



ASIC

Australian Securities & Investments Commission

REPORT 206

Market assessment report: NSX Ltd group

National Stock Exchange of Australia Limited, ACN 000 902 063

Bendigo Stock Exchange Limited, ACN 087 708 898

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About this report

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

This assessment covers the period from 8 March 2009 to 7 March 2010.

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 NSXL group licensees

The Stock Exchange of Newcastle Limited was granted an Australian market licence on 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 (NSXA).

Bendigo Stock Exchange 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 41	June 2005
REP 82	September 2006
REP 118	January 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

NSXL group report number	Date released
REP 175	November 2009

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Key findings and recommendations

Key findings

- 1 ASIC is satisfied that NSXA and BSX have:
 - adequate arrangements for the supervision of their markets in accordance with their obligations under s792A(c) of the Corporations Act; and
 - sufficient resources to operate their markets 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 the NSXL licensees' current supervisory arrangements and resources.

A The assessment

Key points

ASIC conducts annual assessments of market licensees, such as the NSXL group licensees NSXA and BSX, 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 under 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).
- 6 This report covers the period from 8 March 2009 to 7 March 2010 (the assessment period), although we have had regard to subsequent developments.
- 7 This report does not deal with arrangements for the transfer of supervision announced by the government on 24 August 2009. NSXL group will continue to have its current supervisory responsibilities for its markets and clearing and settlement arrangements until at least the third quarter of 2010. Next year's assessment(s) will include consideration of how NSXA and BSX have responded to the change in the supervision landscape.

Background

- 8 At the end of the assessment period, the licensees, NSXA and BSX, were wholly owned subsidiaries of NSXL, a company listed on the Australian Securities Exchange. ASIC's report on the two NSXL group market licensees for the period to 7 March 2009 was published on the ASIC website on 6 November 2009: see *Market assessment report: NSX Ltd group* (REP 175).
- 9 The NSXL/FEX BSX market was renamed SIM Venture Securities Exchange Ltd (SIMVSE), with Ministerial consent given on 9 April 2010. On 3 June 2010, NSXL shareholders approved the sale of 50% of BSX to NSXL related party shareholder, Financial and Energy Exchange Limited (FEX). FEX owns the Mercari Pty Limited licensed market for interest rate and foreign exchange derivatives. Throughout this report we will refer to the licensed SIMVSE market as BSX.
- 10 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).
- 11 On 25 May 2009, prior to the vote of a general meeting requisitioned by substantial shareholders, NSXL's directors resigned and were replaced by three new directors. In November 2009 two of the three directors were in turn replaced. The board is now made up of an independent¹ chairman and two directors linked to substantial shareholder FEX.
- 12 Since the previous assessment period, the NSXL group under its new board conducted a capital raising in November 2009 via a placement of 10% of issued capital to raise \$1.489 million, a non-renounceable rights issue in December 2009 to raise \$2.796 million, and sold 50% of BSX to FEX in June 2010 to raise a further \$3 million payable to NSXL over a three-year period.
- 13 Since our 2009 assessment (REP 175) there have been an additional four listed entities added to the NSXA official list, and a substantial number of new debt and option products admitted to quotation. Declines attributable to the global financial crisis in trading volumes, average trade sizes and values that were described in REP 175 plateaued for the period covered by this report.

¹ As defined in ASX Corporate Governance Council (2007) *Corporate governance principles and recommendations*, 2nd edition, Box 2.1. Available at: www.asx.net.au/about/corporate_governance/revised_corporate_governance_principles_recommendations.htm

- 14 In June 2010 the NSXA market had 40 entities on its official list, with those entities accountable for 91 quoted products. BSX had 53 listed entities with 53 quoted products. NSXA trading volume/value for April 2010 was 2,099,148/A\$744,979. Trades per day on the NSXA market in recent months have averaged four.
- 15 The Stock Exchange of Newcastle Limited and BSX licences, both issued on 8 March 2002, have been varied subsequently. Copies of the NSXA and the BSX market licences, and variations to them, are available on our website at www.asic.gov.au/markets

