



ASIC

Australian Securities & Investments Commission

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ASIC's Market Supervision Strategic Priorities 2017–18

- Next month, we will publish *ASIC's Corporate Plan 2017–18 to 2020–21*, outlining ASIC's strategic priorities for 2017–18.
- This letter outlines the strategic priorities for ASIC's Market Supervision team for 2017–18.
- Plan for the year ahead by assessing your firm's risk management framework against these priorities.

Well-functioning markets give investors the confidence to invest capital in businesses – helping them innovate and grow. This letter focuses on issues that ASIC's Market Supervision team has identified to support fair and efficient markets, which affect market intermediaries, including investment banks, market participants, securities dealers, corporate advisers and over-the-counter (OTC) derivatives providers.

Our key strategic priorities for 2017–18 are:

1. **Technology, risk and resilience**
2. **Conduct**
3. **Effective capital markets**

We have prioritised these three risks because, if not properly addressed, they could adversely affect market integrity and investor confidence.



Strategic Priority 1: Technology, risk and resilience

- Consider the systems and controls that apply to your firm's operational and technology infrastructure, including proprietary systems and third-party providers.
- Cyber threats are a risk to businesses and the stability of the financial markets. You should consider your cyber resilience profile relative to your risk-appetite.
- We will continue to provide cyber self-assessment questionnaires to market intermediaries to understand market practice and provide feedback.

Technology and operational risk is a significant concern for financial markets. To prevent and address critical issues, you should review your firm's technology and operational systems and processes.

Cyber resilience

We encourage firms operating in Australia's financial markets to improve their cyber resilience practices by considering the technology and cyber risks to their business and taking appropriate action. You can do this by establishing robust collaboration and information-sharing networks to access the best defensive intelligence and technology. To assist you to drive behaviour that improves the overall cyber resilience of the market, we will collaborate closely with industry, regulators and Government.

To help improve your firm's cyber resilience take a look at ASIC's [Report 429](#) and [Report 468](#). You should also consider the [ASX 100 Cyber health check report](#). In the event of a compromise or unauthorised third-party access to the firm's systems, we would like to remind you of your reporting obligations to ASIC.

We will continue to provide cyber self-assessment questionnaires to select market participants and check in with top tier investment banks to understand changes since our last survey. Our goal is to conduct a cyber resilience health check of our regulated population and identify common areas for improvement.

Going forward, we will continue our compliance reviews of technology-dependent offerings such as crossing systems, order management systems and outsourcing of technology.

Risk measurement

We have reviewed our approach to risk rating financial intermediaries. In addition, improvements to the modular risk-based assessment detection and response (RADAR) program and annual compliance liaison visits mean that we are better placed than ever to identify, understand and respond to risks that arise in our markets.



Strategic Priority 2: Conduct

- Review the culture in your organisation to make sure it drives good conduct.
- Ensure your firm is adequately managing confidential information and conflicts of interest. Review your firm's controls (including policies, procedures, training and monitoring) to make sure you are appropriately managing risks identified by ASIC in [Report 486](#).
- Contribute to the consultation on the proposed guidance for sell-side research.

We are continuing our focus on conduct that enhances market integrity across all market-based activities. In particular, we are asking firms to consider whether their controls are appropriate.

Sell-side research and allocations

The handling of confidential information is an ongoing focus for us. The leakage of material, non-public information can threaten market integrity by creating information inequality. This can damage investor confidence and increase the risk of insider trading. We encourage you to consider the risks identified in [Report 486](#) when assessing your firm's conduct risk.

It is also important to ensure that conflicts between your firm and its clients – and between the competing interests of different clients – are properly managed. To improve market practices around sell-side research we want your feedback on proposed regulatory guidance in [Consultation Paper 290](#).

We will review market practices on allocation policies for capital raisings by engaging with industry to understand market practices, and reviewing policies, procedures and specific transactions. We intend to report on our findings. We are also conducting ongoing reactive reviews on capital raisings and staff trading.

Supervisory frameworks, risk management and controls

Where your firm takes on increased risks, we will seek to ensure you have the appropriate supervisory, risk management and compliance controls in place. In particular, we will assess whether your firm has adequate human, technological and financial resources. We will also consider the risk management practices and risk limit settings for principal traders in the equities and futures markets.

Reporting suspicious activity

We will continue to supervise market participants' trade monitoring and surveillance practices and compliance with their suspicious activity reporting (SAR) obligations under the market integrity rules. Where our systems identify suspicious market activity, but the market participant has not lodged a SAR with ASIC or a suspicious matter report (SMR) with AUSTRAC, we will investigate.

