



ASIC

Australian Securities & Investments Commission

REPORT 99

Market assessment report:

**Sydney Futures Exchange Limited
(ACN 000 943 377)**

**SFE Clearing Corporation Pty Ltd
(ACN 050 615 864)**

Austraclear Limited (ACN 002 060 773)

September 2007

About this report

This report summarises ASIC's fifth assessment of Sydney Futures Exchange Limited (SFE) under s794C of the *Corporations Act 2001* (Corporations Act).

This report also summarises ASIC's fifth assessment of SFE Clearing Corporation Pty Ltd (SFECC) and its third assessment of Austraclear Limited (Austraclear) under s823C of the Corporations Act.

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

Key findings and recommendations	4
Key findings	4
Recommendations.....	4
A The assessment.....	5
Purpose and scope.....	5
Background.....	6
Our methodology	6
B Our observations and recommendations for SFE	10
SFE is meeting its obligations	10
SFE referrals and notifications to ASIC	11
Enforceability of operating rules	12
Documenting formal advice	13
Resources.....	14
Direct market access	14
Supervisory committees	15
Conflict handling arrangements.....	18
Other matters	19
Conclusion	20
C Our observations and recommendations for SFECC and Austraclear	22
SFECC and Austraclear are meeting their obligations.....	22
SFECC's system—incident management	23
Austraclear's system—incident management	23
Conclusion	25
Key terms	26

Key findings and recommendations

Note: See Sections A, B and C of this report for the background to and scope of our assessment and details of our observations and findings.

Key findings

- 1 ASIC is satisfied that:
 - Sydney Futures Exchange Limited (SFE) has adequate arrangements to supervise its market under s792A(c) of the Corporations Act;
 - SFE Clearing Corporation Pty Ltd (SFECC) has adequate arrangements to supervise its clearing and settlement facility under s821A(c); and
 - Austraclear Limited (Austraclear) has adequate arrangements to supervise its clearing and settlement facility under s821A(c).

Recommendations

- 2 ASIC recommends that SFE:
 - reviews its policies and practices in relation to referrals to be notified to ASIC under s792B(2)(c);
 - reviews its operating rules to ensure that where there is any ambiguity, rules are amended so that they are enforceable against the relevant party;
 - formally document legal advice provided to disciplinary committees and ensure copies of the advice is placed in all relevant files;
 - implements the findings of the ASX review into 'direct entry' trading platform access, specifically for certifying and approving that the independent software vendor (ISV) software applications used by SFE participants to connect to the SYCOM® order entry interface, in order to ensure they have appropriate risk management capabilities; and
 - reverts to issuing notices/bulletins for all disciplinary actions taken in an appropriate form that is available to all interested parties.
- 3 ASIC recommends that Austraclear continues to work closely with RBA and the system supplier to enhance its EXIGO system.

A The assessment

Key points

ASIC conducts annual assessments of market licensees, such as SFE, because it is required to do so under s794C of the Corporations Act. We also conduct annual assessments of clearing and settlement facility licensees under s823C.

The scope of our assessment must include the obligations found in s792A(c) and 821A(c) for market licensees and clearing and settlement facility licensees respectively, but we can include other Ch 7 obligations too.

ASIC has undertaken a joint assessment of SFE, SFECC and Austraclear.

ASIC uses the licensee's self-assessment reports, information from its previous assessments, ASIC's observation of the licensees' performance, market intelligence and other things to form a view of how well the licensee(s) have operated its market and clearing and settlement facilities respectively.

Purpose and scope

SFE annual assessment

- 4 Section 794C(2) of the Corporations Act requires ASIC to assess how well a market licensee complies with its obligations in s792A(c) at least once a year.
- 5 Section 792A(c) requires a market licensee to have adequate arrangements for supervising the market including 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.
- 6 In addition, s794C(1) permits ASIC to extend the scope of its assessment to review how well SFE complies with any or all of its obligations under Ch 7.

SFECC and Austraclear annual assessments

- 7 Section 823C(2) requires ASIC to assess how well a licensed clearing and settlement facility operator complies with its obligations in s821A(c) at least once a year.

- 8 Section 821A(c) requires a clearing and settlement facility licensee to have adequate arrangements for supervising the facility, including arrangements for:
- handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the facility's services are provided in a fair and effective way; and
 - enforcing compliance with the facility's operating rules.
- 9 In addition, s823C(1) permits ASIC to extend the scope of its assessment to review how well SFECC and Austraclear comply with any of their obligations apart from s821A(aa) under Ch 7.

