



ASIC

Australian Securities & Investments Commission

REPORT 243

ASIC supervision of markets and participants: January to June 2011

July 2011

About this report

This report summarises key operational statistics and outcomes of ASIC's market and participant supervisory functions in relation to ASX, ASX 24 and other Australian market licensees for the period 1 January 2011 to 30 June 2011.

A summary of ASIC's markets-related deterrence outcomes, for the period 1 July 2009 to 30 June 2011, 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.

Contents

Executive summary	4
A Market and participant supervision: Key outcomes	6
B Market surveillance and supervision	8
Real-time surveillance of Australia's licensed financial markets	8
Preliminary and formal enquiries	8
Pre-emptive supervision action.....	10
C Supervision of market participants	11
Participant compliance activity.....	11
Referrals	13
D Markets-related deterrence outcomes	14
Investigation and deterrence outcomes.....	14
Charges laid.....	15
Key terms	16

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 the ASIC market integrity rules and the *Corporations Act 2001* (Corporations Act) and ensures that Australian financial services (AFS) licence conditions are met by market participants.

A core outcome for ASIC is investor confidence that our markets are fair and efficient. This requires our market infrastructure to be robust; trading, clearing and settlement of transactions to be orderly and efficient; and market misconduct to be minimised. We do this through engagement with stakeholders, surveillance of markets and market participants, education, guidance and our deterrence activities.

ASIC is committed to reducing the incidence of market misconduct by:

- ensuring that market participants have better controls in accordance with required standards;
- supervising markets and market participants to detect market misconduct quickly; and
- conducting timely investigations of market and market participant misconduct, resulting in significant penalties where appropriate.

This report summarises key operational statistics and outcomes of ASIC's market and participant supervisory functions in relation to ASX, ASX 24 (previously the Sydney Futures Exchange) and other Australian market licensees for the reporting period 1 January to 30 June 2011. Section A outlines key outcomes achieved during the period.

Section B provides details of ASIC's real-time market surveillance and supervision activity for the period 1 January to 30 June 2011. During this time, there were 23,494 trade surveillance alerts. We conducted preliminary enquiries into 121 market matters. A total of 35 matters were referred to ASIC's Deterrence team for formal investigation. We also took pre-emptive action in market matters on 22 occasions, including raising concerns about potentially disruptive execution strategies and algorithmic trading issues.

Section C summarises ASIC's market participant supervision activity for the period 1 January to 30 June 2011. This includes surveillance,¹ monitoring and remediation work, and risk-based assessment visits.²

¹ The term 'surveillance' is used to refer to the process of gathering and analysing particular information on a particular market participant or other relevant entity. We conduct surveillance to assess and enforce compliance with financial services laws and ASIC market integrity rules to produce constructive change by all market participants and to promote public confidence in Australia's financial markets and its participants.

² Risk-based assessments are an analysis of the business of a licensee, the risks inherent in its business model and how it is managing those risks.

Section C also summarises market participant compliance applications, waivers, notifications and exemptions. In this reporting period, ASIC received a total of 232 applications³ from market participants (four were already open as at 31 December 2010) and 181 notifications⁴ (85 were already open as at 31 December 2010). We completed 234 participant applications and 258 notifications. Eight market participant matters were referred to ASIC's Deterrence team for formal investigation.

Section D summarises ASIC's markets-related deterrence outcomes from 1 July 2009 to 30 June 2011. Reporting against this timeframe takes into account the time required to conduct an investigation and undertake court actions.

³ This includes accredited derivatives adviser (ADA) accreditation, reaccreditation, exemptions and business connections consents.

⁴ 'Notifications' includes professional indemnity insurance, responsible executive changes and ADA withdrawals.

A Market and participant supervision: Key outcomes

Table 1 summarises the preliminary enquiries and Deterrence team referrals from our market and participant supervision between 1 January and 30 June 2011, and includes the data for the first five months of supervision undertaken by ASIC from 1 August to 31 December 2010.⁵

Table 1: Preliminary enquiries and Deterrence team referrals*

Outcomes (number of matters)	Current period (1 Jan–30 June 2011)	Previous period (1 Aug–31 Dec 2010)**	Main issues
Preliminary enquiries: markets	121	91	Potential market misconduct matters, including insider trading, market manipulation and ASIC market integrity rule breaches identified by the Market Surveillance team.
Deterrence referrals: markets	35	17	Potential insider trading, market manipulation and breaches of ASIC market integrity rules.
Deterrence referrals: market participants	8	4	Unauthorised securities trading. Trust money. Breaches of ASIC market integrity rules. Supervision of representatives.

