



**ASIC**

Australian Securities & Investments Commission

# ASIC's approach to market integrity

*Notes used in a speech by Tony D'Aloisio, Chairman, Australian Securities and Investments Commission*

*Monash Centre for Regulatory Studies and Clayton Utz Luncheon Lecture*

11 March 2010

## A Introduction

- 1 The integrity of Australia's financial markets is a vital element in promoting confident and informed participation by firms and investors, thus contributing to an efficient and prosperous economy.
- 2 This address begins with an examination of the foundations of market integrity – why it is important, and who the key players are in promoting market integrity, and particularly, the role of ASIC as an oversight body.
- 3 The address finishes with a discussion of some current and emerging issues which raise challenges for regulators and market participants in ensuring that our financial markets retain their integrity.

## **B What is market integrity and why is it important?**

- 4 Market integrity is important for promoting the liquidity and depth necessary to attract investors. This is particularly so in the case of international investors, who compare Australian financial markets against the rest of the world when deciding where to invest.
- 5 For listed markets, the anonymity of transacting virtually mandates that participants have confidence that they can invest on a level playing field. Australia's listed markets are well regarded – they are seen as clean and fair and this is reflected in the attraction of foreign investment and in the liquidity of our markets.
- 6 Market integrity is also important for unlisted markets. The types of products traded in unlisted markets – mortgage trusts, unlisted property trusts, debentures – are important forms of investment for the economy. The prime target for these products is retail investors.
- 7 Both the listed markets and the unlisted markets were impacted by the GFC. Confidence in the listed markets has returned more quickly than for unlisted markets. This, in part, reflects greater confidence by investors in the listed markets (for example, access to liquidity and greater transparency).

## C Elements that work to maintain confidence in the integrity of our markets

### The law – self executing

- 8 The Corporations Act has been framed to maintain market integrity through self-executing laws. The policy behind the Corporations Act resulting from the Wallis Inquiry<sup>1</sup> is that allowing markets to operate is the best way to achieve efficiency. Regulation should be kept to a minimum and directed towards:
- (a) using disclosure as the way to keep markets informed; and
  - (b) prohibiting certain types of misconduct (notably insider trading and market manipulation).
- 9 In the last 20 to 30 years, there has been a large body of economic evidence to support the proposition that the efficiency of financial markets is best achieved with a minimum of regulation. But this has started to be tested as a result of the GFC and collapses in Australia and overseas. There is a challenge for policy makers, regulators and market participants to rethink the assumptions underpinning regulation in light of emerging market integrity issues. The main issues include:
- (a) the adequacy of disclosure. For retail investors, disclosure on its own may not be enough (e.g. it might be better to prohibit certain products from being offered to retail investors) and there may need to be stronger regulation of intermediaries (e.g. financial advisers);
  - (b) in relation to the institutional market, the lack of transparency, particularly with over-the-counter trades, pose challenges for encouraging market integrity.

Nevertheless, the Market Efficiency Hypothesis is likely to remain the main body of economic evidence to continue to underpin our regulatory framework.

### Gatekeepers

- 10 Gatekeepers play an important role in maintaining market integrity. By "gatekeepers" we mean those intermediaries who help promote compliance

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<sup>1</sup> On 30 May 1996, the Treasurer established an inquiry into the Australian financial system. The Financial System Inquiry was chaired by Mr Stan Wallis and reported its findings to the Government on 9 April 1997.  
<<http://fsi.treasury.gov.au/content/default.asp>>

with the law, professional ethics and so on. These gatekeepers include auditors, accountants, lawyers, research houses, asset managers/advisers, credit rating agencies (CRAs), valuers, responsible entities for MIS and trustees (e.g. for debentures). They all play a role and are important. Proper discharge of their functions is important to maintaining confidence in the integrity of the markets.

- 11 We have seen some examples where there were issues with gatekeepers which impacted on market integrity:
- (a) investment bank research houses in the mid 1990s in the US;
  - (b) auditors in the US and the dot com boom in the early 2000s;
  - (c) CRAs with the GFC.
- 12 Gatekeepers will continue to remain important in financial markets, and thus in contributing to confidence in the integrity of our markets.

