



**ASIC**

Australian Securities & Investments Commission

**REPORT 367**

# **Market assessment report: IMB Ltd**

**ACN 087 651 974**

August 2013

## **About this report**

This assessment covers the period 25 February 2012 to 20 February 2013 (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 IMB Ltd (IMB)

IMB was granted an Australian market licence on 8 July 2005. It was also granted an Australian clearing and settlement facility (CS facility) licence on that date too. This report covers our assessment of how well IMB has complied with its obligations as a market and CS facility licensee.

| Report number | Report date    |
|---------------|----------------|
| REP 323       | December 2012  |
| REP 249       | August 2011    |
| REP 208       | June 2010      |
| REP 171       | August 2009    |
| REP 148       | January 2009   |
| REP 100       | September 2007 |
| REP 86        | October 2006   |

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# Key findings and recommendations

## Key findings

- 1 ASIC is satisfied that during the assessment period IMB had:
- adequate arrangements for the operation of its market in accordance with its obligations under s792A(c) of the *Corporations Act 2001* (Cwlth) (Corporations Act);
  - adequate arrangements for the supervision of its CS facility in accordance with its obligations under s821A(c) of the Corporations Act; and
  - sufficient resources to comply with its obligations under s792A(d) and 821A(d) of the Corporations Act.

## Recommendations

- 2 We do not have any recommendations to make about:
- IMB's arrangements for the operation of its market and for the supervision of its CS facility; and
  - IMB's resources for operating the market and CS facility.

## A The assessment

### Key points

ASIC may conduct assessments of market licensees, such as IMB, under s794C of the Corporations Act. We may also conduct assessments of CS facility licensees under s823C.

The scope of our assessment must always include the obligations found in s792A(c) and 821A(c), but we can include other Chs 7 and 8 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 and supervised its CS facility.

### Scope

- 3 Under s792A(c), a market licensee must have adequate arrangements for operating the market, including arrangements for:
  - handling conflicts between the commercial interest of the licensee and the need for the licensee to ensure that the market operates in a fair, orderly and transparent way; and
  - monitoring and enforcing compliance with the market's operating rules.
- 4 ASIC is required to assess how well a market licensee complies with its obligations under s792A(c) at least once a year: s794C(2) <sup>1</sup>.
- 5 Under s821A(c), a CS facility licensee must have adequate arrangements for supervising the 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; and
  - enforcing compliance with the facility's operating rules.
- 6 ASIC must assess how well a CS facility licensee complies with its obligations under s821A(c) at least once a year: s823C(2) <sup>2</sup>.
- 7 In addition, in accordance with s794C(1) and 823C(1), we are permitted to extend the scope of our assessment to review how well a licensee complies with any or all of its obligations under Chs 7 and 8 respectively. In this

<sup>1</sup> From 19 July 2013, the *Corporations and Financial Sector Legislation Amendment Act 2013* removed ASIC's obligation to conduct annual assessments of market and CS facility licensees unless an annual assessment is prescribed by the regulations for the purpose of s794C(2) and s823C(2).

<sup>2</sup> *Ibid.*

instance, we extended the scope of the assessment to include a review of whether IMB had sufficient financial, technological and human resources to comply with its obligations under s792A(d) and 821A(d).

## 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.<sup>3</sup>
- 9 The first two priorities are particularly important for licensed markets. In the context of IMB's market, it is important to note that it is a small domestic market, where comparatively little trading occurs compared with the larger domestic markets. IMB's market is further differentiated from the other larger domestic markets by certain unique features with only one security traded (being ordinary shares in the market operator, IMB) and trading restricted to people who have a deposit or loan account with IMB. In these circumstances, for investors and financial consumers to be confident and informed and for IMB's market to be fair and efficient, our primary focus is on the reliability of the market's operation and the extent to which it meets the legitimate expectations of its members who are market users.
- 10 In the context of IMB's CS facility, it is important to note that it too is operated only for IMB shares. IMB's clearing and settlement function is of limited nature when compared to the larger and more systemically important domestic facilities operated by the ASX Group, as it only involves the debiting and crediting of IMB members' transaction accounts after a share trade. What further differentiates IMB's CS facility from the other larger domestic facilities is that it is not required to comply with the financial stability standards as determined by the Reserve Bank of Australia (RBA) under s827D of the Corporations Act. This is because IMB does not settle more than \$100 million annually.
- 11 For these reasons, our assessment of this market and related CS facility focuses on a narrower sub-set of the key measures than we might otherwise use if the market was a large domestic market and if the CS facility was a larger, systemically important facility. To determine whether IMB has complied with its obligations to have adequate arrangements and resources for its market and CS facility, we focused on:
- whether there have been any changes during the assessment period to the way IMB operates its market and supervises its CS facility;

