



ASIC

Australian Securities & Investments Commission

REPORT 165

Market assessment report: Mercari Pty Limited

ACN 102 928 727

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About this report

This report summarises ASIC's fourth annual assessment of Mercari Pty Limited (Mercari) under s794C of the *Corporations Act 2001* (Corporations Act).

This assessment covers the period 21 December 2007 to 18 December 2008 (assessment period).

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 Mercari

Mercari was granted an Australian market licence to Mercari Direct on 30 May 2005.

Report number	Date released
REP 80	September 2006
REP 105	October 2007
REP 149	February 2009

Contents

Key findings and recommendations	4
A The assessment.....	5
Purpose and scope.....	5
Background.....	6
Our methodology	6
B Our observations.....	8
Supervisory arrangements.....	8
Resources.....	11
Conclusion	12
Key terms	13

Key findings and recommendations

Key findings

- 1 ASIC is satisfied that Mercari has:
 - adequate arrangements for supervising its market in accordance with its obligations under s792A(c) of the Corporations Act; and
 - sufficient resources to operate its market properly and for the required supervisory arrangements to be provided under s792A(d) of the Corporations Act.

Recommendations

- 2 We do not have any recommendations to make in relation to Mercari's current supervisory arrangements.

A The assessment

Key points

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

The scope of our assessment must always include the obligations found in s792A(c), but we can include other Ch 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 a licensee has operated its market.

Purpose and scope

- 3 Under s792A(c), a market licensee is required to have 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 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.
- 4 ASIC is required to assess how well a market licensee complies with its obligations in s792A(c) at least once a year: s794C(2).
- 5 In addition, we are permitted to extend the scope of our assessment to review how well Mercari complies with any or all of its obligations under Ch 7: s794C(1). As such, we have examined whether Mercari had sufficient financial, technological and human resources to comply with its obligations under s792A(d).
- 6 This report covers the period 21 December 2007 to 18 December 2008 (assessment period), although we have had regard to subsequent developments.

Background

- 7 Mercari is an Australian registered company wholly owned subsidiary of Financial and Energy Exchange (FEX). FEX is also an Australian registered company, developing a suite of services for the Asian energy, commodity, environmental and financial markets.
- 8 Mercari's Australian market licence permits Mercari to operate its financial market, Mercari Direct. Mercari Direct is an electronic bilateral negotiated market that facilitates trading in foreign exchange derivatives and interest rate derivatives.
- 9 The total turnover in the Australian over-the-counter (OTC) financial markets for 1 July 2007 to 30 June 2008 was \$79,576 billion. The turnover for foreign exchange and interest rate derivatives in the Australian OTC financial markets for the same period was \$60,469 billion.¹ There has been limited trading on Mercari Direct during the assessment period.
- 10 The participants of Mercari Direct are wholesale entities, and are either banks or subsidiaries of banks.
- 11 In addition to an Australian market licence, Mercari continues to hold an Australian financial services (AFS) licence authorising it to carry on a financial services business to wholesale clients in relation to certain financial products. A copy of Mercari's Australian market licence and the terms of its AFS licence are available on our website at www.asic.gov.au/markets.

Our methodology

Our assessment process

- 12 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.
- 13 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 Corporations Act at the time of the assessment; and
 - identify issues, which in our view need, or may need, to be addressed to ensure ongoing compliance.

¹ Australian Financial Markets Association, *2008 Australian Financial Markets Report*, p. 2.

What we focused on for this assessment

- 14 Our focus in this assessment was to review:
- how well Mercari complied with its ongoing supervisory and reporting obligations under its Australian market licence and the Corporations Act;
 - any changes in Mercari's operations from the previous year's assessment; and
 - whether Mercari had adequate resources.

What we considered

- 15 In conducting our assessment of Mercari we reviewed:
- material received under a notice served under a s30 of the *Australian Securities and Investments Commission Act 2001* (Cth) including financial statements;
 - Mercari's annual regulatory report required under s792F of the Corporations Act;
 - policies and procedures for the conduct of Mercari in general and its supervisory responsibilities in particular;
 - publicly available information on Mercari's website; and
 - discussions held with Mercari personnel, including a director, the compliance officer and a broker about their responsibility for the supervision of Mercari.

Consultation

- 16 Our findings are set out in Section B of this report. Mercari has had the opportunity to view and comment on the factual accuracy of a draft version of this report. Where appropriate, our findings in Section B reflect Mercari's clarifications.

B Our observations

Key points

We consider that Mercari's arrangements for supervising its market are adequate, including arrangements 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.

Mercari did not make any substantial changes to its supervisory arrangements during the assessment period.

We also consider that Mercari has adequate financial, technological and human resources to operate its market.

We do not have any recommendations to make in relation to either Mercari's current supervisory arrangements or resources.

Supervisory arrangements

- 17 We conclude that Mercari has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act.
- 18 Our conclusion is based on the following observations drawn from information gathered during the assessment process:
- ASIC is not aware of Mercari substantially changing the arrangements it has in place for supervising the market from that considered during the last assessment;
 - no serious market failures or disruptions have come to our attention;
 - there has been limited trading on Mercari Direct during the assessment period; and
 - during the assessment period no information came to our attention to suggest that the supervisory arrangements in place were not operating adequately.
- 19 Mercari's framework for supervision includes:
- the surveillance officer who—

- has the responsibility for the supervision of the market and the monitoring the conduct of participants, and
- reports any suspected or actual breaches to the directors;
- the product supervisors play a supporting role in monitoring the market and report any significant concerns about the operation of the market to the surveillance officer; and
- the directors of Mercari decide what action Mercari will take to a suspected or actual breach.

