



ASIC

Australian Securities & Investments Commission

REPORT 32

**Market assessment report:
Australian Stock Exchange /
ASX Futures Exchange
Limited**

August 2004



ASIC

Australian Securities & Investments Commission

Annual assessment (s794C) report

**Australian Stock Exchange Limited
ACN 008 624 691**

**ASX Futures Exchange Pty Limited
ACN 006 599 364**

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Executive summary

Section 794C of the Corporations Act requires ASIC to assess how well a licensed market operator is complying with its obligations as the holder of a markets licence. More specifically, ASIC must assess whether a market operator has adequate arrangements for supervising the market(s) it operates.

This report summarises ASIC's assessment of compliance by Australian Stock Exchange Limited (ASX) and ASX Futures Exchange Pty Limited (ASXF) with their obligations under s792A(c) of the *Corporations Act 2001* (Act).

This is the second ASIC assessment report on ASX and ASXF. The first report (the first assessment report), based on assessment that ASIC carried out in late 2002, was publicly released on 4 September 2003.

The assessment report is divided into three parts:

- The first part is our main assessment report, which summarises our overall assessment, conclusions and recommendations
- Several Appendices set out our detailed findings on ASX group business units that carry out key supervisory functions.
- A table summarising our recommendations and ASX's responses to those recommendations.

Our approach

Our formal assessment of licensed market operators has two aspects.

- *The historical aspect:* we use the assessment process to examine and report on the extent to which we consider a market licensee has, since our last assessment, met and is continuing to meet its supervisory obligations;
- *The future aspect:* we also use the assessment process to identify and comment on areas that may potentially affect the market operator's ability to meet its obligations in the future.

In our view, the historical and future aspects are equally important parts of the assessment process.

As with our first assessment, in this assessment we examined in detail the day-to-day supervisory functions carried out by ASX. In this part of our work, we paid particular attention to the extent to which ASX has responded to issues and concerns we raised in our first assessment report.

However, our approach to the second assessment of the ASX group differs in some respects from our first assessment. In particular, in this assessment we considered broader aspects of the supervisory role of ASX, including the organisational, structural and governance arrangements ASX has adopted to

deliver on its obligations under the Act. We also reviewed in greater detail the arrangements ASX has in place for handling conflicts of interest between its commercial and supervisory functions.

Conclusions

Viewed from the historical aspect, we conclude that each of ASX and ASXF has adequate arrangements for supervising its market, including arrangements for:

- handling conflicts between its commercial interests and the need to ensure that the market operates in a fair, orderly and transparent manner;
- monitoring the conduct of participants in the market; and
- enforcing compliance with its listing rules and business (now market) rules.

ASX Group has experienced staff, long-established operating practices and robust technological infrastructure, which together provide a solid basis for the operation and supervision of a fair, orderly and transparent market.

At the same time, we have identified a number of areas where, to ensure compliance in the future, we think ASX group should strengthen existing ongoing arrangements for supervising its markets and for monitoring and assessing its own compliance with its obligations as a market licensee. Overall, we think ASX has relied heavily on its experienced staff at all levels, and on its established practices, rather than on a more systematic, whole-of-organisation approach to supervision. This creates the potential for less effective supervision over time as long-serving staff leave and market conditions and risks change.

Our key recommendations are that ASX should:

- accelerate steps to restructure its supervisory areas, to ensure a more coordinated approach to supervision and to provide clearer lines of accountability for its supervisory obligations;
- review its arrangements for managing conflicts between its commercial interests and its requirement to supervise its markets; and
- improve the consistency with which it monitors and enforces its listing rules.

These "future aspect" issues do not mean that either ASX or ASXF are currently not complying with their obligations.

Other recommendations build on comments made in our assessment report last year. There has been progress on those recommendations, but in some cases it has been slower than in our view is desirable.

Important notes

- (a) Shortly after our main assessment activities were completed, and before we finalised this report, ASX announced significant changes to the structure

of its supervisory activities by creating a single division, the Integrity Division, which is now responsible for managing all ASX's core supervisory functions.

- (b) We have discussed our recommendations with ASX and, where possible, their comments are reflected in our report. At least in part as a response to those discussions, ASX has also signalled a number of other changes to supervisory practices and approaches. Many of those are now being implemented.

Section 1: Background

1.1 The ASX group

At the time we carried out the main assessment work on which this report is based (November 2003), the ASX group held two Australian market licences under s795B of the Act:

- one issued to ASX covers the operations of ASX's equity, options, debt and warrants markets; and
- the other issued to ASXF covers the operations of ASX's futures market.

An ASX wholly-owned subsidiary, ASX Operations Pty Limited (ASXO), provides the infrastructure and services that support the operation of the ASX and ASXF markets. ASXO provides supervisory resources for both ASX and ASXF, and supervision of both market licensees is largely conducted using common staff and infrastructure.

We therefore conducted our assessment of both ASX group market licensees at the same time, and this report covers our assessment of both licensees.

ASX applied to vary its licence in early 2004. That variation has now been approved, and ASX now operates all of its market activities (including trading in futures contracts) under a single licence. We do not consider these changes in licensing arrangements affect our assessment or the conclusions we draw from it.

1.2 The assessment process

ASIC's role

Section 794C of the Corporations Act requires ASIC to assess at least once a year how well a market licensee is complying with certain of its obligations as a market licensee. That assessment must consider whether the licensee has adequate arrangements for supervising the market, including arrangements for handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the market it operates is a fair, orderly and transparent market.

A market 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 the assessment process to:

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

Assessment process

In conducting our assessment, we:

- interviewed ASX group personnel;
- reviewed policies and procedures for the conduct of ASX's and ASXF's markets in general and their supervisory responsibilities in particular; and
- reviewed extensive material provided under the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

We also considered:

- the annual regulatory report given to ASIC by ASX on 30 September 2003 as required under s792F of the Act; and
- the annual report prepared for the ASX Board by ASX Supervisory Review Pty Limited (ASXSR), and given to ASIC on 30 September 2003.
- information we received from and about ASX and ASXF in the ordinary course of our dealings with each of them as a market licensee, including:
 - information received as part of the rule amendment process;
 - referrals of serious contraventions;
 - the register of listing rule waivers; and
 - ASX's most recent annual report;
- information from external sources, including media commentary and reports published by ASX;
- the operation of the market throughout the period, in particular in relation to issues of disclosure;
- internal ASX and ASXF material, including disciplinary and investigation files, internal reports and information collected by ASX on a continuous basis;
- comments made in interviews with a range of ASX personnel who carry out market supervision functions; and
- discussions with senior ASX management, including members of the board.

From 17 November 2003 to 10 December 2003, we spent some time at ASX offices in Sydney, Melbourne, Adelaide and Brisbane and spoke to a number of business units (see the Appendix). During this period we also held a videoconference with Perth. On 10 December 2003, we held an "exit" interview with ASX to discuss our preliminary findings. We also discussed the final results of our assessment with ASX, seeking their comments on both the factual matters set out in this report and our conclusions.

1.3 Focus of this assessment report

In our first assessment of ASX, we focussed primarily on the work carried out by those units within the ASX group with direct responsibility for supervisory activities.

The assessment covered by this report continued to examine the work done by those units. We paid particular attention to the extent to which ASX has responded to issues and concerns raised in our first assessment report.

In addition, in this assessment we considered broader aspects of the supervisory role of ASX, including the organisational and structural arrangements it has adopted to deliver on its obligations under the Act. This involved a more systematic consideration of the relationship between ASX's role as a listed public company, with commercial objectives to maximise profits for its shareholders, and its obligations as a market licensee to ensure the safety and integrity of the market it operates.

We considered the role of the Board, the role of the Board Audit Committee and the way in which the most senior levels of management with accountability for supervision within ASX discharge their responsibilities. We also reviewed in more detail the arrangements ASX has in place for handling conflicts of interest and the consistency with which it monitors and enforces its listing rules.

1.4 ASX responses and changes

We did much of the assessment work reflected in this report over several weeks toward the end of 2003. In preparing our formal report, we discussed many aspects of it with ASX, to verify findings and conclusions and to discuss possible recommendations.

During this period, ASX made, or commenced work on, a number of changes that have a bearing on, and in some cases respond to, our conclusions and recommendations. Perhaps the most significant of these is the restructure of ASX supervisory responsibilities described in Section <2.4>.

We acknowledge these changes and that many of them are likely to be a means of dealing appropriately with issues we raise in this report. At the same time, it would not be sensible for us fundamentally to revisit the findings and conclusions we have drawn from the assessment work carried out in late 2003. In some cases, the work ASX is undertaking is not complete, and in others it is too early to assess fully what the impact of the changes will be. We expect to be able to answer those questions in our next assessment. However, where possible we have noted ASX's comments and responses on our findings in the relevant parts of our assessment.

Section 2: Conclusions and recommendations

2.1 Overall compliance

After making our assessment, ASIC concludes that ASX and ASXF each generally has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c) of the Act.

This conclusion is based on the following observations drawn from information gathered during the assessment process, and the present operating conditions (including trading volumes and financial products traded on each market):

- 1 No serious market failures or disruptions came to our attention during the course of our assessment.
- 2 In most instances the operating rules and guidance notes provide an adequate framework for a fair, orderly and transparent market.
- 3 Key supervisory areas that monitor the conduct of participants and trading generally have adequate procedures in place.
- 4 During the course of our interviews, key management and staff responsible for supervision demonstrated a strong commitment to their supervisory role and a high level of expertise in the operations of the market.
- 5 Our review of operational records on supervisory decisions showed that:
 - decision-making on supervisory matters is generally sound;
 - ASX conducts ongoing supervision of its participants and listed entities.
- 6 ASX has good market infrastructure (including technology) to support its obligation to maintain a fair, orderly and transparent market.
- 7 ASX demonstrated a strong commitment to educating participants and listed entities in their obligations under the business (now market) rules and listing rules.
- 8 ASX actively shares information on supervisory matters with ASIC.

ASX's own assessment of its supervisory activities

ASX's own regulatory report provides a comprehensive review of the supervisory and educational activities it undertook during the year. Those activities show the active role ASX plays as front-line supervisor of its markets and provides considerable support for our conclusion that it is complying with its supervisory obligations.

In particular, we acknowledge the significant contribution ASX has made to overall market integrity through:

- the leading role it played during 2003-2004 in the review of corporate governance practices in Australia through the ASX Corporate Governance Council. In ASIC's view, this work has made a major contribution by fostering debate about key issues of corporate governance for listed companies, and encouraging best practice in a practical and effective way;
- adapting the market framework, including market rules, to facilitate the single licensing regime introduced by the financial services reform legislation;
- maintaining highly reliable technology systems for its market operations; and
- its educational activities for market participants and users of markets operated by ASX, including retail users.

ASXSR's report

In reaching the conclusions described in this report, we have been encouraged that in many areas our conclusions are similar to those reached by ASXSR. In particular, we note ASXSR's comments on:

- the need for more systematic and formally documented policies and procedures in some areas (such as the Companies area and ASX's derivatives market area);
- its concerns about an "unevenness" of approach to supervision between different supervisory units;
- the need for a more systematic, whole-of-organisation approach to ASX's supervisory functions, including for senior management to develop and action a focused plan for those functions.¹

We note that these comments were made by ASXSR in the context of an overall conclusion that ASX has appropriate policies and procedures in place for performing its supervisory functions.

2.2 Observations and recommendations for future action

Notwithstanding our conclusion on overall compliance, ASIC believes ASX should make changes to, or review, a number of specific arrangements for supervision to ensure continued compliance with its obligations in the future. The changes referred to on pages 13 and 14 are, in our view, an important start, but further work remains to be done.

One set of observations and recommendations reflect the focus in this assessment on the overall approach ASX takes to how it delivers on its obligations as the holder of an Australian markets licence. Organisational structures, internal reporting and accountability, and governance arrangements generally are

¹ ASXSR report pages 16, 21 and 27

important components of a licensee's ability to meet its obligations on a continuing basis. Similarly, comprehensive and effective arrangements for identifying and managing conflicts are essential where there is a continuing potential for conflict between commercial objectives and public supervisory responsibilities. However, neither organisational arrangements nor conflict management arrangements will be fully effective unless there is a systematic, whole-of-organisation approach to compliance with obligations. ASIC's views on these issues and their importance are set out in its Policy Statement 172.

Our observations on these topics and our recommendations for future action are set out in 2.3, 2.4 and 2.5.

A second set of observations and recommendations deals with more detailed aspects of ASX supervision. Topics covered are: consistency in the application and enforcement of listing rules (2.6); the need for more complete documentation of supervisory decisions (2.7); rule waivers, rule amendments and transparency (2.9); ASX's review of disciplinary tribunals (2.8); and a small number of other issues (2.11).

A number of matters we raise in this report were raised in our first assessment report. Good progress has been made in some areas, such as the documentation of supervisory policy and procedures and the supervision of warrants and futures markets. The restructure of Compliance Services (previously Compliance & Information) and its refinement of a number of processes have substantially addressed recommendations made in the first report (see Appendix A4). In some other cases, progress is slower than we had anticipated.

2.3 Supervisory structures and accountability

ASX's governance arrangements for supervision are an important part of ensuring that there are adequate accountability and control systems to ensure that ASX continues to meet its obligations as a licensee. ASX's Board and senior management are ultimately responsible for its compliance with its obligations to supervise its market, including assessing how well it is delivering a fair, orderly and transparent market. For Board and management to be confident that this is occurring, we would expect there to be formal structures for monitoring, testing and reviewing ASX's compliance. This is also important in enabling review of whether sufficient resources are being devoted to supervisory responsibilities.

