



ASIC

Australian Securities & Investments Commission

REPORT 307

Market assessment report: Asia Pacific Exchange Limited

ACN 080 399 220

September 2012

About this report

This report relates to the period 1 January 2011 to 31 December 2011 (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 APX assessment reports

Asia Pacific Exchange Limited (APX) was granted an Australian market licence on 11 August 2004, in its registered name at the time, Australia Pacific Exchange Limited. Since then, variations to APX's market licence have been granted to:

- reflect the change to APX's current name, Asia Pacific Exchange Limited (APX). This variation took effect from 8 April 2009; and
- include an unconditional bank guarantee as a source of funds for APX's Division 3 compensation arrangements and to remove certain obsolete licence conditions. This variation took effect from 29 June 2010.

Report number	Report date
REP 239	May 2011
REP 199	June 2010
REP 166	August 2009
REP 154	April 2009
REP 116	January 2008
REP 90	February 2007
REP 61	November 2005

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Key findings and recommendations

Key findings

- 1 ASIC is satisfied that, in terms of the standards set out in the *Corporations Act 2001* (Corporations Act) and given that there was no trading during the assessment period, Asia Pacific Exchange Limited (APX) had adequate arrangements in place for meeting its statutory obligations under s792A(c) of the Corporations Act, and the provision of those services was sufficiently resourced under s792A(d).

Recommendations

- 2 We do not have any recommendations to make about APX's arrangements and/or resources for operating and monitoring its market, as there was no active trading during the assessment period.

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), which require a market licensee to have adequate arrangements for operating the market, including adequate arrangements for handling conflicts and for monitoring and enforcing the operating rules. We can also include other Ch 7 obligations.

We use the market 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

ASIC's obligations

- 3 Under s794C(2) of the *Corporations Act 2001* (Corporations Act), ASIC is required to assess how well a market licensee is complying with its obligations under s792A(c) at least once a year.

Licensee's obligations

- 4 In line with our statutory obligations, we reviewed APX's arrangements for the operation and supervision of its market under s792A(c). This includes its arrangements for handling conflicts and its arrangements for monitoring and enforcing compliance with the market's operating rules.
- 5 Under s794C(1), 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 of the Corporations Act. In keeping with our standard practice, we extended the scope of our assessment to include a review of whether APX had sufficient financial, technological and human resources to properly operate its facilities: see s792A(d).

Assessment period

- 6 Our assessment covers the period from 1 January 2011 to 31 December 2011.