Background

The SFE Group

- 10 SFE Corporation Limited (SFE Corp) was listed on the ASX between 16 April 2002 and 26 July 2006. On 5 July 2006, the shareholders of SFE Corp approved a Scheme of Arrangement whereby they would receive shares in ASX in exchange for their shares in SFE Corp, and all shares in SFE Corp would be transferred to ASX. The Scheme of Arrangement was implemented on 25 July 2006 and SFE Corp became a wholly owned subsidiary of ASX.
- 11 During the period of the assessment, SFE Corp's subsidiary company SFE, held an Australian market licence that permits it to operate a market in the financial products described on its licence. Two other SFE Corp subsidiary companies, SFECC and Austraclear, hold licences to operate clearing and settlement facilities. Copies of SFE, SFECC and Austraclear licences are available on ASIC website at www.asic.gov.au.
- 12 Our last reports about SFE, SFECC and Austraclear were publicly released in June 2006.

Our methodology

Joint assessment

- 13 During the assessment period the SFE Group was structured so that the one business unit performs the same function that relates to the operation and supervision of the market operated by SFE and the clearing and settlement facilities operated by SFECC and Austraclear. The monitoring and enforcement of compliance with each of the SFE Operating Rules, the SFECC Clearing Rules and the Austraclear Settlement Rules is undertaken

on an SFE group basis. For instance the business unit Compliance and Surveillance monitors market, clearing and settlement participant compliance with the market, clearing and settlement rules respectively.

14 Further, as a result of the merger between SFE and ASX Limited (ASX) it is now the ASX group that performs the functions for the SFE group entities as described above.

15 The human and technological resources used for supervision of the group are fundamentally the same as they were prior to the merger.

16 Subsequent to our assessment process SFE has advised that from 1 July 2007 one additional full-time employee will be added to Compliance and Surveillance in anticipation of increased workflows, following the commencement of operation by SFE of its Contracts for Difference futures contracts that are proposed to be listed in September 2007.

17 Our assessment below of each licensee in SFE group (i.e. SFE, SFECC and Austraclear) is conducted in one integrated review.

Our assessment process

18 A market licensee's and a clearing and settlement 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.

19 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 and a clearing and settlement facility licensee has in place for supervising its clearing and settlement facility in accordance with its obligations under 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.

What we considered

20 In conducting this assessment we considered:

- the annual regulatory report given to ASIC by SFE issued 29 March 2006 as required under s792F of the Corporations Act;
- the annual regulatory report given to ASIC by SFECC and Austraclear issued 29 March 2006 as required under s821E;
- information we received from and about SFE group in the ordinary course of our dealings with SFE and SFECC/Austraclear as a market licensee and clearing and settlement facility licensees, including:

- information received as part of the rule amendment process;
 - interaction with SFE, SFECC and Austraclear on a range of operational issues;
 - referrals of serious contraventions; and
 - SFE group's most recent annual report;
 - information from external sources, including media commentary and reports published by SFE group;
 - the operation of the market throughout the period;
 - internal SFE, SFECC and Austraclear material, including disciplinary and investigation files, internal reports and information collected by SFE group on a continuous basis;
 - discussions with senior SFE group management;
 - comments made in interviews or discussions with a range of SFE group personnel; and
 - the report prepared by RBA on its assessment under s823CA(1) dated 22 December 2006.
- 21 In conducting our on-site visit, we:
- interviewed SFE group personnel;
 - reviewed policies and procedures for the conduct of SFE group markets and clearing and settlement facilities in general and their supervisory responsibilities in particular; and
 - reviewed extensive material provided by SFE group under the *Australian Securities and Investments Commission Act 2001* (ASIC Act).
- 22 We served a number of notices that required SFE to give ASIC documents relating to a wide range of SFE group activities for the period 1 November 2005 to 30 June 2006. This was the relevant period we assessed for the report. From 21 August 2006 to 24 August 2006 we also attended SFE group offices in Sydney and during this on-site phase of the assessment we reviewed SFE group operational records and spoke to personnel across all levels of SFE group management.

Consultation

- 23 After our on-site visit was completed we provided written findings to SFE group and had discussions about a number of issues. Where appropriate, our report reflects SFE group's responses.