## Operators of listed markets

- 13 For the listed markets, the market operators such as the ASX play an important role in maintaining confidence in market integrity. For example, the market operator has a critical role in establishing and enforcing rules for continuous disclosure in a listed market.
- 14 We have seen that, during the GFC, Australia's market operators did well in maintaining confidence in market integrity. For example, short selling was an issue that arose but was resolved relatively quickly.
- 15 For unlisted markets, the responsible entities for MIS and trustees for debenture issues play important roles. The recent downturn has thrown the spotlight on MIS and the regulation of REs and role of compliance committees.<sup>2</sup>

## Boards and management

- 16 Corporate governance is critical in maintaining confidence in the integrity of our markets. The behaviour and ethics of boards is important in creating entities that investors have confidence in.

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<sup>2</sup> Since April 2009, we have seen the insolvency of a number of schemes associated with responsible entities that have become insolvent in their own right. For example, schemes operated by Great Southern, Timbercorp and Rubicon Asset Management Limited. Compliance committees are required to monitor to what extent a responsible entity complies with a scheme's compliance plan and to report such findings to the RE, and if serious enough, to ASIC. In recent examples, there is information to suggest some members of these committee's have fallen short of their obligations.

- 17            Our corporate governance has stood up well during the crisis – we have well run companies. Assisting in that regard is support available from professional bodies such as AICD and ASX Corporate Governance Council.

## D ASIC's role in promoting market integrity

- 18 ASIC plays an important role in maintaining confidence in market integrity within our regulatory policy framework.
- 19 In thinking about ASIC's role in promoting market integrity, it is helpful to make the distinction between what ASIC is, and what it is not. ASIC is an oversight body. ASIC is not a guarantor of last resort, nor is it a guarantor against failures.
- 20 One way of understanding these different roles is to liken ASIC to attending the scene of a car accident. The first role is about providing immediate first aid and dealing with the damage; in relation to market integrity this represents ASIC's role in seeking compensation for investors.
- 21 The next role relates to investigating the cause of the accident and ensuring that, if the driver is at fault, they are punished – this is akin to ASIC's enforcement role in investigating behaviour that threatens market integrity and taking action against those who have broken the law.
- 22 The third role in relation to a car accident would involve addressing systemic safety issues, such as the adequacy of safety barriers – this is akin to ASIC's role in relation to the market rules that are necessary to promote integrity.
- 23 The final role involves driver education so that accidents can be avoided in the future – ASIC has a very strong interest in improving investor education so that investors can be sure of their own confidence in engaging with financial markets.
- 24 ASIC's role in maintaining confidence in market integrity can be expanded under a number of headings:
- (a) enforcement;
  - (b) supervision and oversight of gatekeepers;
  - (c) supervision and oversight of brokers and market participants;
  - (d) surveillance of ASX and other markets;
  - (e) working with ASX and companies to keep the market properly informed.

### Enforcement

- 25 There have been concerns that 'insider trading' and market manipulation go unpunished or that they are rife in the market. Anecdotal data in 2003-2007 showed that price movements occurred ahead of price sensitive announcements in a significant number of cases.

