



**ASIC**

Australian Securities & Investments Commission

**REPORT 80**

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

August 2006



**ASIC**

Australian Securities & Investments Commission

# **Annual assessment (s794C) report**

**Mercari Pty Limited  
ACN 102 928 727**

**August 2006**

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# Executive summary

Section 794C(2) of the *Corporations Act 2001* (Act) requires ASIC to assess whether a licensed market operator has adequate arrangements for supervising the market it operates. ASIC also has the power under s794C(1) to assess how well the licensee is complying with any of its obligations as a market licensee.

This report summarises ASIC's first assessment of compliance by Mercari Pty Limited ("Mercari") with its obligations under s792A(c) and s792A(d) of the Act.

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

## Compliance by Mercari

Taking into consideration the operations of the Mercari market, we conclude that Mercari has adequate arrangements for supervising its market including:

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

and that Mercari has sufficient resources (including financial, technological and human resources) to operate the market properly and for the required supervisory arrangements to be provided.

## 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 the licensee to meet its obligations in the future.

As this was our first assessment of Mercari, we were primarily interested in understanding how Mercari operates its market and carries out its supervisory functions from day to day.

As a result of the assessment, ASIC has suggested some improvements as set out in section 2.2 of this report. Mercari has responded to these suggestions in a positive way. It is important to make it clear that none of the suggestions for improvement in this report detract from our conclusion that Mercari has met and continues to meet its statutory obligations.

# Section 1: Background

## 1.1 Mercari

Mercari was granted an Australian market licence (AML) on 30 May 2005. Mercari's market, Mercari Direct, is an electronic bilateral negotiated market that facilitates trading in foreign exchange derivatives and interest rate derivatives. The participants of Mercari Direct are wholesale entities, and are either banks or subsidiaries of banks.

During the assessment period, in addition to an AML, Mercari held an Australian financial services licence (AFSL) authorising it to carry on a financial services business to wholesale clients in relation to certain financial products. This assessment of Mercari does not cover Mercari's compliance with its AFSL obligations. A copy of Mercari's market licence and the terms of its financial services 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 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 a fair, orderly and transparent market. In addition to this obligation ASIC may also assess how well a market licensee is complying with any of its other obligations by virtue of s794C(1).

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 use 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.

ASIC's assessment this year produced a number of findings and identified some areas for improvement. Mercari has responded to these in a constructive manner by making or planning improvements to policies, procedures and practices where applicable.

### Assessment process

ASIC's assessment and the views expressed in this report are a combination of processes including the ongoing interaction we have with Mercari 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 Mercari to ASIC for the year ending 30 June 2005 as required under s792F of the Act;
- reviewed Mercari's quarterly reports provided as a condition of Mercari's AML;
- reviewed information we received from and about Mercari in the ordinary course of our dealings with Mercari as a market licensee;
- reviewed material received under notices served under the *Australian Securities and Investments Commission Act 2001*, including policies and procedures for the conduct of Mercari's market and its supervisory responsibilities, disciplinary and investigation files, internal reports and information collected by Mercari on a continuous basis;
- interviewed Mercari personnel; and
- received a demonstration of Mercari's trading platform for the market.

We visited Mercari's offices from 8 May 2006 to 12 May 2006. After our visit we had discussions with Mercari about our findings.

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

As this was our first assessment of Mercari, we were primarily interested in understanding how Mercari operates its market and carries out its supervisory functions on a day-to-day basis. We also examined whether Mercari had sufficient technological, financial and human resources to comply with its obligations under s792A(d).

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

### **2.1 Mercari is meeting its obligations**

After making our assessment, ASIC concludes that Mercari has adequate arrangements and resources for the supervision of its market in accordance with its obligations under s792A(c) and that Mercari has sufficient resources to operate its market properly and to provide the required supervisory arrangements in accordance with its obligations s792A(d) of the Act.

This conclusion is based on the following observations drawn from information gathered during our assessment process, our observations on the basis of our ongoing correspondence with Mercari and the present operating conditions (including trading volumes and financial products traded on the market):

1. Mercari has good market infrastructure (including technology) to support its obligation to maintain a fair, orderly and transparent market.
2. Mercari has an adequate framework of operating rules and procedures in place to supervise the market.
3. During the course of our interviews, the directors and compliance staff responsible for supervision demonstrated an understanding of their supervisory role and of the operations of the market.
4. Our review of Mercari's supervisory decisions showed that the process of decision-making on supervisory matters is adequate.

