



ASIC

Australian Securities & Investments Commission

REPORT 166

Market assessment report: Asia Pacific Exchange Limited

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About this report

This report summarises ASIC's fifth assessment of Asia Pacific Exchange Limited (APX) under s794C of the *Corporations Act 2001* (Cth) (Corporations Act).

This assessment covers the period 17 April 2008 to 1 April 2009.

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

Australia Pacific Exchange Limited was granted an Australian market licence commencing 11 August 2004. The licence was varied with effect from 8 April 2009 to reflect the change of name of the licensee to Asia Pacific Exchange Limited (APX).

Report number	Date released
REP 61	November 2005
REP 90	February 2007
REP 116	January 2008
REP 154	April 2009

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Key findings and agreed actions

Key findings

- 1 ASIC is satisfied that APX has:
 - adequate arrangements for the supervision of 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.

Agreed actions

- 2 We have made the following recommendation to promote improved record-keeping by APX of its supervisory decisions.
- 3 APX has agreed that it will implement and maintain a framework for ensuring that its registers, and the other records it maintains for supervisory decisions, include clear records of which party made the decision and what the basis for that decision was.

A The assessment

Key points

ASIC conducts annual assessments of market licensees, such as APX, because it is required to do so under s794C of the Corporations Act. We also conduct annual assessments of clearing and settlement facility licensees under s823C.

The scope of our assessment must 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 the licensee has operated its market.

Purpose and scope

- 4 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.
- 5 ASIC is required to assess how well a market licensee complies with its obligations in s792A(c) at least once a year: s794C(2).
- 6 In addition, we are permitted to extend the scope of our assessment to review how well APX 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.
- 7 The report covers the period 17 April 2008 to 1 April 2009 (the assessment period), although we also had regard to subsequent developments.

Background

- 8 The APX Australian market licence (market licence) permits APX to operate a market in securities and managed investment products. Australia Pacific Exchange Limited was granted a market licence commencing 11 August 2004. APX commenced operation of its market on 20 January 2005. The market licence was varied with effect from 8 April 2009 to reflect a change of name of the licensee to Asia Pacific Exchange Limited. A copy of APX's market licence is available on ASIC's website at www.asic.gov.au/markets.
- 9 APX currently has a 'broker' approved to participate in its market and three participating 'sponsors'. The sponsors act as advisers to APX-listed entities (listees). For some parts of the assessment period, APX had up to three listees on its market. However, Australian Social Infrastructure Fund was removed from APX's official list on 30 May 2008 and the Future Capital Development Fund was delisted on 16 January 2009. At the end of the assessment period, APX had one listee, namely Everbrite Corporation Limited, which was suspended from quotation throughout the assessment period. Limited trading took place on APX's market up until the delisting of Future Capital Development Fund and since then no further trading has taken place.
- 10 APX also has a category of participant known as 'research panellist', which is relevant only to listed property funds. APX currently has no property listees and as such, there is no requirement for research. However, there are currently two entities approved as research panellists.
- 11 Participants enter orders into the APX market via an electronic interface and then APX manually processes buy and sell orders received from these participants. These orders are matched within the APX trading system and settled via a paper-based transfer of certificates between counterparties, on a 'T+5' cycle.
- 12 APX was acquired by AIMS Financial Group (AIMS) in October 2008. Changes to the APX Board and operating teams have since been made and APX's operations were relocated from Melbourne to Sydney in March 2009.
- 13 Within the wider AIMS Group, two companies hold Australian financial services licences to deal in and provide general advice for a number of classes of financial products, including securities, derivatives, insurance products and managed investment schemes. This assessment of APX does not cover other AIMS entities' compliance with Australian financial service licence obligations.
- 14 Under its new owners, APX is undertaking a process of reassessing its business and looking for new development opportunities. AIMS has indicated that it plans to build APX into a quality, sustainable, long-term business. As part of this, over the next 12 months, APX will invest in a re-

write of the APX business and listing rules, the acquisition of additional resources, and certain longer-term projects, where appropriate.

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 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 that, in our view, need or may need to be addressed to ensure ongoing compliance.

