ASIC
Australian Securities & Investments Commission

REPORT 175

Market assessment report: NSX Ltd group

National Stock Exchange of Australia Limited, ACN 008 624 691

Bendigo Stock Exchange Limited, ACN 087 708 898

November 2009

About this report

This report summarises ASIC's seventh assessment of NSX Limited (NSXL) group licensee National Stock Exchange of Australia Limited (NSXA) and the seventh for Bendigo Stock Exchange Limited (BSX), under s794C of the *Corporations Act 2001* (Corporations Act).

The assessment covers the period from 3 March 2008 to 7 March 2009. Accordingly, it does not address the Government announcement of 24 August 2009 on proposed structural changes to the supervision of Australia's financial markets.

NSXL group will continue to have its current supervisory responsibilities for its markets and clearing and settlement facilities until at least the end of the next period for assessment purposes.

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 NSXA and BSX

The Stock Exchange of Newcastle Limited was granted an Australian market licence (market licence) commencing 8 March 2002. The market licence was varied with effect from 31 March 2004 and again from 20 December 2006, the latter variation including recognition of the change of name of the licensee to National Stock Exchange of Australia Limited.

BSX was approved as a stock exchange under s769(1) of the Corporations Law on 6 October 2000. BSX subsequently was granted a market licence under the transitional provisions (s1413) of the Corporations Act, effective from 8 March 2002. The licence was varied with effect from 13 May 2004.

NSXA report number	Date released
N/A	November 2003
REP 36	December 2004
REP 42	June 2005
REP 82	September 2006
REP 118	March 2008
REP 157	May 2009

BSX Report number	Date released
REP 35	November 2004
REP 47	July 2005
REP 141	April 2009 (finalised May 2007)
REP 151	March 2009

Contents

Key findings and recommendations

Key findings

1 ASIC is satisfied that the NSXL group has:

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

Recommendations and agreed actions

2 ASIC has made recommendations to promote:

- improved supervision of NSXL participants' capital adequacy returns;
- adequate management of certain conflicts of interest; and
- policy development to mitigate and anticipate the effects of 2008–09 financial market turmoil, including in relation to trading in partly paid shares.

NSXL group has agreed to implement these recommendations.

3 We have also made observations about some areas where consideration could be given for improvements.

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. 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 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, an on-site inspection including interviews with directors and supervisory staff, 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 under 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 a market complies with any or all of its obligations under Ch 7: s794C(1). For this reporting period we extended the scope of the assessment to include a review of the two NSXL licensees' 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 This report covers the period 3 March 2008 to 7 March 2009 (the assessment period) although we also had regard to subsequent developments, in particular the May 2009 contest for control of NSXL and successive boards' differing proposals for injections of additional capital.

Background

8 The licensees, NSXA and BSX, are wholly-owned subsidiaries of NSXL, a company listed on the Australian Securities Exchange. ASIC's report on NSXA for the period to 2 March 2008 was published on the ASIC website on 18 May 2009 (*Market assessment report: National Stock Exchange of Australia Limited* (REP 157)). The most recent ASIC assessment report on BSX was published on the ASIC website on 9 April 2009 (*Market assessment report: Bendigo Stock Exchange Limited* (REP 151)).

9 NSXA and BSX's market licences permit them to operate markets in the financial products that they traded before they moved under the Corporations Act licensing regime. The products they are permitted to trade are described on their licences (i.e. government debentures, stocks or bonds, shares and debentures of a body, managed investment scheme interests, options, and agreements of a kind to which s92A of the Corporations Law applied).

10 The Stock Exchange of Newcastle Limited and BSX came under market licences commencing 8 March 2002. Their licences have been varied subsequently. Copies of NSXA and BSX's market licences, and variations to them, are available also on our website at www.asic.gov.au/markets.

The nature of the markets

11 At the end of March 2008 there were 61 equity and debt securities quoted on the NSXA market and 62 on the BSX market. By March 2009, the numbers of quoted products were, respectively, 74 and 34. The fall in BSX listings was mainly due to community banks delisting and obtaining ASIC registration as low-volume exempt markets.

12 In March 2008, NSXA had 14 participants, and BSX had three. The three BSX participants were common to the two licensees. By March 2009, NSXA had 11 participants, and BSX retained three. The three participants remain common to both licensees.