What we focussed on for this assessment

- 24 In our last assessment report we made a number of observations and recommendations about improvements in SFE group's supervisory arrangements.
- 25 This assessment involved a review of various changes made by SFE group, in response to key recommendations and other issues that came to our attention during the assessment period. One of the key issues we examined was direct market access to SFE's trading platform by SFE's participants' clients.
- 26 We continued to focus on SFE group's rule enforcement, complaints handling and disciplinary action framework and on the quality of SFE group's arrangements for managing conflicts of interest.
- 27 We reviewed inspection files, participant breach files, complaints files and Board papers to help us form a view as to how well SFE group was undertaking its supervisory responsibilities and that decisions made are consistent based on seriousness of an issue.
- 28 We sought reassurances about the adequacy of the practices of those business units such as Compliance and Surveillance and Business Operations Derivatives that have a key supervisory role.
- 29 We looked in particular at the quality and consistency of supervisory outcomes to assure ourselves that SFE group is meeting its statutory obligations to supervise its market.

B Our observations and recommendations for SFE

Key points

ASIC considers SFE's arrangements for supervising its market are adequate, including arrangements for:

- handling conflicts between the commercial interests of the market licensee and the need for the market 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.

ASIC's assessment has produced a number of observations, recommendations and a key finding. SFE has responded to ASIC's assessment in a constructive manner by making or planning for improvements.

SFE is meeting its obligations

30 After making our assessment, ASIC concludes that SFE has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act.

31 Our conclusion is based on:

- the observations below drawn from information gathered during the formal part of our assessment process;
- our observations on the basis of our regular contact with SFE; and
- the present operating conditions (including trading volumes and financial products traded on the market).

Observations from our assessment

32 Based on information gathered for our assessment, we make the following observations:

- SFE has good market infrastructure (including technology) to support its obligations to maintain a fair, orderly and transparent market.
- The operating rules and guidance notes provide an adequate framework for a fair, orderly and transparent market.
- Key supervisory areas that monitor the conduct of participants and trading have adequate procedures in place.

- Key management and staff responsible for supervision demonstrated a strong commitment to their supervisory role and a high level of expertise in the operations of the market.
- Our review of operational records on supervisory decisions showed that:
 - decision making on supervisory matters is sound;
 - SFE conducts ongoing supervision of its participants.
- SFE demonstrated a strong commitment to educating participants in their obligations under the operating rules.
- SFE shares information on supervisory matters with ASIC.

SFE referrals and notifications to ASIC

- 33 We note that during the assessment period SFE provided regular notifications to ASIC under s792B(2)(b). This section requires a market licensee to give written notice to ASIC, as soon as practicable, if the licensee takes any kind of disciplinary action against a participant in the market. SFE provides the notifications to ASIC once the disciplinary action has been taken and after the participant has had the opportunity to appeal the decision.
- 34 Section 792B(2)(c) requires a market licensee to give written notice to ASIC, as soon as practicable, if the licensee has reason to suspect that a person has committed, is committing, or is about to commit a significant contravention of the market's operating rules or the Corporations Act.
- 35 Some of the matters identified by SFE during the assessment period could be construed as being significant contraventions of the market's operating rules and/or the Corporations Act and therefore a s792B(2)(c) notification should have been furnished to ASIC at the same time as SFE identified the possible contravention. For example, a couple of investigations undertaken by SFE during the assessment period should have been notified to ASIC when first identified as a possible significant breach of the operating rules and/or a possible breach of the Corporations Act.
- 36 SFE agrees with ASIC that some of the matters identified in the assessment could have been construed as potential significant contraventions of the operating rules and/or the Corporations Act and therefore may have warranted referral under s792B(2)(c).
- 37 SFE submits that historically it has not formally referred some matters under s792B(2)(c) on the basis of its belief that it was satisfactorily complying with its obligations by way of a combination of informal discussions, ongoing dialogue and discussions at regular MOU meetings (as a result of which formal provision to ASIC of additional information was sometimes

subsequently made where agreed appropriate) and by way of formal s792B(2)(b) referrals of any and all disciplinary outcomes.

Recommendation 1

ASIC recommends that SFE review its policies and practices in relation to referrals to be notified to ASIC under s792B(2)(c).

- 38 Notwithstanding its firm belief that it was satisfactorily complying with its obligations, SFE recognises that prompt and formal referral of some matters under s792B(2)(c) would both facilitate ASIC's ability to take more timely action in respect of the breach (if considered appropriate) and also provide a formal record to aid empirical demonstration of SFE's compliance with its obligations under the Corporations Act.
- 39 SFE has implemented ASIC's recommendation by aligning its referrals process with that used by ASX. As a result, SFE anticipates a higher frequency of s792B(2)(c) referrals to ASIC going forward.
- 40 SFE and ASIC have met and established the most appropriate points of contact and subsequent distribution lists to ensure the effectiveness and efficiency of the new process is maximised.

