



ASIC

Australian Securities & Investments Commission

REPORT 335

Market assessment report: Mercari Pty Limited

ACN 092 250 345

March 2013

About this report

This assessment covers the period 1 January 2012 to 31 December 2012 (the assessment period).

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Previous reports on Mercari

Mercari was granted an Australian market licence on 30 May 2005.

Report number	Report date
REP 294	July 2012
REP 231	March 2011
REP 198	April 2010
REP 165	August 2009
REP 149	February 2009
REP 105	October 2007
REP 80	August 2006

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Key findings and recommendations

Key findings

- 1 ASIC is satisfied that during the assessment period Mercari Pty Limited (Mercari) had:
 - adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c) of the *Corporations Act 2001* (Corporations Act); and
 - sufficient resources to operate its market properly and for the required supervisory arrangements to be provided under s792A(d) of the Corporations Act.

Recommendations

- 2 We do not have any recommendations to make about Mercari's supervisory arrangements.

A The assessment

Key points

ASIC conducts annual assessments of market licensees, such as Mercari, because it is required to do so under s794C of the Corporations Act.

The scope of our assessment must always include the obligations found in s792A(c), but we can include other Ch 7 obligations too.

We use the licensee's self-assessment reports, information from our previous assessments, our observation of the licensee's performance, market intelligence and other things to form a view of how well the licensee has operated its market.

Scope

- 3 On 1 August 2010, the responsibility for supervising Australia's domestic licensed markets was transferred from the majority of domestic market licensees to ASIC. For these operators, the obligations under the Corporations Act to supervise their market were amended in recognition of this new arrangement.
- 4 The Corporations Act was also specifically amended to exclude a small number of licensed domestic market operators, including Mercari, from this transfer. Mercari and three other operators were excluded on the basis that they have certain distinguishing features. These include the requirement that only professional entities may be users of the market and that they may typically use the market for trading only over-the-counter type products. These are also requirements of ASIC's exempt professional markets policy, by which ASIC may consider recommending an exemption from the requirement to hold an Australian market licence.
- 5 As a result, Mercari's supervisory obligations under the Corporations Act are unchanged and continue to require it to have adequate arrangements for supervising the market, including arrangements for:
 - handling conflicts between its commercial interests and its need to ensure that the market is fair, orderly and transparent;
 - monitoring the conduct of participants on or in relation to the market; and
 - enforcing compliance with the market's operating rules.
- 6 ASIC is required to assess how well a market licensee complies with its obligations under s792A(c) at least once a year: s794C(2). In keeping with usual practice, we extended the scope of the assessment to include a review

of whether Mercari had sufficient financial, technological and human resources to comply with its obligations under s792A(d).

7 This report covers the period 1 January 2012 to 31 December 2012.

Approach to assessment

8 ASIC's current strategic framework focuses on three key priorities or outcomes. These are:

- confident and informed investors and financial consumers;
- fair and efficient financial markets; and
- efficient registration and licensing.

9 The first two of these are particularly important for licensed markets. In the context of Mercari's market, it is important to note that no retail investors are permitted to directly or indirectly use the market. ASIC considers that markets that limit participation to professional entities are those in which users are typically already confident and informed. In these circumstances, for the market to be fair and efficient a primary focus is on the reliability of the market's operation and the extent to which it meets the legitimate expectations of its users.

10 For that reason, our assessment of these types of professional markets focuses on a narrower subset of the key measures than we might otherwise use if the market permitted retail investors. To determine whether Mercari has complied with its obligations to have adequate supervisory arrangements and adequate resourcing, we focus on:

- whether there have been any changes during the assessment period to the way Mercari supervises its market;
- the nature of any complaints made by market users to Mercari or ASIC about the market's operations and/or Mercari's supervisory activities;
- the occurrence of any technological outages of Mercari's market or concerns about Mercari's technological resources;
- any material changes in human resources dedicated to the operation and supervision of the market which have given rise to concerns or complaints about supervision and/or conflict handling;
- the maintenance of information and data records to support the monitoring of participant conduct on or in relation to the market, including monitoring order information and transactions effected through the market (such as date, time, volume, price and parties); and
- whether Mercari has adequate financial resources to continue to operate its financial market.

