



**ASIC**

Australian Securities & Investments Commission

**REPORT 68**

# **Market assessment report: Australian Stock Exchange Limited**

February 2006



**ASIC**

Australian Securities & Investments Commission

# **Annual assessment (s794C) report**

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

**February 2006**

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# Executive summary

Section 794C of the *Corporations Act 2001* (Act) requires ASIC to assess how well a licensed market operator is complying with its obligations as the holder of a market 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 fourth assessment of compliance by Australian Stock Exchange Limited (ASX) with its obligations under s792A(c) of the Act.

Our last report about ASX was publicly released on 19 July 2005.

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

Generally our assessment reports focus on suggested areas of improvement in ASX's arrangements rather than on the more positive aspects that support our overall conclusion. It is important to make clear that none of the suggestions for improvement in this report detract from our conclusion that ASX's arrangements have met and continue to meet their statutory obligations.

## Compliance by ASX

1. We conclude that ASX continues to have 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 market rules.
2. ASX has addressed the matters we raised in our last report and has made substantial and satisfactory progress in addressing the remaining issues. In particular, considerable progress has been made regarding our previous concerns with ASX's supervision of, and the adequacy of, the operating rule framework for the warrants market as well as the adequacy of its conflict handling arrangements in that area.
3. During the assessment period ASX (on its own motion) instigated a major review of supervision. The results of the review have been announced including the announcement of projects related to reviewing the ambit of the operating rules. Other changes have included a major internal restructuring of the Supervision division, already implemented. Further changes that will be made include the movement of the Supervision division into a separate subsidiary of ASX Group with a separate board. ASIC has been kept informed by ASX of these changes on an ongoing basis.
4. ASIC's assessment this year produced a number of findings and identified a few new minor matters for improvement, which ASX has responded to in a constructive manner by already making or planning improvements to policies, procedures and

practices where applicable. ASIC supports the improvements ASX has made or has suggested. In particular ASX has made certain changes to its procedures and practices concerning supervision of suspended companies and also regarding complaints management. ASX will also look at establishing benchmarks for staffing levels in its key supervisory units.

## **Our approach**

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

In this assessment, we examined in detail the day-to-day supervisory functions carried out by ASX. We paid particular attention to the extent to which ASX has responded to issues we raised in our third assessment report.

The regulatory report ASX provided to ASIC and the Minister reviews 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 ASX is complying with its supervisory obligations.

# Section 1: Background

## 1.1 The ASX group

During the period of the assessment, ASX held an Australian market licence that permits it to operate a market in the financial products described on its licence. A copy of ASX's market licence is available on ASIC's website at [www.asic.gov.au](http://www.asic.gov.au). Two ASX group entities, Australian Clearing House Pty Limited (ACH) and ASX Settlement and Transfer Corporation Pty Limited (ASTC), hold licences to operate clearing & settlement facilities. ASIC's assessment of these licensees pursuant to section 823C of the Act will be set out in a separate report.

## 1.2 The assessment process

### ASIC's role

Section 794C of the 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. The 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 that in our view need, or may need, to be addressed to ensure ongoing compliance.

### Assessment process

ASIC's assessment and the views expressed in this report are a combination of processes - the ongoing interaction we have with ASX in our role as regulator of companies and financial markets, an on-site inspection of books and records and interviews with ASX personnel, and the discussions we have with ASX about the issues that have arisen from our previous assessment processes.

In conducting our assessment we have particularly considered:

- the annual regulatory report given to ASIC by ASX dated September 2005 as required under s792F of the Act;
- the annual report prepared for the ASX Board by ASX Supervisory Review Pty Limited (ASXSR), and given to ASIC dated September 2005;

- information we received from and about ASX in the ordinary course of our dealings with ASX as a market licensee, including:
  - information received as part of the rule amendment process;
  - interaction with ASX on a range of operational issues;
  - referrals of serious contraventions;
  - the register of listing and market 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 and trading;
- internal ASX material, including disciplinary and investigation files, internal reports and information collected by ASX on a continuous basis;
- discussions with senior ASX management; and
- comments made in interviews or discussions with a range of ASX personnel.