- 26 Rather than debate this anecdotal data, ASIC made market integrity a key area of focus as part of ASIC's strategic review in 2007/08. As a result, ASIC has done the following:
- (a) ASIC has dedicated Commissioner Belinda Gibson with responsibility for overseeing market integrity issues;
  - (b) ASIC has created two dedicated enforcement teams (headed by Chris Savundra and George Stogdale) with 40 fulltime equivalent staff in each team to investigate and take action in market integrity cases;
  - (c) ASIC has built an improved working relationship with the Commonwealth DPP that allows us to work together towards a common purpose;
  - (d) ASIC has improved training and skilling for ASIC staff, including additional skills for the legal and other professions;
  - (e) ASIC has made better selective use of external law firms to supplement our internal capabilities and provide expert assistance when necessary.
- 27 ASIC is now converting the changes into improved outcomes which will have a greater deterrent effect as well as punishing wrongdoing. Since 1 January 2009, we have had 10 significant outcomes:
- (a) 3 convictions for insider trading (Panchal, O'Reilly and Stephenson);
  - (b) 4 convictions for market manipulation (Wade, Musumeci, Newing, and Soust);
  - (c) 3 false and misleading statements to ASX (Roberts/Barnes of Chamelon Mining and Narain);
- We also have 10 contested cases before the courts and a further 14 cases before the Commonwealth DPP.
- 28 This is a significant improvement on previous outcomes. These results are better than those for at least the previous 5 years.
- 29 There have been criticisms of ASIC's running of cases. For the most part, those criticisms relate to decisions made before our recent strategic review was undertaken and the changes noted above implemented. ASIC has made significant changes (as outlined above) and those changes are producing results.

## Supervision and oversight of gatekeepers

- 30 ASIC carries out a range of compliance and oversight activities to target specific areas that potentially raise problems for market integrity. For example, in relation to auditors and audit standards, ASIC makes referrals to the Companies Auditors and Liquidators Disciplinary Board relating to

- misconduct or can negotiate enforceable undertakings where failings are apparent. ASIC also undertakes inspections of audit firms with the objective of improving audit quality, which is important in the context of market confidence in financial reports. We also have a systematic programme to review the financial reports of selected listed and unlisted companies<sup>3</sup>
- 31 In relation to unlisted companies and managed investment schemes, ASIC has undertaken work to improve disclosure, such as new disclosure standards for unlisted/unrated debentures and if not, why not disclosure for mortgage trusts.<sup>4</sup>
- 32 In the field of corporate governance, ASIC has enforced the law against directors, including:
- (a) Fortescue/Forrest for misleading and deceptive conduct (currently on appeal);
  - (b) Centro (currently before the court);
  - (c) James Hardie (in relation to market disclosure and currently on appeal);
  - (d) AWB in relation to misleading and deceptive conduct (currently before the court)
- 33 As important gatekeepers for the proper functioning of the stock market, ASIC undertakes supervision and oversight of brokers. Our current work involves:
- (a) risk based surveillance to look at compliance with the law by brokers;
  - (b) a survey of retail investors to assess the quality of advice provided to them;
  - (c) ongoing review of day trading to assess and take action in relation to aggressive marketing techniques and misleading and deceptive conduct.
- 34 The transfer of ASX surveillance to ASIC will change the way ASIC undertakes its supervision and oversight role. From later this year ASIC will take over the supervision of Australia's domestic licensed markets. This means, in effect, that market rules (such as rules about market manipulation, front running and other forms of misconduct) as well as rules relating to

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<sup>3</sup> Since July 2006, ASIC action against auditor misconduct has resulted in 3 CALDB proceedings and 10 enforceable undertakings. The 3 CALDB outcomes for auditors since July 2006 include 1 reprimand and 2 orders of suspension for 9 months. The Enforceable Undertakings resulted in undertakings not to accept new appointments for 12 months and undertakings not to practise as a registered auditor for periods ranging from 9 months to 5 years as well as 3 cancellations of registration. For the same period, ASIC action against liquidator misconduct has resulted in 9 CALDB proceedings, 4 court proceedings (3 complete/1 in progress) and 3 enforceable undertakings. The 9 CALDB outcomes for liquidators include 1 order of cancellation; 6 orders of periods of suspension ranging from 3 months to 2 years; 1 order of no new appointments for 3 months; 1 order of reprimand.

<sup>4</sup> RG69 Debentures—improving disclosure for retail investors; CP123 Debentures: Strengthening the disclosure benchmarks; RG45 Mortgage schemes—improving disclosure for retail investors; RG46 Unlisted property schemes—improving disclosure for retail investors <<http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/New%20regulatory%20documents>>

participant conduct in treatment of their clients will be supervised and enforced by ASIC instead of ASX.