Assessment process

In this assessment, we examined in some detail the way in which supervisory activities are reported to the ASX Executive General Managers and to the Board. We interviewed the Chief Operating Officer and a number of the Executive General Managers about the way in which they assess the supervisory work undertaken by ASX. We reviewed all ASX's internal reports on supervision over a period of 12 months.

At the time of our assessment, while the Board Audit Committee had a role in assessing risk to the ASX Group, consideration of ASX's supervisory obligations was generally not part of its mandate.

Observation and recommendations

The ASX Board exercises oversight of ASX's supervision, to a large extent, by relying on the work of ASXSR and in particular, the annual report it provides to the Board. Apart from the oversight role performed by ASXSR in relation to listed entities and participants who may have direct commercial conflicts with ASX and who select the oversight option (which may require ASXSR to consider a particular decision), the role of ASXSR does not extend to review of the merits of individual decisions. It focuses primarily on ASX's policies and procedures for supervision. There was some expansion of ASXSR's mandate during 2003-2004, particularly to include for the first time, supervisory oversight of some ASX participants.

Aside from the work done by ASXSR, at the time of our assessment, senior management of ASX with line responsibility for supervisory tasks relied on a combination of internal management reports and management meetings and discussions in satisfying themselves about ASX's continued compliance. These reports, which included reports given to ASXSR on a quarterly basis, provided extensive information on the supervisory activities undertaken by ASX, but were generally confined to quantitative recording of supervisory activity. They did not contain specific analysis of ASX's performance against its licence obligations, nor review underlying trends and issues that may affect ASX's ability to carry out its supervisory functions effectively. Nor did they identify incidents or exceptions to compliance with ASX's obligations that might provide the basis for further scrutiny of supervisory arrangements, or provide for such exceptions to be highlighted.

These observations mirror comments we have previously made about ASX's annual regulatory report. In our first assessment, we commented that the ASX annual regulatory report was largely a statement of activity and that it would be more useful if it provided a more systematic assessment against defined objectives. The report for 2002-2003 provided more analysis of this kind. We note, however, that some statistics in the report are not internally consistent and there is still not a comprehensive explanation of regulatory trends and possible weaknesses in the supervisory framework.

In its report, ASXSR notes that it requested that, "*The focus of the Quarterly Reports it receives be changed from an emphasis on providing details and facts to one of analysis and interpretation of the supervisory activity data provided. ASX agreed to this request and delivered the first report in this format for the June 2003 quarter.*"²

² ASXSR Annual Report p.14

In our view, ASX has tended to favour less systematic mechanisms for undertaking and reporting on its market supervision and has therefore not maintained consistent records of many of its supervisory decisions. This makes it more difficult for ASX to analyse the effectiveness and efficiency of those decisions. This in turn means that those at the Executive General Manager level have been unlikely to receive sufficient information to reliably to assess ASX's overall compliance with its supervisory obligations.

The work of ASXSR provides an additional level of comfort, although as noted, its mandate does not generally extend to review of day-to-day supervisory decision-making, other than in the context of specific conflicts of interest. While ASXSR's mandate is more narrow than the statutory review provided by ASIC, and its methodology for review of ASX supervision is quite different, we are encouraged by the fact that, as noted in section 2.1 of this report, its recommendations are in many respects similar to ours.

Overall, we formed the impression that the review of supervisory issues at this level could be more systematic and complete. ASX places great reliance on the independence of individuals at an operational level to make decisions, including as one answer to its management of conflicts of interest.

Similarly, in considering the resources allocated to supervision, there is considerable reliance on managers to request further resources where they think they are required. We would expect there to be a clearer focus in business planning, or some other process, to test the efficiency and effectiveness of ASX's supervision and the adequacy of the resources being applied to the task.

This level of comparative informality is unlikely to be a reliable way to obtain early warning of emerging weaknesses in the supervisory framework or its administration, or to decide what resources should be applied to supervision.

In addition to the more specific detailed recommendations contained in this report, we think that ASX should, as a matter of priority, accelerate and complete moves toward a more methodical and systematic approach to senior management accountability for supervision, its management of conflicts of interest and its overall approach to testing and reviewing its compliance with its obligations as a market licensee.

January 2004 restructure

On 1 January 2004 ASX restructured its supervisory activities by creating a single division, known as the Integrity Division, which is now responsible for managing and administering all of ASX's core supervisory activities. The new position of chief integrity officer (CIO) has been created to head this division. The CIO will report directly to the managing director and chief executive officer and has an additional reporting line to the Audit and Risk Committee.

The CIO will be supported by the creation of another new position, that of general manager, supervision, who will "lead and co-ordinate" the activities of all core

supervisory areas within the division. ASX advise that they have recognised the need for greater coordination in the state branches of the Companies Department and have appointed a National Manager to lead that function nationally.

Furthermore, ASX has advised that as part of their commitment to develop the internal Group Compliance function they have appointed a senior practitioner to develop this function and to review its reporting lines to the managing director and chief executive officer and the Audit and Risk Committee.

ASX have announced that the objectives of the restructure are to:

- "Facilitate better management of the conflict between ASX's supervisory and commercial roles;
- Enhance the level of coordination of supervisory activity across the organization and improve consistency of approach and outcomes;
- Ensure that integrity concerns are considered at the highest management level and pervade all of ASX's activities; and
- Focus the strategic development of the supervisory capability and regulatory framework to meet changing market conditions and expectations and help to shape the local and international environment."

ASIC welcomes these steps and agrees with the principle that, as far as possible, there should be structural separation of supervisory and commercial roles. The restructure has the potential to address a number of the issues raised in this section. We cannot at this relatively early stage of these developments comment on the full practical effect of these changes.

2.4 Managing conflicts

As a demutualised, for-profit, public company listed on its own exchange, ASX faces a number of potential conflicts of interest. At the broadest level, there is the potential for conflict between ASX's commercial interests, with the objective to maximise profits for its shareholders and its obligations as an Australian market licensee to supervise its market. In its "Issues Paper on Exchange Demutualisation", the IOSCO Technical Committee stated that:

*The commercial role of an exchange is to provide services to generate revenues from listing, trading services, settlement fees, fees for membership and charges for the sale of market information.*³

Demutualisation may have lessened some conflicts by separating ownership of the ASX from its participants. However all for-profit exchanges with public supervisory responsibilities face the potential for actual or perceived conflict, and may be less willing to commit resources to enforcement, or to take action against

³ Report of the Technical Committee of the International Organisation of Securities Commissions, "Issues Paper on Exchange Demutualisation", June 2001 (IOSCO 2001), p.6

market users and listed companies, who are a source of income for the exchange.⁴ In determining its allocation of resources, in setting its rules and in undertaking its supervision, ASX must balance those interests, and ensure that it continues to meet its obligations as a market operator under the Act.

ASX has stated publicly and in its conversations with us during our assessment, that the integrity of its market is a key commercial imperative and that this commercial imperative complements its legal obligation to supervise the conduct of listed companies and participants on its market. We accept that ASX's reputation as a market of high integrity is a key element of the confidence needed to ensure its long-term success as a commercial organisation.

As a market licensee, ASX is specifically required to have in place adequate arrangements for handling conflicts of interest. Accordingly, ASX's commitment to maintaining market integrity must be supported by detailed processes to manage actual and potential conflicts of interest. If ASX is to adequately manage the overall conflicts arising from its dual status as a shareholder-owned public company and a market licensee with a public responsibility to operate a fair, orderly and transparent market, it is important that it both identifies all of the conflicts that it faces and has in place adequate arrangements to either avoid or manage those conflicts. Those arrangements should also be subject to ongoing review for their effectiveness.

In our view, a number of ASX's present arrangements for handling conflicts of interest should be strengthened. In particular, the present arrangements apply too narrow a definition to the recognition of conflicts of interest. The most formal arrangements apply in relation to those entities with which ASX has a direct commercial or competitive relationship and those arrangements appear to be adequate.

ASX places considerable reliance on the role of ASXSR in managing its conflicts of interest, giving it a particular role in reviewing decisions in relation to Review Group Entities and Review Group Participants (which have a direct commercial or competitive relationship with ASX) as well as reviewing its policies and procedures and resources for supervision. In our view ASXSR has operated with genuine independence and has done an effective job in dealing with its present mandate, but that mandate, while broadened in the past year, remains quite narrowly defined.

Outside those specific circumstances however the arrangements are less formal, the relevant codes of conduct do not adequately identify the full range of conflicts and they are not in all cases well understood or effective in practice. In our view, to the extent that ASX needs to recognise the broader scope of conflicts it faces and improve their overall arrangements, there is also scope for a broader mandate for ASXSR, which has demonstrated a willingness to expand its focus and to give robust scrutiny to issues that have come to its attention.

⁴ IOSCO 2001p.7

Conflict management arrangements

ASX has a number of documents that deal with conflict management. In our view the most detailed and practical conflict procedures relevant to Companies at the time were set out in two ASX documents. These are the ASX Group Compliance Plan dated September 2003 and the Companies Department Code of Conduct.

A third document, "Approaches to Conflict Management" provided a higher level discussion and review of conflict issues. The document refers personnel to the respective Codes of Conduct and to another high level document titled "General Conflict Handling Arrangements". The Group Compliance Plan refers to the Codes of Conduct that are to apply in each business unit. The Compliance Plan does not explore the nature and scope of what is to be considered a conflict beyond the situation where ASX has a direct commercial or competitive relationship with the nominated entity and is therefore dealt with under the procedures agreed with ASXSR in relation to such entities. Similarly the Companies' Code of Conduct does not consider conflict beyond this scenario.

The Code requires Companies personnel to exercise their delegated powers for proper purposes and to resist being influenced by such things as personal gain or advancement. The Code says that any attempt to influence the outcome of an exercise of power should be referred to various national coordinators within Companies. It is silent on whether or not there will be any variation to the normal Companies decision-making processes, as described in ASX Guidance Note 17, in the event of a conflict situation arising that is not defined in the Code.

Barriers to information exchange

The Code of Conduct contains provisions that mandate the quarantining of information: "Information obtained from entities and Companies exercise of Powers will at all times be quarantined from the commercial areas of ASX."

The Code allows disclosure and discussion if prior approval is obtained from a State manager or national coordinator "if there is a valid market integrity reason." The Code does not define what a "valid market integrity reason" might be. Nor does it identify what areas within ASX are to be regarded as "commercial."

The Code does not deal with situations where "commercial" areas seek to communicate with a listed company on supervisory matters, nor does it provide any protocols for these areas in seeking to comment on supervisory decisions delegated to Companies.

Conflicts – a case study

Immediately prior to beginning our 2003 assessment, a matter was brought to ASIC's attention involving suggestions that a business unit primarily concerned with the commercial interests of ASX (Listings Business Development unit (LBD)) became involved in and sought to influence the outcome of an application for in principle advice being considered by a supervisory unit (the Companies Department (Companies)).

Under the structure in place at the time of our assessment, each of these units fell within the Issuers & Market Integrity Division of ASX (IMI). Their activities however are quite different. The work of LBD might be broadly described as attempting to grow the suite of products traded on ASX and to encourage new companies who wish to list on ASX. Companies is responsible for the administration of the listing rules, including approving applications for admission, determining requests for rule waivers, providing guidance on interpretation of the listing rules and monitoring disclosure by listed companies so as to ensure that they are continuing to comply with the listing rules.

Outline

Personnel from the LBD were aware that an application for listing would be made prior to this application being made to Companies. LBD made email contact with the relevant Companies Branch to advise that an application for listing would be made and that "in principle" advice on the operation of certain listing rules would be sought. LBD also asked that it be kept advised of progress of the application.

While the application was being considered, LBD were approached by the applicant for assistance with its application to Companies for in principle advice. As a result, LBD both consulted with the applicant and sought to discuss the merits of the issue with Companies staff. Based on the material obtained by ASIC there is no evidence that procedures for quarantining information between the commercial and supervisory areas were referred to in this process.

There is a risk in these circumstances that LBD may have appeared to be acting as the applicant's advocate in relation to a significant supervisory decision. In our view, it is inappropriate for those undertaking a commercial function within ASX to seek directly to influence a particular supervisory decision as an advocate of a customer of ASX.

In the particular situation we examined, and under the ASX procedures in place at the time, it appears ASX's existing conflict handling arrangements:

- did not require IMI to notify any party outside of IMI that a potential conflict may have arisen; and
- did not apply because they only mandate procedures to be followed in narrowly defined situations. These are situations where ASX as a listed entity has a direct commercial or competitive arrangement with a nominated entity.

Conclusions

Our examination of this matter highlighted two issues:

- the adequacy of ASX's conflict management arrangements as they applied to this matter; and

- the clarity of the policy basis for some listing rules and therefore the extent to which they can be consistently and effectively applied by ASX Companies staff and understood by listed companies.

We do not think the supervisory decision ASX made was in fact flawed as a result of conflict. However, the events associated with the making of the decision highlighted shortcomings in ASX's arrangements for handling conflicts of interest between its commercial objectives and its obligation to supervise its market.

ASX's conflict handling arrangements in place at that time were not adequate for the situation that arose in this case. Based on the documents obtained by ASIC, none of the ASX personnel involved in this matter appear to have made any reference to conflict handling arrangements. This indicates that the need to observe conflict handling arrangements is not embedded in the practices of the operational areas.

No internal ASX document set out the process that should have been followed in a situation that might produce a conflict between ASX's commercial activities (for example, in attracting listings) and its obligations to supervise the market (for example, by applying its listing rules in a way which might lead to a disincentive to list).

ASX told us that no internal Code of Conduct was breached in the handling of the application. We are not persuaded this is correct, but in any event the relevant Code was inadequate in these circumstances.

The matter also highlighted a lack of clear definition in some ASX listing rule policy, which has implications both for the consistency of internal ASX decision-making and for the transparency of its administration of the listing rules.

