



**ASIC**

Australian Securities & Investments Commission

**REPORT 116**

# **Market assessment report: Australia Pacific Exchange Limited (ACN 080 399 220)**

January 2008

## **About this report**

This report summarises the third assessment of Australia Pacific Exchange Limited (APX) by the Australian Securities and Investments Commission under s794C of the *Corporations Act 2001* (Cth) (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.

### Previous reports on APX

APX was granted an Australian market licence on 11 August 2004.

Report number	Date released
REP 61	November 2005
REP 90	February 2007

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# Key findings and recommendations

## Key findings

- 1 We conclude that Australia Pacific Exchange Limited has adequate arrangements and sufficient resources to operate and supervise its market.

## Recommendations

- 2 We recommend that:
  - the APX board (board) improve its procedures to ensure that any committees exercising its delegated authority are properly constituted at all times;
  - the board review APX's conflict management plan and consider amendments to prevent ongoing breaches of the plan;
  - that the market supervision committee should more pro-actively engage the board on decisions affecting APX supervisory arrangements; and
  - APX consider tightening its conflict handling arrangements and in particular, its new employee questionnaire to ensure that the questionnaire works to identify any relationships between APX employees with supervisory functions, and entities which might give rise to a potential conflict of interest in the performance of the employee's duties.

## A The assessment

### Key points

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

The scope of our assessment must 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 licensee's performance, market intelligence and other things to form a view of how well the licensee has operated its market.

### Purpose and scope

- 3 ASIC is required to assess how well a market licensee complies with its obligations in s792A(c) at least once a year (s792(2)).
- 4 A market licensee is required to have adequate arrangements for supervising the market (under s792A(c)) 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.

In addition we are permitted to extend the scope of our assessment to review how well a market complies with any or all of its obligations under Chapter 7 (s794C(1)).

### Background

- 5 APX was granted an Australian market licence (AML) on 11 August 2004 that permits it to operate a market in the financial products described on its licence. This can be viewed at ASIC's website.
- 6 This is the third assessment of APX we have conducted. Previous assessment reports can also be found at ASIC's website.

## Our methodology

### Our assessment process

- 7 A market licensee's obligations are ongoing. Whether it is likely to comply with its obligations in the future cannot be judged merely by reference to its past compliance.
- 8 We use the assessment process to:
- reach conclusions about the adequacy of the arrangements a market licensee has in place for supervising its market, in accordance with its obligations under the 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

- 9 In conducting this assessment we:
- reviewed the 2006 annual regulatory report dated 29 September 2006 provided by APX to ASIC as required under s792F of the Corporations Act;
  - checked publicly available information on APX website, including share price, news releases, policies and procedures;
  - reviewed internal APX material, including information collected by APX on a continuous basis;
  - engaged in discussions with APX senior management;
  - checked other publicly available information on APX; and
  - reviewed the material received under the notice served pursuant to the *Australian Securities and Investment Commission Act 2001*.
- 10 From 14 June 2007 to 15 June 2007 ASIC representatives attended the offices of APX in Melbourne. During this on-site phase of the assessment, we reviewed APX operational records and spoke to APX personnel and management.

### Consultation

- 11 After our onsite visit was completed, we provided initial written findings and recommendations to APX and requested comments on these. Where appropriate, our report reflects APX's responses.

## What we focused on for this assessment

- 12 Our assessment involved a review of the changes made by APX in response to the issues we identified in our previous assessment.
- 13 We also reviewed the general adequacy of APX's supervisory arrangements in practice, along with any significant changes to the way that APX operates the market and carries out its supervisory functions since our last assessment. We also considered the adequacy of APX's financial resources to operate and supervise its market.

## B Our observations and recommendations for APX

### Key points

We consider APX's arrangements for supervising its market are adequate, including arrangements for:

- monitoring the conduct of participants on or in relation to the market; and
- the adequacy of its financial resources to operate its market.

However, improvements could be made to APX's arrangements for handling conflicts between its commercial interests and the need for APX to ensure that the market is fair, orderly and transparent.

We have made a number of observations and recommendations based on our assessment. These are detailed in this section.

### Quotation committee

- 14 Under APX's listing standards, the board has delegated to a quotation committee (committee) the power to grant or reject listing applications or listing rule waivers, suspend or reinstate quotation of a company's securities, cancel quotations, remove a listee from the official list, and impose sanctions on a listee or its directors. The board appoints members of the committee.
- 15 In our review, it emerged that there was a period of over a year in which the committee was not properly constituted. Previous members' terms had expired in January 2006, and new members were not appointed until January 2007. Furthermore, in this period the committee met on one occasion in February 2006 (although no substantive action was taken at this meeting). It appears that APX did not realise that the committee was not properly constituted until preparations began for a committee meeting in early February 2007.
- 16 The consequences of this lapse were not serious, given the low level of activity that this committee has to deal with at present. Nevertheless, it is the responsibility of the board, in having delegated its authority to the quotation committee, to ensure that this committee is properly constituted on an ongoing basis whenever it exercises this delegated authority.



**Recommendation 1**

We recommend that the board improve its own procedures to ensure that any committees exercising its delegated authority are properly constituted at all times.

