



ASIC

Australian Securities & Investments Commission

REPORT 198

Market assessment report: Mercari Pty Limited

ACN 102 928 727

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About this report

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

This assessment covers the period 18 December 2008 to 31 December 2009 (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 operate Mercari Direct on 30 May 2005.

Report number	Date released
REP 80	September 2006
REP 105	October 2007
REP 149	February 2009
REP 165	September 2009

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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 a licensee 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 whether Mercari has sufficient financial, technological and human resources to comply with its obligations under s792A(d).

Background

- 6 Mercari is an Australian registered company and wholly owned subsidiary of Financial and Energy Exchange Ltd (FEX). FEX is also an Australian registered company, developing a suite of services for the Asian energy, commodity, environmental and financial markets.

- 7 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.
- 8 The total turnover in the Australian over-the-counter (OTC) financial markets for 1 July 2008 to 30 June 2009 was \$69,378 billion.¹ The turnover for foreign exchange and interest rate derivatives in the Australian OTC financial markets for the same period was \$40,709 billion.² There has been limited trading on Mercari Direct during the assessment period.
- 9 The participants of Mercari Direct are wholesale entities, and currently are either banks or subsidiaries of banks.
- 10 Mercari has applied for a variation to its market licence which, if granted, will allow the trading of other derivative products. This application is currently under consideration.
- 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.

² Australian Financial Markets Association, *2008 Australian Financial Markets Report*, p. 50.

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 pursuant to a notice served under s30 of the *Australian Securities and Investment 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 surveillance and compliance officer and an administrator/product supervisor 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 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.
 - sufficient resources to operate its market properly and for the required supervisory arrangements to be provided under s792A(d).
- 18 This conclusion is based on the following observations:
- 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 a surveillance and compliance officer who is responsible for supervising the market and monitoring the conduct of participants, in addition to administrators/product supervisors who play a supporting role in monitoring the market. Any breaches or

suspected breaches are reported to the directors who decide on the appropriate action to take.

Managing conflicts of interest

- 20 The Mercari Direct Written Procedures detail how conflicts between Mercari's supervisory and commercial interests are managed. These procedures detail:
- 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 Further information regarding Mercari's conflicts of interest policy is contained in ASIC's previous assessment report (REP 165) at paragraph 21.
- 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. No conflicts of interest events were identified during the assessment period.

Monitoring the conduct of participants

- 23 The operation of Mercari Direct is overseen and managed on a daily basis by Mercari's administrators/product supervisors. The administrators/product supervisors monitor all active dealing screens to ensure all authorised users are acting in compliance with the operating rules and that all screens are functioning correctly. In addition, post-trade market surveillance activities are undertaken by the surveillance and compliance officer who is ultimately responsible for supervising the market and monitoring the conduct of participants. All breaches or suspected breaches are reported to the directors of Mercari and recorded in the Compliance (Breach) Register.
- 24 Further details regarding Mercari's supervisory arrangements (including the process followed once an actual or potential breach is reported) are set out at section 2.2 of ASIC's report on its first annual assessment of Mercari (REP 80) and in paragraphs 25–27 of REP 165.
- 25 Mercari did not identify or take action in relation to any breaches during the assessment period.

Enforcing compliance with operating rules

- 26 Compliance with Mercari's operating rules is to a large extent facilitated through the operation of Mercari Direct which rejects certain trading activity which is or may be in breach of the operating rules. In accordance with the

operating rules, 'out of market' dealing is not permitted and the system will not accept rates that are materially different from the most recent traded or quoted rates. The default setting is +/-10 basis points but can be adjusted according to market conditions.

- 27 In addition, Mercari's administrators/product supervisors and the surveillance and compliance officer use internal procedures to monitor participant conduct and identify patterns of behaviour that may evidence breaches or possible breaches of the operating rules and/or the Corporations Act.
- 28 Further details regarding the way Mercari enforces compliance with its operating rules are contained at paragraph 29 of REP 165.
- 29 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 or Corporations Act was identified.

Resources

- 30 We are satisfied that Mercari has sufficient financial, technological and human resources for the required supervisory arrangements to be provided.

Financial resources

- 31 We have reviewed Mercari's financial position and are satisfied that it has access to sufficient financial resources to operate its market and to provide adequate supervisory arrangements.
- 32 Mercari's financial resources are derived from:
- income generated by brokerage fees;
 - net assets within Mercari's ownership and control; and
 - financial support from FEX.

- 33 Mercari is currently supplying ASIC with monthly financial reports.

Technological resources

- 34 The current technology has coped with existing volumes on the market and no serious market disruptions have occurred.
- 35 Recent upgrades to Mercari's technology has resulted in enhanced capacity and post-trade connectivity. According to Mercari, there is significant overcapacity to meet the needs of the current market and therefore ample capacity to accommodate new products.

Human resources

- 36 During the assessment period, Mercari relied on its surveillance and compliance officer and administrators/product supervisors to perform the required supervisory function for the market. In our view this resourcing is sufficient.

Conclusion

- 37 Based on our assessment, we do not have any recommendations to make in relation to Mercari's current supervisory arrangements.

Key terms

Term	Meaning in this document
\$69,378 billion	An amount in Australian dollars (in this example 69,378 billion)
AFS licence	Australian financial services licence
ASIC	Australian Securities and Investments Commission
Australian market licence	Australian market licence under s791A
Corporations Act	The Corporations Act 2001 (Cth)
Market licensee	Holder of an 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)