



**ASIC**

Australian Securities & Investments Commission

**REPORT 154**

# **Market assessment report: Asia Pacific Exchange Limited**

## **ACN 080 399 220**

April 2009

### **About this report**

This report summarises the fourth assessment of Asia Pacific Exchange Limited (APX) by the Australian Securities and Investments Commission under s794C of the *Corporations Act 2001* (Cth) (Corporations Act).

This report covers the period 16 June 2007 to 16 April 2008. In respect of trading data and financial information, the assessment period was varied as detailed in this report.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Previous reports on APX

APX was granted an Australian market licence on 11 August 2004.

Report number	Date released
REP 61	November 2005
REP 90	February 2007
REP 116	January 2008

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# Key findings and recommendations

## Key findings

- 1 We are satisfied that Asia Pacific Exchange Limited had adequate arrangements and sufficient resources to operate and supervise its market during the assessment period.
- 2 Our assessment report focuses on suggested areas for improvement in APX's arrangements rather than on the more positive aspects that support our overall conclusion. None of the suggestions for improvement in this report detract from our conclusion that APX's arrangements have met their statutory obligations.

## Recommendations

- 3 We recommend that:
  - APX document a policy regarding employee trading on its market; and
  - APX prepare a set of guidelines as to the criteria that should be considered in deciding whether or not to levy fail fees for a failed settlement, and introduce a means of recording these decisions.
- 4 APX has indicated that it accepts these two recommendations and agrees to implement policies accordingly.

## A The assessment

### Key points

ASIC conducts annual assessments of market licensees, because it is required to do so under s794C of the Corporations Act.

The scope of our assessment must include the obligations found in s792A(c), but we can include other Chapter 7 obligations too.

We use the licensee's self-assessment reports, information from our previous assessments, our observation of the licensee's performance, market intelligence and other things to form a view of how well the licensee has operated its market.

### Purpose and scope

- 5 Under s792A(c), a market licensee is required to have adequate arrangements for supervising the market, including for:
  - handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the market is fair, orderly and transparent;
  - monitoring the conduct of participants on or in relation to the market; and
  - enforcing compliance with the market's operating rules.
- 6 ASIC is required to assess how well a market licensee complies with its obligations in s792A(c) at least once a year: s792(2).
- 7 In addition we are permitted to extend the scope of our assessment to review how well a market complies with any or all of its obligations under Ch 7: s794C(1). In this instance we extended the scope of the assessment to include a review of APX's compliance with s792A(d), specifically, the obligation to have sufficient financial resources to operate the market properly and to provide the required supervisory arrangements.
- 8 This report covers the period 16 June 2007 to 16 April 2008 although trading information was examined for the 12-month period to 31 December 2007. In respect of financial resources, this report also discusses the impact of a change in APX's ownership, which occurred in October 2008.

## Background

- 9 APX was granted an Australian market licence on 11 August 2004 that permits it to operate a market in the financial products described on its licence. This can be viewed on our website at [www.asic.gov.au/markets](http://www.asic.gov.au/markets).
- 10 APX commenced operation of its market on 20 January 2005.
- 11 When ASIC has issued its previous assessment reports on APX, the licensee was named 'Australia Pacific Exchange Limited'. On 22 December 2008, APX changed its company name to 'Asia Pacific Exchange Limited' and it has since applied to the Minister for the name on its Australian market licence to be updated accordingly.
- 12 APX is licensed to operate a financial market in securities and managed investment products. It currently has two listed entities (listees) and one broker participant. Settlement occurs on a 'T+5' cycle, and is effected by the broker via the transfer of paper-based certificates between counterparties. During the 12 months to 30 June 2008, a total of 163 trades occurred in APX's market, equating to turnover of 2,463,405 securities, valued at \$2,330,328.45.
- 13 On 14 October 2008, AIMS Financial Group (AIMS) acquired a majority ownership in APX. Since then, a number of changes to APX's executive team have been made and APX has relocated the bulk of its operations activities from Melbourne to Sydney.
- 14 This is the fourth assessment of APX we have conducted. Previous assessment reports can also be found on our website.

## Our methodology

### Our assessment process

- 15 A market licensee's obligations are ongoing. Whether it is likely to comply with its obligations in the future cannot be judged merely by reference to its past compliance.
- 16 We 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 Corporations 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.

## What we focused on for this assessment

- 17 Our assessment involved a review of the changes made by APX in response to the issues we identified in our previous assessment.
- 18 We reviewed the general adequacy of APX's supervisory arrangements in practice, along with any significant changes to the way that APX operates the market and carries out its supervisory functions since our last assessment.
- 19 We also considered the adequacy of APX's financial and other resources to operate and supervise its market.
- 20 We also focused on certain events that occurred outside the assessment period—in particular the acquisition of a majority shareholding in APX by AIMS.