### **2.2 Other observations and recommendations for future action**

#### **Documentation of supervisory procedures**

The person primarily responsible for day to day supervision of Mercari's market is the surveillance manager. On the basis of Mercari's current supervisory policy and procedures, and discussions with Mercari's surveillance manager, we are of the view that the surveillance manager has a good understanding of the nature and duties of the supervisory role and tasks. The directors have an understanding of the responsibilities of the surveillance manager. Whilst they have oversight of the surveillance manager they recognise the need for the surveillance manager's independence to negate conflict of interest issues.

Mercari has adequate arrangements for supervising its market. However Mercari's current procedures in regard to supervision are high level and some are focused on meeting its AFSL obligations rather than its AML obligations. ASIC has suggested that Mercari further develops its written procedures to more accurately reflect the comprehensive approach and day-to-day procedures performed by the surveillance

manager. By detailing the activities performed by the surveillance manager Mercari's procedures will more accurately reflect the work it does to meet its supervisory obligations. In addition, the documentation of these procedures will help minimise any key person risk.

In response to this, Mercari has updated its procedures document for the surveillance manager's daily duties. We acknowledge the prompt reply to our suggestion and will review these changes made by Mercari in due course.

### **Documentation of supervisory processes and decision making**

As stated above, the person primarily responsible for day to day supervision of the market is the surveillance manager. The board of directors also plays an important role in the supervision of the market because the Mercari board is responsible for making key supervisory decisions - for instance, whether to take action against a participant for a breach of Mercari's operating rules. In our view, appropriate documentation of supervisory investigations and decision making is important for Mercari in the management of conflicts of interest arising between Mercari's commercial interests and its supervisory responsibilities. Documentation of investigations and decisions can assist in demonstrating that supervisory actions are taken for appropriate rather than inappropriate reasons. It can also assist in ensuring that supervisory practices and decisions are consistent over time.

During the assessment period few supervisory issues appeared to arise. However Mercari did conduct an investigation into an operating rule breach. We interviewed the surveillance manager about the investigation process, reviewed the relevant records and interviewed the directors about the investigation.

We found the investigation was adequately and fairly conducted by the surveillance manager. However not all aspects of the investigation were recorded, in particular the reasons why a course of action was taken or not taken by the investigating officer. For future investigations we suggest that the person conducting the investigation (usually the surveillance manager) records the reasons why a particular course of action was taken or not taken. As a result of our interviews of Mercari personnel we determined the outcome of the investigation was communicated to all relevant parties and that the board had considered the investigation. -

The surveillance manager appears to have an informal communication flow with the directors and the directors appear to make decisions about the market without appropriately documenting them. Whilst we found documentary evidence that the board was informed by the surveillance manager, there were no board minutes or board documents in relation to supervisory matters.

We suggest that the results of any investigation be documented in the relevant participant's file. We also suggest that any subsequent decision by the board be documented on the participant's file and noted in the Mercari board minutes. We also believe that there should be a written record of any communication in relation to market supervision that occurs between the directors and the surveillance manager and that this communication should be filed and recorded by Mercari. The directors



should also ensure any other considerations and actions undertaken by them in regards to supervisory matters are documented and recorded in both Mercari's board minutes and, if relevant, participant files.

### **Documentation relating to client files / authorisations**

The participant files are generally documented in a comprehensive manner with all required information present in the files. However some participants files contained out dated authorised user information which was signed off by a person no longer employed by the authorised entity. Mercari's client agreement, and in particular, the client responsibilities section 5.2 (e) says that "the client must immediately notify Mercari of any changes to the list of authorised person in schedule 2". In this instance, there was no notification on file of any changes of client personnel. However we note that Mercari's surveillance manager keeps information electronically on who can access the market.

We suggest it would be helpful if Mercari implements a system whereby the compliance officer reviews the participant files on a regular basis to confirm they contain relevant and updated information.

In response to this, Mercari has implemented a new quarterly process to review each participant's access to Mercari Direct. We acknowledge the prompt reply to our suggestion and will review these changes made by Mercari in due course.

### **Resources**

We reviewed the adequacy of Mercari's resources (including human, technical and financial resources) to operate the market properly and to provide adequate supervisory arrangements.

Mercari has employed staff in various capacities for commercial, supervisory and technological functions. Mercari current staff members have specific job descriptions, which outline their individual responsibilities, and have a good understanding of their role in the organisation.

We received a demonstration of Mercari Direct, the trading platform for the market. The current technology has coped with existing volumes on the market and no serious market disruptions have occurred. Mercari has undertaken some forward planning in relation to its technology resources in the event that there is significant growth in the market.

We receive quarterly reports detailing Mercari's financial status. At this stage the costs of operating the market day to day are low and are covered by current turnover. It is anticipated that the market can operate efficiently over the coming year without significant additional outlays.