- 35 The present arrangements require individual financial markets to supervise trading on their markets. In announcing the Government's decision to transfer domestic financial market supervisory responsibility to ASIC, the Minister noted that it is more appropriate for an agency of the Government to perform this important function and that this reform is in line with the move towards centralised or independent regulation in other leading jurisdictions.<sup>5</sup>
- 36 It is a legitimate question for industry to ask whether ASIC will do a better job under these new arrangements. ASIC is aware that it is building on supervision and enforcement which has worked well for the market. Our first objective is to achieve a "seamless transition" from ASX to ASIC. We are on target to do that. We can see, however, that we can improve. These improvements will come from, over time, better systems and a more integrated approach. This will benefit the market and market participants through less duplication, reduced costs of compliance and more speed in enforcement. It is important, however, to stress that the emphasis on market integrity which the ASX has successfully promoted will continue with ASIC.

## Working with ASX on continuous disclosure

- 37 The continuous disclosure regime is important for ensuring investors remain informed and confident. As continuous disclosure is primarily a function of the operation of the market, ASX which will remain the front line supervisor and ASIC will continue to work with ASX.
- 38 Examples of ASIC's current work which illustrate our involvement in this area are:
- (a) continuous disclosure cases and infringement notices (e.g. recent litigation in the Fortescue<sup>6</sup> case and an infringement notice issued to Commonwealth Bank<sup>7</sup> last year);

<sup>5</sup> Joint Media Release by The Hon Wayne Swan Treasurer, and The Hon Chris Bowen Minister for Financial Services, Superannuation and Corporate Law. Media Release No. 093, 24/08/2009  
<<http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/093.htm&pageID=003&min=wms&Year=2009&DocType=0>>

<sup>6</sup> ASIC is currently appealing the Federal Court's decision to dismiss its application for civil penalty orders against Fortescue Metals Group Ltd and its CEO, Mr Andrew Forrest. In ASIC's view, the case raises important issues concerning a listed entity's continuous disclosure obligations, the operation of the misleading and deceptive conduct provisions of the Corporations Act and the role of directors and officers in making statements to the ASX and the investing public. See ASIC Media Advisory 10-13AD '**ASIC appeals federal court decision in Fortescue metals group civil penalty proceedings**', Thursday 4 February 2010. <<http://www.asic.gov.au/asic/asic.nsf/byheadline/10-13AD+ASIC+appeals+federal+court+decision+in+Fortescue+metals+group+civil+penalty+proceedings?openDocument>>

- (b) providing guidance to the market in improving disclosure.<sup>8</sup>

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<sup>7</sup> In October 2009, the Commonwealth Bank of Australia (CBA) paid a penalty of \$100,000 to ASIC relating to its alleged failure to comply with the continuous disclosure obligations under s 674(2) of the Corporations Act (2001). ASIC issued an infringement notice to CBA alleging it had failed to immediately notify ASX after becoming aware of information regarding an increase in its expected loan impairment expense to gross loans and acceptances for the financial year ending 30 June 2009. See ASIC Media Release 09-199 '**Commonwealth Bank pays \$100,000 penalty**', Wednesday 14 October 2009.

[http://www.asic.gov.au/asic/asic.nsf/byheadline/09-199MR+Commonwealth+Bank+pays+\\$100%2C000+penalty?openDocument](http://www.asic.gov.au/asic/asic.nsf/byheadline/09-199MR+Commonwealth+Bank+pays+$100%2C000+penalty?openDocument)

<sup>8</sup> Among other initiatives, in 2008-09 ASIC and ASX held a number of joint seminars to provide guidance to company directors on how we approach continuous disclosure matters.