13 NSXA market capitalisation at the end of July 2009 was $720 million. As in the last reporting period, NSXA trade executions have rarely been more than 10 per day. Over the period covered by the report, monthly trading declined. In March 2008 there were 72 executed trades ($745,237). In March 2009 there were 56 trades ($471,388). In calendar year 2008 average trade value was $14,377 (38,358 securities). In 2007, it was $24,672 (42,701 securities).

14 BSX lists community bank entities which have unusual investment characteristics and whose securities are rarely traded. The trading volumes for the remaining BSX entities are higher than those on the NSXA list. In March 2009 there were 28 trades ($233,926) through the BSX market. At the

end of July 2009, the market capitalisation of the four substantial listed property and SME entities was $44.27 million.

Change of control during the assessment period

15 During the assessment period there was a change of board composition in the parent company. On 27 March 2009, NSXL shareholders, concerned about liquid capital reserves and the rate of increase in NSXL expenses, requisitioned an extraordinary general meeting (EGM).

16 The requisitioned EGM was held on 28 May 2009. Prior to the EGM the NSXL board resigned. Three new directors were nominated by the requisitioners and endorsed by shareholder vote on 28 May. NSXL shareholders voted against a proposal of the former NSXL board that New Zealand Stock Exchange Limited (NZX) should take a controlling interest in NSXL, through placement of over 50% of NSXL shares to NZX in return for consideration of A$11.78 million, and it did not proceed.

17 As this capital injection did not proceed, after the change of board composition ASIC met with the new board to discuss sufficiency of resources and market supervision key person risk.

Business model

18 In addition to operating the BSX and NSXA licensed markets for financial products described in those two licences, during the assessment period NSXL operated markets for taxi licences and water interests. Neither the taxi licences nor the water interests constitute a financial product at law.

19 During the assessment period the pre-26 May 2009 NSXL board decided to move away from its previous strategy of establishing differentiated market segments based on discrete geographical or other descriptors.

Policy on admission to quotation

20 The NSXA and BSX market rules differ in the way they approach the question of whether a product is admitted for quotation. NSXA requires issuers applying for admission to its official list to have a sponsoring broker and an exchange-approved nominated adviser (NOMAD). The sponsor is required to ensure the issuers' directors understand:

- their contractual obligations to the market operator;
- the avenues for exchange disciplinary action that may lie against them for the listed entity's breach of listing rules; and
- that they must not place equity shares with related parties.

The role of NOMADs is described in REP 157.

21 BSX has a set of admission criteria for new listings. In the past, ASIC noted concerns with the admission of community bank entities, which require frequent standard waivers of BSX listing rules. Previous assessment reports REP 141 and REP 151 elaborate on this issue.

Enforcement of operating rules

22 Both markets have in place memoranda of understanding that provide for referrals to be made to ASIC of suspected contraventions of law. Both licensees also make provision to enforce their listing and business rules directly through disciplinary panels. NSXA operating rules make provision to discipline sponsoring brokers and NOMADs that fail to perform their obligations to NSXA.

Clearing and settlement

23 The NSXL group does not operate a clearing and settlement facility. BSX securities are not CHESS registered and clearing and settlement is performed by participants bilaterally. NSXA is a CHESS settlement participant. For clearing of NSXA trades where the NSXA participant is not also an ASX Settlement and Transfer Corporation Pty Ltd settlement participant, NSXA produces the net settlement report for its participants. Participants deposit funds into NSXA's account. When ASX CHESS produces daily net holdings reports which detail shares that need to be transferred in CHESS, NSXA issues CHESS messages to its trading participants to effect settlement of securities.

Our methodology

Our assessment process

24 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.

25 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

26 This assessment focussed on:

- the sufficiency of NSXL financial resources (we examined whether NSXL would have sufficient liquid capital to operate its markets for financial year 2009–10 and maintain supervision standards);
- how NSXA and BSX responded to the recommendations and issues we identified with their supervisory arrangements in our previous assessment (see Section C); and
- criteria to determine suitability for listing (this year we again focused on BSX community bank listings, but also examined NSXL policy on supervision of partly paid shares).