Enforceability of operating rules

- 41 During the on-site phase of our assessment we reviewed a significant amount of material on disciplinary actions taken by SFE on various participants. We noted that upon reviewing the investigation file for particular operating rules breaches by one particular participant, the Markets Practices Committee (MPC) initially proposed a significant financial penalty for breaches of three operating rules.
- 42 The participant subsequently appealed the fine to the Business Conduct Committee (BCC), as it questioned the enforceability of two of the operating rules on the basis there was ambiguity in the language used in those two particular operating rules.
- 43 BCC gave the benefit of doubt to, and found in favour of, the participant. As a result the BCC decided that a breach of only one operating rule took place and subsequently reduced the original financial penalty to reflect the final decision.

Recommendation 2

ASIC recommends that SFE reviews these and other similar operating rules. Where there is any ambiguity in relation to enforceability then those rules should be amended so that they are enforceable against the relevant party.

- 44 SFE has subsequently submitted that it continually reviews the applicability and enforcement of its operating rules as various scenarios arise in the market. The rules in question in this matter related to the participant's client actions and SFE is considering the policy issues of participant liability for this type of breach.

Documenting formal advice

- 45 On reviewing Compliance and Surveillance and MPC files and books relating to disciplinary action taken in the matter described above, there did not appear to be a hardcopy of any specific legal advice provided to MPC. It would appear that the legal advice provided to MPC was verbal and not formally documented except when being referred to in the minutes of the MPC meeting.

Recommendation 3

ASIC recommends that any legal advice provided to the disciplinary committees should be formally documented and copies of such advice should be inserted in all the relevant files.

- 46 This would make each file complete and provide a document than can be used as precedence for future similar matters. As indicated above ASIC notes that ASX already follows this procedure.
- 47 ASIC notes that one of the subsequent initiatives undertaken within ASX Markets Supervision following the merger between ASX and SFE is the integration of the disciplinary processes of these two market operators (including disciplinary tribunal/committees). One of the outcomes was that the Legal Counsel assisting the ASX Disciplinary Tribunal now also provides legal advice and administrative assistance to the MPC and BCC.
- 48 Under this new model, the Legal Counsel to the Tribunal will (before the Tribunal convenes in a matter) provide a written briefing paper and a written penalty paper which addresses (among other things) relevant legal issues in relation to that matter. If during the course of a hearing the Tribunal (or the MPC/BCC) requires substantive legal advice, that advice is reduced to writing (and not recorded in the minutes) and placed on the relevant file maintained by the Legal Counsel (in the case of Tribunal matters) or on the Compliance and Surveillance file (in the case of MPC/BCC matters). If the legal advice requested by the Tribunal or MPC/BCC is of a routine nature such advice usually is provided verbally and a file note is prepared and placed on the relevant file.

Resources

- 49 ASIC notes and acknowledge SFE's continued improvement in the retention and hiring of experienced market individuals in the supervisory business units of Compliance and Surveillance and Business Operations Derivatives.
- 50 We also acknowledge and compliment SFE on their continued policy of rotating and training staff between the supervisory business units, ensuring they have a core group of employees with varied skills in supervising SFE's market.
- 51 As noted in Section A of this report, from 1 July 2007 an additional one full-time employee resource will be added to Compliance and Surveillance.

Direct market access

- 52 ASIC has commenced a project to more fully understand the supervisory arrangements being used by brokers to monitor and control their direct market access (DMA) business.
- 53 Our regulatory premise is that the scope of s912A of the Corporations Act requires an Australian financial services (AFS) licence holder to have in place supervisory arrangements to adequately monitor and control the conduct of their clients using DMA systems provided by the AFS licence holder.
- 54 Consistent with our regulatory responsibilities, one of the focuses of our assessment has been to determine the appropriateness of SFE's arrangements for supervising the market in this regard.
- 55 ASIC is aware that ASX has recently completed a review of the management of 'direct entry' to its trading platform by clients of participants, and in particular its risk management procedures for client omnibus accounts.
- 56 ASIC notes that the ASX and SFE markets operate differently. Perhaps reflecting this, the supervisory practices of some AFS licence holders connecting clients to the SFE platform are different to those generally in place to monitor orders flowing onto the ASX platform. This is in part due to the different risk-management requirements imposed by ASX and SFE (as a matter of history), and that omnibus account trading does not exist on ASX.
- 57 While ASIC acknowledges that the SYCOM® workstation order entry system allows participants to monitor and control access to the market, there is limited pre-trade functionality to monitor or control the orders placed by their client onto the market.
- 58 In addition, regardless of the functionality that exists on SYCOM®, it appears that there is scope for improvement to the monitoring and control undertaken by some participants.