We discussed this matter with ASX senior management, who expressed the view that the events in question were an example of robust policy debate that became over heated. They also indicated that it was a policy debate in which LBD had a legitimate interest, and pointed to internal processes that enable staff to escalate such debates internally.

While we accept there was a genuine policy dispute at the heart of the matter, we do not think the process that enabled LBD to have ongoing communication with the entity on its request for interpretation of the listing rules, as well as discussion with the Companies officers dealing with the request, was consistent with good practice for managing conflicts.

We note ASXSR also considered the issues that arose out of the particular conflict issue referred to above and wrote to the ASX Board about it. ASXSR's conclusions in relation to the events were similar to ours. We are encouraged by ASXSR's actions in this instance.

We also note that it was difficult to form a definite conclusion about the policy applied in this case, as ASX's Guidance Note and internal documents did not

provide a clear statement of the underlying rationale for the relevant rules and their applicability to the particular facts in this case.

Other conflict issues

During the course of the assessment we reviewed other material which highlighted the potential for conflicts of interest between the commercial interests and the supervisory obligations of ASX.

For example, in some business planning documents considered at the senior management level, business development considerations and allocation of resources to commercial activities did not appear to be matched by a corresponding focus on supervisory issues and resources.

We are also aware of proposals to increase the focus on customer relationship management by the Companies staff who also have day-to-day responsibility for monitoring compliance with the listing rules. Effectively managing interactions with ASX customers is not incompatible with effective supervision, but it creates a potential risk that customer relationship activities may detract from the ability or willingness of supervisory staff to enforce the listing rules in appropriate cases. This risk needs to be carefully managed. It is also important that such activities do not result in a practical reduction in the resources available for monitoring and enforcement of the listing rules.

Recommendations

We recommend ASX adopt a Code of Conduct for all business units. The Code should identify a broad range of possible conflicts of interest and set out arrangements for dealing with them. The use of Codes should not be confined solely to those areas with primary supervisory responsibilities.

We also recommend that ASX review more generally its conflict handling arrangements to ensure that all conflicts are properly identified and that there are clear procedures in place to deal with any conflict between ASX's commercial objectives and its obligations to operate and supervise a fair, orderly and transparent market.

Finally, ASX should review its internal policy-making processes to ensure that there is a clear understanding and articulation, both within ASX and externally, of the policy behind its listing rules. Where guidance does not cover a particular set of facts, there should be clear escalation procedures to ensure that any necessary consideration of broader policy objectives can take place. More clarity in this regard would help diminish the possibility of conflicts in interpretation internally and would assist in identifying legitimate policy considerations. It would also contribute to greater certainty in the application of ASX's operating rules and is also relevant to our comments in relation to the reliance on rule waivers later in this report.

2.5 Processes for ensuring compliance

In our first assessment report, we noted ASX did not have a centralised approach to compliance with its licence obligations and that the degree of systematic risk analysis and planning for supervision varies widely between business units. We commented that current ASX practices fell short of the guidelines in ASIC Policy Statement 172 (PS 172) and that ASX's approach to planning for and evaluating compliance with its licence obligations needed to be developed.

We noted that ASX was in the process of improving its coordination and planning for supervisory activities; that ASX had a draft group compliance plan; and that ASXSR was also having a positive influence in driving procedures documentation and better capturing supervisory actions.

ASX agreed to review its overall approach to demonstrating compliance with its statutory obligations and said that it was still considering the appropriate structures to achieve this. These measures were to include the appointment of a compliance manager tasked to ensure compliance with statutory licence obligations. The compliance manager was to be given responsibility for development of a framework for reporting against statutory obligations by the end of September 2003. ASX said it would undertake a more rigorous trend analysis of supervisory matters.

A group compliance manager was appointed in August 2003 and the immediate objectives of preparing group compliance plans and a reporting framework have been achieved.

In our view, however, full adoption of a revised approach by ASX has been slower than is desirable. Employing a compliance officer was a positive step, but that officer, at the time of our assessment, did not report to a sufficiently senior level within ASX to ensure they would be in a position to influence compliance outcomes. In a relatively short time, the compliance officer sought to revise and strengthen ASX's compliance plan and internal policies. They were, however, also required to assume a number of tasks previously performed by other ASX personnel. As a result, there appears to have been limited time to drive a change in ASX's overall approach to compliance.

During our assessment, ASX management continued to express a preference for less formal compliance structures rather than comprehensive record-keeping and reporting.

In our view, ASX's processes for planning for compliance and monitoring and assessing its own compliance still fall short of the standard contemplated in PS 172. Without these more formal processes, it is hard to see how ASX can in the future be confident that it can comply with its obligations and plan for emerging compliance risks. We recommend the adoption of such processes without delay.

The compliance officer must have the appropriate authority to influence compliance outcomes and to bring to the attention of the most senior levels of

ASX any compliance failures or risks. We also recommend that the resources for compliance be reviewed to ensure that the compliance officer has sufficient resources to allow comprehensive compliance planning, monitoring and review of ASX's compliance with its obligations under the Act.

ASX has recently appointed a senior practitioner to develop the compliance function and has reviewed the reporting line so that the function now reports directly to the Managing Director and CEO and to the Audit & Risk Committee.

2.6 Consistency in listing rule enforcement

Issues in our last assessment report

In our last assessment report, we expressed concern about consistency of decision-making across ASX, particularly in issues that arose across business units. We said that some inconsistency also seemed to show up across various Companies state offices. We recommended that ASX develop more detailed procedures for monitoring decision-making across business units and home branches to promote consistency in interpretation of its business and listing rules and in supervisory decision-making.

ASX told us in 2002 that it relied generally on a series of internal meetings as its major way of promoting consistency across the business. In response to our report, ASX told us that they were reviewing any inconsistencies in approach between their Surveillance and Companies areas. ASX anticipated amendments to internal procedures to be in place by the end of September 2003.

In July 2003 a written agreement was put in place between Market Surveillance and Companies to deal with the management of differences of opinion in the area of disclosure, in particular continuous disclosure.

In this assessment we have revisited these issues in further detail.

This assessment

During our November 2003 interviews, Companies personnel generally expressed satisfaction with the degree and quality of interaction between these key real-time supervisory units. However some case files we reviewed suggest a need for further work in the area of cooperation between the units. The trend is less evident than in our previous assessment, but we still observed instances where ASX staff in one business unit have not considered particular market behaviour to be an apparent breach of ASX listing rules and therefore have not taken action to query or suspend a company, while staff in another business unit have considered the same facts sufficiently serious to formally refer the matter to ASIC for consideration of enforcement action. In these instances, ASX's own apparently inconsistent view on the application of its rules may make it more difficult for ASIC to pursue action.

Consistency in applying the listing rules: Companies offices

ASIC looked in more detail this year at the level of consistency across the different Companies offices, particularly in relation to monitoring and enforcing the disclosure provisions of the listing rules.

We were assisted in this by a statistical analysis Companies have undertaken over the last two years of queries raised with listed entities by Companies about disclosure. The analysis indicates significant and on-going variations between offices. In some states, a listed entity is twice as likely to receive a disclosure query from ASX as in other states. A listed entity is also less likely in some States to be required to make further disclosure as a result of such queries.

Companies have explained many of these variances as being a result of the differences in the profile of the entities listed in the respective States. In our view not all of the variances are explained by these factors. A more detailed analysis of this issue is contained in Appendix A2 of this report dealing specifically with the Companies Department.

In our discussions, a number of ASX staff at all levels have expressed the view that the interpretation of listing rule 3.1 requires an exercise of judgement in each specific instance and needs to be applied with some flexibility. We do not accept this proposition as a general description of the continuous disclosure regime. We acknowledge that in some instances fine exercises of judgement may be required, but in others – perhaps the majority – we do not believe there is, or should be doubt as to how the listing rules apply.

It is important for both market transparency and business certainty that, as far as possible, the application of the listing rules is clear on its face and supported by detailed and robust market guidance. ASX issues guidance notes and has issued a comprehensive guidance note on the application of listing rule 3.1. In some instances, however, ASX staff do not appear to apply the listing rule consistently with that guidance note.

ASX might improve consistency in the administration of its listing rules in a number of ways. Clearer policy and guidance, adhered to by operational Companies staff, would go some way to improving the consistency and transparency of ASX's listing rules. There may also be a need for more centralised decision-making on issues that do not fall within the range of issues contemplated by ASX Guidance Notes.

In our view, there were inconsistencies in ASX's monitoring and enforcing of compliance with the disclosure provisions of the listing rules, including in the area of continuous disclosure. We recommend that ASX review the reasons for this inconsistency as a matter of priority and take steps to reduce it. We also recommend that ASX put in place arrangements to ensure that consistency of decision-making in monitoring and enforcing its listing rules is maintained and is reviewed on an ongoing basis.

ASX have responded to this analysis by advising that they accept the need for greater consistency across State offices and for better documentation of supervisory activity and decision-making in some areas and have committed to achieve this. ASX advise that the restructuring referred to above, particularly the appointment of a National Manager, Companies, will advance this outcome.

Cross unit coordination of compliance with the listing rules

ASX uses a number of detailed mechanisms for monitoring compliance with its operating rules. Key mechanisms are the work undertaken by:

- the Surveillance Unit, which systematically monitors trading and price movements, electronic media and broker reports; and
- the State Companies offices, which monitor media reports, review continuous and periodic disclosure made by companies, and make contact with companies, either informally or through the use of formal query letters, to obtain disclosure where there appear to be gaps.

If these processes work effectively together, as is generally the case, they provide good mechanisms for monitoring and obtaining compliance with the operating rules, particularly the key continuous and periodic disclosure rules.

However, we note that only Companies staff have authority to grant a trading halt or impose a suspension where there is an uninformed market. Instances of disorderly trading will often first be identified in the Surveillance unit. Current ASX processes require Surveillance staff to notify the relevant Companies officer if trading anomalies cannot be explained by information in the market. The Companies officer will then generally query the company and seek an explanation for the anomalous trading.

ASX sets internal target times to encourage timely notification of matters from Surveillance to Companies where trading may indicate an uninformed market. Nonetheless, this process can result in some delay between noticing anomalous changes in price or trading volume and disclosure being obtained. In addition, the inquiry made of the company may not be conclusive where, for example, the company is not aware of reasons for the apparent disorderly trading, such as false or unsubstantiated rumours circulated by someone unrelated to the company. Separating the monitoring of market disclosure from detection of indicators of possible non-disclosure may increase the risk of inefficiencies.

We suggest ASX undertake a review to satisfy itself that the split of these functions between different business units does not result in unnecessary delay in acting to correct some instances of non-disclosure.

We further recommend that ASX review whether, in some circumstances, it should consider adopting a more readily available mechanism to prevent trading where it appears that there is a disorderly market, and therefore that it may not be in the best interests of the market for trading to continue while the reasons for that trading are investigated.

Enforcing the listing rules

The listing rules play a vital role in ensuring that trading on ASX's market takes place in an informed environment, and therefore that that market operates in a fair, orderly and transparent way. Effective enforcement of the listing rules is a critical factor in ensuring compliance by listed entities with their obligations under the rules. An effective enforcement regime will generally provide the tools to ensure correction of any rule breach and be sufficiently robust to discourage non-compliance.

ASX's business rules (now market rules) generally govern trading behaviour and broker recognition and conduct and ASX has in place the National Adjudicatory Tribunal that can impose disciplinary penalties on brokers for breaches of the rules or prohibited conduct.

ASX has more limited tools for dealing with breaches of its listing rules. This is particularly so with non-disclosure based rules. ASX's Companies Department Policies and Procedures note that it has available the following courses of action⁵:

- suspension;
- formal retrospective waivers;
- issuing "no action" letters;
- issuing "non-compliance" letters requiring corrective action; and
- referral to ASIC under the Memorandum of Understanding.

ASX also has the ability to institute legal proceedings for breach of contract or pursuant to section 793C of the Act, although this is not referred to in the Companies Policies and Procedures and we are not aware of any instances where ASX has pursued this course. In any event, it is not likely to be an efficient mechanism to obtain real time market disclosure.

The threat of suspension is clearly a strong incentive to persuade companies of the need to disclose information. In practice, suspensions are generally only imposed for breaches of periodic disclosure requirements, such as non-lodgement of financial reports, or for failure to pay listing fees. ASX suggests that this is because timely disclosure outcomes can generally be achieved other than by actual suspension, and therefore suspension is used only as last resort.

Suspension is used only to remedy defective disclosures, and not for other breaches of the listing rules. We agree with the view expressed by Companies officers that trading suspensions are potentially detrimental to shareholders and unsuitable once disclosure concerns have been corrected.

Trading halts cannot be imposed by ASX and can be put in place only at the request of the entity concerned.

⁵ Listing Rule Breach Document Kit Document BR01 Procedures

In this situation, we query whether ASX currently has a fully effective range of remedies available to it to ensure that listed entities comply with their obligations under listing rules, and that ASX can take effective enforcement action if those rules are breached.

Many of the tools available under the listing rules are of limited benefit in the enforcement of those rules, particularly after disclosure has been obtained, or for those rules that do not deal with continuous or periodic disclosure, such as rules in relation to notices of meeting or shareholder approvals.

We recommend that ASX review how it enforces the listing rules, to satisfy itself that it has sufficient mechanisms to achieve practical enforcement outcomes. It may consider, for example, whether there should be an enhanced power in the operating rules for officers to prevent trading where it appears that there may be a disorderly or uninformed market. It may also consider whether some other sanctions may be appropriate, where there has been a breach of the listing rules, but which may not justify enforcement action by ASIC, which we can generally only take for breaches of the Act.