What we considered

27 In conducting our assessment we:

- analysed information we received from and about NSXA and BSX in the ordinary course of our dealings with the licensees, including NSXA and BSX's annual regulatory reports to ASIC required under s792F;
- reviewed information from the media, NSXA and BSX's websites, ASIC's complaints management records and other sources;
- considered the operation of the two markets throughout the period, in particular in relation to issues of disclosure and trading;
- interviewed NSXL group market supervision personnel and directors, who are common to the two licensees; and
- reviewed policies and procedures for the conduct of the NSXA and BSX markets in general and their supervisory responsibilities in particular.

28 From 1 April to 3 April 2009 we attended the offices of NSXA/BSX in Newcastle. We also had regard to matters that came to our attention after 4 April. We interviewed the chairman of the NSXL board audit committee on 4 April 2009 and, during May 2009, were in regular contact with the pre- and post-28 May 2009 NSXL boards. During the on-site phase of the assessment we reviewed NSXA and BSX operational records and spoke to NSXL managers. We met with the NSXL post-28 May 2009 directors on 1 June 2009.

Consultation

29 The NSXL group has had the opportunity to comment on the factual accuracy of draft versions of this report. Where appropriate, this final report reflects NSXL's clarifications and agreement to act in response to our recommendations.

Topics for next assessment

30 As part of its next assessment of the NSXL group, in addition to a review of NSXL group's supervisory arrangements, ASIC intends to include a review of the following matters:

- real-time surveillance;
- conflicts management;
- participant capital adequacy reporting;
- sufficiency of resourcing for supervision;
- appropriateness of securities for admission to quotation; and
- processes for identifying and pre-empting emerging risk.

B Our observations and recommendations for NSXL group

Key points

We consider NSXA and BSX's arrangements for supervising their markets are adequate. This includes the 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 (see paragraphs 31–41);
- monitoring the conduct of participants on or in relation to the market (see paragraphs 65–81); and
- enforcing compliance with the market's operating rules (see paragraphs 42–64).

We have made a number of observations and recommendations based on our assessment. In summary we think that there are improvements which could be made, including:

- involvement in revision of the JORC code; and
- increased deployment of NOMADs to make enquiry of their client listed entities with solvency concerns.

Handling conflicts and the need to ensure that the market is fair, orderly and transparent

31 Generally, we consider NSXA and BSX have adequate arrangements to manage their conflicts. In accordance with ASIC published policy guidance, NSXA and BSX permit staff to mix business development and supervisory duties, and use independent committees to make all significant supervisory decisions. An NSXA compliance committee was established in 2000. NSXL took over BSX on 30 June 2006 and the Charter of the Compliance Committee was then extended to the BSX. From that date, NSXL has used (for its two licensed markets) a committee structure consisting of two separate bodies—the listing and admissions committee and the compliance committee. The two committees make all key supervisory decisions. Both committees are made up of externally engaged members, the majority of whom are independent of the NSXL group, its participants, its listed entities and other commercial stakeholders.

32 Adherence to procedures for staff referral of matters requiring supervisory decision by the two supervisory committees, together with board review of committee processes, gives us assurance that NSXL's two licensees are

meeting their obligations to have adequate arrangements to manage conflicts of interest. We examined decisions made, and the processes followed, by the supervisory committees on admission and ongoing continuous and periodic disclosure supervision and concluded they were satisfactory.

33 In last year's reports we agreed with NSXA and BSX that the NSXL board would take additional steps to ensure that it is kept informed of the licensees' supervisory activities so it is able to make an assessment about whether they continued to meet their obligations to have adequate supervisory arrangements.

Listing and admissions committee

34 The listing and admissions committee is responsible for assessing and approving applications by entities for admission to the BSX and NSXA official lists and, where appropriate, approving applications to be recognised as an NSXA broker or NOMAD. The listing committee refers to the compliance committee decisions on rule waivers that the listing applicant has sought to facilitate its admission.

35 NSXA and BSX's listing rules set out the requirements that an entity must satisfy before it can be listed. During our assessment, we examined all applications for NSXA and BSX listing by community entities and applications from issuers linked to NSXL directors and substantial shareholders presented in the 12 months previously to the listing and admissions committee.

36 The management analyses forwarded to the committee for its review were thorough and involved more than a 'box-ticking' approach. The listing and admissions committee undertook its functions in an appropriate manner and in accordance with its stated charter. We concluded that the listings and admissions committee was making supervisory decisions that were not adversely affected by commercial or other non-supervisory considerations.

