



**ASIC**

Australian Securities & Investments Commission

**REPORT 105**

# **Market assessment report: Mercari Pty Limited ACN 102 928 727**

October 2007

## **About this report**

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

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## Key findings and observations

### Key findings

- 1 ASIC is satisfied that Mercari Pty Limited (Mercari) has adequate arrangements and resources for the supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act.

### Observations

- 2 ASIC is satisfied that Mercari has adequately addressed the observations we made in our 2006 annual assessment report regarding the documentation of supervisory procedures and completeness of client files.
- 3 We note Mercari has made a significant improvement in the documentation of supervisory processes and board decisions. We suggest Mercari continue to improve its documentation of the directors' deliberations of market related matters.

## A The assessment

### Key points

ASIC conducts annual assessments of market licensees, such as Mercari because it is required to do so under s794C of the Corporations Act.

The scope of our assessment must always include the obligations found in s792A(c), but we can include other Chapter 7 obligations too.

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.

### Purpose and scope

- 4 Section 794C(2) 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 Mercari complies with any or all of its obligations under Chapter 7.

### Background

#### Mercari Pty Limited

- 7 Mercari was granted an Australian market licence (AML) on 30 May 2005. Mercari's market, Mercari Direct, is an electronic bilateral negotiated market

that facilitates trading in foreign exchange derivatives and interest rate derivatives. The participants of Mercari Direct are wholesale entities, and are either banks or subsidiaries of banks.

- 8 In addition to an AML, Mercari has held an Australian financial services licence (AFS licence) authorising it to carry on a financial services business to wholesale clients in relation to certain financial products. This assessment of Mercari does not cover Mercari's compliance with its AFS licence obligations. A copy of Mercari's AML and the terms of its AFS licence is available on our website at [www.asic.gov.au](http://www.asic.gov.au).

## Our methodology

### Our assessment process

- 9 ASIC uses the formal assessment process to examine whether a market licensee has been and is continuing to meet its supervisory obligations. We also use the process to identify areas where improvements may be needed to enable the licensee to meet its obligations in the future.
- 10 As this is our second assessment of Mercari, we are primarily interested in how Mercari responded to the observations we made in the 2006 assessment report. We are also interested in any significant changes to the way Mercari operates its market and carries out its day-to-day supervisory functions since the last assessment.
- 11 Our assessment and the views expressed in this report are a combination of processes which include the ongoing interaction we have with Mercari in our role as the regulator of financial markets and information we gathered for the specific purpose of the assessment.

### What we considered

- 12 In conducting our assessment we reviewed:
- the annual regulatory report provided by Mercari to ASIC for the year ending 30 June 2006 as required under s792F of the Corporations Act;
  - Mercari's quarterly reports provided as a condition of Mercari's AML;
  - information we received from and about Mercari in the ordinary course of our dealings with Mercari as a market licensee; and
  - Mercari's response to a letter we sent to Mercari prior to this assessment to obtain information about how Mercari is meeting certain obligations under the Act.
- 13 In conducting our on-site visit, we:

- interviewed Mercari compliance manager and the board of directors;
  - reviewed the material received under notices served under the ASIC Act 2001, which included changes to Mercari's policies and procedures since our last assessment; and
  - received a demonstration of Mercari's surveillance and compliance procedures.
- 14 We visited Mercari's office on 23 April 2007 and 27 April 2007 during this on-site phase of the assessment we reviewed operational records and spoke with personnel from Mercari.

### **Consultation**

- 15 We have discussed the result of our assessment with Mercari, seeking their comments on both the factual matters set out in this report and our conclusions.

## B Our observations

### Key points

As part of this assessment we have considered the adequacy of Mercari's arrangements and resources for supervising its market.

We have also considered Mercari's response to the three observations we made in the 2006 annual assessment report.

- 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.

ASIC has also considered Mercari's compliance with its reporting obligations under the Act.

### Supervisory arrangements

- 16 We conclude Mercari has adequate arrangements and resources for the supervision of its market in accordance with its obligations under s792A(c).
- 17 This conclusion is based on the following observations drawn from information gathered during our assessment process, our observations on the basis of our ongoing correspondence with Mercari and the present operating conditions (including trading volumes and financial products traded on the market):
- Mercari has good market infrastructure (including technology) to support its obligation to maintain a fair, orderly and transparent market.
  - Mercari has an adequate framework of operating rules and procedures in place to supervise the market.
  - During the course of our interviews, the directors and compliance manager demonstrated an understanding of their supervisory role and of the operations of the market.
  - Our review of Mercari's supervisory decisions showed that the process of decision-making on supervisory matters is adequate.



### **Sufficient resources**

- 18 We conclude Mercari has sufficient resources to operate its market properly and to provide the required supervisory arrangements in accordance with its obligations under s792A(d) of the Corporations Act.
- 19 We reviewed the adequacy of Mercari's resources (including human, technical and financial resources) to operate the market properly and to provide adequate supervisory arrangements.