Recommendation 4

ASIC recommends the implementation of the findings from the ASX review in relation to certifying and approving that the independent software vendor (ISV) software applications used by SFE participants to connect to the SYCOM® order entry interface have appropriate risk management capabilities.

- 59 As part of this review ASX also intends to cease offering SYCOM® workstations as an order entry system option to the SYCOM® order entry interface.
- 60 ASX intends to implement these changes in a timely manner and agrees that it will work closely with ASIC to ensure that it manages these issues in a way that enables it to continue to meet its regulatory obligations as a financial market operator.

Supervisory committees**Recording regulatory decisions**

- 61 The minutes of both the BCC and MPC were reviewed as part of this assessment. As per the last assessment we consider the BCC minutes to be adequate. If the BCC found a breach of operating rules had occurred the minutes outlined the operating rule breached, the penalty imposed, the reasoning why the penalty was imposed and whether the committee felt the participant should be publicly named for the breach.
- 62 In the last assessment report we noted the MPC minutes were less detailed than the BCC minutes. We stated that this may be due to the fact that the MPC minutes we reviewed largely concerned matters that were less serious in nature to those dealt with by the BCC. In our last assessment report we stated if the MPC considers a serious rule breach, ASIC would expect that the relevant minutes contain more detail than those reviewed by ASIC as part of its assessment.
- 63 We note the MPC minutes have improved during this assessment period and we now also consider the minutes of the MPC to be adequate. If the MPC finds that a breach of operating rule has occurred the minutes then outline the operating rule breached, the penalty imposed and the reasoning why the penalty was imposed.
- 64 ASIC acknowledges the improvements made and notes that this is an area we will continue to monitor on an ongoing basis.

Publication of disciplinary committee findings

- 65 Historically SFE published quarterly notices and bulletins on its website detailing action taken against participants by its disciplinary committees for

a particular quarter. We note that SFE has not published any such notices or bulletins since January 2005.

66 As part of this assessment we took the opportunity to ask SFE why it was no longer publishing such details of disciplinary actions taken.

67 SFE submits that there are a number of limitations with publishing this information including the fact that the documents only allowed for a limited amount of detail of the circumstances of the breach and the disciplinary committee's rationale regarding the finding and/or penalty.

68 SFE advised that it was supplying the information contained previously in the quarterly notices/bulletins in other ways, for instance, it is now issuing more detailed notices for serious disciplinary actions, publishing of the Penalty Determination Guidelines on the SFE website and more often issuing notices providing guidance on operating rule interpretations or acceptable market practices. SFE is also presenting this information as part of its Compliance and Regulatory Forums.

69 ASIC is concerned that in stopping the quarterly notices and bulletins not all users and potential users of the market have a transparent avenue to view all disciplinary actions that SFE has taken.

70 While we acknowledge SFE's concern with the limitations of the notices and bulletins it was producing, we consider that the publication of all disciplinary actions taken by SFE should be seen as necessary in the interests of transparency.

71 It is our view that details of disciplinary actions should be transparent and available to all investors and stakeholders rather than just SFE participants.

Recommendation 5

ASIC recommends SFE revert to issuing notices/bulletins for all disciplinary actions taken in an appropriate form that is available to all interested parties.

72 ASIC notes that under the proposed integration of the disciplinary processes of ASX and SFE, all disciplinary outcomes will be published by way of circular either on an anonymous basis or by naming of the participant.

SFE review of rule enforcement and disciplinary action framework

73 In the previous assessment report it was noted that SFE was reviewing its rule enforcement and disciplinary policies. SFE has completed that review and noted that various changes were implemented in 2005 and 2006.

