



ASIC

Australian Securities & Investments Commission

REPORT 227

ASIC supervision of markets and participants: August to December 2010

January 2011

About this report

This report summarises key operational statistics and outcomes of ASIC's market and participant supervisory functions in relation to the Australian Securities Exchange (ASX) and ASX 24 (previously Sydney Futures Exchange) for the period 1 August to 31 December 2010.

A summary of ASIC's markets-related deterrence activity, for the period 1 January 2009 to 31 December 2010, is provided in Section D of the report.

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.

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Executive summary

On 1 August 2010 the Australian Securities and Investments Commission (ASIC) commenced market supervision and real-time surveillance of trading, which were previously undertaken by the Australian Securities Exchange (ASX). ASIC also supervises compliance with market integrity rules and the *Corporations Act 2001* (Corporations Act), and ensures that Australian financial services (AFS) licence conditions are met by market participants.

This report summarises key operational statistics and outcomes of ASIC's market and participant supervisory functions in relation to ASX and ASX 24 (previously Sydney Futures Exchange) for the reporting period 1 August to 31 December 2010, with Section A outlining key outcomes achieved during the period.

Section B provides details regarding ASIC's first five months of real-time market surveillance and supervision. During this time there were 28,512 trade surveillance alerts, which is consistent with the number of alerts received by ASX. ASIC conducted preliminary enquiries in relation to 91 markets matters and formal enquiries in relation to 40 markets matters, with 17 of these matters being referred to ASIC's Deterrence team for investigation. ASIC also took pre-emptive action in markets matters on 14 occasions, raising concerns regarding potentially disruptive execution strategies and algorithmic trading issues.

Section C summarises ASIC's market participant supervision activity in the reporting period. This activity included surveillances, monitoring and remediation work, and risk-based assessment visits. In the reporting period, ASIC received a total of 132 participant applications and 251 notifications, completing 128 and 166 of these respectively within the reporting period. Four market participant matters were referred to ASIC's Deterrence team for investigation.

Section D provides a summary of ASIC's markets-related deterrence activity from 1 January 2009 to 31 December 2010. Reporting against this timeframe takes into account the time required to conduct investigations and undertake court actions.

A ASIC's market and participant supervision: Key outcomes

Table 1 summarises the outcomes from ASIC's first five months of integrated market and participant supervision.

One of the key benefits of ASIC taking on responsibility for market surveillance has been a reduction in the time taken to commence an investigation into suspicious market conduct. During the reporting period there were 14 investigations commenced within 60 days and nine within 30 days of the matter having been identified. Insider trading detection, investigation and prosecution remains a key priority for ASIC, reflected in the referral of 10 matters during the reporting period for investigation of possible insider trading. Details and commentary on investigation outcomes, for the period 1 October 2009 to 31 December 2010, are contained in Section D of this report.

In addition to our focus on insider trading and market manipulation, we have been active in identifying problematic algorithms and working with market participants and their clients to reduce the risk of algorithms having a negative impact on market integrity. If it is warranted, we will take enforcement action against a participant whose system interferes with market integrity.

In the participant area, two matters relating to alleged unauthorised trading were referred for investigation. Prevention of unauthorised trading and appropriate supervision of representatives are key themes addressed during our participant surveillance visits and we expect participants to have appropriate controls and a culture of compliance in place.

Table 1: Investigation and deterrence outcomes—1 August to 31 December 2010*

Outcomes (number of matters)	Current period (1 Aug–31 Dec 2010)	Previous corresponding period (1 Aug–31 Dec 2009)**	Year to date (1 Jan–31 Dec 2010)	Main issues
Preliminary enquiries: markets	91	Not applicable	91	Potential market misconduct matters, including insider trading, market manipulation and market integrity rule breaches identified by the Market Surveillance team.
Deterrence referrals: markets	17	Not applicable	17	Potential insider trading (10 of 17 referrals).