In conducting our on-site visit, we:

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

This year our assessment reviewed the operation of 14 business units.

We served a number of notices that required ASX Group to give ASIC documents relating to a wide range of ASX Group activities.

From 14 November 2005 to 25 November 2005 we attended ASX Group offices in Sydney and Melbourne. During this on-site phase of the assessment we reviewed ASX operational records and spoke to a wide range of personnel across ASX management.

In previous years we had chosen to do an onsite assessment of most if not all business units carrying out supervisory functions. This year, partly to increase the efficiency of the assessment process for both ASIC and ASX Group we applied a desk audit approach to seven business units (approximately half the number of business units reviewed) incorporating a question and answer style letter sent to ASX Group in October 2005. The letter sought information about each of the applicable business unit's activities in the assessment period including information about any changes in operations, structure and resources and the units' actions in response to previous assessment report recommendations where applicable. ASX provided a response in November that addressed these matters.

The business units selected for this process either do not have a significant number of supervisory functions or in our view did not require an onsite assessment based on previous assessment findings and our knowledge of the business unit.

After our onsite visit was completed we provided written findings to ASX and had discussions about a number of issues. Where appropriate, our report reflects ASX's responses.

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

In our assessment report dated June 2005 we made a number of recommendations about improvements in ASX's supervisory arrangements.

Much of the current assessment involved a review of various changes made by ASX in response to these key recommendations and other issues that we had raised in previous assessments.

In addition to this we sought a more practical on the ground understanding of the restructure of the Supervision division. The restructure took effect on 1 October 2005, towards the end of the relevant period for this assessment. There were however significant staff changes during the assessment period and we sought to appreciate whether this had had any impact on performance.

We continued to focus on the quality of ASX's arrangements for managing conflicts and in particular looked to ensure that there has been no retreat from the clearer division of commercial and supervisory functions instituted by ASX with the establishment of the Integrity division.

We also sought reassurance generally about the adequacy of the practices of those business units such as Market Surveillance, Compliance Services, Companies, and Investigation and Enforcement (I&E) that have a key supervisory role. We looked in particular at the quality and consistency of supervisory outcomes to assure ourselves that ASX is meeting its statutory obligations to supervise its market.

We also considered specific events that occurred during the relevant period.



# Section 2: Observations and recommendations

## 2.1 ASX is meeting its obligations

After making our assessment, ASIC concludes that ASX 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 formal part of our assessment process, our observations on the basis of our regular contact with ASX 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. 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 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 sound;
  - ASX conducts ongoing supervision of its participants and listed entities;
6. ASX has good market infrastructure (including technology) to support its obligations 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 market rules and listing rules; and
8. ASX shares information on supervisory matters with ASIC.

## 2.2 Other observations and recommendations for future action

### Review of supervision

ASX established the Integrity division on 1 January 2004 to house ASX's supervisory functions in one operational area. Prior to this, commercial and supervisory functions sat alongside each other amongst various ASX divisions. The Integrity division provided for clearer separation between commercial and supervisory functions and

decision making than under the previous structure. Integrity division was headed by a Chief Integrity Officer (CIO), who reported directly to ASX's Chief Executive Officer (CEO). The CIO was also given access to the Audit & Risk Committee of the Board of ASX to discuss supervisory issues, particularly where there may be a potential conflict between the commercial interests and supervisory responsibilities of ASX.

At the release of its interim financial results on 15 February 2005, ASX announced the review of a number of senior positions and titles. This included a change in the title of CIO to Group Executive Market Supervision.

Following these changes ASX announced a broader review of its supervisory organisation and functions. The review was undertaken in two stages. The first stage involved an internal reorganisation of the Supervision division (formerly Integrity division) designed to improve efficiency and facilitate a structure more responsive to stakeholders. This stage was implemented in early October 2005 and involved the reorganisation of Supervision Division into 3 main operational groups: Issuers (incorporating Companies Unit), Participants (incorporating Compliance Services, Surveillance and the Investigations arm of I&E) and Enforcement (incorporating the Enforcement arm of I&E).