The nature of the markets

- 16 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 role of a sponsor is described in REP 175. The role of NOMADs is described in our report *Market assessment: National Stock Exchange of Australia Limited* (REP 157).
- 17 Both markets have in place arrangements for referrals to be made to ASIC of suspected contraventions of law and for notifications to ASIC of disciplinary action taken by the licensees under their operating rules. The arrangements will be replaced in the third quarter of 2010 with agreed protocols for enforcement of overlapping licensee and ASIC market integrity rule books.
- 18 Both licensees make provision to enforce their business rules through disciplinary panels. NSXA listing rules, in addition to provision for suspension or de-listing, make provision to discipline listed entities, listed entity directors, sponsoring brokers and NOMADs that fail to perform their obligations to NSXA. BSX's listing rules' ongoing obligations are enforced through the sanctions of suspension and de-listing only.

Clearing and settlement

- 19 The NSXL group does not operate a clearing and settlement facility.
- 20 NSXA is a CHESSE settlement participant. For clearing of NSXA trades where the NSXA participant is not an ASX Settlement and Transfer Corporation Pty Ltd (ASTC) settlement participant, NSXA produces the net settlement report. Participants deposit funds into NSXA's account. When ASTC CHESSE produces daily net holdings reports which detail shares that need to be transferred in CHESSE, NSXA issues CHESSE messages to its trading participants to effect settlement of securities.

- 21 BSX securities as at the date of this report are not CHESS registered and clearing and settlement is performed by participants bilaterally. Subject to the Minister's consent to vary its licence, and Ministerial non-disallowance of operating rule changes, BSX plans for 'cleantech' products to adopt the settlement arrangements used in the NSXA market. Other legacy BSX listed entities' quoted products will continue to settle bilaterally on a T+5 basis.

Our methodology

Our assessment process

- 22 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.
- 23 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

- 24 Our focus in this assessment was to review NSXL group licensees' supervision of their listing rules. In particular, we examined decisions about listing applicants' suitability for admission to the official list, and the obligation under reg 7.2.07(g)(ii) of the Corporations Regulations to, where appropriate, have arrangements for the disciplining of listed disclosing entities that breach listing rules.
- 25 In addition, we looked closely at arrangements and procedures around ensuring timely disclosures to the market of information that potentially may affect price formation.

What we considered

- 26 In conducting our assessment we considered:
- material received under a notice served under s30 of the *Australian Securities and Investment Commission Act 2001* (Cth), including financial statements;

- NSXA and BSX's annual regulatory reports required under s792F of the Corporations Act;
- information received from and about NSXA and BSX in the ordinary course of our dealings with them;
- information received from other market licensees and foreign regulators about entities seeking to be admitted to NSXA;
- publicly available information on the NSXA and the BSX websites;
- discussions held with NSXL group personnel, including directors; and
- listed entity disclosure processes and procedures.

27 We visited NSXL premises in Newcastle on 24 March 2010 and met subsequently with NSXL directors.

Consultation

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

B Our observations

Key points

We have considered the adequacy of NSXL's arrangements and resources for supervising its markets, including:

- handling conflicts between the commercial interests of the licensees and the need for the licensees to ensure that their markets are fair, orderly and transparent;
- monitoring the conduct of participants on or in relation to the markets; and
- enforcing compliance with the markets' operating rules.

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

Supervisory arrangements

- 29 We conclude 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).
- 30 Our conclusion is based on the following observations:
- the nature of the markets as described in paragraphs 16–18;
 - NSXL's confirmation that the arrangements for supervising its markets have not changed from the previous reporting period;
 - no serious market failures or disruptions have come to our attention; and
 - during the assessment period, no information came to our attention to suggest that the supervisory arrangements in place were not operating adequately.
- 31 A description of NSXL's supervisory framework for its two markets is set out at paragraphs 34–38, 49–50 and 52–54 of REP 175.