* *ASIC supervision of markets and participants: August to December 2010* (REP 227), published in January 2011, contained Deterrence outcomes. This information is now consolidated into Section D of this report.

** The previous reporting period was five months—from 1 August to 31 December 2010. Accordingly, the figures are not directly comparable. Future reports will use standardised six-month reporting period comparisons.

As outlined in ASIC's first market supervision report (REP 227), one of the benefits of ASIC taking on responsibility for market supervision has been a reduction in the time taken to commence an investigation into suspicious market conduct. ASIC has continued to build upon the results achieved in the first five months of supervision. Of the 52 market matters referred to Deterrence since ASIC assumed responsibility for market supervision on 1 August 2010, investigations formally commenced for 21 of these matters within 30 days of detection. Insider trading detection, investigation and prosecution continues to be a priority for ASIC. Seventeen of the market matters referred to Deterrence during the latest reporting period related to insider trading. Details and commentary on investigation outcomes, for the period 1 July 2009 to 30 June 2011, are contained in Section D of this report.

During this reporting period, we observed an increase in referrals in relation to the potential misuse of confidential information by persons employed by companies that provide advice on mergers and acquisitions and other significant corporate transactions. The individuals who are the subject of the referrals are employed by organisations such

⁵ This report shows a six-month reporting period (1 January to 30 June 2011) compared to the previous five-month reporting period (1 August to 31 December 2010). Future reports will use standardised six-month reporting periods.

as investment banks, consultancy firms and other firms that are privy to confidential information before transactions are publicly announced. We will continue to actively monitor, and vigorously pursue, any possible misconduct of this type.

In addition to our focus on insider trading and market manipulation, we have been increasingly active in identifying problematic algorithms and working with market participants to ensure retail client orders for exchange-traded funds (ETFs) are appropriately priced. We identified a number of instances where index ETF orders were placed well away from the value implied by the underlying index. This is reflected in the number of pre-emptive actions, increasing from 14 in the previous reporting period to 22 in the current reporting period: see Table 2. Importantly, this does not replace Deterrence action. If it is warranted, we will take enforcement action against a participant whose system or actions interfere with market integrity.

Table 2: Remedial and pre-emptive action

Outcomes	Current period (1 Jan–30 June 2011)	Previous period (1 Aug–31 Dec 2010)	Main issues
Pre-emptive action (guidance to prevent potential misconduct)	22	14	Exchange-traded fund (ETF) trades significantly above or below prices of an underlying index. Discussions with participants regarding algorithmic trading issues.
Remediation (agreed compliance actions)	13	8	Unauthorised discretionary trading service, non-compliance with financial conditions of licence, non-compliance with rules relating to order records and trusts, inadequate controls for conflicts of interest and supervision of representatives.

In our market participant surveillance visits, we continue to focus on unauthorised trading and appropriate supervision of representatives. We expect participants to have appropriate controls and a culture of compliance in place.

B Market surveillance and supervision

This section provides details of ASIC's real-time market surveillance and supervision activity, preliminary and formal enquiries, and pre-emptive supervision action, for the period 1 January to 30 June 2011.

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.

Trade surveillance alerts are indicators of unusual trading activity. During the reporting period, there were 23,494 alerts compared to 28,512 alerts generated during the previous reporting period: see Table 3. The number of alerts is affected by a range of factors, including general market volatility, the level of corporate transactions and trading conditions generally.

In the current period, the Market Surveillance team has reviewed the alert parameters in order to reduce the number of alerts generated resulting in 'false positives' that do not require any follow-up. The aim is to reduce the number of alerts that are clearly able to be explained by normal market activity. The Market Surveillance team is continuing to calibrate and refine alert parameters to better identify market anomalies.

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

Surveillance activity	Current period (1 Jan–30 June 2011)	Previous period (1 Aug–31 Dec 2010)
Total number of alerts	23,494	28,512
Preliminary enquiries conducted	121	91
Referrals to Deterrence team	35	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 27 formal enquiries undertaken during this reporting period, compared with 40 formal enquiries in the previous period: see Table 4.

