



**ASIC**

Australian Securities & Investments Commission

**REPORT 76**

**Market assessment report:  
SFE Clearing Corporation  
Pty Ltd / Austraclear Limited**

May 2006



**ASIC**

Australian Securities & Investments Commission

# **Annual assessment (s823C) report**

**SFE Clearing Corporation Pty Ltd  
ACN 050 615 864**

**Austraclear Limited  
ACN 002 060 773**

**May 2006**

## Contents

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<b>Executive summary .....</b>	<b>3</b>
<b>Compliance by SFECC and Austraclear .....</b>	<b>3</b>
<b>Our approach.....</b>	<b>3</b>
<b>Section 1: Background.....</b>	<b>5</b>
<b>1.1 The SFE group.....</b>	<b>5</b>
<b>1.2 The assessment process .....</b>	<b>5</b>
<b>1.3 Focus of this assessment report .....</b>	<b>7</b>
<b>Section 2: Observations and recommendations .....</b>	<b>8</b>
<b>2.1 SFECC and Austraclear are meeting their obligations .....</b>	<b>8</b>
<b>2.2 Other observations and recommendations for future action ....</b>	<b>9</b>

# Executive summary

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

This report summarises ASIC's fourth assessment of SFE Clearing Corporation Pty Ltd's (SFECC) and the second assessment of Austraclear Limited's (Austraclear) compliance with its obligations under section 821A(c) of the Act.

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

## Compliance by SFECC and Austraclear

1. We conclude that each of SFECC and Austraclear 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.
2. Austraclear has addressed the recommendation made in our previous report in relation to delegations creating conflicts of interest situations. In response to our recommendation Austraclear has revoked the delegation of certain powers to particular officers.

## Our approach

ASIC uses the formal assessment process to examine whether a clearing and settlement facility has been and is continuing to meet its supervisory obligations. We also use the process to identify areas where improvements may be needed to enable the licensee to meet its obligations in the future.

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

Generally our assessment report focuses on suggested areas of improvement in SFECC's and Austraclear'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

SFECC's and Austraclear's arrangements have met and continue to meet their statutory obligations.

The regulatory report SFECC and Austraclear provided to ASIC and the Minister reviews the supervisory and educational activities the relevant operator undertook during the year. Those activities show the roles SFECC and Austraclear play as front-line supervisors of their clearing and settlement facilities and provides support for our conclusion that SFECC and Austraclear are complying with their supervisory obligations.

# Section 1: Background

## 1.1 The SFE group

During the period of the assessment SFE group's wholly owned subsidiaries SFECC and Austraclear both held an Australian clearing and settlement facility licence. Each of SFECC and Austraclear is permitted under its licence to operate a clearing and settlement facility for the financial products described in the licence. A copy of SFECC's licence and Austraclear's licence is available on ASIC's website at [www.asic.gov.au](http://www.asic.gov.au).

SFECC provides clearing and settlement services to the Sydney Futures Exchange Limited (SFEL), another wholly owned subsidiary of the SFE group. SFEL currently holds an Australian market licence. ASIC's assessment of SFEL is set out in a separate report. Austraclear provides depository, clearing and settlement systems, and registry services to participants in Australian financial markets.

On 27 March 2006 Australian Stock Exchange Limited and SFE Corporation Limited announced their intention to merge, pursuant to a scheme of arrangement. Under this proposal, SFE group companies including SFECC and Austraclear, will become part of the ASX group. The proposed merger has no impact on the conclusions in this report

## 1.2 The assessment process

### ASIC's role

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

A clearing and settlement facility licensee's obligations are ongoing, and whether it is likely to comply with its obligations in the future cannot be judged merely by reference to its past compliance. We therefore use this assessment process to:

- reach conclusions about the adequacy of the arrangements a clearing and settlement facility licensee has in place for supervising its clearing and settlement facility in accordance with its obligations under the Act at the time of the assessment; and
- identify issues that in our view need, or may need, to be addressed to ensure ongoing compliance.

## Assessment process

ASIC's assessment and the views expressed in this report are a combination of processes – the ongoing interaction we have with SFECC and Austraclear in our role as regulator of clearing and settlement facilities, an on-site inspection of books and records and meetings with SFECC and Austraclear personnel, and the discussions we have with SFECC and Austraclear about the issues that have arisen from our previous assessment processes.

In conducting our assessment of the licensees we have particularly considered for each licensee:

- the annual regulatory report given to ASIC by the licensee for the period 1 January 2004 to 31 December 2005 as required under section 821E of the Act;
- information we received from and about the licensee in the ordinary course of our dealings with the licensee as a clearing and settlement facility licensee, including:
  - o information received as part of the rule amendment process;
  - o interaction with the licensee on a range of operational issues; and
- the operation of the clearing and settlement facility of the licensee throughout the period;
- internal material of the licensee, including disciplinary and investigation files, internal reports and information collected by the licensee on a continuous basis; and
- comments made in discussions with a range of personnel of the licensee.

In conducting our on-site visit of each licensee, we:

- received presentations from personnel of the licensee;
- held discussions with the licensee's personnel;
- reviewed policies and procedures for the conduct of the licensee's clearing and settlement facility in general and its supervisory responsibilities in particular; and
- reviewed material provided by the licensee under the *Australian Securities and Investments Commission Act 2001*.