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<sup>3</sup> This key priority is not directly relevant to our assessment of IMB Ltd.

- the nature of any complaints made by market users to IMB or ASIC about IMB's market and/or CS facility;
- the occurrence of any technological outages of IMB's market or concerns about IMB's technological resources;
- any material changes to the resources (including human, financial and technological) dedicated to the operation of the market and supervision of the CS facility;
- the occurrence of any conflict of interest situations, and how IMB dealt with these; and
- whether there have been any market incidents during the assessment period.

## Background

- 12 IMB is an authorised deposit-taking institution (ADI) under the *Banking Act 1959* (Cwlth) and is regulated by the Australian Prudential Regulation Authority (APRA).
- 13 IMB was granted a market licence and a CS facility licence in July 2005. The licences are available for viewing at [www.asic.gov.au/markets](http://www.asic.gov.au/markets).
- 14 The only class of financial products that can be dealt with on IMB's market is ordinary shares in IMB. IMB's motivation for operating the market is to provide its members with a low-cost, simple and accessible platform for the trading of IMB shares with other IMB members. To become a member of IMB, an individual must have a deposit or loan account with IMB.
- 15 To trade on IMB's market, a member needs to have a transaction account and a share trading account. IMB shareholders and market users are predominantly retail investors.
- 16 The IMB Share Trading team, which currently consists of nine members from the Banking Services department, operates the market and CS facility. The team is led by the Market Manager, who is responsible for the day-to-day running of the market and CS facility. With the exception of one share trading officer, none of the other employees in the Share Trading team have exclusive responsibilities over the market, but are instead rotated in and out of the role.
- 17 At the time of the assessment, IMB had approximately 37 million shares on issue. During the assessment period, the total volume traded on IMB's market was approximately 1.8 million shares, with a monthly average of 146,698 shares. The total value of shares transacted on IMB's market during this period was approximately \$6 million, with a monthly average of \$501,966. The total number of share trades on the market during this period was 599.<sup>4</sup>

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<sup>4</sup> There is the ability to conduct off-market transfers of IMB shares (through a transfer order). The statistics in this report do not include off-market transfers of IMB shares.

- 18 The volume and value of trading on the IMB market during the assessment period is a very small fraction of the total volume and value of trading on larger Australian financial markets. What further differentiates IMB's market is the single listing, compared to the multiple listings and trading of these entities on the larger Australian financial markets.
- 19 IMB's CS facility is operated only for IMB shares. IMB's clearing and settlement function is limited to facilitating the debiting and crediting of IMB members' transaction accounts after a share transaction. When a share transaction is completed, IMB's share trading system, known as FACTS, automatically updates the share registry and the Share Trading team generates the share certificates.
- 20 IMB is not a listed disclosing entity, as defined in the Corporations Act. However, a condition of IMB's market licence requires IMB to disclose price-sensitive information to ASIC and to make it available to the market. IMB provides this information on its website and at IMB's branches.
- 21 In addition to holding a market licence and a CS facility licence, IMB holds an Australian financial services (AFS) licence that permits it to carry on a financial services business in deposit and payment products, general insurance products, life risk insurance products and retirement savings account products. This assessment of IMB does not cover IMB's compliance with its AFS licence obligations.