2.7 Documenting supervisory decisions

Our previous assessment

In its first assessment report, ASIC commented that ASX did not have consistent protocols for recording supervisory decisions and the extent to which supervisory decisions are formally recorded across ASX business units varied widely. We said that we accept the need for a degree of flexibility in how matters are recorded (given the varied supervisory responsibilities and structures of business units). We also said, however, that it was important for ASX to continue its push to better capture and record its supervisory activities.

We said in the earlier report that this issue was particularly important in the key supervisory areas of Investigations and Enforcement, Compliance and Information [now known as Compliance Services] and Companies, where it was sometimes difficult for ASIC to clearly understand the reasons for supervisory decisions on the basis of the information reviewed.

We expressed the view that all significant supervisory activities and decisions, whether or not they result in a disciplinary or other outcome, should be recorded and that recording procedures should be sufficient (within the demands of each business unit) to facilitate appropriate scrutiny of all significant supervisory activity, both for internal ASX compliance purposes and by ASIC as part of our assessment.

This assessment

Based on our latest assessment, it is clear that the standard of record keeping in ASX supervisory units has improved and is generally at an acceptable standard. The exception, however, is in the area of recording of supervisory activities

associated with ensuring compliance by listed entities with the disclosure provisions of the listing rules.

Companies is the largest supervisory business unit and due to the need to have Companies officers available to deal with the requirements of listed entities in each State, is the only supervisory unit not centrally located. It is the key real time supervisor of disclosure on all ASX markets. Achievement of its mandate poses unique challenges to ensure consistency that are not present in any other ASX supervisory business unit. In the context of our concerns expressed above regarding consistency of decision-making within Companies, we recommend that ASX review as a matter of priority the standard of record keeping in this area.

ASX has advised that it accepts the need to improve the documentation of supervisory decisions and has committed to achieve this.

2.8 Review of disciplinary tribunals

The National Adjudicatory Tribunal

The Act requires ASX to have, as part of its arrangements for supervising the market, arrangements for enforcing compliance with the market's operating rules. To this end ASX convenes a number of peer review tribunals to hear cases of alleged failures by participants to comply with ASX operating rules.

The most active of these tribunals is the National Adjudicatory Tribunal (NAT), which hears allegations of breaches of business rules or prohibited conduct by a participating organisation or an affiliate.

In our first assessment report we recommended that NAT penalties and outcomes be reviewed. ASX had undertaken its own reviews of NAT in 2000, 2001 and 2002. These reviews had made recommendations similar to those suggested by ASIC, but had not been fully implemented by ASX.

We are concerned that ASX has not acted on its own recommendations to deal with shortcomings it has identified in its supervisory arrangements. This particular instance suggests that ASX has not made available sufficient resources, nor given sufficient priority, to implementation of those recommendations.

ASIC recommends that ASX develop penalty guidelines that specify the range of penalties available for a breach of each rule. This will ensure that participants and panel members are aware of the types of rule breaches that the ASX considers to be minor and technical and the types of rule breaches that are more significant in terms of market integrity and investor protection.

ASX advised in February 2004 that a paper outlining a methodology to be used by the disciplinary tribunals in determining penalties had been developed. It said that the guidelines "will lead to greater consistency in penalty decisions as well as bringing Disciplinary Tribunal decisions in line with penalties in overseas jurisdictions." The paper does not provide any timeframe for implementation of those guidelines.

We also recommend that ASX formalise induction or training processes for panel members. In February 2004 ASX advised that it would support its new penalty guidelines "by education for Panel members in relation to procedure and evidence and a newsletter providing details of disciplinary decisions in other jurisdictions."

We also recommend that NAT decision-making should be better documented so that it is clear that the NAT has examined the evidence of a matter and determined the outcome based on that evidence. We also recommend that tribunal policies and procedures be consolidated and updated.

A policy or code of conduct should also be developed to deal with conflicts of interest. A central register of panel members should be kept that records identified conflicts, the panels that each member has sat on, training undertaken by each panel member, and so on.

ASX has now advised that a code of conduct for NAT has been adopted.

2.9 Rule waivers, rule amendments and transparency

A market's operating rules play an important part in ensuring that that markets are conducted in a fair, orderly and transparent manner. The legislation provides that rules adopted by a market operator are subject to regulatory scrutiny through the rule disallowance process. This process helps ensure that the framework a market operates within has been carefully scrutinised to ensure it meets the public policy goals underlying market regulation, and is predictable and transparent to market users and participants.

For this process to be effective, the rules should ordinarily determine what takes place on the market and what the conduct of the market operator and market participants should be. ASIC accepts that market rules will not be able to cover every situation the market operator will face, and therefore that it is appropriate for a market operator to have a waiver power to enable it to adapt its rules to cover unusual circumstances or cases.

However, in our view the operating rules should be the basis on which the market operator makes most of its supervisory decisions, including decisions about products that are to be traded on the market. Waivers should be the used only for exceptional cases not contemplated by the rules. If those "exceptional" cases become the norm for the market, then the rules should be amended to deal with them. Publication of waivers granted provides some transparency, but not to the same level and degree of certainty that is provided when matters are clearly set out in the market's operating rules. Reliance on waivers also has the potential to undermine the Ministerial disallowance process that is required for amendments to operating rules. It can also result in a lack of comprehensive review of the policy and supervisory processes that ought to accompany substantive changes to the operating rules.

Our previous assessment

In our first assessment report, we identified some instances where ASX has relied on long-term rule waivers (rather than rule amendments) to facilitate the introduction of new products or the development of particular markets. The most significant examples were in the rules for warrants and admission to trading of exchange-traded funds (ETFs). In the case of warrants, ASX had recognised the need for a review of the relevant operating rules but it had not been given priority due to other rule changes associated with FSR implementation being dealt with first.

We advised that rule amendments dealing with warrants had been informally lodged with ASIC and that rule amendments in relation to ETFs were expected to be released for public comment in May 2003.

This assessment

ASIC is concerned with the state of progress in this area. The ETF amendments were deferred for some time and were informally lodged with ASIC in February 2004. The changes required to the warrant rules to eliminate the need for standard waivers for warrant issuers were formally lodged only shortly before we undertook our assessment in November 2003 so that their effectiveness in reducing the quantity of waivers could not be readily measured through this assessment. We note that during the 2002/2003 financial year, however, some 3000 waivers of Chapter 8 of the business rules (dealing with warrants) were granted by ASX.

Apart from the granting of standard waivers, our main concern with the warrant rules is, as discussed in our earlier assessment report, that the rules do not regulate warrant issuers' obligations to act as market makers in relation to certain warrant series, even though an agreement to make a market is obtained from warrant issuers as a matter of routine. We are aware of instances where the absence of a market maker has led to disorderly trading in the warrants market, but at present, in the absence of a specific rule, ASX does not monitor this obligation. We have advised ASX of our continuing concern about this aspect of the rules.

There were also 901 waivers of the listing rules, only some of which were addressed by rule amendments contemplated by ASX in its October 2003 exposure draft and subsequently implemented early in 2004. As an example, reliance has been placed on rule waivers to facilitate the increasing number of "jumbo" placements in the market, yet this issue has not been dealt with in the rule amendments.

In ASIC's view, the heavy reliance on rule waivers reduces the transparency of ASX's rule framework.⁶ ASX does publish details of listing rule waivers on its

⁶Over 4,100 waivers were granted in the 2002/2003 financial year. This figure includes waivers from both the business rules and listing rules and also includes waivers granted to OCH participants as, in the September 2002 and December 2002 quarters, the figures were not separated.

website after they are granted. It does not publish, nor did it until May 2004 provide ASIC with, details of waivers granted from its business (now market) rules.

As each waiver of the listing rules entails individual analysis of a particular application and consideration on the basis of a formal paper to the Companies National Management Meeting, it also appears to be a highly resource-intensive process for ASX. This has the potential to reduce the amount of time available to Companies staff to engage in front line supervision of its rules.

As stated in our first assessment report, ASX should not continue to rely on rule waivers as an alternative to amendments to its operating rules and we recommend that ASX devote more resources to analysing its rule waivers and implementing changes in its rules as appropriate.

We recommend that the details of market rule waivers granted should be sent to ASIC on a monthly basis. ASX have agreed to this. We further recommend that details of market rule waivers should be published on ASX's website. The information provided should include the reasons for the decision to grant the waiver.

2.10 Complaints handling

ASIC noted in its first assessment report that ASX did not have a centralised system for recording and handling complaints about trading, participants or listed entities. In our view a centralised complaints system is an important part of any compliance framework. We recommend that consistent with our views in PS 172 ASX should institute a centralised system for recording and tracking all complaints.

At the time of this assessment the practices for recording and responding to complaints were much the same as had been the case in the earlier report. However, a new system and its associated procedures have been agreed upon and we understand that it will be introduced across the ASX in early 2004. No specific date has been provided for implementation.

2.11 Other issues

Interest Rate Market and Structured Products

The business units known as the Interest Rate Market and Structured Products are two units that have both business development and supervisory responsibilities. Their supervisory activities and responsibilities, while not minor, are less significant to ASX as a whole when compared to those of the core supervisory units. However, our assessment is that the supervisory practices of these units need substantial improvement.

Issues of concern with these units include the adequacy of policy and procedure documentation, conflict handling arrangements, the standard of record keeping and enforcement practices.

Our detailed recommendations for these units are set out in the relevant business unit reports. [Refer to Appendices A6 and A7]

Market surveillance systems

ASX has an obligation to monitor participants and do all things necessary to ensure that the markets it conducts are fair, orderly, and transparent. Its electronic market surveillance system, SOMA, has been in use for some time as a tool to identify possible disorderly trading, market manipulation, or indicators of market disclosure inequalities. Based on the declining number of alerts generated per trade, the low number of those alerts which ultimately lead to further action by either ASX or ASIC and its declining importance in the tools that ASX's Surveillance Unit uses to identify possible areas of market misconduct, it would appear that this system is becoming outdated.

We recommend that the replacement of SOMA be made an operational priority for the unit. ASX advised in February 2004 that it was planning to implement a new market surveillance system. Completion of this project is planned for the third quarter of 2004.

Memorandum of Understanding

ASIC and ASX have been working for some time on revising the various supervisory Memoranda of Understanding ("MOUs") between the two organisations. A new MOU to replace a number of the current MOUs was signed by ASIC and ASX on 30 June 2004.

Appendix: Additional Information

Individual business units

This appendix explains in more detail our assessment process for some individual ASX business units and provides further information in support of our conclusions in relation to Companies, Surveillance and National Adjudicatory Tribunal processes. It also includes detailed reports and recommendations in relation to the Interest Rate Market and Structured Products Business Units, which we think raise a number of important issues that are specific to those units.

We also undertook comprehensive reviews of a number of other business units. Our previous assessment report provided a detailed overview of the functions of most ASX business units with some supervisory responsibility and provided considerable detail of the work we undertook. We have not repeated all of that work in this report. We have included some comments where we believe there has been some significant change since our last assessment. In particular, we have provided a comprehensive update for Compliance Services (previously known as Compliance and Information) to reflect structural changes and a number of other positive steps undertaken since our previous assessment.

The Business Units we reviewed were:

- Market Integrity
- Companies Department
- Market Surveillance
- Investigations and Enforcement
- National Adjudicatory Tribunal
- Compliance Services
- Client Relations
- Customer Services
- Legal Division
- Structured Products
- Interest Rate Market
- SEATS Market Control
- Derivatives Market Control

We note that many of these business units undertake functions relating to the supervision of the clearing and settlement facility licences held by the ASX group. Our assessment does not cover those activities.

A1 National Adjudicatory Tribunal

Role of unit

The National Adjudicatory Tribunal (NAT) is a peer tribunal comprising three persons chosen from a panel of members. NAT hears charges of breaches of business (now market) rules or prohibited conduct by a Participating Organisation or an Affiliate. Charges may be contested or uncontested.

A legal adviser supports NAT. The role of the adviser includes: the coordination of the tribunals' activity; liaison with the parties; advising the tribunal members on procedural issues arising during a hearing; undertaking research; preparation of briefing papers for the tribunal; and the drafting of tribunal decisions.

In the 2002-2003 financial year NAT determined 15 fast track matters and 13 hearings. Of those 2 were appealed to the Appeal Tribunal.

Assessment process

Documents and information reviewed

We reviewed the following documents during our assessment:

- NAT Policies and Procedures;
- NAT Procedural Guidelines for Disciplinary Hearings; Procedures for appointment of persons to the Disciplinary/Appeal Tribunal; General Procedures for NAT Disciplinary Hearings; Principles Governing Composition of NAT and SCHDT (Securities Clearing House Disciplinary Tribunal); Guidance Note 3/01 on "ASX Disciplinary Hearings"; "Role of adviser to NAT and SCHDT";
- 27 randomly selected NAT files ranging from 1 January 2002 to the date of the onsite visit;
- NAT and SCHDT Annual Report to the Board, September 2003;
- Criteria for Independence;
- "Disciplinary Tribunal Penalties A Discussion Paper", November 2003;
- Disciplinary Tribunals Review Paper, June 2002; and
- Code of conduct.

On-site visit

We interviewed the legal adviser to NAT.

Observations

Review of NAT penalties

In our first assessment report ASIC recommended that "ASX conduct a review of NAT penalties and outcomes to satisfy itself that the Tribunal continues to be effective in providing a disincentive to breach the business rules". The ASX advised that the "*Tribunal policies and procedures were in the process of being reviewed and that there was a proposal to review penalties and the functions of the NAT for October 2003*".

During this assessment it came to our attention that ASX has conducted formal reviews of the Disciplinary Tribunals in November 2000 and June 2002 and an informal review in October 2001. The issues raised by ASX during its 2002 review process included the concern "*that fines remain low...and at times appear overly low*" and the concern was expressed that this may "*indicate that either ASX is out of step with industry practice or that the tribunal does not have a full understanding of the ramifications of certain breaches in terms of market integrity*".