## What we considered

- 21 In conducting this assessment we:
- reviewed the 2007 annual regulatory report dated 21 September 2007 provided by APX to ASIC as required under s792F of the Corporations Act;
  - checked publicly available information on APX website, including share price, news releases, policies and procedures;
  - reviewed internal APX material, including information collected by APX on a continuous basis and internal reports prepared in relation to the supervision of its market;
  - engaged in discussions with APX senior management and APX staff members involved in key operational functions;
  - checked other publicly available information on APX;
  - discussed with AIMS its future plans for the APX market, particularly its plans for financing the future operation of the market; and
  - reviewed the material received under a notice served under the *Australian Securities and Investment Commission Act 2001 (Cth)*.
- 22 During May and June 2008, ASIC representatives conducted telephone interviews with APX personnel and management. ASIC has also liaised closely with APX senior management since this time in respect of the ongoing financing of APX's market.
- 23 In respect of financial resources, our observations and recommendations consider the fact that APX was subject to a change in control in October 2008 (that is, after the assessment period). APX is now majority-owned by AIMS. All other content of this report relates to the assessment period specified in paragraph 8.

## **Consultation**

- 24      After our review of the information provided by APX was completed, we provided initial written findings and recommendations to APX and requested comments on these. Where appropriate, our report reflects APX's responses.

## B Our observations and recommendations

### Key points

We consider APX's arrangements for supervising its market are adequate, including arrangements for:

- handling conflicts between the commercial interests of the market licensee and the need for the market licensee to ensure that the market is fair, orderly and transparent;
- monitoring the conduct of participants on or in relation to the market; and
- the adequacy of its financial resources to operate its market.

We have made a number of observations and recommendations based on our assessment. These do not relate to matters of non-compliance by APX but rather, are suggestions that we consider may assist APX in its ongoing activities. Specifically, we have recommended improvements be made to arrangements for handling potential conflicts arising from employee trading and to the decision-making process for levying or not levying a fail fee for late settlement. These have been discussed with APX and APX has agreed to our recommendations.

- 25 We conclude that APX has adequate arrangements and resources for the supervision of its market in accordance with its obligations under s792A(c).

## Conflict handling

### Employee trading

- 26 The principles that apply in the event that an APX executive or staff member wishes to trade on APX are contained in the APX code of business conduct and the APX conflict management plan. Collectively, these two documents set out APX's general expectations of its staff, the overarching requirements that staff must adhere to in their roles, and the arrangements APX has in place for handling conflicts between its commercial interests and its obligations as a market operator. APX does not currently have a written policy and procedure in respect of staff trading.
- 27 None of the staff members interviewed during the assessment indicated that they conduct any personal trading on APX.

**Recommendation 1: Policy on employee trading**

ASIC recommends that APX document a policy regarding employee trading on its market. Although such a policy is not necessary at the current time (because staff have not expressed a desire to trade), by preparing the policy APX will be in a position to make decisions in the event that a staff member does ask to trade on its market. APX should implement this recommendation within three months of receiving this report.

**Monitoring market and participant conduct**

- 28 Based on our review of all information at hand and information provided by APX, APX's arrangements for monitoring the conduct of participants appear to be adequate for the nature of the market it operates.

**Resources**

- 29 We are satisfied that the financial, technological and human resources available to operate APX's market are adequate, given the size of the market. The following paragraphs set out our key observations in respect of APX's resources.

**Financial resources**

- 30 In ASIC's 2007 assessment report, we noted that there had been a \$700,000 shortfall from an entitlement issue in which APX was involved in 2006. APX advised that an imminent recommendation would be made to the Board to consider allowing listees to become shareholders of APX by subscribing to APX shares. At the time of ASIC's 2008 assessment, the APX Board was in the process of determining how it would address the impacts of this \$700,000 shortfall.
- 31 Following discussions about APX's financial resources during this year's assessment, APX agreed to supply ASIC with monthly financial reports from 31 July 2008. We are satisfied that APX's financial resources were sufficient to operate its market during the assessment period.
- 32 On 14 October 2008, AIMS Financial Group acquired a majority ownership in APX. AIMS will provide APX with ongoing financial support in the operation of its market via a loan facility. APX also undertook a capital raising via a fully underwritten non-renounceable rights issue to its shareholders. Accordingly, as we are satisfied with APX's financial resources, commencing from the date of this report, we no longer require APX to supply monthly financial statements to ASIC.

## Human resources

- 33 During ASIC's 2007 assessment of APX, we noted that APX did not have a formal training policy/program in place, and suggested that ASIC would welcome a more formal approach to training, should APX's market grow. Although this was not a formal ASIC recommendation, APX chose to introduce a training policy in October 2007.