Managing conflicts of interest

- 20 Mercari's written policy and procedure detail how conflicts between its supervisory and commercial interests are managed. They include:
- the obligations and priorities of Mercari's employees;
 - how a conflict of interest may be identified;
 - procedures to minimise conflicts of interest; and
 - how employees may avoid conflicts of interest.
- 21 The procedure states that all Mercari employees must report any conflict of interest they identify to the directors of Mercari. The directors then assess the conflict of interest and respond to the staff or clients involved by either meeting with them or by written announcement. In response to a conflict of interest the directors may:
- rearrange the allocation of client representatives to avoid or reduce the conflict of interest;
 - decline to provide services to the particular client;
 - initiate internal or external disciplinary action where warranted; or
 - refer to an appropriate and independent body to offer alternative solutions for managing the conflict of interest.
- 22 All conflict of interest situations reported or observed and all actions taken to correct conflict of interest situations are recorded in the Compliance (Breach) Register.
- 23 No conflicts of interest events were identified during the assessment period.

Monitoring the conduct of participants

- 24 Mercari's supervisory arrangements for monitoring the conduct of participants on or in relation to the market is set out at section 2.2 of ASIC's report on its first annual assessment of Mercari (REP 80) issued in September 2006. A summary follows in paragraphs 25–27.

- 25 Operating rule 4.1 states that the surveillance officer will monitor all active dealing screens to ensure that all participants are acting in compliance with the operating rules. Mercari Direct Written Procedure 10—Supervision states that the surveillance officer will be responsible for the supervision of the market, including the conduct of participants on or in relation to the market and enforcing compliance with the operating rules.
- 26 If the surveillance officer discovers an actual or suspected breach the surveillance officer will report the breach to a director of Mercari and provide a written recommendation as to the appropriate action that Mercari should take. The surveillance officer will record the actual or suspected breach in the compliance register. The surveillance officer will then convene a surveillance action assessment meeting to discuss the actual or suspected breach with the directors. The procedures require that a report must be produced after the meeting. The report will include information about the perceived issue, the surveillance officer's recommendation, the decision taken by the directors, and if the director's actions were different from the surveillance officer's recommendation why these alternative actions were taken.
- 27 Procedure 6 notes it is the responsibility of the product supervisors to report immediately to the surveillance officer and to a director any regulatory breaches that they deem may compromise Mercari's ability to meet its obligations as a market licensee or deliver its service. The product supervisors must also enter the outline of any reports into the Product Supervisor Log Book and Compliance Register. Operating Rule 4.1 notes that the administrators will also monitor all active dealing screens to ensure that participants are acting in compliance with the operating rules.
- 28 Mercari did not identify or take action in relation to any breaches during the assessment period.

Enforcing compliance with operating rules

- 29 Operating rule 2.2 states that all participants of the market must comply with the operating rules of Mercari. Under operating rule 3.1, to participate in Mercari Direct, a participant must operate in accordance with the operating rules. Operating rule 3.2.10 gives Mercari the right to suspend or cancel the authorisation of any participant or employee of a participant if they breach an operating rule. Operating rule 6.4 gives Mercari the right to remove any order from the dealing screen at any time. Clause 5 of Mercari's Client Agreement gives Mercari the right to remove a participant's order from the dealing screen at any time and for any reason.
- 30 Compliance with the operating rules is largely facilitated through the operation of Mercari Direct. The system rejects certain trading activity, which is or may be in breach of the operating rules.

- 31 Market supervisors and the compliance officer use internal procedures to monitor participant conduct and enforce compliance with the operating rules.
- 32 Mercari informed us that during the assessment period, there were:
- no changes to the operating rules; and
 - no breach or potential breach of the operating rules was identified.
- 33 During the assessment we did not identify any substantial changes to the processes, which were outlined in Mercari's application for an Australian market licence to enforce compliance with its operating rules.

Resources

- 34 We conclude Mercari has sufficient resources to operate its market properly in accordance with its obligations under s792A(d) of the Corporations Act.

Financial resources

- 35 We are satisfied that Mercari's financial resources were sufficient to operate its market during the assessment period.
- 36 Mercari's financial resources to operate its market are derived from:
- income generated by brokerage fees;
 - net assets within Mercari's ownership and control; and
 - financial support from FEX.
- 37 Following discussions about Mercari's financial resources during this assessment period, Mercari agreed to supply ASIC with monthly financial reports from 30 April 2009.

Technological resources

- 38 The current technology has coped with existing volumes on the market and no serious market disruptions have occurred.

Human resources

- 39 Mercari employs staff in various capacities for commercial, supervisory and technological functions.
- 40 Changes in personnel include the replacement of two executives whose duties were absorbed by two existing senior managers. An additional four staff have been employed to work in administration, brokerage, product supervision and product development.

41 We consider Mercari has sufficient human resources to operate and supervise its market.

Conclusion

42 ASIC is satisfied that Mercari has:

- adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c); and
- sufficient resources to operate its market properly and for the required supervisory arrangements to be provided under s792A(d).

Key terms

Term	Meaning in this document
\$79,576 billion	An amount in Australian dollars (in this example 79,576 billion)
AFS licence	Australian financial services licence
ASIC	Australian Securities and Investment Commission
assessment period	The period covered by this report being 21 December 2007 to 18 December 2008
Corporations Act	The <i>Corporations Act 2001</i> (Cth)
FEX	Financial and Energy Exchange Ltd
market licensee	Holder of a s795B Australian market licence
Mercari	Mercari Pty Limited
Mercari Direct	Mercari's market (an electronic bilateral negotiated market that facilitates trading in foreign exchange derivatives and interest rate derivatives)
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C)