Managing conflicts of interest

- 32 The NSXL group as far as is practicable effectively manages its conflicts of interest. Supervisory decisions are referred by NSXL management to two

committees: the listing and admissions committee and the compliance committee. The listing and admissions committee, which is made up of three independent members, makes decisions on suitability for entities that apply to list, registration of new participants, NOMADs and sponsors. The compliance committee, which is chaired by the contracted compliance officer and which includes three other members, makes decisions under the operating rules on rule waiver requests and discipline of listed entities and participants.

- 33 In REP 175 we noted that the then chairman of the NSXL group, who is a substantial shareholder of NSXA listed entities, a sponsor of NSXA listed entities, a principal of a NSXA participant and the principal of a NSXA NOMAD, was also a member of the compliance committee. We recommended that NSXA consider whether the conflicts of interest could be adequately managed. These conflicts are now addressed with the 17 November 2009 appointment of an independent NSXL chairman.

Monitoring the conduct of participants

- 34 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 allow NSXL to monitor compliance, participants are required to lodge surplus liquid funds (SLF) calculations each month (for the previous month) with the Exchange Examining Accountant (EEA), McCosker & Partners Pty Ltd. This is described in greater detail in paragraphs 73–81 of REP 175.
- 35 In last year's report we noted that a significant proportion of SLF returns were not lodged on time. By the end of this assessment period, the 2008–09 patterns of non-compliance had been eliminated through interventions by both the EEA and NSXL staff. From July 2009 all participants in both licensed markets were fully complying with their capital adequacy obligations, including reporting lodgement deadlines.

Compliance with operating rules

Suitability of entities for admission to the official list

- 36 We looked at how NSXL staff and the listing and admissions committee had interpreted NSXA listing rule 3.6, which requires issuers' management to be 'of known character and integrity', and NSXA listing rule 1.5, which requires that an entity be suitable for listing.
- 37 In order to assess how NSXA and BSX made their judgements about suitability for admission of the issuer to the official list, we reviewed applications for listing, in particular those companies whose prospectuses

disclosed existing, or intention to enter into, related party transactions. We considered NSXA processes to be satisfactory.

- 38 In general, the admission procedures for NSXL management and independent listings and admissions committee's determinations of suitability are based on a checklist. The checklist includes commentary and is not merely a box-ticking exercise. Suitability for listing rests mainly on a NSXL conclusion that the entity following admission will disclose immediately material new information, including related party transactions, to the market.
- 39 Suitability depends, too, on whether it will be possible for NSXA to enforce its rules on the particular listed entity. ASIC draws comfort from the capacity for NSXA to directly discipline listed entities, their directors and listed entities' professional advisers (where these are sponsors or NOMADs). Mechanisms such as use of sponsors and NOMADs in the NSXA market assist to secure listed entity compliance. Therefore, selection of a sponsor and a NOMAD are important aspects of determining suitability.
- 40 NSXA suitability analysis needs to address whether a NOMAD is both (1) independent from the listed entity, and (2) has the capacity to proactively identify material developments and assist NSXA to secure continuous disclosure. We note in REP 157 that, in response to ASIC's recommendation, NSXA requires NOMADs to annually attest that they remain independent of the listed entities they assist NSXA to supervise. For this assessment period, we saw instances where NOMAD involvement anticipated or rectified entity's disclosures.
- 41 Since our assessment, we are aware that in considering a May 2010 application, the listings and admissions committee conducted exhaustive analysis of suitability as a discrete hurdle. This resulted in improved identification of NSXL reputation risk and the design of bespoke conditions and supervisory measures to address these risks. While not necessary for most applications, we consider that the processes and analysis devoted to this application should be adopted for, at least, listing applications where an entity is listing in conjunction with an initial fundraising. We will continue to discuss this process with NSXA.
- 42 Even though prospectuses and Product Disclosure Statements (PDSs) are required to be lodged with ASIC, we consider that NSXL licensees should more closely review prospectus and PDS disclosure of related party transactions in order to assist the NSXL listings and admissions committee to identify risks.
- 43 In 2004, NSXL and ASX group licensees entered into a multilateral memorandum of understanding (MOU) to provide for cooperative supervision of dual ASX/NSXA-listed and ASX/BSX-listed entities, in

particular around continuous disclosure and provision for simultaneous suspensions to prevent disorderly trading. Recently, the dual listing of an entity, albeit in suspension on the ASX market, highlighted the need for NSXL and ASX to maintain close and cooperative consultation.