ASX has adopted some of its own recommendations from its 2002 report, for example, engaging an in-house NAT adviser. Also, ASX has as part of the 2003 NAT review process prepared a discussion paper entitled "Disciplinary Tribunal Penalties", November 2003. The paper has recently been circulated within ASX for comment.

A review of NAT files and ASX Disciplinary Circulars indicates that the fines are still low. There were instances where the fines imposed were overly low: a fine of \$8500 was imposed for 142 breaches of the rules and similarly a fine of \$5000 was imposed for 132 breaches.

ASIC is concerned that whilst ASX has been aware of issues surrounding NAT and is conducting internal reviews on a regular basis, progress made with respect to this issue has been slow. ASIC supports the recommendations made in the ASX 2002 review of NAT report. The implementation of these recommendations needs to be given priority.

Panel Members and the Conduct of Hearings

ASX relies on internal procedures and guidelines and the services of the legal adviser to govern the conduct of a hearing. There are no specific procedures in place for what the role of the Chairperson of NAT involves, nor of what is expected of panel members.

ASIC notes that the 2002 NAT review report recommended "bi-annual training seminars be offered to the Chairman and Deputy Chair, dealing with procedural and policy issues and an induction course should be provided for new tribunal members and for newly appointed Chair and Deputy Chair". ASIC supports this recommendation. Panel members are not given any particular training upon appointment to the Panel or at any later stage.

We note that NAT relies on the NAT adviser to ensure that proceedings are conducted with procedural fairness and to assist on questions of law that may arise. The NAT

adviser indicated that there were instances whilst he was in the position where parties were being represented by senior counsel who argued on the correct interpretation of particular business rules and that NAT were at times unsure of the appropriate response. In these instances, it was the role of the adviser to guide NAT on the interpretation of the rules.

ASIC considers that the ASX ought to consider this issue when appointing panel members and ensure that once appointed panel members receive ongoing training. We note that ASX has, in appointing the 2004 panel, considered current financial market practice in appointing four new panel members. For example, candidates with derivatives or on-line experience were actively sought.

NAT Determinations

The Procedures for Fast Tracks provide that "fast tracks are usually held by teleconference". A review of the files indicates that in some fast track matters, the Tribunal did not conduct a teleconference to discuss the matter but rather expressed agreement by email with a document containing a draft determination and a suggested penalty. In that instance, there was no evidence on the file to suggest that there was any consideration by the Tribunal of whether the evidence supported a finding that a rule was breached.

None of the files reviewed contained any contemporaneous notes taken by the adviser, or any other person, during the course of a hearing or discussion to assist in drafting a determination. Some files contained errors in draft determinations that were prepared by the NAT adviser. ASIC notes that the NAT adviser role has been undertaken by up to five different persons during the 2002-2003 period. ASX has now addressed this issue by appointing a permanent adviser to NAT. However, ASIC is of the view that the files should contain:

- in a fast track matter (that is not conducted via a teleconference) evidence that NAT considered the material presented; and
- in non fast track matters, contemporaneous notes taken which will assist the adviser in drafting a determination.

Policies and Procedures

ASX have indicated that whilst the policies and procedures are currently being reviewed, they are updated as the need arises. There were instances where documents clearly relevant to NAT procedures and policies did not form part of the formal documents:

- A number of files contain a checklist for the NAT process, this checklist however, is not included in the policies and procedures.
- ASX provided ASIC with a document titled "Role of adviser to NAT and SCH DT", this is also not in the procedures.

ASIC also sighted two versions of the "Criteria for independence" document. ASIC is of the view that the NAT policies and procedures ought to be consolidated to ensure that all relevant documents are available to personnel and tribunal members.

Panel member conflicts of interests

The current process for establishing whether a panel member has a conflict of interest in relation to a matter involves asking the member directly. This process is not formalised. Some files contain emails that show the question being asked and response given, however the majority do not contain any references to this process. ASIC is concerned that there is no central register kept of the conflicts of panel members.

A2 The Companies Department

Role of unit

Companies has primary responsibility for ensuring that entities listed on the ASX comply with the listing rules. This unit assesses prospective new listings, makes decisions on the application and waiver of the listing rules, and promotes, monitors and enforces on-going compliance with the listing rules.

The point of contact for each listed entity is the Company Adviser in the listed entity's designated home branch. There are home branches in Sydney, Melbourne (which also takes responsibility for Tasmanian based entities), Perth, Brisbane and Adelaide. A State Manager heads each home branch.

At the date of our assessment, 1541 entities were listed on the ASX.

Assessment process

Our assessment this year focussed on what we considered to be the main areas of risk in relation to Companies and included a follow-up on issues raised in our first assessment report. These are:

- complaints handling;
- record-keeping and file management;
- monitoring and enforcing disclosure based listing rules;
- monitoring and enforcing non-disclosure based listing rules;
- listing rule waivers and amendments;
- conflicts handling; and
- adequacy of resourcing and funding.

The new listings process was not included as we were satisfied with these arrangements in our previous assessment. We have also relied on the work done by ASXSR in reviewing this area and the results of that review in its report.

Our assessment involved an examination of the unit's policies and procedures and supervisory reports. During our on-site visits, we reviewed a cross-section of listed entity operational records and held interviews with State Managers. We also discussed specific case-examples of the supervisory activities undertaken by home branches.

Documents and information reviewed

We reviewed the following during our assessment:

- Companies - Policies & Procedures;
- Companies - Complaints Register;
- Companies - Monthly, Quarterly and Annual Activity Reports for the year ended 30 June 2003;
- Monthly ASX waiver reports for the year ended 30 June 2002;
- ASX listing rule amendment Exposure Draft, October 2003;
- Market Surveillance Unit referrals on alleged listing rule breaches; and
- External information sources including IRESS.

On-site visits

We conducted on-site visits in Sydney, Melbourne, Adelaide and Brisbane and interviews were held with each State Manager to discuss the main areas of operational risk. State Managers were also interviewed about some specific case examples. Although Perth was not included in these visits, a videoconference was held with the State and Assistant Manager to discuss some particular cases.

We selected and reviewed the files for approximately 100 listed entities. The files contained information relating to an entity's on-going compliance with the listing rules, applications for admission of further securities and waiver applications and decisions. Where available, we also reviewed the electronic records held on these entities.

Observations*Complaints handling*

In our assessment last year, we concluded that complaints handling is left largely to the discretion of individual Company Advisers. There was no central group register of complaints against listed companies and no uniform protocol on how they should be recorded. This remains the case. Although there has been some progress since the appointment of the Compliance Officer in August 2003, these plans were in their early stages at the time of assessment in November 2003. Initial approval for a centralised complaints handling process was given by the Risk and Audit Committee in December 2003. ASX advised in February 2004 that these new complaints handling procedures were being put into operation.

Record Keeping and File Management

In our assessment last year, we stated:

"The Companies Department has no written protocol that sets out what activities or documents are to be recorded on an entity's file. Filing processes appear to be largely at the discretion of the particular Company Adviser. In the extensive sample of files reviewed, there was no consistency in the file maintenance practices across the unit, nor does it endeavour to maintain a complete record of the supervisory activity for an entity. Accordingly, reviewing a case file is not a reliable means for understanding the supervisory history of an entity.

Monthly internal reports of supervisory actions taken are compiled and these are a better record of the supervisory work undertaken... Our conclusion that the level of supervision of listed entities is appropriate is to a significant degree reliant on our overall impression that the personnel involved are knowledgeable and that the processes for monitoring disclosure appear satisfactory. This is supported by our review of monthly and other internal reports."

Since that assessment, no single record keeping procedure has been implemented and these processes are still largely left to the discretion of Company Advisers. Each home branch holds some supervisory records in hard copy files and some in electronic records. With the exception of waivers, the retained records for supervisory work in most State offices do not provide a complete and reliable representation of an entity's supervisory history. Whilst monthly activity reports are a better record of supervisory activity, they largely lack the necessary detail to permit understanding of the reasons for decisions on particular matters. The retained records in the smaller home branches were significantly more complete but in our assessment, only one home branch maintained a standard of record keeping that enabled a comprehensive review of the work undertaken by personnel.

To keep informed of developments, State Managers rely on the Monthly Activity reports, which in some cases are updated daily. These are a better record of the supervisory work undertaken and appear to be a useful management tool. However, in our view the Monthly Activity reports do not provide sufficient information to assess whether the supervision undertaken is adequate.

Monitoring and enforcing disclosure based listing rules

The Companies procedures require media reports to be monitored and continuous and periodic disclosure to be reviewed in a timely manner. They are assisted by referrals from the Market Surveillance unit, which monitors share price movements, electronic media and broker reports.

In our report last year we said that procedures were required for resolving differences of view between Market Surveillance and Companies over supervisory action to be taken or in making referrals to ASIC. Procedures were implemented between these units which appear to be adequate on their face. There continue to be instances of inconsistency, however, in the consideration of some cases, as evidenced by our conversations with ASX staff and our observations in relation to some ASX referrals.

In our assessment last year, we also expressed concern about consistency in monitoring and enforcing the disclosure provisions of the listing rules. We concluded in our previous report that:

"At present ASX relies generally on a series of internal meetings as its major way of promoting consistency across the business. We recommend that ASX develop more detailed procedures for monitoring decision-making across business units and home branches to promote consistency in interpretation of its business and listing rules and in supervisory decision-making".

In this year's assessment we focused on this issue in some detail. We have found that while the general standard of monitoring and enforcing is satisfactory, not all offices within the unit undertake these activities with equal degrees of rigour.

ASX explains these variations by pointing out that there are differences in the profile and character of listed entities within different States. However, this does not always provide a complete explanation. For example, there is inconsistency in the activities and outcomes from the monitoring of the listing rules in circumstances where different states are broadly comparable in terms of size and activities. We would expect that that over time each group would tend to generate similar levels of supervisory attention. For example ASX figures indicate that an entity based in one State is twice as likely to be queried than its counterpart in another State.

Further, when an ASX query is raised one office is much less likely than all other Companies offices to require the entity to make an announcement.

ASX's own analysis of variances across Companies' offices does not seek to explain all of the differences. Given record keeping and management practices that prevailed during our assessment, ASIC is not able to form any specific conclusions about the reasons for these variances.

Management of monitoring practices

Last year we drew attention to the reliance being placed on the knowledge and experience of Company Advisers to ensure monitoring and enforcement of the listing rules is adequate. The methods used by State Managers to supervise the monitoring practices across the unit in our view should be strengthened. For example, the effectiveness of the Monthly Activity reports is predicated on the escalation of issues to the State Manager by Company Advisers.

Similarly, the daily review conducted by State Managers of "un-actioned" announcements on CAP presupposes "actioned" announcements have in fact been properly reviewed by Company Advisers and that any disclosure issues have been identified and followed up.

When this issue was raised with managers, a regular comment was that if any significant issues were missed they would be picked up in the market, either by the media, brokers or investors. In ASIC's view this is not satisfactory, particularly given that not all listed entities are the subject of routine media or broker scrutiny.

Press review

Each home branch undertakes a daily press review of the weekday and weekend newspapers to identify disclosure issues that may require clarification by a listed entity. The press review is conducted prior to the start of market trading at 10:00am EST. Disclosure issues may be escalated to the Daily Morning Meeting held at 9:30am EST and attended by all State Managers, except Perth due to time differences. The purpose of this meeting is to share information with a view to ensuring consistency in monitoring and enforcement practices

Trading halts and suspensions

During our assessment ASX personnel displayed a general reluctance to suspend entities in situations where disclosure concerns had arisen. This reluctance was reflected in the relatively low number of suspensions that resulted from this type of situation.

Reviewing preliminary final and interim reports and audited account:

In some offices it was difficult to determine if Company Advisers had assessed periodic financial disclosure reports for listing rule compliance. We regard these announcements as particularly important where a material variation to the profit number is announced which may suggest prior non-disclosure under listing rule 3.1. We also observed an inconsistency in the methods used across the unit to review such reports. It is difficult, however, to form a conclusion on this issue in view of the record-keeping and file management practices of the unit referred to above.

Education programs

The unit's personnel stressed that they seek to engender a "culture of disclosure" amongst listed entities rather than "wielding an enforcement stick". They pursue this objective by conducting an ongoing program of education and regular liaison with listed entities and market professionals. During the 2003 financial year, ASX advised that as part of their educational campaigns they hosted 143 events that were attended by over 5,100 industry professionals. The Companies Department also held its orientation programs during the 2003 financial year which were attended by 297 company representatives.

Listing rule waivers and amendments

In our assessment last year, we commented that the waivers process appeared to ensure a high level of consistency and transparency for waiver decisions.

This year, it became apparent that the unit spends a considerable amount of its resources dealing with rule waivers. 970 waiver applications were made during the year and 901 were granted. While this is down from the previous corresponding period of 1167 and 1099 respectively, this is still significant considering the total number of listed entities. An analysis of the waivers granted demonstrates that approximately one third of all waivers related to listing rules 7.1 and 10.11. The ASX's Exposure Draft, October 2003 proposes to amend the listing rules relating to capital raisings' and should alleviate the number of waiver applications. However, not all 7.1 type waivers will be covered by these rule amendments (e.g. jumbo placements) nor will the vast bulk of waivers in general.

A3 Market Surveillance Unit

Role of unit

The Market Surveillance unit is responsible for identifying and investigating unusual trading activity on the ASX markets that may indicate possible contravention of its operating rules or the Act. Depending upon the nature of the trading pattern and the suspected contravention, the unit may make referrals to other ASX business units or to ASIC.