Background

- 11 Mercari is an Australian registered company and wholly owned subsidiary of Financial and Energy Exchange Ltd (FEX). FEX is also an Australian registered company, developing a suite of services for the Asian energy, commodity and environmental financial markets.
- 12 Mercari was granted an Australian market licence on 30 May 2005. We have conducted eight assessments of Mercari since its licence was granted. Mercari is licensed to operate its electronic trading platform, Mercari Direct. During the assessment period, the products available to be traded on Mercari Direct were foreign exchange and interest rate derivatives, in addition to derivatives in relation to commodity, energy, and environmental products.
- 13 Participation in Mercari's market is restricted to professional investors trading on their own behalf or on behalf of anyone who is not a retail client. As at 30 June 2012, there were 23 authorised participants on the market.
- 14 During the assessment period, in addition to an Australian market licence, Mercari held an Australian financial services (AFS) licence authorising it to carry out a financial services business to wholesale clients for certain financial products. Our assessment of Mercari does not cover Mercari's compliance with its AFS licence obligations. However, ASIC confirms that no compliance breaches were reported for Mercari's AFS licence obligations during the assessment period.
- 15 A copy of Mercari's Australian market licence and the terms of its AFS licence are available on ASIC's website at www.asic.gov.au/markets.

Our methodology

Our assessment process

- 16 A market licensee's obligations are ongoing. 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 (such as Mercari) had in place for supervising its market in accordance with its obligations under the Corporations 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.

Materials we reviewed

- 17 In conducting our assessment we considered:
- Mercari's annual regulatory report for the period 1 July 2011 to 30 June 2012;
 - Mercari's audited financial accounts for the year ended 30 June 2012;
 - information we received from and about Mercari in the ordinary course of our dealings with Mercari as a market licensee (e.g. when processing Mercari's operating rule changes, discussed at paragraph 27);
 - Mercari's response to our notice under s30 of the *Australian Securities and Investments Commission Act 2001* to obtain information about how Mercari is meeting certain obligations under the Corporations Act; and
 - information from the media and the Mercari website.

Consultation

- 18 Our findings are set out in Section B of this report. Mercari has had the opportunity to view and comment on the factual accuracy of a draft version of this report. Where appropriate, our findings in Section B reflect Mercari's clarifications.

B Our observations

Key points

We have considered the adequacy of Mercari's arrangements and resources for supervising its market, including arrangements for:

- handling conflicts between its commercial interests and its need to ensure that the market is fair, orderly and transparent;
- monitoring the conduct of participants on or in relation to the market; and
- enforcing compliance with the market's operating rules.

Mercari did not make any substantial changes to its supervisory arrangements during the assessment period.

We do not have any recommendations to make about Mercari's supervisory arrangements or resources.

We also note that Mercari has complied with its reporting obligations under the Corporations Act.

Supervisory arrangements

- 19 We conclude that during the assessment period Mercari had:
- adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act, including adequate arrangements for:
 - handling conflicts between its commercial interests and its need to ensure that the market is fair, orderly and transparent;
 - monitoring the conduct of participants on or in relation to the market; and
 - enforcing compliance with the market's operating rules; and
 - sufficient resources to operate its market properly and for the required supervisory arrangements to be provided under s792A(d) of the Corporations Act.
- 20 This conclusion is based on our review of the measures that typically guide our assessment of Mercari and like markets, being:
- there were no material changes to the way in which Mercari supervised its market;
 - there were no complaints made by market users to Mercari or ASIC about the market's operations or Mercari's supervisory activities;

- there were no technological outages of Mercari's market or concerns about Mercari's technological resources;
- there were no changes in human resources dedicated to the operation and supervision of the market during the assessment period that gave rise to concerns or complaints about supervision and/or conflict handling;
- Mercari maintains information and data records to support the monitoring of participant conduct on or in relation to the market; and
- Mercari's annual audited accounts indicate it has access to adequate financial resources to continue to operate its financial market.

21 Our conclusion takes into consideration the fact that there was no trading on Mercari Direct during the assessment period.