What we focused on for this assessment

- 17 Our focus in this assessment was to review:
- any changes in APX's operations from the previous year's assessment, including changes made in response to the matters we identified in our previous assessment;
 - APX's supervisory arrangements including any changes to the way it carries out its supervisory functions since our last assessment and since APX's change in ownership;
 - APX's arrangements for managing conflicts of interests, including ensuring its operations are adequately segregated from the operations of AIMS; and
 - whether APX had adequate resources.
- 18 We also discussed with APX executives their immediate and longer-term plans and priorities for the market.

What we considered

- 19 In conducting this assessment we:
- analysed information we received from and about APX in the ordinary course of our dealings with APX, including APX's annual regulatory report required under s792F;

- reviewed monthly financial statements previously supplied by APX;
- reviewed information from the media, APX's website, ASIC's complaints management records and other sources;
- reviewed operational records relating to the conduct of the market, including APX's supervisory responsibilities;
- considered the operation of the market throughout the period;
- interviewed APX personnel; and
- reviewed updates made to APX policies and procedures for the conduct of its market in general and their supervisory responsibilities in particular.

20 From 9 June 2009 to 11 June 2009, ASIC representatives attended the offices of APX in Sydney. During this on-site phase of the assessment, we spoke with APX personnel and management.

Consultation

21 Our findings are set out in Section B of this report. APX has had the opportunity to comment on the factual accuracy and recommendations contained in a draft version of this report. Where appropriate, our findings in Section B reflect APX's responses.

B Our observations and agreed actions for APX

Key points

ASIC is satisfied that 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
- enforcing compliance with the market's operating rules.

We have made a number of observations and a recommendation based on our assessment. APX has agreed to implement the recommendation and, therefore, it has been identified as an agreed action in this report.

Specifically, improvements will be made to APX's framework for recording supervisory matters and decisions.

APX has indicated that it will undertake a review of its operating rules, including those relating to the power of waiver.

We note that APX has complied with its reporting obligations under the Corporations Act.

Supervisory arrangements

- 22 ASIC is satisfied that APX has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c).
- 23 This conclusion is based on the following observations drawn from information gathered during our assessment process and our observations from our ongoing correspondence with APX:
- APX's framework for supervision includes:
 - a full-time Compliance Officer who operates in the Sydney office and is responsible for the day-to-day monitoring of operational activities, complaint handling, investigations and enforcement;
 - a General Manager Compliance and Supervision (GMCS) who is located in the Melbourne office and addresses high-level supervisory and compliance issues (the Compliance Officer reports to the GMCS);

- a Market Supervision Committee (MSC) which operates out of Melbourne and is comprised of independent members who review APX’s ongoing regulation of its market and compliance with the terms of its market license (the GMCS reports on a bi-monthly basis to the MSC on matters that may impact APX’s ongoing ability to comply with matters within the MSC’s ambit); and
 - a number of other independent committees and tribunals responsible for monitoring and/or overseeing particular aspects of APX’s operations and supervisory obligations.
- The only change to this framework during the assessment period was to the Compliance Officer role. APX’s Compliance Officer previously worked part-time, out of the Melbourne office. Following the AIMS acquisition and relocation of APX’s operations to Sydney, a new person assumed this role on a full-time basis.
 - There has been no trading conducted on APX’s market since January 2009. Consequently, it was only necessary for the APX Quotation Committee, which deals with matters relating to quotation of listed entities on APX, to convene on two occasions during the assessment period. The MSC met every two months throughout the assessment period to discuss matters relating to APX’s ongoing compliance and financial arrangements.
 - From March 2009, APX relocated its operations from Melbourne to premises in Sydney, which it shares with AIMS. All APX operational functions are now performed out of the Sydney office, where APX has a dedicated room within the AIMS office. The designated APX area is accessible to authorised APX personnel only, via swipe card.
 - During the assessment period, no serious market failures or disruptions have come to our attention, and no information came to our attention to suggest that the supervisory arrangements APX had in place were not operating properly.

Supervisory decisions

- 24 ASIC noted three instances during the assessment period where, in minutes of Committee meetings and the APX breach register, it was unclear whether certain supervisory decisions were made by operations staff, rather than supervisory staff (as appropriate). One involved a listee and the other two a broker. Further, the records were less than clear on the basis of any decisions.
- 25 Based on our discussions with supervisory personnel during the assessment, we are satisfied that the decisions in question were in fact made by supervisory staff, independently of commercial considerations. Our concern

on this matter relates only to the manner in which APX recorded the decisions. Complete records assist review of decisions by APX or third parties (such as ASIC).