### **Human**

- 20 Mercari has employed staff in various capacities for commercial, supervisory and technological functions. Mercari current staff members have specific job descriptions, which outline their individual responsibilities.

### **Technological**

- 21 The current technology has coped with existing volumes on the market and no serious market disruptions have occurred.

### **Financial**

- 22 We received quarterly reports detailing Mercari's financial status. Based on these reports, it appears that the costs of operating the market were covered by current turnover.

## **The 2006 annual assessment report**

- 23 In the 2006 annual assessment report, we made observations to Mercari regarding
- documentation of supervisory procedures;
  - documentation of supervisory processes and decision making; and
  - documentation relating to client files.

### **Documentation of supervisory procedures**

- 24 In the 2006 report we suggested that Mercari further develop its written procedures to more accurately reflect the day-to-day procedures performed by the compliance manager. By detailing the activities performed by the compliance manager, the procedures reflect more accurately the work Mercari does to meet its supervisory obligations. In addition, the documentation of these procedures will help minimise any key person risk.

- 25 In response to this, Mercari has updated its procedures manual (for the compliance manager's daily duties) to more comprehensively reflect the day-to-day activities performed by the compliance manager. During our on-site visit, the compliance manager took us through the updated procedures manual and demonstrated on Mercari's system how the daily activities are carried out. Based on our observations, we are able to conclude that the updated procedures manual adequately documents the tasks carried out by the compliance manager.
- 26 Consistent with our observations made in the 2006 report, we consider Mercari's compliance manager and the directors to have a good understanding of the supervisory role of the compliance manager and the tasks involved. It appears that the compliance manager's role is well supported within Mercari.
- 27 We consider Mercari has adequately addressed the observation we made in the 2006 report regarding documentation of supervisory procedures.

### **Documentation of supervisory processes and decision making**

- 28 In the 2006 report we suggested that Mercari improve its practice on documentation regarding supervisory processes (e.g. investigations of potential operating rules breaches), communication between directors and the compliance manager on market related issues and directors' deliberation on market related matters.
- 29 In response to this Mercari formalised the process for its monthly directors meeting. For each meeting, an agenda is produced and decisions of the directors are recorded in the minutes of meeting. A surveillance report is also produced to be tabled at each of these monthly meetings. Surveillance reports cover breaches, complaints and any other issues that have occurred over the month.
- 30 As part of our assessment process, we reviewed all board minutes and surveillance reports for the assessment period. From our review, we observed one instance where a decision of the directors was recorded in the minutes but without the associated consideration or deliberations of the directors. Nevertheless, we note that Mercari has taken positive steps to address the issues we raised in the 2006 report regarding documentation of supervisory process and decision making, despite the single incident mentioned.
- 31 Based on the material we have reviewed, we are of the view that in general, Mercari has made a significant improvement in the documentation of supervisory processes and board decisions. We suggest Mercari continue to

improve its documenting of the directors' deliberations of market related matters.

### **Documentation relating to client files/authorisations**

- 32 In the 2006 report we suggested that Mercari implement a system whereby the compliance officer reviews the participants' files on a regular basis to confirm they contain relevant and updated information.
- 33 In response to this Mercari has updated its processes and procedures for the periodic review of client files. The updated process includes bi-annual checks on the accuracy of the list of authorised traders in each client file. In addition, Mercari has also enhanced the functionality of the Mercari Direct system to facilitate this process. These enhancements include an 'audit log' which allows all changes and updates made to any client authorisation be recorded in a log in the Mercari Direct system. As part of the bi-annual checks, the compliance manager will cross check the changes recorded in audit log to the client files and update the client files accordingly.
- 34 Based on our observation, we consider that changes implemented by Mercari, including changes to its procedures and the Mercari Direct system, adequately address the observations we made in the 2006 report regarding completeness of client files.

## **Conclusion**

- 35 ASIC considers Mercari has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c).
- 36 We find Mercari has sufficient resources to operate its market properly and to provide the required supervisory arrangements in accordance with its obligations under s792A(d) of the Act.
- 37 Our conclusion is based on the assessment that we conducted and the following observations drawn from information gathered during the assessment process:
- ASIC is not aware of Mercari substantially changing the arrangements it has in place for supervising the market from the description provided in its AML application;
  - During the assessment period no information came to our attention to suggest that the supervisory arrangements in place were not operating properly; and
  - No serious market failures or disruptions have come to our attention.

## Key terms

Term	Meaning in this document
AFS licence	Australian financial services licence
AML	Australian market licence
ASIC	Australian Securities and Investment Commission
ASIC Act 2001	The <i>Australian Securities and Investment Commission Act 2001</i> (Cth)
Corporations Act	The <i>Corporations Act 2001</i> (Cth)
market licensee	Holder of a s795B Australian market licence
Mercari	Mercari Pty Limited
Mercari Direct	Mercari's market (an electronic bilateral negotiated market that facilitates trading in foreign exchange derivatives and interest rate derivatives)
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C)