



**ASIC**

Australian Securities & Investments Commission

**REPORT 231**

# **Market assessment report: Mercari Pty Limited**

**ACN 102 928 727**

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## **About this report**

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

This assessment covers the period 1 January 2010 to 31 December 2010 (the 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	Report date
REP 198	April 2010
REP 165	September 2009
REP 149	February 2009
REP 105	October 2007
REP 80	September 2006

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# Key findings and recommendations

## Key findings

- 1 ASIC is satisfied that Mercari 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 about 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 the 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). 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).
- 6 This report covers the period 1 January 2010 to 31 December 2010.

### Background

- 7 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 and environmental financial markets.

- 8 Mercari's Australian market licence permits Mercari to operate its electronic trading platform, Mercari Direct. During the assessment period, the products available to be traded on Mercari Direct were foreign exchange derivatives and interest rate derivatives. As a result of a recent market licence variation (and subsequent related operating rule changes), additional products are now available on the platform (see paragraph 11 below).
- 9 The total turnover in the Australian over-the-counter (OTC) financial market for the 2009–10 period was \$66,678 billion.<sup>1</sup> The turnover for foreign exchange and interest rate derivatives in the Australian OTC financial market for the same period was \$39,538 billion.<sup>2</sup> There was no trading activity on Mercari Direct during the assessment period.
- 10 During the assessment period, there were 23 authorised participants on the market. These were wholesale entities (and either banks or subsidiaries of banks) who were permitted to trade only on their own behalf.
- 11 Mercari was granted a variation to its market licence on 9 December 2010. As a result of this variation, Mercari is now permitted to offer commodity, energy and environmental derivatives on Mercari Direct. In addition, participation is now restricted to professional investors and participants are now permitted to trade on behalf of wholesale clients.
- 12 In addition to a 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 market licence and the terms of its AFS licence are available on our website at [www.asic.gov.au/markets](http://www.asic.gov.au/markets).

## Our methodology

### Our assessment process

- 13 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.
- 14 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

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<sup>1</sup> Australian Financial Market Association, *2010 Australian Financial Market Report*, p. 6.

<sup>2</sup> *ibid*, p. 48.

- identify issues, which in our view need, or may need, to be addressed to ensure ongoing compliance.

### **What we focused on for this assessment**

- 15 Our focus in this assessment was to review:
- any changes in Mercari's operations from the previous year's assessment;
  - Mercari's supervisory procedures—including, in particular, its arrangements for managing conflicts of interest; and
  - whether Mercari has adequate resources.

### **What we considered**

- 16 In conducting our assessment we considered:
- information we received from and about Mercari in the ordinary course of our dealings with Mercari, including Mercari's annual regulatory report required under s792F;
  - documents produced by Mercari in response to our notice under s30 of the *Australian Securities and Investments Commission Act 2001*, issued to obtain information about how Mercari is meeting certain obligations under the Corporations Act;
  - Mercari's policies and procedures for the conduct of Mercari in general and its supervisory responsibilities in particular; and
  - publicly available information on Mercari's website.

### **Consultation**

- 17 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 have considered the adequacy of Mercari's arrangements and resources for supervising its 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.

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

We do not have any recommendations to make about either Mercari's current supervisory arrangements or resources.

We also note that Mercari has complied with its reporting obligations under the Corporations Act.

### Supervisory arrangements

- 18 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; and
  - sufficient resources to operate its market properly and for the required supervisory arrangements to be provided under s792A(d) of the Corporations Act.
- 19 This conclusion is based on the following observations:
- Mercari's supervisory arrangements did not change during the assessment period. These arrangements include:
    - a compliance and surveillance officer who is responsible for supervising the market, monitoring the conduct of participants, and enforcing compliance with the operating rules, Client Agreement and relevant law in order to fulfil Mercari's market licence obligations; and
    - product supervisors/administrators who play a supporting role in the supervision of the market and have day-to-day responsibility for the operation of the trading system.
  - There was no trading on Mercari Direct during the assessment period.



- No serious market failures or disruptions occurred during the assessment period.
- No information has come to our attention to suggest that the supervisory arrangements in place have not been operating properly.

### **Managing conflicts of interest**

- 20 Mercari's arrangements for managing conflicts of interest between its supervisory and commercial interests have not changed since the previous assessment.
- 21 These arrangements include the Mercari Direct Written Procedures which set out the obligations and priorities of Mercari's employees and detail how conflicts of interest may be identified, minimised and avoided.
- 22 Further information regarding Mercari's conflicts of interest policy is contained in a previous ASIC assessment report (Report 165 *Market assessment report: Mercari Pty Limited* (REP 165) at paragraphs 20 and 21).
- 23 Mercari has reported that no conflicts of interest have arisen during the assessment period.

### **Monitoring the market and conduct of participants**

- 24 Mercari has not made any changes to its arrangements for monitoring the market and conduct of participants. These arrangements include:
- product supervisors/administrators who monitor all active dealing screens on a daily basis to ensure all authorised participants are acting in compliance with the operating rules and that all screens are functioning correctly; and
  - a compliance and surveillance officer who undertakes post-trade surveillance activities to enforce compliance with the operating rules. The compliance and surveillance officer is required to report all suspected or actual breaches to the directors and record these in the Compliance Register.
- 25 Further details regarding Mercari's supervisory arrangements are set out in Report 198 *Market assessment report: Mercari Pty Limited* (REP 198) at paragraph 23 and REP 165 at paragraphs 25–27.
- 26 Mercari did not identify or take action in relation to any breaches during the assessment period.

## Enforcing compliance with market operating rules

- 27 As stated in paragraph 11, on 9 December 2010 Mercari's market licence was varied to permit it to offer additional products to participants and to allow professional investor participants to trade on behalf of wholesale clients. Mercari made changes to its operating rules consistent with that variation, which became effective on 10 February 2011.
- 28 Mercari enforces compliance through:
- the operation of Mercari Direct, which rejects certain trading activity which is or may be in breach of the operating rules; and
  - Mercari's product supervisors/administrators and surveillance and compliance officer, who use internal procedures to monitor participant conduct and identify patterns of behaviour that may evidence breaches or possible breaches of the operating rules or Corporations Act.
- 29 Further details regarding Mercari's procedures for enforcing compliance are set out in REP 198 at paragraphs 26–27 and REP 165 at paragraph 29.
- 30 Mercari informed us that during the assessment period no breach or potential breach of the operating rules or Corporations Act was identified.

## Resources

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

### Financial resources

- 32 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.
- 33 During the assessment period, Mercari's financial resources were derived from net assets within Mercari's ownership and control, and financial support from FEX.
- 34 Mercari is currently supplying ASIC with monthly financial reports.

### Technological resources

- 35 Mercari has reported that during the assessment period there were no serious market disruptions.

- 36 According to Mercari, technology upgrades have resulted in enhanced capacity and post-trade connectivity and the system can now accommodate the new products and expansion to the class of participants.

### **Human resources**

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

## **Conclusion**

- 38 Based on this assessment, we do not have any recommendations to make about Mercari's current supervisory arrangements.

## Key terms

Term	Meaning in this document
AFMA	Australian Financial Market Association
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services <p>Note: This is a definition contained in s761A of the Corporations Act.</p>
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> , including regulations made for the purposes of that Act
FEX	Financial and Energy Exchange Ltd
Mercari	Mercari Pty Limited
market licensee	Holder of an Australian market licence
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C)