## E Current issues

### Responsible Handling of Rumours

- 39 Confidence in the integrity of capital markets is undermined if investors believe that rumours are actively spread in the market so as to distort proper price discovery. During the recent financial crisis there was much discussion about short selling on the back of negative rumours about an entity.
- 40 There were particular concerns when long buyers (because of the GFC) were staying away and share prices were falling further than would ordinarily have been the case fuelled by false rumours. ASIC took 2 decisive steps to address these concerns and followed up with a third. These were:
- (a) A ban on 'short selling' as a "circuit breaker". This interference with the market was exceptional but, in the context of the post Lehman situation in mid September 2008, it was needed;
  - (b) Investigations (known as Project Mint) to delve into the rumours to assess if they were false and actionable. In law enforcement terms, this was a "disruptive" strategy. Essentially, this involves moving in quickly and searching the emails and other material sent as messages to the market. It disrupted possible activity of false rumours and it reassured the market that the regulator was there. While there has been criticism that Project Mint did not produce 'scalps', its disruptive activity has been an important benefit.<sup>9</sup>
- 41 The third aspect has been to assist market participants and industry to better manage rumours. We issued CP118: *Responsible Handling of Rumours* to seek feedback on how best to assist the industry.<sup>10</sup> We proposed principles for handling of rumours to assist AFS licensees which included the following requirements:
- (a) to have written policies and procedures on handling rumours and a process for supervising compliance with these;

<sup>9</sup> In March 2009, ASIC banned Richard John Macphillamy from providing any financial services for 18 months after finding he did not comply with a financial services law (section 1041H of the *Corporations Act 2001*) when he spread false and misleading information about Macquarie Group Limited (Macquarie) and the Macquarie Cash Management Trust (CMT) while working as a representative of Linwar Securities Pty Ltd. This matter arose out of investigations into rumourtrage in the course of Project Mint. See ASIC Media Advisory 09-48 '**ASIC bans broker for spreading misleading information**', Monday 23 March 2009. <<http://www.asic.gov.au/asic/asic.nsf/byheadline/AD09-48+ASIC+bans+broker+for+spreading+misleading+information?openDocument>>

<sup>10</sup> CAMAC in its report *Aspects of Market Integrity* (June 2009), noted that it would be appropriate for "ASIC to be empowered to impose various record-keeping and other obligations to enhance compliance efforts and assist in any investigative and enforcement processes" and noted that there was little regulatory guidance on how market participants should deal with rumours they receive and expressed support for ASIC's then proposal to provide guidance to the market on how to respond to rumours.

- (b) to have formal training for employees and representatives on the policies and procedures applicable to rumours;
  - (c) general prohibition on the origination of rumours;
  - (d) a prohibition on the circulation of rumours, except where the rumour is already in wide circulation and the AFSL holder believes that it could be a factor in explaining the current market price of the security;
  - (e) a process for attempting to verify rumours; and
  - (f) a requirement that a rumour must be described as such, if it is approved to be passed on and must not be embellished.
- 42 The consultation period ended in mid November 2009 and we received a wide range of submissions from a variety of sources, including relevant industry bodies, AFSL holders and individuals.
- 43 We are assessing those and will follow up with a Regulatory Guide, which will provide guidance to relevant participants about what ASIC expects of them, how ASIC interprets the law, and describes the principles underlying ASIC's approach. It is expected that this will be released by June 2010.
- 44 We will, in our assessment, balance market integrity issues against unduly adding to cost of compliance. We do not wish to achieve market integrity at a cost which adds to cost of capital.

## Confidential information

- 45 The proper handling of confidential information promotes market integrity and efficiency by reducing the risks of leaks or insider trading. It empowers a company to manage the timely release (in accordance with the law) of its information in accordance with the continuous disclosure rules.
- 46 ASIC uses its enforcement powers to deal with insider trading and market manipulation and misleading and deceptive conduct. However there is a role for corporations and gatekeepers to do more to protect leaks of confidential information on price sensitive information. It is the responsibility of all companies, advisers and other service providers to ensure their own policies and procedures for handling confidential information are sufficiently robust and effective to minimise the risk of leaks.
- 47 ASIC has released CP128: *Handling confidential information* for consultation on best practice guidelines for handling confidential information. This was in part, based on practice in the US and UK.
- 48 In summary the guidelines:
- (a) describe a set of policies and practices companies can adopt to maximise the protection of confidential information. These cover:

- (i) implementing the "need-to-know" principle;
  - (ii) information barriers, IT and physical document management;
  - (iii) insider lists for sensitive transactions; and
  - (iv) personal confidentiality obligations and personal account dealing.
- (b) set out steps a company should take when providing confidential information to its advisers, to minimise the risks of leaks or insider trading. These include:
- (i) ensuring advisers have systems which, at a minimum, comply with the company's own practices for handling confidential information;
  - (ii) executing specific and general confidentiality agreements; and
  - (iii) implementing strict controls around beauty parades.
- (c) provide guidance on how advisers and other third parties should handle confidential information, where this guidance differs from that offered to companies. Advisers and other third parties include investment banks, lawyers, accountants, trading banks, brokers, tax advisers, credit ratings agencies, registries, public relations firms, specialist valuers and printers.
- 49 CP128 also describes best practice guidelines for sounding the market prior to a capital raising.
- 50 The consultation period closed in February 2010. We are assessing impact and will strive for balance between the cost of compliance and benefits to improved integrity.
- 51 With both the Rumourtrage proposal and confidential information proposals, there has been an additional concern that they may go too far and deny important information to the market. After all, the market does operate on important flows of information. We do not think that they will restrain proper information flows including information flows to the media. Our focus is on improper use of price sensitive information.

## Market soundings

- 52 We recognise that market soundings are important to help people make decisions. Our focus has been, and will continue to be, on abuse. Our approach will focus on the following principles:
- (a) Soundings should, as far as possible, take place when the market is closed or, if during market, after appropriate trading halts are sought; and
  - (b) Confidentiality must be maintained (including confidentiality through not trading while a sounding takes place).

- 53 We are conscious that our approach should be both practical and appropriate in helping to minimise the risk of market sensitive leaks during soundings on capital raisings or merger and acquisition proposals. For instance, it may not always be possible to sound when the market is closed or a company's stock is in trading halt. Similarly, practical issues arise about the best way for institutions to provide confirmation that they agree to be wall-crossed and will not trade in the relevant securities. We will take these issues into account when finalising any guidance or policy on market soundings.
- 54 Ultimately, though, we think the proper handling of confidential, price sensitive information is important in promoting market integrity and efficiency.

## Investor briefings

- 55 ASIC's view is that analyst/investor briefings play an important and positive role in increasing the dissemination of accurate information on companies to the market. They enable management to explain the company's financial results, business strategies and outlook and they provide analysts with the opportunity to question and evaluate management.
- 56 Of course any disclosures at briefings must comply with the laws relating to continuous disclosure and insider trading. At such briefings, the company must take care not to inadvertently disclose any price-sensitive confidential information. Such information should instead be first released to the market through the ASX's companies announcement platform.
- 57 There may be fairness issues (both real and perceived) in relation to the practice of private briefings with well-connected analysts/investors potentially having access to more detailed and higher quality discussions with management. We note that this practice appears to be diminishing, and that briefings are increasingly public. We encourage this movement.
- 58 Part of ASIC's approach will be to (selectively) attend investor briefings. When it does, it will let the company and those there know.

## Selective individual institutional briefings

- 59 It is the practice of some institutions with large shareholdings in a company to seek one on one discussions with the Chairman and/or CEO. For example, in relation to acquisitions or change of Chair.

- 60 ASIC notes that private briefings with analysts/investors may be appropriate provided the laws relating to continuous disclosure and insider trading are complied with.
- 61 These practices need to be carefully managed. Depending on the questions asked, institutions may have a series of these briefings with companies in the same industry to assist them with their investment strategies. Companies need to consider this when assessing if they need to make additional disclosures to the market. Otherwise, retail investors can be disadvantaged.

