



ASIC

Australian Securities & Investments Commission

REPORT 199

Market assessment report: Asia Pacific Exchange Limited

ACN 080 399 220

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About this report

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

This assessment covers the period 2 April 2009 to 1 March 2010 (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 APX

Australia Pacific Exchange Limited was granted an Australian market licence (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
REP 166	August 2009

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Key findings and recommendations

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.

Recommendations

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

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.

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 its previous assessments, ASIC's 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 APX complies with any or all of its obligations under Ch 7: s794C(1). As such, we examined whether APX had sufficient financial, technological and human resources to comply with its obligations under s792A(d).

Background

- 6 APX is a wholly owned subsidiary of AIMS Financial Group (AIMS). AIMS acquired APX in October 2008.
- 7 The APX 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.
- 8 No trading has been conducted on APX's market since January 2009; hence, there was no trading activity during the assessment period.
- 9 APX has the following three categories of 'participant' in its market:
- *Broker*—involved in buying, selling and settling transactions (one entity is currently approved in this category);
 - *Sponsor*—acts as adviser to APX listed entities (listees) throughout the listing process (seven entities are currently approved APX sponsors); and
 - *Research panellist*—responsible for producing an independent research report for each APX listed property fund. APX has advised that it plans to phase out the research panellist participation category under new operating rules that it proposes to introduce when it recommences operating an active market.
- 10 APX has one listee, namely Everbrite Corporation Limited (Everbrite), which was suspended from quotation throughout the assessment period. APX has advised that during the assessment period, Everbrite took several proactive steps towards becoming relisted, including obtaining shareholder approval to relist. APX continues to monitor the company's position in the expectation that at some future date it will satisfy the listing criteria and recommence quotation on APX's market.
- 11 The processes for order entry and trading on APX's market remain as they have been since APX commenced operating a market. Participants enter orders via an electronic interface, then APX manually matches the orders to form trades and advises the counterparties of their obligations. Settlement occurs on 'T+5', via a process of paper-based transfer of certificates through APX, and the exchange of money directly between counterparties.
- 12 APX's operations have been conducted in a segregated part of AIMS' Sydney premises since March 2009, when they were relocated from Melbourne.
- 13 The wider AIMS Group includes two companies that hold Australian financial services (AFS) 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 AFS licence obligations.

- 14 Since it was acquired by AIMS, APX has commenced a process of reviewing its business, assessing new opportunities and planning for the future. ASIC continues to work with APX in relation to its new suite of proposed operating rules and associated licence changes, particularly in the context of the transfer of responsibility for market supervision to ASIC.
- 15 The transfer of supervision is proposed for the third quarter of 2010. This will necessarily involve changes to supervision practice in the APX market. Next year's assessment will examine in detail how APX has responded to the change in the supervision landscape.

Our methodology

Our assessment process

- 16 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.
- 17 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

- 18 Our focus in this assessment was to review:
- APX's progress with developing business plans and goals for the future direction of the market;
 - how well APX complied with its ongoing supervisory and reporting obligations under its Australian market licence and the Corporations Act;
 - any changes in APX's operations and/or approach to supervision of its market from the previous year's assessment; and
 - the sufficiency of APX's financial resources.

What we considered

- 19 In conducting this assessment we reviewed:
- material received under a notice served under s30 of the *Australian Securities and Investment Commission Act 2001* (Cth), including financial statements;
 - APX's annual regulatory report required under s792F of the Corporations Act;
 - information received from and about APX in the ordinary course of our dealings with APX;
 - policies and procedures for the conduct of APX in general and its supervisory responsibilities in particular;
 - publicly available information on APX's website; and
 - discussions held with APX personnel, including the APX Managing Director, Chief Financial Officer, Operations Manager and compliance management and staff.
- 20 On 11 March 2010, ASIC representatives attended the offices of APX in Sydney and held discussions with APX management.

Consultation

- 21 APX has had the opportunity to view and comment on the findings and recommendations contained in this report. Where appropriate, this report reflects APX's responses.

B Our observations

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.

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

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

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

Supervisory arrangements

- 22 We conclude that APX 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).
- 23 Our conclusion is based on the following observations:
- APX confirmed that the arrangements for supervising the market have not changed from the previous reporting period;
 - no serious market failures or disruptions have come to our attention;
 - no trading occurred on APX's market 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.
- 24 A description of APX's supervisory framework is set out at paragraph 23 of our report on our fifth annual assessment of APX, Market assessment report: Asia Pacific Exchange Limited (REP 166) issued in August 2009.