Compliance committee

37 In addition to deciding waiver applications, the compliance committee decides whether to take disciplinary action. This committee has as its chairman the NSXL's external consultant compliance officer. From 28 May 2009, one of its four members has been the NSXL/NSXA/BSX board chairman. The involvement of the group chairman gives rise to, at the very least, a perception that for-profit considerations may carry the day. As ASIC has previously said in relation to financial market licensees, at RG 172.89 and 90:

> Conflicts between the commercial interests of the licensee and the need to ensure the market is fair orderly and transparent may arise in any area where a market licensee makes supervisory decisions…

> Conflicts of interest may arise in connection with decisions about:
>
> (a) admission of a person to the market as either a participant or a listed entity;
>
> …
>
> (c) monitoring of a listed entity or market participant;
>
> (d) investigative or disciplinary action; or
>
> (e) the exercise of discretions, such as granting waivers from the market's operating rules or charging variable fees.

38 NSXL takes the view that the group chairman's membership of the four-person compliance committee assists the board to meet the agreed action referred to in paragraph 33. ASIC considers that in order for this conflict to be adequately managed it needs to be monitored and managed closely by NSXL.

Agreed Action 1: Monitoring of NSXL group chairman's conflicts of interest

To assist ASIC in the next assessment, NSXL has agreed to report to us by the end of March 2010 on the effectiveness of its conflicts management arrangements for the operation of the compliance committee in the period between 1 September 2009 and 28 February 2010. The report will include discussion of how NSXL:

- identified and monitored conflicts;
- addressed any identified conflicts.

39 The compliance committee charter defines the responsibilities of its chairman—the group's compliance officer. These are elaborated in previous NSXA assessment reports.

40 During the assessment period the compliance committee held meetings where formal minutes were taken. On other occasions that it met, the compliance committee convened on an ad hoc circular resolution basis to consider waiver applications. The committee attended to significant matters in a timely way; we had no sense that consideration of important supervisory developments was postponed to fit meeting timetables.

41 On referral from the listings and admissions committee, the compliance committee determines prospective listed entity applications for listing rule waivers. Waivers should be used only for exceptional cases not contemplated by the rules. A number of years ago, BSX granted 'standard waivers' of BSX listing rules to permit the listing of community banks, as outlined in *Market assessment report: Bendigo Stock Exchange Limited* (REP 141) (finalised May 2007). While this is no longer the practice, the compliance committee should, as part of its now increased reporting to the

NSXL board, commence positively assuring the board that waivers are not granted which undermine operating rules' normative value.

Enforcing compliance with the market's operating rules

BSX supervision of listed community entities

42 In our last assessment for BSX (*Market assessment report: Bendigo Stock Exchange Limited* (REP 151)) we noted that ASIC and BSX have differences of view as to whether community entities should trade on a public financial market for securities.

43 We note that community entities are a separate segment of the BSX list and when accessing the community entity part of the BSX website, potential investors are warned that these products are securities with different investment characteristics and that brokers will require investors to acknowledge in writing that they have been so advised.

44 In REP 141 we note that there have been some improvements to BSX's supervision of disclosure requirements of community bank entities regarding updates to their prospectus forecasts, but found that only a small number of announcements about the discrepancies were made to the market. We recommended that BSX should address the issue of community entities' non-compliance with listing rules disclosure requirements by more actively monitoring companies that have current prospectus forecasts.

45 During the assessment period, there were a number of community bank entities that still had current prospectus forecasts. These included Inglewood & Districts (admitted June 2008), Canterbury Surrey Hills (June 2008) and Harbord Community Bank (April 2009). We examined these listed entities' prospectus forecasts and compared them to their actual financial performance published in their annual report. Our review noted that there were material differences between prospectus forecasts and actual financial performances for some of them, but BSX had identified these and required announcements to be made.

46 Our review of documents during the onsite visit did reveal that BSX have taken steps to improve its supervision of continuous disclosure requirements of community bank entities in relation to active prospectus forecasts. For instance, BSX supervision staff compiled a list of entities with current prospectus forecasts, and compared these with actual financial performance. This analysis was submitted to the compliance committee for its attention. BSX wrote to the affected entities reminding them of their continuous disclosure responsibilities.

47 BSX followed up these letters with calls to the community bank entities to bring the issue of continuous disclosure compliance to the attention of the relevant community bank entity's board. In some cases, BSX monitored their financial reports more closely, and if necessary contacted the entity to request that they release an explanation to the market. BSX has also formally referred to ASIC a community bank that possibly breached s674 of the Corporations Act.