## Directors

- 62 ASIC notes that some concerns have been raised that ASIC is being too "heavy handed" on directors. There are concerns that the role of non-executive directors is difficult and this difficulty needs to be factored in. We are alert to these issues. A lot of our effort is in improving and working with directors to assist them with compliance.
- 63 For instance, in November 2009 we issued CP124 *Duty to prevent insolvent trading: Guide for directors* seeking feedback on our proposed guidance to help directors understand and comply with their duty to prevent insolvent trading. We published this paper to assist directors, particularly directors of small-to-medium enterprises (SMEs) in financial difficulty, who may not fully understand their duty to prevent insolvent trading.
- 64 Among other initiatives, in 2008-09 ASIC and ASX held a number of joint seminars to provide guidance to company directors on how we approach continuous disclosure matters. ASIC also maintains a close relationship with the Australian Institute of Company Directors (AICD).

## F Emerging issues

### Sponsored access

- 65 With technology there is a move to provide greater direct access to the stock market, including by clients directly accessing the market using the unique identifier of their broker. Sponsored access (e.g. so called "white label" trading and day traders) raises issues, such as:
- (a) whether it facilitates high frequency trading, and whether this:
    - (i) encourages 'dysfunctional' competition by exchanges for high frequency trading and harms the interests of long-term investors;
    - (ii) provides an 'unfair' technological advantage over other market participants;
    - (iii) introduces unacceptably high levels of market risk due to increased volume, speed and volatility of order entry cancellations.
  - (b) the possibility that it may introduce additional levels of risk for the market if there is insufficient testing of systems or insufficient pre-trade filters; and
  - (c) the possibility that it may introduce additional levels of risk for retail investor protection.
- 66 ASIC is considering each of these issues, particularly in the context of increased competition for trading services and ensuring the integrity of Australia's financial markets.

### Dark pools

- 67 Dark pools are crossing networks that provide liquidity that is not made generally available to the public. Dark pools are useful for traders who wish to move large blocks of stock without revealing who they are. However, these dark pools raise some concerns:
- (a) There may be an appearance of unfairness as those with access to the dark pool transactions could use the information, for example, to engage in front running;
  - (b) Proprietary trading and dark pools can raise perceptions of conflict of interest. If the information is used or there is a perception of conflict, it could damage the market. Workings of "fire walls" will need greater scrutiny.

- 68 Dark pools operate in Australia within the franchise of the ASX (ie. in accordance with ASX rules and reporting requirements) and are regulated by ASIC. More specifically:
- (a) Trades are regulated under the rules of the ASX;
  - (b) Trades are reported to the ASX immediately for surveillance;
  - (c) Trade reports are aggregated with other ASX trades and published to the market; and
  - (d) The operators hold an AFSL.
- 69 ASIC continues to monitor the development of dark pools and implications for market integrity and is involved in the current IOSCO work to develop principles for their regulation.

## Competition for trading services

- 70 If the Government introduces competition for trading services, it should deliver some benefits and it will raise some market integrity issues.
- 71 The benefits of competition are likely to include greater innovation and increased pressure to prices, cost of execution, liquidity and speed of execution. Investors would benefit as they would be provided with more choice, better services and cheaper execution costs.
- 72 However, we are also conscious of the potential risks to market integrity and investor protection that competition poses in relation to:
- (a) ensuring investors receive the best execution possible (typically the best prices);
  - (b) ensuring information about trading opportunities and executed trades (pre- and post-trade transparency) are made available to investors in a timely, consolidated and cost effective way. Ensuring trading opportunities are widely known and can be acted on will instil confidence in investors (encouraging greater liquidity) and enable the evidencing of best execution;
  - (c) potential risk of market abuse in a multi-venue environment. ASIC has recently procured a market surveillance system that has the capability to monitor orders and trades across multiple trading platforms. We are also building on our human resource capability to deal with emerging market developments like sponsored access and algorithmic trading,
- 73 We will assess these issues further in consultation should the Government introduce competition for market services.