Agreed Action 1: Recording supervisory decisions

APX has agreed to implement a framework for ensuring supervisory decisions are adequately recorded. This will include recording at least the following information in relevant APX registers and/or other books:

- details of any operational input sought from commercial APX divisions; and
- who the ultimate decision maker was, and the basis/reasons for the decision.

Compliance plan

- 26 During ASIC's 2008 assessment of APX, we noted that Part 7.1 of APX's compliance plan states that an amendment or variation to the plan is not effective without ASIC's approval. As discussed with APX at that time, it is not ASIC's practice to approve or endorse the internal policies and procedures of a market licensee, except to the extent that they amount to 'operating rules' as defined in s761A of the Corporations Act. APX advised that when it next updates the compliance plan, it would amend this provision to state that a copy of the compliance plan must be provided to ASIC, rather than referring to any requirement of ASIC approval of the plan.
- 27 The only updates APX made to its compliance plan during the assessment period were changes to the logo and company name on the document, to reflect APX's corporate name change in December 2008. Subsequent to the assessment period, APX made more substantive amendments to the plan and Part 7.1 was updated as agreed in the 2008 assessment.

Conflicts handling

- 28 APX operates out of a secure area within the AIMS office. After moving its operations to Sydney, APX entered an arrangement with AIMS for two AIMS staff members to fill the role of APX Action Officer on a part-time basis, assisting the one dedicated, full-time APX Action Officer. Since completion of the assessment one of the part-time employees ceased employment with AIMS (and therefore, APX). Action Officers perform operational functions in APX's Listing and Market Administration & Supervision divisions and report to the Department Manager. APX's current Department Manager is also an AIMS employee, however, once she has finalised certain AIMS matters she will work on a full-time basis for APX.

- 29 In certain circumstances, where the performance of AIMS work is warranted, permission may be granted on a restricted basis for APX staff or management to bring AIMS work into the secure APX area. Such arrangements are subject to stringent conditions regarding confidentiality, conflicts management and adherence to APX policies and procedures. Both staff and management demonstrated an understanding of these requirements during on-site discussions.
- 30 All electronic APX files are saved in a directory/drive that AIMS employees do not have permission to access. The APX Action Officer who is currently shared with AIMS has no ability to access the APX drive and files within it when he is not working within the secure APX area.
- 31 The APX employee code of conduct requires all staff members to disclose their material interests and APX's Conflict Management Plan (CMP) requires supervisory decisions to be separated from commercial ones. The CMP specifies that all staff must complete a questionnaire to identify their material interests when they commence employment with APX, and that employees who make supervisory decisions must provide certification of their material interests at least annually thereafter.
- 32 During on-site discussions with APX's Compliance Officer, he indicated that APX intends to review and update its approach to conflicts management in the future. ASIC suggests that APX should annex its conflict questionnaires to the CMP and refer to the requirements and processes for each questionnaire in the policy itself.
- 33 Based on our review of all information at hand and information provided by APX, APX's arrangements for managing conflicts between its supervisory obligations and its commercial interests are adequate for the nature of the market it operates. ASIC will monitor the ongoing adequacy of APX's conflicts handling arrangements in its next assessment of APX and as APX implements its future business plans via changes to its operating rules.

Employee trading

- 34 In response to a recommendation made in ASIC's 2008 assessment, APX formulated an employee share trading policy in April 2009. The APX board formally approved this policy via circular resolution in early June 2009. In the interests of maintaining internal controls and a transparent market, APX's policy prohibits all employees from conducting personal trading on APX's market.
- 35 The policy was circulated to APX staff prior to formal approval and those staff members interviewed during the assessment knew and understood the policy's general terms.