48 We believe the actions taken by BSX to date in relation to community entities are in line with the agreed action contained in REP 151 regarding the need to improve monitoring of forecasts and continuous disclosure.

Nominated advisers and sponsors—general oversight

49 Of the two NSXL licensees only NSXA adopts the supervisory practice of requiring listed entities to contract separately with an exchange-approved NOMAD and sponsoring broker. Listing sponsorship is used in many international exchanges to supplement exchange or statutory–regulator vetting of disclosure in prospectuses, product disclosure statements and offer information statements. We have seen no evidence to suggest there have been any shortcomings in the NSXA supervision of sponsors.

50 NOMADs complement NSXA's supervision of its market. They are required to be available at all times to advise and guide the directors of an issuer as to their responsibilities and obligations and to ensure the issuer complies with the NSXA listing rules on an ongoing basis. Due to NSXA actions taken in response to recommendations in our last report (see paragraphs 96–97), NSXL has closely monitored potential conflicts of interests held by NOMADs.

51 During the assessment period NSXA concluded that no issues arose that required it to investigate a NOMAD's performance.

Monitoring NOMAD effectiveness in securing disclosure from listed entities

52 NSXA's eligibility criteria for NOMADs require that the NOMAD show 'a degree of independence' from the listed entity that they are advising. NSXA requires each NOMAD to certify annually that it continues to:

- meet the eligibility criteria; and
- act independently, responsibly and in a professional manner in ensuring compliance with NSXA's applicable rules and practice notes.

53 NOMADs have a supervisory role, not least because they may be disciplined under NSXA's rules for not performing their advisory role with a particular issuer satisfactorily.

54 A NOMAD with a business or other relationship with an NSXA-listed disclosing entity or its directors that may have the potential to compromise its regulatory obligation to NSXA is asked to explain in response to the Nominated Adviser annual declaration how it manages its conflicts of interest. The annual declaration return is then lodged as an announcement for each issuer once received.

55 We found no evidence that NOMADs were not performing their obligations as a consequence of lack of complete independence.

Monitoring of continuous disclosure generally

56 NSXA Listing Rules 6.4 and 6.5 require a listed disclosing entity to provide information to NSXA immediately it becomes aware of any information concerning it that a reasonable person would expect would have a material effect on the price or value of the entity's securities. BSX has a similar rule.

57 NSXL encouraged improvement in BSX and NSXA listed entities' continuous disclosure by circulating a draft guidance note on profit forecasts and continuous disclosure responsibilities to listed entities and to NOMADs, seeking their comments. NSXA have subsequently published a final version of this guidance note incorporating comments received from the NOMADs.

58 On both the NSXA and BSX markets there was a drop in trading volumes and frequency of trade executions. Despite this the number of announcements to the market increased.

59 NSXL does not promote use of its announcements platforms for dissemination of marketing material that has no bearing on pricing of securities. NSXL supervisory staff check announcements to ensure they are complete and not potentially misleading.

Monitoring periodic disclosure

60 Under the NSXA and BSX listing rules, an entity must advise the relevant licensee of its financial results for each half year and full financial year. Both licensees' procedures require licensee supervision staff to pay particular attention to both the timeliness and substance of the information provided.

61 We sampled entities' compliance with the financial reporting lodgement deadlines imposed by the licensees' rules. We noted that NSXL supervisory staff proactively contacted listed entities when reporting deadlines were imminent and that the vast majority of entities met those deadlines. NSXA and BSX appropriately suspended trading immediately in the securities of any that did not.

62 NSXL undertakes reviews of all periodic annual financial reports to ensure they comply with the additional information requirements of NSXA and

BSX's listing rules. NSXL sent letters to entities where additional disclosure was required. NSXL recognised that periodic disclosure required that follow-up requisitions take place as soon as possible after receipt of financial reports. NSXL continues to improve its timeliness for sending out these letters.

63 During the reporting period, five listed entities were suspended from trading due to late lodgement of half-yearly or full-year financial reports, and the action notified/referred to ASIC for possible additional enforcement action.