- 74 At its February 2006 meeting the SFE Board approved management's recommendation to increase the maximum financial penalties that could be imposed by the BCC and MPC. The board agreed that for events or activities occurring from 1 June 2006 the BCC will be able to impose a maximum financial penalty of \$150,000 and the MPC would be able to impose a maximum financial penalty of \$75,000.
- 75 However we note that the implemented maximum financial penalties are lower than the maximum financial penalties recommended in the disciplinary action framework review document. The disciplinary action framework recommended that the maximum financial penalty for the BCC to be \$250,000 and the MPC \$150,000.
- 76 We queried SFE why the maximum financial penalties for the committees had been decreased.
- 77 SFE submit that the penalties were reduced so that they would reflect the hierarchy of the disciplinary committees. This meant the Board would continue to hold the ability to impose the highest financial penalty on participants at \$250,000, followed by the BCC now with the ability to impose a financial penalty of \$150,000 and the MPC now with the ability to impose a financial penalty of \$75,000.
- 78 ASIC notes that these maximum financial penalties are now more in line with other similar global derivatives exchanges.

Future of disciplinary committees

- 79 SFE has advised that work is well progressed towards developing a framework to integrate the disciplinary processes (including disciplinary tribunal/committees) of the two market operators SFE and ASX. An Exposure Paper on the integration of ASX and SFE disciplinary tribunals and appeals processes was released to the market for consultation in April 2007. The main thrust of this paper is the combination of the 'best of breed' of both the existing SFE and ASX processes.
- 80 It is envisaged that the membership of both the BCC and MPC will be amalgamated with the existing ASX Disciplinary Tribunal to produce a pool of industry experts from which tribunal panels can be selected and tailored to hear specific matters.
- 81 ASIC will review any new disciplinary committee arrangements to ensure SFE continues to meet its obligation under s792A(c)(iii).

Conflict handling arrangements

- 82 Section 792A(c) of the Corporations Act requires a market licensee 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 the market operates in a fair, orderly and transparent manner.
- 83 ASIC has once again concluded that SFE has adequate arrangements in place for handling conflicts between its commercial interests and the need to ensure that the market operates in a fair orderly and transparent manner.
- 84 In our annual assessment report dated November 2005 we recommend that these arrangements should be compiled in one centrally held document which describes the broader conflict handling arrangements across the organisation as well as including each business unit's responsibilities for its own conflict handling arrangements. In our recommendation we suggested that Group Compliance be the business unit that develops and expands a SFE conflicts framework document to improve the identification of conflicts situations and management of any identified conflicts.
- 85 In October 2005 SFE finalised a document titled 'Conflict of Interest Arrangements'. The purpose of the document was to identify the structural arrangements that are in place to control or avoid actual or perceived conflicts, consistent with legislatively imposed requirements.
- 86 In our last report we indicated that the document was not as comprehensive or sophisticated as might be expected for a market of SFE's stature. We recommended that SFE continue to develop and refine its centralised conflict arrangements as suggested in the recommendation made in our report dated November 2005.
- 87 In SFE's annual regulatory report dated 29 March 2006 SFE indicated that it continues regular reviews of its conflict handling arrangements to seek further improvements. One such improvement was to expand the conflict handling arrangements to include a risk-based approach which would also include further examples of potential conflicts that may arise. SFE's Group Compliance initiated the planning process to complete the improvements.
- 88 SFE submit that to date, some developments surrounding the methodology of the revised approach, structure and policy has been completed. SFE further submit, that in mid June 2006, in light of the merger with ASX, the development on the specific SFE arrangements ceased and following discussions with ASX Group Compliance, the SFE and ASX Group Compliance departments afforded development of group-wide conflict handling arrangements a high priority and this process has been completed.

- 89 SFE licensees have now been integrated into the ASX Group's arrangements for handling conflicts of interest and are subject to the ASX Group Commercial and Supervisory Conflicts of Interest Policy, which has been updated. The operation of the policy in practice is the subject of a biannual report by ASX Licence Compliance.
- 90 ASIC acknowledges the ongoing work on conflict handling arrangements and will review the updated Conflicts of Interest Policy during our next scheduled annual assessment of the ASX/SFE group.