Supervisory function

22 Mercari's supervisory work is primarily undertaken by a compliance/surveillance officer and production supervisors/administrators as described in Section B of Report 198 *Market assessment report: Mercari Pty Limited* (REP 198), published April 2010. These arrangements did not change during the assessment period.

Managing conflicts of interest

23 We have concluded that Mercari had adequate arrangements for managing its conflicts of interest. Section B of REP 198 contains a description of Mercari's arrangements for handling conflicts of interest.

24 Mercari has reported that no conflicts of interest were identified during the assessment period. We note that Mercari did not make any material changes to its conflict handling arrangements during the assessment period nor has it made any material changes since its licence was granted. There were also no complaints made about Mercari's conflict handling arrangements during the assessment period.

Supervising the market and conduct of participants

25 Mercari is also required to monitor the conduct of participants in relation to its market. As at 30 June 2012, there were 23 authorised participants on the market.

26 Mercari reported that no investigations were required to be carried out during the assessment period. Further, no disputes arose between participants or between Mercari and participants regarding trading and compliance with the operating rules during the assessment period.

Enforcing compliance with market operating rules

- 27 On 5 December 2012 Mercari amended its operating rules by:
- removing product details of certain products available to be traded on Mercari Direct (and inserting them into the procedures);
 - introducing into the rules four market structures under which the market operates—‘direct’, ‘broker assisted’, ‘broker allocated’ and ‘hybrid’;
 - removing marketing text, procedural/system type information and product descriptions; and
 - making minor grammatical and drafting changes, and minor miscellaneous amendments for tidying up and clarification purposes, to reflect current practices on Mercari’s market and to reflect different practices between different products.
- 28 Mercari has confirmed that during the assessment period it did not identify any potential breaches of its operating rules requiring investigation and/or enforcement. In addition, there were no complaints made to Mercari or to ASIC about the conduct of Australian participants on Mercari’s market.

Resources

- 29 We are satisfied that during the assessment period Mercari had sufficient financial, technological and human resources for the required supervisory arrangements to be provided.

Financial resources

- 30 During the assessment period, Mercari’s financial resources were derived from net assets within Mercari’s ownership and control, in addition to financial support from FEX.
- 31 FEX has undertaken to maintain at all times an amount of \$220,000 in Mercari’s bank account for Mercari to pay its debts when they become due. Monthly financial reports provided by Mercari during the assessment period have confirmed that this amount is being maintained.
- 32 Mercari’s audited financial accounts (for the financial year ending 30 June 2012) confirm that Mercari depends on FEX for significant financial support. Mercari’s auditors have taken the view that in the event FEX is unable to provide ongoing financial support there would be significant uncertainty regarding Mercari’s ongoing viability.
- 33 There has been no trading on Mercari Direct since April 2009. Taking into consideration this lack of trading, we are satisfied that Mercari had access to sufficient financial resources to operate its market and to provide adequate

supervisory arrangements. We will, of course, review our approach to assessing the adequacy of Mercari's financial resources if the market becomes more active.

- 34 Mercari continues to supply ASIC with monthly financial reports to confirm the amount of support provided by FEX.

Technological resources

- 35 During the assessment period, no major system outages were reported and there were no complaints received from participants.

Human resources

- 36 Mercari has submitted that a minimum of five full-time equivalent staff (including the surveillance and compliance officer and production supervisors/administrators) were involved to ensure the proper operation of the market and related supervisory arrangements during the assessment period. In our view this resourcing is sufficient.

Conclusion

- 37 Based on this assessment, we do not have any recommendations to make about Mercari's supervisory arrangements.

Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
ASIC	Australian Securities and Investments Commission
Australian market licence	Australian market licence under s795B of the Corporations Act that authorises a person to operate a financial market
Ch 7 (for example)	A chapter in the Corporations Act (in this example numbered 7)
Corporations Act	<i>Corporations Act 2001</i> (Cth), including regulations made for the purposes of that Act
FEX	Financial and Energy Exchange Ltd
market licensee	Holder of an Australian market licence
Mercari	Mercari Pty Limited
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C), unless otherwise specified