64 We have no recommendations concerning NSXA or BSX's monitoring of disclosure obligations.

Monitoring the conduct of participants on or in relation to the market

65 For supervision of participants, NSXL:

- monitors participant trading in its market for principal and agency trading irregularities;
- monitors participant governance arrangements through a universal annual participant self-assessment together with subsequent on-site interview program; and
- conducts monthly analysis of participants' capital adequacy.

66 ASIC considers that the NSXL group program of on-site visits is adequate for the nature of the licensees' markets. We do not comment further on this aspect.

Surveillance for trading irregularities

67 NSXL uses 'Compliance Explorer' and SMARTS, software products of Capital Markets CRC Limited, as its main tools for market trading surveillance.

68 NSXL's SMARTS surveillance monitors trading behaviour in real time, and generates automatic alerts where trading falls outside certain pre-determined parameters. NSXL specifies these parameters in its internal written surveillance procedures, with responsibility for monitoring alerts resting with NSXL's general manager.

69 Whenever an alert is triggered, it is investigated by surveillance staff, who subsequently inform the general manager when necessary. If it is deemed necessary to query an entity regarding unusual trading behaviour, NSXL writes to the company, which then has three days to respond. This correspondence is released to the market through licensees' websites.

70 We have no recommendations concerning NSXA and BSX's market surveillance.

Participant capital adequacy supervision

71 During the assessment period, there were at various times 13 and 14 NSXA participants. Three of these are also the only BSX participants (AAA Shares, ABN Amro Morgans and Stratagem Investment Services). Findlay & Co Stockbrokers, an NSXA participant, was deregistered during the assessment period. During the assessment period Centre Capital Securities was admitted as an NSXA participant.

72 Under NSXA Business Rule E1.3, all NSXA participants are required to maintain an ongoing capital position of $50,000 or 5% of adjusted liabilities, whichever is greater. To permit NSXL to monitor compliance, participants are required to lodge surplus liquid funds calculations (SLF) each month (for the previous month) with the Exchange Examining Accountant (EEA), McCosker & Partners Pty Ltd.

73 Participants are also required monthly to submit a Return of Aged Debtors (RAD) to the EEA, under Business Rule E1.4. Both reports must be lodged within five business days of the end of the preceding month. The EEA then collates this information in a monthly Member Compliance Report to the compliance committee.

74 From April to December (excluding June), on average, 68% of participants did not submit their RAD on time. This peaked in September and October at 79%. At least six participants did not submit their RADs at all for the period of April to December. There does not appear to have been any coordination with ASX for joint NSXA/ASX participants to ensure this information was being submitted under the Memorandum of Understanding (MOU), however, we do note that the compliance committee has resolved to impose a Capital Adequacy Reserves reporting requirement on joint ASX/NSXL participants as an additional risk management measure.

75 There was also a pattern of late submission of SLF calculation reports during the same period. In July, September and November, no SLF reports were received by the EEA within the required time frame, and only one SLF calculation was received on time in August and October.

76 This late submission of SLF calculation reports meant NSXA was not able to monitor closely Findlay & Co Stockbrokers' capital adequacy prior to its deregistration. No RAD reports were submitted and every SLF report was received late. In addition, Findlay's SLF dropped in the order of 20% each month from August to September, before being written down to zero in November. The zero SLF should have prompted an immediate referral to the compliance committee as per NSXL's procedures, however, the committee's

minutes show that NSXL only became aware of Findlay's intention to resign as an NSXL participant in January, following a merger with another securities firm.

77 NSXA became aware of a possible breach of the operating rules specifically by Findlay & Co in January 2009. This related to Findlay not informing NSXA of the resignation of a Dealing Trading Representative. NSXA had contacted Findlay & Co and were in the process of referring the matter to the compliance committee when Findlay & Co lodged a notice of resignation with NSXA. Findlay & Co resigned in January 2009. We note Findlay & Co was one of a number of participants that during 2008 was late in submitting SLF calculation reports.

78 Of the few trades that Findlay & Co effected on the market, there were no significant delays.

79 In April 2009, ASX referred Findlay & Co to ASIC due to concerns about its ability to meet its compliance and capital liquidity risk obligations, because of extensive overdue settlement debts.

80 In response to our questions concerning late receipt of RAD and SLF reports, NSXL advised that the EEA will normally telephone a participant three times to remind them to submit their report. If this is still not received, the EEA sends the Member Compliance Report to NSXL with a note advising that the particular participant's required monthly submissions have not been received. Participant supervision staff subsequently write a letter to the participant which usually results in receipt of the SLF/RAD report a few days later.