## Our methodology

### Our assessment process

- 22 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 IMB) has in place in accordance with its obligations under s792A(c) and 821A(c) of 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

- 23 In conducting our assessment we considered:
- IMB's annual regulatory report provided by IMB to ASIC, as required under s792F and 821E;



- IMB's financial accounts for the half year ending 31 December 2012;
- the previous assessment report on IMB;<sup>5</sup>
- information we received from and about IMB in the ordinary course of our dealing with IMB as a market licensee and CS facility licensee;
- publicly available information on IMB's website, including share prices, media releases, market announcements, and policies and procedures;
- information obtained from a media search on IMB;
- information obtained from searches on ASIC's internal systems;
- IMB's response to our questionnaire; and
- material provided by IMB under notice.

### Consultation

24 Our findings are set out in Section B of this report. IMB 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 IMB's clarifications.

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<sup>5</sup> See Report 323 *Market assessment report: IMB Limited* (REP 323) at [www.asic.gov.au/reports](http://www.asic.gov.au/reports).

## B Our observations

### Key points

We have considered the adequacy of IMB's arrangements and resources for the operation of its market and supervision of its CS facility, including arrangements for:

- handling conflicts between its commercial interests and its need to ensure that the market is fair, orderly and transparent and the CS facility's services are provided in a fair and effective way; and
- monitoring and enforcing compliance with the operating rules of the market and CS facility.

IMB did not make any substantial changes to its arrangements for operating the market and supervising its CS facility.

We do not have any recommendations to make about IMB's arrangements and resources for the operation of its market and supervision of its CS facility.

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

### Supervisory arrangements

- 25 We conclude that during the assessment period IMB had:
- adequate arrangements for the operation of its market in accordance with its obligations under s792A(c) of the Corporations Act;
  - adequate arrangements for the supervision of its CS facility in accordance with its obligations under s821A(c) of the Corporations Act; and
  - sufficient resources to comply with its obligations under s792A(d) and 821A(d) of the Corporations Act.
- 26 This conclusion is based on our review of the measures that typically guide our assessment of IMB and like markets, being:
- the nature of any changes made to the policies and procedures relating to the operation of the market, supervision of the CS facility and enforcement of the market's operating rules;
  - the nature of any complaints made by market users about the market and/or CS facility;
  - the occurrence of any technological outages;
  - changes in human, financial and technological resources dedicated to the operation of the market and supervision of the CS facility;
  - arrangements for managing conflicts of interest;

- the occurrence of any market incidents;
- the nature or level of trading activity conducted on the market; and
- arrangements for monitoring the market.

### Nature or level of trading

- 27 During the assessment period, the nature or level of trading activity conducted on IMB's market was subject to significant change in comparison to the previous assessment period. The total volume of shares traded on the market has increased by 34%, which represents an increase in trading of 488,129 shares. IMB confirmed the change was largely due to the matters outlined below.
- 28 Following an external review of IMB's capital structure, commissioned by the board to achieve IMB's aims of longer term growth and viability, it was recommended that the mutual structure of IMB be supported by seeking to cancel ordinary shares through share buybacks. During the assessment period, IMB conducted the first off-market share buyback. It was completed on 27 September 2012 and IMB bought back 2.9 million shares or 7.3% of all shares on issue.<sup>6</sup>
- 29 IMB notes that in the three months after the 31 July 2012 announcement of the first off-market share buyback, the trading volumes were at their highest during the assessment period. IMB believes this may be due to:
- some shareholders exiting the share register based on IMB's commitment to conduct a long term series of annual buybacks, with a view to IMB buying back all shares on issue;
  - some shareholders choosing to demonstrate their lack of support for the buyback by selling their shares; and
  - conversely, an increased demand for IMB shares from investors.
- 30 Although there were higher levels of trading activity on the market during the assessment period, ASIC did not detect any market anomalies in IMB's share trading under Part 7.2A of the Corporations Act and is satisfied with IMB's explanations for the increased trading on the market, and IMB's monitoring of market: see paragraphs 44–49.

### Policies and procedures

- 31 During the assessment period, IMB made four minor changes to its policies and procedures as a result of an internal audit of IMB's share market activities. For example, newly created management positions that have potential access to price-sensitive information have been included in the Conflict of Interest

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<sup>6</sup> The statistics in this report do not include transactions related to the off-market buyback.