## Derivatives

- 74 We have seen with the GFC that derivatives can embed significant but undetermined risks when traded on the OTC market. The OTC markets pose significant operational and financial risks.
- 75 We can see that this debate is heading towards greater transparency and a shift for OTC derivatives to be cleared via central counterparties. In addition, consideration is being given to how to deal with counterparty risk and the role of central clearing houses.
- 76 These issues are being played out both domestically and internationally. In September 2009, the Financial Stability Board reported a number of recommendations for regulators to consider in relation to strengthening regulation of OTC derivative markets.
- 77 The G20 Leaders endorsed the FSB's proposals and went further. They called for:<sup>11</sup>
- (a) all standardised OTC derivatives to be traded on exchanges or electronic platforms, where appropriate, and cleared through central counterparties (CCPs) by end of 2012 at the latest;
  - (b) OTC derivatives to be reported to Trade Repositories; and
  - (c) non-centrally cleared contracts to be subject to higher capital requirements.
- 78 In Europe and the United States, proposals are taking a legislative form. In Australia, the legislative framework for CCPs is already in place. However there are not yet any CCP solutions for OTC derivatives in Australia or the Asia-Pacific region.
- 79 Also in September 2009, an OTC Derivatives Regulators Forum was established to focus on information sharing and cross-border consistency in regulation. It has been working to improve post-trade transparency for regulators and the market.
- 80 ASIC is part of a joint working group with the RBA and APRA that is promoting improved risk management and transparency practices in relation to OTC derivatives dealing in Australia. This work is proceeding with

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<sup>11</sup> G20 Leader's Statement – The Pittsburgh Summit, September 24 – 25 2009  
<[http://www.g20.org/Documents/pittsburgh\\_summit\\_leaders\\_statement\\_250909.pdf](http://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf)>

significant industry involvement. I also note ASIC aims to finalise soon a Regulatory Guide on 'Clearing and Settlement facilities' that is partly aimed at making it easier for CCPs to apply for a relevant licence to operate in Australia.

## Point of sale disclosure

- 81 We have seen retail investors have borne a significant part of the risk with recent collapses. Concerns are being raised in relation to the disclosure regime and its adequacy. There are also concerns about access to advice and its quality (e.g. whether some advice may have been unduly influenced by commissions).
- 82 Internationally, considerable work has been undertaken on point of sale disclosure. IOSCO recently produced a consultation paper that analyses issues relating to 'key information' disclosures to retail investors. The paper proposes six key principles:<sup>12</sup>
- (a) key information should include disclosures that inform the investor of the fundamental benefits, risks, terms and costs of the product and the remuneration and conflicts associated with the intermediary through which the product is sold;
  - (b) key information should be delivered, or made available, for free, to an investor before the point of sale, so that the investor has the opportunity to consider the information and make an informed decision about whether to invest;
  - (c) key information should be delivered or made available in a manner that is appropriate for the target investor;
  - (d) disclosure of key information should be in plain language and in a simple, accessible and comparable format to facilitate a meaningful comparison of information disclosed for competing products;
  - (e) key information disclosures should be clear, accurate and not misleading to the target investor. Disclosures should be updated on a regular basis; and
  - (f) in deciding what key information disclosure to impose on intermediaries and product providers, regulators should consider who has control over the information that is to be disclosed.

<sup>12</sup> Technical Committee of the International Organization of Securities Commissions, Principles on Point of Sale Disclosure, November 2009. <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD310.pdf>>

83           While much of these disclosure principles are already covered by Australian law, regulation and practice, ASIC has supported the publication of this paper. We also support the assertion in principle (b) above that, as with all disclosure, proposed point of sale disclosure should always be consumer tested before it is finalised.

## G Conclusion

- 84 This address has focused on how market integrity is important for promoting the liquidity and depth necessary to attract investors. The integrity of Australia's financial markets is a vital element in promoting confident and informed participation by firms and investors, thus contributing to an efficient and prosperous economy.
- 85 Although ASIC plays an important role in market integrity within the regulatory policy framework, promoting market integrity requires more than just a good regulatory framework. The key role lies with Boards and management, the gatekeepers and investors. Their ethical behaviour is the prime contributor to a market in which all investors can have confidence that it is 'clean'.
- 86 ASIC is working to address current issues that have been identified that may raise concerns about market integrity, such as rumourtrage, the handling of confidential information, market soundings and investor briefings. ASIC is also working to identify those emerging issues which may become concerns in the future. It too is playing its part!