General Managers were appointed in respect of each group reporting directly to the Group Executive Market Supervision. A fourth unit, Regulatory Policy unit, was also established with responsibility for the analysis and development of ASX regulatory policy. The investigations functions of the former Investigations & Enforcement unit were allocated to Participants, while Enforcement became singularly responsible for the handling of all referrals to ASIC and ASX disciplinary tribunals. This represented a deliberate strategy to separate the investigation and enforcement functions to provide more checks and balances between the investigative and enforcement processes.

The second stage involved a review of ASX's supervisory role. The results of this review were announced in December 2005. ASX's supervisory activities are to be moved into a separate subsidiary, known for the time being as "ASX Supervision". The "Chief Supervision Officer" will report to a subsidiary board comprising some ASX Limited board members and independent directors. The ASX CEO will have no direct role in relation to ASX Supervision.

ASX has discussed with ASIC the changes to its supervisory structure that have already been made and those that are to be made in the near future. ASIC has not identified any risks related to the changes but will continue to monitor the effects of the implementation of the new structure.

ASIC noted at the time of ASX's announcement that the ASX Limited Board (as the market licensee) remains responsible for ASX's obligations to regulate its market. The changes mean there will be an explicit and transparent allocation of resources to ASX's regulatory functions, and supervision will be more fully accountable to the ASX Board.

ASIC supports a clearer distinction between supervisory and commercial functions. We will continue to monitor the effects of the implementation of the new structure, through our regular interaction with ASX and through the assessment process. ASX has also announced a review of its operating rules, primarily to address areas of overlap within the operating rules (between the listing and market rules) and between the rules and the Corporations Act. These projects will take up to 2 years to complete. Significant consultation with ASIC is planned.

### **Costs of supervision**

Part of the charter of ASX Supervisory Review Pty Limited (ASXSR), is to report to the ASX Board on the adequacy of funding for supervisory activity. At the suggestion of ASXSR, ASX revised its methodology for costing its supervisory activity and has adopted a narrower definition of "supervisory activity".

Previously, ASX costed supervisory activity using a definition that included all activity or operations of the ASX Group that generate or contribute to a market of higher integrity. The definition of supervisory activity is now an activity that contributes directly to the operation of a fair, orderly and transparent market.

In actual terms this has meant that activities such as the provision of investor education have not been costed as a supervisory activity. Consequentially ASX Group has reported a lower cost for the year ended 30 June 2005 than for the year ended 30 June 2004. On a similar basis, staffing for supervisory activity is slightly lower compared with the previous financial year.

ASIC is satisfied with the revision of ASX's costing methodology, which places it on a more conservative and reliable basis. We also recognise that the lower figures reported do not portray a reduction in the resources ASX allocates to supervision.

### **Warrants market**

In our last assessment report we made a series of observations and recommendations about the operation of ASX's warrants market. Many of those recommendations addressed what we considered potentially serious deficiencies. We are pleased to report that ASX Group has adopted or is in the process of adopting a number of changes to address the deficiencies that we identified. These are detailed below.

#### *Warrants rule framework*

We recommended in our last report that ASX conduct a full audit of the warrants market and the warrant rules to determine what obligations issuers must perform, and whether ASX can adequately enforce the performance of those obligations without commensurate rule amendments. This recommendation arose from a longstanding concern that there were no rules covering warrant issuers obligations to make markets in respect of warrant series where there is not sufficient holder spread at issue. Also we made note of one occasion where ASX had no power under the rules to act against a warrant issuer who failed to identify a barrier event on a barrier warrant and a disorderly market resulted.

ASX appointed an external expert to conduct an audit of the warrant market and its rules.

ASX consulted with various stakeholders, including market participants, about draft rule amendments at the end of May 2005. The proposed amendments were released as an exposure draft in December 2005. The draft rules include a principles based market making requirement and a rule concerning issuer admission criteria which requires ASX to be satisfied on an ongoing basis that an issuer has adequate facilities, procedures and resources in respect of their obligations as an issuer of warrants. In February 2006, ASX provided a draft of the new rules to ASIC for review.