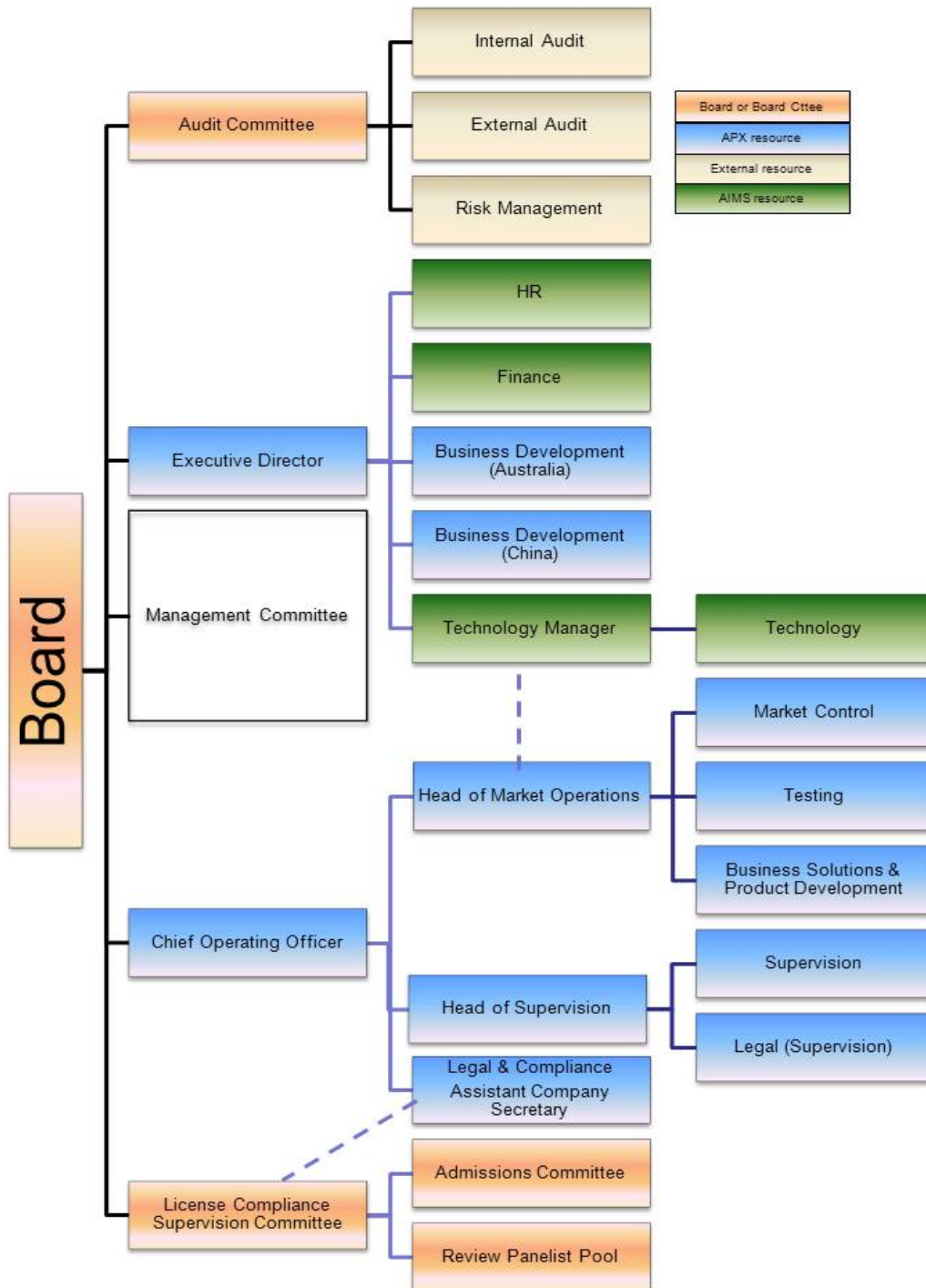
Background

- 7 Due to an inactive market, APX has not needed to practically implement any operational changes as a result of the transfer of market supervision to ASIC on 1 August 2010.
- 8 Before the transfer of market supervision, APX was responsible for supervising and enforcing rules relating to market conduct and market integrity more broadly. Since the transfer, responsibility for frontline supervision of certain APX operating rules was transferred to ASIC.
- 9 From 1 August 2010, s792A(c) of the Corporations Act was amended to recognise the transfer. From this date, a market licensee (such as APX) is required to have adequate arrangements for ‘operating’ (rather than ‘supervising’) its market. This still includes the requirement that a market licensee must have adequate arrangements for monitoring and enforcing compliance with its remaining operating rules, and still includes the requirement to handle conflicts of interest.
- 10 More broadly, a market licensee continues to have:
- the overarching obligation to do all things necessary to ensure that its market operates, to the extent reasonably practicable to do so, in a manner that is fair, orderly and transparent; and
 - the same responsibilities in the critical area of its listing functions and for frontline supervision of compliance with its listing rules.
- 11 As a result, when APX recommences its market, ASIC will supervise APX market participants’ compliance with the ASIC Market Integrity Rules (APX Market) 2010. These market integrity rules are based on the rules previously contained in the APX operating rules that predominantly dealt with matters such as participant conduct and participant-client relations.
- 12 However, the transfer has not changed the important role that will be played by APX when trading recommences on its market, in ensuring fair and efficient markets and confident and informed investors and in ensuring that APX meets its overarching regulatory obligation to operate its market in a fair, orderly and transparent manner.
- 13 For example, APX is responsible for:
- (a) information technology (IT) issues and outages, which are critical to the fair, orderly and transparent operation of its market;
 - (b) the admission and ongoing monitoring of its market participants; and
 - (c) having in place adequate policies and procedures to assure itself that potential listed entities meet the admission requirements and their ongoing disclosure obligations.
- 14 Given the importance of these issues, APX’s management of aspects like technology, risk and operations are likely to receive greater focus in future assessment periods. In particular, we will continue to work with APX to

ensure that it's financial, technological and human resources, its business plan and proposed changes to operating and listing rules are adequate to ensure a viable market upon the recommencement of active trading.

15 Figure 1 reflects the current structure of APX and the roles played by the range of business units in supporting markets that are fair and efficient.