Outcomes (number of matters)	Current period (1 Aug–31 Dec 2010)	Previous corresponding period (1 Aug–31 Dec 2009)**	Year to date (1 Jan–31 Dec 2010)	Main issues
Deterrence referrals: participants	4	Not applicable	4	Unauthorised securities trading (2 referrals). Trust money and insolvent trading (1 referral). Market integrity rule: order records (1 referral).
Deterrence investigation outcomes*	10	3	20	Insider trading and market manipulation, pleadings and convictions; continuous disclosure breaches; broker bannings.

* The figures given here are for outcomes obtained during this reporting period only—all investigations were commenced prior to the current reporting period.

** For the purposes of this first supervision report by ASIC, the previous corresponding period has been taken to be the same five-month period in 2009. In future supervision reports, this will refer to the previous six-month period.

An important part of ASIC's supervisory role is to prevent disorderly markets and market misconduct through active dialogue with market participants. Table 2 summarises instances where ASIC has engaged with participants to amend order execution methods and review algorithmic trading issues. This preventative and proactive role is essential in improving participant conduct and preventing potential misconduct. Importantly, it complements ASIC's deterrence role in relation to more serious misconduct.

Table 2 also summarises instances where ASIC has agreed with a participant that it will take remedial action to address deficiencies in its processes and procedures.

Table 2: Remedial and pre-emptive action—1 August to 31 December 2010

Outcomes	Current period (1 Aug–31 Dec 2010)	Previous corresponding period (1 Aug–31 Dec 2009)	Year to date (1 Jan–31 Dec 2010)	Main issues
Pre-emptive action (guidance to prevent potential misconduct)	14	Not applicable	14	Brokers agreed to amend order execution strategies to minimise possible market disruption. Discussions with participants regarding algorithmic trading issues.
Remediation (agreed compliance actions)	8	Not applicable	8	Unauthorised discretionary trading service, non-compliance with financial conditions of licence and supervision of representatives

B Market surveillance and supervision

Real-time surveillance of Australia's licensed financial markets

ASIC's Market Surveillance team uses the SMARTS trade surveillance system, internally developed market monitoring tools and information provided by the market and other ASIC stakeholder groups to identify possible market misconduct matters. ASIC's Market Surveillance team is made up of a number of former ASX Surveillance staff and ASIC staff with extensive market experience to ensure continuity and consistency in identifying and addressing market misconduct matters.

Trade surveillance alerts are indicators of unusual trading activity. During the first quarter of market surveillance at ASIC there were 28,512 alerts (see Table 3), which is consistent with the number of alerts received previously by ASX. The number of alerts can be affected by a range of factors, including general market volatility, the level of corporate transactions and trading conditions generally. We expect the number of alerts may vary during each reporting period.

Table 3: Trade surveillance alerts, preliminary enquiries and referrals to Deterrence team

Surveillance activity	1 Aug–31 Dec 2010
Total number of alerts	28,512
Preliminary enquiries created	91
Referrals to Deterrence team	17

Preliminary and formal enquiries

Preliminary enquiries are conducted where our market surveillance analysts are not able to explain an alert or a series of alerts by reference to available market information, including media, internet chat sites, broker research and dialogue with brokers.

Should preliminary enquiries suggest further work is required, ASIC will use its compulsory powers to conduct formal enquiries of participants, clients, listed entities, and corporate and other advisers. There were 40 formal enquiries created during the first five-month period: see Table 4 and Table 5. One formal enquiry referred to Deterrence was identified by ASX prior to 1 August 2010 and one continuous disclosure formal enquiry referred to Deterrence was identified by ASX after 1 August 2010.

Table 4: Preliminary enquiries, by alleged offence

Alleged offence	1 Aug–31 Dec 2010	
	Number of preliminary enquiries	Number of formal enquiries
Insider trading	67	13
Market manipulation	11	12*
Continuous disclosure	4	11**
Miscellaneous market offences	9	4
Total	91	40

* Some significant matters were referred immediately for formal enquiries, which accounts for the number of formal enquiries being higher than the number of preliminary enquiries.