Assessment process

In our assessment this year, we revisited issues raised in our first assessment and reviewed the unit's main areas of operational risk. These are:

- supervision of the warrants and futures markets;
- supervisory reporting structure;
- interaction with other supervisory business units;
- monitoring disclosure based listing rules;
- staffing levels;
- record-keeping;
- implementation of the new alerting system;
- upgrading of alert parameters; and
- changing market conditions and modifications to supervisory practices.

The assessment involved a review of the documentation set out below as well as on-site visits to review operational case files, a sample of SOMA alerts and to interview the unit's personnel.

Documents and information reviewed

We reviewed the following during our assessment:

- Markets Surveillance Products - Policies and Procedures; and
- Monthly reports prepared by Market Surveillance during the period 1 July 2002 and 30 June 2003.

On-site visit

During our on-site visit in Sydney we interviewed the Market Surveillance Manager and the Senior Analyst of Investigations. The Senior Analyst provided a presentation on the unit's responsibilities and how these are fulfilled covering such matters as the type and method of analytical tools used in the monitoring of trading. An analyst also provided a real-time demonstration of SOMA (Surveillance of Market Activity) and the "coding" of an alert. A number of informal discussions were also held with analysts during the course of the visit.

We selected and reviewed a sample of 50 operational case files. The files related to Market Surveillance investigations and primarily contained information such as SOMA reports and other forms of research, correspondence with participants, internal analysis and referrals to Companies and ASIC.

Observations

The Market Surveillance unit utilises SOMA as its primary electronic platform for identifying abnormal trading patterns. SOMA will trigger an alert in relation to unusual trading activity if that activity falls within pre-determined parameters. Trading data can then be used to generate detailed and complex reports on the trading activity of listed securities with a view to identifying suspected malpractice for further investigation.

We observed that on average SOMA generates 280 alerts each trading day. The unit aims to analyse and code these alerts within 30 minutes. If an alert is received that cannot be explained, the unit may contact or refer the matter to the Companies, contact relevant brokers or commence a formal investigation.

Market Surveillance also reviews trading on the basis of its review of media articles, broker research and complaints.

Supervision of the warrants and futures market

In our previous assessment, we concluded that the supervision of warrants and futures should take into account the specific risks arising in relation to those products, particularly where the underlying security is not supervised by the ASX.

In our assessment this year, we observed that Market Surveillance has developed such written procedures.

Interaction with other supervisory business units

In our report last year, we said that procedures were required for resolving differences of view between Market Surveillance and Companies over supervisory action to be taken or in making referrals to us. Procedures were implemented between these units. However the degree to which substantive cooperation takes place between the units is hard to evaluate.

Monitoring disclosure based listing rules

The unit supports Companies in monitoring compliance with the continuous disclosure provisions. To this end Market Surveillance monitors internet chat sites devoted to share trading, electronic media and broker research. Information is passed to the relevant Companies Adviser as required. The unit will notify the Companies Adviser of trading activity that may suggest a disorderly or uninformed market.

During our on-site visit, we were informed that contact between Market Surveillance and Companies, particularly in relation to listing rule 3.1 disclosure issues, is mostly done on a real-time basis via telephone or email contact.

In our view the division of disclosure monitoring (as opposed to monitoring of trading) between Companies and Surveillance is difficult to understand and creates a risk of inefficiency and loss of information between the two units. It has also contributed to inconsistent referrals to ASIC on particular enforcement matters.

Record- Keeping

Hard copy and electronic files are generally of a high standard. The records enabled us to track through issues, work undertaken and outcomes.

Implementation of a new alerting system

ASX is currently considering a replacement for SOMA. We were informed at the time of our assessment in November 2003 that a decision would be made in the next few months about a new alerting system and that it would be in production by the end of June 2004.

During our on-site visit, we were informed that alterations and amendments to the pre-determined alert parameters had been put on "hold" since the beginning of the 2003 calendar year. This was said to have been due to the work being done on identifying a replacement for SOMA. It is currently the intention of the unit not to make any alterations or amendments to these parameters until a replacement has been implemented.

While trading volumes on ASX markets have been increasing in recent years the effectiveness of the SOMA alert system in identifying instances that require further explanation appears to have been decreasing. The number of queries as a percentage of total trades is declining while the number of occasions that have lead to a referral to companies has declined significantly and progressively in recent years.

	2001	2002	2003
No. of Alerts as a % of total trades	0.61%	0.49%	0.45%
Number of Alerts	85,377	76,071	69,453
Number of referrals to Companies	388	220	99

ASX suggests that this result reflects an improvement in the rate of compliance by listed entities.

A4 Compliance Services Unit

Role of unit

The Compliance Services business unit was, at the time of our last assessment, known as Compliance & Information. The change of name has not resulted in any change to the responsibilities of the unit.

Compliance Services is headed by a National Manager and forms part of the Market Services Division. The unit contains two discrete sections:

Participant Information Services – A group that maintains the Market Services' databases, provides data analysis services and publishes data regarding participants.

Compliance Services – A team of Compliance Advisers responsible for monitoring and promoting compliance by participants with relevant rules and regulations as well as ensuring participants and potential participants satisfy ASX requirements for recognition.

Our review focused on the activities of the Compliance Services (CS) section only.

CS represents a key part of the ASX supervisory structure and its activities include:

- providing compliance approval for the recognition and admission of participants;
- granting or refusing waivers from business (now market) rules;
- monitoring ongoing compliance with business (now market) rules;
- providing ongoing rule interpretation and education to participants, in particular Responsible Executives;
- conducting self-assessment and inspection programs;
- withdrawing or suspending rights of trading and recognition; and
- referring potential rule breaches to Investigation and Enforcement.

Assessment process

Our previous assessment of this business unit was primarily concerned with understanding the tools and methods used to monitor the ongoing compliance of participants.

In our previous report we made several recommendations dealing with levels of documentation and file management procedures. The recommendations relevant to this unit were:

- minimum levels of information be retained on each participant file;
- capturing follow-up actions as a result of complaints; and
- systematic recording of the results of compliance activity.

In addition, the key risk areas we wanted to target in this assessment were:

- structure and potential for influence by operational areas in supervisory decisions;
- co-ordination with other supervisory business units;
- the balance between programmed and reactive activities; and
- risk targeting and business planning.

Our methodology remained consistent with our previous assessment in that we reviewed a selection of participant files and, where necessary, discussed them with the relevant Compliance Adviser to measure the adequacy of procedures and the consistency of their application. However, in order to better test the effectiveness of the CS procedures to monitor ongoing compliance, we reduced the overall number of participant files reviewed and incorporated a detailed review of contemporaneous public information as well as that held within ASIC systems to gain an understanding of the issues affecting the relevant participants during the period.

Documents and information reviewed

We reviewed the following documents and files during our assessment:

- CS policies and procedures including template documents;
- issue reports provided to Executive Management;
- weekly Waivers/Inspections/Complaints/I&E matters/Participant issues report;
- self-assessment related material; and
- 15 participant files (including correspondence, inspections, rule waivers, referrals and complaints).

On-site visits

We interviewed the National Manager, covering the following topics:

- structural changes introduced in CS since our last assessment;
- staff training;
- participant education;
- interaction with other business units; and
- responsibilities and reporting.

We had discussions with several Compliance Advisers on specific matters arising from our review of participant files.

We attended the weekly meeting of all members of CS. Topics covered included:

- current work and issues;
- rule waivers;
- filing procedures; and
- business planning.

We conducted a secondary interview with the National Manager and the Compliance Services Manager covering the following topics:

- filing procedures;
- rule waivers;
- self-assessments; and
- inspections.

Observations

Structure, Resources and Planning

CS has undergone a restructure since our last assessment, centralising all operations in Sydney. While recognising there are important regional differences among participants, the restructure was designed to ensure consistency of process and decision-making.

As was the case last year, Compliance Advisers are assigned as the primary contact for a number of participants. The restructure involved a significant reallocation of participants amongst the Client Advisers and we observed that they each had considerable knowledge of the participants for which they were responsible. The Compliance Advisers indicated that their rapid understanding was the result of information dealing with business plan, organisational structure, management experience and qualifications provided by participants as they transfer to the Responsible Executive regime.

Ongoing advice and education of participants remains a key tool of CS to facilitate compliance by participants. There appears to be an increased focus by industry on the role of their internal compliance function and CS continue to develop lines of communication to assist in the early identification and resolution of problems. CS actively promotes the need for participants to provide adequate resources to support their compliance function. In order to highlight the need for minimum educational standards it is planned that each ASX Compliance Adviser will obtain accreditation from the Australian Compliance Institute.

Another structural change in CS has been to create a manager position to monitor the day-to-day operations allowing the National Manager to focus greater attention on systemic issues and strategic planning. This was a relatively recent development and therefore we were unable to measure the impact of this initiative on the performance of the business unit. However, we note that CS plans to incorporate improved delivery mechanisms, particularly web-based mechanisms, to support its ongoing supervisory work. CS also plans to pilot a new self-assessment methodology that will allow participants to undertake an operational risk and control analysis against the CS database of industry best practice.

The weekly meeting of all CS staff remains a significant forum for discussion of participant-specific and general compliance issues. We note that the meeting we attended also included an active discussion of business planning and Compliance Advisers were encouraged to provide input to improve risk targeting.

Record Keeping

In our previous assessment we outlined the importance of capturing the results of compliance activities and the reasoning used in making supervisory decisions. This was in part to assist our assessment process but also to provide Compliance Advisers with a complete and reliable picture of a participants' business structure and compliance history. As a result of our recommendation, CS has introduced a documented filing procedure to ensure a consistent standard and easy location of hard and soft copy information.

Our on-site review showed some minor inconsistencies in file maintenance, however collation of appropriate information had substantially improved. We were able to get a clear sense of the level of CS interaction with each participant and the key issues encountered. Our observation in relation to the Inspection/Referral files is that as these can often extend to many lever arch files it would be worthwhile considering inclusion of some form of summary of issues and outcomes for ease of reference.

Rule Waivers and Rule Rewrite

Notwithstanding our observations in Section 2 of this report regarding the use of rule waivers, we observed that CS had undertaken some analysis of the rule waivers it granted and in one instance recommended a rule amendment that had subsequently been introduced (requirement for employees to trade only through employer participant). The National Manager advised that he intends to undertake more extensive trend analysis of both granted and declined waivers and where appropriate would provide further guidance to the market or recommend rule changes to improve processes.

ASX has undertaken a major rule rewrite and in response CS has established a weekly process to review, as a group, the new rules chapter by chapter discussing the implications of changes. The National Manager described this as a very useful process that has led to a much better understanding of the rules, more consistent interpretations by the CS team as well as highlighting certain inconsistencies. Investigations & Enforcement have joined in this process of review and consideration of interpretation. A substantive outcome of this initiative is that CS will in February 2004 be providing internal training across ASX on the new rules.

ASX advised in February 2004 that a procedure is being established to deal with waiver notification across core supervisory areas and that it was anticipated that this system would be operating in the 3rd quarter of 2004.

Complaints Handling

In our previous assessment we noted that the files maintained in relation to complaints about participants lacked documentation dealing with follow-up action. At that time we were advised that the National Manager reviewed the register every 2 months to ensure that no serious matters were overlooked. We recommended that a more systematic approach to data capture and review of complaints be introduced.

CS has now introduced written procedures for handling complaints relating to participants and Compliance Advisers are actively involved in complaints assessment. Information systems have also been improved to better capture information including classifying the relative seriousness of each complaint and noting the results of ASX involvement. Information relating to complaints is used to identify potential compliance structure weaknesses when preparing for a participant inspection.

Supervisory Co-ordination

CS interacts with both commercial and supervisory business units through a combination of scheduled meetings and informal interactions.

The most significant interactions take place with the Investigations and Enforcement business unit on a monthly basis to discuss the progress of referrals made by CS as well as identification of trends that might lead to future referrals. Our previous report recommended that records relating to referrals include information on follow-up activities conducted or required, and the subsequent results. In this assessment we were able to see, to a much greater extent, the finalisation of referrals by I&E and any subsequent follow-up activity by CS.

A5 Legal Division

Role of unit

ASX Legal Division provides in-house legal services to the ASX business units. Legal Division now comprises three practice groups who report to the position of General Counsel:

- Trading and Clearing and Settlement (Trading);
- Issuers and Quoted Products; and
- Corporate and Commercial.

Since our last assessment the Trading and Clearing and Settlement practice groups have been merged.

Our assessment focussed on Trading and Quoted Products practices. This is because these practices have responsibility for the ASX and ASXF operating rules, including in particular, the rule amendment process.

Assessment process

Documents and information reviewed

We reviewed the following documents during our assessment:

- An organisational chart for the Legal Division;
- ASX internal procedure and policy documents relating to the listing rule and business rule amendment process;
- Legal Division Register of requests for business rule amendments;
- ASX analysis of waivers of the listing rules for the period 1 July 2002-30 June 2003 (analysis undertaken for one quarter of the period);
- Compliance Services Business Rules Waiver Report for the period 1 July 2002 – 30 June 2003;
- Monthly reports to the ASX Board for the Legal Division;
- Agendas, papers and minutes of the Business Rule Committee for meetings occurring during 1 July 2002 – 30 June 2003 and documents tabled at those meetings; and
- Circular resolutions of the Business Rules Committee considered during 1 July 2002 – 30 June 2003 and material accompanying the circular resolutions.

We also considered in this context material reviewed in the course of our review of other business units and material available to ASIC through its ordinary dealings with ASX and ASXF.

On-site visit

We interviewed from Legal Division the Legal Counsel and Team Manager of Issuers and Quoted Products and two lawyers from the Trading practice group. We also raised questions relevant to our review in our interviews with Executive General Manager, Market Services, Executive General Manager, Issuers and Market Integrity, National Coordinator Market Integrity and National Manager, Compliance Services. Specific issues were also discussed with the Compliance Officer.