Figure 1: APX's organisational structure as at May 2012



Approach to assessment

ASIC's strategic priorities

- 16 ASIC's current strategic framework focuses on three key strategic priorities or outcomes. These are to ensure:
- fair and efficient financial markets;
 - confident and informed investors and financial consumers; and
 - efficient registration and licensing.
- 17 The first two priorities are particularly important for licensed markets. For example, appropriate resourcing is fundamental to ensuring that markets operate in an efficient manner. The adequate management and transparency of matters such as conflict handling arrangements are important to the fairness of the market.
- 18 Similarly, the effective monitoring and enforcement by a market operator of its continuous disclosure requirements is critical in ensuring that investors and consumers are confident and make informed decisions. For these reasons, we regard the assessment process as an important tool by which we continue to strive to meet our strategic outcomes.

Guiding principles

- 19 Our assessments are guided by certain principles that draw on the International Organization of Securities Commission (IOSCO) objectives and principles of securities regulation. The principles we use to guide assessments are:
- admission standards for issuers and participants are robust and administered in a fair and transparent way;
 - post-admission standards are robust and effectively monitored and enforced in a fair and transparent manner;
 - operating rules promote transparency to market users of material price and trading information;
 - the deterrence of unfair trading practices is supported by robust arrangements for detection and prompt referral to ASIC of significant contraventions of the operating rules, the Corporations Act and ASIC market integrity rules;
 - conflicts are adequately managed; and
 - sufficient resources (including technological resources) are deployed to operate the market in a proper and reliable manner.

Our methodology

Our assessment process

- 20 A market licensee's obligations are ongoing. Whether a market licensee is likely to comply with its obligations in the future cannot be judged merely by reference to its past compliance.
- 21 We therefore use the assessment process to:
- reach conclusions about the adequacy of the arrangements a market licensee has in place in accordance with its obligations under s792A(c) of the Corporations Act at the time of the assessment; and
 - identify issues, which in our view need, or may need, to be addressed to ensure ongoing compliance.
- 22 In this assessment report (which covers the period 1 January 2011 to 31 December 2011), where we refer to APX's compliance with its statutory obligations for matters that have occurred since 1 August 2010, we do so noting that from that date:
- APX no longer has frontline responsibility for monitoring and enforcing certain operating rules that were transferred to ASIC as ASIC Market Integrity Rules (APX Market) 2010;
 - amendments to the wording of s792A(c) of the Corporations Act were made to recognise the transfer; and
 - APX's other obligations (when it recommences trading on its market) remain materially unchanged.

What we focused on for this assessment

- 23 During the assessment period, there was no active trading on APX's market (as was the case during the preceding two assessment periods). There were therefore no particular areas of focus for this assessment.

What we considered

- 24 In conducting our assessment we:
- held discussions with senior APX personnel;
 - reviewed internal APX documentation obtained under notices issued under s30 of the *Australian Securities and Investments Commission Act 2001*;
 - reviewed APX's annual regulatory report, dated 30 September 2011, as required under s792F;
 - considered information received from and about APX in the ordinary course of ASIC's dealings with APX as a market licensee;

- reviewed policies and procedures relating to the conduct of APX in general and its supervisory responsibilities (given that APX's market was not operational during the assessment period); and
- considered information from external sources, including media and industry commentary.

Consultation

25 APX has had the opportunity to view and comment on the factual accuracy of this report. Where appropriate, this report reflects APX's comments.

B Our observations

Key points

We are satisfied that, in terms of the standards set out in the Corporations Act and given that there was no trading during the assessment period, APX had adequate arrangements in place for meeting its statutory obligations under s792A(c) of the Corporations Act, and the provision of those services was sufficiently resourced under s792A(d).

We do not have any recommendations about APX's arrangements and/or resources for operating and monitoring its market, as there was no active trading during the assessment period.

Adequate arrangements

26 In assessing how well a licensee is complying with its statutory obligations to have adequate arrangements in place to supervise (before 1 August 2010) or operate (from 1 August 2010) its market, we consider whether a licensee has adequate arrangements to:

- monitor and enforce its operating rules; and
- handle conflicts of interest.

Monitoring and enforcing operating rules

27 In determining whether a licensee is complying with its obligations to monitor and enforce its operating rules, we consider how the licensee:

- deals with listed entities and monitors disclosure to detect potential or actual non-compliance with the law or the market's operating rules;
- monitors trading and participant activity in relation to its operating rules to detect potential or actual non-compliance with the law or the market's operating rules;
- plans and documents procedures for ensuring frequent and comprehensive assessment of its ongoing compliance with its obligations, and ongoing compliance by listed entities and market participants with their obligations;
- deals with actual or suspected breaches of the law or the operating rules, including remedial, disciplinary and other deterrent measures;
- deals with complaints about the market or market participants; and
- shares information with ASIC and (where appropriate) operators of other markets and clearing and settlement facilities.