Quality of advice

The quality of advice provided to retail clients is an ongoing focus for us. We will carry out compliance reviews where appropriate, focusing on the implementation of the Future of Financial Advice requirements.

You should ensure your firm has appropriate compliance, risk and adviser supervision frameworks in place that have been designed to identify and address any process deficiencies, knowledge gaps and inappropriate advice.

Foreign Financial Service Providers (FFSPs)

FFSPs should ensure they comply with all of the class order requirements if they are relying on the FFSP relief that applies until 27 September 2018.¹ We have entered into a number of enforceable undertakings in this area.

We intend to consult with industry on the policy settings underlying this relief, including the use of the limited connection relief, the impact on FFSPs if it were repealed, the types of financial products and services offered by those relying on the relief, the volume of trade occurring under the relief, the jurisdictions involved, and the number of clients affected.

¹ ASIC Corporations (Repeal and Transitional) Instrument 2016/396, ASIC Corporations (CSSF Regulated Financial Services Providers) Instrument 2016/1109 and ASIC Corporations (Foreign Financial Services Providers – Limited Connection).



Strategic Priority 3: Effective capital markets

- Review your systems and controls for managing conduct risk in fixed income, commodities and currencies, and equity derivatives.
- Review your capital arrangements and the capital calculations used to assess financial strength.
- Ensure you are prepared for the new client money reporting and reconciliation rules.

We are conducting a review of market activity in the OTC sector of the market, primarily fixed income, currencies and commodities (FICC), and equity derivatives. This multi-year project will be undertaken while the market considers how to implement the [Global FX Code](#) and ASIC [Report 525](#). We will use [Report 525](#) as a reference point for our surveillance of the FX market and, where appropriate, broader wholesale OTC markets.

Our broader OTC review will consider whether you have appropriate systems and controls in place to prevent, detect and address inappropriate conduct within your organisation (including governance, supervision, monitoring and compliance measures).

We will continue to build on our existing market surveillance capabilities, including data collection and analysis for the OTC sector. We will also work with ASX (the BBSW benchmark administrator), participants, trade reporting agents and trade reporting venues to develop a framework to ensure we can effectively supervise liquidity, price formation and behaviour in these markets.

Financial stability and capital review

We are conducting a high-level review of the capital framework in the market integrity rules, as it applies to market participants (that are not also clearing participants). We intend to consult with industry on proposed changes to the framework to ensure market participants can conduct business in compliance with the rules, provide enough capital in the event of an orderly wind-down for the safety of investors, and provide ASIC with information to identify key risks.

We have noticed a number of firms take steps to recapitalise or restructure their organisations in a bid to increase profitability. We will continue to review the capital calculations of a number of participants in order to assess their financial strength. As part of our monthly review process, we will review the recognition of deferred tax assets on participants' balance sheets, particularly where there are continual losses and no evidence is provided to support their continuing recognition.

Client money

Reforms to strengthen the protection of client money provided by retail derivative clients will commence on 4 April 2018. As part of the reforms, Parliament has given us the power to make new client money reporting and reconciliation rules, which will ensure more formal and consistent standards across the derivatives sector. We issued [Consultation Paper 291](#) in July 2017 and will continue to work with AFS licensees during the transition period.

From a supervision perspective we will focus on areas of ongoing concern such as adequate record keeping of reconciliations and ensuring the review process is timely and robust (including sign-off).

Appropriate regulatory oversight of retail OTC derivatives and complex products

We will continue focusing on retail OTC derivative issuers of margin FX, CFDs and binary options, among other derivative products offered to retail investors. We recently commenced a review of retail OTC derivative issuers to gain a better understanding of the nature, scale and complexity of the industry and the risks posed to investors. This year we also intend to broaden our focus on secondary market distribution practices of other complex products.

Market integrity rule consolidation

Our work to consolidate the market integrity rules is nearing completion. Responses received from industry on [Consultation Paper 277](#) have helped shape our final policy, which we will shortly report on. Subject to approval by the Minister, the consolidated market integrity rules will commence in 2018.

Conclusion

It is our goal to keep you informed of the issues we are currently experiencing in the Australian market, and those we see emerging. We hope you will use this letter to assess your firm's risk management framework as part of a robust review process. We also provide ongoing updates to intermediaries through our website, Market Integrity Updates, media releases, conferences and liaison meetings.

Yours Sincerely

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