The fall in the number of formal enquiries from the previous reporting period (from 40 to 27) can be attributed to two factors. First, in the previous reporting period, formal enquiries were conducted in response to 16 ASX referrals because the practice was for these to go straight to the formal enquiry stage. Second, in the current reporting period, 25 matters were referred directly to Deterrence from the preliminary enquiry stage.

Table 4: Preliminary and formal enquiries

Alleged offence	Current period (1 Jan–30 June 2011)		Previous period (1 Aug–31 Dec 2010)	
	Number of preliminary enquiries	Number of formal enquiries	Number of preliminary enquiries	Number of formal enquiries
Insider trading	72	9	67	13
Market manipulation	29	4	11	12*
Continuous disclosure	13	12 [†]	4	11**
Miscellaneous market offences	7	2	9	4
Total	121	27	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.

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

The time taken to get matters identified as suspicious referred to Deterrence for investigation is generally less than the time that was taken before ASIC's commencement of market supervision. In total, from 1 August 2010 to 30 June 2011, 21 of 52 referrals were made to ASIC Deterrence within 30 days of identifying the possible misconduct: see Table 5. Previously, this process (which involved a referral from ASX Surveillance to ASIC for assessment prior to investigation) took considerably longer. In more serious matters identified by the Market Surveillance team, we continue to bring Deterrence into the process earlier to expedite investigation. In one recent matter, Market Surveillance identified possible insider trading in mid-January 2011 and by involving Deterrence at a very early stage, the investigation was conducted and charges were laid by 29 June 2011. As noted above, while insider trading remains a focus, ASIC has also referred six matters relating to possible market manipulation breaches to Deterrence for investigation in this reporting period.

Table 5: Market matters referred to Deterrence for investigation

Alleged offence	Current period (1 Jan–30 June 2011)	Previous period (1 Aug–31 Dec 2010)
Insider trading	17	10
Market manipulation	6	1
Continuous disclosure	2	2
Breach of market integrity rules	10	4
Total	35	17

Pre-emptive supervision action

One of ASIC's objectives is to change behaviour by providing guidance before misconduct occurs. An important part of ASIC's supervisory role is to prevent disorderly markets and market misconduct through active dialogue with market participants. Table 6 summarises instances where ASIC discussions with participants have led them to amend order execution methods and to review their trading algorithms. This preventive and proactive role is essential in improving participant conduct and preventing potentially serious misconduct. Importantly, it complements ASIC's deterrence role in relation to more serious misconduct.

During the reporting period, we raised concerns with market participants about trading in index exchange-traded funds (ETFs) where an ETF trades at a price significantly above or below the underlying index. In response, several market participants have put in place new filters and processes to ensure that these orders, which are usually initiated by online retail clients, are reviewed by a designated trading representative (DTR) before being released to the market.

Table 6: Pre-emptive supervision action

Pre-emptive action relating to:	Current period (1 Jan–30 June 2011)	Previous period (1 Aug–31 Dec 2010)
Execution strategy	7	3
Algorithmic trading and filter issues*	14	10
Miscellaneous	1	1
Total	22	14

* We have amended this category in the current period to include filter issues associated with algorithmic trading.

We encourage market participants to raise any trading issues or concerns at an early stage. The Market Surveillance and Analysis teams may be contacted via the hotline and the markets email address:

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 January to 30 June 2011.

Participant compliance activity

Table 7 details market participant compliance activity. In addition to the assessments identified in Table 7, a number of reactive reviews⁶ 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. These plans may include changes to compliance structures, processes and procedures. They may also include undertakings to cease offering discretionary account services, undertakings to cease offering certain financial products to clients and improved supervision of representatives. The implementation of the agreed remediation plans is monitored by ASIC's Participant Compliance team. A number of reviews also found poor order record-keeping and we are now targeting this issue to lift standards across the market.

