Section 2: Observations and recommendations about ASX**

## **2.1 ASX is meeting its obligations**

After making our assessment, ASIC concludes that ASX has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(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 ASX and the present operating conditions (including trading volumes and financial products traded on each market):

1. No serious market failures or disruptions came to our attention during the course of our assessment;
2. The operating rules and guidance notes provide an adequate framework for a fair, orderly and transparent market;
3. Key supervisory areas that monitor the conduct of participants and trading have adequate procedures in place;
4. During the course of our interviews, key management and staff responsible for supervision demonstrated a strong commitment to their supervisory role and a high level of expertise in the operations of the market;
5. Our review of operational records on supervisory decisions showed that:
  - decision-making on supervisory matters is sound;
  - ASX conducts ongoing supervision of its participants and listed entities;
6. ASX has good market infrastructure (including technology) to support its obligations to maintain a fair, orderly and transparent market;
7. ASX demonstrated a strong commitment to educating participants and listed entities in their obligations under the market rules and listing rules; and
8. ASX shares information on supervisory matters with ASIC.

## **2.2 Other observations and recommendations for future consideration and as appropriate action**

### **Merger with SFE**

On 5 July 2006, the shareholders of SFE Corp approved a Scheme of Arrangement whereby they would receive shares in ASX in exchange for their shares in SFE Corp, and all shares in SFE Corp would be transferred to ASX. The Scheme of Arrangement

was implemented on 25 July 2006 and SFE Corp became a wholly owned subsidiary of ASX. SFE Corp's subsidiary company Sydney Futures Exchange Limited (SFE) operates the SFE futures market. Two other SFE Corp subsidiary companies, SFE Clearing Corporation Pty Limited (SFE Clearing) and Austraclear Limited (Austraclear), hold licences to operate clearing & settlement facilities. This assessment report is about ASX, ACH and ASTC. The assessment of SFE group licensed entities was conducted separately and the results will be the subject of another report.

ASX has not publicly announced any short or medium term plan to integrate the SFE derivatives and ASX equities and derivatives markets. Nor has it announced its plans in respect of the CS facility licensees that now comprise ACH, ASTC, SFE Clearing and Austraclear.

All SFE staff moved to ASX's Sydney premises by late 2006. While staff rationalisation occurred in commercial areas, ASIC was informed that there were no changes to supervisory staff, flowing as a direct result of the merger. As from September 2006 SFE group supervisory staff became part of ASXMS, which now also provides supervisory services to SFE licensees. As at the time of our reviews, however, there was no cross-over of functions between SFE group licensee supervisory staff and ASX group licensees' supervisory staff. Subsequently several steps have been taken or are underway to align and assimilate SFE and ASX supervisory functions including the cross training of staff, the integration of SFE's and ASX's referral processes and the co-ordination of SFE and ASX participant inspection programs. Other proposed changes to ASX group's supervisory and disciplinary processes have been put up for public comment, including the integration of disciplinary tribunals and appeal processes for ASX and SFE licensees.

In early December 2006 the group holding company "Australian Stock Exchange Limited" changed its name to "ASX Limited" and announced that it would operate under the brand "Australian Securities Exchange".

### **Establishment of ASXMS**

ASX group's supervisory activities have undergone significant restructuring in the last 3 years, directed at improving the separation of commercial and supervisory activity, improving efficiency and enhancing the relationship and communication between stakeholders. Integrity Division was created on 1 January 2004 to house most ASX group supervisory functions in one division, whereas previously they had been diffused across divisions. In October 2005, Supervision Division, which by then had succeeded Integrity Division in name, was reorganised into 3 main operational units: Issuers; Participants; and Enforcement. A fourth unit, Regulatory Policy, was also set up with responsibility for the analysis and development of regulatory policy.

#### *Rationale for ASXMS*

Following an internal review of supervision in 2005, ASX group identified the need to improve the way it managed the conflict between its commercial and supervisory roles, including perceptions about the role of the ASX group CEO straddling both commercial and supervisory areas.

The establishment of ASXMS aimed to address this conflict by:

1. corporatising Supervision Division and providing it with a more transparent and less discretionary funding basis. ASXMS's budget for the coming financial year is subject to ASX board approval;
2. separating the reporting line of the head of supervision from the ASX CEO by having the Chief Supervision Officer (CSO) report to a separate board; and
3. separating the activity of supervision from the regulatory policy function by relocating Regulatory Policy unit outside of ASXMS.