Other matters

Interruptions to SFE's trading system

- 91 In our last assessment we noted that SFE's SYCOM® trading system experienced approximately 14 interruptions as a result of market halts and system failures for the period between the 2004 and 2005 assessments.
- 92 SFE advised that the outages were a series of diverse mostly unrelated events arising from either upgrades to the system, participant initiated events, normal production and managed refreshes of the system.
- 93 In the last assessment report ASIC recommended that SFE consider engaging external systems experts to assess the reliability of and maintenance practices of SYCOM® should the SYCOM® interruptions continue to occur with similar frequency.
- 94 ASIC is pleased to note that from 1 January to 30 June 2006 of the assessment period the SYCOM® trading system was available for price discovery and risk transfer for 99.925% of potential trading hours.
- 95 There were 2 unrelated incidents of trading system unavailability during this period that were managed in a manner consistent with the published Market and Product Recovery Policy. The Market and Product Recovery Policy is designed to ensure transparency and consistency of market recovery in the event of a system incident.
- 96 ASIC acknowledges the improvements and notes that this is an area we will continue to monitor on an ongoing basis.

Error resolution policy

- 97 In our last assessment report we noted that SFE was developing a more comprehensive error resolution policy. The Error Resolution Policy (ERP) was implemented in July 2006 to provide the foundation for transparent,

consistent and expedient resolution of error transactions that created erroneous price signals in SFE products.

- 98 The policy has reduced cancellations and disputes, and significantly reduced the resolution time associated with errors.
- 99 SFE further submit that the five-month period since the implementation of the ERP has seen an 83% reduction in on-market deal cancellations from the equivalent period prior to implementation. This drop has been achieved in an environment that has seen an increase in deals and average daily volumes.
- 100 Subsequent to our assessment an incident occurred on 25 July 2007 resulting in deal cancellations in the three-year bond and bank bill futures contracts. Shortly after 11.30 am (and immediately following a CPI announcement) a number of orders were entered into the trading system that resulted in erroneous price discovery occurring. SFE then implemented its ERP. A total of 337 deals, equating to approximately 26,000 contracts, were cancelled due to the price of deals exceeding the Market Integrity Range, of SFE's ERP, as determined by SFE's calculated Fair Price Values. SFE advised the implementation of the ERP allowed them to address this incident without halting the market.
- 101 SFE has issued several notices about the incident. In a notice dated 3 August 2007, SFE advised that they have commenced an internal investigation that will cover the following matters:
- the circumstances that gave rise to the incident;
 - the actions of its participants throughout the incident; and
 - the actions taken by SFE.
- 102 SFE has advised that although implications for participants will not be known until the investigation concludes, there is a possibility that SFE will need to investigate Operating Rule breaches by one or more participants via its disciplinary process. In addition to the above processes, SFE is also responding to lines of enquiry from ASIC and is assisting ASIC on all aspects of the incident.
- 103 SFE has advised that in the event of any findings from the above giving rise to the need for refinements to existing policy, it will work with the relevant stakeholder groups, including ASIC, AFMA and participants, in an appropriate consultative process to ensure the ERP remains relevant and continues to meet its objectives.

Conclusion

- 104 We conclude that SFE has adequate arrangements for supervising its market, including arrangements for:

- handling conflicts between its commercial interests and the need to ensure that the market operates in a fair, orderly and transparent manner;
- monitoring the conduct of participants in the market; and
- enforcing compliance with its operating rules.

C Our observations and recommendations for SFECC and Austraclear

Key points

ASIC considers SFECC's and Austraclear's arrangements for supervising their respective clearing and settlement facilities are adequate, including arrangements for:

- handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the facility's services are provided in a fair and effective way; and
- enforcing compliance with the facility's operating rules.

ASIC's assessment has produced some observations, recommendations and key findings.

SFECC and Austraclear are meeting their obligations

105 After making our assessment of SFECC and Austraclear, ASIC concludes that each of SFECC and Austraclear have adequate arrangements for the supervision of its clearing and settlement facility in accordance with its obligations under s821A(c) of the Corporations Act.

106 This conclusion is based on:

- the following observations drawn from information gathered during the formal part of our assessment process;
- our observations on the basis of our regular contact with the licensee; and
- the present operating conditions.

Observations from our assessment

- Key management and staff responsible for the operation and supervision of the clearing and settlement facilities demonstrate a high level of operational expertise. This view is supported by the:
 - competence, knowledge and expertise of personnel involved in operating the clearing and settlement facilities;
 - very high operational reliability of the facilities; and
 - absence of any significant supervisory issues detected.

- SFECC and Austraclear have good and reliable technology in place that enable them to provide a fair and effective clearing and settlement facility;
- SFECC and Austraclear are active and vigilant in financial risk management. Operational personnel and management involved in risk management are knowledgeable and experienced and demonstrate a commitment to sound risk management practices.
- SFECC and Austraclear operating rules provide an adequate framework for the operation of a fair and effective facility; and satisfactory procedures are in place for the key supervisory areas.