**Role of compliance officer**

- 17 APX's conflict management plan (CMP) requires it to have a compliance officer who reports to the general manager of compliance and supervision (GMCS). The compliance officer role is part time and its current incumbent is on long-term leave. Although APX sought a temporary replacement, and conducted a recruitment exercise, it was unable to find a suitable candidate. This amounted to a breach of the CMP, which at paragraph 11 indicates that from a risk management perspective, each supervisory unit must have at least two staff to deal with the situation where one staff member is away on leave or otherwise absent. At the time of our assessment, ASIC was advised that an APX staff member had been allocated the duties of the compliance officer, with a subsequent oversight function performed by the GMCS.
- 18 The APX Market Supervision Committee (MSC), which is afforded the responsibility to supervise the APX's compliance and supervisory arrangements, was aware that the above situation had arisen. While the MSC had expressed its dissatisfaction, and considered it to be a technical breach, subsequently concluded that compliance activity has not suffered.

**Recommendation 2**

We recommend that the board review the CMP in order to prevent ongoing technical breaches and to ensure the efficacy and integrity of the CMP.

- 19 APX has since advised ASIC that its compliance officer has returned from long-term leave and has resumed work.

**Consultation between board and market supervision committee**

- 20 ASIC notes the importance of effective communication between the board and the MSC. In this context, ASIC notes that the board had expressed concern about delays in communication from the MSC about certain matters pertaining to APX's compliance and supervisory arrangements. In particular the board pointed to the MSC's lack of consultation about certain personnel appointments that were not advised to the board until after they were finalised.

- 21 ASIC notes that the sequence of events that led to the lapse in communication about appointments is unlikely to recur. However, the lapse in dialogue between the board and the MSC remains of concern.

#### Recommendation 3

We recommend that the MSC should more proactively engage with the board on decisions affecting supervisory arrangements.

## Conflict management

- 22 As a result of a previous concern we had regarding recruiting staff for supervisory roles without adequately checking for potential conflicts of interest, APX agreed to change its new employee questionnaire.
- 23 While changes have been made, we think that the questionnaire should expressly refer to any previous or ongoing relationships with an entity that may give rise to a potential conflict in relation to an employee's supervisory duties.

#### Recommendation 4

We recommend that the employee questionnaire be further amended to expressly refer to any previous or ongoing relationships with an entity that may give rise to a potential conflict.

## Security

- 24 We also noted an instance of inappropriate access to APX's premises by an Austock employee.<sup>1</sup>
- 25 APX indicated that the incident occurred during a changeover in the security system, and that the fault in security had been rectified immediately. Permission to access APX's premises can now only be authorised by appropriate APX personnel.

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<sup>1</sup> While physically separated, Austock Limited and APX share premises and occupy the same floor.

## Resources

### Financial resources

- 26 We made enquiries regarding the adequacy of APX's financial resources, in particular a shortfall of \$700,000 during a recent entitlement issue. APX advised that there would be an imminent recommendation to the board to consider allowing listees to become shareholders of APX, by subscribing to APX shares. Should such a recommendation be successful, APX will need to demonstrate to ASIC that its conflict handling arrangements are adequate to ensure that supervisory decisions about listed entities that are also shareholders in APX, are not inappropriately influenced or conflicted. APX also advised that should this proposal not eventuate, the shortfall would be addressed through funding obtained from high net worth clients of APX.
- 27 In the meantime however, we consider that APX's financial resources are adequate, given the current size of the market.

### Human resources

- 28 We note that APX does not have a formal APX training policy or program. We would welcome a more formal approach in this area should the size of the market grow. Expanding training as the market grows will help in ensuring that APX continues to be in a position to be meet its obligations.

### Technological resources

- 29 APX's trading system has experienced a minor malfunction affecting the processing of orders. This fault has occurred intermittently over the past 24 months. APX has investigated the malfunctions, and has taken appropriate action to prevent reoccurrence.
- 30 Our view is that APX's technological resources are adequate, given the current size of the market.

## Response to previous recommendations

- 31 We made two recommendations in our 2006 annual assessment of APX.

### Recommendation 1 (2006 assessment)

- 32 We recommended that APX review its risk management policy to more appropriately allocate responsibility for risk.

33 We made this recommendation because we consider it inappropriate for the GMCS to have responsibility for risks associated with business development and client retention, given the GMCS' obligation to oversee APX's supervisory activity.

**APX's response**

34 APX have advised that, together with its CMP, the risk management policy is in the process of being rewritten to take into account our recommendation.

**Recommendation 2 (2006 assessment)**

35 We recommended to APX that the compliance division update its procedures to deal with the completion of monthly and annual compliance checklists, and also to ensure that actual reports are prepared as required by procedures.

**APX's response**

36 APX have advised that the updating of the compliance division's procedures is ongoing.

**Our view of response**

37 We are satisfied with the progress made in regards to both recommendations from the 2006 assessment.

## Key terms

Term	Meaning in this document
AML	Australian market licence
APX	Australia Pacific Exchange Limited
ASIC	Australian Securities and Investments Commission
CMP	Conflict Management Plan
Corporations Act	The <i>Corporations Act 2001</i> (Cth)
GMCS	General Manager of Compliance and Supervision
MSC	APX's Market Supervision Committee