Table 7: Participant compliance—Key activity summary

Compliance activity	Current period (1 Jan–30 June 2011)				Previous period (1 Aug–31 Dec 2010)		
	Outstanding at 31 Dec 2010	New	Completed	Outstanding at 30 June 2011*	Outstanding at 1 Aug 2010**	New	Completed
Surveillance (includes business-as-usual equities and futures participants, reactive, proactive and targeted)	40	85	61	64	14	65	39
Monitoring and remediation	12	8	6	14	9	9	6
Risk-based assessment visits	11	47	38	20	6	15	10
Industry presentations	–	2	2	–	–	2	2

* Matters 'outstanding at 30 June 2011' represent the opening balance at the beginning of the reporting period (i.e. matters 'outstanding at 31 December 2010') plus 'new' matters less 'completed' matters.

** Before 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 ASIC market integrity rules.

⁶ A reactive review is action taken in response to matters or potential misconduct being brought to our attention (e.g. by complaint and breach report).

Table 8 highlights that 251 notifications were received between 1 August and 31 December 2010 and 181 notifications were received between 1 January and 30 June 2011. The reason for the drop in number is that under ASIC market integrity rules all ASX market participants were required to submit their management structure between 1 August and 31 December 2010. As a result, 91 management structure notifications were received by the end of 2010. This was a one-off transitional requirement. The market integrity rules now require new market participants to submit management structures, and established market participants to submit a new management structure only if there has been a material change.

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

Applications, waivers, notifications and exemptions	Current period (1 Jan–30 Jun 2011)				Previous period (1 Aug–31 Dec 2010)		
	Outstanding at 31 Dec 2010	New	Completed	Outstanding at 30 June 2011*	Outstanding at 1 Aug 2010**	New	Completed
Applications [†]	4	232	234	2	0	132	128
Waivers requested (ASX) ^{††}	1	1	1	1	0	3	2
Waivers requested (ASX 24) ^{††}	1	5	5	1	0	6	5
Relief applications ^{††}	6	11	11	6	1	14	9
Automated order processing (AOP) certifications received (includes significant changes)	0	30	29	1	0	23	23
Notifications (includes professional indemnity insurance, responsible executive changes and accredited derivatives adviser (ADA) withdrawals)	85	181	258	8	0	251	166

* Applications, waivers, notifications and exemptions 'outstanding at 30 June 2011' represent the opening balance at the beginning of the reporting period (i.e. 'outstanding at 31 December 2010') plus 'new' applications, waivers, notifications and exemptions matters less 'completed' applications, waivers, notifications and exemptions.

** Before 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 ASIC market integrity rules.

[†] This includes ADA accreditation, reaccreditation, exemptions and business connections consents.

^{††} Waivers are in respect of ASIC market integrity rules and relief applications are in respect of the Corporations Act.

Referrals

In addition to the work undertaken by the Market Participants teams (as outlined above), the teams also receive and review referrals from Misconduct and Breach Reporting. The following specific referrals were reviewed between 1 January and 30 June 2011:

- 10 complaints made by the public about indirect market participants and market participants;
- 4 Corporations Act breaches that were self-reported by market participants;
- 2 Corporations Act breaches that were reported by the auditors of market participants relating to the actions of the market participants; and
- 14 ASIC market integrity rule breaches that were self-reported by market participants.

Between 1 January and 30 June 2011, the Market Participants teams reviewed one referral from ASX and 10 market integrity rule notifications that were made in respect of trust account deficiencies.

The teams are continuing to focus on key areas such as market integrity rule compliance, unauthorised discretionary trading, managed discretionary accounts, compliance monitoring and adequacy of management supervision. Table 9 lists the market participant matters referred to Deterrence.

Table 9: Market participant matters referred to Deterrence for investigation

Alleged offence	Current period (1 Jan–30 Jun 2011)	Previous period (1 Aug–31 Dec 2010)
Adviser: unauthorised trading	1	2
Licensee solvency	–	1
Breach of market integrity rule:		
• order records	–	1
• adviser accreditation	1	–
• clients' segregated accounts	2	–
Supervision of representatives	3	–
Participant: Corporations Act misconduct	1	–
Total	8	4

Work on unauthorised discretionary trading and protection of clients' money remains a high priority for ASIC's Market Participants teams. The Market Participants teams may be contacted via the hotline and the Market Participants email address:

Hotline: 1300 029 454

Email: market.participants@asic.gov.au

D Markets-related deterrence outcomes

This section provides a summary of ASIC's markets-related deterrence outcomes from 1 July 2009 to 30 June 2011. Reporting against this timeframe takes into account the time required to conduct investigations and undertake court actions.