SFECC's system—incident management

- 107 During April 2006, a critical end of day overnight process was not initiated by operational staff due to an oversight in their procedure. The issue was identified early the next morning. However even though SFE initiated fixes it still resulted in delays in distribution of the daily financial status advice reports to clearing participants by 2 hours.
- 108 SFE submit that all clearing participants were contacted in a timely manner and informed of progress. SFE further submit that even though they extended settlement deadlines by 30 minutes, all daily settlements were actually completed no later than 8 minutes after the standard daily deadline.
- 109 Other incidents occurred during the assessment period, however ASIC is of the opinion that in each of these instances SFECC adequately managed each incident with minimal disruption to its participants and the clearing system.
- 110 We subsequently do not have any recommendations for SFECC as a result of our annual assessment.

Austraclear's system—incident management

FINTRACS

- 111 During the assessment period FINTRACS was the main operating system for Austraclear.
- 112 FINTRACS provided participants with confirmation, clearing and settlement services for financial product transactions. FINTRACS acted as a feeder system into the Reserve Bank of Australia's (RBA's) RITS/RTGS system. FINTRACS also provided issuing and registry services for paper and non-paper securities, respectively. FINTRACS was owned by Austraclear with

the management and servicing of the system being outsourced to OM Technology AB and OM AB (PUBL) (together 'OM').

113 There was a significant outage on Monday 3 October 2005, when the primary Austraclear processing node ceased processing due to a hardware memory failure. ASIC reviewed two reports made to Austraclear management regarding the operation of FINTRACS. Both reports made various recommendations and findings in regard to the operation of FINTRACS.

114 Austraclear's response, as documented in the reports, noted that the problem would be remedied by the implementation of EXIGO.

EXIGO

115 EXIGO replaced FINTRACS as the main operating system for Austraclear on 21 August 2006. Like FINTRACS, EXIGO is also managed by OM.

116 We note that there have been a number of system outages of EXIGO since its launch and after the onsite phase of our assessment.

117 EXIGO initially experienced problems in September and October 2006. These problems resulted from a number of different causes, notably, increased demand from the participant base and inefficient database queries. These issues resulted in the system running slowly and at times prevented some participants from connecting. Austraclear identified several reasons for these problems, including that the average number of users on the system—around 400 to 600—has been higher than expected and significantly higher than the maximum of 200 in FINTRACS.

118 In addition, the increased functionality available within the system, together with the longer period over which EXIGO holds data online (increased from five days in FINTRACS to three months in EXIGO) has resulted in participants performing more complex and resource-intensive queries.

119 Some queries have also been poorly designed to handle such significant increases in data volume.

120 Austraclear has instituted a number of fixes for these problems, including upgrading the hardware configuration and implementing various software 'patches' to improve the system's ability to handle queries.

121 SFE submit that the system upgrades have quadrupled the processing power of the system and coupled with the streamlining of the database queries have significantly improved the performance characteristics of the system.

122 In November 2006 EXIGO experienced two further outages that directly affected financial institutions' funding operations.

123 The SFE group has been working very closely with the RBA from the time of the initial problems until the present time.

124 SFE further submit that significant improvements have been made to the system resulting in resolution of the performance issues and that the SFE group continues to work with the supplier OM to enhance the system.

Recommendation 1

ASIC notes the improvements in the operation of the EXIGO system and recommends that SFE continues to work closely with RBA and the system supplier to enhance the system.

125 ASIC will monitor future developments with the EXIGO system closely.

Conclusion

126 We conclude that each of SFECC and Austraclear continue to have adequate arrangements for supervising their respective clearing and settlement facilities, including arrangements for:

- handling conflicts between the commercial interests of the licensee and the need to ensure that the clearing and settlement facility's services are provided in a fair and effective way; and
- enforcing compliance with the operating rules of the clearing and settlement facility.

Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B
AML	An Australian market licence under s795B
ASIC	Australian Securities and Investments Commission
Austraclear	Austraclear Limited
BCC	Business Conduct Committee
Corporations Act	The <i>Corporations Act 2001</i> (Cth)
Market licensee	The holder of an Australian market licence under s795B
MPC	Markets Practices Committee
s794C	A section of the Corporations Act (in this example, numbered 794C)
SFE	Sydney Futures Exchange Limited
SFECC	SFE Clearing Corporation Pty Ltd