- 28 A description of APX's current supervisory framework is set out in paragraph 23 of Report 166 *Market assessment report: Asia Pacific Exchange Limited* (REP 166), issued in August 2009.
- 29 We conclude that during the assessment period, in which there was no active trading on APX's market, APX had:
- adequate arrangements for the operation of its market in accordance with its obligations under s792A(c) of the Corporations Act; and
 - sufficient resources to comply with its obligations under s792A(d) of the Corporations Act.
- 30 This conclusion is based on the following observations:
- there has been no active trading on APX's market during the assessment period and as discussed in paragraphs 28–32 of REP 166 and paragraphs 27–28 of Report 239 *Market assessment report: Asia Pacific Exchange Limited* (REP 239), issued May 2011, APX's arrangements for monitoring the market and the conduct of its market participants have not changed for some time;
 - APX is in the process of rewriting its suite of operating rules and arrangements for monitoring and enforcing compliance with these rules, to reflect a more contemporary market structure; and
 - during the assessment period, no information came to our attention to suggest that the operational, supervisory and enforcement arrangements in place were not operating adequately, given there was no active trading on APX's market.

Handling conflicts of interest

- 31 In assessing the adequacy of a market licensee's arrangements for managing conflicts of interest, it is relevant that the regulatory regime does not preclude the existence of conflicts. APX must, however, manage any conflicts it does have so that when it recommences trading on its market it does not allow its commercial interests to prevail over its obligation to operate a market that is fair, orderly and transparent.
- 32 Conflicts of interest may arise in any area where a market licensee makes decisions in relation to monitoring and enforcing its operating rules. For example, conflicts of interest may arise in connection with decisions about:
- admission of a person to the market as either a participant or a listed entity;
 - monitoring of a listed entity or market participant;
 - investigative or disciplinary action;
 - the exercise of discretions, such as granting waivers from the market's operating rules; or
 - the determination of the fees schedule of a financial market, including any trading incentive programs and/or relevant shareholder rebates.

- 33 In assessing a market licensee's arrangements for handling conflicts of interest, we consider a range of matters, including:
- whether, under current arrangements, actual or potential conflicts of interest are reliably anticipated, identified and appropriately responded to;
 - whether there is a sufficient level of disclosure to the market about the nature and existence of any actual or perceived conflict and the steps taken to adequately manage it; and
 - whether the licensee's organisational and reporting structures separate its commercial activities from its monitoring activities to a significant degree.
- 34 For example, a suitable organisational and reporting structure is one where employees who are responsible for assessing the market licensee's compliance with its monitoring obligations report to a person who is not responsible for making commercial decisions.
- 35 As far as is practicable, given that there was no active trading during the assessment period, APX effectively manages its conflicts of interest.
- 36 APX continues to operate out of a secure area within the office of its parent company, AIMS Financial Group (AIMS). APX and AIMS save their electronic files in separate electronic directories. Access to APX's directory is not available to AIMS employees and shared employees may only access APX's directory when working within the secure APX area.
- 37 APX's employee code of conduct and conflict management plan specify requirements regarding employees' disclosures of material interests and the separation of supervisory decisions from commercial ones. These are described in paragraph 31 of REP 166.
- 38 APX previously had a policy of sharing employees with AIMS, as reflected in paragraphs 22–24 of REP 239. However, APX has since modified this approach, on the basis that APX considers it needs dedicated operational resources to allow it to focus on preparing to relaunch the market as soon as possible. In addition, having dedicated operational staff in these areas is seen as a basic premise for APX's conflict handling arrangements.
- 39 In early 2012, the APX board also approved a new organisational structure (see Figure 1 of this report), which will more appropriately separate the compliance and monitoring functions of APX's business from the operational ones, with relevant oversight functions built into both.
- 40 We note that following the recent resignation of the General Manager of Compliance, Legal & Supervision, the current Chief Operating Officer (then General Manager of Operations) has assumed both the roles of General Manager of Compliance, Legal & Supervision and General Manager of Operations. This person also appears to be part of the 'Management Committee' formed by APX as an interim measure to perform high level functions following the resignation of the chief executive officer in August 2011.

- 41 Given the current inactivity on APX's market, we are satisfied with the interim measures APX has in place and that APX understands its obligation to manage conflicts and is committed to doing so. We will monitor the ongoing adequacy of APX's conflict handling arrangements and review them in our next assessment of APX.