81 In terms of following up on late SLF and RAD reports, NSXL determined that there were no breaches of the Business Rules serious enough to warrant disciplinary action. Administrative follow up action was sufficient to address this. NSXL was aware of the recalcitrants, however, it took the view that as long as there was no serious breach of SLF/RAD adequacy requirements, disciplinary action was not needed.

Agreed Action 2: Enforcement of participant capital adequacy reporting rules

NSXL will examine how it will promote compliance by participants in meeting their reporting obligations, and report its proposal to ASIC by 28 February 2010.

Ongoing and emerging issues

82 ASIC believes that the market events of 2008 were such that it is now a good opportunity to consider a range of broader issues having regard to the statutory obligation of NSXL group to do all things necessary to ensure it operates markets that are fair, orderly and transparent.

Monitoring solvency disclosure of microcaps

83 Most listed disclosing entities on the BSX and NSXA markets are microcaps. Although NSXA listed entities are required to have minimum capital of A$500,000 at the date of admission to quotation, if they fall below this following admission—as is the practice with other Australian exchanges—they are not delisted.

84 NSXL staff closely monitor entities with solvency concerns and consult with ASIC. We suggest NSXL consider how it may require NOMADs to engage proactively with entities when NSXL, due to half-yearly reporting and annual financial statements, has concerns about growing risk of insolvency.

Monitoring JORC code standards for mining/extractive entities' disclosure

85 Eight mining and exploration entities trade on the NSXA market, with market capitalisations ranging between $1.8 million and $10.2 million. NSXA Listing Rule 6.13(1A) requires certain continuous disclosures of these companies to be made in the form specified by the Australasian Joint Ore Reserves Committee's Code for Reporting of Mineral Resources and Ore Reserves (JORC code).

86 NSXA key supervisory staff have good knowledge of the JORC code. If changes are proposed to be made to the code, we suggest that NSXL, to the extent possible, seek to become involved in any review.

Partly paid shares

87 As NSXA and BSX currently have no technical ability to permit trading at a price lower than $0.001, it has limited alternatives to facilitate trading in securities where genuine demand and supply factors would be likely to result

in a traded price of less than \$0.001. At present, only one partly paid security trades—on the NSXA market. The NSXA website flags it clearly as such.

88 NSXA and BSX should review whether it is appropriate to list an entity with a security structure with partly paid securities bearing a ratio of paid to unpaid amounts of greater than 1:1, or at all.

89 The licensees' review should consider:

- whether partly paid securities of this type should be quoted;
- their approach to trading halts and suspensions;
- when trading in other low-priced securities may no longer be fair, orderly and transparent and how the NSXL group should respond in these circumstances; and
- preparation of a guidance note to participants about NSXL expectations of how participants should fulfil their licence and other legal obligations to advise their clients of additional risk involved with partly paid securities, before they trade in these products.

Agreed Action 3: Policy for admission to quotation of partly paid securities

NSXL has agreed that, in relation to partly paid securities that have the potential to have negative value, it will review its two licensees' policy on listing of partly paid securities, and provide a report to ASIC by 28 February 2010.

Resources

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

Technology

91 NSXL uses the OMX NASDAQ X-stream system for trading, a system used in 40 other exchanges around the world, and Capital Markets CRC Limited's SMARTS surveillance system.

Human resources

92 Throughout the reporting period NSXA retained at least four salaried supervisory staff. In addition, it engaged the services of the compliance and listing and admissions committee members.

Financial resources

93 In March 2009, NSXL's board recognised that it had sufficient cash reserves to operate its market without reducing supervisory spend only until December 2009. Our interviews and inspection of board papers identified that NSXL had no plans for addressing looming solvency issues. On 28 May 2009 the co-extensive NSXL/NSXA/BSX boards were reconstituted. We met with the new board after 28 May and confirmed that cost cuts had been identified to bring revenues and expenses into much closer alignment. Our analysis is that even were NSXL not to raise new capital in financial year 2009–10, it will have sufficient ongoing financial resources to remain solvent and have the resources to maintain the existing standard of market supervision.

C Response to 2008 NSXA and BSX assessment recommendations

Key points

Our last BSX and NSXA assessment reports contained a common agreed action for improved NSXL board oversight of the market supervision activity of the two licensees: see paragraphs 94–95.