#### *ASXMS organisation*

ASXMS is a wholly owned subsidiary of ASX Limited. ACH and ASTC are wholly owned subsidiaries of ASX Operations Pty Limited (ASXO), itself a subsidiary of ASX.

The roles and relationship between ASXMS, ASX and ASXO are set out in a Supervisory Services Agreement (SSA). This essentially provides that ASXMS is to provide ASX group licensees i.e. ACH, ASTC & ASX, with the services required to ensure that there are adequate arrangements for supervising the financial market and C&S facilities, including arrangements for handling conflicts. ASX and ASXO must provide sufficient funding and resources (staff, equipment and software) to ASXMS to enable ASXMS to meet its obligation above. The licensees retain legal accountability for their statutory obligations.

ASXMS's constitution provides for a board of up to 9 members. ASX policy is to populate the board with 5 members comprising 3 non-executive ASX directors and 2 independent directors. The board is appointed by ASX. ASX has a policy to maintain a majority of ASXMS directors who are also ASX directors. At this time the chair of ASXMS is also the chair of ASX.

The ASXMS board through its obligations under the Supervision Charter must assist the licensees to meet their supervisory obligation by: monitoring the handling of conflicts; monitoring participant conduct and compliance with the operating rules; enforcing the operating rules; and monitoring that ASXMS has sufficient financial, technological and human resources for the supervisory services to be provided. ASXMS must report to the licensee boards biannually on whether appropriate standards of supervision are being met and whether resources for supervisory activity are adequate.

The CSO reports to the ASXMS board but is appointed by the CEO of ASX with the agreement of the ASXMS board. The CSO's responsibilities are to ensure the efficient and effective operation of ASXMS and bring material and other relevant matters to the attention of the board in a timely and accurate manner.

## **Dissolution of ASXSR**

The functions undertaken by ASXSR pursuant to a 'Supervisory Oversight Functions Agreement' between ASXSR and ASX group were to review: the adequacy of ASX group supervisory policies and procedures, including conflict handling arrangements; the adequacy of funding and resources for supervisory activity; and ASX group supervision of listed entities and participants (review group entities and review participants) whose relationship with ASX group companies may give rise to a conflict of interest in their supervision by ASX group.

ASXSR reported annually to the ASX board on these matters and provided a copy of that report to ASIC and the Minister. ASX decided to disband ASXSR and it ceased to operate in October 2006. ASXSR provided its final report to the ASX board in September 2006.

In ASIC's view the ASXSR board performed its functions (as determined by ASX) with thoroughness and objectivity and was aided by a highly effective secretarial unit.

ASXMS was established with functions duplicating the functions of ASXSR. In particular the board of ASXMS is tasked with both monitoring and reporting to the licensee boards on the adequacy of supervision and the sufficiency of resources available for that purpose. The Licence Compliance unit is now responsible for the oversight of ASX group supervision of review group entities and review participants. Consequently there are no gaps as such in the activity performed by the ASXSR board and the activities now performed by the ASXMS board and Licence Compliance unit.

While the ASXMS board is not as independently constituted as the ASXSR board, this is mitigated by the role ASIC plays in conducting annual assessments pursuant to s794C and s823C of the Act. Licence Compliance has also been given specific functions to assist the ASXMS board in its supervisory responsibilities for example, to monitor and advise on the adequacy of ASX Group's arrangements for handling conflicts of interest and to carry out a program of reviews to monitor that the work performed within ASXMS is in accordance with licence obligations.

### ***Recommendation 1***

Licence Compliance has been given additional functions as a consequence of the establishment of ASXMS and the dissolution of ASXSR. Accordingly, Licence Compliance should be closely monitored to ensure it has the requisite resources to do these additional functions.

## **Sufficiency of resources**

In last year's assessment report we said that supervision is a key, core function of the exchange and it is vital that ASX ensures that resources are adequate not only in the current buoyant market conditions, but also in the event that additional supervisory demands are created by a market downturn with the pressures for instance of earnings revisions and solvency issues. We observed that workloads in the Companies unit (now Issuers unit) were quite high and that there was evidence of periods of understaffing in other business units due to staff turnover. In response, ASX said it

would benchmark itself against comparable overseas exchanges in areas such as supervisory staff to listings and participants ratios in order to establish objective standards for staffing levels. In November 2006, ASX wrote to 15 overseas exchanges to ascertain interest in comparing the resources devoted to supervisory activities.

