



ASIC

Australian Securities & Investments Commission

Market supervision moves to ASIC – what does it mean for brokers?

*A speech by Greg Yanco, Head of Market and Participant
Supervision Division, Australian Securities and Investments
Commission*

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Today I'm going to talk about how the transfer of market supervision affects you operationally.

Outline

The questions I'd like to answer for you today are:

- What will be our approach to market supervision?
- How ready is ASIC to take on market supervision?
- How and when do you contact ASIC?
- What will we be focusing on in both market surveillance and participant supervision?

A What will be our approach to market supervision?

- 1 As Belinda already mentioned it is our intention that transfer of responsibility for supervision of the markets is relatively seamless for market participants. We are putting in place Market Integrity Rules that are based on the existing ASX, SFE, NSX and BSX rules. We are putting in place the same systems, processes and many of the people that currently work with the market operators, particularly ASX, now. The reason for keeping things similar is that we do not want brokers to have to make significant changes to their processes in a relatively short implementation period.
- 2 We will be recognising ASX waivers, notifications – including AOP certifications – and consents and our guidance will initially rely on the existing ASX guidance notes. About 24 people will be transferring from ASX to ASIC to join our existing market participant and market watch teams. We are supplementing this with additional recruitment from the market. This will provide a strong basis for us to supervise the markets to at least the same standard as ASX.
- 3 We are working with ASX to develop protocols, working arrangements and a new memorandum of understanding to ensure we work together efficiently and minimise any duplication.

B How ready is ASIC to take on market supervision?

- 4 Within ASIC, market supervision falls under a new unit that brings together responsibility for market surveillance, supervision of compliance with the market integrity rules and supervision of compliance with the Corporations Act and Australian Financial Services Licence conditions as they affect market participants. The Market Integrity Rules also impose some obligations on market operators.
- 5 The new unit at ASIC that you will deal with is known as Market and Participant Supervision and it comprises four teams that will focus on real-time market surveillance, relationship management, participant compliance and market analysis.
- 6 We will be conducting real time market surveillance in essentially the same way that ASX does using the SMARTS surveillance system. SMARTS is a

global leader in market surveillance and is installed at 50 markets around the world. This system has recently been delivered, our current staff are going through SMARTS training and we are configuring our alerts. ASIC staff will be complemented by ASX surveillance staff that will transfer over on Day 1. This team will be led by Jonathan Coultas who is with ASIC now, and has more than twenty years experience in broking and investment banking. ASX will continue to run its version of SMARTS to assist its monitoring of the continuous disclosure rules. It is important that the market surveillance team has a strong network of industry contacts to discuss market issues and we intend to build on the relationships that ASX has built up. This group will conduct the initial enquiries that will lead to a decision on whether more investigation is warranted. After Day 1 you will also be able to contact this group on 1300 029 454 or by emailing market.surveillance@asic.gov.au.

- 7 As you all know markets have been evolving rapidly over the last ten years. We've gone from an average 50,000 trades a day to 650,000 with a peak of 972,000 recently. While the broad focus of market surveillance continues to be on insider trading and market manipulation the proliferation and speed of electronic trading systems means we have to respond both in terms of capacity to deal with enormous amounts of information and in being flexible enough to change focus to types of market abuse that are also evolving. For example, some markets are seeing programs that attempt to manipulate a response from other algorithmic programs. Consequently, part of the development of our market supervision system has been to skill up on Automated Order Processing and algorithmic trading. In addition to having staff skilled in electronic trading and controls we have, since the May 6 'flash crash', put together a group that will work with ASX and the market to examine whether we should make any changes to the existing market settings and the rules regarding automated order processing. I'm not flagging that we would introduce circuit breakers however that will be looked at. If we consider there should be changes to the market rules we will consult on that.
- 8 ASX is completing a thematic review of the automated order processing controls of a number of brokers. We will be continuing that work and will be particularly interested in the processes for bringing on and testing new algorithms.
- 9 The main objective of the relationship management team, led by Amanda Mark, is to understand the business models of market participants, the risks they are taking and how well they are managing those risks. They will also handle your enquiries about compliance with the Market Integrity Rules, Corporations Act and AFSL requirements and manage Derivatives Accreditation. Each participant will be allocated a relationship manager.