### *Monitoring of issuer obligations*

In our previous assessment we found that ASX did not and in some cases could not, monitor warrant issuers' compliance with all their obligations, particularly those obligations the subject of undertakings to ASX. In particular we were critical of the arrangements ASX had in place to monitor the market making obligations of issuers, in addition to obligations that issuers had to advise ASX of certain events under the terms of a warrant such as the occurrence of a barrier event. At that stage ASX had no capacity to automatically monitor such obligations where the warrant was based on an underlying asset that is not quoted on ASX's market.

We also reported in our last assessment that Surveillance and Investigations (formerly Market Surveillance unit) assumed responsibility for monitoring the warrants market in December 2004. At this time, the ASX automated market surveillance system known as SOMA was being replaced with SMARTS.

In this assessment we reviewed how Surveillance and Investigations undertakes monitoring of warrants market making through SMARTS. In particular we reviewed Surveillance's procedures and observed how SMARTS alerts are generated and responded to.

We also reviewed how Surveillance and Investigations monitors warrants which are based on underlying assets that are not quoted on ASX's market. At the time when these monitoring functions were transferred to Surveillance and Investigations, SMARTS did not have data feeds from non-ASX markets. For instance, barrier events could not be identified by SMARTS where the underlying asset was not listed on ASX. Surveillance and Investigations adopted manual processes to address these gaps and ASX advised that informational links were due to be implemented during June 2005. At the time of our visit, a SMARTS link to IRESS was under construction but not yet in place. The link was installed in December 2005 but technical issues arose which delayed its effective operation until the end of January 2006.

While the installation of external data feeds to SMARTS took longer than first envisaged, the surveillance of the warrants market including the surveillance of market making appears more effective with the roll out of SMARTS and the transfer of the monitoring function to the Surveillance and Investigations Unit. This is a welcome development.

*Market making*

In our last assessment report we noted our concern that ASX has never seriously studied whether market-making activity on the warrants market is generally fair and reasonable.

As part of its review of the warrants market, ASX contracted the Securities Industry Research Centre of Asia-Pacific (SIRCA) to produce quantitative research on the quality of market making in the warrants market. The SIRCA report documents liquidity measures on the warrants market and compares warrants liquidity with liquidity measures on the ASX equity and options markets. The report concluded that relative to the ASX equity and option markets, the ASX warrants market has narrow spreads and significant volumes displayed at best quotes, indicating a liquid market. Spread and quantity at quote for orders provided by market makers were very similar when compared with orders of all participants including market makers.

*Supervisory operations and conflict management*

In our last report we said that during the course of the year, the primary responsibility for supervision of the warrants market remained with the Primary & Structured Products Unit (PSPU) and that while this unit clearly has a significant commercial focus, we did not understand why PSPU's supervisory functions had not been transferred to the Integrity division. We said that there remained a high risk of actual or perceived conflicts of interest in relation to this area of the market.

We think that the proposals put forward by ASX to manage the limited role of PSPU in supervision of the warrants market are sufficient to address the concerns we have raised, but ASIC will continue to review the practical application of these arrangements.

In May 2005, a transitional arrangement called the 'Interim Protocol' was adopted which moved final decision making on structured product supervisory matters, (namely, issuer admission and warrant series admission to trading status decisions and warrant rule waiver applications) to either a committee of managers and senior staff from Issuers (the Warrants Management Committee) or a single member of that committee depending upon whether the decision was a non standard or standard decision<sup>1</sup>. Decisions are classified as standard or non-standard depending upon whether the circumstances of the decision are unique. That is a standard decision essentially involves a decision where there is a precedent.

Issuers staff are also responsible for supervising the disclosure and reporting obligations of warrant issuers. The Interim Protocol was said to be open to further review following the completion of the warrants market review and ASX's broader review of supervision.