While ASIC agrees that this type of benchmarking can be a useful guide in determining the appropriate level of resources, at the time of our onsite assessment ASIC continued to have concerns with regard to the sufficiency of resources. In particular we thought that there were pressure points apparent in supervisory staffing throughout the review period. We also thought that ASXMS lacked a process for measuring the adequacy of staffing against workload as well as for planning for future staffing needs. These concerns were amplified by the dissolution of ASXSR which, under its charter, independently attested to the sufficiency of ASX resources.

We noted that ASXMS experienced some difficulty in retaining and recruiting staff and that it took in the vicinity of 12 – 18 months of on the job training to make new staff fully effective. During the review period four experienced staff left the Perth Issuers unit including the Manager and Assistant Manager. The General Manager of Issuers also left and the Sydney Assistant Manager acted as the Perth Manager. As a result the Sydney Issuers unit Manager was simultaneously acting as the General Manager, Issuers and Assistant Manager for an extended period. At the same time the Sydney Issuers unit had a high proportion of new starters on staff. However, we found no evidence to suggest that these resourcing issues had any significant impact on ASX group's overall supervisory performance.

Until late 2006 and since 1999, the staffing level of Company Announcement Office (CAO) that operates the Company Announcement Platform (CAP), had not changed and no significant new technology had been introduced in that period. However there has been a 40% increase in announcements being processed through CAP from 2000/01 to 2005/06. Recently ASX announced that record numbers of announcements had been processed on days in October 2006 and February 2007.

The Investigations unit in ASXMS experienced significant staff turnover during the review period and a number of investigations had been delayed because of resource issues.

ASIC is satisfied that the ASXMS board is cognisant of this issue. Regular reporting between the CSO and ASXMS board on resourcing has been in place since ASXMS's inception. However in January 2007 a new management tool was implemented in the form of a workload reporting system based on pre agreed drivers of supervisory activity as well as acceptable levels of workload. This will assist ASXMS management to identify and manage actual and possible pressure points in staffing and bring such issues to the attention of the ASXMS board more readily.

The ASXMS board has also implemented a number of strategies aimed at improving staff retention, knowledge retention and new starter upskilling. In addition ASXMS has implemented a graduate program and will also hire additional general staff. These two employment initiatives should result in a net gain of approximately 9 budgeted FTE positions in the 07/08 financial year.

## ***Recommendation 2***

ASIC recommends that the ASXMS board closely monitors the continuing efficacy of the strategies it has put in place to address the need to have sufficient human resources.

### **Supervisory activities conducted by non ASXMS business units**

Upon the establishment of ASXMS, certain areas that conduct supervisory activity remained outside of the ASXMS structure. These areas included the CAO which disseminates company announcements to the market.

Licence Compliance ranked the risk that 'Supervisory activities undertaken outside the Market Supervision area may not be undertaken with sufficient vigour' as the highest risk in 15 top compliance risks developed as part of a group wide enterprise risk assessment exercise.

ASIC is not fully satisfied with the controls currently put in place to manage this risk.

The following issues in non-ASXMS business units highlight that the current governance arrangements require further consideration.

- The staff resourcing issue in CAO referred to above has the potential to seriously undermine the functions that CAO performs, and in turn, has significant consequences for ASX's ability to run a fair, orderly and transparent market. As also noted above no significant new technology has been introduced into CAO since 1999. While the existing company announcements platform still functions effectively, we note that there has been a significant delay in the rollout of an upgrade to a new platform (CAP 2). ASX has advised that the expected implementation date of CAP 2 is now July 2007.
- We found what appeared to be a formal arrangement between ASX and Corporate File Pty Ltd<sup>1</sup>(Corporate File). Corporate File undertakes commissioned company CEO interviews, which are then released through CAP. The arrangement ensured that all open briefings produced by Corporate File were given "sensitive status" when lodged as announcements with CAO. Although this arrangement has ceased to exist, the CAO continued to tag the Corporate File briefings as "sensitive". The tagging of an announcement as "sensitive" has the effect of drawing investors' attention to the announcement without requiring operational staff in CAO to make a judgment about price sensitivity. Most of the Corporate File announcements examined were interviews of CEOs following the release of a listed entity's results and ASX took the view that the market would expect such matter to be significant. Even though the briefings are produced by Corporate File, they are released to the market as announcements by the listed entity. ASIC accepts that there are occasions when an announcement released in this manner by a listed entity may contain information that is price sensitive. Our concern is that automatically treating all reports produced by Corporate File as sensitive may

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<sup>1</sup> see [www.corporatefile.com.au](http://www.corporatefile.com.au)

lead the market to be confused about their price sensitive nature. After we brought this matter to the CSO's attention, CAO stopped the practice of automatically tagging all Corporate File open briefings as sensitive.