Register. IMB also added management-level Banking Services department staff to the list of employees who are required to provide conflict of interest declarations at the time they commence their employment with IMB.

32 Based on the information received from IMB during the assessment process, we consider that IMB's policies and procedures relating to the operation of the market and supervision of its CS facility are adequate.

### **Managing conflicts of interest**

33 Given the nature of the operation of IMB's market, we agree with IMB on what it has identified as possible areas of conflicts of interest flowing from operating a market in its own shares. These are:

- conflict between IMB's interest in reducing costs to its business generally and its duty as a market licensee to run a fair, orderly and transparent market;
- the potential for staff and their associates to trade ahead of other participants based on an informational advantage by virtue of their employment or association with IMB; and
- conflict that may arise due to staff and director ownership of IMB shares, which could adversely affect the policing of disclosure obligations imposed by the market licence.

34 There were minor changes to IMB's conflict management arrangements during the assessment period: see paragraph 31.

35 Based on the information we have received from IMB, we consider that IMB's arrangements for managing conflicts of interest are adequate.

### **Continuous disclosure**

36 Only one product is quoted on IMB's market, being IMB ordinary shares, so it has no official list. As IMB is not listed on an 'official list', as defined in the Corporations Act, it is not a 'listed disclosing entity', as defined in the Corporations Act.

37 Accordingly, IMB is not subject to statutory obligations to immediately disclose to its market material developments that a reasonable investor would expect should be disclosed. However, it is a condition of IMB's market licence that all price-sensitive information must be lodged with ASIC and made available on IMB's website and at IMB's branches in a timely manner.

38 IMB has in place policies and procedures to comply with this licence condition. To assess the extent to which IMB has complied with this licence condition, we analysed all 13 market announcements sent to ASIC and general media releases published on IMB's website during the assessment

period. We did not find any evidence to suggest that price-sensitive information was not disclosed to the market on a timely basis.

39 To further test IMB's compliance with its continuous disclosure obligations, we conducted a search of various media sources to see if there was any price-sensitive information about IMB that was not disclosed publicly. We did not find any information of this nature.

## Complaints

40 We did not receive any complaints from market users about IMB's operation of its market and supervision of its CS facility during the assessment period.

41 IMB has a share market dispute resolution policy to deal with market-related disputes; a copy is available on its website.

42 During the assessment period, IMB received two market-related complaints about human errors in loading and withdrawing buy orders. IMB has indicated that both complaints were resolved to the satisfaction of both shareholders. We have not identified any information that would suggest otherwise.

## Trading system outages

43 There were no outages to the FACTS system during the assessment period.

## Monitoring the market

44 IMB's main monitoring tool for the market is the Share Market Monitoring Log, which the Share Trading team uses to record actions taken or observations made about:

- suspicious activity;
- market manipulation by a participant or IMB;
- withdrawn orders;
- director trades;
- procedural errors and complaints; and
- fluctuations in the share price of 15 cents or more.

45 During the assessment period, there were 14 observations of notable share price movements involving a movement in price of more than 15 cents (approximately 4.39% of the average IMB share price during the assessment period). IMB made inquiries and concluded that the share trades occurred as a result of matters such as:

- shareholders seeking quick access to funds or requiring the shares to be sold by a certain date, and thus placing an order at a price that would ensure a match;

- large disposals of shares due to sales by deceased estates; or
- more demand from purchasers of shares, leading to an adjustment in price.

- 46 During the assessment period, IMB became aware of a breach of Market Operating Rule 17.2 and Article 4.20 of its constitution, which sets out that the maximum permissible shareholding of a holder is 5% of all shares issued. The constitution sets out the actions to be taken if the limit is exceeded. After the announcement of the off-market share buyback results on 27 September 2012, IMB's largest shareholder slightly exceeded the 5% limit set by the constitution.
- 47 IMB has advised that it was in discussion with this shareholder before the off-market share buyback was finalised about the potential for this situation to arise, and highlighted to the shareholder that it should consider whether or not to participate in the voluntary buyback.
- 48 IMB contacted the shareholder after the close of trade on 26 September 2012 to confirm that the shareholding would exceed the 5% limit and asked it to sell an amount of shares in an orderly manner to bring the shareholding within the limit. By the end of October 2012, the shareholding was within the 5% limit.
- 49 Based on the information we received from IMB during the assessment period, and the actions taken in relation to the breach, we are satisfied that IMB's market monitoring tool is adequate.