Topics included:

- the process for the identification of operating rule amendments;
- the process for the amendment of operating rules;
- Legal Division's procedures;
- the analysis of waivers of operating rules undertaken by ASX; and
- the membership of, and process followed by, the Business Rule committee.

Observations

In our first assessment report last year we recommended that ASX:

- use rule amendments rather than relying on rule waivers to facilitate the introduction of new products or the development of new markets; and
- develop more detailed procedures for rule amendments including a more systematic approach to consulting other business units on rule amendments.

Use of rule waivers

During last year's assessment we noted that ASX had relied heavily on its waiver power to facilitate the introduction of new products or development of new markets. In particular, we identified that this approach had been taken in relation to the listing of Exchange Traded Funds (ETFs). We also noted that the warrant rules were routinely waived.

Although ASX advised us that proposed amendments to the listing rules for ETFs were expected to be released for public comment in May 2003 no such release had occurred at the time of our assessment. Warrant rules to eliminate the use of standard waivers were formally lodged with ASIC on 24 October 2003.

We have a concern that the obligations to which issuers are subject are, through the repeated use of waivers for similar circumstances, being eroded without the transparency and regulatory checks involved in making a formal amendment of the listing rules. According to the ASX Annual Regulatory Report for the year to 30 June 2003 there were 901 waivers granted (section 3.3, although the Listed Entities Waiver Analysis set out in section 1.4.3.2.1 indicates a figure of less than 600 waivers). The ASX Annual Regulatory Report for the year to 30 June 2002 indicates that 1099 waivers of the listing rules were granted during that period.

In contrast, the ASX Annual Regulatory Report for the year to 30 June 2001 identifies 389 listing rule waivers granted. Many of the listing rule waivers granted over the 2001/2002 and 2002/2003 financial years concerned the same rules and a significant number were concerned with similar situations.

The immediate concern associated with the use of waivers is the progressive detrimental impact on the transparency of how ASX operates its market and the de facto amendment of the listing rules without the opportunity for Ministerial disallowance. However, the high number of waivers also has an adverse impact on the resources available within Companies to monitor disclosure at an acceptable standard in acceptable timeframes.

The fact that ASX's current practice is to amend listing rules with effect only once a year means that it is particularly important for ASX to act quickly to consider rule amendments if there is any pattern emerging from the waivers granted or waivers are being granted due to a change in ASX's policy. At the date of the assessment ASX had released an exposure draft for proposed amendments to the listing rules designed to eliminate the need for some further waivers in circumstances where they have been routinely given in the past. ASIC has been informed that further more technical amendments will also take effect at the same time. At the date of the assessment visit (November 2003) ASX had not, however, completed its assessment of the waivers to identify where waivers have been given in similar circumstances throughout the 2002-2003 year.

Procedures for rule amendments including a more systematic approach to consulting other business units on rule amendments

During our previous assessment we noted that there was a lack of procedures relating to operating rule amendments and specifically that the relationship between ASX Legal Division and other business units in respect of the rule amendment process was not structured.

ASX has now developed more detailed procedures for both Listing and Business (now market) Rule amendments, which include procedures for consulting with other business units. This is a considerable improvement.

A6 Structured Products

Role of unit

Structured Products Unit (SPU) is part of the Issuers and Market Integrity Division of ASX. SPU approves new warrant issuers, admits new warrant series to trading status and is responsible for monitoring the ongoing obligations of warrant issuers under Chapter 8 of the ASX Business (now Market) Rules including warrant issuers' obligations to make markets in warrant series.

SPU is a relatively small team with approximately half of its full time equivalent personnel of 7 involved in promoting and educating investors about the warrants market. We did not review this aspect of SPU's operations.

The Market Surveillance Unit is responsible for monitoring trading in warrants on ASX's market. Similarly, Compliance Services (formerly Compliance and Information Unit), not SPU, is responsible for monitoring the conduct of brokers in relation to warrants. Accordingly our comments on these business units also reflect the adequacy of ASX's supervision of the warrants market.

Assessment process

We spoke to the National Manager of SPU and reviewed all of SPU's documented procedures and policies. We also reviewed a range of operational files.

Documents and information reviewed

We obtained and reviewed all of SPU's documented policies and procedures. We also reviewed SPU's operational records and files including the following:

- adjustments to warrant terms (July 2002 to June 2003);
- trading halts imposed by SPU in relation to warrant series (March 2003 to November 2003);
- complaints received by SPU from warrant holders, issuers and participants in relation to the warrants market (received between August 1999 and November 2003);
- all of the files known as the 'Issuer Correspondence Files'; and
- files known as the 'Issuer Reporting Files' for a selection of current warrant issuers (5 of 10).

On-site visit

We interviewed the SPU National Manager in relation to the following areas:

- SPU's organisational structure and the relative proportion of personnel responsible for supervision;
- SPU's supervision of warrant issuers' market making obligations and the responsibilities and practices of SPU, Market Surveillance and SEATS Market Control regarding this function;
- How SPU works with other supervisory business units including Market Surveillance, SEATS Market Control and Compliance Services to supervise the warrants market. In particular we queried the existence of protocols and procedures between these different business units;
- SPU's general supervisory policies and procedures. In particular we queried whether these are sufficiently detailed;
- SPU's record keeping practices regarding its supervisory activities. We queried whether SPU's ongoing supervision of the warrants market is systematically recorded; and
- The way complaints are currently handled, recorded and tracked by SPU.

Observations*Policies and procedures for supervision*

We reviewed all of SPU's most current policies and procedures relating to its supervisory work. The two documents entitled 'Structured Products Supervisory Function' and 'Structured Products Policies and Procedures' respectively outline SPU's supervisory functions and broad processes. While useful as descriptions of SPU's approach and broad practice, in our observation these documents utility in assisting SPU personnel to systematically and consistently undertake supervision of the warrants market is limited as they are not sufficiently detailed. For instance in relation to SPU's supervision of warrant issuers market making obligations, the procedures do not identify the practical steps SPU personnel undertake to carry out this supervision in any detail. In our general observation we think that there is too much reliance on the accumulated experience and expertise of SPU personnel and not enough importance placed on documenting practice.

Supervision of warrant issuers' market making undertakings

Currently the obligation that warrant issuers act as market makers on applicable warrant series is not reflected in the operating rules. ASX is undertaking a review of the policy issues involved in reflecting warrant issuers' market making obligations in the operating rules. At present warrant issuers are required in most cases to give ASX an undertaking to act as market makers. In our view SPU does not have a clear procedure for the supervision of warrant issuers' compliance with this undertaking.

The following reflects the extent of SPU's written procedures about market making. The 'supervision of ongoing compliance with the undertaking is conducted by each of

Structured Products, [Market] Surveillance and SEATS Market Control. Potential breaches are identified through combinations of periodic market monitoring (through IRESS and directly through SEATS), SOMA price alerts, broker/investor compliance, and issuer notification. Any potential breaches are directed to the Structured Products area for investigation.⁷

We were advised that SPU periodically and randomly monitors IRESS to see if bids and offers are in the market but there are no written procedures to this effect and furthermore no written records are kept of any such surveillance done. In this way it is not possible for ASIC or (we assume) SPU management, to determine if such surveillance is undertaken. We understand that complaints received from warrant holders and participants about the availability of prices are actively followed up by SPU, but records are not systematically kept where the complaint is not written, so we had no means of verifying this claim. We also note that a complaint about the absence of prices, from a holder wishing to sell warrants for instance, may take time to follow up during which time the market may move disadvantaging the holder.

SEATS and SOMA have no functionality to monitor market-making activity automatically such as by generating an alert when there is no bid and offer on an applicable warrant series. Personnel in Market Surveillance and SEATS Market Control are capable of randomly inspecting the market for an absence of prices. However, while ultimately responsible for the supervision of this obligation, SPU has no documented protocols or other forms of procedures about Market Surveillance's or SEATS Market Control's oversight of market making in the warrants market.

Referral process / interaction with other supervisory business units

In our assessment last year we noted that SPU had a number of routine interactions with other business units of ASX, however in some cases there was no formal framework for the referral of matters of a supervisory nature to other business units such as Market Surveillance, Compliance Services, and Investigations and Enforcement. SPU has developed procedures for referral of matters to Compliance Services, and Investigations and Enforcement. We do not think that the procedure deals adequately with the recording of such referrals. For instance the procedures do not require SPU to log such referrals.

There are no central or summarised records kept of SPU's referral of matters to other business units. In particular SPU appears to keep no records of referring supervisory matters to other business units unless the matter was a written complaint.⁸

Record keeping

In our previous assessment, we found that SPU dealt with new warrant issue applications in a consistent and efficient manner and that the use of checklists and sign-offs contributed to the ease with which files could be read and understood. We

⁷ *Structured Products Supervisory Function* p.4

⁸ We formed this view because, in response to our notice asking for all records of incidents of warrant issuers failing to make markets and all referral of supervisory matters to and from SPU, we were given one file of 15 written complaints covering 1999 to date.

also commented that SPU should better document its record keeping regarding the suspension of warrant series ordered by SPU through SEATS Market Control. We observed better record keeping practices have been adopted in this regard. We also noted in last year's assessment that SPU should keep files for each warrant issuer, so that information on monitoring of warrant issuers is readily available. From the selection of issuer files we reviewed including the Issuer Reporting Files and the Issuer Correspondence Files, the files were not kept in a way that addressed this concern insofar as it was possible to readily determine if and what kind of monitoring had been performed, for instance as regards whether each warrant issuer continued to meet the criteria for approval in rule 8.6.

Complaints

In our assessment report last year we noted that SPU should develop better policies and procedures in regard to complaints and the referral of complaints to other business units. We also note ASX's broader intentions to review and centralise its complaints management function. SPU have developed interim procedures, however in our observation these do not adequately deal with how SPU personnel should record, investigate and resolve a complaint (although they may be useful in describing what complaints SPU should deal with vis a vis complaints that should be forwarded to other areas of ASX).

Recommendations

We recommend that SPU should:

- Further expand and develop its written procedures for its supervisory functions.
- Review its supervision of warrant issuers' market making obligations and generally adopt a more systematic approach.
- Continue to review its record keeping practices including considering a greater reliance on the use of the use of checklists and sign-offs to record any monitoring undertaken.
- Further refine its interim complaints handling procedures to ensure that complaints it receives are properly investigated and resolved by SPU personnel and that they fully record both the type of and reasons for any action taken.

ASX advised in February 2004 that work will be undertaken to address ASIC's concerns. It said that written procedures will be reviewed and enhanced, a checklist to record monitoring would be adopted where appropriate and that a procedure developed in December 2004 for improving record keeping in relation to complaints will be implemented.

A7 Interest Rate Market

Role of unit

Interest Rate Market ("IRM") undertakes different functions depending on whether the listing application is made by a new applicant or by an entity already admitted to the list in relation to equity securities. Where the applicant has not previously been admitted to the list, IRM reviews the listing application and prepares a Management Paper making a recommendation in relation to the listing of the entity. The application is formally considered by Companies at the National Management Meeting. Where an applicant is already listed on the ASX in relation to equity securities, the application for listing is reviewed and processed by Companies, with IRM vetting the documentation relating to the debt securities proposed to be quoted.

The responsibility for on-going supervision of the market in debt securities is divided between Companies and IRM, with IRM primarily responsible for monitoring compliance with continuous and periodic disclosure obligations of wholesale-only debt issuers.

Assessment process

We interviewed IRM personnel, reviewed all of IRM's documented policies and procedures and a selection of its operational files.

Documents and information reviewed

We reviewed the following during this year's assessment:

- All of IRM's policies and procedures that were provided pursuant to ASIC notice dated 31 October 2003;
- IRESS and the ASX website for information in relation to periodic reporting by debt issuers;
- All IRM files regarding new admission to the official list (there were 7 in total); and
- A sample of files maintained in relation to wholesale debt issuers that have already been admitted.

On-site visit

We interview relevant ASX personnel in relation to the following areas:

- The issues raised by ASIC in its 2002 Assessment Report, particularly in relation to monitoring compliance with periodic reporting requirements; IRM policies and procedures regarding processes for quotation of debt securities; passing on referrals/notifications to another business unit; dealing with trading halts or suspensions; assessing compliance with listing rules by entities; dealing with breaches of rules; and conflicts of interest;

- Any significant changes in the roles and of functions performed by IRM since our 2002 assessment;
- Roles and duties of each member of IRM in terms of their supervisory activities and involvement in the business development;
- New Applications with respect to new debt listings handled by IRM and the waivers granted, during the period 1 November 2002 to 30 October 2003;
- Monitoring on-going compliance with listing rules, for example, IRM's supervision of wholesale debt issuers' obligation to comply with periodic reporting requirements;
- How IRM works with other supervisory business units such as Markets Surveillance and Companies;
- IRM's general supervisory policies and procedures; and
- IRM's record keeping practices regarding its supervisory activities.

Observations

IRM has failed to implement a number recommendations made by ASIC in our 2002 assessment report.

Specific recommendations made by ASIC last year - Compliance with periodic reporting requirements

Under ASX listing rules, most wholesale debt issuers are required to lodge their annual reports with ASX. In response to our recommendation of last year, IRM has put in place an arrangement whereby IRM conducts an "annual audit" to ensure that a wholesale debt issuer has submitted an annual report to ASX during the year. In 2003, the IRM audit was conducted after 30 June 2003, and a report was prepared indicating whether the reports had been lodged. Outstanding annual reports of wholesale debt issuers have been chased-up informally through email.