Conflicts of interest

- 25 A description of APX's supervisory arrangements for handling conflicts of interest is set out at paragraphs 28 to 33 of REP 166.
- 26 APX continues to have some employees and management who perform functions for AIMS in addition to their APX role. The APX management team considers it important for staff to be challenged and stimulated, particularly during the business's current 'planning/preparation' phase. Accordingly, employees with spare capacity and AIMS experience may be allocated AIMS work, subject to strict confidentiality arrangements. When APX market activity recommences, APX functions will take priority and APX employees' involvement in AIMS work will be reassessed.
- 27 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

Monitoring the conduct of participants

- 28 APX's approach to monitoring the conduct of participants on, or in relation to, the market has not changed since our last assessment.
- 29 APX is directly involved in most aspects of the paper-based trading and settlement arrangements that apply under APX's current market infrastructure. Hence, APX has knowledge and control of all market orders and trades.
- 30 APX completes a number of periodic checks in relation to its brokers and listees and it records the outcomes via a system of checklists and spreadsheets. APX has advised that as part of its current processes of assessing potential trading and other market systems, it is considering those systems' capacity to produce electronic reports to assist with monitoring the market and participants' conduct.
- 31 Based on our review of all information at hand and information provided by APX, ASIC is satisfied that APX has adequate arrangements for monitoring the conduct of participants, given the nature of the market it operates.
- 32 As the market develops, APX's approach to participant supervision may adjust to cater to electronic trading and/or settlement and/or a larger number of listees and participants.

Compliance with operating rules

- 33 APX did not make any substantial changes during the assessment period to the way in which it enforces compliance with its operating rules.

- 34 Chapter 8 of the current APX Business Rules sets out APX's approach to monitoring, surveillance and enforcement of the business rules. This includes APX's rights to investigate a broker's potential or apparent failure to comply with the rules and to take action against a broker or affiliate for non-compliance.
- 35 During the assessment period there were no identified breaches of the operating rules or market conduct that may have contravened the operating rules or Corporations Act, and there were no investigations or disputes.
- 36 Based on our review of all information at hand and information provided by APX, ASIC is satisfied APX has adequate arrangements for enforcing compliance with its operating rules.

Resources

- 37 ASIC is satisfied that APX's financial, technological and human resources were adequate for the required supervisory arrangements to be provided in respect of the market it operated over the assessment period.
- 38 Paragraphs 39–46 contain observations and commentary in relation to resourcing considerations for APX when it recommences operating an active market.

Financial

- 39 ASIC focused on APX's financial resources during the 2008, 2009 and 2010 assessments, in order to understand how AIMS intends to implement and fund its future plans for the market.
- 40 AIMS has entered an agreement to provide a non-recourse financing facility to APX. APX will draw funds via this facility as and when required to fund its ongoing activities.
- 41 APX's future business developments (for example, moving to electronic trading and settlement regimes) are likely to necessitate a number of large cash outlays and investments in additional resources. APX has supplied an indicative cash flow forecast up to June 2013, on the basis that it will recommence operating an active market in late 2010.
- 42 ASIC is satisfied that AIMS is committed to funding APX's preparations to reposition its market and then the operation and supervision of the market.

Technological

- 43 APX's technological resources were adequate over the assessment period.

- 44 APX has commenced processes to secure electronic trading and settlement services for the market and it is envisaged that these arrangements will be in place when active trading recommences.

Human

- 45 As indicated under paragraph 26 above, there is still some sharing of human resources between AIMS and APX. These arrangements will be reviewed when APX recommences operating an active market.
- 46 In our view, APX's human resources are sufficient for APX's current activities. As with all its resources, APX will need to closely monitor the adequacy of its human resources when its market recommences.

Response to 2009 assessment recommendations

- 47 In ASIC's 2009 annual assessment of APX, we recommended that APX implement a framework for ensuring that its registers and the other records of supervisory decisions include clear records of the party that made the decision and the basis of the decision.
- 48 In response to this recommendation, for this year's assessment, APX has set out instructions for what details must now be recorded in a Supervisory Decisions Register. ASIC suggests that this Register be annexed to, or reflected in, APX's Conflict Management Plan.

Our view of APX's response

- 49 We are satisfied with APX's response to the recommendation in the 2009 assessment.

Conclusion

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

Key terms

Term	Meaning in this document
AFS licence	Australian financial services licence under s913B of the Corporations Act
AIMS	AIMS Financial Group
APX	Asia Pacific Exchange Limited
Australian market licence	Australian market licence under s791A of the Corporations Act
ASIC	Australian Securities and Investments Commission
Ch 7	a chapter in the Corporations Act (in this example, numbered 7)
Corporations Act	the <i>Corporations Act 2001</i> (Cth)
listee	an entity approved to list on APX
market licensee	holder of an Australian market licence
s794C	a section of the Corporations Act (in this example, numbered 794C)