** Seven formal enquiries were commenced during the period as a result of continuous disclosure referrals from ASX.

Table 5: Market matters referred to Deterrence for investigation, by alleged offence

Alleged offence	Matters referred for investigation 1 Aug–31 Dec 2010
Insider trading	10
Market manipulation	1
Continuous disclosure	2
Market integrity rules	4
Total	17

The time taken to get matters that are identified as suspicious referred for investigation is decreasing, with 14 of the 17 referrals for investigation being made within 60 days and nine within 30 days of the matter having been identified. This is an improvement from the previous situation where ASX would do the early detection and preliminary work and then the matter would be referred to ASIC's Deterrence team. We are now able to bring Deterrence into the process earlier, to expedite investigation of the most serious cases identified by ASIC's Market Surveillance team.

As noted above, while insider trading remains a focus, ASIC is currently undertaking preliminary enquiries into possible market manipulation and continuous disclosure breaches.

Pre-emptive supervision action

One of ASIC's objectives is to change behaviour before misconduct occurs by taking pre-emptive action: see Table 6. This includes discussing our concerns with the market participant or end clients directly. We encourage market participants to discuss with ASIC Market Surveillance trade execution strategies that are unusual and may have significant market impact. We are also proactive in contacting participants and clients where we believe automated execution strategies are potentially disruptive.

Table 6: Pre-emptive action taken by ASIC

Pre-emptive action relating to:	1 Aug–31 Dec 2010
Execution strategy	3
Algorithmic trading issues	10
Miscellaneous	1
Total	14

ASIC encourages market participants to raise any trading issues or concerns with ASIC's Markets teams. The Market Surveillance and Analysis teams may be contacted via the hotline and the markets email address below:

Hotline: 1300 029 454

Email: markets@asic.gov.au

C Supervision of market participants

This section summarises ASIC's market participant supervision activity from 1 August to 31 December 2010.

Participant compliance activity

Table 7 details participant compliance activity for the period 1 August to 31 December 2010.

Table 7: Participant compliance—Key activity summary

Surveillances and risk-based assessments	1 Aug–31 Dec 2010			
	At 1 Aug 2010*	New	Completed	At 31 Dec 2010
Surveillances** (includes business as usual equities and futures participants, reactive, proactive and targeted)	14	65	39	40
Monitoring and remediation	9	9	6	12
Risk-based assessment visits	6	15	10	11
Industry presentations		2	2	

* Prior to the transfer of market supervision, ASIC supervised compliance by market participants with their obligations under the Corporations Act and their licence conditions. Following the transfer, ASIC also supervises compliance with the market integrity rules.

** The term 'surveillance' is used to refer to the process of gathering and analysing particular information in relation to a particular market participant or other relevant entity. ASIC conducts surveillances to assess and enforce compliance with financial services laws and the market integrity rules, to produce constructive change by all market participants and to promote public confidence in Australia's financial markets and its participants.

As a result of the risk-based assessments, there are currently four ongoing enquiries, two targeted surveillances and four entities where no additional compliance work is required. It is anticipated that over the course of the year, the Participant Relationship team will complete 70 such assessments. Assessments will cover equities and futures brokers and indirect market participants.

In addition to the above, a number of reactive reviews were commenced and several were completed. Issues identified in the completed reviews were generally resolved with the participants rectifying the issues of concern and putting in place agreed remediation plans. Remediation may include changes to compliance structures, processes, procedures and other measures. They may also include undertakings to cease offering discretionary account services, undertakings to cease to offer certain

financial products to clients and improved supervision of representatives. The implementation of the agreed remediation plans is being monitored by ASIC's Participant Compliance team on an ongoing basis.

A number of reviews found poor order record-keeping and this is an issue we may target in a future thematic review across the market.

Table 8 details participant compliance applications, waivers, notifications and exemptions.