Despite the implementation of the above arrangements, the ASIC has noted that there were several occasions on which a wholesale debt issuer had lodged an annual report with ASX during the year in relation to a prior reporting periods (for example, reports were lodged for the financial years ended 2000 and 2001). In this regard, IRM appears to have failed to ensure that the annual report lodged by a wholesale debt issuer was the most recent report available.

Furthermore, if IRM had checked the relevant period of the annual report lodged by the debt issuers in the "annual audit" process, it is possible that appropriate follow up action would only be taken after considerable delay.

During the interview, IRM acknowledged that the annual checking process was not working very well, as in some cases it appeared that the failure to lodge had not been identified until up to 10 months later.

*Policies & Procedures**Processes for quotation of debt securities*

The procedures for processing applications for the quotation of debt securities have been updated since our first assessment. In the ASX Group Compliance Plan, the admission of appropriate issuers has been flagged as a supervisory priority of IRM for the 2003/2004 period.

Amongst the policies and procedures documentation updated by IRM, there was a document entitled "checklist" for facilitating assessment of new applications.

However, ASIC did not find evidence that this document had been relied upon by IRM, as it was not found in any of the seven new listing files that were reviewed.

Dealing with trading halts, suspension and passing on referrals to another business unit

As recommended by ASIC in our first assessment report, IRM has now put in place procedures that deal with suspension and trading halts.

However, during discussions, ASX indicated that under current arrangements IRM does not need to make any referrals and does not receive any referrals from other ASX business units. When asked who was responsible for wholesale debt securities if, for example, a trading halt or suspension was required due to a failure by a debt issuer to comply with periodic requirements, IRM personnel indicated that IRM would be responsible in such a case. With respect to price alerts, IRM indicated that Companies would ring IRM to seek clarification on how a product worked, but Companies are responsible for evaluating the price alert.

Apart from a document that outlines the supervisory functions to be performed by IRM and Companies, IRM does not have any written procedures for passing on referrals to other ASX business units.

Monitoring compliance with listing rules by entities

Apart from the new arrangement whereby IRM will perform an annual audit of annual reports lodged by wholesale debt issuers, there appear to be no major changes to the IRM policies and procedure documentation in monitoring compliance with the listing rules.

IRM confirmed during this year's assessment that IRM operates in the same way as at the time of ASIC's previous assessment in the area of monitoring compliance with listing rules by debt issuers. IRM indicated that it had not been required to make any formal requests in the last 12 months for companies to provide information to the market under listing rule 3.1. However, letters had been sent to issuers on several occasions reminding them of their periodic disclosure obligation.

Dealing with breaches of rules

As was the case last year, IRM processes for dealing with breaches of the listing rules are not documented.

Conflicts of interest

In response to a recommendation in our first assessment report IRM has now developed and put in place a staff code of conduct.

No systemic or formal filing system

IRM has no formal system of maintaining records. IRM files consist of loose papers in folders. It appears that IRM has no procedure for record keeping and it is left to each individual analyst as to how they wish to maintain their files. For example, as mentioned earlier, there was no evidence that IRM personnel had used the checklist in assessing new applications. We have incidentally come across other versions of checklists in older files that we reviewed and this suggests that it is in fact an individual analyst preference and not a mandated policy.

We also note that there was no record of any systematic analysis of the adequacy of on-going compliance by an entity.

Enforcement of ASX Listing Rules

In discussion IRM confirmed that where IRM becomes aware of a wholesale debt issuer's failure to lodge its annual report IRM would resolve the matter by sending a reminder letter to the issuer. IRM has never taken any formal disciplinary action or effected any suspension for any such failure. In a subsequent discussion with IRM it was indicated that IRM has been quite reluctant to pursue any formal disciplinary action or suspension against wholesale debt issuers because investors in wholesale debt securities are sophisticated and these securities may be traded over-the-counter, outside the ASX trading platform, which makes ASX's suspension meaningless.

Notwithstanding this explanation, it is ASIC's view that IRM should be more vigorous in enforcing the listing rules.

Grant of Waivers

During the period 1 November 2002 to 30 October 2003, there were 7 new wholesale debt listing applications handled by IRM for which the standard waivers were granted. The main reason for granting the standard waivers to wholesale debt issuers is that the listing rules apply to debt listing generally and do not differentiate between retail and wholesale issuers. According to ASX personnel, the standard waivers are essentially CHES and SEATS waivers. ASX indicated that amending the rules is not a priority and there are no immediate plans for rule change.

Supervisory structure

Our general observation is that IRM's main focus is business development. In this regard ASIC has noted that nearly all the supervisory activities of IRM are undertaken by a particular business analyst. This analyst has confirmed that 60% of her time was devoted to carrying out supervisory activities and the other 40% was devoted to business development.

Consistency and co-ordination across business units

The operation of IRM is closely linked to Companies. The interactions between these two business units include:

- a) with respect to each new admission, IRM prepares a report to the National Management Meeting of Companies for approval; and
- b) Companies will consult IRM in relation to unusual movements in retail debt securities.

Apart from Companies it is our general understanding that IRM has very limited interactions with other ASX business units in relation to supervisory activities.

In its Annual Regulatory Report for 2003 ASX stated that Companies is responsible for wholesale debt issuers' continuous disclosure obligations. However when this was raised with operational personnel there appeared to be some confusion about who was responsible for this function.

Recommendations

We recommend that:

- IRM review its arrangements for monitoring compliance by wholesale debt issuers with obligations under the listing rules.
- IRM further develop its written procedures and team structure for its supervisory functions. ASIC is concerned that there may be either actual or potential conflicts of interest arising from a staff member associating with both supervisory and business development functions, as well as reporting both matters to the same person.
- IRM review its record keeping practices including considering a greater reliance on the use of checklists and sign-offs to record any supervision undertaken.
- IRM consider whether they should take disciplinary actions against those wholesale debt issuers who failed to comply with their periodic disclosure obligations under the listing rules.
- IRM prioritise amendments of the listing rules in relation to the admission process so that they place less reliance on the use of waivers.

ASX advised in February 2004 that it would be addressing the adequacy of procedures and making improvements. The process for listing and monitoring continuous disclosure would also be reviewed. It also said that a quarterly audit of annual accounts lodgement will be implemented.

Summary of assessment recommendations

ASX business unit	Key recommendations	ASX response	Timing
General	Review arrangements for managing conflicts between its commercial interests and its requirement to supervise its markets to ensure that there are procedures in place to identify and deal with all conflicts	<p>Restructure supervisory business units to create a single division responsible for supervision.</p> <p>Create a new position of Chief Integrity Officer reporting directly to the managing director and restructure some business unit management and reporting lines.</p> <p>Expand and review internal compliance function.</p> <p>Appoint a senior compliance practitioner to assist.</p> <p>Codes of Conduct to be reviewed in light of new structure.</p>	<p>Completed</p> <p>Completed</p> <p>Senior compliance adviser appointed in January and review ongoing.</p> <p>Completed</p> <p>Completed. Enhancement and training ongoing.</p>
	Adopt a Code of Conduct for all business units (page 19)	Developed.	Implementation and training in progress.

ASX business unit	Key recommendations	ASX response	Timing
	Review internal policy-making processes to ensure a clear understanding and articulation, both within ASX and externally, of the policy behind its listing rules (page 19)	Reviewing its communication, policy formulation and Chinese wall policies.	Project underway to articulate and communicate policy. Completion anticipated July 2004.
	Accelerate steps to restructure supervisory areas, to ensure a more coordinated approach to supervision and to provide clearer lines of accountability for its supervisory obligations	Restructure supervisory business units to create a single division responsible for supervision. Create a new position of Chief Integrity Officer reporting directly to the managing director and restructure some business unit management and reporting lines.	Completed Completed
	Adopt more formal process for planning for compliance and monitoring and assessing compliance	Expand and review internal compliance function and appoint a senior compliance practitioner to assist.	Completed
	Review reporting arrangements for the Compliance Officer (page 20)	Compliance function reporting lines have been reviewed and are now directly to the managing director/CEO and the Audit and Risk Committee.	Completed

ASX business unit	Key recommendations	ASX response	Timing
	Review compliance resources to ensure that the Compliance function has sufficient resources to undertake comprehensive compliance planning, monitoring and review.	Expand and review internal compliance function and appoint a senior compliance practitioner to assist.	See above. Completed

ASX business unit	Key recommendations	ASX response	Timing
	ASX improve the consistency with which it monitors and enforces its listing rules.	<p>Accepts the need for greater consistency across State offices of the Companies Department.</p> <p>Committed to achieve better documentation of supervisory activity and decision-making in some areas.</p>	<p>Steps to promote consistency undertaken including:</p> <ul style="list-style-type: none"> • Daily meetings now include policy discussion; • Policy discussion documented and updated. <p>Steps undertaken include:</p> <ul style="list-style-type: none"> • Procedures established for recording supervisory activity in those areas not previously recorded. • Daily discussions now include policy discussion.
	Review use of trading halts where there is a disorderly market	Review of "enforcement" mechanism more broadly underway.	Anticipated completion by September 2004

ASX business unit	Key recommendations	ASX response	Timing
	Review mechanisms for enforcement of the listing rules.	Review of "enforcement" mechanism underway.	Anticipated completion by September 2004
National Adjudicatory Tribunal	<p>Develop penalty guidelines for rule breaches</p> <p>Establish formalised induction or training processes for panel members</p> <p>Improve record keeping</p> <p>Update policies and procedures</p> <p>Develop policy or code of conduct in relation to conflicts of interest</p> <p>Maintain a central register of panel members to record identified conflicts of interest and any training undertaken by the panel member, etc.</p>	ASX have indicated that steps are underway to implement all of ASIC's recommendations.	<p>Penalty guidelines – Completed</p> <p>Training for panel members – scoping of programme has commenced</p> <p>Record keeping – improvements implemented with further review ongoing</p> <p>Policies and procedures updated –to be completed by the end of May</p> <p>Code of conduct – Completed</p> <p>Central register of panel members – established. Identification of conflicts etc. in progress</p>
Market Integrity	Clarify/define the role including authority and	Restructure of Compliance function	Completed. See above

ASX business unit	Key recommendations	ASX response	Timing
	resources of Compliance Officers		
The Companies Department	Develop and implement record-keeping & management procedures Review inconsistencies in monitoring and enforcement practices Conduct a more timely and expanded analysis of waivers granted Update Complaints Handling procedures to include guidance on complaints against listed entities	Committed to achieve better documentation of supervisory activity and decision-making in some areas. Accepts the need for greater consistency across State offices of the Companies Department. Accepts that greater analysis is possible. Committed to ensure that this happens on a more structured basis. New complaints handling system is being implemented	See above See above Waiver analysis now undertaken on monthly basis Expected completion by June 2004
Markets Surveillance Unit	Review disclosure monitoring processes Increase the priority for the SOMA replacement project	Surveillance to assume responsibility for disclosure referral activity. New alert system being implemented	Completed Completion scheduled for 3 rd quarter 2004
Investigation and Enforcement	Recommend that a designated person be responsible for updating procedure manuals.	Manager and Assistant Manager to assume responsibility	Completed
Compliance Services	Provide ASIC with details of business rule waivers granted on a monthly basis	Awaiting adoption of new rules on 11 March allowing publication of waivers	Monthly provision commenced
Client Relations	Include complaints made by Participating Organisations in relation to ASX actions or level of	Included in complaints handling project	Project scheduled for completion in June 2004

ASX business unit	Key recommendations	ASX response	Timing
	<p>service in the Complaints Handling Procedures</p> <p>Clarify the scope of the Account Managers' role in relation to the provision of business rule information</p>	<p>Amend position description to clarify Account Managers' role</p>	<p>End of May 2004</p>
ASX Legal Division	<p>Take timely action to implement listing rule changes where a pattern of similar circumstances emerge</p> <p>Prioritise amendments to listing rules to accommodate ETFs</p>	<p>Committed to greater and more structured analysis of rule waivers</p> <p>Draft rule amendments informally lodged February 2004</p>	<p>Waiver analysis underway – see above</p> <p>ASX currently preparing response to ASIC comments received April 2004</p>
Structured Products	<p>Update policies and procedures, particularly in relation to supervisory functions</p> <p>Review arrangements for supervision of warrant issuers' market making obligations</p> <p>Further develop unit's complaints handling procedures</p> <p>Improve record-keeping</p>	<p>ASX has agreed to address all ASIC concerns.</p>	<p>Have already been updated for FSR – further updates to be made by 31 July 2004</p> <p>To be completed by end September 2004</p> <p>SPU will be part of the centralised complaints system</p> <p>Largely completed (although ASIC's single file preference is not</p>

ASX business unit	Key recommendations	ASX response	Timing
			considered effective as it undermines existing functions of the filing system)
Interest Rate Market	<p>Review arrangements for monitoring compliance by wholesale debt issuers with listing rule obligations</p> <p>Update policies and procedures, particularly in relation to supervisory functions</p> <p>Improve record-keeping</p> <p>Consider disciplinary action for non-compliance by debt issuers with periodic reporting requirements</p> <p>Prioritise amendments to the listing rules in relation to the admission process</p>	<p>Will implement procedure for quarterly review of annual accounts lodgements. Will review process for monitoring continuous disclosure.</p> <p>Will review procedures and make improvements.</p> <p>Will review the process for listing.</p>	<p>Completed</p> <p>To be completed by June 2004</p> <p>Completed</p> <p>To be completed by June 2004</p> <p>Policy agreed internally and drafting amendments is ongoing</p>
SEATS Market Control	Update policies and procedures (to include the Code of Conduct)	Agree to address	Completed
Derivatives Market Control	Update policies and procedures (to include the Code of Conduct and updated Options Listing Guidelines)	Agree to address	To be completed by June 2004