Investigation and deterrence outcomes

Table 10 details significant market integrity-related outcomes for the period 1 July 2009 to 30 June 2011.

Table 10: Investigation and deterrence outcomes

Significant market integrity-related outcomes	1 July 2009–30 June 2011
Bannings	8
Insider trading verdicts and judgements	6
Continuous disclosure infringement notices	3
Other sanctions (enforceable undertakings and pecuniary penalties)	3
Market manipulation verdicts and judgements	4
Total	24

Details of the 24 outcomes in Table 10 can be summarised as follows:

- *Bannings*: Eight advisers were banned from providing financial services for periods ranging from three to seven years.
- *Insider trading verdicts and judgements*: These include individuals who have pleaded guilty to insider trading where sentences have not yet been handed down (two matters), and sentences of up to four years and six months 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*: A pecuniary penalty was imposed for misleading and deceptive conduct by a director, and 200 hours community service, a \$5000 fine for providing false and misleading information to ASX and an enforceable undertaking requiring a company to engage an independent external consultant to review its financial reporting and disclosure systems.
- *Market manipulation verdicts and judgements*: The outcomes included pecuniary penalties up to \$80,000 and jail sentences for up to 22 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 July 2009 to 30 June 2011, but court proceedings and findings had not been finalised by 30 June 2011.

Table 11: Summary of matters in which charges have been laid: 1 July 2009 to 30 June 2011

Alleged offence	Number of matters
Insider trading	7
Market manipulation	1
Total	8

NOTE: In addition, there is one matter in which charges were laid prior to 1 July 2009 but court proceedings and findings had not been finalised by 30 June 2011.

Key terms

Term	Meaning in this document
ADA	Accredited derivatives adviser
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 Note: This is a definition contained in s761A of the Corporations Act.
AFS licensee	A person who holds an Australian financial services licence under s913B of the Corporations Act Note: This is a definition contained in s761A of the Corporations Act.
algorithm/algorithmic trading	Electronic trading activity whose parameters are set by predetermined rules aimed at delivering specific execution outcomes
AOP (automated order processing)	Orders generated by an electronic system
ASIC	Australian Securities and Investments Commission
ASX	ASX Limited (ACN 008 624 691) or the exchange market operated by ASX Limited
ASX 24	The exchange market formerly known as Sydney Futures Exchange (SFE), operated by Australian Securities Exchange Limited
Australian domestic licensed financial market	A financial market licensed under s795B(1) of the Corporations Act
Australian market licence	Australian market licence under s795B of the Corporations Act that authorises a person to operate a financial market
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
DTR (designated trading representative)	A representative of the market participant who has been authorised by the participant to submit trading messages to the trading platform on behalf of the participant
enforceable undertaking	An enforceable undertaking that may be accepted by ASIC under reg 7.2A.01 of the Corporations Regulations
equity market	The market in which shares are issued and traded, either through exchange markets or over-the-counter (OTC) markets

Term	Meaning in this document
equity market products	Shares, managed investment schemes, the right to acquire by way of issue shares and managed investment schemes, and CHESS Depository Interests (CDIs) admitted to quotation on ASX
financial market	As defined in s767A of the Corporations Act. It encompasses facilities through which offers to acquire or dispose of financial products are regularly made or accepted
indirect market participant	A broker that is not itself a market participant, but that accesses the market through a market participant
infringement notice	An infringement notice issued under reg 7.2A.04 of the Corporations Regulations
market integrity rules	Rules made by ASIC, under s798G of the Corporations Act, for trading on domestic licensed markets
market licence	An Australian market licence
market manipulation	As defined in Pt 7.10 of the Corporations Act
market operator	A holder of an Australian market licence that is the operator of a financial market on which equity market products are quoted
market participant	An entity that is a participant of a financial market on which equity market products are quoted
MDP (Markets Disciplinary Panel)	ASIC's Markets Disciplinary Panel, through which ASIC exercises its power to issue infringement notices and to accept enforceable undertakings in relation to breaches of the market integrity rules
REP 227	An ASIC report (in this example, numbered 227)
surveillance	Refers to the process of gathering and analysing particular information on a particular market participant or other relevant entity. We conduct surveillance to assess and enforce compliance with financial services laws and ASIC market integrity rules to produce constructive change by all market participants and to promote public confidence in Australia's financial markets and its participants