Sufficient resources

- 42 In assessing how well a licensee is complying with its obligation under s792A(d) to have sufficient resources to properly operate the facility, we consider:
- how the licensee makes available and uses resources for supporting its arrangements for operating the facility, taking into consideration:
 - the financial, technological and human resources made available compared with previous assessment periods; and
 - a general expectation that resourcing should increase in step with the licensees' operations and that any reduction is appropriate only where changed circumstances or specific efficiencies can be clearly demonstrated;
 - the licensee's information technology system 'uptime' and instances of market disruption; and
 - our own experiences and observations, as well as those of market users, that there can be confidence that the market will operate in a reliable manner.
- 43 We are satisfied that during the assessment period, in which there was no live trading on APX's market, that APX had sufficient financial, technological and human resources to comply with its obligations under s792A(d) of the Corporations Act.

Financial resources

- 44 APX's financial resources have been a focus of the last six assessments. Over the periods covered by these assessments, APX underwent a change in ownership and has been preparing new operating rules and a new market framework.
- 45 Since October 2008, AIMS has provided APX with a non-recourse financing facility to fund APX's ongoing activities. During the assessment period, AIMS injected additional capital into APX. AIMS is also in the process of finalising a new services agreement, under which AIMS Financial Service Group Pty Ltd will fund all staffing and other costs associated with operating APX and will retain any profits made by APX or absorb any losses (as the case may be).

- 46 In this year's assessment, we considered:
- APX's monthly profit and loss statements for the assessment period;
 - APX's profit and loss summary for the period ended 31 December 2011;
 - APX's monthly balance sheets for the assessment period;
 - APX's audited financial report for the period 1 July 2010 to 30 June 2011;
 - APX's finance report for the month ending January 2011;
 - the Deed of Loan Amendment Agreement dated 5 October 2011, which amends the agreement with AIMS and APX; and
 - discussions held with APX management about future plans for its market, including financial resourcing.

Technological resources

47 APX's technological resources were adequate over the assessment period, during which there was no active trading on its market.

48 APX has entered an agreement with ASX Settlement Limited, under which ASX Settlement will provide APX with a settlement facilitation service for transfer of securities. This will enable APX market participants to use the CHES system to electronically transfer securities they trade on APX, for the purposes of settling those securities. APX is also in discussions with ASX Settlement to put in place delivery-versus-payment settlement functionality.

Human resources

49 APX's human resources were adequate over the assessment period, during which there was no active trading on its market.

50 Throughout the assessment period, APX provided us with regular updates on changes to its operational and supervisory staffing, aside from the mandatory notifications it is required to make under s792B of the Corporations Act. This has helped us monitor APX's staffing resources on an ongoing basis.

51 As indicated in paragraph 38, APX has recently revised its policy of sharing operational employees with AIMS. Instead, staff will be employed for the purposes of APX operations only and will not also concurrently perform AIMS tasks.

52 Further to paragraph 40, we note that the person who is performing the role of General Manager in both the Compliance, Legal & Supervision division and the Operations division has considerable experience in similar roles with a large exchange. This person is an important element of APX's human resources and in future assessments we will consider whether there is an appropriate succession plan in place for key roles such as those currently performed by this person.

- 53 The proposed services agreement between AIMS and APX (see paragraph 45) will remove the direct costs of human resources from APX's balance sheet. Based on discussions with APX management, we are satisfied that this will not compromise APX's ability to gain access to appropriately trained and experienced staff and management to accommodate its future plans.

Ongoing areas of consideration

- 54 In May 2011, we published our previous assessment report on APX. That report did not include any recommendations and/or agreed actions, as there had been no active trading during the assessment period.
- 55 Our next assessment will commence early in calendar year 2013. At that time, any changes to APX's current inactive operating environment will be a focal point of the assessment.
- 56 On an ongoing basis, we will work with APX in relation to finalising its suite of amended operating rules and providing assurance to ASIC about the adequacy of its financial, technological and human resources. These factors will be a prerequisite to enable APX to recommence its market operations.

Conclusion

- 57 Based on this year's assessment, which was done in an environment in which there was no active trading on APX's market, we do not have any recommendations to make about APX's arrangements and resources for the operation of its market in accordance with its obligations under the Corporations Act.

Key terms

Term	Meaning in this document
AIMS	AIMS Financial Group
APX	Asia Pacific Exchange Limited
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
IOSCO	International Organization of Securities Commissions
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