- Market Control's performance in relation to supervising the ASX market's short selling rules referred to in more detail below has been sub optimal.

### ***Recommendation 3***

ASIC recommends that the governance arrangements for non ASXMS business units in respect of their supervisory activities is reviewed, so that the responsibilities and activities are consolidated with ASXMS to ensure that the ASXMS is both apprised of activity and has the necessary authority to ensure supervisory obligations are being met. Alternatively this could be addressed through a revision of the terms of the Supervision Charter. Licence Compliance needs to develop an appropriate methodology for gaining assurance in respect of supervisory activity carried out by non-ASXMS business units.

ASX has advised that in March 2007, Licence Compliance reviewed CAO's performance standards and resourcing and is of the view that ASX remains in compliance with its statutory obligations; however ASX has agreed to review reporting arrangements between ASXMS and ASX's Market Operations Division and or review ASXMS's agreed responsibilities. Licence Compliance is currently undertaking a project to develop an appropriate review methodology in respect of non-ASXMS business units.

## **Issuers Unit**

### ***Staff Training***

New staff in the Perth Issuers unit were given a substantial number of companies to monitor without receiving any formal ASX based training. New starters are provided with "on the job training" by shadowing an experienced staff member. Even though Perth based listings are predominantly resources, we were concerned about the level of training in the Code for Reporting of Mineral Resources and Ore Reserves (JORC) provided to new starters or Issuers staff generally, as at the time of our visit. The JORC requirements are highly specialised and the ability to monitor resource companies effectively requires some skills or expertise in this area. We note however that there are now Perth based senior staff and other senior staff in each of ASX's interstate offices with JORC expertise and that arrangements are in place with external consultants to provide expert assistance on an as-needs basis. ASX organised JORC/mining-related training for all Issuers staff in Perth and Sydney in February and April 2007 and will continue to be an ongoing initiative.

There has, on some occasions, also been a lack of orientation and induction, and training on continuous disclosure and the process of referrals to ASIC for new starters in Perth.

#### ***Recommendation 4***

ASXMS should ensure that adequate staff training is in place for all new staff. New staff should be trained in generic ASX relevant areas as well as specific supervisory areas, such as JORC.

##### *Management of price queries*

In the assessment, we observed some deficiencies in the way in which Issuers unit manages company price queries. In particular, we found instances where company responses to price queries did not address the substance of the query, but no further action was taken by Issuers unit staff.

A policy for handling price queries was developed in October 2006 and all Issuers staff received additional training on procedures to follow in handling continuous disclosure and price-related queries.

#### ***Recommendation 5***

Issuers unit should ensure that in practice company responses to price queries are properly scrutinised to ensure that they address the substance of the query.

##### *Suspended companies and Interest Rate Market*

Issuers unit, in response to a recommendation in our last report, now conducts an annual review of all suspended companies and their compliance with the Listing Rules.

ASIC's 2005 assessment noted that there were a number of entities admitted to the interest rate market debt list that did not have any debt securities quoted. The "Wholesale debt issuers list" located on the ASX webpage had not been updated to reflect those entities removed from the official list by reason of not having any debt securities quoted.

The ASX website has now been updated.

## **Market Control**

### *Short selling rules*

The Market Control unit has supervisory functions but sits outside ASXMS, in the Market Operations Division. Market Control is responsible for maintaining and administering the Approved Short Sell list amongst other functions related to the operation of ASX's trading platform. However at the time of the assessment there appeared to be some confusion as to whether Market Control was the supervisory unit responsible for this task. The procedures for administering the Approved Short Sell list also appeared to be either inadequate or not adhered to in practice. In particular:

- records do not appear to be kept of where Market Control exercises a discretion to retain a stock on the short sell list, where the stated criteria is otherwise not satisfied;
- the procedures for removing stocks from the approved short sell list do not



specify on what timeframe the stocks should be removed from when the decision is taken that the stock be removed;

- one aspect of Market Rule 19.7.1(a) has not been enforced. Rule 19.7.1 stipulates that ASX may designate a Cash Market Product to be an Approved Short Sale Product if 50 million Cash Market Products of the class have been issued (excluding Cash Market Products of the class issued but held by any entity which ASX considers is related to the Issuer). However ASX does not always check for products held by related parties; and
- pursuant to the procedures the review of the Approved Short Sell list is scheduled to occur quarterly. The review has not been performed in this timeframe. Market Operations became aware of this in October 2006. New controls have been put in place to ensure adherence to the quarterly review timeframe.