In our last assessment report regarding NSXA, we made recommendations about ensuring that NOMADs disclosed how they were substantially independent of the entities they were required to supervise, to ensure more effective complementary supervision of NSXA-listed entities' disclosure obligations: see paragraphs 96–97.

Our last BSX assessment report had a number of recommendations relating to suitability of products admitted to quotation, in particular those issued by community entities such as Bendigo and Adelaide Bank Limited's franchisee listed entities, and supervision of those entities' post-admission market disclosures: see paragraphs 98–101.

Board oversight

Common NSXA and BSX agreed action 1

94 For our last assessments, the boards of both NSXA and BSX agreed that:

- Each board would take steps to ensure that it was kept informed of the licensee's supervisory activities so as to be able to make an assessment about whether it was meeting its obligation to have adequate supervisory arrangements. In particular, each board would henceforth receive a more detailed report from the respective compliance committee on a biannual basis.
- In addition each compliance committee would:
  - request and be given more detailed information about the respective licensee's supervisory activities and results, by defining and agreeing on the information to be given to the committee;
  - at its regular meetings, assess whether the licensee's supervisory policies and procedures were being adhered to and its compliance plan was being followed; and
  - formally report to the licensee's board on its supervisory activities, the outcomes of those activities and the adequacy of its supervisory

arrangements in general. Such reports were to include whether policies and procedures were adequate, whether staff were following policies and procedures and whether participants were complying with the operating rules.

95 NSXL group board papers demonstrated that the board, in addition to previous six-monthly general reports from the chairman of the compliance committee, now also receives reports on matters considered by the compliance committee. These reports contain sufficient detail for the board to make a judgement about the compliance committee's preparedness to monitor day-to-day market supervision metrics proactively and obtain sufficient information to initiate investigations themselves.

Closer scrutiny of role of NOMADs

NSXA agreed action 2

96 NSXA agreed that the Compliance Committee would expand the Conflicts of Interest question in the Nominated Adviser annual declaration that is sent to Nominated Advisers in July of each year, to require NOMADs to explain on an ongoing basis how they manage their conflicts of interest. NSXA will make the response available to the market through publication of the annual declaration returns, as an announcement for each issuer, once received.

97 NSXA performed this undertaking. NSXA has updated its guidance material for NOMADs. NOMADs are obliged to submit an annual statement to NSXA that attests that they act independently. NSXA has defined 'independent' to mean that a NOMAD may not control, be controlled by or be under the same control as the issuer, with 'control' defined as including the holding, directly or indirectly, of shares carrying 30% or more of the voting rights of a company. NSXA notes in its guidance to NOMADs that a normal business relationship between the issuer and another company or part of the NOMAD's group will not usually bar a NOMAD from acting. NSXA adds that where relationships exist that would give the NOMAD's group a material interest in the success of the flotation, new issue or other relevant transaction, such relationships may not be consistent with the independence undertaking.

Monitoring of listed company prospectus forecasts

BSX agreed action 2

98 BSX agreed to undertake additional monitoring of companies with forecasts in place. More particularly, it has undertaken an analysis of forecasts on the market and will target those companies with existing ‘live’ forecasts for direct contact, to remind them of their obligations.

99 BSX performed this undertaking.

BSX-specific participant supervision

BSX agreed action 3

100 BSX’s three participants are also participants of NSXA. The same questionnaire is sent to all participants, whether they are participants of NSXA only, or participants of both BSX and NSXA. In our view, the wording of certain questions is problematic because in places it only makes explicit reference to NSXA and the NSXA business rules and does not refer to equivalent BSX rules. BSX agreed to amend its self-assessment questionnaire to clarify which questions are applicable to each respective market.

101 BSX performed this undertaking.

Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission
BSX	Bendigo Stock Exchange Limited
Ch 7 (for example)	A chapter in the Corporations Act (in this example, numbered 7)
Corporations Act	*Corporations Act 2001* (Cth)
EEA	exchange examining accountant
JORC code	Australasian Joint Ore Reserves Committee Code for Reporting of Mineral Resources and Ore Reserves
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
microcap	A publicly traded company with a market capitalisation of roughly US$250 million or less
NOMAD	nominated adviser
NSXA	National Stock Exchange of Australia Limited
NSXL	NSX Limited
RAD	return of aged debtors
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C)
SLF	surplus liquid funds