We served notices that required SFECC and Austraclear to give ASIC documents relating the activities of SFECC and Austraclear. From 15 February 2006 to 17 February 2006 we attended the SFECC and Austraclear office. During the on-site phase of the assessment we reviewed relevant files and spoke to SFECC and Austraclear personnel. We also chose to write to SFECC and Austraclear to seek information about changes in procedures, the handling of any conflict of interest situation and other specific matters.

After our onsite visit was completed, we corresponded and had discussions with SFECC and Austraclear about our findings and their proposed responses to issues raised. Where appropriate, our report reflects SFECC's and Austraclear's responses.

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

For each licensee the focus of the assessment was to review the supervisory arrangements of the licensee. In particular we reviewed the work done by the Compliance and Surveillance unit of the SFE group in regard to the participants of each licensee to ensure the supervisory work done by this unit was adequate and performed in a consistent manner across all participants of each clearing and settlement facility. For each licensee we also sought to increase our understanding of the functions performed by relevant business units of each licensee.

As part of our assessment of SFECC we considered internal work undertaken by SFECC on risk management.

In conducting our assessment of Austraclear, we reviewed changes made in response to the recommendation regarding the delegation of power in Austraclear. We also reviewed work undertaken in relation to the operations of and procedures for the main operating system of Austraclear, known as FINTRACS.



## Section 2: Observations and recommendations

### 2.1 SFECC and Austraclear are meeting their obligations

After making our assessment of SFECC and Austraclear, ASIC concludes that each of SFECC and Austraclear 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:

1. key management and staff responsible for the operation and supervision of the clearing and settlement facility 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 facility; and
  - the absence of any significant supervisory issues during the period;
2. each licensee has good and reliable technology in place that enables it to provide a fair and effective clearing and settlement facility. There were no serious CS facility failures or disruptions that had an adverse impact on clearing and settlement for the facility during the period covered by this assessment;
3. each licensee has adequate financial risk management arrangements in place. Operational personnel and management involved in risk management are knowledgeable and experienced and demonstrate a commitment to sound risk management practices;
4. the operating rules for the clearing and settlement facility provide an adequate framework for the operation of a fair and effective facility;
5. satisfactory procedures are in place for the key supervisory areas; and
6. operational files on supervisory decisions that we reviewed demonstrated that decision-making on supervisory matters generally follows sound procedures, and the licensee conducts ongoing supervision of the participants in its clearing and settlement facility.

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

### **Austraclear's system – FINTRACS and EXIGO**

FINTRACS is currently the main operating system for Austraclear. FINTRACS provides participants with confirmation, clearing and settlement services for financial product transactions. FINTRACS acts as a feeder system into the Reserve Bank of Australia's RITS/RTGS system. FINTRACS also provides issuing and registry services for paper and non-paper securities, respectively. FINTRACS is owned by Austraclear with the management and servicing of the system currently outsourced to OM Technology AB and OM AB (PUBL) (together 'OM').

FINTRACS was due to be replaced in 2005 by a new system, also managed by OM, called EXIGO. However the implementation of EXIGO has been delayed until mid 2006.

We reviewed two reports made to Austraclear management regarding the operation of FINTRACS. Both reports made various recommendations and findings in regard to the operation of FINTRACS. On occasion Austraclear's response, as documented in the reports, noted that the problem would be remedied by the implementation of EXIGO. As noted above EXIGO's implementation has been delayed. However, we have been given assurances by Austraclear that FINTRACS is a robust system and will continue to provide adequate services until such time as EXIGO is implemented.

We also made enquiries about the small number of outages that occurred in FINTRACS. It appears that the outages had minimal impact on the operation of Austraclear. Austraclear noted that fixes had been put in place and assured us that the fixes are adequate until such time EXIGO is implemented.

In the event that the implementation of EXIGO is further delayed, we suggest that Austraclear find other ways of addressing the findings in the reports made to Austraclear management. In addition, we recommend that any fixes made to FINTRACS or any changes to the procedures regarding FINTRACS are reviewed regularly until such time as EXIGO is implemented.

### **Risk management**

Both SFECC and Austraclear maintain comprehensive risk management arrangements designed to ensure that the interests of relevant parties are protected and the integrity and financial stability of the market place is maintained. Our previous assessment report fully describes the risk management arrangements for both SFECC and Austraclear.

During our assessment, we reviewed a report to management of SFECC regarding the activities of the Risk Operations department. We asked for an update from SFECC about its responses to the findings and recommendations of the operational audit. At March 2006, all agreed actions to be taken in response to the recommendations had been completed.

We are pleased to note that SFECC is taking an active role in ensuring its operations and procedures are adequate by conducting an internal audit and responding to the report.

### **Delegation of powers under the Austraclear operating rules**

In our last assessment report concerning Austraclear we noted that despite the segregation of the Clearing Business Development unit from the operational and supervisory areas of Austraclear, a number of powers of the Committee (being the board, a committee of the board or a delegate of the board) under the operating rules had been delegated to the General Manager Business Development Clearing and Settlement and to the General Manager Business Operations.

We recommended that Austraclear revoke the delegation to the General Manager Business Development Clearing and Settlement of Committee powers under the operating rules in relation to supervisory matters.

Austraclear has advised us that it has reviewed its delegations and revoked the relevant supervisory related delegations from the General Manager Business Development Clearing and Settlement. Procedures relating to the approval of new participants were reviewed and it was noted that the employee approving the new participants was not related to a commercial area.