### ***Recommendation 6***

The procedures for administration of the Approved Short Sell list should be revised to address the following matters as soon as possible:

- where responsibility for administering the Approved Short Sell list resides;
- documentation of the reasons supporting the exercise of ASX's discretion to retain a stock on the Approved Short Sell list where the stated criteria is otherwise not satisfied;
- once ASX determines that a stock no longer meets the criteria and does not exercise the discretion above, a clear time frame for a stock to be removed;
- ways to determine whether an entity is related to the Issuer for the purpose of Rule 19.7.1(a).

ASX has or is currently in the process of addressing each aspect of this recommendation.

### ***Procedures for derivatives trading***

There is no written procedure in relation to the suspension of trading in derivatives where the underlying ASX security has been suspended or placed in trading halt to avoid an uninformed market. We found an instance where an ETO series on the last day before expiry was allowed to continue trading, in the case where the underlying security had been placed in a trading halt. This raised the issue of whether the ETO series was traded in a fair, orderly and transparent manner during the relevant period. It is ASX general policy that derivatives trade only where the underlying market exists. However in a limited number of cases, exceptions have been made to allow expiring ETOs to trade for a brief period on the expiry date where the underlying is either suspended or in trading halt to allow holders of open positions in the expiring month to realise the time value of and possibly trade out of their position(s). Market participants are informed in these cases by market notice and messaging via the trading and clearing systems.

***Recommendation 7***

ASX should review and document its procedures for arrangements in the derivatives market when the underlying ASX security has been suspended or placed in a trading halt.

ASX has now commenced a review of its policy in this area to ensure continued efficacy of the policy.

**Complaints handling**

In last year's report we noted some deficiencies in the processes for handling complaints about ASX participants. In particular, in some instances ASX's responses to some complaints were potentially confusing or suggested action which was then not taken. ASX advised that changes to ASX's complaints management process were occurring so that more senior staff members would be engaged to initially analyse the complaint and then approve the responses to complainants. Based on our review, it is apparent that ASX has completed a review of its complaint procedures and that a new system has been set up to record complaints. We did not identify any concern with the way complaints had been handled in this period.

# **Section 3: Observations and recommendations about ACH & ASTC**

## **2.1 ACH & 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**

### **Management reporting to the ACH and ASTC Boards**

In relation to reporting by Market Support management regarding clearing and settlement issues, there is no written criteria to determine what matters should be reported to the ACH and or ASTC boards including system incidents or other operational matters such as significant staff movements. For example the reports Clearing Risk Management unit (CRMU) put to the ACH board are clearing risk only, such as the adequacy of the financial resources of ACH and changes of the internal credit rating of clearing participants.

***Recommendation 1***

The boards of ACH and ASTC should consider establishing written guidelines on what operational issues including system incidents should be reported to them by Market Support.

ASX has agreed to effect this recommendation however contend that Market Support management already report all significant issues to the boards of ACH or ASTC as appropriate. In addition all significant operational incidents affecting the C&S facilities are also reported to an internal risk group which focuses on events which have an actual or potential impact on the operation of a fair and effective C&S facility so that relevant policy or procedural learnings can be captured and embedded to assist in the prevention or management of future events.

**ASX Supervisory Code of Conduct**

CRMU staff are not subject to the dealing restrictions set out in Clause 6 and the Schedule of the ASX Supervisory Code of Conduct. There is no reason for CRMU staff to be treated differently from PRMU staff in respect of ASX dealing restrictions because like PRMU staff, CRMU staff could have access to information of ASX listed participants.

***Recommendation 2***

CRMU staff should be subject to the dealing restrictions set out in Clause 6 and the Schedule of the ASX Supervisory Code of Conduct.

ASX has amended its staff dealing procedures accordingly.