## Resources

- 50 We are satisfied that during the assessment period IMB had sufficient financial, technological and human resources to comply with its obligations under s792A(d) and 821A(d) of the Corporations Act.
- 51 IMB advised that during the assessment period there were no significant changes to the financial, technological or human resources used to operate the market and supervise the CS facility. The only notable changes to human resources are set out in paragraphs 55–57.

### Financial resources

- 52 The operation of the market and CS facility forms only a small fraction of IMB's general business activities and is low cost. IMB generates income from the market by levying an administration fee for each completed transaction. The expenses associated with the market and CS facility are generally limited to the employment costs for one dedicated full-time employee and stationery expenses associated with the production of trade records and share certificates. Any shortfall between income and expenses

directly associated with its market and CS facility is not considered material by IMB and can be easily absorbed by profits generated from IMB's general banking and lending activities.

- 53 We reviewed the latest audited financial statements available from IMB at the time of our assessment and consider that IMB has sufficient revenues to cover the costs of operating its market and CS facility for the next 12-month period.

### **Technological resources**

- 54 There were no changes made to FACTS during the assessment period. IMB advised that, given the nature of trading on the market, there are no planned changes to FACTS in the near future.

### **Human resources**

- 55 The Share Trading team, which is responsible for operating the market and supervising the CS facility, is made up of nine members. Only one share trading officer has exclusive responsibilities over the market, with the remaining members being rotated in and out of the role. IMB advised ASIC that it manages any potential or actual conflicts in the Share Trading team by not remunerating these staff according to a commission structure.
- 56 During the assessment period, one new employee was appointed to the Share Trading team, replacing two staff members who had left, leaving the team with its current nine members.
- 57 Based on the current size and nature of IMB's market, we are satisfied that IMB's human resources are sufficient to operate the market and supervise the CS facility.

## **Clearing and settlement**

- 58 We are satisfied that during the assessment period, IMB had adequate arrangements and sufficient resources for the supervision of its CS facility in accordance with its obligations under s821A(c) and (d) of the Corporations Act.
- 59 The CS facility operated by IMB is limited to the debiting and crediting of a buyer's and seller's transaction account.
- 60 In May 2005, the RBA amended its financial stability standards for securities settlement facilities under s827D of the Corporations Act, so that the standards now only apply to facilities settling more than \$100 million per year. This was done so that small CS facilities such as IMB's, which are unlikely to affect the overall stability of the Australian financial system, are

not subject to unnecessary regulation. Accordingly, IMB's CS facility does not need to comply with the RBA's financial stability standards.

- 61 IMB has indicated that during the assessment period there were no changes to the way it operates the CS facility. We are not aware of any changes to this facility and it continues to operate according to statutory requirements.

## Conclusion

- 62 Based on this assessment, we do not have any recommendations to make about:

- IMB's arrangements for the operation of its market and for the supervision of its CS facility; and
- IMB's resources for operating the market and CS facility.



## Key terms

| Term                      | Meaning in this document  |
|---------------------------|---|
| ADI                       | Authorised deposit-taking institution   |
| 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<br><br>Note: This is a definition contained in s761A of the Corporations Act. |
| APRA                      | Australian Prudential Regulation Authority  |
| 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> (Cwlth), including regulations made for the purposes of that Act   |
| CS facility               | Clearing and settlement facility  |
| FACTS                     | IMB's share trading system  |
| IMB                       | IMB Ltd   |
| market licensee           | Holder of an Australian market licence  |
| RBA                       | Reserve Bank of Australia   |
| s794C (for example)       | A section of the Corporations Act (in this example, numbered 794C), unless otherwise specified  |