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<sup>1</sup> Non Standard Decision are all decisions in relation to a new warrant issuer, a new type of warrant and any waivers or in-principle decisions that haven't been previously considered. Standard Decisions are decisions in relation to the admission of a type of warrant that has been previously been admitted and any waiver to in principal decision that has previously been considered.

ASX refined the Interim Protocol in December 2005 significantly reducing the input of SPU in non-standard decisions. Changes were also made to the way that Issuers overights input by PSPU in relation to standard decisions that are then decided by Issuers.

Ideally, all supervisory discretions should be exercised by Supervision Division free from any substantive input by a commercially focussed area. However, ASX argues that it is difficult to completely separate PSPU's involvement from the warrants admission process because of the commercial risks inherent in the administrative, operational, market and organisational issues involved in the admission of warrants to trading.

#### *Content of ASX website regarding market making*

In our last report we said that ASX's website gave prominence to describing the market making "obligation" that exists for warrant issuers. Given our view that the obligation may not be enforceable at law and was not effectively enforced in practice in any event, we were concerned that investors may have been misled by some of ASX's website content. ASX addressed this by making appropriate changes to the content of its website and booklets.

#### *PSPU investigations of complaints*

In our previous report we said that PSPU had not adequately investigated a number of investor complaints, and particularly complaints about market making. In response to this concern, ASX has changed its complaint handling procedures. After being recorded centrally by ASX Customer Services unit, complaints regarding warrant issuers, trading or participant conduct in relation to warrants are now handled by Issuers, Surveillance & Investigations, and Participants, respectively, rather than by PSPU.

## **Issuers**

#### *Consistency in monitoring disclosure*

In our previous report we noted that while progress had been made in ensuring consistency amongst ASX's State offices, there were still significant unexplained variances between the State offices about the number of queries made to listed entities, and the outcomes resulting from those activities. Some States were generating significantly less queries of companies and obtaining significantly fewer announcements in response to queries than other States.

We concluded that due to the size and persistence of the statistical variance we observed, the State offices could not be said to be operating on a comparable basis. We did however note that the ASX figures for the three months ending 30 September 2004 indicated that some change to this pattern was occurring.

During the assessment we observed that there has been a significant increase overall in the number of ASX disclosure queries during the most recent financial year.

Furthermore, we did not identify significant discrepancies between States in terms of the number of queries generated. We will however continue to monitor ASX's performance in this area.

#### *Record keeping about supervisory actions*

In our previous report we said that Issuers should improve the consistency and contemporaneousness of record keeping of supervisory actions. We also reported that ASX advised that it had adopted a system for the contemporaneous recording of all supervisory activity in March 2005.

In a few instances during this assessment period concerns about contemporaneous record keeping on individual continuous disclosure matters were brought to the attention of ASX management by ASIC as they arose. However, we noted there has been improvement in the consistency and contemporaneousness of record keeping since our last assessment, and that ASX is continuing to work on this area.

#### *Interest Rate Market*

In our last report we said it appears that ASX responds differently to non-compliance with its rules by entities admitted as debt listings when compared with ASX equity listings and that it is important in principle that supervisory standards are equivalent regardless of the smaller size of the debt market. We had expressed reservations about the supervisory arrangements for debt issuers in previous assessment reports.

ASIC's primary concern about supervision in relation to debt issuers was that ASX appears to have categorised those entities that had not sought to quote their securities as not being required to lodge annual returns, or comply with any other ongoing requirements in the rules, and accordingly has not been reviewing these entities as part of its ongoing supervision of the debt market. We also raised this issue in our second assessment. In response, supervision of debt issuers was moved from the primarily commercially focused Interest Rate Market unit (IRM) to Issuers.

In response to our last report, ASX said that Issuers would follow up debt issuers who had failed to lodge annual returns. Our assessment this year confirmed that this has been done. In most cases all outstanding annual returns have been provided and have been released to the market on the Companies Announcement Platform. Issuers has also written to those entities that have no securities quoted and advised that unless the situation is rectified by 31 May 2006, ASX will remove the entity from the debt market.

Since March 2005, new admissions of debt issuers have, as a condition of admission, a requirement that securities be quoted within 6 months of admission.