Table 8: Participant compliance applications, waivers, notifications and exemptions

Applications, waivers, notifications and exemptions	1 Aug–31 Dec 2010			
	At 1 Aug 2010*	New	Completed	At 31 Dec 2010
Applications**	0	132	128	4
Waivers requested (ASX)***	0	3	2	1
Waivers requested (ASX 24)***	0	6	5	1
Relief applications***	1	14	9	6
Automated order processing certifications received (includes significant changes)	0	23	23	0
Notifications (includes professional indemnity insurance, responsible executive changes and accredited derivatives adviser (ADA) withdrawals)****	0	251	166	85

* Prior to the transfer of market supervision, ASIC supervised compliance by market participants with their obligations under the Corporations Act and their licence conditions. Following the transfer, ASIC also supervises compliance with the market integrity rules.

** Includes ADA accreditation, reaccreditation and business connections consents.

*** Waivers are in respect of market integrity rules and relief applications are in respect of the Corporations Act.

**** These numbers include the submission by all ASX market participants of their management structure document. This initial submission by all ASX market participants is a one-off event. In future, participants will only be required to submit details of their management structure if they are a new participant, or for established participants, if there has been a significant change.

Between 1 August and 31 December 2010, the Participant Relationship team received 132 applications and 251 notifications. ASIC also received referrals relating to eight complaints, 17 market integrity rule notifications in respect of trust account deficiencies, one reported Corporations Act breach and one (ASX) self-reported

market integrity rule breach, and a further five (ASX 24) self-reported market integrity rule breaches. In addition, 91 management structure notifications were also received.

The Participant Relationship team is scheduled to undertake further work covering key areas such as market integrity rule compliance, unauthorised discretionary trading, managed discretionary accounts, compliance monitoring and adequacy of management supervision.

Table 9 lists market participant matters referred to Deterrence for investigation.

Table 9: Market participant matters referred to Deterrence for investigation, by alleged offence

Alleged offence	Matters referred for investigation 1 Aug–31 Dec 2010
Adviser: unauthorised trading	2
Licensee solvency	1
Market integrity rule: order records	1
Total	4

Work on unauthorised discretionary trading and protection of clients' money remains a high priority for ASIC's Participant Compliance team.

The Participant Relationship and Compliance teams may be contacted via the hotline and the market participants email address:

Hotline: 1300 029 454

Email: market.participants@asic.gov.au

D ASIC markets-related deterrence activity

This section provides a summary of ASIC's markets-related deterrence activity from 1 January 2009 to 31 December 2010. Reporting against this timeframe takes into account the time required to conduct investigations and undertake court actions.

Investigation and deterrence outcomes

Table 10 lists investigation and deterrence outcomes.

Table 10: Investigation and deterrence outcomes

Significant market integrity-related outcomes	1 Jan 2009–31 Dec 2010
Bannings	11
Insider trading court actions	7
Continuous disclosure infringement notices	3
Other sanctions (enforceable undertakings and pecuniary penalties)	4
Market manipulation court actions	6
Total	31

Details of the 31 outcomes summarised in Table 10 are as follows:

- *Bannings*: Eleven advisers have been banned from providing financial services for periods ranging from 18 months to six years.
- *Insider trading court actions*: The outcomes include individuals who have pleaded guilty to insider trading where sentences have not yet been handed down (three matters), and sentences of up to two years imprisonment.
- *Continuous disclosure infringement notices*: Three infringement notices were issued, one for \$33,000, one for \$66,000 and one for \$100,000.
- *Other sanctions*: Two enforceable undertakings were entered into for various offences, including a breach of the short selling provisions. A pecuniary penalty was imposed for misleading and deceptive conduct by a director and a custodial sentence for providing false and misleading information to ASX.
- *Market manipulation court actions*: The outcomes include individuals who have pleaded guilty to market manipulation where sentences have not yet been handed down, pecuniary penalties up to \$80,000 and jail sentences for up to 20 months upon being found guilty of market manipulation by the court.

Charges laid

Table 11 summarises ASIC insider trading and market manipulation investigations where charges were laid by ASIC in the period 1 January 2009 to 31 December 2010, but court proceedings and findings had not been finalised by 31 December 2010.

Table 11: Summary of matters in which charges have been laid

Alleged offences	Number of matters
Insider trading	3
Market manipulation	1
Total	4