Waiver power in APX Business Rules

- 36 During discussions with APX management, ASIC was advised that the APX Business Rules do not include a power of waiver. These discussions arose in the context of a matter where a participant had failed to comply with an APX rule over an extended period, and APX had allowed this to continue because there were extenuating circumstances and APX did not consider any enforcement action was warranted.
- 37 The rules framework of a public exchange operating in Australia gives rise to certain expectations in the minds of investors about the organisations participating in that exchange, the entities listed upon it, and the obligations by which they will be bound. In unique or new circumstances that the existing rules do not accommodate, it may be appropriate to waive certain rules. However, consistent with the principles of a fair, orderly and transparent market, such waivers should be granted and recorded in accordance with a formal procedure. This will assist the licensee to track instances of recurring waivers, assess the effectiveness of its rules (and identify any need to amend the rules or create new ones) and monitor recurrent issues arising in relation to market participants.
- 38 During assessment discussions, APX indicated it would undertake a comprehensive review and re-write of its operating rules as one of its immediate priorities. Subsequent to the assessment period, on 8 July 2009, APX informally submitted changes to its business and listing rules, including insertion of a power of waiver. Under the proposed changes, a power of waiver will exist in the operation of both the business and listing rules. We will liaise with APX to ensure the adequacy of the new rules as part of the rule change process.

Monitoring the conduct of participants

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

Clearing and settlement arrangements

Late settlement policy

- 40 Following a recommendation made in ASIC's 2008 assessment report, APX prepared a late settlement policy in April 2009.
- 41 Settlement of trades in APX's market involves a paper-based exchange of certificates, five business days after trade date (T+5). APX's late settlement

policy states that a fine of \$50 per day will be imposed 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. APX has the discretion to waive fail fees if it considers the circumstances surrounding the failed trade warrant such a waiver.

- 42 ASIC is satisfied that APX's late settlement policy appears to address the key areas raised during the 2008 assessment. However, we note that given the low levels of trading throughout this year's assessment period, the policy has not yet been empirically tested.

Resources

- 43 ASIC is satisfied that APX has sufficient resources to operate its market properly and for the required supervisory arrangements to be provided under s792A(d). The following paragraphs set out our key observations in respect of APX's resources.

Financial resources

- 44 Following discussions about APX's financial resources during the 2008 assessment, APX agreed to supply ASIC with monthly financial reports from 31 July 2008. We indicated in our 2008 assessment report (issued April 2009) that we were satisfied with APX's financial resources, based on the financial reports and other financing arrangements that APX had put in place.
- 45 Based on the information supplied by APX for this year's assessment and discussions with APX executives during the assessment, this view has not changed and we are satisfied that APX's financial resources are sufficient.
- 46 ASIC accepts that APX's cash flows may be uneven during its intended development phase over the next 12 months, and is satisfied that AIMS is committed to funding the market during this period.

Human resources

- 47 During the assessment period, APX underwent a number of changes in senior management and operational staff, following the AIMS acquisition. As discussed in paragraph 28, it now has a part-time Action Officer (shared with AIMS) in addition to the existing full-time Action Officer. By comparison, during the 2008 assessment period, APX only had one Action Officer, who worked on a full-time basis.

- 48 A full-time Compliance Officer based in APX's Sydney office was also appointed during the assessment period, as per paragraph 23. This was previously a part-time position.
- 49 The current APX Department Manager will become a full-time APX employee once she has finalised certain AIMS matters.

Technological resources

- 50 APX's current technology has coped with existing volumes on the market and no serious market disruptions have occurred. APX has indicated its preparedness to invest in additional technological resources as the market grows and develops in future.

Response to 2008 assessment recommendations

- 51 We made two recommendations in our 2008 annual assessment of APX. Specifically, we recommended that APX implement policies/procedures for dealing with late settlement fees and in respect of employee trading on APX's market. As set out in paragraphs 40–42 and 34–35 of this report, APX implemented these policies in April 2009.

Our view of APX's responses

- 52 We are satisfied with APX's responses to the recommendations in the 2008 assessment.

Key terms

Term	Meaning in this document
AIMS	AIMS Financial Group
APX	Asia Pacific Exchange Limited
ASIC	Australian Securities and Investments Commission
Ch 7 (for example)	A chapter in the Corporations Act (in this example, numbered 7)
CMP	Conflict Management Plan
Corporations Act	<i>Corporations Act 2001</i> (Cth)
GMCS	General Manager Compliance and Supervision
market licence	An Australian market licence under s795B that authorises a person to operate a financial market
market licensee	A person who holds a market licence under s795B
MSC	Market Supervision Committee
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C)