#### *Resourcing*

A particular focus of this year's assessment was to consider whether the recent restructuring of ASX Supervision division had had any impact on ASX's ability to supervise markets. The restructuring process resulted in some staff turnover during the assessment period. We looked at staffing across all supervisory units with

particular regard to key supervisory units such as Issuers. Supervision is a key, core function of the exchange and it is vital that ASX ensures that resources are adequate not only in the current buoyant market conditions, but also in the event additional supervisory demands are created by a market downturn with the pressures, for instance, of earnings revisions and solvency issues.

During the assessment period staff shortages caused by turnover were evident in Market Surveillance (now Surveillance and Investigations) and to a lesser extent in the Group Compliance unit. We believe that the output of these units suffered albeit in a temporary fashion but in a way not fundamental to key supervisory tasks. For instance we did not see any evidence that Market Surveillance's key functions of monitoring the market for continuous disclosure issues and market misconduct were affected. The staff shortages have now been addressed.

We observed that in some cases certain ratios, such as the number of listings per companies adviser, are nominally quite high. However, ASX argues that the different compliance characteristics of companies ie. the presence of more (or less) compliant entities, as well as the different experience and skill levels of companies advisers, explains varying and in some case quite high nominal numbers of allocated entities per companies adviser.

ASX has said it will consider how it can benchmark its supervisory resources against other comparable exchanges, and is confident that the current level of resources for supervision is adequate. It is not ASIC's conclusion or suggestion that this area is currently understaffed. However, ASIC will continue to review the resources allocated to these functions as part of our ongoing interaction with ASX.

### *Suspended companies*

At the time of our assessment there were about 100 suspended companies on ASX's market. As part of the assessment we reviewed Issuers' oversight of suspended companies.

At the time of our review, ASX had no policy or procedures (formal or otherwise) to deal with companies that are suspended from its list. For instance there was no ASX policy regarding whether clearly non-compliant or moribund albeit suspended companies should remain on ASX's official list.

We reviewed all the announcements of companies that have been suspended for more than 12 months. This process identified a number of companies that have not been complying with listing rule requirements relating to continuous disclosure and periodic reporting.

Although listing rule 18.6 requires a company which is suspended to continue to comply with all of the listing rules, in practice little if any monitoring of ongoing compliance with the listing rules was being performed by Issuers.

In response to our concerns, ASX has implemented a new policy under which Issuers will conduct an annual review of all suspended companies. The purpose of the review will be to determine which of those companies, due to their lack of operations and/or



financial condition, (and consequent breach of listing rules) should be considered as potential candidates for removal.

The category of companies likely to be removed following due process would include any company that has been suspended for a significant period e.g. 12 months or more and due to its circumstances has no apparent prospect of reinstatement to the official list in the following 6 to 12 months.

ASIC welcomes the revision of ASX's approach to suspended companies.

### *Disclosure issue*

In early November 2005, during the assessment period, a disclosure issue involving Westpac Banking Corporation (“Westpac”) occurred. The issue arose as a result of the inadvertent release by Westpac to a number of analysts of a results template that contained factual but ‘embedded’ information relating to Westpac’s 2005 full year profit.

Notwithstanding attempts to recall the information, it is clear that the fact that the template contained embedded information became known more broadly. There was a clear risk that, unless a trading halt was put in place, the market may not have been trading in a fully informed environment until the results were formally released.

At the time of this event and immediately afterwards, ASIC and ASX discussed the adequacy of the procedures ASX had in place to deal with such novel and irregular events, and the way in which ASX handled this matter.

As a result of its review and discussions with ASX, we are now satisfied that ASX has adequate processes to ensure that it effectively monitors the continuous disclosure obligations under its listing rules, and welcomes ASX’s assurance that it will, as a matter of priority, continue to monitor and review these processes on an ongoing basis.

## **Complaints handling**

### *Centralisation of complaints*

In our last report we said that ASX has worked to implement a process for the centralisation of complaints management, that we supported this move and that we understood that this work would be completed by June 2005. We also said that we proposed to follow-up on this project's progress in our next assessment.