- 10 For those that remember when I ran relationship management at ASX I'd like to clarify that this will not involve AFL, Rugby, Cirque du Soleil or the Archibald Prize.
- 11 The participant compliance team performs on-site surveillance, and where necessary, refers possible breaches to our investigators for further action. This team, led by Bill McNickle, will also monitor remediation plans and review your approach to Automated Order Processing. You will also be able to contact both participant groups on a 1300 029 454 or by emailing market.participants@asic.gov.au after Day 1.
- 12 The market analysis team, led by Tom Veidners, will take on matters after preliminary analysis by the real-time surveillance team, from our misconduct and breach-reporting unit and from the participant compliance team. They assess incoming matters and recommend a course of action that may include a referral to a deterrence unit for investigation of possible misconduct.
- 13 I know there is great interest in how we will make preliminary enquiries with you. We are empowered to make enquiries under the corporations legislation. The Act also affords you protections in terms of how the information we collect will be processed. Our request for information would come as a Market Enquiry or other Notice or as a request under s912E of the Corporations Act.
- 14 We are supplementing our existing deterrence teams with some ASX investigators and some new recruits. There will be a deterrence team dedicated to market integrity matters. The unit will be built around staff transferring from the ASX investigations and enforcements units. Neil Owen, currently with ASIC will lead one the teams focusing on market integrity issues and the other team will be lead by a Senior Manager from ASX.
- 15 We expect that the practical outworking of this will be a more efficient and effective investigation process. Consolidating supervision with investigations will streamline and improve what is not necessarily a great experience for you. We have established a Triage Committee that will examine and prioritise the matters that we detect and expedite their investigation. This will allow us to identify matters where the facts are suggesting a potentially significant breach that we should address quickly. Our broader powers will facilitate this. The most obvious change is that we can make direct inquiries of clients of market participants. ASX is limited to making inquiries of market participants as to their clients and listed entities and to accessing information in the public domain.
- 16 The markets deterrence teams at ASIC can take matters to court. They are therefore, more focused on evidence gathering than ASX needs to be. So the investigation process will be more targeted at the matters that will lead to a

deterrent outcome. We will be more streamlined because we are taking a big step out of the process which is the referral from the market operator to ASIC.

- 17 So the process will be faster. The conduct of investigations will also be improved, with the commercial expertise of the former ASX people complementing our current strengths in investigation and legal case management.
- 18 What else will be different for you? Apart from the obvious points of new contact numbers and emails, we will have a closer and more in depth relationship than before. ASIC will be more engaged with your industry.

C How and when do you contact ASIC?

- 19 Who do market participants contact for what? The short answer is – ASIC for market integrity issues and ASX for operational issues. If you are unsure who to contact then the best thing would be to go to your ASIC relationship manager or emailing market.participants@asic.gov.au after Day 1.
- 20 You can get more clarification about how ASIC can help you on market integrity issues from our website. We will be conducting information roadshows for market participants in the major capital cities next month. You can find details of these events on the website and I encourage you to attend. The Roadshows will provide an overview of our approach to supervision, confirm relationship management protocols and contact information, outline our surveillance approach, and provide an opportunity to meet the team and ask any questions.
- 21 As Belinda has said our Day 1 structures are in mostly in place. The guidelines and procedures are developed to support the new structure. I've already mentioned our real time trading system SMARTS is in place and training is progressing well. We are building on our existing capabilities and adding talent in derivatives, futures and algorithms. Our Market Integrity Rules will be finalised shortly and Treasury is due to finalise regulations well before Day 1.
- 22 We are already looking at beyond Day 1 enhancements. We are developing an extranet to make communication between us easier, and we are focusing on enhancing our market surveillance techniques. We are looking at how we will integrate the supervision of the futures market with the supervision of the equities market and as Belinda has mentioned, deal with the challenges of competition.

- 23 All in all I believe we are well placed to meet the high standard of supervision set by ASX and we are aiming higher!
- 24 Now, I'd like to turn to some issues and offer you our perspective. Then I'll hand over to you for your comments and to answer any questions.

D What will we be focusing on in both market surveillance and participant supervision?

- 25 In the market surveillance area our key areas of focus will include:
- Market Manipulation – particularly marking the close, gaming the opening and closing auctions, layering including bait and switch as well as pump and dump and hype and dump manipulations.
 - Insider Trading – we will be looking beyond equities to derivatives, CFDs and other OTC trades
 - Algorithms that disrupt market integrity either because they are badly written, e.g. stop loss orders that just place a market order and disregard market impact, or because they are designed to cause a reaction from another trader of system, – e.g. algos that create the impression of market depth.
- 26 In the Participant area our focus will include:
- Management's involvement in risk management and the firm's compliance culture
 - Supervision of authorised representatives including corporate representatives
 - Client protection e.g. churning and also unauthorised trading (other – stock promotion, discretionary trading, client monies)
 - The standard of education advisers
 - Automated order processing controls and
 - Internal controls e.g. to prevent and detect front running, manipulation, rumour spreading
- 27 These are our highest priorities and we therefore expect that you will be across these issues. You will want to ensure you have the right approach and controls, and are able to detect potential breaches including market abuses. I expect you will also want to work with us on resolving issues as they arise.
- 28 We intend to supervise participants' Market Integrity Rule compliance in the same way we have supervised participants' compliance with the AFS licence regime – a balance of risk assessment, analysis of intelligence and formal surveillance. For example, a participant's risk profile will influence our expectations of their management structures and in turn influence how often and how rigorously we review the participant's management procedures. We would not generally want to look at every document that you have in place.

That documentation is your responsibility and our regulatory guides cover what we expect.

E Conclusion

- 29 To summarise. Whilst responsibility for market supervision will change the substance of the participant obligations under the market integrity rules remains substantially the same our rule interpretations should be consistent with ASX and the existing waivers and notifications remain in place. Our systems and processes are mostly in place and we have arrangements to have the full complement of staff we will need in place on Day 1.

Thank you for your time today. Belinda and I are happy to take questions.