Continuous and periodic disclosure supervision

- 44 NSXL has adequate procedures for enforcing its disclosure rules. It suspends BSX and NSXA listed entities that do not make the required periodic disclosures by the dates required, and refers suspected breaches of s674 of the Corporations Act to ASIC.
- 45 NSXA rules permit dual listings provided an entire class of shares or CHESSE depository instruments are quoted. Foreign entities are subject to NSXA's disclosure rules (NSXA rules do not make provision for a 'foreign exempt entity').
- 46 During the assessment period, NSXA experienced some difficulties with supervision of a foreign listed disclosing entity, Agrinurture Limited, which made announcements to the Philippines Stock Exchange prior to making the same disclosures to the NSXA market. Through NOMAD early interventions, Agrinurture's disclosure timing was improved and the issue did not recur.

Resources

- 47 ASIC is satisfied that NSXL's financial, technological and human resources were adequate for the required supervisory arrangements to be provided in respect of the markets it operated over the assessment period.

Financial resources

- 48 We focused on the NSXL group's financial resources in our 2009 assessment report (REP 175). Based on the capital raisings outlined in paragraph 12 above, and because the NSXL group's cash flow is now positive, we assess that the group has sufficient financial resources.

Technological resources

- 49 NSXL has a technology agreement with OMX NASDAQ for the supply and maintenance of trading technology. The trading system is sized to perform at least 100,000 trades per day. The announcements platform in its current configuration is capable of handling at least 300 announcements per day. NSXL licensees therefore have considerable excess capacity. During the assessment period there were no outages that impacted trading.

Human resources

- 50 NSXL market licensees share supervisory resources. In addition to six committee members (on the two independent committees that make supervisory decisions—the listings and admissions committee and the compliance committee), and a contracted compliance officer, the NSXL group has four full-time and two part-time employees. There are sufficient staff to ensure that absences will not compromise supervision of ongoing listing rule obligations, such as continuous disclosure.

C Responses to 2009 assessment recommendations

- 51 In our 2009 report we made three 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 and revisions to the Joint Ore Reserves Committee (JORC) standards for extractive industries' disclosure.

Our view of NSXL's responses

- 52 We are generally satisfied with NSXL's responses to the recommendations in the 2009 assessment: see paragraph 33 above for comment on our recommendation relating to management of conflicts of interest.
- 53 NSXA's policy response was that it had only one partly paid security quoted and this was clearly flagged on its website as such. Because there is no facility for direct electronic order entry for retail investors, retail investors are only able to enter bids and offers to trade the partly paid share through market participants. Noting the nature of the NSXL licensed markets in relation to the single partly paid share currently traded, NSXA has advised that no further action is required at this time. Should additional partly paid securities be quoted, NSXA should encourage participants to provide retail investors with advice about risks. We will monitor the market in partly paid shares.
- 54 In relation to updates of the JORC code, we consider that NSXL should monitor and apply any extension of the JORC code beyond exploration results, mineral resources and ore reserves to oil and gas disclosure requirements.

Conclusion

- 55 There have been no significant changes in the way the NSXA and BSX markets operate since our last assessment. Based on our assessment, we do not have any recommendations to make in relation to NSXL's current supervisory arrangements for its two licensed markets.

Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission
Australian market licence	Australian market licence under s795B of the Corporations Act that authorises a person to operate a financial market
Ch 7 (for example)	A chapter in the Corporations Act (in this example, numbered 7)
Corporations Act	<i>Corporations Act 2001</i> (Cth), including regulations made for the purposes of that Act
market licensee	Holder of an Australian market licence
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C), unless otherwise specified