A manual centralised complaints management system has been in place since June 2005 and is operating effectively. This manual system is being converted to an electronic complaints database that is anticipated to be operational prior to 30 June 2006. Development work started in January 2006.

*Improvements to complaints handling*

During this assessment, we noted some deficiencies in ASX's response to particular complaints dealt with by various ASX business units. While some responses were potentially confusing, others said that certain investigatory action would be taken, which was then not undertaken.

ASX has acknowledged many of ASIC's concerns with the handling of the complaints in question. We were advised that changes to ASX's complaints management process have been put in place which require more senior staff members to be engaged in the complaints process particularly where more serious complaints are concerned. The way in which Customer Services unit classifies complaints according to their severity has also been revised. ASIC supports this approach.

**Conflict management***Continue efforts to ensure commitment to identifying and managing all conflicts monitoring compliance*

Responsibility for conflict handling arrangements was transferred to ASX Group Compliance (Group Compliance) on 1 January 2005. We reviewed Group Compliance's work in this area to gain assurance that ASX conflict handling arrangements were adequate. Group Compliance prepared a report on conflict handling arrangements to the ASX Managing Director entitled the ASX Group Compliance Report on the Operation of the ASX Group Conflict Handling Arrangements that was dated 28 July 2005.

We reviewed the report and the file supporting its production and also spoke to the General Manager of Group Compliance. The finding of the report is based on the operation of various controls administered by Group Compliance under ASX's conflict handling procedures and policies such as:

- The requirement for quarterly written representations to Group Compliance from Supervision division managers that they have not experienced or become aware of staff from a commercial area seeking to influence a supervisory decision; and
- Emails sent between Primary & Structured Products (formerly known as Listings Business Development) and Companies unit must be copied to Group Compliance.

We saw evidence suggesting that these controls were operating effectively in practice.

The report's finding is also based on Group Compliance's interaction with ASX commercial and supervisory staff regarding the operation of conflict handling policies and procedures.

We saw evidence of this interaction strengthening in our mind the perception that ASX's conflict handling policies and procedures has permeated all levels of ASX staff and management. Our assessment this year reiterates the positive contribution that

Group Compliance is making to ASX Group's conflict handling arrangements noted in our last report.

*Finalisation of formal conflict management arrangement for ASX subsidiaries compliance with operating rules*

In our last report we noted the potential conflict of interest in ASX supervising compliance with and enforcing rules in relation to ASX International Services Pty Limited ("AIS"). AIS is a participant in ASX's market and is wholly owned by ASX. It acts as the broker for the Worldlink service. AIS is subject to the ASX market rules on a limited basis because of the restricted nature of AIS's participation in the market.

ASX has advised that the Worldlink service is to be discontinued.

In April 2005 formal procedures (approved by ASIC) were finalised that established interim ASXSR oversight of three ASX subsidiaries including AIS. The other subsidiaries are CHESSE Depository Nominees Pty Ltd and ACH. These arrangements are temporary. A more permanent solution will require law reform to allow ASIC to assume a monitoring role on similar basis as its role in respect of ASX as a self listed entity. ASIC (with ASX's support) will make a recommendation to the Government about this.

**The rule amendment process**

We noted the importance in the regulatory framework of the operating rules in our last report. Accordingly, while the impetus for rule amendments will often be the commercial demands of issuers or brokers for the introduction of new products or changes in the way the market operates, the involvement of supervisory areas in the rule amendment process is very important. That involvement is necessary, both to ensure that the rules provide appropriate integrity standards, and to ensure that supervisory arrangements can be modified as necessary to take into account rule changes. While detailed procedures were in place regarding the Legal Business Unit's interaction with other business units during that process ASIC said that it would revisit the issue of supervisory areas practical engagement in the rule amendment process.

In this year's assessment we sought and received ASX's confirmation in writing that this consultation was occurring in practice. We also expect that the establishment of a Regulatory Policy unit will greatly enhance the continuing efficacy of the operating rules, and the process by which changes to the rules are developed and implemented.