## Clearing and settlement arrangements

### Late settlements

- 34 APX liaises on a daily basis with market participants that have trades which have failed to settle within the prescribed settlement period of five business days after trading (T+5).
- 35 The APX business rules state that failure to settle on the settlement date may render the APX broker liable for a failure fee. In practice, APX may impose a fine of \$50 per day for failed trades after T+8. The fee is calculated on the basis of the full number of days that the trade has failed to settle beyond T+5, but is not levied until T+8. Fail fees are accrued and charged to the broker on a quarterly basis.
- 36 APX's settlement system is paper-based and the process of settling a trade involves paperwork being transported to the buyer and seller via post, for signoff. At times, this can lead to delays in the time taken for associated parties to receive, sign and pass on trade-related documentation.
- 37 APX takes into consideration matters such as the distance between the buyer and seller, when deciding whether to levy fail fees for late trades. In some circumstances, APX may decide not to charge a fail fee on the basis that the time taken for the involved parties to receive the documentation is likely to have contributed to the late settlement.

### Recommendation 2: Criteria for levy of fail fee

ASIC recommends that APX prepare a set of guidelines as to the criteria that should be considered in deciding whether or not to levy a fee for a failed settlement. In conjunction with this, ASIC recommends that APX introduce a register to record these decisions, including the circumstances surrounding each case, the reasons why it was considered appropriate to levy (or not levy) a fail fee, and any other relevant information. APX should implement this recommendation within three months of receiving this report.

## Reporting obligations

- 38 We note that APX lodged its s792F annual regulatory report for the 2008 year within the required period and provided sufficient information to satisfy its obligation.

## Response to 2007 assessment recommendations

- 39 We made four recommendations in our 2007 annual assessment of APX. In its response to the interim 2007 assessment report, APX did not dispute or object to any of the recommendations made. In this year's assessment, we checked APX's progress with implementing these recommendations.

### Recommendation 1: Proper constitution of committees

- 40 We recommended that the Board improve its own procedures to ensure that any committees exercising its delegated authority are properly constituted at all times.
- 41 We made this recommendation because an APX quotation committee with certain Board-delegated powers had functioned for some time without a full complement of current members.

#### APX's response

- 42 APX introduced a register of appointees to the quotations committee to assist it in ensuring all committee members have properly delegated authority from the APX Board.

### Recommendation 2: Review of CMP

- 43 We recommended that the Board review the APX conflict management plan (CMP) in order to prevent ongoing technical breaches and to ensure the efficacy and integrity of the CMP.
- 44 This recommendation was made in relation to a period when the compliance officer was on extended leave, during which time the General Manager Compliance and Supervision (GMCS) was the only staff member in the Compliance and Supervision unit. This amounted to a breach of the CMP, which requires each supervisory unit to have at least two staff members.

#### APX's response

- 45 By the time the final assessment report was issued in January 2008, the APX compliance officer had returned from long-term leave and resumed work.

46 During discussions in this year's assessment, APX advised that it considers its CMP is still relevant and should not be changed. APX will plan more effectively for future instances when a supervisory staff member leaves or is absent for an extended period. If the compliance officer is absent for some time, APX will ensure that a replacement is found rather than having the GMCS perform both his or her own role and the role of compliance officer. APX will continually monitor its business situation and assess the adequacy of its supervisory and compliance resources.

### **Recommendation 3: MSC to engage better with Board**

47 We recommended that the market supervision committee (MSC) should more proactively engage with the Board on decisions affecting supervisory arrangements.

48 This recommendation was made because the APX Board had expressed concern about delays in the MSC communicating certain compliance/ supervision-related matters to the Board. Specifically, the MSC did not advise and/or consult with the Board in respect of certain personnel appointments until after they were finalised.

#### **APX's response**

49 APX has made arrangements for the MSC and the Board to meet on a six-monthly basis, and the GMCS attends both Board and MSC meetings.

### **Recommendation 4: Revision of new employee questionnaire**

50 We recommended that APX's then new employee questionnaire be amended to expressly refer to any previous or ongoing relationships with an entity that may give rise to a potential conflict.

51 ASIC had previously raised concerns regarding the adequacy of APX's checking processes for potential conflicts of interest when recruiting staff for supervisory roles. APX made some changes to its employee questionnaire to address these concerns, however, in the 2007 assessment report we recommended the questionnaire be further strengthened by introducing express questions regarding relationships that may lead to a conflict of interest.

#### **APX's response**

52 APX has further strengthened the employee questionnaire in line with our recommendation.

### **Our view of APX's responses**

53 We are satisfied with APX's responses to the recommendations from the 2007 assessment.

## Key terms

Term	Meaning in this document
AIMS	AIMS Financial Group
APX	Asia Pacific Exchange Limited
ASIC	Australian Securities and Investments Commission
Australian market licence	An Australian market licence under s795B of the Corporations Act
CMP	APX's Conflict Management Plan
Corporations Act	The <i>Corporations Act 2001</i> (Cth)
GMCS	General Manager of Compliance and Supervision
MSC	APX's Market Supervision Committee
s794C	A section of the Corporations Act (in this example, numbered 794C)